Series on International Tax Law
Univ.-Prof. Dr. Michael Lang (Ed.)

Volume 57

ECJ
Recent Developments in Direct Taxation 2008

edited by

Michael Lang
Pasquale Pistone
Josef Schuch
Claus Staringer

IFA Austrian Branch
WIEN KULTUR
Linde

Bibliografische Information der Deutschen Bibliothek

Die Deutsche Bibliothek verzeichnet diese Publikation in der Deutschen Nationalbibliografie; detaillierte bibliografische Daten sind im Internet über http://dnb.ddb.de abrufbar.

Gedruckt mit Unterstützung des Bundesministeriums für Wissenschaft und Forschung in Wien.

Supported by the Wolfgang Gassner Research Fund for International Tax Law, the Austrian Branch of the International Fiscal Association (IFA), and the City of Vienna.

ISBN 978-3-7073-1443-4

1210 Wien, Scheydgasse 24, Tel.: 0043/1/24 630
www.lindeverlag.at

Satz: EXAKTA GmbH, 1180 Wien, Hasenauerstraße 67
Druck: Hans Jentzsch & Co. GmbH.
1210 Wien, Scheydgasse 31
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Preface

The European Court of Justice is a driving force in the field of direct tax harmonization. Cases pending at the ECJ are therefore very carefully analysed by both academics and practitioners.

On 25–27 September 2008, we organized a conference to discuss the cases now pending before the ECJ in connection with the fundamental freedoms and direct taxation. The possible consequences of future ECJ decisions were also considered. A great number of leading experts on European tax law accepted our invitation to attend the conference. This book contains the results of the conference.

Without the support of the Wolfgang Gassner Research Fund for International Tax Law, the Austrian Branch of the International Fiscal Association (IFA), and the City of Vienna, the conference and the entire project itself would not have been possible.

We are very grateful to the authors, who not only gave us impressive presentations on the pending cases but who also committed themselves to an extremely ambitious schedule and participated in the discussions at the conference with considerable enthusiasm.

Again, we would like to express our sincere thanks for the co-operation and swift realization of this publication project to the publisher Linde, who generously agreed to include the book in its catalogue.

Our particular thanks go to Renée Pestuka for the smooth organization of the conference, to Margaret Nettinga, who greatly contributed by editing and polishing the texts of the authors and to Lisa Paterno who supported us in deciding on the structure of the conference and did essential work in the preparation and publication of this book.

Vienna, October 2008

Michael Lang *Pasquale Pistone* *Josef Schuch* *Claus Staringer*

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Claus Staringer

The author wishes to thank Mag. Lisa Paterno (Institute for Austrian and International Tax Law, WU Vienna) for her assistance.

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The Polish government already prepared draft legislation introducing changes to the Personal Income Tax Act. The draft law includes a number of changes introduced with a view to assure compatibility of income tax law with the EC fundamental freedoms.

The provision at stake in the *Rüffler* case was amended in response to the judgment of the Constitutional Tribunal delivered on 7 November 2007.

The proposed draft includes provisions allowing the social security contributions payable in the other EU, EEA Member State or the Swiss Federation to be deducted from taxable income by residents of Poland. The draft also provides for the possibility of tax deduction of the health insurance contributions payable by residents of Poland in the other EU, EEA Member States or the Swiss Federation. The amendment should enter into force on 1 December 2008.

Portugal: The Infringement Procedures Involving Portugal and the Commission v. Portugal Case

