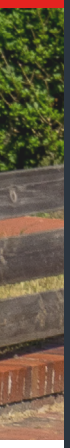
afm
all finance matters

FRAMEWORK FOR INCOME



ALL FINANCE MATTERS

Largo das Sete Ruas, 1-B
8800-604 – Tavira

Rua Frederico Lecor, Nº 53 B
8000-247 Faro

E : info@afm.tax
P : +351 281 029 059 | +44 (0) 20 3151 0021
W : www.afm.tax

Understanding Informação Vinculativa (Binding Information): Framework for income from the imputation to shareholders of the result of the liquidation of a non-resident company – Non-Habitual Residents Regime (Enquadramento dos rendimentos provenientes da imputação aos sócios do resultado da liquidaçao de uma sociedade não residente – RNH)

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 disputes 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: Art. 81º – Elimination of international double taxation
Subject: Framework for income from the imputation to shareholders of the result of the liquidation of a non-resident company – Non-Habitual Residents Regime

Details of the Scenario:
Request for Binding Information:
The applicant, a Spanish national residing in Portugal, requests binding information on the applicable tax framework under the IRS for the result of the li-

quidation of a Spanish company in which he held a substantial participation of more than 25%, considering the different qualification of income under domestic legislation and the Double Taxation Convention between Portugal and Spain and taking into account that the applicant benefits from the regime applicable to non-habitual residents.
Thus, the applicant requests confirmation from the AT of the following understanding: "Confirmation of the tax nature of the income detailed in this Binding Information Request, in accordance with the applicable legal terms, as a dividend, according to the terms of the PortugalSpain DTC; If confirmed that the income in question will effectively qualify as a dividend, additional confirmation that it should be reported in box 8 of Annex J of the Model 3 IRS Declaration of the Applicant with code E11. If it is understood that the income in question should be reported in box 9 of Annex J of the Model 3 IRS Declaration regarding capital gains income (Category G), how to avoid such income being taxed in Portugal, given the exemption under Article 81 of the IRS Code."

II – FACTS DESCRIBED IN THE REQUEST

1. "The applicant was the legitimate holder of shares corresponding to 3X.XXXX% of the share capital of a Spanish entity called B, domiciled in Madrid, Spain;

2. On .. July 2021, it was decided by the shareholders of Company B, in an ordinary and extraordinary general shareholders' meeting, according to the minutes of the meeting attached as Document No. 1, that the entity would cease all its activities, being consequently dissolved and liquidated, the corresponding shareholdings extinguished, and the result of the liquidation attributed proportionally to the shares held by each shareholder. (...)

3. On .. November 2021, the aforementioned company was dissolved and consequently liquidated, according to Dissolution and Liquidation Deed number xxxx, carried out before a Spanish notary, attached as Document No. 2.

4. According to the list of shareholders present in the Dissolution and Liquidation Deed number xxxx (page 13 of Document No. 2 attached to the Process: 22922), the applicant was a shareholder of the liquidated entity B holding, at the time of liquidation, xxxxx shares, corresponding to xxxx% of the company.

5. Following the dissolution and liquidation of the Company, the applicant received an amount of xxxxxxxxx EUR, corresponding to xxxxxxxx EUR in cash and xxxxxxx in credits. (...)

6. The applicant thus earned a gain in the amount of xxxxxxx EUR as a result of the mentioned dissolution and liquidation of the Company.

7. It should be noted that the applicant has been residing and working in Portuguese territory since September 2018."

Response and Guidance:

1. Under Article 10, No. 1, paragraph b), point 3 of the IRS Code: "1 – Capital gains are the gains obtained which, not being considered business and professional income, capital or property income, result from: (...) b) The onerous transfer of social parts and other securities, including: (...)

