Anonymised version

Case C-388/19

Request for a preliminary ruling:

Date lodged:

17 May 2019

Referring court:

Tribunal Arbitral Tributário (Centro de Arbitragem Administrativa — CAAD) (Tax Arbitration Tribunal (Centre for Administrative Arbitration — CAAD))

Date of the decision to refer:

30 April 2019

Applicant:

MK

Defendant:

Autoridade Tributária e Aduaneira (Tax and Customs Authority)

Arbitration award

Preliminary Ruling Procedure

1. Background

The applicant, MK, married, taxpayer No [...], of [...], residing in Paris, France, whose Serviço de Finanças Local (Local Tax Office) is Coimbra Local Tax Office 2, asked [...] for the Arbitration Tribunal to be convened.

The applicant requested that:

(a) Income Tax assessment No [...], dated 5 July 2018, for the sum of EUR 24 654.22 be ruled unlawful and consequently annulled.

(b) An order be made for the said sum to be repaid on the grounds that the tax had been wrongly paid.

c) The Tax and Customs Authority be ordered to pay default interest, which should accrue until the date on which the relevant credit note is issued and processed, in accordance with Articles 43 and 100 of the LGT [Lei Geral Tributária (General Tax Law)] and Article 61 of the CPPT [Código de Procedimento e de Processo Tributário (Code of Tax Procedure and Proceedings)].

The defendant is the TAX AND CUSTOMS AUTHORITY.

[...] the Arbitration Tribunal — comprising a single member — was duly convened on 11 February 2019 and has jurisdiction by virtue of the subject matter.

The parties are duly represented and have legal personality, capacity and standing.

Notice was served on the Tax and Customs Authority on 12 February 2019, and it responded on 18 March 2019. In its response it argued that the version of Article 72 of the Código do IRS (Income Tax Code) introduced by Law 67-A/2007 of 31 December 2007 produced a new legal framework that has yet to be examined by the Court of Justice of the European Union in order to ascertain whether it is compatible with EU law, since the judgment of the Court of Justice in Case C-443/06 is dated 11 October 2007 and, while that judgment ruled that the legislation then in force governing the taxation in Portugal of capital gains on immovable property realised by non-residents, contained in Articles 72(1) and 43(2) of the Income Tax Code, was incompatible, that legislation has been superseded by the aforementioned amendments to Article 72 of the Income Tax Code that were introduced by Law 67/2007 of 31 December 2007, and the legislation is therefore now consistent with Article 56 EC.

The defendant also argues that the current legislative framework now provides two alternative options:

1. As the taxable person, the applicant in the present case can elect to be subject to the tax rate that would apply to him under the table established in Article 68(1) of the Income Tax Code in conjunction with Article 42(3).

2. Or (as the applicant himself noted), he can elect to be taxed at the specific rate of 28% established by Article 72(1)(a) of the Income Tax Code, without the application of the 50% reduction provided for in Article 43(2). This was the method used to assess the income tax owed by the applicant.

The defendant therefore suggests **that these arbitration proceedings should be suspended and the question should be referred to the Court of Justice of the European Union** under the preliminary ruling mechanism (Article 267 TFEU) that applies to the Portuguese State.

The defendant's proposal was put to the applicant to enable him to respond.

On 11 April 2019 the applicant argued that the matter had already been examined by the national courts, citing the following cases:

(a) Case 45/2012-T of 5 July 2012, in which a ruling was made under the auspices of the Centre for Administrative Arbitration, based on the judgment given by the Court of Justice of the European Union on 18 March 2010 [1] in Case C-440/08. The ruling reproduces part of that judgment, which is quoted in the following extract:

> *'The Court of Justice of the European Union ruled on this point (... in the judgment cited) in a situation which has clear parallels, the only difference being that that case concerned breach of Article 49 [TFEU] rather than Article 63 [TFEU].*
>
> *The Court of Justice notes that "the option to be treated as a resident taxable person provides non-resident taxable persons ... with a choice between a discriminatory tax regime and one which is ostensibly not discriminatory", pointing out that such a choice does not remedy the discriminatory effects of the first of those two tax regimes.'*

The Court of Justice of the European Union goes on to note the existence of a paradox:

> *'... if such a choice were to be recognised as having the effect described, the consequence would be to validate a tax regime which, in itself, remains contrary to Article 49 TFEU by reason of its discriminatory nature.'*

The Court of Justice of the European Union concludes that the Treaty:

> *'... precludes national legislation which, in relation to the granting of a tax advantage, ... is discriminatory towards non-resident taxable persons, even though those taxable persons may opt for the regime applicable to resident taxable persons in order to benefit from that tax advantage ...'*

The applicant nevertheless acknowledges the following point:

– It is accepted that the consequences of the EU case-law cited above, particularly the *Hollmann* judgment, [2] have resulted in a more favourable tax

[1] To summarise, that case concerned the differential application of the legislation concerning a deduction available to self-employed persons that was applied differently to residents as compared with non-residents and that prevented non-residents from taking hours worked in another Member State into account ... That is not comparable with the situation at issue in the present case, which is examining the right of non-residents to opt for the tax treatment applicable to residents.

