Self Employed Allowable Expenses

This advice is for Sole Traders not Limited Companies. This guide does not cover every type of business expense, just the ones that we are asked about most often.

Home office costs These days a lot of self employed freelancers work from home so it is important to ensure a sufficient "Use of Home as Office" cost is put against your tax return. There are two options:

1 – Simplified HMRC rate

This is a nice, easy and straightforward option but you might not save as much as you do using the proportion of home method below. If you work from home an average of 25 hours per month or more, you can use HMRC simplified expenses which gives a simple monthly flat rate. There are three levels depending on how many hours you are working from home. The current maximum rate is £26 per month if you work 101 hours per month or more, which would give a max £312 per year for your use of home expense. So where possible we tend to go for option 2:

2 – Apportionment of Home running costs

You can allocate a portion of your home running costs as allowable expenses to the business. Firstly work out what your actual running costs of your home are. If you own a property this can include mortgage interest but not capital repayments. If you rent then it is simply the rental charge. If you pay costs jointly that's fine but you can't include costs that are being paid entirely by someone else. Other costs which you need to capture are Gas, Electricity, Insurance, Service Charges, Cleaning and Council tax.

You then need to work out what proportion of these costs would be fair to allocate to your business. The simple way of doing this is to firstly work out how many rooms you have in your house excluding bathrooms, kitchens and hallways. You then need to work out what % of the time you use one of the rooms for business use. Let's assume you use one of your rooms as an office and 50% of the time that it is in use it is used for your self employed work. Let's then assume that in total you have 5 rooms excluding bathrooms, hallways and kitchens. If your total running costs of your house per year are £15,000 it would therefore be justifiable to charge £1,500 per year (50% x 1/5 x £15,000) to the business as rent.

If you are renting only part of a property (e.g. a house share) then you should only include the rooms that you have access to in the calculation.

Another tip is that you shouldn't use your office room entirely for business use – keep at least a small element of the room for personal use as this protects you from any potential capital gains tax issues.

UPDATE MARCH 2017 – new rules around property interest relief for higher tax earners come in from April 2017 so if your earnings are above the basic tax band you will have to adjust your mortgage interest in your 'use of home as office' calculation accordingly.

Mobile phone You can claim some of your mobile phone costs as a business expense, the tricky bit is what proportion to claim as usually a freelancer will use their phone for both personal and business use. What you should in theory do is go through one or two sample months of bills each year and highlight your business use vs personal and use that as a basis of what % of your total bill to claim as a business expense.

We tend to be a bit more pragmatic and suggest that if you use your mobile phone heavily for business and just a bit personally then to claim perhaps 80% of the total costs for business would be fair and justifiable. However, if you use it quite evenly for business and personally, then we would suggest claiming perhaps 50%. What you need to remember is that you might have to justify this percentage to HMRC in the event of an enquiry, so keep a note of your workings and lean on the side of caution when it comes to what % to claim.

Accounting fees If you engage an accountant like us then the accounting fees that are in relation to the preparation of your self-employed accounts can be claimed as a tax-deductible expense, however if there are any fees which are in relation to the preparation of your tax return in general, these are not allowable. In practice this means that as long as you have self-employed income on your tax return then generally the accounting fees can be claimed.

Travel Travel rules for the self-employed are a little different than for those who operate through a Limited company. It is all about the 'base of operations' which is where the self-employed person carries out their work. There can be more than one 'base of operations' and it can be an area rather than a single location. Travel between home and the 'base of operations' is not an allowable expense. Examples of bases of operations are:

– the delivery round for a milkman
– a market for a market trader

If your home is your base of operations then all business travel will be allowable.

An exception to these rules is where the trade is a 'travelling occupation' or 'itinerant in nature'. For example, if you are a travelling sales person or regularly visit different clients. In these circumstances, all business travel can be claimed.

For added complication, if the travel is simply to a temporary base of operations it can actually be claimed. It should be noted that case law is still developing in this area, but we have highlighted some examples from tax cases:

Milkman – a self employed milkman claimed his travel costs between his home and his milk dairy depot. HMRC successfully challenged to disallow these costs because the court decided his base of operations was the milk depot, not his home. The key factors were that he was a franchisee and was required to keep his milk float at the depot and that is where is started his milk round. Also he did not maintain a proper office at home.

Electrician – an electrician who worked on different building sites around the south of England – he did various items of work at his home office including working on quotes, entering into contracts and storing his tools which he brought home with him each evening. Also all his business correspondence was sent to his home address which was shown on his business insurance documents. Another key fact was that he did not visit the contractors offices and any discussion regarding his work was conducted from his home office. The judge found that his home was his base of operations so he was allowed to claim travel costs between his home and the sites he worked at.

