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The EC Interest Savings Directive

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editor

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2.14. Portugal

Ana Paula Dourado
Ricardo Reigada Pereira

2.14.1. Introduction: historical background of some policy issues

The Savings Directive is the result of hard negotiations based on a proposal presented on 4 June 1998, and subsequently to the ECOFIN on 1 December 1997. In the accompanying Exposition of Motives, reference was made to its inclusion in a package of measures against harmful competition in tax matters in the European Union and to its aim at "reduc[ing] distortions subsisting in the internal market, avoid[ing] important losses of tax revenues and orient[ing] tax structures" in a more favourable direction to employment. It was "destined to assure a minimum of effective taxation of savings income (...)" of individuals (beneficial owners) through a coexistence model.

According to this model, the source state (the state of the paying agent) could choose between withholding tax on interest or communicating automatically the information on that interest and the beneficial owner to the residence state, without a reciprocity reservation.

Art. 8 of the proposal in its original version (1998) precluded any other withholding taxes on interest payments covered by the Directive. Such a prohibition was valid for all Member States (including those choosing the information regime), as was clarified by the commentaries to Art. 8 of the proposed Directive. In other words: ordinary withholding taxes under double taxation treaties (DTTs) could not be applied, although both the paying agent concept and the amount of withholding tax under the Directive did not coincide with the paying agent concept and amount of withholding tax under a DTT.

It was clear, since the beginning of the negotiations, that the concept of paying agent (*agente pagador*, *Zahlstelle*, *agent payeur*) in the Directive would (have to) be much broader than the concept of paying agent (*devedor dos juros*, *Schuldner*, *débiteur des intérêts*) in double taxation treaties ("the payer (debtor) is he who owes the interest under private law"¹)². There were two main reasons for this: on the one hand, for the purposes of the Directive, the source state had to play the main role, obtaining the relevant information on the amount of interest paid to a beneficial owner, and therefore allowing effective taxation of non-resident individuals. On the other hand, and accordingly, the paying agent in the Directive should be the entity, in the source state, occupying the best position in order to identify the recipient and characterize

1. As explained by Klaus Vogel/Moris Lehner, *DBA Doppelbesteuerungsabkommen Kommentar*, 4. Edition, München, 2003, § 103; See Ana Paula Dourado, *The EC Draft Directive on Interest from Savings from a perspective of International Tax Law*, EC Tax Review, 2000, No. 3, 151.
2. See Frans Vanistendael, General Report, section I.3.4.1.

him/her as an individual and a beneficial owner, leaving aside any other persons or entities receiving interest, as these fall outside the scope of the Directive.

As the commentaries to Art. 3 (b) of the original proposal stated, the definition of paying agent aims at guaranteeing identification of only one paying agent.

In fact, the paying agent "owes the responsibility for the payment for the immediate benefit of the beneficial owner" (see Art. 3 of the original proposal of 1998: "any economic operator who is responsible for the payment of interest for the immediate benefit of the beneficial owner").

The coexistence model was apparently designed to satisfy the different interests of Member States, by accepting tax competition among source states: source Member States with rigid bank secrecy regimes could keep them, opting for the withholding tax on interest, whereas source Member States exempting interest would inform the residence state about the identity of the taxpayers and the amount of interest obtained.

Treating the withholding tax option and the information system on an equal basis was, however, viewed by some Member States as a non-competitive solution for the European Community³. Moreover, if most Member States chose the withholding tax option, the coexistence system would be unbalanced for Member States choosing the information system. These would not benefit from a reciprocity reservation and the withholding tax would probably function as a final levy.

As negotiations based on this model failed, a choice was made in favour of the information system and taxation by the residence state, under an agreement reached in the European Council of Santa Maria da Feira on 19-20 June 2000 (under the Portuguese EU presidency), which was the basis for the Savings Directive as enacted and now in force.

Under the agreement, all Member States would exchange information with each one of the other states seven years after the date on which the Directive entered in force.

In Santa Maria da Feira, it was further agreed that the withholding tax on interest payments by the state of the paying agent could be exceptionally adopted for a transitional period by some Member States (Austria and Luxembourg, due to their strict regime of bank secrecy; and Belgium, Greece and Portugal should inform the Council on their position until the end of 2000).

As the withholding tax regime was a concession for a transitional period, and limited to the aforementioned Member States, it means that in case these states do not wish to withhold tax on interest payments, they have to adopt the information system. In fact, Annex IV of the Conclusions of the Santa Maria da Feira European Council provides that "any Member State operating a withholding tax shall agree to implement exchange of information, as soon as conditions permit, and in any case, no later than seven years after the entry into force of the Directive".

The new draft of the proposal, presented during the French presidency to the Council, contained a novelty worth mentioning: it permitted ordinary withholding taxes under DTTs, as was being claimed by Portugal, on the basis of a relevant risk of displacement of interest towards paying agents (in the sense of the Directive) situated in other Member States. As this is a residual rule, taking into account that only a few Member States withhold taxes on interest under DTTs, the question regard-

3. Ana Paula Dourado, *The EC Draft Directive on Interest from Savings...*, cit., e.g. 150, 151, 152.

ing elimination of double taxation was not dealt with and may now raise problems regarding the free movement of capital.

