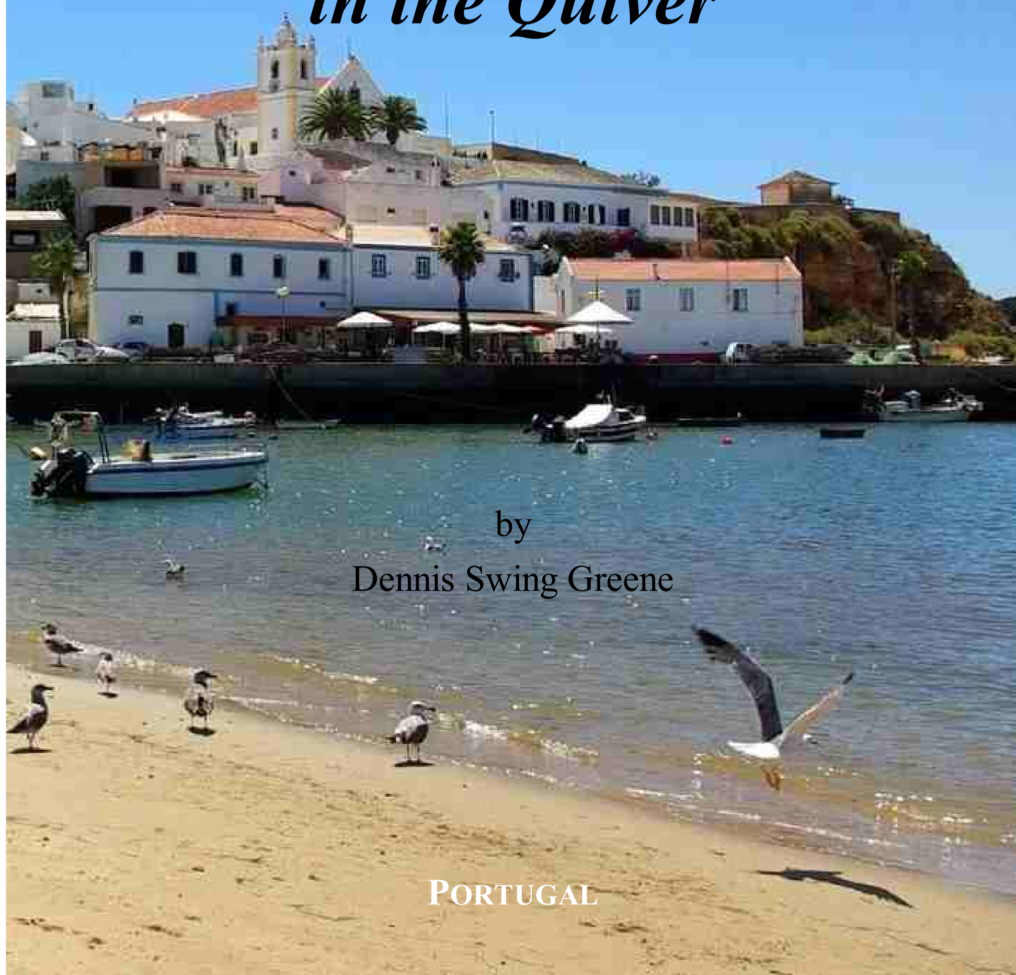
*euro*FINESCO

*e*BOOK nº 21

CGT MITIGATION

14 Arrows in the Quiver



by

Dennis Swing Greene

PORTUGAL

Ficha Técnica:

10ª Edição:	*euro*FINESCO *e*Book nº21: CGT Mitigation: *14 Arrows in the Quiver*
Autor:	Dennis Swing Greene
Designer:	Maria de São José Belchior Horta
Distribuição:	www.eurofinesco.com
Tiragem:	Internet
Executado:	Abril 2018

Reservados todos os direitos.
Esta publicação não pode ser reproduzida no todo ou em parte,
por qualquer processo, sem prévia autorização por escrito do autor.

COPYRIGHT © ALL RIGHTS RESERVED
Violators will be prosecuted to the full extent of the law

euro*FINESCO *s.a.

HEADQUARTERS
Rua do Sol, 4
8200-448 GUIA (Algarve)
tel: +351 289 561 333
fax: +351 289 562 061

Lisbon Branch
Rua Ant. Mª. Cardoso, 15, 4ºD
1200-273 LISBOA (Chiado)
tel: +351 21 342 4210
fax: +351 21 342 4212

Madeira Branch
Rua do Aljube, 61, 2º Dtº
9000-067 FUNCHAL (Sé)
tel: +351 291 221095
fax: +351 291 221103

Internet
e-mail: info@eurofinesco.com
www.eurofinesco.com
Portugal
mobile: +351 96 910 2813

Table of Contents

Beyond Advising on CGT Mitigation in Portugal. 5

Introduction 7

1. Rollover Relief 9

2. "*Usufruto*" - Tenancy Rights. 11

3. "*Permutas*" - Property Swaps. 13

4. Short-Term Swaps 15

5. Portuguese Nominee Companies 17

6. Redomiciliation 19

7. Capital Improvements 21

8. Company Transformation 23

9. Property Subdivision 27

10. Foreign Property 29

11. Inheriting Portuguese Property 31

12. Fractional Ownership 33

13. Selling a Property out of an Offshore Company. 35

14. Winding up a Company - *Closing thoughts* 39

Selling Property out of a Company

Trash to Treasure

Shareholder's Loans

Conclusion 43

Other *e*Books from ***euro*FINESCO**. 44

At ***euro*FINESCO**, we take pride in being a frontrunner in fiscal and expatriate services in Portugal, playing a leading role in interpreting Portuguese fiscal legislation as plain English for the foreign resident community since 1991.

