



**NHR STATUS**  
*An Update*

The status of *Non-Habitual Resident*, in force in Portugal since 2009, offers both opportunity and risk to the potential migrant to Portugal. On the one hand, there is the promise of an attractive tax rate for professional income (20%) and full exemption from other income earned outside of Portugal. On the other, there is a great deal of ambiguity and uncertainty, both in the wording of the legislation and its subsequent interpretation and implementation.

The designated specialties that qualify for this status are listed in Ministerial Decree 12/2010. They include scientists, artists, auditors & tax consultants, medical doctors & dentists, university professors, computer engineers and technicians, investors and company directors & managers.

Up until now, the implementation of this new regime has been riddled with logistical problems: lack of information at local tax offices, prolonged delays and confusing bureaucracy. In addition, no mention nor clarification has been made regarding Social Security obligations - a considerable accessory expense for anyone working. Someone with the intelligence necessary to qualify for one of these “value-added” professions is unlikely to jump into such a long-term commitment without greater assurances of success.

This legislation was introduced with the specific purpose of attracting highly skilled professionals to move to Portugal and contribute to the country’s development. To achieve this status, we understand as implicit that one must be actively engaged in a qualifying activity and subsequently compensated in Portugal, either via salaried employment or as self-employed in the field. This compensation currently enjoys the special tax rate of 20% and additional income earned outside of Portugal becomes tax exemption under most circumstances. The extrapolation to any and all pensioners has been a subsequent interpretation that has led to on-going controversy.

## TAXATION OF PENSIONS FOR NON-HABITUAL RESIDENTS

Category H income (pensions) received abroad by non-habitual residents shall be exempt from tax in Portugal when:

- 1) for the part in which that income, where it arises from contributions, did not give rise to deduction (*for Social Security*) for the purposes of article 25º (2) of the Personal Income Tax Code;
- 2) or where:
  - a) it is taxed in the State of origin in accordance with the relevant Double Taxation Convention; or
  - b) in accordance with article 18º of the Personal Income Tax Code, it cannot be considered that this income was obtained in Portugal.

Despite being tax exempt under the conditions described above, this income must be aggregated in order to determine the tax rate applicable to the remaining taxable income.

Finally, because this status does not allow for a double exemption, it should be mentioned that the Decree-Law gives non-habitual residents the possibility to waive the right to exemption in favour of the method of tax credit.

## OUR CONCERNS

We are uneasy with several fundamental problems regarding the current Non Habitual Residents status:

- 1) **Scrutiny** - *non-habitual resident status may provoke increased scrutiny from tax inspectors about to loose departing taxpayers.*
- 2) **Potential Retaliations** - *Within Portugal, painful pay and benefit cuts to nationals will not make tax holidays for foreigners popular. Beyond Portugal, Northern European countries may review their own no-tax policies on pensions in light of the Portuguese tax policy. A “tax war” is not out of the question. Alternatively, more consistent norms may be imposed via an EU Pension Directive.*

- 3) **Objective Achieved** - *Portugal has captured the attention of retirees around the EU with its 10-year tax holiday. With the publicity purpose achieved, it won't be long before the tax "sale" ends.*
- 4) **Viable Alternatives** - *Finally, stable alternatives already exist in Portuguese legislation that achieve similar objectives for occupational pensions that been successfully implemented for foreign resident since 1996. It is difficult to fathom why discriminating pensioners would not prefer more stable, time-tested solutions.*

### **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*.

## ***A Better Way?***

The Portuguese Tax System already offers ample ways to minimise taxation without the need for further incentives. Let's look at a few:

- a) no Wealth Tax;
- b) no Inheritance Tax;
- c) Innumerable Tax Exclusions ranging from 33% to 85% across almost every category of income. For example, holiday letting income is taxed at only 5% after an 80% exclusion;
- d) *Roll-Over Relief* - If you sell your principal residence and fully reinvest the proceeds in a new primary home, there is full exemption on the capital gain.
- e) *Fiscal Territoriality* - many taxes are only domestic in scope. The corollary to this rule is that many forms of investments from abroad may be tax exempt.

While Portugal may not be known as a Tax Haven within Europe, knowledge, *know-how* and foresight may be able to achieve considerably more tax relief than the *Non-Habitual Resident* status without the disarray, reversals and limitations.

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**euroFINESCO s.a.**

### **HEADQUARTERS**

Rua do Sol, 4  
8200-448 GUIA (Algarve)  
*tel:* +351 289 561 333  
*fax:* +351 289 562 061

### **Madeira Branch**

Rua do Aljube, 61, 2º Dtº  
9000-067 FUNCHAL (Sé)  
*tel:* +351 291 221095

### **Lisbon Branch**

Rua A.M. Cardoso, 15, 4ºD  
1200-273 LISBOA (Chiado)  
*tel:* +351 21 342 4210  
*fax:* +351 21 342 4212

### **Internet**

e-mail: [info@eurofinesco.com](mailto:info@eurofinesco.com)  
**[www.eurofinesco.com](http://www.eurofinesco.com)**  
PORTUGAL