

# AN INTRODUCTION TO TAX ALLOWABLE BUSINESS EXPENDITURE

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## Introduction

All businesses need to be able to account for their business expenditure and to understand what expenditure is allowable for tax purposes in the eyes of HM Revenue & Customs (HMRC). A business' taxable profit is calculated after all legitimate business expenditure is deducted. In order to get your net profit right you need to know which business expenditure can and which business expenditure can't be claimed as an allowance against tax.

This factsheet explains what business expenditure is allowable for tax purposes and gives guidance on how to claim allowances for business and employee expenses. It also contains hints and tips and sources of further information.

## What are tax allowable business expenses?

The specific expenses allowable for tax are not defined in legislation. HMRC rules allow you to deduct expenditure from business income only where it is 'wholly and exclusively' incurred for the purposes of that business. The rules recognise that the expenses you have to pay out in order to run your business will vary according to the work you do.

When deciding if an expense is allowable, you need to look at the specific expense and show that it was purchased solely for the benefit of the business. The reason you justified the expense must be primarily a business reason and the items must be used in your business. If you have more than one business, a separate account will help to show which business the expenses are for. Expenses can only be set against the business that the items were purchased for.

## Which types of expense are allowable?

Not all the expenses included in your business accounts are allowable for tax purposes. It is important, however, to show all business expenditure in your accounts, so you can justify the purchases commercially. The following types of expenses are allowable for tax purposes:

- Costs of purchases subsequently sold or consumed by the business, with adjustments for stock.
- Direct costs of doing the work, commissions, carriage, contract costs and tools.
- Employees and subcontractors, employers' National Insurance Contributions (NICs), recruitment, training and benefits provided.
- Premises, rates, energy, property insurance, security, rents and use of home.
- Repairs and renewals, maintenance of business premises and equipment.
- General administration, telecoms, office expenses, professional subscriptions, insurance and consumable office supplies.

- Motor expenses, hire and lease, parking and mileage allowances.
- Travel, subsistence, taxis, accommodation, rail and air fares.
- Advertising and promotion, free samples, business entertainment and hospitality.
- Professional fees, accountancy, solicitors and professional indemnity insurance.
- Bad debts, amounts written off as unrecoverable and previously included in the turnover.
- Interest, alternative finance payments on loans and overdrafts.
- Finance charges, bank charges, credit charges, hire purchase interest and leasing costs.

## Which types of expense are not allowable?

Expenses that are not allowable are things paid for by your business that have had some other use. These need to be disallowed for tax purposes, and include:

- Non-business use of assets.
- Non-business work paid for by the business.
- Depreciation (capital allowances are given instead).
- Costs of running non-business areas of the premises.
- Alteration, replacement or improvements to capital assets (these are added to acquisition costs).
- Political or charitable donations (although these may be allowed in profitable companies).
- Non-business motoring costs.
- Fines and penalties.
- Entertainment expenses.
- Tax investigation costs unless no tax is added to your liability.
- Professional costs for purchase of fixed assets (these are capital acquisition costs).
- Repayments of capital in a finance agreement.
- Ordinary, everyday clothing.

## When and how do you claim the allowances?

Your annual accounts will reflect the income and expenditure for your accounting year. The accounts should be prepared along accepted accountancy practice lines and include the relevant costs of running

your business for that year. An accounting year end may not be the same as the HMRC tax year end.

The tax due on your net profit after deduction of all these allowances is calculated by reference to the tax year rather than the accounting year. The accounts year-ending in the period 6 April 2008 to 5 April 2009 form the basis of your tax return for a tax year ending 5 April 2009, so there may be a delay before the expenses affect your tax calculation. This can have an impact on your January and July tax account when self-employed. If you think the current year's accounts show higher expenses and lower profit than the year before, you can ask to reduce your payments on account to HMRC.

## What can you claim when running a business from home?

If you run your business from home, the extra costs incurred are tax allowable. HMRC will accept a reasonable calculation of these expenses provided you can show how you arrived at the figure in your accounts.

