

Euro Tax Flash
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Euro Tax Flash from KPMG's EU Tax Centre



AG's opinion in the Brisal case

Freedom to provide services – Net taxation of interest – Neutralization of discrimination

On March 17, 2016 Advocate General (AG) Kokott of the Court of Justice of the European Union (CJEU) rendered her opinion in the Brisal case. The case concerns whether the Portuguese withholding tax on interest paid to non-resident financial institutions is contrary to EU law because it is imposed on the gross amount of the interest paid, whereas resident financial institutions are taxed on their net income. The AG concluded that the Portuguese legislation constitutes a restriction of the freedom to provide services. In addition, she concluded that financing costs could, in principle, be deducted even where these could not be traced to specific loans.

Background

Under its domestic law, Portugal imposes a 20% withholding tax on interest paid to non-residents, which in the case at hand was reduced to 15% under the relevant tax treaty. The tax is withheld from the gross amount, without any deduction for the costs of financing the underlying loans. Portuguese residents, on the other hand, are subject to 25% corporate income tax on their net income, i.e. after deduction of business expenses, such as financing costs.

The European Commission had already challenged this tax treatment in 2010, arguing that it resulted in non-resident financial institutions being more heavily taxed than resident financial institutions and was

therefore contrary to the free movement of capital and the freedom to provide services (Commission vs. Portugal C-105/08). The CJEU rejected the Commission's case without addressing the substantive issues, arguing that no concrete evidence had been put forward to support the calculations used as basis for the arguments.

In the case at hand, two companies Brisal – Auto Estradas do Litoral S.A. ("Brisal") and KBC Finance Ireland ("KBC") used similar arguments to challenge the Portuguese tax. As a consequence, the Portuguese Supreme Administrative Court referred the following questions to the CJEU: (1) Does the Portuguese legislation infringe the fundamental freedoms? and (2) Is this the case even if such legislation may sometimes result in a higher tax burden being imposed on residents (i.e. whether the lower tax rate applicable to the gross income derived by non-residents may neutralize the difference in tax treatment)?.

The AG's Opinion

Referring to the *Truck Center Case* (C-282/07), the AG noted that the technique of deducting tax at source only for non-residents does not infringe the freedom of services since it is justified by the need to ensure the efficient collection of tax. She went on to conclude that, following the Court's consistent approach since the judgment in the *Gerritse* case (C-234/01), not allowing non-residents to deduct expenses directly related to the taxable activity would, in principle, be an infringement.

When establishing whether financing costs such as interest may be directly linked to a taxable activity, she noted that the recent decisions in the *Miljoen, X and Société Générale* cases (C-10/14, C-14/14, and C-17/14) should be narrowly interpreted and that it did not mean that financing costs could generally not be linked. She also distinguished those cases on the basis that interest is income from an economic activity whereas dividends are a consequence of holding shares. On the question whether 'overhead costs' such as a bank's financing costs, which cannot be directly linked to specific loans, could be directly related, the AG referred to the case of *Centro Equestre da Lexiria Grande* (C-345/04) and concluded that they can be. If the financial entity cannot identify the actual directly related costs, they may therefore, in principle, be determined as a proportion of the overhead of the financial institution. The AG concluded, however, that the extent to which the overhead can be directly attributed to the taxed activity is a question of fact to be determined by the referring court. The court must, in principle, take into account the costs actually incurred. The applicability of average interest rates based on interbank financing, as suggested by the referring court, is not permissible according to the AG, *at least in this case* (because the financing costs were not limited to interbank interest).

Referring in particular to the CJEU's case law, the AG further concluded that the disadvantageous tax treatment cannot be justified by other tax advantages (such as a lower tax rate for non-residents).

The justifications submitted related to (i) the allocation of taxing powers between Member States, (ii) double deduction of operating costs, (iii)

efficient tax collection and (iv) tax supervision. According to the AG, these should all be rejected.

EU Tax Centre Comment

As the tax provisions applied by Portugal have been previously dealt with by the CJEU, it remains to be seen whether the AG's opinion, which significantly differs from the *Commission v Portugal* case, will be followed.

As regards which costs should be considered as deductible, the AG appears to consider that the very restrictive interpretation given by the Court in the *Société Générale* case should only apply to the specific facts and circumstances of that case. However, it remains unclear to what extent the Court will follow its previous case law or confirm its decision in the *Société Générale* case as a turning point.

Should you require further assistance in this matter, please contact the EU Tax Centre or, as appropriate, your local KPMG tax advisor

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