Ana Paula Dourado/José Almeida Fernandes

I. Interest Payments on Mortgage Loans, C-105/08

1.1 Description of the facts and issues

As a rule, interest payments on mortgage loans are subject to a withholding tax at a tax rate of 20% on the gross amount. However, Portuguese banks are not subject to a withholding tax on interest derived from such loans and thus are only taxed on their profit. Non-resident banks with a permanent establishment (hereinafter, also PE) in Portugal to which the debt claim in respect of which the interest paid is effectively connected with such a PE are also understood to benefit from non-application of the said withholding tax obligation. Other non-resident banks deriving interest arising in Portugal are subject to a final withholding tax of 20% on the gross amount of interest. The latter withholding tax rate may be reduced by virtue of the application of double taxation conventions[1] concluded by Portugal or by the application of the Interest & Royalties Directive, but the application of the latter to mortgage loans seems quite doubtful, since the requirements of the Directive will not be fulfilled. Besides, there are no election or refund mechanisms available for a non-resident bank without a permanent establishment within the Portuguese territory to enable it to deduct at source its financing costs connected with the interest income arising in Portugal. It is known that the difference in treatment between resident and non-resident banks has led to the use of loan structures involving resident banks acting for fronting purposes[2] to offset the disadvantage of the application of withholding tax in the interest payment flows that may cause a market distortion.

1.2 Commission infringement procedure and referral to the European Court of Justice

The European Commission (hereinafter, the Commission) first sent a formal request to Portugal regarding the alleged discriminatory treatment concerning interest payments to foreign banks in December 2005. According to the Commission, current rules restrict Portuguese consumers from taking out mortgage loans from banks outside Portugal.[3] Reference was then made to both the decision of the European Court of Justice (ECJ) in *Gerritse*[4] and the previously announced willingness

1 The double taxation conventions entered into by Portugal provide for a sharing of taxing rights between contracting states concerning interest income, but restrict the taxation at source to a maximum tax rate of 5%, 10%, 12% or 15%.

2 Resident banks interest payments to non-resident banks are not subject to the withholding of tax and hence the possible interposition of the bank might be to be able to avoid the interest payment flows from being subject to any tax withheld.

3 See IP/06/42 dated 16 January 2006.

4 ECJ 12 June 2003, C-234/01, *Gerritse* [2003] ECR I-5933.

of the Commission to take action against national mortgage credit rules deemed incompatible with EC law in the Green Paper "Mortgage Credit in the EU".[5]

In July 2006, the Commission acknowledged the failure of Portugal to amend its tax legislation and announced its decision to refer Portugal to the ECJ under Art. 226 para. 2 EC.[6] The action against Portugal was only actually brought before the ECJ on 6 March 2008.[7]

1.3 Free movement of services, free movement of capital or freedom of establishment

The first issue to be raised concerns the fundamental freedom that is possibly infringed by Portuguese legislation. According to the Commission, both the free movement of services and the free movement of capital are restricted by the Portuguese rules. The Commission argued that "the taxation applicable in Portugal to interest paid to non-resident financial institutions leads to a far heavier real tax burden than that borne by resident taxpayers in respect of similar income" and that as such that legislation "constitutes a restriction of the fundamental freedoms enshrined in Arts. 49 and 56 EC and in the corresponding provisions of the EEA Agreement".[8] In the pending *Truck Center* case,[9] the question referred to the ECJ is similar to the one raised by Portuguese legislation. Belgian withholding tax on interest payments by resident companies on loans taken out from companies outside the Belgian territory may deter Belgian residents from taking out loans from those non-resident companies, since there is no withholding tax on interest payments on loans taken out from resident companies; the aforementioned legislation may also produce a restrictive effect in relation to those companies, inasmuch as it constitutes an obstacle to their investing in Belgium in the form of loans.[10]

In *Truck Center*, according to Advocate General Kokott, the compatibility of the Belgian regime is to be analysed under the freedom of establishment, following the definite influence criterion,[11] because the discriminatory regime results from a joint application of domestic rules and tax treaty rules: although domestic

5 See IP/05/971 dated 19 July 2005.
6 See IP/06/971 dated 11 July 2006.
7 See OJ 2008 C 116, p. 15.
8 Ibid.
9 Opinion of Advocate General Juliane Kokott on ECJ 18 September 2008, C-282/07, *Truck Center*, pending.
10 See ECJ 15 July 2004, C-315/02, *Lenz* [2004] ECR I-7063, paras. 20–22; 24 May 2007, C-157/05 *Holböck*, [2007] ECR I-4051, para. 30.
11 ECJ 13 April 2000, C-251/98, *Baars* [2000] ECR I-2787, para. 26; 12 September 2006, C-196/04, *Cadbury Schweppes* [2006] ECR I-7995, paras. 31–33; 3 October 2006, C-452/04, *Fidium Finanz* [2006] ECR I-9521, paras. 34 and 44–49; 12 December 2006, C-374/04, *ACT Group Litigation* [2006] ECR I-11673, paras. 37–38; 13 March 2007, C-524/04, *Thin Cap Group Litigation* [2007] ECR I-2107, paras. 26–34; C-157/05, *Holböck*, para. 22.

