Portugal, Tax Arbitration Court, Decision, 30 April 2019

CJEU Decision, 18 March 2021

Tax Arbitration Court, Decision, 26 April 2021

Member State
Portugal

Topic
Arbitration

Deciding Court Original Language
Tribunal Arbitral Tributário//Centro de Arbitragem Administrativa

Deciding Court English translation
Tax Arbitration Court//Centre for Administrative Arbitration

Registration N
Process no. 598/2018-T

Date Decision
Preliminary ruling asked by the Tax Arbitration Court: 30 April 2019

CJEU Decision: 18 March 2021

Tax Arbitration Court final decision: 26 April 2021.

ECLI (if available)
Not available

National Follow Up Of (when relevant)
Not available

EU legal sources and CJEU jurisprudence

Articles 63 and 65 of the Treaty on the Functioning of the European Union.

Freedom of movement of capitals:

Judgment of 11 October 2007, Hollmann (C 443/06, EU:C:2007:600)

Non-discrimination:

Judgment of 18 March 2010, Gielen, (C-440/08, EU: C: 2010: 148)

ECtHR Jurisprudence

Not available

Subject Matter

Arbitration - Taxation of capital gains - Free movement of capital

Legal issue(s)

The referring court asked whether the amendments made to Portuguese tax law following the judgment of 11 October 2007, Hollmann (C ? 443/06, EU: C: 2007: 600), namely, the introduction of the possibility for non-residents to opt, under article 72, paragraphs 9 and 10, of the CIRS, for a taxation regime similar to that applicable to residents and, thus, benefit from the 50% reduction provided for in Article 43 (2) of that code, are sufficient to remedy the restriction on capital movements identified by the Court of Justice in that judgment.

Request for expedited/PPU procedures

Not available

Interim Relief

Not available

National Law Sources

Articles 43 and 72 of the Personal Income Tax Code (CIRS).

Facts of the case

MK, a tax resident in France, acquired, on 17 January 2002, a property located in Portugal, for the price of €79,807.66, which he subsequently sold, in July 2017, for the price of €180000. In May 2018 he submitted his periodic income declaration, in which, in addition to income from real estate in the amount of €8,800, he declared the sale of the said property, as well as the purchase and sale expenses of the same.

Article 43, under the heading "Capital Gains", of the Personal Income Tax Code, in the version applicable to the facts in the main proceedings ("CIRS"), provided, in paragraphs 1 and 2

"1 - The value of income qualified as capital gains is that corresponding to the balance ascertained between the capital gains and capital losses made in the same year, determined in accordance with the following articles.

2 - The balance referred to in the previous paragraph, in respect of the transfers made by residents provided for in paragraphs a), c) and d) of Article 10(1), whether positive or negative, shall only be considered in 50% of its value."

Article 72 of the CIRS, under the heading "Special rates", provided in particular the following provisions:

"1 - The following shall be taxed at the autonomous rate of 28 %:

(a) Capital gains provided for in Article 10(1)(a) and (d) earned by non-residents in Portuguese territory which are not attributable to a permanent establishment located therein;

[...]

9 - Residents of another Member State of the European Union or the European Economic Area [(EEA)], provided that, in the latter case, there is an exchange of information in tax matters, may opt, in respect of the income referred to in paragraphs 1(a) and (b) and 2, to be taxed on that income at the rate which, according to the table provided for in Article 68(1), would be applicable if it were earned by residents in Portuguese territory.

10 - For the purposes of determining the rate referred to in the preceding paragraph, all income, including income obtained outside this territory, shall be considered, under the same conditions as those applicable to residents.

[...]"

Therefore, as these are capital gains made at the moment of onerous alienation of real estate Article 43(2) and Article 72(1) of the CIRS provide for different taxation rules according to the different rules of taxation depending on whether or not the taxpayers of the income tax resident or not in the territory of that Member State. In particular, under Article 43(2) of the CIRS, capital gains made by residents at the time of disposal of property situated in Portugal were only considered in 50% of its value. In contrast, for non-residents, Article 72(1) of the CIRS provided for the taxation of those same capital gains on the entire amount at an autonomous rate of 28%.

On 5 July 2018, the AT issued an assessment notice in the amount of EUR 24 654.22, as income tax for the year 2017, applying the single rate of 28 % applicable to non-residents on the basis of Article 72(1) of the CIRS to the entire positive balance of the real estate capital gain realised.

