Returns on residential rental property are taxable

Residential rental property can be a great source of income as well as long-term capital gain, but what many investors forget is that those returns are not tax-free.

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“In South Africa, owners are liable in terms of the Income Tax Act to pay tax on the profits they make from any rental properties, and SARS requires them to keep and submit records of all income and expenditure with regard to those properties in order to accurately calculate the profits,” says Jan Davel, MD of the RealNet estate agency group.

“This means that even if you are just breaking even on your rental property, or only renting out your holiday home or garden flat on an occasional basis, you can’t just quietly pocket the rental you receive and not declare it as part of your annual income.”

Deductible expenses

Having said that, however, most rental property owners also don’t realise that they can deduct certain expenses from their gross rental income to determine the profit and therefore reduce their tax liability.

These expenses include:

- Municipal rates and taxes;
- The interest on the home loan used to buy the property;
- Sectional title levies, if applicable;
- Any advertising costs paid to find new tenants;
- Any fees or commission paid to a managing or letting agent;
- The annual home owners insurance premium;
- The cost of security and garden services; and
- The cost of repairs and maintenance needed to keep the property in good condition.

But, it must be said that SARS will expect landlords to present invoices, receipts and bank statements as proof of any and all expenses that they claim. In addition, landlords may not claim VAT as an expense or charge VAT on the rental.

Capital gains tax

Davel also notes that expenditure of a capital nature, including the purchase price of the property and the cost of any additions or improvements (such as an extra bedroom or the refitting of an old kitchen), may not be deducted from rental received - but could possibly be added to the 'base cost' of the property for capital gains tax (CGT) purposes.

“And that brings us to the question of whether the investor will be liable for CGT or for income tax if and when the property is resold. In general, if you can show that you bought a property with the intention of holding on to it as a long-term investment, and then rented it out for a number of years, SARS will regard the proceeds of the eventual sale as being of a capital nature, and thus subject to CGT rather than income tax.

“But if you buy an investment property and then quickly resell it, SARS is quite likely to categorise the original purchase as speculative, and the proceeds of your sale as taxable income - even if your original intention was to hold on to the property and your sale was prompted only by a sudden change of circumstance.”

The difference between the two possible tax liabilities is of course very large, he says, and underlines once again the fact that time is the property investor’s greatest ally.