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The Portuguese Administrative Arbitration Center ("CAAD") recently published a decision within case no. 217/2021-T that may be of interest to taxable persons based in countries with a more favorable tax framework (usually called "*tax havens*") earning capital gains on real estate following the disposal of properties located in the territory.

The Arbitration Court found that taxing real estate-related capital gains earned in Portugal by natural persons residing in jurisdictions listed as tax havens at the higher rate of 35% set forth in the Personal Income Tax ("PIT") Code (instead of at the special rate of 28% generally applied to non-resident natural persons) is illegal.

Note that the Arbitration Court did not uphold the Claimant's first argument, namely that the act's provisions establish that natural persons cannot be taxed at the higher PIT rate, only legal persons (corporate persons and similar entities) can. We agree with the Court's decision to the extent that only natural persons are subject to PIT, which means that the subjective scope of any rules on levies, exemptions, and rates is limited to such persons, as the Arbitration Court rightly ruled.

The Claimants further argued that this increased tax scheme is at odds with Union law, namely the principle of free movement of capital enshrined in Article 63 of the Treaty on the Functioning of the European Union ("TFEU"). The Claimants won their case with this argument, which is in line with Court of Justice of the European Union ("CJEU") case law, according to which the principle of free movement of capital applies between Member States as well as between Member States and third countries, the Lebanon (the Claimant's country of residence and nationality) being a case in point.

Article 63 TFEU then generally prohibits any restrictions to the movement of capital between Member States, and between Member States and third countries. Although the TFEU does not specifically define free movement of capital, the concept has been consistently interpreted to include real estate transactions.

Relying on CJEU case law for their decision, the Arbitration Court concluded that applying a higher PIT rate to "*tax haven*" residents, pursuant to Ordinance 150/2004, of 13 February 2004, which includes the Lebanon, is discriminatory and deters residents in those countries from investing in Portuguese real estate and is, as such, a restriction to the freedom of movement of capital.

The Arbitration Court further reasoned that there were no pressing general interest reasons warranting such a restriction to the movement of capital, considering that the Lebanon was both the country of residence and nationality of the Claimants, which also rules out any evidence that they were seeking to evade taxation.

This decision could be a turning point as regards the application of automatic anti-abuse rules and their alignment with Union law. In keeping with Draft Directive ATAD 3, the concepts of abuse or "*tax haven*" should be fleshed out in the law, as should the tax and legal limitations they currently entail. In any event, we can expect to see similar actions brought in the near future, and only then will we be able to confirm whether this case law stands in both the arbitral and the judicial jurisdictions.

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