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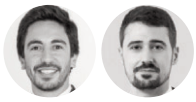

Miguel Gonzalez Amado and Vítor Loureiro e Silva

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

Miguel Gonzalez Amado and Vítor Loureiro e Silva of Vieira de Almeida update their analysis on the concept of beneficial ownership and comment on the first decision in Portugal regarding this issue.

After the Portuguese Tax and Customs Authority (TCA) started applying the findings of the European Court of Justice (ECJ) in the Danish cases (C-115/16, C-118/16, C-119/16 and C-299/16), it was a matter of time until the domestic tax courts were called upon to address the matter of the beneficial ownership of interest for the purposes of the Portuguese domestic rule transposing Council Directive 2003/49/EC of June 3 2003 (IRD).

Accordingly, the Arbitral Tribunal made public the first award in Portugal concerning a situation in which the TCA challenged, in the context of a tax audit, the application of the withholding tax (WHT) exemption on outbound interest payments, by alleging that the entity that formally received the interest is not its beneficial owner.

Background to the case

In case 776/2022-T, of June 15 2023, successive shareholder loans were made along a chain of entities based in different jurisdictions; i.e., a Portuguese entity (PT Co), which needed funds to acquire a stake in the share capital of another Portuguese company (PT Op Co), was financed by its parent company resident in United Kingdom (UK Co 1), which, in turn, was financed by its parent company resident in the UK (UK Co 2), with the latter also financed by its parent company resident in the UK (UK Co 3), which, in the end, was financed by two companies resident in Hong Kong (both held by entities resident in Hong Kong, the British Virgin Islands, the Cayman Islands, Bermuda and Panama).

The Arbitral Tribunal's ruling

Based on the guidance provided by the ECJ in the Danish cases, the Portuguese Arbitral Tribunal stressed that the UK companies did not have economic substance, since such companies did not have their own premises, equipment or personnel and did not perform any activity, besides receiving untaxed interest and paying untaxed dividends to their shareholders.

Furthermore, the Arbitral Tribunal understood that most of the amount of the interest paid by PT Co to UK Co 1 has been pulled up, throughout the chain of companies, without any taxation, confirming that there are no valid economic reasons sustaining the existence of the UK companies.

In this regard, the Arbitral Tribunal also noted as relevant the fact that the dividends distributed by PT Op Co to PT Co were, at least for the most part, remitted by the latter to UK Co 1, as payment of interest, without WHT, due to the application of the IRD. Then, UK Co 1 has transferred most of those amounts to UK Co 2, as dividends, and the latter distributed dividends to UK Co 3, in both cases without any taxation. Moreover, UK Co 3 has transferred such amounts to the Hong Kong companies, as payment of interest, without WHT, under the double tax treaty (DTT) concluded between the UK and Hong Kong. In the view of the Arbitral Tribunal, there is a situation of abuse of the IRD since the tax savings achieved by the scheme above are not covered by the purposes of such directive. The Arbitral Tribunal also pointed out the following:

Although the shareholder loans were not formally 'back-to-back loans', there was a close connection (due to their closeness in time, the amounts involved and the interest rates) between these financings and the acquisition, by PT Co, of a stake in the share capital of PT Op Co, strengthening the conclusion that the whole chain of companies and financing had the single purpose of providing PT Co with the necessary funds to acquire a stake in the share capital of PT Op Co.

In substance, with the Portuguese and the UK companies being entirely held, directly or indirectly, by the Hong Kong companies, the latter had the necessary powers to determine and control the decisions taken by the subsidiary companies, namely with regard to the payment of the interest due under the shareholder loans. In fact, it was proved that if the chain of payments described above was not performed, UK Co 3 would not have the means to comply with its obligations before the Hong Kong companies.

The fact that UK Co 1 had a certificate issued by the UK tax authorities, confirming that it is resident and subject to tax in that jurisdiction, is not decisive, since it depends on the source state (in this case, Portugal) to analyse whether the requirements regarding the concept of the beneficial owner of the interest are met, once the reduction of the tax revenue, by applying the WHT exemption, occurs in this country.

A 'beacon' decision?

In the authors' opinion, the Arbitral Tribunal closely followed the path of the ECJ's settled case law and since the company based in the UK has no effective economic activity and is part of a chain of companies based in different jurisdictions, with most of the interest transferred to a third territory (Hong Kong) – taking advantage, first, of the IRD and, later, from the UK and Hong Kong DTT – such background was decisive in leading the Arbitral Tribunal to the conclusion that the UK company, which received the interest from the Portuguese subsidiary, does not qualify as the beneficial owner of such interest.

With this being the first such decision in Portugal – although it is not final and may be appealed – it will be interesting to see whether it will be a beacon for subsequent ones, which are expected to come very soon.

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