tax notes international

Volume 56, Number 4 ■ October 26, 2009

Portugal's New Nonhabitual Resident Tax Regime

by José Almeida Fernandes and
Andreia Gabriel Pereira

Reprinted from *Tax Notes Int'l*, October 26, 2009, p. 377

taxanalysts®

PRACTITIONERS' CORNER

Portugal's New Nonhabitual Resident Tax Regime

by José Almeida Fernandes and Andreia Gabriel Pereira

José Almeida Fernandes and Andreia Gabriel Pereira are with Morais Leitão, Galvão Teles, Soares da Silva & Associados in Lisbon.

The new Investment Tax Code (Código Fiscal do Investimento) was published on September 23 as Decree-Law 249/2009 and seeks to create an overall competitive tax strategy by granting Portuguese international tax policy instruments to enhance entrepreneurship and competitiveness.

The Investment Tax Code introduces a new nonhabitual resident personal income tax regime that aims to attract qualified expatriates engaged in high added value activities to Portugal and other high net worth individual investors by establishing a favorable tax regime to those who take up Portuguese tax residency. The regime is particularly favorable, even in comparison with similar regimes adopted in countries such as the United Kingdom, France, or Spain, and might prove to be a competitive advantage of the Portuguese tax system.

Summarized below are the main features of the nonhabitual resident tax regime, eligibility criteria, and its favorable tax features, as well as commentaries on possible solutions and issues this new regime might give rise to in the future.

Eligibility Criteria

An individual is eligible to register on a voluntary basis as a nonhabitual resident if:

- he qualifies as a Portuguese tax resident as provided by the Portuguese Personal Income Tax Code (CIRS), which establishes that an individual is resident:
  - — if he has remained more than 183 days in Portugal; or
  - — even if that period is not fulfilled, the individual on December 31 of the relevant fiscal year holds a dwelling under circumstances that one might presume his intention to hold and occupy it as his habitual residence or abode; and
- he has not been taxed as a resident in the Portuguese territory in the five years before his qualification as a Portuguese tax resident.

Individuals who fulfill these two requirements are eligible to register themselves as nonhabitual residents and be entitled to be taxed as such for a renewable 10-year consecutive period, provided fulfillment of both criteria is met every year throughout the applicable 10-year period.

The regime appears to be quite flexible in the sense that it encompasses individuals who take up either a permanent or temporary residence in Portugal, if they qualify as residents for Portuguese tax purposes. Also, the regime's flexibility is highlighted by the fact that if the individual fails to qualify as a Portuguese resident in any of the years during the 10-year period, he will not lose entitlement to be taxed as a nonhabitual resident if he again qualifies to be considered a Portuguese resident for tax purposes in the following years until the 10-year period elapses. The individual might resume the application of the nonhabitual resident tax regime on any of the remaining years of the 10-year period if he once again meets the requirements to be eligible as a tax resident in Portugal.

Main Features

Individuals who qualify as nonhabitual residents benefit from a flat tax rate on Portuguese-source employment and business income derived from high added value activities and from the application of the exemption method (with progression) on foreign-source income, namely, passive income, capital gains, income from property, business profits, and pensions. Further, the individual might elect to switch over to the credit method where foreign-source income is concerned, which will be aggregated to his taxable income and subject to tax at progressive rates of up to 42 percent.

Flat-Tax Rate

The main thrust of the nonhabitual resident regime is the schedular taxation of the Portuguese-source employment or business and professional income arising from high added value activities that are of a scientific, artistic, or technical nature (as defined by a specific order to be published by the Ministry of Finance) at a flat tax rate of 20 percent applicable on its net amount. Nonetheless, the taxpayer might still opt for the aggregation of that income to his taxable income and be subject to tax at progressive rates of up to 42 percent. Portuguese enterprises are thus able to offer an attractive salary and fringe benefits package to possible expatriates in Portugal.

Foreign-Source Income

As for foreign-source income, nonhabitual residents might benefit from the application of the exemption method to avoid double taxation, if some variable conditions according to the type of income are fulfilled, as follows.

Employment Income

The exemption method will be applicable to foreign-source employment income (*rendimentos do trabalho dependente*) if the income is subject to tax in the source state under a double taxation convention (DTC) entered into between Portugal and that state. Alternatively, if there is no DTC, the income is subject to tax in the source state and is not considered sourced in Portugal. Therefore, where employment income is concerned, effective taxation in the other state is required to benefit from the application of the exemption method in Portugal.

