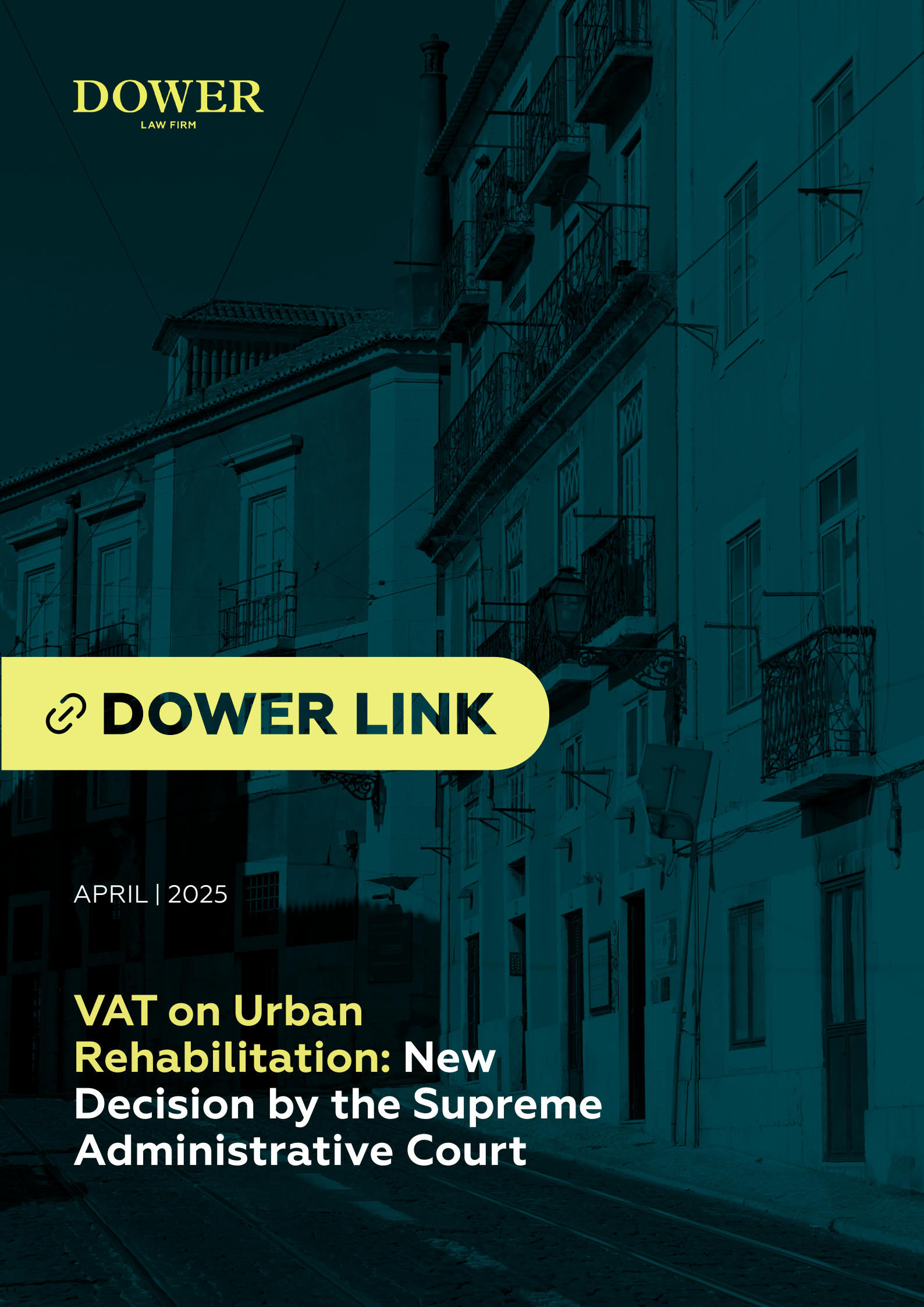
DOWER
LAW FIRM



DOWER LINK

APRIL | 2025

VAT on Urban Rehabilitation: New Decision by the Supreme Administrative Court

The Supreme Administrative Court recently ruled on the application of the reduced VAT rate (6%) for urban rehabilitation contracts — and the decision may have a direct impact on projects carried out in recent years.

