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Appointment of fiscal representative: Portugal in breach with EC law?

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1. Introduction

Portuguese tax legislation, like many others within the EU, is being closely scrutinised by the European Commission. In fact, on 26 June 2008 the European Commission released a notice concerning an infringement procedure against Portugal¹ requesting the end of discriminatory treatment of non-resident taxpayers. Such infringement is grounded on the fact that, under Portuguese law, non-resident taxpayers that obtain taxable income therein must appoint a fiscal representative in Portugal. The European Commission sees this as a requirement in breach of the fundamental freedoms, in particular, with the free movement of persons and the free movement of capital stated in Article 18 and Article 56 of the EC Treaty.

In the first part of this article we start our analysis by describing the legal framework that provides for the obligation to appoint a fiscal representative in Portugal by non-resident taxpayers obtaining taxable income in Portuguese territory. Further reference is made to the legal obligations that arise to a fiscal representative of a non-resident taxpayer in Portugal.

In the second part of this article we will turn to the analysis of the Portuguese regulations under the light of the fundamental freedoms of the EC Treaty. The scrutiny will be made considering the line of reasoning followed by the ECJ - based on its case law as it currently stands - as well as the relevant secondary Community legislation.

Finally we will try to draw some conclusions on whether the mandatory appointment of a fiscal representative and its regime stated under the Portuguese law may be considered to be in breach with the fundamental freedoms as provided by the EC Treaty.

2. The Portuguese legal framework

According to both the Portuguese Corporate² and Personal³ Income Tax Codes non-resident taxpayers who do not have a permanent establishment in Portugal and obtain income within this territory have to appoint a fiscal representative.⁴ This fiscal representative must be in any case either a person or an entity resident for tax purposes in the Portuguese territory.

The consequence of the lack of appointment of the

fiscal representative is, aside from the application of penalties, that the non-resident payer is inhibited of exercising its rights before the Tax Authorities namely submitting administrative or judicial claims.⁵

The necessary appointment of a fiscal representative came about due to the practical need felt by the Portuguese legislator to regulate the relations between the Portuguese Tax Authorities and the non-resident taxpayers. It must be borne in mind that these rules arose with the entering into force of the Tax Reform of 1988⁶ on 1 January 1989. At the time the concern was how the non-resident taxpayers - which did not have physical presence in Portugal - comply with their ancillary tax obligations for income earned within this country and how the Tax Authorities would notify the taxpayer in due time whenever needed.

The duties of the fiscal representative were then set in accordance with the above identified needs: on the one hand the fiscal representative must represent the non-resident taxpayers before the Portuguese Tax Authorities and on the other, it must guarantee the accomplishment of their tax obligations. Accordingly, the declared purposes of this compliance requirement are twofold:

- (i) to ensure the compliance of the ancillary tax obligations (such as tax returns and related deadlines) of the non-resident taxpayers⁷ in order to allow for a correct assessment of the tax due on its income arising in Portugal; and
- (ii) to ensure a contact reference for any notices that the Portuguese Tax Authorities address to the non-resident taxpayer.

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¹ The reference of the procedure is IP/08/1024.

² See Art. 118 of the Portuguese Corporate Income Tax Code (*Código do Imposto sobre o Rendimento das Pessoas Colectivas*).

³ See Art. 130 of the Portuguese Personal Income Tax Code (*Código do Imposto sobre o Rendimento das Pessoas Singulares*).

⁴ This obligation is stressed by the provision stated in Art. 19(4) of the General Tax Law (*Lei Geral Tributária*).

⁵ See Art. 19(5) of the General Tax Law.

⁶ That approved the Personal and Corporate Income Tax Codes.

⁷ See Circular Letter no. 14/93 of 31 May 1993.

