

TAX DEDUCTIONS FOR EXPENSES- EXCLUDING TRAVEL

A summary of the rules that determine which items of expenditure can be claimed as a tax deduction.

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Tax deduction for expenses – excluding travel

This article considers general business expense claims. Motor, travel and accommodation are a special case and are dealt with in a separate article.

General comment

This is a very important but complex area. Self-assessment means that it is for the taxpayer to decide whether they can legally claim a deduction for expenses. It is therefore important that they understand the rules before making a claim.

One of the biggest problems is that different taxpayers will make different judgements based on how well they read / understand the rules and this means that there is likely to be inconsistency as to whether a tax deduction is claimed or not as the decision is dependent upon the level of knowledge and understanding in a complex area.

HMRC involvement

HMRC do not routinely check these claims.

It is important to realise that just because a claim is made and not queried by HMRC, this does not in itself mean that the claim is valid.

It is only when HMRC open an enquiry into their tax affairs that taxpayer judgement is questioned and found to be correct or not.

Another important point is that if HMRC do open an enquiry and discover a problem then it is not possible to have a defence that you did not fully understand the rules and made an innocent error. As an individual in self-assessment there is a legal assumption by HMRC that you have read and understand the rules.

Furthermore, if you are incorrectly advised by an agent, again, this rarely counts as a defence in itself. You will need to show that you have good reason to believe that the agent had specific detailed knowledge in the area concerned and that they were up to date with their knowledge. Only then can you claim that you were not careless in making any errors in the return.

Penalties for incorrect claims

If taxpayer judgement is found to be incorrect and there has been an erroneous claim, it is likely that this may have been going on for many years and the amount of unpaid tax could be substantial. How many years HMRC can go back to claim back tax, whether or not there will be a penalty and how much this is, depends on the conduct of the taxpayer. Specifically, whether they made a simple mistake, were careless in making a wrong decision or deliberately claimed the expense knowing full well that the expense was not deductible and whether they then tried to conceal it.

In reading and retaining this article on file, you will be able to show that you were not careless if an error is made.

General rules

The rules are different for self-employed / partnership traders, Limited Companies and employees.

Tax deductions from profits or employee expense claim

Firstly, decide whether you are considering a claim for a deduction from profits or an employee expense claim from employment income. The rules are different.

Remember that some expenses paid by a limited company that have a private nature may well be allowed as a tax deduction in the company but will be taxable income in the hands of the employee. It is then for the employee to make an employee expenses claim deduction which is governed by a separate set of rules.

Tax deductions from profits

The expense must be wholly and exclusively for the purposes of the trade

Wholly and exclusively

In deciding whether you claim a deduction it is important to understand how this part of the rule works

If the expenditure is only business related, then it is allowed.

The problem is that often expenditure has two purposes, part business and part private. If it is possible to split the expense, then you can claim the proportion that is business related

When can I claim a proportion?

Whether you can claim a business proportion depends on the nature of the expense.

Example: Although this article does not specifically cover travel expenses, it is useful to consider the logic here as it provides a good example.

If a private car is used for a non limited company business there will be all the fuel, insurance, repair costs etc that are incurred to run the car. The car will be used for a mixture of business and private. It is possible to ascertain the proportion of the mileage the car is used for business and the proportion used for private. This business proportion is then applied to the total expense costs and this element is claimed as a deduction.

In summary, if it is possible to split the total costs between business and private the you can claim a proportion.

When it is not possible to claim a proportion?

Often the nature of the expense is such that you cannot split the business and private element

Example: Medical treatment for a bad back.

The expense is incurred for two reasons:

- 1 So you can carry on working
- 2 So you can carry on with a comfortable, less painful life

It is not possible to apply a percentage to the total cost of medical treatment and claim a business share.

In circumstances like this, HMRC do not allow any deduction against profits

Revenue and Capital expenses

Both revenue and capital expenses can get a tax deduction. However, the way you get the deduction, and which type of tax it is deducted against will differ.

You may not be able to get a deduction against profits charged to income tax but you may get a deduction against gains charged to capital gains tax.

How the items are treated also depends on whether you use traditional accounting rules or cash accounting rules.

Employee expenses claim – Limited Companies / company employees

Expenses paid by a limited company are not apportioned and are all allowed as a deduction from the company profits even if it includes a private element for an individual. However, the individual must treat the whole expense as income but then claim an employee expense deduction if the expenditure was for business and meets the rules outlined below. If there was a private element involved, or the rules are not met, then the employee will be taxed on this as if it was salary.

An employee may spend their own money on a business-related expense which is then repaid back to them by the company. The repayment is taxable income. However, if the expense meets the rule below, the employee claims a deduction against the taxable income and then no tax is payable.

If the expense from the company (or repayment of employee expenses) meets the conditions below to be classified as an employee expenses claim, then there is no tax for the employee and no disclosure is required.

Whose name is on the contract?

It is important to understand the distinction between a company paying an amount that is really the liability of the employee (e.g. a mobile phone contract in a personal name) and paying for a contract in the company name that benefits the employee personally (e.g. private health cover).

If the company pays an employee's personal contract expense, then this is treated as employment income for the employee. The employee can then consider an employee expense claim against the income if the expense meets the conditions outlined below. If there is personal benefit from a company contract, then the employee can be taxed via the benefit in kind rules.

