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TAX

Newsletter

2nd Quarter 2019

Contents

EDITORIAL

The perspective of a hot summer arriving is an excellent opportunity to take a look at the most relevant events that occurred on the second quarter of 2019.

On an international level, and in contrast with the previous quarters, few events are worth mentioning. Nevertheless, reference should be made to the OECD report on *Taxing Wages 2019*, which analyzes the progress on the income tax burden during the year of 2018. In general, and because of several reforms carried out by some Member States, there is a 0.16% decrease when compared with the year of 2017. The OECD income tax burden average rate is now 36.1%. This is the fourth annual consecutive decrease, mainly due to the income tax reforms implemented by Estonia and the United States of America, and to the reduction of social security contributions in Hungary and Belgium. Even so, 22 OECD countries registered a tax increase in this period.

Regarding transfer pricing, we highlight the Report on the application of the profit split method within the EU, agreed by the *EU Joint Transfer Pricing Forum*, which clarifies key concepts and conditions to use the method.

In addition, the Netherlands has deposited the instruments of ratification of the Multilateral Convention ("MLI") and now the MLI also applies to Curaçao and other Dutch territories located in Europe and in the Caribbean.

The list of EU non-cooperative jurisdictions has decreased from 15 to 12 due to the removal of Aruba, Bermuda and Barbados. Bermuda and Barbados were included in Annex I in exchange for their commitment to increase efforts in order to comply with the conditions for definitive removal of such list.

A final word to the agreement reached by the 139 members of the OECD/G20 *Inclusive Framework on Base Erosion and Profit Shifting ("BEPS")*, regarding the planning and scheduling of the digital economy action. Based on this agreement it is expected that the international community will reach a long-term solution by the end of 2020.

In contrast with the few relevant events that occurred at an international level, from a domestic perspective 2019's second quarter was quite remarkable.

Reference should be made to two key matters: the transposition (still partial) of Council Directive (EU) 2016/1164, of 12 July 2016 (commonly known as ATAD) and the disclosure of the preliminary draft law transposing Council Directive (EU) 2018/822, of 25 May 2018, which amends Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation in relation to reportable cross-border arrangements (also known as DAC 6).

Aiming the reinforcement of the rules against tax avoidance within the common market, ATAD purports to implement anti-abuse provisions applicable to cross-border transactions. In fact, the absence of harmonization at the EU level regarding income tax matters may lead to profit shifting to lower taxation jurisdictions and to double deductions. With the purpose of creating profit shifting avoidance mechanisms, the majority of the ATAD's measures, now formally transposed into domestic law, were already present in the Portuguese legislation. The main objective of these recent amendments was to extend and facilitate ATAD's applicability, actually going beyond the terms laid down on the referred Directive. Even though the new legal provisions and mechanisms do not represent a breakthrough on the subject matter, it is possible to anticipate some difficulties in the respective application. This requires economic groups operating cross-border to reevaluate their structures and to implementation reporting and control mechanisms of considerable complexity. In addition, one can anticipate an increase of the Portuguese Tax Authorities' ("PTA") intervention in this field, which will be enhanced and facilitated by the information exchange mechanisms already in place – and envisaged – at an European level.

The draft law transposing DAC 6 (currently under public consultation) arises precisely within this information exchange context. In fact, Portugal was pioneer on the implementation of mechanisms against tax evasion, determining the mandatory communication of structures that may comprise such risk. Reason why the new diploma will apply both to cross border and to domestic transactions, and will revoke the existing mechanism. According to the draft law, any transaction – whether legal or illegal – that meets certain hallmarks shall be reported to the PTA that, in case of cross-border transactions, will then communicate them to the other jurisdictions involved. Moreover, the PTA may entail any investigation proceedings deemed appropriate.

In contrast with what DAC 6 imposes, according to the draft law the duty to communicate the transaction prevails over any obligation of confidentiality, which reflects excess of zeal by the Portuguese legislator. We must now wait for the final version of the law, anticipating that its implementation will certainly revolutionize how both economic groups and advisors operate in the international arena.

Also worth mentioning is the draft law that transposes Council Directive (EU) 2017/1852, of 10 October 2017, on tax dispute resolution mechanisms in the EU. Particularly relevant for economic groups operating in a cross-border context that face double taxation over income taxed in more than one country, this draft law aims to set out alternative dispute settle mechanisms. Initiated by a mutual agreement procedure among the Tax Authorities involved, the dispute resolution may evolve to arbitration by independent experts. This long-awaited mechanism intends to overcome the insufficiencies of the Transfer Pricing Arbitration Convention, as well as the shortfalls of the current mutual agreement procedures set forth in the Conventions for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income signed by Portugal.

