Tax Techniques

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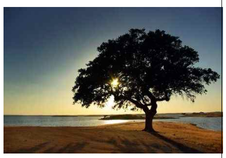
Residency from A to Z

We explore the concept of Residency and how it touches the lives of residents in Portugal

A) Civil Residency



The current Residency Law regulates the free circulation and residency of EU Citizens in Portugal. The statutes define three phases and are in harmony with similar measures being adopted throughout EU and EEA member states . . .

B) Fiscal Residency

Whether you are planning an impending move to Portugal to retire, are seeking an attractive lifestyle in the sun or have lived here for many years yet are in arrears in your compliance obligations, those who live more than six months in the tax year in Portugal are required to submit a Portuguese "*IRS*" tax declaration . . .

C) Dual Residency

Relocation on either a temporary or permanent basis is increasing frequent in our shrinking world. Moving abroad can provoke an unanticipated tax bill with multiple jurisdictions attempting to tax your income . . .

D) Year 1 of Residency - *a Split Tax Year*

With the 2015 Tax Reform, tax residents in Portugal are those who:
a) stay in Portugal for more than 183 days (consecutively or not) during any 12 month period either commencing or ending in that year (not only between January 1 and December 31); or
b) or remaining for less than 183 days, with their principal abode in Portugal . . .

E) Non-Habitual Residents - *the other side of the coin*

The status of *Non-Habitual Resident* offers both opportunity and risk to the potential migrant to Portugal. On the one hand, there is the promise of an attractive 20% tax rate for professional income and exemption from most sources income earned outside of Portugal. On the other, there is a great deal of ambiguity and uncertainty . . .

F) *Closing Notes*: News Briefs

- *EU approves repeal of Savings Directive*
- *Higher earners on the decline in Portugal*
- *Local Lodging in Madrid*
- *OECD combats fraud and tax evasion*
- *Airbnb dominates Local Lodging market*
- *EU bank transfers to replace NIB*
- *IRS statistics*
- *IMI statistics*

Important Dates - 1st quarter of 2016

15 February — *Last day for online tax credit verification*

April: *Round 1 "IRS" Declarations*

May: *Round 2 "IRS" Declarations*

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A) CIVIL RESIDENCY

The current Residency Law regulates the free circulation and residency of EU Citizens in Portugal. The statutes define three phases and are in harmony with similar measures being adopted throughout the 28 member countries of the European Community and European Economic Area.

What are the advantages of holding *Residência*?

Apart from the fact that you are secure in the knowledge that you have the correct documentation to reside here, there are other advantages that can prove to important to you:

- A home-owner, in certain circumstances, can apply for the exemption of property taxes (*Imposto Municipal Imobiliário - "IMI")*.
- A resident is entitled to vote in local elections;
- The Portuguese Health Authorities have a reciprocal arrangement with other EU National Health for the provision for medical treatment;
- Mortgages, bank loans and credit are more readily available;
- Education is free from nursery school through graduate school;
- In most cases, there is no importation duty on an E.U. motor vehicle when making application for *Residência*.

What are the disadvantages of becoming resident?

None. The basic requirements are that you declare that you are able to provide your own means and will not be a burden on the local Social Security system.

Phase 1: Free Circulation - *up to 3 months*

For periods less than three months, all that is required for an EU citizen to travel in Portugal is an Identity Card or Passport. No visa and no registration are required.

Phase 2: Residency - *more than 3 months*

When staying beyond three months, you must register through the *Câmara* (local Council) in the town where you reside within 30 days following the initial period. You must show your passport and make a sworn declaration to the effect that you will meet your own needs and not depend on the State. A Residency Registration Certificate (*Certificado de Registo*) is to be issued in the act (or within one week) and is valid for 5 years.

Phase 3: Permanent Residency - *more than 5 years*

After five years, a permanent Residency Card is required. This document is issued by the S.E.F. (*Serviços de Estrangeiros e Fronteiras).* The only required documentation is an Identity Card or Passport and the original *Certificado de Registo* from the *Câmara*. Upon application, the foreign resident should receive an acknowledging certificate with the final version to follow within 15 days - a photo ID "credit-card style" credential (*Cartão de Residência*). In the interim, the current 3-fold green *Residências* remain valid and may be exchanged on demand.

Loss of Residency

As a foreign resident, you may continue to travel freely within the EU. Your Residency status will only be lost when absent from Portugal for 2 consecutive years or when there is evidence of abuse of rights, fraud or a marriage of convenience.

Fines

Those who fail to comply with the residency permit requirements leave themselves open to complications. Fines are as follows:

Lack of Registration:	€400 - €1,500
Ongoing non-compliance:	€500 - €2,500

Conclusion

With these simple, universal procedures being applied throughout the member countries of the European Union, it only makes sense to be in compliance. If you currently live in Portugal and intend to stay, yet don't have a *Residência*, now is the time to take action.

