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Portugal Implements EU Tax Directives

by Francisco de Sousa da Câmara, and Bruno Santiago

Portugal is implementing several EU tax directives. The first group of directives, implemented through measures provided in the 2005 budget,[1] have been in force since January 1. Others are being integrated into the Portuguese tax system through the adoption of specific legislation (Decree-Law 34/2005 of February 17, 2005), which will become effective on July 1, 2005.

The provisions that entered into force on January 1 include the following:

- mutual assistance by the competent authorities of the EU member states in the field of direct taxation, certain excise duties, and the taxation of insurance premiums (transposition of Directive 2003/93/EC[2] and Directive 2004/56/EC[3]);
- rules on the place of supply of gas and electricity for VAT purposes (transposition of Directive 2003/92/EC[4] into the Portuguese VAT legislation); and
- rules amending the parent-subsidiary directive concerning the elimination of double taxation in connection with the distribution of dividends (Directive 2003/123/EC[5]).

The second set of directives provides rules on the taxation of interest and royalties paid between associated companies (Directive 2003/49/EC[6]) and

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[1]Law 55-B/2004, published in the official gazette of December 30, 2004.

[2]Council Directive 2003/93/EC, of October 7, 2003, amending Council Directive 77/799/EEC concerning mutual assistance by the competent authorities of the member states in the field of direct and indirect taxation, published in Official Journal L 264, October 15, 2003, pp. 23-24.

[3]Council Directive 2004/56/EC of April 21, 2004, amending Directive 77/799/EEC concerning mutual assistance by the competent authorities of the member states in the field of direct taxation, certain excise duties, and taxation of insurance premiums, published in Official Journal L 127 of April 29, 2004, pp. 70-72.

(Footnote continued in next column.)

[4]Council Directive 2003/92/EC of October 7, 2003, amending Directive 77/388/EEC as regards the rules on the place of supply of gas and electricity, published in Official Journal L 260 of April 11, 2003, pp. 8-9.

[5]Council Directive 2003/123/EC of December 22, 2003, amending Directive 90/435/EEC on the common system of taxation applicable in the case of parent companies and subsidiaries of different member states, published in Official Journal L 007 of January 13, 2004, pp. 41-44.

[6]Council Directive 2003/49/EC of June 3, 2003, on a common system of taxation applicable to interest and royalty payments made between associated companies of different member states, published in Official Journal L 157 of June 26, 2003, pp. 49-54.

rules on the taxation of savings income in the form of interest payments (Directive 2003/48/EC[7]). The latter directive is especially relevant for Portugal because the application of Directive 2003/49/EC (the interest and royalties directive) is dependent on the entry into force of Directive 2003/48/EC (the savings tax directive).

This article focuses first on the amendments to the parent- subsidiary directive (Directive 2003/123/EC); then on the new interest and royalties directive (Directive 2003/49/EC); and finally on the savings tax directive (Directive 2003/48/EC).

Parent-Subsidiary Directive

Portugal's 2005 budget transposed into national law Directive 2003/123/EC, amending Directive 90/435/EEC, on the common system of taxation applicable in the case of parent and subsidiary companies and subsidiaries of different EU member states.

The parent-subsidiary directive was implemented in Portugal through a dual regime: When the parent company is located in Portugal, economic international double taxation is eliminated in accordance with the exemption method, which applies if the parent company has at least 10 percent of the capital (or a corresponding percentage of rating rights, when so established in any double taxation treaty) of the subsidiary, or a participation not lower than €20 million, and the participation has been owned for a minimum of one year. When the parent company is located in another EU member state, Portuguese rules establish that no withholding tax applies on the distribution of dividends, provided that the parent has had a minimum holding of 20 percent in the capital of the Portuguese subsidiary for a minimum of two years.

If the uninterrupted period of at least two years is accomplished only after the tax is due, the withholding tax will be charged on the distribution of the dividends at the domestic rate of 25 percent (or the double taxation treaty rate if the relevant forms are completed in due course). However, the beneficial owner may request, within two years from the date on which the withholding tax is sent to the tax authorities, a reimbursement of the excess tax paid. In that event, tax authorities must refund the excess tax withheld at source within three months of the presentation of the request and supporting information.

