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Developments Reduce Spanish Inheritance and Gift Tax for Non-residents

By Luis J. Durá
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INTRODUCTION

A unique aspect of Spanish Inheritance and Gift Tax (I.H.T.) law is that it is imposed under national law and regional law. Historically, regional rules for computing I.H.T. applied to taxpayers that are resident in the region, while non-residents applied national rules, which are not as attractive. This diverse treatment has been the subject of debate, and recent changes to I.H.T. law have improved the outlook for non-residents.

Each of Spain's 17 autonomous regions has introduced its own set of I.H.T. rules, and the tax benefits vary widely. Each autonomous region retains the power to regulate the calculation of the taxable base, the assessment of pre-existing wealth, the computation of multiplication coefficients, the allowance of deductions, and the scope of allowances that reduce the tax due. In some cases, little benefit is provided. In others, such as Madrid, the regional benefits almost eliminate the burden of I.H.T. for taxpayers residing in that region.

While the benefits vary, the general effective rate of I.H.T. for non-residents was significantly greater than for residents under historical rules. I.H.T. was also greater for inheritances and gifts of real property located abroad than property located in Spain. This approach was deemed to be discriminatory according to a series of decisions at the European level and the national level.

In 2011, the European Commission sued Spain for breaching obligations imposed by Article 63 of the Treaty on the Functioning of the European Union (T.F.U.E.) and Article 40 of the Agreement on the European Economic Area (the E.E.A. Agreement), which mandate the free movement of capital. Subsequently, the European Court of Justice (E.C.J.) held that Spanish I.H.T. violated the right of free movement of capital in a ruling issued on 3 September 2014, Case 127/12. In response, the Spanish government amended the I.H.T. legislation in 2015.

On its face, the 2015 amendment affects only E.U. residents and residents of the E.E.A. Initially, it was not applicable to persons who are resident outside the E.U. However, in an appeal brought by a resident of Canada, the Spanish Supreme Court ruled in 2018 that the exclusion of regional I.H.T. allowances for residents of countries outside the E.U. or the E.E.A. was contrary to the E.U. concept of freedom of capital.

This article will address events that struck down the Spanish system and provided equal treatment for persons resident in the E.U. and elsewhere. It also suggests a path forward for persons to reclaim excessive I.H.T. and provides some comfort for non-residents owning a vacation home in Spain.

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PRECEDENT IN E.C.J. CASE LAW

The path to non-discrimination began with three cases in the E.C.J., *Jäger*, *Mattner*, and *Welte*.

Jäger (E.C.J. 17/01/2008 – C 256/06) involved the computation of German inheritance tax when the estate consisted of assets situated in Germany and agricultural land and forestry situated in France. German inheritance tax rules provided for a tax-free amount and the application of favourable valuation rules when calculating German inheritance tax payable by an estate when the assets were located in Germany. In the case, the agricultural land and forestry were situated outside Germany. Consequently, they did not qualify for a tax-free amount and were assessed at a higher value for German inheritance tax purposes.

The E.C.J. characterized the German inheritance tax as a tax on the transfer of capital, which is covered by Article 56 of the Treaty Establishing the European Community (E.C.). The E.C.J. ruled that the German rules were discriminatory. No valid reason existed to justify disparities in valuing and taxing assets based on their location inside within Germany or another Member State of the E.U.

In reaching its decision, the E.C.J. dismissed the argument of the German government that a valid societal reason existed for the advantage provided by German law in connection with the transfer of assets located in Germany. Germany argued that the inheritance tax reduction compensated the owner for specific costs involved in maintaining agricultural and forestry activities within Germany. It also argued that the reduction assisted in preventing a forced sale by the heir in order to fund the tax payment. The E.C.J. was unconvinced by the asserted societal arguments. It concluded that the German government failed to demonstrate a valid distinction existed between an heir holding property in Germany and an heir holding property in another Member State. In both circumstances, the societal value of agricultural and forestry land existed and the economic burden of paying I.H.T. were likely the same.

As a result of *Jäger*, Germany revised its I.H.T. in 2008. From that point, the same tax-free allowances and valuation methods have applied to assets located in Germany or another Member State.

Mattner (E.C.J. 22/04/2010 C-510/08) also involved German rules, this time involving the calculation of gift tax. Ms. Mattner was a German citizen but a tax resident of the Netherlands. She made a gift to her daughter, who was also a tax resident of the Netherlands. The gift involved land and a private residence located in Düsseldorf. In computing the tax, the German tax authorities limited the applicable tax-free amount to €2,000, the amount allowed to a non-resident rather than the €205,000 allowance available to donors that were resident in Germany at the time.

The Tax Court in Düsseldorf sought guidance on whether the provision violated European law. In response, the E.C.J. ruled that the I.H.T. provision allowing a greater personal allowance for residents has the effect of restricting the movement of capital by reducing the value of a gift of the German property. Moreover, the restriction could not be justified by a coherent national policy. Consequently, it was in breach of E.U. law.

Welte (E.C.J. 17-10-2013 C-181/12) is another watershed case. It held that discriminatory legislation directed towards non-residents violates the freedom of movement of capital even when the taxpayer is a resident of a country that is not an E.U. Member State.

In *Welte*, the decedent was a Swiss national and resident. He owned property in Germany and bank accounts in Germany and Switzerland. His wife was born in Germany. She became a Swiss national and resident by reason of the marriage. She was the sole heir of the decedent's estate. German situs real property comprised 62% of the total value of the estate. The limited deduction of €2,000 was allowed against the value of the German assets, while the non-German situs assets of the estate were not taxed. If either the decedent or the surviving spouse had been a German resident, or a resident of an E.U. Member State, the allowance would have been increased to €500,000 under German domestic law applicable to residents at the time.

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The surviving spouse called this treatment into question, filing a complaint to the German Finance Court, which submitted the matter to the E.C.J. The question posed was whether unequal treatment of residents and non-residents as to matters of inheritance tax is incompatible with the free movement of capital guaranteed by the E.C.

The E.C.J. held that there is no objective difference between residents and non-residents justifying unequal tax treatment since the amount of tax on gifts is calculated on the basis of the value of immovable property and the family relationship between the donor and the recipient:

> Articles 56 EC and 58 EC must be interpreted as **precluding legislation of a Member State relating to the calculation** of inheritance tax which provides that, in the event of inheritance of immovable property in that State, in a case where, as in the main proceedings, the deceased and the heir had a permanent residence **in a third country**, such as the Swiss Confederation, at the time of the death, **the tax-free allowance is less than the allowance which would have been applied if at least one of them had been resident in that Member State** at that time. [Emphasis added.]

SPANISH DEVELOPMENTS

In response to the E.C.J. decisions in the foregoing cases, the Spanish government continued to defend the right of its autonomous regions to apply lower effective rates of I.H.T. to residents. The result was a series of defeats in the E.C.J. and the Spanish Supreme Court.

E.C.J. decision of 3 September 2014

The first defeat for the Spanish government came in a case brought by the European Commission (E.C.J. 03-09-2014 C-127/12). The European Commission claimed that the differences in the tax treatment of gifts and estates for Spanish residents and non-residents violated Articles 21 and 63 T.F.E.U. and Articles 28 and 40 of the E.E.A. Agreement. It claimed also that differences in I.H.T. for gifts involving real property situated in Spain and comparable real property located outside Spain violated the same provisions.

In the proceedings, Spain took the position that the European Commission's argument was technically deficient because of procedural errors and was overly broad in its approach because it failed to look at each autonomous region separately. It also argued that no national measure was involved, since regional benefits were at issue, and that, as a result, Spain did not violate any of the applicable freedoms.

The E.C.J. dismissed the procedural challenges and then ruled against Spain as to the legal matters. I.H.T. constitutes a tax on the transfer to one or more persons of the property left by a decedent person. Consequently, it is subject to the provisions of European law regarding free movement of capital. Identical treatment must be afforded to residents and non-residents, except where the constituent elements of the law are confined to items that exist within a single Member State.

Citing *Jäger* and *Mattner*, the court explained that restrictions on the movement of capital include national measures which have the effect of reducing the value of an inheritance or gift of a person who is not a resident of a State where the asset is located. Thus, a regulation of a Member State constitutes a restriction on the free movement of capital when the application of an allowance to the tax base is conditioned on residence within that Member State. The provisions of the Spanish I.H.T. rules are a restriction on the movement of capital because they explicitly provide for the possibility that autonomous regions can introduce tax abatements for residents of, or property located in, the autonomous region. From this, it follows that a person who does not reside in Spain or who owns property outside Spain faces impediments to free movement of capital because the value of property will be impaired by the increased cost of the I.H.T.

