The Private Wealth and Private Client Review

Ninth Edition

Editor
John Riches

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Ninth Edition

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John Riches

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PREFACE

I would like to focus my remarks on some of the key trends that might be expected to affect the world of high net worth individuals in the immediate aftermath of the covid-19 pandemic.

I ISSUES DURING THE PANDEMIC

During the pandemic, we have seen a relatively consistent pattern among OECD countries of measures that are mainly focused on delaying obligations to file tax returns and make tax payments to reflect the turmoil in some business and personal finances that these exceptional circumstances have wrought. Interestingly, at the beginning of April the OECD issued an analysis examining double tax treaties and the impact of the crisis on individuals' presence, which may have been constrained as a result of the pandemic. The following were notable conclusions.

i Permanent establishments

For individuals constrained to work in a different location and, in particular, for those working from home, provided the state of affairs is regarded as temporary and exceptional it would not generate the required degree of permanency to create a fixed place of business.

ii Corporate tax residence

The view from OECD is that the temporary relocation of board members to different locations will not generally impact a company's tax residence.

iii Personal tax residence generally

In considering where an individual's centre of vital interest may be, any exceptional circumstances generated by the covid-19 pandemic should not, by themselves, cause an individual's residence to change.

One specific area where countries have taken steps to introduce exceptional guidance is in the context of a day count test. Specifically, Australia, Ireland and the UK have given guidance in the context of disregarding days of presence where this is used as a factor in determining residence. Clearly in all these cases, significant care needs to be taken to ensure that a temporary, exceptional circumstance does not become a permanent state of affairs. Where any tax analysis is dependent upon an individual being constrained in their ability to travel, it is likely to be prudent to keep contemporaneous records of attempts to travel to show that an individual has not changed his or her behaviour or residence in consequence of

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the crisis on a more permanent basis and taken the opportunity to leave the relevant country as soon as possible. Difficulties may arise if an individual in Country A is unable to travel to Country B but could have gone to other locations. Will it be possible to argue that all steps were taken to leave if the individual waited until it was possible to travel to Country B?

II POSSIBLE RESHAPING OF TAX POLICY POST COVID-19

There have been many pronouncements and speculations appearing in the media about how national governments will look to finance the deficits they have incurred during the crisis. A significant degree of speculation has focused on the extent to which high net worth individuals will be targeted with an increased tax burden as one of the mechanisms for financing government deficits. Speculation varies between the possible introduction of some form of annual wealth tax to increased estate taxes.

One interesting example is a proposal in Argentina for a one-off tax levy on ultra-high net worth individuals (UHNWI). The bill being promoted in Argentina proposes a one-time tax on wealth calculated on personal assets of Argentine residents as at 31 March 2020. For individuals with a personal asset base of US$3 million, the proposed rate of tax would fall in the range of 2 per cent to 5.5 per cent. This would be in addition to the current annual wealth tax burden of 2.25 per cent for individuals on wealth that is held outside of Argentina. An article published by an Argentine think tank in April 2020[1] sets out an interesting array of proposals that have been advanced, principally by opposition parties, in South America and Europe. One additional strand that has emerged in Europe is the exclusion from state aid programmes for companies that are headquartered in 'tax havens'. This has been promoted in countries including the United Kingdom, Denmark and France.

A pan-European tax for UHNWIs in the EU has been suggested by economists, Gabriel Zucman and Emmanuel Saez (University of California at Berkeley) and Camille Landais (London School of Economics).[2] The suggested parameters they advance would be to tax those holding assets of more than €2 million (the top 1 per cent) at 1 per cent, those holding assets of more than €8 million (the top 0.1 per cent) at 2 per cent above that threshold and those holding more than €1 billion at 3 per cent above that threshold. They also argue that by making the tax EU-wide, there will be no incentive for individuals to relocate within the EU to avoid the tax.

Historically, one of the objections that has been raised, certainly in Europe, to wealth taxes is the relative inefficiency in the collectability of wealth tax because of the significant degree of compliance work required in checking an individual's filings and valuing their net worth to calculate the levy.

