

Director's use of home as an office – part 1

(Lecture P1147 – 10.07 minutes)

During the school-run outside the school gates the other day, I found myself in conversation with my wife's friend's friend. And, as regularly happens when I am forced to tell relative strangers what I do for a living, she said "Oh, can I ask you a quick question?" following which we enter the world of hopefully brief but inevitably free tax advice!

Cutting a long-story short, she quit her job to start a family and is going back to work in a few months. But rather than trying to find an accommodating and flexible local employer who will allow her to fit her hours around the school-run, she will set-up as a freelance "whatever-it-is-she-does" and work from home. She will form a company and will be the sole shareholder / director. She will need a home-office, so she is hoping to build a small extension on the side of her house that she will use as her workspace. The other alternative is the 'cabin-in-the-garden' type of office, but the house extension is preferred as this will add more value.

She had a couple of questions which 'she was sure were simple and I would know the answer to':

1. Can she claim the building costs back from her company?
2. Once things are up and running, can the company pay her for "use of home"?

I've been around long enough to know that there isn't a simple answer here (and this was certainly not something I wanted to get into without the promise of cash changing hands which I sensed wasn't on the agenda). So I basically said, "yes" and "yes" and suggested she talk to her accountant about how she should go about doing this. Free consultation over. You're welcome, don't mention it.

But just to prove that there is much more to these questions than meets the eye, I've expanded on the 'yes, yes' approach with some proper answers.

Part 1 of these notes will deal with the tax issues concerning the construction of a home office at the director's home and whether these costs should be borne by the director or the company.

Part 2 of these notes will discuss the ways in which a company can reimburse a director for the costs of working from home and the tax effects of such payments.

Can a director reclaim the building costs of a home-office from the company?

When I said, 'yes', to this question, what I should really have said is, er...."no". Not really. Not unless she wants to pay tax.

The costs of building of extension will be capital expenditure on the director's only or main residence. The CGT base cost of the house will be increased by the VAT-inclusive costs of the works, this being genuine enhancement expenditure.

Principal private residence (PPR) relief is affected where part of a home is used “exclusively” for business. If this is the case, no part of a subsequent gain on the disposal of this part of the house would qualify for PPR relief (not even the final 18 months), as this bit of the house has never been occupied as a residence. Apportionment of proceeds and costs on sale would then be required (itself subject to HMRC agreement).

The sensible advice here would be to either:

- (a) Use the extension for ‘family living’ for a short period – for example, as a kids’ play room, TV room etc – before bringing it into use as a home-office. This accesses PPR relief for the initial non-business period plus the final 18 months (reducing to 9 months from April 2020). It might also mean that any gain arising on the office element would be eligible for entrepreneurs’ relief under the associated disposals rules, this being a disposal of an asset used in the business of the taxpayer’s personal trading company which is sold as part of the taxpayer’s withdrawal from that business; or
- (b) Do not use the extension “exclusively” as an office and instead have some consistent mixed-use of the space (for example by having a TV and sofa in there or coupling the office with occasional use as a mini-gym by the surreptitious housing of a treadmill in the corner). This would leave any PPR claims unaffected. Entrepreneurs’ relief would not then come into the picture as PPR relief will deal with the gain. B) in most cases is the sensible way to go.

Any attempt by the director to seek reimbursement of the building costs from the company will give rise to a taxable benefit equal to the VAT-inclusive cost to the company of providing that benefit. This cost should be reported on form P11D. Even if the company is VAT registered, it will not be allowed to recover any input VAT on the building costs, this being expenditure incurred for the private benefit of a director.

As the company would be settling an employee’s personal liability, the amount reimbursed would be liable for Class 1 NICs (both primary and secondary) and should accordingly be put through the payroll for NIC only. As any amounts reimbursed by the company will be taxable as remuneration in the hands of the director, these costs will be corporation tax deductible for the company.

The office will then need to be equipped with the usual paraphernalia such as furniture (desk, office chair, cabinets, shelving etc) and equipment (laptop and printer). It makes sense for these costs to be suffered by the company (either directly or by reimbursement to the director).

A taxable benefit only arises where a company purchases an asset and subsequently makes that asset available to a director for private use. In this case there will be a strong argument that the plant and machinery acquired for the office is for business use only and any private use by the director is incidental and can be ignored. No income tax or NIC charge should therefore arise.

If the costs of the TV and treadmill are borne by the company, that is a different story and a taxable benefit will arise being 20% per annum of the cost of the assets. The benefits are reportable on form P11D and will be subject to Class 1A employer’s NIC. A further benefit could arise if and when the assets are transferred to the employee. Advice is not to do this as it’s more trouble than it’s worth.

The company will be able to claim capital allowances (in most cases at 100% within the annual investment allowance) on the cost of the furniture and equipment so provided.

The company can reclaim VAT on the purchase of assets used to make taxable supplies, so it will be able to recover its input VAT on any furniture and equipment used by the director in the home office. [Assuming of course that the business is VAT-registered. If it isn't, it may be able to recover this later as pre-registration input tax.]

The garden-office alternative....

The (probably cheaper and less disruptive) alternative is for the company to construct its own office on the site. This could be achieved by building an office in the garden – typically by parachuting-in some sort of log-cabin or similar structure - which is then kitted out as an office and used for that purpose.

Planning permission is not usually needed. However, business rates may need to be paid (so a phone call to the Council is recommended). Business rates are not usually payable by home-based businesses if only a small part of the home is used for the business, although this is worth checking with the local Council in case of separate home-office.

The company could pay for, and retain ownership of, the structure. Assuming the director is not receiving any personal benefit from the garden-office - i.e., the director can demonstrate that any private use of the workspace is incidental and insignificant - there are no benefit-in-kind and NIC issues. However, if the workspace is used for a non-business purpose, a value will need to be placed on this and that benefit value reported on the P11D (with a Class 1A NIC charge added on for good measure).

Although the building would be a “new commercial structure” rather than a residential dwelling, the new Structures & Buildings Allowances (SBA) is not available as the HMRC Technical Notes on the new SBA tell us that “no relief will be provided for work spaces within domestic settings, such as home-offices”.

However, any expenditure qualifying as plant and machinery within the construction costs would be eligible for capital allowances. This would include things such as insulation, wiring and plumbing. In most cases relief would be available at 100% giving an effective immediate write-off against profits.

The company (if VAT registered) would be able to recover the VAT both on the structure and on business set-up costs (plant and machinery etc).

One issue to bear in mind with this arrangement is that, on an eventual sale of the property, part of the proceeds should be allocated to the garden-office and this element will need to be paid to the company. This will potentially give the company a chargeable gain on the disposal on which no relief is available. This should not be a major concern because the gain is unlikely to be substantial as log-cabins tend not to appreciate in the same way as bricks and mortar.

From the homeowner's point of view, there is also the possible argument that the 20 square metres or so of garden and grounds on which the log-cabin has been standing has not been “used for the enjoyment of the residence” giving a possible restriction in PPR relief. However given that cabins tend not to take up a significant amount of space, this is likely to prove immaterial in most cases. A particularly officious HMRC Officer may however make this point.

Legal fees on sale could be higher as the conveyancer may point out that there are two vendors here selling two separate assets, so two sale contracts may need to be drawn up leading to two sets of fees. This paper-mess can be easily tidied-up by the homeowner simply buying the log-cabin from the company for its market value before the house is sold.

Contributed by Steve Sanders