

**Computation of Taxable  
Business Profits**

Book-Tax Conformity and Other Issues

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## Preface

This volume results from a research project on the relationship between accounting and tax conducted on behalf of the European Association of Tax Law Professors (EATLP) in the academic year 2022-2023. However, the work started much earlier, when the Academic Committee of the EATLP selected this topic during the EATLP Online Congress 2021. The General Reporter immediately began work, assisted by a committee of tax lawyers and accountants, on designing a questionnaire that would make it possible to draw up the National Reports of the various branches of the EATLP. The Academic Committee approved the final version of the questionnaire during the EATLP Congress 2022 at Wirtschaftsuniversität Wien so that the National Reporters could begin drafting the documents due by the end of 2022. Based on the 25 National Reports received, the General Reporter drew up its conclusions document (*see* chapter 1, General Report) and proposed to five renowned authors the elaboration of the topical reports which the 2023 EATLP Congress in Luxembourg would be based. The distinguished academics produced four topical reports on the pros and cons of linking commercial accounts and taxable profits, the topic's European and procedural law facets, and the future of book-tax conformity under Pillars One and Two and the Business in Europe Framework for Income Taxation.

The editor has found nothing but help and goodwill at every door he knocked on in the three years of the project. It is, therefore, time to be grateful. Of course, my main thanks go to the national and topical report authors whose contributions form the backbone of this book. It would be too late to mention them by name and unnecessary as they appear in each relevant chapter. However, I would like to mention in particular the academics who, without being tax lawyers, made a decisive contribution to the work of the association (the EATLP), which, in principle, was alien to them. Their involvement was crucial in the Committee of Experts, who helped the editor prepare the questionnaire (Prof. David Alexander and Prof. Dr Christoph Spengel) and in developing the Congress itself as chairs or speakers (Prof. Dr Chris Nieuwenhuis and Prof. Dr Erlend Kvaal), in preparing topical reports, and even in performing these functions simultaneously (Prof. Dr Eva Eberhartinger). Special thanks are also due to Prof. Dr Daniel Gutmann, who, far beyond his commitment as Academic Chairman of the EATLP, was fully involved in the project, facilitating some problematic aspects with his *savoir faire* and overcoming some blockages with unquestionable *auctoritas*. I would also like to thank Dr Marina Castro Bosque for her invaluable help in the hard editing of the book's contents. Her proactive attitude – even going so far as to n

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## Chapter 24

### Portugal

Nina Aguiar

#### 24.1. Relevance of the topic and status of its discussion

Concerning the relationship between corporate tax and accounting, Portugal has had a dependence system since 1963, although it was limited to the largest corporations until 1988 (smaller companies were taxed on deemed income). The principle was introduced under the direct influence of the tax administration, without any theoretical input from academics or courts. The example provided by other tax systems in which a tax on corporate income was introduced earlier was probably the decisive factor.

In the past 30 years, though, the topic has caught the attention of scholars, both from the field of tax and the field of accounting.<sup>1</sup> On the accountants'

1. The first authors who studied the subject in Portugal were: J. Saldanha-Sanches, *A quantificação da obrigação tributária*, Cadernos de Ciência e Técnica Fiscal 173 (1995); J. Saldanha-Sanches, *Estudos de Direito Contabilístico e Fiscal* (Coimbra Editora 2000); later, N. Aguiar, *A relação entre a contabilidade comercial e o lucro tributável em Portugal na atualidade*, in *Lucro Contábil e Lucro Tributário - Diálogos entre Brasil e Portugal* (E. Pinto ed., FIPECAFI 2022); H. Charnesky & N. Aguiar, *A True and Fair View: como o Direito e o Padrão IAS/IFRS Alinharam Caminhos para uma Visão Verdadeira e Adequada da Tributação*, in *Controvérsias Jurídico-Contábeis*, vol. 3 (Murcia et al. eds., Atlas 2022); N. Aguiar & J. Tormenta, *Portugal*, in *Tax Aspects of New Accounting Rules in the European Union context* pp. 163-181 (M. Grandinetti ed., Kluwer Law International 2016); N. Aguiar, *Juízos Contabilísticos Discricionários e Lei Fiscal*, in *O SNC e os Juízos de Valor – Uma Perspetiva Crítica e Multidisciplinar* pp. 297-332 (A. Rodrigues, C. Mota & T. Tavares eds., Almedina 2013); N. Aguiar, *O Direito Fiscal perante as Normas Contabilísticas: Uma abordagem metodológica*, in *Liber Amicorum Professor Doutor José Luís Saldanha Sanches* pp. 1021-1063 (F. Araújo, J. Gama & P. Otero eds., Coimbra Editora 2012); N. Aguiar, *Tributación y contabilidad internacional, alineación de sus bases*, in *Estudios de Derecho Tributario, Derecho Aduanero y Comercio Exterior*, Proceedings of the 40th Jornadas Colombianas de Derecho Tributario, Derecho Aduanero y Comercio Exterior, pp. 69-95 (D. Moreno Daza ed., Cartagena de Indias 2016); N. Aguiar, *Income taxation and Accounting: Conceptual Tools for Comparing European Systems*, *Rivista di Diritto e Pratica Tributaria* 3, pp. 1291-1309 (2009); N. Aguiar, *Tributación y Contabilidad. Una Perspectiva Histórica y de Derecho Comparado* (Ruiz de Aloza 2011); T. Cantista-Tavares, *Da relação de dependência parcial entre a contabilidade e o Direito Fiscal na determinação da matéria colectável das pessoas colectivas: algumas reflexões ao nível dos custos*, *Ciência e Técnica Fiscal* 396, pp. 7-177 (1999); T. Cantista-Tavares, *A dedutibilidade dos custos em sede de IRC*, *Revista Fisco* 101/102 (2002); T. Cantista-Tavares, *A interpretação jurídica das normas contabilísticas*, in *O SNC e os Juízos de*

side, the focus has been mainly on the differences between the substantive rules that apply in commercial accounting and those that apply to the calculation of taxable income, emphasizing the differences between both sets of rules, and the accounting treatment of those differences. Tax lawyers, on the other hand, have been mostly concerned with how to explain the legal relationship between tax law and accounting. One factor largely responsible for much of the discussion on the subject was the gradual development, beginning in the late 1970s, of a set of accounting standards separate from tax law and inserted into commercial (accounting) law.

Two main constitutional principles have played a major role in the discussion: the principle of the ability to pay<sup>2</sup> and the principle of justice (article 266(2) of the Portuguese Constitution (CRP) 1976).<sup>3</sup> In the specific case of companies, the ability-to-pay principle is expressed in article 107 of the CRP 1976, being termed therein as the “principle of taxation based on real income”.<sup>4</sup> The principle of taxation based on real income has been widely applied by courts in cases in which they must decide whether a cost included in the taxpayer’s financial statements that has been contested by the tax administration on the basis of special tax law rules is tax deductible.<sup>5</sup> Tax rules on cost deductibility are strict since they require evidence of a particular link between the costs and the business activity or income.<sup>6</sup>

Based on the principle of justice, the courts formulated the “symmetrical correction” rule: whenever the tax administration modifies the taxable income, based on the *Código do Imposto sobre o Rendimento das Pessoas Coletivas* (Corporate Tax Act, CIRC) 1988,<sup>7</sup> in a way that is detrimental to the taxpayer, the tax administration must make a “symmetrical correction”

*Valor – Uma Perspetiva Crítica e Multidisciplinar* (A. Rodrigues, C. Mota & T. Tavares eds., Almedina 2013); and S. Costa, *Da Relação entre Contabilidade e Fiscalidade. Estudo das Reformas em Espanha e Portugal*, SFC Advogados (2016).

2. The principle of the ability to pay is not expressly enshrined in the Portuguese Constitution, but it is derived from jurisprudence and academic literature regarding the principle of equality of citizens before the law, enshrined in art. 13 of the Portuguese Constitution. See PT: TC [Constitutional Court], 10 Mar. 2004, 142/2004; PT: TC, 14 Oct. 2003, 452/03; and PT: TC, 12 Feb. 2003, 84/2003, all available at [www.tribunalconstitucional.pt](http://www.tribunalconstitucional.pt).

3. PT: *Constituição da República Portuguesa* [Portuguese Republic Constitution], 1976, Decreto 10 Apr. 1976, DR 86/1976, Série I de 1976-04-10, pp. 738-775.

