Introduction

It’s easy to overlook the importance of business expenses when you’re contracting or freelancing but knowing what you can and can’t claim can make a huge impact on your bottom line and ultimately reduce the tax burden.

Read this first: This guide has been written for contractors and freelancers operating a limited company which is considered to be outside IR35. If you are not operating as a limited company, or are inside IR35, the rules are different and therefore the information in this guide will not apply to you.

The guide is not intended as a substitute for professional advice tailored to your own circumstances. BroomeAffinity will not be held responsible for any loss resulting from action or inaction based on the information in this guide.

In this guide, we have split expenses into three categories: (1) fully allowable – those are expenses which, under normal circumstances, your limited company will always get tax relief on and which there is no tax impact on you personally. (2) Not allowable but valid – these are expenses you can charge to the company but corporation tax is not given. There should be no personal tax impact. (3) disallowed – expenses which are not allowable under any circumstances and which, if paid through the company, will attract tax and NICs to the director personally.

At the end of the guide there is a pretty comprehensive list of expenses which most contractors claim or try to claim. If you have an expense you’re not sure of, you can use this list as a handy reference.

Impact on tax bill(s)

Claiming expenses correctly (or wrongly) will have an impact on your tax bill. A common mistake is to assume that, if you claim an allowable expense, this will reduce your tax bill by the same amount – effectively meaning HMRC are paying your expenses. This is not the case: If you earn £5,000 per month with no expenses, you’ll pay corporation tax on £5,000. If you have £5,000 of income and £1,000 of expenses, the company will pay tax only on £4,000. At the current corporation tax rate (20%), these expense will reduce the corporation tax by £200.

If these expenses claimed reduce the amount of dividend you pay yourself – and it will – then your own personal tax liability will reduce by 7.5% or 32.5% of the amount paid as an expense.

You can see now that claiming your expenses could massively reduce the amount of tax you pay overall – in certain cases by more than 50% of the cost of the expense.

Duality of Purpose

Understandably, therefore, HMRC are keen that you do not claim more than you are entitled to. The general rule is that you can only claim for expenses which are incurred wholly and inclusively in the performance of your duties. If there is duality of purpose, ie, there is personal and business use, the expense cannot be claimed. And note, that in many cases, it’s not whether there is any personal use, but whether there could be personal use. For example, if you buy a suit which you use exclusively for visiting clients but you could also wear it out on the town, there would be duality of purpose, and therefore you could not claim it.
Recording Expenses

Your expenses can be paid for in one of two ways: direct from the company bank account (or credit card account) or as out-of-pocket (OOP) expenses which you have from your personal funds and want to reclaim from the company.

**Direct From Account**
Where possible, we recommend that all business expenses are paid direct from the business bank account or using the company's credit card. This keeps the book-keeping nice and simple as you only have to explain the transaction in Freeagent as follows:

The FreeAgent mobile app is great for allowing you to record your invoices on the fly and you can instantly take a pic of the receipt and attach it to the transaction.
**Travelling, accommodation and mileage**

Full tax relief can be claimed on all expenses incurred when travelling on business, providing it’s reasonable and not excessive. Staying at the Ritz, or hiring a limo to get to and from meetings is likely to raise a few eyebrows at HMRC.

You can claim travel and/or mileage from home to your main place of work, provided you do not fall foul of the 24-month rule (see below).

If you use public transport, these costs are fully allowable. If you use your personal car, you can claim mileage at 45p per mile for the first 10,000 in the year, and 25p per mile thereafter.

If you work away from home, then your accommodation costs can be expensed. If you stay in a guest house or hotel then all room charges are considered a valid business expense. It may however prove to be more viable to rent a furnished flat or house. These costs are also allowable provided the standard of accommodation isn’t better than that of the contractor’s normal residence.

**Subsistence and meals**

If you are travelling to a temporary location (see the 24-month rule for a definition), then you can claim for the cost of your lunch. Again, this cost cannot be excessive – it’s unlikely eating at The Fat Duck every day could reasonably be classed as reasonable but a sandwich or a meal in a café or canteen is perfectly acceptable.

If you are away from home for ten hours or more, then you can also claim for either breakfast or dinner.