B) FISCAL RESIDENCY

Whether you are planning an impending move to Portugal to retire, seeking an attractive lifestyle in the sun or have lived here for many years yet are in arrears in your compliance obligations, those who live more than six months in the tax year in Portugal and earn income on a worldwide basis are required to submit a Portuguese "*IRS*" tax declaration with only rare exemptions.

Your First "*IRS*" Return

Submitting a tax return is not synonymous with paying tax. The Portuguese tax code has generous allowances and unexpected exclusions on certain forms of income, broad deductions for numerous types of expenses and liberal tax credits for many common expenditures. Many people find their new tax burden in Portugal to be significantly lower than they experienced before in their country of origin.

Fiscal Residency

Submitting your first income tax submission in Portugal is just the kick-off point. You will not be recognised as resident for tax purposes in Portugal or no longer resident back home unless you follow the appropriate procedures. With your first declaration in the hands of *Finanças*, the next step is to make application for a *Certificate of Fiscal Residency*.

Eliminating Withholding

With the completion of this formality, the International Division of the Tax Authority in your home country must be alerted to the change in your status. Some countries have specific dual language forms, while others accept the duly translated Portuguese *Certificate of Fiscal Residency*. From this point on, most sources of income can be paid to you gross, thereby avoiding any withholding tax levied at source.

Your Refund

Normally, there will be taxes that were inappropriately withheld after the initial date of establishment of fiscal residency in Portugal. By completing the appropriate steps, you will most likely be entitled to a tax refund. Many taxpayers are pleasantly surprised to find that the fiscal residency transition process, when properly completed, can more often than not pay for itself for most people.

Compliance

Just because you have already paid tax in another jurisdiction does not mean that you have done so *correctly*. The relevant Double Taxation Treaty sorts out conflicts between jurisdictions and defines your obligations as a taxpayer. Beyond meeting basic formalities and essential obligations, ***euro*FINESCO** will be by your side to help resolve problems that may arise in navigating your way through Portuguese bureaucracy: arranging for documentation, tax inspections, myriad manifestations of "red tape". It is our purpose to assist you to become fully compliant while helping you pay the legal minimum.

C) Dual Residency

Relocation on either a temporary or permanent basis is increasing frequent in our shrinking world. Moving abroad can provoke an unanticipated tax bill with multiple jurisdictions claiming to be your state of residence and attempting to tax your income.

Increasingly, countries challenge former residents who attempt to move overseas. Although the rules vary, most states define *a resident* as an individual who is in the state for other than a temporary or transitory purpose. Countries consider a person's "residence" or home to be the place of his or her permanent home to which he or she intends to return to whenever absent for a period of time. Most claim the right to tax an individual's income if they are believed to be a resident. Usually, they also impose tax on 100% of a resident's income from all sources, including investment portfolio income.

Because residence is defined so broadly, most double taxation agreements recognize that a person could meet the definition of residence in more than one jurisdiction – *dual residence* – and provide a "tie breaker" clause. Such clauses typically have a hierarchy of three to five tests for resolving the dual residency question, typically including permanent abode or "home" as the major factor. Tax residency rarely impacts citizenship or permanent resident status, though certain residency statuses under a country's immigration laws may influence tax residency.

Nearly all tax treaties provide some mechanism under which taxpayers and the jurisdictions can resolve disputes arising under the treaty. Generally speaking, the government agencies responsible for conducting dispute resolution procedures under the treaty are referred to as the *competent authorities* who generally has the power to bind their government in specific cases. The treaty mechanism typically calls for the *competent authorities* to attempt to agree in resolving disputes.

Individuals who could be caught in the trap of dual residency and double taxation are retirees with a second home in another state; taxpayers who live in one country but have business activities or interests in another; individuals who have relocated to another state but return after a number of years; individuals who temporarily relocate overseas for a job assignment; and individuals who have severed all ties with a state but fail to establish residence in another.

Factors used to determine residence

A major determinant of an individual's status as a resident for income tax purposes is whether he or she resides or maintains an abode and is present for 183 days or more (more than one half of the tax year).

Other evidence often considered in evaluating whether there has been a permanent change is by viewing an individual's *centre of interests*. These may include the following:

- Location of employment;
- Classification of employment as permanent or temporary;
- Location of business relationships and transactions, such as active participation in a profession or trade or substantial investment in or management of a closely held business;
- Serving on the Board of Directors for a business or charity;
- Whether a person's former living quarters were sold, rented out, or retained;
- Whether another property was leased/purchased in the new location;
- The amount of time spent in the country versus amount of time spent outside (183-day rule);

- The state where the taxpayer is registered to vote;
- The state of issuance of a driving license or fishing/hunting permits;
- Location of the school a family's child attends;
- Memberships in country clubs, social, or fraternal organizations.