Implementation of Directive 2003/123/EC

As mentioned earlier, Directive 2003/123/EC amended Directive 90/435/EEC, and Portugal's domestic rules have been amended accordingly. First, the scope of the directive was extended to other entities, including the European Company (*Societas Europaea* or SE). Second, it was clarified that the permanent establishments of EU companies should also benefit from the tax relief provided by the directive. And third, the shareholding threshold for one company to be considered a parent (and the other, its subsidiary) will be gradually reduced from 25 percent as follows: to 20 percent from January 1, 2005, to December 31, 2006; to 15 percent from 2007 to December 31, 2008; and to 10 percent from 2009 on.

Regarding inbound dividends, it is expressly stated that Portuguese PEs should benefit from the exemption participation regime, provided that the parent and the subsidiary company are resident and benefit from the requirements and conditions set forth in article 2 of the parent-subsidiary directive.

No special provision regulates a situation in which the parent company is in Portugal, but the payments to it were made through a PE in Portugal or abroad. Therefore, that situation has to be treated as a direct payment from an EU subsidiary to a Portuguese parent company.

Implementation of the New Directives

While the implementation of the savings tax directive will go into effect with the creation of a special regime in the form of a decree-law (the comments below are made in accordance with a preliminary draft), the interest and royalties directive was implemented by a decree-law that made some amendments to the existing rules (articles 80 and 90) and introduced one entirely new rule (article 89-A)[8] in the Corporate Income Tax Code (CITC).

Interest and Royalties Directive

According to the directive, interest and royalties[9] arising in one member state of the European Union and paid to an associated company of another member state or to the PE of a company of a member state situated in another member state are exempt from taxation in the source state, that is, the state

[7]Council Directive 2003/48/EC of June 3, 2003, on the taxation of savings income in the form of interest payments, published in Official Journal L 157 of June 26, 2003, pp. 38-48.

[8]Decree-Law 34/2005, published in the official gazette of February 17, 2005.

[9]The concept of interest is presented in very similar terms to the definition given in the OECD model income tax treaty. The same applies to the concept of royalties, with the directive expressly including in its definition "payments for the use of, or the right to use, industrial, commercial or scientific equipment."

where the associated company that makes the payment has its seat, or where its PE is located. There can be no doubt that the new regime does not apply to interest and royalty payments between the PE and the general enterprise.[10]

Because the directive states that the beneficial owner may be "a permanent establishment situated in another Member State of a company of a Member State,"[11] we assume that "a company of a Member State" also includes associated companies resident in the same member state as the payer of interest and royalties, but with a PE in another member state, to which the payments are attributed.

Associated companies are companies that have a direct minimum holding of 25 percent in the capital of other companies, or companies that are owned, according to the referred percentage, by another company. In any case, the holding must be maintained for an uninterrupted period of at least two years. The last requirement was optional in the directive, but the Portuguese legislature decided — as it has on other occasions — to introduce it.

A PE will be treated as the payer of interest or royalties only insofar as those payments are connected with the activity pursued by that establishment and represent a tax-deductible expense for the PE in the member state concerned.

One issue expressly dealt with in the directive, but not transposed into national law, is the inadmissibility of cost-sharing agreements and loans made by the general enterprise for the benefit of different parts of the company, or by a distinct part of the company to the benefit of the others. As stated in article 1(6) of the directive, "where a permanent establishment of a company of a Member State is treated as the payer, or as a beneficial owner, of interest or royalties, no other part of the company shall be treated as the payer, or as the beneficial owner, of that interest or those royalties."

Because of budgetary constraints, Portugal and Greece were granted a transitional period during which they can still impose tax on those payments when acting as the source state of the interest and royalties. During the transition period, which is expected to start July 1,[12] the tax rate for interest or royalty payments made to an associated company of another member state, or to a PE in another member state of an associated company of a member state, must not exceed 10 percent during the first four years and 5 percent during the final four years.