4. As far as we know, this is an original trace of the Portuguese constitutional tax law, related to a strongly disseminated practice of the tax administration of taxing companies based on deemed income before 1974.

5. PT: STA [Supreme Administrative Court], 12 Oct. 2022, 0115/12.2BECTB.

6. PT: STA [Supreme Administrative Court], 27 Oct. 2021, 0610/15.1BELRA.

7. PT: *Código do Imposto sobre o Rendimento das Pessoas Coletivas* [Corporate Income Tax Act], 1988, Decreto-lei no. 442-B/88, de 30/11 (amended 2014), DR no. 277/1988, I 1988-11-30 [hereinafter CIRC].

that logically follows the unfavourable modification. The concept of “symmetrical correction” can be understood as follows: if, for example, the tax administration refuses the deduction of a cost in year  $N_2$  on the grounds that the cost corresponds to year  $N_0$ , the tax administration must correct *in minus* the profit of year  $N_0$ . Without the court’s intervention, the administration would deny the correction *in minus* of year  $N_0$  profit, on the grounds of the dependency principle: the cost, which has not been recognized in the accounts of year  $N_0$ , should not be tax deductible in that year either, with the consequence that the taxpayer would not be able to deduct the cost in any year.<sup>8</sup>

Within the same context, the courts have also applied the inquisitorial and material truth principle.<sup>9</sup> According to this two-folded principle, the tax administration must, within a tax procedure to assess the tax debt, carry out all the necessary steps to satisfy the public interest and discover the material truth, without being dependent on the initiative of the author of the request.<sup>10</sup> It often happens that the administration modifies a certain element of the profit (e.g. eliminating a cost that is deemed to be non-deductible), without making a symmetric correction that would be favourable to the taxpayer. In these situations, the administration claims that it is not its responsibility to correct the taxpayers’ accounts; and, since accounting is the basis for calculating profit, the tax administration can correct any component that it deems incorrect but does not have to make any symmetrical corrections that benefit the taxpayer. The courts have considered that the inquisitorial and material truth principles, in the context of the determination of the taxable income, require the administration not only to correct the taxpayers’ mistakes that unduly favour them, but also to identify and correct symmetrical situations in favour of them.

The adaptation of local generally accepted accounting principles (GAAP) to International Accounting Standards/International Financial Reporting Standards (IAS/IFRS) somehow gave rise to an intensification of the debate. The discussion, however, has so far focused more on explaining the consequences of adapting national GAAP to IAS/IFRS, within a book-tax

8. PT: STA [Supreme Administrative Court], 18 May 2022, 01874/05.4BEPRT.

9. Id.

10. In 1994, the *Supreme Tribunal Administrativo* (Supreme Administrative Court, STA) judged that the tax administration is required to apply a legal provision favourable to the taxpayer, even when the latter, in their accounts, did not make some distinctions or classifications necessary to apply that favourable rule, based on the idea that the tax administration, during the tax procedure, is in charge of enforcing the law (PT: STA 2nd Seccion, STA [Supreme Administrative Court], 29 June 1994, 017825).

conformity system, than on debating the legal basis of the relationship between accounting and taxation.

The adoption of the IAS/IFRS in 2005 by the EU institutions<sup>11</sup> led to a deep reformation of the domestic accounting regulations in Portugal. The revision of the domestic accounting regulations led, in turn, to a substantial amendment to the CIRC in 2014. This amendment to the CIRC consisted, essentially, in eliminating the dependency rule on a case-by-case approach, and, in quite a number of cases, led to a drastic erosion of the dependency principle in general.

The accounting standardization saw some development before the introduction of the corporate tax in 1963.<sup>12</sup> However, the introduction of the corporate tax in 1963 brought to light the problem of flexibility and the unreliability of accounting standards for tax purposes. The Portuguese legislator then faced the same problem as any other European tax legislator, which was to decide between comprehensively regulating accounting for tax purposes or relying on commercial accounts for the purpose of calculating the tax base. As in many other countries, the tax legislator chose to usurp the regulation of commercial accounting.<sup>13</sup> The accounting profession, in turn, gradually became accustomed to the idea that accounting was designed to serve tax purposes. The origin of the link between commercial accounts and corporate tax lies in the fact that commercial accounting itself was seen as part of the taxation legal system. Accounts were merely an instrument for taxation and were prepared as such.

In formal terms, the tax regulation initially followed the French model – a “general accounting plan” – of a hybrid nature, i.e. of a mixed fiscal and civil legal nature.<sup>14</sup> This pattern was a tradition that remained until Portugal became a member of the European Community. At present, accounting regulations continue to be adopted by legislative acts; however, they are no longer part of tax law, but rather commercial law.

11. Regulation (EC) 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards, OJ L243 (2002).

12. The first tax on corporate income was the *Contribuição Industrial* [Industrial Levy] enacted by PT: Law-Decree no. 45103, 1 July 1963.

13. Until 1998, the courts endorsed the view that the accounting rules embedded in the tax laws were mandatory for commercial accounting (PT: STA 2nd seccion, STA [Supreme Administrative Court], 18 Nov. 1998, 21703).

14. Aguiar (2011), *supra* n. 1, at p. 126.

The current accounting regulation, *Sistema de Normalização Contabilística* (Accounting Standard Act, SNC),<sup>15</sup> dates back to 2009<sup>16</sup> and responds to the requirement to adapt the Portuguese system to the European Regulation on the Application of International Accounting Standards (2002/1606). The entire content of the EU Regulation 1126/2008<sup>17</sup> was translated into the SNC. The national legislator did so with the aim of creating an accounting law applicable to entities outside the scope of Regulation 1126/2008, but keeping to its main content, so that all national business entities are required to follow the same rules regardless of whether or not they are under the scope of Regulation 1126/2008.

In this context, there is actually not much room for professional bodies to create any accounting standards of an extra-legal nature. There is a body, the Accounting Standards Commission, which is a hybrid organization, made up of members from both public bodies and private entities, whose mission is to produce interpretation standards and, above all, to translate the interpretations of the IFRS Interpretation Committee.<sup>18</sup> Therefore, the national system does not incorporate any professional accounting standards in the proper sense. The system is totally formalistic and legalistic in nature.

The accounting standard setting system in force under the SNC is applicable to all sectors of activity, including the banking and insurance sectors. However, within this regulation, there are also special rules applicable to these sectors. There is also an accounting standard subsystem for small businesses and another subsystem for non-profit entities. In both cases, the accounting regulation of these sectors follows the same pattern: it is passed by an act of the legislature and is covered by the normative reference made by article 17(3) of the CIRC 2014.

As is well known, article 5 of Regulation on the Application of International Accounting Standards (2002/1606) provides that Member States, internally (i) can allow or impose on listed companies the adoption of IAS in their individual accounts; and (ii) can allow or impose on non-listed companies the adoption of IAS in their consolidated or individual accounts. In this

15. PT: *Sistema de Normalização Contabilística* [Accounting Standard Act], 2009.

16. PT: Decreto-Lei no. 158/2009, 13 July, DR no. 133/2009, I 2009-07-13, pp. 4375-4384.

17. Commission Regulation (EC) No 1126/2008 of 3 November 2008 adopting certain international accounting standards in accordance with Regulation (EC) No 1606/2002 of the European Parliament and of the Council, OJ L320 (2008).

18. The Accounting Standards Commission (*Comissão de Normalização Contabilística*) was created by a legislative act, see PT: Decree Law no. 134/2012 from the Ministry of Finance.

context, through a legislative act,<sup>19</sup> the Portuguese government carried out a global reform of the national accounting regulation system, introducing the SNC. The SNC 2009 is an autonomous set of accounting standards, enacted by national legislative bodies, which do not formally refer to international accounting standards or any other accounting standards.<sup>20</sup> However, the SNC still requires the direct application of IAS/IFRS in specific cases.

The SNC 2009 is applicable to all unlisted companies and also to the individual accounts of listed companies. However, article 4 of the SNC 2009 comprises two important rules that extend the scope of application of IAS to Portuguese companies. Paragraph 2 of that provision grants unlisted companies the option, at their discretion, to apply IAS to their consolidated accounts, pursuant to article 3 of Regulation on the Application of International Accounting Standards (2002/1606), provided that their financial statements are subject to certification. Further, in paragraph 3, it requires listed companies who consolidate accounts under the Regulation to also apply IAS in their individual accounts. Therefore, in Portugal, today, international accounting standards, as they are transposed into EU law, are mandatory to listed companies' consolidated accounts as well as to individual accounts of listed companies with consolidated accounts, and they are optionally applicable to non-listed companies' consolidated accounts.

