Portugal: Non-discrimination and access to domestic law incentives for individuals in the residence state

João Félix Pinto Nogueira[1]

1 – Introduction

Nowadays, each country tries to position itself as a competitive jurisdiction in the international scenario. Portugal is not an exception and has lately become a very attractive jurisdiction in particular in what concerns (wealthy retired) individuals.

There are several non-tax reasons behind this such as the excellent weather, the low cost of living, the peacefulness (besides absence of internal territorial tensions, our country is not seen as a likely target of future terrorist attacks) and the friendliness of our people. And the gastronomy… we should always highlight this issue.

Lately, there are also sound tax reasons. We have recently approved a regime for non-habitual tax residents[2]. Any individual moving its tax residency to Portugal may qualify, if not resident here in the previous 5 years. Provided that all the conditions are met, a partial or full exemption of the taxpayer's income will be available.

This regime is boosted by pension clauses included in some of our treaties, attributing exclusive tax jurisdiction to the Residence State. The combination of the conventional regime with this domestic regime for non-habitual tax residents may lead to reduced or non-existing double non-taxation. Currently benefiting from this are several (wealthy) individuals from central and northern European countries that, after their retirement, move to Alentejo or Algarve (south of the country).

Some countries have "denounced" this situation and even threaten to terminate their tax treaties with Portugal[3]. Some treaties have even been renegotiated. In the meanwhile, this opportunity is still possible for taxpayers of some countries, who keep moving their residency to our country. These taxpayers are normally quite well informed of their tax position and bring new challenges to our tax authorities, not used to deal with foreign taxpayers or in foreign languages.

The case *sub judicio* is an example of the new challenges faced by Portuguese tax authorities and courts. It is not about the non-habitual resident regime in itself but concerns the use of domestic tax incentives by non-residents.

2 – Facts of the case

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[1] Adjunct to IBFD's Academic Chairman. Visiting Professor at the Universidade Católica Portuguesa (Lisbon and Oporto, Portugal) and at University of Cape Town, Cape Town, South Africa. The author can be contacted at joaofelixpintonogueira@gmail.com.
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[2] Introduced by Decree-Law 249/2009, 23 September.

[3] On 19 February 2016, Finland's Ministry of Finance started the process for possible termination of the tax treaty with Portugal, signed in 1970. One of the reasons is the possibility of double non-taxation for finish that move their residency to Portugal, taking advantage of the non-habitual resident regime. For more information see: http://online.ibfd.org/kbase/#topic=doc&url=/highlight/data/tns/docs/html/tns_2016-02-19_fi_3.html&q=finland+portugal+termination+finlands+portugals+terminations&WT.z_nav=Navigation&colid=4913.

2.1 Introduction

Our taxpayer is Else, a Norwegian national born in 1942. At a certain point in time (not mentioned in this case, she moved her tax residency to Portugal.

This case concerns her liability to personal income taxation in Portugal in 2005. In that year, her sole income was a pension, paid by the "*NAV*", the Norwegian body responsible for the payment of public pensions due by disability and old age to Norwegians resident abroad. Before the disability pension, Else was a teacher in Norway[4].

The gross amount of her pension was NOK 287 052,00 which, at the time, was equivalent to EUR 35.299,32. It seems that this was the sole income obtained by Else. In Norway, an amount of NOK 10 397,00 was withheld at source[5]. The amount and nature of the pension (as public pension due to a 100% disability) was confirmed by the embassy of the Norwegian Kingdom in Portugal[6].

Else submitted her tax return and, in the first assessment received, all her income had been considered exempt. On 2009, and following an audit, the tax authorities considered that at least part of her income should be taxed in Portugal and issued an additional tax assessment. All this case flows from that additional assessment.

2.2 Legal framework

In Portugal, residents (regardless of their nationality) are taxed on their worldwide income[7]. There are no different rules for the computation of the tax base if the income is derived from foreign sources.

Disabled taxpayers may benefit from a partial exemption of personal income tax (PIC)[8]. In the case of retired people with a 60% or more invalidity coefficient, 30% of their income is exempt (with a ceiling of EUR 7 777,74)[9]. If the invalidity coefficient is equal or above 80%, the afore mentioned ceiling is be raised by 15% (to EUR 8 945,55)[10]. According to domestic law, the coefficient of disability needs to be determined by the "competent entity"[11]. As mentioned, this case occurred before the enactment of the non-habitual resident regime mentioned in the introduction and thus, it is not applicable.

