Doing your homework

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Working from home is becoming more popular. Office equipment to make it feasible is fast becoming affordable, working styles are making it practicable and transport congestion and travel costs are rendering it attractive. The possibilities range from a self-employed person working solely from home and having no other business base, to an employee who takes work home from time to time but is mainly based at a conventional office. In these notes we shall look at

- Tax deductible expenses
- Problems for employees
- Capital Gains Tax
- Travelling expenses to the office
- Other issues

Tax-deductible expenses

For a self-employed person, tax relief will generally be available on additional expenses which are incurred through working at home. But it is important to have some record which will support any expense claim. It is no longer possible, as might have been the case in the past simply to claim tax relief for a round-sum notional figure such as "use of home as office - £10 per week." Instead, it will be necessary to show specific items of actual expenditure. If an expense relates only partly to the business (telephone bills, for example, where the phone is used for private calls as well as business ones) then the cost should be apportioned and you should keep some evidence to show that the apportionment is reasonable - a log of phone usage for a representative period, perhaps.

For a self-employed person working from home the following household costs might be tax-deductible:

- Phone charges relating to business calls
- Phone rental for an exclusively business line
- Internet access charges for business usage
- Any additional insurance premium charged for business use of the home
- Capital allowances on furniture and equipment purchased specifically for use in the business

Tax relief for part of the general running costs of the home is a moot point. One might have thought that the requirement in ICTA 1988 s74(1)(a) that expenses must be incurred "wholly and exclusively for the purposes of the trade" would deny relief: but in practice (see IM 601e) the Revenue agree that where there is part-business and part-private use of property the running costs may be apportioned. Of

course, in property cases one usually encounters such apportionments where defined parts of the premises are used either wholly for business or wholly for non-business purposes, such as living accommodation in a pub or a flat over a shop; but there seems to be no reason, by analogy with the apportionment of motoring costs, why running costs should not also be apportioned where a property or a part of a property is used sometimes for business purposes and sometimes privately.

The more frequent and substantial the use of facilities at home, the better the case for claiming relief for part of the costs. At the one extreme, a dedicated office used for no other purpose should allow you to claim relief for a pro-rata part (usually by reference to floor area) of all the running costs of the house including mortgage interest (but not capital repayments or endowment premiums), rent, insurance, repairs, council tax etc. Heating and lighting costs can be apportioned on the same basis, though it may be that the facts support apportioning a larger (or smaller) amount to the office on the basis of usage. And if an office or study has been built specifically for the business, there is no reason why interest on any loan taken to finance the building work should not be deductible in full.

At the other extreme, if "working from home" involves little more than setting papers out on a corner of the dining-room table for a few hours a month, the costs which can reasonably be attributed to such use may be negligible.

Commonly a spare bedroom doubles as an office during the week and guest accommodation at weekends - in that case the whole-house costs need first to be apportioned on the basis of floor area and then the part attributable to the room should be apportioned by reference to the time it is used for domestic or business purposes.

Employee problems

For employees, there is the additional and considerable problem of s198 (now Income Tax (Earnings and Pensions) Act 2003 s336): expenses will be tax-deductible only if incurred not only "wholly and exclusively" (as to which, see above) but also "necessarily in the performance of the duties." Before Finance Act 2003 this made it practically impossible for employees to secure tax relief for any general household costs and sometimes difficult to get relief even for specific identifiable additional costs. The Revenue would tend to trot out the observation of Donovan L J in Brown v Bullock –"*The test is not whether the employer imposes the expense but whether the duties do, in the sense that, irrespective of what the employer may prescribe, the duties cannot be performed without incurring the particular outlay*." The emphasis on "the particular outlay" can be carried to absurd lengths by the Revenue: there have been attempts to deny relief for telephone costs borne by a home-worker on the basis that it would have been perfectly possible to either write or wait until next in the office and make the call then! Curiously, the Revenue have never given the same prominence to Lord Evershed's comment in the very same case that *"I would point once again to the distinction between the two Schedules, which I for my part regard as somewhat regrettable as something which tends to bring the law into a*

measure of disrepute and to make the Income Tax obligations of the taxpayer a game of ingenuity divorced from principle or ethical or other common-sense considerations."

