HOW TO MAXIMISE LANDLORD EXPENSES

2020/21

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PROPERTY

Contents

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About Jennifer Adams

Jennifer Adams FCIS TEP ATT (Fellow) has been a professional business author for over 15 years, specialising in corporate governance and taxation. She is also the proprietor of her own accountancy firm and as such, she is well placed to advise on tax problems that companies and their directors may face.

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

She is the author of the following Tax Insider guides:

- Tax Tips for Company Directors Guide
- How to use Trusts to Reduce Property Taxes Guide
- Dividend Tax Savings Strategies Explained Guide

About This Guide

Property owners become landlords for a variety of reasons but one thing that they all have in common is the desire to maximise rental income profits and/or capital growth from their property investment. A common mistake is to think that the only way that this can be achieved is by increasing the rent to as high a level as the market can take but this might not be practical, depending on a variety of reasons. This year, 2020/21, the coronavirus has meant that rather than being able to increase rents landlords have been legally obliged to consider reducing or deferring collection of rent without eviction for non payment should a tenant so request (initially for three months extended to 30 September 2020). There is no legal obligation to reduce the rent and the tenant remains liable for any unpaid rent. Where rent is not paid during the period and remains unpaid then the landlord still has the right to claim tax relief for bad debts (see section 1.1 for further detail).

A survey undertaken on behalf of the National Residential Landlord's Association during the third week of May 2020 confirmed that tenants and landlords were working together and that most tenants had been able to pay their rent as usual. However that survey was undertaken at the beginning of the pandemic and any subsequent survey may produce different results as the summer month's progress.

There is another way to increase profits without increasing rent and that is via the effective use of tax planning around maximising expenses. Many landlords may not be aware that there are different methods of calculation depending upon the type of income and expenses. There are also a variety of tax claims available, the choice of which may be beneficial in increasing expenses and reducing profits.

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 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

Tax is charged on the full amount of profits arising in the tax year. All profits from UK land or property are treated for UK tax purposes as arising from a business carried on by the registered owner (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 he were trading.

If a landlord benefits from different types of income from land and property (i.e. commercial or residential lets, furnished or unfurnished) in the UK, then they are all treated as being part of a single business; as such it is not necessary to maintain separate records for each property (although in practice this might be a good idea in order to ascertain the profitability of each property). However, this is only the case for properties in common ownership. If the landlord owns some properties on his or her own and some jointly, then there will be different property businesses and separate records will need to be kept.

Should a landlord also have income from property situated outside of the UK, then this is treated as a separate business. Income from furnished holiday lets (FHL) must also be calculated separately as different rules apply. Special rules apply to the UK rental income of non-resident landlords (not covered in this text).

1.1 Cash Basis v Accrual Basis

Many landlords automatically use the ‘cash’ receipt method of profit calculation not being aware that there is another method that may be more beneficial for use in certain circumstances (the ‘accrual’ basis -also termed the ‘earnings’ basis).

The cash basis is the default method of accounting for profits 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 ‘accrual’ basis must be used should the income exceed £150,000 a year or the property business is run by a company or Business Premises Renovation Allowance (BPRA) has been claimed, or because the person believes that the ‘accrual’ basis is more appropriate than the cash basis. BPRA is a 100% tax allowance for certain spending when qualifying business premises are being converted or renovated in a disadvantaged area.

Importantly, landlords can opt out of using the ‘cash’ basis and use the ‘accruals’ basis of calculation which follows the ordinary accounting rules.

The difference between the two bases is that under the cash basis the income is recognised only when it is received and not recognised at all if not paid. Similarly relief for expenditure is not given until the payment has been made or incurred, whereas under the accruals basis, a landlord has to recognise the income when it is due to them and the expenses that relate to the tax year under review, irrespective of whether or not the income has been paid or the expenses met. This means that under the cash basis, no adjustments are needed for debtors and /or creditors, for example, whereas under the ‘accruals’ basis, adjustments will be required.

This could mean that relief is given in a later tax year under the cash basis than under the accruals basis.

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 this on to the landlord. If the agent fails to pass on any payments, then the income must still be recognised when paid to the agent.

1.2 Capital Allowances

Under the 'accrual' basis of accounting the purchase of any capital item is dealt with under the capital allowances rules. The Annual Investment Allowance provides a 100% deduction for the cost of plant and machinery (P&M) and integral fixtures and fittings (F&F) up to a certain annual limit. The limit of AIA deduction £200,000 has been in place since 1 January 2016 but has been temporarily increased to £1 million for the two years to 31 December 2020, reverting to £200,000 as from 1 January 2021. Timing is therefore critical to take advantage of this higher limit and care is needed in calculation during the transitional period 31 December 2020 and 1 January 2021.

For expenditure greater than the AIA, then 'writing down allowances' are available at 18% on P&M and 8% on F&F.

1.3 Opt-out

Where the landlord has separate property businesses (e.g. one letting UK properties and another letting overseas properties) for each different type of property business e.g. opt out of the cash basis for the residential UK let business but remain in the cash basis for the other FHL business, depending upon which method is more appropriate/tax effective. Those landlords with a separate trade as well as a property business both being eligible to apply the cash basis, will be able to decide separately as to which basis to use.

Practical Tip

Opting out of the cash basis is via election on the personal tax return but note that the 'opt out' only applies for one tax year. Unless a further election is made on the subsequent tax return then the cash basis will automatically revert to the 'accruals' basis.

1.4 Jointly Owned Property

Where a property business is jointly owned by individuals who are not married to each other, each individual owner can independently decide whether to opt out of the cash basis or not. When one owner stays within the cash basis and the other opts out, the accounts for the property business will have to be drawn up twice - one set under the accrual basis and a separate set using the cash basis of accounting.

However, where the property business is owned by a married couple or civil partners, both individuals must either use the cash basis or both use the accrual basis. This ruling is in place to prevent the manipulation of profits between connected individuals.