PORTUGAL

Parent-Subsidiary Directive: The *Epson* Case

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I. INTRODUCTION

On 8 June 2000 the European Court of Justice (ECJ) decided the *Epson*[1] case, which provides an interpretation of Article 5(4) of the Parent-Subsidiary Directive (90/435/EEC). On the surface the ECJ's decision and its interpretation of Article 5(4) clarified the tax regime applicable to the distribution of dividends from Portuguese subsidiaries to their EU parent companies. It is clear, however, that the ramifications of the case are likely to be broader and more wide-ranging.

This article describes the case and shows that the reasoning underlying the case that was brought before the Portuguese Administrative Supreme Court (STA) has European value. At the same time, newly emerging issues and the reaction on the part of the tax authorities are discussed.

II. THE DIFFERENT INTERPRETATIONS OF THE FACTS AND THE ECJ'S DECISION

A. The request for a ruling from the ECJ

As a rule, dividends paid by Portuguese subsidiaries to non-resident (including EU) parent companies are subject to a corporate income tax (IRC) withholding rate of 25%, unless a special regime applies,[2] and to 5% ISDA[3] on the distribution of dividends paid by corporations.[4]

Article 5(1) of the Parent-Subsidiary Directive provides that profits that a subsidiary distributes to its parent will, at least where the latter holds a minimum of 25% of the capital of the subsidiary, during a period of two years, be exempt from withholding tax.

Paragraph 4 of Article 5 of the Parent-Subsidiary Directive allowed Portugal to maintain a withholding tax (at a rate of 15% up until the end of 1996 and a rate of 10% from 1 January 1997 to 31 December 1999)[5] on the distribution of profits from Portuguese subsidiaries to their EU parent companies. Portugal implemented this derogation under the corporate tax rules,[6] but maintained the legal provision that established the 5% ISDA withholding tax.

Accordingly, distributions of dividends from Portuguese subsidiary companies to their EU parent companies were subject to 15% (from 1 January 1992 to 31 December 1996) or 10% (from 1 January 1997 to 31 December 1999) IRC and to 5% ISDA. Both taxes were withheld by the Portuguese subsidiaries paying the dividends.

In the shareholders' general meeting of 31 March 1993, Epson Portugal – Informática S.A. (hereinafter: Epson Portugal) decided to distribute dividends to its shareholders and effectively paid to Epson Europe BV, a Dutch company owning more than 25% of Epson Portugal, an amount of PTE 40,795,733. This payment was subject to the following withholdings (a) CIRC at a rate of 15%, which corresponded to a withholding of 6,119,360; and (b)

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1. ECJ, 8 June 2000, Case C-375/98, *Ministério Pública v. Epson Europe B.V.* [2000] ECR I-4243.
2. Special regimes existed and still exist at either a treaty or domestic level. The majority of treaties signed by Portugal limit the source state's right to tax to a range of tax rates that vary between 5% and 15%. In addition, some income tax treaties also apply to the substitute inheritance and gift tax (*Imposto sobre as Sucessões e Doações por Avença*, ISDA). See Alberto Xavier, *Direito Tributário Internacional* (Almedina: Coimbra, 1993), p. 124 et seq.
Moreover, the Portuguese Tax Incentive Statute (*Estatuto dos Benefícios Fiscais*, EBF) (Arts. 31 and 32)) also created two specific cumulative tax incentives concerning dividends. Art. 31 excludes from IRC or individual income tax (IRS) 40% (in 2000) and 20% (in 2001) of the dividends distributed in respect of shares listed on the domestic stock exchanges in Lisbon and Oporto. Art. 32 establishes that 50% of the net dividends from shares of corporations in the process of privatizing, acquired by the end of 2002, are also excluded from IRC and IRS for a five-year period from the date the privatization process is completed. As a result, the general withholding tax rate of 30% (25% IRC plus 5% ISDA) may be reduced (even if the Parent-Subsidiary Directive does not apply) whenever a treaty or the domestic rules mentioned above apply. If the latter provisions apply cumulatively, the withholding tax may be reduced significantly in 2000 and 2001. A dividend of PTE 100 million distributed by a company listed on the Lisbon or Oporto stock exchange that concluded its privatization process in the last five years is subject to tax as follows (all figures in PTE): 100 x 40% = 40 million; 60 million x 50% = 30 million; 30 million x 25% = 7.5 IRC plus 5 ISDA (100 x 5% ISDA).
Some authors, including this one, contend that domestic tax incentive rules (excluding from tax part of the dividends) should be preserved even if a treaty applies, in accordance with the principle that prevents tax treaties from creating a tax claim that does not exist under domestic law, i.e. that the limited treaty rate attributed to the source state should apply to dividends subject to tax and not to gross dividends, regardless of whether they are subject to or exempt from tax (for instance, if a treaty establishes a tax rate limit of 10%, the latter should apply directly to the 30 million (30 million x 10%) in the example above, rather than to the gross dividends. The tax authorities take a different approach, however, and there are no known court cases dealing with this controversy. See Francisco de Sousa da Câmara "O regime fiscal comum aplicável às sociedades-mães e sociedades afiliadas de diferentes Estados Membros da Comunidade Europeia", *Fisco* 43/44, June 1992, p. 54 et seq., Maria de Lurdes Correia e Vale, *Opinion No. 21/90 of the Center of Fiscal Studies, Ciência Técnica Fiscal No. 359*, pp. 381-383 and Alberto Xavier, "The taxation in Portugal of non-residents without permanent establishment", *Corso di diritto tributario internazionale* (Cedam: Milan, 1999), p. 164.
3. In the *Epson* case, the Court simply referred to this tax as "a succession and donation tax".
4. The term "corporations" means companies whose capital is represented by and divided into shares (*acções*), i.e. a joint-stock company or SA or a partnership limited by shares. Arts. 182 and 184 of the Municipal Transfer Tax and the Inheritance and Gift Tax Code (CIMSISD) impose ISDA at a rate of 5% on the distribution of dividends from shares and interest from bonds.
5. It is clear from the fifth recital in the preamble to the Parent-Subsidiary Directive that this temporary derogation was introduced for budgetary reasons.
6. Art. 69(2)(c) of the Corporate Income Tax Code (*Código do Imposto sobre o Rendimento das Pessoas Colectivas*, CIRC)) was introduced by Decree-Law 123/92 of 2 July 1992.

