CONFEDERATION FISCALE EUROPEENNE

# Opinion Statement of the CFE ECJ Task Force

## on the decision of the European Court of Justice of 17 June 2010 in Case C-105/08, Commission v Portugal and the evidential requirements imposed by the ECJ in the context of infringement procedures

**Submitted to the European Institutions in November 2011**

**Confédération Fiscale Européenne (CFE) | 188A, Av. de Tervuren 1150 Bruxelles**
**tel: +32 2 7610091 | fax: +32 2 761 00 90**
**email: brusselsoffice@cfe-eutax.org | www.cfe-eutax.org**

*This is an Opinion Statement prepared by the ECJ Task Force[1] of the CFE, the leading European federation of tax advisers with 33 tax adviser organisations from 24 European countries representing over 180,000 tax practitioners.*

*1.* This Opinion Statement focuses on the evidential requirements imposed on the European Commission by the European Court of Justice in Case C-105/08, Commission v Portugal, in the context of an infringement procedure under Article 258 TFEU and whether such evidential requirements allow the Commission effectively to fulfil its role of ensuring that Member States comply with their obligations under the European Treaties.

2. The CFE considers that a particular problem arises as to the extent of the evidential burden on the Commission in circumstances where it demonstrates a clear difference of treatment, entailing a serious and self evident risk of discrimination, but does not have available to it the data which would be necessary to demonstrate the impact of the national rules[2].

# 1 The case

3. This was a case brought by the Commission against Portugal concerning the different tax treatment applied to interest on mortgages and other loans paid to resident and non-resident financial institutions. The Commission's complaint was that Portugal, while imposing corporation tax at the general rate of 25% on the net income (i.e. interest income after deduction of re-financing and operating costs) of resident financial institutions, charged a definitive withholding tax on the gross amount of interest payments to foreign institutions at the statutory rate of 20%, reduced by tax treaty in the case of most EEA countries to 10%, 12% or 15%.

4. The Commission argued that the comparatively high rate of withholding tax on gross income paid to non-residents was liable to result in a heavier tax burden than the 25% general corporation tax rate applied to net income received by resident lenders. It was very unlikely that a foreign financial institution would be able to achieve a profit margin greater than 10%, in which case the margin

[1] Members of the Task Force are: Axel Cordewener, Paul Farmer, Daniel Gutmann, Volker Heydt, Michael Lang, Franck Le Mentec, Pasquale Pistone, Albert Raedler, Stella Raventos-Calvo (Chair), Isabelle Richelle, Friedrich Roedler and Kelly Stricklin-Coutinho. The views expressed in this statement do not necessarily represent the views of each individual member of the Task Force or of organisations with which any of the members are associated.

[2] It may be noted that Advocate General Kokott (para. 46 of the Opinion) suggested that had the Commission alleged that there was a restriction on market access for non-resident banks because foreign banks had to attain a margin at least equal to the withholding tax, whereas Portuguese banks could undercut them and still make a profit. The Court, however, did not comment on this observation.



**Confédération Fiscale Européenne (CFE) | 188A, Av. de Tervuren 1150 Bruxelles**
**tel: +32 2 7610091 | fax: +32 2 761 00 90**
**email: brusselsoffice@cfe-eutax.org | www.cfe-eutax.org**

would be cancelled or even exceeded by the withholding tax. In order to restore equality with resident financial institutions, taxed at 25% on their net income, non-resident financial institutions would have to achieve profit margins at least four times higher than those obtained by resident institutions.

5. Portugal accepted – as it had to – that its rules entailed a formal difference of treatment. It contended however that the Commission had failed to make out the charge of discrimination because it had failed to produce evidence demonstrating that the difference in treatment entailed a higher tax burden for non-resident lenders. Its case was based on presumption and hypothetical examples.

6. Portugal produced a table demonstrating that, where the treaty withholding tax rate of 10% applied, non-residents would be more heavily taxed only if the net income was 40% or less of the gross income (the corresponding figures for a 15% treaty rate and the 20% statutory rate being 60% and 80% or less of the gross income).

7. The Court, following the Opinion of Advocate General Kokott, upheld Portugal's submission, reminding the Commission that it was its responsibility to place before the Court the information required to enable it to establish the breach. The Commission had failed to provide any actual figures of the net income of domestic lenders and had based its case on an arithmetical example that was purely hypothetical. The Commission should have furnished statistical data or information concerning the level of interest paid on bank loans and relating to the refinancing conditions in order to support the plausibility of its calculations.