Clearly there is a paradox for tax authorities in considering any form of one-off, or permanent, tax measures that are targeted on high net worth individuals, namely the concern that such measures do not detract from the efforts of business entrepreneurs to create employment and prosperity for others. Furthermore, there will clearly be concern about measures that could be seen as targeting wealthy individuals from other jurisdictions who are looking to locate in the relevant country where increased tax measures could both discourage

1 https://centrocepa.com.ar/files/informes/20200502-wealth-tax.pdf.
2 https://voxeu.org/article/progressive-european-wealth-tax-fund-european-covid-response.

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high net worth migrants from relocating to the jurisdiction or, in some cases, might create an incentive for such individuals to give up their residence.

If new measures of this character are proposed, it will be very interesting to see, in countries such as the UK or Italy that have special regimes for non-domiciliaries, how those regimes will be impacted, if at all, by tax-raising measures targeted at wealthy individuals.

Turning to estate taxes, one recent proposal that is worthy of note in the UK is a report published in January 2020 by a cross-parliamentary group of politicians that considered the UK's inheritance tax policy in the context of intergenerational fairness.[3] Notable conclusions from the report were to highlight the extent to which the UK's rule exempting gifts between individuals that occurred more than seven years before the death of the donor as allowing the very wealthy to mitigate their estate tax burden in a way that is not open to those of more modest means who do not have significant surplus to donate to future generations. The central proposal from the report was to scrap a 40 per cent inheritance tax burden levied on gifts occurring on death or within seven years with a flat rate 10 per cent tax that would apply to all gifts giving each individual a lifetime allowance for gifts that were exempt. Part of the thinking behind switching to a donee-based tax system is to encourage senior generations to make wealth transfers to younger generations (potentially from grandparents to grandchildren) in a manner that rebalances the distribution of wealth towards the young. While such measures are unlikely to be central in financing any deficits arising from the covid-19 pandemic in the short term, it will be interesting to see whether a flat rate tax, at a lower level, will find favour with policy makers in the UK. The thinking of the group issuing the report was that the overall unpopularity of the current regime, where taxes are levied on death could be overcome by one that is levied at a much lower rate and is applied uniformly to gifts during the lifetime as well as on death.

Another notable initiative from the EU that is likely to, potentially, impact private clients are the proposals incorporated within the sixth version of the EU Directive on administrative cooperation (DAC6). DAC6 aims to provide the tax authorities of EU Member States with additional information to enable them to close potential loopholes in tax legislation and harmful tax practices. Intermediaries advising on cross-border arrangements involving EU jurisdictions are obliged to report details of the arrangements and the relevant tax payers involved to their Member States who will share the information with other Member States' tax authorities. If there is no intermediary with an obligation to report, the relevant taxpayer will be obliged to do so. For the purposes of DAC6, an arrangement is interpreted very broadly and a cross-border arrangement is reportable if it concerns at least one EU member state and satisfies at least one of the hallmarks described in the Directive.

The hallmarks are very broadly worded and describe certain characteristics which, if satisfied, make the arrangement reportable. The majority of the hallmarks cover arrangements with some form of tax 'benefit' but there are specific hallmarks relating to arrangements that undermine the application of automatic exchange of information agreements such as the Common Reporting Standard and attempts to conceal beneficial ownership. A key concern with this particular hallmark is that the test appears to be wholly objective and the intentions of the parties are arguably not relevant. Intermediaries acting for high net worth individuals

3 www.step.org/sites/default/files/media/files/2020-05/STEPReform_of_inheritance_tax_report_012020.pdf.

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and their structures will need to consider the impact of these rules on any arrangements entered into that may concern one or more EU Member States.

Turning away from the tax arena, many jurisdictions have introduced measures during lockdown to facilitate the digital execution of documents, including wills. It will be interesting to see to what extent policymakers will be happy to allow such measures to prevail on a long-term basis. Historically, the very strict measures that prevail on the execution of wills are clearly designed as a protective measure to mitigate the impact of undue influence. It seems likely that such measures will become a permanent part of the overall landscape for the execution of wills going forward. In circumstances where wills are drawn up by professional advisers who have direct contact with a testator or testatrix without the intervention of family members, such measures could well be a welcome relaxation that will make it easier for individuals to make wills in the years ahead in circumstances where it is likely to be less easy to travel to meet, in person, with one's professional advisers for a significant period of time. Given that, in many circumstances, there is a significant degree of 'inertia' that stops individuals from engaging with estate planning, this can only be a welcome development.