[2] It should also be noted that the amendments made by the Tax and Customs Authority (then the DGCI) to the Income Tax Code under Law 67-A/2007 of 31 December 2007 in order to remove

treatment for capital gains on immovable property realised by EU residents not resident in Portugal than for those realised by Portuguese residents, given that the former not only benefit from the same 50% reduction in the taxable amount for Income Tax purposes but are also subject to a single tax rate of 25%, which in most cases is less than the (progressive) tax rate applicable to residents under the table established in Article 68(1) of the Income Tax Code; moreover, residents are required to include all their income in the calculation of taxable income.

The applicant also refers to the Arbitration Tribunal's decision in Case 127/2012-T, which ruled … that Article 43(2) of the Income Tax Code '*is not compatible with EU law, which includes EU case-law, or with Portuguese case-law*'. [3]

The applicant also cites Case 748/2015-T of 27 July 2016, where it was held that EU law had been breached, due to the incompatibility of Article 43(2) of the Income Tax Code with EU law and to the alleged breach of free movement of capital. [4]

Finally, the applicant refers to the subject matter of the ruling by the Supremo Tribunal Administrativo (Supreme Administrative Court) in the judgment of 22 March 2011 in Case 1013/10 of 22 March 2011 …, in the following terms:

> *'Moreover, it should be noted that in Law 67-A/2007 of 31 December 2007 (2008 National Budget), the legislature is seeking to avoid that favourable treatment for non-residents from the European Union and the European Economic Area who realise capital gains in Portugal, by allowing them to elect to have those gains taxed under similar arrangements to those applicable to Portuguese residents (see the wording added to Article 72 of the Income Tax Code by paragraphs 7 and 8 — now paragraphs 8 and 9 following the renumbering introduced by Article 4 of Decree-Law 240/09 of 23 September 2009).*
>
> *However, that has no bearing on the present case, since it was the Administração Fiscal (Tax Authority) that performed the tax assessment, based on the return submitted by the taxpayers (as is always the case with Income Tax), and it applied the tax rate applicable to non-residents (25% under Article 72(1) of the Income Tax Code) to the full amount of the realised gains rather than applying it to only 50% of that amount (Article 43(2) of the Income Tax Code). The Tax Authority therefore ignored EU case-law, and the case-law of this Supreme Court that followed the same*

discrimination between residents and non-residents in the tax treatment of capital gains on immovable property postdate the *Hollmann* judgment cited above.

3 It should also be pointed out that, unlike the present case, the cited decision was concerned with a situation in which the non-resident taxable person did not make an election in respect of tax treatment.

4 It should also be noted that in that case the taxable person simply stated on his Form 3 Income Tax return that he was not resident in Portugal, which is not what happened in the present case.

approach (see the judgment of 16 January 2008 [...] 439/06) on the incompatibility of that legislative provision with (then) Article 56 EC (now Article 63 of the Treaty on the Functioning of the European Union), thereby running the risk that the contested assessment would be annulled in proportion to that part of the amount of the gains, which is indeed what happened, given the primacy of EU law.

Judgment available at: http:/www.dgsi.pt/jsta.nsf/35fbbbf22e1bb1e680236f8e003ea931/5942b010aec666d28023 7862003e595e?OpenDocument&ExpandSection=i#_Section1

It should be noted that the decision in the judgment of the Supreme Administrative Court in Case 0439/06 of 16 January 2008 followed the reasoning in the judgment of the Court of Justice of the European Union, because at that time the amendments introduced by the aforementioned Law 67-A/2007 of 31 December 2007 had not yet come into force.

2. Points of fact

2.1. Facts as found

(a) The applicant is resident for tax purposes in Paris, France, [...], and comes under the Serviço Local de Finanças de Coímbra-2 (Coimbra Local Tax Office 2) [...].

(b) On 17 January 2002 the applicant purchased the unit designated by letter C in the building situated at [...], which was registered in the land register for the district of [...], for the sum of EUR 79 807.66, on which he paid capital transfer tax.