ISDA at a rate of 5%, which corresponded to a withholding of PTE 2,039,786.

Epson Portugal brought proceedings before the first instance tax court in Oporto, claiming that ISDA was improperly levied on the grounds that since January 1992 the Directive provided that the withholding tax could not exceed 15% of the amount of dividends distributed by Portuguese subsidiaries to their EU parent companies. On 4 April 1995 the Oporto Court upheld the action in its entirety; the ISDA was considered null and void and a refund of the tax unduly paid was ordered.

Both the public prosecutor (*Ministério Público*) and the tax authorities (*Fazenda Nacional*) appealed the judgment to the STA. The appellants argued that the scope of the Parent-Subsidiary Directive did not extend to ISDA and took the position therefore that Portugal had appropriately incorporated the Parent-Subsidiary Directive into domestic law.

The STA expressed its doubts about this interpretation, however, noting that ISDA is income-based (since it is levied in the form of a withholding tax of 5% on dividends and some other forms of income from securities). On this basis the STA stayed further judicial proceedings in Portugal and requested a preliminary ruling from the ECJ on the following question:

> Must Article 5(4) of Council Directive 90/435 of 23 July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States, in so far as it sets limits of 15% and 10% for the derogation granted to Portugal, be interpreted as meaning that such limits refer only to the levying of corporate income tax (in Portugal) or does it extend to any tax on income from shares, levied on dividends, regardless of the legislative instrument which provides for it?[7]

B. The parties' positions

Epson Europe BV, with the support of several authors, contended that ISDA was included in the scope of the Parent-Subsidiary Directive, while the Portuguese government and the Portuguese tax authorities defended the opposite point of view.

Epson Europe BV stressed that Paragraph 4 of Article 5 of the Parent-Subsidiary Directive covers all withholding taxes and not only the IRC. In fact, the aim of the Parent-Subsidiary Directive is to relieve double taxation in dealings between groups of companies established in different EU Member States. Therefore, the prohibition imposed by Article 5(4) (as well as by Article 5(1)) concerns all taxation in the form of a withholding tax on dividends distributed by a subsidiary in Portugal to a parent company in another EU Member State.[8]

The Portuguese government and the Portuguese tax authorities based their arguments on the fact that ISDA merely corresponds to the official inheritance and gift tax regime and the tax charged reflects the extent to which the dividends are capitalized. According to this argument, tax is not levied on income, but on the value of the securities; the fact that it is calculated on the basis of income does not mean that it is not a substitute inheritance and gift tax. Moreover, the Portuguese government also claimed that it was clear from the Parent-Subsidiary Directive negotiations that the Council had agreed to the maintenance of the ISDA.

C. Other views

The Commission supported the arguments presented by Epson Europe BV. Apart from those mentioned above, the Commission pointed out that this regime was designed to allow enterprises to adjust to the requirements of the common market and to facilitate groupings of companies in different Member States. The levying of ISDA on dividends, however, is liable to frustrate the objective entirely and deprive the Parent-Subsidiary Directive of any useful effect.

Reinforcing the same points, and drawing on relevant tax literature, the Advocate-General, George Cosmas, noted in Paragraphs 48 and 49 that "all withholding taxes are forbidden by the scope of the Directive, whatever the name or the nature of the tax that is levied on the distributed profits (dividends)". Therefore "the Portuguese Republic is obliged to reach a specific result: not withholding taxes on dividends at a higher rate than the maximum limit authorized in accordance with Article 5(4)".[9]

Further on in the Opinion (Paragraph 61) he commented that "[t]he maintenance of the ISDA would frustrate and withdraw the useful effect of Article 5(1) of the Directive..." In Paragraph 66 he stressed that:

> [a]ccording to settled case-law, declarations recorded in Council minutes in the course of preparatory work leading to the adoption of a Directive cannot be used for the purpose of interpreting that Directive where no reference is made to the content of the declaration in the wording of the provision in question, and, moreover, such declarations have no legal significance.[10]

Thus, Cosmas remarked that the answer to be given to the STA should be that:

> Article 5(4) of Council Directive 90/435/EEC of 23 July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States must be interpreted as meaning that the higher derogation limits of 15% and 10% granted to Portugal relate to a tax that, although classified as an inheritance and gift tax, is collected in reality as in the main case.[11]

7. Rec. 19.730, preliminary decision of 23 September 1998.
8. Epson Europe BV added that ISDA is effectively a tax on income and not a tax on the transfer of assets. Even though ISDA might have been historically justified as a result of the difficulties in taxing share transfers, ISDA is now superfluous and is inconsistent with the Portuguese tax system itself. Moreover, in 1993 (at the time the dividends were distributed) the Portuguese constitution – Art. 107(3) – prescribed that the inheritance and gift tax should be levied at progressive rates, whereas the 5% tax rate is proportional. In fact, the 5% withholding tax is a tax on income with a different name – substitute inheritance and gift tax.
9. According to the Advocate-General, this conclusion is based on a literal and teleological, but also systematic, interpretation.
10. In this paragraph reference is made to several cases.
11. Unofficial translation from the Portuguese version, Para. 67.