Vehicle costs When you are a sole trader and use a car or van for your work you have two different methods of claiming mileage / travel costs. What you must remember is that once you have chosen which method to use you must stick with that method for the life of that vehicle. First of all you should read the section above on "Travel" to ensure your travel costs are an allowable business expense.

Method 1 – Mileage rates

This is the simplest method. You simply keep a mileage log of all allowable business journeys Note the date of journey, start point, end point, purpose of journey and total number of miles. To calculate how much you can claim as a business expenses it is currently 45 pence per mile for the first 10,000 miles and 25 pence per mile thereafter.

Please note that you can only use the mileage rate method if at the point the car is first used for the business your business is below the VAT threshold rate. This is currently £83,000. If you are above this rate you would have to use method 2, discussed below.

Method 2 – Actual costs less private element deduction

This is more complicated but can be more tax efficient, depending on your level of use. Using this method, you keep a tally of all motor expenses which will include road tax, insurance, fuel, repairs and maintenance and breakdown cover. Also if you have bought your vehicle on a lease you can include the interest costs. Warranty costs can also be included but must be spread over the life of the warranty which may for example be three years.

The purchase cost of the vehicle is a capital item so is dealt with through a treatment called 'Capital Allowances'. If you have bought a Van it will be eligible for the Annual Investment Allowance (AIA) so potentially the entire cost could be offset in the first year. Car's however are not eligible for the AIA. The rate at which you claim the allowances varies depending on when it was purchased and the emissions rate.

When you sell the vehicle the value it is sold for must be taken into account as well so you could end up with a balancing amount which is taxable.

The key element when using this method of calculation is working out the percentage of your vehicle that should be disallowed because of private use. In theory you should keep a detailed mileage log of all work journeys and note the mileage at the beginning and end of the financial year. This will allow you to work out the exact personal element. However this is not always feasible. It is acceptable to keep a mileage log for a 'snap shot' period of, say, three months and work out the private element from this. This area of judgement is one of the most looked at by HMRC so make sure you do not over claim and can justify your claim.

Remember these methods of claiming vehicle costs are only relevant for the self-employed, if you operate through a limited company the rules are very different.

Subsistence The "reasonable" costs of food and drink can be claimed as allowable expenses in conjunction with business travel. Reasonable is not defined by the tax law, so this takes its everyday meaning. For subsistence to be allowable the taxpayer needs to be travelling to a place in the course of carrying on their trade or profession or staying away on business. So, travel has to also qualify as business travel (see section on Travel earlier on in this article) Two conditions must be met:

1: Travel expenses would qualify for a deduction for business travel (whether incurred or not), and

2: The taxpayer is engaged in a trade or profession that is "itinerant" by nature at the time, or The taxpayer only travels to the place occasionally and this travel is not part of a normal pattern of travel, or you there is no normal pattern of travel.

Entertaining Clients or Third Parties The cost of entertaining clients, customers or third parties in relation to the business is disallowed as a deduction for tax purposes. It still should be included as a business expense on your "Profit and Loss" account but it should be separately analysed so that it can be added back for tax purposes.

When a room is hired for an event and entertaining also takes place it can be possible to claim tax relief on the cost of the room.

The cost of entertaining yourself or members of your family, is not deductible as it is entertaining and under the general principle of "wholly and exclusively". The only exception is where family members are your employees. In that case the cost may be allowable providing that it is not excessive.

Entertaining employees Where an employer entertains his staff the cost is not treated as entertaining. It is staff welfare so it is allowable for tax purposes. Please note that Subcontractors / Freelancers are not Staff.

Accommodation Accommodation costs are tax deductible when they are incurred:

- wholly and exclusively for the purposes of the trade or profession, or
- if there is mixed business and private use and it is possible to claim an identifiable proportion of an expense as business related.

In practice this means that accommodation used as a workplace, used as a stop over when travelling on business or used for any other business purpose is allowed for tax. The key issue is determining business purpose, as ordinary living expenses are not allowable for tax, although the "Use of Home as Office" costs come into play then as discussed earlier in this article.

Training It is not possible to claim the cost of a training or course fee for tax purposes if the object is to learn a new skill or qualification. Why? Any new skill or knowledge obtained creates an intangible asset; it is something of enduring benefit which is totally personal to the individual.

Example of a disallowed expense : Dave is a self-employed sales consultant; he attends a college course and obtains an MBA in business studies. The cost is not allowed, as this is a new qualification. His incidental costs of obtaining his MBA, such as travel, stationery and subsistence are not allowed either.

On-going training and development – Once a knowledge, skill or qualification is acquired, the cost of up-dating or continuing development costs are allowed for tax.

Hopefully the information contained in this factsheet has been useful. For further information covering other types of expenses please get in touch.