3. The value attributed as a result of the sharing, as well as as a result of the liquidation, revocation, or extinction of fiduciary structures to the taxpayers who constituted them, under the terms of Articles 81 and 82 of the IRC Code;"

2. Now, Article 81 of the IRC Code provides as follows: "1 – For the purposes of taxation of the shareholders, in the taxation period in which it is made available to them, the value attributed to each of them as a result of the sharing, deducted from the acquisition value of the corresponding social parts and other own capital instruments. 2 – In the inclusion, for the purposes of taxation of the difference referred to in the previous number, the following must be observed: a) This difference, when positive, is considered as capital gain; b) This difference, when negative, is considered as a deductible capital loss by the amount that exceeds the sum of the tax losses deducted under the special taxation regime for group companies and the profits and reserves distributed by the liquidated company that have benefited from the provisions of Article 51."

3. It thus follows from the above-cited precepts that the excess between the value attributed to these shareholders in the sharing of the remaining assets and the respective capital contributions made or the acquisition cost of these capital parts, including the realization or acquisition of other own capital instruments, is taxed in the sphere of the shareholders, in IRS, in category G – Capital Gains Income, under paragraph a) of No. 2 of Article 81 of the IRC Code and point 3) of paragraph b) of No. 1 of Article 10 of the IRS Code.

4. According to national legislation, the income in question constitutes a capital gain, subsumable in category G.

5. However, in this case, the company subject to liquidation and dissolution, and consequently, the source of the income under analysis, was a company based in Spain, therefore not resident in Portugal.

6. Thus, existing a territorial connection of the situation under consideration with another State (Spain) in addition to the Portuguese State, it is necessary to ascertain the existence of a Double Taxation Convention concluded between the two States.

7. In fact, it is found that a Convention to eliminate Double Taxation between Portugal and Spain was concluded, approved by the Resolution of the Assembly of the Republic No.6/1995, published in the Official Gazette No. 24/1995, Series I-A of 28/01/1995.

8. Having a Convention to avoid Double Taxation between Portugal and Spain, it is necessary to frame the income here under analysis according to the provisions of the said Convention.

9. In this respect, doubts were raised to this Directorate of Services regarding the nature and legal regime applicable to the Spanish entity here in question, called XPTO, Sicav S.A., under the Spanish legal system, as well as regarding the framing of the income from the liquidation of such an entity, in the light of the Convention to avoid International Double Taxation concluded between Portugal and Spain.

10. Thus, the collaboration of the Directorate of International Relations Services was requested, in order to request the Spanish tax authorities to pronounce, under the exchange of information, about the nature and legal regime applicable in Spain to the entity called B, as well as about the framing that the Spanish tax authorities make of the income from the liquidation of such an entity, in the light of the Convention to avoid International Double Taxation concluded between Portugal and Spain and the respective Additional Protocol.

11. More specifically, the question was asked whether such income falls under Article 13, No. 3 of the Convention, being qualified as "Capital Gains", under Article 10 of the Convention (in conjunction with paragraph a) of Point 2 of the Protocol annexed to the Convention), being qualified as "Dividends", or if they do not fall under any of the previous articles, and as such, if they fall under Article 22 of the Convention, being qualified as "Other Income".

12. In response to the request for collaboration from this IRS Directorate of Services, the Directorate of International Relations Services informed the following: "In response, the Spanish tax authorities indicated the legal regime of this type of companies and confirmed that the value of xxxxx, received by Mr. A (as a result of the liquidation of the said Spanish company), was taxed in Spain as a capital gain. The taxpayer filed an income tax declaration in Spain as a non-resident (Model 210) for the 4th Quarter of 2021, having paid a tax of xxxxx. It was also mentioned that they framed these incomes under Article 13, No. 3 of the DTC between Portugal and Spain, as the taxpayer held a participation of more than 25% of the capital of the said company. Let's see,

13. Article 13, No. 3 of the DTC establishes the following: "3 – Subject to the provisions of No. 2, the gains from the alienation of shares or other participations resulting from a substantial participation in a resident company of a Contracting State may be taxed in that State. A substantial participation exists when the seller, alone or in conjunction with associated persons, has held, directly or indirectly, at any time during the 12 months preceding the alienation,

at least 25% of the capital of that company."

