

Opinion of the Advocate-General concerning withholding tax on cross-border interest payments

The European Commission reproached Portugal for taxing interest received by non-Portuguese financial institutions more heavily than interest received by Portuguese financial institutions. The European Commission brought the case before the European Court of Justice (“ECJ”).

The Opinion of Advocate-General Kokott in this case was recently published [1]. As far as we can see, the case will have no direct impact on Belgian law, but could have an effect on interest received by Belgian financial institutions from other EU Member States.

1. The disputed Portuguese regulation is as follows:

A 20% withholding tax is levied on gross income of non-residents derived from cross-border interest. Existing double-taxation treaties with some other countries reduce this rate to 10%, 12% or 15%. The refinancing costs associated with the provision of credit are not tax-deductable. The withholding tax is thus levied on the **gross** income of the non-resident.

By contrast, for Portuguese residents, only the **net** income (after deduction of the operating costs, including the refinancing costs) from cross-border interest is subject to corporate income tax at the normal rate of 25%.

2. This regulation displays similarities with the regulation disputed in the **Truck Center** case, which concerned interest payments between associated enterprises (C-282/07, Jurispr. page I-10767).

In that case, the ECJ held that a different treatment of resident and non-resident taxpayers cannot in itself be categorised as “discrimination” within the meaning of the Treaty. The ECJ further stated that these situations were not objectively comparable.

Moreover, according to the ECJ, the resident interest-receiving companies do not necessarily derive an advantage from this regulation, given that:

- they are obliged to make advance payments of corporation tax, and
- the amount of withholding tax deducted from the interest paid to a non-resident company is significantly lower than the corporation tax charged on the income of resident company.

3. In her Opinion, the Advocate-General now claims that this case relates only to the tax treatment of interest which financial institutions receive in exchange for the loans they provide; the contested provisions therefore only have to be tested against the principle of the **freedom to provide services**.

[1] Case C-105/08 European Commission versus Portugal

The Commission argued that the Portuguese government is taxing the interest income of non-resident financial institutions more heavily, because it taxes the gross amount, compared to the net amount for residents. The Advocate-General rejects this argument, in the absence of concrete evidence to support the relationship between the gross interest income and the operating costs of financial institutions in Portugal.

The Advocate-General does suggest that another argument could be relied on: regardless of how great the refinancing costs are in reality, the Portuguese regulation makes it more difficult for financial institutions with registered offices in other Member States to compete with Portuguese institutions. If a bank from another Member State, despite constant refinancing costs, lowers its interest rates, the tax owed in Portugal is not reduced in proportion to the lower profit margin but only in proportion to the lower gross income. For domestic institutions, a fall in profits results in a parallel fall in tax. Portuguese banks can thus set their prices (interest rates) lower and yet still book profits after tax.

Since the Commission had not raised this argument as a grievance, the Advocate-General does not examine it in any greater detail. The Advocate-General also gave no opinion on whether or not a higher tax burden can be justified. She proposes that the ECJ reject the Commission's claim.

4. Conclusion: if a Belgian resident – in particular a financial institution – is subject to withholding tax in Portugal or in other EU Member States, it could be worth checking whether or not an objection could be raised in those Member States, if only to avoid prescription.

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Sources:

- Opinion of Advocate-General J. KOKOTT of 25 March 2010, case C-105/08, European Commission versus Portugal
- Decision of the European Court of Justice of 22 December 2008, case C-282/07, Belgium & FPS Finance versus TRUCK CENTER SA