Let us add a final note to this introduction: at the ECOFIN Council, May 1999, it was stressed that there was a need for anti-abuse provisions preventing EU resident beneficial owners from avoiding application of the Directive, in particular by channelling interest payments through country resident recipients. The possibility of Art. 4 of the proposed Directive including an anti-abuse clause was discussed. It would oblige the paying agents to apply the Directive, if they had reasonable grounds for suspecting that the beneficial owner was an individual resident in a Member State. Such a clause was not included in the Directive, and in fact we doubt whether any anti-abuse clause could play its role within this Directive, as it would have to be applied by a paying agent. And demanding from a paying agent such a task, in addition to the identification obligations and their communication to the tax administration, would increase the paying agents' compliance costs, and could ultimately violate the principle of proportionality.

2.14.2. Overview: taxation of interest income

2.14.2.1. Taxation of interest income of individuals

2.14.2.1.a. Domestic source interest

In respect of interest income earned by resident and non-resident individuals within the Portuguese territory, a withholding tax on interest applies, in the case of both resident and non-resident individuals, at a rate of 20%. It is a final withholding tax both for residents and non-residents. Resident individuals may aggregate such income within their overall income, but are not obliged to do so. Such a rate may be reduced in accordance with the relevant DTT (from 10% to 15%).

Art. 104.1 of the Portuguese Constitution requires a unique and progressive personal income tax, and accordingly, Portuguese personal income tax takes into consideration global income and subjects it to progressive rates. However, until the deduction of personal allowances, it uses the technique of isolating categories of income. The law defines six different categories of income: income from dependent work, independent work and business income, capital income, real estate income, capital gains, income from pensions.

In the first place, this technique aims to determine the taxable items of income, but, as happens in other countries that adopt the same system, it may in practice be difficult to include the income in a specific category.

Furthermore, the different categories of income are integrated into a partially analytical system in order to determine net income. In fact, in contrast to a synthetic system, each income category is subject to specific deductions. Expenses are not transferable among categories. This solution was designed as an anti-abuse measure, but the analytical system is not absolute: losses obtained in some categories are deductible from the whole of the taxable net income, introducing an element of communication among categories, and a more equitable solution.

The constitutionality of this legal regime was subject to the examination of the *Tribunal Constitucional* – the Portuguese Constitutional Court – which did not hold the legal regime incompatible with the Portuguese Constitution⁴. However, the

4. See *Ac. Tribunal Constitucional* No. 57/95 of 16 February.

Court avoided any reference to the final levy on capital income accruing to resident individuals.

Interest earned "within the Portuguese territory" refers, as a rule, to cases where "paying agents", in the aforementioned sense of double taxation treaties, are located in Portugal⁵. I.e. "the payer (debtor) is he who owes the interest under private law"⁶; he is the "devedor dos juros", "Schuldner" or "débiteur des intérêts". But in the case of income arising from securities paid by non-resident entities without a permanent establishment located within the Portuguese territory, a final levy of 20% on the income is withheld by a paying agent in the sense of the Directive (the agent that pays or secures the income, appointed by the beneficial owner, the debtor or an investment fund)⁷.

Until 1999 the domestic concept of paying agent was broader and also included: (a) capital income *paid or secured* by resident entities or non-resident entities with a permanent establishment within the Portuguese territory for the benefit of a resident (in a sense similar to the one given to the paying agent in the Savings Directive); and (b) capital income placed within the Portuguese territory due to the conclusion of juridical acts within this territory (the Savings Directive also seems to include this meaning of paying agent), or guaranteed by property situated within this territory⁸.

Non-residents were historically granted some relevant exemptions. In 1988 a special exemption tax regime was approved regarding Portuguese public debt. Under the 1988 regime, non-resident entities were exempt from Portuguese Corporate Income Tax or Portuguese Personal Income Tax, as applicable, on income received from Portuguese Treasury Bonds. A new regime entered into force on 1 January 2006, which replaced the 1988 regime.

It extends the exemption to private debt securities⁹ and provides for a more efficient system to certify the non-residence of the beneficiaries¹⁰, as well as for a special reimbursement mechanism¹¹ when the withholding tax exemption cannot apply upfront.

2.14.2.1.b. Foreign-source interest

Portuguese resident individuals to whom interest is paid by non-resident entities are taxed at the progressive personal income tax rates that vary from 10.5% to 42%. The interest received is aggregated in the overall income of the individual.

5. See Art. 18, 1g) Personal Income Tax Code (PITC).
6. As explained by Vogel/Lehner, 2003, § 103; See Ana Paula Dourado, *The EC Draft Directive on Interest from Savings...*, cit., 151.
7. See Art. 101, 2 b) PITC.
8. (Art. 17 1 e), Decree-Law 206/90, June 26). See Alberto Xavier, *Direito Tributário Internacional*, Coimbra, 1993, 257.
9. The beneficiaries will be exempt from Portuguese corporate tax and personal income tax on interest and capital gains derived from Portuguese treasury bonds or from private debt securities. The beneficiaries are required to register their securities in an exempt account with a so-called "Direct Registering Entity", which will pay the coupon on a gross basis, without assessing any Portuguese tax.
10. They must be non-resident individuals or entities, with no permanent establishment in Portugal, and they may not be deemed residents in a low-tax jurisdiction, as defined by the Portuguese law.
11. The special reimbursement mechanism has to be requested and filed within the 90 days following the withholding tax assessment. If not filed before that deadline, the reimbursement will have to be requested through the normal mechanisms which will take longer to process.

However, should any of the income obtained by a resident individual be subject to taxation in the state of source, Portugal grants a tax credit which corresponds to the lower of the following amounts: (a) tax paid abroad; or (b) the portion of Portuguese tax, assessed prior to the deduction of the tax credit, corresponding to income obtained abroad, net of the specific deductions foreseen for Portuguese resident individuals, as well as costs or losses directly or indirectly incurred to obtain the income regarding corporate entities.