At the conventional level, there was a tax treaty in force between Portugal and Norway[12]. This treaty is already not in force, as a new treaty was meanwhile signed[13]. The

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[4] We assume that, at a certain point, her health status has changes and Else was no longer able to continue to perform her duties and teacher in Norway.

[5] Section II.1, letter N of this decision.

[6] Letters from 6 May 2005, 10 September 2008 and 28 December 2009, referenced in the decision and annexed to the procedure.

[7] See PT: Código do Imposto sobre o Rendimento das Pessoas Singulares – CIRS [Personal Income Tax Code - PITC], 1989, art. 15(1). If nothing else is mentioned, all references to domestic legislation or treaties are referred to the norms that were in force at the moment of the facts.

[8] PT: Estatuto dos Benefícios Fiscais – EBF [Statute for Tax Benefits – STB], art. 16.

[9] Art. 16(1)(b) STB.

[10] Art. 16(5) STB.

[11] Art. 16(4) STB *in fine*.

[12] Convention between the government of Norway and the government of Portugal for the avoidance of double taxation with respect to taxes on income and on capital, signed on 24 June 1970. See Norway – Portugal Income and capital Treaty (1970), Treaties IBFD.

[13] Convention between the Portuguese republic and the Kingdom of Norway for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income, signed on 10 March 2011. See Norway – Portugal Income and capital Treaty (2011), Treaties IBFD.

following provisions were claimed by at least one of the parties: Art. 18, 19 and 24. As none of them match with any of the model's wording, we will now refer specifically to them.

Article 18, entitled "pensions" states that "[s]ubject to the provisions of paragraph 1 of article 19, pensions and other similar remuneration paid to a resident of a Contracting State in consideration of past employment shall be taxable only in that State". This rule attributes exclusive taxing rights to the paying state for all income derived from pensions, apart from the items covered by Art. 19(1).

Article 19, devoted to "public remunerations, etc" states in its paragraph 1: "Remuneration, including pensions, paid by, or out of funds created by, a Contracting State or a local authority thereof to any individual, in respect of services rendered to the first-mentioned State or local authority thereof may be taxed in that State. 2. The provisions of articles 15, 16 and 18 shall apply to remuneration or pensions in respect of services rendered in connection with any trade or business carried on by one of the Contracting States or local authority thereof". Thus, and as an exception of the previous article, public pensions may be (cumulatively) taxed by source and residence state.

Lastly, Art. 24 ("non-discrimination") states "1. The nationals of a Contracting State shall not be subject in the other Contracting State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which nationals of that other State in the same circumstances are or may be subjected." Paragraph 2 of this provision further defines what should be considered as "national". Individuals are considered "nationals when "possessing the nationality of a Contracting State"[14].

The method chosen for the relief of double taxation in what concerns pensions was the ordinary credit method[15].

2.3 Pleadings of the parties and procedures before this court's decision

On 2009, tax authorities considered that at least part of Else's income would be taxable in Portugal.

Firstly, claimed that there was no real evidence, neither of the amount nor of the nature of the pension. Second, claimed that regardless of its nature, Portugal – as residence state – could always tax pensions under both Art. 18 and 19 of the applicable tax treaty: i) under Art. 18, as it attributes exclusive taxing rights to the residence State; ii) under Art. 19 (in case it would be considered as a public pension) as it attributed cumulative taxing rights to source and residence state. Finally, tax authorities considered that the exemptions foreseen for these cases in Norwegian domestic law would not be applicable in Portugal.

Else considered that all her income should be exempt in Portugal and complained to the competent administrative authority, which maintained the additional assessement. She appealed to the first instance court ("*Tribunal Administrativo e Fiscal de Loulé*") which revoked the additional assessment and considered that all her income should be considered exempt[16].

The "Fazenda Pública" appealed of that decision on the following grounds. Firstly, claimed that the applicable allocation rule was not Art. 18(1) but 19(1) of the applicable treaty since it was a public pension. Pursuant that article, Portugal had taxing rights over that income. Secondly, argued that despite the applicability of Art. 24 of the tax treaty and Art. 16

[14] Art 24(2) Norway – Portugal Income and capital Treaty (1970), Treaties IBFD.