As for the SNC 2009 itself, it is worth noting that, being a legislative act, it has the unequivocal character of law. However, it does not have the normal structure of a normative text, but rather that of a technical document, composed of different parts with different functions, not all of them of a normative nature. The SNC 2009 incorporates a set of accounting standards, the Financial Reporting Accounting Standards (NCRFs). According to the wording of the SNC itself (point 5.1), these NCRFs "adapt the international accounting standards, adopted in the EU, taking into account the specificity of the national businesses and the fact that some entities are required or given the option to the aforementioned international standards, under the terms of Regulation 1606/2002." Thus, it is also said, "the set of NCRFs may not contemplate some international standards and the NCRFs may waive the application of certain procedures and disclosures required in the

19. PT: *Sistema de Normalização Contabilística* [Accounting Standardization System] 2009, DL 158/2009, of 13 July, DR. 133/2009, I 2009-07-13, pp. 4375-4384.

20. By using the term "refer" in this context, the meaning intended is the technical term that in Portuguese is called "*remissão legal*", which is a normative technique that consists of the norm applicable to the case ordering the content of another legal norm to be applied.

corresponding international standards, while guaranteeing, in essence, the recognition and measurement criteria contained in these standards."

Like in European law, with Regulation on the Application of International Accounting Standards (2002/1606), current Portuguese accounting law operated a material incorporation of the IAS of the International Accounting Standards Board (IASB). However, it did not make a formal reference to the source of these standards, nor did it carry out an "adaptation" of these standards to the Portuguese business reality.<sup>21</sup> There is, though, an exception. NCRF 27 (financial instruments), based on IAS 32, IAS 39 and IFRS 7, expressly says that "an entity may not apply this standard if it chooses to fully apply IAS 32 - Financial Instruments: Presentation, IAS 39 - Financial Instruments: Recognition and Measurement and IFRS 7 - Financial Instruments: Disclosure of Information".

The Preamble to the SNC 2009 states that the NCRFs, the central core of the Portuguese SNC, are an adaptation of the international accounting standards as adopted by the European Union. The Preamble also clarifies the purpose of the Portuguese legislator by incorporating IAS, although to a limited extent, saying that "the SNC is a modern instrument envisaging Portuguese companies that, being not traded on a regulated market, have features (capital structure, type of activity) that place them in a global context regarding business, partners and financing." The Preamble further states that "the process of adapting international accounting standards to the Portuguese reality was intended to eliminate treatments that are not applicable to the national reality and to avoid excessive levels of information demand".<sup>22</sup>

In addition, the SNC refers to international accounting standards for the purpose of fulfilling gaps, providing in point 1(4) that "whenever the SNC does not respond to particular aspects of transactions or situations, in terms of accounting or financial reporting, or the gap in question is so material that failure to fill it jeopardizes the goal of providing information that truthfully and fairly reflects the financial position at a given date and performance for the period covered", then the "International Accounting Standards adopted under Regulation (EC) no. 1606/2002, the IAS/IFRS, issued by the IASB, and respective SIC-IFRIC interpretations can and must be applied."

21. As expressly stated in the preamble of the law: "Therefore, national accounting standardization should approach, as closely as possible, the new community standards, in order to provide our country with alignment to EU accounting directives and regulations, without ignoring, however, the specific characteristics and needs of the Portuguese business context." [Author's translation.]

22. PT: Decreto-Lei no. 158/2009, 13 July, DR no. 133/2009, I 2009-07-13, p. 4375.

From what has just been said, it follows that IAS/IFRS are not formally incorporated into national law by any domestic endorsement process. Only the IAS/IFRS content is partially transposed to the Portuguese standards. As to the process through which IAS/IFRS content is incorporated into national law, two groups of enterprises must be distinguished.

The first group is the one formed by companies who directly apply the European IAS, i.e. the IAS after the endorsement and as endorsed by the European Commission. For this group of corporations, those entities applying the IAS/IFRS directly from its European legal source, there is nothing like an internal endorsement process. A second group of entities that apply the Portuguese SNC (the Portuguese set of commercial accounting rules) apply internal commercial accounting regulations that are based on IAS/IFRS but do not make a true legal transposition of those to the internal law. As previously mentioned, the current Portuguese accounting regulations, enacted in 2009, operated a substantial incorporation of the IASB's international accounting standards, but without making a formal reference to the source of these standards. Those regulations do not incorporate the IAS/IFRS in all its entirety, either. There is a body, the Accounting Standards Commission, which is a hybrid organization, made up of members from both public bodies and private entities, whose mission is to produce interpretation standards and, above all, to translate the interpretations of the European IFRS Interpretation Committee.

## 24.2. General principles of relation between commercial and tax accounting

### 24.2.1. Material dependence: Existence, policy and scope

The relationship between accounting and taxable profit is regulated in article 17 of the CIRC 1988. Article 17(1) reads:

The taxable profit of legal persons and other entities<sup>23</sup> [...] is calculated by the algebraic sum of the earnings before taxes for the period and the positive and negative variations in equity occurred in the same period and not revealed in the earnings before taxes, determined *on the basis of the accounts and corrected whenever justified in the terms of this Code*. [Emphasis added.] [Author's translation.]

23. The expression "legal persons and other entities" in this particular provision can be interpreted as corporations.

Paragraph 3 of the same article reads: "In order to allow the calculation referred to in paragraph 1, the accounts must: a) Be organized in accordance with accounting standards and other legal provisions in force for the respective sector of activity, without prejudice to compliance with the provisions set out in this Code" [author's translation]. The provision establishes a reference to accounting standards, as a whole, without any condition or restriction. Respect for accounting standards is a condition that accounting must observe so that the calculation of taxable profit can be based on accounting profit.

The accounting standards referred to in this legal provision, as explained previously, are the accounting standards approved for the purposes of commercial accounting and that, therefore, form part of Portuguese commercial law. The material dependence rule, or, in other words, the reference to the accounting standards of commercial law does not suffer any exception or specific departure imposed by the corporate tax law. Thus, we can conclude that the rule of material dependence exists, and that it is total and unconditional.

### 24.2.2. Formal dependence: Existence, policy and consequences

Article 17(1) of the CIRC 1988 also contains the rule of formal dependence when it states that:

The taxable profit of legal persons and other entities [...] is calculated by the algebraic sum of the earnings before taxes for the period and the positive and negative variations in equity occurred in the same period and not revealed in the earnings before taxes, determined on the basis of the accounts and corrected whenever justified in the terms of this Code. [Author's translation.]

It means in the first place that taxable profit is to be calculated based on the earnings before taxes (EBT) disclosed in commercial accounts, i.e. based on the profit and loss account prepared for commercial accounting purposes (formal dependence).<sup>24</sup> The expression "positive and negative equity changes occurred in the same period and not shown in the earnings before taxes" refers to an asset's variations that are recognized directly in equity and, therefore, are not shown in the income statement but should be considered part of the income of the period according to the "Schanz-Haig-Simons" income concept. In turn, the expression "amended under the

24. Aguiar (2011), *supra* n. 1, at p. 464.

terms of this Code” is related to a large number of rules of an accounting nature that were inserted in the CIRC 1988. These rules may, in certain cases, impose accounting treatments different from those used in commercial accounting; however, in most cases, they set quantitative limits to the costs recognized in financial statements or limit the diversity of accounting options related to a given financial fact.

So, the EBT determined through the income statement prepared for commercial accounting purposes forms the “basis”<sup>25</sup> of the calculation of taxable profit. And the only changes that can be made to the EBT, for the purposes of determining the taxable income, are those provided for in the tax law itself. The rule that taxable profit is determined based on the EBT must necessarily translate into requirements or prohibitions imposed on taxpayers, as it is a legal rule. In the case of the rule in article 17, it translates into obligations and prohibitions both for the taxpayer and for the tax administration. For the tax administration, the rule means that they are bound to accept the EBT as the basis for calculating taxable income, and they are therefore not allowed to rule out the accounting options that the taxpayer made in their business accounts. This rule has two exceptions or limitations. The first one is contained in the rule itself: the administration can modify the taxable income when these modifications are required by rules provided for in tax law (“corrected under the terms of this code”). The second limitation stems from paragraph 3 of the same article 17: for taxable profit to be determined based on the “net profit for the period, determined on the basis of accounting”, it is necessary that accounting, in addition to the other two requirements, is “organized in accordance with accounting standards and other legal provisions in force for the respective sector of activity”.<sup>26</sup> Paragraph 3 clearly lays down the rule of *material dependence*. The tax standard accepts, as a basis for calculating taxable income, the EBT determined on the basis of the accounting standards in force.

