

The Meades
Knowledgebase



How to...
manage
your
expenses



Hello

As a Contractor running your own limited company, the main focus will be to get as much money out of the business, whilst paying the lowest amount of tax as legally possible. Ensuring you claim expenses correctly is just one way of managing this process.

There are numerous opinions on expenses. Whilst some are valid, the vast majority are inaccurate. Too many people think they know what's claimable and what isn't - and more often than not unfortunately they are wrong.

As specialist Contractor Accountants, we offer guidance based on facts (HMRC rules and legislation) rather than on opinion. That's why our advice will arm you with the correct facts for making an informed decision.

I've often heard people say: "I was talking to my friend who is a Contractor and he said....." My answer is to always remember to take advice from a specialist accountant!

Remember, too, that penalties levied by HMRC on companies (and employees) claiming incorrect expenses are significantly greater than in previous times. HMRC can even go back seven years and charge penalties (and interest) - yet another reason to ensure that you are armed with all the facts before putting an expense through your limited company.

As well as some worst case scenarios, this guide will provide interesting and amusing examples of the more bizarre things I have been asked about. Hopefully these will raise a smile!

Louise Williamson FCCA



1 What are expenses?

Expenses and capital expenditure - what are they and what's the difference?

2 What makes an expense allowable or disallowable?

Contractors running their own limited companies are exactly the same as any other employee.

3 What expenses can be claimed?

There are a multitude of expenses claimable by contractors.

4 What expenses can't be claimed?

... including weddings, flying lessons and massages!

5 What are the common misconceptions surrounding expenses?

The rules for claiming 'use of home as office' for employees are very different than those for self-employed people.

6 How often should I be recording my expenses?

For VAT registered businesses, books and records should never be more than three months out of date.

7 How can technology help me?

IT plays an enormous part in keeping business accounting records up to date.

8 What are the implications of getting it wrong?

If you get your expenses wrong, you run the risk of being charged penalties and interest by HMRC.

1 What are expenses?

It's fair to say that a business exists to make profit for its owner. Put simply, profit is calculated as follows:

Sales/turnover/income - costs/expenses = profit

All businesses (limited companies, sole traders and partnerships) pay tax on profits.

For owner-managed businesses, expenses serve the following accounting functions:

- To reduce business profits - in turn reducing tax.
- To enable the owner to extract money from the business as tax efficiently as possible.

It goes without saying that there's no point in a business spending money on frivolous expenses simply to save tax. However, when incurring expenditure is necessary, then it is important to understand the impact.

Expenses

These are your business' day-to-day running costs ie goods and services used up quickly, and on a recurring basis including salaries, postage, insurance, accountancy fees and travel. Such items are included in the profit and loss account.

Capital expenditure

Significant expenditure on items like IT equipment adds future economic benefit to your business, as it will be used for longer than one year. Consequently, expenditure of this kind is treated differently from expenses. Rather than appearing in the profit and loss account, capital expenditure does not reduce profit. Instead, it is recorded on the balance sheet as an asset and 'written off' over a period of time.

2 What makes an expense allowable or disallowable?

Contractors running their own limited companies are exactly the same as any other employee.

REMEMBER: You are an employee (you are not self-employed). You simply happen to own the company you are employed by.

For an expense to be an 'allowable business expense' and a non-taxable expense for an employee, it must be incurred 'wholly and exclusively' whilst carrying out duties of employment (HMRC – Employment Income Manual (EIM) 31660)*.

To help work this out, stop and consider whether or not the expense could have been incurred for anything other than for business. If you can answer "yes", HMRC would argue there to be 'duality of purpose' (ie it has been incurred for more than one reason) and therefore the expense is not wholly allowable. The expense may possibly be apportioned between business and non-business use or, if ambiguous, may be totally disallowable.

Some forms of expenditure by their very nature have an inevitable non-trade purpose and are therefore never allowed, including the following as upheld by court:

- Ordinary 'civilian' clothing
- Food for sustenance
- Having somewhere to live
- Wishing to enjoy good health
- Wishing to avoid a criminal conviction - especially if there is a custodial sentence
- Helping one's nearest and dearest

When incurring a business expense, a receipt/invoice must be made out to/in the name of the actual business.

This is very important for a couple of reasons:

1. The supply of goods/services must be made directly to the business to avoid it being possibly deemed a taxable expense on the employee that made the purchase.
2. If HMRC were to investigate, it firstly would check your invoices and receipts. Receipts not in the name of the business will prompt it to ask why.

* Does not apply to travel expenses.

