

## Director's use of home as an office – part 2

**(Lecture P1148 – 11.01 minutes)**

*Can the company pay for the director's "use of home"?*

This is a definite 'yes'. If the company is wholly or partly run from the home and the director performs a substantial amount of duties from that home, it is only fair that the director receives reasonable recompense for the additional costs incurred in performing those duties. It's just a question of how we go about doing this.

To this end there are two ways:

1. The director can charge rent to the company for effectively letting-out the part of her house which is then used by the company as its business premises; or
2. The director can simply recharge the company for costs she has incurred in performed those duties.

Considering each in turn.

*Renting-out part of the property to the company*

If rent is charged, the director will then have a property letting business, the profits from which must be declared via the Land and Property section of their SA return. The profits are chargeable to income tax but (unlike most forms of income from an employer company) are not liable to NICs.

If the property is jointly owned (meaning that any newly built extension to act as an office will also be jointly-owned land), each landlord will record their share of the rental profit on their separate personal returns.

Care must be taken here not to push this particular envelope too far because the rents charged to the company should not exceed a normal commercial rent payable to an unconnected third-party tenant. [There is a strong argument that excessive rents are 'disguised remuneration' and should be taxed as employment income via PAYE, but even if this can be defended, the excess will be a distribution.]

It should also be remembered that a company director has obligations under the Companies Act to ensure that he does not allow the company to enter into detrimental contracts or agreements (which a licence agreement with a landlord at excessive rents would be). Some research is therefore recommended as to what is a typical monthly rent for a serviced office in the local area.

The rental payments are tax-deductible for the company provided they are wholly and exclusively incurred for the purposes of its business. As long as genuine business activities are taking place and the rents charged are reasonable and justifiable, this is rarely a problem.

It is advisable for the director to draw up a licence agreement with the company to formalise the arrangement and give evidential back-up for the deductibility of the rental payments in the company. Typical licence agreements are for short periods (say 12

months, renewable annually) and formalise things such as the level and frequency of rental payments and terms of notice. If the house is jointly owned, the licence agreement should be in joint names.

This agreement would typically give the company the non-exclusive right to occupy part of the property during working hours. This agreement should be properly recorded (ideally by means of a Board Minute). The mortgage-lender should also be consulted before the licence agreement commences (just in case the terms of the mortgage are infringed).

The rent will cover the running costs of the home-office. These costs will then be deductible expenses for the director / landlord. Note that there is no possibility of the rents falling under the rent-a-room scheme because the letting is not residential.

Arriving at the amount of deductible expenses requires a 'just and reasonable' apportionment of total household expenses such as light and heat, cleaning, insurance, council tax, water rates and any repairs / re-decoration costs. Apportionment can be based on the number of rooms or on square footage as long as the result is fair. Only normal living spaces are considered, so we can exclude hallways and landings. Kitchens and bathrooms can also be ignored as these are not considered workspaces.

If the workspace will be occasionally used for a non-business purpose (which is sensible given that exclusive use will impact on PPR relief), then further apportionment is required. The apportionment method should be disclosed to HMRC (for example, via a white space disclosure) and is subject to their agreement.

For example, assume that the running costs of the house are £6,000 per year. The house has 8 living spaces, one of which is use as an office. The office itself is used 90% of the time for business (with occasional private usage). A reasonable apportionment would be:

$$£6,000 \times 1/8 \times 90\% = £675 \text{ as a deduction from rents.}$$

Telephone calls can be considered separately and can also be apportioned if the business is sharing the home land-line. However it is often more sensible for the company to contract in its own name for a separate phone line (and possibly for separate business broadband) in which case the company can reclaim the full costs (and the associated input VAT).

It is worth mentioning here that the £1,000 "property allowance" is not available where rental income includes payments from an employer, or from a close company in which the individual is a shareholder. This particular simplification tool is not therefore an option, so we have to do this the long way.

Where a loan is taken out for the purpose of the property business (a "dwelling-related loan"), the interest is deductible from rental income. Since 2017/18, the interest deduction is restricted with any disallowed interest being relieved as a 20% tax reducer in the taxpayer's income tax computation. In 2018/19, only 50% of the interest paid is deductible against rental profits. The deduction reduces to 25% in 2019/20 and is zero from 2020/21 (with all interest then being relieved as a tax reducer at basic rate only).

