

Article

Portugal: overview of foundations under Portuguese tax law

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ABSTRACT

Portuguese Foundations are relatively new in Portuguese legal history. In this article, the authors provide an overview of the main characteristics of Portuguese Foundations as well as their legal and tax framework. The fact that Portuguese law requires foundations to necessarily have a social or public interest purpose makes these legal entities unattractive and thus, in Portugal, they are rarely used for wealth protection purposes and in family estate planning (apart from bequests for charitable purposes). However, with the increase in the number of foreigners who have become tax residents in Portugal in recent years and who are either founders or beneficiaries of foreign foundations, Portugal had inevitably to adapt and in 2015 introduced specific provisions on the taxation of income from this type of legal entity.

INTRODUCTION AND LEGAL FRAMEWORK

The Foundation as a type of nonprofit organization is relatively new in Portuguese legal history. In fact, the first Civil Code to make reference to “foundations” in Portugal dates back to 1867.¹

According to the Portuguese Civil Code, foundations in Portugal are intended to fulfill purposes of social interest and can be established either by an inter vivos act (a duly authenticated deed, such as a public deed, which becomes irrevocable as soon as an application for legal recognition is filed) or by a will.

Since the establishment of a foundation diminishes the wealth of its founder, the Portuguese Civil Code also provides that forced heirs and creditors can oppose the creation of a foundation under forced heirship and creditor protection laws, respectively.

In its turn, under the terms of the Portuguese Foundations framework law² (*Lei-Quadro das Fundações*) which establishes the principles and rules governing foundations in Portugal, a

foundation is defined as a nonprofit legal person, endowed with assets deemed sufficient and irrevocably allocated to the foundation to ensure the pursuit of a purpose of social interest.

Although there are no strict limitations on the type of purposes allowed, as long as they are not illegal or immoral, the reality is that, according to the Portuguese legal framework, foundations in Portugal can be characterized by the fact that they must (i) be of social or public interest, which means that they must be exclusively dedicated to the interest of a general public and not exclusively to the interests of a particular person or family; (ii) be endowed with assets considered sufficient and adequate to pursue the purpose for which they were created³; (iii) their statutes must not be contrary to the law, public order or morality; and (iv) their legal existence depends on legal recognition, which can only be granted to entities with a social purpose.

Since foundations under Portuguese law must necessarily pursue a social or public interest, meaning that both the assets endowed by the founder to a foundation and the income

¹ Although information about the foundation sector in Portugal is still very scarce, according to the Portuguese Institute of Registries and Notaries (*Instituto de Registos e Notariado*), as of 2021, there were only 873 Portuguese foundations in Portugal, both private and public, following social or public interest purposes.

² The Portuguese Foundations framework law was enacted by Law no. 24/2012, of 9 July, duly amended by Law no. 67/2021, of 25 August.

³ According to article 22, no. 3 of the Portuguese Foundations framework law (*Lei-Quadro das Fundações*) and to articles 2 and 3 of Order no. 75/2013 of 18 February, and with the exception of foundations established with the aim of creating higher education institutions, for which higher amounts may be required, sufficient endowment is deemed to exist if the foundation's assets amount to at least €250,000.00, 30% of which must be in the form of cash and in any case at least €100,000.00.

generated at foundation level cannot be used for the private benefit of an individual or a family, there is little interest, unless the purpose is philanthropic for a family to set up a foundation under Portuguese law. Therefore these entities are rarely used in Portugal for asset protection and estate planning purposes within the family (apart from bequests for charitable purposes).

Finally, one should distinguish between public and private foundations according to the quality of its founders.

Public foundations are established on the initiative and within the framework of a legislative procedure with public funds and in pursuit of public interests, whereas private foundations are generally established by a private legal act (usually a public deed) on the initiative of one or more persons under private law (or also in conjunction with legal entities under public law, provided that the latter do not exercise a controlling influence over the foundation).

Among the private foundations, emphasis should be given to private foundations for social solidarity⁴ and to those with a public utility status⁵ as both can apply for certain tax benefits under the Portuguese law, which are also provided to their founders and donors.