Finally, a word regarding the controversy on the compatibility of the environmental component of the Car Circulation Tax applied on the import of used cars. After a conviction by the Administrative Arbitration Court – in line with the warning released by the European Commission –, the Portuguese Government restated that the environmental component is compliant with the Treaty on the Functioning of the European Union. We must now wait for the Commission's position on this matter and for future judicial and arbitral decisions.

It is now time to invite you to analyze the topics we selected for this quarter, hoping the upcoming months provide for new opportunities for joint reflection.

Diogo Ortigão Ramos

I. PORTUGAL'S STAMP DUTY IMPLICATIONS ON THE LIQUIDATION OF TRUSTS

Distribution of assets due to a foreign trust liquidation to Portuguese tax resident beneficiaries is, in principle, liable to Stamp Duty taxation in Portugal. However, there are cases when such taxation does not occur. The topic of this article has gained particular relevance due to the recent binding rulings issued by the Portuguese Tax Authorities ("PTA") on cases of distribution of assets on the liquidation of Trusts and associated tax treatment.

As it is well-known, Portugal has not ratified the Hague Convention regarding the recognition of foreign trusts, and it is not expected to do so either in the near future.
Portuguese law, as a rule, does not provide for the settlement of trusts, with the exception of offshore

trusts in the Madeira Free Trade Zone. As a civil law country, certain legal instruments rooted in common law, including trusts, are not regulated by the Portuguese legal system.

In light of the above, foreign trusts are subject to the general Portuguese Civil Code regulations on private international matters. Under these rules, a trust must be interpreted as a bilateral agreement from which mutual obligations arise for the parties involved (the settlor and the trustee).

Foreign trusts exist as arrangements, although are generally unknown and lacking civil legislation to specifically and comprehensively deal with them. Analysis of the applicable legal framework must take into account the main features of the trust, including the parties' obligations and the effects over the trust assets.

It was only in 2015 that most regulations on the tax treatment of income generated through fiduciary structures were introduced in the Portuguese legal and tax framework under the Personal Income Tax Reform (Law No. 82-E/2014, of December 31).

Tax Treatment on Liquidation

One of those regulations applies to values allocated on liquidation, revocation, and termination of fiduciary structures to taxpayers, other than those that have incorporated them, *i.e.*, non-settlors.

It sets out that such values are not subject to Portuguese Personal Income Tax, but rather fall within the scope of Portuguese Stamp Duty. Hence, values allocated upon liquidation, revocation, and termination of fiduciary structures to non-settlor Portuguese resident taxpayers are considered gratuitous transfers subject to Stamp Duty in Portugal at a 10% rate (increased to 10.8% for real estate assets located in Portugal).

However, because of the territorial scope of Stamp Duty, the tax only applies if the assets are deemed to be located in Portugal, specifically to:

I. Rights over movable assets or real estate in Portugal;

II. Shareholdings where the entity has its head office, place of effective management, or permanent establishment ("PE") in Portugal (provided the acquirer also has its domicile in Portugal); and

III. Monetary values deposited at credit institutions with their head office, place of effective management, or PE in Portugal, or, in case of non-deposited monetary values, the transferor has the domicile, head office, place of effective management or PE in Portugal.

Stamp Duty territorial scope considerations

Accordingly, distribution of assets resulting from the liquidation of a fiduciary structure to its beneficiaries will only trigger Portuguese Stamp Duty if the assets are deemed to be located in Portugal, pursuant to the aforementioned criteria.

Otherwise, there will be no territoriality for Portuguese Stamp Duty purposes on a direct allocation of the assets to a Portuguese tax resident beneficiary.

The territorial scope of Stamp Duty described above comes from the general rules of the Portuguese Stamp Duty Code (no specific territorial rule was introduced regarding the termination of fiduciary structures).

In other words, when we say that there will be no territoriality for Portuguese Stamp Duty purposes (if the assets are not deemed to be located in Portugal), we believe that this is the correct interpretation of the applicable rules.

According to the recent binding rulings addressing cases of distribution of assets on the liquidation of fiduciary structures, the PTA fortunately take the same view (*i.e.* no Stamp Duty is due on the distribution of non-Portuguese located assets to a Portuguese tax resident beneficiary (that is not a settlor) as a result of the liquidation).