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Revised Spanish I.H.T. rules

The Spanish parliament applied the E.C.J. ruling literally. The court applied the European principle regarding the freedom of movement of capital, a fundamental freedom enjoyed by residents of the E.U., and addressed the effect of discriminatory treatment on residents of Member States other than Spain and property located in other Member States. Hence, the Spanish law was redrafted to extend local treatment to I.H.T. taxpayers that were residents of the E.U. or E.E.A. For those individuals, objective choice of law rules were adopted to identify the autonomous regional law that would be applied in specific fact patterns. The revisions did not apply the same treatment to persons resident in other countries or to property located in other countries.

Spanish litigation

In judgment 242/2018 issued on 19 February 2018, the Spanish Supreme Court struck down the revised provisions of I.H.T. that prevented a person resident in a country outside the E.U. and E.E.A. from accessing I.H.T. benefits under the law of an autonomous region. The decision in judgment 242/2018 in this case was followed by judgments 448/2018 of 21 March 2018 by Spanish Supreme Court and 2018/39506 of 21 March 2018 by Spanish National Court. All reached the result that persons resident outside the E.U. and the E.E.A. may access benefits granted by the I.H.T. of an autonomous region.

In judgment 242/2018, a resident of Canada inherited real property located in the autonomous region of Catalonia. She filed the I.H.T. self-assessment under Spanish national law. As a result, the I.H.T. liability amounted to €308,547.34. Had she been able to file the self-assessment under the rules of the autonomous region of Catalonia, the tax would have been limited to €189,525.91. She timely filed a claim for refund in the amount of €119,021.43 , the difference between the tax due under Spanish national law and the tax due under the regional rules in Catalonia. The tax for the Canadian resident was almost 60% greater than the tax for a resident of the Catalonian autonomous region.

In a first stage hearing, the Spanish Council of Ministers denied her petition on the grounds that she was not a tax resident of the E.U. or the E.E.A. The Spanish Council of Ministers chose to apply a literal reading of the E.C.J. decision dated 3 September 2014. Consequently, it held that the E.C.J. decision was not applicable to a Canadian resident inheriting Spanish real property.

The matter was appealed to the Spanish Supreme Court, where the issue was squarely presented by the parties. Acknowledging that unequal tax treatment existed for the Canadian heir, at issue was whether the unequal treatment violated E.U. law.

The Spanish tax authorities argued that unequal tax treatment at the level of the autonomous regions was justified. They contended that discrimination did not exist because the matter did not involve unequal treatment between a resident of Spain and a resident of another Member State of the E.U. No E.U. resident suffered because the I.H.T. benefit granted by Catalonia was not extended to a resident of Canada.

Following the lead of the E.C.J., the Supreme Court held that the unequal treatment violated the freedom of movement of capital. The decision of the Council of Ministers was reversed. In the view of the court, the principal set out by the E.C.J. in *Welte* was squarely

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on point. A tax allowance granted on the basis of the residence of the decedent and the heir impairs the value of the inheritance. Such impairment violates the right to free movement of capital which is protected by Article 56(1) E.C. Spanish I.H.T. rules and related autonomous region I.H.T. rules include reductions of the taxable base. These provisions must be applicable also to persons who are not E.U. tax residents.

PATH FORWARD

Legislative action is expected. However, at this stage, it is still unclear how Spain will implement these rulings to bring the I.H.T. regime in line with the E.C.J. ruling and the E.U. principle of free movement of capital. Until legislation is enacted, heirs who are resident in a country that is not a Member State of the E.U. or E.E.A. may wish to avoid penalties by filing an I.H.T. return based on Spanish national law without claiming benefits under regional I.H.T. rules and then file a claim for refund of tax.

For I.H.T. taxpayers that are not residents of the E.U., consideration should be given to filing claims for refunds within the four-year period of limitations, which begins to run as of the final date for filing the I.H.T. return. For inheritance tax purposes, the last day for timely filing is six months after the date of death. For gift purposes, the last day for timely filing is 30 days following the taxable event.

After the effective date of Brexit, U.K. residents will no longer be granted immediate access to the I.H.T. rules of the autonomous regions but should be entitled to claim the benefits in by filing a refund. Once the Spanish law is changed to allow persons outside the E.U. to claim the benefit of regional law, British residents should be entitled automatically to lower I.H.T.

TABLE OF POTENTIAL DISCRIMINATION

Potential scenarios involving non-E.U. tax residents or elements are included, in which the potential discriminations may take place. For clarification purposes, one table deals with the inheritance tax and the other includes gift tax scenarios. In both tables, the compulsory application of Spanish national I.H.T. legislation, as opposed to tax rules in the autonomous regions, is highlighted.

INHERITANCE TAX

Tax residence of deceased	Tax residence of heir	Asset type	Asset Location	I.H.T. rules
Spain	Third country	Real estate or others	Spain	National I.H.T.
			Third country	Not subject
Spain	Spain	Real estate or others	Spain or third country	Autonomous region tax law based on tax residence of deceased
Third country	Spain	Real estate or others	Spain or third country	National I.H.T.
Third country	Third country	Real estate or others	Spain	National I.H.T.
			Third country	Not subject

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GIFT TAX

Tax residence of donor	Tax residence of heir	Asset type	Asset location	I.H.T. rules
Spain	Third country	Real estate	Spain	National I.H.T.
			Third country	Not subject
		Others	Spain	National I.H.T.
			Third country	Not subject
Spain	Spain	Real estate	Spain	Autonomous region tax law based on the location of the real estate
			Third country	National I.H.T.
		Others	Spain or	Autonomous region tax law based on donee’s tax residence
Third country	Spain	Real estate	Spain	Autonomous region tax law based on location of real estate
			Third country	National I.H.T.
		Others	Spain or third country	Autonomous region tax law based on residence of the recipient
Third country	Third country	Real estate	Spain	National I.H.T.
			Third country	Not subject
		Others	Spain	National I.H.T.
			Third country	Not subject

Taxation of Canadian Real Estate What Non-Residents Need to Know

By Michael Cadesky
Cadesky Tax (Canada)

This article provides a summary of important points concerning the taxation of Canadian real estate for non-residents of Canada.

The Canadian real estate market has attracted a lot of attention from foreign buyers. The Toronto and Vancouver residential property markets have had extraordinary price increases (for example, a 30% increase in Toronto in one year). This has caused governments at all levels (federal, provincial, and municipal) to focus on the area. Government attention has produced the following results:

- An additional 15% land transfer tax for foreign buyers for properties in a defined area of Southern Ontario (in and surrounding Toronto) and British Columbia (Vancouver area)
- Increased enforcement of income tax compliance
- Changes in legislation to close a number of loopholes

The opportunity to profit from Canadian real estate is enticing for three main reasons:

1. Availability of low interest rate financing in Canadian currency
2. The low value of the Canadian dollar (at $.76 to the U.S. dollar) allowing for possible foreign exchange gains
3. Steady price increases in Toronto and Vancouver compared to bargain prices elsewhere (such as in Calgary, Edmonton, and Montreal)

As a result, there continues to be a steady flow of investment funds into Canada, chasing real estate bargains.

TAXATION ON PURCHASE

For a foreign buyer, a purchase of residential real estate in Southern Ontario and in the Vancouver area will now attract an additional 15% land transfer tax. In Ontario, this is on top of a 2.5% land transfer tax on value exceeding $2,000,000 (lower rates apply on the value below this). In addition, the City of Toronto levies a municipal land transfer tax at the same rate. This means that a non-resident buying a home in Toronto, for example, will now pay up to 20% land transfer tax, while a Canadian resident will pay 5%.

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The additional 15% tax does not apply to Canadian citizens, even if they are non-residents of Canada.

There are certain exceptions for non-resident persons who become permanent residents of Canada. Because of this, persons who are planning to immigrate to Canada may wish to carefully consider the timing of the move and co-ordinate this with the timing of the purchase of a residence.

The additional 15% land transfer tax does not apply to non-residential property.

TAXATION ON SALE

On a sale of Canadian real estate, the first question to arise is whether any resulting gain is a capital gain or business income. A residential property which is purchased for personal use, or for rental and held for long-term investment, will be capital property. On a sale, any gain will be a capital gain. However, a property which is purchased on speculation (an adventure in the nature of trade) will result in the gain on sale being treated as business income.

The important distinction is that business income is fully taxable, whereas only 50% of a capital gain is included in income.

The Canada Revenue Agency (C.R.A.) is now aggressively following up on sales of real estate – especially residential real estate – examining the circumstances concerning the purchase and the sale, and the occurrence of other similar transactions (a pattern of buying and selling). In some cases, C.R.A. will challenge the capital gains treatment on sale. The "default" position is that the gain is business income and not a capital gain.

In order to support a gain being a capital gain, the seller may need to demonstrate that the property was purchased for personal use or long-term investment, with no intention to sell the property in the short term. There is a great deal of uncertainty and subjectivity concerning this area, and advice should be obtained at the time of purchase as to the likely treatment on an eventual sale.

