

NEWSLETTER

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URBAN REGENERATION IN PORTUGAL: AN AUTHENTIC INTERPRETATION OF VAT PROVISION 2.23 AND THE NEW CIRCULAR LETTER OF 25 SEPTEMBER

The application of the reduced VAT rate (6 %) to work in Urban Regeneration Areas (ARUs) has returned to the centre of the debate following the approval of an interpretative law.

Is this law already too late? Following the publication of Circular Letter No. 25121, dated 25 September It is time for businesses, the tax authorities and the Government itself to prepare for its entry into force by analysing and mapping out the situations that may fall within its scope, in order to safeguard the practical effect of an interpretation now reaffirmed by the legislature.

Advisory Team



THE BACKGROUND

The application of the reduced VAT rate (6%) to construction works in Urban Regeneration Areas (ARUs) has once again become the focus of debate.

For years, the tax authorities have maintained a restrictive interpretation of clause 2.23 of List I annexed to the VAT Code, requiring, in addition to the demarcation of the ARU, the approval of an Urban Regeneration Operation (ORU). This interpretation has led to additional VAT assessments at the standard rate on proceedings already carried out, increasing costs and uncertainty in the sector. [Circular Letter No. 25121 of 25 September of this year](#) — which brings the matter back into focus — itself recalls that the Tax Administration took the view that the mere location of a property within an ARU was insufficient, requiring both an approved ORU and the inclusion of the specific works within that operation.

As we have previously noted in articles dedicated to this topic (namely [NL37 26 UrbanRehabilitation NewDraftLaw](#)), it has always seemed to us that this interpretation lacked clear support in the legislator's intention when introducing Item 2.23. The case law was, however, divided. In a judgment harmonising case law dated 26 March 2025 (Case No. 12/24.9BALSB, published as [Judgment No. 3/2026](#)), the Supreme Administrative Court (STA) held that the reduced 6% rate applies only to urban rehabilitation works carried out in an ARU for which an ORU had previously been approved, thereby endorsing the position adopted by the Tax Administration. The judgment was delivered unanimously and published in the Portuguese Official Gazette on 17 March 2026.

Far from bringing the matter to a close, this standardization ultimately refocused the debate and highlighted the practical impact of an interpretation heavily dependent on an administrative assumption which, in many cases, is beyond the taxpayer's control.

RESTORING WHAT IS DUE

Meanwhile, the legislator reacted, seeking to return to what had always been its view regarding the rationale behind this provision. This led to the introduction of [Bill No. 642/XVII/1st](#), the aim of which was to provide an authentic interpretation of provision 2.23, to the effect that the location of the property within a legally defined ARU would be deemed sufficient, irrespective of the approval of an ORU.

This Bill was passed very quickly, having gone through the parliamentary process which culminated, on 17 July 2026, in its unanimous approval in a final plenary vote. On the same date, the corresponding Decree of the Assembly of the Republic was published, entitled 'Providing an authoritative interpretation of item 2.23 of List I annexed to the Value Added Tax Code, as amended by Law No. 64-A/2008 of 31 December'.

The present legislative framework culminated in the publication, in *Diário da República*, of [Law no. 48/2026, of 17 August](#), which provided an authentic interpretation of item 2.23 of

List I annexed to the Value Added Tax Code, as amended by [Law no. 64-A/2008](#), of 31 December, and entered into force on the day following its publication.

The significance of this legislative development does not, however, lie solely in the substantive content of the approved solution. The truly decisive point is that the legislature has introduced a law characterized as interpretative, contrary to the understanding previously established by the STA, as well as the *timing* of this legislative action.

More than mere clarification, this is a legislative intervention that seeks to resolve the debate over past situations and pending disputes.

REHABILITATING THE PAST?

The central issue is thus no longer merely a question of determining the best interpretation of item 2.23 of List I annexed to the VAT Code, but rather of understanding the practical effects of this interpretation, now referred to as the authentic one.