In fact, the PTA clearly state that assets distributed in the context of liquidating fiduciary structures to a Portuguese tax resident beneficiary are only subject to Stamp Duty in Portugal provided the objective, subjective and territorial scope of Portuguese Stamp Duty is verified.

Structuring a liquidation

Notwithstanding the current binding rulings referred to above, one must proceed with caution. Liquidating a fiduciary structure with a Portuguese tax resident beneficiary must be properly structured to mitigate the possibility of being scrutinized by the PTA and ultimately triggering Stamp Duty.

In particular, two issues must be considered when structuring:

1. The documentation supporting the liquidation of a fiduciary structure must undoubtedly prove that the asset allocation aims at terminating the fiduciary structure; and

2. The fiduciary structure must be totally terminated (partial liquidation or termination is not advisable).

Overall, liquidating fiduciary structures with assets allocated to a non-settlor may be an interesting planning route, especially for individuals considering a change of tax residence to Portugal to take advantage of the tax incentives of our Non-Habitual Tax Resident Regime, as well as for those already in Portugal wishing to restructure their wealth at the lowest tax rate possible.

Diogo Ortigão Ramos
Marta Duarte Silva

II. CASE C-278/18: VAT EXEMPTION ON THE BUSINESS LEASE OF RURAL PROPERTIES

The decision of the Court of Justice of the European Union ("CJEU" or "Court") on the Portuguese case *Manuel Jorge Sequeira Mesquita* (Case C-278/18) became recently available. This case deals with the application of the VAT exemption provided for the leasing of immovable property to a so-called business lease of land comprising vineyards for agricultural purposes.

The CJUE analyzed whether a business lease agreement granting the right of use land comprising vineyards for agricultural purposes, for a period of one year, automatically renewable for a period of the same length, constitutes a leasing or letting of immovable property within the meaning of the article 13B(b) of the Directive 77/388/EEC, 17 May 1977 ("Sixth Directive"), which corresponds to article 135 (1) (l) of Directive 2006/112 ("VAT Directive"), and transposed into the domestic legislation by article 9 (29) of the Portuguese VAT Code (corresponding, at the time the relevant facts, to article 9 (30) of this law).

Firstly, the Court stressed that the concepts underlying to the VAT exemptions provided for in article 13 of the Sixth Directive (corresponding to the articles 132 *et seq.* of the VAT Directive) constitute independent concepts of European Union

Law and, although those exemptions should be interpreted strictly, in the case of the concepts of “leasing” or “letting”, these have a broader scope for VAT purposes when compared with the respective concepts provided for Civil Law purposes under the domestic legislation of the Member States of the European Union.

Moreover, the Court stressed the *ratio* of the said exemption, which is based on the relatively passive nature of the leasing or letting of immovable property – *i.e.,* simply the making available of a good – not generating any significant added value. Hence, said activity is distinguished, on the one hand, from other activities that are expressly excluded from the VAT exemption at stake, those having a predominant commercial or industrial nature or even, on the other hand, from those transactions that, in light of the elements forming part thereof, go beyond the simply making available of a good.

Thus, the Court held that an activity is excluded from that exemption whenever it entails not only a passive activity of making immovable property available but also the supply of other elements/services with commercial nature provided in full by the lessor, which go beyond the simply letting or leasing of the property (*e.g.,* supervision, management and continuing maintenance by the owner).

As such, according to the Court, the inclusion or not of a given transaction within the scope of the exemption applicable to the leasing or letting of immovable properties will depend on the elements forming part of that specific transaction and not on the subsequent use given to the property by the tenant, namely the use thereof for commercial purposes, which is not, by itself, sufficient to preclude the application of the VAT exemption applicable to the lease of real estate.

With regard to the case at hand, the CJEU clarified that rural properties with vineyards, whose operation was transferred, qualify as immovable properties and, as such, the granting of the right to use them constitutes a “leasing or letting of immovable property” for VAT purposes. It is so since under that “business lease” agreement the transferee/tenant acquired temporarily the right to use the properties against the payment of a rent.

Furthermore, the Court held that nothing in the judicial proceeding indicates that, in addition to that leasing of the property, the owner/lessor supplied to the transferee other services or goods classifiable as commercial activities.

