

Morris Owen

chartered accountants, business advisers and more...

Cash basis for landlords

The default basis for landlords' accounts.

Traders have been able to prepare their accounts using the cash basis since April 2013, as long as they meet certain eligibility conditions.

This option was extended to landlords running unincorporated property businesses from 6 April 2017.

However, while traders must elect for the cash basis, it applies by default to landlords who meet the qualifying conditions.

Consequently, if they do not want to prepare accounts using the cash basis they must elect for it not to apply.

The cash basis doesn't apply to:

- incorporated businesses that must continue to prepare accounts on an accruals basis
- landlords whose annual rental income exceeds £150,000.

Cash basis v accruals basis

Preparing accounts under the cash basis is much simpler than under the accruals basis – the cash basis simply takes account of money in and money out.

Sales are taken into account in the accounting period in which payment is received and expenditure is deducted.

By contrast, under the more usual accruals basis required under generally accepted accounting practice (GAAP), income and expenditure is matched in the period the income was earned or the expenditure incurred.

This means it's necessary to recognise money owed and owing (debtors and creditors) and expenditure relating to different accounting periods (prepayments and accruals).

The accruals basis is sometimes referred to as the earnings basis.

The key differences

A landlord prepares accounts to 5 April each year. From 30 April 2017 onwards, he issues invoices on the 10th of each month for rent of £1,000. The invoices are paid on 10th of the following month.



In the year he has issued invoices of £12,000 (12 x £1,000) of which payment has been received for 11 months.

In February and March 2018, the landlord undertakes some maintenance work.

He receives an invoice of £750 on 16 February, which he pays on 3 March, and an invoice of £475 on 22 March, which he pays on 9 April.

The income and expenditure taken into account under the cash and accruals basis for the year to 5 April 2018 is as follows:

	Cash basis	Accruals basis
Income		
Rent received (11 x £1,000)	£11,000	
Rent invoiced (12 x £1,000)		£12,000
Less: expenses		
Expenses paid	(£750)	
Expenses invoiced		(£1,225)
Rental profit	£10,250	£10,775

Eligibility

The cash basis applies by default to unincorporated property businesses which meet the following eligibility tests.

There are five tests which effectively apply to disqualify the landlord from preparing accounts using the cash basis.

If the landlord meets any of these tests, they must prepare accounts on the accruals basis; otherwise the cash basis applies by default.

Test one

The property business is carried on by a company, a limited liability partnership, a corporate firm, the trustees of a trust, or an individual's personal representatives.

Test two

The receipts for the year, worked out using the cash basis, are more than £150,000.



Cash basis for landlords

Test three

The property is jointly owned with a spouse or a civil partner who is entitled to the share of the profits and the co-owner calculates their rental profits using the accruals basis.

Test four

A business premises renovation allowance is given when calculating the profits and a balancing event in the year gives rise to a balancing adjustment.

Test five

None of tests one to four apply, but the landlord has opted out of the cash basis and elected for the accruals basis to apply.

So, to recap, if the landlord does not meet any of the first four tests above and has not elected to prepare accounts under the accruals basis, the accounts must, from 6 April 2017 onwards, be prepared using the cash basis.

More than one business

If the landlord has more than one unincorporated property business, the tests are applied separately to each business.

Depending whether any are met or not, it is possible that the cash basis may be used for some businesses and the accruals basis for others.

Capital expenditure

Simpler rules also apply to capital expenditure under the cash basis. Most items can simply be deducted when computing profits.

However, this rule does not apply to certain types of capital expenditure, such as land, a car, or an asset not used in the business.

A non-depreciating asset or a financial asset cannot be deducted in computing profits, nor can expenditure on 'special assets', such as education or training.

Likewise, no deduction is allowed for the costs incurred in connection with the acquisition or disposal of a business.

Where a deduction has been given for an item of capital expenditure (say, a van) and that item is subsequently sold, the sale proceeds are taken into account as income when they are received.

Cars

A deduction for cars is disallowed under the cash basis capital expenditure rules.

Consequently, relief for expenditure on cars is given in the form of a capital allowance in the usual way.

Replacement of domestic items

The normal rules for relief on the replacement of domestic items in a residential let apply equally, regardless of whether accounts are prepared on the cash basis or the accruals basis.

A deduction is given for the cost of an equivalent replacement.

Interest relief

The rules for deducting interest on the cash basis are the same as under the accruals basis, with the gradual switch from relief by deduction to relief as a basic rate income tax reduction.

Entering and leaving the cash basis

Moving between the cash basis and accruals basis requires some adjustments.

When entering the cash basis, opening debtors are not counted as income when the money is received and opening creditors are not treated as expenditure when paid.

When leaving the cash basis, either because the landlord is no longer eligible or because an election is made for the accruals basis to apply, adjustments are also required to prevent double counting.

Accruals basis – should you elect?

As noted above, where the landlord qualifies for the cash basis, this will apply by default unless the landlord elects to prepare accounts in accordance with GAAP using the accruals basis.

This may be because the landlord wishes to continue preparing accounts on the same basis as previously, or because accounts on an accruals basis are required by the bank to support a mortgage application.

Alternatively, it could be because the landlord has other businesses for which the accruals basis is a must, and wishes to use the same basis for all business for consistency.

Whatever the reason, the landlord must elect within the normal self-assessment time limit, by 31 January 2019 for 2017/18.

An election can be made by ticking the relevant box on the tax return.

Fixed rate deduction for mileage

A further simplification was announced at Autumn Budget 2017. This is to allow landlords (regardless of whether they use the cash or accruals basis) to claim a fixed-rate deduction for mileage costs rather than deducting actual costs.

The deductions mirror those available to traders and are set at:

- 45p per mile for the first 10,000 business miles
- 25p per mile thereafter for business travel in a car or goods vehicle
- 24p per mile for business travel by motorbike.

However, where the cash basis is used, it is not possible to claim mileage rates where the cost of the vehicle has been deducted under the capital expenditure rules, or where the vehicle is a car, if capital allowances have been claimed.

Mileage rates can be claimed from 6 April 2017 onwards.

Getting to grips with the changes

The cash basis is already here, and landlords who have not yet taken the tests should do so to see if it applies to them.

As the tax year-end approaches, if they are within the cash basis, they may wish to pay bills before the end of the tax year rather than after to get the deduction in 2017/18.

Get in touch for advice on your accounts.