Reports of Cases

OPINION OF ADVOCATE GENERAL
KOKOTT
delivered on 17 March 2016[1]

Case C-18/15

Brisal — Auto Estradas do Litoral SA
KBC Finance Ireland
v
Fazenda Pública

(Request for a preliminary ruling from the Supremo Tribunal Administrativo (Supreme Administrative Court, Portugal))

(Tax legislation — Freedom to provide services (Article 49 EC) — National corporation tax — Income from interest — Non-resident interest creditor subject to limited taxation — Deduction of tax at source — Operating costs directly linked to the taxed activity — Financing costs — Overheads of the activity))

I – Introduction

1. For the second time, the question as to whether a Portuguese provision concerning deduction of tax on interest at source is compatible with the fundamental freedoms has reached the Court. Where the interest recipient is non-resident, not only does a withholding tax apply for the interest payer, but, in comparison with resident interest recipients, tax is also calculated differently.

2. The first time, in Case C-105/08, the Court dismissed an action raised by the Commission against this provision, because the Commission had not sufficiently clarified the extent to which the specific provision actually disadvantaged non-residents.[2] In the reference for preliminary ruling that has now come to the Court, the Portuguese provision is once again the subject of scrutiny. This time the Court must decide the substance, unburdened by procedural issues of the onus of pleading and proof.

3. In this connection, the question is which aspects of the withholding tax scheme may lawfully depart from the normal tax regime for residents. This is likely to be of great importance in particular for competition between credit institutions in the internal market.

1 — Original language: German.

2 — Judgment in *Commission* v *Portugal* (C-105/08, EU:C:2010:345).

II – Legal framework

A – *Union law*

4. In relation to freedom to provide services, Article 49(1) EC (now Article 56(1) TFEU) provides:

'Within the framework of the provisions set out below, restrictions on freedom to provide services within the Community shall be prohibited in respect of nationals of Member States who are established in a State of the Community other than that of the person for whom the services are intended.'

B – *National law*

5. In Portugal, corporation tax is charged on the income of companies under the Código do Imposto sobre o Rendimento das Pessoas Coletivas (Corporation tax law, 'CIRC').

6. According to the information given by the referring court, the Portuguese provisions applicable in the main proceedings for tax years 2005 to 2007 are those which were the subject of the Commission's action against the Portuguese Republic in Case C-105/08. As is apparent from the judgment of the Court in that case,[3] companies which were not resident in Portugal paid corporation tax only on income which arose in Portugal (limited taxation). That income included interest payments from debtors who were resident in Portugal.

7. Under Article 80(2)(c) of the CIRC, such profits were taxed at a rate of 20%, or at such other rate as might be provided for by a double taxation convention with the State in which the company which was subject to limited taxation was resident. In the present case, on that basis it appears that the tax rate was 15%. No deduction of operating costs was possible. The tax was charged, through the interest debtor's withholding of the corresponding part of the interest due and paying it over to the Portuguese tax authority (deduction of tax at source).

8. By contrast, under Article 80(1) CIRC all income declared by resident companies was taxed at 25%, after deduction of operating costs (unlimited taxation).

III – Dispute in the main proceedings

9. The subject of the main dispute is the charging of Portuguese corporation tax on interest arising in Portugal and paid to a financial institution resident in Ireland.

10. The Portuguese company Brisal — Auto Estradas do Litoral S.A. ('Brisal') and the Irish bank KBC Finance Ireland ('KBC') were contract partners under a finance contract ('loans'). Within that framework, in certain months in the years 2005 to 2007 Brisal was obliged to pay interest to KBC totalling EUR 350 806. From the payments, Brisal withheld EUR 59 386 in total, and on the basis of deduction of tax at source paid it to the Portuguese tax authority on behalf of KBC.

11. Both Brisal and KBC challenge this obligation to withhold part of the interest in order to pay Portuguese corporation tax, because, they claim, it discriminates against non-resident financial institutions by comparison with resident ones in a manner which is unlawful under EU law. In particular, KBC asks for its re-financing costs for the loan to be taken into account for tax purposes.

3 — Judgment in *Commission* v *Portugal* (C-105/08, EU:C:2010:345, paragraphs 2 to 6).

IV – Proceedings before the Court

12. The Supremo Tribunal Administrativo (Supreme Administrative Court, Portugal), before which the case is pending, referred the following questions to the Court on 19 January 2015 pursuant to Article 267 TFEU:

'(1) Does Article 56 TFEU preclude national tax legislation under which financial institutions not resident in Portuguese territory are subject to tax on interest income received in that territory, withheld at source at the definitive rate of 20% (or at a lower rate if there is an agreement to avoid double taxation), a tax applied to *gross* income with no possibility of deducting business expenses directly related to the financial activity carried out, whereas the interest received by resident financial institutions is incorporated in the total taxable income, with deduction of any expenses related to the activity pursued when determining the profit for the purposes of corporation tax, so that the basic rate of 25% is applied to the *net* interest income?