rules are discriminatory even in the case of minority holdings, application of the tax treaty rules to the concrete situation implies discrimination only in the case where there is at least 25% holdings. However, the question referred by the national court concerns the compatibility of domestic legislation with the freedom of capital. The first issue then is whether the Portuguese legislation falls within the scope of the free movement of services, capital (as argued by the Commission) or establishment (as in the *Truck Center* case, according to Advocate General Kokott). Unlike the Belgian legislation (i.e. domestic rules and tax treaty rules) analysed in the *Truck Center* case, the Portuguese legislation is not intended to apply only to those shareholdings which enable the lender to have a definite influence on the borrower's decision and to determine its activities (for a similar reasoning, *mutatis mutandis*, cf. *Holböck*,[12] para. 23). The Portuguese legislation that makes mortgage interest subject to withholding tax in the event the lender is a foreign bank without a permanent establishment within the Portuguese territory whereas there is no withholding where the lender is a Portuguese bank or a permanent establishment of a non-resident bank, does not differentiate according to the existence of any holding or the extent of the holding (cf. *Holböck*, para. 24). The same is true for tax treaties concluded by Portugal. We can therefore conclude that the legislation under analysis does not fall within the scope of the freedom of establishment.

If we now consider whether it falls within the scope of the free movement of services or the free movement of capital, it follows from the *Fidium Finanz*[13] case that the activity of granting credit on a commercial basis concerns, in principle, both the freedom to provide services within the meaning of Art. 49 et seq. and the free movement of capital within the meaning of Art. 56 et seq. (*Fidium Finanz*, para. 43). Moreover, the Portuguese legislation that provides exemption from withholding interest paid to resident banks aims at facilitating banking transactions and the offer of their financial services. As in the *Fidium Finanz* case, free movement of capital is an unavoidable consequence of a possible restriction on the freedom to provide services (*Fidium Finanz*, paras. 48–49). Thus, contrary to the Commission's position, the Portuguese legislation only falls within the scope of the free movement of services and not within the scope of the free movement of capital. This also means that banks established in non-Member States cannot rely on the provisions concerning free movement of services and are not protected by Art. 56.

Let us now focus on the withholding tax and the arguments raised by the Commission in respect of the Portuguese legislation and by the taxpayer in the *Truck Center* case (cf. Opinion of Advocate General Kokott, *Truck Center*, paras. 26–27):

12 See footnote 11.
13 See ibid.

- It is argued that the withholding tax implies additional compliance costs;
- It is also argued that there is a financial disadvantage due to immediate reduction of the interest received; and finally
- It is argued that there are cash flow disadvantages to the lender.

1.4 Discriminatory treatment of comparable situations

However, the first issue to be raised is whether there is discriminatory treatment of comparable situations. The Commission stated that "the taxation applicable in Portugal to interest paid to non-resident financial institutions leads to a far heavier real tax burden than that borne by resident taxpayers in respect of similar income". Portugal argued in the currently pending infringement procedure regarding the application of a withholding tax on service payments to non-resident service-providers "that in the case of taxation on the gross income the difference in the tax base might be offset by the difference between the rate applicable to resident entities – 25 %, and the final withholding tax rate – 15 % – applied to non-resident entities."[14]

On the one hand, the authors' understanding is that such a possibility will, on a factual basis, be extremely unlikely where the banking industry is concerned. On the other hand, according to the Commission reply in the course of the same infringement procedure, "discrimination exists when it cannot be ensured that differences in the level of taxation due to the differences in the tax bases are always offset by the differences in the tax rates".[15] The adoption of an implicit presumption according to which the level of taxation would be lower by simply referring to the difference in terms of tax rates does not appear to be an adequate analysis of the compatibility of a provision with the EC Treaty.[16, 17]

1.5 Withholding tax and source taxing rights

Let us accept that the point of departure is the comparison to be made between taxation of resident banks (lenders) and taxation of non-resident banks (lenders). Resident banks are exempt from withholding tax, whereas interest accruing to non-resident banks is withheld at source. The issue is whether this ultimately means

[14] See IP/08/1353 dated 18 September 2008.

