

Taxation of the income acquired through rental revenues and real estate sale

Taxpayers deriving business profits and independent personal service gains must file tax returns annually, regardless of whether there is income or not. The same does not apply to other taxpayers. For example, individuals who rent or sell their real estate must file tax returns only for the year when rents are collected or the sale is performed.

In this article, we will discuss the taxation of incomes derived in 2018 from residential property or offices outside of the scope of commercial activity, under two main titles (rental income and gains on sales).

I. Taxation of rental incomes

A. Rental income from residential property

TL 4.400 of the rental income derived in 2018 from real estate rented as residence is exempt from income tax. Tax returns do not have to be filed; in case an income less than this amount is gained.

However, in cases where a revenue exceeding the exemption limit is gained but not declared or is declared deficiently, the exemption may not be enjoyed. Furthermore, those who are obliged to declare their commercial, agricultural or professional profits with annual tax returns may not benefit from this exemption either.

On the other hand, of those who derive rental income from residential property exceeding the exemption amount of TL 4.400 in 2018, the total gross amount of whose incomes (wages, income from securities, income from real estate and other gains and revenues) exceeds TL 120.000 may not benefit from this exemption either, regardless of their being subject to declaration or not.

In case taxpayers who are entitled to an exemption gain rental income from residential property exceeding the exemption amount in 2018, firstly the exemption amount (TL 4.400) is deducted from the gross revenue, and then the amount which should be taxed (tax base) is calculated by deducting the expenses (actual or lump-sum expenses).

The income tax payable is calculated by applying the tax rates shown in the income tax tariff effective in the year 2018 to this amount.

B. Rental income from offices

In the declaration of rental incomes from offices that are subjected to withholding tax, there is a “declaration limit” determined separately for each year. This limit is TL 34.000 for rental incomes from offices derived in 2018.

Accordingly, if the gross amount of the rental incomes derived in 2018 subjected to withholding tax, is lower than TL 34.000, these incomes do not need to be declared. However, while benchmarking aforementioned declaration limit of TL 34.000, the total amount of other declarable incomes from marketable securities should be taken into account in addition to the incomes mentioned above.

In case the gross rental income from the office exceeds the declaration limit, the whole income should be declared. The expenses would be deducted from the amount in question using one of the methods of lump-sum expense or actual expense, depending on the income recipient's preference in order to reach the tax base.

The taxes withheld within the year by the tenant may be deducted from the income tax calculated, according to the income tax tariff over the mentioned amount.

On the other hand, we would also like to remind you that over the rent of the real estate rented as an office to taxpayers deriving business profits taxed under the simple procedure, income tax withholding is not applied by these taxpayers. The declaration limit for such rental incomes that are not subject to tax withholding or exemption application is TL 1.800. All office rental incomes exceeding this amount in 2018 (that are not subject to withholding tax) need to be declared.

C. In cases where office and house rental incomes are combined

If rent is received both from a residential property and an office, first of all, whether the house rent will be declared should be checked. Accordingly, if the house rents collected in 2018 by taxpayers in the scope of the exemption exceed TL 4.400, the income exceeding this amount should be declared.

If the total gross amount of the rental income from office that is subjected to withholding and residential rental income exceeding the exemption exceeds the declaration limit of TL 34.000, the office rental income should also be included in this declaration. On the other hand, if the total amount is less than TL 34.000, only residential rental income shall be declared and office rental income shall not be included in this declaration.

In case a tax return is submitted due to rental incomes exceeding the exemption or declaration limit above, one of the methods of lump-sum or actual expense would be selected to calculate the net revenue, depending on the income recipient's preference and tax would be calculated over this amount according to the income tax tariff.

When office rental incomes are declared, taxes withheld throughout the year by the tenant would be deducted from the tax calculated on the tax return.

D. Expenses to be deducted from rental income

Expenses that may be taken into account in the determination of the declared rental income can be determined using two different methods, which are “lump sum expense” and “actual expense” methods. Taxpayers may choose the method they prefer.

1. Lump-sum expense method

In this method, 15% of the rent can be deducted directly as expense. (This rate was last applied as 25 % in the submission of rental revenue for 2016 and it was lowered to 15 % to be applied on the income acquired as of 1 January 2017).

If the income is partly exempt for example, TL 4.400 of residential rental incomes is exempt from income tax for the year 2018), the exemption should first be deducted from the rent amount and the 15% lump-sum expense should be deducted from the remaining income.

Since there are no exempt amounts for rents received from offices, 15% of the rent should be deducted as lump-sum expense and the remaining amount should be declared.

It should be taken into account that those who select this method may not revert to the actual expense method before 2 years.

2. Actual expense method

In the actual expense method, expenses that are listed in the article 74 of the Income Tax Law and that must be based on documents are deductible.

However, since TL 4.400 of the revenue is exempt from tax in case of residential rental income, the part of the expenses corresponding only to the taxable gains should be calculated and deducted from the income.

