The Florida of Europe...

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Getting acquainted with Portugal

Portugal forms part of the Iberian Peninsula and is the most south-westerly country in continental Europe. With a total area of approximately 90,000 square kilometres (34,749 square miles), Portugal borders Spain to the north and east and the Atlantic Ocean to the south and west. Portugal comprises continental Portugal and the archipelagos of Azores and Madeira, which are situated in the Atlantic, 1,360 kilometres (845 miles) west and 1,040 kilometres (646 miles) south-west of the mainland, respectively. Portugal's urban and economic centres are concentrated on the Atlantic coast, principally around its capital, Lisbon (located at the mouth of the Tagus River), and Oporto (located in the northern part of the country) which is world-famous for its wine.

The climate is similar to that of the Mediterranean region in the south and temperate in the north, with maximum and minimum average temperatures during the year of 20°C (68°F) and 10°C (50°F). August is the warmest month, with daily average high and low temperatures of 28°C (82°F) and 17°C (62°F), and January is the coldest, with daily averages of 14°C (57°F) and 8°C (46°F).

The population of Portugal, including the Azores and Madeira, is approximately 10 million, accounting for 3% of the total population of the European Union (EU). The Azores and Madeira each have a population of approximately 250,000.

Portuguese is the national language. A large part of the population, especially in the urban and tourist centres, speaks English, and French is also widely understood.

Portugal is a typical Western Europe civil law jurisdiction and parliamentary democracy, with a president, who is directly elected for a five-year period and may serve for a maximum of two consecutive terms and has certain reserve powers. In the autonomous regions of the Azores and Madeira power to initiate legislation lies with their respective regional legislative assemblies.

Portugal is a member of most principal international organisations, including the United Nations (UN), the North Atlantic Treaty Organisation (NATO), the Organisation for Economic Co-operation and Development (OECD), the International Monetary Fund (IMF), the World Bank and the World Trade Organisation (WTO). In July 1996, Portugal founded the Community of Portuguese-speaking Countries (CPLP). Its objectives include the promotion of trade and investment opportunities among the seven member countries with a population of about 200 million. Joining Portugal in the group are Angola, Brazil, Cape Verde, Guinea-Bissau, Mozambique and São Tomé and Príncipe. On 1 January 1986, Portugal joined the European Economic Community, now the EU, and has been and will continue to be a major beneficiary of its funding.

The legal basics of residence

The rules for obtaining visas, residence permits and work permits differentiate between non-European Union (EU) and EU citizens. The rules for non-EU nationals intending to enter into a labour contract in Portugal are somewhat more complex and were recently amended to try to curtail illegal immigration.

Non-EU nationals

Non-EU nationals intending to work in Portugal, either on a dependent or independent basis, are required to obtain a work visa.

The visa should be requested in the Portuguese consulate in the home country before entering Portugal. In order to apply for the visa, the individuals will be required to present several documents, namely valid travel document passport, colour photographs, complete identification, official forms, criminal records, medical certificate or health insurance, accommodation declaration and documents proving means of subsistence, as well as the service contract or a promissory labour contract.

The Foreigners and Borders Service (SEF) is consulted before the visas are issued. Additionally, in the case of a dependent worker, the employer is forced to present an employment offer in the Work Centre of its head office or in the place where work will be rendered, presenting the demands for the work as well as the contractual clauses. This is used to allow preferential candidates (Portuguese or EU nationals) to fill the vacancy. If there are no local candidates, the Work Centre communicates this to the Regional Delegation of Labour and Professional Training, which usually notifies its EU counterparts so that the employment offer is advertised therein. If no EU citizens apply with the required professional status, the Delegation notifies the employer, who should then request from the General Inspection on Labour (IGT), an opinion on the labour contract. After all these steps are fulfilled successfully, the work visa is issued,

normally being valid for several entrances into Portugal and for one year. Extensions can be obtained. The Portuguese labour law further requires the work contract to be entered into between the foreign individual and the Portuguese company to be made in writing and in triplicate, and, prior to the exercise of the work, to be deposited before the Employment Conditions Development and Inspection Institute (IDICT).

Those who want to live, but not work, in Portugal should first request a residence visa in the Portuguese consulate which enables them to enter twice in Portugal and stay six months so as to apply for a residence permit. The latter is granted by the SEF for a period of two years, renewable for consecutive periods of three years. These should be easier to obtain than work visas, provided that means of subsistence are evidenced.

EU nationals

EU nationals and their families may enter Portugal simply by presenting their passports or identification cards. They may reside in Portugal, seek and accept employment or set themselves up as self-employed persons without restriction. EU individuals working in Portugal during more than three months must request a temporary or normal residence card, although labour contracts can still be executed immediately while the card procedures are pending. It provides the expatriate with an instant form of identification - in Portuguese - which can be time saving when, for example, opening a bank account or buying a car. Residence cards are issued for the period of work (temporary) or an initial period of five years (normal), and are renewable. Proof of means of subsistence while living in Portugal is required.

