



Working from home? Don't forget the home office deduction

**“Home office?
Make sure you’re not
missing out.”**



Home office and what are you entitled to claim?

Running your own company generally involves functions that occur away from the client’s premises. Many administrative jobs, planning, report writing and preparation are most likely performed from home. Other companies claim the cost of running and maintaining their offices. So if your office is also your home, which costs are you entitled to claim?

In this ebrief, Paul Gough, Managing Director of InTouch Accounting, the personal online accounting adviser for contractors and freelancers, explains how, if you use a portion of your home for business, you may be able to claim a home office deduction.

Read on and make sure you’re not missing out on all you’re entitled to.

So what are the rules?

There is a general rule that expenditure is permissible as a tax deduction if it is *wholly and exclusively for the purposes of the trade*, the strict application of this would say that expenditure with dual purpose (both business and private use) is not therefore allowable as a tax deduction.

But, fortunately not even HM Revenue and Customs (HMRC) is that unfair!

The view of HMRC for the purposes of apportionment of costs when you use your home as your office is that, when part of your home is being used for business, for the duration of that time its **sole** purpose is business and it passes the “wholly and exclusively test”. But, if part of the premises used for business purposes is at the same time also available for some other non-business use, then no deduction is due.

Which expenses of operating from home can be claimed?

HMRC generally takes a rather pragmatic approach and has confirmed that, provided the claim is reasonable and consistent with the type of business being operated, it is unlikely to make any enquiry into the value of the claim by the company or the receipt of income by the home owner.

Sadly, not all local HMRC officers follow this approach, or apply consistent reasonableness tests; and so it remains important that you are prepared to justify the basis upon which you make your claim.

What are the alternatives?

There are two common and quite sensible alternatives that are generally considered:

1. The flat rate, and
2. The calculated apportionment basis.

The flat rate

HMRC publishes a range of flat rate expenses that are considered reasonable without having to maintain detailed records or evidence of expenditure. The current flat rate allowance from April 2013-2014 for using your home as an office, is a whopping £4 a week, or £18 a month if you prefer. Making an annual claim worth £208! With Corporation Tax at 20% this provides relief of £41.60. Generous, but not life changing you may be thinking...

The apportionment basis

Apportionment is the term used when an expense is “split” between business use and private use, on a basis intended to show the proportion of time it is used for each activity.

A practical difficulty in quantifying use of home claims has always been that accurate apportionment of expenses between the two forms of use requires knowledge of the overall household expenses attributable to the business area of the house, and the actual time duration of personal and business use for that area. For this reason, and in an attempt to simplify the process, HMRC recognises this difficulty and has indicated that they will accept a *reasonable basis being used*.

What expenses can be considered?

Property costs can be divided into fixed and running costs. A claim can be made for both of these and can also include apportionment of any capital expenditure. Unfortunately, capital expenditure on property improvements is not available, but capital expenditure on office equipment can be, provided it has some business use.

Where part of the house (such as a study) is set aside for business use for a specific period of time, then it's normal to apportion costs on the basis of floor area and time period, unless there is a more appropriate basis that can be applied.

Fixed costs

Some fixed costs relate to the whole house and have to be paid even if there is no business use; these include costs such as Council Tax, mortgage interest or rent, insurance, water rates and general repairs. Capital repayments on your mortgage are not an allowable deduction and you should make sure you don't use the repayments in calculating the apportionment of interest.

Where fixed costs are clearly attributable to one use, business or personal, then the cost should be entirely allocated to that use. When you decorate your study (home office), if it has been set aside entirely for business use, the cost of decorating that room can all be claimed.

Running costs

Running costs generally vary according to use. When apportioning running costs such as metered water rates, sewerage, light, heat and power, telephone and broadband, and cleaning, maintenance and repair; you should consider not only the floor area and time period, but also perhaps other more relevant factors, such as the number of people in the household.

Running costs (with a fixed element)

Some costs can have both fixed and variable elements, such as telephone bills. Telephone bills consist of a fixed line rental and variable call costs. HMRC has accepted that a proportion of the fixed landline rental costs can be claimed where the calls are business and private, on the basis that during the business call the line rental is solely for business purposes. Strictly speaking, with home telephone charges you are supposed to record all incoming and outgoing calls, divide these between business and private and split the fixed line rental accordingly.

In reality this is impossible, but HMRC still expects you to maintain a split between business and private outgoing calls.

Broadband is another example where, strictly speaking, it should be apportioned according to actual use. In reality, and with broadband costs becoming cheaper, a sensible split based on the users in the household and expected periods of time would be deemed reasonable.