Information regarding expenses deductible in the actual expense method is brought to your attention below:

a. Loan interests

If the real estate acquired with a loan is rented, the interests paid for the loan can be deducted from the rent income derived. As a matter of fact, if the loan interests exceed the rent income, this amount is deemed as surplus expense, which means that this part, which cannot be deducted from the rent income, can be deducted from other incomes declared.

b. 5 % of the house purchase price

5 % of a real estate purchase price as a residence can be deducted as expense for 5 years as of the year of acquisition. However, if the expense calculated in this way exceeds

the rent income derived, the exceeding part may not be deducted from other incomes or carried forward to following years.

c. Rent of houses occupied

Another actual expense item on the other hand is the rent paid by those who rent the houses they own and pay rent for another house they live in. The part of these rents corresponding to the non-exempt gains can be deducted from the revenue in accordance with the actual expense method. However, as explained above, if the expense exceeds the rent income, the exceeding part may not be deducted from other incomes or carried forward to following years.

d. Thermal insulation expenditures

Expenditures intended to ensure thermal insulation and energy saving which provides a feature of increasing the real estate's economical value made by the leaser may be deducted from rental income. On the other hand, in the circumstance that these expenditures exceed the amortization limit (TL 1000) in a single calendar year, considering them as a cost is also possible.

e. Other actual expenses

Some other actual expense items that can be taken into account in the declaration of rental income, provided that they are related with the real estate rent, are as follows:

- Lighting, heating, water and elevator expenses,
- Management expenses,
- Taxes, duties, fees and goodwill paid along with insurance expenses,
- Depreciation (2%),
- Repair and maintenance expenses,
- Rents and other actual expenses paid by those who lease the property and rights they rent.

II. Real estate sales profits

Gains derived from the sale of the real estate purchased, outside of the scope of the commercial activity by real persons, are deemed as "capital gains". Under normal circumstances, these gains are subject to income tax, but income tax shall not be paid regardless of the amount of the income, in case of sale of real estate that is acquired through inheritance or donation.

A. Time of retention and its effect on taxation

In order not to pay taxes over the income in case of sale of real estate acquired through means other than inheritance or donation (acquired, constructed, etc.), the real estate must have been retained for at least 5 years. In other words, in case the real estate is sold

after being retained for less than 5 years, income tax must be paid over the gains derived in principle. The five-year period is calculated in days.

B. Indexation

The effect of inflation can be eliminated during the calculation of the gains that are generated from real estate sold before expiration of the five-year period and that must be declared. This is briefly called as “indexation”. The Turkish Statistical Institute (TSI) announces the domestic producer’s price indexes (D-PPI) used in the calculation of the inflation of the previous month, at the beginning of each month. These D-PPIs must be used in the indexation relating to real estate sold in 2018.

The rate of increase between the index of the month prior to the month when the real estate is sold and the index of the month prior to the month it is purchased is calculated. A new cost price is determined by increasing the purchase price at this rate. The amount remaining after deducting the expenses, if any, from the difference between the new cost price and the sales price calculated in this way is deemed as net profit. However, the index difference must be more than 10% in order to benefit from this implementation. Otherwise, the profit must be calculated by deducting the initial purchase price and expenses from the sales price.

C. Exemption implementation

TL 12.000 (for 2018) of the gains generated from the sale of a real estate in 5 years is exempted from income tax. Tax return shall not be submitted and therefore tax shall not be paid, in case the gains calculated after indexation, if indexation is possible, or the difference between the sales and purchase price, if indexation is not possible, is less than 12.000 liras.

If gains exceeding this amount are generated, the exceeding part should be declared with an income tax return and the related tax should be paid.

III. Tax rate, declaration and payment

A. Income tax rate

Income tax is applied at increasing rates. If tax return is filed for incomes derived in 2018, the tax must be calculated according to the following income tax tariff (except employment incomes).

Income bracket	Tax rate
Up to TL 14.800	% 15
TL 2.220 for TL 14.800 of TL 34.000, for the exceeding part	% 20
TL 6.060 for TL 34.000 of TL 80.000, for the exceeding part	% 27
TL 18.480 for TL 80.000 of the part exceeding TL 80.000, for the exceeding part	% 35

B. Time of declaration

Real persons must declare the rent income they derive or the gains they generate from the sales of real estate, with an annual income tax return between the 1st and 25th days of March in the following year.

Accordingly, the said incomes derived in 2018 must be declared by Monday, 25 March 2019 starting from 1 March 2019.

C. Method of filing the tax return

The annual income tax return for rent incomes or real estate sales profit can be filed manually by going to the tax office. These tax returns may be sent by mail as well.

As of 2012, taxpayers who have no declarable income other than rent were also able to submit their tax returns without going to the tax office, using the “Prepared Rent Declaration System” if they wished. The scope of this system has been expanded and the “Prepared Declaration System” has been implemented effective from 1 March 2016.

Accordingly, income taxpayers whose incomes are comprised only of salary, rent income, income from securities and other gains and revenues or several or all of these items may submit their declarations pertaining to such incomes through the “Prepared Declaration System” which is prepared in advance by the Revenue Administration and then submitted to the approval of taxpayers.

Taxpayers may log in the system via the Administration’s website www.gib.gov.tr by replying to the security questions or by using their Internet Tax Office passwords.

D. Payment time of the tax

The first installment of the income tax calculated on the tax return must be paid in two equal installments, the first one by the end of March and the second one by the end of July.

Accordingly, the first and second installments of the income tax calculated on incomes declared for 2018 must be paid:

- By Monday, 1 April 2019 (since 31 March corresponds to Sunday)
- By Wednesday, 31 July 2019 respectively.

Explanations in this article reflect the writer's personal view on the matter. EY and/or Kuzey YMM ve Bağımsız Denetim A.Ş. disclaim any responsibility in respect of the information and explanations in the article. Please be advised to first receive professional assistance from the related experts before initiating an application regarding a specific matter, since the legislation is changed frequently and is open to different interpretations.