The personal income tax

Residents of Portugal are subject to Personal Income Tax (IRS) on their world-wide income, whereas non-residents are subject to tax only on their Portuguese-source income, which includes capital gains.

An individual will typically be considered as resident in Portugal for IRS purposes if he spends more than 183 days, consecutive or not, in any given calendar year in the Portuguese territory or if he has residential accommodation, available on December 31 of that year, which suggests the intention to maintain and occupy it as an habitual abode. The legal title under which the individual occupies that accommodation (ownership, lease, etc.) is irrelevant.

Individuals who on 31 December are members of the crew of ships or aircraft are deemed to be resident in Portugal, provided that they are at the service of entities with residence, head office or effective management in Portugal, a provision that is sometimes overlooked.

If an individual is deemed resident both in Portugal and in another country which has entered into a tax treaty with Portugal, the prevailing residence shall be determined pursuant to the convention provisions, which override domestic tax legislation. Portuguese tax treaties tend to follow the OECD Model Tax Convention, namely in the definitions of residence (article 4), income from employment (article 15), and pension income (articles 18 and 19).

The taxation of expatriates (either employees or self-employed) depends on their residence or non-residence status as they have no special tax privileges. If the expatriate is resident in Portugal, he must file an IRS return in Portugal, his employment income will be included with his global world-wide income and will be subject to IRS at progressive tax rates of up to 40%. Alternatively, if the expatriate is not resident in Portugal, and no tax treaty is applicable to the situation, income of work rendered in Portugal or paid by a Portuguese entity will be subject to a 25% or 15% final withholding on gross income received (with no deductions allowed), settling all Portuguese tax obligations and waving the need to file a tax return.

In relation to expatriates whose residence or prevailing residence is in a country which has a tax treaty with Portugal, there are some tax planning opportunities, in particular in the first or last year of work. Salaries earned are generally not subject to tax in Portugal if the employees remain in Portugal for less than 183 days in any given 12 month period (or, under some tax treaties, in a tax/calendar year, which effectively allows for 365 tax free days in Portugal), the remuneration is paid by, or on behalf of, an employer who is not a Portuguese resident, and is not borne by the permanent establishment of a non-resident company. Salaries paid abroad but subsequently charged back to the permanent establishment are therefore treated as being paid in Portugal. Service fees of non-resident self-employed expatriates are generally exempt from IRS under the tax treaties provided that they do not have a permanent establishment herein.

Concerning residents, a unilateral tax credit is available for foreign taxes paid on income from other countries. The limit of the credit is the amount of Portuguese tax payable on the foreign income in relation to the lower value between the tax paid on income from foreign countries and the amount estimated to be paid in Portugal before the deduction. If the income obtained abroad derives from a country that has a tax treaty with Portugal, the amount to be deducted cannot exceed the tax that can be paid in the foreign country under the terms of the convention. Furthermore, if there is insufficient tax due and the credit cannot be deducted in the same year of the income, it may be carried forward during the five subsequent years.

The residence of one spouse in Portugal automatically renders the other spouse resident. A married couple and children are taxed jointly as a family. Married taxpayers that are not separated *de jure* or *de facto* are assessed on their combined income. However, to ease the effects of the progressive tax rates, an income splitting system operates. The net taxable income is divided and one portion is charged to tax, the resulting amount of tax is then doubled, thus, two sets of reduced tax rates are applied to the combined income.

Taxable income derives from the sum

of the net income of all baskets. For this purpose, there are six baskets: employment income, professional and entrepreneurial income, investment income, rental income, wealth net increases (encompassing capital gains) and pensions. Gross receipts for each basket are aggregated and reduced by the allowable expenses for that basket, when applicable. Aggregated net income is taxed at progressive rates of tax, between 12% and 40% in mainland Portugal, between 10% and 39% in Madeira, and between 10% and 34% in Azores, being the higher bracket reached at an income level of €52,276,51. Personal allowances as well as other credits such as withholding tax are subtracted to the tax liability. Individuals must normally pay any balance of tax due by 31 May. Overpayments are refunded by 31 August.

Social security

In general, individuals employed or carrying out their professional activity within the Portuguese territory will be subject to Portuguese social security laws and regulations.

All employees must register with the Department of Social Security in order to qualify for benefits granted by its system. Under the general contributions scheme, social security contributions are payable on all salaries, wages, regular bonuses and other regular income, excluding lunch subsidies. The rate of contributions is 23.75% for employers and 11% for employees. An employer must deduct the employee's contribution and pay the total amount to the authorities by the 15th of the following month.

Members of a company's management and supervisory boards are usually subject to social security contributions based on actual compensation. For contribution purposes, the actual compensation base must equal at least 1 and no more than 12 times the monthly statutory minimum salary. However, in certain circumstances no maximum is imposed. The contribution rates are 10% for individuals and 21.25% for companies.

A self-employed individual is subject to monthly social security contributions calculated on a base, pre-selected by the individual, which varies between 1 and 12 times the monthly statutory minimum salary. The contribution rates for self-employed individuals are the following: 25.4% for compulsory coverage only (retirement, disability, death and old age); or, 32% for compulsory coverage plus coverage for professional sickness and illness subsidies and other family benefits.

