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Non-habitual tax residents - Portugal

I. Requirements for non-habitual tax resident status

For the Portuguese tax authorities to grant non-habitual tax resident (NHR) status, it is necessary to meet three essential conditions:

- The applicant cannot have been taxed as a tax resident in Portugal in any of the five years preceding the one in which NHR status is requested;
- The applicant must meet the conditions to be considered a tax resident in Portugal.

Residence in Portugal for tax purposes may be acquired in any year, among other situations, when the taxable person:

i) Has stayed in Portugal for more than 183 days, whether consecutive or not, in any period of 12 months beginning or ending in the year in question; or

ii) Has stayed for less time but has, on any day of the above-mentioned 12-month period, a residence in Portugal in conditions that suggest an intention to maintain and occupy it as their habitual residence.

- The application to be granted NHR must be lodged with the Portuguese tax authorities on or before 31 March of the year following the one in which the status should take effect.

> "Once the Portuguese tax authorities recognise the status of non-habitual tax resident, taxpayers in these circumstances acquire the right to be taxed as non-habitual residents for a period of 10 consecutive years."

Serena Cabrita Neto
Tax team

II. The advantages associated with obtaining NHR status

once the Portuguese tax authorities recognise the NHR status, taxpayers in these circumstances acquire the right to be taxed as non-habitual residents for a period of 10 consecutive years. The status is maintained for this period provided that, with reference to each tax year, the taxpayers may be considered resident for tax purposes under the Portuguese domestic rules and Portugal is the state of residence that prevails under any tax treaty. When this 10-year period ends, these taxpayers will be taxed in accordance with the general personal income tax (PIT) rules as set out in the Personal Income Tax Code (PIT Code).

In practical terms, obtaining NHR status gives the taxpayer tax advantages in relation to the following income sources: (i) employment and self-employment income obtained in Portugal from what are known as high added value activities as listed in the Order of the Minister of Finance; (ii) employment income; self-employment income from high added value activities; pension income; and passive income, in all cases obtained abroad.

1. Income sourced in Portugal

The granting of NHR status will allow the person receiving income originating in Portugal from employment and/or self-employment to benefit from the application of a reduced PIT rate of 20%. To benefit from this rate, that income must come from one of the high added value activities approved by the Order of the Minister of Finance.

High added value activities are those of a scientific, artistic or technical nature and include the following:

- Architects, engineers and similar;
- Visual artists, actors and musicians;
- Auditors and tax consultants;
- Doctors and dentists;
- University lecturers;
- Psychologists;
- Liberal, technical and similar professions;
- High-level professionals;
- Investors, managers and directors.

The PIT Code does not set out any prior procedure for the Portuguese tax authorities to validate the professions classified as being of high added value. However, that validation must be requested immediately after the award of NHR status so that the entities paying the income can apply the reduced withholding tax rate of 20%. The validation is also necessary to allow the taxpayers to file their annual income tax return properly adjusted to their registered tax status.

Finally, in addition to PIT, contributions may also be due to the Portuguese Social Security. This is subject to its own legal rules, which are independent from the rules on non-habitual tax residents.

Other types of income received by NHR residents are subject to taxation under the rules applicable to ordinary tax residents at the progressive PIT tax rates of up to 48%. If applicable, an additional solidarity surcharge will be applied progressively. A rate of 2.5% will be levied on taxable income between EUR 80,000 and EUR 250,000, and a rate of 5% will be levied on the part of the taxable income that exceeds EUR 250,000.

However, it should be noted that, in certain situations, the income earned by the taxable person is taxed through the application of special rates or definitive withholding tax rates. This results in an actual taxation rate that is lower than the progressive PIT rates. This will be the case, for example, with interest, dividends and capital gains deriving from the transfer of securities (the positive balance between gains and losses). In these cases, the applicable rate is 28%.

"Of particular relevance to the application of the PIT exemption to income from employment and self-employment earned abroad is the distinction drawn by the law between "effectively taxed" or merely "being subject" to taxation by the source state"

2. Foreign sourced income

In this case, a distinction must be drawn between (i) professional income and royalties, (ii) pension income and (iii) passive income.

2.1. Professional income

Employment income earned abroad will be exempt from Portuguese PIT as long as it is actually taxed in the source state, in accordance with an applicable tax treaty signed between Portugal and that state. Alternatively, in the absence of a tax treaty, the income will be exempt if it is taxed in the source state and may not be deemed earned in Portugal in accordance with the rules set out in the PIT Code.

In turn, income from self-employment providing high added value services of a scientific, artistic or technical nature, on the list defined by Ministerial Order, and certain royalties, will be exempt from income tax provided that one of the following conditions is met:

- That income may be taxed in the source state under a tax treaty signed between Portugal and that state; or

- In cases in which there is no such tax treaty, the income in question may be taxed by the source state in accordance with the OECD Model Tax Convention on Income and Capital. In this case, the income must not be considered earned in Portugal and must not come from a country, territory or region with a clearly more favourable privileged taxation regime appearing on the list approved by Portuguese legislation.