D. The ECJ's decision

The ECJ's method to determine whether or not the levying of ISDA on distributed profits fell within the scope of Article 5(1) of the Parent-Subsidiary Directive required a preliminary analysis of the wording of that provision. Thus, the ECJ held that, "[t]he term "withholding tax" is not limited to certain types of national taxation".[12] In addition, the ECJ held that from the specific reference to IRC made by Article 2(C) it cannot be inferred that other taxes having the same effect are authorized "... particularly since the final part of Article 2 refers expressly to any other taxes which may be substituted for any of the above taxes".

Finally, the ECJ decided that ISDA is collected as a withholding tax that has the same effect as a tax on income, and the fact that it is called an inheritance and gift tax is immaterial. Otherwise, the objective of the Parent-Subsidiary Directive could be undermined by a single deliberation of each Member State that would subject dividends to withholding tax by classifying the latter as a different type of tax.

As regards the Portuguese government's argument that it is clear from various documents and, in particular from a declaration of the Council, that ISDA was excluded from the scope of Article 5(1) of the Parent-Subsidiary Directive, the ECJ reasoned, echoing the Advocate-General's words, that there is no basis for that contention in the wording of the Parent-Subsidiary Directive and that settled case law definitively evidences that those declarations have no legal significance.[13]

Therefore, in answering the question put to it by the Portuguese STA, the Court ruled that:

> Article 5(4) of Council Directive 90/435/EEC... in so far as it limits to 15% and 10% the amounts of the withholding tax on profits distributed by subsidiaries established in Portugal to their parent companies in other Member States, must be interpreted as meaning that the derogation relates not only to corporate income tax but also to any taxation, of whatever nature or however described, which takes the form of a withholding tax on dividends distributed by such subsidiaries.[14]

III. CONSEQUENCES OF THE ECJ'S REASONING

A. Immediate effect on the *Epson* case

On 4 October 2000 the STA gave a decision in this case that since the STA was bound by the ECJ's interpretation and because it considered that the Parent-Subsidiary Directive's requirements were met, it held that the decision of the first instance tax court in Oporto was in accordance with the interpretation given by the ECJ. The STA therefore confirmed the decision previously made by the Oporto court and disallowed the appeal of the tax authorities and the Public Prosecutor.[15]

The tax authorities were compelled to refund the ISDA previously withheld. No reference was made at this level to the obligation of refunding this amount with interest but, in the author's opinion, such an obligation exists and is currently derived from Article 43 of the General Tax Law (*Lei Geral Tributária*, LGT).[16] The tax authorities incorrectly interpreted EC obligations and, therefore, an obligation to pay interest exists.[17] Meanwhile, the Portuguese tax authorities still have not changed the legislation and thus, the Parent-Subsidiary Directive has not been appropriately incorporated into domestic law. EC groups of companies can likely rely on the ECJ's ruling, but Portuguese subsidiaries are, in such situations, subject to a reverse discrimination, as ISDA continues to be withheld on the distribution of dividends by Portuguese subsidiary corporations to their parent companies.[18]

B. The taxpayer's response

In view of the uncompromising position adopted by the Portuguese government and the tax authorities,[19] and the inherent costs and lengthy process likely to be involved, the majority of taxpayers have avoided entering into an open conflict on this subject. Since 1992 several investors in Portugal have chosen other company vehicles – such as limited liability companies ("Lda" companies) – because the payments of their profits to EU parent companies are not subject to ISDA. The structure of these companies has always been used by small and medium-sized companies (including family companies), mainly because they combine a reduced and inexpensive corporate body regime

12. See note 1, Para. 22.
13. See note 1, Para. 26.
14. See note 1, Para. 27.
15. The presiding judge in this case was prompt in presenting the decision in light of the judicial holiday from mid-July to mid-September.
16. This obligation was already included in Art. 24 of the former Tax Procedure Code (CPT). Currently, the same right is included in Art. 61 of the new Code on Tax Procedure and Appeals (CPPT) and Arts. 43 and 100 of the LGT. Moreover, recent case law of the STA also confirms the right to compensatory interest despite the fact that it was not claimed when the first petition was lodged in Court. The payment of interest is a legal consequence of the requirement to refund tax illegally collected. The right to receive compensatory interest derived from an assessment declared null and void depends on the evidence that is shown by the taxpayer. The taxpayer should evidence that the tax assessment was motivated by a factual or legal mistake attributable to the tax authorities. See the following decisions from the STA: Acordão STA 1.10.1996, *CTF* 384/299, Acordão STA 24.3.1999, *CTF* 396/375, Acordão STA, 5.5.1999, *BMJ* 487/181 and Acordão STA 15.11.2000, Rec. No. 22.791. See also Pedro Patrício Amorim, "Reembolso de Emolumentos", *Fiscalidade No. 5*, January 2001, pp. 49-53. However, please note that this question has not yet been definitively resolved. It is relevant to determine how and when the question was brought to the Court (at which stage of the proceedings) – see also notes 37 and 38.
17. As of June 2001 the tax and corresponding compensatory interest had not yet been refunded to Epson Europe BV.
18. Maria de Lurdes Correia e Vale, "A tributação dos fluxos internacionais de dividendos, juros e royalties", *XXX Aniversário do CEF 1963-93, Colóquio a internacionalização da Economia e a Fiscalidade*, ed. Ministério das Finanças, Lisbon, 1993.
19. One should note that senior tax officials have taken this position since the Parent-Subsidiary Directive was incorporated into domestic law, expressly contradicting the views of independent authors. Id., Maria de Lurdes Correia e Vale, who was in 1992/1993 the Chairwoman of the Centre for Fiscal Studies of the Directorate-General of Taxes for the Ministry of Finance. Independent authors expressed other views: Francisco de Sousa da Câmara, "O regime fiscal comum aplicável às sociedade-mães e sociedades afiliadas de diferentes Estados-Membros da Comunidade Europeia. Comentário à Directiva 90/435/CEE", *Fisco*, 43/44, June 1992, pp. 40-58 and Alberto Xavier, *Direito Tributário Internacional*, p. 380.

with a system whereby the transfer of quotas is better controlled.[20]

Other investors who did not want to incorporate their subsidiaries as Ldas, or were forbidden to do so (e.g. financial and credit institutions), viewed this ruling as the legal justification they were seeking to stop the withholding of ISDA and as the starting point for requesting refunds.

