

Claiming expenses - it's all or nothing

The rules which determine what expenses can be deducted from profit for tax purposes are essentially the same whether you trade through a limited company or a sole trade or partnership.

To be deductible for tax purposes the expenditure must be incurred wholly and exclusively for the purpose of the trade carried on. This rule applies for both income tax and corporation tax, but in reality it is mainly in income tax that issues arise. This is because with a sole trader or partner there is the issue of personal benefit, or personal purposes in incurring the expenditure. Strictly, when expenditure is incurred partly for the purposes of the trade, and partly for other purposes - such as to benefit the individual - then the expenditure fails the "wholly and exclusively" test and no part of the expenditure can gain tax relief. With a company, because the personal benefit issue does not normally arise - as a company is not a person - there is less likely to be a problem.

Travel and subsistence

When a self employed business person travels on business, generally speaking the costs of travel and accommodation will be incurred because of the business and therefore the costs would be allowed against tax. Where, however, the trip is extended to allow the individual to take a holiday at the end of the trip, the whole trip is no longer wholly and exclusive because it is part private, so the costs would be disallowed.

Where the individual travelled by first class train or air, while it might be possible to argue that the business did not require them to travel first, and that economy would have been acceptable, this is not a point that is often raised by HM Revenue & Customs. In reality, the first class train journey may allow the business person to work en route, or to arrive more rested and ready to do business, so there is usually a plausible business reason for incurring the expenditure, and any personal benefit such as increased comfort is normally disregarded. If the expenditure was excessive, such as chartering a private jet, then this might well be challenged.

The same is true of accommodation costs and meals taken when away on business. There is no requirement to go for the cheapest option, but reasonable costs will normally be tax deductible.

In the case of income and corporation tax, there is a specific ban on tax relief for entertaining expenditure, so any restaurant bills which relate to meals taken with customers/suppliers / contacts would be disallowed, including the element that relates to the proprietor or employee - claiming that they would have been able to charge had they eaten alone isn't sufficient as this again breaches the "wholly and exclusively" rule. Note that the rule about whether this would be taxable on the employee is quite distinct, and it is rare for an employee to be taxed on the benefit of entertaining clients.

Clothing

Claiming successfully for clothing and similar expenses is normally very difficult. There are one or two professions where the proprietor might be able to claim for clothing that is either "protective clothing" or special purpose clothing, including costumes, but where the clothing is normal every day wear it is unlikely to qualify for tax relief as it breaches the wholly and exclusively rule. The courts have rules that even if the secondary motive is subconscious this will still be sufficient to make the expenditure dual purpose and thus cause it to be disallowed.

Paying your family

Whether in a sole proprietor, partnership or small limited company, the tax authorities are suspicious of payments made to family members, including benefits in kind provided to them such as company cars and pension contributions. In all cases to obtain a tax deduction for these the business would need to show that the family member was actually working for the business, and that they gave equivalent value for the payments received. In short, if paying a family member for services the same rate that an equivalently qualified arm's length person would be paid, then the

amount will be deductible for tax. But providing a good salary and company car in return for a few hours work a week would not be acceptable.

Office use of home

The tax rules have relaxed over the last few years to allow sole traders who are based at home to claim a reasonable proportion of their household expenses (including in some cases mortgage interest) against the business. What is claimed will depend on the space made available to the business, and the number of hours it is made available and actually in use, but this can be fairly generous. The same treatment would not apply to a company, as the household expenses are incurred by the individual householder and not the company. It is not unusual for the company to pay a modest rent to the director for the office space, against which the director can set some expenses for the purposes of his own income tax liability. It is highly unlikely that any claim could be made for garden upkeep or grounds!

To discuss any points arising from the above, do please contact us.