



USING OPERATORS FOR LOCAL LODGING

While some Owners create their own bespoke site to publicise their Local Lodging offering, most rely on the major web sites that have become popular in recent years. However, not all of these Operators work in the same way. The nature of their business can influence the way the activity is classified by the tax Authorities. While not always of direct concern to Owners, there are basic Double Tax Treaty issues that are important to understand.

Tax Treaty Doublespeak

These international agreements are not written in plain English and are not easily understood at first glance. While some people may be misled into thinking that Local Lodging might fall under “Income from Immoveable Property” (because of underlying letting), the article defining “Business Profits” is the relevant one. It is the overall commercial nature of tourism plus the fact that the short-term offerings are open to the general public that are applicable. All commercial activities have their base in what is call a “*Permanent Establishment*”, a fixed place of business which gives rise to taxable income in a particular jurisdiction. In general, it could be an office, a factory, etc. In the case of Local Lodging, it is the property. If a business has permanent establishments in more than one country, the rule to follow is that only associated income in a given jurisdiction is assessable therein. Instances of double taxation are normally eliminated through international tax credits. Let us look at concrete examples to understand why this point proves to be pivotal.

Situation n° 1 - Assignment of Operation

Through a local administrative “*permanent establishment*”, a company such as *James Villas* operates in the UK where it pays tax. It also leases villas from Owners and then offers the accommodations to holidaymakers as Local Lodging in Portugal.

Rented villas are also considered a permanent establishment in Portugal under Double Tax Treaty rules and lead to tax liabilities in Portugal on net profits.



Finally, the Property Owners are seen as conducting an *Assignment of Operation* (“*Cessão de Exploração*”). Classified as “*tourism leasing*” from assigned immovable property for onward tourist operations, this type of business activity (CAE 68200) falls under the Simplified Regime where it has 5% exclusion. Assessment on the remaining 95% is at 25% for non-residents and at marginal rates for resident owners.

Situation nº 2 - Local Lodging

Unlike *James Villas*, a company like *Owners’ Direct* does not rent accommodation either from Owners or to Tourists. They offer support or “*conciierge*” services to the Owner’s Local Lodging activity: advertising. They make it very clear that holidaymakers are letting accommodation directly from Owners (hence the company’s name). Thus, *Owners Direct* does not have a permanent establishment in Portugal and owes no Portuguese tax. The Owners must be registered in Category B in Portugal under Tourism and enjoy an 85% exclusion. Final tax is <4% for non-residents.

	<u>Support Services</u>	<u>Local Lodging</u>
Airbnb	Yes	No
Booking, Ltd.	Yes	No
James Villas	No	Yes
Lowcost Holidays	No	Yes
Owners’ Direct	Yes	No
Thomas Cook	No	Yes
Vacasol	Yes	No
Villaplus	No	Yes

Portuguese-based Agencies and Managers

The same basic principles apply to Portuguese-based Tourist Agencies and Property Managers using booking services from major web sites. Income from immovable property is attributable to business and professional activities and is also considered to be in Category B.



When conducting support services to a tourist business that are eventually carried out in the name of the Owner, a charge is made. Whether this is a fixed amount or a percentage does not influence the nature of the activity nor how it is assessed. In the 2014 tax year, this type of business can take advantage of 90% exclusion under the Simplified Regime of IRS that typically reduces final tax to $\pm 1\%$. In 2015, the exclusion is 65% with the remaining being the taxable amount. Owners continue to benefit from the highly favourable tax regime in Category B (an 85% exclusion).

“Change is Constant”

While it is only human to resist change and carry on “business as usual”, evolution to compliance under Local Lodging legislation is so favourable that migration to the new system can only be seen as a “win-win situation”.

Example

A local holiday letting agency invoiced €500,000 in gross rentals under IRC at a final tax rate of 21% on an underlying charge of 20%. The Company then paid dividends to the owner/operator that were assessed at 28%. Nearly half of the proceeds were swallowed up in taxes.

The Proprietor of the Agency switched to Category B, “Other Service Activities”, under the Simplified Regime in IRS. Invoicing 20% (€100,000) to Property Owners based on the same volume of gross rentals, he is able to take advantage of the IRS Simplified Regime exclusion of 65%, leaving a taxable income of just €35,000. A final tax of €8,000 is due as opposed to almost €50,000 before.

At the same time, the total tax bill to the Company’s group of Property Owners dropped considerably. Definitely another win-win situation. While the State may be perceived to be the loser, this is not the case. In the past, with less than 10% of Local Lodging establishments reporting and paying income tax and VAT, any move encouraging general compliance increases net tax revenues appreciably.

Conclusion

Unless the Owner assigns a property for onward Local Lodging operation, it is no longer possible for an Owner to report commercial income under Category F (*long-term Rental Income*). Tourism-based income is commercial, not residential, and must be reported in Category B. (Line a, n^o2, Art.3, CIRS)



If Owners are conducting the Local Lodging business, they invoice holidaymakers directly under CAE 88201 in Category B and enjoy an 85% exclusion on gross invoiced income. The balance is taxed at 25% for non-residents and at marginal rates for residents.

If the Owner *assigns* the tourist activity to an Operator (*Cessão de Actividade*), he still normally declares income to the Portuguese Tax Authorities in Category B. However, in this case, reporting is under CAE 68200 (*Income from Real Estate*) with only a 5% exclusion in the Simplified Regime. Tax is due on the remaining 95% at 25% for non-residents and at marginal rates for residents. Alternatively, he can report “*locação turisica*” (tourism leasing) under Category F. In this case, the normal tax rate is 28%. Prior simulations can determine which method is preferable.

In summary:

- a) The property must be duly registered under *Decree Law 128/2014 of 29/08*;
- b) Owners must named in invoices using Electronic Green Receipts (to Holidaymakers or to the Operators, respectively).
- c) Immigration reporting (“*SEF*”) is also mandatory. When the Owners conduct the Local Lodging business, they assume responsibility for reporting foreign guests. When the Operators manage the tourist activity, they become accountable to “*SEF*”;
- d) Annual IRS income tax returns submitted including annex B or annex F depending on which method was used.

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