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Personal Income Tax and capital gains on real estate by non-residents

INTRODUCTION

Decisions were recently published regarding this subject, which enhance the prohibition of discriminatory treatment of the taxpayers according to their residency.

In effect, the courts have been considering to be discriminatory and, therefore, against the European Union's founding principle of freedom of movement, to tax the non-residents in Portugal over the global amount of the capital gains on real estate, compared to the residents which are only taxed over 50% of such gains.

These decisions are extremely relevant to the non-resident citizens that choose to sell real estate goods that they own in Portugal, since it grants them the right to a fairer taxation.

THE QUESTION

According to Portuguese Personal Income Taxation (PIT) Code, when a natural person residing in Portugal sells a real estate good (which is not his personal and permanent residence) and such sale results in a capital gain, only 50% of the capital gain will be taxed under IRS. This capital gain is subject to mandatory income aggregation, and therefore the IRS progressive rates (14,5%-48%) shall be applied.

This rule results in a higher taxation of the natural person in the year when the sale of the real estate occurs, as the capital gain is added to the remaining income, leading to a higher rate applicable to the yearly income.

However, if the capital gain is achieved by a non-resident, such gain is considered in full and taxed at the autonomous rate of 28% (despite the Code granting the non-resident with domicile in the European Union or the European Economic Area the possibility to opt for the residents' regime, adding such capital gain to the remaining income).

Over the last years, several non-resident citizens have questioned the legality of the IRS tax settlements which determined the taxation of the global amount of the achieved capital gains on real estate, bringing to courts what they considered to be a discrimination. In effect, the non-resident citizens considered that they should be taxed in the exact same terms as the residents, in other words, only over 50% of the capital gain.

CASE LAW

The Court of Justice of the European Union has issued several decisions on this subject, expressly stating that the PIT Code rule which sets forth that the capital gains on real estate achieved by residents are only considered in 50% is discriminatory in face of the single market of European Union's rules, namely, the free movement of capital.

Afterwards, the national courts and the arbitration court (CAAD) have confirmed the same understanding, by concluding that the legislation at stake represents an unjustified discrimination.

Accordingly, the IRS notices of settlement have been cancelled in several cases, allowing the non-residents with domicile in a Member State of the European Union to be taxed only over 50% of the capital gain, maintaining, however, the application of the autonomous rate of 28%.

Therefore, resulting in an effective tax rate applicable to non-residents of 14%.

REACTIVE MECHANISMS

Until the mentioned PIT Code legal rules are not amended and the Tax Authority adjusts its internal procedures according to the courts understanding, the non-resident citizen will remain to be taxed at the rate of 28% of the global achieved capital gain.

However, there are mechanisms that the taxpayers can use to question the legality of this taxation and request the taxation of only 50% of the capital gains. In order to do so, it will always be necessary (i) to submit the tax return within the legal time frame, (ii) receive the PIT notice of settlement, from which results the taxation of the global capital gain, and (iii) react against such notice of settlement, requesting the Court or CAAD to decide on such matter.

Only a favorable decision, in each case, will lead the Tax Authority to tax only 50% of the capital gain. Although it is not possible to ensure that the Court or CAAD will decide in favour of the taxpayer, this has been the most recent understanding of such entities, and therefore there is a high probability of success.

Finally, it is important to mention that, in order to prevent a tax execution procedure, the PIT settlement notice must be paid or, alternatively, a guarantee must be given.

PARES | Advogados is available to provide information on the legislation applicable to the taxation of capital gains on real estate, as well as to provide all the necessary support to the taxpayers that have achieved capital gains on real estate and intend to ensure that they are being taxed correctly.

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