Additionally, it's imperative to pay expenses with business funds for the following reasons:

- HMRC does not have power to inspect an employee's personal bank statement(s). However, this can change in the event of a significant number of transactions (excluding salary and dividend payments) flowing between employee and employer. For this reason, always keep your business and personal lives separate.
- Unless you have special dispensation, many common expenses (eg travel, postage, phone) reimbursable to an employee, must be included on a P11D. When this form is completed incorrectly, filed late with HMRC, or not filed all, the penalties can be severe.

3 What expenses CAN be claimed?

There is a multitude of expenses claimable by contractors, including:

- Travelling
- Business mileage
- Business parking and congestion charges
- Accommodation (if necessary to work away from home overnight)
- Subsistence (evening meals relating to the above and a flat rate to cover incidental costs)*
- Mobile phone bills (if in the name of the limited company)
- Bank interest and charges (company held accounts only)
- Professional subscriptions/memberships
- Accountancy fees
- Legal and professional fees (relating to the company affairs only)
- Printing, postage and stationery
- Fixed assets required for business activities of the company ('duality of purpose')
- Continuing professional development training costs (excludes training costs for new skills)
- Insurance (usually a contractual requirement for limited company contractors)
- Cost of goods sold on to clients
- Computer consumables
- Business entertainment (although this will not reduce your Corporation Tax bill)
- Annual staff events (up to £150 per head within the personal tax year, for every employee plus guest)
- Salaries (normally a minimal salary to use up an individual's NI free allowance)
- Pension contributions made to an approved company scheme
- Books and publications related to the business of the company
- Use of home
- 'Relevant' life insurance premiums

* Subject to 24 month rule

- Childcare (subject to specific conditions)
- Annual eye tests plus the cost of any lenses required for VDU use only (not the frames)
- Safety clothing/equipment to comply with Health & Safety regulations
- Equipment or services provided to employees with a disability (inc. hearing aids)
- Long-service awards (with certain restrictions)
- Executive income protection
- Trivial benefits to employees (such as small gifts, seasonal gifts, Christmas turkey, seasonal flu jabs, tea and coffee, water dispenser)
- Cycle to work scheme (employers may claim capital allowances; employees may borrow the bicycle as a tax exempt benefit)
- Company van costs (especially if you are caught by the 24 month rule)

4 What expenses CAN'T be claimed?

We are always asked if the following expenses can be put through the business for tax saving purposes. Unfortunately none of the following are allowable, and if anything will incur additional tax.

- Lunches, teas, coffees, breakfasts etc unless for genuine business entertainment
- Gym membership (this will trigger a P11D benefit in kind charge to you and your company)
- Health Insurance (this will trigger a P11D benefit in kind charge to you and your company)
- Household bills (eg electricity, gas, water, council tax, rent etc)
- Broadband (unless specifically installed as a requirement of your company's business)
- Training costs for new and/or irrelevant qualifications/skills
- Travel to and from a permanent place of work
- Personal grooming and business dress
- Private school and university fees
- Golf club membership fees

Some of the more bizarre (disallowable) expenses I have been asked about include:

- Weddings
- Flying lessons
- Massages

5 What are the common misconceptions surrounding expenses?

Use of home

The rules for claiming 'use of home as office' for employees are very different from those of self-employed people. These differences are the source of much confusion among contractors.

Remember: You are employed by your limited company - you are not self-employed. For this reason it is only allowable to claim for 'use of home as office' at HMRC's approved flat rate.

The only exception is if you were to provide evidence of the 'separate metered cost' of running your business from home. As far as we can deduce, this would mean installing a separate feed for all utilities (eg gas, electric, water, phone etc) to that area of your home used for business only. Totting up utility bills then dividing the total by the number of rooms you have is not allowed.

Internet access

Unless you are required to install a new or upgraded broadband line for employment purposes, claiming broadband costs are disallowed.

Life Insurance

Taking out a 'relevant' life insurance policy is a deductible company expense. Your company will receive Corporation Tax relief, and as employee you won't receive a benefit in kind charge on any premiums paid.

A 'relevant' life policy is a Self Assurance Term Business plan applied for by an employer on the life of a single employee. It must include lump sum death benefit only. The plan provides death in service benefits for the benefit of the employee's family. If certain legislative requirements are met, the plan can offer significant tax savings benefits for both employer and employee.

For more information on 'relevant' life policies, it's worth speaking to an Independent Financial Advisor (IFA).

Training Costs

If 'work related training' is paid for by an employer on an employee's behalf, it will reduce the employer's Corporation Tax bill and won't be taxable on the employee as a benefit in kind. However, the definition of 'work related training' is very strict and is defined as follows;

Any training course or other activity which is designed to impart, instil, improve or reinforce any knowledge, skills, or personal qualities which:

- are, or are likely to prove, useful to the employee when performing his/her duties or
- will qualify or better qualify the employee to undertake the employment, or to participate in charitable or voluntary activities arising through the employment.

In other words, training costs unrelated to your current employment are not allowable.