The most important point is to demonstrate an investment intention at the time of purchase. This can be hard to show objectively so intention is often deduced from other factors such as the following:

- Frequency of transactions
- The length of time the property is owned
- The use to which the property was put
- Whether rental income was derived (showing production of income was a main purpose)
- The factors that led to the sale

For a Canadian-resident individual, the gain on sale of a principal residence is tax free. Non-residents have tried to use the same exemption through the use of Canadian-resident trusts and other means. These planning possibilities have now been closed by new legislation.

Graduated tax rates apply for individuals and vary based on the income level. The lowest tax rate for a non-resident is approximately 22%, while the highest rate – reached at taxable income over $200,000 (roughly) – will be about 49%. The effective tax rate on a capital gain is half of these rates.

Ownership of Canadian real estate by foreign persons through a foreign corporation can result in a significant tax advantage because such a corporation will pay a 25% corporate tax rate. Thus, on a capital gain, the effective tax rate will be 12.5%.

If the real estate is not capital property, the gain will be fully taxable. If a foreign corporation is used, then branch tax at 35% (or the lesser treaty rate if applicable) will also be charged. Treaty shopping limitations need to be considered in determining the rate of branch profits tax.

The other possible structures are use of a Canadian corporation or a trust.

There is no tax advantage to using a Canadian corporation versus a foreign corporation and there may be a disadvantage (the rate of dividend withholding tax may be higher than that of the branch profits tax). However, a Canadian corporation may be able to obtain Canadian financing more easily that a foreign corporation.

Generally speaking, there are no advantages to using a trust over a corporation. If a trust is to be used as part of the structure, it should be in the ownership of the corporate entity.

CLEARANCE CERTIFICATE PROCEDURE

Where a non-resident sells Canadian real estate, the purchaser is required to withhold 25% of the gross purchase price and remit this to C.R.A. as a withholding tax. If the property is (i) land inventory, (ii) real estate which is not capital property, or (iii) the building component that is used in a rental activity, the withholding tax rate is 50% of gross proceeds.

The vendor is required to obtain a clearance certificate from C.R.A. which serves two purposes: a notification to C.R.A. of the sale and a request for a reduction in the amount of the withholding tax. C.R.A. will give permission to reduce the withholding tax to 25% of the gain rather than 25% of the gross proceeds. (This presumes that the gain is a capital gain and not business income – or else the rate of withholding will be 50% of the gain.)

The clearance certificate process requires the filing of a form with C.R.A. together with a considerable amount of back-up information. At least 30 days, and preferably 60 days, should be allowed for completion of this process prior to closing of the date of the sale.

A Canadian tax return must be filed to report the sale. The withholding tax will be claimed there as a tax payment. Any excess will be refunded.

RENTAL

If the property is rented out, then the rental income will be subject to Canadian tax. This is often overlooked by non-residents, especially if the property produces rental losses.

There are two choices as to how the rental income can be treated. The default is that the tenant should remit to C.R.A. 25% withholding tax on the gross rental income. No reduction or offset is allowed for expenses. The alternative is to make an election to report the net rental income on an income tax return filed in Canada, in which case expenses may be deducted.

Many non-residents only become aware of the requirement to pay tax on rental income when the property is going to be sold and they apply for the clearance certificate.

The election to report the net rental income at regular Canadian income tax rates is usually beneficial compared to paying 25% withholding on the gross rental income. This is particularly the case if a foreign corporation holds the real estate, since its corporate tax rate will only be 25% in any event.

The election to pay tax on the net rental income must be made within two years of the end of the taxation year (six months if an application has been made to reduce the 25% withholding tax from gross rental income to the estimated net rental income and to file on the net rental income basis).

There is no provision to late-file the election. However, C.R.A. will allow a one-time late filing of elections going back to inception by administrative policy if it is done voluntarily by the taxpayer coming forward.

This will require filing of a tax return: a T-1 for a non-resident individual, a T-2 for a foreign corporation, or a T-3 for a foreign trust. The tax return is due six months after year end (calendar year for an individual or a trust).

FINANCING

Interest expense incurred on debt used to purchase a Canadian residential property will not be deductible if the property is held for personal use. However, interest will be deductible from the net rental income if the property is rented. One complication, however, is that a net rental loss cannot be used – except against other Canadian net rental income – and cannot be carried forward or back.

If the interest expense is paid to a related non-resident, it may be subject to non-resident withholding tax.

Interest expense may also be subject to capitalization limitations (the limit is generally 1.5:1 debt to equity).

H.S.T. (HARMONIZED SALES TAX)

The purchase of used residential property is exempt of H.S.T. (a V.A.T.-type sales tax at 5% federally and a provincial component of, typically, 8%). Other real estate, however, is also subject to H.S.T. A person paying H.S.T. may claim it back if the person carries on a business activity other than an exempt activity. Real estate rental and/or development will not be an exempt activity except for rental of residential real estate.

A person is required to register for H.S.T. to obtain a refund of H.S.T. or if taxable receipts exceed $30,000.00 in a 12-month period.

In a commercial real estate rental, the tenant will add H.S.T. to the rental. The landlord will collect the H.S.T. and remit to C.R.A. after claiming H.S.T. paid. Remittance may be required annually, quarterly, or monthly based on the amount.

CONCLUSIONS

As can be seen from the discussion above, the issues involved in owning Canadian residential property are complex. There are both tax planning considerations and tax compliance issues (various tax filings which need to be done). There are three main taxes to consider: land transfer tax, income tax, and H.S.T. Each comes with tax filing requirements.

C.R.A. is now aggressively enforcing the rules and following up on delinquent filers. They are examining land title registries and tracing title changes to tax returns. Because of the political attention which this area has now attracted, further and even more aggressive action can be anticipated from C.R.A. going forward.

Any non-resident of Canada who has ownership of Canadian real estate, or who is considering the purchase of Canadian real estate, should obtain professional advice.

C.I.V.s and V.C.F.s: The Keys to Investing in Portugal

By João Luís Araújo and Miguel Torres

Telles Advogados (Portugal)

INTRODUCTION

In recent years, Portugal has been best known for its national football team, its sun, and its good food. Whilst these basic ideas about Portugal still apply, the country has become more talked about in the context of international investment after a number of tax and legislative reforms were first introduced in 2012 – and, especially, from 2014 onwards. Portugal now has a favourable tax regime for individuals seeking to relocate to Portugal called the non-habitual resident (N.H.R.) regime, a Golden Visa regime available to investors seeking to invest in Portugal and receive a residency visa, and a visa-free travel regime for the Schengen Area. Also, from a corporate perspective, Portugal offers access to a number of structures, which are very tax efficient and compete with similar tax regimes found in other European countries.

This article will start by describing the general characteristics of the Portuguese corporate tax regime and will then focus on why Portugal is an efficient location to set up structures from which to make international investments or investments into Portugal. We will focus on describing the main features of the Portuguese tax regime as applicable to holding company structures and special regulated vehicles, such as real estate investment funds and companies, financial assets investment funds and companies, and venture capital funds (V.C.F.s).

MAIN CHARACTERISTICS OF THE PORTUGUESE CORPORATE TAX REGIME

Portugal has a typical corporate tax regime with corporation tax being levied at 21%, plus an additional municipal rate of up to 1.5%. Additionally, for companies with taxable profits greater than €1.5 million, an additional state corporate tax rate applies, starting at 3% and increasing to 7% for taxable profits over €35 million.

The set-up, administration, and liquidation of a Portuguese company is

C.I.V.s and V.C.F.s The Keys to Investing in Portugal

quite a simple process. Portugal is also considered an easy place to do business, ranking 34th on the World Bank's 2018 Ease of Doing Business Index. Importantly, whilst Portuguese-based banks apply all the same compliance and strict anti-money laundering practices as other European countries, recent experience shows that it is easier to open a bank account in Portugal than in a number of other European locations. This means that what is currently a significant constraint for companies to operate in certain locations should not be so much of an issue in Portugal, at least for the time being.

Portugal is an E.U. Member State and is, therefore, able to access the benefits granted by all relevant E.U. directives. Additionally, more than 75 double tax treaties (D.T.T.s) have been signed by Portugal with countries all over the world. Portuguese-based corporations, therefore, have access to a wide and relatively modern treaty network. The recently-signed D.T.T. with Angola stands out in this context since Portugal is now the first country with which Angola has a D.T.T. The same holds true for Brazil, with which Portugal has had a longstanding treaty in place and which does not have many other treaties.

Another point worth mentioning is that it is possible to resolve tax disputes very quickly by using the tax arbitration courts, a topic which would merit a separate article and where Portugal has really introduced an innovative concept. The regular tax courts in Portugal are notoriously slow and decisions may take years to be reached. This, coupled with the fact that taxpayers typically need to pay the amount of tax being challenged before contesting its legality in the courts, means that taxpayers rightly consider that going to court to ascertain their rights is a time consuming and typically expensive process. Understanding these concerns, the legislator introduced, in 2011, tax arbitration courts in which disputes are settled in a maximum timeframe of one year, or often less. This innovative approach to the arbitration courts allows the taxpayer to choose whether or not to use this route to settle disputes, and the tax authorities have to accept the choice made by the taxpayer. Tax arbitration courts have been a highly successful experiment and the way they were implemented in Portugal is actively being analysed by many other countries around the world.