FISCAL FRAMEWORK

In this context, it should first be mentioned that, under Portuguese law, there is no special tax regime that applies to entities organized as foundations. In general, foundations are taxed same as any other not for profit entities, such as civil associations.

They enjoy from the social solidarity or public utility statuses. In such case, the foundation shall be exempt from the following taxes: Corporate income tax on non business income (which in the case of a foundation with public utility status is not automatic, but rather depends on the prior acceptance by the Minister of Finances); VAT refund in some expenses; Stamp duty; Property tax (in relation to buildings or parts of buildings used directly for the fulfilment of their purposes); Property transfer tax (in relation to assets directly and immediately intended for the fulfilment of their purposes), and in certain situations, vehicle circulation tax (private foundations for social solidarity are exempt from circulation tax, provided that this exemption has been previously recognized by the Tax Office); and vehicle tax (some

vehicles purchased by private foundations for social solidarity or with public utility status also benefit from vehicle tax exemption, which is not automatic but rather depends on prior recognition).

TAXATION OF DISTRIBUTIONS AND INCOME OBTAINED FROM FOREIGN FOUNDATIONS

Considering that the legal framework in Portugal does not allow foundations to be created for the exclusive benefit of an individual or a family, traditionally resident families and individuals' have opted to established foundations in other civil law jurisdictions with the main purposes of wealth protection and estate planning.

In fact, with the increase in the number of foreigners who have become tax residents of Portugal since the non-habitual tax resident regime was enacted in 2009, the authors have observed an increasing number of cases in which Portuguese tax resident individuals are either founders⁶ or beneficiaries of foreign foundations.

Resulting from that trend, in 2015, Portugal enacted rules on the taxation of fiduciary structures, amending the provisions of the personal income tax code (hereinafter referred to as "PIT Code"). Although the concept of "fiduciary structures" is not defined by Portuguese law, it is broadly accepted that, besides *trusts*, the concept includes private foundations established under foreign law.

According to the Portuguese PIT Code, income from a trust structure upon its *dissolution, cancellation or extinction* is considered a capital gain if it is earned by a beneficiary who is also the founder and is taxed at 28% (or 35% in case that the income has its origin in blacklisted jurisdictions⁷). If earned by beneficiaries (who are not, simultaneously, the founder), these amounts are not subject to personal income tax (hereinafter "PIT") but to Stamp duty tax at a rate of 10%, levied on the beneficiary, as if the amounts were a gift, provided that the assets "gifted" are physically or legally deemed to be located in Portugal ("territoriality principle").

Whether or not the assets distributed in this context are deemed located in Portugal depends on the nature and location of the assets distributed to the Portuguese tax resident

⁴ Private foundations for social solidarity are set up exclusively at the initiative of private individuals, for the purpose of giving organized expression to the moral commitment to justice and solidarity and thus contributing to the realization of the social rights of citizens.

⁵ The public utility status can be attributed to foundations that: (i) pursue nonprofit purposes of general, regional or local interest and, in this regard, cooperate with the central, regional or local administration, that is, public entities; and that (ii) have been effectively active in one of the sectors provided for by law (which includes teaching, education, science, sports, culture, health, charity or beneficence purposes, etc.) for at least 3 years.

⁶ Whenever a Portuguese tax resident founder establishes a foundation stamp duty or CIT (corporate income tax) may be due in Portugal depending on whether or not the foundation is subject to CIT in its country of incorporation and whether the assets being transferred are deemed to be legally or physically located in Portugal. The transfer of assets by a Portuguese tax resident individual to a foreign foundation will be deemed a gratuitous transfer. As a rule, gratuitous transfers are subject to stamp duty in Portugal but only if the beneficiary of the gratuitous transfer is not a corporate entity subject to CIT and provided the assets being transferred gratuitously are deemed legally or physically located in Portugal (please refer to footnote 8 below with respect to assets deemed legally or physically located in Portugal for stamp duty purposes). Whenever the beneficiary of a gratuitous transfer is a CIT-taxable person, no stamp duty will be due in Portugal upon such gratuitous transfer, but CIT may be due. CIT rules establish that nonresident entities without a permanent establishment in Portugal are taxed on the income deemed herein located (unless Portugal's taxing rights are set aside by a double tax treaty concluded between Portugal and the country of residence of the nonresident entity). Regarding free transfers, they are considered located in Portugal for CIT purposes whenever they relate to:

- rights over real estate located in Portuguese territory;
- movable assets registered or subject to registration in Portugal;
- shares and other securities whose issuing entity has its head office or place of effective management in Portugal;
- industrial property rights, copyrights and related rights registered or subject to registration in Portugal;
- credit rights to entities with residence, head office or effective management in Portugal; and
- shares in companies that do not have their head office or place of effective management in Portugal, but whose assets are predominantly composed by rights over real estate situated in the said territory.

⁷ The list of jurisdictions deemed as blacklisted for Portuguese purposes is defined in Ministerial Order no. 150/2004, of 13 February 2004, as amended from time to time.

beneficiary (not simultaneously the founder) upon the foundation's liquidation (cash, shares, real estate, etc.).⁸

If the foundation's liquidation proceeds consists of moneys, as of January 2023, the gift is deemed located in Portugal, provided that the beneficiary is tax resident in Portugal. Therefore, stamp duty shall be due in Portugal at a rate of 10%, if the winding-up of a foreign foundation results in the distribution of cash values, regardless of whether such moneys are deposited or not with a bank, to a Portuguese tax resident beneficiary (which is not simultaneously the founder).⁹

In turn, amounts *paid or made available* to a Portuguese tax resident individual (be it the founder and/or a beneficiary who is not also the founder) which are *not linked to the liquidation (winding-up), revocation or extinction* of the structure, are considered *investment income*, and thus are generally subject to taxation at a rate of 28%¹⁰ (or a 35%, if the income originates in a black-listed jurisdiction), as long as such amounts have not yet been taxed under the Portuguese controlled foreign corporation (CFC) rules.

Portuguese tax resident individuals are subject to tax on their worldwide income earned in a given tax year, regardless of whether said income derives from Portuguese or foreign source (worldwide taxation principle). Moreover, in general, taxation is triggered by the income being received or the capital gain being realized by the individual. Consequently, as a rule, unrealized capital gains, undistributed income or the increase in value of an investment are not subject to tax in Portugal. The principal exception to that rule is the taxation in the hands of Portuguese tax resident individuals of undistributed profits or income obtained by nonresident entities, e.g. foundations, which are subject to a privileged tax regime under the above referred CFC rules.

In general, Portuguese CFC rules establish that the undistributed income of a non-resident entity which is subject to a more favorable tax regime is to be attributed to the Portuguese-resident taxpayer (individual or corporate) having a substantial interest in such entity (regardless of any effective distribution). This means that Portuguese CFC rules will apply, if a Portuguese tax resident has (a) *a substantial interest* in a nonresident company subject to a (b) *more favorable tax regime*—and these conditions are cumulative.

A “*substantial interest*” is given, when a Portuguese tax resident holds, directly or indirectly, including through a nominee

or any other form of fiduciary arrangement, 25% or more of the share capital, voting rights or rights to the income or to the assets of such entity, regardless of whether this person is the founder in the case of a foreign private foundation or, as is more frequently the case, a beneficiary.

The law does not define the term “*rights to the income or to the assets*”. Nonetheless, it can be said that a “right” is not equal to vesting but is certainly more than a mere expectation. Theoretically, it can also be of a purely economic nature, but should be combined with the power to exercise a relevant degree of control over the trust structure. Considering that the CFC rules are specific anti-avoidance and anti-deferral rules, the CFC rules should not apply where a taxpayer is not in a position to exercise any control over the entity. The question of whether the taxpayer exercises control is not limited to analyzing the terms of legal arrangements, but importantly, all the facts and circumstances (which must be proven by the tax authority).