(c) On the front of the relevant tax return, in Table 8B the applicant ticked box 4 (for 'non-resident'), box 6 (for 'resident in an EU country') and box 7 (electing to be subject to the tax regime applicable to non-residents) and rejected the option in box 9 (to be taxed in accordance with the general tax rates established in Article 68 of the Income Tax Code) and the option in box 10 (to be taxed under the legislation applicable to residents).

(d) He filed his Form 3 Income Tax return for the 2017 tax year on time, via the internet. In Annex G (Capital gains and other capital increases) he recorded the purchase and sale value of a residential property, together with the relevant years and the expenses and costs of the purchase and sale.

(e) The Tax and Customs Authority drew up Income Tax assessment No [...] of 5 July 2018 for the sum of EUR 24 654.22, by applying the specific tax rate of 28% to the capital gains on the immovable property, and therefore not applying the 50% of capital gains applicable to resident taxable persons.

(f) On 30 November 2018 the applicant filed a challenge to that assessment with the Centre for Administrative Arbitration on the grounds that the assessment was unlawful because he had been subject to negative discrimination as compared with resident taxable persons. The applicant argued that this constituted a restriction on the free movement of capital established in Article 63(1) of the Treaty on the Functioning of the European Union.

[...]

[...]

3. The question of whether Portuguese legislation governing capital gains on immovable property is incompatible with EU law

3.1 The Portuguese legislation governing taxation of capital gains on immovable property realised by residents of the European Union is as follows.

(a) Legislative framework — Amendments to Article 72 of the Income Tax Code:

a.1. Version in force on 31 December 2007 pursuant to Law 55-B/2004 of 30 December 2004:

'Article 72

Special tax rates

1. Capital gains and other income obtained by persons not resident in Portuguese territory that are not attributable to a permanent establishment situated in the said territory and that are not subject to withholding tax providing full discharge of tax liability shall be taxed at the specific rate of 25%, or 15% in the case of property income, without prejudice to paragraph 4.

2. Income obtained by persons not resident in Portuguese territory that are not attributable to a permanent establishment situated in the said territory shall be taxed at the rate of 25%.

3. …

4. Any net positive balance on gains and losses from the transactions provided for in Article 10(1)(b), (e), (f) and (g) shall be taxed at the rate of 10%.' [5]

a.2. Version introduced by Law 67-A/2007 of 31 December 2007, which came into force on 1 January 2008:

'Article 72

Special tax rates

1. Capital gains and other income obtained by persons not resident in Portuguese territory that are not attributable to a permanent establishment situated in the said territory and that are not subject to withholding tax providing full discharge of tax liability shall be taxed at the specific rate of 25%, or 15% in the case of property income, without prejudice to paragraph 4.

2. Income obtained by persons not resident in Portuguese territory that are not attributable to a permanent establishment situated in the said territory shall be taxed at the rate of 25%.

3. ...

4. Any net positive balance on gains and losses from the transactions provided for in Article 10(1)(b), (e), (f) and (g) shall be taxed at the rate of 10%.

5. ...

6. ...

7. Residents of another Member State of the European Union or of the European Economic Area (provided, in the latter case, that there is exchange of information on tax matters) may elect, in respect of the income to which paragraphs 1 and 2 apply, for such income to be taxed at the rate which would apply under the table established by Article 68(1) had the income been obtained by persons resident in Portuguese territory.

8. In order to determine the tax rate referred to in the previous paragraph, all income shall be taken into account, including income

[5] Amendment introduced by Decree-Law 199/2005 of 7 November under legislative authority conferred by Article 4 of Law 39-A/2005 of 29 July in accordance with Article 198(1)(a) and (b) of the Constitution.

obtained outside the said territory, on the same terms that apply to residents.'

a.3- Version introduced by Law 82-E/2014 of 31 December 2014, which came into force on 1 January 2015:

7. (Repealed)

8. ...

9. Residents of another Member State of the European Union or of the European Economic Area (provided, in the latter case, that there is exchange of information on tax matters) may elect, in respect of the income to which subparagraphs 1(a) and (b) and paragraph 2 apply, for such income to be taxed at the rate which would apply under the table established by Article 68(1) had the income been obtained by persons resident in Portuguese territory.

10. In order to determine the tax rate referred to in the previous paragraph, all income shall be taken into account, including income obtained outside the said territory, on the same terms that apply to residents.

11. ...

