

THE GOODWILL OF BUSINESS CONCENTRATIONS. ACCOUNTING, TAX, AND ARBITRAL COURT PERCEPTIONS IN PORTUGAL

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ABSTRACT

Purpose: *The main goal of this paper is to understand if Portuguese companies recur to Tax Arbitral Court to resolve disagreements from the accounting and tax recognition of goodwill in the business combinations.*

Design/Methodology/Approach: *For this purpose, it researches the accounting and tax legislation of Portugal. In particular, the Accounting Standardization System - Sistema de Normalização Contabilística (SNC) and the Corporate Income Tax law - Imposto sobre o Rendimento das Pessoas Coletivas (IRC). Beyond that, it uses the case law-based research methodology leads to choose and collect the arbitral court decisions.*

Findings: *The results show that for tax base determination, the legal dispositions impose to consider the accounting standards understandings, namely, to record the goodwill recognition as an intangible asset since observed the accounting criteria. Nevertheless, there are differences of treatment inc accounting and tax domain in recognition of the costs as deductible tax spending, and it is the case of the impairment losses and the amortisations. Although the identified differences, it seems not to be enhancers of conflicts between of Portuguese Tax Authority and legal entities, due to the case-law of Centre for Administrative Arbitration, in this matter, is not significant.*

Originality/Value: *In the last decades, states try to adopt measures investment-friendly and being the business combinations a way of investment, it is relevant to understand the level of disagreement between tax authority and companies. The research evidence that in the business combinations' matter it is low the level of litigation, this conclusion can influence the investment decisions in Portugal.*

Keywords: Accounting, Taxation, Portugal, Goodwill, Business Combinations

INTRODUCTION

In the opinion of Hughes (1982) the globalisation's phenomenon was responsible for technological and knowledge's advances. The intangibles assets fit into the markets' globalisation context, and they have been assuming relevance because they represent considerable amounts in the entities' equity. The innovation, the technologies' diffusion, the emerging of new wealth concepts such as the intellectual capital and the goodwill in business concentration, highlight the importance of recognising intangible assets in the new economic scenario.

In Portuguese jurisdiction, the corporate income taxation underpins in the direct taxation regime, and it means that corporate tax rules are not totally different from the accounting guidelines (Sarmiento, Nunes, & Pinto, 2019). Tax legislator assumes the accounting profit as the starting point for legal entities' taxable income, although the tax corrections imposed by the Portuguese corporate income tax law (Nabais, 2018). However, several times the corrections imposed by tax legislation are a source of litigation between taxpayer and tax authority (Portocarrero, 2020). Thus, the recognition of business combinations' goodwill can be, also,

motivation to conflict, and lead enterprisers to recur to court in to clarify the views of each part.

International literature has paid some attention to goodwill matter, in particular in acquirer goodwill in a business combination (Carvalho, Rodrigues, & Ferreira, 2016; Gary, Warren, & Robert, 2020; Maruszewska, Strojek-Filus, & Pospíšil, 2019). However, to the best of our knowledge, this is the first paper focusing on the tax adjustment in the goodwill recognition and the level of litigation between taxpayers and the tax authority in Portugal. There is a need to better understand if Portuguese companies have resorted to the Portuguese Arbitral Court to resolve disputes arising from the recognition of goodwill in business combinations. This research addresses this gap by studying the legal norms that approached the recognition of enterprises combinations' goodwill; it also uses a database of Portuguese tax court's decisions and employs a case law-based research methodology. The research question tackled by the study are : Have Portuguese companies recur to arbitral court to resolve disputes arising from the recognition of goodwill in business combinations? For this purpose, the most relevant Portuguese legal norms were examined and case-law of CAAD was analysed.

Six parts compose the paper. The first section contains the introduction; in the second part, it presents a literature overview; the third ones, it clarifies the methodology and database used for paper goals; the fourth section explains the recognition criterion of the purchased goodwill in the combination of companies, in accounting and tax domain; In the fifth unit it explores the arbitral court's case law CAAD 147/2018-T, and the last one explains the final remarks and limitations.

LITERATURE REVIEW

In the last decades, the globalisation phenomenon provoked several changes in the worldwide economy (Ceaurescu, 2013), that lead to the interdependence between countries and markets. The advance of information technologies and communications forced changes in organisations (Barbera & Gelpi, 2018), and the technology's use leads to the knowledge and techniques' development. This improvement allows corporations to create value, that is the result, for example, of employees' knowledge, of recognition, of brands, of patents, and software (Mohammed & Al Ani, 2020). Therefore, the creation, the development and the management of organisations' knowledge have become an important issue nowadays (Silva, 2010). Thus, human resources, the research and development, the new technology and advertising are intangible investment (Cañibano, Garcia-Ayuso, & Sanchez, 2000). Some studies highlight the vital role that intangibles have come to assume in the companies' activity, and they reinforce that intangibles assets stand out concerning tangible fixed assets (Carvalho et al., 2016; Lev, 2001; Stewart, 1997).