It should be recalled that the interpretative law forms part of the law it interprets but excludes the effects already produced by a final and binding judgement, a settlement or acts of a similar nature. This exception is significant: amongst past situations, it is important to distinguish between cases that have already been definitively decided — which, in principle, cannot be reopened on the basis of the new interpretation — and those that have not yet become final, or which have not even been contested, in which the scope for invoking this interpretation is substantially greater, always subject to the available procedural remedies and the applicable statutory time limits.

In practical terms, by stipulating that the law takes effect from the entry into force of Law No. 64-A/2008 of 31 December, the legislature intends for this interpretation to apply to the entire period during which the wording of item 2.23 of List I annexed to the VAT Code — now the subject of an authentic interpretation. According to the Circular Letter recently issued, that wording was generally in force between 1 January 2009 and 6 October 2023, although it continues to apply to transactions covered by the transitional regime laid down in Article 50(9) of Law No. 56/2023 of 6 October.

This clarification is important, as it is not strictly accurate simply to state that all transactions after 6 October 2023 are subject to the new regime. The previous wording may continue to apply in situations covered by the transitional regime, even where VAT becomes chargeable after that date. In other words, the specific way this interpretation is applied depends on the facts and context of each transaction. Approval of this interpretative provision should not, therefore, be regarded as an automatic solution for all cases.

There is also an additional caveat which the Portuguese Tax Administration has now expressly acknowledged: the ARU must have been lawfully designated and remain in force. According to the Circular Letter, where no ORU has been approved, the designation of the

ARU lapses if the corresponding ORU is not approved within three years. The Tax Administration therefore takes the view that, when VAT becomes chargeable, either an approved ORU must exist or, if none exists, the ARU must have been designated less than three years earlier. This is, indeed, one of the main practical limitations that the Circular Letter places on the scope of the authentic interpretation.

A technical note issued by the Portuguese Certified Accountants Association (OCC) also confirms the scope of this interpretation in relation to the previous wording of item 2.23 — and rightly so. Although this legislative development is positive and consistent with the position, we have long advocated — which, unfortunately, was not adopted when the case law was harmonised — it may have come too late for certain situations that have already become legally settled, as the passage of time is itself a *problem*.

In this regard, the Tax Administration recently issued [Circular Letter No. 25121, of 25 September](#), in which it acknowledged that the retroactive effect of the law under analysis does not result in the reopening of statutory time limits that have already expired.

Accordingly, for transactions in respect of which the tax became chargeable on or before 17 August 2026, the taxpayer must assess, on a case-by-case basis, the applicable conditions and the statutory time limits that have expired and that are still pending, in order to determine which legal means are available to regularise its tax position.

Regarding ongoing tax audit procedures, the Circular Letter provides that no adjustments should be proposed or made solely on the grounds that no ORU has been approved or that compliance of the works contract with an ORU has not been demonstrated, without prejudice to the other applicable statutory requirements. Where other grounds for adjustment exist, it must be determined whether they are independent and sufficient to support the adjustment.

With respect to additional tax assessments and pending administrative proceedings, the Portuguese Tax Administration further takes the view that, where the sole basis for the adjustment is the absence of an approved ORU or the failure to bring the works contract within the scope of an ORU, that basis cannot be maintained. Where other grounds exist, they must be assessed to determine whether they are independently sufficient to support the assessment.

The Circular Letter does not expressly address assessments that are the subject of judicial appeals or tax arbitration proceedings. In relation to pending procedures, it refers specifically to administrative appeals, ex officio reviews, hierarchical appeals or any other procedure permitted by law. We therefore prefer not to infer from these administrative instructions any automatic procedural consequence for ongoing court or arbitration proceedings; each case should instead be assessed in the light of its own procedural framework.

Lastly, it should be noted that, for transactions in respect of which VAT becomes chargeable on or after 18 August 2026 and to which the previous wording of item 2.23 remains applicable under the transitional regime provided for in Law no. 56/2023, of 6 October (the “Mais Habitação” Programme), the Portuguese Tax Administration considers that the requirements for the application of that provision should likewise be assessed in accordance with the authentic interpretation established by Law no. 48/2026, of 17 August. In such circumstances, neither an approved ORU nor, where an ORU exists, compliance of the works contract with the rehabilitation options set out therein may be required as a separate condition for applying the reduced rate.