Disclosure rules

There is no need to make a disclosure on form P11d if the following conditions are satisfied:

- 1 The reimbursed expense will not become taxable as it meets the conditions to be covered by an employee expenses claim

And

- 2 The company has systems in place to identify the expense

If Complete Accounts maintain the accounting records, then the systems used can identify the expense and no disclosure requirement is triggered from 2 above.

Beware: Technically, if you do not have systems in place then HMRC could make a tax claim on the individual for amounts paid by the company.
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If the company pays for a company contract and the employee benefits from this (e.g. private health cover, or provision of a company car) then the amounts must be disclosed on forms P11d.

Employee expenses claim -Claiming a deduction

In order to claim the amount as a deduction, the expense must be incurred wholly, exclusively and necessarily in the performance of the duties of employment.

It is rarely a problem when you do not also own the company as it would be unlikely that you will be repaid the expense in the first place if it is not business related and in the performance of your duties as an employee.

However, many people control their own company and may repay themselves expenses that are not business.

Example: Being repaid for stationery purchased with your own money would be a deductible expense and there would not be a tax issue. However, if the employer reimbursed your BUPA private health care then this is taxable in the same way that wages are taxable. If the company paid a BUPA contract in the company name and you benefited from private healthcare from this, then the employee is taxed as a benefit in kind and additional disclosures are required.

If you pay money for company expenses and make an employee expense claim, then the expenditure must be after your duties had started
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Company cars

There are special rules for cars. If the company provides a car for the employee, they can use it for business and private. However, they are taxed on a fixed annual sum calculated on Co2 emissions and list price when new, regardless of how much they use the car for private.

Motor and travel expenses

Travel costs paid by a Limited company for an employee (either direct or reimbursed) are subject to special rules and these are covered in a separate article.

Special cases

Entertaining

There are some items that HMRC specifically deny tax relief for. The most common of these is entertaining customers. No tax deduction is allowed.

Entertaining staff can be allowed, but there are restrictions

Mobile phone

Mobile phone contracts often involve a fixed tariff, and this is used to cover both personal and business calls. If the phone is required for business, there is no need to apportion the private call element as it does not involve any extra cost i.e. the business has to pay the fixed tariff for business regardless of the private call element.

For those with their own limited company, it is vital that the mobile phone contract is in the name of the company (not personal) and that the bill is paid direct by the company (not paid private and then reimbursed)

Business use of space at home

You can claim the additional cost of working from home. So, if you have a room and you have extra heating and lighting on for that room, then the extra cost can be claimed. It is not possible to claim a share of council tax / mortgage interest unless you built an office extension and these costs increased as a result of this.

Contact Complete Accounts for full details on what can be claimed and how this can be calculated.

Spectacles

It is possible that a deduction is available, but not in all cases. Please contact Complete Accounts for full details.

Trivial payments

Small payments may not attract a tax charge on the employee. Contact Complete Accounts Limited for the current government limits on these.

Working out the amount

You can add up the actual cost of the allowable expenditure or use some of the fixed rate deductions

Fixed rate deductions

You can not use these if you are a limited company (except mileage claims for staff expense claims)

- You can claim a fixed rate pence per mile for journeys if they qualify as business (see separate detailed article on travel costs)
- Business use of home. There is a fixed monthly rate depending on how many hours you work from home. It starts at 6 hours per week. Contact Complete Accounts for the latest rates

Trading income allowance

As an alternative to claiming actual business expenses, you can claim a fixed amount of £1000 to cover all expenses. This is advantageous when the actual expenses are less than £1000.

Calculating the tax deduction

Traditional accounting

If you do not use cash accounting, then include the amount that relates to the accounting period. For items like Insurance, you need to take out the element that relates to a future period. However, you also need to bring in the element paid last year that relates to the current year.

You also need to take out:

- the cost of goods not sold at the period end that have not been sold and are held for sale in a future period.
- The cost of work partly completed but not invoiced to the customer yet

Items that are capital in nature (as opposed to revenue) DO NOT act as a deduction from profits. They can attract a tax deduction following different rules called Capital Allowances or can possibly be used as a deduction against capital gains tax.

Cash accounting

You can not use the cash accounting scheme if your turnover is high or you are a Limited Company. There are also some other exclusions, contact Complete Accounts for full details.

If you operate cash accounting, some of the rules are different:

- You can get a tax deduction for some business capital items as well as revenue items
- You get a tax deduction for items paid in the accounting period, even if the expenditure relates to a different period.
- There is no requirement to take out goods not sold yet or work not completed yet.

There are some other important restrictions in calculating the amount of profits subject to tax for the following items:

- Interest payments
- Losses and how they are relieved

Contact Complete Accounts for full details.

Examples of items that can be deducted from profits

- Costs of goods you buy to sell
- Premises costs – Rent rates, buildings insurance and water costs
- Light, heat and power costs
- Repairing premises or equipment – If the premises are newly acquired then contact Complete Accounts as additional rules may apply
- Vehicle running and travel expenses – used to distribute the goods or attend sales meetings etc. Special rules apply – see separate article for full details
- Bank charges
- Interest on loans for the business (note: this is restricted if you use cash accounting or you are a buy to let landlord)
- Professional fees connected with running the trade
- Staff and associated costs
- Research and development of products – special rules apply – contact Complete Accounts for details.
- Some costs incurred before you started trading

Disclaimer

This article is designed as an aid to understanding the basic rules that apply when making a tax deduction in the UK. It is not designed to replace detailed professional advice and no responsibility is accepted by Complete Accounts Limited for any decision made based on this article. Complete Accounts are available to discuss any specific item in detail on

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