Travel expenses

Employees may only receive tax free reimbursement of travel expenses when required to travel to a 'temporary workplace' ie when an employee undertakes a task of limited duration or on a temporary basis. Related expenses incurred during the course of these journeys (eg subsistence) are allowable.

If you spend 40% or more of your working time at a particular place of work for over 24 months, then the workplace is permanent, and travel is not tax deductible.

Health Insurance

Health Insurance is one of the most common benefits in kind. When running your own limited company, it's important to consider the implication of health insurance from both the employee's and employer's standpoint.

If your company pays the insurance, it will receive a Corporation Tax deduction for the expense. However, you will be taxed personally on the value of the benefit (ie the premium your company pays). As a higher rate tax payer, this tax will exceed the Corporation Tax relief received by the company.

Furthermore, your company will have to pay Class 1A National Insurance on the value of the benefit you receive (though it will receive Corporation Tax relief for this additional expense.)

In a nutshell, unless your company receives a significant discount on its health care policy vs an employee taking out a private policy, it simply is often not cost efficient.

Personal grooming

Other misconceptions include:

- Clothing
- Make up
- Hairdressing
- Manicures
- Facials
- Dry cleaning

Over the years, several cases have come before the courts about whether or not the above items are deductible and/or allowable expenses.

Let's refer back to 'duality of purpose'. Everyone has to wear clothes! For this reason clothing cannot ever be considered to be a 'wholly and exclusively' business expense. Even if the suit you wear to work is only worn to work and nowhere else, it is still disallowed. And the fact you have to conform to a certain 'style' at work does not make work clothes a deductible expense.

The only exception is when it is required to wear a recognisable uniform or protective garments.

Cycle to work scheme

Employers may purchase bicycles and related safety equipment to loan or hire to employees without giving rise to a benefit in kind charge. There is no monetary limit on the value of the bike and safety equipment.

The equipment however should be mainly used for qualifying journeys (ie between an employee's home and workplace (or part of the journey) as well as for journeys between one workplace and another. Mileage logs are not necessary (as per HMRC's official guidelines).

Employees using their own bicycles for business purposes may claim mileage from their employer at the prevailing HMRC rate. Mileage may not be claimed when using an employer's bike. This should be factored in when deciding whether or not to utilise this scheme (ie it may be of increased benefit for employees that use their bikes for several business journeys, to continue claiming mileage).

Motor expenses

Let's now look at the infamous company car. Clients will often ask whether or not to purchase a car. In short, the answer is usually no, for the following reasons:

The Government has made company cars increasingly more expensive. Calculating the 'benefit' of a company car is extremely complex and unless the vehicle has virtually zero CO2 emissions, it is usually cheaper for the employee to buy the vehicle privately, and claim business mileage at HMRC's prevailing rate.

However, for Contractors incurring significant business mileage, it may be wise to buy or hire a 'company van' (as the benefit in kind charge for these vehicles is significantly lower than for company cars). The HMRC definition of a company van is:

"A van is a vehicle built primarily to carry goods or other loads which has a maximum laden weight of up to 3,500 kilograms."

When private use of a company van is either for commuting or for 'insignificant' use, there is neither tax charge on the employee nor NI charge on the employer, including fuel paid for by the employer when the below is met.

Private use is insignificant when:

- it is very much an exception to normal use
- it is intermittent and irregular
- it lasts for short periods of time, on odd occasions during the year

Examples of insignificant use include an employee who:

- takes an old mattress or other rubbish to the tip once or twice a year
- regularly makes a slight detour to drop off a child at school
- stops at the newsagent en route to work
- calls in at the dentist on the way home from work

Examples of significant use include:

- regular use of the van for supermarket shopping
- taking the van away on a week's holiday
- using the van outside of work for social activities

6 How often should I be recording my expenses?

In a perfect world, expenses would be recorded as and when they are incurred. However, in reality this is impossible to maintain.

With the implementation of HMRC's Business Records Checks (BRC) in November 2012, it is now more important than ever for business accounting books and records be kept up to date. For VAT registered businesses, books and records should never be more than three months out of date.

For limited companies paying dividends to shareholders, company books and records must be up to date before each and every dividend is paid out. An accurate assessment of profits must be made prior to the transaction. If not the case, the dividend could be considered illegal.

If such a financial assessment is not made, HMRC may argue that the 'dividend' is actually taxed income, in the hands of the individual. As a result, HMRC can approach either the person or company paying out the dividend for the 'grossed up' tax and NI on the payment.

