



Portuguese State Budget Law for 2018

AMENDMENTS TO THE RULES OF THE SIMPLIFIED REGIME

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I – Brief framework

On the 29th of December 2017, it was published in the Official Gazette of the Republic of Portugal, the **Portuguese State Budget Law for 2018** (Law no. 114/2017).

The most relevant and newsworthy measures of this State Budget Law were the amendments to the Personal Income Tax Code regarding the simplified regime, applicable to the self-employed professionals and other service providers (e.g. short-term rental entrepreneurs).

In fact, the amendments to the simplified regime introduced by the State Budget Law for 2018 represent a substantial change in the way of determining the taxable income of taxable persons that annually earn category B income higher than € 27,360 to whom the simplified regime is applicable.

Regarding the subjective scope of application of these new rules, it should also be noted that they are not applicable to all the taxable persons who earn category B income, but only to those who perform one of the professional activities envisaged in the table mentioned on article 151 of the Personal Income Tax Code¹ (hereinafter "**self-employed professionals**") and the service providers whose activity doesn't correspond to any of those activities neither to the sale of products and goods (hereinafter "**other service providers**").

Although the amendments introduced in the simplified regime may be harmful to some of the taxable persons to whom it is applicable, the self-employed professionals will be able to benefit from other amendments introduced by the Portuguese State Budget Law for 2018, namely:

- The unseizability of two-thirds of the net category B income (article 738, no. 8 of the Civil Procedure Code).
- The widening of the scope of the "subsistence level", for the purpose of Personal Income Tax, which is now also applicable to the self-employed professionals (article 70, no. 1 of the Personal Income Tax Code).
- The restructuring of the general rates' table, given that the second and the third yield ranges have each split into two (article 68 of the Personal Income Tax Code).

¹ *Vide* Decree no. 1011/2001, 21st of August, which approved the table mentioned on article 151 of the Personal Income Tax Code.

II – Simplified regime for determining taxable income before the Portuguese State Budget Law for 2018

The simplified regime is a method of determination of the taxable income arising from professional and business activities, that is to say, the category B taxable income (article 28, no. 1, a) of the Personal Income Tax Code).

The simplified regime is applicable to the taxpayers whose annual net income of category B has not exceeded, in the prior tax period, the value of € 200,000 and do not exercise the option to have their taxable income determined on the basis of organized accounts (article 28, no. 2 and no. 3 of the Personal Income Tax Code).²

According to the legal regime prior to the new rules of the simplified regime introduced by the Portuguese State Budget Law, the determination of the

taxable category B incomes depended solely on the application of certain coefficients to the gross incomes of that category (article 31, no. 1 of the Personal Income Tax Code).

Thus, in the light of the **former rules** of the simplified regime, in order to determine the taxable income, **it was enough to apply the coefficient** and that application resulted in a presumption that a portion of the taxpayer's gross income corresponded to expenses related to his activity. In that scenario, **there was no need to present invoices** or receipts to prove the presumed expenses.³

Concerning the self-employed professionals (e.g. lawyers), **see the following example:** assuming an annual gross income of € 100,000 and taking into consideration that the applicable coefficient is 0.75 (article 31, no. 1, b) of the Personal Income Tax Code), the application of the abovementioned rules allows us to conclude that:

Gross income = € 100,000

² If the actual expenses related to the taxpayer's activity are higher than the ones that are presumed by the application of the simplified regime, it is more favorable for the taxpayer to opt for the determination of his taxable income based on organized accounts (option that has to be made until March of each fiscal year), because such rules can grant the taxpayer a higher deduction than the one allowed by the coefficient.

³ Note that these rules are still valid for taxpayers that earn category B income and to whom is applicable one of the coefficients envisaged in paragraphs a), d), e) f) and g) of no.1 of article 31 of the Personal Income Tax Code or one of the coefficients envisaged in paragraphs b) and c) providing the annual gross income isn't higher than € 27,360.