In case a DTT is applicable, the tax credit amount may not exceed the tax that would be due abroad under the terms of the relevant DTT.

2.14.2.2. Tax treaties

The concept of interest set out in most Portuguese DTTs employs both an "autonomous" and "dependent" concept, i.e. relying not only on the DTT definition, but also on the concept used in the domestic tax law of the states concerned. This occurs because the majority of Portuguese double taxation treaties were drafted following the OECD Model Convention of 1963 and therefore use the wording "(...) as well as all other income assimilated to income from money lent by the taxation law of the State in which the income arises".

Thus, the concept is greatly enlarged since it also covers the concept used in the domestic law of the state of source, implying simultaneously the existence of different and mobile concepts that will accordingly vary following each country's domestic legal changes. By reason of this, great uncertainty was created for economic operators who, therefore, cannot rely only on the double taxation treaties applicable in the relevant case, but will also need an expert's opinion on a regular basis concerning Portuguese domestic tax law.

Some DTTs avoided the difficulties arising from the described regime. For instance, the DTT with Belgium has adopted a negative approach in order to limit the broad formula, outlining a number of cases where the characterization under domestic law as "interest" cannot prevail. Another significant example can be provided by the DTTs entered with Austria, Finland, Switzerland and Norway. In these conventions "interest" also encompasses compensation amounts received against the suspension or reduction of a commercial or industrial activity.

Later treaties have tended to adopt an autonomous concept of interest, closer to the OECD Model of 1977¹².

Another peculiarity in the Portuguese double taxation treaties relates to interest penalty charges for late payment. The second sentence of paragraph 3 of the OECD Model excludes from the definition of interest penalty charges for late payments. However, Portugal usually opts to omit this sentence and treats penalty charges as interest in bilateral conventions. Characterization of penalty charges is a controversial issue in the EU Member States. According to the EU Joint Transfer Pricing Forum (DOC: JTPF/017/2005/EN, 8.), "some commentators consider commercial interest for late payment of tax as penalties where such interest is non-deductible" but "tax administrations (...) generally take the view that interest for late payment of tax at a commercial, i.e. market, interest rate does not constitute a penalty. Such interest can be considered as compensation for the 'interest-free loan' that the taxpayer has enjoyed due to his underpayment of tax".

12. This being the case, for instance, with double taxation treaties with Bulgaria, China, Cuba, the Czech Republic, Denmark, Hungary, Iceland, India, Latvia, Lithuania, Malta, Morocco, the Netherlands, Poland, Romania, Singapore, Tunisia, Ukraine.

Thus, the tax regime within the European Union may change in the near future, at least in connection to transfer pricing issues, as the EU Joint Transfer Pricing Forum recommends that penalties related to transfer pricing adjustments be distinguished from interest for late payment of tax.

2.14.3. Implementation issues

2.14.3.1. Full or partial implementation

Portugal fully implemented the Savings Directive. The Decree-Law (No. 62/2005) implementing the Savings Directive was published on 1 March 2005, even though all Member States should have adopted and published the relevant laws, regulations and administrative provisions prior to 1 January 2004, as stated in the Directive. Portugal, like other Member States, waited until the Commission negotiated all the relevant issues of the Savings Directive with third states and associated and dependent territories.

2.14.3.2. New or identical concepts

The relevant regulations and administrative provisions were issued a few days before the Savings Directive entered into force (and, subsequently, Law No. 39-A/2005 of 29 July amended the Decree-Law¹³).

A rather simple way of dealing with the basic concepts foreseen in the Directive was adopted. In other words, the Decree-Law reproduces the Directive's definitions for all basic concepts. However, it must be highlighted that there was an attempt to clarify the meaning of paying agent and the concept of interest is more determinate than in the Directive.

2.14.3.3. Beneficial owner

Despite the introduction of the concept of beneficial owner in the OECD Model in 1977 and its presence in many double taxation treaties to prevent treaty shopping and justify domestic taxation limitation at source, the concept ("beneficiário efectivo") is still quite vague (a standard concept, *unbestimmtes Rechtsbegriff*) within the Portuguese legal system.

In fact, in Portugal, as in most civil law countries¹⁴, the concept has not yet been accorded a stable meaning by either the tax authorities or the courts. This is a consequence of the concept not being a term of art under Portuguese law.

In any case, it is clear that a substantive approach underlies the concept. In fact, it is generally accepted that beneficial ownership goes beyond the meaning of "legal ownership", i.e. it means "economic ownership", since this concept better reflects the underlying economic reality in which the risks and rewards of owner-

ship lie. This common understanding is therefore coincident with the international meaning of the expression within the OECD context.

Besides the implementation of the European directives – the Savings Directive and the Interest and Royalties Directive – in domestic law, the legal concept of beneficial ownership was introduced in 2005 in domestic tax law, by a Decree-Law No. 193/05¹⁵ on Portuguese withholding tax provisions for public and private debt instruments issued by Portuguese resident entities. According to Art. 2 a) of the Decree-Law, beneficial owner is any entity obtaining income derived from debt instruments on its own behalf and not in the capacity of an agent or nominee.

