Taxation of Trusts in Portugal

Portuguese law views a trust as a contract. All transactions involving trusts are deemed to be made with the trustees – the legal owners of the trust's assets – rather than with the beneficiaries entitled under the terms of the trust. Beneficial interest is not a right formally recognised under Portuguese legislation. Let's examine some common questions regarding the taxation of trusts in Portugal.

Is it true that Portugal does not tax trusts?

Historically, transfers made to the trustees or of distributions made by the trustees were not subject to income tax in Portugal. Income tax implies a certain action (work, investment, consideration) on the part of the recipient. Nevertheless, Portuguese law did allow for certain gratuitous transfers (gifts) to be taxed under the Stamp Duty Code. This assessment could apply to contributions made by a Portuguese settlor to a trust, where the trust is considered a non-resident corporate entity, and the assets being transferred were deemed to be located in Portugal. These circumstances were the exception rather than the rule.

Has this situation changed?

Yes. In the 2015 Budget, Portugal formally recognise trusts in mainstream legislation for the first time. In these statutes, trusts are defined as *bespoke fiduciary structures* and are liable to assessment.

Under current legislation, how can a trust be taxed?

As defined under these rules, three forms of taxation may now be levied: a flat 28% tax on distributions from a Trust; Capital Gains Tax when winding up a Trust; and Stamp Duty on gifts distributed from a Trust. Whenever a trust is deemed to be a bespoke fiduciary structure (a private trust), transfers made by trustees to a Portuguese resident beneficiary are considered to be a chargeable event, assessed as follows:

1. Distributions characterised as investment income (Category E) from the trust paid to a Portuguese resident beneficiary are taxed under the Individual Income Tax Code (CIRS) at the current rate of 28%. Income paid by an entity resident in a black-listed jurisdiction is taxed at 35% rather than the normal rate;
2. Distributions on the winding-up of the trust will be:
    a. Characterised as Capital Gains (Category G) if the beneficiary, being resident in Portugal, is the settlor of the trust, to be taxed under CIRS at the current rate of 28%. Nevertheless, no Capital gains Tax is due upon winding up a trust when the Beneficiary is different from the Settlor;
    b. Qualifying as a Gift if the beneficiary, being resident in Portugal, is not the settlor of the trust and is taxed under the Stamp Duty Code at a general rate of 10% (only if the income, either cash or assets, is to be deemed located in Portugal).
    c. A beneficiary who is related to the settlor (spouse, ascendant or descendant) may qualify for an exemption from this tax.

My pension is paid by a "pension plan". Do these changes affect me?

Pension plans are considered "public pensions" and are collective rather than bespoke in nature. They have always been assessed under Category H (pensions), not in the categories elaborated above. There has been no change in the tax treatment of pension plans.

I don't have Pension Plan. What should I do?

While most people believe that the only way to meet the prerequisites of a pension is via regular contributions throughout a working career, many are unaware that a compliant plan can be created on a lump-sum basis. Unlike annuities or conventional onshore retirement plans, often implying a labyrinth of restrictive do's and don'ts, an International Pension Plan can be simple, flexible and tax-efficient, all in a fully compliant structure.

What is an International Pension Plan?

An International Pension Plan is a segmented "public trust" as are most pension funds. These are fiduciary structures where the assets of the pension fund are held by trustees/administrators for the benefit of the plan's members. They are collective as opposed to bespoke in nature. The segmentation assures full autonomy within the structure. Investment choices of each member remain independent from others and allow full control by individual participants as well as freedom to choose how and when to draw income.

How are International Pension Plans taxed?

The 2015 statutory changes on taxation of trusts were directed at "private trusts" – those customised to an individual or family – not collective group structures. Pension plans have always been taxed in Category H (pensions) and continue unchanged. As a fiscal resident of Portugal, you are only taxable on 15% of your gross annual income from an International Pension Plan.

For example, in 2016, with this exclusion, a couple, each receiving a qualifying pension of €60,000, would pay less than €1,000 jointly in gross Portuguese income tax, rather than almost €42,000 if taxed on the full €120,000 pension income.

I am a Non-Habitual Resident yet much of my income is still taxed in my home jurisdiction. Can an International Pension Plan help?

The Non-Habitual Resident regime has proven popular with beleaguered taxpayers throughout the EU. Enticed by the promise of a 10-year tax holiday, many thousands have signed up for the programme only to discover that there is a "*fly in the ointment*". The guidelines state that most sources of foreign income are exempt from tax in Portugal provided that they are subject to taxation in the Source Country as defined in the appropriate Double Tax Treaty. This means that most streams of revenue "may be taxed" or are exclusively taxed at source prior to being considered for assessment in Portugal.

What about pension income from an International Pension Plan?

The only income category eligible for full tax exemption in Portugal is *Pensions*. That's not much of a "holiday" if first you must pay tax before any income arrives in Portugal. This is specially true since protection from double taxation already existed under these treaties.

Are there any estate planning opportunities?

An International Pension Plan can also qualify as a QNUPS (Qualifying Non-UK Pension Scheme), leaving the fund independent from one's estate. It acts as an effective estate planning vehicle, free from Inheritance Tax, just as it does for EU nationals.

An International Pension Plan can offer flexible benefits upon death:

- Within two years of death of the member the scheme can be wound up and the assets paid over to the beneficiaries;
- The trust can continue to allow the assets to roll-up for future beneficiaries;
- Beneficiaries can elect to continue taking income from the pension plan.

For more information, please consult our *e*Book nº 32:
"Trusts, Foundations and Fiduciary Structures"

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