(2) Does Article 56 TFEU preclude this provision even if the tax base of resident financial institutions, after deduction of the financing costs related to the interest income, or of expenses directly related, economically, to such income, is or may be subject to a higher tax than is deducted at source from the gross income of non-resident institutions?

(3) For this purpose, can the financing costs associated with the loans granted, or the expenses directly related, economically, to the interest income received, be proved by the data provided by the EURIBOR ('Euro Interbank Offered Rate') and by the LIBOR ('London Interbank Offered Rate') — which represent the average interest rates charged on interbank financing used by banks to carry out their activity?'

13. Before the Court, the applicants in the main dispute, the Belgian Government, the Danish Government, the Portuguese Government and the Commission submitted written observations. At the oral hearing on 13 January 2016, only the Belgian Government, the Portuguese Government and the Commission participated.

V – Legal analysis

14. By its three questions, which I shall consider together, the referring court asks in essence whether a provision for deducting tax on interest payments to non-resident creditors, such as that in the main dispute, is compatible with the freedom to provide services.

15. As the law as in force for the years 2005 to 2007 is applicable to the main dispute, it is necessary to interpret Article 49 EC, and not Article 56 TFEU (to which the questions refer).

16. Article 49(1) EC prohibits restrictions on freedom to provide services in respect of nationals of Member States, where the service provider and the service recipient are established in different Member States. According to Article 55 EC in conjunction with Article 48 EC, this applies also for services provided by companies. As I have already explained in more detail elsewhere, freedom to provide services is the fundamental freedom applicable on the present facts of a cross-border loan.[4]

4 — See my Opinion in *Commission* v *Portugal* (C-105/08, EU:C:2010:162, paragraphs 14 to 22).

17. All measures which prohibit, impede or render less attractive the exercise of the freedom to provide services must be regarded as a restriction on it.[5] The freedom of a service-provider (KBC in the present case) to provide services is restricted if a national rule makes the provision of services between Member States more difficult than the provision of services purely within a Member State.[6] In addition, the recipient of a service (Brisal in the present case) is also entitled to rely on the freedom to provide services.[7]

18. In the present case, the fact that KBC, which is resident in Ireland, suffers disadvantageous taxation of its interest income in Portugal in comparison with resident loan providers, because it is subject to tax calculated in a different way and deducted at source, could constitute an impediment to cross-border services.

19. In that connection, two different aspects of the special provision for non-resident creditors in comparison with taxation of interest income in the case of resident creditors are to be distinguished and discussed separately: first, the different techniques for charging tax (Section A below), and second, the different ways of calculating the amount of the tax charged (Section B below).

A – *Infringement by the technique for charging tax*

20. First, the question arises whether the disadvantages that Brisal and KBC suffered because of the technique of deducting tax at source constitutes an infringement of freedom to provide services. This is because, by comparison with a loan obtained from a resident interest creditor which itself pays tax on its interest income, this procedure imposes at least an additional administrative burden on the service recipient which, at the same time, imposes a burden on the business of the service provider.[8]

21. This question has been answered by the case-law.[9]

22. The Court has already held on a number of occasions that the specific technique of deducting tax at source for non-resident service providers in principle does not infringe freedom to provide services. This is because the restriction on freedom to provide services which arises out of this charging technique is justified by the need to ensure the efficient collection of tax.[10] In its judgment in *Truck Center*, the Court justified the same conclusion as regards freedom of establishment by the consideration that there was no restriction at all on this fundamental freedom because the situations of resident and non-resident taxpayers in that regard were objectively not comparable.[11]

23. In the present case, there are no exceptional circumstances which demand a departure from these conclusions of the case-law. Thus, as regards the particular charging mechanism applicable in relation to non-resident interest recipients the Portuguese provisions in dispute in the main proceedings do not infringe freedom to provide services.

5 — See inter alia judgments in *Säger* (C-76/90, EU:C:1991:331, paragraph 12), *Tankreederei I* (C-287/10, EU:C:2010:827, paragraph 15), and *Laezza* (C-375/14, EU:C:2016:60, paragraph 21).

6 — See inter alia judgments in *Commission* v *France* (C-381/93, EU:C:1994:370, paragraph 17), *X and Passenheim-van Schoot* (C-155/08 and C-157/08, EU:C:2009:368, paragraph 32), and *X* (C-498/10, EU:C:2012:635, paragraph 20).