In terms of anti-avoidance legislation, Portugal introduced, many years ago, controlled foreign company (C.F.C.) legislation, general anti-abuse provisions, and an interest deduction limitation rule.

Having provided a very high-level introduction to Portugal, we will now look at some of the specific measures and investment vehicles currently in place that make Portugal an interesting location from which to structure domestic or international investments.

THE PORTUGUESE PARTICIPATION EXEMPTION REGIME

As is widely known, Portugal suffered a very severe financial crisis beginning in 2009. The worst years were in the 2011-2014 period, when Portugal was under a severe austerity program supervised by the International Monetary Fund, the European Central Bank, and the European Commission. However, from every crisis comes opportunity. Nowhere is this more apparent than in Portugal. The times of the financial crisis were seen by the Portuguese government as an opportunity to push through economic and legislative reforms, which could have been more difficult to introduce under other circumstances.

These legislative changes were not only tax-related. Tax reforms coincided with labour market reforms, the liberalisation of the rental market, and actions in a number of other areas of the economy aimed at making Portugal a more attractive place in which to invest.

> ***C.I.V.s and V.C.F.s The Keys to Investing in Portugal***

Two key measures in this package of reforms were the introduction of the participation exemption regime and changes to the taxation of dividend distributions to foreign shareholders. When taken together, these changes make Portugal a favourable country from which to set up holding company structures and carry out international investments.

The Portuguese participation exemption regime was designed taking into consideration the tax regimes of many other European countries. The specific purpose was to increase the competitiveness of the domestic tax regime. As such, it will not be a surprise to see many features in Portuguese tax regimes that we encounter elsewhere in Europe.

For Portuguese companies with qualifying shareholdings, there will be:

- No tax on dividends received from qualifying shareholdings,
- No tax on capital gains received from qualifying shareholdings, and
- No withholding tax (W.H.T.) on dividends paid (so long as the distribution is made to a company that meets all the necessary criteria).

Dividends received or capital gains arising from a qualifying shareholding will be exempt from tax in Portugal if:

- The company receiving the income or realizing the capital gain holds no less than 10% of the shares or voting rights in the company making the distribution or being sold; and
- This shareholding is maintained for a period longer than 12 months.

The Portuguese participation exemption includes a number of anti-abuse provisions which are aimed at ensuring that the exemption on dividend income or capital gains on the disposal of shares only applies where the underlying company is subject to a level of tax that is considered to be at an appropriate tax rate. In particular, for the participation exemption to apply:

- The company that makes the distribution or is being sold must be resident in a jurisdiction that is not a tax haven[1];
- The company that makes the distribution or is being sold must be subject to tax in its country of residence at a rate which cannot be less than 60% of the Portuguese tax rate (i.e., cannot be less than 12.5%); and
- Even if the company making the distribution or being sold is resident in a tax haven, the participation exemption will still apply if it carries out a real trade in that country.

Provided that the above-mentioned conditions are met, the disposal of shares of qualifying companies and the receipt of dividends from such shares will be fully exempt from tax in Portugal.

Furthermore, dividends paid by a Portuguese-resident company are exempt from Portuguese W.H.T. as long as they are paid to:

- A company that is resident for tax purposes in another E.U. Member State (this is due to the

[1] Ordinance 345-A/2016 of 30th of December sets out the list of jurisdictions which, from a Portuguese perspective, are considered to be tax havens. This list includes around 80 territories, and it is relevant to (i) the application of the C.F.C. legislation, (ii) the granting of benefits under the N.H.R. regime, (iii) the application of a number of anti-abuse provisions, and (iv) the taxation at aggravated rates of a number of items of income sourced from these jurisdictions, as well as a number of other purposes.

application of the Parent-Subsidiary Directive) or in a country in the European Economic Area (E.E.A.), or

- A company that is resident for tax purposes in a country with which Portugal has signed a D.T.T.

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The above exemption from Portuguese W.H.T. applies where the company to which the dividend is paid:

- Is subject to, and not exempt from, tax at a rate which is at least 60% of the Portuguese tax rate, and
- Holds more than 10% of the Portuguese company and held these shares for an uninterrupted period of one year prior to the distribution.

This exemption to tax on the dividends paid from Portugal does not apply where the recipient of the dividend is not a company but an individual. In this case, a 28% W.H.T. rate will apply. This rate will be reduced should the individual recipient of the dividend be resident for tax purposes in a country with which Portugal has a D.T.T. providing for such a reduction.

As can be seen, the Portuguese participation exemption regime is extremely competitive when compared to other European countries such as Luxembourg or the Netherlands, which have, for a long time now, been used as the location of choice for the creation of international holding structures.

Furthermore, in a world where substance is ever more important, especially once the multilateral instrument (M.L.I.) and other O.E.C.D. B.E.P.S. measures are implemented across multiple jurisdictions, it is worth noting that the costs of incorporating and maintaining structures in Portugal are much lower than in other European destinations. This also goes for the hiring of office space or employees, since labour and the general cost of doing business are significantly lower in Portugal than in other European locations. As such, creating substance in Portugal should be much cheaper than in other European jurisdictions. This fact has not gone unnoticed by companies from all over the world, who are currently busy moving their businesses to Portugal.

PORTUGUESE REGULATED VEHICLES – FUNDS AND COMPANIES

A brief introduction to the legal regime

Portuguese collective investment vehicles (C.I.V.s) were regulated by legislation enacted in March 2015. The legislation that introduced the new legal regime was closely followed by a new tax regime, also introduced in 2015, which set out the tax rules applicable to such entities.

From a legal perspective, C.I.V.s can be defined as institutions, with or without legal personality, which are aimed at the collective investment of capital obtained from investors, whose operation is subject to the pursuit of the participants' exclusive interest.

Under Article 5(1) of the C.I.V. legislation, these entities may take the form of a contractual relationship, created as an investment fund, or may be incorporated in a corporate form –– in this case, investment companies in the form of *sociétés anonymes* (SAs) or public companies.

Where C.I.V.s are created in the form of funds, they constitute autonomous assets, without legal personality, belonging to the participants in the special communion regime. The main characteristic of these entities is that they offer the collective investment of capital with the benefits that come from economies of scale and professional management with a dispersion of risks and a dilution of costs.

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Investment companies are incorporated in the form of an SA or public company and have all the main characteristics that would be expected of a corporate entity: distinct legal personality, ability to enter into contracts, limited responsibility, statutory bodies, etc.

Collective investment funds must be managed by a third-party management company which is regulated in Portugal or in another E.U. country. Collective investment companies may be managed by a third-party management company or may be self-managed. A self-managed investment company will face closer scrutiny from the regulatory authorities since it must demonstrate that it has the necessary internal to manage all the compliance and regulatory requirements that are imposed by the authorities.

C.I.V.s can be open- or closed-ended vehicles regulated by the financial authorities, the *Comissão de Mercado e Valores Mobiliários* (C.M.V.M.). They are A.I.F.M.D.-ready (referring to the E.U. Alternative Investment Fund Managers Directive), which means that they can access the European investment passport, assuming all conditions are met.

It should be noted that these C.I.V.s must receive approval for incorporation from the C.M.V.M., as well as the Portuguese Central Bank. The process of approving such vehicles takes around 90 days, and our recent experience in dealing with the authorities in such projects has been quite positive.

Apart from the traditional distinctions between open -ended and closed funds, capitalisation, or income distributing, Portuguese C.I.V.s are distinguished mainly by the types of assets in which they can invest. The distinction between real estate vehicles and financial investment entities is very important. On one hand, the objective of the latter is to manage assets composed of highly-liquid securities, financial instruments admitted to trading or on a regulated market, and overnight deposits. On the other hand, real estate vehicles can only invest in real estate assets or in securities of companies with the objective of mediating, transacting, developing, or exploiting real estate.

The tax regime applicable to C.I.V.s

C.I.V.s are, in principle, subject to tax in Portugal. However, they are exempt from tax on all categories of income typically received, since the applicable legislation provides that the following items of income will not be taken into consideration when calculating taxable income:

- Capital income,
- Property income, and
- Capital gains.

These sources of income are excluded from the tax base in all cases, except where such income is derived from entities which are resident or domiciled in a country, territory, or region where it is clear there is a more favourable tax regime. (See, for example, the above-mentioned tax haven list.)

Like other corporate taxpayers, C.I.V.s must submit a periodic declaration of income and also comply with self-assessment of the tax due by the last day of May.