Regarding the “more favorable tax regime” criteria, under Portuguese law a nonresident entity is considered to be subject to a more favorable tax regime if: (a) the entity is resident in a jurisdiction included on a “blacklist” issued by the Portuguese Ministry of Finance or (b) the tax effectively paid by the entity is less than 50% of what the entity would have effectively paid had it been resident of Portugal.

A private foundation whose place of effective management is not in Portugal is treated as a non resident in Portugal for corporate tax purposes. In such case, the CFC income shall be deemed located in the territory of the place of administration of the foundation, usually the jurisdiction of the registered offices of its (fiduciary) directors.

If CFC rules apply, the Portuguese tax resident founder or beneficiary shall be taxed on the proportionate share of their interest in the foundation income.¹¹ On the other hand, if CFC rules do not apply, the Portuguese tax resident founder or beneficiary may only be liable to tax on income from a Foundation which is actually distributed to him.

CONCLUSION

Portuguese law foresees and recognizes the institute of private foundation. Portuguese foundations are rarely used for wealth protection or estate planning since they cannot be used to pursue mainly a private purpose. However, it is increasingly

⁸ Under Portuguese law, the following assets shall always be deemed located in Portugal for stamp duty purposes:

- rights over movable assets and real estate located in Portugal;
- movable assets registered or subject to registration in Portugal;
- credits or economic rights relating to individuals or collective persons with residence, head office, effective center of management in Portugal, when the donee is also domiciled in Portugal;
- securities when the company has its residence, head office, effective center of management in Portugal and the donee is also domiciled in Portugal;
- cash assets and crypto assets deposited with institutions having their registered office, effective management or permanent establishment in Portugal or, if they are not cash assets or deposited crypto assets: (a) in case of deceased, when the transferor is domiciled in Portugal; (b) in all other free transfers, when the beneficiary is domiciled in Portugal; and
- rights over industrial property, authors and related rights registered or subject to registration in Portugal.

⁹ Whenever the beneficiary of a foundation is a forced heir of the foundation's founder, one may argue that, from a civil law point of view, the distribution from the foundation should be equivalent to an indirect donation, in which case a stamp duty exemption would apply (Stamp duty tax exemption applicable to spouses, civil partners, children and grandchildren of the donor).

¹⁰ Unless the founder or beneficiary of the foundation is subject to the nonhabitual tax resident (NHR) regime and the foundation is deemed located notably in the USA or Canada. In this exceptional case, the residual provision of the relevant double tax treaty (which relates to income distributed by trusts and foundations) grants the country in which the recipient of the income is resident (in this case Portugal) and the country from which the income originates (Canada or the USA), cumulative taxing rights, which means that the income received by a Portuguese resident from a distribution from a Canadian or US foundation can be exempt from taxation in Portugal under the NHR regime for as long as it lasts.

¹¹ The allocated amounts will be taxed in the hands of the Portuguese tax resident as net business or professional income (Category B income) at PIT progressive tax rates that vary between 13.25% and 48% (plus an additional solidarity surcharge of 2.5% or 5% depending on whether the income exceeds EUR 80,000 or EUR 250,000) provided the share capital or rights held in the foreign entity relate to a business or professional activity. Otherwise, the amounts will be taxed in the hands of the Portuguese tax resident as investment income at a rate of 28% (or at an aggravated flat rate of 35% if the CFC entity is deemed resident for tax purposes in a blacklisted jurisdiction).

frequent to come accros in Portugal with foreign private foundations, whose founders or beneficiaries individuals have taken up Portuguese tax residence in the last decade. In part to respond to that phenomenon, Portuguese tax law was amended in 2015 to provide for a specific regime on the taxation of foreign fiduciary structures such as trusts and foundations. Several rulings have since been published which have contributed to legal certainty in respect of the application of the regime. But relevant technical questions, especially in what concerns the application of the Portuguese CFC rules, await clarification by the Portuguese tax authority or the tax courts.

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