[15] Ibid.

[16] Pistone, European Direct Tax Law: Quo Vadis?, in Hinnekens (ed.), *A Vision of Taxes within and Outside European Borders – Festschrift in honour of Prof. Dr. Frans Vanistendael* (2008), pp. 717 (pp. 722–723).

[17] In *Truck Center*, GA Kokott has apparently devised a difference between the taxation of services and interest that would have a bearing on whether business expenses directly related to the income should be taken into consideration primarily in the state of source or the state of residence to determine whether it was plausible or not to make an appraisal of whether the level of taxation of non-residents was higher or lower than that of residents (see point 70).

that in order to eliminate that heavier burden, Portugal should not tax interest income at source accruing to foreign banks. Thus, we have to confirm in the first place whether the source state has taxing rights on interest income accruing to non-residents.

The issue of the application of withholding taxes on gross interest income and its inappropriate nature has been thoroughly discussed at the OECD level. In the Commentary to Art. 11 para. 2 of the OECD Model Convention it is highlighted that this type of taxation raises a problem that "*essentially arises because taxation by the State of source is typically levied on the gross amount of the interest and therefore ignores the real amount of income derived from the transaction for which the interest is paid, and which is particularly important in the case of financial institutions. For instance, a bank generally finances the loan, which it grants with funds lent to it and, in particular, funds accepted on deposit. Since the State of source, in determining the amount of tax payable on the interest, will usually ignore the cost of funds for the bank, the amount of tax may prevent the transaction from occurring unless the amount of that tax is borne by the debtor.*"[18]

Exclusive taxation by the state of residence would solve this problem. And in fact, some tax treaties concluded by Portugal provide for exemption from withholding tax in the source state when the lender is a certain financial institution (identified in the treaty – e.g. the tax treaty with Romania [1999] and the tax treaty with Sweden [2003]).

In this case, the issue is whether the ECJ must analyse the compatibility of the domestic rule with the EC Treaty or instead, the compatibility of the effective regime resulting from the application of the tax treaty with the EC Treaty, as Advocate General Kokott suggests in the *Truck Center* case. But if according to a tax treaty, the source state has taxing rights on interest accruing to non-resident banks,[19] and since there is no harmonization beyond the scope of the Interest & Royalties Directive, the next issue is whether it is possible to tax interest income accruing to non-resident banks in the same way as interest income accruing to resident banks or permanent establishments from a bank resident in a Member State.

According to *Scorpio*[20] (paras. 33–35) and the Opinion of Advocate General Kokott in *Truck Center* (para. 35), a withholding tax is the instrument that assures taxing income paid to non-resident companies, and these include banks. Besides, unlike the withholdings analysed in *Gerritse*,[21] *Scorpio* and *Centro Equestre*,[22] it

[18] See para. 7 of the OECD Commentary on Art. 11.

[19] Cf. Schön, Losing out at the snooker table, in Hinnekens (ed), *A Vision of Taxes within and Outside European Borders – Festschrift in honour of Prof. Dr. Frans Vanistendael* (2008) pp. 813 and 821.

[20] ECJ 3 October 2006, C-290/04, *Scorpio* [2006] ECR I-9461.

[21] C-234/01, *Gerritse*.