In conclusion, we can expect a significantly changed paradigm to prevail to the planning arena for wealthy families in the months and years ahead once the primary crisis generated by the pandemic concludes. A key area of uncertainty at present is the extent to which enhanced tax measures will be targeted at the wealthy. The wider changes in business practice and greater use of video meetings could, however, provide something of a 'silver lining' in terms of making it easier for individuals to access reliable estate planning and succession advice and measures on digital execution could facilitate the easier execution of documents once that process is concluded. What is certain is that a combination of these various measures is likely to significantly impact the planning environment for wealthy families in the years ahead. It seems likely in this context in particular that the EU will become more assertive in its approach to wealthy individuals and their tax affairs as DAC6 is implemented.

John Riches
RMW Law LLP
London
July 2020

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Chapter 30

PORTUGAL

Mafalda Alves[1]

I INTRODUCTION

Although historically not a target country for wealthy individuals, Portugal has implemented structural reforms that have made it one of the best all-round jurisdictions for high net worth individuals to relocate to, in a whitelist-friendly tax environment.

Much of this success is down to the special programmes introduced to attract individual investors – the 'Golden Visa' Residence Permit Regime and the Special Tax Regime for Non-Habitual Residents – and the absence of wealth tax, gift and inheritance taxation on transfers between spouses, descendants or ascendants, exit tax, free remittance of funds and international trends. In addition, there is, of course, the reduced cost of living, public safety, healthcare system and climate, among other factors.

II TAX

i Personal income tax

An individual is liable to personal income tax (IRS) if he or she is deemed to be considered a resident in Portuguese territory, or, if not, if he or she derives income from a Portuguese source. Generally, a person is deemed to be considered tax resident subject to unlimited taxation if, in the year to which the income relates, he or she:

a stays there for more than 183 days, whether these days are consecutive or not, in any 12-month period commencing or ending in the year concerned; or

b has at his or her own disposal a dwelling place in such conditions that it may be inferred that there is the intention to keep and occupy it as a habitual abode.

Portuguese tax residents are subject to IRS on their worldwide income, on an unlimited liability basis. Non-resident individuals are subject to tax on the income obtained within Portuguese territory.

For IRS purposes, income is divided into six categories: A (employment income); B (business and professional income); E (investment income); F (real estate income); G (capital gains); and H (pensions).

Employment income, business and professional income, capital gains from the sale of property and pensions are subject to a progressive income tax rate of up to 48 per cent. A

1 Mafalda Alves is a partner at SRS Advogados.

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surcharge applies to the part of the income exceeding €80,000, as follows: 2.5 per cent on the part of income exceeding €80,000 and up to €250,000; and 5 per cent on the part of income exceeding €250,000.

Investment income (such as dividends, royalties and interests), real estate income (excluding capital gains from the transfer of real estate) and capital gains derived from the disposal of securities (such as shares, bonds, etc.) are subject to taxation at an autonomous final rate of 28 per cent.

Among other tax benefits, income regarding insurance policies, life assurance policies and pension funds schemes may be partially excluded from taxation whenever the amount of premiums, sums or contributions paid in the first half of the term of the contracts represents at least 35 per cent of the total.

ii Special tax regime for non-habitual residents

With the aim of attracting high net worth professionals, entrepreneurs and pensioners, Portugal has implemented an attractive tax regime for foreign individuals who wish to establish permanent or temporary residence in Portugal: the Non-Habitual Residents Tax Regime (NHR).

The major advantage of the NHR, and the one that makes it extremely attractive compared with similar regimes adopted in other European countries, consists of the introduction of a 10-year period during which Portuguese-source income received by individuals developing a high value-added activity is subject to a reduced flat tax rate, and some types of foreign-source income, namely capital gains or business profits, may be fully exempt from tax in Portugal, irrespective of remittance.