However, the duties of the fiscal representative are currently not circumscribed to the previously referred ones. The regime was subsequently changed⁸ to set forth a joint and several liability of the fiscal representative⁹ for any tax liabilities arising to the non-resident taxpayer whenever the fiscal representative is also the manager of its assets or rights. It happens that this regime of joint and several liability ends up being triggered by a presumption: unless the fiscal representative appoints before the Tax Authorities in the moment of the acceptance of its duties the person who is the rights or assets' manager of the non-resident taxpayer in Portugal or, alternatively, informs of its inexistence, it is presumed that the fiscal representative is also acting as such for the non-resident taxpayer. As a consequence he becomes joint and severally liable for the non-resident's tax liabilities. A third aim can be found to exist in this requirement to appoint a fiscal representative: to ensure the collection of any taxes due by the non-resident taxpayer.

Although it may seem rather simple to avoid this it should be considered that:

- (i) as a rule the vast majority of the non-resident taxpayers who invest in Portugal do not have a resident manager of assets or rights;
- (ii) the proof of inexistence of such manager turns to be a *probatio diabolica* due to the difficulties relating to produce evidence of such negative fact.

In a nutshell we can then summarize the Portuguese fiscal representative regime of non-resident taxpayers has having the following characteristics:

- (i) mandatory appointment;
- (ii) a person or entity resident for tax purposes in Portugal;
- (iii) possibly joint and severally liable for the non-resident tax liabilities in the Portuguese territory.

Considering the characteristics described above we should now turn to the analysis of the fiscal representative regime under the test of the EC law.

3. A breach with EC law?

3.1. Overview

The scrutiny on whether a national measure as the one at stake is in accordance with the EC Treaty freedoms typically involves an analysis of the following questions:

- (a) Does the case falls within the scope of the EC Treaty?
- (b) Does the national measures imposes a restriction on the fundamental freedoms?
- (c) Is there is a valid reason which justifies the restriction imposed, and if that is the case, is such restriction proportionate?

3.2. Does the appointment of a fiscal representative by non-resident tax payers falls within the scope of the EC Treaty?

The first element common to the fundamental free-

doms is the existence of a cross-border element¹⁰ meaning a link between the particular measure at stake and two different EU Member States.¹¹ Such requirement¹² can be withdrawn by the general rule provided by Article 3(1)(c) of the EC Treaty which provides that 'The activities of the Community shall include ... an internal market characterized by the abolition, as between Member States, of obstacles to the free movement of goods, persons, services and capital'.

Accordingly, the general obligation of an EU non-resident taxpayer to appoint a fiscal representative resident in Portugal constitutes an intra-EU transaction that is covered by the EC Treaty.

3.3. Is there a restriction to the fundamental freedoms?

The underlying principle of the reasoning followed by the ECJ is that national measures which provide for distinctions between domestic and cross-border situations placing these last ones in a disadvantage situation may constitute a barrier to the free movement of economic factors on an EU-wide level. This may be the case where national measures make it particularly burdensome to enter into the domestic market. The aim of the internal market requires the removal of those obstacles within a cross-border context as it requires the neutrality of treatment between cross-border and purely domestic transactions. In fact, what is at stake from an economic standpoint is that the ECJ is trying to suppress distortions of choices for economic players who want to become market participants and desire to make use of an EU internal market and benefit from it.¹³

Taking the above into consideration one should now turn to the analysis on whether the obligation to appoint a fiscal representative in Portugal by a non-resident taxpayer constitutes a restriction to the fundamental freedoms, typically the free movement of capital.¹⁴

Article 58(1)(a) of the EC Treaty states that the application of Article 56 should be made 'without

⁸ With the entering into force of the General Tax Law as from 1 January 1999.

⁹ See Art. 27(3) of the General Tax Law.

¹⁰ See Dennis Weber *Tax Avoidance and the EC Treaty Freedoms: A Study of the Limitations under European Law to the Prevention of Tax Avoidance*, Eucotax Series on European Taxation, vol. 11 (Kluwer Law International, 2005), pp. 12-14.

