

# Beneficial owner for the purposes of the IRD – the state of the art in Portugal

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**Miguel Gonzalez Amado and Vítor Loureiro e Silva of Vieira de Almeida discuss the concept of beneficial ownership of interest in Portugal.**

After years of theoretical discussions in the international tax environment and despite the efforts made by the OECD, the concept of beneficial ownership of interest has evolved significantly in the EU context, as the decisions of the European Court of Justice (ECJ) in the so-called *Da* 115/16, C-118/16, C-119/16 and C-299/16) have put the concept at the centre of atte

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played an important role on the approach followed by the tax authorities and tax courts in several jurisdictions.

Portuguese case law is still at an embryonic stage on this topic, but the Portuguese Tax and Customs Authority (TCA) is starting to apply the findings of the ECJ in its current tax audits involving Portuguese companies included in major international groups, giving rise to relevant (withholding) tax (WHT) assessments on interest payments.

In particular, TCA is now performing a more in-depth analysis of intragroup loans and financing structures (even to fiscal years previously audited), testing the position of EU holding companies vis-à-vis the concept of beneficial ownership, challenging the application of the WHT exemption provided for the Portuguese domestic rule transposing the Council Directive 2003/49/EC of June 3 2003 (IRD) on outbound interest payments, by alleging that the entity that receives the interest is not its beneficial owner.

To assess if the recipient of the interest is the beneficial owner for the purposes of the IRD and, therefore, if it has the right to use and freely benefit from such interest, the following approach has been observed by the TCA:

- Apply for the administrative cooperation mechanism provided for in Article 5 of Council Directive 2011/16/EU of February 15 2011 on administrative cooperation in the field of taxation, with the aim to gain access to information concerning the intragroup flow of funds, the tax status of the entities of the group and their financial statements;
- Analysis of whether there is a contractual or legal obligation of the company receiving interest to pass it on to a third party;
- Test whether the group of companies is structured in such a way that the company which receives the interest paid by the Portuguese debtor must itself transfer such interest to a third company which does not fulfil the conditions for the application of the IRD;
- Evaluate if the beneficiary company acts as a conduit and obtains an insignificant taxable profit in order to allow the flow of funds from the Portuguese debtor company to the entity that is the beneficial owner of the interest paid or to other conduit companies; and
- Review the time elapsed between each of the financial flows within the group.

Where the recipient of the interest is a typical holding company, it is possible to observe a tendency for the TCA to disregard the specific features of its economic activity and to consider that it cannot be qualified as the beneficial owner of the interest.

Considering that pure holding companies have, typically, small business structures and meaningful activity, due to the specific nature of its functions, they seem to constitute, in the TCA's opinion, mere conduit companies acting as intermediaries, whose activity is the receipt of interest and the transfer of such interest to the beneficial owner or to other company. In these cases, the beneficial owner's concept has also been used by the TCA as a starting point to a broader discussion on the substance of the group's structure.

The increased focus on the issue of beneficial ownership of the interest is also beginning to draw attention to potential problems of compatibility of Portuguese domestic legislation with the IRD, as the concept of beneficial owner under the IRD, as interpreted by the ECJ in Danish cases, is built on the basis of a company that actually receives interest payments, while, under Portuguese domestic rules, WHT is due on the date interest becomes due, regardless of its actual payment.

This situation entails additional difficulties to the Portuguese taxpayers, which are now being obliged to prove that the envisaged recipient of the interest has the right to use and freely benefit from interest payments that were never made as a result, for example, of an agreement for its capitalisation.

Considering the recent approach performed by the TCA, we expect a significant increase in litigation on the issue of the beneficial ownership of interest, as well as in the matters related to such concept, like the broader discussion of the substance and artificiality of a group and the conciliation of the Portuguese general anti-abuse rule (GAAR) and the direct application by the TCA of the EU's prohibition of abuse of rights principle.

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