Net income / Taxable income = 75,000 € (= 0.75 x € 100,000)

Presumed expenses = 25,000 € (= 0.25 x € 100,000)

Here is another example, now regarding the other service providers (e.g. short-term rental entrepreneurs): assuming an annual gross income of € 100,000 and given that the applicable coefficient is 0.35 (article 31, no. 1, c) of the Personal Income Tax Code), from the application of the abovementioned rules, the following conclusions can be drawn:

Gross income = € 100,000

Net income / Taxable income = € 35,000 (= 0.35 x € 100,000)

Presumed expenses = € 65,000 (= 0.65 x € 100,000)

III – Amendments to the rules of the simplified regime introduced by the Portuguese State Budget Law for 2018

A. Application scope of the new rules

The Portuguese Budget State Law for 2018 envisages a substantial change in the way of determining the taxable income of taxable persons that earn category B income and to whom the simplified regime is applicable.

However, it should be noted that, as it has been mentioned above, the new rules are not applicable to all the taxpayers to whom the simplified regime is applicable, but only to the self-employed professionals and to the other service providers (e.g. short-term rental entrepreneurs) that annually earn category B income higher than € 27,360.

B. The new rules for determining the taxable income

Regarding the new rules for determining the taxable income, it should be mentioned that there is an amendment to article 31, no. 1, g) of the Personal Income Tax Code which concerns the application scope of the coefficient of 1.00. Indeed, the **coefficient of 1.00** is made applicable not only to the **taxpayers that render services to companies in which they participate** and which are covered by the fiscal transparency regime (article 6, no. 1, b) of Personal Income Tax Income), but also to taxpayers that render services to companies in which they hold a participation of at least 5% or their family members (e.g. partner, ancestors and descendants) hold a participation of at least 25%. Thus, it is applicable a coefficient of 1,00 to the taxpayers who directly or through their family members hold a participation in the companies to which they render services (e.g. real state agencies,

clinics, etc.), signifying that their taxable income corresponds to their gross income, not being taken into account any expenses.

Regarding the self-employed professionals and the other service providers, to whom the coefficients of 0.75 and 0.35 are still applicable, the Portuguese State Budget Law for 2018 introduces the **no. 13 on article 31 of the Personal Income Tax Code**, which states that the «*deduction to the income that arises from the application of the coefficients envisaged in paragraphs b) and c) of no. 1 is partially dependent on the verification of the actual expenses and costs*».

It follows from no. 13 of article 31 that to the income that arises from the application of the coefficients **shall be added the positive difference between 15% of the gross income and the total sum of the following amounts:**

- The amount corresponding to the specific deduction envisaged in article 25, no. 1, paragraph a) of the Personal Income Tax Code (€ 4,104) or, when higher, the amounts actually incurred with mandatory social security contributions related to the taxpayer's activity that are not deductible (article 25, no. 2 of the Personal Income Tax Code);
- **Personnel expenditures** and costs in the form of remunerations, wages or salaries, that are communicated by the taxpayer to the Portuguese Tax Authority as prescribed on article 119, no. 1, paragraph c) of the Personal Income Tax Code;
- **Costs from renting immovable property** that is used in the professional or business activity, providing that those costs are supported in invoices and other documents, communicated to the Portuguese Tax Authority as prescribed on article 78-E, no. 2 of the Personal Income Tax Code;
- **1.5% of the taxable patrimonial value of properties** used in the professional or business activity, when the taxpayer is the owner, usufructuary or superficiary; **or 4%** of the taxable patrimonial value when the property is used in **hotel activities or short-term rental**;
- **Other expenses** with the acquisition of goods or the provision of services, that are supported in invoices communicated to the Portuguese Tax Authority or issued in its website;
- **Imports and intra community acquisitions** of goods and services related to the taxpayer's activity.

Two important inferences follow from the no. 13 of article 31 of the Personal Income Tax Code, which states that to the income that arises from the application of the coefficients **shall be added the positive difference between 15% of the gross income and the total sum of the amounts above mentioned.**

Firstly, the expression “**positive difference**” means that, even if the taxpayer is able to prove that his expenses are higher than the presumed ones, while the simplified regime is applicable⁴, he cannot achieve a taxable income lower than the one that arises from the application of the coefficient.