14. In the case at hand, according to the facts described in the request, the seller of the shares (the applicant here) held a participation of 31.3656% of the share capital of the company resident in Spain, which qualifies as a relevant participation, under No. 3 of Article 13 of the DTC (cited above).

15. Given the above, it is concluded that for the purposes of the Double Taxation Convention between Portugal and Spain, the income obtained by the applicant as a result of the liquidation of the company is qualified as capital gains, under No. 3 of Article 13 of the DTC, since the seller of the shares held a relevant participation in the company resident in Spain.

16. Having framed the income, both under domestic legislation and under the DTC, it is now necessary to analyze the rules of territorial distribution of the competence to tax the said income.

17. According to No. 3 of Article 13 of the DTC, the taxing competence is cumulative of the State of Residence and the State of Source (shared by Portugal and Spain, respectively), and the income in question may be taxed by both States, having been effectively taxed in Spain as capital gains, as mentioned above.

18. Since the applicant has enjoyed the status of a non-habitual resident since 2018 and until 2027, it is necessary to determine the taxation of the income under analysis, in light of the regime for non-habitual residents.

19. Under No. 5 of Article 81 of the IRS Code (in the wording in force at the date of the facts): "5 – Non-habitual residents in Portuguese territory who obtain income () from categories E, F, and G abroad, are subject to the exemption method, provided that any of the conditions listed in the following paragraphs are met: a) They may be taxed in the other Contracting State, in accordance with a convention to eliminate double taxation concluded by Portugal with that State; ()"

20. If under the DTC Portugal/Spain, the income in question can be taxed in both States (having even been taxed in Spain) and the applicant enjoys the status of a non-habitual resident in Portugal since 2018, then the conditions for the exemption provided for in No. 5 of Article 81 of the IRS Code are considered to be met.

21. Finally, regarding the question posed by the applicant on how to declare the income under analysis in the Model 3 IRS Declaration, it is informed that they should be declared in box 9 of Annex J of the Model 3 IRS Declaration.

22. Since the competence to tax the income in question is cumulative, the Portuguese State exercises its competence to tax, so that, under the general rules of liquidation, this income is, by default, taxed.

23. However, the taxpayer has the right to eliminate double taxation, with the application of the exemption method, under No. 5 of Article 81 of the IRS Code.

24. In this way, in response to the question posed by the taxpayer about how to avoid the mentioned income being taxed, it is informed that this can only be achieved through the deduction of a gracious complaint against the respective liquidation, invoking the respective legal basis that supports, in this case, the non-taxation of the income.
25. This foundation stems from the combination of the rule of No. 3 of Article 13 of the DTC between Portugal and Spain, with No. 5 of Article 81 of the IRS Code.

Conclusion:
Binding information is essential as it provides official and precise guidance on specific tax matters. In this case, the applicant sought clarification on the tax treatment of income resulting from the liquidation of a non-resident company, particularly under the Non-Habitual Residents Regime. For conclusion the income from the liquidation of a non-resident company, for a shareholder with non-habitual resident status in Portugal, is classified as capital gains and should be reported in Annex J of the Model 3 IRS Declaration. Furthermore, such income can be exempt from taxation in Portugal under the Double Taxation Agreement between Portugal and Spain, provided it has already been taxed in Spain and the taxpayer benefits from the non-habitual resident regime. The taxpayer can eliminate double taxation by filing a complaint invoking the applicable legal basis for non-taxation. This ensures that taxpayers receive accurate information, helping them comply with tax regulations and avoid potential penalties or errors in their tax filings.

For any inquiries or support with the residency process for businesses or individuals, our team can guide you through the whole moving process. Feel free to reach out to us at **info@afm.tax** or call us at **+351 281 029 059**.

"YOU MUST PAY TAXES, BUT THERE'S NO LAW THAT SAYS YOU NEED TO LEAVE A TIP."