The material dependence rule and the formal dependence rule are fully interconnected since, according to article 17(3), the administration will no longer be bound by the EBT when the taxpayer has not complied with commercial accounting standards in their commercial accounts. Although the

25. As explained in *id.*, at p. 294, the expression “the income statement/the commercial balance sheet forms the basis for the calculation of taxable profit” has no legal content and should be abandoned by the legislator.

26. The two other requirements are that the accounting must be computerized and that it must “reflect all operations carried out by the taxable person and be organized so that the results of operations and changes in equity subject to the general IRC regime can clearly be distinguished from the rest” [author’s translation].

formulation of this rule is quite clear in theory, in practice, it creates many difficulties. From the outset, it would be appropriate to question the extent of the administration’s power to deem the financial statements to not be in conformity with the accounting standards. In a literal interpretation of the rule, one would be led to conclude that, in the event of non-compliance of commercial accounts with the applicable accounting standards, the formal dependency rule would no longer bind the tax administration, which would thus create the possibility of discarding commercial accounts as a whole.<sup>27</sup> In practice, this prerogative of the tax administration has been quite limited by the courts, as they tend to consider that even though the tax administration is allowed to correct errors committed in the taxpayer’s accounts, it must maintain and conform to any elements that can be considered correct in the accounts.<sup>28</sup>

Another question that arises in this regard is the extent of the tax administration’s power to rebuild the taxable profit, moving away from the EBT, in cases when the taxpayer does not strictly comply with legal regulations. Here, again, jurisprudence indicates a very restrictive practice. Even when it is proven that the taxpayer made errors in their financial statements, when making any rectifications the tax administration is required to consider all accounting elements that deserve credibility, correcting and replacing only those that cannot be used.<sup>29</sup> Finally, even when the accounts are not in compliance with accounting regulations, the taxpayer has the right to correct any mistakes.<sup>30</sup>

According to consistent case law, if financial statements, although inaccurate, allow for a reliable computation of real income, the tax administration should only carry out “technical modifications”. “Technical modifications” are based on a strict application of accounting standards without resorting to any type of discretionary judgment or indirect method of assessing the taxable income. In this case, the formal dependency rule (meaning that the

27. The issue of correcting commercial accounting, as a condition for the taxpayer to be taxed by its real profit, shown by accounting, is an old one in Portuguese law, originating prior to the IRC. In 1979, the Administrative Supreme Court ruled on a dispute in which the tax administration intended to disregard taxpayer accounting as incorrect. The Court found the accounting correct (PT: STA 2nd seccion., STA [Supreme Administrative Court], 10 Feb. 1971, 16314).

28. PT: STA [Supreme Administrative Court], 27 May 2015, 01509/14; and PT: TAC [Central Administrative Court - North], 28 Jan. 2021, 00329/05.1BEMDL.

29. PT: STA 2nd seccion., STA [Supreme Administrative Court], 7 Apr. 2022, 01562/14.0BEPRT.

30. PT: STA 2nd seccion, STA [Supreme Administrative Court], 18 Nov. 2020, 02024/06.5BEPRT.

administration is bound to the accounting judgements and choices made by the taxpayer in their financial statements) will continue to apply fully to the parts of the accounting considered accurate.<sup>31</sup> If financial statements do not contain the necessary data to calculate the real income but most of the accounting information is still valid, the administration may only use indirect methods to correct deficiencies that cannot be corrected otherwise but will still apply the rule of dependency to any parts of the accounts that are correct. Only in the limited case that financial statements are non-existent or incorrect as a whole and there are no elements that allow the direct determination of real income, may the administration disregard financial statements as a whole.

The rule that the accounting EBT is binding for the administration, set forth in article 17, was only enshrined in 1989 with the enactment of the CIRC 1988, and it was made possible by the standardization brought about by the “official accounting plans”. Until then, commercial accounting, which did not follow uniform rules, was not considered sufficiently reliable to determine the tax base of companies. As a result, the tax administration had broad discretion in determining taxable income and, in practice, taxpayers felt compelled to follow the tax administration’s guidelines in their accounting.

From the taxpayer’s perspective, the rule (that taxable profit is determined on the basis of the accounting EBT) translates into the prohibition for the taxpayer, in the face of a financial fact for which there are different possible accounting treatments (options or judgments), to choose, when determining the taxable profit, a treatment different from that adopted in commercial accounts, based on considerations relating to, for example, the different purposes of commercial accounting and taxation.

This can be described as the *formal dependence* between taxable profit and accounting EBT, and it means that the accounting choices made in financial statements are preclusive for the determination of taxable profit, except when a tax law provision expressly states otherwise.<sup>32</sup> For instance, if a taxpayer chooses to amortize a certain asset at a 20% rate in their commercial accounts, they cannot amortize at 25% in their tax accounts. If the taxpayer has chosen not to make a provision for a certain risk in their commercial accounts, they cannot make that provision in the tax accounts, even when the tax rule would expressly allow for such provision. If a taxpayer chooses

31. Aguiar & Tormenta (2016), *supra* n. 1, at p. 167.

32. Aguiar (2011), *supra* n. 1, at p. 382.

to consider a certain expense as an asset and recognizes it as capital in their financial statements, they will not be able to consider that expense as a current expense for tax purposes, even when the tax provision expressly allows it. It is important to underline that the preclusive effect of the accounting EBT for the determination of the taxable profit (dependency principle) occurs exclusively in the field of accounting options and judgements, i.e. the financial facts for which the accounting regulations allow more than one possibility of treatment.

To characterize the dependency rule from the taxpayer’s perspective, a second aspect worth mentioning is that it only prevents a taxpayer from using different accounting options that reduce profit – it does not prevent them from using different accounting options that increase profit. This particular aspect of the rule is not expressed in article 17 of the CIRC 1988, but it can be derived from many other rules within the CIRC.

On the one hand, the rationale behind the dependency rule lies in the principle of taxation according to the ability to pay, and on the other hand, in the probative value of commercial accounting.<sup>33</sup> Regarding the first aspect, article 104(2) of the Portuguese Constitution outlines the principle that companies should be taxed based on their real income. The incorporation of this principle in the 1976 Constitution is contemporaneous with the adoption of the first official chart of accounts, and both entail a departure from the previous largely used practice of taxing companies on deemed profit or “normal” profit.<sup>34</sup> The legislator considers that commercial accounts show real profit as they are required to show the company’s true equity situation, which reveals the company’s ability to pay.

The second aspect relates to the subjectivity present in a large number of accounting judgements and choices that the preparer of accounts must make and the value that tax law assigns to these judgements and choices. Going back to the previous example, if, in their commercial accounts, the taxpayer did not make a provision that, in theory, they could have made, on the grounds that there was no economic risk that would justify it, from a tax point of view, that option made in the commercial accounts proves the inexistence of a risk that justifies the provision – so it cannot be made for tax purposes either.

33. Id., at p. 378.

34. J. Teixeira Ribeiro, *Incidência da Contribuição Industrial*, vol. XII, pp. 10-11 (Bol. da Fac. de Direito 1965).

The basic assumption underlying this rule is that judgements and choices made in financial statements reveal a true and fair view, as it is perceived by the taxpayer. The principle has been in force in Portuguese law since much earlier than the current CIRC; it was recognized by jurisprudence as early as 1966<sup>35</sup> and has been widely developed since then.

The adoption of the IAS/IFRS in 2005 at the European level led to a deep change of the domestic accounting regulations, which in turn induced an extensive reform of the CIRC 1988 in 2013. This reformation of the CIRC 1988 essentially consisted of eliminating, in the corporate tax law and on a case by case approach, the dependency principle, which led to a drastic rupture from the dependency principle in general.

We can illustrate this evolution with the following example: in terms of the depreciation of fixed assets, the CIRC 1988 provides a set of specific rules, which no longer match the accounting rules on the measurement of fixed assets. The CIRC 1988 provision just requires that tax rules are applied in the calculation of taxable income, and that adjustments made in financial statements in the value of the same assets under different methods are completely excluded from it. Depreciations are an example where the dependency rule is no longer applicable. Another example concerns expenditure on development projects. Article 32 of the CIRC 1988 states that taxpayers can now deduct development project expenses as current expenses, even if these expenses have been capitalized in their financial statements. Finally, in practically all cases in which the fair value model is applied in financial statements, the tax provision will require the taxpayer to eliminate the corresponding adjustments from the taxable profit, replacing them with the old GAAP methods.