[22] ECJ 15 February 2007, C-345/04, *Centro Equestre* [2007] ECR I-1425.

seems very difficult to withhold the tax on the interest accrued to the non-resident on its net amount, or to refund any concrete amounts corresponding to costs, since, contrary to what happens in respect of other services, it is very difficult, if not impossible, to determine the amount of expenses related to the interest derived from a mortgage loan. Banks financing costs are of such a nature that a tracing approach able to allocate the costs to a concrete mortgage loan does not seem practical. Moreover, the difficulty in determining the attributable expenses to a bank's permanent establishment have been somewhat indirectly highlighted in the work of the OECD Discussion Draft on "*The attribution of profits to permanent establishments – Part II – Special considerations for applying the authorised OECD approach to permanent establishments (PEs) of banks*" (December 2006), namely on the discussion on how to attribute capital (i.e., non-interest bearing capital) to a permanent establishment of a bank. The difficulties arising from such an issue where Portugal is concerned are enhanced by the fact that Portugal has made an observation to the 2008 OECD MC Commentary stating that it "*reserve its right not to follow the position expressed in paragraph 45 of the Commentary on Article 7* [i.e., methods for 'free' capital funding determination] *except whenever there are specific domestic provisions foreseeing certain levels of 'free' capital for permanent establishments*".

The previous paragraphs mean that ultimately we are discussing the compatibility of the withholding tax mechanism with the free movement of services and not whether it has to be calculated on the net vs. gross amount of interest paid. And prohibiting withholding tax on interest paid to foreign banks ultimately implies that the source state of the interest does not have a taxing right on that income. In other words, the issue is whether a withholding tax is a proportional and adequate measure to tax interest accruing to non-resident banks (*Truck Center,* para. 37). If instead of a tax withheld, net income would be directly collected from the non-resident taxpayer at a later moment, with the assistance of the residence state, compliance costs would be much higher (*Truck Center*, paras. 43-46). Unlike *Denkavit*[23] and *Amurta*,[24] there is no double economic taxation in this case and all expenses will be deducted in the State of residence.

We may then claim that the disadvantages resulting to the non-resident banks are an unavoidable consequence of the exercise of their taxing rights by the source State and the State of residence (*Kerckhaert & Morres*,[25] para. 20; *Truck Center*, Advocate General Kokott, paras. 55–56).

It cannot be denied however, that the banking business and its players in the industry are quite sensitive to timing issues and the disadvantage of the application of a withholding tax on interest income is burdensome and can easily be quantified by applying the existing market interest rates to the amount of money withheld and a possible partial refund. Moreover, on several occasions the ECJ has already considered that a cash-flow disadvantage represented a restriction to the free movement of capital.[26] The proportionality test may also play a significant role in the case under discussion, since even if the application of a withholding tax is not considered incompatible with the EC Treaty, one could still discuss whether the cash-flow disadvantage derived from the application of the withholding tax might lead us to claim whether such a national tax provision is proportionate.[27]

Although in the end, the issue raised in the *Portugal v. Commission* case is an issue of taxing rights and therefore an unavoidable consequence of the absence of harmonization, a balanced solution lies in giving the option to non-resident banks to be taxed on their net interest, following the criteria laid down in *Gerritse, Scorpio* and *Centro Equestre*. In this case, the taxpayer can also take into account whether the expenses are deducted in the residence state.

II. Other Infringement Procedures

The Commission has initiated a series of infringement procedures against Portugal regarding its discriminatory rules on direct taxation. The spectrum of issues covered is wide and deals with subjects such as tax amnesty rules, procedural rules, lottery winning and especially with different types of issues concerning withholding tax issues. Although several infringement procedures are currently pending, the European Commission has only brought Portugal to the ECJ recently in the case dealing with the discriminatory taxation of foreign banks (C-105/08), discussed above. Below we summarize the current pending infringement procedures on direct taxation. They seem quite simple to solve, taking into account existing case law, and therefore we only make reference to the Commission arguments and to the relevant case law when applicable, no further comments being added.

[23] ECJ 14 December 2006, C-170/05, *Denkavit Internationaal* [2006] ECR I-11949.
[24] ECJ 8 November 2007, C-379/05, *Amurta* [2007] ECR I-9569.
[25] ECJ 14 November 2006, C-513/04, *Kerckhaert & Morres* [2006] ECR I-10967.
[26] ECJ 14 December 2000, C-141/99, *AMID* [2000] ECR I-11619, para. 23; 8 March 2001, C-397/98, *Metallgesellschaft and Hoechst* [2001] ECR I-1727, para. 44; 12 December 2006, C-446/04, *FII Group Litigation,* para. 172; Opinion of the Advocate General Sharpston [2006] ECR I-11753; 14 February 2008, C-414/06, *Lidl Belgium* (not yet published), para. 29.
[27] In *Truck Center*, GA Kokott has clearly dismissed any interpretation that could draw from the *Lidl Belgium* decision an argument against the relevance of cash-flow disadvantages and a possible reversal of the ECJ regarding the issue (see point 48). The Advocate General even stated clearly that "a disadvantage in terms of liquidity may be perfectly relevant to appreciate the proportional character of a regulation of internal law" but it is dismissed as not having "significant occurrence" in the case *sub judice* (see point 49). The authors believe that on a factual basis, where the banking industry is concerned, a cash-flow disadvantage can be said to almost certainly be a "significant occurrence".