C. Withholding taxes on the distribution of dividends

1. The effect of the ECJ's ruling from 2000 onwards

Without making any express reference to the ECJ's ruling adopted one month previously (8 June 2000), on 21 July 2000 the Directorate-General of Taxes issued a Ruling clarifying that when the derogation period granted to Portugal by Article 5(4) of the Parent-Subsidiary Directive expired on 31 December 1999 dividends paid by a Portuguese subsidiary to its EU parent company became exempt from withholding tax with effect from 1 January 2000, provided the latter owned a minimum of 25% of the capital of the former for the last two consecutive years.[21] No reference was made to ISDA.

According to the Directorate-General of Taxes' Ruling 16/2000, a parent company should evidence to its subsidiary that these two requirements have been met before the payment of dividends is made. More particularly, a reference to adherence to the rules established in Article 75(8) of the CIRC is made. This provision states that proof can be made by obtaining a certificate in duplicate, validated by the tax authorities of the state in which the parent company is resident. One copy must be given to and kept by the subsidiary and the other submitted to the Directorate-General of Taxes together with annual form 130.

The drafting of Article 75(8) CIRC is rather ambiguous with respect to whether it is sufficient to get a certificate issued by the tax authorities in the parent company's state of residence confirming its residence in the previous two years or since its incorporation, as well as its compliance with the other requirements of Article 2 of the Parent-Subsidiary Directive, or if it is also required that such authorities confirm the holding of 25% of the capital of the subsidiary for the last two years or since its incorporation.[22]

2. The *Denkavit* case ramifications

The Tax Reform Law 30-G/2000 of 29 December 2000 added a new Article to the CIRC (Article 75-A) designed to deal with outbound dividends, i.e. the tax that may or may not be withheld upon distributing dividends to EU companies. Firstly, a withholding tax of 25% has to apply to the distribution of dividends between a Portuguese subsidiary and its EU parent company if all Parent-Subsidiary Directive requirements, except the minimum two-year holding period requirement, are met. It is clear that this two-year period must have elapsed for the tax relief to apply automatically.[23]

Secondly, in order to comply with the *Denkavit*[24] case, on a strict reading, Paragraph 2 of Article 75-A establishes a procedure for requesting the withholding tax refund once it is assured that the minimum holding period has been met. The parent company is required to present a written request to the Directorate-General of Taxes within the two-year period following the verification of these requirements, provided the conditions mentioned in Article 2 of the Parent-Subsidiary Directive are met and documentary evidence is provided.[25] According to this provision, the refund will be made by the end of the third month following the date the claim is filed. The claim should be accompanied by the necessary documentation and prove that the requirements are met. If there is a delay, the principal will be repaid with interest for late payment at the same rate (currently 7%) established for the compensatory interest payable to the state by taxpayers when taxes are assessed late.[26] However, the law does not provide for the payment of interest or an equivalent payment in respect of a financial loss suffered as a result of the loss of use of sums paid prematurely in circumstances where, for example, dividends are distributed by a new subsidiary to its

20. The corporate capital of an Lda is represented by and divided into "quotas" that cannot be denominated as shares and for which certificates cannot be issued (i.e. quotas of capital are always in the name of the quotaholders and registered in the commercial registry). The transfer of "quotas" must be effected through a notarized deed registered in the Lda's register book and the local commercial registry. In general, the company's charter reserves certain pre-emptive rights in the event one or other quotaholder intends to transfer his quota to a third party to the company or to the quotaholders in general.

21. The Directorate-General of Taxes' Ruling 16/2000 of 21 July 2000. In accordance with this principle, Art. 69(2)(c) CIRC was revoked by Tax Reform Law 30-G/2000 of 29 December 2000. It is curious to observe that no legal provision has been substituted for the former provision, namely to establish that dividends distributed by Portuguese subsidiaries to their EU parent companies are exempt from IRC. Art. 5 of the Parent-Subsidiary Directive is not directly implemented in the CIRC and one may consider that – theoretically – Portuguese subsidiaries are directly applying Art. 5(1) Parent-Subsidiary Directive when they distribute dividends to their EU parent companies without withholding tax.

22. In the author's opinion, the Portuguese tax authorities cannot demand certification in addition to that required by Art. 2 Parent-Subsidiary Directive, i.e. the certificate of residence of the parent company, specifying that such a company is subject to one of the taxes mentioned in the Appendix to the Parent-Subsidiary Directive and that it is not exempt from such tax.

23. Regarding inbound dividends, Portuguese law (Art. 45 CIRC, as amended by Tax Reform Law 30-G/2000) was not properly redrafted and it can be considered not to be in conformity with EC law (Art. 3(2) Parent-Subsidiary Directive) as was pointed out by Dali Bouzoraa, "The Parent-Subsidiary Directive: *Denkavit*'s Lessons", 37 *European Taxation* 1 (1997), p. 17. An interpretation in conformity with EC law requires that relief be granted to inbound dividends even if they are received before the expiry of the minimum two-year holding period. It is also arguable whether or not Art. 75-A CIRC is contrary to Art. 52 EC Treaty, as domestic distributions of dividends from a new subsidiary to its Portuguese resident parent company may automatically benefit from the tax exemption regime, provided the parent company maintains its shareholding during the two-year period. See Art. 45(1) CIRC and ECJ, 8 March 2001, Joined Cases C-397/98 and C-410/98, *Metallgesellschaft Ltd and Others v. Commissioners of Inland Revenue and H.M. Attorney General; Hoechst UK Ltd v. Commissioners of Inland Revenue and H.M. Attorney General.*

24. ECJ, 17 October 1996, Joined Cases C-283/94, C-291/94 and C-292/94, *Denkavit International BV, VITIC Amsterdam BV and Voormeer BV v. Bundesamt für Finanzen* [1996] ECR I-5063.