#### 24.2.3. Reverse dependence: Existence and policy

The author understands reverse dependence to mean, in line with Falsittà,<sup>36</sup> the application of tax rules in the elaboration of financial statements. In numerous countries, at different times, this happened as a consequence of a legal requirement and Portugal was no exception. Today, the phenomenon of reverse dependence is not explicit but rather devious.

35. PT: STA 2nd seccion. [Supreme Administrative Court], 30 Mar. 1966, 15325.

36. G. Falsittà, *Il bilancio di esercizio delle imprese* p. 10 (Giuffrè 1985).

First of all, many accountants do not correctly understand the principle of dependency. They often still think in terms of the reality prior to 1988 (the date of the entry into force of the current corporate tax), where rules dictated by the tax administration were binding for commercial accounts. For these accountants, the accounting rules contained in the tax law are mandatory for commercial accounts. This situation occurs mainly in the thousands of small companies that prepare accounts primarily for tax purposes.

As for tax incentives concerning the tax base, in general, they do not implicate any “reverse dependence”. Two examples will be provided to illustrate this. The first example concerns the deduction of capital gains arising from the sale of tangible fixed assets. Essentially, the tax incentive consists of deducting part of the gains derived from the sale of certain types of tangible fixed assets from the tax base, under certain conditions of reinvestment. The important aspect here is that the tax provision applicable explicitly states “for the purposes of determining taxable income”, which means that the tax incentive does not require a corresponding deduction in the commercial profit and loss account.

The second example relates to the incremented social spending deductions. Spending on the maintenance of day care centres, nurseries, kindergartens, canteens, libraries and schools, as well as other social utility projects, is deductible from the tax base augmented by an increment of 40%. In this case, the provision does not explicitly state that the deduction in the tax base should not affect financial statements, but the income statement form contains a field to make this adjustment without affecting the accounting profit.

When accelerated amortizations are considered, article 30 reads: “(1) The calculation of depreciation and amortization of the assets referred to in the previous article is done, as a rule, using the straight-line method, considering their useful life. (2) Taxable persons may, however, opt for the method of decreasing amortization in relation to tangible fixed assets that [...]” [author’s translation]. The problem with this wording is that the provision does not expressly say that an amortization made under the accelerated method for tax purposes does not need to be reflected in financial statements, and the income statement form does not contain a field to make this adjustment either. As a result, entities who opt for accelerated amortizations usually also make the amortizations in financial statements, and disclose a note as an annex, explaining the reason for this procedure. In this particular case, the author thinks that the reason for the existence of such reverse dependence is that the tax administration and the tax profession in general

do not have a clear idea about the tax incentive nature of accelerated amortizations.

In addition to tax incentives, there are other rules that, due to their ambiguous reading, can and do actually lead to reverse dependency cases. Article 17 contains a formal reference to commercial accounting law, providing in its paragraph 3: “in order to allow the calculation of taxable profit on the basis of accounts [...], the accounting must: a) Be organized in accordance with accounting standards and other legal provisions in force for the respective sector of activity, *without prejudice to compliance with the provisions set out in this Code*” [emphasis added] [author’s translation]. Should this provision be interpreted in the sense that accounts must comply with the CIRC? No one has ever answered this question, because as far as is known, no court has to date interpreted this norm.

It is the author’s view that the provision, approved in 1988, is a holdover from the previous system, in which written tax rules were imposed on commercial accounting. Today, its scope is uncertain. Since there is no record of court rulings on the matter, this may happen because, in practice, taxpayers tend, out of prudence, to conform their financial statements with the tax accounting rules to avoid conflicts with the tax administration, which gives rise to reverse dependence situations.

Another case concerns impairments in receivables, where tax law imposes tight timing requisites and only allows deduction in taxable income if the impairment is recognized in the financial statements (dependency principle). For example, in period  $N_0$ , the CIRC 1988 provision allows the deduction of an impairment loss of 25% of the receivable; if in period  $N_0$  no impairment was recognized in financial statements because the taxpayer considered there was no risk at that point in time, this impairment of 25% will never be deducted for tax purposes.

Accounting rules, as discussed in section 24.1., are currently strictly based on IAS/IFRS and do not allow for the phenomenon of reverse dependence. In many cases, those situations will definitely entail a breach of higher-ranking accounting standards such as the true and fair view requirements in Accounting Directive (2013/34).<sup>37</sup>

37. Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC Text with EEA relevance, OJ L182 (2013).

## 24.3. Particular commercial/tax accounting issues

### 24.3.1. Elements of financial statements

#### 24.3.1.1. Elements of financial statements which relate to a reporting entity’s financial position

##### 24.3.1.1.1. Assets

As already pointed out, Portugal has incorporated the IAS/IFRS into its internal accounting regulations, albeit with some adaptation/simplification of certain points.<sup>38</sup> Therefore, whether an expense is to be treated as a deductible current expense or accounted for as an asset will be determined by the Portuguese standard 2 – which closely reproduces IAS 18 and 6, which in turn closely reproduce IAS 38.

Very concisely, an expense should be treated as a current cost/expenditure if its utility has run out in the period in which the asset must be calculated; that is, if its utility was fully incorporated into the productive flow (of goods or services) of the fiscal period. An expense should be accounted for as an asset if it has the potential to generate income in the future. This rule is accepted in general terms by the CIRC. The only exception concerns expenses with development projects that, according to a CIRC 1988 provision (article 32) can be treated as current expenses in the tax period in which they are incurred, even if they have been recognized as capital (intangible assets) in financial statements. This is clearly a tax incentive for innovation, given that this extra-fiscal purpose is the reason for the divergence.

The accounting regulations contain a definition of “asset of a company” closely inspired by the definition of an asset in IAS 38. According to the Portuguese definition, “an asset is a resource controlled by the entity as a result of past events and which is expected to generate future economic benefits flowing to the entity”. This definition is fully accepted by tax legislation.

The requirements for the recognition of intangible assets are set out in Portuguese accounting standard 6, which is similar to IAS 38. There is no specific or additional requirement in the Portuguese accounting standard for the recognition of an intangible asset that is not in IAS 38. Portuguese

38. A. P. Silva, A. Fontes & A. Martins, *Portuguese Experience with IFRS Adoption as perceived by Auditors*, 28 Central European Management Journal 1, pp. 81-98 (2020).

legislation does not place any limitations on the recognition of intangible assets. However, it contains some detailed and quite limiting rules concerning the deduction of amortization of intangible assets. According to article 45-A of the CTA, the cost of acquiring industrial property elements such as trademarks, permits, production processes, models and other “assimilated rights” can be amortized over a period of 20 years, in equal parts. Other assimilated rights may refer to patents but there are many other assimilated rights that are recognized in Portuguese legislation on industrial property. Amortization has to be made in the first 20 years of the asset’s life.

Amortization depends on the assets recorded in commercial statements, which is a consequence of the formal dependency rule. Assets must have been recorded in commercial statements in compliance with accounting standards. According to the same article 45-A of the CIRC 1988, goodwill acquired in a business merger can also be amortized in equal parts in the first 20 years after accounting recognition. The rule is ambiguous and does not make it clear whether amortizations, to be carried out for tax purposes, must also be carried out in commercial accounts. If the general rule of formal dependency is applied, the amortizations will also have to be made in financial statements. However, article 45-A could also be interpreted as an exception to the dependency rule.

As for expenses relating to development projects, which was referred to in section 24.2.2., they can be treated as current tax expenses in the tax period in which they are borne, even if they are recognized as intangible assets in financial statements. In such a case, there is an unequivocal exception to the formal dependency rule: the tax deduction is made independently of a corresponding deduction in the financial statements.

The distinction between inventories and fixed assets is relatively clear in accounting regulations. According to Portuguese accounting standard (NCRF)18 (transposing IAS 2) inventories are assets that are held for sale (in the ordinary course of business, in the process of production for such sale, or in the form of materials or supplies to be consumed in the production process or in the rendering of services). Fixed assets are assets that are held for use in the production or supply of goods or services, for leasing to others or for administrative purposes, and they must be expected to be used for more than one period.