¹¹ See Axel Cordewener, 'The Prohibitions of Discrimination and Restriction within the Framework of the Fully Integrated Internal Market', in *EU Freedoms and Taxation* (IBFD, 2006), p. 7.

¹² See among others, ECJ, 31 March 1993, Case C-19/92, *Dieter Kraus v Land Baden-Württemberg*.

¹³ See Axel Cordewener, n. 11 above, p. 16.

¹⁴ It may as well be the case that the freedom to provide services is also being threatened. If both freedoms are potentially at stake, Art.50 of the EC Treaty sets an hierarchy according to which the freedom to provide services is only exercisable to the extend that the services are not already within the scope of the provisions relating to the free movement of capital under Art. 49 of the EC Treaty. For further developments see Julian Ghosh, *Principles in Internal Market and Direct Taxation* (Key Haven Publications, 2007), p. 33 and Dennis Weber, n. 10 above, pp. 66-68.

prejudice of the right of Member States to apply the relevant provisions of their tax law which distinguish between taxpayers who are not in the same situation with regard to their place of residence or the place where the capital is invested'. However and as already expressed by the ECJ,¹⁵ since Article 58(1)(a) constitutes a derogation to the principle of free movement of capital it should be interpreted strictly. It is itself limited by Article 58(3) which refers that the domestic tax laws 'shall not constitute a means of arbitrary discrimination or disguised restriction on the free movement of capital and payments as defined in article 56'.

The concept of discrimination should be understood in broad terms in order not only to guarantee equal treatment among market participants but also to ensure market access whenever such market entrance is being constrained by means of discriminatory national provisions.¹⁶ Accordingly a discriminatory measure is prohibited in the way that it makes less attractive (as it hinders or restricts) the exercise of the freedom of movement.¹⁷

The requirement imposed on non-resident taxpayers to appoint a fiscal representative in Portugal constitutes a restriction to Article 56 of the EC Treaty. In that it not only imposes the appointment of the fiscal representative but also that it should be a resident in Portugal, such regime is liable to dissuade investment in Portugal. It creates an additional cost – as the services rendered by the fiscal representative will naturally typically be remunerated – and in consequence increasingly complicates the exercise of the free movement of capital.¹⁸

In fact, the Portuguese tax law creates a requirement for those non-resident persons or entities wishing to access and invest in the domestic market giving rise to an additional burden for cross-border investments. Accordingly, and having regard to the fundamental freedoms established by the EC Treaty, the obligation laid down in the Portuguese tax law stating the need to appoint a fiscal representative in Portugal for non-resident taxpayers who receive taxable income entails costs and constraints which are liable to dissuade the undertaking of investments in Portugal constitutes an obstacle to the free movement of capital laid down in Article 56 of the EC Treaty.

Such restriction in a similar case has already been subject to the scrutiny of the ECJ in the case *Commission v Belgium*.¹⁹ The issue referred to the obligation imposed on foreign insurance undertakings to appoint a tax representative residing in Belgium. The ECJ considered that obligation as constituting an obstacle to the freedom to provide services by companies located in other Member States.²⁰

A similar line of reasoning can also be found in the case *Futura Participations*²¹ where the ECJ dealt with the obligation of a non-resident taxpayer to keep and hold in the host state separate (and additional) accounting records relating to its activity developed in that state. Furthermore, those accounts had to be kept not at the company's seat (home state) but rather at the place of establishment of its branch (home state).

Therefore, as the provisions of the Portuguese tax law which require the appointment of a tax representative is restricted to taxpayers who are non-resident in Portugal it can then be thus concluded that there is a restriction of the free movement of capital which is forbidden by the EC Treaty unless it can be validly justified.

3.4. Is such restriction justified and, if that is the case, is that restriction proportionate?

A restriction to the fundamental freedoms is forbidden only in case it cannot be validly justified. Accordingly it should be examined whether the restriction on the free movement of capital provided by the obligation to appoint a fiscal representative is capable of being justified having regard to the provisions of the EC Treaty.