For the purposes of the Decree-Law implementing the Savings Directive, beneficial owner is defined as any individual who receives an interest payment or any individual for whom an interest payment is attributable¹⁶, regardless of whether the interest payment constitutes business income or private investment income of the individual. This individual is deemed to be beneficial owner unless he provides evidence that he has not received or secured such interest for his own benefit, that is to say, if:

- he acts as a paying agent within the meaning of the Decree-Law's definition;
- he acts on behalf of a legal person or entity which is taxed on its profits under the general arrangements for business taxation in any EU Member State (including Portugal)¹⁷, an undertaking for collective investments in transferable securities (UCITS) authorized in accordance with Directive 85/611/EEC or its management entity when acting on behalf of such a UCITS;
- he acts on behalf of an entity specified in Arts. 3 or 9 of the Decree-Law¹⁸ and discloses the name and address of this entity to the economic operator making the interest payment and the latter communicates aforementioned information to the tax administration authorities (*Direcção-Geral dos Impostos*) as the competent authority¹⁹; or
- he acts on behalf of another individual who is the beneficial owner and discloses the identity and the residence of that beneficial owner to the paying agent.

The Interest and Royalties Directive implementation also resulted in a new legal definition of beneficial ownership that, in this case, was included in the Portuguese Corporate Income Tax Code. Pursuant to this Code, and for purposes of payments of interest and royalties made between associated companies of different Member States, a company will be treated as the beneficial owner of interest or royalties only if it receives those payments for its own benefit and not as an intermediary, such as an agent, trustee or authorized signatory, for some other person. A permanent establishment will be treated as the beneficial owner of interest and royalties if: (i) the debt claim, right or use of information in respect of which interest or royalty payments arise is effectively connected with that permanent establishment; and (ii) the interest or royalty payments represent income for which that permanent establishment is subject to taxation in the Member State in which it is situated.

15. Decree-Law No. 193/2005 of 7 November 2005 that will only enter into force on 1 January 2006.

16. Since the exact meaning of the term "secured" is still being discussed it is advisable to use a more verbatim translation.

17. An individual acting as paying agent or on behalf of somebody else may be proved by copies from commercial registers, articles of association, certificates of authority or other contractual proofs of authorizations or assignments.

18. Articles that correspond to Art. 4(2) of the Directive.

19. A specific form was drawn up for this purpose: *Modelo 36* (Income from savings in the form of interest paid or attributed to individuals that are not deemed beneficial owners). This form must be electronically submitted.

13. Only two relevant amendments were introduced. The first pertains to the relevant dependent or associated territories to which the Decree-Law is applicable and the other consists of a waiver of any secrecy duty to which the paying agents might be bound.

14. See, among others, Klaus Vogel/Moris Lehner, *DBA*, cit., Vor Art. 10-12, 14 ff., pp. 894 ff.; J. Killius, *The Concept of 'Beneficial Ownership' of Items of Income under German Tax Treaties*, Intertax, 1989, 340; and Zenon Folwarczny, *Taxation of Savings Income in the Form of Interest Payments under the EU Savings Directive, in Source Versus Residence in International Tax Law*, Linde Verlag, Wien, 2005, 458.

Regarding the application of the concept of beneficial ownership to trusts, only the Madeira Free Zone legal framework sets out a possibility of creating Madeira offshore trusts constituted pursuant to foreign law.

As a condition, the trustee must be a legal person authorized to operate in the International Business Centre of Madeira. The offshore trust itself is not an entity, as the trust assets constitute an autonomous part of the patrimony of the trustee.

The payment of interest by an economic operator to a trust may imply that the trustee declares it is acting on the basis of Art. 2.1., c), of the Directive (on behalf of an individual). In this case, the economic operator is a paying agent and must fulfil its obligations. If the trustee is the economic operator, it will be characterized as a paying agent (Art. 2.1., a), of the Directive).

Otherwise, the Portuguese legislation does not recognize the constitution of trusts.

Foundations are tax exempt under domestic law if they are deemed to be public utility foundations. Thus, the tax exemption framework will always depend on the specific purpose of the relevant foundation.

All other foundations are taxed under the Corporate Income Tax Code, but their taxable base is assessed following other methods, close to the provisions of the Personal Income Tax Code. Besides, gratuitous subsidies and gratuitous accrued income such as capital gains used for the immediate and direct purposes of the foundation are not included in the taxable base. "Accrued income" for these purposes does not include "interest" as defined in the Directive.

We may therefore conclude that in relation to both trusts and tax-exempted foundations, when they act as recipients of interest payments, it may be difficult to determine who the beneficial owners are. And although the definition of beneficial ownership is intended to work as an anti-abuse provision in the Directive, it may not always achieve its aim.

2.14.3.4. Paying agent

As a rule, in the domestic system as well as in DTTs concluded by Portugal, the relevant "paying agent" is the entity who is legally bound to pay the interest (the "debtor", "he who owes the interest"). As mentioned in the introduction above, in Portuguese this entity is called the "*agente devedor*", whereas the paying agent referred to in the Directive is the "*agente pagador*", i.e. an entity that may not coincide with the entity owing the interest; the "paying agent" in the Directive is bound to pay the interest, eventually following an arrangement with the debtor or the beneficial owner.

As also written above, it is clear that the meaning of paying agent in the Directive is extended well beyond its normal meaning under international law²⁰.

20. As mentioned in the introduction above, in the context of a directive designed solely to be applicable to individuals and within a space in which the incapacity of the residence state to tax the income derived outside its territory is widely recognized, adopting a broader meaning for the traditional concept of paying agent was a must. If, as a general rule, paying agent in the OECD Model means the entity that is legally bound to pay the interest, the definition of paying agent in the Directive is different, with a much less effective tie to the income. In the Decree-Law's definition a paying agent will be "any economic operator (no legal definition was provided for such term; however, it is expected that such term shall mean any entity acting in the course of a business or professional activity) resident or established within the Portuguese territory that, in the course of its business activity, pays interest to or attributes the payment of interest arising from savings for the immediate benefit of the beneficial owner, whether the operator is the debtor of the debt claim which produces the interest or the operator charged by the debtor or the beneficial owner with paying interest or securing the payment of interest". (The second prong of the definition was added in the Direc-

As is known, under the Directive, the paying agent can be the debtor (or issuer), a collecting agent appointed by the individual, a paying agent appointed by the debtor or an investment fund, provided it is the last paying agent in a chain of intermediaries making the payment to the individual²¹. Thus, only if there are no intermediaries is the debtor deemed the paying agent.

