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WITHHOLDING TAX

Transfer of funds from a Permanent Establishment to Head Office

Ricardo Seabra Moura / Francisco Matos

The tax regime applicable to Permanent Establishments has often raised pertinent tax issues, such as those concerning withholding tax.

For this purpose, a recent Central Administrative Court – South Division (“CAC-S”) decision has come to our attention, regarding the qualification for tax purposes of internal financing transactions between a Permanent Establishment and its Head Office in France (see court decision of 29 January 2008, Process no. 2161/07). In particular, the taxation applicable to income paid by the Permanent Establishment of a non resident credit institution to its Head Office.

This controversial question was raised before CAC-S, owing to the fact that the Portuguese tax authorities had classified the payments under an internal transaction as “interest payments” and, therefore, subject to withholding tax in Portugal. As this controversial matter was subject to judgement, the Court has decided to classify these payments merely as internal cash flow transfers.

We believe that this case is indeed a relevant one, on the grounds that it recognizes that payments made by a Permanent Establishment cannot be classified as interest, given that a Permanent Establishment has no legal personality, it being an economic activity that acts as such, carrying out transactions directly that are imputable to the mother Company or Head Office.

CAC-S concludes that the existence of a loan agreement requires a contractual relationship between autonomous legal individuals – which does not occur at the present time – and that the Permanent Establishment’s income taxation should take place as if it were an independent entity (*i.e.* in identical terms to those applicable to a resident Company). For this

reason, charges derived from internal financing should be considered as costs, deductible to the taxable amount calculated by the Permanent Establishment on the relevant tax period.

Bearing in mind that the company in question shall only be subject to taxation in Portugal concerning income attributable to its Permanent Establishment therein located, payments regarding the internal cash flow transfers are exclusively subject to taxation on the State of residence of the Headquarters.

Therefore, although the CAC-S’s decision delivers no ground-breaking interpretation of the Portuguese tax regime, it is our understanding that it does at least clarify the tax regime applicable on payments (*i.e.* in internal transactions) made by a Permanent Establishment to its Headquarters.

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TRANSFER PRICING

Advanced Pricing Agreements with the Tax Authorities

Tiago Marreiros Moreira / João Riscado Rapoula

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Following the legislative authorisation contained in the budget law for 2007, the budget law for 2008 has introduced the possibility, as in many other countries of the OECD, of arranging advanced price agreements (APA) with the tax authorities.

The recently amended article 128-A of the Personal Income Tax Code states that taxable persons may request to the Tax Directorate General for the execution of agreements towards the previous determination, on its intra-group transactions, of the method to apply the arm's length principle.

With the execution of these agreements, therefore, taxpayers may benefit from some legal security concerning the conduct of tax authorities, as this entity will not be able to proceed to corrections on the taxable amount as long as the conditions contained in the agreement are verified, a situation that will provide taxable persons the possibility of more accurate planning regarding their economic activity.

In general terms, three types of APA are recognized: unilateral, bilateral and multilateral. The first is executed between the taxpayer and tax authorities of one country, the second demands the participation of tax authorities and the latter occurs when more than two countries' tax authorities are involved.

The request of the APA must contain its period of execution, the method for determining the transfer price on intra-group transactions and must identify the operations to which the APA is applicable, as the agreements do not apply to the requesting entity but to its operations. The APA may be applicable to only one operation, to a number of combined operations or to all intra-group operations.

Once the APA enters into force, it must contain the method for determining the transfer price, the operations to which it is applicable, all the assumptions on which it is based and the revising, prorogation and revocation conditions. It must also provide its period of validity, which may not exceed three years. If there is no legislative amendment or any modifications on the economic and operational assumptions upon which the agreement is based, the tax authorities' conduct is governed by the details of the agreement. Therefore, the agreement can only be revised if a relevant modification on the circumstances that determined its content takes place.

The determination of the procedures that the taxable person shall adopt in order to execute the APA will be determined by a Ministerial Order of the Minister for Finance. However, this Ministerial Order must clarify some important issues.

First of all, it is important to decide if the legal configuration of the APA will render it accessible to small taxpayers, considering that it is a long and extremely complex process. In the USA, for example, in the year 2002 the average length of the negotiations of a bilateral APA was 27 months. Is a small taxpayer able to enter a process such as this? International practice reveals that normally are the major economic groups who make use of these agreements. Considering the fabric of Portuguese company life, it might be quite valuable if Portuguese law establishes a similar measure to that in the USA, where an abbreviated APA procedure was set up, which was less lengthy and complex and thus accessible to small tax payers.