Secondly, the fact that it is only added to the difference between 15% of the gross income and the sum of the amounts above-mentioned means that **a part of the gross income is still automatically regarded as expenses, even though it is smaller than before**. Thus, with respect to self-employed professionals, given that the maximum deduction is 25%, it is presumed that 10% (= 25% - 15%) of the gross income corresponds to expenses. In turn, 50% (= 65% - 15%) of the other service providers’ gross income is assumed as expenses. To sum up, it is no longer presumed that 25% of the self-employed professionals’ gross income and 65% of the other service providers’ gross income corresponds to expenses, as it has been up until now, **being automatically regarded as expenses only 10% and 50%** respectively.

In view of the above, it becomes clear that, with the new rules of the simplified regime, **in order for the taxpayer to benefit from the maximum deduction** permitted by the coefficient envisaged in article 31, no. 1 of the Personal Income Tax Code and consequently not to suffer an increase in its Personal Income Tax, **the taxpayer has to justify some of the expenses** related to his activity.

In fact, for the taxpayers whose category B income is determined according to the simplified regime to fully achieve the maximum deduction permitted by the coefficients, **they will have to justify the equivalent to 15% of their gross income** through the presentation of invoices that prove expenses related to their activity in that amount.

Nevertheless, it is worth mentioning that **to achieve the amount equivalent to those 15%, it should be taken into consideration the automatic deduction of € 4,104** envisaged on article 25, no. 1, a) of the Personal Income Tax Code. Therefore, to the amount equivalent to 15% of the gross income has to be deducted the value of € 4,104 (or the value of the mandatory social security contributions), which means the taxpayer only has to submit invoices that justify the remainder.

C. Expenses eligible for the determination of the taxable income

Regarding the type of expenses that will be accepted by the Portuguese Tax Authority as being related to the taxpayer’s activity, it should be noted that

⁴ In that case, just like it was previously mentioned, it may be more favorable for the taxpayer to opt for the determination of his taxable income based on organized accounts.

it is not used an indispensability criterion, which means it is only required that the expenses are related to the taxpayer's activity.

As a result, the no. 13 of article 31 of the Personal Income Tax Code states that **are eligible as deductible expenses**, *inter alia*, the following expenses:

- Remunerations, wages and salaries;
- Immovable properties used in the taxpayer's activity (as prescribed in the rules above mentioned);
- Rents from immovable properties used in the taxpayer's activity;
- Current consumption materials;
- Electricity and water;
- Transports;
- Communications;
- Litigation;
- Insurances;
- Financial lease rents;
- Contributions to professional associations (*e.g.* Bar Association) and other organizations representative of other professional categories concerning the taxpayer;
- Travels and stays of the taxpayer or his employees.

With respect to the deductibility of costs with immovable property used in the taxpayer's activity, it is important to make two warnings, since the **allocation of immovable properties** to the professional or business activity **may have harmful consequences on the medium/long-term** that do not offset the advantage obtained through the deduction of the costs related to those properties. A self-employed professional that works from home (*e.g.* translator, lawyer, architect) may be tempted to allocate his immovable property to his activity in order to be able to have higher deductions, but it must be pointed out that in the moment that allocation takes place, the taxpayer obtains an unrealized capital gain, that stays unrealized until the property is sold or allocated to the taxpayer's personal sphere. To this should be added that in the event of allocation of the permanent abode to the taxpayer's professional or business activity, the capital gain realized with the sale of the property will be taxed in 95% of its value and not in 50% and the taxpayer will no longer have the possibility of reinvestment of the capital gain that would have existed if he hadn't allocated the property to his professional sphere.