In residency audits, some elements are likely to be reviewed:

- Credit card statements where charges were incurred, where the bill was sent, and the location of the account used to pay the bill;
- Location of bank accounts, investments, and other financial transactions such as automated teller machine withdrawals;
- Resident and non-resident fishing/hunting licenses;
- Motorway toll charges;
- Records of airline frequent flier miles;
- Jurisdiction issuing a driving license, vehicle registration, professional license, or union membership;
- Property tax abatements, credit applications and property tax bills;
- Church attendance and membership;
- Location of doctors, dentists, accountants, and attorneys;
- Official mailing address and where mail is received;
- Where an individual is registered to vote (and actually does).

If you live elsewhere but travel on a regular and frequent basis to another country, it is a good idea to maintain a diary that clearly indicates the dates on which you are in a specific state, accompanied by supporting records such as tickets and receipts.

Action steps to take when changing your residence

Changing one's residence takes planning and is a proactive process. While courts consider taxpayer intent in state residency disputes, they ultimately look to documents and facts to decide where the state of residence is. Careful documentation is key:

- Note the date of your change of residence;
- Document in writing the reason for the change in residence which shows basis and intent (i.e., permanent retirement, relocation, etc.);
- Obtain a driving license in your new state;
- Register your vehicle in your new state;
- File a resident income tax return in your new state;
- Revoke any property claims in your former state and file similar documents in your new state of residence;
- Register to vote in your new state;
- Open bank and/or brokerage accounts in your new state.
- Replace involvement with business, charities, and other organizations in your former location with activity in similar organizations in your new country of residence;
- Change the mailing address for all bills: banks, insurance, doctors, etc. to your new address;
- Keep a calendar of when you are in your former state versus when in the new one;
- Retain plane tickets, credit card statements, hotel records, etc. that will support your calendar;
- Change professional licenses to your new country (if applicable);
- Establish relationships with new doctors, dentists, accountants, attorneys, etc.

If you have previously filed a tax return in your current jurisdiction but are changing your residence, it is imperative that you closely observe the formalities of making a change of residence and that you retain all documentation you may need to prove your new residence. Tax law generally holds that you are not deemed to have created a new residence until you have abandoned your former one. In addition, be sure to keep the documentation until your former state's statute of limitations runs its course.

D) Year 1 as Resident - *a Split Tax Year*

The 2015 Tax Reform broadened the criteria for *tax residence* in Portugal. As a result, tax residents in Portugal are those who:

- stay in Portugal for more than 183 days (consecutively or not) during any 12 month period commencing or ending in that year (and not only between January 1 and December 31 of the fiscal year in question);
- having remained for less than 183 days, have housing that permits them being regarded as *ordinarily resident* in Portugal (and not just the 31 December each year) at any time during the period referred.

On the other hand, the possibility was introduced that taxable persons could be considered to be tax residents during a partial year. According to the AT, partial residence allows the taxpayer to be a resident in Portugal for only part of the year, as long as he/she remains more than 183 days, consecutive or not, in any 12-month period. The taxpayer will also be considered a resident if, having remained for a period of time of less than 183 days, he/she has available housing in this territory in conditions considered as the primary residence. Once these conditions are met, the taxpayer is regarded as resident in Portugal as of the 1st day of stay.
The understanding is that "by days present" means any full or partial days that include an overnight stay. Ceasing residence is assumed to be on the last day of stay in Portuguese territory.

Exceptions to the application of Partial Tax Residence Status

In the year of return, if a taxpayer fulfills at any time of the year the conditions to be taken as a tax resident in Portugal and, in the previous year, was also considered resident for tax purposes, he is considered to have obtained tax residence from the first day of the year of the return.
In the year of exit, the rule being the last day of stay in the country that determines the end of residence. Nevertheless, the taxpayer will always be considered resident for tax purposes in Portugal throughout the year when staying in Portugal for more than 183 days, consecutive or not, if:

- he/she has obtained income subject to personal income tax (not exempt from IRS) in that year after the last day of stay, or:
- he/she reestablishes the status of tax resident in Portugal in the following year.

This differs from the exit year when he/she remained in Portugal for more than 183 days and can demonstrate that his earnings are taxed in a similar fashion:

- in another Member State of the European Union or the European Economic Area; or
- in another State where the tax rate is not less than 60% of what would apply if resident in Portugal.

Once the partial tax residence is established, it is important to determine which sources of income should be declared during the entry and exit years to Portugal. The AT clarifies that the taxpayers must declare the income earned in Portugal, as well as those obtained abroad, that have been earned during the period in which he/she was considered a tax resident in Portugal.
Thus, up to the first day of the stay (in the year of arrival in Portugal), or after the last day of stay (in the year of termination of tax residence), the only income to be declared for IRS purposes is that earned in Portugal requiring a mandatory IRS declaration as a *non-resident*.

