



Landlords and IRS

Changes in Assessment

The 2015 “IRS” Reform has brought substantial changes in taxation of rental income for landlords. The following highlights punctuate the principal modifications in the law. Most allowable tax relief has been brought into line with the principles and practices of other European Union member states.

- **Category F - New basis for deductible expenses**

If you choose to be taxed under category F, the income from rents, net of allowances, will normally be subject to IRS at a separate rate of 28%. Most necessary expenses incurred in conducting the activity – not just maintenance and repairs as before – are now deductible. This means that the agent’s costs are now covered. Note that expenses for building contents (furniture, household articles, comfort or decoration) are not eligible.

- **Landlords can choose to be taxed in Category B**

Until now, when calculating income tax, landlords could only declare the proceeds from long-term letting of property in Category F (*rental income*). With the “IRS” Reform in the 2015 Budget, landlords are now able to declare as a business and be taxed according to the rules of Category B (*Sole Trader* business income).

The legislation provides that, in either case, the basis for assessment is the same: rental income is only taxable on net income after subtracting allowable overheads. In other words, landlords have the option to deduct all expenses essential to the exercise of the activity to determine their net income and apply the Category B tax rates.

Keep in mind that beyond income tax, “business” income from Category B is also subject to VAT when it exceeds €10,000 per annum. Category F remains VAT exempt.



What then is the advantage of opting for taxation of Category B or Category F? Proceeds from the Category B are aggregated with other sources of income and taxed at marginal rates while rental income taxed under Category F can be assessed at the antonymous flat rate of 28%. It is up to each individual to choose which method proves more advantageous.

- **Aggregation: *new options***

Many categories of income may be taxed in one of two ways: *autonomous assessment* - taxed separately at a flat rate independent from other sources of income (as happens with bank interest), or *aggregate assessment* - all forms of income are added together and then taxed at marginal rates (according to the tax tables). In the past, when one option was selected, it had to be applied to all forms of income. Starting in 2015, the most appropriate form of declaration may be selected for each category of income. They no longer have to be the same.

Losses may be deducted in subsequent years

If you incur losses in conducting your rental activity, they may be written off over six years. This also applies to capital improvements in the property and, consequently, there were losses rather than profits. For losses to be distributed over future years, the building must be leased for at least 36 months, consecutively or not, over the following five years to those who directly benefit from the expenditures. The owner can do the work in a year when the property is not rented and present the spending up to two years later. However, as always, all expenses must still be documented with proper invoices.

- **Registration of Rental Contracts ("Modelo 2")**

Rental contracts must now be registered using "Modelo 2". In addition, each contract is assessed Stamp Duty of 10% based on the monthly rent. This 11-page form is somewhat complex and is available only in Portuguese. Professional help may be required.



- **New Electronic Rent Receipts**

Taxpayers who declare under category F are now required to issue electronic rental receipt for all rental income received from their tenants. This receipt is issued through the *Finanças* website in an online application created for this purpose. However, the use of electronic rent receipt system only becomes mandatory as of November 2015.

- **Annual statement of rental income (*Modelo 44*)**

As an alternative to issuing electronic receipts, owners over 65 years of age may continue to use paper invoices but are still obliged to submit an annual statement with an annual breakdown of rents (*Modelo 44 - "Comunicação Anual de Rendas Recebidas"*). This form is available both in paper as well as in electronic form over the internet via the *Finanças* website.

- **Cross check of utility bills to catch undeclared rental income**

Utility providers for electricity, water, gas and telephone are now required to identify customer contracts as well as the Property owners' identity to the "AT" (Portuguese Tax Authority). When data does not correspond to declarations, owners will be summoned to explain discrepancies.

- **Short term lets under Category F**

Certain forms of short term lets should be reported under Category F rather than as Local Lodging under Category B. For example, if you have an annual contract to the same party for repeated short-term use of a property (ie. one weekend each month throughout the year), this rental contract falls under Category F (rental income) as opposed to tourist lets to random holidaymakers (Category B). Keep in mind that each tenant (when more than one) will require a contract and each contract must be registered via a *Modelo 2* and pay the 10% Stamp Duty.



Conclusion

Beyond EU harmonisation, many of these changes have come about to counter rampant tax cheating that has existed over the years with rental income. On the positive side, the reform of long-term leasing should add new deductions that will reduce tax and increase profits for compliant landlords. Coupled with the additional reporting requirements and data verification, time will tell whether greater overall compliance will actually come as a result.

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