The literature early starts to define the concept of goodwill, Dicksee and Tillyard (1906) established it as whatever improves value to a corporation by reason of situation, name, status, relationship, introduction to old customers. Wen and Moehrle (2016) define it as the "amounts paid more than fair value of the identifiable net assets for a business acquisition". Thus, it represents an incremental paid amount with the prospect of getting future economic benefits, because of this; accounting literature recognises it as an intangible asset, in the same level of the tangibles fixed assets. Johnson & Petrone (1998) the goodwill can promote expected net cash entries; the research also reinforces why it is an intangible and not a tangible asset. Considering, in several times, it is not possible to define useful life for goodwill, and it is liable to impairment losses (Sun, 2016). Nevertheless, during a long time, this kind of asset was not amortised, according to Carvalho et al. (2016), this situation increases results' volatility, due to the application of unreliable assumptions. In 2014, international organisations gave an important step to recognise the goodwill's amortisation through the International Accounting Standard 38 (IAS38).

These questions increment the need for an international accounting harmonisation, to uniformise the procedures and disclosures of that kind of assets that lead, in some situations, to

create future economic benefits (Alsharairi, Atmeh, & Al-Abdullah, 2019). Thus, the intangible assets' disclosure in the financial statements requires uniform criterion due to the globalisation; thus, regulators organisations have been working to standardise concepts, recognition, and measurement of intangibles assets. Accounting standardisation is no longer an issue confined to each country, and it has become an issue of interest to all countries, in general, despite efforts, there is still no complete uniformity. Nevertheless the relevance of intangibles recognition, according to Hamberg, Paananen, and Novak (2011) companies had not made enough efforts to measure the intangible assets acquired in a business combination, as it is endorsed by International Financial Reporting Standard (IFRS) 3 – Business Combinations.

The research of Wen and Moehrle (2016) inferred goodwill has represented up to 14–15% of the overall assets of U.S. public companies, which reported non-zero goodwill on their balance sheet, in the interval of 2005 and 2013. However, in the same year, Carvalho et al. (2016) analysed 197 Portuguese business combinations and had concluded that although the despite the considerable amounts paid for material goods, the recognised value of intangible assets is not significant. The authors consider that Portuguese's companies do not make enough efforts to identify and release the goodwill acquired in a business combination. More recently, Gary et al. (2020) study how goodwill's attributes relate with theories of neoliberalism and stewardship to disclose different viewpoints on the accounting for goodwill. It concluded that the accounting for goodwill demands for a revision. The authors defend a “hybrid accounting model”, in which goodwill is recognised as an asset (neoliberalism), and it is subject to amortisation, and the “recognition effect of inefficient negotiation of the purchase price be recognised in profit or loss (stewardship)”.

METHODOLOGY

The evidence took from the real world's observation underpin empirical research. Empirical legal research, qualitative or quantitative, recurs to the analysis of legislation and public policies. Thus, legal norms and courts' case law can represent observations of a real word (Epstein & King, 2002). In this conceptual background, this research aims to address the question: Have Portuguese companies recur to court to resolve disputes arising from the recognition of goodwill in business combinations?

To answer it, first, the research recurs to the analysis of legal norms that approached the acquired goodwill at corporate combinations, and, after, it utilises a case law-based research methodology. Thus, it develops an examination of legal structures of the European Community State, in specific, the case study of Portugal. The study includes some Portuguese data source the Accounting law, and the Corporate Income Tax Law, and the Regulatory Decree no. 25/(2009), of September 14 (DR 25/2009).

On the other hand, it researches case law in goodwill's business combination, in the database of the Portuguese Tax Arbitration Court (TAC) - CAAD, from 2011 until 2019. Nowadays, the TAC represents a reactive institution that brings a solution to the high litigation between taxpayers and tax authority and the judicial courts' backlog. The engagement of the case law-based research methodology conducts to identify and combined the court decisions. Additionally, the compilation, the reading and the explanation of lawful decisions represent a case of content analysis, being a resource for an experimental legal approach (Hall & Wright, 2008; Taborda & Sousa, 2020).

