MUST YOU PAY TAX ON YOUR RENTAL INCOME?

"Few of us ever test our powers of deduction, except when filling out an income tax form" (Laurence J. Peter of The Peter Principle)

Letting out property can give you an excellent “annuity” income, and if that concept appeals to you and a buy-to-let property comes your way at the right price put an offer in right now; before the current ‘buyer’s market’ runs its course.

In your financial planning however remember the tax implications, because as a landlord you must add your rental income to your salary and other taxable income in your tax return every year. Not to do so is tax evasion, and that carries heavy financial penalties as well as the very real threat of criminal prosecution.

Having to pay tax on your rental income could be make-or-break when it comes to deciding on how much you should pay for a particular property, so do your homework before you put your offer in.

Our tax laws are complex and specialised, so professional advice on your particular circumstances is essential here. These general concepts will however help you in your initial planning –

* You must declare all property rental income
* You must declare your gross rental income to the taxman whatever type of accommodation you rent out – whether a whole house or apartment, just a room/garden flat or anything similar – or if you are in the guesthouse/B&B/Airbnb business.

* You can claim some expenses, but not all

Your taxable income will be calculated by subtracting allowable deductions from your gross income.

In general, only “expenses incurred in the production of that rental income can be claimed” (SARS). So you can claim things like levies, rates and taxes, bond interest, advertising, agent’s fees, homeowner’s insurance, garden services, electricity and water, repairs and maintenance to the leased area (which would, says SARS, “usually take place when a person attempts to restore an asset to its original condition as a result of damage or deterioration”). Beware the “beginner’s mistake” of thinking that your full bond repayment instalments are deductible – not so, only the interest portion can be claimed and not the capital repayments.

In regard to VAT (per SARS): “The supply of accommodation in a dwelling is an exempt supply for VAT purposes, and consequently you may not deduct VAT incurred on expenses in respect of supplying accommodation in a dwelling.”

And when it comes to renting out only a portion of a property (a room say in the house you live in) you can only claim pro-rata to total floor area. Click here for a practical example from SARS.

Take advice also on claiming depreciation on furniture and the like – your allowable deduction there might be worthwhile.

Not allowed are “expenses that are capital in nature or that are not in the production of rental income” (SARS). So the cost of improvements to the property - which would normally “result in the creation of a better asset” (SARS) - cannot be claimed. Improvements can however be added to the “base cost” of your property – important when you come to pay CGT (Capital Gains Tax) on eventual disposal.

* How are you taxed, and what about “ring-fencing”?

Your total taxable income (i.e. including net rental income) will be taxed as per current tax tables.

What if your letting business shows a loss? Per SARS - “should the expenses exceed the rental income, the loss should be available for set-off against other income earned by the individual, provided that the loss is not “ring-fenced” in terms of prevailing anti-avoidance provisions”. In other words SARS could ring-fence your letting business losses to stop you from setting them off against your regular non-rental income. But if that happens you don’t lose those losses, they are just carried forward so that when your letting business starts turning a profit the losses can then be set off against that profit.

Keep an eye also on your obligation to register for and pay provisional tax. As an individual if you earn taxable income of R30,000 p.a. or more in “rental from letting of fixed property” you fall into the net.

* Keep full records from Day 1!

Create and maintain a full spreadsheet, with a file of supporting documents, of all income and expenditure (distinguish between revenue and capital, claimable and not claimable). It’s a relatively painless exercise if you update it regularly, but a real challenge if you end up trying to recreate everything only when the annual “income tax return panic” sets in, or when SARS and/or your accountants call for breakdowns and documentation.