Portugal: Insolvency Courts vs. Tax Administration – Will rescue culture eventually triumph?

After three hard years, the programme of international financial assistance to Portugal has finally come to an end, with the Troika leaving our country last May.

For better and for worse, much has changed concerning the political, economic and social structures.

With regard to insolvency, the Troika required the fostering of a rescue culture concerning both corporations and individuals. The Portuguese Insolvency Act was amended in accordance in 2012. The definition of insolvency proceedings was altered in order to accommodate the priority of rescue purposes, the insolvency plan was renamed "*restructuring plan*" and brand new pre-insolvency proceedings were created (the special revitalisation proceedings). Concerning the possibility of tax claims being affected by restructuring or revitalisation plans, however, no measures were taken, in spite of the Troika Memorandum (2011), which required that obstacles to recovery had to be abolished and expressly referred to the need to "*amend Tax Law with a view to removing impediments to voluntary restructuring of debts*" (2.19. of the Troika Memorandum). At the end of the day, this legislative 'stubbornness' makes us wonder whether the Portuguese legislator was genuinely concerned with recovery and has, in fact, done more than paying 'lip service'.

The 'battle' between courts and the Tax Administration over tax inalienability has been going on for quite a while. The issue may be described in the form of a question: can a restructuring or revitalisation plan provoke modifications to tax claims (discharge, reduce their amount, and reschedule payments)? On the one hand, there is the traditional understanding that tax claims represent an indispensable element to the public welfare and must, therefore, be unattainable. On the other hand, considering that recovery plans depend on the willingness of the creditors to accept changes to their claims, if tax claims are kept intact the purpose of recovery will be jeopardized.

Almost from the start, and even before amendments to the Insolvency Act in 2012, the Portuguese courts fiercely fought the Tax Administration in its attempts to overestimate the principle of inalienability of tax claims. And, in a first stage, they actually managed to stop that. Whenever a recovery agreement negotiated by the debtor and the majority of the creditors modified tax claims and was subsequently challenged by the Tax Administration, the courts would nevertheless approve it, stating that Tax Law could not be given priority over Insolvency Law, given the special nature and purposes of the latter and the fact that the principle of inalienability was designed for general purposes. The legal ground was *lex specialis derogat legi generali*, meaning that a law governing a specific subject matter (*lex specialis*) overrides a law which only governs general matters (*lex generalis*).

It was then that the Portuguese legislator decided to intervene and strengthen the position of tax claims. Tax Law was amended in 2010 so as to provide for the prevalence of the principle of inalienability of tax claims even in cases of special legislation. This represented a major setback. It was no longer possible to confront the Tax Administration with the usual argument since the law clearly contradicted it. The thing that makes us wonder is: how can the legislator amend the Insolvency Act with a view to recovery and at the same time hamper the achievement of this purpose?

After a short period characterized by the absence of an effective reaction, and when everything seemed hopelessly lost, a new line of action gradually emerged. In a recent judgment (of 18 February 2014), the Portuguese Supreme Court ruled that a revitalisation plan may be approved by the court regardless of the nature of the claims that it modifies. The plan has a contractual basis; therefore, whenever the Tax Administration argues that the plan collides with a given provision and requires not to allow it to affect the tax claims, it should still be admissible if it restricts its effectiveness to the remaining creditors.

This Supreme Court ruling made an important point and its judgment will undoubtedly enable a lot of plans being saved. One single problem remains: the plan which is ultimately approved by the court is (may) not (be) the one that was negotiated and agreed upon by the debtor and the creditors. Without the measures designed to change tax claims, will the plan still be able to work in most of the cases? Will recovery still be a realistic and feasible aim?

For this and other reasons, it seems that a rescue culture in Portugal is far from being established. At present, the process of making recovery instruments work relies almost exclusively on courts and how they are able to surmount legal obstacles through the way of interpretation. Given the contradictory paths the Portuguese legislator took recently, maybe this is the only possible way.

> **HOW CAN THE LEGISLATOR AMEND THE INSOLVENCY ACT WITH A VIEW TO RECOVERY AND AT THE SAME TIME HAMPER THE ACHIEVEMENT OF THIS PURPOSE?**

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