Selling your home office - will you have to pay tax?

Part of your home has been used for business purposes and you've claimed a corresponding income tax deduction for the running costs. You're about to sell your home for much more than you paid for it. Will you have to pay any tax?

Do your homework

Working from home is increasingly commonplace and misunderstandings about the capital gains tax (CGT) and VAT consequences when you sell are equally common.

Capital gains tax

You need to consider CGT if you sell your home for more than it cost you and at some time you've used part of it for business. There are two rules which determine if and how much of any gain you make is taxable. Which of these applies depends on whether your home was used because you were self-employed (this includes being a business partner) or an employee (or director).

Self-employed. If any part of your home was exclusively used for your business, the gain relating to that part must be worked out separately from the rest of the property. Any reasonable method of doing this is acceptable. Usually, you can apportion the gain according to the area of your home used for business and, if it wasn't used for business for the entire period you owned it, the amount of time for which it was used. The apportioned gain doesn't qualify for private residence relief (PRR).

Tip. The gain can qualify for entrepreneurs' relief and is not liable to the higher CGT rates which apply to gains on residential property.

Directors and employees. If you use part of your property for any purpose other than as your home, e.g. in the course of your employment, HMRC can reduce the PRR (by a "just and reasonable" amount) you're entitled to claim against the total gain made from selling your home. Subject to the Tip below the resulting gain is liable to the higher CGT rates that apply for gains on residential properties.

Tip. HMRC's view is that *"No adjustment"* to PRR *"should be made where, for example, a room is used as a study"* unless *"a substantial part of the residence is used exclusively"* used for work.

Example. Keith is a director of Acom. He's owned a house jointly with his partner for 16 years. They sell it in May 2018 and make a gain of £260,000. For eight years Keith used 20% of it for work purposes. A just and reasonable reduction in the PRR would be £260,000 / 16 x 8 x 20%, i.e. the gain for the part of the property used for business for the period it was so used. Therefore, £26,000 of the gain won't qualify for PRR, and will be within the scope of CGT - that's £13,000 for Keith and £13,000 for his partner. If they make no other gains in 2018/19 their annual CGT exemptions (£11,700 each) can be deducted leaving just £2,600 taxable at either 18% or 28%.

What about VAT?

Thankfully the VAT position is simpler. Where you've reclaimed VAT on expenses relating to business use of your home, including the cost of creating a separate office etc. (unless it exceeded £250,000), there are no consequences when you sell your home. The general rule is that the supply (sale) of dwellings is VAT exempt.

Capital gains tax might be payable on a proportion of any gain if you're self-employed or in a business partnership. However, if you're a director or employee and use only one room or a small area of your home for work, HMRC's practice is to ignore this and allow full private residence relief.