On the other hand, it is particularly relevant to clarify what tax authorities are

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able to do with the information provided by the taxpayer during the negotiation process if these negotiations are abandoned. Although the law establishes a confidentiality obligation, which additional guaranties have the taxable persons that the information provided will not be used against them at some point in the future?

Despite the issues that these agreements may arise, it is undeniable that they can provide taxpayers with legal security towards the transactions with related entities, considering that these agreements allow them to know, in advance, what is the correct method that will be used to apply the arm's length principle. Additionally, these agreements also control tax authorities' conduct and therefore may contribute to attracting foreign investment.

Another important advantage results from the fact that these agreements can restrict the conflicts that may arise, for transfer pricing purposes, between the taxable persons and the tax authorities.

From the tax authorities' perspective these agreements may contribute to reduce its investigative obligations, which, under certain circumstances, might be restricted to verify the correct implementation of the agreement. Finally, one last question begs to be answered: do the Portuguese tax authorities possess the technical and human resources to execute an APA? And are they able to do it for all business sectors in identical conditions?





11th January

Scientific Patronage Statute – ancillary obligations

Following the approval of the Budget Law for 2008, any beneficiary of donations under the Scientific Patronage Statute will, from now on, be bound to comply with several declarative obligations, the most relevant of which is the delivery of a form by the end of February, listing the donations received in the past year. The form “Modelo 25” has also been approved with the aim of complementing the fulfilment of this obligation. The tax authorities announced, through the statutory instrument number 20125/2008, that in 2008 the beneficiary entities are dismissed of this obligation, considering that those entities may not have kept a record of the donors. Therefore, this tax obligation will only be complied with in 2009, relating to donations received in 2008.

17th January

Tiago Marreiros Moreira in the Queen Mary University of London

On January 17, 2008 Tiago Marreiros Moreira, head of VdA's Tax Group, participated as a speaker in the conference organized by the Queen Mary University of London and the Portuguese Chamber of Commerce that took place in the Portuguese embassy in London regarding “Tax Law and The Portuguese Budget”. The conference welcome and introduction was made by the Portuguese ambassador in the United Kingdom HE Mr. António Santana Carlos and several highly reputable Portuguese and international tax practitioners were speakers in this event. The initiative was such a success that the organization of similar events in the near future is already being considered.

29th January

Nomination of the new State Secretary for tax affairs

Carlos Baptista Lobo has been nominated State Secretary for tax affairs, succeeding Amaral Tomaz and returning to the Ministry of Finance, where he has already acted as adviser and assistant of the cabinet of the Minister for Finance in former governments. Carlos Baptista Lobo graduated in Law from the University of Law in Lisbon and has built up broad experience in tax practice, as his participation in the development of EU tax legislation demonstrates.

30th January

Double Tax Treaty entered into with Israel

Parliamentary Resolution number 2/2008, which approves the Double Tax Treaty entered into between Portugal and Israel, has been published. As far as Portuguese taxes are concerned, this Treaty is applicable to

Personal Income Tax, to Corporate Income Tax and to Municipal surcharge. The Israeli taxes to which the Treaty is applicable are: income taxes, corporate taxes and gains derived from immovable property transfer of ownership.

4th February

Mortgage Savings Accounts legal framework amended

In order to avoid credit institutions interpreting the law in a way that makes the invocation of the right to retain part of the fees derived from the deposit of mortgage savings accounts possible, the law now establishes that the interest penalty for the use of those deposits for any purpose other than those contained in the law, is only applicable to deposits made after January 1st 2004. Penalties cannot be applied in any other cases.

11th and 12th February

VdA Tax Group in IFE Seminar

Rita Magalhães, Catarina Belim and Pedro Manuel participated as speakers in a Seminar organized by the International Faculty for Executives regarding the tax law on real estate, in which several issues related to the impact of tax law on that sector and the main innovations in the taxation of real estate operations were discussed.

Directive establishing VAT refunds on different Members States published

The recent Directive 2008/9/EC has defined the types of VAT refunds already contained in the Directive 2006/112/EC, applicable to taxable persons established in a different Member State than the State in which the refund takes place in operations that grant the entitlement to deduct. In order to benefit from this regime, the taxable persons must submit an electronic refund request to the Member State from where the VAT refund is desired and present it to the Member State in which they are established by means of a website portal. It is also important to note that Member States may be subject to dilatory interest payment if the refund takes place after the deadline.

As far as the so called “VAT package” is concerned, it has been approved: the Directive 2008/8/EC that revises the rules of service supplies location – despite it requiring a progressive conversion – and the EC Regulation 143/2008, related to the cooperation and exchange of information in the scope of the above mentioned Directives.

These amendments will come into effect in 2010.