As a result of the above, whilst C.I.V.s are subject to corporate tax, they will actually pay little or no corporate tax at the entity level, unless they have items of income that do not fall under the categories excluded from tax. In practice, this is unlikely to happen. However, this does not mean that C.I.V.s are not subject to any taxation in Portugal, since the net asset value (N.A.V.) of the C.I.V.s will be subject to Portuguese Stamp Duty on a quarterly basis.

The N.A.V. of the C.I.V. is determined on the basis of the average values reported to the C.M.V.M. or disclosed by the management entities. The following stamp duty rates will apply per quarter:

> ***C.I.V.s and V.C.F.s The Keys to Investing in Portugal***

- 0.0025% per quarter (i.e., 0.01% a year) for C.I.V.s investing exclusively in financial instruments and deposits, and
- 0.0125% per quarter (i.e., 0.05% a year) for other C.I.V.s, such as real estate investment entities.

Settlement of Stamp Duty must be made by the last day of the month subsequent to the constitution of the tax obligation, which is established on the last day of March, June, September, and December of each year.

This means that, at the entity level, no taxation is expected to apply to C.I.V.s, apart from the stamp duty costs. Portugal has, as such, implemented the exit approach to tax on these entities. This means that it seeks to apply only one level of tax and to apply it at the level of the individual unitholders or shareholders in these vehicles. The tax rate at the investor level will depend on whether the investor is resident in Portugal and whether the vehicle invests in real estate or in financial assets.

For foreign investors in Portuguese investment vehicles, the applicable W.H.T. rates are:

- 10% on real estate investment vehicles, and
- 0% in relation to all other income.

Capital gains made by foreign investors on the disposal or redemption of shares or units in C.I.V.s investing in financial assets will not be subject to tax in Portugal. However, capital gains made by foreign investors on the disposal or redemption of shares or units in real estate C.I.V.s may be taxable in Portugal.

For Portuguese investors in Portuguese C.I.V.s, the tax applicable is typically a flat rate of 28%, the rate that is generally applicable to capital and rental income. The same rate will apply to gains arising on the disposal or redemption of such assets.

An added advantage of a Portuguese C.I.V. is that it is able to access tax treaties, as (from a Portuguese perspective) it is considered to be a local taxpayer and subject to tax. Certain countries may not consider these vehicles to be funds with access to the treaties, since they are not a body corporate. Where this proves to be an issue, it may be advisable to incorporate as a collective investment company rather than a collective investment fund to avoid such limitations.

Our law firm has recently been working on projects relating to the conversion of existing non-regulated real estate entities with very significant real estate assets into regulated investment companies. This is a time-consuming and complex project, but subject to all necessary conditions being met, it should be possible to convert a non-regulated entity into a regulated investment company without triggering any adverse tax consequences. Once the entity has been converted and is fully authorised by all relevant authorities, the above-described tax regime will be available. This may represent a substantial tax saving, since corporate tax may no longer be levied on the capital gains realised on the disposal of the properties or on the income generated by the assets.

In summary, these vehicles can be extremely tax efficient, since taxation at the level of the vehicle will be relatively low (relating to stamp duty only) and taxation on the distribution may be as little as 0% (for foreign investors in financial asset vehicles) or 10% (for foreign investors in Portuguese real estate companies or funds).

PORTUGUESE REGULATED VEHICLES – PORTUGUESE V.C.F.s

C.I.V.s and V.C.F.s The Keys to Investing in Portugal

Portuguese V.C.F.s have proven to be very efficient and very popular for a number of different purposes.

Similar to the C.I.V.s described above, V.C.F.s are regulated entities, albeit the regulations are less stringent – especially for funds with assets below a certain threshold and which market only to qualified investors. The purpose of a V.C.F. is, however, distinct from the other vehicles mentioned above. V.C.F.s are meant to invest in companies – mainly in Portugal or other E.U. countries, although they can also invest in non-E.U. companies within certain limits. The aim of a V.C.F. is to acquire securities in such entities with a goal of improving their returns and increasing the value of the investments before a potential exit. As such, the purpose of a V.C.F. is to invest in companies with high potential for development in order to benefit from an increase in their valuation. V.C.F.s cannot invest directly in assets nor carry out trading activities in their own name. Direct investment in real estate is expressly forbidden, although V.C.F.s may invest in real estate investment companies.

V.C.F.s are managed by venture capital management companies, which are themselves regulated entities.

The Portuguese tax regime applicable to V.C.F.s

From a tax perspective, the income of a V.C.F. incorporated and operating under the Portuguese legal regime is exempt from taxation. Similarly, the subscription of units in the fund is not subject to tax.

The income obtained by investors who are resident for tax purposes in Portugal will be taxed differently, depending on the type of investor (individual v. entity) and whether the investor is based in Portugal.

Individuals and entities resident in Portugal for tax purposes will be subject to a 10% W.H.T. on income paid by the V.C.F. and on the income resulting from the redemption of units in the fund. While the W.H.T. rate is the same for resident entities and individuals, there is one significant difference:

- In relation to resident entities, the 10% W.H.T. has the nature of a payment on account of the final tax due. Corporate tax at the normal rates will always be payable on this income.

- In relation to resident individuals, the 10% W.H.T. has the nature of a final tax, so that no further income tax is payable on the income.

Individuals that are resident in Portugal for tax purposes will be subject to a 10% tax

rate on capital gains made on the disposal of a participation in the fund. Entities that are resident in Portugal for tax purposes will be subject to the general corporate income tax regime on capital gains made on the disposal of a participation.

Non-resident entities, on the other hand, are exempt from tax on the income paid by V.C.F.s. This same treatment will apply on the redemption of the units of the fund. Income received, or redemptions made, by non-resident individuals should be subject to a 10% W.H.T. Capital gains made on the disposal of a participation by non-resident investors will generally be exempt from taxation in Portugal.

Contrary to C.I.V.s, V.C.F.s cannot access the Portuguese treaty network since they are not subject to tax and, therefore, will not meet one of the main conditions for the application of the treaties, namely being a taxpayer of Portugal.

The table below provides a brief overview of the taxation regime applicable to C.I.V.s and V.C.F.s.

CONCLUSION

Whilst being a small country in the Western corner of Europe, Portugal has recently been attracting significant international investment via a combination of positive external factors: a fantastic economic turnaround following what was one of the worst financial crises in recent memory and a number of legal and tax changes intended to make the country a more investor-friendly jurisdiction. Portugal has, in a relatively short amount of time, introduced a number of programs that are among the most interesting and tax efficient in Europe. In Portugal, investors will find access to highly-qualified staff for a comparatively low cost, a fantastic quality of life, sun, good food, and a never-ending choice of good beaches and beautiful golf courses!

For all these reasons, Portugal is, now more than ever, open for business, open for investment, and ready to seize the many opportunities that arise as a consequence.

	CIV Financial assets	CIV Real estate assets	VCF
Taxation at the level of the vehicle and investor	Corporate taxpayer but typically not subject to tax since most relevant items of income are not included in the tax base Capital gain on the sale of shares or units by foreign investors typically not taxed in Portugal 0% WHT in Portugal on income paid to foreign investor 28% tax on income paid to Portuguese investor	Corporate taxpayer but typically not subject to tax since most relevant items of income are not included in the tax base Capital gain on the sale of shares or units by foreign investors may be taxed in Portugal 10% WHT in Portugal on income paid to foreign investor 28% tax on income paid to Portuguese investor	Not a corporate taxpayer. Capital gain on the sale of shares or units by foreign investors is typically not taxed in Portugal 0% WHT on income distributed to non-resident entities and non-resident individuals may be subject to 10% WHT 10% WHT applicable on income paid or gains made by resident entities or individuals, with some importance distinctions having to the made in this context
Access to treaties?	Typically, yes	Typically, yes	Typically, no
Stamp duty	Yes, at a 0.01% rate a year applicable on the NAV	Yes, at a 0.05% rate a year applicable on the NAV	Not subject to stamp duty

U.K. Tax Developments for the Digital Age

By Gary Ashford

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The world has changed, and tax authorities find that new rules are required to accomplish old tasks. Existing tax systems applying domestic tax rules to cover international taxation were created at a time when international trade principally meant production of a physical product in one country that was shipped by vessel to a market overseas. These systems have become obsolete as value drivers in trade now focus on state-of-the-art intellectual property (I.P.) that can be transferred to ten different locations in less time than it took to read this sentence. Now, we are seeing governments and tax authorities introducing new rules to counter the perceived, and often real, inappropriate enjoyment of benefits by international digital businesses and to bring the law in line with the increasing digitalisation of the traditional economy.

