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LEGAL ALERT

TAXATION OF REAL ESTATE CAPITAL GAINS MADE BY NON-RESIDENT INDIVIDUALS: THE LAST CHAPTER OF A NEVER-ENDING STORY?

I. Introduction

The Portuguese Personal Income Tax ("PIT") regime applicable to capital gains obtained by non resident individuals with the transfer of real estate located in Portugal has had a troubled life during the past two decades.

Basically, the original terms of this regime contained an obvious discrimination between residents and non-resident individuals, according to which the residents were subject to taxation only on 50% of these capital gains at the general progressive tax rates (ranging between 14.5% and 48%) while non-residents were subject to taxation on 100% of the capital gains at the flat rate of 28%. Therefore, on one hand, non-residents were always subject to an effective taxation of 28%, while, on the other hand, the effective taxation applicable to tax residents, as a rule, did not exceeded 24%. This discrimination led to several tax disputes between non-resident individuals and the Portuguese Tax Authorities. These tax disputes have reached their first pinnacle in 2007, when this discrimination was subject to the judgement of the European Court of Justice ("ECJ") in Hollmann's Case, where ECJ has declared 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 the one that would be applicable for the same type of transaction to capital gains realised by a resident of the State in which that real estate is located should be deemed contrary to the free movement of capital.

After ECJ put some light on this matter, it was expected that this ruling would work like a turning point on this regime, clarifying its limits towards the free movement of capital principle and putting an end on the tax controversy surrounding the same.

Nevertheless, this issue did not exactly evolve as planned and Portuguese Tax Authorities have entered again into a torturous route of tax disputes for more than ten years, converting something that should have been duly clarified long time ago into an apparently never-ending story.

Fortunately, this never-ending story seems to have acknowledged its final chapter recently, either by means of a case law uniformization issued by the Portuguese Supreme Administrative Court ("STA") and a new decision of the ECJ on this matter.

II. The Portuguese way out from Hollmann's case

From a Portuguese standpoint, the effects of Hollman's Case made themselves felt in the 2008 State Budget Law. In general terms, this law included an amendment to this regime, pursuant to which non-resident individuals were granted with an option to be subject to the taxation regime applicable to Portuguese tax residents.

The optional regime arising from this amendment remains until today, and, as result of the same, the PIT Code 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 new chapter on tax disputes

Unfortunately, the Portuguese way out from Hollmann's Case has led to nothing more than tax disputes between non-resident individuals and the Tax Authorities, due to the notorious shortcomings of this optional regime.

In this regard, the main shortcoming of this optional regime that has led to a new chapter of more than one decade of tax disputes is its tricky nature based in the absence of economic rationale regarding the option, considering that there are no scenarios where the application of the standard non-residents' tax regime does not prejudice them when compared with the regime applicable to tax residents. Therefore, the introduction of this option does not exclude the discriminatory nature of this standard regime that has been recognized by the ECJ.

Bearing the above in mind, the Portuguese Courts have consistently declared the illegal nature of the PIT assessments on real estate capital gains made in accordance with the standard regime applicable to non-residents, grounding their position in several ECJ decisions, namely the decision issued in Gielen Case, of 18 March 2010, where the ECJ has stated 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 recognised 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".

Moreover, this optional regime is only available to tax residents of other EU Member States, being excluded from its application tax residents of third countries outside the EU even though that the same are also eligible to benefit from the free movement of capital.

This additional shortcoming has also led to several tax disputes subject to appreciation both by national Courts and the Court of Justice. In this regard, it should be pointed out that Court of Justice has determined, in Case C-184/18, of 6 September 2018, that the free movement of capital does not apply only between EU Member States but also between EU Member States and third countries.

Notwithstanding the clear nature of the Court decisions around this matter, the Portuguese Tax Authorities seemed not willing to accept the content of such decisions and always tried to find new ways and specific details to sustain the application of the non-residents' standard regime, contributing to an apparently never-ending story where they issue illegal tax assessments condemned to be invalidated in Court years later.

Nevertheless, this never-ending story may have reached its final chapter during the past year, in the STA's legal procedure no. 075/20.6BALSB, in which the Portuguese STA has finally issued a decision, dated of September 12, 2020, according to which it uniformizes the understanding that recognizes: i) the illegal nature of the standard regime applicable to real estate capital gains made by non-resident individuals, due to violation of the free movement of capitals set out in TFUE's article 63; and that ii) such illegal nature of this standard regime is not excluded as result of the introduction of the optional regime.

Finally, on March 28, 2021, the ECJ has also issued a decision within the scope of its procedure no. C-388/19, where it addresses the current optional regime declaring without any shadow of a doubt that "Article 63 TFEU, read in conjunction with Article 65 TFEU, must be interpreted as precluding the legislation of a Member State which, in order to permit the capital gains realised from the transfer of immovable property situated in that Member State, by a taxable person resident in another Member State, to not be subject to a tax burden greater than that which would be applied to capital gains realised from the same type of transaction by a person resident in the first Member State, makes the taxation regime applicable dependent upon the choice made by that taxable person".

Thus, after more than one decade of tax disputes, this tax controversy seems to finally reach its happy ending, as result of the action of the Portuguese STA and the ECJ in order to protect the free movement of capitals principle and the fair and equal treatment between resident and non-resident individuals.

IV. Final remarks

Notwithstanding the resistance of the Portuguese Tax Authorities to recognize the discriminatory nature of the standard taxation regime applicable to real estate capital gains made by non-resident individuals the Portuguese STA along with the ECJ seem to have written the final chapter on this tax controversy, converting the Portuguese optional regime that has arisen from Hollmann's Case and the underlying tax disputes of more than one decade into a dead letter.

Therefore, and as it has occurred in 2008 after the issuance of Hollmann's Case decision, it is our understanding that these recent decisions of the STA and ECJ may lead to a new amendment of the law aimed to eliminate the optional regime and match the tax treatment given to real estate capital gains made in Portuguese territory by resident and non-resident individuals that we sincerely hope to be the end point on this tax controversy instead of the unexpected beginning of a new sequel.

Tax team

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