PORTUGUESE TAXATION

- *IRS* - Individual Income Tax Returns
- *IRC* - Tax Preparation for Portuguese Nominee Companies as well as Non-Resident Companies
- Fiscal Residency Transitions to Portugal
- Fiscal Representation for Non-Resident Individuals
- Fiscal Representation for Companies

INTERNATIONAL TAX ISSUES

- Bilateral Tax Treaties
- International Tax Reconciliation
- Compliance Issues

PERSONAL TAX PREPARATION

The Portuguese tax system offers surprising opportunities to the foreign resident. When properly prepared, Portugal can prove to be a "tax haven within Europe" for you.

PORTUGUESE "*IRS*" INCOME TAX RETURNS

***euro*FINESCO** specializes in helping foreign residents by preparing their annual Portuguese *IRS* Income Tax Returns.

NOMINEE COMPANIES FOR PORTUGUESE PROPERTY

- Meeting basic compulsory compliance commitments;
- Liaison between *Finanças* and Company Owners.
- Resourcing information to Owners;

FISCAL REPRESENTATION

- Protecting your Valuable Investment
- Meeting Compliance Requirements
- Resourcing Key Information
- Liaison with *Finanças*
- Personalised Service
- Payment Facility
- Plain English

DOCUMENTATION

We can assist you by cutting through the bureaucracy:

- *"Residências"*
- Portuguese Wills
- Driving Licences
- Rates Exemptions
- Fiscal Numbers
- Medical Cards

SMALL BUSINESS FORMATION

We can help expatriates launch new businesses in Portugal:

- Choosing the right structure
- Accountancy Services
- Social Security & VAT
- Local Lodging Plan

When homeowners sell their property in Portugal, they must report the transaction on a Portuguese "*IRS*" annual Income Tax declaration in the year following the sale. If there is a Capital Gain (a profit on the net difference between purchase and sale prices), then tax will be due in Portugal. If owners are not tax residents, they may also have subsequent fiscal obligations in their home jurisdiction.

How is the Capital Gain calculated?

Although it is *Portuguese Tax Authority*, not you, who does the actual calculation, it may be worthwhile knowing what the damage will be. Let's suppose that you sold your home last year that you had originally purchased in 1994. Calculate your capital gains as follows:

Step 1: Based on the year of acquisition, multiply the purchase price by the Inflation Adjustment Coefficient.

Step 2: Subtract the adjusted purchase price from the selling price. This is your gross gain.

Step 3: Subtract any qualifying buying or selling costs (commissions, notary and legal fees, transfer tax, etc.) and documented capital improvements to the property in the past 12 years. This is your net taxable gain.

Step 4: One half of the net profit is assessed unless the gain is rolled over into another principal residence. Either way, report the sale on your annual *IRS* declaration.

Resident vs. Non-Resident Individuals

If you are Non-Resident for tax purposes in Portugal, the Capital Gains Tax calculation is quite simple: 25% of the full net profit. If you are resident in Portugal, there are two options:

1) one half of the capital gain of the adjusted net profit on the sale of your principal residence acquired after 01 January 1989 is added to overall income for the fiscal year and taxed at marginal rates.

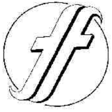
2) However, gains may be rolled over if another *principal residence* of equal or greater value is bought between 24 months prior and 36 months after a sale. When only a partial re-investment is made, the gain is calculated on a pro-rata basis.

Deductable Expenses

There are two types of expenditures that can be reported to reduce your tax CGT liability: necessary expenses for the transfers of the property as well as capital improvements.

a) Necessary buying & selling costs (notary & registry fees, *"Sisa"/"IMT"*, etc.) supported by proper documentation.

b) Documented capital improvements to the property are deductable only within a 12 year period prior to sale. Stated inversely, your capital improvements expire after 12 years for tax purposes.



1. Rollover Relief

Rollover Relief is a tax break available to Portuguese tax residents who sell their *principal residence* and reinvest the proceeds directly into another. In practical terms, your "*principal residence*" is the one that you registered as your address with *Finanças*.

Needless to say, rollover relief does not apply to *non-residents* who, by definition, are tax residents of another country and therefore are presumed to have their *principal residence* in that jurisdiction. Rollover relief is applicable when the principle residence is replaced anywhere within the EU. However, formal proof of residency is required for approval to be granted.

Properties sold have a 5 year "window" to make the reinvestment: up to 2 years prior to the sale and as much as 3 years after. If you buy a building plot when reinvesting, you have 2 years to make the purchase, 6 months to sort out planning permission and 2 years to complete construction.

If you eventually reinvest less than the full amount that you receive for the property, the tax will be reduced on a *pro rata* basis.

While the purchase price is adjusted for inflation when calculating tax expenses are not.

