IMPACTS OF A NEW EU GAAR ON PORTUGUESE DIVIDENDS TAXATION - VIEIRA DE ALMEIDA & ASSOCIADOS

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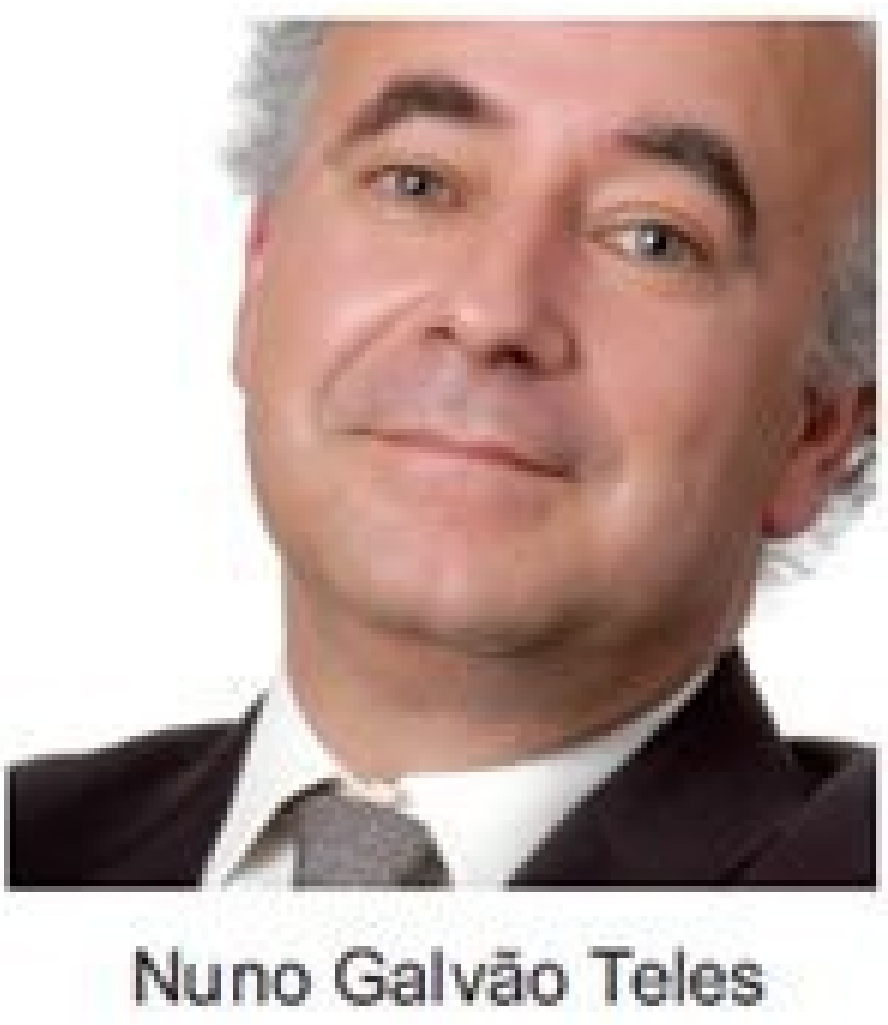

Category: Tax

Pursuant to the EU Council Directive 2015/121 (the "Directive"), all Member States were required to adopt new provisions implementing a general anti-avoidance rule ("GAAR") to prevent abusive tax planning structures aimed at benefitting from the participation exemption regime foreseen in the Parent Subsidiary Directive.

The Directive was enacted to tackle situations where complex corporate structures were put in place with the main purpose of achieving a flow of dividends tax free across Member States and eventually to non-EU shareholders.

In general terms, the Directive is in line with the most recent international tax developments, namely with the outcome of the BEPS Report.

The Directive foresees that Member States should not grant an exemption on profit distributions to "an arrangement or a series of arrangements which, having been put into place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of this Directive, are not genuine having regard to all relevant facts and circumstances".

It further clarifies that "an arrangement or a series of arrangements shall be regarded as not genuine to the extent that they are not put into place for valid commercial reasons which reflect economic reality". In view of the above, most Member States have foreseen specific criteria in domestic legislation to ascertain whether, in a given situation, the relevant taxpayer carried out a transaction or a series of transactions on the basis of commercially valid reasons and, in addition, if together with an economic rationale there was also a minimum degree of economic substance in each level of the corporate chain. In many cases, the setting up of the above mentioned criteria was complemented with pre-existing guidance from tax authorities and domestic case law on the application of domestic anti-avoidance provisions.

Given the emphasis of the new GAAR on the "facts and circumstances" (i.e. on a case-by-case analysis), the definition of general criteria and guidance for the application of the GAAR is of essence for (at least) two main reasons: to ensure that taxpayers may anticipate the conditions that should be complied with and – equally important – to provide a common setting for the assessment of an abusive arrangement, to avoid a discretionary and non-harmonized application of the GAAR.

Unfortunately, Portugal recently enacted Law nr. 5/2016 of 29 February, which adopts the new GAAR foreseen in the Directive, without providing any clarification on what conditions or criteria should be taken into consideration to assess the existence of valid commercial reasons and economic substance in a given transaction.

The new Portuguese GAAR works in practice as a "carve-out rule", which in essence precludes the application of the *participation exemption* to dividend distributions whenever "there is an arrangement ("construção") or a series of arrangements which, having been put into place with the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of eliminating double taxation on the distributed income, are not genuine having regard to all relevant facts and circumstances".

It is relevant to point out that Portugal decided to adopt the new GAAR as an additional provision to the domestic *participation exemption* regime. It follows that although the Parent Subsidiary Directive applies only to EU companies, the Portuguese GAAR will apply to all dividend distributions that may potentially benefit from the tax exemption, including dividends paid by/to non-EU entities.

To add some complexity to the application of the new GAAR, not only the Portuguese domestic legislation leaves great room for interpretation, but also the adopting provision foresees a new concept of arrangement – "construção" – which has not yet been used in Portuguese tax law. In fact, previous anti-avoidance rules made reference to other concepts, such as transaction – "operação". The latter concept – for being commonly used in anti-avoidance provisions – has already been addressed, discussed and clarified by Portuguese literature and tax courts.

Whilst the objectives of the GAAR seem relatively clear, it must be noted that the text of the Directive and, from a Portuguese standpoint, the domestic adopting provisions, provide no guidance on how the GAAR should be interpreted. It follows that it is yet uncertain how tax authorities will apply the new GAAR and, most of all, what criteria will be developed – most probably through tax practice (in the course of tax inspections) and through court decisions (in case law to follow).

Notwithstanding the above, and the fact that Portuguese tax authorities are often reluctant to

address EU tax law matters and ECJ case law during the course of tax inspections (leaving such discussion for court proceedings), the new GAAR should be interpreted in line with the extensive track record of cases brought before the ECJ concerning anti-avoidance rules – first and foremost, the Cadbury Schweppes case. Notably, the ECJ has already elaborated on how to assess whether a given tax structure may be seen as *compliant*, how to ascertain the existence of genuine economic activities and to evaluate the impact of tax advantages arising from a corporate structure in the context of a (yet sound and proper) business decision.

In view of all matters that remain uncertain, increasingly corporate groups are addressing this matter cautiously, reviewing the existing transactions and performing a risk assessment analysis, while following closely all developments in other Member States – seeking comparable transactions and criteria adopted by tax authorities – trying to validate the economic substance of ongoing structures to overcome the lack of specific guidance in Portuguese tax law.

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