[15] Art. 23(1) Norway – Portugal Income and capital Treaty (1970), Treaties IBFD.

[16] The text of the case does not provide more elements in what concerns the reasons why the first instance court took that decision.

of the Statute for Tax Benefits, the exemption foreseen in Portuguese domestic law was only a partial exemption.

Else claimed that the applicable allocation rule was Art. 18, which granted exclusive taxing rights to the source State. This conclusion was "entirely confirmed" by the new text of the treaty[17]. In subsidiary order, taking into account her disability and pursuant Art. 16 of the STB read in conjunction with Art. 24 of the applicable treaty, all her income should be considered exempt.

3 –Decision of the Court

The decision was rendered on the 4th of June 2015 by the second section of the south central administrative court[18].

The court started clarifying that Else was a resident and, thus, taxed on all her worldwide income. The pension income received would thus be taxed under domestic law.

Secondly, acknowledged the applicability of the tax treaty. Under that treaty, the income would fall under Art. 19(2), granting cumulative taxing rights to both residence and source state, *i.e.*, Portugal and Norway.

In what concerns the exercise of its taxing rights, the court considered applicable Art. 24(1) of the applicable treaty (which had been also invoked by the taxpayer). From that analysis, it concluded that the taxpayer would be entitled to the treatment as granted by domestic law for disabled people. It is somehow difficult to ascertain fully the reason why it considered Art. 24 applicable. In the court words " [I]f nationals of a Contracting state shall not be subject in the other contracting State to any taxation or any requirement connected therewith, which is other or more burdensome than those that are applicable to nationals of that other Contracting State, what is then stated by the Statute for Tax Benefits, in the version resulting from Law 32-B/2002, 30th December, as in force when the facts took place?"-

It is not entirely clear the value attributed to Art. 24. From the wording it seems that the court makes the application of our domestic tax regime for disable people dependent on this non-discrimination clause although that is never explicitly mentioned.

Finally, the court considered that the STB regime for disabled people would be applicable and thus the taxpayer would not be taxed on her full income but only partially (as an amount of 30% with a ceiling of EUR 8 945,55[19]). Thus, an amount of EUR 26 283,77 would be liable to personal income tax, following the domestic rules.

Accordingly, the court revoked the first instance decision and upheld the additional assessment of the tax authorities.

4 – Comments on the Court's reasoning

"To no one will we sell, to no one will we refuse or delay, right or justice" is one of the commands established the Magna Charta, 1215[20]. Eight centuries later, we continue to face issues in what concerns the time it takes to have a decision, in our judicial system. The

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[17] The taxpayer is referring to the treaty signed in 2011, several years after the facts of the case in discussion.

[18] PT: SCAC, 4 June 2015, 05768/12.

[19] This would be the result of applying the coefficients as set out by domestic law. The original ceiling was EUR 7 778,74. As the disability was of 100%, that limit would be increased by 15% bringing it up to EUR 8 945,55 (7 778,74 + 0,15*7 778,74).

[20] Clause 40 of the Magna Charta, 1215.

final decision on this case – which does not amount more than a straightforward application of the applicable treaty – took more than 10 years. One judicial appeal, one administrative complaint and several clarifications by the taxpayer were needed.

The main outcome of the decision is correct. The income received by Else should be considered as a public pension and framed under Art. 19, which grants cumulative taxing rights to both source and residence states. Portugal is entitled by domestic and treaty law to tax all that income and then it should credit eventual foreign paid tax.

The treaty was signed in 1963 and, in its outcome, Art.s 18 and 19 is pretty similar to the one used on the OECD MC[21]. There are, nonetheless, some noteworthy nuances.

In both MC and actual treaty, Art. 18 clearly admits the precedence of Art. 19. And Art. 19 clearly establish a different allocation rule for public pensions. In the latter article, whereas the 1963 OECD model convention uses the expression "governmental services" the 1971 treaty uses the expression "public remuneration, etc". This deviation seems not to be relevant at the case in hand. Firstly, as the expression "public remuneration" (and specially when suffixed with etc) seems to be even broader than "governmental services". Secondly, because in the relevant criteria is, for both model and treaty, that the income is paid out of funds by or created by a Contracting State. Thirdly, since the safeguard provision of Art. 19(2) does not apply, since we are before a disability pension, and thus unrelated with any trade or business[22].