Deductible Expenses

There are two types of expenditures that can be reported to reduce your tax CGT liability: necessary expenses for the transfers of the property as well as capital improvements.

a) Necessary buying & selling costs (notary & registry fees, *"Sisa"/"IMT"*, etc.) supported by proper documentation.

b) Documented capital improvements to the property are deductible only within a 12 year period prior to sale. Stated inversely, your capital improvements expire after 12 years for tax purposes.

Note: *When you move, it is always important to update your "fiscal" address with Finanças. Not only do you risk losing important tax breaks such as Rollover Relief, but you will also miss important correspondence that will continue to be sent to the outdated address unless you inform them otherwise.*

2. Tenancy Rights
“Usufruto”

Many investors want to buy their home and include their children in the ownership, intending to leave their affairs in order and mitigating eventual inheritance tax problems.

However, life sometimes takes unexpected and cruel twists: bitter divorce, crippling illness, untimely death. In the worst case scenario, a retirement home in the children’s name can vanish as a consequence of an unanticipated calamity, leaving the parents without a home, nor the means to replace it.

Staying in Control

One simple solution is to use your Nominee Company with the shareholding in the name of the children. The Company grants a Deed of Life Tenancy (“*Usufruto Vitalício*”) to the parents who then have full and exclusive rights to the property for as long as they live without suffering the normal taxation associated with property transfers.

Upon the passing of the last surviving parent, the tenancy rights automatically revert to the Company which is already owned by the children, thereby solving harmlessly any potential inheritance problem inside and outside of Portugal.

What is “Usufruto”?

Usufruto (tenancy rights) is the right to the use and enjoyment of the fruits or profits of another’s asset, without fundamentally changing its substance. It is the right to enjoy things that someone else owns, in the same way as an owner, but subject to

an obligation to conserve the substance. *Usufruto* grants the right to use the asset and receive the benefits (fruits).
Unlike a lessee, the usufructor (*usufrutário*) takes and accepts the thing as he finds it, but is obliged to return the subject matter as he found it originally or to provide equivalent value.

Creating Tenancy Rights

The right of *Usufruto* may be created by deed, by testamentary grant or it may be created by law, as with the right of parents over the property of their children while they are minors. *Usufruto* may be granted over movable assets (*móveis*), such as your Nominee Company or immovable property (*imóveis*). Using a Company usually sidesteps "IMT" (Property Transfer Tax) and Stamp Duty associated with direct ownership.

Tax Implications

As with any property transaction in Portugal, the legal minimum transaction price for "*permutas*" is the rateable value ("*VPT*"). This fiscal evaluation is also the basis for annual "*IMI*" Property Rates. A "*permuta*" will trigger a update of the "*VPT*" which will be used to calculate any tax due. This may occur at the point of sale or, more likely, several months later. Beyond these restrictions, the buyer and the seller are free to negotiate the final value of the exchange.

Low or no "IMT"

The final transaction value is based on the formula "**A - B**", not "**A + B**". "*IMT*" (Property Transfer Tax) will only be calculated on the *difference*. Since Property Transfer Tax is progressive in nature, the tax savings will be even greater. When "**A = B**" (properties declared at equal value), there is no "*IMT*"due.

Low or no Stamp Duty

Stamp Duty on the deed is assessed at the rate of 0.8%, also based on the difference between the two values, with the owner with the larger amount paying the tax. If the amounts are equal, there is no tax to pay.

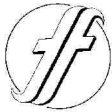
Partial or full CGT Exemption

As in any property transfer, the Capital Gain is calculated on the difference between the original price in the deed of acquisition adjusted for inflation and the net sales price, reduced by expenditures and capital improvements within the previous 12

years. Rollover Relief is achieved when there is a full re-investment of the proceeds of the sale of the *principal residence* (as registered with *Finanças*). In the case of a "*permuta*", the "sales price" will be of equal value to both: either a) the higher property value or b) the lower property value plus the cash difference.

The swap simultaneously accomplishes both the sale of the former *principal residence* and the purchase of the new one. Since both are of equal value ("**A=B**"), there is a full re-investment of the proceeds, achieving a full exemption from Capital Gains Tax for both parties.

If one of the parties receives a cash balance to compensate any divergence in underlying property values, this difference will be seen as a gain and will be taxable on a *pro rata* basis.



4. Short-term Swaps

Even if your interest in an exchange may not be permanent, you may find the rewards to be worthwhile on a temporary basis to resolve certain problems associated with property ownership. By applying the swap principle, ***a short-term swap*** - a form of double exchange - both anticipates and eliminates Capital Gains Tax for an eventual sale.

An Illustration

John and Mary bought their home in the hills of the Algarve in 1990. Old farmhouses were inexpensive in those days as were labour and materials. After a few plans, a couple of years and almost no records of expenses, they had their dream home.

Twenty years later, their modest investment had a market value of almost a million euros, most of which was capital gain, even had they managed to save their invoices.

As they were getting on in years, they wanted to begin planning for a "*downsize*" to a simple bungalow with a small garden. But the prospect of paying a huge CGT bill left them both with sleepless nights.

"Then came the idea of the Short-term Swap"

1) First, they made an agreement to swap properties of similar value;
2) Next, they swapped homes - on paper only - at the identical value. Because the swap involves properties of equal worth, there was no "*IMT*" and no Stamp Duty - only due on any difference in values. Because both were trading their

principal residence, they were still eligible for *Rollover Relief* on Capital Gains. The "*permuta*" means that they both achieved an immediate reinvestment of the proceeds, so the transaction was exempt from Capital Gains Tax.