On 30 November 2018, MK challenged that assessment notice before the referring court, the Tribunal Arbitral Tributário/Tax Arbitration Court (Centro de Arbitragem Administrativa - CAAD) (Portugal), claiming that that notice was vitiated by illegality to the extent that it was based on a regulation that discriminates against taxable persons residing in the territory of a Member State other than the Portuguese Republic in relation to taxable persons residing in Portugal, maintaining, that the above mentioned legal framework constituted a restriction on the free movement of capital enshrined in Article 63(1) TFEU.

It should be noted that MK, in its reasoning, invokes the Hollmann judgment of 11 October 2007 (C 443/06, EU:C:2007:600), in which the Court of Justice held that Article 43(2) of the CIRS, which provided that only capital gains made by taxpayers resident in Portugal would be taken into account in 50% of their value, led to a higher tax burden for non-residents and therefore constituted a restriction on the movement of capital, prohibited by Article 63 TFEU. The Portuguese tax authorities then point out that the Portuguese legislature amended the applicable legislative framework by introducing, in Article 72(9) and (10) of the CIRS, the possibility for non-residents to opt for a tax regime similar to that applicable to Portuguese residents and thus to benefit from the 50% deduction provided for in Article 43(2) of the CIRS, as well as from progressive rates, provided that they make a tax return in Portugal on all their worldwide income. In the present case, MK opted for the tax regime provided for in Article 72(1) of the CIRS and not for that provided for in Article 72(9) and (10) of the CIRS.

However, for MK, choosing between one discriminatory tax regime and another non-discriminatory tax regime cannot exclude the discriminatory effects of the first of those two tax regimes.

Reasoning (role of the Charter or other EU, ECHR related legal basis)

In view of the foregoing, the Tax Arbitration Court decided to stay the proceedings and refer a reference for a preliminary ruling to the CJEU:

The combined provisions of Articles [18 and 63 to 65 TFEU] must be interpreted as precluding national legislation, such as that at issue in these proceedings (Article 43(2) of the [CIRS]), as amended [...] [with the addition of paragraphs 9 and 10 to Article 72 of that Code], so as to allow capital gains resulting from the transfer of immovable property situated in a Member State (Portugal) by a resident of another Member State of the Union [...] (France) not to be subject to the application of Article 43(2) of the [CIRS]. with a view to enabling capital gains resulting from the transfer of real property situated in a Member State (Portugal) by a resident of another Member State of the Union [...] (France) not to be subject, by choice, to a tax burden greater than that which would apply, in respect of that same type of transaction, to capital gains realised by a resident of the State in which the property is situated?

The CJEU starts by clarifying that the transfer for consideration of immovable property situated in the territory of a Member State by non-resident natural persons falls within the scope of Article 63 TFEU. At the same time, it states that Article 63 TFEU prohibits any restrictions on the movement of capital between Member States, subject to the justifications provided for in Article 65 TFEU.

It also notes that, following the Hollmann judgment, the Court of Justice has already had occasion to declare that the setting, by Article 43(2) of the CIRS, of a taxable amount of 50% for capital gains realised only by taxpayers resident in Portugal, and not by non-resident taxpayers, constituted a restriction on the movement of capital, prohibited by Article 63 TFEU. Moreover, it adds that that finding is not called into question by the judgment of 19 November 2015, Hirvonen (C 632/13, EU:C:2015: 765), in which the Court held that a difference in treatment between non-resident and resident taxpayers, consisting in subjecting the former's gross income to taxation on a definitive basis at a single rate by means of withholding tax, whereas the latter's net income is taxed according to a progressive scale including a basic allowance is compatible with EU law, in so far as that finding is subject, however, to the condition that the single rate is not higher than the rate resulting from the actual application of the progressive table for the person concerned to the net income exceeding the basic allowance. However, according to the CJEU, in the present case, the differentiated taxation regime in question leads to non-residents being systematically subject to a higher tax burden than that applied to residents when realising capital gains on the sale of real estate.

Thus, it concludes that the setting of the taxable amount at 50% for capital gains realised by all taxpayers resident in Portugal, and not for non-resident taxpayers who have opted for the tax scheme provided for in Article 72(1) of the CIRS, constitutes a restriction on the movement of capital, prohibited by Article 63(1) TFEU.

Next, the CJEU examines whether that restriction can be justified under Article 65 TFEU. It follows from Article 65(1) TFEU, read in conjunction with Article 65(3) TFEU, that Member States may draw a distinction between resident and non-resident taxpayers in their national legislation, provided that such distinction does not constitute a mean of arbitrary discrimination or a disguised restriction on the free movement of capital.

