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FISCAL & EXPATRIATE SERVICES

Tax Treatment of Insurance Investment Bonds in Portugal

Insurance Investment Bonds are used for tax, estate and probate planning purposes in many countries. The Portuguese tax system provides beneficial tax treatment for life insurance policies issued by their resident insurance companies and in certain circumstances extends this treatment to policies issued by non-resident insurers.

An insurance investment bond is a single premium whole of life insurance policy issued by a life insurance company on the life of an individual (single life assured) or individuals (multiple lives assured). The element of life assurance, however, is normally relatively small. In form, it is insurance; in substance it is a bond, except that the value of the bond fluctuates in line with the investments with which the policy is linked to its underlying portfolio. The premium is often in the form of a single premium, or premiums if the policy is issued in segments, paid at the outset of the policy. It is usually possible to make top-up investments to the bond.

The single premium is paid to the insurance company by the individual by transferring his investment portfolio and/or a cash sum to the insurance company. The amount of the premium would be equal to the market value of the portfolio at the time of transfer, less any initial charges. The insurance company may restrict the types of investment that can be transferred and generally, investments such as shares in the insurance company issuing the bond, any insurance life fund, precious metals, commodities, option and futures; and UK National Savings Capital Bonds are normally not acceptable. In certain cases, private company shares can be transferred, which could include a private investment company.

The insurance company becomes the beneficial owner of the portfolio, although the portfolio can continue to be managed by the investment manager on whatever basis has been agreed by the investment manager with the individual. It is important to note that the individual only has access to portfolio funds through the insurance company, although in practice, this access is entirely at the discretion of the individual.

The life policy written by the insurance company usually has a minimum level of death benefit, typically at 101 per cent. As a result the life or lives assured can be elderly without there being an excessive premium uplift or a medical examination. The policy can also be written on multiple lives, eg. the individual, his or her spouse, their children and their grandchildren. On the death of the individual, or the last survivor if multiple lives are assured, the policy proceeds are paid out to the heirs (via the executors) of the individual whose death triggered the realisation of the policy. The value of the policy proceeds is effectively the value of the investment portfolio plus the insured death benefit, less any dealing and other charges incurred in connection with the realisation of the portfolio. Since the insurance company is the beneficial owner of the portfolio, its realisation would be no more complicated than carrying out normal investment transactions.

The initial premium - as well as additional top-us - paid into the bond can be in the form of cash or the transfer of an existing portfolio of securities held by the investor. The transfer of a portfolio to the insurance company may constitute a disposal of the portfolio for capital gains tax purposes. Alternatively, the assets may be transferred *in specie,* thereby retaining their current form, avoiding a chargeable event. In addition, since the payment of the premium in cash is not a transfer of value or a gift, but merely placing the asset in custodianship with the Insurance Company, there should be no capital transfer tax, gift tax or inheritance tax consequences.

TAXATION

If the foreign insurance company is resident in a low-tax jurisdiction named in the "blacklist" published through the Ministerial Order nº 1272/2001 of 09/11, this does not bear on the tax treatment of Portuguese tax resident individuals.

Under general tax principles, the income and gains arising in the bond are not assessable on the individual taking out the policy, or on any of the other lives assured, since the income and gains arise to the insurance company as beneficial owner of the portfolio.

In addition to the payment of premiums and annual accrued income charges, there are three types of potentially chargeable events, that could give rise to a charge to tax during the life of the bond:

a) Disbursements

1) Many policies define withdrawals up to the amount of the original premium as reimbursement of capital that, as such, are not seen as taxable income.
2) The Portuguese Individual Income Tax Code (*CIRS*) differentiates between income and capital on partial withdrawals *(renda temporária*). When the distinction between the two cannot be accurately made, one may exclude 85% representing the capital portion, with the remaining 15% assessed as taxable growth (*Art. 54*º).
3) If disbursements were to come directly from growth and not capital, normal Portuguese "*IRS*" rules would apply.

b) Surrender of the Policy

On surrender of the policy, the premiums paid and the gains previously charged are deducted from the proceeds of surrender aggregated with the previous withdrawals to give the chargeable income gain. A form of holding discount is allowed, i.e. the taxable gain reduces, the longer the bond is held. Between years 5 and 8, 20% of the gain is excluded from taxation. After 8 years, 60% is exempt.

c) **Death Benefit**
Benefits payable upon the death of a life assured are tax exempt in Portugal. As of 1 January 2004, Portugal abolished Inheritance Tax assessment between immediate family members. However, even prior to this change, Death Benefits from life insurance policies were excluded from IHT assessment.

Conclusion

In summary, an Insurance Investment Bond is a useful tool for Income Tax and Estate Planning purposes for individuals with complex cross-border situations involving multiple jurisdictions. The use of a Bond can achieve the following tax planning objectives:

* tax free roll up of income and gains;
* long term holding discount;
* reduced or tax free cash withdrawal mechanism;
* a consolidated investment structure, facilitating on-going administration and eventual probate of internationally diverse portfolios.

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euro*FINESCO *s.a.

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

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

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

Internet
e-mail: info@eurofinesco.com
www.eurofinesco.com
PORTUGAL