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HOW TO MAXIMISE DEDUCTIONS FOR BUSINESS EXPENSES

Sarah Bradford

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BUSINESS

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About Sarah Bradford

Sarah Bradford (BA) Hons, FCA, CTA (Fellow) is a Chartered Accountant and Chartered Tax Adviser. She is the director of Writetax Ltd, a company providing technical writing services on tax and National Insurance.

Sarah writes widely on tax and National Insurance. She regularly contributes to:

- Business Tax Insider;
- Property Tax Insider; *and*
- Tax Insider Professional.

She is the author of:

- Tax-Efficient Ways To Extract Cash From Your Company;
- IR35 – Tax Tips for Contractors;
- Tax-Efficient Business Exit Strategies;
- Cash Basis for Landlords;
- Directors' Loan Accounts Explained; *and*
- Property Company v Property Trust.

About this guide

This report presents you with a comprehensive view of the ways to maximise business expenses. This means you can claim more tax-deductible business expenses, pay less tax and keep more of your profit.

1

Introduction

This guide explains the rules governing the deductibility of business expenses by unincorporated businesses (such as sole traders or partnerships in which the partners are individuals).

When working out the profits or losses of your business, you can deduct any allowable expenses that you incur in running your business to arrive at the profit (or loss) before tax. The more expenses you deduct, the lower your taxable profit and the less tax you pay. In most people's books, that is a good thing! It is important, therefore, that you claim a deduction for all allowable expenses.

However, there is a lot of confusion as to what can and cannot be deducted.

To ensure that you claim the maximum permissible deductions for business expenses, it is important that you:

- understand the rules as to what can be deducted;
- understand the difference between capital expenditure and revenue expenditure;
- appreciate which expenses are not allowable, and why;
- understand when relief is given; *and*
- keep good records so that you know which business expenses you have incurred.

2

'Wholly and exclusively' rule

2.1 The basic rule

The basic rule is that a deduction is allowed for expenses incurred wholly and exclusively for the purpose of the trade. The rule works by prohibiting expenses that are not wholly and exclusively so incurred, stating:

"In calculating the profits of a trade, no deduction is allowed for –

- a. expenses not incurred wholly and exclusively for the purposes of the trade..."

Unlike the equivalent rule for employment expenses, there is no requirement that the expense is 'necessarily' incurred. This means that as long as an expense is incurred for the purposes of the business and only for that purpose, a deduction is given. There is no requirement that it is necessary to incur the expense for it to be deductible.

2.2 No deduction for private expenditure

To qualify for a deduction from trading profits, the 'trade purpose' must be the sole purpose of the expenses. Private expenditure is not incurred 'for the purposes of the trade' and, as such, it fails the deductibility test. No deduction is given for private expenditure, and under no circumstances should private items be 'put through the business'. When preparing the accounts, it is prudent to check for any private items that might have slipped through by mistake so these can be treated correctly.

It is important to appreciate that the existence of a non-trade or private purpose will preclude the deduction in full unless there is an objective test by which the trade element can be distinguished from the non-trade element. By contrast, if it is possible to identify the trade and non-trade elements separately, a deduction may be permitted for the trade portion (see section 2.3).

Example: Non-deductibility of personal expenses

Hattie is a sole trader. She meets her friend Helena for lunch and pays for the lunch with her business debit card. The expense is a private expense, not a business expense, and cannot be deducted in working out the taxable profits of the business.

It is not always easy to keep business and private expenditure separate, particularly if the business is small and run from home. It can be very easy when, say, picking up some pens and paper for the office to buy a magazine and some chocolate at the same time, to pay for them together and to claim a deduction for the whole lot. This should not be done, and if HMRC takes a look, it may attract unwanted attention. A deduction is only allowed for the cost of the paper and the pens.

It is also important to keep business and private expenditure separate so that business expenses are not met from a personal account and overlooked. In the above example, it would be equally easy to buy some stationery for the business at the same time as buying a newspaper and a book, pay for it from a personal account and fail to claim a deduction for the business items. Good record-keeping and separate accounts are essential to help avoid errors.

Practical tip

It is good practice to keep private and business expenditure separate and to have a separate bank account for business expenses.

2.3 Mixed use expenses and apportionment

Sometimes, expenses will be incurred for both business and private purposes. The fact that a deduction is not permitted for private expenditure does not preclude a deduction for the business portion, as long as it is possible to identify the different elements.

The legislation provides that:

“If an expense is incurred for more than one purpose, this section does not prohibit a deduction for any identifiable part or identifiable portion of the expense which is incurred wholly and exclusively for the purposes of the trade.”

Where an expense is incurred for both private and business purposes, the extent to which any deduction is permitted depends on whether it is possible to identify the trade portion.

Where an expense has a business and private element, the expense should be apportioned, and a deduction claimed for the business portion. The apportionment should be done on a just and reasonable basis.

This may arise if a mobile telephone is used for both business and personal calls. From the bill, it will be possible to identify the private calls and the business calls, and the cost of each.

Example: Apportionment of mixed use expenditure

John has a mobile phone that he uses for home and work. He works out that 65% of his calls are business calls. In a year, his bills total £750. He can claim a deduction for £488 (65% of £750).

Another common scenario where an apportionment might be required is in relation to a car which is used for both business and personal purposes. In this case, HMRC confirms (in their Business Income Manual at BIM37600) that a deduction will be allowed for the actual cost of any journey undertaken for the purposes of the trade (including fuel, tolls, parking fees, etc.) and also for a proportion of the cost of the road tax, insurance (as long as it covers business use), repairs, finance costs, etc.

Practical tip

To save work in recording actual expenditure and performing an apportionment calculation, consider the use of simplified expenses, where appropriate (see section 8.4).

The issue of apportionment was considered in the case of *Wildbore v Luker* [1951] 33 TC 46. The case involved a claim to deduct all of the increase in rates for a public house that was used in part for the purposes of the trade and in part for private living accommodation. The court rejected the claim for the full deduction, accepting instead the then Revenue's approach of apportioning the expenditure and allowing a deduction in relation to that part which was used for the purposes of the trade.

Trap

If it is not possible to apportion the expenditure between trade and non-trade use, no deduction is permitted.

2.4 Duality of purpose

There is a significant difference between expenses in respect of which an identifiable portion relates solely to the purposes of the trade (see section 2.3), and expenditure which is incurred for a dual purpose and in respect of which no part is allowable.

To meet the deductibility test, the expense must be incurred 'wholly and exclusively for the purposes of the trade'. Where there is duality of purpose, this test is not met, and consequently, none of the expenditure is deductible; there is no apportionment here.

The courts have considered the issue of duality of purpose in respect of a range of business expenses. One of the leading cases is that of *Mallalieu v Drummond* [1983] 57 TC 330, which considered whether a barrister was allowed to claim a deduction for expenditure on replacing and laundering professional clothing. In