Distribution of dividends from a foreign company to shareholders. Taxation under the Non-Habitual Resident Regime (Distribuição de Dividendos de uma sociedade estrangeira aos acionistas. Tributação à luz do Regime dos Residentes Não Habituais)

What is Informação Vinculativa (Binding Information)?
Binding Information, refers to an official response issued by tax authorities in Portugal, addressing specific queries from taxpayers regarding the interpretation or application of tax laws in particular situations. These rulings hold legal authority and must be followed by both the taxpayer and the tax authority, provided that the circumstances remain unchanged.

Importance of Binding Information:
Formality: They provide an official and authoritative interpretation of tax legislation.
Obligation: Both the tax authority and the taxpayer must adhere to the ruling, provided the facts presented remain unchanged.
Legal Certainty: Binding rulings offer taxpayers clarity and legal certainty regarding their tax obligations. By outlining how tax laws apply to their specific circumstances, taxpayers can plan and conduct their financial activities with confidence.
Procedure: Taxpayers must formally request binding information by detailing their specific circumstances for accurate analysis.
Facilitating Planning: Provides confidence for taxpayers in planning their financial activities.
Avoiding **Disputes**: Ensures compliance with tax laws, thereby reducing potential qdisputes with tax authorities.
Ensuring Fairness: Promotes fairness in tax treatment by providing consistent interpretations of tax laws.

Example Scenario:
Legislation: Personal Income Tax Code
Article/Item: Article 81 - Elimination of international double taxation
Subject: Distribution of dividends from a foreign company to shareholders. Taxation under the Non-Habitual Resident Regime

Details of the Scenario:
Request for Binding Information: The applicant requests binding information regarding the applicable legal-tax framework under the Personal Income Tax (IRS) for income distributed to shareholders in the capacity of shareholder, originating from shares in a foreign commercial company domiciled in Hong Kong.
The Applicant is a shareholder of a foreign commercial company domiciled in the Hong Kong Special Administrative Region (People's Republic of China), which provides advisory services in the buying and selling of stocks in stock markets. The commercial company was established in 2014 and is subject to corporate income tax in force in the Hong Kong Special Administrative Region (e.g., profits tax within the meaning of the Convention for the Avoidance of Double Taxation concluded with Portugal). The commercial company distributes annual income to its shareholders in the form of dividends. The Applicant intends to become a tax resident in Portugal and apply for the special status of non-habitual resident. Considering the aforementioned facts, the Applicant wishes to know whether the dividends paid to him by the commercial company domiciled in Hong Kong are exempt from individual income tax (IRS) in Portugal, pursuant to the terms and for the purposes of the provision of article 81, paragraph 5, item a) of the CIRS, or, otherwise, to what rate they will be taxed.

Response and Guidance:
1. According to national legislation, the income in question constitutes capital income, falling within category E.

2. Indeed, under subparagraph h) of paragraph 2 of article 5 of the IRS Code, profits made available to partners/income holders (dividends) are classified as capital income (Category E).
3. However, according to the aforementioned facts, the distributed income originates from shares in a foreign commercial company domiciled in Hong Kong. Therefore, considering the territorial connection of the situation in question with another State, in addition to the Portuguese State, it is important to ascertain the existence of a Double Taxation Convention concluded between the two States.
4. It is noted that a Convention to eliminate Double Taxation between Portugal and Hong Kong has been concluded, approved through Resolution of the Assembly of the Republic no. 49/2012, published in the Official Gazette no. 75/2012, Series I-A of 16/04/2012.
5. Now, according to paragraph 3 of article 10 of the Convention: 3 The term "dividends", as used in this article, means income from shares, shares or bonus bonds, parts of mines, founder parts or other rights, with the exception of credits, which allow participation in profits.
6. Whereas, whether in the other provisions of the Convention, or in the additional Protocol thereto, the concept of "Dividends" is not expanded or restricted compared to that provided for in this paragraph 3 of article 10.
7. Therefore, since the applicant has not identified the commercial company of which he is a shareholder, it is not possible to conclude that the income in question constitutes dividends, in the light of the Convention.
8. However, if the income in question is classified as dividends, the provisions of paragraph 1 of article 10 of the Convention apply, according to which:

"1. Dividends paid by a resident company of a Contracting State to a resident of the other Contracting State may be taxed in that latter State

2. However, such dividends may also be taxed in the Contracting State in which the company paying the dividends is a resident"

9. Hence, tax jurisdiction is concurrent between the Residence State and the Source State (shared by Portugal and Hong Kong, respectively), allowing the income in question to be taxed by both States.
10. Therefore, since the applicant intends to apply for the status of non-habitual resident and wishes to know the applicable taxation under said regime, it is important to determine the taxation of income classified as dividends, under the non-habitual resident regime.
11. According to paragraph 5 of article 81 of the IRS Code:

"5 - Non-habitual residents in Portuguese territory obtaining income from categories E, F and G abroad, are subject to the exemption method, provided that any of the conditions set out in the following subparagraphs are met:

a) Can be taxed in the other Contracting State, in accordance with the Double Taxation Convention concluded by Portugal with that State; "

12. Since under the Portugal/Hong Kong DTC, the income in question may be taxed in both States and if the applicant obtains the status of non-habitual resident in Portugal, then in that case, the conditions for benefiting from the exemption provided for in article 81, paragraph 5 of the IRS Code will be met.
13. Regarding the question raised by the applicant as to whether the fact that Hong Kong is listed in Ordinance no. 150/2004, of February 13, as a country with a clearly more favourable tax regime, excludes the application of the exemption from taxation provided for in article 81, paragraph 5 of the IRS Code, and instead applies the autonomous taxation of 35%, provided for in subparagraph a) of paragraph 18 of article 72, the following information is provided.
14. The autonomous tax rate provided for in subparagraph a) of paragraph 18 of article 72 constitutes the general taxation regime applicable to capital income due by non-

resident entities without a permanent establishment in Portuguese territory, domiciled in a country, territory or region subject to a clearly more favourable tax regime.

15. On the other hand, the regime provided for in article 81, paragraph 5 of the IRS Code constitutes a special regime applicable to taxpayers benefiting from the special non-habitual resident regime, so if the conditions set out therein are met, this special regime prevails over the general regime.
16. Still regarding the regime provided for in article 81, paragraph 5 of the IRS Code, it is important to note that it includes subparagraph a) and subparagraph b), whereby subparagraph a) applies in cases where a Double Taxation Convention is concluded between Portugal and the other State, and subparagraph b) applies in cases where such Convention does not exist.
17. Now, subparagraph a) depends solely on the application of the exemption method from the possibility of income in question (in this case, capital income) being taxed in the Source State, whereas subparagraph b) provides that the exemption method applies only when capital income may be taxed in the Source State, provided that this State is not listed in a list approved by ordinance of the member of the Government responsible for finance, regarding clearly more favourable tax regimes.
18. In the present case, as mentioned above, there is a Double Taxation Convention concluded between Portugal and Hong Kong, therefore, the provision set forth in subparagraph a) applies, and the fact that Hong Kong is listed in Ordinance no. 150/2004, of February 13, is irrelevant in this case, because where the legislator does not distinguish, the interpreter should not distinguish ("ubi lex non distinguit nec nos distinguere debemus").
19. In conclusion, dividends paid by a commercial company domiciled in Hong Kong to a passive subject resident in Portugal and holding the status of non-habitual resident are exempt from individual income tax (IRS) in Portugal, under the terms and for the purposes of article 81, paragraph 5, item a) of the CIRS.

Conclusion:

The binding information provided offers crucial guidance on the tax treatment of dividends received from a foreign commercial company domiciled in Hong Kong by a Portuguese resident holding the status of non-habitual resident. The analysis underscores that under the Double Taxation Convention between Portugal and Hong Kong, dividends may be taxed in both jurisdictions. However, given the applicant's potential qualification as a non-habitual resident in Portugal and the conditions outlined in Article 81(5) of the IRS Code, the dividends in question are exempt from individual income tax (IRS) in Portugal. This conclusion ensures clarity for taxpayers, facilitating compliance with tax obligations and minimizing the risk of errors or penalties in tax reporting.

For more detailed guidance and to ensure compliance with tax laws, please contact AFM at info@afm.tax