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Vieira de Almeida & Associados

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A closer look at exit taxes on accrued capital gains in Portugal

Samuel Fernandes de Almeida and Rita Pereira de Abreu of Vieira de Almeida & Associados discuss the exit taxes on accrued capital gains in Portugal, double taxation and the interaction with the non-habitual tax residents regime.

Taxation of foreign-sourced capital gains in Portugal

The sale of shares of foreign companies by Portuguese resident individuals may trigger 28% personal income tax (PIT) in Portugal on realised capital gains – a 50% exemption may apply to small and medium-sized enterprises (SME) and latent gains are not subject to tax.

For non-habitual tax residents (NHR), an exemption may be available provided that the capital gain may be taxed in the source state according to the provisions of the applicable Double Tax Convention (DTT) or the OECD Model Convention, in the absence of a DTT in force between Portugal and the source state.

Notwithstanding, in a few exceptions – notably the DDT with Brazil – the general rule for capital gains is the attribution of exclusive taxing rights to the state of residence (Article 13 of the OECD Model Convention) and as such net capital gains arising from the disposal of securities will be, in principle, taxable in Portugal (i.e. after offsetting losses).

Exit taxes on accrued capital gains: The risk of double taxation

In some states, exit taxes are levied on accrued and (non-realised) capital gains upon the transfer of residency to another country. In the EU, EC law prevents immediate taxation on unrealised gains, requiring pursuant to settled case law of the ECJ that taxation is deferred to the moment of the sale, whilst preserving its taxing rights through different mechanisms.

This is the case for instance of France, whereas unrealised capital gains on shares are, under certain circumstances, subject to PIT and social security contributions at the exit from France, being such taxation deferred for transfers within the EU and EEA member states.

Different tax treatments deriving from such deferral may result in adverse tax consequences for taxpayers, as France will calculate the exit tax based on the value of the gain at the moment of departure, whilst Portugal shall calculate the whole capital gain from acquisition up to the actual sale of shares.

Interaction with the NHR regime

Taking the above in consideration, if a French taxpayer relocates to Portugal under the NHR regime and realises a capital gain, we may anticipate a few challenges to properly assess the net taxable gain in Portugal.

The taxable event for French exit taxes purpose shall be the transfer of residency – even if taxation is deferred – whilst the taxpayer is still tax resident in France. In Portugal, the taxable event is the sale of shares that occurs when the individual is already a tax resident in Portugal. Tax is collected simultaneously in both countries, but the taxable event occurs at different times, preserving each state's taxing rights.

There is no dispute between source state versus resident state, but rather two residency states at different times – transfer of residency versus realisation of capital gain, as taxpayer was resident in two different states for purposes of assessing the taxing rights of each state.

The NHR regime under Portuguese law shall not provide any tax relief, as under the DTT between Portugal and France, capital gains are exclusively taxed in the state of residency and, given the mismatch on the relevant taxable events, both countries may claim to be the country of residence.

Mutual agreement procedure: The only way out?

The same line of reasoning that led us to the conclusion that the exit tax suffered in France may not be assimilated to a taxation in source for purposes of the applicable DTT may also lead to denial of a tax credit in both states.

From a Portuguese law standpoint, upon the realisation of the capital gain, France has no taxing rights under the DTT and as such Portugal is not required to grant any tax credit for the taxable event occurred (but suspended) back in the year of the taxpayer's relocation of residence.

Although there is no clear-cut solution to the mismatch identified (i.e. liability to tax of two different countries at different times), this problem has been expressly addressed in the Commentary on Articles 23-A and 23-B of the OECD Model Convention, to conclude that these situations do not trigger a conflict of source-residence double taxation and, therefore, are not under the scope of these articles.

The commentary leaves open the possibility to use the mutual agreement procedure (MAP) to deal with such cases.

A possible (although very debatable) way to mitigate the double taxation would be to include the exit tax suffered in the exit state in the tax return to be filed in Portugal in the year of realisation – as a cost, since Portugal allows certain costs linked with the sale to be deducted to the realised gain.

We anticipate that this alternative to mitigate double taxation would, bottom line, be challenged by the Portuguese tax authorities. The potential success of any innovative approach to this matter would need to be tested in a case to be built before the Portuguese tax courts.

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