**The 24-month rule**

Travel and accommodation expenses are generally only allowable if the journey/trip is to a “temporary” place of work. In a nutshell, for a place to qualify as temporary, one should look at the 40% rule – if you spend less than 40% of your working time at a location, then this location is classed as a temporary workplace and travelling costs to and from your home can be claimed as a business expense.

If the location fails the 40% test, in that you spend more than 40% of your working time there, then the location must pass the 24-month rule. Essentially, if you expect to work at the location for less than 24 months, then you can continue to claim travel expenses.

**How the 24-hour rule works for contractors**

The 24-month rule is based on expectation. As soon as a contractor expects to be at a location for more than 2 years, then the workplace is no longer considered temporary and expenses associated with getting to and from there can no longer be claimed.

For example, if a contractor starts a 12-month contract in Edinburgh and his last contract was in, say, Glasgow, then the contractor can claim travel expenses for the duration of this contract. If, at the end of this contract, he is given a six month extension, he can continue to claim travel expenses throughout the extension period as the time at this location will only be 18 months. If after 18-months, he receives a further 7 month extension, this will take his/her time at this location beyond 24 months. The location ceases to be a temporary workplace when the contractor is aware that the time at the
location will exceed 24 months. Crucially, the travel expenses must stop being claimed *when the extension is awarded* (ie, month 18), rather than when the 24 month period is actually exceeded.

**Resetting the clock with a change in location**

The only way to reset the 24-month clock is to make a significant change to the location and/or the journey needs to occur. Changing clients makes no difference. Changing agencies makes no difference. Moving from permanent to contractor makes no difference. There must be a significant change in the overall journey to re-set the clock. The keyword here is *significant* and it is more often than not more helpful to look at the journey than the location. So, moving from a contract in one street in Glasgow to another in Glasgow will not significantly affect the journey so even if the client has changed, and the agency, and the location, the travel expenses can no longer be claimed.

**Resetting the clock by taking a break from the location**

There is no defined length of time you must be away from a location before you can return and start claiming expenses again. So, provided you are satisfied that there has been a significant location change, then one must revert back the application of the 40% rule over the last 2 years. So, when you return to location 1, count back 24 months from that date and if, in total, you have spent less than 40% of your working time there, then you can start to claim travel expenses again. Practically, this means that you need to have been working elsewhere for 14.4 months in the last two years before the expenses can be claimed again.

This should be reviewed periodically, we would suggest monthly or even weekly, because for each week that passes in the second spell at the first location, the percentage of time at the second location decreases.

So, in conclusion, if you cannot satisfy yourself that the location is temporary under either the 40% rule or the 24-month rule, then you must not claim travel expenses.

**NOTE: The 24-month rule applies to ALL travel and accommodation: this includes mileage, flights, train travel, taxis, hotels, privately rented house, meals, subsistence etc.**

**Cycle Travel**

Provided your journey constitutes a business journey (ie, under the 24 month rule) you can claim mileage at 20p per mile.

**Subsistence**

If you are travelling on business and the travel is qualifying travel under the 24-month rule, you may also be able to claim subsistence, which is the tax term for food and drink. The scale rates HMRC allow are as follows:

- **Breakfast rate (if you leave home before 6am)** £5.00 per day
- **Five hour rate (away from home for more five hours)** £5.00 per day
- **Two meal rate (away from home for more than 10 hours)** £10.00 per day
- **Late evening rate (finish after 8pm)** £15.00 per day

These is also the combined rate where you might qualify in more than one of the categories but the maximum is £25.00 per day.
**Partner’s Salary**

You can pay a salary to your spouse or partner but this must be done with justification. For example, if your partner’s involvement was simply looking after the admin of a one-man limited company, HMRC may take the view that this wouldn’t take more than a few hours per month paid at an appropriate hourly rate.

If the partner is also an office-holder in the company – ie, a director or company secretary, then the responsibility conferred just by holding the office will justify an increase in the salary.

Currently, the maximum it’d be worthwhile to pay would be £8,052 per year (changing to £8,160 for 2016-17). This would reduce if your partner had other income from outside the business. If their income is more than £11,000 per year it is not worthwhile.

If you plan to pay your partner a salary you should always operate the appropriate payroll system and ensure that the salary payments is distinct and separate from any payments made to you, for example salary or dividend.

**Mobile Phone**

The company can provide and pay for a mobile phone including smartphones. The contract should be in the company name and payment should come from the company account.