Those rates are established without prejudice to a more favorable rate in a double taxation treaty. (Cyprus is the only EU member state with which Portugal has not yet entered into a double taxation treaty.) As a rule, income tax treaties signed by Portugal stipulate that tax charged by the source state on interest and royalties should not exceed 10 percent and 5 percent, respectively.

Portuguese law expressly includes three cases that preclude, partly or totally, the application of that regime:

- when the majority of the capital or of the voting rights of the company receiving the payments is held by one or more residents in third countries that are not members of the European Union (unless evidence is given that the shareholding does not have the predominant scope to benefit from the reduced rate);
- when the amount differs from what would have been agreed to at arm's length between separate enterprises; or
- if the domestic thin capitalization regime applies.

The first case is considered to be a special antiabuse provision allowed by article 5 of the directive, which states that this kind of provision prevails over the rules of the directive.[13] The application of that provision in Portuguese law may, in practice, create problems in other member states that, with third countries, have entered into tax treaties with clauses similar to article 24(5) of the OECD model income tax treaty. In fact, an EU company whose capital is wholly or partly owned, or controlled by one or more residents of a third state with which the member state concerned has entered into a double taxation treaty, can claim discrimination in comparison to a company of that member state that is receiving royalties or interest from Portugal at the reduced rate under the special regime.

If Portugal refuses to apply the reduced rate, will the other member state have to concede a credit for

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[10]*See* article 1(7) of the directive.

[11]Article 1(1) of the directive, implemented in article 80(2)(f) of the CITC.

[12]The conditions for its entry into force are being made dependent on the accomplishment with the disposed in article 17(2) and (3) of Directive 2003/48/EC on the taxation of savings income in the form of interest payments. *See also* Council Decision 2004/587/EC of July 19, 2004.

[13]For more developments on domestic and treaty-based antiabuse provisions in derogation of the substantive rules of the directive, see Terra and Wattel, *European Tax Law*, 3rd Edition, Kluwer Law International, 2001, pp. 364 and ff, and also J. David B. Oliver, "Anti-avoidance rules in the EU Directives and in the double taxation conventions," an article based on a Lisbon conference organized by the Portuguese Association of Tax Consultants with the collaboration of the Faculdade de Direito da Universidade Nova de Lisboa and the law firm Morais Leitão, Galvão Teles, Soares da Silva & Associados, published in *Planeamento e Concorrência Fiscal Internacional*, Lex, Lisboa, 2003.

the tax surplus withheld at source by Portugal (currently 15 percent for royalties and 20 percent for interest), compared with the tax withheld when shareholders of the company of the other member state are resident in that member state? It remains to be seen how that issue will be resolved.

In the second and third cases mentioned above that partly or totally preclude the application of the regime, the inapplicability of the directive regime will apply only to those payments considered to be in excess (that is, income not characterized as interest or royalties).

The recipient of the interest and royalties must deliver to the payer, by the date on which the withholding applies,[14] a certificate confirming that the recipient:[15]

- is resident in the applicable country, as certified by the tax authorities of its residence state;
- is a taxable entity without benefit of any exemption in the residence state;
- is incorporated according to one of the forms referred to in the annex to the directive;
- has legal justification for the payments under a specific contract (for example, a loan agreement or licensing contract);
- documents that the requirements concerning the percentage and time period of the holding required to benefit from the directive regime were respected; and
- is the beneficial owner.

A company of a member state will be treated as the beneficial owner of interest or royalties only if it receives those payments for its own benefit, and not as an intermediary, such as an agent, trustee, or authorized signatory for some other person. A PE will be treated as the beneficial owner of interest or royalties if the debt claim, right, or use of information for which interest or royalty payments arise is effectively connected with that PE, and if the interest or royalty payments represent taxable income for which the PE is subject to tax in the member state in which it is situated. Furthermore, the PE also must fulfill the aforementioned requirements regarding the head office of the company and prove that it is a company associated with the company paying the interest and royalties.