In the case of properties, if they are intended for sale in the course of the entity’s current activity, they will be treated as inventory (stocks), according to paragraph 11(1) (a) of the NCRF, regardless of whether or not they are

rented. In some cases, construction companies acquire land without having a defined purpose at the outset. In this case the land should be treated as investment property, while its function is not clearly defined. If the taxpayer changes the purpose to be given to the asset, then the asset must be reclassified from inventory to fixed assets. Frequently in the case of construction companies, the assets that were intended for sale are not sold as quickly as expected. In these situations, in order to monetize the assets while companies are unable to make the sale, properties can be leased. However, this raises complex accounting questions. There are no divergences in this matter between accounting regulations and tax regulations.

#### 24.3.1.1.2. *Liabilities and provisions*

Liability is defined in the Portuguese NCRF 21, which transposes IAS 37. A liability is a present obligation of an entity arising from past events that is expected to be settled by the outflow of economic benefits.

The tax law of 2009 accepted the concept of provision outlined in IAS 37, but it treats provisions and contingent liabilities as if they were the same. Currently, the tax law sets strict rules for the acceptance of provisions and contingent liabilities. These are:

- those intended to comply with obligations and charges arising from legal proceedings that are in progress for facts that would determine their inclusion among the expenses of the tax period;
- those intended to cover charges with guarantees to customers provided for in sales and service contracts;
- mandatory technical provisions for insurance companies; and
- those formed with the objective of meeting the costs of repairing environmental damages in locations where the exploitation of natural resources has taken place, whenever this is mandatory under the terms of the applicable legislation and after the cessation of the latter (e.g. mines and quarries).

There is a vast amount of tax jurisprudence on provisions and contingent liabilities. Disputes often concern the qualification of situations as provisions or contingent liabilities.<sup>39</sup> Further, many disputes concern the moment when the provision or contingent liability should be deducted.<sup>40</sup>

39. PT: TAC [Central Administrative Court - South], 24 Jan. 2020, CT 1632/10.4BELRS; and PT: STA [Supreme Administrative Court], 28 Jan. 2015, CT 0652/14.

40. PT: STA 2 Sec., STA [Supreme Administrative Court], 14 Mar. 2018, 0716/1; and PT: STA [Supreme Administrative Court], 4 Sep. 2013, 0164/12.

Portuguese accounting standard 21, which transposes IAS 37, authorizes the deduction of provisions to cover liabilities arising from onerous contracts. In turn, article 39 of the CIRC 1988, which exhaustively lists the provisions that are deductible for tax purposes, does not include provisions for onerous contracts. Therefore, although the author is not aware of any case that has already been decided by the courts, the author believes that this will be a case in which a cost shown in the balance sheet will not be accepted for tax purposes and will require a tax adjustment.

Portuguese accounting standard 28 concerns all kinds of employee benefits and transposes IAS 19 almost completely. Employee pensions are deductible under the same conditions as provided for in IAS 19.

#### 24.3.1.2. Elements of financial statements which relate to a reporting entity's financial performance

##### 24.3.1.2.1. *Income*

The commercial accounting criteria for recognizing income are those set out in the Portuguese accounting standard 20, which transposes IAS 18 very closely. The tax law contains very detailed rules regarding the time of recognition of income as well as costs relating to income. Tax rules are not, *prima facie*, in contradiction with accounting rules. However, they use different concepts, and they are more conceptual, more generic and less casuistic. Tax rules are also stricter and more formal, so divergences may arise. A significant case was decided recently by an arbitral court.<sup>41</sup>

##### 24.3.1.2.2. *Expenses*

The conditions that an expense must meet to be tax deductible are quite strict and complex. In short, for an expense to be deductible it must be documented, which means that it must have an invoice that complies with the VAT formal requisites for invoices;<sup>42</sup> and it must be either related to the normal activity of the taxpayer and not conflicting with the profit-making purpose of the company or have a clear profit-making purpose.<sup>43</sup> In general, the tax administration is very strict when applying the requisites for expense deduction, which has led to numerous judicial lawsuits. Courts,

41. PT: CAAD [Arbitral Court], 14 Mar. 2019, 334/2018-T.

42. With a different view, see G. Gaspar-Lagoa, *O Regime da Dedutibilidade de custos à luz do novo artigo 23º do CIRC* p. 28 (2015).

43. PT: TAC [Central Administrative Court - North], 28 Apr. 2016, 01395/04.2BEBRG.

in general, have adopted a flexible position, regarding both formal and substantial requisites.

For several decades, the central criterion for an expense to be deductible was "indispensability".<sup>44</sup> Nowadays, this criterion is outdated as a result of intervention by the courts. Recently, the Central-South Administrative Court ruled in the following terms:<sup>45</sup>

Doctrine and jurisprudence have been adopting a view regarding indispensability of costs (as a requisite for its tax deductibility) in which the finalistic conception, according to which a direct cause and effect relationship between costs and income is necessary, may be deemed as outdated. Under the current interpretation, a cost will be accepted for tax purposes as long as, in a judgment reported at the time it was made, it is appropriate to the company's productive structure and to obtain income; the tax administration can only disregard tax costs that are not related to the scope of the taxpayer's activity and were incurred, not in the taxpayer's interest, but for the pursuit of other people's interests.<sup>46</sup> It cannot be deemed that a contract between the shareholders and the company by which the latter undertakes to build a warehouse on the formers' land as usufructuary for 10 years with the purpose of allocating it to its activity corresponds to the pursuit of an alien interest (that of the shareholders) and not a genuine business interest. Likewise, the annual depreciation of the construction, recorded in the tangible fixed assets of the contesting company must be recognized as a deductible cost, thus allowing the company to recover the capital invested in the construction of the warehouse. [Author's translation.]

On the other hand, testimonial evidence, which was once largely accepted as a method to demonstrate the existence or veracity of non-documented costs,<sup>47</sup> has now been suppressed by the legislator, according to the author's personal interpretation. Apart from expenses that are not deductible because they are not directly or indirectly related to the company's activity or the profit purpose, there is a list of expenses that are never deductible, and, when they exist, they result in a kind of tax penalty or additional taxation. These include, non-exhaustively: (i) non-documented expenses, which are taxed at 50% to 70%; (ii) expenses for which documentation is deemed totally incorrect; (iii) illegal expenses and administrative penalties; (iv) subsistence allowances and travel expenses that exist outside of very strict conditions;

44. Regarding this concept, see Cantista-Tavares (2016), *supra* n. 1; and A. Moura-Portugal, *A Dedutibilidade dos Custos na Jurisprudência Fiscal Portuguesa* pp. 188 et seq. (Coimbra Editora 2004).

45. PT: TAC [Central Administrative Court - South], 11 Feb. 2021, 09/06.0BESNT.

46. Gaspar-Lagoa, *supra* n. 42, at pp. 28 et seq.

47. PT: STA Plenary CT Section [Supreme Administrative Court], 22 Jan. 2014, 01632/13.

(v) expenses relating to vehicles and fuels are only deductible under very strict conditions; (vi) interest paid by the taxpayer on loans from shareholders beyond a maximum rate fixed by the government are not deductible; and (vii) leisure expenses are deductible but give rise to an additional taxation of 10% (article 88(7) of the CIRC 1988).

### 24.3.2. Valuation/measurement

#### 24.3.2.1. Valuation/measurement at recognition

Unlike IAS 16, the Portuguese accounting regulations display different standards for tangible assets, intangible assets and property.<sup>48</sup> However, they are quite similar in terms of recognition rules. All those assets must be recognized at historic cost. The cost must include:

- its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates;
- any costs directly attributable to bringing the asset to the location and making it capable of operating in the manner intended by management; and
- the estimated costs of dismantling and removing the item and restoring the site on which it is located, unless those costs relate to inventories produced during that period.

The tax rule does not contain any differences to the accounting rule.

#### 24.3.2.2. Valuation/measurement after recognition (downward update of historical cost)

##### 24.3.2.2.1. Depreciation

For tax purposes, tangible fixed assets, intangible assets, non-consumable biological assets and investment properties accounted for at acquisition cost can be depreciated. Components of the assets, major repairs and improvements recognized as elements of the asset subject to deterioration are also depreciable.<sup>49</sup> As a rule, the calculation of depreciation and amortization (referred to in article 30 of the CIRC) follows the straight-line method, considering their useful life period. Taxpayers may, however, opt for the declining method in relation to tangible fixed assets that:

48. Arts. 6, 7 and 8 Financial Reporting Accounting Standards.

49. Art. 29(1) CIRC.

- have not been acquired in a used condition; and
- are not (i) buildings; (ii) private passenger vehicles or mixed passenger/commercial vehicles, except when they are used to operate a public transport service or are intended to be rented in the exercise of the taxpayer's normal activity; (iii) furniture; and (iv) costs relating to education and/or social care (e.g. charges for canteens, schools, libraries and kindergartens).

