# NON-HABITUAL RESIDENCY STATUS

## *Our Interpretation*

**Taxation of Pensions for Non-Habitual Residents in Portugal**
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 a Double Taxation Convention signed entered into by Portugal and that State; 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.

**Interpretation**
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 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 drafting 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.

Because 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. To date, approved case confirm this interpretation. This compensation currently enjoys the special tax rate of 20%. Only then does additional income earned outside of Portugal become tax exemption under most circumstances.

## Conclusion

*euro*FINESCO's view of Portugal's **Non-Habitual Resident Policy** is as a *quid pro quo*: contribute to Portugal's defined areas of development and receive generous tax concessions in return. Although certainly not the only one, it is our interpretation that this legislation was not intended to be simply a 10-year tax holiday for any resident foreigner, neither working nor taxed in Portugal, with sundry income derived from abroad, blithely exempted from assessment. Those seeking conditions harmonious with the spirit of the law can find a very attractive solution in Portugal. Those merely hoping to find a tax-free solution will have to keep looking.

## A Better Way?

For those familiar with the Portuguese Tax System, ample ways already exist to minimise taxation without the need for further incentives. Let's look at a few:

a) no Wealth Tax;
b) no Inheritance Tax;
c) Innumerous Tax Exclusions ranging from 33% to 85% running across almost every category of income. For example, holiday let income 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 home, the capital gain is exempt.
e) Fiscal Territoriality - many taxes are only domestic in scope. The corollary to this rule is that some 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.

## Existing Pension Exclusion

Under the Portuguese IRS tax code, contributions to pension plans may seen as having already satisfied tax obligations in the fiscal year in which they were made and be treated as "capital". In this case, only the subsequent growth portion of the Pension Fund is taxable upon withdrawal. When the appropriate statutory criteria have been satisfied, 85% of pension income may be excluded with the remaining 15% liable for assessment.

> **Example:** A *couple, each earning €50,000 in pensions, will have a total gross tax before deductions of just €260 on the total income of €100,000 after the exclusions.*
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> *With tax treatment like this on the books for many years, who needs the confusion and disarray of the Non-Habitual Resident status in the first place?*

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