25. In this respect, this provision does not state specifically that a declaration certified by the parent company's tax authorities is necessary, but it can be inferred that it is necessary.

26. See Art. 75-A(4) CIRC and Art. 35(10) LGT, which refer to Art. 559(1) of the Portuguese Civil Code and indirectly to Ministerial Ordinance 158/1999 of 18 February 1999.

parent company (i.e. before the two-year period has elapsed).[27]

The Portuguese state has clearly devised a time-consuming process and a cumbersome application procedure for obtaining a refund. On the one hand, this may be seen as consistent with its budgetary constraints. On the other hand, this seems contrary to the approach of the majority of Member States that are attracting investment through holding companies. The same pattern of behaviour was recently seen again in the dramatic amendment of the capital gains rules, in respect of both resident and non-resident holding companies.[28]

This narrow *Denkavit* approach results in two immediate problems. The first relates to the tax rate itself. Should the withholding tax be at the ordinary domestic rate on the distribution of dividends (e.g. 25%) as Article 75-A(1) effectively requires or does a treaty rate supplant the domestic rate when the applicable treaty rate is more favourable (e.g. currently all the treaties signed by Portugal with EU Member States include reduced tax rates for dividends, varying from between 10% and 15%)?[29] Secondly, there is the problem of the proof that, in the end, the parent company will be required to provide in order to get its refund.

As far as the first issue is concerned, the author's view is that EU parent companies should not be prevented from requesting application of the treaty rate (or any other domestic rate that is more favourable) at the time that the Portuguese subsidiary pays the dividends and at a later stage (when the minimum holding period elapses) to request that the withholding tax that was paid be refunded in accordance with the Parent-Subsidiary Directive.[30] The rules apply cumulatively and are not exclusive.

The strictest and most orthodox interpretation of the *Denkavit* decision[31] should respect the main decision – Article 3(2) of the Parent-Subsidiary Directive cannot be interpreted as requiring the expiry of the period before relief is granted – and any provisional withholding should be refunded, provided it is evidenced, at a later stage, that the minimum holding period requirement has been met. First, the general domestic rate provision is superseded by the bilateral agreement provision that stipulates a maximum withholding tax rate of 10% or 15% when dividends are distributed; subsequently, it is the EC legal instrument that again takes precedence over the domestic and treaty provisions and requires that the previous withholding be considered and treated as provisional and not a definitive withholding, with the effect that a refund should be granted.

The second problem, as mentioned above, relates to the administrative burden placed on taxpayers. Article 75-A of the CIRC refers to the requirements mentioned in Article 2 of the Parent-Subsidiary Directive, as well as to the other requirements. This means that it should be enough for the parent company to evidence that: (1) it is resident in the European Union, (2) it has adopted one of the forms listed in the Annex to the Parent-Subsidiary Directive and (3) it is subject to tax without being exempted from it. These requirements must be certified by the tax authorities in the parent company's state of residence. In addition, the parent company should be able to demonstrate that it has maintained the 25% holding for a minimum of two years. The parent company should be able to prove these requirements in any reasonable manner, including providing evidence that the latter held bearer shares.[32] Therefore, in such circumstances, the declaration of the holder of the shares should be enough to entitle him to the right to benefit from a refund.[33] The reversal of the burden of proof, in order to apply the Parent-Subsidiary Directive to the first two years (once the minimum holding period elapses the distribution can be made without any withholding if the companies believe that they meet the Parent-Subsidiary Directive requirements) may be too cumbersome and it is expected that small and medium-sized companies, less familiar with these formalities, may be prevented from obtaining Parent-Subsidiary Directive benefits.

D. Recovering overpaid taxes

1. The current experience

In its decisions of 21 and 26 September 2000 and of 21 June 2001 the ECJ held that the Portuguese capital duty legislation contravened EC law.[34] In practical terms the charges or fees paid by companies to notaries and registered public entities for drawing up a notarially attested act recording the expansion of a company's capital or an amendment of its corporate charter or for entries in the National Corporate Registry were considered illegal and contrary to EC law, violating Directive 69/335/EEC of 17 July 1969 (Article 10(e)), as amended by Directive 85/303/EEC of 10 June 1985.[35] Until recently, few tax questions with a social impact had been put by Portuguese tax courts to the ECJ.[36] The media attention this decision

27. If this payment had been made to a Portuguese parent company, no withholding tax would have applied. This seems contrary to Art. 52 of the EC Treaty. See note 23, *Hoechst* case.

28. Art. 42 CIRC and Art. 33 EBF. See also Francisco de Sousa da Câmara and Phillippa Cannon "Tax Reform Negatively Impacts Non-resident Entities Operating in Portugal", *Tax Notes International*, 26 March 2001, pp. 1487-1491.

29. This problem may increase if the subsidiary is listed on the Portuguese stock exchange ab initio and benefits from the domestic tax incentive. See note 2.

30. In general, subsidiaries should not withhold more than the 10% or 15% that corresponds to the ordinary rate when a treaty applies.

31. See note 23, Bouzoraa, p. 16.

32. To hold bearer shares is not only admissible but common in many situations. Presently, shares may not only be deposited with a bank or the company, but can also be kept by the holder.

33. This declaration should benefit from the legal presumption of truth and good faith as indicated in Arts. 59(2) and 75 LGT.

