PORTUGAL

Vieira de Almeida

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The effect of Brexit on Portugal: What happens next?

Ricardo Seabra Moura and Joana Sequeira of Vieira de Almeida examine the tax implications for Portugal as the UK prepares to exit the EU.

In January 2020, the EU and the UK agreed terms on the withdrawal agreement. A transition period is in force until December 31 2020 and any reference to member states in EU law and EU directives in the field of taxation, should be understood as including the UK. Likewise, the EU fundamental freedoms will continue to apply in the UK.

However, changes are expected to occur from January 1 2021, with a consequent impact on UK resident companies and their business development activities, notably in Portugal.

After the transition period, in the event of no further specific tax agreements concluded between the EU and the UK, relevant changes to the European income taxation field should only be available to EU resident companies.

This will be the case for the withholding tax exemption on interest paid by Portuguese subsidiaries, as established in the corporate income tax (CIT) code, which has transposed the Interest and Royalties Directive. In such cases, in the best scenario, a reduced withholding tax rate may be claimed under the Portugal-UK double tax treaty (DTT). The possibility of deducting business expenses when taxing interest gross income under the EU principles will no longer be possible based on the *Brisal* case (ECJ decision, C-18/15 of July 13 2016), which in practical terms may imply negotiations linked to gross-up clauses.

Similarly, shareholdings held by entities resident in the UK can no longer have access to the Portuguese groups of companies regime, as UK resident companies cannot be parent companies for this special regime. This will likely entail changes to existing groups that have this regime in place. Moreover, the Portuguese special regime for tax neutrality in mergers and acquisitions, which transposed the EU Directive, will no longer be available on transactions involving UK entities.

As an exception to the above, Portuguese withholding tax exemption rules on dividend distributions, which has transposed the Parent-Subsidiary Directive, continues to apply. This is provided that the remaining share capital participation and minimum period requirements are met, since dividends will be distributed to beneficiaries resident in a country (UK), which Portugal has a DTT in force with an administrative cooperation clause.

Taking a VAT perspective, in the case that no specific trade regime between the UK and the EU is agreed, the post-Brexit period will mostly impact the cross-border movement of goods between the EU and the UK. For instance, goods dispatched from the UK to Portugal, and vice-versa, will no longer qualify as intra-community transactions, but as imports and exports subject to customs controls. This will be accountable under the supply of services rules, notably taking business-to-consumer (B2C) treatment, and there will be further changes to the VAT refund rules under EU law.

The post-Brexit environment also presents international financial entities with new challenges, which will essentially depend on the nature of the future EU-UK relationship agreement, in respect of financial services and on whether any temporary measures will be adopted. This relies on the fact that UK has already implemented EU financial services legislation as a member of the EU, and on whether its internal regulatory regime already in place is deemed to be considered as equivalent in any future trade agreement with EU.

The definition of a precise route underlying the future EU-UK relationship will be relevant, for instance, to understand how financial entities resident in the UK and operating in Portugal under the EU Freedom to Provide Services (FPS) provision, will redefine their presence herein, notably whenever loans are granted and financial fees or interest are charged to Portuguese debtors.

In fact, the stamp duty code establishes that financial entities operating under the FPS provision in Portugal must appoint a tax representative resident in Portugal, endowed with a power of attorney and is jointly responsible for the stamp duty amounts assessments herein.

At this stage, it is important to stress that this tax representative appointment is not in line with the Portuguese general tax representative provisions, according to which the appointment is not mandatory to entities resident in EU countries. It is contestable as it directly breaches the EU principles of freedom of establishment and freedom of movement. It should be noted that ECJ has already issued a decision applicable on income taxes (C-267/09, of May 5 2011) refusing the mandatory appointment of tax representatives under discriminatory treatment reasoning. Such reasoning will not be applicable for UK entities after the transition period is elapsed.

UK-based entities should be prepared for the challenging circumstances that arise post-Brexit, as the future EU-UK relationship continues to remain uncertain with no specific tax agreements envisaged to be concluded.

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