One way round the difficulty in the past has been to grant a licence over a part of the home to the employer for use in the business. A reasonable rent should be fixed, lest it be challenged by the Revenue as disguised remuneration; but a rent which reflects only the apportioned costs, perhaps with a modest addition for the use of furniture, would normally be reasonable. The rent received will be taxable on the employee, of course - but it should be possible to deduct from the rent the costs of providing the accommodation so the net effect is that tax relief is given on the apportioned part of the general and specific household costs attributable to the use of home. The same caveats as above apply as to the need to ensure that the deduction claimed is reasonable having regard to the actual amount of use made of the home for business purposes.

Alternatively, it may be possible to secure the same result by altering the terms of the employment contract so that the employee is contractually obliged to work from home and to provide working facilities there. It is true that even that arrangement might not be enough to overcome Lord Donovan's emphasis on the requirements of the job rather than of the employer – indeed in Brown v Bullock itself it was "virtually a condition of appointment" that Mr Brown should join a suitable gentlemen's club: but it is worth noting that in the recent case of Kirkwood v Evans [2002] STC 231 the Revenue appear to have conceded before the Commissioners that "had the taxpayer been contractually obliged to work from home these expenses may have been deductible."

The problem is now somewhat alleviated (but by no means removed) by the s316A of Income Tax (Earnings and Pensions) Act 2003. This provides exemption from tax where an employer makes a payment to an employee in respect of "reasonable additional household expenses" which the employee incurs in carrying out duties at home under "home working arrangements". Importantly, there is no requirement under s316A that the costs be "necessary" in the Brown v Bullock sense.

Several points should be noted all of which tend to suggest that the new relief owes more to spin than to any real desire to encourage home-working:

First, this is only an exemption for payments made by employers. It does not afford any relief to the employee who has to meet these costs himself. Thus even the new relief would have been of no assistance to the taxpayer in Kirkwood v Evans {2002] STC 231 who failed to secure relief for the costs that he himself bore of working from home under a scheme promoted by the department of the Civil Service for which he worked.

Second, the relief extends only to reasonable <u>additional</u> household expenses (i.e., additional "expenses connected with the day to day running of the employee's home"). It would not, therefore, appear to cover a contribution towards any apportioned part of general household running costs and it is difficult

to envisage what could be included other than additional heating, lighting, telephone and internet costs directly attributable to working from home.

Third, the amount of the exemption is in principle unlimited; payments of up to £2 per week may be made regardless of the actual costs incurred but if an employer pays more £2 per week the exemption will apply only if there is actual evidence showing what additional household expenses have been incurred. Given the limitations of the kinds of costs covered by the relief, valid claims for more than £2 per week will probably be uncommon.

Fourth, the relief applies where "the employee regularly performs some or all of the duties of the employment at home". Well, once a year is "regular" but it seems unlikely that the employer will be allowed to pay up to £104 tax-free every year merely because the employee works at home on 28th April every year. More realistically, it is not clear what is to happen where an employee spends time working at home for a few days every month – or every other month: does he get his tax-free £2 only for a week during which he spends some time working at home, regardless of whether he works from home for just half a day that week or for the full week? This would impose a compliance burden out of all proportion to the benefit. Or can he get his tax-free £2 week in week out regardless of what time if any he works at home in that particular week provided that he works at home at some time with some degree of regularity? Or, frankly, does anyone really care for the sake of a weekly tax benefit that even for a higher-rate taxpayer is worth about the same as a litre of petrol?

Capital Gains Tax

A gain made on the "principal private residence" is of course free of CGT. But the exemption is restricted if and to the extent that any part of the home is used "exclusively for the purposes of a trade or business." The important word here is "exclusively." Use of a part of a home for the business will not compromise the CGT relief if that part is also used for domestic purposes - though, as explained above, the income tax relief for part-business and part-private use will be less than for wholly-business use. And even if part of the home is used exclusively for the business, there may in the event of sale be little or no CGT to pay for a number of reasons:

- Properties prices can go down as well as up.
- There may not be a chargeable gain on the property, having regard in particular to indexation relief on the cost up to April 1998.
- If there is a gain, the part apportioned to the "exclusively business" part (usually on the basis of floor area) may be small and within the CGT annual exemption - remember that if the house is jointly-owned by husband and wife then each spouse gets a separate annual exemption.
- If there is a gain which is in excess of the annual exemption, and a new house is being bought which will also have some exclusive business use, it may be possible to claim CGT roll-over relief to defer payment of any tax until the replacement house is sold.