7 — See inter alia judgments in *Eurowings Luftverkehr* (C-294/97, EU:C:1999:524, paragraph 34), *FKP Scorpio Konzertproduktionen* (C-290/04, EU:C:2006:630, paragraph 32), and *Strojírny Prostějov and ACO Industries Tábor* (C-53/13 and C-80/13, EU:C:2014:2011, paragraph 26).

8 — Judgments in *FKP Scorpio Konzertproduktionen* (C-290/04, EU:C:2006:630, paragraph 33), and *X* (C-498/10, EU:C:2012:635, paragraph 28).

9 — See to this effect the Opinion of Advocate General Jääskinen in Joined Cases *Miljoen and Others* (C-10/14, C-14/14 and C-17/14, EU:C:2015:429, paragraph 53).

10 — Judgments in *FKP Scorpio Konzertproduktionen* (C-290/04, EU:C:2006:630, paragraphs 36 to 37), and *X* (C-498/10, EU:C:2012:635, paragraph 39).

11 — Judgment in *Truck Center* (C-282/07, EU:C:2008:762, paragraph 41 and 50).

B – *Infringement by calculation of tax*

24. However, the particular charging technique must be distinguished from the question whether the difference in calculating the tax on interest income of residents and non-residents infringes freedom to provide services. [12]

25. Whereas in the years 2005 to 2007 interest income of taxpayers resident in Portugal was subject to a tax rate of 25% within the framework of a calculation of their entire income after deduction of operating costs, interest income of non-resident taxpayers was subject to a tax rate of, at most, 20%, but without any possibility of deducting operating costs.

1. Deduction of operating costs

26. First, freedom to provide services could be infringed by the fact that the Portuguese provision refuses non-resident taxpayers any deductions for operating costs in calculating the tax due. For that reason, KBC also cannot claim any financing costs which may arise in making the loan available to Brisal.

27. In fact, according to the Court's consistent case-law since its judgment in *Gerritse*, it is in principle an infringement of freedom to provide services if non-resident taxpayers (subject to limited taxation) — by contrast with resident taxpayers (subject to unlimited taxation) — are precluded from deducting expenses directly connected to the activity which is being taxed. [13]

28. According to the Court's case-law, expenses are directly connected with a taxed activity if they are occasioned by the activity and therefore necessary in order to carry it out. [14] Where and when the expenses were required to be incurred is immaterial. [15]

29. In the present case there is a dispute as to whether there is a direct connection between the financing costs incurred by KBC and its making the loan available to Brisal, within the meaning of the case-law. It must first be clarified whether mere financing costs can ever have a direct connection with the taxable activity (see Section (a) below).

30. However, even if in principle this is possible, in the present case there must be taken into account the particular feature that KBC did not finance its loan to Brisal — as is apparently normal in banking transactions — by obtaining a loan for itself in an equal amount (so-called direct costs). Instead, financing costs arise to KBC because of the fact that the whole of its activity is burdened with financing costs. For that reason, KBC wants to deduct a proportion of the financing costs which it incurs in carrying out its activity as a whole (so-called overheads) as operating expenses. Against this background, the deeper question thus arises as to whether financing costs are deductible only as direct costs or whether a proportion of a taxpayer's overheads must also be taken into account (see Section (b) below).

12 — To this effect see judgments in *Santander Asset Management SGIIC and Others* (C-338/11 to C-347/11, EU:C:2012:286, paragraph 43), *X* (C-498/10, EU:C:2012:635, paragraph 33), and *Miljoen and Others* (C-10/14, C-14/14 and C-17/14, EU:C:2015:608, paragraphs 70 and 71).

13 — Judgments in *Gerritse* (C-234/01, EU:C:2003:340, paragraphs 25 to 29), *FKP Scorpio Konzertproduktionen* (C-290/04, EU:C:2006:630, paragraph 43), and *Centro Equestre da Lezíria Grande* (C-345/04, EU:C:2007:96, paragraph 23); see to the same effect as regards freedom of establishment judgment in *Conijn* (C-346/04, EU:C:2006:445, paragraph 20); see to the same effect as regards free movement of capital judgments in *Schröder* (C-450/09, EU:C:2011:198, paragraph 40), *Commission* v *Finland* (C-342/10, EU:C:2012:688, paragraph 37), *Grünewald* (C-559/13, EU:C:2015:109, paragraph 29), and *Miljoen and Others* (C-10/14, C-14/14 and C-17/14, EU:C:2015:608, paragraph 57); see to the same effect in contexts outside profits taxes judgments in *Eckelkamp and Others* (C-11/07, EU:C:2008:489, paragraph 50), and *Arens-Sikken* (C-43/07, EU:C:2008:490, paragraph 44).

14 — Judgments in *Schröder* (C-450/09, EU:C:2011:198, paragraph 44), and *Grünewald* (C-559/13, EU:C:2015:109, paragraph 30).

