RESEARCH ARTICLE

Taxation of Capital Gains on IRS Comparative Study between Portugal and Israel

Alves, Lídia¹ | Pereira Adalmiro²* | Vaz Ângela²

¹ISCAP-PPorto, Porto, Portugal
²Management, ISCAP-PPorto, CEOS member, Porto, Portugal

Abstract

This article aims to analyze, normative and jurisprudential, the taxation of capital gains in the IRS. Methodologically, the work has a qualitative profile, as it is based on the investigation of Portuguese legislation, doctrine and jurisprudence, as well as on the compartmental study of the taxation regime for real estate gains in Israel. Israel was chosen as a comparative term to Portugal, due to the notorious growth in terms of real estate investment in the big cities, Porto and Lisbon. The objective is to analyze the whole process of capital gains, namely the taxation process when the property is sold, the tax to which the taxable person is subject at the time of sale and the possibility of the taxable person being exempt, through reinvestment.

Keywords: Capital gains, IRS, Israel, real estate

1 | INTRODUCTION

The topic that we propose to analyze has given rise to some dispute due to the unequal treatment between residents and non-residents in the taxation of real estate gains in the context of personal income tax (IRS).

The taxation of real estate gains was introduced on June 9, 1965 by Decree-Law No. 46373, over the years the concept and its taxation have evolved, however, the 1989 reform was marked by significant changes made in order to adjust the taxation system to the economic and social reality experienced in the country at that date. With the reform of 89, the tax base was extended to a greater number of relevant situations defined by the Code of the Income Tax on Individuals (CIRS), previously only gains from the sale of land for construction were taxed.

Throughout the work, we will elucidate the entire process of taxing real estate surplus value and how the taxable person may not be taxed for the gain obtained from the sale of the property. In order to test the Portuguese tax regime we will make a comparison with a country with a completely different way of life and culture than ours.

We chose Israel for its strong presence in the real estate investment we have faced. Portugal, has been the target of numerous foreign investments, the in-

Supplementary information The online version of this article (10.15520/jro.v7i9.80) contains supplementary material, which is available to authorized users.

Corresponding Author: Pereira Adalmiro
Pereira Adalmiro
vestment comes from several points of the world, namely Israel. In recent years, Israel has been a common real estate investment presence in Portugal, we come across several groups of investors with an interest in the big cities Porto and Lisbon. This is the case of a group of Israeli capital that in 2019 planned nine real estate projects that represent an investment of 85 million euros, a value that makes up only part of the 200 million euros that the group wants to invest over the next few years in the market. real estate in the city and its surroundings and which represents the first phase of the investment strategy.

2 | TAXATION OF CAPITAL GAINS ON REAL ESTATE

According to article 10 no.1 paragraphs a) of the Code of (CIRS), in Portugal the gains obtained with the onerous sale of real rights in real estate are considered to be capital gains, provided they are located in Portuguese territory. This happens only after the tax reform of 89, since before only construction land was taxed.

Building land has, according to (1), raised some doubts as to whether the concept of legally relevant building land is the concept at the time of acquisition, at the time of disposal or when the entry into force of the CIRS. Another pertinent question is to know when to consider the concept of “land for construction”, that is, it is important to know how to qualify the land since there is only taxation if it is one, otherwise the land should not be subject to taxation (Decree-Law 442-A / 88, November 30, article no. 5).

When the CIRS came into force, the legislator had to choose horizontal equality, that is, from the moment the code came into force, all taxpayers are treated equally, regardless of the “moment of origin of their tax situations” (2) (Gama, 2008, p. 89), or by an individual justice and keep the taxable person with the same tax regime, that was previously.

Following none of the options to the letter, the legislator decided to tax gains that were not subject to capital gains tax (tax created by the Code approved by Decree-Law No. 46 373, of June 9, 1965), if acquisition assets or rights to which they relate has been made after the entry into force of this decree. Despite this, the question of when the surplus value tax will be subject remains, the case law is not clear on this issue. For Gama (2008), in order to safeguard the expectations of category G, the ideal is to consider the date of acquisition, since it determines the applicability of CIMV.

