



## LANDLORDS AND IRS

### *Changes in Assessment*

The IRS reforms have brought substantial changes on taxation of rental income for landlords. The following highlights punctuate the principal modifications in the law. In fact, the premise for allowable relief from assessment has been brought into line with the principles and practices of other member states throughout the European Union.

- **Category F - *New basis for deductions***

If you choose to be taxed under category F, the income from rents, net of allowable expenses, is subject to IRS at a autonomous rate of 28%. Most necessary expenses incurred in conducting the activity – not just maintenance and repairs as before – are now admissible. Agent's costs are now covered. Note that, however, expenses for furnishing and contents (furniture, household articles, comfort or decoration) are not eligible.

- **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 (such as 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.

- **Landlords can choose to be taxed under Category B (*as a business*)**

Until now, when calculating income tax, landlords could only report long-term letting in Category F (*rental income*). With the "IRS" Reform in the 2015 Budget, landlords can 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 identical: rental income is only taxable on net income after subtracting allowable overheads. In other words, landlords now have the option to deduct all expenses essential to the exercise of the activity to determine their net income and still apply the Category B tax rates.

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

Category F remains VAT exempt.

- **What is the advantage of assessment under Category B or F?**

Proceeds from the Category B can be aggregated with other sources of income and taxed at marginal rates while rental income taxed under Category F can be assessed at the flat rate of 28%. It is up to each individual to choose which method proves more advantageous. If landlords prefer to be taxed under category B, they must submit an “*Início de Actividade*” (Declaration of Opening of Business) with *Finanças* where they should opt for the *Simplified Regime*. If gross annual income exceeds €200,000, they are required to switch to *standard accounting practices*.

- **Bank declaration no longer required**

Anyone with rental income in IRS no longer needs a bank declaration regarding income obtained from capital as was required in the past. This measure already applies in the 2015 tax return in respect 2014 income. The IRS Reform law has brought substantial changes on taxation of rental income for landlords.

- **Losses may be deducted in subsequent years**

If you incur losses in conducting your rental activity, they may be amortized 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.

- **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. The use of electronic receipt system became mandatory near the end of 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 electronically 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 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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