Finally, the domestic Personal Income Tax Code uses the concept of paying agent in a similar way as the Directive does, whenever income arising from securities is paid by non-resident entities without any permanent establishment located within the Portuguese territory. In this case, there is a need to assess whether such income is being made available by a "paying agent" (the last paying agent in a chain of intermediaries making the payment to the individual) in Portugal. The paying agent then becomes a relevant element, as it justifies domestic taxation (a withholding tax rate of 20% will be charged).

2.14.3.5. Interest

The Directive's - as well as the Decree-Law's (implementing the Directive) - concept of interest is narrower than the concept of interest in domestic income tax law. In domestic law, interest income is included in the capital income category for personal income tax purposes. There is no legal definition of interest within the Personal Income Tax Code, but according to the Tax Supreme Court (2.^a *Secção do Supremo Tribunal Administrativo*), any fixed remuneration of capital investment is to be characterized as interest (see e.g. case No. 026764, 10/04/2002).

Some types of income - income arising from derivatives²² and insurance contracts - despite their domestic characterization as capital income, when they are not taxed as capital gains, will consequently fall outside the Decree-Law's scope²³.

The Decree-Law implementing the Directive enumerates the following income arising from savings as interest falling within its scope:

- (a) interest arising from facility agreements, open from a credit or repurchase agreement and any other that, against payment, temporarily provide a cash availability;
- (b) interest arising from any kind of deposit in financial institutions;
- (c) interest arising from deposit certificates²⁴;

tive, according to the July 2001 Commentary, to make it clear that an economic operator who is a "collecting agent", i.e. the beneficial owner's agent who collects the interest on behalf of the beneficial owner, may be a paying agent for the purposes of the Directive.) (As noted above, the phrase "pays (...) to, or secures for the immediate benefit of the beneficial owner" suggests that only direct payments by the paying agent to the beneficial owner fall within the scope of the Directive.)

- 21. The July 2001 Commentary makes it plain that "paying agent" means the last intermediary who pays interest directly to or secures the payment of interest for the immediate benefit of the beneficial owner, regardless of whether that person is acting on behalf of the debtor or the recipient.
- 22. The Directive does not mention them. Also in the OECD, while the characterization of such income was broadly discussed for purposes of Art. II (3) of the OECD Model, it was expressly excluded from the concept of interest in the OECD Commentaries of 1995.
- 23. Also addressing these issues, Manuela Duro Teixeira, *A Transposição da "Directiva da Poupança" por Portugal - Algumas Questões*, Ciência e Técnica Fiscal, 2005, No. 415, 157.
- 24. Portuguese law clarifies this point, something that is not completely clear in Art. 6 (1) (a) of the Directive.

- (d) interest, repayment premiums, reimbursements of public debt²⁵ and income from bonds or debentures, including premiums and prizes attaching to such securities, bonds or debentures as well as any other financial or credit instruments²⁶;
- (e) the result of interest accrued on a current account;
- (f) interest accrued on shareholders' loans, allowances, or share capital advance contributions from shareholders to their companies;
- (g) interest due following circumstances in which shareholders do not exercise their rights to profit distribution or other remuneration to which they are entitled;
- (h) interest paid or attributed by the following entities:
 - a UCITS authorized in accordance with Directive 85/611/EEC;
 - residual entities whenever they receive interest arising from savings for the benefit of beneficial owners;
 - undertakings for collective investment established outside the territory in which the EC Treaty is applicable;
- (i) income realized upon the sale, refund or redemption of shares or units in the undertakings and entities mentioned above in paragraph (h), if they invest directly or indirectly, via other undertakings for collective investment or entities, more than 40% of their assets in debt claims referred to in paragraphs (a) to (e)²⁷.

Despite paragraph (h), any income deriving from those undertakings or entities is excluded from the Decree-Law's provisions if the investment in debt claims of such entities referred to in paragraphs (a) to (e) does not exceed 15% of their assets.

There are two main differences between the Personal Income Tax Code and the Decree-Law implementing the Directive:

- While in the Personal Income Tax Code the expression "other forms of remuneration" aims at including any income arising from capital investment (unless it is capital gain), the concept of interest in the Directive and the implementing Decree-Law is restricted to the enumerated cases. In fact, the concept of interest in the Directive (and the implementing Decree-Law) expresses the feasible political agreement in the Council of Ministers in the European Union.

This restrictive concept of interest will have an impact in those situations that in accordance to the Personal Income Tax Code may lead to their characterization as interest but that pursuant to the Decree-Law will not be deemed as such. An example may be provided regarding the *yens* case that occurred in Portugal some years ago²⁸. In this situation, the income that was supposed to arise from the deposit was originally defined between the financial institution and the

25. It has been noted that while the English version of the Directive mentions "income from government securities", the Portuguese version has "income from public debt". Since the EC directives are able to create new taxable events, unlike double taxation treaties, it has been discussed whether this different wording is not exceeding the solution stated in the English version of the Directive. See Ana Paula Dourado, *The EC Draft Directive on Interest from Savings...*, cit., 147.