E) NON-HABITUAL RESIDENCE: *The other side of the coin*

The status of *Non-Habitual Resident*, in force in Portugal since 2009, offers both opportunity and risk to the potential migrant to Portugal. For those qualifying (non-resident during the previous 5 years), there is the promise of an attractive 20% tax rate for professional income and exemption from most income earned outside of Portugal. On the other, there is a great deal of ambiguity and uncertainty, both in the drafting of the legislation and its subsequent interpretation and implementation both in Portugal and around the European Union.

Retaliation

The NHR regime requires only a potential liability to taxation in the source State under the rules of a tax treaty or of the OECD Model Tax Convention. After your registration as a *non-habitual resident* in Portugal, you must request an International Certificate of Fiscal Residence from the Portuguese tax authorities. This document then has to be sent to the tax authorities in the country of the source of income. In principle, this should enable you to be exempt from tax in that jurisdiction.

However, this narrow interpretation is not necessarily shared by all tax authorities around EU. In the Netherlands, for example, the NHR status is under hostile attack from the *Belastingdienst* with Portugal accused of being a “Tax Haven” inside Europe. Under current practice, withholding tax exemptions that were formerly granted without difficulty are being systematically rejected by the Dutch tax authorities.

Eventual EU ruling

Given the European Union Commission’s active stance against tax competition between member states, it seems likely that the Commission and/or the Court of Justice of the European Union will eventually issue a ruling on the admissibility of the NHR status. What retroactive impact such a decision might have on the 10-year tax holiday is anyone’s guess.

Deferred IHT tax exemption

Under *Brussels IV*, the EU Directive that governs estate successions within the European Union which came into effect in August 2015, you may now choose either for the Law of your country of *nationality* or the Law of the country of your last *habitual residence* for determining succession rights to your cross-border estate.

If you have elected *Non-Habitual Resident* status in Portugal, you will likely only to be seen as *habitually resident* after the 10-year period has passed plus the usual five years to qualify for “*permanent resident*” status.

Given the fact that Portugal has no Inheritance Tax between immediate relatives (and no Wealth Tax at all), high net worth individuals will find themselves opting out of eligibility for capital tax exemption in exchange for their income tax holiday under NHR. Fifteen years may prove too long for many to wait.

F) *Closing Notes:* NEWS BRIEFS

OECD advances in combating fraud and tax evasion
Significant advances have been reported with regard to increased fiscal transparency. At the recent OECD Global Forum in Barbados, a total of 96 countries have taken public commitment to exchange information on tax matters as of 2017.

Local Lodging in Spain
Local Lodging offerings in Madrid outpace Lisbon by ten fold. The Spanish capital currently has over 210,000 listing and continues to grow. Spain's Local Lodgings yield are almost 50% higher on average than conventional long-term lets.

IRS statistics
Since 2013, the effective IRS tax rate has increased from 10.1% to 12.9%, an increase of almost 22%. Statistics published by *Finanças* show that 10% of taxpayers paid almost 70% of the €10.5 billion collected while 46% of families paid no tax as their income fell below the poverty line.

IMI statistics
Of the 8.12 million urban properties, only 1.14 million (14%) are granted exemption from council tax ("IMI"). This was a drop of 16% from the previous year. Among the 11.58 million parcels of agricultural land, just 5.6% are exempt.

Higher earners on the decline in Portugal
Between 2011-2013, 791 families have disappeared from the ranks of taxpayers earning over €250,000 (-16.7%), now numbering 2,276 in 2014. Those who earn between €100,000-€250,000 are also on the wane, losing 9,000 taxpayers over the past three years, down to 33,300.

EU approves repeal of Savings Directive
The European Council has repealed the Directive on the Taxation of Savings. The previous policy permitted bank interest to be taxed in the State of fiscal residence. The old directive has been superceded by DAC2 which establishes mandatory automatic exchange of a much broader range of fiscal information with the view to combat fraud and cross-border tax evasion.

Airbnb dominates Local Lodging market in Portugal
The Local Lodging giant reports that it currently lists 32,000 properties in Portugal. In Lisbon alone, *Airbnb* offerings surpass 12,000. Of these, 70% are peer-to-peer (a single listing from a sole operator) while the remaining are multiple offerings from commercial operators.

European bank transfers to replace NIB in 2016
As of 01 February 2016, European bank transfers will replace the Bank Account Identification Number, "NIB", with the "IBAN" (International Bank Account Identification Code) upon the completion of the migration to the new *Single Area Payments in Euros System*, "SEPA".