RENTING TO RESIDENTS

Long-term property leases to residents (usually having a rental contract between landlord and tenant) are included in Category F and are reported on "Anexo F". The fiscal year in Portugal corresponds to the calendar year.

When a rental agreement exceeds six months, a contract is required by law. At many levels, it is important to spell out expectations, rules and requirements during the renter's stay in your property. Everyone's rights need to be protected and a written contract is a prerequisite to a satisfactory arrangement for all concerned. With a proper contract, registered with *Finanças*, tenants should be eligible for a housing tax credit, much as they would as if they were paying a mortgage.

On "*Anexo F*" of the IRS Individual Income Tax Return, you report your fiscal number, registration details regarding the property, the total amount of invoiced income as well as any deductible expenses. Finanças will add the net to other sources of income, such as pensions, interest, etc. Tax is calculated on total income at marginal rates (14.5% - 48%).

Rental Income (Category F) is taxable in Portugal based on income made available to the property owner and is not related to where payment may be made nor which currency used. Even if holidaymakers contract abroad through a foreign agency and pay in another currency, the letting of a Portuguese property constitutes a chargeable event in Portugal because the business activity in question factually takes place in Portugal. Payments from Rental Income Guarantees are also taxable in Portugal and are taxed in category G.

Taxation

Non-Residents are taxed at a flat 28%. According to most Double Taxation Agreements, Portugal has the priority in assessing rentals of Portuguese properties. Double taxation in the home jurisdiction is eliminated via tax credits for Portuguese tax paid and then assessed according to local rules. Residents may elect to be assessed autonomously at 28% or aggregate this income with other sources and be taxed at marginal rates.

Deductible Expenses

The main categories of deductible expenses which reduce notional or actual rental taxable income for tax purposes are:

- Maintenance, e.g., interior and exterior painting;
- Repairs, e.g., parts or repair of plumbing or electrical systems;
- Condominium charges and, in apartment buildings, collectively shared expenses such as: doorman & common area cleaning costs; building security; elevators, maintenance; energy for lighting, heating and air conditioning of common areas;
- Rates ("IMI or Municipal Property Tax") and other Municipal charges, such as sewage disposal, rubbish collection, etc.;
- Insurance - Multi-Risk & Tourist Liability coverage.

Finanças has been tightening up on its procedures in recent years, with more cross-referencing against different sources of information and a more concise interpretation of legislative guidelines. As a consequence the range of deductible expenses is significantly narrower than in previous years.

The Tax Office also appears to perform more frequent audits than previously. Should the inclusion of non-deductible expenses lead to an audit, this will (probably) result in a re-submission and other extra costs such as interest and fines.

Non-Deductible Expenses

The following expenses are examples of expenditures which are not deductible:

- Construction altering the structure of the building;
- Land or building acquisition;
- Installation of air conditioning;
- Other capital improvements.

When properly documented, capital improvements made in the 12 years prior to sale can enter into the calculation of the taxable base of the building for Capital Gains purposes when the property is eventually sold:

- Furnishings (when included, these normally appear on the deed of purchase/sale of the property);
- Mortgage costs;
- Utilities (except when included in condominium fee)
- Pool and garden maintenance;
- Property management

When correctly documented, you may enter capital improvements made within the previous 5 years into the calculation of the taxable base for capital gains purposes when the property is eventually sold.

Invoices ("Facturas")

While you must be able to substantiate amounts declared with proper invoices, these documents are not required at the time of submission. Portuguese law stipulates that all documents must be kept for the following 5 years in the event of a tax audit. Allowable invoices ("facturas") follow European Union rules. They must be dated and sequentially numbered; state the name and fiscal number of both of the provider and the recipient; list the nature and cost of the goods and services provided; specify the rate and amount of any Value Added Tax ("IVA") paid.

VAT

Rental Activity (Category F) is exempt from Value Added Tax.

25 March 2015