- Having regard to the changes to business taper relief (albeit that for some unexplained reason the most recent relaxation does not come in until 6 April 2004) it is likely that any gain will benefit from business taper so that the effective rate of tax on any gain may not exceed 10%. Thus, even if there is a gain, the value of income tax relief now may be greater than the possible cost of an indeterminate amount of CGT at some possibly remote future date.

Travelling expenses

Costs of commuting (i.e., travelling to a normal place of work) are not tax-deductible, whether for an employed or self-employed person. So if you do not work from home at all the costs of getting to wherever you normally work have to be met out of taxed income. On the other hand, if you travel from home on a business journey (i.e. to somewhere other than your usual workplace), the full cost of the journey is generally tax-deductible. This applies whether you are employed or self-employed, and regardless of the extent to which you work from home (or indeed if you don't work from home at all).

It is clear from Kirkwood v Evans that the fact that an employee works from home is of no effect at all in interpreting the employee travel rules at ICTA s198(1A) – (now Income Tax (Earnings and Pensions) Act 2003 s337). So there is still no relief for going into the office, even if you have to go in only occasionally and then only to collect and deliver work. Mr Evans went in weekly but presumably even less frequent attendance would be caught provided it was “regular”. But if the other workplace is "temporary" (meaning, broadly, that you do not expect to be working there on a regular basis for more than two years) your costs of travelling there will be tax-deductible.

For the self-employed working from home the position is less clear. A self-employed person - a partner in a professional firm, say - may regularly work from home a day or two every week but attend the firm’s office on the other days. There will be no relief for that travel, which remains essentially home-to-work travel. The position is slightly less clear if he works at home for four (or five, or six!) days a week and travels in for meetings just once a week. It may then be possible to argue on the facts that the principal place of work is home and that the travel to the firm’s premises should be treated in the same way as travel to client meetings. Less contentious is the position where someone starts and ends the day working from home but in the course of it travels in for a meeting at the office. There seems no reason why in that case travel costs should not be deductible as for any other business trip.

Business rates

Business rates may be due in respect of any part of a property from which a business is run. If there is exclusively business use of part of the property, it is likely that business rates will be due on that part (with the remaining, domestic, part being assessed to Council Tax. According to the Valuation Office (which is responsible for business rates valuations) if there is only part business use, the property is likely to remain banded as domestic property unless the business use predominates or structural

alterations have been carried out to facilitate business use. A Lands Tribunal case in 2003 (Tully v Jorgensen [2003] RA 233) goes a little further and indicates that business rates will probably not be due (even in respect of a part of the property used predominantly for business) if:

- Any rooms used for home-working are part of the ordinary accommodation of the house which has not been structurally altered to accommodate home-working and
- The furniture and equipment used for home-working is such as might be found in any domestic study and
- No customers or clients visit the premises home in connection with the business.

The president of the Lands Tribunal went on to say that business rates were unlikely to be in point unless a business at the premises is advertised or if planning permission is sought for building operation or for business use.

On balance therefore, it is likely that working from home will not in most cases give rise to a liability to account for business rates.

Other issues

Some other non-tax issues need also to be considered.

- Insurance needs to be considered. Use of the home for business may invalidate insurance cover unless the insurers are notified. Again, insurance companies seem to be happy provided they are told and provided that the business does not involve business visitors coming to the house. But remember that you may need to tell insurers about expensive office equipment in the house, and to increase cover accordingly.
- Strictly, the terms of a mortgage deed may require lenders to be told, particularly if you are proposing to grant a licence to your employer. In practice, we find that few lenders are notified and we have yet to see any problem caused by this.

Summary

Proposed changes in legislation help a little in this area. But they do not solve all the problems and careful planning may still be needed to achieve the maximum possible tax relief for home working.

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