



ILLEGAL WITHHOLDING TAX ON INTEREST PAID TO FOREIGN BANKS

The judgment of the European Court of Justice ("ECJ"), of 13 July 2016, held that levying withholding tax on interest paid to non-resident financial institutions constitutes an infringement of the principle of freedom to provide services.

The ECJ believes that Portuguese law discriminates between residents and non-residents, since with regard to the latter it does not offer the possibility of deducting business expenses directly related to the financial activity carried out (in other words, withholding tax is levied on the gross and not on the net income).

The judgment requires therefore not only a change in the law to make Portuguese domestic legislation fully compatible with European law, but above all a discussion of the legality of collections of tax at source in similar situations.

The judgment, held following a request for a ruling submitted by the Portuguese Supreme Administrative Court to the ECJ, made in the context of a dispute between *Brisal Auto Estradas do Litoral, S.A.* ("Brisal") and KBC Finance Ireland ("KBC") against the Portuguese Tax and Customs Authority ("AT").

In this matter, Brisal entered into an external financing agreement with a syndicate of banks, of which only some were resident in Portugal (KBC was not). In this context, Brisal withheld, and paid to the Portuguese AT tax on interest accrued in favour of KBC.

The fact is that interest earned in Portugal by non-resident financial institutions is subject to withholding of tax on gross amounts, while interest earned by resident financial institutions is not subject to withholding of tax and is actually taxed on its net amount. Thus, non-resident financial institutions are subject to a heavier tax burden than resident financial institutions, which is contrary to the principles of freedom to provide services and of free movement of capital.

In the opinion of the ECJ, restrictions on these principles are only permitted when justified by overriding reasons in the general interest and must ensure achievement of the aim pursued, not going beyond what is necessary for such purposes, which does not happen in this case.

In the opinion of the CJEU, restrictions on these principles are only permitted when justified by overriding reasons in the general interest.

As noted above, the effects of this judgment may be felt both in the future and on the past, first of all because taxpayers may now submit appeals against withholding taxes levied in recent years, opening a battle front against the AT.

In addition to an expected change in legislation to make domestic legislation fully compatible with European law, with effects for the future, there is also the possibility of the national legislature implementing a change in legislation that also covers financial institutions resident in third countries.

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Chambers European Excellence Awards, 2014, 2012, 2009

 Iberian Law Firm of the Year
The Lawyer European Awards, 2015-2012

 Top 5 - Game Changers of the last 10 years
Top 50 - Most Innovative Law Firm in Continental Europe
Financial Times - Innovative Lawyers Awards, 2014-2011