Claims for home-office costs typically include a reasonable proportion of the mortgage interest on the property (which is fair enough given that the taxpayer has borrowed

money to acquire a property, part of which is being used for business). The question is, do the interest restrictions apply?

There was a school of thought which said that because the purpose of the mortgage was to provide the director with a home (and any subsequent business use of part of that home is incidental), the loan was not “borrowed for the purposes of the business” and is not dwelling-related meaning that the interest restrictions do not apply.

HMRC’s view is (not surprisingly) the opposite. The part of the property being used for business is part of a dwelling and that part is used “for the purpose of generating income” (as required by ITTOIA 2005, S.272B). This makes the loan “dwelling-related” and brings it within the interest restriction rules.

Where a loan is taken out specifically to construct an office (as is the case for my ‘non-client’), the interest on that specific loan should be deductible against rents without apportionment. Bearing in mind our previous advice that the director should not use the new room “exclusively” for business due to PPR restrictions, it is not advisable to claim a full deduction for such interest. The part of the interest attributable to business use will then be subject to the interest restriction rules in S.272A as outlined above.

Conversely, where there is an existing mortgage on the house, but a home-office has been separately constructed and funded by cash (such that no loan relates to that “business” part), it may be difficult to justify an interest deduction at all.

For example, assume an extension to the house was constructed at a cost of £50,000 and funded by a loan of the same amount. Interest is paid on the loan at a fixed annual rate of 4%. The extension is licenced to the company and used as an office. Business use of the space is 90%.

The interest paid on the loan in 2019/20 is  $£50,000 \times 4\% = £2,000$ . 90% of this relates to the property business being £1,800. The deduction against rental profits in 2019/20 is  $£1,800 \times 25\% = £450$ . The disallowed interest (£1,350) is then relieved as a 20% tax reducer in the taxpayer’s income tax computation giving a tax reduction of £270.

In terms of physically receiving the money, the director would typically fill in an expense form and submit that claim to the company for approval and payment. Alternatively the director could be set up as a supplier on the company’s system and approved expenses entered as purchase invoices and paid accordingly. For businesses with a payroll, a third option is to pay the costs via the payroll (with no tax or NIC). Expenses can either be paid physically or offset against a director’s loan account.

#### *Recharge expenses to the company*

As an alternative to drawing up a licence agreement and charging rents, the director could simply make an expense claim to the company to cover any costs she is personally incurring while working from home.

Any employee (including directors of one-man companies) can reclaim ‘homeworking expenses’ from an employer company without triggering a taxable benefit provided that the employee/director performs some or all of his duties from home.

The simplest method is to make a claim based on HMRC’s approved homeworking allowance of £4 per week (or £18 a month). This guideline rate can be reclaimed from

the company without keeping detailed expense records (which is perhaps the main attraction).

HMRC expect that £4 per week is normally sufficient in most cases, particularly where the additional costs are only for heating and lighting the work area. However, a higher amount can be claimed provided it does no more than reimburse the average additional costs that the director will incur while working at home. This higher amount must be agreed in advance with HMRC (who might also allow this to be increased annually with inflation). This is usually achieved by carrying-out a sampling exercise to demonstrate that £4 per week is insufficient to cover the additional homeworking costs.

Amounts paid to the director within HMRC agreed rates are exempt income and are tax and NIC free and tax-deductible for the company.

The £4 a week allowance excludes business telephone calls which can be separately reclaimed based on actual costs incurred.

Alternatively, an employee/director can make an expense claim based on the actual additional costs (i.e., the “marginal” costs) of working from home. This claim will typically include a reasonable proportion of light and heat, home telephone calls, broadband costs, insurance and cleaning. Expenses should be supported by receipts.

No claim can be made for ‘fixed’ costs such as mortgage interest (or rent paid to a superior landlord), insurance premiums (unless there is a separate policy under which business items are insured), general repairs, council tax or water rates as these expenses would have been paid anyway irrespective of whether any employment duties were carried on in the home.

As my non-client said, just a quick question...

*Contributed by Steve Sanders*