The CJEU makes a point of recalling that, according to the aforementioned Hollmann judgment, in

order for national tax provisions, such as Article 43(2) and Article 72(1) of the CIRS, to be considered compatible with the Treaty provisions on the free movement of capital, the difference in treatment must concern situations which are not objectively comparable or must be justified by overriding reasons in the general interest.

And, for the same Court, this is not the case. Therefore, the CJEU concludes that Article 63 TFEU, read in conjunction with Article 65 TFEU, must be interpreted as precluding legislation of a Member State which, in order to allow capital gains resulting from the transfer of immovable property situated in that Member State by a taxpayer resident in another Member State not to be subject to a higher tax burden than that which would be applied, for that same type of transaction, to capital gains realised by a resident of the first Member State, makes the applicable tax regime dependent on the taxpayer's choice.

Relation of the case to the EU Charter

Not applicable, since only provisions of the Treaty on the Functioning of the European Union are cited (and used)

Relation between the EU Charter and ECHR

Not applicable.

Use of Judicial Interaction technique(s)

Arbitration played a key role in ensuring consistent interpretation with European Union Law in Portugal. In fact, the Court's initiative to submit a preliminary ruling demonstrates the need to clarify whether the provisions of the CIRS were in accordance with what is stipulated in the treaties and in previous case law of the CJEU. It goes a long way towards increased legal certainty and protection of basic EU citizens' rights attached to freedom of movement.

Horizontal Judicial Interaction patterns (Internal – with other national courts, and external – with foreign courts)

Not applicable.

Vertical Judicial Interaction patterns (Internal – with other superior national courts, and external – with European supranational courts)

There is a vertical judicial interaction in that the Court decides to submit a preliminary ruling to the CJEU. It is on the basis of the CJEU's decision that the domestic dispute will subsequently be resolved.

Strategic use of judicial interaction technique (purpose aimed by the national court)

As we have said, the Court's concern in submitting a preliminary ruling to the CJEU is precisely to interpret and apply the provisions of the CIRS in accordance with what is stipulated in the treaties and in the case law of the CJEU.

Impact on Legislation / Policy

This was not the first time that the state was condemned for taxing the capital gains of non-resident citizens in excess. The first time CJEU condemned the Portuguese State, considering that it discriminates against non-residents in terms of real estate gains obtained in the national territory was in 2007.

The same conviction occurred in the Hollman case. However, after this conviction, instead of changing the tax regime for non-residents, Portugal maintained the main regime and did approve a new subsidiary regime, supposedly equivalent, but applicable only to residents in another EU Member State or in Space European Economic Area. This allowed non-residents to be taxed by 50% but obliged them to declare all their income to determine the applicable progressive tax rate.

Non-residents did not adhere to this procedure on account of its complexity. The ECJ has now ruled that the existing analogous regime is not likely to exclude the discriminatory effects of the first regime (Gielen, C-440/08, EU: 2010: 148, n. ° 52).

To date, the Portuguese Tax Authority continues to apply and interpret articles 43 and 72 of the CIRS; neither legislation nor practice has changed.

In this regard, reference should also be made to a recent decision of the Tax Arbitration Court, of 23 March 2021, which concludes, precisely, that the provisions of Article 43(2) of the CIRS and the current Article 72(13) and (14) of the CIRS do not comply with EU law and are therefore illegal.

Notes on the national implementation of the preliminary ruling by the referring court

In view of the CJEU's decision, the Tax Court confines itself to accepting the understanding set out in the ruling of the European judicial body, thus deciding that the tax assessment made by the Tax Authority was in breach of Articles 63 and 35 of the TFEU, and was therefore illegal, and determining the reimbursement to the claimant of the unduly paid tax.

Impact on national case law from the same Member State or other Member States

Not applicable.

Connected national caselaw / templates

Not applicable.

(Link to) full text

Decision of the Tax Arbitration Court:

https://caad.org.pt/tributario/decisoes/decisao.php?s_irs=1&s_processo=&s_data_ini=&s_data_fim=&s_re

CJEU Decision:
https://curia.europa.eu/juris/document/document.jsf?text=&docid=239005&pageIndex=0&doclang=PT&mo

Final decision of the Tax Arbitration Court:
https://caad.org.pt/tributario/decisoes/decisao.php?s_processo=598%2F2018-T&s_data_ini=&s_data_fim=&s_resumo=&s_artigos=&s_texto=&id=4467