26. Penalty charges for late payments may not be regarded as interest payments, a solution that is in accordance with Art.II (3) of the OECD Model. The Commentaries to the OECD Model suggest, however, that such a provision may not be included in the relevant conventions, thus allowing the taxation of such penalty charges. This solution is, in fact, used by Portugal in its double taxation treaties.

27. The threshold is reduced to 25% from 1 January 2011.

28. Manuel Faustino highlighted this example as one of the situations to which the Portuguese legislator should have been more precise. See Manuel Faustino, *A Directiva da Poupança no Âmbito da UE - Alguns Aspectos*, Fiscalidade, 2005, No. 22, 30-31.

individual. The definition clearly tried to avoid the characterization of the related income as interest, referring to a "fictitious currency gain", corresponding, in a substantive approach, to interest paid on a deposit.

- The second difference relates to the domestic tax regime of income arising from investment funds. Under domestic law, investment funds themselves are taxpayers, subject to the Personal Income Tax Code. As interest and dividends are both taxed as capital income, marketable security funds' income is either taxed as capital income or capital gains.

2.14.3.6. Transfer of information to the national tax authority

New domestic rules have been developed and implemented, in order to organize the transfer of information by the paying agent to the competent authority.

The minimum amount of information to be reported by the paying agent to the competent authority of its Member State of establishment consists of: (i) the identity and residence of the beneficial owner; (ii) the name and address of the paying agent; (iii) the account number of the beneficial owner or, where there is none, identification of the debt claim giving rise to the interest; (iv) information on the interest payment. The amount of information on interest payments to be reported by the paying agent is restricted to the total amount of interest or income and to the total amount of the proceeds from sale, redemption or refund.

The information must be reported by the end of February of the year following that in which the payments or income attributions are made²⁹. A specific form has been drawn up for this mandatory communication: *Modelo 35 - Income from savings in the form of interest paid or attributed to non-residents*. This form must be electronically submitted.

The documents that provide evidence of the facts stated in the information to be reported must be kept for a period of ten years, counting from the moment of payment or income attribution, and be presented within that period whenever the tax authorities so demand.

2.14.3.7. Transfer of information between Member States

Until now the national legislator has been silent on the transfer from the national competent authority to the competent authorities of the other Member States.

Portugal is waiting for the standard electronic transfer procedures which are being prepared for this purpose at the EU level. The procedures envisaged will be based on the OECD arrangements on exchange of information.

2.14.3.8. Transfer of information between paying agents

Regarding the exchange of information from one paying agent to another paying agent within the Portuguese tax jurisdiction, no legal guidance on the matter has been given until now. It is up to the paying agents to arrange forms of proceeding with the relevant communications and, therefore, to comply with the applicable law.

29. Art. 3 of Portaria No. 563-A/2005.

2.14.3.9. Evidence of residence

For contractual relations entered into before 1 January 2004, the paying agent must establish the residence of the beneficial owner, consisting of his address, by using the information at its disposal³⁰, in particular pursuant to the regulations in force in its state of establishment and to Council Directive 91/308/EEC of 10 June 1991 on preventing the use of the financial system for the purpose of money laundering. These obligations are stipulated in Law No. 11/2004 of 27 March³¹ and are available and used in Portugal, corresponding to the "know your customer rules". The Decree-Law implementing the Directive does not impose further obligations on financial institutions.

For contractual relations entered into, or transactions carried out in the absence of contractual relations, on or after 1 January 2004, the documents mentioned in the Directive are available and correspond to the ones normally used in Portugal to determine residence: passport, official identity card or any documentary proof of identity presented by the beneficial owner. For individuals presenting a passport or official identity card issued by a Member State who declare themselves to be resident in a third country, the tax residence certificate issued by the competent authority of the third country in which the individual claims to be resident has been accepted as a valid form of evidence to establish the tax residence.

The aforementioned documents are sufficient to determine the residence of a taxpayer in most situations.

2.14.3.10. Credit for special withholding tax

Portuguese resident individuals who have been subject to the withholding tax in Belgium, Luxembourg and Austria can claim a tax credit in Portugal equal to the amount of tax withheld.

The Portuguese Personal Income Tax Code was specifically amended for this purpose (Art. 78 PITC). The tax withheld functions as an "advance payment tax" from the perspective of Portugal as residence state, as there is no limitation on the deduction of the withheld amount, which may imply a reimbursement.

This regime may also trigger some quite peculiar problems, in case the tax authorities challenge the individual's tax returns (following the assumption that the individual effectively reports the income generated abroad). It may be difficult for the beneficial owner to prove that a tax was withheld at source, as the paying agent and the source state will not, as a rule, identify the taxpayer. The beneficial owner may then use Art. 13 of the Directive and avoid the retention, as long as he declares the interest amounts in the residence state and the source state discloses the information regarding the taxpayer³².

30. See Manuela Duro Teixeira, *A Transposição da "Directiva da Poupança...*, cit., 159.

31. See OJ L 166, 28. 6. 1991, p. 77. Directive last amended by Directive 2001/97/EC of the European Parliament and of the Council (OJ L 344, 28. 12. 2001, p. 76).

32. Highlighting this particular aspect, Manuel Faustino, *A Directiva da Poupança...*, cit., 24-25. The best way of avoiding these problems seems to be the mechanism foreseen in Art.13 of the Directive.