We also note that an opportunity may have been missed for the legislator to establish, from the outset, an incentive, in the form of procedural costs, to bring about the swift conclusion of court proceedings or tax arbitration cases in which this issue is being debated.

With regard to the adjustment of VAT charged in excess as a result of applying the standard VAT rate instead of the reduced rate, the Circular Letter allows the tax to be adjusted in certain circumstances by correcting the invoice through the issue of a credit note corresponding to the difference between the VAT calculated at the standard rate and the amount due at the reduced rate. Where VAT was charged by the supplier to a customer who is not entitled to deduct it, an adjustment in favour of the taxable person is conditional upon proof that the customer has been reimbursed for the excess VAT charged.

Where VAT is self-assessed by the customer under the reverse-charge mechanism, and the customer carries out transactions giving rise to a full or partial right of deduction, the adjustment may be made by the recipient of the service within the statutory four-year period, provided that the applicable legal conditions are met.

In relation to such ex officio reviews, the Circular Letter adopts a particularly significant position. Although it states that the interpretation previously followed by the Tax Administration was supported by the Supreme Administrative Court's judgment harmonising the case law, it considers that, by virtue of the entry into force of the interpretative law and the retroactive effects attributed to it, an error attributable to the tax authorities exists for the purposes of the General Tax Law (LGT), which may provide grounds for an application for an ex officio review.

It should nevertheless be noted that applications for an ex officio review must comply with the statutory requirements and be submitted within the applicable time limit. The existence of an error attributable to the tax authorities does not automatically result in the application being granted: it will be refused where the assessment is supported by independent grounds other than the absence of an ORU. The Circular Letter further provides that an administrative appeal based on the interpretation enshrined in Law No. 48/2026 must, naturally, be converted into an ex officio review procedure under the relevant provision of the Code of Tax Procedure and Proceedings (CPPT).

Against this background, the Circular Letter focuses its guidance on applications submitted by taxpayers and on pending procedures. It is therefore important to note that the instructions set out in the Circular Letter do not require the Tax Administration, on its own initiative, to conduct a general review of all past assessments potentially covered by the new interpretation. In short, the Government, the tax authorities and businesses must all prepare themselves and act with a view to safeguarding, as far as possible, the practical effect of the interpretation intended by the legislator.

FINAL REMARKS

In this context, the enactment of the law providing an authentic interpretation of item 2.23 of List I annexed to the VAT Code represents a significant development in the tax framework applicable to urban rehabilitation works contracts carried out in Urban Rehabilitation Areas (ARUs). By establishing an authentic interpretation contrary to the position previously harmonised by the Supreme Administrative Court (STA), the legislature redefined the interpretation applicable to the wording of item 2.23 introduced by Law No. 64-A/2008, giving it effects from 1 January 2009.

It is precisely these types of issues that must be monitored closely and at an early stage. Although the legislative development is positive overall, it does not remove the need for the affected taxable persons to prepare for its consequences and for the potential benefits arising from it; rather, it makes that need all the more pressing.

In light of the recently enacted law and the Circular Letter issued by the Portuguese Tax Administration, potentially affected entities should, as a matter of priority, review their procedures and reconstruct the relevant supporting files: identifying the transactions and periods covered by the previous wording of item 2.23 — including, where applicable, under the transitional provisions — verifying whether the ARU was valid at the relevant time and mapping the status of each case, together with the applicable time limits and any procedures available to correct VAT assessments that do not comply with the interpretation in question.

In our view, it would also be desirable for the Portuguese Tax Administration to conduct an internal audit of assessments made under an interpretation contrary to that now authentically established by the legislature. This should involve mapping ongoing tax inspection procedures and assessments that have already been challenged, with a view to ensuring strict compliance with the principles of legality and inquisitorial procedure, as well as safeguarding the practical effectiveness of this interpretation and now, of the instructions arising directly from the new Circular Letter of 25 September of this year.

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