Based on the area, usage or time your home is actually available to your business, you can work out a proportion of the general and establishment costs. If you have a separate office, workshop or studio, this may form, say, one in five of your rooms and so one-fifth of the following expenses would be allowable:

- Heating, lighting and water.
- Council tax, insurance and mortgage interest.
- Cleaning and decorating.

## What is allowable under employee expenses?

Paying for employees can be a major expense in your accounts so it is essential to collate all the following relevant costs under this heading:

- Salaries and wages.
- Bonuses.
- Benefits in kind such as cars, fuel, medical insurance and so on.
- Pension provisions.
- Key man insurance - premiums paid on key man policies may be allowable, but if any claims are made this will be treated as taxable income. Where they are not allowable, any claims are usually tax-free. However, this is not guaranteed and professional advice should be sought. A common use of key man policies is to provide cover for a director who is a major shareholder, but not for other employees, and in this case the premiums would be likely to be disallowed.
- Temporary and casual staff.
- Employers' NICs.
- Canteen and working lunches.
- Recruitment and training.
- Annual parties, incentives and awards (up to certain limits).
- Locum fees.
- Travel and subsistence expenses.

## What happens if you claim expenses that are not allowable?

It is important to check your receipts while bookkeeping during the year so you don't inadvertently include things that are not business expenses. When it comes to the self-assessment or corporation tax calculations, ensure private expenses are added back for any usage made by you, family or employees. Other accounting adjustments include making sure depreciation is replaced by capital allowances. See BIF 243, An Introduction to Tax Allowances for Capital Expenditure for more information.

If there is an enquiry about your tax return, HMRC may start an investigation into your accounts. At this point you need to be able to back up any claims made with documentation and explanations.

If you claim expenses that are subsequently disallowed by HMRC, you will have to pay the increased tax due plus backdated interest and penalties.

## What can be claimed retrospectively?

If you have spent money researching and preparing your business before actually starting to trade, some of these expenses can be claimed in your first accounts. This pre-trading expenditure must have been wholly and exclusively for the business you subsequently set up.

If you find expenses have been missed out of one year's accounts, you can amend your tax return to include them in the correct year's accounts.

## Hints and tips

- Keep all receipts and record at the time what the purpose of the expenditure was.
- Record business and private use as you go along to support any private proportions used in your tax computations.
- If you use one room in your house exclusively for business purposes you may incur a liability for capital gains tax when you sell your house.
- When planning expenditure, focus on the benefits to your business so you avoid unnecessary spending and possible queries from HMRC.

## Further information

For practical start up and small business tips, ideas, know-how and news, go to:

Website: [www.enterprisequest.com](http://www.enterprisequest.com)

To access hundreds of practical factsheets, market reports and small business guides, go to:

Website: [www.scavenger.net](http://www.scavenger.net)

BIF 38 Choosing and Using an Accountant  
BIF 243 An Introduction to Tax Allowances for Capital Expenditure  
BIF 252 A Guide to Corporation Tax  
BIF 264 A Guide to Tax Self-assessment for the Self-employed

## Legal publications

'Expenses and benefits - A tax guide'  
Ref: 480  
HMRC  
Website: [www.hmrc.gov.uk/guidance/480.pdf](http://www.hmrc.gov.uk/guidance/480.pdf)

'Employee travel - A tax and NICs guide for employers'  
Ref: 490  
HMRC  
Website: [www.hmrc.gov.uk/helpsheets/490.pdf](http://www.hmrc.gov.uk/helpsheets/490.pdf)

**Useful contacts**

HM Revenue & Customs (HMRC)  
Tel: 0845 915 4515 (Helpline for the newly self-employed)  
Website: [www.hmrc.gov.uk](http://www.hmrc.gov.uk)

TaxAid is a charity providing free tax advice to those who are unable to pay a professional adviser.  
Room 304  
Linton House  
164-180 Union Street  
London  
SE1 0LH  
Tel: 0845 120 3779  
Website: [www.taxaid.org.uk](http://www.taxaid.org.uk)

**CONTACT-**

**for further information.**

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