This is certainly the case in the U.K. Statistics show that the U.K. has the greatest percentage of online retail shopping in Europe. As of 2017, the percentage of online retail sales in the U.K. was 17.8% of total trade, steadily up from a figure of 13.5% in 2014[1]. In comparison, online retail sales in Italy amounted to 3.4% of total trade in 2017, which was up from 2.1% in 2016. On a world basis, the U.K. is third, behind only China and the U.S.[2]

The U.K. government and H.M.R.C., the U.K. tax authority, are focused on countering tax imbalances between international digital businesses and more traditional, often domestic, brick-and-mortar businesses. The international community is also working to address many of the same challenges. For example, we saw the Organisation of Cooperation and Development (O.E.C.D.), set up the Base Erosion and Profit Shifting (B.E.P.S.) initiative in 2012, which published 15 findings and recommendations (Actions) in 2015. Many Actions are being adopted by tax authorities globally, including H.M.R.C. We have also seen the European Commission (the Commission) take action with the implementation of the E.U. Anti-Tax Avoidance Directive (A.T.A.D.). Separately, the U.S. has updated its tax code with various amendments in this area through the introduction of B.E.A.T., G.I.L.T.I., and anti-hybrid provisions.

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[1] Statisa, the Statistics Portal, https://www.statista.com/statistics/281241/online-share-of-retail-trade-in-european-countries/.

[2] Id., at https://www.statista.com/statistics/274493/worldwide-largest-e-commerce-markets-forecast/.

U.K. Tax Developments for the Digital Age

This article looks at some of the International challenges but also at changes and potential proposals introduced in the U.K. to address this new, developing, and increasingly digitised world.

THE B.E.P.S. INITIATIVE

As stated above, the O.E.C.D., as well as the G-20 countries, set out in 2012 to look at the challenges of the digital economy and the challenges produced more generally by the current international tax model.

Over a short period, findings were introduced by way of the 15 B.E.P.S. Actions:

Action 1	The Digital Economy
Action 2	Hybrid Mismatches
Action 3	C.F.C. rules
Action 4	Interest Deductions
Action 5	Harmful Tax Practices
Action 6	Treaty Abuse
Action 7	Permanent Establishment
Actions 8-10	Transfer Pricing
Action 11	B.E.P.S. Data Analysis
Action 12	Disclosure of Aggressive Planning
Action 13	Transfer Pricing Documentation
Action 14	Dispute Resolution
Action 15	Multilateral Instrument

Most members of the O.E.C.D. have implemented the recommendations in whole or in part. The U.K. already had rules for many of the Actions, such as C.F.C.s, transfer pricing, and permanent establishments (P.E.s). In relation to other Actions, the U.K. has introduced rules around hybrid mismatches and interest deductions. Interest expense deductions will generally be limited to 30% of EBITDA where interest expense exceeds £2 million.

B.E.P.S. Action 1

B.E.P.S. Action 1 addressed issues arising from the digital economy. On 16 March 2018, the O.E.C.D. published "Tax Challenges Arising from Digitalisation – Interim Report 2018". This report sets out an O.E.C.D. Inclusive Framework-agreed programme and a direction of work on digitalisation and international tax rules through to 2020.

The report determined that technological advances have brought about a rapid decline in the unit cost of data processing, leading to dramatic increases in the use of digital information which can be manipulated at high speeds and low marginal costs. This change has facilitated the adoption and integration of digital products and transactions, inducing an ongoing, structural transformation of the economy. As a result, the structure of businesses and the process of value creation have evolved significantly. The report identified the most salient, common characteristics of digitalised businesses. These characteristics, which may become common features of an even wider number of businesses as digitalisation continues, include: (1) cross-jurisdictional scale without mass; (2) reliance on intangible assets, including I.P.; and (3) data, user participation, and their synergies with I.P.

Cross-jurisdictional scale without mass

The interim report explains the ways by which digitalisation has allowed businesses to locate various stages of production processes across different countries, whilst at the same time accessing a greater number of customers around the globe. It states that digitalisation allows highly digitalised businesses to be heavily involved in the "economic life" of a country without any "significant presence" in that country.

Reliance on intangible assets, including I.P.

According to the interim report, digitalised enterprises are characterised by the growing importance of investment in intangibles, especially I.P. assets, which could either be owned by the business or leased from a third party. For many digitalised enterprises, the intense use of I.P. assets, such as software and algorithms supporting their platforms, websites, and many other crucial functions, are central to their business models.

Data, user participation, and their synergies with I.P.

According to the report, data, user participation, network effects, and the provision of user-generated content are commonly observed in the business models of more highly digitalised businesses. The benefits from data analysis are also likely to increase with the amount of collected information linked to a specific user or customer. The important role that user participation can play is seen in the case of social networks, where without data, network effects, and user-generated content, the businesses would not exist as we know them today. In addition, the degree of user participation can be broadly divided into two categories: active and passive. However, the degree of user participation does not necessarily correlate with the degree of digitalisation. For example, cloud computing can be considered as a more highly digitalised business that involves only limited user participation.

Whilst participating O.E.C.D. members agree on the characteristics of digitised business models and have established a programme to continue examining the issue, no consensus exists regarding the location of the value creation or the identity of the value creator. In the absence of consensus, many countries, including the U.K., are pressing ahead with interim taxing methods. The U.K. government believes that the way in which highly digitised businesses derive value from user participation is the fundamental challenge to the historic model of cross-border business taxation. As a result, it introduced the diverted profit tax in 2015 and proposes to introduce additional taxes on digital sales to U.K. customers.

B.E.P.S. Action 5

B.E.P.S. Action 5 looked at harmful tax practices and, in particular, rules relating to the taxation of intangibles. Many countries, including the U.K., already offered regimes for taxing profits of a corporation arising from patent income at a lower rate. The U.K. patent box regime, for example, taxed profits from qualifying patents structured as royalties or embedded within sales income at a reduced rate of 10% (less than 53% of the current rate of U.K. corporation tax of 19%).

Action 5 recommended close alignment between these regimes and underlying research and development (R&D) activity. In line with the recommendation, the U.K. introduced changes to its patent box regime in 2016. Qualifying income from patents remains taxed at the 105% rate but, in line with Action 5, the U.K. adopted the "modified nexus" rule, which requires tracking of R&D activity and differentiating between R&D activity carried out by the company claiming the relief and R&D which has been outsourced.

B.E.P.S. Action 7

Regarding P.E.s (Action 7), the U.K. announced that it will conform its P.E. rules to the O.E.C.D. recommendations.

In the meantime, several jurisdictions have sought to introduce local, short-term solutions to the issue of overseas media and tech businesses selling services within the particular jurisdiction and often paying little tax because of the absence of a P.E., notwithstanding substantial sales to thousands of customers. Both the E.U. and the U.K. are looking to introduce a form of digital sales tax, based in part around the interaction of the website and users in the country where "sales" occur.

U.K. DIVERTED PROFITS TAX (D.P.T.)

The U.K. introduced the D.P.T. (known colloquially as the Google tax) on 1 April 2015 by way of Finance Act 2015. The D.P.T. is intended to apply to two broad situations:

- The first situation involves a foreign company that structures its arrangements to avoid creating a U.K. P.E. Several thresholds must exist before the D.P.T. applies. One is that the foreign company must generate more than £10 million annually in U.K.-related sales revenues from the supply of goods, services, or other property. A second is that the foreign company must incur more than £1 million in U.K.-related expenses.

- The second situation involve entities or transactions involving affiliated parties that lack economic substance. Here the transaction must involve either a U.K.-resident company or a U.K. P.E. of a foreign company that is part of an arrangement designed to exploit tax mismatches.

In general, profits chargeable to U.K. taxes are subject to transfer pricing rules under Section 147 TIOPA 2010. Under that provision, tax law calculations are to be based on arm's length principles where there is a participation relationship between two persons. Where the transaction value yields to a result that is not-arm's length in amount, an adjustment is required to reflect arm's length principles. The result of any transfer pricing adjustment is a potential adjustment in the company's tax return.

The aim of the D.P.T. is to apply in those cases where the transfer pricing adjustment is insufficient or there is some sort of recharacterisation of the arrangements. In those circumstances, the D.P.T. is applicable on a just and reasonable basis.

The rules are intended to apply only to large enterprises and not to small- or medium-sized enterprises (S.M.E.s). S.M.E.s broadly comprise enterprises employing globally fewer than 250 persons, an annual global turnover not exceeding €50 million, and an annual balance sheet not exceeding €43 million in assets. It is important to appreciate that the D.P.T. can still apply if there is one large company and one S.M.E. Note that the rules are not limited to transactions or arrangements within tax havens or low -tax jurisdictions but can apply more broadly. If the D.P.T. applies, any D.P.T. adjustment will be taxed at 25%, which exceeds the current corporation tax rate of 19%.

U.K. Tax Developments for the Digital Age

H.M.R.C. has set up D.P.T. investigation teams and these teams have already secured significant returns. Figures released in September 2017 show that application of the D.P.T. raised £281 million in the tax year 2016/17, of which about half arose from 14 D.P.T. charging notices. D.P.T. is moving into a new phase within the U.K., and H.M.R.C. anticipates raising £200 million in 2017/18 and £300 million in each of the following two years.