When comparing the conditions imposed by the PIT Code to apply the PIT exemption to the types of income referred to above, it is clear that the Portuguese law imposes different conditions for each case. They are:

- To be exempt from PIT on employment income from a foreign source, it is necessary for that income to be actually taxed (e.g., through the application of a withholding tax rate) by the source state. However, that income does not need to come from high added value work;

- Income from self-employment will only be exempt from PIT (i) if it results from the provision of services (income from any commercial, industrial, agricultural, forestry or livestock activity is, therefore, excluded,) or from certain royalties, and (ii) if it results from engaging in a high added value activity. However, unlike employment income, for the exemption to apply, it is sufficient that the income in question may potentially be taxed by the source state[1].

As pointed out above, taxpayers must confirm, on a case-by-case basis, whether or not the income is subject to the payment of Portuguese Social Security contributions.

Where the employment income, self-employment income or income from royalties does not meet the conditions described above, it will be taxed in accordance with the general PIT rules. This means the income will be subject to the progressive PIT rates of up to 48% and, when applicable, the additional solidarity rate referred to above will be added on.

"In practical terms, this means that, even if pension income is not effectively taxed by the source state, it will not be subject to PIT taxation provided that, under the Portuguese tax rules, the pensions are not earned in Portugal."

2.2. Pension income

Pension income will be exempt from taxation in Portugal provided it is taxed in the source state in accordance with a tax treaty made between Portugal and that state. Alternatively, this income will also be exempt if, under the rules in the PIT Code, it is not deemed to be earned in Portugal.

In practical terms this means that, even if the pension income is not effectively taxed by the source state (because, among other situations, a domestic exemption applies), it will not be subject to PIT taxation provided that, under the Portuguese tax rules, the pensions are not earned in Portugal.

1 In practice, the possibility of taxation by the source state depends, as a general rule, on the existence of a permanent establishment in accordance with article 7 of the OECD Model Tax Convention on Income and Capital. Therefore, that possibility will tend, in the majority of cases, to involve the actual taxation of the income in question.

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2.3. Passive income

Passive income is income from capital (for example, interest, dividends and certain royalties), income from property (real estate) and the gains resulting from the disposal for value of shareholdings or property (real estate).

Passive income earned abroad is exempt from income tax, provided that:

- The income may be taxed in the source state under a tax treaty concluded between Portugal and that state; or

- In cases in which there is no such tax treaty, the income may be taxed by the source state in accordance with the OECD Model Tax Convention on Income and Capital. In this case, the income must not be considered earned in Portugal and must not come from a country, territory or region with a clearly more favourable privileged taxation regime appearing on the list approved by Portuguese legislation.

To correctly frame the taxation of passive income earned abroad, it is important to bear in mind that many debt instruments are issued from entities located in countries, territories and regions with clearly more favourable privileged taxation regimes. When this happens, the passive income arising from holding, transfer or write-off / redemption of the debt instruments in question does not, as a rule, benefit from the exemption from income tax applicable under the NHR scheme[2].

Similarly, there are cases where, although income earned abroad has the nature of capital income, it does not fall under the definition of «interest» or «dividends», as these concepts are defined in the tax treaties signed by Portugal and interpreted in accordance with the OECD Model Tax Convention on Income and Capital (taking into consideration the observations and reservations expressed by Portugal). Classic examples of this situation are the income from holding certain units in investment funds / collective investment undertakings, and the income that comes from certain insurance policies. When this happens, the income in question falls into the residual category of «other income». Most tax treaties give the state of residence exclusive jurisdiction to tax that category of income. Therefore, the necessary condition of the income being potentially taxed by source state is not met. In these cases, the PIT exemption under the NHR tax scheme does not apply.

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2 In general terms, the taxation of passive income coming from countries, territories or regions with clearly more favourable privileged taxation regimes is a reality. However, technically there are some exceptions to this rule when the income comes from jurisdictions with which Portugal has entered into a tax treaty. In these cases, it could be argued that this income should be exempt from income tax, provided that the conditions laid down in the PIT Code are met.

"The majority of tax treaties concluded by Portugal provide for the taxation of capital gains from securities solely by the residence state, which makes it outright impossible to apply the NHR PIT exemption."

Finally, we turn to the taxation of capital gains from securities. Here, it is important to point out that the majority of tax treaties concluded by Portugal provide for the taxation of this type of income solely by the state where the taxable person is resident. This makes it outright impossible to apply the NHR PIT exemption.

3. Other taxes

the Portuguese tax system does not currently include any tax on fortunes or wealth.

Similarly, gratuitous transfers, including those upon death or by gift are exempt from Stamp Duty if made to certain classes of person. These are the spouse or unmarried partner (the Portuguese concept of união de facto), and relatives in the ascending or descending lines. However, it should be noted that Stamp Duty will always be due on transfers of property (real estate) located in Portugal).