Goodwill's Portuguese Treatment In Accounting Standards

The Portuguese accounting standard 6-Norma de Contabilidade e de Relato Financeiro 6

(NCRF 6) determines accounting rules related to the Intangibles Assets (IA), this standard explains the concept of IA. According to it, they are not monetary assets; they do not have an identifiable physical substance. Thus, the accounting rule's analysis allows understanding their characteristics, and they have physical presence-absence, they can be identifiable, the entity has to the control over the IA, and ultimately the possibility to generate future economic benefits. Thus, the IA is an asset due to it observes the asset's concept clarified in the conceptual framework - Estrutura Conceptual (EC). The EC consider um asset if it is controlled by the entity, it is a past event's result, and it is expected to flow economic benefits for the organization.

The lack of physical substance, the first attribute of IA, is a particular characteristic of that kind of assets. Nevertheless, some literature considers a not essential feature in the intangibles assets definition, due to, some assets may have visible substance, it is the case of the disk of software or the certificate mentioning of a patent (Rodrigues, 2011). The second feature, the identifiability implies to observe on of the two conditions, it means, (1) it needs to be separable or divided, so it can be sold, licensed, transferred, exchanged or rented, or, (2) it may result of contractual or other legal rights (Castro, Cunha, & Rodrigues, 2015). The control represents the third trait, and it is associated with the possibility of obtaining future economic benefits. For Cañibano, et al. (2000), this attribute represents the ability of the entity in to exercise its rights, it represents the possibility of legally to complaint rights or services (Castro et al., 2015). The last characteristic refers to the possibility to generate future economic benefits; it can be the sales of products or services' revenues, savings costs, or other advantages obtaining from the assets' use.

The accounting recognition is relevant in the financial statements, thus, to the initial recognition of the intangibles asset, entities must observe two conditions: the asset's definition compliance and the recognition criteria imposed by the paragraph 18 of the NCRF 6. The second condition imposes that through the asset entity expect to flow future economic benefits, and the asset's cost can be reliably measured. The NCRF 6 determines categories of the intangibles assets; it is the case of the assets separately acquired, the assets acquired as a business combination's part, and the assets generated into the entity.

Relatively to the goodwill acquired in a concentration of economic activities, in the national domain, not only it is necessary to analyse the NCRF 6 but also the NCRF 14. These rules must articulate, at the international level, with the IFRS 3. The NCRF 14 determines the goodwill's concept, considering as future economic benefits arising from assets that are not possible to individually identified and separately recognised.

The accounting norm, also, evidence that the acquired goodwill signifies a payment made by the entity, in advance to future economic benefits resulting from an asset that cannot be independently identified or individually recognised. The purchase method is the model chosen to recognise the business activity concentrations; this method reflects the operation in acquirer's perspective, implying procedures. It means, the need of acquiring company's identification, the cost of business concentration's measurement, and, finally, the imputation of the act's cost to the acquired assets and liabilities and assumed contingent liabilities. The use of this method represents the liquid assets' purchase and recognises the liabilities, and contingent liabilities assumed and assets; it means that the assets that were not recognised previously in the individual accounts of the acquire will have recordation. Furthermore, if there is a remainder, it will correspond to other IA not independently recognised in the accounts of the acquiring entity; thus, it is identified as goodwill. As a universal directive, the liabilities and assets must comply with the definition predicted in the Conceptual Framework, it means that its fair value must be reliably measured. Thus, the goodwill is considered by the business combination residual cost's, after the recordation of the recognisable assets, it means that being the acquired goodwill bigger than zero there will be an asset's recognition, measured by the cost.

In the goodwill's subsequent measurement, it maintains the cost model recognition, with the deduction of accumulated amortisations and impairment losses, due to should be determined

amortisations according to the assets' useful life, if estimated with reliability. Nevertheless, sometimes it is not possible to determine it with reasonable consistency, so, in that case, it shall be amortised in ten years. Alongside the depreciation, the acquirer needs to execute impairment tests when there is impairment's evidence. However, the acquired goodwill can be less than zero; in that case, it was a low-price purchase or badwill. In this case, the acquirer must pay attention to two practices; first, to make a process' reassessment, and second, to recognise the remaining value as a differed income, recognising it as it is accomplished.

Corporate Income Tax

In the tax field, the corporate income tax - Imposto Sobre o rendimento das Pessoas Coletivas (IRC) and Regulatory Decree no. (25/2009), of September 14 (DR 25/2009) are the main relevant legal dispositions when the issue is intangibles assets. In the Portuguese tax jurisdiction, the IRC assumes the direct estimation regime to determine the taxable income, and it represents that tax legislator accepts the accounting result as a valid income for a tax settlement. Nevertheless, lawmaker requires tax correction to this result. In the accounting domain, amortisations and impairment losses have the status of expense, and it means they are accounting profit's negatives components and they are tax spending since they observe all the requirements imposed by the tax law.