[14]According to Portuguese law, tax will be withheld when the interest is due and when the amount of royalties is determined.

[15]Without that certificate, the payer must withhold the tax at the domestic general rates otherwise applicable (interest at 20 percent, and royalties at 15 percent) or the double taxation rates, in cases in which other forms have to be completed.

If the uninterrupted period of at least two years is accomplished only after the tax is due, or if the aforementioned certificate is not presented in due course, withholding tax will be imposed in accordance with domestic rules, but the beneficial owner may request from tax authorities a reimbursement of the excess tax paid. The deadline to present the request is two years from the date on which the participation requirement is satisfied, in the first case, and from the date on which the withholding occurred, in the second case.

Tax authorities must repay the excess tax withheld at source within one year of receipt of the application and any supporting information eventually requested. If the tax is not refunded within that period, the receiving company or PE will be entitled to interest on the tax refunded.

Savings Tax Directive

The aim of the directive is to make savings income in the form of interest payments made in one member state to beneficial owners who are individuals resident for tax purposes in another member state taxable in accordance with the laws of the latter member state. That is an important measure in the fight against tax evasion.

Portuguese law is drafted to define the ways in which paying agents established in Portugal obtain and report information about the payment of interest to individual beneficial owners resident in other member states. Articles 10, 11, and 12 of the directive were not transposed into national law because they apply only to Austria, Belgium, and Luxembourg.

The scope of the law, following the directive:

- defines the terms "paying agent" (article 2), "similar entities" (article 3), "interest" (article 4), and "beneficial owner" (article 5);
- establishes rules to determine the identity and residence of the beneficial owner (articles 6 and 7);
- sets out the regime for information provided by the paying agent to Portuguese tax authorities (article 8),[16] as well as other reporting information due by economic operators in Portugal paying interest to entities in other member states in the situation referred to in articles 4(2) to (5) of the directive (article 9);
- summarizes the information provided by Portuguese tax authorities to the tax authorities of the member state of residence of the beneficial owner (article 10);

[16]This information is to be provided in an official certificate of the tax authorities.

- rules on the acquisition of the certificate issued by Portuguese tax authorities to the beneficial owner according to article 13(1)(b) of the directive[17] (article 11);
- excludes some negotiable debt securities from the special regime (article 12);
- establishes certificates to be approved by the Ministry of Finance (article 13);
- defines the consequences of an infringement of articles 6, 7, 8, or 9 (article 14);
- extends the application of the special regime to interest received by beneficial owners resident in states with which Portugal has concluded an agreement (article 15);
- alters the Personal Income Tax Code to allow for a refund of the withholding tax as described in article 14(4) of the directive (article 16); and
- establishes the date of entry into force (article 17).

Concerning the definition of interest in article 6 of the directive, there is a difference in style in Portugal's implementation. While the directive defines interest with the same wording used in the OECD and UN model treaties, generally referring to "interest paid or credited to an account, relating to debt claims of every kind, whether or not secured by mortgage and whether or not carrying a right to participate in the debtor's profits," including income realized on the sale, refund, or redemption of shares or units in undertakings for collective investment in transferable securities (UCITS), Portuguese law opted for an exhaustive categorization (in very similar wording to that used for the definition of capital income in article 5 of the Personal Income Tax Code) of the debt claims included in that regime.

Conclusion

The first measures related to company taxation are intended to facilitate the proper functioning of the internal market, ensuring that enterprises working in a cross-border European context are taxed only once on payments of dividends, interest, and royalties to an associated company, therefore avoiding international double taxation.

The last directive represents the possible agreement between member states to tax by the residence-state interest received from savings that were deliberately moved to low-tax jurisdictions to take advantage of the traditional banking secrecy laws and to escape taxation.

In any case, specific cases must be scrutinized to appreciate whether Portugal implemented the directives in total compliance with EU law. ◆

♦ *Francisco de Sousa da Câmara and Bruno Santiago, Morais Leitão, Galvão Teles, Soares da Silva & Associados*

[17] This certificate is valid for only one year.