CAPITAL GAINS - *Investment Portfolios*

With the introduction of Decree Law 15/2010 of 26 July, a new Capital Gains Tax Regime has been approved and implemented that, despite several important exceptions, defines a new level of flat-rate assessment on the disposal of shares, bonds, derivatives, warrants, and other similar securities. In general, these gains are be subject to a flat-rate tax of 20% in 2010 & 2011. In 2012, this rate increased to 25% and to 28% in 2013. This principle also applies to mixed or closed (private subscription) investment funds.

While small investors enjoyed a partial reprieve from the rate hike with **the first €500** of Capital Gains from listed shares excluded from assessment for resident taxpayers, this exemption has been eliminated in 2013.

New reporting obligations also apply to intermediaries involved in these operations in line with other measures combatting fraud and tax evasion. Capital losses can be carried forward two years. Even if your portfolio had a net loss with no tax income, it is important to report for two reasons: a) it is a statutory requirement and b) if you fail to report a loss in the year that it occurred, you will not be able to carry the losses forward to offset future gains.

A Key Exception

One significant exemption is the assessment of gains from the sale of *shares of micro and small companies* not listed on the stock exchange. Although the 28% formally applies, these companies will now benefit from a 50% exclusion, leaving a net effective tax rate of 14%. This means that most small businesses ("*Limitadas*") as well as Portuguese

Nominee Companies *("Sociedade Civil)"* have a reduced impact from the CGT rules. Portuguese Nominee Companies are non-trading companies - sharing certain similarities with "*trusts*" in English Common Law - used to hold real property and other assets in Portugal and elsewhere in Europe. Nominee Companies have become increasingly popular with Non-Residents in recent years due to their tax efficiency, moderate cost and fully compliant structure.

Overall Strategy

The introduction of the flat 28% tax rate to Capital Gains accompanies the application of a general tax rate rule for all income from Capital. Both Interest and Dividends also suffer the same 28% flat-rate assessment as is being applied to Capital Gains. Likewise, exemptions may be available to accommodate specific situations.

Flat-rate taxes are assessed autonomously, thereby avoiding the "top-slicing" effect customary with most additional income. Simultaneously, they fail to allow for any deductible expenses being applied against them, *restricting their benefit to certain taxpayers*

This is the latest in numerous attempts over the years to overturn CGT exemptions. Under the Socialist administration of Antonio Guterres in 2002, Capital Gains rates were lifted to 30%. Needless to say, after a year of capital flight, the old rules were reinstated. It remains to be seen whether this attempt will have more long-lasting results.

QUESTIONS & ANSWERS

Question: What constitutes a Capital Gain?

FINESCO: Capital Gains come from the sale of property or rights:

- termination of real estate property rights;
- partnerships shares, stocks & other securities & funds;
- literary and industrial rights;
- winnings from gambling.

Question: Are there any exemptions?

FINESCO: Yes. The following are exempt from Capital Gains Tax:

- housing purchased prior to 1 January 1989;
- construction lots acquired by gift or inheritance prior to 08/06/1965 as well as rural property;
- shares in partnerships acquired before 01/01/1989;
- government bonds and debentures;
- unit trusts (to the institution, not the investor)

Question: How is the sale of shares of a Limited Liability Company assessed?

FINESCO: While the 28% tax rate still applies, small and micro companies (as defined in legislation) enjoy a 50% exclusion, thereby reducing the final levy to 14%.

Attention: Don't get confused by the semantics in Portuguese. While English uses the word "**share**" for all kinds of Companies, Portuguese is more complex. "*Acções*" refer to Corporate *("Sociedade Anónima")* Shares. Shares in a Limited Liability Companies *(Lda.)* are called *"Quotas"*. Shares of Nominee Companies *(Civil Companies)* are normally referred to as *"Participações"*. The latter two have distinct tax treatment - flat 20% CGT - to corporation shares ("*acções*").

Question: I sold some shares and my broker charged a commission. Are these expenses deductible?

FINESCO: Yes. Brokers' purchasing expenses are deductible for the purchase (but not for the sale) and should be reported on Annex G.

Question: ***I sold some shares and made a small profit. How do I report the gain?***

FINESCO: Capital Gains on corporate shares are taxed at a flat rate of 28% like other forms of income from Capital. Alternatively, they can be aggregated with other income and assessed at marginal rates.

Question: ***I was not so lucky. I had to sell shares at a loss. Is there any relief?***

FINESCO: Net losses may be carried forward up to five years on income within the same category. In order to be eligible, losses must be reported in the year that they occurred.

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