15th February

Tax fraud avoidance and simplification of custom and excise rules

In order to amend the Directive 92/12/EEC, applicable to the circulation and control of all products subject to excise duties, the Commission approved a proposal that is based on the use of a computer system to supervise the circulation of those products (Excise Movement Control System) which have not yet been subject to taxation. This circulation control will be quite useful in order to avoid excise duty fraud, considering it promotes an exchange of information mechanisms between the customs authorities. This proposal also aims at simplifying the rules of the commercial circulation of products subject to excise duties.

23th February

State and public entities liability

The new regime for State liability and public entities for damages derived from the legislative, jurisdictional and administrative attributions has been published. The main amendments consist of: (i) State's right to recourse from the public officer that provoked the damage to the amount previously paid as a result of that damage; (ii) joint and several liability of the public officer in case of guilt or serious negligent conduct, which means that the judicial procedures may be directed simultaneously against the State and the public officer; and (iii) the fact that when the actions are illegal, there is a presumption that the State must refute.

25th February

Tax planning Decree-Law approved

In the scope of the combat of so-called tax fraud and tax evasion avoidance it has finally been approved the Decree-Law that establishes the duties of communication, information and clarification before Portuguese tax authorities, regarding proposed schemes or actions adopted to obtain, mainly or exclusively, tax advantages. This Decree-Law will enter into force on the 15th May and will be revised within three years.

29th February

New Tax Forms approved

New tax forms have been approved, in order to make it possible for non-resident claims for total or partial exemption from withholding tax or for repayment of the withheld tax. The following table contains the former and the currently applicable tax forms:

	PREVIOUS TAX FORMS	NEW TAX FORMS	MAIN AMENDMENTS
CLAIM FOR TOTAL OR PARTIAL EXEMPTION FROM WHT	7-RFI; 8-RFI; 9-RFI; 10-RFI; 11-RFI e 12-RFI	21-RFI	⇒ REDUCTION FROM 12 TO 4 TAX FORMS ⇒ SIMPLIFICATION BY REMOVING REFERENCE TO PAYMENT DATE AS WELL AS PAYMENT'S AMOUNT (SEE TAX FORM 21-RFI) ⇒ AMENDMENT TO BOX III WHICH PRESENTLY REQUIRES THE IDENTIFICATION OF THE YEAR THE CERTIFICATE OF RESIDENCE REFERS TO, ACCORDING TO AMENDMENTS PROVIDED FOR IN STATE BUDGET FOR 2008 REGARDING EXPIRATION TERM OF NEW TAX
CLAIM FOR REPAYMENT OF TAX WITHHELD	13-RFI; 14-RFI; 15-RFI; 16-RFI; 17-RFI e 18-RFI	22-RFI; 23-RFI; 24-RFI	

Tax Calendars

MARCH 2008		
Day	Tax	Obligation
10	VAT	Monthly VAT returns - submission of January 2008 VAT return (and its annexes) and payment of the tax due
17	PIT	Submission of tax return Model 3 (in paper) regarding 2007 employment and pension's income
20		Payment of the tax withheld in the previous month
20	CIT	Payment of the tax withheld in the previous month
	Stamp Tax	Payment of the tax withheld in the previous month
31	PIT	Submission of a declaration of amendments in case of a regime change
	VAT	Submission of tax form 1074 (three copies) regarding acquisitions made in the previous year by retailers under the special regime foreseen in article 60 of the Portuguese VAT Code
	CIT	Submission of a declaration of amendments in case of option/renewal for/of the simplified taxation regime
		Submission of the declaration of amendments in case of option/renewal for/of the special Company Group taxation regime (taxable persons in which the fiscal year is coincident with the civil year)
		1st instalment of Special Payment on Account by resident taxable persons which have a commercial, industrial or agricultural activity, as well as non-resident taxable persons with a permanent establishment in Portugal. Taxable persons under the simplified taxation regime are outside the scope of this obligation

APRIL 2008		
Day	Tax	Obligation
10	VAT	Monthly VAT returns - submission of February 2008 VAT return (and its annexes) and payment of the tax due
15	PIT	Submission of tax return Model 3 (via internet), regarding 2007 employment and pension's income
		Payment of the tax withheld in the previous month
21	CIT	Payment of the tax withheld in the previous month
	Stamp Duty	Payment of the tax withheld in the previous month
30	PIT	Submission of tax form 3 (in paper), regarding income categories A, B, E, F, G and H
	Municipal Real Estate Tax	Payment of Municipal Real Estate Tax related to 2007. If the tax is equivalent to or inferior to € 250 it must be paid in full. If superior, taxable person is only required to pay a first instalment