In relation to the second question, the concept of land for construction is defined by article no. 1 of the CIMV. Thus, we consider land for construction if it is declared as land for construction when acquired, is located in an urbanized area and included in an urbanization plan. (3)

We can see from the code that there are two types of capital gains taxed under IRS: gains that fall into Categories B, E and F and, on the other hand, the gains typified in Category G (4).

2.1 | Taxation by Category G

Equity increments are considered as Category G income if they are not considered in other categories (Art. No. 9 CIRS), as is the case with capital gains. Thus, paragraph a) of the aforementioned article enshrines that the gains obtained which, not being considered business and professional income, from capital or property, result from the onerous sale of real rights over real estate as well as the allocation of any assets from private property to business and professional activity carried out on an individual basis by its owner.

For the calculation of taxable income, the real estate surplus in the scope of Category G is included in the income of the various categories of income earned each year. Income, whether earned by residents or non-residents, does not have to be included if the taxable person so wishes. The taxable person has the right to choose to include the gain from surplus value to the remaining income, or tax the gain autonomously, by articles 71 and 72 of the CIRS. The

---

1The rate to be taxed is only influenced by the date of acquisition, the status (quality) of the land at that date has no influence in terms of taxation. [2] An example given by Vidal (2019, p. 27) is the transfer to private property and the occurrence of a claim.
principle of universal taxation applies to residents, in which the tax will be levied on the totality of income earned, including those obtained outside Portugal, as indicated in article 15 of the standard and, Principle of Withholding Tax to non-residents, where the tax will only apply to income obtained in Portuguese territory.

For taxation purposes, the gain obtained is determined by the difference between the realization value and the acquisition value, net of the part qualified as capital income, being determined using the following formula (5):

\[ MV = VR - (VA \times CM) - D - E \]

The following must be taken into account for this calculation:

- Realization value (VR): Amount, generally, of the consideration received by the seller (art. 44 (1), al. F) CIRS). In the case of sale of real property rights, the equity value of the relevant building for the purposes of IMT prevails, even if there is no taxation of this tax (6).
- Acquisition value (VA): Amount that served or should serve as the basis for the payment of the tax on the transfer of the property to the seller, to this value can be added expenses inherent to the acquisition.
- Monetary correction of the acquisition value (CM): Related to the depreciation of the real value of the currency as a result of inflation, under penalty of being taxed only nominal values, that is, it must be known what the amount, that at the date of the sale, corresponds to the acquisition value.
- Expenses (D): Expenses necessary and actually incurred with the sale (for example, commission from the real estate agency that sold the property).
- Charges (E): Charges for the valuation of assets, proven to have been made in the last 12 years (art. 51 (1), al. A) CIRS)

The value of income classified as capital gains corresponds to the balance between capital gains and losses, for tax purposes this balance is only considered at 50% (article 42, paragraphs 1 and 2 of the CIRS).

We note that Article 10, inserted in the rules of real incidence, ultimately translates into a norm of negative delimitation of incidence. Gains considered business and professional income are taxed by Category B, capital gains taxed by Category E and property tax by Category F, thus leaving Category G. (7)

### 2.2 Taxation by Category B

We consider Category B income when an immovable property that was used for business and professional activity is transferred to individual assets. The acquisition value in this phase is the market value at the date of the transfer (Art. 29 no. 3 and Art. 47 of the CIRS). That said, if the gain is obtained within the scope of an activity that generates business or professional income (defined in terms of article 3 of the CIRS), it is also included in the concept of surplus value, however this gain will be taxed accordingly with the rules provided for Category B.

The gain obtained is not immediately subject to taxation, the gain is only considered truly gained when the asset is sold or an event occurs that determines the calculation of results under similar conditions. When this happens, two capital gains are calculated: the one that results from the allocation of the asset to the category G business activity and the other to be included as income from the Category B, arising from the sale of the asset that was already allocated to an activity.

