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MAXIMISING TAX RELIEF FOR LANDLORDS' EXPENSES

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PROPERTY

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About Jennifer Adams

Jennifer Adams FCG TEP ATT (Fellow) has been a professional business author for over 20 years, specialising in corporate governance and taxation. She is the proprietor of her own accountancy firm and also the landlord of a portfolio of properties. As such, she is well placed to advise on any tax problems that landlords may face.

Jennifer has been a regular contributor to *Business Tax Insider*, *Property Tax Insider* and *Landlord Vision*.

She is the author of the Tax Insider book '101 Property Tax Tips' and of the following guides:

- Tax Tips for Company Directors Guide
- Dividend Tax Saving Strategies Explained
- Directors' Loan Accounts Explained
- How To Use Trusts to Reduce Property Taxes
- Investing in Property – Personal or Company Ownership
- Implications of the Coronavirus for Landlords

About this guide

Property owners become landlords for a variety of reasons, but one thing they all have in common is the desire to maximise rental income profit or capital growth from their property investment. A common mistake is to think that the only way this can be achieved is by increasing rent to as high a level as the market can take, but this might not be practical, depending on a variety of reasons.

There are other ways of increasing post-tax profits without increasing rent, this being via the effective use of tax planning around expenses. For example, many landlords may not be aware that there are different methods of calculating various types of expenses; there is also a variety of tax claims available.

This guide concentrates on areas where tax savings may be possible, the actual amount of saving being dependent upon the precise circumstances of the situation and of the individual landlord, and, as such, the examples are included as a guide only. It must be stressed that professional advice should always be sought when undertaking any form of tax planning.

1 Taxable profits – Method of calculation

All profits from UK land or property are treated for UK tax purposes as arising from a business carried on by the registered landowner (even if an agent is employed to carry on the business for them). Profits are broadly calculated using the same principles as for a trade, although the taxpayer is not treated by HMRC as if trading.

If a UK resident landlord benefits from different types of income from property situated in the UK (i.e., land, commercial or residential lets), then they are all treated as being part of a single business (furnished holiday lets being calculated separately as different rules apply). Should a UK resident landlord also have income from property situated outside of the UK, then this is also treated as a separate business. Special rules apply to the UK rental income of non-resident landlords (not covered in this text).

It is not necessary to maintain separate records for each property (although, in practice, this might be a good idea to ascertain the profitability of each property). However, this is only the case for properties under common ownership. If the landlord owns some properties on their own and some jointly, then there will be different property businesses, and separate records will need to be kept. This method of record-keeping will be vital under the new Making Tax Digital regime to be implemented by 6 April 2023 (see section 1.9 for further detail).

1.1 Cash basis vs accruals basis

Many landlords automatically use the cash receipt method of profit calculation, not being aware that another method may be more beneficial in certain circumstances. This alternative method of calculation is the accruals basis (also termed the earnings basis) which follows the ordinary accounting rules.

The cash basis is the default method of accounting used by landlords whose total gross income from UK property (including FHL) and income from foreign property situated in the EEA is less than £150,000 per year.

The accruals basis must be used in the following circumstances:

- The gross rental income computed on a cash receipt basis exceeds £150,000 a year.
- The property business is run by a company.
- Business premises renovation allowance (BPRA) has been claimed.
- The landlord believes that the accruals basis is more appropriate than the cash basis.
- The properties are owned jointly, and one spouse uses the accruals basis.

Note: BPRA is a 100% tax allowance for certain spending when qualifying business premises are converted or renovated in a disadvantaged area.

Importantly, landlords can opt out of using the cash basis and use the accruals basis of calculation, if it is tax advantageous to do so (see section 1.3 for further detail).

The difference between the two bases is that under the cash basis, the income is recognised when it is received and not recognised at all if not received – this basis gives automatic relief for bad debts. Similarly, relief for expenditure is not given until payment has been made or incurred. In comparison, under the accruals basis, a landlord has to recognise the income and expenses in the accounting period to which they relate, irrespective of whether or not the income has been received or the expenses paid. This could mean that relief for expenses is given, and rental income is taxed in a later tax year under the cash basis than under the accruals basis. Under the cash basis, no adjustments are needed for debtors and /or creditors, whereas they may be required if using the accruals basis depending on the amount outstanding at the end of the tax year.

Practical tip

If a landlord calculates the profits of their property business under the cash basis and uses an agent to collect payments, then the income will be recognised when it is paid to the agent and not when the agent passes the money on to the landlord. If the agent fails to pass on any payments, then the income will still be recognised at the date that the payment was made to the agent.

1.2 Capital allowances

Capital allowances may be claimed on non-residential lets only. Claims can be made on plant and machinery (P&M) not within a 'dwelling-house'; HMRC accepts that in a block of flats, for example, each flat is a 'dwelling-house', but the rest of the building is not. The lifts are not within any of the flats, and so they qualify for a claim for capital allowances.

If the method of calculation is under the accruals basis of accounting, the purchase of any capital item is dealt with under the capital allowances rules. If under the cash basis, then payment is allowed on the date payment was made.

The annual investment allowance (AIA) provides a 100% deduction for the cost of P&M and integral fixtures and fittings (F&F) up to an annual limit, the exact amount depending on the type of let. For the period to 1 January 2022, this limit is £1 million reducing back to £200,000 for expenditure after 1 January 2022.

The Finance Act 2021 provides for a super-deduction of 130% and a 50% first-year allowance for P&M expenditure incurred by rental companies only between 1 April 2021 and 31 March 2023.

For expenditure greater than the AIA, writing down allowances are available on a reducing value or cost basis at 18% on P&M and 8% on F&F.

Practical points

- As a furnished holiday let is treated as a trade for income tax, capital allowances can be claimed on residential properties
- A landlord can also claim capital allowances on the cost of office furniture and equipment, including motor vehicles used in the business.
- Relief for the replacement of certain domestic items can be claimed