It is also worth mentioning that, when it comes to expenses related to rents, immovable property and acquisitions of goods and services, if these expenses are only partially allocated to the taxpayer's activity, they will only be considered in 25% of their value (article 31, no. 14 of the Personal Income Tax Code). Thus, when "**mixed**" costs are at stake, it is applicable a criterion similar to the one applicable in organized accounts regime and thereby those costs **are considered in 25% of its value** in the sum referred in article 31, no. 13 of the Personal Income Tax Code.

Regarding the expenses accepted by the Portuguese Tax Authority, finally, it should be pointed out that the taxpayer has to prove the amount of expenses mentioned in his declaration, just as he has to prove that those expenses were incurred within his activity. As a result, **each taxpayer is responsible for the allocation of the expenses** that are related to his activity.

In principle, the Portuguese Tax Authority's website will allow the submission of any expense regardless of the specific personal or business activity in question, as it is presumed that the taxpayer acts in good faith, but the Portuguese Tax Authority can undertake inspections to analyze the allocation of the expenses made by the taxpayers.

D. Conclusions

In view of the legal framework abovementioned, it is possible to sum up the simplified regime's new rules for the determination of the category B taxable income on the following **mathematical equation**⁵:

$$N_{\text{income}} = C_{\text{income}} + \underbrace{[15\% \times G_{\text{income}} - (4,104 \text{ €} + E)]}_{\geq 0}$$

Given the obvious complexity of the simplified regime's new rules, in order to **determine the category B taxable income**, instead of the mere application of the coefficients, it is now necessary to go through the following **logical steps**:

1. Application of the coefficient envisaged in no. 1 of article 31 of the Personal Income Tax Code to ascertain the maximum deduction permitted;

⁵ N_{income} = Net income according to the new rules of the simplified regime;

C_{income} = Net income arising from the application of the coefficient;

G_{income} = Annual gross income;

E = Expenses related to the taxpayer's activity, envisaged in the no. 13 of article 31 of the Personal Income Tax Code.

2. Determination of the actual amount of deductions envisaged in no. 13 of article 31 of the Personal Income Tax Code;
3. Determination of the category B net income by adding up to the net income resulting from the application of the coefficient the difference between 15% of the gross income and the sum of the amounts envisaged in no. 13 of article 31 of the Personal Income Tax Code.

IV – Logical steps for the determination of taxable income according to the new rules of the simplified regime

A. Determination of the maximum deduction permitted by the coefficient

The first logical step to calculate the category B taxable income is the application of the coefficient envisaged in no. 1 of article 31 of the Personal Income Tax Code to the taxpayer's annual gross income. However, it should be noted that this is only the first step, which means that the income that arises from the application of the coefficient is not necessarily the taxable income, as it was under the former rules of the simplified regime.

In fact, with the amendments to the simplified regime, it is not applicable anymore the irrebuttable presumption that a certain amount of the taxpayer's gross income, resulting from the application of the coefficients, corresponds to expenses of his activity. Thus, according to the current regime, the application of the coefficient does not allow us to determine the category B net income immediately, but only to ascertain the maximum deduction permitted.

Regarding the self-employed professionals, **let us look again at the foregoing example:** assuming an annual gross income of € 100,000 and taking into account that the applicable coefficient is 0.75 (article 31, no.1, b) of the Personal Income Tax Code), on this first step of the application of the new rules, it is possible to draw the following conclusions:

Gross income = € 100,000

Net income arising from the application of the coefficient = € 75,000 (= 0.75 x € 100,000)

Maximum deduction allowed by the coefficient = € 25,000 (= 0.25 x € 100,000)

Taking up now the example concerning the other service providers (e.g. short-term rental): assuming an annual gross income of € 100,000 and taking into consideration that the applicable coefficient is 0.35 (article 31, no. 1, c) of the Personal Income Tax Code), on this first step of the determination

of the net income according to the new simplified regime's rules, it is possible to conclude that:

Gross income = € 100,000

Net income arising from the application of the coefficient = € 35,000 (= 0.35 x € 100,000)

Maximum deduction allowed by the coefficient = € 65,000 (= 0.65 x € 100,000)

B. Determination of the actual amount of deductions

Once the maximum deduction is ascertained, it is now important to calculate the sum of amounts envisaged in no. 13 of article 31 of the Personal Income Tax Code, since the positive difference between 15% of the annual gross income and that sum will be added to the net income that has arisen from the application of the coefficient.