H.M.R.C. recently announced a temporary voluntary disclosure program for companies that have participated in diversion schemes. It will run through December 31, 2019. In principle, participants will be viewed to make unprompted disclosures, which should lower penalties.

NEW U.K. TAX ON OFFSHORE INTANGIBLE INCOME LINKED TO U.K. SALES

In the 2017 Budget, the U.K. government set out their intentions to find a way to tax royalty income of offshore companies where a direct or indirect link exists to U.K. sales. The legislation is included in Finance Bill 2019.

The tax is currently in the consultation stage within the U.K. It will apply from 6 April 2019 and will have the effect of imposing U.K. income tax on the owners of intangible property or those that are entitled to intangible property income that is linked to the sale of goods or services in the U.K.

A safe harbour is to be provided if all the following facts can be established:

- The value of U.K. sales is less than £10 million in a given tax year.
- Substantially all, of the business activity in relation to the intangible property historically has taken place in the territory of residence of the company generating intangible income.
- The tax actually paid on the intangible income is at least 50% of the U.K. income tax that would otherwise arise under this measure.

Several proposed administrative rules are designed to ensure collection of the tax. Joint and several liability will exist for the income tax charge among the members of the control group that contains the foreign company generating the royalty income. Targeted anti-avoidance rules are proposed to ignore arrangements entered into on or after 29 October 2018.

U.K. Tax Developments for the Digital Age

These proposed changes will exist side-by-side with current provisions that were adopted in Finance Act 2016. Those provisions were not specifically targeted to the digital economy but had the effect of broadening the U.K. withholding tax rules on payments of royalties to owners overseas.

NEW U.K. DIGITAL SERVICES TAX (D.S.T.)

In the 2018 Budget, the U.K. government announced the introduction of the D.S.T. This is a new tax which seeks to protect the U.K. tax base whilst in principle recognises the international tax rule that multinational groups should be taxed only on profits derived from activities undertaken and value generated within the jurisdiction. The tax will apply from April 2020 and the legislation will be included in the U.K. Finance Bill for 2019/20. A Consultation document was released by HM Treasury and H.M.R.C. in November 2018. The D.S.T. will apply a 2% tax on revenues of specific digital business models linked to the participation of U.K. users. The tax will apply to search engines, social media platforms, and online marketplaces. The U.K. government estimates that the D.S.T. will raise £1.5 billion over four years.

The government states that the D.S.T. will only apply to the revenues that are attributable to business models linked to U.K. users. What matters is the location of the user, not the location of the business. Certain fact patterns illustrate the scope of the D.S.T.:

- A social media platform generates revenues from targeting advertisements at U.K. users.
- A marketplace generates commissions by facilitating a transaction between U.K. users.
- A search engine generates revenues by displaying advertising keyed by search terms input by U.K. users.

The D.S.T. will apply only to large businesses. To come within its scope, the consultation document provides that a business must generate more than £500 million in annual global revenue from targeted business activities. Once that condition is met, the tax will apply only to annual revenue from targeted business activities linked to the participation of U.K. users. The first £25 million of business revenue will be exempt. Businesses will be entitled to make an alternative calculation of their D.S.T. liability when the model produces low profit margins. The D.S.T. will be deductible against a company's corporation tax but will not be creditable.

THE PROPOSED E.U. DIGITAL SERVICES TAX

The Commission has developed two proposals that achieve goals that are similar to those of the D.S.T. The first proposal aims to reform corporate tax rules so that profits are registered and taxed where businesses have significant interactions with users through digital channels. This is the preferred long-term solution of the Commission. The second proposal responds to requests from several Member States for an interim tax which covers the main digital activities that currently escape tax altogether in the E.U.

Common corporate tax rules for digital activities

The Commission states that this proposal would enable Member States to tax profits that are generated in a territory in the absence of physical presence. Under the proposals, a digital platform will have a taxable digital presence or a virtual P.E. in a Member State if it meets any one of certain criteria:

- The digital platform generates more than €7 million in annual revenues in a Member State.
- The digital platform has more than 100,000 users in a Member State in a taxable year.

- The digital platform generates 3,000 business contracts for digital services between the company and business users in a taxable year.

The Commission contends that the potential changes will modify the way profits are allocated to Member States. The goal is to better reflect how companies create value online. In this way, the goal of the proposal is similar to the U.K. D.S.T. in that it attempts to link the right to tax to the location of users at the time of consumption.

Interim tax on certain revenue from digital activities

As an interim measure, the Commission has proposed an indirect tax that will apply to revenues created from activities where users play a major role in value creation. The term "indirect tax" connotes a tax on gross sales revenue with no relief provided for cost of goods sold or operating costs. The interim tax will apply to revenue generated in the following circumstances:

- Revenue created from selling online advertising space.
- Revenue created from digital intermediary activities which allow users to interact with other users and which can facilitate the sale of goods and services between them. (EBAY is an example.)
- Revenue created from the sale of data generated from user-provided information.

The rate of tax being proposed is 3%, which exceeds the U.K.'s own 2% proposal. The tax will apply only to companies with total annual worldwide revenues of €750 million or more, including E.U. revenues of at least €50 million.

U.K. ANTI-PROFIT FRAGMENTATION RULES

The U.K. government has proposed a new set of rules designed to attack schemes that fragment profits in an abusive way. The changes will amend the territorial scope set out within Section 6 of Income Tax (Trading and Other Income) Act 2005 (I.T.T.O.I.A.) or Part 3 Corporation Tax 2009 (C.T.A.).

The proposals are intended to be effective from April 2019. The purpose of this legislation is to prevent U.K.-resident businesses and professional firms from avoiding U.K. tax by arranging for U.K.-source business profits to accrue to entities resident in territories having significantly lower tax rates that those imposed in the U.K. This will exist when tax paid abroad on a portion of business directed to the U.K. is less than 80% of U.K. tax. For corporations, the current tax rate in the U.K. is 19%. Consequently, the proposal attacks fragmentation plans of corporations that allocate profit to a jurisdiction which imposes tax at a rate of less than 15.2% when the computation of income in the U.K. and the other jurisdiction is computed without material differences. If a business or profession is carried on in partnership form and the members are individuals, the target rate will be much higher, reflecting the graduated rates of tax imposed on individuals.

Currently, profits of a trade arising to a U.K. resident are chargeable to U.K. tax wherever the trade is carried on. Also, profits of a trade arising to a non-U.K. resident are chargeable to U.K. tax only if they arise from a trade carried on wholly or partly in the U.K. In the latter case, the profits from the part of the trade or professional activity carried on in the U.K. is subject to tax.

The new legislation will apply when a set of specified factors exist:

- There is a transfer of value from a U.K. trader to an offshore entity. (This could arise from a diversion of income or payment of expenses to an offshore entity.)
- The effect of the arrangement is that a significantly lower level of tax is paid on the profits than would be the case if properly taxed in the U.K. in the absence of the arrangement.
- The proprietor of the business, whether a sole trader or partner in an unincorporated business,

or director and/or shareholder of a company can enjoy the profits that have been diverted.

- The U.K. person has arranged for the profits to be diverted to the offshore entity.

- The diversion or payments are not commensurate with the work undertaken by the offshore entity.

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The legislation applies only where it is reasonable to conclude the relevant arrangements were entered into to obtain a tax advantage. Where the new legislation is applicable to a U.K. business, taxpayers will be required to notify H.M.R.C. of relevant arrangements meeting certain criteria within their tax returns. Where all factors exist and the prohibited tax -saving intent exists, the arrangement is counteracted by bringing the profits back into U.K. tax by attributing the correct amount of profits to the U.K. business or professional activity.

PERSONAL SERVICES COMPANIES (P.S.C.s)

The U.K. has seen a significant increase in the number of individuals operating in the U.K. through P.S.C.s. This phenomenon was first apparent shortly after H.M.R.C. introduced the off-payroll working rules known as IR35.

These rules attempt to ensure that people working through a P.S.C. who would have been employees if they had been engaged directly, pay broadly the same income tax and national insurance contributions as would be paid if they were employed. The provisions of IR35 were largely unsuccessful. H.M.R.C. estimated that prior to 2017, only 10% of individuals working in this way applied the rules properly, costing the government millions of pounds in lost tax revenues every year.

In April 2017, the government reformed these rules for engagements in the public sector. As a result, a public authority must decide whether the off-payroll working rules apply because the appropriate conditions have been met. If so, it must deduct income tax and national insurance contributions from a payment to a P.S.C. If the worker is paid by an agency or other labour provider, a public authority must advise the agency that pays the worker that the off-payroll working rules should apply.

For purposes of the off-payroll rules, a public authority is defined by the Freedom of Information Act 2000 and the Freedom of Information (Scotland) Act 2002. Included are government departments and their executive agencies, companies owned or controlled by the public sector, schools and universities, local authorities, and the National Health Service.