15 — Judgment in *Centro Equestre da Lezíria Grande* (C-345/04, EU:C:2007:96, paragraph 25).

a) General exclusion of financing costs?

31. Therefore, it must first be clarified whether the financing costs of a taxable activity can ever have a direct link to it.

32. Specifically, in its judgment in *Miljoen* the Court held ultimately that there was no direct link between the financing costs for the acquisition of a shareholding and the dividends received in respect of those shares. This is because the financing costs concerned only ownership of the shares per se. [16] This approach could be applied by analogy to the present case involving financing costs of a loan and the interest arising from it.

33. On the other hand, however, according to the definition developed in the case-law, every expense which is necessary in order to carry out the taxed activity is directly linked to that activity. [17] Thus, the concept of 'direct link' is not to be interpreted narrowly. [18] Therefore, such a link also exists in the case of financing costs which are necessary for carrying out an activity.

34. This is confirmed by the Court's case-law as regards an annuity paid to the previous owners for the acquisition of shares or immovable property. In that context the Court found in principle that there was a direct link between the annuity payable and the income from the shares or the immovable property. [19] However, such annuities are nothing other than the costs of acquisition and financing of the shares or the immovable property. In addition, in a further judgment the Court similarly found that there was a direct link between the acquisition costs of shares and the profits from a share buy-back, which was taxed as a dividend by the Member State in question. [20]

35. Against this background, it is not possible to interpret the judgment in *Miljoen* as meaning that the financing costs relating to a source of income generally cannot have any link to it. In any event, the reasoning in this judgment, which concerns income from shares, is not applicable by analogy to the present case of income from a loan. This is shown also by the case-law on value added tax (VAT), in which the Court draws a fundamental distinction between dividends and interest. Specifically, it regards only interest as income from economic activity, whereas dividends are merely the consequence of holding shares. [21]

36. Thus, in principle it is possible for financing costs relating to the grant of a loan to be costs which have a direct link, within the meaning of the case-law, to that activity.

b) Direct costs only or also overheads?

37. However, next comes the question whether only financing costs with a direct link to the grant of a specific loan count as direct costs, or whether the share of the whole of the undertaking's financing costs (overheads) which may be allocated to it also has such a link.

38. In that regard, in the proceedings before the Court the Belgian Government and the Portuguese Government submitted in essence that in banking transactions financing costs could not be directly attributed to any particular loan, and therefore, according to the case-law of the Court, were not to be taken into account as costs.

16 — Judgment in *Miljoen and Others* (C-10/14, C-14/14 and C-17/14, EU:C:2015:608, paragraph 60).

17 — See above, paragraph 28.

18 — See also judgment in *Conijn* (C-346/04, EU:C:2006:445, paragraph 22), according to which even costs incurred in obtaining tax advice in connection with declaring the profits from an activity are linked directly to the activity itself.

19 — Judgments in *Schröder* (C-450/09, EU:C:2011:198, paragraphs 43 to 46) and *Grünewald* (C-559/13, EU:C:2015:109, paragraphs 30 to 33).

20 — Judgment in *Bouanich* (C-265/04, EU:C:2006:51, paragraphs 21 and 40).

21 — See simply the judgment in *Régie dauphinoise* (C-306/94, EU:C:1996:290, paragraph 17).

39. However, our case-law does not by any means exclude the possibility that a proportion of the overheads of the activity carried out by a person subject to limited taxation also may have a direct link to the activity taxed in the source State. This is clear also from the fact that in its judgment in *Centro Equestre da Lezíria Grande* the Court did not give the referring court any indication that the overheads of an activity claimed in the main proceedings could not have any direct link to it. [22]

40. Specifically, it is only by taking into account the share of overheads which is to be attributed to a taxed activity that non-resident and resident taxpayers can receive equal treatment as regards operating costs and approximately equal conditions of competition can thereby be achieved.

41. In addition, overheads are not to be equated with the 'personal circumstances' of a taxpayer, which, according to the case-law, need in principle be taken into account for tax purposes only by the State of residence and not by the source State. [23] Expenses arising from the personal circumstances of a taxpayer are those which are connected with his personal situation and not with a taxed activity. [24] This applies in particular as regards taking his family situation [25] and other expenses of his private life [26] into account for tax purposes. It is already doubtful whether this case-law, which has developed in relation to natural persons, is applicable to companies at all, because it may be that companies do not have any 'personal situation' at all. In any event, however, the general costs of a company's economic activity cannot be equated to the costs incurred by a taxpayer in relation to his private life, which do not serve to earn income at all.

