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Tax implications of working from home

Advice for contractors and the self-employed.

Working from home offers all kinds of benefits, from the opportunity to create the perfect environment in which you can be most productive, to the improvements to work-life balance that come with ditching the commute.

There are advantages for businesses, too, assuming they trust their employees to work without direct supervision. For example, if only a portion of your workforce is on site on any given day, you might be able to run a smaller office, saving on rent and operating costs.

According to research undertaken by the TUC, 1 in 20 people worked from home in 2005; by 2018, that figure had leapt to 1 in 16. For many freelancers and contractors in particular, working from home is both normal and desirable.

For one thing, it's a way of underlining their separation from those who hire them, and thus helping achieve compliance with IR35.

It also provides at least some stability for those who might work on multiple different jobs, for multiple different clients, from one week to the next.

For startup founders and entrepreneurs, especially in those early days, the private home can often be the only premises within budget.

Working from your house or flat keeps costs down and allows the water to be tested with minimal risk.
Running a business from your home isn't without tax implications, however, and it's worth considering capital gains tax compliance, business expenses and other issues before deciding to go down this route.

Business expenses

The idea behind allowing self-employed people to deduct certain expenses from their turnover is that it gives a more accurate reflection of profits, and thus makes for a fairer tax bill.

What makes it tricky is working out what expenses count as allowable. The basic rule is that it covers any expense incurred 'wholly, exclusively' in the running of your business.

Working from home, blurring the lines between business and your private life, makes this distinction more difficult. For example, is your household electricity bill a legitimate business expense?

Some might decide to claim against the whole bill, thinking it would be difficult or impossible for anyone to prove which watts were used for what. It's straightforward and easy but, of course, quite the wrong approach, and could get you in trouble.

On the flipside, some people decide to keep it simpler again by claiming nothing, and thus miss out on a benefit to which they are fully entitled.

The correct approach, accepted as a sound principle by HMRC, is to make a sensible estimate of the proportion of the bill that applies to your work, and how much is personal, and claim only against the former.
In general, as long as there is evidence that you have acted in good faith, the Revenue is quite tolerant of sensible guesswork. But do keep the records of your calculations in case they are queried later, along with all the original bills.

The same principle applies to telephone bills, mobile phone contracts, and even gas and heating bills.

What can you claim?

HMRC's Business Income Manual is something of a sacred text for accountants, setting out in exhaustive detail what can and cannot be claimed as a business expense by self-employed people.

Remember, though, that in the real world, each case will be judged on its own merits. The manual also provides a list which the small print insists is non-exhaustive, but which might reasonably be interpreted as authoritative.

It includes: council tax, mortgage interest, rent, repairs and maintenance, cleaning, and metered water charges.

Again, the usual principle applies: if a cleaner is responsible for dusting and polishing throughout the entire house, the Revenue expects you to make an estimate of how much work they do in the office, and what proportion of their wages that represents, and then claim only against that.

Simplified expenses claims

If you're self-employed as a sole trader (if you operate an unincorporated business) and work from home for more than 25 hours a month, the process can be even less painful, thanks to an optional flat-rate system introduced by HMRC in 2013.

It allows you to sidestep some of the detailed calculations and make a claim based on the following thresholds:

Hours of business use per month	Flat rate per month
25 to 50	£10
From 50 to 100	£18
Above 100	£26

This only applies to utilities, though – not telephone bills, because they can more easily be itemised, or broadband, to name two examples of exceptions.

Unfortunately, simplified or not, there might still be some sums to be done. For example, if you worked 72 hours each month from home for eight months (8 × £18) then cut down to 36 hours per month for the remaining four (4 × £10) you could claim £184 in total for the year.

A capital gains tax trap?

One thing to watch out for if you have a room in your house that you use only as an office is that it could reduce the amount of capital gains tax relief you can claim when you sell the property.

That's because this specific part of the property won't qualify as a 'private residence' and so falls outside the bounds of that particular tax relief.

In practice, few people who work from home have the luxury of a dedicated office – it usually doubles as the guest bedroom, makeshift gym, or storage space for all those boxes that never got unpacked after the last move.

Risks and benefits

You certainly shouldn't let the complexities of working from home put you off, given the many advantages this approach offers.

As with many areas of tax planning, it's simply a matter of taking some time upfront to think through potential pitfalls and make considered arrangements, rather than operating on guesswork and assumptions.

If you would like to speak to a member of our team please contact us on 020 7330 0000.

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