As for intangible assets, it was previously mentioned that the tax law authorizes their depreciation. In accordance with paragraph 70 of NCRF 6, an entity must choose either the cost model or the revaluation model as its accounting policy for the subsequent measurement of intangible assets. However, the revaluation model can only be used when there is an active market for the intangible asset in question.<sup>50</sup>

In the cost model, the intangible asset should be carried at its cost minus any accumulated amortization and any accumulated impairment losses. The determination of the amortization of intangible assets is based on the estimated useful life and residual value. The estimated useful life of the intangible asset is based on the period in which it is expected to be used in the course of the entity's activity. When accounted for in accordance with these rules, depreciation of intangible assets is deductible for tax purposes.

##### 24.3.2.2.2. Impairments

Impairments are regulated in NCRF 12, which closely transposes IAS 36. According to the national standard, if the recoverable amount of an asset is less than its carrying amount, the asset's carrying amount should be reduced to its recoverable amount. The CIRC 1988 allows for the deduction of impairments, encompassing different regimes for inventories, receivables and non-current assets (articles 28 and 29 of the CIRC 1988). As for inventories, the tax rule (article 28) provides that impairment losses on inventories are deductible from taxable income, recognized in the same tax period or in previous tax periods, up to the limit of the difference between the cost of acquisition or production of inventories and the corresponding net realizable value at the balance sheet date when this is lower.<sup>51</sup>

50. PT: *Ordem dos Contabilistas Certificados* [Certified Accountants College], opinion PT19582 - *Ativos intangíveis* [tangible assets], 1 Aug. 2017.

51. L. Santos, *Divergências entre a Contabilidade e a Fiscalidade. Análise e Implicações* p. 45 (University of Aveiro 2017).

Regarding receivables, the CIRC 1988 (article 28-A) allows taxpayers to deduct the impairment losses related to receivables resulting from their normal activity, including interest for delay, on the condition that such receivables can be considered as bad debt at the end of the tax period, are showed as such in the accounts, and have been accounted for in the same tax period or in previous tax periods (formal dependency rule). The dependency rule is quite evident here, as well as the rule that, according to the dependency principle, costs recognized in accounts can be postponed for tax purposes but never anticipated.<sup>52</sup> However, the tax law imposes clear limits to this kind of impairment, in such a way that the accumulated annual amount of the impairment loss cannot exceed the following percentages of debts in arrears:<sup>53</sup>

- 25% for bad debts overdue for more than 6 months and up to 12 months;
- 50% for bad debts overdue for more than 12 months and up to 18 months;
- 75% for bad debts overdue for more than 18 months and up to 24 months; and
- 100% for bad debts overdue for more than 24 months.

Obviously, differences can occur between the accounting treatment and the tax treatment, which the CIRC 1988 solves with the above-mentioned rule: the taxpayer can deduct impairment losses recognized in accounts in the same period or in previous periods. However, if the taxpayer in period  $N_0$ , when the bad debt is overdue for more than 6 months and up to 12 months, esteems that there is no risk (there is no bad debt despite the delay) and therefore will not recognize any impairment loss in its accounts, they will no longer be able to deduct the 25% part of the debt authorized by tax law for that period.

As for non-current assets, impairment losses arising from confirmed abnormal causes, namely, disasters, natural phenomena, exceptionally rapid technical innovations or significant changes with adverse effects in the legal context, are deductible when solidly substantiated. However, for the impairment loss to be accepted for tax purposes, it is necessary that the taxpayer proves the facts that determined such devaluation, under the terms set out in article 31B of the CIRC 1988.<sup>54</sup> Therefore, all unproven impairment losses or ones resulting from other phenomena will not, in principle, be accepted as a tax expense in the year of their recognition.

52. Aguiar (2022), *supra* n. 1, at pp 54-56.

53. Santos, *supra* n. 51, at p. 43.

54. Santos, *supra* n. 51, at p. 46.

### 24.3.2.3. Valuation/measurement after recognition (current value/market/fair value)

For tangible fixed assets as well as for intangible fixed assets and property, the accounting standards applicable (NCRF 6, 7 and 11) provide for two possible methods for measuring them after recognition: the cost model and the revaluation model (fair value). Under the cost model, the asset is written down at cost minus any accumulated amortization and any accumulated impairment loss.

However, if the asset's fair value can be measured reliably it must be written down for a revalued amount, which is its fair value at the date of revaluation minus any subsequent accumulated depreciation and subsequently accumulated impairment losses. The revaluations must be carried out with sufficient regularity to ensure that the amount written down does not differ materially from that which would be determined by the use of fair value at the balance sheet date.

The fair value of land and buildings must be determined based on market-based evidence through assessment that must be carried out by professional, constructed and independent evaluators. The fair value of plant and equipment items is generally their market value determined by appraisal. If there is no evidence, based on the market, of the fair value due to the specialized nature of the item or because the item is rarely sold, the entity cannot use the revaluation method. The frequency of revaluations depends on changes in the fair value of tangible fixed assets that are being revalued. When the fair value of a revalued asset differs materially from its written description, a new revaluation is necessary.

### 24.3.3. Non-tax adjustments

The income tax law provides for a few cases of non-tax adjustments, the most relevant are accelerated depreciation, allowance for reinvested gains obtained from the sale of assets, deduction of development expenses and expenses for social purposes. In all cases mentioned, the adjustment must be made only in the tax form, without affecting the commercial accounts in any case.

As for accelerated depreciation, this is an option left to the taxpayer that is limited to assets acquired in new condition and excludes buildings, passenger or mixed commercial/passenger vehicles (except when used for the

operation of a public transport service or intended to be rented in the exercise of the taxpayer's normal activity), furniture and costs relating to education and/or social care (e.g. charges for canteens, schools, libraries and kindergartens) (article 31 of the CIRC 1988). As accelerated depreciation is a tax incentive for productive investment, the legislator excluded from its application assets that could mask financial investments or acquisitions of assets not strictly related to production.

Regarding capital gains, the taxable gain obtained from the sale of some assets (tangible fixed assets, intangible assets and non-consumable biological assets) can be included in the tax base at only half of its value (article 48 of the CIRC 1988). In order to be eligible for this treatment, the assets must be held for a period of not less than 1 year, and the amount obtained must be reinvested in the acquisition, production or construction of tangible fixed assets, intangible assets or non-consumable biological assets. Reinvestment can take place in the tax period prior to the sale, in the tax period itself or until the end of the second following tax period. Additionally, in this case there is a tax incentive for company investment.

As for expenses relating to development projects, they can be treated as tax expenditure in the current period in which they are incurred (article 32 of the CIRC 1988). This treatment will be allowed even when any intangible assets (e.g. patents, industrial models or new production processes) coming out of such projects are recognized (capitalized) in the financial statements of taxpayers.

The tax regime for social expenses refers to expenses resulting from the optional maintenance of day-care centres, milk dispensaries (for new mothers), kindergartens, canteens, libraries and schools made for the benefit of the company's staff or retirees and their families. This regime may apply to other social utility expenses recognized as such by the tax administration (article 43 of the CIRC 1988). The tax incentive character of the regime lies in the fact that such expenses are considered, when determining taxable profit, in an amount corresponding to 140% of their real amount.

## 24.4. Specific interpretation and application issues

### 24.4.1. Interpretation of accounting rules

In the Portuguese legal system there is a body called the Accounting Standardization Commission. This body does not have a professional

private nature. It is a body created through a government legislative act and brings together public sector entities, including the tax administration and the private sector, and it is designated as an "independent body". This organization has, among other functions, the role of interpreting the accounting regulations, namely through opinions.

The Certified Accountants College has an extremely important and active role in the interpretation of accounting regulations, also through opinions. As for the courts, until recently, they avoided entering into the analysis of accounting issues and, above all, the analysis of accounting standards. It can be said that this situation is changing slowly with more and more judicial pronouncements based on the interpretation of accounting standards. However, the courts may, whenever they deem it necessary, ask for the intervention of experts to clarify questions of interpretation of accounting law, but this has not happened very frequently either. In summary, the activity of interpreting accounting law is rather incipient, which is why accounting principles have not played a relevant role in it so far.

