



Tax & Business Lawyers

NEWSLETTER

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TAXATION OF PRIVATE PENSION PLANS – PENSION PLANS THROUGH MEMBERSHIP OF PENSION FUNDS (II)

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 second 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” which was published by Almedina and can be found at [\[insert link\]](#). 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.

RFF Lawyers has prepared a series of three articles/newsletters addressing each of these topics, this being the second.

PENSION FUNDS

Pension funds are financial instruments that finance one or more pension plans. These funds are managed by specialised entities that invest participants' contributions in various financial assets, with the aim of obtaining returns that will be used to pay pensions in the future. Professional and diversified investment management can provide greater security and growth potential for accumulated savings.

Open Pension Funds

Open pension funds are financial instruments that allow anyone or any entity to subscribe, provided they are accepted by the managing entity. There is no need for a prior relationship between the parties, which makes these funds accessible to a wider audience. The flexibility of open pension funds is one of their main advantages, allowing individuals and companies to join according to their needs and retirement savings goals.

Closed Pension Funds

Closed pension funds, on the other hand, are intended for a specific group of participants who have a prior connection, such as employees of a particular company or members of an association. These funds are established to provide pension benefits exclusively to members of that group, based on collective agreements or internal policies of the sponsoring entity.

Closed pension funds are often used by companies that wish to offer additional benefits to their employees as part of a compensation and benefits package. Contributions to these funds can be made by both the company and the employees, depending on the conditions established in the pension plan.

One of the advantages of closed pension funds is the possibility of tailoring plans to the specific needs of the group of participants. In addition, companies can benefit from exemptions from social security contributions and consider the amounts as a tax expense, while employees can benefit from tax exemptions and deductions.

In sum, both open-ended and closed-ended pension funds offer distinct advantages and can be chosen based on the needs and circumstances of participants. Open-ended funds provide flexibility and accessibility, while closed-ended funds allow for greater customisation and tax benefits for companies and employees.

THE CLASSIFICATION OF PENSION PLANS

Pension plans can be classified according to the guarantees established:

- ✓ **Defined Benefit Plans:** Benefits are predefined and contributions are calculated to guarantee these benefits, varying according to biometric and financial risks
- ✓ **Defined Contribution Plans:** Contributions are predefined and benefits are determined based on the amount of the contributions and accumulated income

- ✓ **Mixed Plans:** They combine features from both defined benefit and defined contribution plans

Plans financed by closed pension funds or collective membership of open pension funds may be of any type, while those financed by individual membership of open pension funds may only be defined contribution plans.

FINANCING METHODS

Pension plans can be financed in two ways:

- ✓ **Contributory Plans:** Participants contribute to the plan
- ✓ **Non-Contributory Plans:** The plan is financed exclusively by the member, as a company whose beneficiaries are the employees

In defined benefit plans, where participants' contributions are mandatory by law or by collective labour regulation, the non-contributory plan regime must be followed, with participants not qualifying as contributors.

THE TAX BENEFITS OF PENSION PLANS

Pension plans that meet the criteria set out in (Article 18 of) the Tax Benefits Statute (EBF) may benefit from tax exemptions, and contributions made by the company may be exempt from income tax for the employee.

CONDITIONS FOR TAX EXEMPTION

In order for contributions made by the company to be exempt from income tax for the employee, the following conditions must be met:

- ✓ The benefits must be established for all permanent employees of the company or through a collective labour agreement
- ✓ Benefits must be established according to objective criteria that are equal for all workers
- ✓ At least two-thirds of the benefits in the event of retirement, disability or survival must be paid as a monthly cash benefit for life
- ✓ The conditions for early retirement and the general social security scheme must be complied with in relation to age and the beneficiaries of the corresponding benefits

- ✓ The management and disposal of expenses should not be carried out by the company itself, and insurance contracts should be concluded with insurance companies established in Portugal or authorised to operate in the country

EXEMPTION LIMITS

The tax exemption applies to a limit of up to 15% of employee expenses recorded as remuneration, wages or salaries. This limit may be increased to 25% if employees are not entitled to social security pensions. These limits are set to ensure that tax benefits are proportional to contributions made and to prevent abuse of tax exemptions.

THE CONSEQUENCES OF NON-COMPLIANCE

Failure to comply with the above conditions will result in the loss of tax exemption and consequent taxation as category A income for personal income tax purposes, plus 10% for each year or fraction thereof from the date on which the contributions were made. For the company, non-compliance will result in separate taxation at a rate of 40% in the financial year of non-compliance with contributions for that year and the two previous years.

Furthermore, the tax benefits established in the EBF also apply to payments made by employers on behalf of and in favour of their employees. Therefore, it is crucial that companies and employees are aware of the conditions and limits established to ensure compliance and avoid tax penalties.

CONCLUSIONS

The taxation of private pension schemes, namely Pension Plans through Membership of Pension Funds, is a relevant complementary solution to the challenges of social security sustainability in Portugal. The diversification between open and closed pension funds, the possibility of personalising plans and the associated tax benefits represent significant incentives for companies and workers who wish to ensure greater financial stability in retirement.

However, compliance with the established requirements, particularly those set out in the Tax Benefits Statute, is essential for maintaining tax advantages and avoiding severe penalties. Therefore, the correct implementation and management of these plans require careful analysis by companies, employees and specialised consultants, in order to ensure that the economic and social benefits associated with these supplementary pension instruments are maximised.

In a context of increasing demographic ageing, private pension systems, properly regulated and taxed, are an indispensable tool in building a more sustainable and financially balanced future for all stakeholders.

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