Specifically, with regard to foreign-source income, the regime provides for a tax exemption if certain requirements regarding the type of income and taxation in the source state are met. These conditions are as follows:

a Employment income: the exemption will apply to foreign-source income if this is taxed in the source state in accordance with a double tax treaty entered into between Portugal and that state, or, if no tax treaty has been entered into between both states, the income is taxed in the source state and is not considered to arise in Portuguese territory according to the domestic criteria.

b Profits, interest, income from immovable property, capital gains, business and professional income arising from high value-added activities that are of a scientific, artistic or technical nature, and royalties: the exemption will apply if the income or gains can be subject to tax in the other state under a tax treaty entered into between Portugal and that state. Alternatively, if no tax treaty has been entered into between Portugal and the source state, the exemption applies if, pursuant to the rules of the Organisation for Economic Co-operation and Development (OECD) Model Tax Convention, interpreted in accordance with Portugal's observations and reservations, the income or gains can be taxed in the source state, and provided that the income is not deemed to be sourced either in a blacklisted jurisdiction or in Portugal.

c With regard to foreign-source pension income, the exemption regime was recently discontinued for new situations. As a consequence, for new non-habitual residents, the exemption regime on foreign-source pensions was replaced by a 10 per cent flat rate taxation (applicable if the income is not considered to arise in Portuguese territory).

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An individual is eligible to register as a non-habitual resident (up until 31 March of the year subsequent to the one in which he or she became a tax resident) if he or she qualifies as a Portuguese tax resident pursuant to the Portuguese personal income tax code and has not been resident in Portuguese territory in the five previous years.

iii Special tax regime for individuals returning to Portugal

A new regime, non-cumulative with the NHR regime, was introduced in 2019 to encourage emigrants to return to the country.

The regime provides for a 50 per cent relief from taxation on employment or self-employment income received by individuals that become residents in 2019 or 2020, for a five-year period, provided that such individuals: (1) have not been considered tax residents in the three previous years; (2) qualified as tax residents before 31 December 2015; and (3) have their tax situation regularised.

iv Inheritance and gift tax

Gift taxes are due at a 10 per cent rate on assets physically or legally located within the Portuguese territory at the time of death or donation. A surcharge of 0.8 per cent of the taxable property value may be imposed on gifts or inheritance as far as they consist of real estate.

Gifts and inheritances in favour of spouses, descendants or ascendants are stamp duty-exempt.

v Wealth tax

There is no wealth tax in Portugal. However, the identification number of bank accounts held abroad must be disclosed in the annual income tax return.

vi Other taxes

The property transfer tax is levied on the onerous transfer of immovable property. The tax is payable by the acquirer, whether individual or company, resident or non-resident. The taxable amount corresponds to the higher of the contracted value or the tax patrimonial value.

The tax due is assessed as described above at the following tax rates:

- *a* rural property – 5 per cent;
- *b* urban property and other acquisitions – 6.5 per cent;
- *c* urban property for residential purposes – progressive tax rates (ranging from zero per cent to 8 per cent); and
- *d* rural or urban property when the acquirer is domiciled in a blacklisted jurisdiction – 10 per cent.

Local property tax (IMI) is levied annually on immovable property located within each municipality. The tax is payable on the taxable value by the owner of the property as of 31 December of each year, to be paid in one to three instalments, depending on the payable amount, in the following year.

The taxable value of urban property corresponds to the tax patrimonial value inscribed in the tax registry and is determined by reference to correcting coefficients.

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The property tax rates are:

a rural property – 0.8 per cent;

b urban property – 0.3 per cent to 0.45 per cent; and

c rural or urban property when the owner is domiciled in a blacklisted jurisdiction – 7.5 per cent.

The addition to IMI (AIMI) is levied on urban properties for dwelling purposes owned by individuals or companies, but individuals will not be taxed if the taxable value of its properties does not exceed €600,000. The tax rate is 0.4 per cent in cases of properties owned by companies and 0.7 per cent for properties owned by individuals (increased to 1 per cent for the amount of taxable value exceeding €1 million, and to 1.5 per cent on the part exceeding €2 million). The AIMI tax rate is 7.5 per cent when the acquirer is domiciled in a blacklisted jurisdiction.

