



Tax & Business Lawyers

# NEWSLETTER

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## TAXATION OF PRIVATE PENSION PLANS – CAPITALISATION INSURANCE (III)

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 third and final edition.

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Private Clients

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## INTRODUCTION

Currently, due to the increase in life expectancy and a range of sociological factors that have led to a decline in birth rates, there has been a significant shift in the age composition of the population. The segment of the population comprising the “very elderly” has been growing most rapidly in the Western world. In Portugal, the number of individuals aged 80 or over has doubled in just two decades, and it is forecast to double again by 2060.

A direct consequence of the growth in the population of retirement age, particularly when compared on a proportional basis with the working-age population, is the challenge it poses to the sustainability of the Social Security system. In Portugal, the old-age pension provided by Social Security constitutes compensation for remuneration earned throughout an individual’s working life and is paid monthly to pensioners who have made contributions to the social protection system. However, the increasing pressure on this system has made it necessary to identify solutions to ensure its long-term sustainability.

In response to this pressure on Social Security, two main solutions have been put forward: increasing the statutory retirement age and reducing the amount of old-age pension. In addition, a growing take-up of private pension arrangements is anticipated, as is the case in the United States, where the system is predominantly private.

In this context, RFF Lawyers authored the article entitled *“Taxation of Private Pension Schemes: Alternatives and Complements to the Social Security Old-Age Pension”*, published by Almedina and available at [insert link]. This article examines the taxation of private pension schemes in Portugal, highlighting alternatives and supplements to the Social Security old-age pension, including Retirement Savings Plans (PPRs), Occupational Pension Plans through Pension Funds, and Capitalisation Insurance Policies.

RFF Lawyers has therefore prepared a series of three newsletters addressing each of these topics, of which this is the third.

## CAPITALISATION INSURANCE POLICIES

Capitalisation insurance policies are versatile and adaptable tools for retirement planning, offering a wide range of investment options tailored to the individual needs of each investor. These products may be taken out through various channels, including insurance companies, banks and financial intermediaries, ensuring broad accessibility for policyholders.

One of the key features of capitalisation insurance policies is the flexibility regarding the level of capital protection. Some products offer a full capital guarantee, while others include a risk component, potentially allowing for higher returns but also exposing the investment to

market fluctuations. This diversity enables investors to tailor the product to their risk profile and specific investment objectives.

In addition, capitalisation insurance policies are particularly attractive to those who favour a single-premium investment approach, allowing for a one-off initial investment without the need for ongoing contributions over time. This simplicity and convenience are especially appealing to investors seeking to streamline their retirement savings strategy and minimise the administrative burden associated with regular contributions.

## THE TAX REGIME

Capitalisation insurance policies are, as a rule, subject to taxation by way of withholding tax at source, at a final flat rate of 28%, without prejudice to the option to elect for aggregation. Withholding tax at source means that the income arising from capitalisation insurance policies is taxed at the time of payment, with the flat rate being withheld by the paying entity and remitted to the Portuguese Tax and Customs Authority.

The 28% flat rate may apply to the entirety of the income received, depending on the duration of the contract at the time of redemption, advance payment or maturity of the capitalisation insurance policy:

- ✓ **Before the fifth year of the contract's term**, the rate applies to 100% of the income
- ✓ **Between the fifth and the eighth year**, the rate applies to 80% of the income, with 20% exempt from taxation, provided that the premiums paid during the first half of the contract term represent at least 35% of the total premiums paid
- ✓ **After the eighth year of the contract's term**, the rate applies to 40% of the income, with 60% exempt from taxation, provided that the premiums paid during the first half of the contract term represent at least 35% of the total premiums paid

## THE OPTION TO ELECT AGGREGATION FOR TAX PURPOSES

At the time of filing the annual Personal Income Tax (IRS) return, taxpayers may opt to aggregate the income derived from capitalisation insurance policies with other income received from different categories. In this case, the aggregated income will be subject to the progressive IRS rates applicable to the taxpayer's taxable income bracket.

Electing for aggregation entails the inclusion of all income from the same category, such as interest and dividends. This option may be advantageous for taxpayers whose overall income places them in lower tax brackets, thereby allowing for a more favourable taxation of the income arising from capitalisation insurance policies.

It should be noted that capitalisation insurance policies are not free from risk, and investors should be fully aware of potential market fluctuations and the specific terms and conditions of the contract before making any investment decision. When assessing their options, investors should carefully consider their financial needs and investment objectives, ensuring that they select the product most suited to their individual circumstances.

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