TAX INFORMATION

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TAX REPRESENTATION FOR NON-RESIDENTS

ANALYSIS – JUDGMENT OF THE COURT OF JUSTICE OF THE EUROPEAN UNION OF 5 MAY 2011

By its judgment of 5 May 2011, the Court of Justice of the European Union (the Court) held that the Portuguese State is in breach of the principle of free movement of capital enshrined in the Treaty on European Union. This breach arises from the obligation to appoint a tax representative imposed on non-resident taxpayers who earn income in Portugal that requires the filing of a tax return here.

TAX REPRESENTATION

The obligation to appoint a tax representative in Portugal is established in the Personal Income Tax Code, in Portuguese, the Código do Imposto sobre o Rendimento das Pessoas Singulares or 'CIRS'. This obligation arises when an individual not resident in Portugal earns taxable income here and also in respect of individuals who, although they are resident in Portugal, leave the country for more than six months.

THE ORIGIN OF THE CASE

The case that led to the judgment in question goes back to July 2007 when the European Commission gave formal notice to Portugal to bring its legislation into line with EU law. The precise basis of this notice was the Commission's belief that the obligation on non-residents to appoint a tax representative was incompatible with EU law and the European Economic Area (EEA) Agreement in so far as both enshrine the principle of free movement of capital.

THE COMMISSION'S ARGUMENTS

The European Commission (the Commission) claimed that the requirement for non-resident taxpayers to appoint a tax representative breaches the principles of free movement of persons and capital as laid down in the Treaty on European Union and the EEA Agreement. According to the Commission, there is a breach both in cases in which the income

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PLMJ
SOCIEDADE DE ADVOGADOS, RL
A.M.PEREIRA, SÁRAGGA LEAL, OLIVEIRA MARTINS, JÚDICE E ASSOCIADOS

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earned by the non-resident implies an obligation to present a tax return and in cases in which the income earned is subject to final tax deduction at source. As a consequence, the non-resident taxpayer should be freed from the requirement to present such a tax return.

According to the Commission, this obligation to appoint a tax representative is discriminatory and disproportionate in light of the apparent objective of the legal provision. In effect, in addition to the fact that the appointment of a tax representative amounts to a financial burden on the non-resident, such an appointment is manifestly excessive in light of the underlying objective of combating tax evasion. This is because the objective is, and can be, ensured by other mechanisms, namely the procedures for mutual assistance that exist between the EU Member States under Directives 2008/55/CE and 77/799/CEE.

THE ARGUMENTS OF THE PORTUGUESE STATE

The Portuguese State alleged, on the one hand, that the obligation to appoint a tax representative on the part of non-residents does not apply whenever income subject to final tax deduction at source is at issue, as the fulfilment of the obligation to pay tax is ensured by this mechanism.

In turn, in respect of the obligation on non-resident taxpayers who earn income in Portugal to present a tax return, the Portuguese State argued

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that this is not discriminatory because it applies, in the same terms, to both resident and non-resident taxpayers.

As regards the financial burden that arises from the obligation to appoint a tax representative relied on by the Commission, the Portuguese State argued that its rules do not create any such financial burden in respect of the requirement for representation.

The Portuguese State also argued that the rules aim to guarantee the effectiveness of control over taxes and the fight against tax evasion and that these are reasons of general interest that justify a restriction on the exercise of the fundamental rights guaranteed by EU law.

Finally, in respect of the application of this obligation to the EEA member states, the Portuguese State considered that the obligation has special grounds because there are no cooperation procedures between the EEA members and EU Member States.

THE VALUES CONSIDERED BY THE COURT OF JUSTICE

The Court held that the consequence of the obligation to appoint a tax representative is a restriction on the free movement of capital because it implies not only the requirement for non-resident taxpayers to take special steps in order to enter the Portuguese market, but also the obligation to bear the cost of paying the representative. This may discourage capital investments in Portugal, in particular, real estate investments.

According to the Court, it was important to evaluate whether or not the guarantee of the effectiveness of tax controls and the fight against tax avoidance - the objective of the obligation to appoint a tax representative – amount to an overriding requirement of public interest capable of justifying a restriction on the principle of free circulation of capital.

> The Court also added that the effectiveness of tax control and the fight against tax evasion may be ensured by other mechanisms such as the procedures for mutual assistance.

THE DECISION OF THE COURT OF JUSTICE

The Court recognised that the tax representative plays an important role in guaranteeing the effectiveness of tax control and the fight against tax evasion in respect of personal income tax. For this reason, it is a requirement of general interest that is capable of justifying a restriction on the exercise of the freedoms guaranteed by EU law. However, the Court understands, in the wake of what has been the direction of its case law, that the justification based on control over taxes and the fight against tax evasion allow a breach of EU principles if it is directed at purely artificial schemes aimed at getting round national legislation. For this reason, general presumptions of fraud may not justify such an approach. Accordingly, by imposing the obligation to appoint a tax representative on an entire category of taxpayer simply because they are non-residents, the Portuguese legislation places a general presumption of fraud or tax evasion on them, and this cannot amount to justification for frustrating the objectives of EU law.

The Court also added that the effectiveness of tax control and the fight against tax evasion may be ensured by other mechanisms such as the procedures for mutual assistance.

Thus, the Court concluded that the obligation to appoint a representative goes beyond what is necessary to achieve the objective of combating tax evasion and infringes the right of free movement of capital. However, This decision by the Court is not only binding on the parties to the case; it can also be relied upon by all EU citizens.

the Court also understood, as did the Portuguese State, that in cases in which there is deduction at source and in the absence of any other ancillary obligation, the obligation to appoint a tax representative is not imposed and, in this case, the Treaty is not infringed.

The CJEU also held that the obligation to appoint a tax representative is not contrary to the principle of free movement of capital laid down in the EEA Agreement because, in this case, there are no procedures for mutual assistance between member states and third party states. This means that the objectives of effective tax control and the fight against tax evasion are not ensured. Therefore, in cases in which non-residents are nationals of a state that is not a member of the European Union, but rather, the European Economic Area (for example, Norway), the obligation to appoint a tax representative does not go beyond what can be required to guarantee the effectiveness of tax control and so it is not contrary to the EEA Agreement.

THE CONSEQUENCES OF THE COURT'S JUDGMENT

This decision by the Court is not only binding on the parties to the case; it can also be relied upon by all EU citizens. Consequently - apart from requiring the Portuguese State to alter its tax legislation so as to repeal the rule that non-resident individuals must appoint a tax representative – any taxpayer bringing an action before the Portuguese courts may, from now on, rely directly upon this judgment.

Rogério M. Fernandes Ferreira
Mónica Respício Gonçalves
Pedro Saraiva Nércio
Maria José Sousa Leite

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