vii Taxation of trusts

Despite not legally recognising trusts, Portugal has implemented the following rules on the taxation of trusts and other fiduciary structures:

a the income accumulated in the trust during its lifetime is not subject to tax at the level of the settlor or beneficiaries, unless controlled foreign companies (CFC) rules apply;

b distributions made during the lifetime of the structure, either to the settlor or to the beneficiaries, are considered as capital income for the full amount distributed (irrespective of its nature of capital or income) and are subject to a 28 per cent flat rate (that may be aggravated to 35 per cent in cases where the income is deemed obtained in a blacklisted territory); and

c at the moment of liquidation, revocation or termination of the structure:
   - if paid to the settlor or founder, qualifying as capital gains, being the taxable income equal to the difference between the amounts delivered to the trusts and the amounts received as it happens with common corporations, and subject to a 28 per cent rate (aggravated to 35 per cent in cases where the income is deemed to have been obtained in a blacklisted territory); and
   - if paid to the beneficiary or beneficiaries, deemed as transfer for free (donation or inheritance) subject to stamp duty (flat rate of 10 per cent), even if, according to the territoriality principle laid down in the Stamp Duty Code, only the assets located within the Portuguese territory would be subject to tax.

viii CFCs

CFC rules were introduced in the 1990s, aiming to combat international tax evasion, notably by means of accumulation of profits in low-taxation territories. Basically, CFC rules provide for the inclusion, in the taxable income of the resident companies and individuals that control foreign legal entities deemed domiciled in a blacklisted jurisdiction, of the undistributed passive income received by such entities.

A relevant control shall be deemed to exist where the Portuguese-resident taxpayer holds, either directly or indirectly, a corporate interest equal to or exceeding 25 per cent of the shares, voting rights or equity rights of the foreign entity or its financial assets, albeit via an agent, nominee, trustee or other intermediary.

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ix Double taxation treaties

In addition to Portuguese domestic arrangements that provide relief from international double taxation, Portugal has entered into double taxation treaties with 79 countries to prevent double taxation, 78 of which are already in force.

Under these treaties, withholding tax rates on outbound dividend, interest and royalty payments are reduced wherever the beneficial owner of the income derived from Portugal is a tax resident of the other contracting state.

Portugal is a signatory to the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting, the implementation of which impacts on the application of the existing double taxation treaties.

III SUCCESSION

i General features

Portuguese succession laws have remained fairly unchanged over the years, partly owing to cultural reasons, as succession is deemed a right of the family members of the deceased in respect of a continuum principle (where possession is retained by the family).

As in most civil law jurisdictions, the Portuguese succession legal framework is complex and characterised by strong limits to the right of free disposition *mortis causa* of one's property. Effectively, Portuguese succession law stipulates a forced heirship regime to protect the spouse, descendants and ascendants, ensuring these heirs from a third to two-thirds of the deceased's total assets.

The portion of the inheritance (deceased's estate) that is reserved for the legal heirs is generally safeguarded and cannot be affected by will or even (in most cases) by donations prior to death, as the assets could be reintegrated in the inheritance.

A distinctive feature about Portuguese succession is that the Portuguese regime only applies if Portuguese law is considered to be the personal law of the deceased at the time of death or will, independent of the location of the assets comprising the inheritance, both movable and immovable (universal succession).

For this purpose, Portuguese private international law stipulates that the deceased's personal law is considered to be the law of his or her nationality at the time of death or at the time of the celebration of the will, being of utmost relevance for the determination of the law applicable to the succession and all its regulatory aspects of distribution and administration of the assets comprising the inheritance, and for the determination of the capacity for and the interpretation of the will.

As mentioned before, the Portuguese succession regime did not keep pace with regulation and social changes related to marital status, being largely irrelevant for succession purposes, *de facto* unions or civil partnerships and matrimonial property schemes adopted or prenuptial agreements, as none of these situations can affect the reserved portion or change the hierarchy of heirship.

ii Wills

In Portugal, the most common forms of will are the public will (which is drawn up by a notary and archived in the notary's books, although remaining strictly confidential) and the private will (which is handwritten by the testator and its conformity with form requirements is then verified by a notary who issues the validation instrument).

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Any of the said wills are freely revoked, with special requirements applicable to the public will, which need to be done by a public (i.e., not confidential) deed.

Portuguese law states that any will would be valid in Portugal if the material requirements of Portuguese law are met, the disposition does not offend or limit the reserved portion of the legal heirs and if it is compliant with the laws of at least one of the following jurisdictions:

a the place where the will was concluded;
b the personal law of the testator at the moment of the declaration;
c the personal law of the testator at the moment of death; or
d the jurisdiction to which the local conflict-of-law rules refer.

Although not as common as any of the said wills, it is also possible to conclude an international will, according to the Convention providing a Uniform Law on the Form of an International Will, concluded in Washington, DC on 26 October 1973.