34. ECJ, 21 September 2000, Case C-19/99, *Modelo Continente SGPS SA v. Fazenda Pública* [2000] ECR I-7213, 26 September 2000, Case C-134/99, *IGI-Investimentos Imobiliários SA v. Fazenda Pública* [2000] ECR I-7717 and 21 June 2001, Case C-206/99, *SONAE – Tecnologia de Informação, SA. v. Direcção Geral dos Registos e Notariado*. The latter case is very relevant as the Court decided that the existence of a maximum charge (see Para. 16 of this decision regarding the legal framework) is not sufficient to make the charge a duty paid by way of a fee or due if that maximum is not reasonably established by reference to the cost of the service in respect of which the charge is levied. Domestic court decisions have also taken this view. See *CNP* case, Tax Court of First Instance of Lisbon, Proc. de Impugnação No. 11/2000, decision of 21 June 2001.

35. For a summary, see 41 *European Taxation* 2 (2001), pp. EC-7 and 8.

36. The first tax case that had a major impact on the Portuguese market dealt with vehicles. See ECJ, 16 July 1992, Case C-343/90, *Manuel José Laurenço Dias v. Director da Afândega do Porto* [1992] ECR I-4673 and ECJ, 9 March 1995, Case C-345/93, *Fazenda Pública and Ministério Pública* v. *Américo João Nunes Tadeu* [1995] ECR I-0479, where the ECJ considered that the Portuguese vehicle tax was contrary to Art. 95 of the EC Treaty that prohibited higher duties

has received has had a social and political impact in view of the broad range of taxpayers that could benefit from such a ruling. This case underlines once again that domestic law has to respect EC law, but also shows that the ECJ may have an impact on enforcing taxpayers' rights. The Court expressly stated in cases C-19/99 and C-134/99 that "Article 10 of Directive 69/335, as amended by Directive 85/303, creates rights on which individuals may rely in proceedings before the national courts".

Apart from the cases on which the ECJ's ruling was based, other cases were pending in the Portuguese courts involving the same issue. Taxpayers continued their challenges in the pending cases and also started new litigation in order to obtain a refund of taxes overpaid in previous years. Meanwhile, the Portuguese government decided to change the rules concerning capital duties. This, however, did not prevent taxpayers from continuing litigation against the capital duties collected in accordance with the new provisions (they were amended in a manner that is still not entirely correct). Many of these taxpayers won their cases and started requesting refunds of the overpaid duties from the authorities.

In view of the authorities' lack of response, taxpayers again came before the tax courts[37] to obtain new decisions that would clearly oblige the tax authorities to refund the charges or fees that were found in the court decision to be null and void as a result of EC law violations.[38] Meanwhile, the *Epson* case reopened the subject, with some companies requesting a refund of the overpaid taxes (normally, the ISDA withheld before the year 2000).

2. The three domestic possibilities to recover overpaid taxes

The possibilities to recover overpaid taxes based on the ECJ ruling by lodging new judicial actions in accordance with domestic rules are discussed below in relation to the limitation periods contained in Portugal's procedural rules. The Portuguese authorities' position is outlined below.

a. *Opportunities*

Although there is no one way to request a refund of taxes illegally assessed and collected,[39] there are three judicial routes that can be pursued to request the refund under domestic procedural law. These are outlined below.

The usual court remedy against a tax assessment is the contest procedure (*processo de impugnação*). In accordance with this procedure the taxpayer must present his case to the first instance tax court within 90 days from one of the following dates:[40]

(a) the deadline for the taxpayer to voluntarily pay the tax assessed;
(b) the date of notification of other tax decisions, even when they do not arise from a tax assessment;
(c) the date on which a person is informed that he bears secondary responsibility in a foreclosure case;
(d) the date a negative tacit decision is considered to have been adopted;
(e) the date of notification of other decisions that may be subject to an autonomous appeal in accordance with the CPPT; or
(f) the date a taxpayer becomes aware of an infringement of a legally protected interest not included in the previous items (items (a) to (e) above).[41]

The contest procedure is the proper judicial forum to challenge tax assessments made by the tax authorities and to obtain a court decision declaring an assessment null and void. As a result of such a declaration, payments already made should be refunded (with or without interest, depending on the circumstances, namely whether the tax

on imported goods from other Member States, because the value of imported second-hand vehicles amounted to 90% of that applicable to new vehicles, regardless of the age of the imported vehicle or any other criterion. The Portuguese method of calculation of the value of the vehicles was changed to bring the litigation to an end (Decree-Law 40/93 of 18 February 1993), but the law still did not permit the value of the imported vehicles to be correctly determined at the time of import. This led the court to issue a second ruling on 22 February 2001 that found that the new legislation was still contrary to Art. 95 of the EC Treaty. See ECJ, 22 February 2001, Case C-393/98, *Ministério Pública and António Gomes Valente v. Fazenda Pública* [2001] ECR I-1327.