2.1 European Commission refers Portugal to court – IP/08/147 (31/01/2008): 2005 tax amnesty legislation, which provided regularization at a preferential penalty rate of 2.5% for investments in Portuguese government bonds (instead of 5% in any other assets)

The Commission announced it had decided to take Portugal to the ECJ regarding the discriminatory treatment of investments in other Member States in what concerned the special tax legislation for the "Tax amnesty for undeclared funds held abroad (RERT)". The said tax amnesty "*allowed the disclosure and regularization of undeclared funds held abroad by filing a confidential statement before 16 December 2005*". Nonetheless, the taxpayers were required to pay a penalty of 5% over the disclosed amount, but "*a reduced tax rate of 2.5 % applied to regularized Portuguese government bonds as well as to any amount of other investments re-invested in Portuguese government bonds at the occasion of the regularization procedure*".[28] The Commission considers that taxpayers were "*dissuaded from keeping their regularized assets in forms other than Portuguese government bonds*" and that "*such a difference in treatment constituted a restriction on the free movement of capital, guaranteed by Article 56 of the EC Treaty*". Although the Commission announced its decision in January 2008, in September 2008 the authors had no knowledge that such an action has been brought before the ECJ.

2.2 IP/08/1024 (26/06/2008): tax provisions according to which non-resident taxpayers have to appoint a fiscal representative if they obtain taxable income in Portugal

The Commission has notified Portugal of a Reasoned Opinion and a request for its tax legislation to be amended with regard to the obligation for non-resident taxpayers to appoint a fiscal representative in order to represent them before the Portuguese tax authorities and to guarantee the fulfilment of their fiscal duties. Although it concedes that those are "*recognised requirements of public interest*", the Commission considers that such an obligation "*goes beyond what is necessary to ensure these objectives and thus impedes the free movement of persons and the free movement of capital as laid down in Articles 18 and 56 of the EC Treaty and in the EEA-Agreement*". The Commission also referred to the ECJ's decision in the *N.* case as providing support for its Reasoned Opinion. The Commission announced in June 2008 that Portugal's failure to amend its tax legislation within a two-month period would lead it to take Portugal to court, but in September 2008 the authors had no knowledge that such an action has been brought before the ECJ.

[28] See IP/08/147 dated 31 January 2008.

2.3 European Commission requests Portugal to amend its discriminatory taxation of lottery winnings – IP/08/1355 (18/09/2008)

The Commission has notified Portugal of a formal request under the form of a Reasoned Opinion to amend its tax legislation "*that provide[s] for the taxation of foreign lottery winnings whereas winnings from lotteries (Euromilhões e Liga dos Milhões) organised in Portugal by Santa Casa da Misericórdia de Lisboa are exempt from income tax*".[29] The different treatment is considered discriminatory as the mentioned income tax exemption is not granted to "*other EU entities also carrying activities of social interest as Santa Casa da Misericórdia de Lisboa does*". The Commission equally announced on 18 September 2008, that failure to amend its tax legislation within a two-month period would lead it to take Portugal to court.

