



TAXATION OF THE AMOUNT RECEIVED AS A SECURITY DEPOSIT FOR IRS PURPOSES

Following some doubts about the IRS tax framework of the amounts received as security deposits by taxpayers earning property income, the Tax Administration published, on 07 June 2023, Circular Letter No. 20256, which sought to clarify and standardise procedures in this regard.

The Tax Administration states that in the context of the negotiation and conclusion of lease agreements, the parties may agree to receive a certain amount in advance of rent or as a guarantee for the proper fulfilment of the lease agreement by the tenant, that is, it may be established from the outset the delivery of

a certain amount that may serve later to repair any damage that may be caused to the property while a lease agreement is in force.

It was debated whether the amounts received as a security deposit, either in anticipation of the payment of rents or to guarantee the proper fulfilment of the obligation to maintain the leased premises, would be considered for IRS purposes, as income, or as a mere deposit of an amount, exclusively for the purpose of guaranteeing the obligations of the contracts by the tenants.

THE AMOUNT RECEIVED AS A SECURITY DEPOSIT BY LANDLORDS AS A CATEGORY F PROPERTY INCOME

In the clarification now provided, the Tax Administration clarifies that the concept of income for tax purposes differs from the concept of income provided for in the civil code.

For tax purposes, it is considered as income and therefore as category F income, namely, *the amounts relating to the transfer of the use of the building or part of it and the services related to that transfer* (Cfr. Article 8.º, n.º 2 a) do CIRS).

The Tax Administration considers that the amount made available to the landlord as a security deposit, translates into an effective asset increase with a reflection on the landlord's ability to pay and because its payment is related to the provision of a property by the landlord to the tenant, under a lease agreement, it should be considered that said security deposit as an income for tax purposes and to that extent should be declared in IRS and paid the corresponding tax on that amount.

WITHHOLDING TAX ON THE SECURITY DEPOSITS RECEIVED BY LANDLORDS

Since the amount received as a security deposit is considered as income (category F income) for tax purposes, the entities that have or must have organised accounting are legally obliged to withhold tax, as a rule at the rate of 25%, on the amount of the security deposit paid to the landlord.

REFUND OF THE SECURITY DEPOSITS

The Tax Administration also clarifies that, in cases where the landlord returns to the tenant the amount previously received as a security deposit, he must consider the amount of the security deposit returned as an expense incurred and identify the amount refunded in the IRS model 3 tax return for the year in which he returns the security deposit.

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