37. The Portuguese authorities (*Direcção Geral dos Registos e Notariados*, DGRN) are currently indirectly contesting the ECJ ruling in the cases still pending in court. The ECJ considered in these cases that notary and registry fees similar to the ones considered in the cases presented before the ECJ were an imposition in terms of the purposes of EC Directive 69/335 and were forbidden by Art. 10(c). A new law was passed and the current charges collected by notaries and other public registries were reduced. Although their amount still increases in direct proportion to the share capital raised, there is now a limit on each operation that is equivalent to PTE 15,000,000 for each service provided by a public notary or registry. Therefore, these duties have to be maintained at least in part. For new cases these arguments might be valid. However, the DGRN is surprisingly refusing to provide refunds to taxpayers when the latter has already won a domestic case based on the ECJ ruling and when the Portuguese court has declared the previous assessments null and void. They point to the fact that there are about 200 cases pending in court and that the amounts involved may surpass PTE 3,790,878,599. According to the Portuguese authorities, apparently Portuguese public interest – which seems to be an interest in not refunding what is thought to be a considerable amount of money – may justify not executing in toto previous court decisions and continuing to violate EC law. From these 200 cases it seems that no more than five taxpayers ("the first to obtain success" emphasizes the DGRN) obtained their refunds. Discussions are now continuing in a new case, which is the execution procedure on judicial decisions (*Processo de Execução de Sentença*) where taxpayers are trying to enforce previous court decisions and obtain a new decision stating that the DGRN does not have a legitimate right to refuse to give taxpayers refunds. Although the illegality of this behaviour seems evident, the authorities persist in refusing to grant refunds. On 12 June 2001, the Tax Court of First Instance of Setúbal decided, for the first time (to the author's knowledge), a case dealing with a similar situation, stating that the DGRN does not have a legitimate right to refuse to give taxpayers refunds plus interest for late payment (*juros de mora*) calculated from the date on which the first decision should have been carried out (*Borealis* Case, Proc. de Execução de Julgados No. 32/99-A).

38. One should distinguish between the cases. In the first case, a court decision is sought that states that a specific tax is illegal, null and void. Therefore, a refund is due. In the second case, if such a refund is not received after success in the previous court case, the same taxpayer seeks to enforce its right by bringing the case before the court in order for the latter to declare that there is no legitimate cause to prevent the refund from being granted. Thus, material and operational acts that must be followed by the authorities may be specifically indicated.

39. In this context only refunds of overpaid illegal taxes are discussed, namely taxes based on domestic provisions contrary to EC law. There are several administrative domestic provisions concerning refunds of overpaid "legal taxes", which are not discussed in this article.

40. Art. 102(1) CPPT.

41. An alternative interpretation is that the relevant date is calculated from the date a taxpayer becomes aware of the decision that infringes his legally protected interest. This interpretation reduces the scope of this legal provision because the taxpayer may be aware of the decision long before finding out that the decision is illegal or that it infringes a legally protected interest.

authorities or the taxpayer was responsible for the incorrect assessment).

There are also specific legal provisions concerning claims against tax assessments directly made by taxpayers (i.e. self-assessments and assessments made through the withholding mechanism) and advance income tax payments.[42] As a rule, in these cases, a preliminary administrative claim is required to be presented before the question can be brought before a court.

If the grounds to contest a self-assessment or a specific withholding are exclusively based on legal reasons, however, taxpayers may immediately file an appeal (under the contest procedure rules). In such a case, the law requires that the file be lodged within the term (i.e. 90-day period) set out in Art. 102(1) CPPT.[43] The taxpayer must determine which, if any, of subparagraphs (a) to (f) of Article 102(1) apply. In the case of ISDA, the issue is whether subparagraph (f) applies.

An alternative to the contest procedure is to introduce a court action to obtain recognition of a right *(acção de reconhecimento de um direito)*, which grants the taxpayer the right to obtain a court decision stating that taxes unduly paid should be reimbursed and that the taxpayer has the right to obtain an administrative decision declaring the assessment null and void.[44] The limitation period for initiating such an action in the first instance tax court is four years from the date such a right comes into existence or from the date on which one becomes aware of an infringement of this right or interest. This action can only be initiated, however, when this procedure is the most appropriate procedure in terms of ensuring the total, efficient and effective protection of the right.[45]

A further alternative is to bring an action against the Portuguese State to receive compensation for an illegal act committed by the state and to rectify the state's unjust enrichment (*enriquecimento sem causa*).[46] The limitation period for bringing such an action in the administrative court is three years from the date the taxpayer claims that his rights have been violated.[47]

There are still no court cases or rulings clarifying whether a taxpayer should follow the first, second or third route in order to seek a refund of the ISDA paid (paid more than 90 days ago). Court decisions involving other matters demonstrate that appeals against tax assessments filed more than 90 days from the date of payment are immediately rejected.[48] At the same time, other court decisions reject actions to obtain the recognition of a right *in limine*, on the basis that the taxpayer should have used the normal contest procedure.[49] Otherwise, these decisions state that such actions would become an artificial route to increasing the 90-day period in which a taxpayer may appeal a tax assessment.[50]

In any case, one should not only bear in mind that the above-mentioned domestic procedural rules have only recently been enacted, but also that ECJ decisions have made it clear that it should be possible to recover overpaid taxes on the basis of claims made under EC law. Thus, the question is, among others, whether a taxpayer has the right to lodge a contest claim on the basis that he was not aware of the infringement of a legally protected interest before 90 days from such date, or whether, in the alternative, the taxpayer should introduce an action to obtain recognition of a right to receive a refund of the overpaid tax within four years from the date of payment.

b. *Difficulties*

At least two difficulties still need to be surmounted. The first relates to the reference in Article 102(1)(f) CPPT that the contest procedure can only be used if the taxpayer's interests cannot be safeguarded in other ways (i.e. the previous subparagraphs do not apply), which means that the taxpayer not only has to prove the impossibility of using (or at least the inapplicability of) the previous subparagraphs of Article 102 of the CPPT in order to be allowed to make use of the contest procedure, but also that he became aware of the infringement of his legally protected interest in the previous 90 days.

Subparagraph (f) of Article 102 CPPT should be read as a last refuge to defend an interest claimed by a taxpayer. So long as the domestic law is considered by the ECJ to be contrary to EC law, it should be possible to use the contest procedure to obtain a judicial decision that renders the tax paid null and void and to obtain a refund.