The surplus value to be taxed is the sum of the surplus value at the time of submission (when allocation) and the surplus value at the time of disposal. The taxation of the surplus value within the scope of Category B is made according to the rules of the CIRS with reference to the CIRC, having, as a practical consequence, the taxation for the totality and not only in 50% as it happens if it were considered Category income G.

### 3 REINVESTMENT

Reinvestment came together with the IRS Code in January 1989. According to (8), it is a way to favor the ownership of real estate for permanent housing

---

2 An example given by Vidal (2019, p. 27) is the transfer to private property and the occurrence of a claim.
and there is no obstacle in the acquisition of own and permanent housing financed by the product of the sale of a another property that had been given the same destination. For (6) already has another objective, which is to eliminate tax barriers to housing changes.

The CIRS, in Article 10 (5), excludes the taxation of capital gains when the taxable person or his household makes the decision to dispose of his own permanent home and decides to reinvest in the acquisition, construction or improvement of another immovable property for the same purpose, provided that all conditions are verified cumulatively:

- The taxpayer reinvests the realization value, less the amortization of a possible loan, between the previous 24 months and the subsequent 36 months, and
- The taxpayer expresses the intention to proceed with the reinvestment, even if partial, mentioning the respective amount in the income statement for the year of sale.

This benefit is only valid if the property is located in Portuguese territory, in the territory of another Member State of the European Union or in the European Economic Area, as long as there is an exchange of information in tax matters.

In addition to the conditions referred to, the taxable person must carry out the reinvestment within a period defined by the CIRS and you also have a maximum term to affect the new property to your home or your household. According to article 10 no. 6 of the aforementioned code, in the case of a reinvestment in the acquisition of another property, the taxable person must allocate the same to his dwelling, or his household, within a maximum period of twelve months after the reinvestment. In the remaining cases, such as in the acquisition of land for construction or improvement of another property, the taxable person has a maximum period of 48 months from the date of realization to request registration in the property’s matrix or changes, and should affect the property to your home, or your household, by the end of the fifth year following that of completion.

The exclusion of capital gains taxation is proportional to what is reinvested, that is, it is made to the extent that the amount obtained in the sale of the first home has been used in the acquisition of the new home.

If the taxable person decides to purchase the new property through a bank loan, for example, the amount of the reinvestment to be taken into account will be the difference between the payment amount and that of the bank loan. If the price of the new property is found to be lower than that of the alienated, there may only be a partial reinvestment.

We conclude so that, in order for there to be a real possibility of non-taxation of capital gains, the taxpayer must buy another property, and cannot sell it and amortize the bank debt. To avoid harmful consequences a transitional regime applicable to the sale of real estate that occurred between the years 2015 to 2020, acquired with loan agreements concluded until December 31, 2014, which allows the exclusion of taxation to be extended to situations where the realization value is applied in amortization of any loan contracted for the acquisition of the alienated property, and without reinvestment in another property, provided that the taxpayer is not the owner of another housing property, and the tax exclusion covers only the proportional part of the gains corresponding to that application and not its entirety, which means that in an example where a taxable person disposes of the immovable property for € 280,000 and only € 200,000 is used to repay the loan, only € 80,000 will be subject to tax, even though there is no reinvestment.

The exclusion is only relevant if the property intended for housing that was the purpose of the transfer was acquired after January 1, 1989, otherwise the tax exclusion occurs according to article no. 5 of DL 442-A / 88, of 30 / 11.

4 | ISRAELI INVESTMENTS IN PORTUGAL

The Prime Minister, António Costa, in a statement made in January this year, stated that in 2019 the country had reached the highest point of foreign investment, however in the beginning of 2020 that record had already been surpassed, since we exceeded the last year.
The investment comes from several countries, namely Israel, with one of the largest economies in the Middle East and North Africa and with a high standard of living (in 2018, GDP per capita approached $370.59 billion).

