Tax Allowable Business Expenditure

Business Information Factsheet

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Introduction

All business owners need to be able to account for their business expenditure and to understand what expenditure HM Revenue & Customs (HMRC) considers allowable for tax purposes. The taxable profit of a business is calculated after all legitimate business expenditure is deducted, so correct calculation of it requires knowledge of which business expenditure can and cannot be claimed as an allowance against tax.

This factsheet explains what business expenditure is allowable for tax purposes and gives guidance about how to claim allowances for business and employee expenses.

What are tax allowable business expenses?

The specific expenses allowable for tax are not defined in legislation. HMRC rules allow deduction of expenditure from business income only where it is "wholly and exclusively" incurred for the purposes of the business. The rules recognise that the expenses incurred in running a business will vary according to its nature.

It must be possible to show that the expense was incurred solely for the benefit of the business. The expense must be justified primarily in terms of business reasons and any items purchased must be used in the business. Where more than one business is owned, a separate account for each business will help to show which business each expense relates to. Expenses can only be set against the business for which the items were purchased.

Not all the expenses included in business accounts are allowable for tax purposes. But it is still important to include them, so that the commercial justification for purchases can be demonstrated.

Which types of expense are allowable?

The following types of expense 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 sub-contractors, employers' National Insurance contributions, recruitment, training and benefits provided.

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- Premises, rates, energy, property insurance, security, rents and use of the 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, legal advice 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 for tax purposes are payments made through the business or allowances for items that are not solely and exclusively for business use. These 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 charitable donations may be allowed in profitable companies).
- Non-business motoring costs.
- Fines and penalties.
- Entertainment expenses.
- Tax investigation costs, unless no tax is added to the business's liability.
- Professional costs for purchase of fixed assets (these are capital acquisition costs).
- Repayments of capital in a finance agreement.

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- Ordinary, everyday clothing.

When and how are allowances claimed?

Annual accounts reflect the income and expenditure for the accounting year. The accounts should be prepared in line with accepted accountancy practice and include the relevant costs of running the business for that year. An accounting year end may not be the same as the HMRC tax year end.

The tax due on net profits after deduction of all these allowances is calculated by reference to the tax year rather than the accounting year. For example, an accounting year ending in the period 6 April 2024 to 5 April 2025 forms the basis of the tax return for the tax year ending 5 April 2025, so there may be a delay before the expenses affect the tax calculation. This can have an impact on the January and July tax account payments of self-employed individuals. If the current year's accounts show higher expenses and lower profits than the year before, it is possible to ask to reduce payments on account to HMRC.

The cash-basis and simplified-expenses income tax accounting schemes are voluntary processes that the owners of small firms can choose to use to account for income and expenses under tax self-assessment.

The cash-basis scheme requires the owner to account for income and expenses and pay tax on them only when they have received the money from customers or paid for the items they have bought.

The simplified-expenses scheme introduces standard flat rates for certain expenses, meaning less complex calculations and quicker completion of paperwork at the year end.

What can be claimed when running a business from home?

Extra domestic costs incurred as a result of running a business from home are tax allowable. HMRC will accept a reasonable calculation of these expenses provided it can be shown in the accounts how the figure was calculated.

Based on the area, usage or time a home is actually available to a business, a proportion of the general and establishment costs can be worked out. Where there is a separate office, workshop or studio, this may form, for example, one in five of the rooms in the home and so one fifth of the following expenses would be allowable:

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

However, care is needed since claiming that a room is devoted solely to the business may lead to a capital gains charge when the house is sold.

What is allowable under employee expenses?

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Paying for employees can be a major expense in business 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 worker insurance: premiums paid for key worker policies may be allowable, but this is not guaranteed, depending on the terms of the policy, and therefore professional advice should be sought. A common use of key worker policies is to provide cover for a director who is a major shareholder, but not for other employees; in this case, the premiums would be likely to be disallowed.
- Temporary and casual staff.
- Employers' National Insurance contributions.
- 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 a business claims expenses that are not allowable?

It is important to check receipts while bookkeeping during the year to avoid inadvertent inclusion of items that are not business expenses. When it comes to self-assessment or corporation tax calculations, it is necessary to ensure private expenses are added back for any non-business usage. Other accounting adjustments include making sure depreciation is replaced by capital allowances.

If there is an enquiry about a sole trader's or partnership tax return, HMRC may start an investigation into the accounts, and any claims made will need to be backed up with documentation and explanations.

If expenses that are claimed are subsequently disallowed by HMRC, the increased tax due will have to be paid, together with backdated interest and penalties.

What can be claimed retrospectively?

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Where money has been spent researching and preparing a business opportunity before starting to trade, some of these expenses can be claimed in the first set of accounts. This pre-trading expenditure must have been wholly and exclusively for the business that was subsequently set up.

If expenses have been missed out of one year's accounts, it is possible to amend the tax return to include them in the correct year's accounts.

Useful resources

'Expenses and Benefits for Directors and Employees - A Tax Guide: 480'
HMRC
www.gov.uk/government/collections/expenses-and-benefits-for-directors-and-employees-a-tax-guide-480

'Tax and National Insurance Contributions for Employee Travel: 490'
HMRC
www.gov.uk/government/collections/tax-and-national-insurance-contributions-for-employee-travel-490

Related factsheets

BIF038 Choosing and Using an Accountant
BIF252 Corporation Tax
BIF264 Income Tax Self-assessment for the Self-employed
BIF383 Benefits in Kind provided to Employees
BIF491 Cash-basis and Simplified-expenses Accounting Schemes

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