42. The proposition that overheads may have a direct link to a taxed activity in any event corresponds to consistent case-law in the area of VAT. There, expenses incurred by a taxable person are to be attributed to economic activity, in order to give a right of deduction under Article 168 of Directive 2006/112/EC. [27] In this context the Court accepts the existence of a 'direct and immediate link' not only between direct costs and taxable turnover, but also between overheads and the general economic activity of a taxable person. [28]

c) Intermediate conclusion

43. Thus, a provision such as the present which does not permit a person subject to limited taxation to deduct, in calculating tax on an activity, financing costs which may be directly attributed to the taxed activity, as part of the taxpayer's overheads, in principle infringes freedom to provide services.

22 — Judgment in *Centro Equestre da Lezíria Grande* (C-345/04, EU:C:2007:96, paragraphs 15, 26 and 27); see also the Opinion of Advocate General Léger in *Centro Equestre da Lezíria Grande* (C-345/04, EU:C:2006:418, point 56), who regarded overheads as possible costs which were directly linked to a taxed activity.

23 — See inter alia judgments in *Schumacker* (C-279/93, EU:C:1995:31, paragraphs 32 to 34), *D* (C-376/03, EU:C:2005:424, paragraphs 27 and 28), and *Kieback* (C-9/14, EU:C:2015:406, paragraphs 22 and 23).

24 — On this point see the Opinion of Advocate General Bot in *Schröder* (C-450/09, EU:C:2010:761, point 60); to this effect, see also judgment in *Gielen* (C-440/08, EU:C:2010:148, paragraphs 43 to 46).

25 — See for example judgments in *Schumacker* (C-279/93, EU:C:1995:31), and *Gschwind* (C-391/97, EU:C:1999:409).

26 — See for example judgments in *de Groot* (C-385/00, EU:C:2002:750), *Wielockx* (C-80/94, EU:C:1995:271), and *Kieback* (C-9/14, EU:C:2015:406).

27 — Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax (OJ 2006 L 347, p. 1).

28 — See simply judgment in *Sveda* (C-126/14, EU:C:2015:712, paragraphs 27 and 28), and the case-law referred to there.

44. The extent to which the overheads can be directly attributed to the taxed activity in the present case is in any event a question of fact to be determined by the referring court.[29] However, in this regard — as in the case of resident taxpayers — the court must in principle take into account costs *actually* incurred. Recourse to average interest rates applicable in the context of interbank financing — which is suggested by the referring court in its third question — is not possible, at least in the present case. This is because, as Brisal and KBC have submitted in the proceedings before the Court, KBC's activity is financed not only by other banks but also by customer deposits.

2. Compensated by a lower tax rate?

45. If, in the present case, the rule against deducting any business expenses thus in principle infringes freedom to provide service, the question arises however as to whether this disadvantage can be balanced out by the lower rate of tax which applies to persons subject to limited taxation (in the present case, 15%) in comparison with persons subject to unlimited taxation (25%).

46. This appears to be supported in particular by the recent judgment in *Hirvonen*. In that case, under reference to the judgment in *Gerritse* the Court explained in essence that taxing the gross income of a person subject to limited taxation is compatible with EU law if the result is no higher than it would be if net income were taxed at the tax rate applicable to persons subject to unlimited taxation.[30] Accordingly, it appears that the only thing relevant to the question of whether a fundamental freedom is infringed is the ultimate result of the tax burden. On that basis, refusing to allow deduction of operating costs could be balanced out by a comparatively lower tax rate. The operating costs would thus be taken into account in a certain sense at a flat rate, by means of a reduction from the tax rate applicable to persons subject to unlimited taxation.[31]

47. However, that interpretation of the judgment in *Hirvonen* is to be rejected, because it is not consistent with the rest of the case-law of the Court, and in that judgment the Court evidently did not intend to renounce that case-law.

48. The Commission has therefore correctly pointed out that in *Gerritse*, in the case of persons subject to limited taxation, the Court clearly distinguished between claiming deduction of operating costs and the tax rate. Accordingly, refusing the deduction of operating costs directly linked to the taxed activity of a person subject to limited taxation in itself infringes the freedom to provide services. According to the judgment in *Gerritse*, only the answer to the additional question whether the same also applies to the tax rate depends on whether the tax burden on persons subject to limited taxation with a uniform tax rate is higher than that on persons subject to unlimited to taxation who, after taking into account a basic tax-free allowance, are subject to a progressive tax rate.[32]

49. This additional question as to compatibility of the tax rate with the freedom to provide services is immaterial in the present proceedings, because both persons subject to limited taxation and those subject to unlimited taxation are liable to a fixed tax rate without any tax-free allowance, and the tax rate for persons subject to limited taxation is lower than that applied to persons subject to unlimited taxation. However, against the background of *Gerritse* this fact is irrelevant for deciding whether there is any infringement of the freedom to provide services because any deduction of operating costs directly linked to the taxed activity is refused.

