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NEWSLETTER

TAXATION OF NON-RESIDENTS CAPITAL GAINS WITH THE SALE OF REAL ESTATE LOCATED IN PORTUGAL

SUMMARY

With the most recent decision of the Court of Justice of the Europe Union, the line of case-law that oblige, under the EU law, to apply to non-resident taxpayers the rule which determines the consideration of only 50% of capital gains earned on the sale of real estate in Portugal was reinforced.

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Capital gains realized with the sale of real estate properties by individuals are taxed under the Personal Income Tax Code (hereinafter PIT Code), within the scope of category G (capital increments). Individuals whose tax residence is located in Portuguese territory are taxed with general progressive rates only on 50% of the capital gains made, whereas non-resident citizens are taxed at a special flat rate of 28%, or, here, by option, at general progressive rates, but always on 100% of the realized capital gain.

This question was initially considered by the Court of Justice of the European Union ("CJEU"), in the Hollman judgment (C-443/06), in which the court found that non-residents were treated in a less favorable manner, thus, being discriminatory and breaching the principle of free movement of capital between EU Member States, in accordance with the Treaty on the functioning of the European Union.

Following this Judgment, the PIT Code has undergone changes. The Law of the State Budget for 2008 (Law 67-A/2007, of December 31st) set forth the option, for non-resident taxpayers in Portugal and resident taxpayers in the EU and EEA (provided that there is mutual exchange of information), to choose the progressive rates applicable to tax-residents in Portugal. As such, as per the general rule, a real estate capital gain realized by a non-resident taxpayer is subject to the special flat rate of 28% and, may, optionally, be taxed under the general progressive rates, in which case all the taxable income will need be taken into account, including income obtained outside of Portugal, for the purpose of determining the applicable rate, in the same conditions applicable to tax-residents in Portugal.

Nonetheless, irrespective of the choice between the flat rate of 28% or the progressive rates, the capital gain is still accounted in 100% of its value, whereas for resident taxpayers the regime only considers 50% of the capital gain realized.

The CJEU, the Administrative Supreme Court ("STA") and Center for Administrative Arbitration ("CAAD") have foreshadowed, in some decisions, this regime as being discriminatory, and, therefore, incompatible with EU law. These last judgments have deemed as illegal the tax assessments carried out by

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the tax administration, thus repealing them from the juridical order.

CAAD continues to address this matter, with some recent decisions, namely in its judgment n.º 644/2017-T. In this case, the non-resident taxpayer included the real estate gains in his PIT tax assessment (Model 3), not having opted for the optional progressive rates. Hence, he was taxed for the totality (100%) of the capital gain with the flat rate of 28%.

Now, according to the opinion of the Tax administration in the arbitral proceedings at stake, the regime contained in the PIT Code restored equality of treatment between residents and non-residents, thus eliminating any discrimination which could exist.

However, in the Arbitration Court's opinion, that was not the case. In the view of CAAD, maintaining a taxable base of 100% of the capital gain obtained by a non-resident taxpayer in Portugal (resident in a EU Member State or EEA) does not eliminate the discriminatory character of the treatment of non-residents in regards to residents, on what concerns real estate capital gains.

The Tribunal considers important to note the decision in the Gielen Judgment of the CJEU (C-440/18), which determined that the option which allows a non-resident taxpayer the possibility to choose between a discriminatory tax regime and a supposedly non-discriminatory one, does not exclude the discriminatory effects of the first regime. If this was recognized, one would validate a tax regime which violates the Treaty, due to its discriminatory nature.

The Tribunal reminded us that, as per the Portuguese Constitution, the decisions of the CJEU binds the decisions of the Portuguese courts, reason why its judgements should be considered and, thus, concluding that the solution adopted by the Portuguese legislation did not eliminate its discriminatory character in which non-residents taxpayers are to be found.

Now, the CJEU, on its most recent decision on the MK v Autoridade Tributária e Aduaneira case (C-388/19), observed that simply giving non-residents the choice to be treated as residents for the purposes of the Portuguese regime on capital gains from the sale of immovable property located in Portugal is not enough to make the regime compatible with EU law, if that regime otherwise

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continues to have discriminatory effects.

In his judgement, CJEU stated the fact that a tax legislation, even though it allows non-residents taxpayers to be taxed in the same way as resident taxpayers, cannot make the restriction – that resident taxation is systematically more advantageous than non-resident taxation – compatible with the TFEU and, consequently, is contrary to the free movement of capital.

The above-mentioned case-law has, thus, been reinforced and offers no doubts about the need, under the EU law, to apply to non-resident taxpayers the rule which determines the consideration of only 50% of capital gains earned on the sale of real estate in Portugal.

We, therefore, consider that the need to change the rule in question is imperative, establishing the consideration of only 50% of the real estate capital gains obtained by taxpayers of other Member States, in the cases where they opt for the application of the general progressive rates applicable to resident taxpayers. The option to tax at a flat rate of 28% may also be maintained, the Court not having addressed whether, in this case, the capital gain should be considered at 100% or at 50%.

Nevertheless, we note that the consideration, of only 50% of the capital gains in a real estate transaction and the application of the progressive rates, may not be the most advantageous for some of the non-resident taxpayers with higher income, as the income obtained outside of Portugal will be taken in consideration, when determining the applicable rate.

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