CGT and a Portuguese Nominee Company: *Create, Transform, Liquidate*

Property purchased a decade or two ago is often liable to substantial Capital Gains assessment at today's market prices. There are numerous reasons for this trend. First and foremost is the obvious fact that property prices have risen far ahead of inflation over the years. In addition, since capital improvements can only be deducted in the 12 years prior to sale, many renovations and refurbishments have, in effect, "expired" and no longer count in the calculation of CGT.

A second element comes in changes in reporting practices. Twenty years ago, it was common to understate selling prices to reduce the impact of the then existing property transfer tax, "*SISA*", which was levied at the rate of 10%.

Another factor was the failure of professionals in the building trades to issue correct invoices; often no VAT was paid nor income reported on annual tax declarations. While these components typically reflected pervasive forms of tax evasion that were common at the time, tougher enforcement today has reduced substantially these once common fiscal abuses.

Whatever the reason, the reality today is much the same: if you purchased your property years ago, you are likely to be in line for a considerable Capital Gains Tax. If you are lucky enough to have a modest rateable evaluation ("*VPT*" - *Valor Patrimonial Tributável*), the creation, transformation and liquidation of a Portuguese Nominee Company may prove to be a viable solution to mitigate your Capital Gains tax liability.

Example

Suzanne and Chris bought a ruin in the hills of the Algarve in 1989 for 10,000,000 escudos (today's equivalent of ±€50,000). In those days, few builders readily produced proper invoices. The couple was focused on the refurbishment project, not on preparing for the eventual sale. In short, there was no documentation to support many of the construction expenses.

Last year, they put the property on the market for €350,000 and were fortunate to find a buyer. They realised that they would be faced with CGT of over €50,000. The purchasers were also coming to grips with considerable taxation on their acquisition: over €20,000 between Property Transfer Tax ("*IMT*") property and Stamp Duty on the deed.

Buyers and Sellers quickly agreed to use a Portuguese Nominee Company to their mutual benefit. First, a simple form of Company ("*SABP*" - *Simples Administração de Bens Próprios*) with no share value was created to buy the property at "*VPT*", thereby keeping taxation to a minimum.

Next, the Company was *transformed* into its final structure ("*sob forma comercial*") with a share value of €350,000, based on a formal appraisal of its newly acquired asset. These shares were then sold to the buyers for the same price of €350,000. With no transfer of the property – only Company shares changing hands – the final transaction suffered no Capital Gains Tax.

Explanation

How is this possible? The Portuguese Tax Code defines a Capital Gain as the *transfer* of ownership or the respective rights. On the other hand, the share value uplift occurs in the *transformation* of one form of company into another. As a rule, a *transformation* does <u>not</u> constitute a chargeable event while a *transfer* typically triggers one or more forms of assessment.

In this case, there are two transfers and one transformation: first, the property is acquired by the Company. Subsequently, the shares of the Company are sold to the Buyers, both without change in respective nominal values. The *transformation* comes in between, altering the form and designation of the company as well as its share capital without changing its legal personality (“*personalidade jurídica*”).

Eventual Liquidation of the Company

Upon liquidation of a company, Capital Gains from the distribution of assets are determined by calculating the difference between the market value of the asset(s) less the cost of acquisition of the shares. Therefore, if the cost of the shares is equal to the market value of the asset, no Capital Gains assessment arises to the shareholders. “*IMT*” (Property Transfer Tax) and Stamp Duty will be due upon the transfer of ownership from the Company to the Shareholder(s).

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