29 — To this effect, see inter alia judgments in *Centro Equestre da Lezíria Grande* (C-345/04, EU:C:2007:96, paragraph 26), and *Grünewald* (C-559/13, EU:C:2015:109, paragraph 32).

30 — Judgment in *Hirvonen* (C-632/13, EU:C:2015:765, paragraphs 44 and 48); to this effect, see also judgment in *Miljoen and Others* (C-10/14, C-14/14 and C-17/14, EU:C:2015:608, paragraphs 48 and 59), which, however, considered questions which expressly concerned a comparison of effective rates of tax.

31 — However, the reason for what is usually a comparatively lower rate of withholding tax for interest income is in fact more probably that the source State and the State of resident want to share the taxing power in relation to this income (see below paragraphs 60 and 61).

32 — Judgment in *Gerritse* (C-234/01, EU:C:2003:340, paragraphs 1 and 2 of the operative part of the judgment).

50. This interpretation of the judgment in *Gerritse* and subsequent case-law is not merely shared by a number of Advocates General.[33] It is also consistent with the Court's consistent case-law, according to which disadvantageous tax treatment which infringes a fundamental freedom cannot be justified by other tax advantages.[34]

51. Apart from that, it is to be emphasised that in those instances in which the expenses exceed the receipts of a taxed activity, refusing deduction of expenses can never be compensated for by a lower rate of tax. If the amount of the costs directly linked with the activity lead ultimately to a loss, a person subject to limited taxation is disadvantaged regardless of the tax rate. This is because in those circumstances he pays tax on his gross income, whereas a person subject to unlimited taxation in the same situation would not pay any tax, because where a loss is made there is no positive tax base.

52. Admittedly, it has since been recognised in the Court's case-law that in the field of tax law Member States have the right to impose flat-rate provisions, including where they are combined with a degree of imprecision. However, it is a pre-condition that it must not lead to systematic inequality of treatment.[35] However, if refusing deduction of operating expenses directly linked with an activity leads to the result that where a loss is made the cross-border service is always disadvantaged by comparison with the domestic service, that in itself requires a finding of systematic inequality of treatment which prohibits a fixed allowance for operating expenses given by means of a lower tax rate.

53. That deduction of expenses and the amount of the tax rate are thus always to be assessed separately for their compatibility with the fundamental freedoms is also not called into question by the judgment in *Commission* v *Portugal*, which already considered the Portuguese provision in dispute in the present case. Admittedly, the Court explained there that both profit margin, which depends on the amount of operating costs, and the tax rate are to be taken into account in determining whether non-residents are taxed more highly.[36] However, this point was made on the basis of the complaint raised by the Commission, which had complained about ultimately higher taxation of non-residents, and not for example about the refusal to permit deduction of operating costs as such.[37] [38]

54. Thus, what is in principle an infringement of the freedom to provide services arising out of the inability to deduct financing costs directly linked to the taxed activity cannot be balanced out by a tax rate that is lower by comparison with that for residents. In that regard, in the present case it is not necessary to enter upon the question of whether such an infringement can be prevented by conferring on persons subject to limited taxation a right to elect to be treated as if they were a person subject to unlimited taxation. This is because such an election was not available in respect of the assessment periods which are relevant in the present case.

3. Justification

55. Finally, the question arises as to whether the infringement of freedom to provide services, which has been held established in principle, can be justified.

33 — See inter alia the Opinion of Advocate General Léger in *Centro Equestre da Lezíria Grande* (C-345/04, EU:C:2006:418, points 49 to 54), Advocate General Mazák in *Arens-Sikken* (C-43/07, EU:C:2008:170, point 79), Advocate General Ruiz-Jarabo Colomer in *Gielen* (C-440/08, EU:C:2009:661, point 34), and Advocate General Sharpston in *Commission* v *Finland* (C-342/10, EU:C:2012:474, point 50).

34 — See inter alia judgments in *Commission* v *France* (270/83, EU:C:1986:37, paragraph 21), *de Groot* (C-385/00, EU:C:2002:750, paragraph 97), *Dijkman and Dijkman-Lavaleije* (C-233/09, EU:C:2010:397, paragraph 41), *Commission* v *Belgium* (C-387/11, EU:C:2012:670, paragraph 53), and *van Caster* (C-326/12, EU:C:2014:2269, paragraph 31).

35 — To this effect, see judgment in *Sopora* (C-512/13, EU:C:2015:108, paragraphs 32 to 35).

36 — Judgment in *Commission* v *Portugal* (C-105/08, EU:C:2010:345, paragraphs 27 and 28).

37 — On this point see the judgment in *Commission* v *Germany* (C-600/10, EU:C:2012:737, paragraphs 25 and 26), which, however, likewise found the Commission had failed to prove its case.

