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Government Tightens Rules for Payments to Nonresident Entities

Francisco de Souse by da Câmara and José Almeida Fernandes

In its battle against tax evasion, the Portuguese government has been tightening the information requirements and formal tax obligations of taxpayers, specifically as they relate to payments to nonresident entities.

The government was forced to revoke its current account tax withholding system, whereby capital gains and losses were to be credited and debited by financial intermediaries, applying a 10 percent rate on the gains and losses, with retroactive effect from 1 January 2003. The system was withdrawn because of doubts regarding its feasibility and strong opposition from financial intermediaries.

However, to comply with the new tax information and withholding rules for payments to nonresidents under Decree-Law 80/2003 of 23 April, taxpayers now are required — upon the payment of any income to nonresident entities that are subject only to a final tax in Portugal — to file a new form providing a tax identification number for those entities. This will allow the cross-checking of tax data for different kinds of payments made to nonresident entities.

In addition, an article on the application of double tax treaties has been introduced into the Personal Income Tax Code (CIRS). Until now, the formal requirements and procedures to apply for treaty benefits for individuals were established solely in an administrative ruling, Circular 18/99, which was legally binding only on tax authorities. The new law establishes a legal obligation for taxpayers to present, before any payment, a specific form to be approved by the Portuguese Ministry of Finance. The form must be certified by the tax authorities of the country of residence of the nonresident entities to be eligible for treaty benefits.

Failure to comply with the new procedures will result in the application of standard withholding tax rates for payments to nonresidents, though those entities may apply for reimbursement by presenting the necessary forms within a two-year period.

The government also issued an administrative ruling in Circular 6/2003, which introduced a special obligation and form for entitlement to the tax exemption for nonresident entities on the interest payments of public debt securities. Although specific antiavoidance legislation was not adopted to prevent bond washing and dividend stripping, the new obligations may be perceived as a means to assess beneficial ownership and prevent the use of such tax arbitrage techniques.

The new rules could give rise to serious tax compliance issues and controversies, preventing nonresident entities from entitlement to treaty benefits or special nonresident tax regimes. Therefore, taxpayers should review their tax compliance practices to avoid future direct tax liabilities. ◆

♦ *Francisco de Sousa da Câmara, partner, and José Almeida Fernandes, Morais Leitão, J. Galvão Teles & Associados, Lisbon*