2.14.4. Unresolved legal issues

2.14.4.1. Conflict of residence between Directive and international tax law

The taxpayer who has been identified as an EU resident under the Directive (on the basis of his passport, identity card or a similar document), must prove he is a resident in a third state according to the Directive's rules: he must present to the paying agent a certificate of tax residence issued by the third state. Still according to the concept of residence under the Directive (Art. 3.3), the certificate should only be accepted by the paying agent if the taxpayer has a permanent home available to him solely in the third state. However, the paying agent is not in a position to confirm that situation. If the paying agent were aware that the taxpayer had a permanent home available to him both in a Member State and in a third state, the ideal procedure would be to ask the tax authority of the Member State where the taxpayer is deemed to be a resident according to the Directive, to issue a certificate declaring that the taxpayer is not a resident in that Member State under the tie-breaker rules of the tax treaty.

The evidence should neither be directly required nor accepted from the taxpayer.

However, as, according to the Directive, a certificate of residence issued by a third state is the only formal evidence required, it is not likely that the paying agent will check in which state the permanent home is available.

Thus, it is not likely that the taxpayer will need to prove he is not an EU resident according to the tiebreaker rules of the tax treaty.

2.14.4.2. Information received for a taxpayer resident of another Member State

If a taxpayer turns out to be a resident of another Member State than the Member State indicated by the paying agent, one of two scenarios may occur: either (i) the Member State indicated by the paying agent does not know to whom such information should be delivered, i.e. it ignores who the residence state is, or (ii) the Member State indicated by the paying agent does in fact know to whom such information should be delivered.

In the first scenario, the exchanged information must be returned to the source state (the state of the paying agent) where the situation has to be clarified following the relevant data made available to the paying agent.

In the second scenario, the solution also generally lies in the return of the information to the Member State of the paying agent. However, if the situation outlined only occurred as a consequence of a simple error – e.g. a clerical error, post destination error, etc. – then the Member State may, indeed, forward such information to the effective residence state (such a situation should also be communicated for security reasons to the competent authority of the Member State of the paying agent).

2.14.4.3. Burden of proof of residence of the beneficial owner

The structure of the Directive itself demands that the burden of proof for the residence of the beneficial owner lies entirely on the paying agent (while under treaty law the burden of proving residence in order to reduce source taxation generally lies on the taxpayer).

Bearing in mind that the Directive's aim was to tackle tax evasion by individuals on cross-border payments of interest that otherwise would not usually be taken into account in their annual tax returns (according to European Council Conclusions

of Helsinki, 10 and 11 December 1999: "All citizens resident in a Member State of the European Union should pay all the tax due on all their savings income."), the Directive had to be based mainly on the role of the paying agent.

Although the paying agents' operating costs involved in such a system are said to be significant, the taxpayer is also called on to play a role. Following what was said above in 2.14.1., the burden of proof that the individual is not effectively resident in an EU Member State rests with that individual.

If the paying agent has evidence that the non-resident taxpayer will not cooperate, the Directive does not prevent the residence state from applying domestic law sanctions for the lack of cooperation.

Thus, each Member State is free to implement such sanctions should it find the implementation useful for inducing the resident beneficial owners to cooperate with the Directive's rules.

2.14.4.4. Competent authority for Money Laundering Directive

Rules regarding the identification of the beneficial owner are based on the Money Laundering Directive, for contractual relations entered into before 1 January 2004. The information demanded by the Directive corresponds to the "know your customer rules", already needed for complying with Council Directive 91/308/EEC of 10 June 1991 on the prevention of the use of the financial system for the purpose of money laundering.

Taking this into account, no confusion seems to arise from the coexistence of the two directives. Moreover, it is absolutely clear that each of the directives pursues a different purpose.

If indicators of money laundering are established, the Member States involved must exchange information as provided for in EEC/77/799 Directive as amended by EC/2003/93 Directive (cf. Arts. 26 and 27 OECD Model for OECD Member countries). Tax authorities in the European Community and in OECD Member countries share information with criminal law enforcement authorities and these may provide international assistance in criminal investigations (see e.g. the Portuguese Act on the international assistance in criminal matters, 99/144, 31 August).

Thus, the reference to the Money Laundering Directive is only aimed at avoiding that the paying agent has additional tax compliance costs.

2.14.4.5. Sufficiency of information

Regarding the information to be provided by the paying agent according to Art. 8 of the Directive (identity, residence, name and address of paying agent, amount of interest paid and account number or identification of debt claim), some difficulties may arise. For example, it may be troublesome for the Portuguese tax administration to make an assessment on the basis of the passport or the official identity card, but in domestic regulations and procedures steps are being taken to overcome these difficulties. Besides, it is expected that a relevant amount of information received will include the tax identification number.

Moreover, regarding the "reasonable steps" expression used in the Directive – for establishing the identity of the beneficial owner, in circumstances where a paying agent has information suggesting that the individual who receives an interest payment or to whom an interest payment is attributable may not be the beneficial owner – the Portuguese Decree-Law that implemented the Directive only indicates that the paying agent must then try to obtain the relevant information on that

individual, in accordance with the rules laid down for the purposes of identifying the beneficial owner. If the paying agent is unable to identify the beneficial owner, it must treat the individual in question as the beneficial owner. In these situations problems may arise.

2.14.4.6. Cross-border transfer of information directly to the tax authority

The Directive organizes the exchange of information in two stages: (a) information transferred from the paying agent to the national competent authority; and (b) information transferred from one competent national authority to another. At the present legal and administrative stage of the EU harmonization and integration, it would be very difficult to implement a system according to which the information would be directly transferred from the paying agent to the competent national authority of the state of residence.