38 — See my Opinion in *Commission* v *Portugal* (C-105/08, EU:C:2010:162, paragraphs 11 and 28).

a) Allocation of taxing powers between Member States

56. Some of the participants in the proceedings put forward the international system for avoiding double taxation as justification for the Portuguese provisions. Accordingly, it is argued that it is normal in particular in the case of interest for withholding tax to be levied on gross income — that is, without taking costs into account. An obligation to tax only net income would therefore affect the allocation of taxing powers between the Member States.

57. Admittedly, in its consistent case-law the Court recognises the maintenance of the allocation of taxing powers between the Member States as a justification for restricting a fundamental freedom.[39] This is because under EU law, Member States continue to have competence to define the criteria for allocating their powers of taxation either by treaty or unilaterally, with a view to eliminating double taxation.[40]

58. Nevertheless, in principle the Member States cannot rely on the contents of double taxation conventions in order to escape obligations imposed by EU law when exercising their taxing powers.[41]

59. In the present case, it is not apparent why the disadvantage suffered by persons subject to limited taxation as regards deduction of operating costs should arise out of the allocation of taxing powers between Member States.

60. Even if the referring court has not provided sufficient information as regards the actual double taxation convention that was in force between Portugal and Ireland, it cannot be inferred from the Model Convention of the Organisation for Economic Co-operation and Development[42] ('OECD Model Convention') that, in general, the source State should be obliged to tax gross income. Article 11(2) of the OECD Model Convention merely provides that the source State — in addition to the State in which the interest recipient is resident — may tax interest, albeit that this tax must not exceed a specific percentage of the gross amount of the interest. However, this merely sets a maximum amount as regards the outcome of the tax, and does not give the source State any instructions as regards taxation.

61. On the contrary, it appears from the commentary on the OECD Model Convention[43] that in precisely a case such as the present, in which interest payments are made to banks, many source States do not impose any tax. This is because, as a result of re-financing costs, even if credit is given for the withholding tax in the State in which the bank is resident, this does not prevent the tax burden being excessive, because in this case the State of residence charges only a small amount of tax, or indeed even no tax at all. In accordance with the second sentence of Article 23A(2) and the second sentence of Article 23B(1) of the OECD Model Convention, the amount of tax deducted is limited to the tax which the State of residence charges on the corresponding *net* income.[44] For this reason, in the present case it is also not apparent that Portugal could balance out the disadvantage suffered by a person subject to limited taxation, within the framework of a double taxation convention, by means of an obligation on the State of residence to give credit, as the Court has in principle recognised as regards withholding tax on dividends.[45]

39 — See inter alia judgments in *Marks & Spencer* (C-446/03, EU:C:2005:763, paragraph 45), *National Grid Indus* (C-371/10, EU:C:2011:785, paragraph 45), and *Verder LabTec* (C-657/13, EU:C:2015:331, paragraph 42).

40 — See inter alia judgments in *Gilly* (C-336/96, EU:C:1998:221, paragraph 30), *Test Claimants in Class IV of the ACT Group Litigation* (C-374/04, EU:C:2006:773, paragraph 51), and *Finanzamt Linz* (C-66/14, EU:C:2015:661, paragraph 41).

41 — To this effect, see inter alia judgments in *de Groot* (C-385/00, EU:C:2002:750, paragraph 94), *Renneberg* (C-527/06, EU:C:2008:566, paragraphs 50 and 51), and *Bukovansky* (C-241/14, EU:C:2015:766, paragraph 37).

42 — OECD, Model Tax Convention on Income and on Capital, version in force from July 2014.

43 — OECD, Commentaries on the Articles of the Model Tax Convention, as at July 2014, Article 11, paragraphs 7.1 and 7.7.

44 — *Ismer*, in Vogel and Lehner, *Doppelbesteuerungsabkommen*, Article 23 paragraph 147.

45 — Judgment in *Miljoen and Others* (C-10/14, C-14/14 and C-17/14, EU:C:2015:608, paragraphs 78 and 79, and the case-law referred to there).

62. Indeed, the same approach to allocating taxing power between the Member States is evident in EU tax law. Thus, it is apparent from recitals 3 and 4 of Directive 2003/49/EC,[46] which is applicable to interest payments within an undertaking, that the source State ought to forego entirely taxing interest, in favour of the State in which the interest creditor is resident.

63. Thus, in the present case the power of Member States to maintain the allocation of their taxing powers does not justify the disadvantage suffered by persons subject to limited taxation as regards the taxation of interest.

b) Double deduction of operating costs

64. Nor can any justification arise out of the fact that in imposing a withholding tax Member States must prevent operating costs from being deducted twice, as the Portuguese Government in particular submitted.

