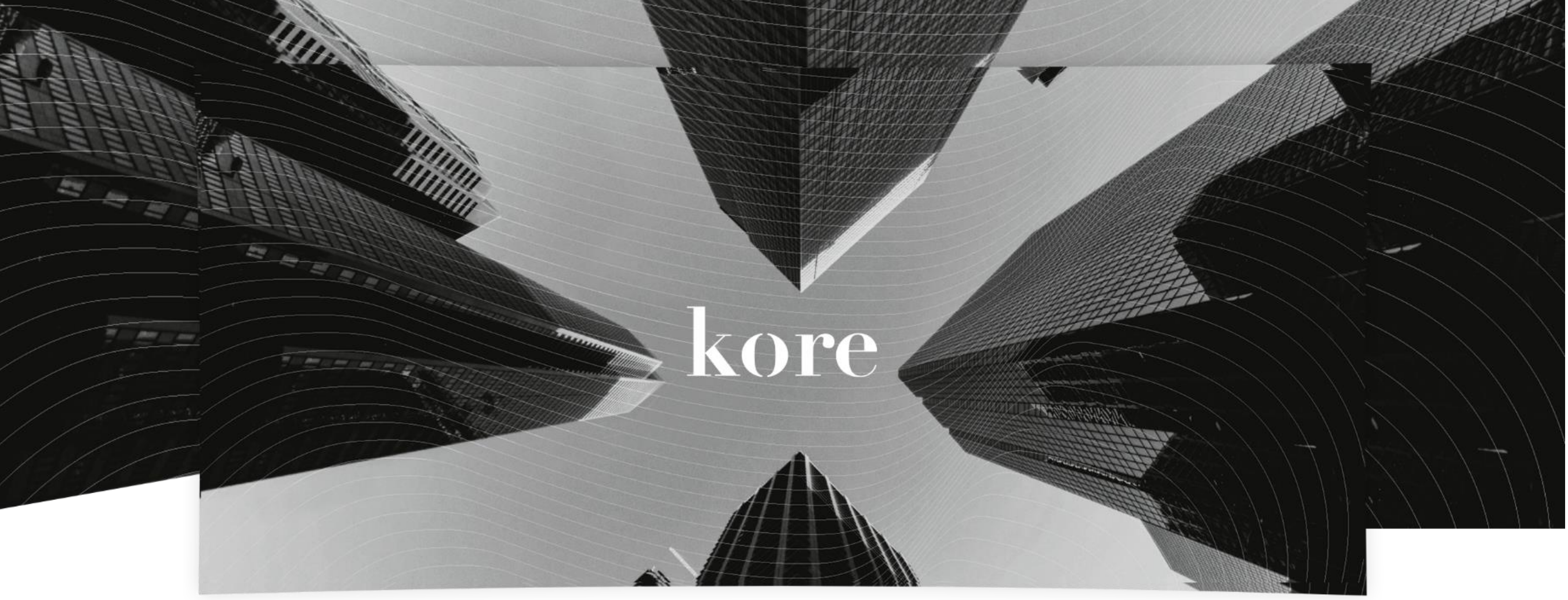

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NHR and practical issues arising from foreign capital gains

ON THIS ISSUE

By Kore Partners

The taxation of foreign-source capital gains of a non-habitual tax resident has been a subject of much technical debate in Portugal.

Capital gains are generally taxable at 28% flat rate in Portugal and only in certain rather exceptional cases the exemption method may apply.

As the 28% flat tax on an NHR sometimes comes as a surprise or is frequently considered a drawback if compared with other favorable regimes, it is therefore useful to delve in more detail how capital gains taxation operates in practice.

Even if we might have touched upon the main aspects in other briefings, it is important to recall the basic rule of NHR regime that provides that foreign sourced capital gains are exempt from tax in Portugal whenever one of the following conditions is met:

(i) the capital gains may be taxed in the source state according to the provisions of a tax treaty with Portugal; or

(ii) the capital gains may be taxed in another non-treaty jurisdiction as provided in OECD Model Convention and to the extent is not derived from a blacklisted jurisdiction (see list).

"capital gains taxation either comes sometimes as a surprise or is considered a drawback of the NHR regime"

To fully understand potential taxation in Portugal, the NHR will have to:

(i) determine the type of gain being derived;

(ii) ascertain the source jurisdiction of the gain;

(iii) verify if a tax treaty is in place with Portugal and see the allocation of taxing rights;

(iv) understand the international rules under OECD Model when no tax treaty is in place; and

(v) calculate the capital gains on the basis of local Portuguese rules (which may differ from source country rules).

The roadmap may lead to complex analysis in some cases. Even if each case is a case, we will see practical examples of how the NHR regime applies to different types of cross-border capital gains.

