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NEWSLETTER

REAL ESTATE REHABILITATION: TAX BENEFITS

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IBFD Tax Correspondent Angola, Mozambique and East-Timor, 2013, 2014, 2015, 2016, 2017, 2018, 2019

SUMMARY

Recognizing the importance of rehabilitating heavily degraded urban areas, Portugal's Tax Benefits' Statute foresees several benefits that aim to encourage the acquisition of property in need of rehabilitation.

While these benefits mainly consist of property and transaction tax exemptions, certain CIT and PIT benefits regarding real estate income are also foreseen.



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BACKGROUND

Recognizing the importance of urban rehabilitation and revitalization towards harmony and sustainability, especially in heavily degraded areas, the Portuguese Tax Benefits Statute (*Estatuto dos Benefícios Fiscais* or EBF) foresees several benefits meant to encourage the acquisition of property that has a poor conservation status and is in need of rehabilitation.

These incentives consist mainly of property tax (IMI) and transaction tax (IMT) exemptions, provided certain requirements are met. However, the EBF also foresees some Corporate Income Tax (CIT) and Personal Income Tax (PIT)-related benefits regarding real estate income.

PROPERTY TAX (IMI) EXEMPTION

The EBF states that rehabilitated property may be eligible for IMI exemption for a three-year period.

If the property in question is registered and allocated to (i) the tenant's permanent residence or (ii) the owner's permanent residence, the duration of this exemption may be extended for an additional five-year period.

This renewal depends on a proposal by the city hall that must be approved by the city council.

In any case, for this exemption to apply, the urban property must have been built at least 30 years prior to rehabilitation and located in specially designated rehabilitation area. In addition, the following criteria must be met:

- the rehabilitation work must be conducted under the Portuguese Urban Rehabilitation Regime (*Regime Jurídico da Reabilitação Urbana*) or the special regime foreseen in Decree no. 53/2014, from April 8th (*Decreto-Lei n.º 53/2014, de 8 de abril*); and
- the rehabilitation must result in a two-level upgrade in the property's current official conservation status and become graded as "good". Additionally it must also meet certain energy and thermal requirements.

Moreover, if these criteria are met, the fees due for the property's conservation status evaluation process should be reduced.

The city hall or the entity responsible for managing urban rehabilitation should recognize the rehabilitation process and

the fulfilment of these criteria, for exemption purposes. In addition, these entities are responsible for communicating said recognition to the competent tax office.

TRANSACTION TAX (IMT) EXEMPTION

Regarding IMT, the EBF foresees the following exemptions:

- exemption on the acquisition of property intended for rehabilitation, as long as the construction work begins within three years; and
- exemption on the first transaction concluded after the rehabilitation work is completed, as long as the property is registered and utilized for the tenant's permanent residence or the owner's permanent residence (in which case, the property must be situated in one of the specially designated rehabilitation areas).

These exemptions are subject to the same criteria and approval rules applicable to the IMI exemption.

REAL ESTATE INVESTMENT FUNDS

The EBF also foresees a CIT exemption on the income obtained by real estate

investment funds, regardless of the nature of said income.

For this exemption to apply, real estate investment funds must have been incorporated between January 1st, 2008 and December 31st, 2013, they must operate in accordance with Portuguese legislation, and 75% of its real estate assets must have been effectively rehabilitated and be situated in one of the specially designated rehabilitation areas.

Income distributed by a real estate investment fund to its investors, whether through simple distribution or withdrawal, is liable to a 10% PIT or CIT flat rate, depending on the nature of the investor.

This reduced tax rate is not applicable if the investor benefits from an investment tax exemption or the investor is a foreign tax resident, without a permanent establishment in Portugal to which the income may be attributable, except:

- the investor is a tax resident in a tax haven; and
- the investor is a foreign tax resident entity that is not held in at least 25% of its share capital by Portuguese tax resident entities.

In case the investors are foreign resident entities that do not have a

permanent establishment in Portuguese territory, or Portuguese PIT taxpayers that receive their income from activities unrelated to commerce, industry, or agriculture, withholding tax will be definitive. As an alternative, they may choose to aggregate the income, in which case it will be considered as a payment on account of the tax due.

As for capital gains obtained from the sale of shares held in a real estate investment fund, they are subject to a 10% flat tax rate, as long as the investor is (i) a foreign tax resident to whom the EBF's special non-residents capital gains exemption does not apply, or (ii) a Portuguese PIT taxpayer and tax resident, whose income derives from activities unrelated to commerce, industry, or agriculture and the income aggregation option is not chosen.

These benefits may only apply when a property's rehabilitation work have begun after January 1st, 2008 and were concluded before December 31st, 2020.

REAL ESTATE CAPITAL GAINS

The EBF foresees an autonomous 5% PIT flat rate for Portuguese tax resident individuals regarding capital gains obtained from the first transaction concluded after rehabilitation, as long

as the property is located in one of the specially designated rehabilitation areas and the income aggregation option is not chosen.

DEDUCTIBLE EXPENSES

Up to 30% (or Euro 500.00) of rehabilitation expenses incurred may be deducted from the property owner's taxable income, if:

- the rehabilitated property is located in a specially designated rehabilitation area; or
- the rehabilitated property is rented under Portugal's new Urban Rental Regime (*Novo Regime de Arrendamento Urbano* or NRAU).

REAL ESTATE INCOME

If the aforementioned criteria are met, rental income obtained by Portuguese tax residents will be subject to PIT at a 5% flat rate, unless the income aggregation option is chosen.

AFFORDABLE RENT PROGRAMS

Finally, the EBF foresees a CIT and PIT exemption on rental income obtained from a property that is included in one of Portugal's affordable rent programs, applicable for the duration of the rental contracts.



Regarding PIT, if individuals choose income aggregation, the exempt rental income will nonetheless, be computed to assess the progressive rates applicable to their global income.

As a final note, it should be mentioned that the member of the government responsible for fiscal matters must officially recognize this exemption.

Lisbon, January 18th, 2020

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