3) Finally, a few months later, they swapped back, also for equal values. Once again, no IMT, no Stamp Duty, no Capital Gains Tax.

4) Now both owners have as the base of acquisition of their respective properties the new uplifted value rather than their respective historical purchase prices.

With no outstanding CGT liability, they can now sell, buy their little bungalow and invest the balance to supplement their retirement income. *A happy ending!*

5. **Portuguese Nominee Companies**

A Fully Compliant Solution

Although infrequently used in recent years, Nominee Companies have existed in Portuguese statute law since the 19th century and have been embraced in subsequent legislative reforms over the past 150 years. They are fully compliant and are not subject to any of the punitive statutes that have made Offshore Property Companies a pariah: no deemed income tax, no higher Rates bill.

Reduced Capital Gains Tax

One of the big advantages of a Nominee Company is a substantial reduction in the Capital Gains rate on the sale of Company shares when compared to non-resident entities. As a resident corporate structure, CGT assessment is only 14%, a half of the 28% rate that a non-resident company (Delaware, Malta and other Offshore) would be required to pay. Resident individuals are normally be taxed at 20-25% depending on their overall income. In addition, this assessment is fixed, so declaring the gain does not “top-slice” other income into a higher tax bracket.

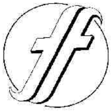
Using Nominee Companies can be tax-efficient and cost effective in many situations:

- First-time home buyers in Portugal
- Property Subdivisions
- Family Ownership and Tenancy Rights
- Off-plan investing
- Downsizing

- Buy-to-let
- Capital Gains Tax mitigation
- Fractional Ownership
- Restorations and Major Improvements
- Leveraging or Gearing

Ease of Transfer

With the property secured safely within the Company, bureaucracy is significantly reduced at the time of sale, cutting costs and complications often associated with property ownership in Portugal. A simple deed of transfer, declaring the sale of the shares, is all it takes, avoiding the complications and headaches related to licensing, registration, not to mention the vacillating rules related to property bureaucracy.



Only Incidental Taxation on Redomiciliation

When an Offshore or a non-resident company moves to Portugal, there is no Capital Gains Tax or Property Transfer Tax upon re-domiciliation. Only the Company Headquarters moves, not the property, thereby avoiding any transfer or assessment of the Company's assets. The only levy is €25 in Stamp Duty on the transformation.

Uplifted Basis for CGT

Following Company registration in Portugal, a Balance of Accounts needs to be recorded to mark the starting point as a Portuguese resident entity. This Balance Sheet must be based on *current* rather than *historical* values. Thus, the Company's "Assets" reflect the market value of the property. The "Liabilities" show the Shareholders' loans into the Company - not the invoicing of how the monies were spent - as well as any outstanding loans or mortgage. As such, there is usually a significant uplift in the basis for eventual CGT assessment and many historical problems can be rendered irrelevant. A colossal problem can be transformed at reasonable expense into a very manageable inconvenience.

Unending Tax Problems

Legislation regulating Offshore Companies has changed 5 times in the past 10 years. After two punishing increases in 2002 and 2004 that saw "*IMI*" Rates for black-listed companies climb to 5% of property evaluations (almost 10-fold normal assessments), a more reasonable charge of 1% was introduced starting in 2008.

Many Company Owners breathed a sigh of relief, in the hope that they were finally out of the woods. However, in 2011, rates climbed again to 5%.
In 2012, property tax increase to 7½% where it continues to date.

Deemed Company Tax
In addition, black-listed Offshore Company owners pay Corporate Tax on "deemed income" equal to 6⅔% of the rateable value of the property. A property with a "*VPT*" of €250,000, the annual tax bill comes to a staggering €27,875 + compliance costs, year in, year out.

Market Perception
With so many problems, it is no wonder that Offshore Companies - both black and white - are viewed as "*white elephants*".

7. Capital Improvements & CGT

When purchasing a property that needs substantial renovations, owners are faced with a dilemma. Capital improvements vastly enhance the value of property, not to mention the comfort, whether they be upgrades to basic infrastructure, a state-of-the-art kitchen or a new swimming pool. On the other hand, under Portuguese law, only capital expenses made in the 12 years prior to sale are deductible from Capital Gains Tax. In other words, after just a few years, these major expenditures expire.
Whether renovating a ruin or improving an aging villa, selling your property after a few years may not fit into your long-term plans. Likewise, losing the deduction can change the economics of the project when the CGT bill eventually comes due.

Expenses that never expire
Unlike individual ownership where capital improvements no longer can be offset against CGT after a few years, any capital invested into a Portugese Nominee Company can always be reflected in the Company's value. This injection of capital can take one of two forms: a) either a direct increase in *share value* or b) or as *shareholders' loans*. Whichever way, with the entry into the Company's books, the capital never expires.
In addition, many owners experience serious difficulty in getting proper invoices from subcontractors. With capital already accounted, any lack of documentation poses only a minor concern.
When the Company with its renovated asset is eventually sold, shareholders' loans are repaid and/or the additional capital included in the share price, reflecting the full investment made by the owners.