It is in fact well-established case law from the ECJ that national measures liable to hinder or make less attractive the exercise of the fundamental freedoms guaranteed by the EC Treaty may nevertheless be authorized provided that they pursue a legitimate objective compatible with the Treaty, are justified by imperative requirements in the general interests, are suitable for achieving the objective which they pursue, and do not go beyond what is necessary to attain it.²²

In order to determine whether the obligation lay down under the Portuguese tax law to appoint a fiscal representative residing in Portugal is necessary to fulfill its aims – ensure the accomplishment of ancillary tax obligations, ensure a contact reference for any notices addressed by the Portuguese Tax Authorities and ensure the collection of taxes – it must be determined whether those objectives could be met by means of less restrictive measures.

Regarding the objectives of ensuring the compliance of ancillary tax obligations in order to achieve a correct assessment of the tax on the income received by the non-resident taxpayer one should bear in mind that as from 1 January 2002²³ it is possible to submit

¹⁵ See ECJ, 7 September 2004, Case C-319/02, *Petri Maninnen*, para. 28.

¹⁶ See Axel Cordewener, n. 11 above, pp. 41–42.

¹⁷ See Dennis Weber, n. 10 above, p. 94.

¹⁸ See ECJ, 3 October 2000, Case C-68/98, *Josef Corsten* paras 34, 42 and 45–58 or ECJ, 11 December 2003, Case C-215/01, *Proceedings against Bruno Schnitzer*, paras 36–37.

¹⁹ See ECJ, 5 July 2007, Case C-522/04, *Commission of the European Communities v Kingdom of Belgium*, para. 41.

²⁰ See ECJ, 5 July 2007, Case C-522/04, *Commission of the European Communities v Kingdom of Belgium*, para. 39.

²¹ See ECJ, 15 May 1997, Case C-250/95, *Futura Participations SA and Singer v Administration des contributions*, paras 22–30.

²² See, among others, ECJ, 15 May 1997, Case C-250/95, *Futura Participations SA and Singer v Administration des contributions*, para. 26, ECJ, 11 March 2004, Case C-9/02, *Hughes de Lasteyrie du Saillant v Ministère de l'Économie des Finances et de l'Industrie*, para. 49, ECJ, 13 December 2005, Case C-446/03, *Marks & Spencer plc v David Halsey (Her Majesty's Inspector of Taxes)*, para. 35 or ECJ, 7 September 2006, Case C-470/04, *N v Inspecteur van de Belastingdienst Oost/kantoor Almelo*, para. 40.

²³ See Ministerial Order (*Portaria*) 1214/2001, of 23 October 2001, which was amended by Ministerial Order 1339/2005, of 30 December 2005.

the ancillary tax obligations (namely to file tax returns) via the Internet. Additionally, it should be considered that the Community legislature has already taken harmonization procedures aimed at achieving the same goal. Directive 77/799/EEC²⁴ (as amended by Directive 2004/106/EC of 16 November 2004) in its Article 1 provides that 'the competent authorities shall exchange any information that may enable them to effect a correct assessment of taxes on income and on capital'. This Directive then places an obligation of mutual cooperation on the Member States in the exchange of information that enables the ascertainment of the correct amount of income tax. There are therefore less restrictive means available which are less expensive and burdensome for the non-resident taxpayer and which, accordingly, provides for a lesser restriction on the exercise of free movement.

