



Technical Update

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Preparing accounts for Resident Management Companies (“RMCs”)

There are a number of scenarios where a company, that owns the freehold of a block of flats, is required to report under the Landlord and Tenant Act 1985 (“LTA85”). Specifically under section 21 of the Act, if there are four or more dwellings and a request is made by an occupant, then the company must prepare a summary of relevant costs which are required to also be independently reviewed by a registered auditor.

From an accounting perspective, where service charges are paid by residents to the RMC, they are often treated as income and reflected in the company’s accounts as such. Likewise, any costs incurred are treated as expenses. The excess monies held are also often reflected on the company balance sheet.

The actual situation with regard to service charges is that the company is merely acting as an agent in looking after the monies and facilitating any transactions (on behalf of the residents). The company is not the principle i.e. the income received from the service charge is not their income, they don’t “own it”. Likewise, the surplus cash is not cash that can be used by the company – they are merely holding it in trust for the residents.

The accounts for the RMC should reflect this and therefore should not include the service charge income or expense transactions. The accounts of the company will be relatively dormant with the property on the balance sheet and possibly a low level of income and expenditure assuming ground rents are received. It is likely that some RMCs will actually be dormant.

For companies where service charges have been accounted for, the removal of them and adjustment will need to be done as a prior year

adjustment, so the comparative and opening position will change as well, as it is a change of accounting policy.

Also the bank account for the service charges should not be the main account of the company – it must contain either “trust” or “client account” in the title to indicate that the company is holding it in trust.

New Landlord and Tenant legislation is proposed which, when implemented, will require service charges to be accounted for and reviewed independently. A separate “statement of service charges” and “balancing statement” will be obligatory and an independent accountant, such as Menzies, will be required to review and report on the statements. There is no guidance with regard to the format or wording at the present time. Once the guidance has been implemented we will issue further advice on the required format.

From a tax perspective, the income and expenses, accounted for within a RMC, have been treated as mutual i.e. no tax charge arises. The only tax being suffered is on the bank interest received. This is normally included within a corporation tax return for the RMC. However, HMRC is suggesting that the service charge income, expenses and interest should technically be declared on a trust tax return. In many instances this will lead to additional tax work being undertaken. The tax rate suffered on bank interest will also increase if this interest is taxed via a trust return and not a corporation tax return.

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