Revenue and Capital

Capital v Revenue

Before one can determine whether it is possible to obtain relief for expenditure incurred in relation to a let property, it is first necessary to determine whether the expenditure in question is capital or revenue in nature.

Capital expenditure generally involved purchasing or improving an asset that is used in the business. In the context of property letting, examples of capital expenditure would include the acquisition of a property, improvements to that property, such as an extending or renovating the property or the purchase of assets such as plant and machinery (for example, office equipment or vehicles used in the property letting business) or furniture where the property is let furnished.

By contrast, revenue expenditure is the expenditure involved in the day-to-day running of the business, and includes items such as repairs to properties (but not improvements), staff wages, legal fees, interest paid (but not capital repayments on a mortgage), any rent paid, council tax and such like.

Revenue Expenses
Providing the expense is incurred wholly and exclusively for business purposes, relief is given in full as a deduction against income in computing the profits of the property rental business. This is attractive as provides immediate relief for the expenditure. The profits of a property rental business are calculated in the same way as the profits of a trade and, as a result, similar considerations apply to determine the deductibility of expenses

The list of revenue expenses that may be computed in calculating the profits of the business is potentially long. Care must be taken that the expense really is a revenue expense, as capital expenditure is not allowed as a deduction against profits.

Although in many cases this will be obvious, the dividing line between a repair (revenue) and a renewal (capital) may not always be clear. This distinction was discussed in my article in the October issue of Tax Insider.

Care must also be taken in relation to mortgage payments as although interest is deductible (subject to some conditions), capital repayments are not.

If the expense is incurred for both private and business purposes, strictly speaking the amount is not deductible. However, where the expenditure can be apportioned between business and private expenditure, HMRC will allow a deduction for the business element.

Capital Expenditure

Capital expenditure is trickier and the options for relief more limited. Further, where relief is available, in the majority of cases it is not immediate.

Capital allowances provide relief for the depreciation of the asset. Capital allowances are available in respect of plant and machinery used in the business, such as office equipment.

Cars and other vehicles will also attract capital allowances. However, with the exception of furnished holiday lettings, furniture provided in a let property, such as a residential let, does not attract capital allowances. Furniture in the property attracts relief either on a renewals basis or by reference to a 10% `wear and tear' allowance.

Some energy saving items attract an immediate deduction of 100% of the cost to a maximum of £1,500 per property. Items covered by this allowance (known as the landlord's energy saving allowance) include loft insulation, cavity wall insulation, hot water insulation, draught proofing, solid wall insulation and floor insulation.

As far as the property itself is concerned, no relief is available. However, when the property is sold, the cost of the property and any subsequent improvements, together with the costs of acquisition and disposal are deducted from the same proceeds in determining any resulting capital gain or loss.

DIFFERENCE BETWEEN CAPITAL EXPENDITURE AND REVENUE EXPENDITURE

Capital expenditures are for fixed assets, which are expected to be productive assets for a long period of time. Revenue expenditures are for costs that are related to specific revenue transactions or operating periods, such as the cost of goods sold or repairs and maintenance expense. Thus, the differences between these two types of expenditures are as follows:

- *Timing*. Capital expenditures are charged to expense gradually via depreciation, and over a long period of time. Revenue expenditures are charged to expense in the current period, or shortly thereafter.
- *Consumption*. A capital expenditure is assumed to be consumed over the useful life of the related fixed asset. A revenue expenditure is assumed to be consumed within a very short period of time.
- *Size*. A more questionable difference is that capital expenditures tend to involve larger monetary amounts than revenue expenditures. This is because an expenditure is only classified as a capital expenditure if it exceeds a certain threshold value; if not, it is automatically designated as a revenue expenditure. However, certain quite large expenditures can still be classified as revenue expenditures, as long they are directly associated with sale transactions or are period costs.