As regards the objective of ensuring a contact reference for any notices addressed by the Portuguese Tax Authorities it seems also possible to illustrate that there are less restrictive means for the exercise of the free movement. Directive 97/67/EC²⁵ provides that Member States shall ensure the right to a universal service involving the permanent provision of a postal service and that service should cover both national and cross-border services. Considering the existence of these common rules at an EU level, it then seems possible that the Portuguese Tax Authorities notify directly the non-resident taxpayers (combining also the exchange of information procedures whenever necessary) rather than requiring a fiscal representative in Portugal for that purpose. In the event that, pursuant to a notice, the non-resident taxpayer is required to come before the Portuguese Tax Authorities it should be possible that it can decide whether to present itself before such Authorities or alternatively, in that moment, to appoint a representative. This definitely entails less costs and constraints to a non-resident taxpayer as it avoids the appointment of a fiscal representative (and the bearing of the inherent costs) and allows the same goals to be achieved as those pursued by the Portuguese tax legislation.

Finally regarding the objective of ensuring the collection of taxes, Directive 76/308/EEC²⁶ (as last amended on 15 June 2001 by Directive 2001/44/EC) refers in Article 2(g) that taxes on income and capital²⁷ (as well as interest, administrative penalties and fines) may be subject to the mutual assistance among Member States for its recovery. Accordingly, the Community legislature has also taken harmonization measures which essentially pursue this same goal of facilitating collection of taxes in cross-border situations.²⁸ It then follows that the obligation of non-resident payers to appoint a fiscal representative resident in Portugal being joint and severally liable for the tax debts goes beyond what is necessary to ensure the payment of the tax and is therefore disproportionate to that objective²⁹ as there are methods less restrictive of fundamental freedoms.

Although the effectiveness of the above mentioned

cooperation mechanisms can be questioned by national Tax Authorities one should always bear in mind³⁰ that even that such mechanisms may not function in an efficient and most satisfactory manner, Member States cannot rely on any deficiencies in the cooperation between Tax Authorities in order to justify any sort of restrictions to the fundamental freedoms.

It follows from the above that the Portuguese state has the necessary means to ensure the objectives related with the appointment of a fiscal representative by non-resident taxpayers. It is therefore possible to conclude that the Portuguese tax law is in breach of EC law as the mandatory appointment of a fiscal representative constitutes an unjustifiable obstacle to the free movement of capital.

4. Conclusions

As we have observed, the conditions set forth under the Portuguese tax law create a barrier to the free movement of capital of a non-resident taxpayer in Portugal as they give rise to additional expenses inhibiting the exercise of such freedom.

Following the ECJ's line of reasoning, the free movement of capital, as a fundamental freedom guaranteed by the EC Treaty, cannot be restricted by national measures unless there are overriding requirements to the public interest and the principle of proportionality is complied with.

It looks apparent that the objectives envisaged by the Portuguese tax law can be met by less restrictive means which are less restrictive to the non-resident taxpayers and provide for a lesser restriction to the exercise of the free movement of capital. Accordingly it seems that the Commission's suspicion alleging infringement on the free movement of capital laid down in Article 56 must be considered to be justified. Naturally, in the end it is up to the ECJ to have the final word on this matter. . .

²⁴ Council Directive of 19 December 1977 concerning mutual assistance by the competent authorities of the Member States in the field of direct taxation.

²⁵ Directive of the European Parliament and of the Council of 15 December 1997 on common rules for the development of the internal market of Community postal services and the improvement of quality of service. The goal of this Directive is 'the development of a single market for postal services' as it is recognized that they are 'an essential instrument of communication and trade' with the aim of establishing an internal market where the fundamental freedoms are ensured.

²⁶ Council Directive of 15 March 1976 on mutual assistance for the recovery of claims relating to certain levies, duties, taxes and other measures.

²⁷ Article 2 also includes other types of duties and VAT.

²⁸ See ECJ, 7 September 2006, Case C-470/04, *N v Inspecteur van de Belastingdienst Oost/kantoor Almelo*, paras 51-52.

²⁹ See ECJ, 5 July 2007, Case C-522/04, *Commission of the European Communities v Kingdom of Belgium*, para. 56.

³⁰ See AG Kokott's Opinion in ECJ, 7 September 2006, Case C-470/04, *N v Inspecteur van de Belastingdienst Oost/kantoor Almelo*, para. 114.