Older Properties and Unauthorised Improvements

Many property owners who acquired their homes in years gone by face a common dilemma: they bought at a time when real estate was dirt cheap in Portugal. These houses were often primitive and in poor condition, requiring substantial improvements. In those days, it was common practice to do the work and worry about the formalities later: no building permits, no formal plans, no invoices issued or kept. In addition, the Rateable Value ("*VPT*") remained low, sometimes too low to tax!

Today, the situation has inverted. Valuations and tax appraisals have skyrocketed; unauthorised alternations now require planning permission prior to sale; small deed prices and low Rateable Values mean a whopping Capital Gains tax assessment when selling.

The Solution

The problem can be solved by *"killing two birds with one stone"*. First, have plans drawn up and building permits issued for any unrecorded improvements. Then, upon completion and inspection, the old "*matriz*" (tax registration) should be struck off and a new one assigned, along with a revision of the Rateable Value.

This new "*matriz*" will serve as the base when you finally sell your property, substantially reducing your CGT liability as well as sorting out the bureaucratic "*skeletons in the closet*".

> ***Example***: The Smiths bought and renovated an old farm house in the mid 1980's with little or no paperwork to show for the improvements that they made over the years. While today's selling price is €500,000, most of the proceeds of the sale will be seen as a Capital Gain.
>
> To achieve a much needed update in bureaucratic formalities and a significant "*VPT*" uplift, they apply for building permits and subsequent inspection. Their old "*matriz*", with an original "*VPT*" of just €50,000, is struck off and a new tax registration approved at over €375,000, leaving them with a far more modest CGT bill to settle.

8. PT Nominee Company Transformation

Property purchased a decade or two ago is often liable to a substantial Capital Gains Tax 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 widespread yet often tolerated, tougher enforcement today has substantially reduced these once common 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 assessment. If you are lucky enough to have a modest rateable evaluation ("*VPT*") on your property, *Transformation* of a Portuguese Nominee Company may prove to be a viable solution.

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 focussed on the refurbishment project, not on preparing for the eventual sale. In short, there was no documentation to support the construction expenses incurred.

Last year, they put the property on the market for €350,000 and were fortunate to have an offer. They quickly realised that would be faced with a 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 company with no share value was created to buy the property at "*VPT*", thereby keeping taxation to a minimum: no CGT and less than €1,000 in IMT.

Next, the Company was *transformed* into its final structure 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 property – only Company shares changing hands – the final transaction suffered no taxation.

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

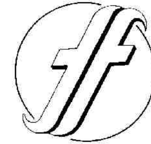
transformation does not constitute a chargeable event while a *transfer* typically triggers one or more forms of assessment.

In this case, there are 2 transfers and 1 transformation: first, the property is acquired by the Company, then 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 of the company and its share capital without changing its legal personality ("*personalidade jurídica*").

This procedure is attractive partially because in this case the Rateable Value of the property is low, thus keeping "*IMT*" assessment to a minimum. Were we dealing with a high rateable value, the tax on the transfer of the Property into the Company could run into the tens of thousands of Euros, possibly undermining the viability of the strategy.

There is a proposal to eliminate "*VPT*" by 2016, recommended by the Troika as part of Portugal's overall fiscal reforms. If property transfer tax were abolished, many more could benefit from this mitigation opportunity.

FISCAL & EXPATRIATE SERVICES from *euro*FINESCO



*We are a full service company, helping expatriates to make the most of their life in Portugal since 1991. Whether it be meeting obligations in a new land, maximizing opportunities in a smooth transition from the past, or financial and estate planning for the future, euro*FINESCO *is here to guide you, keep you compliant and prepare you to meet your goals*.

TAX CONSULTANCY

FISCAL REPRESENTATION

NOMINEE COMPANIES FOR PORTUGUESE PROPERTY

CROSS BORDER ESTATE PLANNING

SMALL BUSINESS FORMATION

DOCUMENTATION

9. **Property Subdivisions**

The value of a tract of land in a desirable location can multiply when partitioned into Building Plots (when developed out) or Horizontal Property (when building up). However, with *Property Subdivision* comes an increment in diverse forms of taxation: Capital Gains Tax ("CGT"); Property Transfer Tax ("*IMT*"); Stamp Duty. Without proper planning, profits will shrivel and final costs to consumers can escalate out of reach.

Nominee Companies are an ideal vehicle to mitigate these tax liabilities. First and foremost, you will be using a fully compliant structure. This means that your strategy has legal foundations built on bedrock legislation: the Portuguese Civil Code. No dicey Delaware Companies, no Offshore snarls.

Normally, at the onset, Nominee Companies cost no more than buying property in your own name. Assuming "average" legal and procedural fees, locking in the long-term advantages of the Nominee Company structure should not increase expenses. However, when it comes time to sell, the respective tax burdens offer a dramatic contrast, specially for the non-resident.

Condominiums are normally created because the owner/lessee of a building or plot, decides to divide a property into separate legal units (homes and/or business accommodations), mostly with the intention to sell them either to tenants or to new owners.

The division is laid down in a notarial deed: the *Deed of Division*. By using Nominee Companies, we achieve impressive combined tax savings, mitigating the principal forms of

assessment on the investment: Property Transfer Tax, Stamp Duty and Capital Gains Tax.

When subdividing a property, ownership by a consortium of Companies allows assessments to take place early on in the process at the lowest acceptable values rather than suffer taxation at the point of final sale, thereby mitigating the various levies.