The 1963 OECD MC commentaries do not provide any further guidance. But even if we took an ambulatory approach, the conclusion would be the same. Para 5 of the OCDE MC explains that the deletion in 1977 of the expression "in the discharge of functions of a governmental nature" – which already had not been included in our 1971 treaty with Norway – was due to the perception by some states as broadening the scope of the article. So, and again, this approach would lead to the same result.

It is curious to note that none of the parties attributed any relevance to the fact that the pension was not paid by the State but by the NAV (an agency paying disability pensions to non-residents). In our view that is irrelevant as long as this NAV is a public creation. In 2005 the commentary was revised and now clarifies that "the expression 'out of public funds created by' (…) covers the situation where the pension is not paid directly by the State, a political subdivision or a local authority but out of separate funds created by a government body. In addition, the original capital of the fund would not need to be provided by the State (…). The phrase would cover payments from a privately administered fund established for the government body"[23].

One outstanding issue in the decision is the complete absence of reference to relief. From the text of the decision (especially in a segment that transcribes the declaration from the embassy) it seems clear that Else supported tax in Norway. That being the case, Else would be entitled to an ordinary tax credit of that amount into her liability in Portugal, following Art. 23(1) of the applicable treaty[24]. For the sake of clarity, a similar system (ordinary tax credit) is available under domestic law, regarding foreign-sourced amounts[25]. One wonders

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[21] OECD Model Tax Convention on Income and on Capital (1963), Models IBFD.

[22] In our opinion, the link that matters is the disability. That is the genetic cause of this pension and not the exercise of the profession as teacher.

[23] See Para. 5.2 OECD Model: Commentary on Article 19 (1963), Models IBFD.

[24] That reads "[w]here a resident of Portugal derives income which in accordance with the provisions of this Convention, may be taxed in Norway, Portugal shall allow as a deduction from the tax on the income of that person an amount equal to the income tax paid in Norway. Such deduction shall not, however, exceed that part of the Portuguese tax, as computed before the deduction is given, which is appropriate to the income taxed in Norway."

[25] Currently, art. 81 of our PITC.

whether this was just forgotten or if Else failed to provide sufficient evidence of the tax paid in Norway.

But the most puzzling part of this decision concerns the application of Art. 24(1) of the treaty. Given the wording of the decision, it seems implicit that Art. 24(1) is legitimizing the application of our domestic tax regime for disabled people. This is not the case. As most modern systems, our system only differentiates between residents and non-residents. Within these categories, nationality is irrelevant (and not even implicitly or explicitly mentioned in the law).

One may only wonder if the judges, faced with the allegation of this Article, had doubts regarding its meaning within our tax system. Art. 24(1) and (2) of the applicable treaty mirrors the text of the 1963 OECD Model. One should start noting that the insertion of this clause is common practice in international public law and similar wordings are used in non-tax treaties. But, apart from academic and /or remote situations, it is difficult to understand the rationale of the article within a tax framework. The 1963 OECD MC Commentary seems to clearly indicate that this article is only applicable when the tax system discriminates on the basis on nationality. Which is not the case, when it comes to Portuguese tax law.

When reading the summary of the case, we thought that Art. 24 had been invoked in connection with the proof of disability. We thought that the taxpayer had no medical record in Portugal and wanted to claim her Norwegian certificates in order to obtain the Portuguese beneficial treatment for disabled individuals. Which would actually make more sense since, as tax systems are not harmonized within the EU, each system has different requirements and asks for a different set of documentation (even when grating very similar tax advantages). But, and even if that was the case, Art. 24(1) would not grant her the desired protection.

Before addressing the issue, it is adequate to briefly describe the Portuguese procedure for claiming the beneficial treatment for disable people. The "competent entity" is the Directorate-General for Health and the procedure was regulated by Decree-Law 202/96, of 23 of October[26]. By petition of the individual, a special medical appointment ("*junta médica*") would take place and a collective of medical doctors would – based on direct examination and on the historic of medical exams – would determine the coefficient of disability. The criteria and modus operandi of the examination is fully set by domestic law[27]. The individual should communicate the results of that examination to his /her general practitioner ("*médico de família*") at the local health centre ("*centro de saúde*") before going to the local tax office ("*serviço periférico de finanças*") where this certificate would be registered and the information would be added to the taxpayer profile. It should be highlighted that the criteria to ascertain the coefficient of invalidity – even if following international guidance – are set by domestic law.