This element was pointed out by the Court to refute the argument invoked by the Portuguese Government according to which the operations carried out by the lessor/transferor had a scope broader than the simply making available of the use of the “vineyards”, but should instead be understood as “transfer” of the totality of the assets and rights, such as legal authorizations for planting vines, transfer of the name or insignia of an agricultural establishment *etc.* According to the Portuguese Government, this fact should have entailed the conclusion that the transactions underlying the so-called business lease, would have to fall outside of the scope of the VAT exemption at stake, reasoning that was not backed by the Court.

Taking into account the case law of the CJEU on composite supplies, the Court held that, even if the use of the properties would have been supplied together with those elements (mostly intangible), the latter would be clearly ancillary when compared with the use of the properties. Thus, it would be concluded that the use of the properties was clearly the principal element of the supply and, in this sense, the single composite supply, as a whole, would have to follow the VAT treatment applicable to the main element – *i.e.,* VAT exemption.

On the other hand, the CJEU noted that in the case at hand the exclusions provided for in the article 135 (2) of the VAT Directive and transposed into the Portuguese VAT Code shall not be applied, in particular, the exclusion of lettings of permanently installed equipment and machinery, once vineyards cannot be classified as equipment or machinery (cfr. article 9 (29) (c) of the VAT Code).

In light of the above, the Court ruled that the so-called "business lease" of land comprising vineyards for agricultural purposes is exempt from VAT as, from a VAT standpoint, it qualifies as a lease or letting of immovable property.

The present decision consolidates the past jurisprudence of the Court on the scope of the VAT exemption applicable to letting of immovable property, underlining its nature of autonomous concept of European Union law and reaffirming that the *nomen iuris* attributed by the parties to a given contract is not critical for its VAT treatment.

Nevertheless, as the Portuguese legislator excluded from the scope of the VAT exemption at stake transactions other than those provided for in article 135 (2) of the VAT Directive, as it is the case of the letting of immovable property entailing the business lease of a commercial or industrial establishment/unit – please see article 9 (29) (c) of the VAT Code – we find strange that both the Portuguese court and the Portuguese Government failed to raise the possibility of excluding the transaction under discussion from the scope of the VAT exemption under these domestic rules – *i.e.,* business lease of a commercial or industrial establishment/unit of agricultural nature. As such, the Court ended up being prevented from examining the scope of that exclusion and the application thereof to the case at hand.

It should also be noted that, in our view, this decision is based on the relative scarcity of other elements allegedly forming part of the so-called "business lease" agreement when compared with its main component – *i.e.*, granting of the use of the land –, which, from the Court's point of view, were not sufficient to exclude that operation from the concept of "letting of immovable property" and, consequently, from the VAT exemption.
Therefore, we consider that the decision of the CJEU would probably be different in typical cases of business leases of agricultural activities, where, for example, the use of rural properties is accompanied by other material and human elements - such as agricultural tools and devices, irrigation systems, right to use a cellar, agricultural workers, *etc.*

In fact, it does not seem that the Court has held that only the business lease of commercial and industrial establishments – and not those qualifying as having agricultural nature – would be covered by the cases excluded from the VAT exemption as provided for in article 9 (29) (c) of the VAT Code. Apart from nothing in the Court's decision allow such a conclusion, this line of reasoning would lead to an unacceptable interpretative result. Firstly, because the concept of agricultural "industry" falls within the wording and *ratio* of said legal provision and, on the other hand, such approach would create an unjustified discrimination - certainly not permitted under the VAT Directive – between the business lease of an "agriculture establishment" – which would be VAT exempt - and the business lease of a commercial or industrial establishment.

Accordingly, notwithstanding the merits of the Court's decision, since it enables economic operators to anticipate with greater level of certainty the VAT treatment of business lease agreements to be concluded in the future, the decision at hand also gives rise to a number of questions which may lead to a different conclusion from that reached in the judgment under appeal, notably on the determination of the principal element *vis-à-vis* the mere ancillary components of a single composite supply and the VAT treatment thereof.