A commercial, business approach

Have you ever thought what would happen if you decided you wanted to formally rent part of your house to the company?

If you did just that, the rent paid by the company would be a permissible deduction; however, the rent received by you, personally, would be a taxable receipt subject to Income Tax (probably at rates in excess of the 20% Corporation Tax rate at which tax relief is obtained).

So not a popular choice!

Some taxpayers used to argue that 'rent a room' relief (where you can receive rent up to £4,250 per annum tax free) could be used, but that's long been discounted. And the rules always stood that rent a room relief does not apply to business use as an office.

There are also other financial and legal issues concerning whether your home can be used for commercial purposes. The local authority might object that it's not a permitted use, or they may consider that business rates (much more expensive than domestic council tax) should be applied to the part commercially let. You could also be charged for commercial refuse collection, and then there's the health and safety, public liability and other insurance issues to consider...

Also not a popular choice!

"My personal online accountant gives me clear advice and helps me claim correctly"



And temporary rented accommodation?

If you work away from home, the costs of your temporary accommodation are eligible to be claimed as part of your travelling and subsistence costs. So be careful not to duplicate costs for "Use of Home" with overlapping periods of time claimed elsewhere.

What records do you need to keep?

If you adopt the flat rate, you keep none whatsoever.

If you adopt the apportionment basis you will need to keep all your invoices and receipts as evidence of the costs incurred. You should then record the basis of apportionment for each type of expense and the detailed calculation.

Calculations can be monthly, quarterly or annually; it's the reasonable nature of the basis used that's important, not the frequency.

What happens if you claim too much?

If you pay expenses personally and then claim reimbursement from the company, more than a reasonable business element, then as for all other claims for private expenses you have two choices:

1. Allocate the excess private element to your director's loan account and not treat the excess as business expenditure, or
2. Claim the full amount and declare the excess private element as a benefit in kind on your P11D.

By adopting a sensible and realistic approach reflecting your business circumstances, you should be able to successfully handle any enquiry from HMRC.

Use of home, IR35 and “genuinely in business”

When you consider yourself to be “genuinely in business on your own account” and contractually outside the scope of IR35, then the nature of any claim for use of home as an office should reflect that status.

- You would be expected to run your business in an efficient manner and that would include provision within your home of dedicated space for business use
- You may also require dedicated furniture, equipment and even unique business telephone and broadband connection as an essential element in running your business
- Your household insurance is unlikely to include your business and so you may take out specific cover for your assets, perhaps including public liability insurance when meeting clients at home.

Any such costs specifically incurred by the business are genuine business costs and tax relief is available.

And what about Capital Gains Tax?

It is well established that a gain in the value of a property whilst it is your main residence is free of Capital Gains Tax (CGT). However, if part of your main residence is used exclusively for business use, this exemption can be lost for that part of the property.

So how does this work alongside a use of home claim?

For Use of Home to succeed, part of the property has to be used solely for business purposes, but for only **part** of the time. Whereas, in order to put at risk the loss of your CGT exemption, the use of part of the property for business purposes has to be **exclusive** – 100%

A restriction for exclusive business use for only part of the time would appear to not jeopardise principal residence relief. This would not be the case if part of the property were commercially rented to your company. In this scenario, it's likely that CGT exemption would be lost for gains attributable to that part of the property.

Building a summer house – (oops! “garden office”)

It is not uncommon for contractors to build a dedicated office building in their garden, or to extend their loft with an office conversion.

The capital cost of these structures can be met by the company, but you won't get Corporation Tax relief via your company for the structural costs.

If you personally borrow the money to fund the build or conversion costs, then the interest is an allowable deduction under use of home, or if the loan was taken out by the company as loan interest.

Costs incurred for carpets, curtains and other fixtures and fittings are business assets and your company can claim capital allowances in the normal way.

When you eventually sell the house, part of the proceeds are allocated to the garden office or loft conversion and belong to the company. The company is deemed to have made a disposal of the asset. The proceeds less the original capital cost, enhanced by some extra reliefs, are a profit subject to Corporation Tax (not CGT).

If you cease to use the building for business purposes and start using it domestically, then there is likely to be a benefit in kind charge. Alternatively, you might consider acquiring the asset outright from the company, making it part of your main residence.

Finally, don't forget to think about VAT. If you have adopted the flat rate scheme it may limit the VAT that can be recovered.

So...

If you only use a table top whilst your family watches TV, there is no right to claim use of home whatsoever. If you set aside part of your home at specific times for business use, then you are able to claim use of home.