65. Regardless of whether such a justification would in principle have to be recognised, it is in any event obvious that operating costs could always be deducted twice if two Member States — that is, the source State and the State of residence — taxed the income in question.[47]

c) Efficient tax collection

66. Beyond that, in the proceedings before the Court it was submitted that the Portuguese provision is justified by the need to ensure the efficient collection of tax.[48]

67. To the extent this submission refers to the technique by which tax is charged, it has already been concluded that this ground of justification prevents the provision in question from infringing freedom to provide services.[49]

68. So far as this concerns the disadvantage suffered by persons subject to limited taxation, one cannot dismiss the possibility that taking into account all operating costs directly linked to earning the interest income can give rise to more extensive administrative costs for the tax authority, the service provider, and, as the case may be, the service recipient. Charging tax simply on the basis of the amount of interest payable is, in comparison, significantly simpler for all participants.

69. Nevertheless, in the present case increased administrative costs can ultimately not justify the refusal to deduct operating costs for persons subject to limited taxation.

70. First, the administrative costs to the authorities of a Member State are indeed also to be taken into account.[50] However, administrative costs where operating costs are claimed arise in the same way in relation to resident taxpayers subject to unlimited taxation.

46 — Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States (OJ 2003 L 157, p. 49).

47 — For that reason, the Court's statements in its judgment in *Centro Equestre da Lezíria Grande* (C-345/04, EU:C:2007:96, paragraphs 33 to 36), are liable to misunderstanding.

48 — On this ground of justification, see judgments in *FKP Scorpio Konzertproduktionen* (C-290/04, EU:C:2006:630, paragraph 35), *X* (C-498/10, EU:C:2012:635, paragraph 39), and *Commission* v *Spain* (C-678/11, EU:C:2014:2434, paragraph 46).

49 — See above, point 22.

50 — See to this effect judgment in *Sopora* (C-512/13, EU:C:2015:108, paragraph 33).

71. Second, it is possible to avoid higher administrative costs for the service recipient who must deduct tax from the interest by requiring the service provider to claim its operating costs subsequently against the tax authority. Moreover, the Court even appears to regard the service recipient as having an obligation to take operating costs into account from the start, if the service provider has notified them to him. [51]

72. Third, this type of postponed procedure to claim operating costs would not only ensure that business secrets of the service provider were maintained. [52] In addition, the burden on it in terms of administrative costs which arises when operating costs are taken into account could in this case be avoided, if need be, as it would have the choice whether subsequently to claim its operating costs or not.

73. Thus, in the present case the complete exclusion of any possibility of deducting operating costs directly linked to interest income cannot be justified by the need to ensure efficient collection of tax.

d) Tax supervision

74. Finally, to the extent that the Belgian Government submits that as regards persons subject to limited taxation, the opportunity to check [53] operating costs claimed abroad is not sufficiently guaranteed, it is appropriate to refer to the consistent case-law of the Court, according to which the Member States have in principle sufficient powers to conduct checks in that regard. [54]

C – *Result*

75. Thus, it must be held that a provision such as the one in the present case which, as regards taxation of interest, does not allow non-residents — by contrast with residents — in particular to deduct financing costs which, as part of the taxpayer's overheads, are directly linked to the taxed activity, infringes the freedom to provide services.

VI – Conclusion

76. On the basis of the foregoing, the questions referred by the Supremo Tribunal Administrativo (Supreme Administrative Court, Portugal) are to be answered as follows:

(1) Article 49(1) EC precludes a national provision of tax law such as the one in the present case, according to which non-resident financial institutions are subject to tax on interest arising within the territory and, unlike resident financial institutions, have no possibility of deducting operating costs directly linked to carrying on the financial activity.

(2) The costs which have a direct link to carrying on an activity include a share of the taxpayer's overheads, to the extent that those costs are necessary for carrying out the taxed activity. The costs are to be taken into account in the amount of the costs actually incurred.

51 — Judgment in *FKP Scorpio Konzertproduktionen* (C-290/04, EU:C:2006:630, paragraph 48).

52 — On this point, see the Opinion of Advcate General Léger in *FKP Scorpio Konzertproduktionen* (C-290/04, EU:C:2006:323, paragraph 30).

53 — As regards this ground of justification, see inter alia judgments in *Rewe-Zentral "Cassis de Dijon"* (120/78, EU:C:1979:42, paragraph 8), *Persche* (C-318/07, EU:C:2009:33, paragraph 41), and *Strojírny Prostějov and ACO Industries Tábor* (C-53/13 and C-80/13, EU:C:2014:2011, paragraph 55).

54 — See inter alia judgments in *Futura Participations and Singer* (C-250/95, EU:C:1997:239, paragraph 41), *A* (C-101/05, EU:C:2007:804, paragraph 58), and *van Caster* (C-326/12, EU:C:2014:2269, paragraph 55).