If you have a PAYG phone, the company can reimburse you for the cost of any top-up credit, provided this is restricted to business use.

The cost of the device is also allowable.

**Computer equipment**

Provided the personal use of computer equipment, including laptops and tablets, is incidental, the cost of computer equipment is an allowable expense. Although the treatment is different from a technical standpoint (you should actually capital allowances at 100%) the effect on taxation is entirely the same.

**Home Broadband**

If you work from home as a one-person business and don’t have separate broadband for the business, you can claim back from the company the full cost of all of your business use and a percentage of the line rental. If you pay a fixed fee for the broadband, you should claim the business percentage of the usage. This should be calculated on a time-basis.

Do not pay the broadband bill from the company account. You should pay this personally and claim the appropriate amount back through your expenses.

**Insurances**

Most business insurances – professional indemnity, public liability, business interruption etc. are fully claimable. Medical insurance, life insurance, illness cover etc are generally not allowable and, while the company can pay for it, there will normally be a P11d charge made.
If you are looking for life insurance, you should seek out a Relevant Life Policy which can be paid by the company with no tax cost to the director.

**Childcare**

Provided you follow the rules, the company can pay childcare costs for you up to £55 per week, if you’re a basic rate taxpayer, dropping to £28 per week if you’re a higher rate taxpayer.

To be eligible, the childcare provider must be registered as a provider of “approved childcare” and the child must be under sixteen.

It’s worth taking care to understand the mechanics of how payment must be arranged as getting it wrong will invalidate any claim: There must be a direct arrangement between childcare provider and the company for the qualifying amount of £55 per week. The provider should invoice the company and the company should pay this direct from the company bank account. If there is a balance to be paid, then this should be paid by the director personally. If the company pays even £1 over the allowed maximum, the WHOLE amount is taxable.

**Entertaining**

Business entertaining / client entertaining is never allowable for Corporation Tax under any circumstances. So whether you have a box at Old Trafford or are buying your client a quick pint, for Corporation Tax purposes these will be disregarded and will not reduce your corporation tax bill.

From a contractor point of view, even though no corporation tax relief is received, it is still better for the company to pay for business entertaining (this includes reimbursing you for business entertaining) compared to you suffering the costs personally and not being reimbursed because you are not paying for the entertaining out of taxed income i.e. net pay of dividends.

However, even if there is no Corporation Tax relief, you still need to consider if there is a genuine business benefit to the expense before you can claim it. If it is disproportionate, IE, the box at Old Trafford mentioned above would appear to be disproportionate if it was only likely to generate a few hundred pounds of business, whereas the couple of pints with the PM at your contract which might help in gaining a six month extension to your contract would probably be OK.

If there is no business benefit, then these payments will be classed as having a personal benefit and therefore would be a benefit-in-kind. The company would be required to submit a P11d and show in detail all the expenses claimed. Then there would be PAYE tax payable by the director and the company would be charged Class 1a NICs at 13.8%. This could increase the total cost by as much as 50% so it is worthwhile ensuring that the expenses are appropriate before claiming them.

**Sponsorship**

In some cases sponsorship is a great way to advertise your businesses, but when is it an allowable expense for tax purposes and when is it justifiable to claim back the VAT on the expense? As a contractor, it is unlikely that the need to raise your company's profile
in the public eye is unlikely to be required so justification for sponsorship costs are extremely difficult. HMRC call this the Commerciality Test and will be looking at the following areas:

- **Sponsoring a relative or close friend** – although as mentioned above there can be some acceptable circumstances, they must be fully justified to be in the benefit of the business. If there is any doubt; disallow the cost.
- **Is the director involved in the club or sport as a hobby?** If so, HMRC may consider this to be disguised earnings, and disallow the expense.
- **Paying over the odds to the sponsored party** – it should still be in the best interest of your business to save on costs and manage overheads so some consideration of the return on your investment should be evident, we would advise that a written sponsorship agreement be put in place setting out your expectations of the sponsored party in return for your sponsorship
- **Not having considered the commercial effect of the activity sponsored** – unless you were looking to launch in Wales – it might be outside your interest to sponsor someone in Wales if your business is solely based in Scotland for example, or for you to provide sponsorship of £100,000 to a local darts team. The commercial effect should be considered, documented and reasonable.
- **Not considering any other option** – have you considered or tried any other media for advertising?

