NHR: *Double taxation or double exemption?*

Amongst Tax Authorities around the European Union, a new approach has emerged that could undermine the application in Portugal of the Non-Habitual Residency Regime to pensioners wishing to take advantage of the 10-year tax holiday on their retirement benefits. The new interpretation goes as follows:

Tax-exempt persons in their country of residence (ie. Portugal) are not considered to be resident for tax purposes in that state according to the intended meaning of the applicable tax treaty. Therefore, they cannot benefit from the provisions of these agreements.

The underlying principle is simple: these bilateral conventions exist to protect against double assessment, not doubling up on tax exemptions.

Since Portugal requires that the terms of the respective tax treaty be met in order to benefit from the Non-Habitual Residency Regime, exemption should not be granted if double relief would result. On the part of source country, potential double exemption would lead the local fiscal authorities not to recognise the non-resident status of the individual. The taxpayer would continue to be assessed as before as *resident for tax purposes*.

What are the alternatives?

In order to overcome the unwanted consequences of this new interpretation, several options exist. Even if the tax exclusion is partial, taxation effectively takes place. As a result, the terms of the double tax treaty can prevail. In other words, if the pension is taxable - regardless of actual amount levied - the intended purposes of the treaty are seen to be satisfied.

If one of the pensions in question is an occupational pension, most foreign residents should qualify for a partial exclusion (see [b] below), thereby achieving partial relief but averting full assessment. Alternatively, if there are other sources of income, such as a Sole Trader activity in the Simplified Regime, that are fully or partially taxed, the problem should also be solved.

"*Should be solved*", but not necessarily so

While taxpayers may be able to present bonafide proof that taxation has taken place, the Fiscal Authorities are still on the "warpath", under orders to use their powers to throw up road blocks whenever and where ever possible for Non-Habitual Residents. Many individuals will not feel comfortable advancing in a strategy that draws them into the "crosshairs" of the taxman.

Tax Abatements on Pensions in Portugal

To select from the permissible alternatives, it is important to understand the rational behind the various forms of tax breaks allowed to pensioners in Portugal. Several types of tax abatements may be implemented as follows:

(a) *Tax Allowance* (*"Dedução específica"*): the Portuguese **Pension Allowance** is €4,104 and has remained unchanged since 2012. This flat deduction applies to all pensions regardless of the gross amount received.

(b) *Partial Tax Exclusion* ("*Desagravamento fiscal"*): A **Partial Tax Exclusion** may apply to occupational pensions to rectify potential underlying double taxation issues when specified conditions are met. The criteria for eligibility are defined in the "IRS" tax code.

(c) *Tax Relief* (*"Benefício fiscal"*): The "Non-Habitual Residency" regime offers newly-arrived expatriates in Portugal a 10-year tax holiday on pensions. This status is designed to attract pensioners to retire in Portugal rather than compensate them for associated tax issues as in (b).

Taxpayers who wish to avoid possible scrutiny of fiscal authorities in their home jurisdiction due to NHR should limit themselves to (a) the *Tax Allowance* and (b) a *Partial Tax Exclusion* where admissible but skip altogether (c) the gratuitous *Tax Relief* as exemplified by the Non-Habitual

Residency regime. In most cases, they will find that the final assessment due in Portugal surprisingly reasonable, achieving their fundamental tax mitigation goals while sidestepping the potential negative consequences now increasingly associated with Non-Habitual Residence.

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