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Sun, sea and succession

Marta Costa TEP and Mariana Ferreira Tiago underscore how essential it is for advisors to review clients' existing succession plans when they relocate to Portugal, to identify and address potential conflicts with the country's civil-law system

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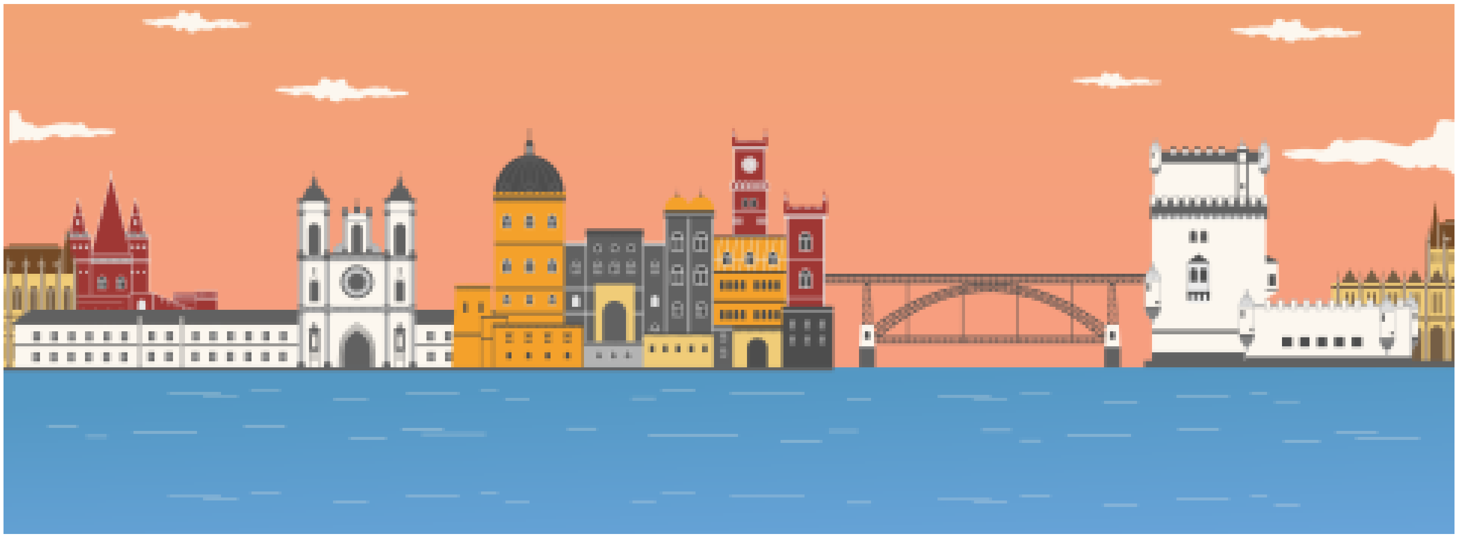

What is the issue?

Portugal can be an attractive destination for internationally mobile high-net-worth individuals, but they may face a civil-law and tax framework that diverges from common-law expectations.

What does it mean for me?

Without a pre-arrival review, families risk forced-heirship claims, reduction of prior dispositions and unexpected tax exposure, including possible double taxation on gratuitous transfers and unfavourable trust outcomes.

What can I take away?

Plan early with local counsel: elect the governing succession law, align wills and estate documents, confirm tax-residence triggers and implications, assess controlled foreign company (CFC) and blacklist exposure and map trust structures against Portuguese law and tax treatment.

Relocating to Portugal introduces a conflict-of-laws dimension that internationally mobile families sometimes underestimate. Under *EU Regulation No.650/2012*, cross-border successions are, by default, governed by the law of the deceased’s habitual residence at the time of death.

Where the habitual residence is Portugal, it means dealing with strict forced-heirship provisions. Under Portuguese law, a substantial portion of the estate (between one-half and two-thirds) must pass to the surviving spouse, descendants and, sometimes, ascendants. Testamentary freedom is therefore limited, as only the remaining portion of the estate may be freely allocated.

> ***Where Portuguese law applies unexpectedly, it may lead to court-ordered reductions of prior dispositions, delays in estate administration and complications for heirs and advisors.***

Families often relocate to Portugal without revisiting estate-planning arrangements established in other jurisdictions. As a result, if no choice of law has been made, Portuguese law may become applicable by virtue of habitual residence and may prove incompatible with those arrangements. Difficulties often arise after death, where lifetime gifts or testamentary dispositions exceed the disposable portion of the estate. In such situations, heirs can demand reduction of those gratuitous transfers that infringe the reserved shares. These adjustments can be complex, costly and lengthy.

For this reason, it is often advisable to elect the law of nationality, in a valid testamentary instrument, to govern one's succession, particularly where that law offers greater testamentary freedom, as is often the case in common-law jurisdictions. Alternatively, individuals may accept the application of Portuguese law, review any lifetime gifts or testamentary arrangements that could infringe the reserved shares and seek advice to structure the estate plan accordingly, using planning tools recognised under Portuguese law (e.g., *usufructs*,[1] *fideicommissary* substitutions,[2] irrevocable powers of attorney and unit-linked life insurance).

The key point is that existing estate-planning arrangements should not be assumed to remain fully effective after relocation. Failure to review and coordinate those arrangements in light of applicable private international law rules is a common pitfall. Where Portuguese law applies unexpectedly, it may lead to court-ordered reductions of prior dispositions, delays in estate administration and complications for heirs and advisors.

