RENTAL INCOME (Category F) FROM ABROAD

If you are like many foreign residents, you may still own property in your home country. As full-time residents in Portugal, it is common to rent out that property on an on-going basis to cover expenses and bring in extra income.

What is the current tax treatment of rental income, both in the source jurisdiction and the country of residence?

The first principle to follow is *situs* (Latin for *position* or *site*). The territory where the property is located has the first right of taxation. While the method for calculating the levy will often vary from country to country, you should follow local rules and settle any taxes due. This income and the related tax paid are then to be reported on *Anexo J* (Foreign Income) on your annual Portuguese IRS declaration.

According to the double tax treaty, you are entitled to a full credit for the tax paid at source. The purpose of this tax credit is to eliminate any double taxation. You are then assessed by Portuguese rules which give you one of two choices: 1) you may elect to pay tax *autonomously* (independent from other income) at the flat rate of 28%; or 2) you may *aggregate* (combine) your rental income with other sources of revenue and be assessed on the total at marginal rates (0 - 48%). Obviously, the 28% threshold will guide you in determining which method will be most advantageous for you.

Please note that when reporting multiple sources of rental income, you must be consistent in your reporting method. You may <u>not</u> declare one source autonomously while aggregating another.

Although there has not been any recent alteration in legislation regarding foreign rental revenues, we do want to bring to your attention upcoming changes in implementation. Because of the tax credit, it has been often the case that there was little difference in the final amount of tax due. In the past, many foreign resident failed to report in Portugal because they were fully compliant in their home jurisdiction and this rental income was a low priority with Finanças inspectors. Regardless of the bottom line, you have a double reporting obligations: first in the source country, then in the country of residence.

With the new international information sharing arrangements, failure to report will likely lead to the dreaded registered letter from Finanças, asking you to amend your IRS declaration and settle any taxes and penalties due. Once "pandora's box" is open, who knows how far tax inspectors may go.

It is our recommendation to be fully compliant both at source as well as in Portugal. In most cases (but not all), the tax implications should be low. More important, as an absentee landlord, you should sleep more peacefully.

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