Several groups of Israeli real estate investors are investing in Portugal, especially in Porto and Lisbon. This is the case of the Israeli capital group Taga-Urbanic, which despite the atypical moment of the coronavirus, intends to invest 100 million euros in Portugal, two major projects will be carried out on Porto.

The reasons for this interest on the part of Israel are clear, since in 2012 the rent law changed that there are investment fundraising programs, such as the tax regime for Non-Habitual Residents (NHR) and Residence Permit for Investment Activities (ARI) - known as Gold Visa.

NHR is considered by many, namely (9) to be a tax benefit, which is not generally agreed is the meaning of tax benefit, since (10) considers that the tax benefit is a derogation from the tax rules, benefiting taxpayers, while (11) states that it is indeed a derogation from the contributory capacity but that it jeopardizes the taxpayers’ economic and social situation.

To be considered a tax benefit, the NHR regime must be exceptional, in the sense of establishing a taxation different from the general taxation regime (12). NHR, despite being considered residents, benefit from a reduction in the tax rate of certain income obtained in Portuguese territory and from tax exemption from many of the income from a foreign source.

The Portuguese law in the Tax Benefits Statute considers in its Article 2, paragraph 1, that tax benefits are “measures of an exceptional nature instituted to protect relevant extra-fiscal public interests that are superior to those of the taxation that they prevent.”. As well then considering NHR as a tax regime, we must take into account the fulfillment of the three mentioned requirements so that a citizen can adhere to this regime:

1. Have an exceptional character;
2. Have an extrafiscal public interest; and
3. The extra-fiscal fundamentals are superior to the taxation itself that

They prevent it.

The Gold Visa, Law No. 23/2007 of 4 July was approved and amended under Law No. 29/2012, of 9 August, came into force in Portugal on 8 October 2012. This regime allows that all nationals of third countries have a residence permit so that they can carry out an investment activity, this regime also applies to nationals of third countries who hold share capital of a company based in Portugal or in another Member State of the EU and with a permanent establishment in national territory. The citizen concerned must meet one of the minimum requirements for at least five years⁴, established by article no. 3 of Dispatch no. 11820- A / 2012, of 4 September, of the following may choose to:

a) The transfer of capital in an amount equal to or greater than 1 million euros;

b) The creation of at least 30 jobs; or

c) The acquisition of real estate with a value equal to or greater than 500 thousand euros.

These two regimes have a very heavy weight in the decision making that leads the Israelis to invest so much in our country⁵, despite the enormous influence of the regimes, the Gold Visa may come to an end in cities of Porto and Lisbon, as a proposal to amend the State Budget for 2020 was approved that limits access to this regime. Golden aims to become only possible for those who buy properties not located in the big cities, Porto and Lisbon. The objective is to promote investment in low-density regions.

(12) states that the Portuguese NHR can be considered very competitive in relation to other countries and that is why there is so much demand from foreigners who intend to reside and make investments, thus taking advantage of total or partial tax exemptions.

⁴Counted from the date of granting a residence permit.

⁵Other European countries such as Ireland, Malta, Latvia, Greece and Spain have very similar regimes.
TAXATION OF CAPITAL GAINS ON IRS COMPARATIVE STUDY BETWEEN PORTUGAL AND ISRAEL

TABLE 1: Portugal v. Israel

<table>
<thead>
<tr>
<th></th>
<th>Portugal</th>
<th>Israel</th>
</tr>
</thead>
<tbody>
<tr>
<td>Taxation of real estate gains Gains taxation</td>
<td>50%</td>
<td>100%</td>
</tr>
<tr>
<td>Taxation of the balance of capital gains and losses</td>
<td>14.5% to 48%</td>
<td>25%</td>
</tr>
<tr>
<td>Tax rate</td>
<td>No subjection</td>
<td>Yes - Reinvestment</td>
</tr>
<tr>
<td></td>
<td>Yes - just own a property</td>
<td></td>
</tr>
</tbody>
</table>

5 | COMPARISON OF CAPITAL GAINS TAXATION WITH ISRAEL

Source: Own elaboration

Table 1 With the table above, we can see that Portugal and Israel have tax regimes differentiate.

