

Brussels, 16 January 2006

Commission requests Portugal to end discriminatory taxation of foreign banks

The European Commission has sent Portugal a formal request to amend its tax legislation concerning outbound interest payments. A withholding tax of 20 % is levied on the gross interest paid by Portuguese resident borrowers to non-resident lenders. Interest paid to resident financial institutions, on the other hand, is not subject to a withholding tax, although it is subject to the Portuguese corporate income tax. The result is that interest payments to foreign banks may sometimes be taxed more heavily than interest payments to Portuguese banks. The Commission considers that the higher taxation of foreign banks restricts the freedom to provide services and the free movement of capital. The request is in the form of a 'reasoned opinion' under Article 226 of the EC Treaty. If Portugal does not reply satisfactorily to the reasoned opinion within two months the Commission may refer the matter to the European Court of Justice.

"The current rules restrict Portuguese consumers to take out mortgage loans from banks outside Portugal" said EU Taxation and Customs Commissioner László Kovács. "Elimination of the restriction will make the Portuguese financial markets more competitive, to the benefit of the Portuguese consumers".

Under the Article 80 (2) (c) of the Portuguese Corporate Income Tax Code (CIRC), a withholding tax of 20 % is applicable to the gross interest paid by Portuguese resident borrowers to non-resident lenders. Double taxation agreements may provide for a lower rate but in any event the non-resident bank is not allowed a deduction for the costs it incurred in raising the capital lent.

By contrast, interest paid to resident financial institutions is subject only to the Portuguese corporate income tax. This means that they pay tax only on the net interest they receive, that is the interest received minus the interest paid in order to acquire the necessary capital.

In many instances foreign institutions therefore pay a higher tax in Portugal than Portuguese institutions on the interest they receive on loans made to Portuguese borrowers. The higher taxation restricts foreign institutions from cross-border lending, and discourages Portuguese borrowers from taking out mortgage loans or other loans from foreign providers. These taxation rules therefore constitute an infringement of Article 49 of the EC Treaty on the freedom to provide services.

The Portuguese system also constitutes a restriction to the free movement of capital provided for in Article 56 of the EC Treaty. The Commission does not see any valid justification for the restriction.

The Commission considers it appropriate to compare the taxation by Portugal of domestic lenders with the taxation by Portugal of foreign lenders. The European Court of Justice made a similar comparison in the Gerritse judgement of 12 June 2003 (Case C-234/01), ruling that insofar as domestic artists were allowed a tax deduction for their costs, a similar deduction should be granted to foreign artists.

In its Green Paper 'Mortgage Credit in the EU' of July 2005 (see [IP/05/971](#)), the Commission has already indicated that it will take action against national mortgage taxation rules that are not compatible with EU law.

The latest information on infringement proceedings against the Member States is available on the following site:

http://europa.eu.int/comm/secretariat_general/sgb/droit_com/index_en.htm