Profits, Passive/Immovable Property Income, Capital Gains

As for the foreign-source business and professional income (*rendimentos empresariais e profissionais*) arising from high added value activities that are of a scientific, artistic, or technical nature (as defined by a specific order to be published by the Ministry of Finance), or from intellectual or industrial property, or yet from the provision of information relating to an experience gained in the industrial, commercial, or scientific areas, the exemption method will apply if the income may be subject to tax in the other state under a DTC entered into between Portugal and that state. Alternatively, if there is no DTC, the rules of the OECD model convention, interpreted in accordance to Portugal observations and reservations, do not restrict the other state to tax that income, and the income is sourced neither in blacklisted jurisdictions nor in Portugal.

Although the previously mentioned requirements appear to have the intention of avoiding double nontaxation, no effective taxation seems required, and it is merely a condition for entitlement to the application of the domestic exemption method that the rules of the DTC or the OECD model convention, where applicable, do not restrict the taxing rights of the other state. The established conditions mentioned above are likewise applicable to foreign-source passive income (*rendimentos de capitais*), immovable property income (*rendimentos prediais*), and capital gains (*incrementos patrimoniais*).

Pensions

Foreign-source pension income (*pensões*) includes:

- benefits due to retirement pensions, old age, invalidity, survival, and maintenance;
- the benefits that are payable by insurance companies, pension funds, or other entities, under a supplementary social security system due to the employer's contributions and that are not considered as employment income;
- pensions and allowances that are not included in the previous description; and
- temporary or life annuities.

The exemption method will apply if foreign-source pension income is subject to tax in the source state under a DTC between Portugal and that state or if the income is not considered to be obtained in Portuguese territory. But, in both cases, if the income is based on contributions, the exemption will apply only to the portion of that income that has not led to a specific deduction in accordance to the CIRS.

Switchover

The nonhabitual resident may also switch over to the application of the credit method to his foreign-source income, if the income is aggregated to its taxable income and subject to progressive taxation at tax rates of up to 42 percent.

Final Remarks

The new nonhabitual resident personal income tax regime will introduce in the Portuguese personal income tax system a similar regime to those established in other EU countries that pursue the same objectives (for example, the Spanish expatriate tax regime or the incentive regime for expatriates in France).

However, the Portuguese system seems to have gone beyond these European examples, not only regarding its eligibility criteria and duration (a 10-year renewable period) but also regarding its scope. The Portuguese nonhabitual resident regime is not restricted to certain nonresidents (for example, experts or researchers), and there seems to be no condition that the employee must be recruited abroad or even that the work must be physically carried out in Portugal. Also, the existing rules do not require that a new contract is entered into with the Portuguese employer or that the employee must be free of any preexisting business or ownership link with the employer.

The Portuguese nonhabitual resident regime seems also particularly interesting for high net worth individuals who might benefit from it by establishing their tax residency in Portugal. The Portuguese system has an advantage over some similar regimes: If the taxpayer's income falls within one of the categories mentioned above and the exemption method is applicable, no tax will be levied in Portugal on the foreign-source income, regardless of whether the income is remitted to Portugal, and without any remittance basis charge.

Even though through this regime the taxpayer seems to be subject to worldwide income taxation, he is able to enjoy a fixed flat tax rate for his Portuguese-source employment and business income, most likely a lower rate than the one applicable to general residents. The taxpayer also benefits from the exemption method for his foreign income (including passive income), whereas the general rule for Portuguese residents is currently the credit method.

Also, the above-mentioned fact that the taxpayer seems to be subject to worldwide income taxation — albeit effectively benefiting from the application of the exemption method to foreign-source income — might further enable residents to properly claim the application of the Portuguese tax treaty network, consisting of more than 50 DTCs with the major European and Western countries, without the problems raised by regimes where residents are taxed on a source basis in their jurisdiction of residency. Hence, residence within the OECD model convention definition might be a moot point (for example, on the assessment of their ''liability to tax'').

Furthermore, from an EC law perspective, the fact that contrary to other regimes in which some features might be said to raise concerns about compatibility with the fundamental freedoms (for example, restriction where the employment is exercised for entitlement), the Portuguese nonhabitual resident regime does not seem to give rise to those issues. As for a possible incompatibility with state aid rules, prospective individuals must be aware that no prior notification was made to the European Commission, probably because Portugal relied on the European Commission's previous stand that those types of regime do not generally constitute incompatible state aid.

The new nonhabitual resident regime has entered into force with retroactive effect, and prospective qualifying individuals might already claim its application for fiscal 2009. Further, the newly introduced binding ruling regime will allow taxpayers to request from the tax authorities, within 60 days, confirmation of the tax consequences of taking up residency in Portugal. Failure to comply with that deadline will deem the requested confirmation of the tax treatment as presented by the taxpayer as tacitly sanctioned.

The new nonhabitual resident tax regime is indeed favorable to nonresident individuals willing to take up tax residency in Portugal, but it is nevertheless complex in legal and tax terms. Therefore, proper legal advice is recommended before any decision to become a Portuguese tax resident is taken on the assumption that the new nonhabitual resident tax regime is applicable. ◆