



Capital Gains Tax and Asset Allocation in Category B

Aaron and Bobby: an illustration

Potential Capital Gains Tax liabilities have caught by surprise many owners engaged in Local Lodging when using privately owned property in a sole trader business activity. As scary as it may sound in theory, the practice is generally far more benign in most cases as we can see in the following illustration.

Underlying the tax treatment of the *allocation of an owner's asset to a business activity* is the difference between the *transfer of a property* (transferência onerosa), representing a change of ownership or conveyance of property rights, giving rise to Capital Gains assessment, versus a *transformation of usage* of a property or the alteration of a property's utilisation from residential to commercial (or visa versa), which does not trigger CGT. (*CIRS Article n°10*)

Example n° 1: Aaron

Aaron buys an apartment in Portugal for €100,000. He and his family use the flat when on holiday. After 10 years, he sells the property for €110,000, realising a gross gain of €10,000. As a non-resident, he is liable for Capital Gains Tax in Category G at the rate of 28% after deducting allowable expenses and adjusting for inflation.

Example n°2: Bobby

Bobby also buys a flat for the same purchase price of €100,000 at the same time. Five years later, he decides to let his apartment to holidaymakers (Local Lodging). Bobby registers as a *Sole Trader* under Category B, exercising a tourist activity (CAE 55201) in the Simplified Regime. Because he uses the apartment for his tourist



accommodation business, he must declare the allocation of the asset (*afetação*) and its market value – now appraised at €105,000 – on his Portuguese “IRS” income tax return in Annex B. Although the asset has now changed use from residential to commercial, there is no transfer of ownership. No Capital Gains Tax arises at this point.

Another 3 years pass and Bobby resolves to stop letting and use the property again for family holidays. He declares the current market value: €108,000. The €3,000 gain occurs under Category B but no tax is due. Once again, while the usage changes, the return to residential occupancy does not constitute a chargeable event because there is no transfer in ownership or property rights.

Finally, two years later, Bobby decides to sell the apartment and buy a villa. The sale triggers Capital Gains assessment. However, rather than a simple, straightforward calculation based on the net difference between the purchase and sale prices in Category G, as was the case with Aaron’s flat, Bobby’s assessment is calculated in stages:

- 1) **years 1-5:** under Category G, on the net difference in value between the date of purchase to the date of allocation of the property to the business activity;
- 2) **years 6-8:** under Category B, from date of business allocation to the date of re-allocation to private residential use;
- 3) **years 9-10:** once again under Category G, from the re-allocation to residential use to the date of final sale.

Stages n° 1 and n° 3 are taxed at 28% in Category G on the full net gain.

Stage n° 2 is assessed at 25% in the Simplified Regime based on 95% of the net gain.



The Calculations

Putting aside similar amounts of deductible expenses and the cost of living adjustment over the 10 year period in order to simplify the comparison, the numbers line up as follows:

Aaron: €110,000 - €100,000 X 28% =

CGT due in year 10 **€ 2,800.00**

Bobby:

Stage 1: *Category G:*

(€105,000 - €100,000) X 28% = €1,400.00

Stage 2: *Category B:*

(€108,000 - €105,000 X 95%) X 25% = € 712.50

Stage 3: *Category G:*

(€110,000 - €108,000) X 25% = € 500.00

CGT due in year 10 **€ 2,612.50**

Although more complicated, Bobby achieves a small savings of €187.50 (+6.7%). This bit of tax relief is unlikely to be perceived by most owners as either a deterrent or an incentive in most cases.

Nevertheless, although difference in the bottom line is not significant, compliance procedures still must be followed.