Mário Silva Costa
André Caetano Ferreira

III. LEGISLATION

Ministry of Finance
Ordinance No. 97/2019, of April 2

- Defines the percentage of revenues derived from collection of debts made by the Portuguese Tax Authorities ("PTA") in 2018 to be allocated to the Tax Stabilization Fund *(Fundo de Estabilização Tributário)*

Ministries of Finance and of Infrastructure and Housing
Ordinance No. 110/2019, of April 12

- Establishes the conditions and requirements provided for in paragraphs (2), (3), (4) and (5) of the article 72 of the Personal Income Tax ("PIT") Code for the reduction of the autonomous PIT rates applicable to rental income foreseen in said paragraphs

Presidency of the Council of Ministers
Decree-Law No. 49/2019, of April 15

- Revokes a set of Decree-Laws that entered into force between 1981 and 1985

Office of the Secretary of State for Tax Affairs
Order No. 12/2019, of April 18

- Amends the Order no. 18-A/2019, of July 1, removing the lack of communication by taxpayers to the PTA of the registration on the Electronic Postal Box *«Caixa Postal Electrónica»* as grounds for the suspension and for the denial of Value Added Tax ("VAT") and Corporate Income Tax ("CIT") refund requests.

Ministry of Finance
Ordinance No. 119/2019, of April 22

- Establishes the form and conditions for the request, supply and control of the special stamp applicable to products liable to Excise Tax on Tobacco ("IT") to be released for consumption in the Portuguese territory, duly packaged in single packages

Ministry of Finance
Ordinance No. 126/2019, of May 2

- Amends the Ordinance no. 2/2015, of January 6, which defines the characteristics and structure of the file that taxpayers should use to report their inventories to the PTA

Parliament
Law No. 32/2019, of May 3

- Transposes Council Directive (EU) 2016/1164, of 12 July 2016, which lays down rules against tax avoidance practices that directly affect the functioning of the internal market

Presidency of the Council of Ministers
Decree-Law No. 60/2019, of May 13

- Establishes the application of the reduced VAT rate to the fixed component of specific supplies of electricity and natural gas

Ministry of Finance
Ordinance No. 144/2019, of May 15

- Determines the conditions under which taxpayers may opt to be released from the issuance of paper invoices or its electronic transmission obligation under article 8 (1) (c) of Decree-Law No. 28/2019. Further determines the terms under which the PTA shall make the elements of those invoices available to the respective acquirers or recipients

Ministry of Finance
Ordinance No. 150-A/2019, of May 17

- Establishes the formalities to be complied with for requesting the unique identifier number, as well as its supply by the *«Imprensa Nacional-Casa da Moeda, S. A.»*, for specific tobacco products

Presidency of the Council of Ministers
Decree-Law No. 67/2019, of May 21

- Determines the increase of Property Tax levied on vacant buildings located in urban pressured zones

Council of the European Union
Communication No. C 176/2, of May 22

- Publishes the European Union list of non-cooperative jurisdictions for tax purposes

Ministry of Foreign Affairs
Notice No. 32/2019, of May 28

- Informs that it was published a note by India's Embassy in Lisbon and Portugal's Embassy in New Deli, announcing that the internal constitutional requirements for the approval of the Protocol, amending the Convention between the Portuguese Republic and the Indian Republic to avoid Double Taxation and Prevent Tax Evasion with respect to Income Taxes, have been complied with

Parliament
Law No. 36/2019, of May 29

- Revokes a set of Decree-Laws that entered into force between 1975 and 1980

Parliament
Resolution No. 75/2019, of May 30

- Recommendation to the Government that the VAT amounts charged on the fundraising solidarity campaign by phone, for the victims of cyclone Idai passage in Mozambique, are reverted directly to that cause

Parliament
Law No. 38/2019, of June 4

- Establishes the tax regime applicable to the organizers of the *UEFA Nations League Finals 2019* and the *UEFA Super Cup Final 2020*

Ministry of Finance
Ordinance No. 200/2019, of June 28

- Establishes a new deadline for the presentation of the initial declaration of the Central Register of Beneficial Owner (*Registo Central do Beneficiário Efectivo)*

Presidency of the Council of Ministers
Decree-Law No. 84/2019, of June 28

- Determines the execution rules for the State Budget Law for 2019

CUATRECASAS

Contacts

Cuatrecasas, Gonçalves Pereira & Associados, Sociedade de Advogados, SP, RL
Sociedade profissional de responsabilidade limitada

Lisboa
Praça Marquês de Pombal, 2 (e 1-8º)
1250-160 Lisboa I Portugal
Tel. (351) 21 355 3800 I Fax (351) 21 353 2362
cuatrecasasportugal@cuatrecasas.com I www.cuatrecasas.com

Porto
Avenida da Boavista, 3265 - 5.1
4100-137 Porto I Portugal
Tel. (351) 22 616 6920 I Fax (351) 22 616 6949
cuatrecasasporto@cuatrecasas.com I www.cuatrecasas.com

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