"IRS": Aggregate vs Autonomous Assessment

BACKGROUND

When reporting income from Investments, Capital Gains (other than real estate) and long-term Rentals, taxpayers have the option to choose between two methods of reporting on their Portuguese "*IRS*" tax declaration:

1) Autonomous (at a flat rate of 28%) or
2) Aggregate (assessed together with other income at marginal rates).

In 2016, the option for aggregation can be applied differently in each category of income, unlike before where an "*either-or*" choice was universal.

AGGREGATE INCOME

Different sources of income are normally added together with the sum total being used to determine the progressive tax rate.

a) **"Top-Slicing"**

A consequence of this method is that each additional source of new income "*top-slices*" onto others with the net effect of being taxed at a higher rate.

b) **Aggregation of Exempt Income**

Another potential effect occurs when exempt income must be used to determine the rate of taxation. Foreign income that is exempt by treaty from Portuguese assessment (such as government service salaries and pensions) must be included to determine the tax rate of the remaining income. In other words, the change in jurisdiction does not "*reset the clock"*. Portuguese taxation simply takes up where other income left off (*top-slicing*).

Example: Mr. Smith is paid a UK "Old Age" pension of €12,000 that is now taxable in his country of residence, Portugal. He alsoreceives a Military pension of €10,000, taxed at source in the UK according to the rules of the Double Tax Convention. When reporting, his Military Pension is not taxed in Portugal but his Old Age Pension is now taxed between €10,000-€22,000 (where the Military pension leaves off) rather than from €0 - €12,000.

AUTONOMOUS OR FLAT RATE ASSESSMENT

Another option is to be assessed at a flat rate of 28%, independently from other income sources.

a) Withholding at Source

Some income sources are assessed at source. Typically, this assessment is seen as final, meaning that the income need not be reported on the "*IRS*" Tax Declaration. For example, Interest and Dividends, when paid by Portuguese banks or companies, undergo a 28% withholding tax (*"taxa liberatória"*). Normally, this assessment is final.

b) Autonomous taxation

The taxpayer can choose independent taxation on other income sources. Capital Gains from the sale of stocks and shares have final flat-rate tax of 28% when taxed apart from other income. In other words, there is no top-slicing effect on the remainder of income.

NOTE: *Antonymous assessment also means that tax credits do not apply. These credits only count with aggregate reporting.*

c) Reporting Options

Taxpayers may elect either Aggregate Assessment or Flat Rate Taxation. This is the case with Interest and Dividends received from within the EU. It is preferable to determine which method is more beneficial. If one's overall tax rate falls below the flat rate of 28%, aggregation may prove to be the more favourable option.

NON-RESIDENTS

While the above rules apply to those *Resident for tax purposes* in Portugal, *Non-Residents* have a more straightforward situation. Whatever the source of income, any withholding tax is seen as a final payment and requires no further reporting to *Finanças*. If no withholding takes place, 25% autonomous taxation is the norm.

CAPITAL GAINS ON MOVEABLE ASSETS

This change has a particular impact on the taxation of capital gains. The 2015 IRS Reform extended the reporting of losses to five years with aggregate reporting. Before, losses only counted for two years. Now, those carrying forward capital losses can do so for 5 years while maintaining unchanged the standard 28% rate applicable to other income in a given year. The new rules allow taxpayers with effective rates of IRS of less than 28% to pick and choose between which tax rate is more beneficial within each category of income.

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