Taxation of life insurance surrender regarding contracts concluded in France or Luxembourg by a Non-Habitual Resident

Life insurance is generally used as a financial investment.

It is a type of savings product that allows the holder to receive interest on the capital invested at the end of the contract.

In case of death of the insurance holder before termination, the contract expires, and the designated beneficiaries receive the capital + interest.

There are also insurance policies that guarantee the risks of disability (incapacity for work), accidents and unemployment, and for which the applicable tax rules are the same that apply for "classic" life insurances.

In Portugal, income from the surrender of a life insurance contract - which corresponds to the positive difference between the invested amount and the received amount at the time of the surrender - is considered as capital income (category E) and is taxed at the rate of 28%.

There are tax benefits regarding these incomes if the amount of premiums/contributions paid by the holder during the first half of the contract represents at least 35% of the total invested. In this case:

a) 1/5 of the income will **not** be taxed if the surrender occurs between the 5th and 8th year of the contract;

b) 3/5 of the income will **not** be taxed if the surrender occurs after the first 8 years of the contract.

As an example:
A contract signed in 2000 with an initial contribution of 100,000 euros, reinforced with 50,000 euros in 2005 and the surrender is made in 2020.
In the middle of the contract (in 2010), we have more than 35% of the capital invested (in fact, we already have the total) and the surrender is made 8 years after signing the contract. In this case, 3/5 of the income is excluded from taxation and, consequently, only 2/5 of the income will be taxed.

For this reason, it will always be more interesting to deposit a large amount of capital at the beginning of the contract and wait at least 8 years before the surrender.

These Portuguese tax rules also apply if the life insurance contract was concluded in another country, such as France or Luxembourg, for example.

Therefore, the question relies on knowing the respective tax impact on people benefiting from NHR status in Portugal.

It should be recalled that the interests and dividends received by an NHR with source in France or Luxembourg may be exempt from taxation in Portugal (provided that they may be taxed in the country of origin as determined by the Double Taxation Agreement - DTA concluded between the two countries).

However, the definition of interests or dividends established by the DTAs concluded with France and Luxembourg does not expressly provide for the income resulting from the surrender of a life insurance contract (probably because these types of products did not exist at the time the DTAs were concluded).

This means that, according to the terms of the DTAs, these incomes will be considered as "other capital income" and, consequently, taxed in the country of residence, in this case Portugal, at the rate foreseen for this type of income which is 28%.

Therefore, in theory, the surrender of a life insurance does not benefit from the exemption provided for in the NHR regime for interests and dividends (it may, without prejudice, benefit from exclusion from taxation under the terms set out above, provided that the respective requirements are met).

However, the main issue focuses on the choice of the category in which this income will be declared in the IRS tax return in Portugal.

Category E (capital income) includes, among others, interests, dividends and other capital income.

In practical terms and adopting a more liberal position, it is possible to consider that the income obtained after the surrender of a life insurance contract corresponds to the interest calculated on the invested capital during the contract and can, as such, be declared in the subcategory "interests" of the Portuguese tax return (and not in the category "other capital income"), in order to benefit from the exemption under the NHR statute.

However, it is important to point out that there may be a subsequent control by the Tax Authority which may request all the documentation associated with the declared capital income and, possibly, reclassify the income in the category of "other capital income" and submit them to a 28% taxation.

A final note on the taxation of life insurance income:

It should be noted that the capital paid to the beneficiary in the event of death or accident of the contract holder is exempt from taxation in Portugal (as opposed to the surrender), including with regard to the Stamp Duty, even if the beneficiary is not the ascendant or descendant of the deceased (this is an exception to the implementation rule of the Stamp Duty).

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