



Tax & Business Lawyers

NEWSLETTER

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TAXATION OF PRIVATE PENSION PLANS – PPR (I)

The increase in life expectancy and the decline in birth rates have placed significant pressure on Portugal's Social Security system, prompting the need for structural solutions such as raising the statutory retirement age and promoting private pension schemes.

RFF Lawyers is now launching a series of three articles aimed at exploring alternatives and supplementary mechanisms to the State Social Security pension, of which this is the first edition.

Private Clients Team



INTRODUCTION

Currently, due to increased life expectancy and various sociological factors that have led to a decline in birth rates, we are witnessing a significant change in the age composition of the population. The “very elderly” segment of the population is the one that has grown the most in the Western world. In Portugal, the number of people aged 80 or over has doubled in just two decades, and this number is expected to double again by 2060.

The direct consequence of the increase in the retirement-age population, especially when compared in percentage terms with the working-age population, is a problem of sustainability for Social Security. In Portugal, the old-age pension provided by Social Security is compensation for the remuneration earned throughout working life, granted monthly to pensioners through contributions to the social protection system. However, pressure on this system has led to the need to find solutions to ensure its sustainability.

Faced with pressure on Social Security, two main solutions have been put forward: raising the retirement age and reducing the value of old-age pensions. In addition, growing participation by citizens in private pension systems is anticipated, as is the case in the United States, where the system is predominantly private.

In this context, RFF Lawyers signed the article entitled “Taxation of private pension schemes: alternatives and complements to Social Security old age pensions” published by Almedina. This article addresses the taxation of private pension schemes in Portugal, highlighting alternatives and supplements to the Social Security old-age pension, including the Retirement Savings Plan (PPR), Pension Plans through Membership of a Pension Fund, and Capitalization Insurance.

We have prepared a series of three articles/newsletters addressing each of these topics, this being the first.

RETIREMENT SAVINGS PLANS (PPR)

The Retirement Savings Plan (PPR) plays a crucial role in citizens' financial planning for retirement, directing capital towards medium and long-term savings, meeting financial needs in retirement and contributing to the development of the capital market. The current legal framework for PPRs is consolidated by Decree-Law No. 158/2002 of 2 July, with subsequent amendments.

THE MANAGEMENT OF SAVINGS FUNDS

The management of savings funds is assigned to specific entities, in accordance with their nature and form of incorporation. Securities investment fund management companies, pension fund management entities and insurance companies authorised to operate in the 'Life' sector are responsible for managing savings funds. Management must ensure risk diversification, security, financial return and ease of conversion of investments made. In the event of a substantial change in the fund's investment policy, the management company must notify each participant individually, giving them the option of transferring the value of their savings plan to a fund other than the original one, free of charge.

APPLICABLE TAX BENEFITS

Repayments from PPRs are taxed according to the rules applicable to income in categories H (pensions) or E (capital), depending on the repayment method chosen. Refunds made in the form of regular and periodic instalments are taxed according to the rules of category H. In the event of total or partial refunds, including those made in instalments over a period not exceeding ten years, the income is taxed according to the rules of category E, observing the following:

- ✓ The taxable amount consists of two-fifths of the income obtained
- ✓ Taxation is autonomous, at a rate of 20%.

In cases of reimbursement through a mixed method (initial single payment followed by regular and periodic instalments), taxation shall be carried out according to the rules of category E for the initial payment and according to the rules of category H for subsequent instalments.

REIMBURSEMENT CONDITIONS

PPR reimbursements are subject to specific conditions to promote medium and long-term savings. PPR holders may only request reimbursement in the following cases:

1. When the participant reaches retirement age due to old age
2. In the event of prolonged unemployment of the participant or any member of their household
3. In the event of permanent incapacity for work of the participant or any member of the household

4. In situations of serious illness affecting the participant or any member of their household
5. After the participant reaches the age of 60
6. To settle instalments on credit agreements secured by a mortgage on property intended for the participant's own permanent residence.

EARLY REPAYMENT

Early repayments of PPRs, outside of legally permitted situations, result in the loss of tax benefits. In these cases, the amounts deducted from tax, increased by 10% for each year or fraction thereof since the right to deduction was exercised, must be added to the income tax for the year in which the early repayment occurred. In addition, the income earned will be taxed separately at a rate of 21.5%, in accordance with the rules applicable to category E income for personal income tax purposes.

If the amount of the payments made in the first half of the plan's term represents at least 35% of the total payments, they are excluded from taxation:

- ✓ One-fifth of the income, if repayment occurs after five and before eight years of the contract term
- ✓ Three-fifths of the income, if repayment occurs after eight years of the contract being in force

The tax benefits established in the Tax Benefits Statute (EBF) also apply to payments made by employers on behalf of and in favour of their employees.

CONCLUSIONS

Retirement savings plans are an important tool for long-term financial planning, offering significant tax benefits and flexible repayment options. However, it is crucial that participants are aware of the conditions and tax implications associated with repayments, especially in cases of early repayment.

Joining private pension schemes, such as PPRs, can therefore be a viable solution to supplement Social Security old-age pensions, contributing to financial sustainability in retirement.

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