LIVING ACCOMMODATION

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The provision of living accommodation is less popular than it once used to be, and one of the main reasons is the generally unfavourable Schedule E tax treatment, brought about by s.33A FA 1977, now s.146 TA 1988. This section imposes an additional charge to tax, over and above the basic charge to tax on living accommodation, found at s.145.

This additional charge to tax is calculated on a percentage of the cost of accommodation, where that cost exceeds £75,000. Thus, the provision of expensive houses to close company directors (and others) has fallen out of favour.

As a hypothetical example, the provision of a £300,000 house would attract a benefit under s.145 based on Gross Annual Value of, say, £500 but the benefit under s.146 might be 10% of the cost (£300,000-£75,000) = £22,500 per year. This article deals only with the benefit arising from the provision of the accommodation, and any running costs met by the employer will attract further benefits under the general provisions of s.154 TA 1988.

Before considering the taxation consequences further, it is necessary to consider two subsections of the main charging sections.

Firstly, s.146(1)(b) makes it clear that the additional charge imposed by s.146 can only apply when there is firstly a charge under s.145.

Secondly, s.145(1) makes it clear that s.145 can only apply where the provision of living accommodation "is not otherwise made the subject of any charge to him by way of income tax ...".

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At this point it is fair to point out that these revelations are not new, and avoidance schemes have been suggested making use of a salary sacrifice to engineer "any other charge" and thus avoid charges under s.145 and s.146. It is not known if this scheme has ever succeeded and what is to be shown in this article is legal, logical and possibly dangerous to anyone in a low cost property, currently enjoying a benefit based on a 1973 rating valuation.

Looking once again at s.145, is it possible that the provision of living accommodation is in fact chargeable to income tax under a different provision? The answer is that in many cases the benefit is almost certainly chargeable under the general Schedule E charging provisions of s.19 and s.131 TA 1988. It is not the purpose of this short article to examine in detail the Schedule E charging provisions, but it will be sufficient to look at a few old and well respected Tax Cases. One of the oldest cases to consider the Schedule E charge was that of *Tennant v Smith* 3 TC 158 and by coincidence this early case was concerned with the provision of living accommodation. This leading case helped to evolve the Schedule E principle that what can be turned into money was an emolument, or profit, of the employment.

The later case of *Ede v Wilson* 26 TC expanded the principle further and concluded that it is irrelevant that a benefit is not turned into cash; what is important is that it is *capable of being turned into cash*.

The later case of *Richardson v Worrall* [1985] STC 693 put some limitations on how far an employee would be expected to go in order to turn his benefit into cash. Illegality is not countenanced, but no definitive ruling exists. In practical terms, these decisions have little relevance to the vast majority of employees who are taxed on their benefits under the general charging legislation at s.154. The cases quoted, however, remain good law and it is often overlooked that the benefits legislation that we all know and love will only apply if, and only if, the general charging provisions of Schedule E do not apply.

Where does this leave us with our living accommodation? Many directors of close companies were in the past provided with company owned houses which they lived in but there seems little doubt that, being in a controlling position, those directors could have sublet those houses at a commercial rent, even though they did not do so. Referring back to our hypothetical house costing £300,000, it is possible that this house could be let for say, £12,000 per year. A letting agent would no doubt be able to provide an accurate figure. Assuming this to be the case, a Schedule E charge of £12,000 by virtue of s.19 TA 1988 seems to be the correct measure of Schedule E income and this automatically removes the benefit from the clutches of s.145 and s.146 TA 1988.

No benefit on the provision of the accommodation arises under s.154 since living accommodation is specifically excluded, and in any case, the provision of s.154(1)(b) would also provide an exclusion.

The possibility of a charge as a distribution under s.418 TA 1988 must be considered when a close company participator is involved, but an argument can be made that subsections (3) and (4) would take the benefit outside the distribution provision.

It was said earlier that this article could be dangerous. Consider, as a further example, an employee living in a modest house provided rent-free by his employer and costing a modest £70,000. The benefit currently assessed may be of the order of £300, based on 1973 Gross Annual Value, but if that house were let it would probably command a rent of £4,000 per annum. Assuming there is no restriction on subletting, it seems that our second Schedule E example could be in for a nasty shock if the Inspector thinks again about the correct basis of assessment to Schedule E. Anyone in this latter situation should think seriously of ensuring that some genuine restriction of use is included in the employment terms.

The legislation relating to living accommodation is due for an overhaul, and the writer has been advised that the Inland Revenue are currently considering changes.