In the sale of a property in Israel, if this sale generates surplus value, a rate of 25% is applied on the total balance generated from the difference between the cost of the property and the sale process. In Portugal, only 50% of the real estate surplus value is taxed, however the rates to be applied on that value can reach 48%, if the taxable person chooses to include, if he does not do so, it is taxed at 28% by art. 72 of the CIRS. From the examples below, we can see that Portugal has a more favorable regime, although the tax rate can reach 48% only 50% of the surplus value is always taxed, unlike Israel, which taxes it in full.

Source: Own elaboration Table 2

Although of the tax rate on the surplus value in Portugal being more beneficial, we find that, in a simpler way, it allows the exclusion of the taxation of gains from the sale of a property. A taxable person who has owned a single property for at least 18 months and who decides to sell it, it is excluded from the taxation of surplus value, unlike Portugal, which in order to obtain this benefit, it is mandatory to reinvest in another property.

6 | CONCLUSION

The present work tried to analyze the taxation process of the real estate gains and in some way, to obtain a way of confronting our tax regime, starting from the comparison with the regime with Israel.

In this context we conclude that, the real estate gains have been evolving over the years, we realize that its concept has suffered several changes until being defined today in, unexpected additions of purchasing power (because they did not result from the counterpart of an activity), obtained without effort or by chance (because the objective with which they had been acquired is not applicable).

The 1989 reform brought several impactful changes to the Portuguese tax regime, in addition to a definitive definition with the entry into force of the CIRS, this reform came to tax all the gains obtained with the onerous sale of real rights in real estate, and not just the land for construction, as it had been until then. The changes did not stop there, because this reform brought us the possibility of enjoying the right to the reinvestment regime and favoring the ownership of properties intended for permanent housing, thus eliminating any fiscal barriers regarding the alteration of household housing.

In order to obtain a better perception of the Portuguese tax regime, we decided to make a comparison with Israel, so we realized that, the country is not distinguished from Portugal only by its culture and way of life, we find that the tax regime of the real estate surplus differs from ours, regardless of in Portugal the rates of article 68, or 72, are used. This is due to the advantage that Portugal has in taxing only 50% of the real estate surplus obtained in the sale of a property. However, Israel opposes it in the simplest way in obtaining the exemption from this regime, and fulfilling the requirements, it is only necessary to sell the property, and there is no need to reinvest it.

---

6 Tax rates updated to 2020
7 The sale value cannot exceed 4.5 million NIS, if it exceeds it is only exempt up to that value.
TABLE 2: Calculation of capital gains tax

<table>
<thead>
<tr>
<th></th>
<th>Portugal - Art. 68</th>
<th>Portugal - Art. 72</th>
</tr>
</thead>
<tbody>
<tr>
<td>Israel</td>
<td>200,000 * 50% = 100,000</td>
<td>200,000 * 50% = 100,000</td>
</tr>
<tr>
<td>200,000 * 0.25</td>
<td>100,000 * 28% = 28,000</td>
<td>80,640 * 37.613% = 29,623.92</td>
</tr>
<tr>
<td>- =</td>
<td>=</td>
<td>+</td>
</tr>
<tr>
<td>50,000</td>
<td></td>
<td>(100,000-80,640) * 48% = 28,000</td>
</tr>
</tbody>
</table>

As a limitation to the study, we can point out the access to information mainly related to Israel. As a suggestion for future work, we point out the study of the impact of Covid-19 on the processes studied in this work.

REFERENCES


How to cite this article: Lídia A., Adalmiro P., Ângela V. Taxation of Capital Gains on IRS Comparative Study between Portugal and Israel. Journal of Research and Opinion. 2020;2809–2815. https://doi.org/10.15520/jro.v7i9.80