Decide whether the weekly flat rate of £4 or the more detailed apportionment basis is most appropriate. If you adopt the apportionment basis, record the basis and method of apportionment, review this annually and maintain a record of the actual costs.

Be careful if you decide to construct a dedicated office building – it is always safer to seek advice **before** you start.

Example 1

Angela is site based and writes up her business records at home. She uses a room solely for business use for a short period each week. She estimates that £4 covers the cost of the proportion of the property costs, plus the electricity for heating and lighting.

Although the claim for £208 is obviously an estimate of £4 per week, the claim is small and reflects the facts of the case. It is arguably a reasonable estimate of the expense incurred.

Example 2

Bill works on site but also runs a small peripherals business through his company. He uses one small room at home as an office, exclusively for the purposes of his trade. The room represents 5% of the floor area of the house.

His Council Tax, insurance and mortgage interest bills total £8,500. He claims 5%.

His electricity bill for heating & lighting is £1,500. He claims 5% of the total.

His total claim is £500 (plus the business proportion of his phone bill).

Although Bill has apportioned his electricity bill by floor area rather than usage, the amount claimed is small and there is nothing to suggest that his business use is significantly greater or lesser than his private use. It can be accepted as a reasonable estimate.

Example 3

Christina is a technical author and uses her living room from 8am to 12am. During the evening, from 6pm until 10pm it is used by her family. The room used represents 15% of the area of the house.

The fixed costs including cleaning, insurance, Council Tax and mortgage interest total £16,600; 15% of the fixed establishment costs are £2,490 and one sixth ($4/24$) of the total room usage is for business, so Christina claims £415.

She uses electricity for heating, lighting and to power her computer, which costs £2,500 per annum. Christina considers an apportionment of these costs first by area and then by time by time; 15% of the costs are £375 and half of these costs (4hrs/8hrs) relate to business use, she claims £188.

She also uses the telephone to connect to the internet for research purposes. Her itemised telephone bill shows that a third of the calls made are business calls. She can claim the cost of those calls plus a third of the standing charge.

Christina has some work done on the house. She has the exterior painted and at the same time has the dining room re-decorated. What, if anything, can she claim as a deduction?

The exterior painting is a general household cost. She can claim a proportion based on business use. Christina does not use her dining room for business purposes. The cost of redecorating the dining room is not an allowable expense.

Example 4

Gordon is a business analyst working mainly from home. He dedicates a room solely for use as his office between 9am and 5pm daily. The room contains a workstation, office furniture and storage for his reference books and software.

He uses the room for an average of 4 hours each day, though often this is spread over his working 8 hour day as he has a number of regular site visits to make. In addition it is not uncommon for Gordon to accommodate clients in his office to discuss plans, outside of normal hours.

The room is available for domestic use outside of business hours and his family regularly make use of the room for around 2 hours each evening.

After apportioning costs by reference to the number of rooms in the house, Gordon calculates the room uses £300 of variable costs (electric and oil) and £600 of fixed costs (council tax, mortgage interest, insurance). In apportioning these costs by time Gordon claims £680 in total, made up of $4/6$ of variable costs (£200) and $8/10$ of fixed costs (£480).

The claim equates to 75% of the total costs attributable to the room (£680/£900), which Gordon views as a more straightforward but equally reasonable basis for future claims, should his circumstances remain unchanged.

In conclusion

Just remember, if you're trying to establish whether a home office expense would be allowable for tax purposes, you need to ask yourself:

Has the expense has been incurred "wholly and exclusively" for the purpose of your business?

If you follow this guideline, in general terms, and allowing for some exceptions, if the expense meets this definition, it is allowable as a tax deduction.

And one final caution: keep your claims reasonable and keep the numbers and paperwork to back them up.

These tips are for information purposes and are just a place to start. We recommend you seek advice from your specialist contractor accountant who will review your specific situation and provide you with the right advice to make sure you're claiming all the benefits you're entitled to.



New Enquiries: 01202 901 385
Email: info@intouchaccounting.com
SKYPE address: Intouchaccounting
Twitter: @intouchacc

www.intouchaccounting.com

At InTouch Accounting, we work with contractors every day, helping them to understand their options, make the right decisions for their businesses and save money. So speak to us about how we can help you reduce the administration burden ... and save more on expenses.

We hope you found this information useful and please feel free to pass it on to a friend or colleague who could benefit from receiving this ebrief – or invite them to contact us and we'll add them to our mailing list to receive this and future editions of our ebriefs.

***Find out more by visiting our website
or contacting a member of your
InTouch Accounting team***

InTouch Accounting – the personal online accounting adviser