By operating in a wholesale environment through a group of Nominee Companies, important savings can also be achieved on costs and disbursements.

When real estate is held in a Company, “immoveable” property is transformed into a “moveable” asset (ie. shares). At the point of sale, the Company shares are transferred while the property remains untouched, securely in the hands of the Company.

Needless to say, assessment on share conveyance is quite different from that of immoveable assets. While no “one-size-fits-all” solution exists, there are many situations where a Company structure can alleviate many burdens, open opportunities while mitigating tax implications of the underlying transaction.

A Fully Compliant Solution

This is a fully compliant solution. The *Portuguese Nominee Company* structure has been in Portuguese legislation since the nineteenth century and has survived countless reforms over almost 150 years. Its recent revival is thanks to the “*win-win*” solution that it offers to both buyers and sellers, squarely within the law.

Confidentiality

In its simple form, required registrations only identify the Company’s administrators, leaving shareholder identity confidential.

Tax Efficiency

As a non-trading entity, Portuguese Nominee Companies are exempt from Portuguese Corporate Tax and Special Tax on Account (“*PEC*”). They follow Fiscal Transparency rules where

any chargeable events are assessed directly to shareholders, not to the Company.

The Capital Gains Tax rate in Portugal on the sale of Nominee Company shares is only 14%.

An Invaluable Estate Planning Tool

Domicile or "Personal Law" - the determination of which body of law governs one's life and estate - is a key element of any Estate Planning strategy. When seeking to establish Domicile of Choice, Portuguese Nominee Companies can be used to retain control of assets located in one country while effectively re-domiciling them in another.

While direct retention of property can often be interpreted as an intention to return by the local Revenue, transfer of ownership to a Nominee Company effectively relocates the holding to Portugal in a confidential yet mainstream structure, thereby eliminating direct links to the individual.

11. Inheriting Portuguese Property

When long-time foreign residents die, it is not uncommon for them to leave their appreciated Portuguese home to their children who continue living in their home jurisdiction.
Caring for a Portuguese property at a distance is not always easy. Often the simplest, best or only solution is to sell the property.

The Inheritance
In Portugal, while there is no Inheritance Tax levied between immediate family members, the transmission of real property, as part of estate succession, is based on the Rateable Value of a property ("*VPT*"). Often this value can be quite low while the property, when sold, fetches a good market price. For the heirs, the difference constitutes a substantial Capital Gain.

Example
Following the death of their father, three siblings inherited a villa in Silves. While the "*VPT*" was only €125,000, the villa sold for €675,000, leaving a net gain of €550,000.

At the non-resident tax rate of 25%, the total Capital Gains assessment came to €137,500.

When property is inherited at a low "*VPT*" (rateable value), a Company can provide the uplift to mitigate or even eliminate Capital Gains when the property is sold on.

After the succession but prior to sale, the heirs first create a simple Portuguese Nominee Company. When they transfer the

property to corporate ownership, they simultaneously transform the Company into a commercial category concern with a share capital equal to the market value of the property: €675,000. This transformation does not constitute a chargeable event.

When the shares are sold to new owners, there is no gain, saving the heirs the CGT levy. Because the buyers acquire shares, not the property, there is no “IMT” (Property Transfer Tax), nor Stamp Duty, avoiding a combined assessments of almost €46,000. Overall, tax savings is €200,000.

The Portuguese Nominee Company continues to work for the new owners, providing an invaluable support structure that will help them make the most of their life in Portugal.

12. **Fractional Ownership**

Fractional ownership is title to real property or a share in a company owning the property, making it possible to own a holiday residence without worrying about maintenance, taxes, or property management. You pay for the period you use or rent out to cover costs with the expenses shared between the owners of each residence.

Many fractional ownership purchasers chose a Private Residence Club for the lavish amenities and the limited time they have to spend at their holiday home. The added value is very appealing, especially when compared with timeshare or full ownership. Timeshare, no matter how luxurious, is a usage contract. Along with full ownership comes full responsibility, including maintenance - a headache for most owners living at a distance.

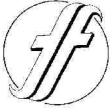
Fuelling the growth of this active slice of the holiday home market is the fact that fractional ownership requires far less capital investment. Because it is deeded ownership, you own a real asset, not just limited usage rights, that you can will to heirs, sell, rent, or mortgage.

Using Nominee Companies

Fractional ownership often starts out *Off-Plan*. In the beginning, the required numbers of Nominee Companies are created and each has a promissory contract regarding the eventual transfer of the property into Company ownership. Individual shareholdings can range from 2 to 5 owners and company statutes define respective usage rights and obligations in common and individually.

From this point on, the Company shares can be bought and sold. When the property is completed and registered, it is transferred into the respective Company at basic fiscal value ("*VPT*"), triggering the sole "*IMT*" levy. CGT assessment only occurs when the shares are actually sold at market value and is only a flat 14%, rather than the normal 28% for a Commercial Company or a Non-Resident individual. In the future, CGT assessments will be based on the net share price differential, also at a fixed 14% rate.

Future sales are also on a share base only, avoiding Property Transfer Tax ("IMT") and Stamp Duty as well as typical property complications and bureaucracy.