As the ECJ has pointed out in *Fantask:*

> [....] it is for the domestic legal system of each Member State to lay down the detailed procedural rules for actions seeking the recovery of sums wrongly paid, provided that those rules are not less favourable than those governing similar domestic actions and do not render virtually impossible or excessively difficult the exercise of rights conferred by Community Law.[51]

As a rule, it would have been impossible for other taxpayers (apart from Epson) to recover the sums wrongly paid within the 90-day period running from the date of payment to the date they became aware of the *Epson* deci-

42. See Arts. 131-134 CPPT.
43. See Arts. 131(3) and 132(6) CPPT. One could argue that this 90-day period should be expanded to one year calculated from the date the taxpayer became aware of a superseding document or court decision. See Art. 151 of the Code governing the municipal tax on transfers and the succession and donation tax (CIMSISD).
44. Art. 145(1) CPPT stipulates that the actions necessary to obtain recognition of a right or a legally protected interest related to tax issues should be initiated by whoever evidences title to recognition of such a right or interest.
45. The contest procedure *(processo de impugnação)* rules are applicable here (Art. 145(4) CPPT). See also Art. 61(1)(m) of the Administrative and Tax Court Statute *(Estatuto dos Tribunais Administrativos e Fiscais)*.
46. In his Opinion in *Fantask* Advocate-General Jacobs put it as follows at Para. 81: "Thus, in those judgments the Court recognized that repayment or entitlement against state authorities and damages claims against the state may co-exist as independent remedies in matters of taxation and social security. Repayment or entitlement claims and damages claims of a different nature, and what is recoverable under each may differ. For example, interest on arrears of benefit irrecoverable under an entitlement claim may be recoverable under a damages claim."
47. See Art. 71(2) of the Administrative and Tax Procedures Law (*Lei do Processo dos Tribunais Administrativos*, LPTA) and Art. 498(1) of the Civil Code.
48. See STA decisions on Appeal Nos. 22.542 and 24.194 of 30 September 1998 and 24 May 2000, respectively.
49. Id. In general the courts decide that the contest procedure would have been a more appropriate procedure in terms of ensuring the total, efficient and effective protection of a right.
50. For example, see the STA decision on Appeal 23.747 of 6 October 1999.
51. ECJ, 2 December 1997, Case C-188/95, *Fantask A/S e.a. v. Industriministeriet (Erhvervministeriet)* [1997] ECR I-6783, Para. 47.

sion. Moreover, in this particular case, the Portuguese government did not change the law nor admit that ISDA was wrongly and illegally assessed. It therefore seems it is "virtually impossible or excessively difficult" for taxpayers to claim refunds if the date their awareness is deemed to arise is simply the date the ruling is handed down.

In a recent case before the Tax Court of Oporto, however, the Court refused to submit a request for a preliminary ruling to the ECJ (whether or not the limitation period rules contained in Article 123 of the Tax Court Procedure Law (equivalent to Article 102 of the CPPT) were contrary to the ECJ ruling in *Fantask),* stating that an appeal in a tax case cannot be suspended pending an ECJ reply to this type of question. In addition, the court stressed that in this case – where the limitation period seemed to have elapsed - the taxpayer should lodge a different kind of claim to obtain recognition of a right.[52]

It is curious to observe, however, that also in 2001, the Tax Court of First Instance of Lisbon seemed to adopt a different view stating that "As long as Directive (69/335) has not been properly implemented into Portuguese Law, the contest procedures that are based on the fact that domestic provisions are not in conformity with the Directive are not subject to the procedural deadlines usually applicable to such contests". This decision follows the ECJ and more particularly the *Emmott* case, although this question (whether a contest procedure can be initiated when the time limit for bringing such a proceeding to court has already lapsed) was not relevant in the case before the Court because the contest procedure was introduced within the terms of Article 102 of the CPPT.[53]

The second difficulty arises in proving that the most appropriate procedure is to lodge a claim to obtain recognition of a right to a refund of the overpaid tax. In spite of the recent decision of the Oporto court, the state and the opponents of this possibility could always say that the appropriate procedure is the contest procedure.

In the author's opinion, there are two main arguments that should prevail over such a view. First, the goal of this remedy is different from the one achieved by the contest procedure. In the latter case, the court is called upon to declare null and void a tax assessment. In the former procedure, the court is required to declare that the taxpayer has a right to a refund. Secondly, this action is intended to guarantee that taxpayers have the possibility to exercise the rights conferred by European law effectively, and to prevent a state from – time after time – invoking domestic procedural rules and limitation periods for bringing proceedings that make it virtually impossible or excessively difficult to exercise these rights.

Even if the *Emmott*[54] decision has been reconsidered and its scope reduced by the more recent rulings in the *Johnson, Steenhorst-Neerings* and *Fantask* cases, the ECJ continues to insist that domestic procedural rules for actions seeking the recovery of sums illegally paid should not set out a limitation period that is unreasonable for a taxpayer to exercise his rights.

In addition, as was pointed out by Advocate-General Jacob in *Fantask* and highlighted by Paul Farmer,[55] nothing should prevent a taxpayer from lodging a claim against the state in addition or in the alternative to the above-mentioned procedures for damages sustained, which could cover, inter alia, interest and the taxpayer's legal costs, including lawyer's fees.

52. *Futop SGPS, SA*, Proc. 39/2000 Impugnação, of the Oporto Tax Court.
53. *CNP, Proc. de Impugnação* No. 11/2000, decision of 21 June 2001 of the Lisbon Tax Court.
54. ECJ, 25 July 1991, *Theresa Emmott v. Minister for Social Welfare and Attorney General* [1991] ECR I-4269. The ECJ held that "until such time as a directive has been properly transposed, a defaulting Member State may not rely on an individual's delay in initiating proceedings against it in order to protect rights conferred upon him by the provisions of the Directive and that a period laid down by national law within which proceedings must be initiated cannot begin to run before that time". See Para. 23.
55. See note 46 and Paul Farmer "An outline of the case law of the European Court of Justice on the capital duty legislation", *ECTR* 1999/1, pp. 45-46.