2.4 Withholding Tax Issues

2.4.1 IP/08/339 (28/02/2008): tax rules applicable to investments held in financial institutions established outside Portugal

The Commission has notified Portugal of a Reasoned Opinion and a request for its tax legislation to be amended concerning the possibility of Portuguese resident taxpayers electing to be taxed on capital income at the applicable individual income tax progressive rates instead of a general final 20% withholding tax, in which the tax withheld is creditable against the recipient's final tax liability. In the Commission's view, such an election only seems to be available where tax was withheld by a financial institution resident in Portugal and hence "*the fiscal treatment of the income obtained from financial investment within the Portuguese territory results in a lower tax burden than that imposed on income flowing from investment held outside Portugal*",[30] which would give rise to a restriction on the free movement of capital. The Commission announced in February 2008 that Portugal's failure to amend its tax legislation within a two-month period would lead it to take Portugal to court, but in September 2008 the authors had no knowledge that such an action has been brought before the ECJ.

2.4.2 IP/08/712 (26/05/2008): rules under which dividends paid to foreign pension funds are taxed more heavily than dividends paid to domestic pension funds

The Commission announced that it first asked for information regarding the taxation of foreign pension funds under formal enquiries in May 2007[31] following

[29] See IP/08/1355 dated 18 September 2008.
[30] See IP/08/339 dated 28 February 2008.
[31] See IP/07/616 dated 7 May 2007.

complaints received from the pension funds industry. The action was also justified by its interpretation of the *Denkavit* case[32] to the effect that "*higher taxation of outbound dividend and interest payments than of domestic dividend and interest payments is not in conformity with the Treaty freedoms*" and where pensions funds were concerned that higher taxation could "*result from the levying of withholding taxes on dividend and interest payments*". Later, the Commission decided to further pursue the existing infringement procedure by sending a Reasoned Opinion to Portugal. The Commission claimed that Portuguese tax law "*exempts the dividends received by domestic pension funds and levies a withholding tax of 25% on dividends paid to pension funds established elsewhere in the EU or in the EEA/EFTA countries*"[33] and that the resulting higher taxation results in a restriction of the free movement of capital and, where a controlling participation is concerned, the freedom of establishment protected by the EC Treaty.

2.4.3 IP/07/66 (22/01/2007): rules under which certain dividend payments to foreign companies (outbound dividends) may be taxed more heavily than dividend payments to domestic companies (domestic dividends)

The Commission first notified Portugal of a Reasoned Opinion and a request for its tax legislation to be amended with regard to the higher taxation of outbound dividends in comparison to domestic dividends in July 2006.[34] However, Portugal did not reply to this Reasoned Opinion and after the ECJ rendered its decision in the *Denkavit* case, the Commission announced it had decided to take Portugal to the ECJ (albeit conceding that the neutralizing effect of "*whether the State of residence of the parent company gives a tax credit for the withholding tax levied by the source State*" should be reflected in its applications to the Court).[35] Although the Commission announced its decision in January 2007, in September 2008 the authors had no knowledge that such an action has been brought before the ECJ. In 2007 Portugal amended it tax legislation, which significantly reduced the differences in tax treatment from domestic and outbound dividends. The possible higher taxation of dividends might currently be said to be limited to cases where an economic double taxation partial relief (50%) is granted to domestic parents from dividends received by distributing Portuguese subsidiaries dividends that does not seem available to EU parents of the same subsidiaries (albeit both domestic and outbound distribution are subject to the same withholding tax upon distribution).

[32] C-170/05, *Denkavit Internationaal.*
[33] See IP/08/712 dated 6 May 2008.
[34] See IP/06/1060 dated 25 July 2006.
[35] See IP/07/66 dated 26 January 2007.

2.4.4 European Commission refers Portugal to court – IP/08/153 (18/09/2008): discriminatory tax provision against non-Portuguese service providers

The Commission announced on 18 September 2008, that it would take Portugal to court regarding its discriminatory tax provisions against non-Portuguese service providers, since "*non-resident entities providing services in Portugal are subject to a withholding tax based on the gross amount of their income, whereas domestic providers are taxed only on their net profits*". Based on previous ECJ case law (*Gerritse, Scorpio, Centro Equestre*), the Commission considers that such a different treatment "*is likely to dissuade foreign services providers from providing services in Portugal, and might dissuade Portuguese clients from buying services from foreign providers, and therefore constitutes an infringement of Article 49 of the EC Treaty (freedom to provide services)*".[36]

[36] IP/08/1353 dated 18 September 2008.