Nothing is mentioned in the text of the decision and we wonder whether Else followed all these procedures before the end of 2005. In case she did, then the decision is right and Else should be entitled to the tax benefit. If not, then we believe that Art. 24(1) of the applicable treaty would not be of any use.

Firstly, because what really matters for Art. 24(1) are cases of direct discrimination[28]. And in this situation, nationality is never used as criterion for the entitlement to the benefits.

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[26] Which was later revoked by PT: Decree-Law 291/2009, of 12th of October. This Law established a new model for the "medical certificate of multi-purpose disability", approved by an Order (PT: Despacho 2643/2009, of 20th November).

[27] For more information see: http://www.dgs.pt/autoridade-de-saude-nacional/atestado-medico-de-incapacidade.aspx.

[28] See N. Bammens & F.J.G.M. Vanistendael, *Article 24: Non-Discrimination - Global Tax Treaty Commentaries*, Global Tax Treaty Commentaries IBFD, Section 2.1.3.2.

All residents, regardless of their nationality, would need to obtain this certificate and to register them next to their local tax office.

Secondly because, and even if we adopted a broader concept of discrimination (encompassing also indirect discrimination – as within the European Union)[29], there would be no discrimination at all. There is no universal criterion to set the coefficient of disability of a taxpayer. As a consequence, and as the criteria and its assessment procedure varies, the coefficient determined under a jurisdiction may not match with the coefficient that would be attributed to that same taxpayer in another jurisdiction. Even if the exam would be performed in the very same day and by the same set of doctors[30] the result could have had been different.

Finally, even within the EU, there is no general acceptance of the mutual recognition principle (at least in no harmonized areas)[31]. Which means that certificates and other documents recognized in a Member State do not immediately recognized as such in another Member State. As there is no harmonization, Member States can set different criteria or even different procedures for obtaining a certain benefit. The results obtained in one country are no guarantee that the same will be obtained in another country. The same holds true *a fortiori* in tax treaty cases.

5 – Conclusions

At this moment we could highlight very different features of the case. But we would like to reserve this conclusion to the function and meaning of Art. 24(1)[32]. In this case, the non-discrimination clause of the tax treaty is argued as a tool to ensure national treatment of the taxpayer (in the sense that taxpayer, when entering and when inside the market of another Member State should be given the freedom to enter that market and the same conditions of national market players)[33].

Art. 24(1) is specially target to cases of direct discrimination. And especially within the EU and EEA[34] these cases are very rare if even existent at all, at least in tax matters. More than 30 years since the first decision in direct tax matters[35], Member States are quite aware of the prohibition to discriminate based on nationality or similar criteria. In this case, national treatment is already ensured by domestic law. And domestic law does not entail any discrimination between individuals based on their nationality.

At least in the EU and EEA context one may wonder what is the real meaning of a clause such as Art. 24(1). It is rather odd to conventionally prohibit "nationality non-

[29] About the differences, see N. Bammens & F.J.G.M. Vanistendael, *Article 24: Non-Discrimination - Global Tax Treaty Commentaries*, Global Tax Treaty Commentaries IBFD, Section 4.

[30] Which, of course, is a purely academic hypothesis.

[31] On this topic, and in the framework of charities, see Hemels, S.J.C., *Are we in need of a European charity? How to remove fiscal barriers to cross-border charitable giving in Europe*, 37 Intertax 8/9 (2009), p. 424-435.

[32] Of the applicable treaties or, of the UN / OECD Model.

[33] Of course, we are not in a "market scenario" since the taxpayer is retired, but *simile modo* the same reasoning applies.

[34] We should bear in mind that Norway is part of the Agreement on the European economic Area, published in the OJ n.º L 1, at 3 January 1994, p. 3 and in the EFTA State's official gazettes.

[35] FR: ECJ 28 Jan. 1986, Case C-270/83, Commission / France, ECR 1986 p. 273, (SVVIII/00389 FIVIII/00407) ECLI:EU:C:1986:37.

discrimination” in tax systems that already do not entail any distinction based on nationality. Which basically means that the ultimate meaning of this provision, if one does not consider its historical context, will be very odd for most of our tax judges and will continue to puzzle them throughout Europe and eventually the world. For this and other reasons, one should re-think whether this provision should continue to be inserted in treaties between countries in the EU and EEA area.