13. Selling a Company's Property

Mitigating CGT when selling a Property in an Offshore Company

One method of reducing Capital Gains Tax when an Company sells its property is to liquidate the Company and distribute the assets to the shareholders. Upon liquidation, Capital Gains from the distribution of assets are determined by calculating the difference between the market value of the asset(s) of the Company 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. If the asset to be distributed is an immoveable property, "*IMT*" (Property Transfer Tax) and Stamp Duty will be due upon the transfer of ownership of the asset.

EXAMPLES:

Situation: A Delaware company owns a property in Portugal with an original purchase price of €250,000. The current market value is €750,000, leaving a potential Capital Gain of €500,000.

If the Company sells the property directly to a buyer, Capital Gains tax will be owed by the Company. In this case, the "IRC" assessment will be €105,000 at 21%. When the profit is subsequently distributed to the shareholders, tax of €110,600 is due, this time in "IRS" to the former shareholders. The seller is caught in double taxation: first to the Company, then to the Shareholders. The double taxation totals €215,600 in this example.

SOLUTION nº 1: ***Step 1 - Sale of Shares to the Buyer***
The Delaware Company redomiciles to Portugal and, in the process, uplifts the share capital to €750,000. The shares are then sold to the Buyer.

Step 2 - Company Liquidation
The new shareholders have two options. The first is to liquidate the Company immediately and distribute the property to themselves. Since the market value of the property is equal to the share value of Company, the capital gain/loss is zero. "IMT" (Property Transfer Tax) and Stamp Duty of €51,000 will be due in the same fashion as in any property transfer.

Alternatively, this method can be applied at a later date, thereby deferring or even eliminating "IMT" and Stamp Duty. Either way, there is no Capital Gains Tax liability.

Conclusion
This method can be implemented simultaneously with the redomiciliation process or applied at a later date, thereby deferring "IMT" and Stamp Duty. Either way, there is no Capital Gains Tax liability.

SOLUTION nº 2: ***Step 1 - Company Liquidation***
The Delaware Company redomiciles to Portugal and, in the process, uplifts the share capital to €750,000. The shareholders liquidate the Company immediately and distribute the property to themselves. The market value of the property is equal to the share value of Company resulting in a zero capital gain/loss. On the transfer of the property, "IMT" and Stamp duty of €51,000 are due to be paid by the former shareholders.

Step 2 - Sale of Property to Buyer
The property is then sold to the new buyer for €750,000. The new buyer will also pay combined "IMT" and Stamp Duty of €51,000.

In the example given, this solution results in tax savings of €159,000 to the Seller when compared to the original double assessment situation, a reduction of 74%.

BRANCH OFFICE REINVESTMENT

Another method of mitigating CGT on the sale of a property owned by an Offshore Company is via Branch Office reinvestment. This type of Company is normally classified as a *Non-Resident Company without Permanent Establishment*. By establishing a Branch Office in Portugal, the mother company can take advantage of resident company "IRC" rules. The Company's property can be sold and fully or partially replaced with reinvestment relief. Any residual capital gain is eligible for a 50% exclusion.

Solution nº 3: *Forming a Branch Office*

Following the assumptions of our previous examples, a Delaware Company opens a branch office in Portugal. The Company can sell the property for €750,000 and reinvest the proceeds. If the full amount is reinvested, there is no gain under "IRC" rules. If only €500,000 were to be reinvested, the gross gain is €250,000. After the 50% exclusion, the taxable gain is assessed at 21%, leaving a final tax to pay of €26,250 rather than €157,500, a reduction of almost 88%.

If the Company were to be redomiciled during the process, any original shareholders's loans that were originally left unrecorded can now be registered. With these loans in the Company books, CGT can often be eliminated even with partial reinvestments.

PORTUGUESE NOMINEE COMPANIES

A versatile vehicle for holding assets

- ✓ First-time homebuyers in Portugal
- ✓ Investment properties → buy-to-let
- ✓ Property subdivisions
- ✓ Downsizing
- ✓ Capital Gains Tax mitigation
- ✓ Redomiciliation from Offshore
- ✓ Estate Planning
- ✓ Shared Ownership

Learn how to take make the most of this essential tool for Financial Planning

Winding up a Property Holding Company

Why not always use a Company?

When you use a Property Holding Company to buy real estate, you essentially convert an immoveable property (*real estate)* into a moveable asset (*shares*). Surprising advantages can be gained in this conversion: tax rules change (usually for the better); bureaucratic requirements shrink, saving both time and money; new opportunities open that didn't exist before.

However, all companies are not created equal. Offshore Companies, once the darling of foreign buyers in Portugal, have fallen into disgrace. In many circles, the word "*offshore*" is now a "*four-letter word*". Tax Authorities in Europe and around the world have become suspicious of some form of financial skulduggery lurking below the surface. Potential buyers are leery of these structures, often insisting on buying the property out of the company, thereby crystallising accumulated Capital Gains to the sellers.

There are also a variety of other reasons why property company owners find themselves forced to sell a property out of a company that may have nothing to do with "Offshore". On occasion, there are technical problems with a property such as unapproved construction or an illegal swimming pool. In some councils, these irregularities can only be sorted out in private ownership.

Alternatively, if the Company is domiciled in a "black-listed" jurisdiction, owners currently face Property Rates ("*IMI*") of 7.5% of the up-dated rateable value, leading to annual assessments in the tens of thousands of Euros. Taking the

property our of the condemned company is one way to avoid this punitive levy. (Redomiciliation is another).