### 24.4.2. Abuse of commercial accounting rules

Situations of abuse of accounting rules are often detected by the tax administration (but not so much in terms of private law relationships, where there are no known cases of disputes that have reached the courts). Although both the "true and fair view" clause and the principle of substance over form exist in national accounting law, there is no known case in which the tax administration has resorted to such principles in order to restore the substantial truth of the accounts. In these situations, the tax administration – which only defends the tax interest and not the private law interests protected by the accounting obligation – may not even need to interfere with commercial accounting since the tax law, i.e. the CIRC 1988, has numerous rules (the so-called special tax rules of accounting content) that are nothing more than, precisely, anti-abuse rules regarding accounting rules for strictly tax purposes.

In situations in which the taxpayer has resorted to more sophisticated constructions and in which the anti-abuse rules contained in the CIRC 1988 prove to be insufficient, the tax administration has at its disposal the general

anti-abuse clause provided for in article 32(2) of the *Lei Geral Tributária* (General Tax Law, LGT),<sup>55</sup> that reads:

Constructions or series of constructions that, having been carried out with the main purpose or one of the main purposes of obtaining a tax advantage that frustrates the object or purpose of the applicable tax law, are carried out with abuse of legal forms or are not considered genuine, taking into account all relevant facts and circumstances, are disregarded for tax purposes, and are taxed in accordance with the rules applicable to businesses or acts that correspond to the substance or economic reality not producing the intended tax advantages. [Author's translation.]

In practice, the tax administration has rarely resorted to the general anti-abuse clause, due, on the one hand, to the complexity of the process associated with it, and, on the other hand, to the efficiency of the numerous anti-abuse rules contained in the CIRC 1988.<sup>56</sup>

#### 24.4.3. Procedural issues

The key rule in this matter is article 17(1) of the CIRC 1988 that reads:

The taxable profit of legal persons and other entities<sup>57</sup> [...] is calculated by the algebraic sum of the earnings before taxes for the period and the positive and negative variations in equity occurred in the same period and not reflected in the earnings before taxes, determined *on the basis of the accounts and rectified whenever justified in the terms of this Code*. [Emphasis added.] [Author's translation.]

The term "rectified" in this provision is twofold. First, the term is intended for tax rules that contain deviations from accounting rules or simply place limits on deductible costs. The application of these corrections gives rise to the so-called extra-accounting adjustments. Clearly, these corrections have nothing to do with errors.

55. PT: *Lei Geral Tributária* [General Tax law], 1998, DL no. 398/98 12 Dec, DR no. 290/98 I.

56. Some recent judicial decisions on the general anti-abuse clause include PT: STA 2nd seccion., STA [Supreme Administrative Court], 16 Feb. 2022, 0299/13.2BEPNF 0460/17; PT: STA 2 Sec. Plenary, 26 May 2022, 0138/20.8BALS; PT: STA 2 Sec., 12 May 2021, 01869/13.4BEBRG 01152/17; PT: STA 2 Sec., 12 May 2021, 01869/13.4BEBRG 01152/17; and PT: STA 2 Sec., 27 Jan. 2016, 01720/13.

57. The expression "legal persons and other entities" can be interpreted as corporations.

There are, however, tax rules that contain criteria that can be applied to commercial accounting itself. To cite a couple of examples, this is the case with the standard on measuring inventories, which replicates the accounting standard in accordance with IAS 2 (article 26 of the CIRC 1988) and with the standard that states which assets can be amortized, which is also in accordance with the accounting standards. Applying these rules, the tax administration can conclude whether taxpayers made mistakes under tax law and make the appropriate rectifications for tax purposes under article 17 of the CIRC 1988.

In addition to this CIRC 1988 rule, article 75 of the LGT 1998<sup>58</sup> reads:

(i) Taxpayers' tax declarations submitted in accordance with the law, as well as the data and findings entered in their accounting or writing, are presumed to be true and in good faith, when these are organized in accordance with commercial and tax legislation, without prejudice to other requirements on which the deductibility of expenses depends. (ii) The presumption referred to in the previous number will not apply when: a) The tax declarations, accounting or books reveal omissions, errors, inaccuracies or well-founded indications that do not reflect or prevent knowledge of the taxpayer's real taxable income. [Author's translation.]

This rule allows the tax administration, during an inspection, to actually assess the conformity of the taxpayer's accounting with the accounting rules in force for the purposes of article 17 of the CIRC, and the tax administration uses this rule very frequently.<sup>59</sup> In such a situation, the tax administration is allowed to disregard the taxpayer's accounting, solely when it comes to the incorrect parts and nothing else, and apply the accounting criteria that it considers correct.

As mentioned in section 24.2.2., the courts have adopted a very restrictive attitude in relation to the tax administration's power to correct the taxpayer's commercial accounts. From the outset, the burden falls on the tax administration to indicate robust evidence that the accounting incurs errors, in which case the taxpayer has the right to counter prove the veracity of their accounts.<sup>60</sup> Once it has been demonstrated that the accounts actually contain errors, the commercial accounts themselves are never rectified, which

58. PT: *Lei Geral Tributária* [General Tax law], 1998, DL no. 398/98 12 Dec, DR no. 290/98 I, pp. 6872-6892.

59. J. Campos-Amorim, *Os Custos Dedutíveis para Efeitos de IRC*, Fiscalidade 32, pp. 22-43 (2007).

60. PT: TAC [Central Administrative Court - South], 4 June 2020, 1426/12.2BEPRT.

means that rectifications can never reflect on private law relationships (the balance sheet approved by shareholders). Finally, even in corrections limited to tax purposes, the tax administration is required to use all valid elements that can be extracted from the taxpayer's accounts.<sup>61</sup>

61. PT: TAC [Central Administrative Court - North], 11 Nov. 2021, 01469/18.2BEPRT, where the Court stated:

However, the Tax Administration has the burden of demonstrating that the judgment underlying its corrective action is well-founded, proving the evidence that supports it, demonstrating the facts capable of undermining the presumption of the veracity of the transactions recorded in the accounts of the taxpayer and the respective supporting documents. It follows that the determination of the taxable amount of any tax must be done, whenever possible, using direct methods or arithmetic corrections, that is, by determining the taxable amount through the elements of the taxpayer's own accounting and there can only be recourse to indirect methods when that direct calculation proves to be completely unfeasible, the Public Treasury not enjoying any margin of discretion regarding the option of the method (direct or indirect) of assessment of the taxable matter, since the determination of the taxable amount by such methods must be of the nature of "ultima ratio fisci" and require careful reasoning as to the option for its use.

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### 25.1. Relevance of the topic and status of its discussion

The legal regulation of accounting in the Slovak Republic is based on statutory legal norms and is characterized by a relatively high degree of regulation – the state guides accounting through the professional guarantee of the Ministry of Finance of the Slovak Republic (MF SR). In order to understand the current approach of the state, it is necessary to look at the regulation in a broader context. The legal regulation of the current form of accounting has undergone a long and rather complex development – it has been developed since 2003 in connection with the approximation of the legal standards of the Slovak Republic with EU law. For this reason, several requirements of international accounting standards were incorporated into the legislation, while the process of international standardization and harmonization of accounting is still ongoing.

The question of connection or separation of tax accounting and book accounting is the subject of discussion by many authors,<sup>1</sup> and some of them point to the growing divergence between reported financial income and taxable income,<sup>2</sup> while there are still differences between countries. In Slovakia, book accounting and taxation overlap, and there is mutual respect between the accounting procedures of book accounting and tax laws. The accounting economic result determined in book accounting is transformed into the tax base outside the accounting system by items increasing (the so-called non-deductible items) or decreasing (the so-called deductible items) the economic result in accordance with the tax law. The tax calculation itself is carried out in the tax return, which the accounting entities must submit to the relevant tax authorities within the specified deadlines. The content of tax accounting includes procedures associated with the preparation of a tax return, as well as various procedures aimed at minimizing tax

1. For example, see M.A. Desai, *The Divergence between Book and Tax Income*, 17 *Tax Policy and the Economy* 1, pp. 169-206 (2003); and M. Paseková et al., *Comparative Analysis of Tax Systems: Some Evidence from CEE Countries*, 77 *International Journal of Economics and Management Engineering* 5, pp. 840-846 (2011).

2. Desai, id.; and N. Stangova & A. Vighova, *Possibilities of creative accounting avoidance in the Slovak Republic*, 158 *Economic Annals-XXI* 3-4(2), pp. 97-100 (2016).