Foreigners working temporarily (normally up to two years) in Portugal and contributing to a compulsory social security scheme in their home country are not subject to Portuguese social security contributions. To provide relief from double social security taxation, ensure benefit coverage and totalisation of pensions, Portugal has an internal and unilateral secondment regime, benefits from the EU regulations, and has also concluded agreements with several countries. EU, Economic European Area member countries (Iceland, Liechtenstein, Norway) and Switzerland, as well as Andorra, Argentina, Australia, Brazil, Canada, Cape Verde, Guinea-Bissau, Morocco, the United States of America, Uruguay and Venezuela are specially covered.

Tax planning opportunities

The following capital gains are not taxed in IRS:

- bonds and debentures;
- investment-fund participations;
- shares and quotas, acquired before 1 January 1989;
- shares held for more than 12 months at the time of the disposal;
- real estate, except land for construction, owned before 1 January 1989; and
- a taxpayer's personal and permanent residence if the proceeds are reinvested in another personal residence set in the Portuguese territory.

Additionally, contributions made by the employer to pension funds and life and health insurance schemes are not regarded as employment income provided that certain conditions are met. As for stock-options/share plans, only the difference to the market value is to be treated as employment income, the remaining being a capital gain. Therefore, these schemes can be structured in a tax effective manner.

Firstly, earnings derived from such options/plans are not taxed on an accrual basis and, consequently, are not liable to tax in Portugal until they are put at the disposal of the employee.

Accordingly putting the earnings at the disposal of the expatriates after they terminate their assignment in Portugal means no tax needs to be paid in Portugal. Secondly, it is possible to avoid any initial income on the acquisition of the shares (if they are acquired at market price) and dispose of them after 12 months so that the capital gain does not become taxable.

In fact, the most important IRS feature for high net worth individuals is the exclusion from taxation of shares held for more than 12 months at the time of the disposal. Although this only applies to participation in Joint Stock Corporations, the law does not distinguish whether such shares are the ones of a Portuguese *Sociedade Anónima* or also those of foreign equivalent companies. And *ubi lex non distinguit nec nos distinguere debemos.* Indeed, this silence from the IRS Code, together with the EU and tax treaty principle of non-discrimination, has led to the widely accepted idea that all shares in Joint Stock Corporations are not taxed, provided that the 12-month period has been met. Additionally, tax treaties entered into by Portugal generally follow the OECD Model Tax Convention, whose article 13, paragraph 4, attributes an exclusive taxation right on capital gains in shareholdings to the State of residence of the alienator, preventing the State of source from levying its own taxes. Therefore, some foreign wealthy individuals have moved to Portugal and acquired residency herein before disposing of their investment empires tax-free.

Estate taxation

There is an on-going estate tax reform in Portugal that will mainly come into force in December 2003-January 2004. It targets off-shore companies (OFCs) holding Portuguese real estate, Property Transfer Tax (PTT) and Property Ownership Tax (POT) wise, and abolishes Gift and Inheritance Tax (GIT) in many circumstances.

From 1 June 2003 PTT is 15% of the transfer value of the property purchased through an OFC, instead of the standard rates which range between 0 and 6.5%. From 1 January 2004 onwards POT will be 5% per year on the value of the property owned through an OFC, instead of new standard rates between 0 and 0.8%. Moreover, OFCs that own non-leased urban property or property that is not used for business purposes in Portugal are deemed since 2002 to have obtained minimum presumptive rent income in an amount corresponding to 1/15 of the immovable tax value, which will also be taxed for Corporate Income Tax (IRC) purposes, at rates ranging from 15% to 30%. In order to reverse the legal presumption, the targeted OFCs must demonstrate that the urban property is not enjoyed by an entity domiciled in the Portuguese territory and that it is empty. Properties leased under the controlled rents system or which have been newly built, rebuilt, improved or bought after 2002 by OFCs no longer qualify for objective exemptions from POT, unless the agreed rent also equals or exceeds 1/15 of the value of the immovable.

It is easy to understand that no new transactions will be made in the future using OFCs in the 83 jurisdictions that have been blacklisted for Portuguese purposes, given the excessive 15% PTT. However, beneficial owners of existing structures will to have to reappraise their situation in order to avoid the negative impact of the new 5% POT. Tax-free solutions might involve re-domiciling OFCs to Portugal or to a non-blacklisted jurisdiction.

From 1 January 2004 close family (spouses, children, grandchildren, parents and grandparents) will be exempt from GIT. Other GIT situations involving the disposal of Portuguese assets are taxed through a 10% Stamp Duty, whereas situations involving the disposal of foreign assets are not liable to GIT. These features may save some unnecessary management fees with the use of corporate fiduciaries while also attracting more people to the country.

Conclusion

Due to the exclusion from IRS for shares held for more than 12 months and the exclusions and exemptions from GIT, sunny Portugal may become the Florida of Europe with regard to income and estate tax.

http://taxventure.com.sapo.pt
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Archive link: "Winning the prize - citizenship & residency in the EU" - *April 1999, Issue 95*