12. ...'

a.4) Version of Article 43(2) of the Income Tax Code introduced by Law 42/2016 of 28 December 2016(2013 National Budget), which applies to the situation at issue in the present case:

Article 43

Capital gains

1. The amount of income classified as capital gains is represented by the balance of the difference between capital gains and capital losses occurring in the same year, determined in accordance with the following articles.

2. The balance referred to in the previous paragraph, in respect of disposals made by residents as provided for in Article 10(1)(a), [6] (c) and (d) whether positive or negative, shall be taken into account to the extent of only 50% of its amount.

[6] Article 10(1)(a) of the Code is as follows:

'**(a) The transfer for valuable consideration of rights *in rem* in immovable property or from the use of any private assets for the purposes of the business or professional activities pursued on an individual basis by the owner of such assets.'**

…

(b) **Changes to the tax return forms —** Changes to the Form 3 Income Tax return applicable from 2009 (in respect of income obtained in 2008 and subsequent years), as referred to in Article 57 of the Income Tax Code, which is the form used by the applicant to file his tax return for the 2017 tax year:

b.1 — Front of the return — Table 8 B:

Box 4 — Non-residents (ticked by the applicant)

Box 6 — Resident in an EU or EEA country (where the code used is 250 — for France)

Box 7 — The claimant elects to be taxed under the general arrangements (on the grounds that he is resident in the European Union or the European Economic Area)

Box 10 — Election to be taxed under the legislation applicable to residents (Article 17-A of the Income Tax Code) — Not ticked by the applicant

It is clear that Article 56 EC (now Article 63 TFEU) prohibits all restrictions on the movement of capital, not only between Member States, but also between Member States and third countries.

Regard should also be had to the case-law arising from the judgment issued by the Court of Justice of the European Union on 11 October 2007 in Case C-443/06 (*Hollmann*), which held as follows:

> '*Article 56 EC is to be interpreted as precluding national legislation, such as that in dispute in the main proceedings,* [7] *which subjects capital gains resulting from the transfer of immovable property situated in a Member State, in this case Portugal, where that transfer is made by a resident of another Member State, to a tax burden greater than that which would be applicable for the same type of transaction to capital gains realised by a resident of the State in which that immovable property is situated.*'

In spite of the above judgment, the Arbitration Tribunal continues to have doubts over whether the situation at issue in the present case can be deemed completely equivalent to the situation under consideration in Case C-443/06, because the legislation that now applies is no longer the same as the legislation that was in force then, and a resident of a Member State can avoid the disputed unequal

[7] The case involves an appeal by the national tax authorities on a question which is identical to the issue raised in the present case but which, by contrast with the present case, arose before Article 72 of the Income Tax Code was amended by Law 67-A/2007 of 31 December 2007 (National Budget Law 2008).

treatment by electing to be treated as a resident, with all the legal consequences which that entails, on the same terms as those in the legislation applicable to residents.

7. Operative part

Having regard to all the above, and precisely because the current Portuguese legal and tax framework governing the way in which capital gains realised from immovable property in Portugal by European Union residents are subject to Income Tax, and the requirement to submit the relevant returns, are no longer the same as when the Court of Justice of the European Union gave judgment — cited by the applicant — on 11 November 2007 in Case C-443/06 (*Hollmann*), due to the amendments described above, and in particular the changes made by the insertion of paragraphs 7 and 8 (now paragraphs 9 and 10) into Article 72 of the Income Tax Code by Law 67-A/2007 of 31 December 2007,

this Arbitration Tribunal decides:

1. **To refer the following question to the Court of Justice of the European Union for a preliminary ruling pursuant to Article 267(a) TFEU**, which it needs in order to make its decision in the present case:

Question:

Should Articles 12, 56, 57 and 58 of the Treaty Establishing the European Community [now Articles 18, 63, 64 and 65 of the Treaty on the Functioning of the European Union], taken together, be interpreted as precluding national legislation, such as that in dispute in the present case (Article 43(2) of the Income Tax Code, approved by Decree-Law 442-A/88 of 30 November 1988, as amended by Law 109-B/2001 of 27 December 2001), with the amendments introduced by Law 67-A/2007 of 31 December 2007, which inserted paragraphs 7 and 8 (now paragraphs 9 and 10) into Article 72 of the Income Tax Code, the purpose of which is to enable the capital gains realised from the sale of immovable property situated in a Member State (Portugal) by a resident of another Member State of the European Union (France) not to be subject, **by election**, to a tax burden greater than that which would be applicable for the same type of transaction to capital gains realised by a resident of the State in which that immovable property is situated?

[...]

Lisbon, 30 April 2019

The Arbitrator,

(José Rodrigo de Castro)

[...] [...]