Keeping your expenses records up to date offers numerous advantages:

- You are more likely to be paying the correct amount of tax
- You are less likely to receive penalties and/or interest from HMRC
- Helps you make better business decisions
- Helps you keep tabs on your accruing tax liabilities more accurately
- Can help if you are applying for finance

Under the self-assessment system (both Personal and Corporation Tax are assessed this way), the burden of proof lies with the tax payer. For this reason, all supporting documentation (receipts and invoices) must be kept for a minimum of 6 years as well as the portion of the tax year during which the expense was incurred. That's why you often hear accountants talking about keeping records for 7 years!

7 How can technology help me?

Today we can connect to the internet 24/7- on the go, at work and at home. Whilst we sometimes yearn for peace and quiet, do use this ever evolving technology to your advantage.

Bookkeeping has come a long way since the days of enormous leather bound paper ledgers. Instead, IT now plays an enormous part in keeping business accounting records up to date.

Software packages designed to record transactions are readily available, some of which are Cloud based for accessing anytime, anyplace, and anywhere.

Smart phone apps also make it possible to take photos of receipts for uploading directly into online accounting packages.

It's also worth taking into account that whilst HMRC is 'trying' to keep up to date with technology, it is still anxious about supporting paperwork. For this reason, retain original paper copies of everything (even if you scan and upload electronic images).

HMRC's argument here is a valid one - if you can't produce the original paper receipt or invoice, it's always possible another business or taxpayer may have used the same one for its accounting purposes. And remember also to back up accounting records!

8 What are the implications of getting it wrong?

If you get your expenses wrong, you run the risk of being charged penalties and interest by HMRC.

If HMRC opens an aspect or full enquiry into your Corporation Tax Return, it may disallow expenses not properly recorded or documented, or not relevant.

If you are VAT registered, the risks can be compounded further. The VAT office may levy penalties and interest in addition to those charged by the Corporation Tax office, on discovering errors in your VAT records.

From an Employment Tax point of view, if you are paying for company expenses privately and reimbursing yourself from your company, without dispensation in place, P11Ds must be completed accurately each year. If incorrect and discovered by HMRC, your company is at risk of significant penalties and interest charges.

The burden of proof always lies with the tax payer!

Supplier / Item	Gross	VAT	Net	Zero VAT	Trade	Parking
2-Sep-13 Void & Sons Ltd	0.00	0.00	0.00	0.00	22.83	0.00
2-Sep-13 Tesco	30.92	6.99	33.31	0.00	0.00	0.00
3-Sep-13 Adbury District Council	1.20	0.25	1.90	0.00	0.00	0.00
4-Sep-13 Abble & Co	23.11	3.80	18.28	2.88	0.00	0.00
5-Sep-13 Welcome Break Group Ltd	2.59	0.44	1.90	0.00	0.00	0.00
7-Sep-13 Computer Serv	2.30	0.38	46.8	0.00	0.00	0.00
9-Sep-13 Acme Stationers	66.00	0.53	4.79	0.00	0.00	0.00
9-Sep-13 B&Q	5.75	0.98	3.98	0.00	0.00	0.00
10-Sep-13 Acme Stationers	4.56	0.78	38.87	0.00	0.00	0.00
12-Sep-13 Roadchef	44.60	1.33	4.88	0.00	0.00	0.00
14-Sep-13 Void & Sons Ltd	5.50	0.92	27.81	0.00	0.00	0.00
15-Sep-13 Ryman	33.13	0.00	16.34	0.00	0.00	0.00
16-Sep-13 Acme Stationers	0.00	0.28	4.79	0.00	0.00	0.00
17-Sep-13 Adbury District Council	19.51	0.96	0.00	0.00	0.00	0.00
20-Sep-13 Costa Coffee	5.75	0.00	3.80	0.00	0.00	0.00
20-Sep-13 Abble & Co	0.00	0.72	39.5	0.00	0.00	0.00
22-Sep-13 Tesco	4.30	7.00	0.00	0.00	0.00	0.00
22-Sep-13 Planet Earth	39.97	8.69	1.80	0.00	0.00	0.00
23-Sep-13 B&Q	0.00	0.00	21.81	0.00	0.00	0.00
24-Sep-13 Deals	4.56	5.52	17.88	0.00	0.00	0.00
25-Sep-13 Planet Earth	0.00	0.78	2.81	0.00	0.00	0.00
26-Sep-13 Costa Coffee	33.13	3.57	0.00	0.00	0.00	0.00
27-Sep-13 Welcome Break Group Ltd	21.10	0.00	18.31	0.00	0.00	0.00
28-Sep-13 Ryman	3.13	0.00	1.92	0.00	0.00	0.00
29-Sep-13 Computer Serv			4.88	0.00	0.00	0.00
30-Sep-13 Roadchef						



Meades Contractors
39 The Metro Centre
Tolpits Lane
Watford
Herts WD18 9SB

t 08000 234484
f 01923 803444
e experts@meadescontractors.co.uk

www.meadescontractors.co.uk