

# Global Rewards Update: PORTUGAL

January 2010

## **NEW PERSONAL INCOME TAX (PIT) SYSTEM APPLICABLE TO "NONHABITUAL" PORTUGUESE TAX RESIDENTS**

### **BACKGROUND AND CURRENT PIT STRUCTURE**

On September 23, the Portuguese Parliament released new legislation impacting the PIT treatment of income realized by "nonhabitual" residents, and this legislation is effective retroactively to January 1, 2009. The term "nonhabitual" has not been incorporated in prior PIT legislation, and an individual's Portuguese PIT liability has historically been calculated based on their status as either a "resident" or "nonresident." An individual's residence status in Portugal is generally dependent on the number of days spent in Portugal and whether the individual/employee's residential accommodations suggest an "habitual residence" in the country.

The law in effect prior to the most recent announcement provided that a Portuguese resident's employment income, which includes all income realized from an employee share plan, was subject to Portuguese PIT whether the income was sourced to Portugal or not. In other words, any employment income earned by a Portuguese resident while working abroad remained subject to Portuguese PIT and the general income tax rates in effect. With respect to equity awards, under this rule, if the employee was a tax resident at the relevant point of taxation (e.g. at vesting of RSUs or exercise of options), all gains were subject to Portuguese PIT.

Alternatively, Portuguese nonresidents are only subject to PIT on that portion of their employment income that is sourced to Portugal. Further, where Portuguese nonresidents are liable for PIT, a flat tax rate (currently 20%) is imposed rather than the general income tax rates in effect. The new PIT legislation does not impact the PIT treatment applicable to Portuguese

nonresidents.

## **NEW TAX REGIME**

Under the new PIT legislation, only the Portuguese-source portion of a nonhabitual resident's employment income will be subject to Portuguese PIT. Additionally, this income will only be subject to PIT at the flat tax rate (currently 20%) rather than the otherwise applicable marginal income tax rates.

The new PIT legislation states that in order to qualify for nonhabitual PIT treatment, the individual/employee must:

1. Qualify as a Portuguese tax resident for the year in question, and
2. Have not been taxed as a Portuguese tax resident in any of the five preceding years.

In effect, nonhabitual residents will be subject to the same PIT treatment applicable to nonresidents for the year in which they are considered a nonhabitual resident and for the following 9 years (a total of 10 years of nonhabitual resident tax treatment).

### Foreign-Sourced Employment Income of Nonhabitual Residents

Foreign-sourced employment income of nonhabitual residents will be exempt from Portuguese PIT pursuant to the following conditions:

- The nonhabitual resident's foreign-source income is taxed according to a Double Tax Treaty entered into between Portugal and the relevant Contracting State, or
- The nonhabitual resident's foreign-source income is taxed in another country with which Portugal does not have a Double Tax Treaty, and the income is not considered to be Portugal-sourced. Separate Portuguese legislation will determine whether income will be considered Portugal-sourced in such a case...

While the foreign-source portion of a nonhabitual resident's employment income will be exempt from Portuguese PIT, such exempt income will be considered when determining the marginal tax rate applicable to any other Portuguese-sourced income obtained by the individual.

## **EMPLOYEE SHARE PLANS**

With respect to employee share plans specifically, the new inbound PIT regime states that:

- Income from employee share plans generated from pre-assignment duties is exempt

from PIT in Portugal, if the conditions applicable to nonhabitual residents mentioned above are met.

- All Portuguese-source income derived from share plans by a nonhabitual resident are liable to tax in Portugal at the flat tax rate of 20%.
- With respect to mobile employees, since Portuguese legislation does not explicitly provide a system for apportioning income between Portugal and another country, employers should look to the OECD Model Tax Convention criteria to apportion the employee's income to Portugal. As such, the number of days worked in Portugal over the grant to vest period should establish that portion of the employee's award income which is subject to Portuguese PIT.
- The apportionment rules apply to all employee equity award types.

### **EXAMPLE**

Assume the following facts:

- An employee is granted stock options prior to commencing an assignment in Portugal.
- The employee then moves to Portugal.
- While working in Portugal, the employee meets the criteria to be considered tax resident.
- The employee has not been considered a tax resident in Portugal for any of the preceding 5 years.
- The employee exercises their options while in Portugal.
- The employee has income, other than employment income, which is subject to PIT ("other income").

Under these facts, the employee may use the number of days worked outside of Portugal over the grant to vest period to calculate that portion of the gain which is exempt from Portuguese PIT. However, all income generated from exercise of the option award will be considered when determining the appropriate marginal income tax rate to apply to the employee's other income.

The Portuguese-source portion of the option income, computed in accordance with the number of days the assignee spent in Portugal, is subject to PIT in Portugal at the flat tax rate of 20%.

### **ACTION POINTS**

- The Portuguese tax authorities have not yet released new Personal Income Tax forms to accommodate nonhabitual resident filers. However, with respect to employment and pension income, the paper filing deadline is March 15<sup>th</sup> and the electronic filing deadline

is April 15<sup>th</sup>. With respect to all other types of income the paper filing deadline is April 30<sup>th</sup> and the electronic filing deadline is May 25<sup>th</sup>. If the tax authorities do not release new forms or regulations on how to obtain this preferential tax treatment (i.e., file as a nonhabitual resident), taxpayers will likely have to file as either resident or nonresident depending on the facts and circumstances of their individual cases.

- Since the new tax legislation is retroactive to January 1, 2009, employers should review their internal payroll systems now to ensure that they are able to adjust for the new tax treatment outlined above.

#### People to Contact

For assistance in this matter or any other issue related to the operation of your global rewards plans, please contact your local Deloitte global rewards consulting services advisor or email us at: **[globalequity@deloitte.com](mailto:globalequity@deloitte.com)** and a global rewards consultant will contact you.

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