Being resident in Portugal

An individual is considered tax resident if they spend more than 183 days in Portugal within a 12-month period, or if they maintain a dwelling in Portugal in circumstances suggesting that it is intended to serve as a habitual residence, a criterion that is often overlooked.

Once tax residence is established, individuals are taxed on their worldwide income, regardless of whether it arises in Portugal or abroad. Some families relocating to Portugal assume that only locally generated income will be taxed, when, in fact, worldwide income may fall within the Portuguese tax net. Portugal nevertheless maintains an extensive network of double taxation treaties on income to mitigate international double taxation.

Portuguese taxation is generally triggered when income is received or a capital gain is realised. Unrealised gains or undistributed profits are typically not taxed. An important exception concerns the controlled foreign company (CFC) rules, under which undistributed profits of entities in low-tax jurisdictions may be attributed to Portuguese resident shareholders.

Under the standard regime, employment, business and pension income are taxed at progressive rates ranging from 12.5 per cent to 53 per cent, while passive income is generally taxed at a flat rate of 28 per cent. However, passive income sourced in blacklisted jurisdictions may be taxed at a rate of 35 per cent.

Portugal has introduced a new inpatriate tax regime, the *Incentivo Fiscal à Investigação Científica e Inovação* (IFICI). Eligible individuals who become tax resident in Portugal and carry out qualifying activities for qualifying entities may benefit from it for ten years. Under this regime, Portuguese-sourced employment income derived from eligible activities is taxed at a flat rate of 20 per cent, while most foreign-sourced income may be exempt from Portuguese personal income tax. However, eligibility is sometimes misunderstood, and individuals should carefully verify the requirements early in the relocation process.

Taxation of wealth transfers

Even where a succession is governed by the law of another jurisdiction, Portuguese tax law still applies if the estate includes assets legally or physically located in Portugal (e.g., real estate located in Portugal or bank accounts held with a Portuguese bank or a foreign bank with an office in Portugal).

Portugal does not levy a traditional inheritance or gift tax. Gratuitous transfers are instead subject to stamp duty or corporate income tax, depending on the beneficiary. Transfers of Portuguese assets to individuals are generally subject to stamp duty at 10 per cent, but transfers to spouses, descendants and ascendants are exempt. Gifts of Portuguese real estate to these relatives remain subject to stamp duty at a rate of 0.8 per cent on the tax value of the property.

> ***Advisors often recommend establishing a Portuguese will dealing specifically with assets located in Portugal, as it cannot be assumed that such assets will be treated in the same way as assets held through trust structures in common-law jurisdictions.***

Although this framework is often perceived as favourable, practical issues frequently arise in cross-border situations. Portugal is not a party to any double taxation treaties on inheritance or gifts. As a result, a beneficiary receiving Portuguese assets may face additional taxation in their country of residence on the gratuitous transfer, in addition to Portuguese stamp duty.

Additional tax consequences may arise on estate division. A common scenario is when several heirs inherit an estate including real estate, and the property is allocated to one heir who compensates the others in cash. The Portuguese Tax Authority treats the heir receiving the property exceeding their real estate entitlement as purchasing the real estate, applying municipal property transfer tax and stamp duty on the excess value. The heirs receiving cash may be treated as disposing of real estate, potentially triggering capital gains tax if the value attributed to the property exceeds its tax value at death.

Foreign trusts

Outside the Madeira Free Trade Zone, trusts are not recognised as a legal institution under Portuguese civil law. Notably, Portugal is not a signatory to the *Hague Convention on the Law Applicable to Trusts and on their Recognition*. As in most civil-law jurisdictions, Portuguese law does not recognise the division between legal and beneficial ownership found in common-law trust structures.

A common scenario involves individuals relocating from common-law jurisdictions with existing trust structures already in place. Advisors often recommend establishing a Portuguese will dealing specifically with assets located in Portugal, as it cannot be assumed that such assets will be treated in the same way as assets held through trust structures in common-law jurisdictions. A local will helps ensure that the transfer of those assets is clearly addressed and that estate administration proceeds smoothly under Portuguese procedures. However, all testamentary instruments must remain properly coordinated and the governing law of succession should be clearly stated and consistent across all wills.

Although trusts are not recognised for civil-law purposes, Portuguese tax law acknowledges their existence, providing a framework for the taxation of income and gains derived from ‘fiduciary structures’, including trusts.

Under these rules, distributions made by fiduciary structures to Portuguese tax-resident individuals are generally treated as investment income unless they arise from liquidation, revocation or extinction of the structure. In such cases, the tax treatment depends on the recipient: if received by the settlor, the amounts are treated as capital gains; if received by a non-settlor beneficiary, they are treated as gratuitous transfers subject to stamp duty at a flat rate of 10 per cent where the assets are deemed to be located in Portugal.

Portuguese tax law may also attribute income of certain foreign structures to Portuguese tax residents under the CFC rules. In practice, undistributed income of a trust established in a low-tax jurisdiction may be taxed annually in the hands of a Portuguese tax-resident settlor or beneficiary. Whether a trust falls within the CFC regime requires a case-by-case analysis, considering the level of control retained by the settlor, the trustee's powers and the rights of the beneficiaries.

Trusts remain one of the most complex areas of cross-border planning for individuals moving from common-law jurisdictions to Portugal.

Portugal may offer sun, sea and an attractive lifestyle, but for internationally mobile families, careful succession and tax planning before relocation is essential.

- [1] *A civil-law term that refers to the right of an individual to use and enjoy property that is vested in another.*
- [2] *A civil-law term relating to a fiduciary's obligation to transmit the whole or part of an inheritance to a second fiduciary when certain conditions are met.*

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