In other cases, an owner's personal circumstances change: marriage, divorce, health matters, to mention just a few. What was once an attractive solution can turn sour over time. Just like any other choice, there is never a simple universal "one size fits all" answer. Different factors invite diverse responses.

The first step to finding the best solution is to be fully informed: know exactly how tax is be calculated and how the rules will be applied in your case. Study the alternatives for mitigation that are appropriate. Remember that the difference between a problem and an opportunity is often your perspective.

Trash to Treasure

If you find yourself forced to divest real estate from your company, do not despair. Don't just simply close down the now empty enterprise and suffer considerable "strike-off" costs that can run into thousands of Euros. You may be able to sell off your shares to someone who can put them to good use.

Question: Who might want to buy a defunct, empty company with only losses to show on its books?

FINESCO: Another company with Capital Gains to offset.

If a business crystallises Capital Gains from the sale of one asset, it can balance its books with a financial loss from another transaction. Even though the sale price of your shares may be only notional, the real savings for you is in avoiding strike-off charges that can be as much as €10,000 in some jurisdictions.

Shareholder's Loans

Property Holding Companies are normally non-trading entities. When a Company originally bought a property, it had no cash of its own to spend other than money belonging to its shareholders. In other words, shareholders's loans were normally used to make

the acquisition. Likewise, any improvements over the years were made via an injection of capital by the Company's owners. Like any other outstanding debt, these loan needs to be settled before the Company books are closed as part of the sale of its sole asset or the Company itself.

Not surprisingly, it is often the case that a substantial portion of overall Capital Gains may be attributable to these shareholders' loans. Assessable profit can normally be reduced in conjunction with their repayment. Nevertheless, it is essential that Company has its paperwork in order: *contracts and board resolutions* acknowledging and authorising the loans, *bank statements* to substantiate the movement of capital, *bills* invoiced in the name of the Company (and not the Shareholders). The list goes on. While most of this documentation should have been in place as developments unfolded over the years, it may still be possible to get something in place before it is too late.

Conclusion

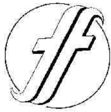
In most cases, your best option will be to carry out your original plan. If you made the appropriate choice in the beginning by using a Property Holding Company, you should be able to crystallise the many advantages offered by these structures by selling your Company to new owners. However, as we all know, the best laid plans of mice and men often go astray. If this proves to be the case, keep cool and take advantage of the final opportunities at hand. With a little luck, you may be able to turn what could be a major disaster into a minor inconvenience by maximising your opportunities and keeping your affairs in order.

*euro*FINESCO

Tax Techniques

Our periodic newsletter brings you the latest news & information before it reaches other media. Stay informed about the crucial changes that will impact your life in Portugal .

Subscribe today at **www.eurofinesco.com**



If you believe that winning the lottery will be your key to prosperity, you may already have defined your strategic outlook. However, if you really want to have the odds in your favour, *planning* is always your best bet. This is specially true when it comes to Capital Gains Tax. Understanding how CGT assessment works in Portugal is the best way to orchestrate a satisfactory and successful outcome.

Anticipating Tax

In this day and age of ever-increasing scrutiny from tax authorities, it is essential to distinguish between a *legitimate* plan of action and pursuing *dodgy* strategies:

compliant tax planning - a systematic analysis of differing tax options aimed at minimising on-going or long term tax liabilities; or

aggressive tax planning - tax strategies where there is a reasonable probability that a particular tax stance will not be upheld by an audit and subsequent legal challenge.

Aggressive tax planning is designed to sidestep fiscal obligations and may well be interpreted as tax evasion. Pursuing such strategies can lead to serious complications, particularly in this age of heightened tax enforcement and open channels of communication between fiscal authorities.

Simply put, proper planning means understanding your options and choosing the most appropriate one. It means working within the law to help you pay the legal minimum.

*e*Books from *euro*FINESCO

1) Offshore Companies: *Moving Onshore*
2) Self-Employed in Portugal
3) Requirements of the Common Reporting Standard
4) Setting Up Fiscal Residence
5) Capital Gains Tax on Portuguese Property
6) Portuguese Tax Code Summaries
7) "*VPT*" Unveiled
8) Tax-Efficient Investing in Portuguese Property
9) Income from Portuguese Property
10) Taxation on Portuguese Property
11) "S.C.I.": *Sociedade Civil Imobiliária*
12) Property Companies: *White-List or Portugal*
13) Nominee Companies for Portuguese Property
14) Fiscal Representation in Portugal
15) *"Permutas"* or Property Swaps
16) Estate Planning & Nominee Companies
17) "I.H.T." – Residence Rules & Determining Domicile
18) Moving to Portugal – *before, during & after*
19) Taxation of Pensions in Portugal
20) "I.R.S." Tax Credits
21) CGT Mitigation: *14 Arrows in the Quiver*
22) Residence Rules: *in the EU, Portugal and the UK*

Extracts from *Relocating to Portugal - Useful Information*

23) Acquiring Portuguese Citizenship
24) Visas and Legal Framework
25) Your Rights to Health Care
26) Access to Education
27) Recognition of Qualifications
28) Social Security Entitlements
29) Golden Residence Visa

30) Leaving Portugal - *Moving Back*
31) Non-Habitual Residence Status and the Alternatives
32) Trusts, Foundations and Fiduciary Structures