## 2 The analysis

8. The case raises a fundamental point of principle concerning the burden of proof on the Commission in infringement proceedings under Article 258 TFEU. The Advocate General suggests that the Commission misunderstands the allocation of the burden of proof in actions under that procedure. Where however, as here, the Commission shows that the Member State applies a radically different regime to income paid to non-residents, entailing a clear and serious risk of discrimination, then the Commission must be considered to have made out its case unless the Member State concerned can demonstrate that the discrimination is merely apparent.



**Confédération Fiscale Européenne (CFE) | 188A, Av. de Tervuren 1150 Bruxelles**
**tel: +32 2 7610091 | fax: +32 2 761 00 90**
**email: brusselsoffice@cfe-eutax.org | www.cfe-eutax.org**

9. The imposition of comparatively high withholding tax rates on gross interest income paid to non-residents runs the inevitable risk of taxing such income more heavily than domestic interest income taxed on a net basis. This problem was explicitly recognised in the Commentary on Article 11 of the OECD Model (at paragraph. 7.7):

> "7.7 [-] The problem described in paragraph 7.1, which essentially arises because taxation by the State of source is typically levied on the gross amount of the interest and therefore ignores the real amount of income derived from the transaction for which the interest is paid, is particularly important in the case of financial institutions. For instance a bank generally finances the loan which it grants with funds lent to it and, in particular, funds accepted on deposit. Since the State of source, in determining the amount of tax payable on the interest, will usually ignore the cost of funds for the bank, the amount of tax may prevent the transaction from occurring unless the amount of that tax is borne by the debtor. For that reason, many States provide that interest paid to financial institution [sic] such as a bank will be exempt from any tax at source."

10. In such circumstances the burden of proof should pass at that point to the Member State to demonstrate that the discrimination is merely apparent and never arises in practice. The Commission should not be required to go further and endeavour to gather further evidence based on confidential internal data.

11. That is particularly so where, as here, on the figures before the Court the rules could fail to be discriminatory only if wholly unrealistic assumptions were made about the net profit margin earned. On the figures produced by Portugal itself and set out by the Advocate General there would be discrimination in some cases wherever the net income fell below 80% of the gross interest income. There would be discrimination in every case if the net income fell below 40% of gross income. It is inconceivable that financial institutions could achieve net profit margins on mortgage and other lending of such magnitude on a sustainable basis. It is extraordinary that a Member State which applies radically different rules to domestic and cross-border situations can escape the charge of discrimination simply by pointing to theoretical scenarios of this kind. It should be borne in mind that national rules are unlawful even if they are discriminatory in certain circumstances only.

12. The judgment runs counter to the principle of effectiveness of Union law by placing a disproportionately heavy burden on the Commission in relation to rules tainted by a clear risk of discrimination. Its effect will be to encourage Member States to run the risk of applying different tax rates and rules to cross-border situations without attempting to find more appropriate responses.



**Confédération Fiscale Européenne (CFE) | 188A, Av. de Tervuren 1150 Bruxelles**
**tel: +32 2 7610091 | fax: +32 2 761 00 90**
**email: brusselsoffice@cfe-eutax.org | www.cfe-eutax.org**

13. The Court observes that the Commission should have produced "further statistical data or information concerning the level of interest paid on bank loans and relating to the refinancing conditions". The Advocate General suggests that the Commission should have provided "concrete evidence relating to the actual relationship between the gross income and operating costs of credit institutions in Portugal".

14. It is however hard to see what publicly available information the Commission could have produced. It might have been possible for the Commission to make an estimate of the gross margin on lending activities but the net income, after taking into account overheads, would only be available from internal management accounts, which are confidential to individual businesses. The necessary information would not be available by reviewing published accounts which contain aggregate data[3]. As regards the Advocate General's comment, it is not obvious that there would be any incentive for Portuguese financial institutions to assist the Commission in the evidence gathering process.

## 3. The Statement

15. The *Confédération Fiscale Européenne* fully recognises that the burden of proof in the framework of infringement procedures is on the European Commission. However, where, as the CFE believes is the case here, the Commission demonstrates that national rules apply radically different tax treatment to income paid to residents and non-residents, entailing a clear and serious risk of discrimination, it should then be for the Member State to demonstrate that the discrimination is merely apparent and never arises in practice. In that regard it is not sufficient for a Member State to point to a number of theoretical scenarios in which the rules would not have a discriminatory effect.

16. That is particularly so, where as here, it would be impossible or excessively difficult for the Commission to provide the relevant data. Imposing such an unreasonable and disproportionate burden on the Commission is liable to undermine the Commission's role in ensuring the effective application of EU law.

[3] Such information would be available to the Portuguese authority.



**Confédération Fiscale Européenne (CFE) | 188A, Av. de Tervuren 1150 Bruxelles**
**tel: +32 2 7610091 | fax: +32 2 761 00 90**
**email: brusselsoffice@cfe-eutax.org | www.cfe-eutax.org**