Finally, according to Portuguese law – and as far as it is the applicable law – the disposition by will of the deceased's assets as the limit stated regarding the rights and the reserved portion of the inheritance of the legal heirs.

IV WEALTH STRUCTURING AND REGULATION

The Portuguese succession regime is still very strict, leaving little room for the legal possibilities of estate planning. In addition, as most transfers on death are exempt from inheritance tax, and taxes levied on wealth are nearly non-existent in Portugal, no advance tax planning is necessary in most cases.

That being said, there are still some situations that may justify the structure of some legal entities (as private limited corporations or public limited companies) or civil entities. In some cases, and for some specific and mostly altruistic purposes, it could also be justified to create a foundation, although in this case the creation and the activity of the foundation is subject to administrative approval and regulation.

Following the transposition of Directive (EU) 2015/849, Portugal has introduced a central register of beneficial owners, under which the individual person or persons who, whether directly or through a third party, own or effectively control entities with legal personality subject to Portuguese or foreign law, and who conduct activities or carry out acts or legal business dealings in Portugal, must be disclosed. Entities subject to the register include associations, cooperatives, civil societies and commercial companies trusts, and other fiduciary structures.

i Trusts

As a classic civil law jurisdiction, Portugal does not regulate trusts or recognise the existence of trusts regulated by foreign law, and does not even refer to such entities, with a few exceptional situations:

a to allow the incorporation of offshore trusts within the scope of the Madeira International Business Centre and regulate the corresponding tax effects;
b in the context of the tax treaties entered into with the US and Canada, acknowledging the trusts as possible resident entities in such states, strictly for the purposes of the application of the treaty dispositions, under certain circumstances;

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c for anti-abuse purposes, to consider attributable to a Portuguese tax-resident individual the income obtained by entities domiciled in blacklisted territories irrespective of the distribution, in cases where the rights over the income are handled through a fiduciary entity; and

d to qualify the income arising from the distributions, liquidation, revocation or termination of the trust.

One consequence of this legal vacuum is that a Portuguese settlor who sets up a trust must respect Portuguese mandatory heirship rules. Any infringement of these rules can be challenged by the heirs of the settlor, and the assets transferred to the trust may be reduced accordingly.

ii Life insurance policies

As Portugal has become a very popular retirement location for foreigners, life insurance is proving to be an attractive wealth-planning tool, thanks to the flexibility granted to the policyholder (allowing for partly redeeming the policies, changing the beneficiaries and, in some cases, intervening in the management of the portfolio), high level of assets protection, and the very advantageous tax regime. From an income tax perspective, taxation of income generated in an individual's life insurance is deferred and should only be taxed in the event of redemption, early payment or maturity of the policy. Tax could only be levied on the net income generated by life insurance. The Portuguese personal income tax law establishes that provided that at least 35 per cent of the insurance premiums contractually due were paid during the first half of the contract's lifetime:

a only four-fifths of the income received is subject to personal income tax (meaning an effective tax rate of 22.4 per cent) if the payments are made under contracts that have been in force for more than five years and less than eight years; and

b only two-fifths of the income received is subject to personal income tax (meaning an effective tax rate of 11.2 per cent) if the payments are made under contracts that have been in force for more than eight years.

V OUTLOOK AND CONCLUSIONS

As a result of the tax reforms and programmes undertaken over the past few years, and other factors relating to economic, social and lifestyle aspects and political stability, Portugal is currently an extremely appealing country for wealthy individuals to have a foothold in, competing in this respect with other countries traditionally chosen for wealth-planning purposes. The NHR, along with the visa programmes, represented a major step forward, allowing for those who become tax resident in Portugal and are accepted as non-habitual residents the opportunity to receive some types of qualifying income tax-free in Portugal.

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Appendix 1

ABOUT THE AUTHORS

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Partner and head of the tax department at SRS Advogados since 2019, Mafalda Alves has vast experience in advising on domestic and international transactions, with a focus on tax litigation and in advising on corporate restructurings and individual asset transactions, real estate transactions and international tax law. She was Deputy Secretary of Portuguese State for Tax Affairs between 2013 and 2015.

Postgraduate in Taxation by the Lisbon Institute of Management, Mafalda also completed an Executive Program in International Tax Law by Leiden University – International Tax Centre.

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