Therefore, the second logical step for the determination of category B taxable income according to the new rules of the simplified regime is seeking the deductions that can be made to the taxpayer's gross income, which must not exceed the maximum limit ascertained in the previous step, that corresponds to the amount of expenses presumed by the application of the coefficient.

Let us look again at the example regarding the self-employed professionals: assuming an annual gross income of € 100,000 and taking into account that the applicable coefficient is 0.75 (article 31, no. 1, b) of the Personal Income Tax Code), the application of the new rules of the simplified regime permits the following deductions, with the maximum limit of € 25,000 (= 0.25 x € 100,000):

- Automatic deduction of € 10,000 (= 10% x € 100,000), corresponding to 10% of the annual gross income, which is presumed automatically as expenses;
- Deduction of € 4,104, corresponding to the deduction envisaged in article 25, no. 1, a) of the Personal Income Tax Code;
- Deduction of expenses related to the taxpayer's activity, envisaged in paragraphs b) to f) of no. 13 of article 31 of the Personal Income Tax Code, providing that they are supported in invoiced that meet the legal requirements.

Taking up the example concerning the other service providers (e.g. short-term rental): assuming an annual gross income of € 100,000 and taking into consideration that the applicable coefficient is 0.35 (article 31, no. 1, b) of the Personal Income Tax Code), the application of the new rules of the

simplified regime allows the following deduction, as long as they do not exceed the maximum limit of € 65,000 (=0.65 x € 100,000):

- Automatic deduction of € 50,000 (= 50% x € 100,000), corresponding to 50% of the annual gross income, which is presumed automatically as expenses;
- Deduction of € 4,104, corresponding to the deduction envisaged in article 25, no. 1, a) of the Personal Income Tax Code;
- Deduction of expenses related to the taxpayer's activity, envisaged in paragraphs b) to f) of no. 13 of article 31 of the Personal Income Tax Code, providing that they are supported in invoiced that meet the legal requirements.

C. Determination of the net income

The determination of the maximum deduction and the actual deductions permitted is followed by the third logical step for the determination of the category B of the net income according to the new rules of the simplified regime, which consists in adding up to the income that has arisen from the application of the coefficient the difference between 15% of the gross income and the sum of the amounts envisaged in no. 13 of article 31 of the Personal Income Tax Code.

According to the new rules of the simplified regime, the **value of the net income depends on the sum of the actual amounts envisaged in no. 13 of article 31 of the Personal Income Tax Code** (€ 4,104 + expenses related to the taxpayer's activity).

Ergo, depending on the value that arises from the sum of the amounts envisaged in no.13 of article 31 of the Personal Income Tax Code, three scenarios can be pondered:

- If the difference between 15% of the gross income and the sum of the expenses is positive, that value is added to the net income determined by the application of the coefficient;
- If the difference between 15% of the gross income and the sum of the expenses is zero, there is nothing to be added and for that reason, the net income corresponds to the income determined by the application of the coefficient;
- If the difference between 15% of the gross income and the sum of the expenses is negative, there is nothing to be added and therefore the net income corresponds to the income determined by the application of the coefficient.

IV – Practical implications of the amendments to the simplified regime

On the basis of the foregoing considerations, it becomes clear that, with the new rules of the simplified regime, **in order to benefit from the maximum deduction** permitted by the coefficient envisaged in article 31, no. 1 of the Personal Income Tax Code and consequently not to suffer an increase in its Personal Income Tax, **the taxpayer has to justify some of the expenses** related to his activity.

Thus, the most relevant practical implication of the amendments to the simplified regime is the need for the self-employed professionals and other service providers to submit invoices that prove a certain amount of expenses related to their activity, or else their taxable income will be higher than the one that arises from the mere application of the coefficients.