First of all, the compliance costs of such a system would be even more significant for all paying agents located within the Directive's territorial scope. Secondly, it would be necessary to create ways of checking that the relevant data was indeed being transferred, as well as the accuracy of the information exchanged. Since the state of residence cannot, as a rule, extend its administrative tax competence to extraterritorial jurisdictions, it would need the assistance of the paying agent state (on the basis of EC Directive 77/799, as amended) in order to verify whether paying agents were fulfilling their obligations.

A direct transfer of information from the paying agent to the competent authority of the state of residence would at least require the existence of (i) a single European form, (ii) a single database and (iii) a European supervisory board.

2.14.4.7. Cross-border transfer of information directly to the taxpayer

On the contrary, nothing in the Directive forbids a direct transfer of information by the paying agent to the taxpayer concerned, if the adopted exchange of information is made in tandem with the transfer. Nevertheless, since the law does not demand the adoption of this direct communication, it is unlikely that such procedures will be used in practice.

As an example of such direct transfers, there are several situations which oblige Portuguese paying agents to send a letter to their clients at the beginning of the year stating all the income they received in the previous calendar year. Some of these statements are sent simultaneously to the tax authorities.

2.14.4.8. Non-compliance of the Directive's obligations by a Member State

Another issue has to do with the consequences that would arise if a Member State implemented the Directive, but in fact did not deliver any useful information. In this case, Art. 10 EC Treaty applies: Member States are obliged to fulfil their EC law obligations. Otherwise the Commission or any Member State may refer to the European Court of Justice, requiring the Member State to fulfil its obligations under the Savings Directive.

2.14.4.9. Interest from hybrid financial instruments

For the definition of interest payment, Art. 6 of the Directive characterizes many hybrid financial instruments as the source of interest.

Regarding the drafting of paragraphs (c) and (d) of the Directive, some criticisms may be made. For example, the percentages defined for the application of the Directive's provisions will possibly cause a change in the investment policy of a UCITS.

Besides, given the total amount of the income of an interest payment, when the paying agent has no further information on the proportion of the income corresponding to interest payments, it will often mean characterizing capital gains or dividends as interest.

Moreover, limiting the scope of the Directive to harmonized funds following Directive 85/611/EEC, discriminates against these harmonized UCITSs, and is an invitation to transform such collective investments into investments not falling within the scope of the Directive³³.

2.14.4.10. Goal of the Directive: taxation or exchange of information

Finally, let us add that definition of interest is only aimed at harmonizing the information paying agents and competent authorities are obliged to gather and transmit to the state of residence of the beneficial owner.

The Member State of residence of the beneficial owner applies its tax regime to the information obtained and is not obliged to tax the interest. Eventually, in the case of tax exemptions, a problem of harmful tax regime may arise, and the European Commission may then take the adequate steps.

33. For an exhaustive list of some particular aspects of the Directive's criteria see Ana Paula Dourado, *The EC Draft Directive on Interest from Savings...*, cit., p. 148. Manuel Faustino also addresses these issues; see *A Directiva da Poupança...*, cit., pp. 14-15 and 31-32, with a special concern about some situations that should, in his opinion, fall within the meaning of interest for purposes of the Directive. It has been noted that some Luxembourg structures have been used – in particular the SICAVs – for the issue of bonds that will not fall within the meaning of the Directive.

2.15. Spain

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2.15.1. Overview: taxation of interest income¹

Since January 1, 2007, Spain has a dual taxation system². Interest income obtained by resident individuals is taxed, as "income from savings" at a rate of 19 percent for the first 6.000 euros and 21 percent onwards (as of October 2014, the percentage may vary depending on the region of residence within Spain), together with other types of capital income and capital gains. Labour income, income from business activities, certain types of capital income (mainly from a ius in re on real estate) and other sources of income are taxed at progressive rates (the top rate being 52 percent as of October 2014; the percentage may vary depending on the region of residence in Spain).

The concept of interest income in the PIT will be discussed below, since Spanish regulations transposing the Directive 2003/48/EC refer to the internal concept of interest income.

As for non-residents, it is interesting to note that most income subject to information requirements under the Savings Directive is exempt in Spain. In general, residents in other EU countries without a permanent establishment that obtain interest income in Spain are exempt from taxation³. Non-residents, whether resident in other EU Member States or not, are exempt in relation to interests from public debt. Income derived from securities issued in Spain by non-residents without a permanent establishment and income derived from non-residents' accounts paid by the Bank of Spain or other entities registered for purposes of the legislation on foreign transactions, except when paid to a permanent establishment located in Spain, are also exempt. Finally, income derived from the sale of an interest in an investment fund traded on an official exchange is also exempt provided that the non-resident does not have a permanent establishment in Spain and is resident in a state that has a

1. List of abbreviations frequently used in this contribution : BOE, Spanish Official Journal (Boletín Oficial del Estado); LGT, Spanish General law of Taxation (Ley General Tributaria); RD, Royal Decree; PIT, Personal Income Tax; TRLIRNR, Consolidated Text of the Non-residents Income Tax Law (Texto Refundido de la Ley del Impuesto sobre la Renta de No-Residentes); LIRPF, Personal Income Tax Law (Ley 35/2006, del Impuesto sobre la Renta de las Personas Físicas).
2. Act 35/2006 (BOE November 29, 2006; the electronic version of BOE is available at www.boe.es).
3. Art. 14.1.c) TRLIRNR, (Consolidated Text of the Non-Residents Income Tax Law) that establishes the exemption and defines the scope by reference to the rules of the LIRPF (Personal Income Tax law) on the concept of interest income.