In connection with an appeal lodged with the Plenary of the Tax Litigation Section of the Supreme Administrative Court for the Harmonization of Case Law, the appellant argued that the arbitral decision rendered is in conflict, on the same fundamental point of law, with the decisions issued by the same Arbitration Centre in cases no. 2/2023-T, 404/2022-T, and 295/2022-T1.[1]

Thus, the appellant raised three essential legal questions, namely:

i. Whether, to benefit from the reduced VAT rate provided for in item 2.23 of List I annexed to the VAT Code (CIVA), it is sufficient for the two conditions expressly stated therein to be met — that it involves an urban rehabilitation contract located within a designated urban rehabilitation area — or whether, beyond that, the law requires other conditions or requirements, namely those related to an urban rehabilitation operation.
ii. Whether the concept of an urban rehabilitation contract applies to the construction of new buildings within the designated urban rehabilitation area, or whether, on the contrary, it only covers the rehabilitation of existing buildings.
iii. Whether certification by the competent municipality that the contract qualifies as an urban rehabilitation contract within a designated urban rehabilitation area and within the scope of an urban rehabilitation operation is sufficient for the application of the reduced VAT rate provided for in item 2.23 of the CIVA.

Although the Court only addressed the first question — considering that the legal requirements for an appeal for the harmonization of case law were not met with regard to the other two — it ruled that:

The application of the reduced VAT rate provided for in item 2.23 of List I annexed to the VAT Code (CIVA) depends on the existence of an approved Urban Rehabilitation Operation for the location within the Urban Rehabilitation Area where the Urban Development Operation (contract work) is carried out.

[1]Fully available for consultation at https://caad.org.pt/tributario/decisoes/

In other words, the Court ruled that the recognition of the right to the tax benefit established jointly in Article 18(a) of the VAT Code (CIVA) and in item 2.23 of List I is legally dependent on the goods and services intended to be taxed at the 6% VAT rate being provided within the scope of an urban rehabilitation contract — and that the qualification of a contract as an urban rehabilitation contract presupposes the prior existence of an Urban Rehabilitation Operation.

Based on the literal wording, only urban rehabilitation contracts may benefit from the tax advantage set out in Article 18(1)(a) of the VAT Code, which defines the applicable tax rates, and in item 2.23 of the aforementioned List I, which states that only "Urban rehabilitation contracts, as defined in specific legislation (...)" qualify for this reduced rate.

> **According to the Court, the concept of an urban rehabilitation contract must be further defined by reference to the concept of urban rehabilitation set out in the Legal Framework for Urban Rehabilitation (Regime Jurídico de Reabilitação Urbana – RJUR), enacted by Decree-Law no. 307/2009, of October 23.**
>
> **In this regard, Article 2(j) of the RJUR states that "Urban rehabilitation" is "a form of integrated intervention on the existing urban fabric, in which the urban and real estate heritage is preserved, in whole or in substantial part, and modernised through the execution of works to remodel or improve urban infrastructure systems, facilities, and public or green spaces for collective use, as well as construction, reconstruction, extension, alteration, conservation, or demolition works on buildings."**

Now, following this reasoning, the Court decided that the urban rehabilitation contract "to which the tax legislator assigns relevance as a condition for accessing the reduced 6% VAT rate must correspond to a work that is part of a strategic rehabilitation plan designed by the Municipalities, the entities responsible for promoting urban rehabilitation."

With added emphasis on understanding the concept of an urban rehabilitation contract and item 2.23, the Court took into account Articles 7, 8, and 16 of the RJUR, which establish that urban rehabilitation arises from the cumulative approval of two instruments: the delimitation of the urban rehabilitation area

[Article 7(a)] and the urban rehabilitation operation to be carried out within the delimited areas in accordance with the previous point, through a specific instrument or a detailed urban rehabilitation plan [Article 7(b)].

In conclusion, and for the purpose of harmonizing case law, the Court decided that:

- Only urban rehabilitation contracts benefit from the reduced 6% VAT rate provided for in Articles 18(a) and in item 2.23 of List I annexed to the VAT Code (CIVA);
- The qualification as an "urban rehabilitation contract" presupposes the existence of a contract and its execution within an Urban Rehabilitation Area for which an Urban Rehabilitation Operation has been previously approved.

In practice, this decision may imply:

- Projects involving new construction or interventions outside of a formal urban rehabilitation operation will not benefit from the reduced VAT rate; and
- The Tax Authority may review past cases and demand payment of the VAT difference, especially in situations where the newly required conditions are not met.

Therefore, we recommend that all companies and developers who have benefited from or intend to benefit from the reduced VAT rate on rehabilitation works:

i. Review the documentation of previous projects (since 2021), particularly to verify if there is formal approval of the urban rehabilitation operation.

Alberto Mateus Vaz
amv@dower.pt