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Samuel Fernandes de Almeida and Filipa Miranda Relvas

A closer look at Portugal's non-habitual residents tax regime

Samuel Fernandes de Almeida and Filipa Miranda Relvas of Vieira de Almeida & Associados discuss the Portuguese taxation of foreign limited liability companies and limited partnerships under the non-habitual residents tax regime.

The Portuguese Personal Income Tax (PIT) Code sets a special tax regime for new tax residents provided that same have not been deemed resident therein the previous five years – the non-habitual residents tax regime (NHR regime).

Being considered as one of the most competitive tax regimes for expats and other high qualified individual investors, the NHR regime provides for a tax exemption applicable to foreign-sourced capital income (interest and dividends), rents and capital gains derived from the sale of securities provided that the following alternative requirements are met:

- The income is taxable in the source country according to the rules set forth under a Double Taxation Convention (DTC) between Portugal and the source country of income; or, in the absence of such DTC;
- It is taxable in the other country, territory or region, in accordance with the OECD Model Tax Convention on Income and on Capital, interpreted in accordance with the observations and reservations made by Portugal.

As a relevant exception, the exemption shall no longer be available if the income derives from a country, territory or region subject to a clearly more favourable tax regime, as set under Ministerial Order No. 309-A/2020, of December 31.

Since all of the DTCs concluded by Portugal – in line with the OECD Model Tax Convention on Income and Capital – allow the source state to tax dividends and interest, no PIT shall be due in Portugal under the NHR regime.

By contrast, with respect to capital gains arising from the disposal of financial assets obtained outside Portuguese territory, most DTCs concluded by Portugal (as well as the OECD Model Tax Convention on Income and Capital) do not allow the source state to tax such income, which means that, as a rule, it will be taxed in Portugal at a rate of 28% (which may be aggravated to 35% if obtained in tax havens) – please note that a 50% tax allowance may be available for small and medium-sized enterprises (SME), as per recommendation from the European Commission No. C(2003) 1422.

With this in mind, let us have a look to the tax treatment to be granted under the NHR regime to income distributed either by limited liability companies (LLC) or limited partnerships (LP).

Firstly, it must be noted that the Portuguese legal and tax system does not provide for specific treatment for opaque and transparent entities such as the LLCs or LPs. This poses some additional challenges when assessing the applicable tax treatment to capital income perceived under the NHR regime.

As a rule, LLCs and LPs are limited liability partnerships deemed transparent under US legislation, whereas income flows to partners without taxation at the level of the company ('pass through taxation'). Given the above, the LLC's annual taxable income allocable to the partners shall be taxed at the hands of the later – notably for US sourced income, whereby the partner shall be liable to US federal taxes.

It must be noted that LLCs and LPs are not generally eligible for the application of the benefits granted under most of the DTCs entered by Portugal. For instance, under Article 3 paragraph a) of the Protocol of the US/Portugal DTC, LLCs shall only be deemed resident in the US provided that income obtained by said corporate vehicles are effectively subject to tax in the US, either at the level of the corporation or at the hands of its partners.

This topic has already been brought to the attention of the Portuguese tax authorities, who have already issued several binding rulings, whereas it is stated that:

- Pursuant to domestic legislation, the allocation of income/profits by an LLC shall be deemed as a distribution of dividends, generally subject to 28% PIT in Portugal;
- An LLC, being tax transparent, is not deemed resident in the US for the purpose of the DTC with Portugal, and as such, income attributed to LLC's partners shall not be deemed or treated as dividends for treaty purposes, but rather shall be subject to the provisions of Article 24 of the DTC ('other income'), which attributes cumulative taxing rights to the source and residency contracting states.

The look-through approach adopted and disregard of the LLC for the purpose of applying the DTC provisions, does fit entirely with the NHR taxing principles, as the Portuguese tax authorities shall be looking to the nature of the income received by the individual taxpayer, rather than the corporate vehicle.

Ultimately, even if the Portuguese tax authorities would deem the LLC/LP eligible for the DTC with the US, the LLC gains could be assimilated to dividends, which pursuant to Article 10 of the treaty are also taxable in the US, allowing, thus, to operate the exemption under the Portuguese legislation.

Samuel Fernandes de Almeida
Filipa Miranda Relvas
Vieira de Almeida & Associados
E: sfa@vda.pt
E: fir@vda.pt

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