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THE PORTUGUESE PERSONAL INCOME TAX REGIME APPLICABLE TO CAPITAL GAINS OBTAINED BY NON-RESIDENT INDIVIDUALS WITH THE TRANSFER OF REAL ESTATE LOCATED IN PORTUGAL:

CONTROVERSIES & OPPORTUNITIES

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The Portuguese Personal Income Tax ("*PIT*") framework applicable to capital gains obtained by non-resident individuals with the transfer of real estate located in Portugal is surrounded in controversy since the early years of the first decade of 2000.

In a nutshell, the root of this controversy is the discrimination to which the non-resident individuals are subject for PIT purposes when compared with tax resident individuals, which has led to approximately two decades of tax disputes between non-resident individuals and the Portuguese Tax Authorities.

Considering the above, this paper aims to provide a brief overview on the PIT framework currently applicable to this type of capital gains when obtained by non-resident individuals, as well as to understand the current state-of-art of the controversies raised by the same as result of the action of the Portuguese Courts and the European Court of Justice ("*ECJ*").

I. The root of the controversy

Originally, the PIT Code established a taxation regime on capital gains arising from the disposal of real estate located in Portugal based on a remarkable distinction between resident and non-resident taxpayers.

On the one hand, tax resident individuals were subject to PIT at the general and progressive rates on 50% of the amount of the relevant capital gain, while, on the other hand, non-resident individuals were subject to taxation on the same capital gains at a flat rate of 28% levied on the total amount of the capital gain.

Thus, the root of the controversy of this regime was placed mainly on the taxable base over which the amount of tax due was determined. This difference on the relevant taxable base led to a level of effective taxation considerably higher on capital gains made by non-resident individuals when compared with tax residents.

In 2007, this discrimination was subject to the judgement of the ECJ in Hollmann's Case, where ECJ has stated that a tax regime that subjects capital gains resulting from the transfer of real estate located in a Member State (in this case Portugal) where that transfer is made by a resident of another Member State, to a tax burden greater than that which would be applicable for the same type of transaction to capital gains realized by a resident of the State in which that real estate is located should be deemed contrary to the free movement of capital.

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II. The Portuguese response to Hollmann's case

In an attempt to adapt this taxation regime to ECJ's jurisprudence, the 2008 Portuguese State Budget Law included an amendment to this framework, according to which non-resident individuals were granted with an option to be subject to the taxation regime applicable to Portuguese tax residents.

The regime arising from this amendment remains until today and as result of the same the PIT Code currently sets out that: i) capital gains with the transfer of real estate located in Portugal that are obtained by tax residents are subject to PIT at the general progressive rates (currently ranging between 14.5% and 48%) on 50% of its amount; and ii) such capital gains, when obtained by non-residents, are subject to taxation on its global amount at the flat rate of 28%, except if such non-resident is deemed resident for tax purposes in other EU Member State, case in which the non-resident taxpayer can choose to be subject to the taxation regime applicable to tax residents.

III. The shortcomings of this response

The response of the Portuguese State to Hollmann's Case was an attempt to tackle the breach of the EU Law incorporated in this regime without introducing any major changes in it. However, this option is wounded with several shortcomings that have been consistently detected either by the Portuguese Courts and the ECJ.

In this regard, the first shortcoming of this optional regime is the absence of economic rationale regarding the option. In fact, taking into consideration the range of the general progressive tax rates, the tax burden arising from the application of the non-resident's standard regime will always lead to a tax burden higher than the one that would arise from the regime applicable to tax residents. So, there are no scenarios where the application of the standard non-residents' tax regime does not prejudice them.

In line with this understanding, the Portuguese Courts have consistently sustained that the introduction of this option does not eliminate the discriminatory nature of this standard regime under the EU law.

To ground this position, the Portuguese Courts have taken into consideration several ECJ decisions, such as the decision issued in Gielen Case, of 18 March 2010, where the ECJ has stated with reference to a tax regime that also included an option between the application of a discriminatory and a non-discriminatory framework that *"It has, however, to be pointed out in that regard that such a choice is not, in the present case, capable of remedying the discriminatory effects of the first of those two tax regimes"*, considering that *"if such a choice were to be recognized as having the effect described, the consequence would be to validate a tax regime which, in itself, remains contrary to Article 49 TFEU by reason of its discriminatory nature".*

Another shortcoming of this optional regime is related with its availability only for tax residents of other EU Member States, excluding its application to tax residents of third countries even though that the same are also eligible to benefit from the free movement of capital.

Nevertheless, this shortcoming has already been detected both by national Courts and the ECJ, which have stated that tax resident individuals of third countries are also covered by the effects of Hollman's Case. In this sense, it is relevant to highlight ECJ's decision regarding Case C-184/18, of 6 September 2018, where ECJ has stated that the free movement of capital does not apply only between EU Member States but also between EU Member States and third countries. Thus, the article 63 of TFEU prevents in a general way all the restrictions made to free movement of capital between EU Member States and third countries.

IV. Final remarks

Despite of the resistance of the Portuguese Tax Authorities to recognize the discriminatory nature of the standard taxation regime applicable to capital gains made by non-resident individuals with the transfer of real estate located in Portugal the Portuguese Courts along with the ECJ have built during the last two decades a consistent jurisprudence recognizing and sanctioning such discriminatory nature.

As result of the application of this jurisprudence, non-resident individuals should be subject to a tax burden on this capital gains of only 14% (corresponding to the application of the flat rate of 28% only to 50% of the amount of the relevant gain), which should be duly considered by any non-resident individual that has transferred real estate in Portugal in the last 4 years and/or envisages to transfer real estate located in Portugal in the future. ■