According to the IRC, article 29, the asset is subject to depreciation when it systematically feels a loss of value subsequent from the use or overtime; furthermore, they are tax expenses the intangibles assets' amortisations. The cost of acquisition represents the amortizable amount when it is acquired to a third part, in the case of built or produced assets the depreciable value is the production's cost; however, decommissioning expenses and residual value are not part of the depreciable amount. In the domain of depreciation method, Portuguese tax legislator considers as a preferential model, the straight-line method, nevertheless, it is possible to use the diminishing balance method or another different method, since fulfilled some conditions presented in article 30 of the IRC. In the case of the intangibles assets, article 16 of the DR 25/2009, expressly determines the intangibles assets are amortizable when subjects to loss of value, because they have a limited term. The law 2/2014, of January 14, brought a significant change, in the sphere tax cost of the intangibles. It introduced the article 45-A of the IRC. With this change, the acquisition's cost of the: 1) industrial property elements (licenses, brands, production processes, models or other similar rights) purchased for the onerous designation and not restricted in time; and 2) goodwill obtained in a business combination; are a tax spending. This possibility imposes that these assets are recognized in entities' individual's accounts in the accounting area. The acceptance occurs in similar parts, for the initial 20 tax periods, after the initial recognition. Thus, the amortization of acquired goodwill of business combination considered as a deductible expense for 20 years.

Article 23 determines that the impairment losses also can be considered a tax expenditure. Thus, it needs to pay attention that it needs to fulfil some criteria, the requirements of article 31-B of IRC. This legal disposition focuses on impairment losses on non-current assets. It establishes that impairment losses on non-current assets occurring from proven abnormal sources can be recognized as tax expenses, it means, disasters, the natural events, the exceptionally fast technological innovations or significant alterations, with an adverse effect, in the legal framework. However, the taxpayer must get the approval of the Tax Authority upon an appropriately substantiated statement. Thus, for accounting costs related to the impairment of intangible assets to be considered for tax determinations, they must follow two requirements. It is not sufficient that it outcomes from extraordinary causes, but also that the Tax Authority effectively recognizes it.

Arbitral Court's Case-Law: CAAD 147/2018-T

According to the Decree-law 10/2011, of January 20, the Tax Arbitral Court has the

competence to appreciate, between others, the illegality's declaration of tax settlement, self-assessment, withholding tax and payment on account. Thus, this Organism can pronounce about the legality of assessment acts or about the acts of tax base determination. In the last years, this Institution has been a relevant function in the resolution of conflict situation between different parts. The research did search for matter (tema) "goodwill", and the research result was the identification of one case-law: process number 147/2018-T.

In the identified sentence a holding company, society A (SA), and a participated company of the Society A, the business B (SB), both domiciled in Portugal, requested the constitution of an Arbitral Tribunal. The companies wanted the Arbitral Court to rule on the tacit rejection of a hierarchical appeal. On February 7, 2014, SB acquired a vending unit to a third company, with this contract SB became the owner of

1. The vending machines and theirs explorations contracts.
2. All the vehicles used for the business operation.
3. The employees and
4. The vending machines inventories.

In consequence of this purchase, SB recognized an intangible asset, in particular, goodwill by business combination in the amount of € 5 107 583, 94. Nevertheless, SB recognised an accounting impairment loss of the goodwill in the value of € 147 757, 12. In the income statement preparation of 2014, the accounting expense was maintained, and it was not unrecognised in the taxable income determination. This fact led to an impact on the taxable income's determination; companies calculated more tax to pay than was due. Thus, due to the income tax statement mistakes, companies replaced the income tax statement giving rise to a decrease in tax to pay. However, tax authority does not recognise this credit in favour to the taxpayers, so they consider to take the matter to CAAD, asking for the consideration of the goodwill tax deduction and the unrecognition of the impairment losses, resulting in a correction in favour of companies in an amount of € 107 622.08. The tax authority does not accept it. The court's decision was favourable to the companies, so the additional amount of € 107 622.08 was deducted from taxable income.

According to the case law exposition, the goodwill recognised observes all the requirements to its recordation, first in accounting domain, and second in the tax field. In the first sphere, it represents that the goodwill was a source in a business combination as it results of the NCRF 14 imposition of paragraph 7. The accounting department recorded goodwill's impairment loss and not recognise an amortisation. In the tax area, this intangible asset complies the requirements of the Article 45-A of the IRC; therefore, the petitioners can deduce five per cent of the asset's cost in the taxable base of the corporate income tax, so, it represents a deduction of the € 255 379,20, as opposed to the tax authority's understanding. As the impairment losses do not observe the conditions to be a tax expense the article 31-B of the IRC, it could not be considered tax expenditure.

