

# **Guide to Calculating Rental Property Deductions**

## **Guide No.10 in the Tax Guide Series**

### **About This Guide**

This Guide has been prepared to help you calculate your income tax deduction for Rental Properties. If you still have some questions after reading it, please call into the Income Tax Office.

### **Introduction**

Rental income is treated as property income taxable under Part C of Schedule 1. It is important to realize that rental income is not Part B taxable income (Income from Self Employment, Trade or Business) but all deductions that would be available to a person deriving income from self employment trade or business are available to a person deriving property income.

### **Classification of Expenditure**

Expenditure incurred in deriving rental income can be classified under two broad headings. The first classification will be expenses that are incurred in bringing the rental property into existence. These costs are generally referred to as capital expenditure. Common examples of capital expenditure would include the cost of land, construction costs, the cost of acquiring an existing property or the cost of renovating a rental property. The second classification of expenditure will be those costs that are incurred as part of the process of deriving income. These costs are generally regarded as revenue expenditure. Common examples of revenue expenditure would be the cost of maintaining the property, the cost of annual services to the property or the costs connected with finding a tenant.

### **Examples of Non Deductible Capital Expenditure**

Capital expenditure on rental property relates to all those costs associated with bringing the property into existence. These costs include:

- (a) The cost of acquiring land;
- (b) The cost of building on the land;
- (c) The costs of constructing roadways and access paths to the building or property;
- (d) The cost of connecting services such as power, water and telephone to the property;
- (e) The cost of acquiring an existing property;
- (f) The cost of any stamp duty and legal costs paid in relation to the acquisition of the property;
- (g) The cost of renovating a property to make it suitable to rent;
- (h) The costs of acquiring furniture, appliances and other fixture and fittings that will be installed in the building and used by the tenant.

## Depreciation of Capital Expenditure

Paragraph 2 of Part D, Schedule 1 applies to allow a depreciation deduction on capital assets. To qualify for a deduction, the asset must satisfy the meaning of a depreciable asset.

## Examples of Deductible Revenue Expenditure:

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### General allowance

As noted earlier, revenue expenditure relates to the costs incurred in deriving the rental income.

Because of the varied nature of expenses that might be incurred by a person when deriving income, only a few deductions are specifically provided for in the Ordinance and the majority of deductions are allowed under the general allowance in paragraph 1 of Part D. Paragraph 1 says that

*“...there shall be deducted all outgoings and expenses to the extent that they are wholly and exclusively incurred...in the production of taxable income...”*

In essence, this general allowance says that any expense incurred for the purpose of earning income is a tax deduction. However, paragraph 3 of Part D qualifies the general allowance by saying that no deductions are allowable for certain categories of expenses. The categories that are most frequently excluded are:

- (a) Capital expenses (see above), and
- (b) Private or domestic expenses.

### Specific deductions

Paragraph 1 of Part D allows a deduction for the following specific types of expenditure;

- (a) Interest paid on moneys borrowed to gain the income. Interest paid on money borrowed to fund either capital or revenue expenditure would be tax deductible. For example, interest paid on money borrowed to fund building costs would be tax deductible.
- (b) Rent paid on any land or buildings used to earn income. For example, rent paid on a property that is subsequently sub let to another person would be a tax deduction.
- (c) Repairs to premises. The cost of a repair relates to the costs of maintaining a property in good order. It does not relate to the cost of building the property, an addition or a major renovation.
- (d) Renewal repair or alteration of a utensil or article. As noted earlier, the original cost of acquiring fixtures, fittings or other items located in a rental property is not deductible but replacements of those movable items will be deductible. As an example, the cost of replacing some of the bedding, linen, kitchen utensils and appliances will be tax deductible.
- (e) Donations to charitable organisations (subject to a limit of 1% of the gross taxable income).
- (f) Contributions to approved superannuation and pension funds (subject to a limit of the lesser of £20,000 or 20% of the net rental income profit).

(g) Depreciation deduction of 2% using the straight line method in relation to a structural improvement.

Example 1. shown below illustrates how to calculate the depreciation deduction for item (g) above.

Year 1	Cost	100,000
	Depreciation Deduction (2%)	2,000
	Written Down Value	98,000
Year 2	Cost	98,000
	Depreciation Deduction (2%)	2,000
	Written Down Value	96,000
Year 3	Cost	96,000
	Depreciation Deduction (2%)	2,000
	Written Down Value	94,000
Year 4	Cost	94,000
	Depreciation Deduction (2%)	2,000
	Written Down Value	92,000
Year 5	Cost	92,000
	Depreciation Deduction (2%)	2,000
	Written Down Value	90,000

Example 1.

#### Deductions that satisfy the general allowance

There is no limit to the nature of a general deduction that would be allowable, provided it is not capital, private or domestic. Common examples include:

- (a) The cost of electricity paid by the property owner.
- (b) The cost of telephone, internet or other communication charges paid by the owner of the property.
- (c) The cost of water paid by the owner of the property.
- (d) The cost of any advertising to find a tenant.
- (e) The cost of preparing a lease agreement.
- (f) Any motor vehicle costs incurred for travelling in connection with arranging and or carrying out repairs, transporting materials, transporting tenants or any similar activities.
- (g) Printing, postage and stationary costs connected with the property.
- (h) The cost of keeping records of income and expenditure.
- (i) The cost of having financial statements prepared.

#### **Rental Property Profits (Paying Tax)**

A profit on a rental property will arise when the total income received from the property exceeds the

allowable tax deductions. Where a profit arises, it is taxable in the same manner as any other form of income. This means that all profits and gains are added together and tax is charged on the total amount remaining after deducting the personal allowance.

For example, a person earns £10,000 from employment during the tax year ended 31st March 2011 and has a rental profit of £3,500. The total chargeable income for the year is £13,500 less the personal allowance and tax is calculated on that amount at the normal rates.

**Government of St Helena**

**Income Tax Office**

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