In the Autumn Budget 2017, the government announced it would consult on how to tackle non-compliance with the off-payroll working rules for workers in the private sector. This was followed by a consultation document on 18 May 2018, in which H.M.R.C. and HM Treasury sought private sector input in drafting the provision. As part of the request, an example of the abusive tax structuring was provided to illustrate the scope of the issue:

> ILLUSTRATIVE EXAMPLE 1: The non-compliant off-payroll project manager Charlie is a project manager working through a limited company (his own P.S.C.). A private sector company, ABC Ltd, contract with Charlie's P.S.C. from 6 April 2018 to 5 April 2019. Charlie's working practices are such that he would be an employee of ABC Ltd if he contracted directly with them. Charlie's P.S.C. charges ABC Ltd £50,000 for his services, and his P.S.C. is not registered for VAT. Charlie follows a typical strategy, paying himself an income tax and N.I.C.s efficient salary. Charlie's P.S.C. pays corporation tax on the remaining payment from ABC Ltd; and he then chooses to distribute all remaining income from the work to himself as dividends. Charlie personally pays £2,119 in income tax. Charlie's P.S.C. pays £7,899 in corporation tax. The total income tax and corporation tax paid would be £10,018.

Charlie is not currently compliant with the off-payroll working rules.

However, if Charlie was compliant, the total income tax and N.I.C.s (including employer N.I.C.s) due on the payment from ABC Ltd would be £15,041, having taken into account a 5% expenses deduction allowable under the off-payroll working rules in the private sector. As a result of Charlie's non-compliance on this engagement £5,023 less tax is paid. Charlie has not paid any N.I.C.s as the salary he has paid himself is at the same level as the primary/secondary N.I.C.s threshold.

Thomas is an employee of ABC Ltd, doing the same job as Charlie. Employing Thomas also costs ABC Ltd £50,000 a year, in salary and Employer N.I.C.s. The total income tax and N.I.C.s due (including employer N.I.C.s), from Thomas and ABC Ltd is £16,047. This means that, despite Charlie and Thomas doing the same job, the total income tax and N.I.C.s paid is £13,928 less as a result of Charlie's non-compliance. When corporation tax payments by Charlie's P.S.C. are taken into account the total tax and N.I.C.s lost is £6,029. Both ABC Ltd for Charlie's services and Charlie pay less.

In addition, the U.K. has recently introduced a targeted anti-avoidance rule aimed at limiting the opportunity for those who wind up companies and seek to extract funds as capital distributions payments of compensation. The provision is aimed at eliminating employee owned businesses from being liquidated in a transaction that provides owners with the benefit of 10% capital gains tax under the entrepreneur's relief provision that is applicable to the liquidation distribution if the liquidation is followed by the formation of a new company that carries on the same business with the same personnel. Were the company to have remained in existence and paid a dividend, the tax on the dividend distribution would be significantly greater than the tax on the capital gain when the entrepreneur's relief is claimed; dividends can be taxed at rates up to 38.1%.

The targeted anti-avoidance rule will have an impact on many workers in the digital economy who work through a P.S.C.

SUMMARY

The timeline for a product to go from life-changing status to obsolescence is constantly shrinking. Think of a Palm Pilot with a stylus, a video tape player, an iPod, a Wang Machine for word processing, or an e-mail account that required a monthly fee. In short, we live in interesting times. One effect of these massive changes is that value is separated from bricks, mortar, and heavy industry. In their place, IP-embedded sales of data, delivery of digital products from a base in the cloud, and virtual marketplaces allowing businesses to access a global customer base are able to generate huge sums of profit with no physical presence in any particular state. It should come as no surprise that governments are wrestling to modernize tax rules to match new business models.

The U.K. has taken steps to address this body of stateless entrepreneurs who profitably serve customers in the U.K. More and more income that was thought to be based at the place of residence of the entity carrying on the business is now being characterized as having a U.K. component. Whether the new tax in the U.K. takes the form of the D.V.P. or the D.S.T., IR35, or the anti-fragmentation rules, change has arrived.

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- Member of the Council of Chartered Institute of Taxation
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PROFESSIONAL HIGHLIGHTS

- Managing Partner, Cadesky Tax, Canadian and International Tax Specialists, Toronto
- Chair, CPA Canada Tax Committee for Small and Medium-Sized Enterprises
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- Elected Fellow of CPA Ontario (FCA Designation)
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- Chairman, Society of Trust and Estate Practitioners (STEP Worldwide), 2004—2006; Chair, STEP Canada, 1998—2004; currently Vice President of STEP Worldwide
- Recipient Geoffrey Shindler Award for Outstanding Contribution to the profession, 2013, STEP's highest award
- Chairman, Tax Specialist Group (TSG), 1999—present
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- Author of numerous papers on Canadian and international taxation, lecturer and media commentator on tax issues
- Editor-in-Chief, Taxation of Real Estate in Canada (Carswell), co-author, Trusts and International Tax Treaties(Tottel), Taxation at Death (Carswell), Towards Greater Fairness in Taxation, A Model Taxpayer Charter (IBFD)
- Frequent speaker at professional seminars in Canada, the Caribbean, Europe, and Asia
- Advised on tax policy and administration to Minister of National Revenue, Auditor General, Department of Finance, Canada Revenue Agency and several foreign governments
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Mr. Durá focuses his practice on inbound and outbound international tax planning, particularly with tax treaty interpretation, investment holding structures and expatriate-impatriate taxation.

Also extensive experience in international corporate, individual, estate planning (involving international inheritance scenarios) and high-level experience with tax audits and court cases before the Spanish tax administration and Spanish Tax Courts, respectively.

PROFESSIONAL HIGHLIGHTS

- Partner of Dura Asesores, a tax & law firm providing comprehensive advisory services since 1972.
- Tax advisor in the International Tax Services Department and the Latin American Business Center of PricewaterhouseCoopers-Landwell in Madrid,
- Co-authored several books as regards Latin American, European and Spanish Taxation, i.e: the Spanish Chapter of the book "Attribution of Profits to Permanent Establishments", published by IBFD, 2006; "Spanish Inbound Investment in Latin America" included in the book of "Fiscalidad Internacional" published by IEF, 2005; and the Spanish chapter of "Tributação Internacional – Análise de Casos") São Paulo, MP Editora, 2010.
- Tax Essay - Finalist of TTN Prize on International Taxation, 2008. "Hybrid entities and instruments: are they adequately covered in the OECD Model Conventions?".
- PhD research thesis "Tax regime of the image rights" at the University of Valencia.
- Speaker at conferences and courses covering fiscal issues.

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PROFESSIONAL HIGHLIGHTS

- GGraduate of the L.L.M. in International Taxation, Queen Mary, Univeristy of London (2005)
- Associate at Deloitte & Touche, SROC.SA, Porto, Portugal, (2003/2004). International Tax and M&A Consultant at Delloite & Touche LLP, London, UK (2005/2008)
- International Tax and M&A Manager at "HSBC Holdings PLC", London, UK (2008/2011)
- Senior Manager Tax at "HSBC Brasil, Banco Múltiplo", Curitiba, Brasil (2011/2013)
- Head of Transfer Pricing for Latin America at "HSBC Brasil, Banco Múltiplo Curitiba", Brasil (between 2011 and 2013)
- Senior Manager in International Taxation and Transfer Pricing at the Oil & Gas Centre of Excellence, "Delloite & Touche, Brasil", Rio de Janeiro, Brasil (2013/2014)
- Senior Manager, Financial Services Tax, at "PWC", London, UK, (2014/2015)
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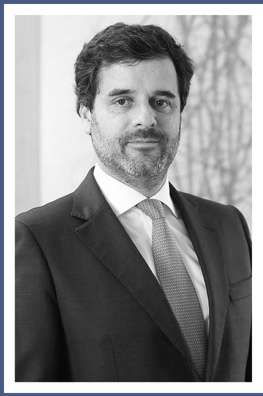

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Mr. Torres has more than 25 years of experience as a Lawyer, which more than half of them were dedicated to practicing and teaching Tax Law. Miguel has a vast experience dealing with M&A transactions, inbound and outbound investments, corporate governance, corporate taxation, individual taxation, tax and criminal litigation, always working for major Portuguese and international clients.

PROFESSIONAL HIGHLIGHTS

- Partner of "TELLES" (since 1992)
- Assistant Professor in General Management Course and Mergers and Acquisitions Course, at Porto Business School
- Managing Partner at "TELLES"

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- Member of "Portuguese Tax Association"
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- Member of General Meetings Board at several Portuguese Companies
- Member of Administration Council at several Portuguese Companies
- Member of Oporto District Council of Portuguese Bar Association (triennium 2005/2007)
- Member of Economy and Taxation of Portugal Olympic Academy Committee (since 2014)
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