(1) Gains derived on the disposal of real estate in a foreign jurisdiction

- **Rule:** All tax treaties signed by Portugal and Article 13(1) OECD Model (in cases where a tax treaty is not in place) allow country where the property is located to tax gains on immovable property.
- **Outcome:** Exemption method for NHR should apply in these cases regardless of any tax levied by the foreign jurisdiction. Real estate located in a blacklisted jurisdiction without a tax treaty remains taxable at 28%.

(2) Gains from movable property part of fixed base in foreign jurisdiction

- **Rule:** All tax treaties and Article 13(2) OECD Model allow country where the fixed place of business is located to tax sale of that property (e.g. goodwill, licenses, etc).
- **Outcome:** Exemption method for NHR should apply in these cases.

“the roadmap for taxing capital gains of NHR may be complex in some cases and require careful analysis”

(3) Gains derived from real estate rich foreign companies

- **Rule:** Large number of tax treaties and Article 13(4) OECD Model allow the country where the real estate company is resident to tax any gains from sale of shares.
- **Outcome:** The NHR exemption should apply in cases where it is proven that the disposed company derives more than 50% of value directly or indirectly from real estate in that foreign country and the tax treaty allows that country to tax.

(4) Gains from substantial shareholding participation in foreign company

- **Rule:** A few tax treaties signed by Portugal allow the source country to tax gains on the sale of shares in which the NHR held a substantial participation (e.g. 25% stake). The NHR exemption should apply in these cases.
- **Outcome:** The NHR exemption should apply in cases where the tax treaty allows that foreign country to tax a substantial participation.

(5) Gains derived from sale of portfolio foreign shares

- **Rule:** Almost all tax treaties (and Article 13(5) OECD Model) give exclusive taxing rights over portfolio gains to Portugal.
- **Outcome:** NHR exemption is not applicable and gains become taxable on realization at 28% flat rate.

(6) Special case of capital gains sourced in Brazil

- **Rule:** This tax treaty provides shared taxing rights on all capital gains, which means Brazil may always tax.
- **Outcome:** NHR exemption should apply in all cases where Brazil is allowed to tax.

(7) Capital gains sourced in blacklisted jurisdictions

- **Rule:** NHR exemption rule does not apply unless there is a tax treaty (e.g. Qatar, UAE, Uruguay and Panama have for example tax treaties in place with Portugal).
- **Outcome:** Gains taxable at 28% or 35% from positions on bonds, funds or trusts.

It is important to note that even if the outcome is that the NHR exemption method should apply there has been some challenges securing direct application on the tax return. Requesting an advance tax ruling may be an option in some cases.

In situations where gains may be taxable in Portugal it then becomes relevant to take into account the rules for determination of capital gains. This includes:

(i) inflation coefficient for long-term gains;
(ii) possible 50% relief for sale of small and micro enterprises;
(iii) anti-abuse rules disregarding losses with counterparty in a blacklisted jurisdiction;
(iv) limits on carry-over of losses to following tax years.

Bottomline, we have learned that foreign based capital gains derived directly by NHR have their own specificities and international tax expertise is needed to navigate tax treaties and reach an outcome.

Key takeaways

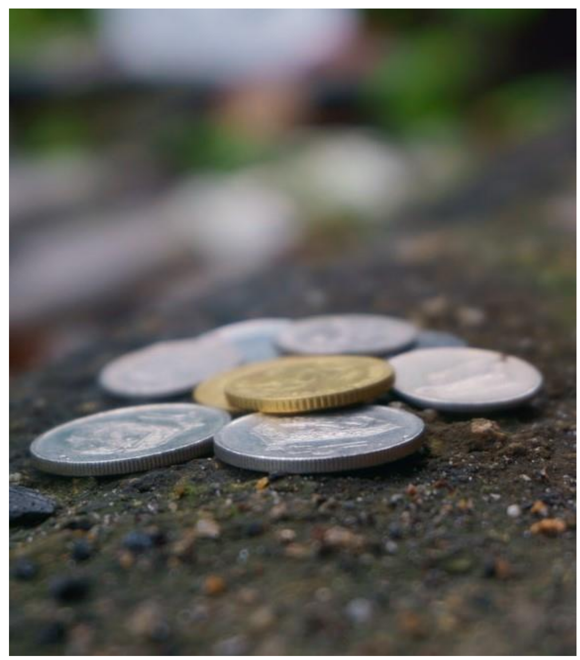
1. Determine carefully the type of gain and the source of income;

2. Evaluate the provisions of the tax treaty or in its absence the OECD Model;

3. Recognize that not all cases are currently resolved under the reporting system of the NHR;

4. Beware of the case of gains from financial portfolio taxable only in Portugal at 28% upon realization; and

5. Be attentive to the domestic rules for the calculation of realized capital gains.



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