DISCUSSION

In accounting and tax domain, the company recognised impairment losses as a deductible cost. Nevertheless, for taxable base determination, tax law does not predict the impairment loss as deductible cost, but it allows to consider five per cent of the asset cost in each of 20 following years, according to article 45-A.1.b) of the CIRC. Thus, from incorrect treatment, the company must not consider the impairment loss cost (147 757, 12) and must recognise a tax spending of 255 379, 20€. In liquid terms, this situation harms the taxpayer in the value difference, and it means 107 622, 07€. Thus, the company is correct in this pretention. According to IRC Reform Commission that prepared the preliminary draft of law (Comissão para a Reforma do Imposto sobre o Rendimento das Pessoas Coletivas, 2013), the introduction of the Article 45-A of the CIRC had strategic motivations. According to this document, it expects to give a competitive and

ambitious fiscal treatment to the intangible assets without determining useful life. So, the tax law recognises the possibility that its acquisition cost may be deductible, in equal parts, over twenty tax periods. The law did not assume this tax cost as an amortisation, but in deep down, it has this function. This interpretation makes perfect sense due to it observes the exercises' specialisation principle that it corresponds to the accrual's basis, in the accounting dimension. The correlation between incomes and expenses supports this fundamental.

The previous interpretation of tax law was in the same sense of the international accounting standards of the IASB. The International Financial Reporting Standards 3 (IFRS3) determines that the acquired goodwill of business combinations do not suffer amortisation, but impairment losses. It implies that the company frequently performs impairment tests.

Table 1			
SOME CONCLUSIONS			
	IASB Standards	Portuguese National Standard (SNC)	Portuguese Tax Law
Asset Recognition	Accept (Since it meets the requirements to be considered as an asset)	Accept (since it meets the requirements to be considered as an asset)	Accept (since it meets the requirements to be considered as an asset)
Impairment Losses	Accept	accept	Not accept
Amortization	Not accept	accept (amortization in 10 years)	Accept (5% of the cost in each of the following twenty

CONCLUSION

The main objective of this paper is to understand if the differences of accounting and tax treatment of goodwill potentiate the conflict between the Portuguese Tax Authority and companies, leading to the taxpayer to recur to Portuguese Tax Arbitral Court.

The corporate tax legislation does not accept the impairment losses as a tax expense, as well as it does not predict, expressly, the amortisation, in opposition to accounting standards. Instead of it, the tax legislator foresees the possibility to deduct, as tax expense, the acquisition cost in the following twenty years. Although it is not expressly prevised the amortisations, in practice, the lawgiver has inherent a useful life of twenty years when it admits as tax cost five per cent of the acquisition price.

Although, the relevance of the business concentration in the international and national domain, the goodwill of the business combinations does not have been a conflict-generating matter between Portuguese companies and Tax Authority. About this matter and after consulting the several Portuguese courts, only one case-law refers to the recognition of goodwill, one explains about the accounting recognition and its implications in the determination of the corporate tax base. It makes to consider that this matter does not represent an eminent source of conflict that make companies complain in tribunal; or that if there is conflict, it is resolved without the recurring to magistrate decision. This conclusion somehow confirms the conclusions of Carvalho et al. (2016), considering that the recognition of goodwill in Portugal is not significant.

In the last decades, countries aim to adopt measures investment-friendly and being the business combinations a way of investing it is important to understand the level of divergence between tax authority and companies. The study demonstrates that in the business combinations' subject, it is minimal the degree of litigation, this assumption can affect the economic investment decisions in Portugal.

The research only studies the level of litigation in Portugal in business combinations'

goodwill, and it could be interesting to analyse others tax jurisdictions that have the Tax Arbitration Regime and to compare with this paper conclusions.

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LEGISLATION

CIRC Código do Imposto Sobre o rendimento das Pessoas Colectivas, Decreto-Lei 442-B/88, de 30/11.

DR 25/2009 Decreto Regulamentar n.º 25/2009, de 14 de setembro.

EC Estrutura Conceptual, Sistema de Normalização Contabilística, Aviso n.º 15652/2009 de 7 de setembro.

NCRF 6 Norma Contabilística e de Relato Financeiro 6 - Ativos Intangíveis, Aviso n.º 8256/2015, de 29 de julho.

NCRF 14 Norma Contabilística e de Relato Financeiro 14 - Concentração de atividades empresariais, Aviso n.º 8256/2015, de 29 de julho.

SNC Sistema de Normalização Contabilística, Decreto-Lei n.º 158/2009 de 13 de julho.

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