**Training**

Whether training is considered an allowable expense, fundamentally comes down to the duality of purpose rule. If the company can justify that the training is “wholly and exclusively” for the company’s business then there should be no issues. Many large consultancies and other businesses send their staff on training courses and this is of course allowable as a company expense

However, where it gets complicated is if the person receiving the training, is also the director of the company because the director is making the decision on whether to take the training, there can potentially be a conflict between the interests of the company and the interests of the director as an individual. If the director goes on a course which enhances his or her CV, and would potentially benefit the director outside the company, then there is clear Duality of Purpose and, as we have seen, HMRC do not like duality of purpose when it comes to expenses.

In simple terms however, if you can justify that the expense is required for the furtherance of your business, HMRC are unlikely to query it. And if they do, there’s a very good chance that you will be able to justify it, as HMRC are unlikely to be as knowledgeable about your industry and the training standards to argue with any great confidence.

**Clothing**

As a general rule, clothing that could be used as part of your everyday wardrobe such as a business suit cannot be claimed as an expense. This is because it will fail under the Duality of Purpose rule, even if you only use this clothing for business purposes.
The company can provide you with all the protective clothing that is required to carry out your job and this is fully allowable, for example, high visibility jackets or steel capped boots. Remember though that this would be job specific: there’d be no problem claiming these items if you are a construction worker, but you wouldn’t be able to claim them if you were an IT consultant.

You can also claim for clothing which has your company “brand” on it. Many companies have polo-shirt or hoodies with the company logo or name prominently displayed. This is generally accepted as an allowable business expense.

**Membership fees and professional subscriptions**
The company cover the cost of any subscriptions to professional bodies mentioned in the HMRC approved list. This can be accessed at [www.hmrc.gov.uk/list3/index.htm](http://www.hmrc.gov.uk/list3/index.htm). If the company pays for a non-approved subscription then there will be tax and NI to pay on the cost as this will be classed as a benefit-in-kind.

**Pension contributions**
The company can normally claim tax relief on contributions made to a director’s pension scheme, up to £50,000 per year.

**Eye tests and glasses**
You can claim for eye tests providing it is necessary for the initial or continued use of VDU equipment in your job. You can’t claim for the glasses though as they fail on the Duality of Purpose rule. However, if the prescription is for exclusive VDU use, then the cost would be allowable.

**Bikes**
HMRC introduced the cycle-to-work scheme a few years ago to encourage employees to get out of their cars. Contractors can take advantage of this. The company can provide the director with a bike and receive full tax providing the following conditions are met:

- The *company* owns the bike and equipment
- The bike is used most for qualifying journeys
- The employee does not gain ownership throughout the period of loan
- The use of a cycle is available to *all* the workforce.

Bear in mind that if you buy a bike under the Cycle to Work scheme, you will not be able to claim the 20p per mile mileage allowance. This applies to personally owned bikes only.

**Use of Home**
As director of a limited company, you would only be able to ask the company to repay you for extra costs that you incurred as a result of working from home, such as additional electricity or gas. There is no option to be reimbursed for a portion of fixed costs like Council Tax as these would be payable whether you worked from home or not.

HMRC allow a fixed £4 per week for this. If the amount is below this, they will not ask to see proof of this cost, but if you seek to claim more than this, then you’d need to
demonstrate the extra cost by showing energy bills and justifying the usage over the area of the house used and the time spent working from home.

In practice, it’s very rare for the amount to exceed to HMRC allowed £4 per week.

**Annual Event / Christmas Party**
The annual event such as a Christmas Party is considered to be an allowable business expense, providing it meets the following criteria:

- The cost of the event must not exceed £150 per head
- All staff must be invited, although they need not attend
- Receipts must be retained for all expenditure
- If partners or guests are invited, this must be extended to all staff members

Each staff member and guest can qualify for the £150 per head. So, in practice, if a contractor company has two directors, four people can attend the party meaning the maximum of £600 can be spent and charged to the company.

Be careful not to exceed the £150 limit. If you do this, even by a pound, the whole amount will then become taxable, not just the excess.
Find out more

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About the Author

Alan Broome founded the contractor accounting firm Broome Affinity in 2007. He has been specialising in accounting and tax planning for contractors, freelancers and interim consultants ever since. Alan and his team provide focused services delivered using market leading technology in a friendly and informal way.
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