Taking up again the example of the self-employed professional that earns an annual gross income of € 100,000 and assuming € 6,000 as the value of expenses related to his activity, being applicable the coefficient of 0.75 (article 31, no.1, b) of the Personal Income Tax Code), it is possible to reach the following conclusions:

Determination of the category B taxable income

Gross income	€ 100,000
Net income arising from the application of the coefficient	€ 75,000 = 0.75 x € 100,000
Maximum deduction allowed by the coefficient	€ 25,000 = 0.25 x € 100,000
Automatic deductions	€ 10,000 = [(25% - 15%) x € 100,000]
	€ 4,104

Ideal scenario ⁶	Expenses related to the taxpayer's activity	€ 10,896
	Difference between 15% of the gross income and the expenses related to the taxpayer's activity	€ 0 [15% x 100,000 – (€ 4,104 + € 10,896)]
	Taxable income	€ 75,000 0.75 x € 100,000 + € 0
Hypothetical scenario ⁷	Expenses related to the taxpayer's activity	€ 6,000
	Difference between 15% of the gross income and the expenses related to the taxpayer's activity	€ 4,896 [15% x € 100,000 – (€ 4,104 + € 6,000)]
	Taxable income	€ 79,896 0.75 x € 100,000 + € 4,896

Resuming now the example regarding the other service providers (e.g. short-term rental), assuming an annual gross income of € 100,000 and expenses related to the activity of € 8,000, being applicable the coefficient of 0.35 (article 31, no. 1, c) of the Personal Income Tax Code, the following conclusions may be drawn:

⁶ The ideal scenario implies that the taxpayer proves the amount of expenses necessary to achieve the same level of deduction permitted by the coefficient, which in each case is determined by the value of x that solves the following equation: [15% x gross income – (€ 4,104 + € x)] = 0.

⁷ The hypothetical scenario corresponds to the example mentioned above, that is to say the scenario in which a taxpayer that is qualified as a "self-employed professional" annually earns € 100,000 and only has invoices that prove € 6,000 of expenses related to his activity.

Determination of the category B taxable income

Gross income		€ 100,000
Net income arising from the application of the coefficient		€ 35,000 = 0.35 x € 100,000
Maximum deduction allowed by the coefficient		€ 65,000 = 0.65 x € 100,000
Automatic deductions		€ 50,000 = [(65% - 15%) x € 100,000]
		€ 4,104
Ideal scenario ⁸	Expenses related to the taxpayer's activity	€ 10,896 = [15% x 100,000 - (€ 4,104 + € 10,896)]
	Difference between 15% of the gross income and the expenses related to the taxpayer's activity	€ 0 = [15% x € 100,000 - (€ 4,104 + € 10,896)]
	Taxable income	€ 35,000 = 0.35 x € 100,000 + € 0

⁸ The ideal scenario implies that the taxpayer proves the amount of expenses necessary to achieve the same level of deduction permitted by the coefficient, which in each case is determined by the value of x that solves the following equation: [15% x gross income - (€ 4,104 + € x)] = 0.

Hypothetical scenario ⁹	Expenses related to the taxpayer's activity	€ 8,000
	Difference between 15% of the gross income and the expenses related to the taxpayer's activity	€ 2,896 = [15% x € 100,000 - (€ 4,104 + € 8,000)]
	Taxable income	€ 37,896 0.35 x € 100,000 + € 2,896

VI – Conclusions

All in all, it can be concluded that, while up until now the taxable income of the self-employed professionals was determined solely by the application of the coefficients envisaged in article 31, no. 1 of the Personal Income Tax Code, with the new rules of the simplified regime, in order to benefit from the maximum deduction permitted by the coefficients and not have an increase of their Personal Income Tax, the taxpayers have to prove some expenses related to their activities.

⁹ The hypothetical scenario corresponds to the example mentioned above, that is to say the scenario in which a taxpayer that is qualified as an "other service provider" annually earns € 100,000 and only has invoices that prove € 8,000 of expenses related to his activity.

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