

How to charge contracting expenses back to your client

Contractors who incur expenses when working for their clients will usually have an agreement where they can reclaim these. When expenses incurred as a result of client work are billed to the client, depending on the nature of the expense, they may be treated differently by the taxman.

HMRC calls these costs 'disbursements'. How the costs are charged to the client depends on the nature of the disbursement and whether or not the contractor is [VAT](#) registered. Some disbursements attract VAT and some are charged to the client at a zero rate, that is, without a VAT component.

Contractors should always invoice clients for expenses, or disbursements, as a separate itemised list on their regular [sales invoice](#) and never using a client or agency expenses form, as this may lead to questions from HMRC about the contractor's [IR35](#) status.

Types of disbursements

There are two types of disbursement:

- o Costs, like travel, hotels, subsistence and postage, that are supplied as part of the overall core service the contractor is providing to the client
- o Third party costs, for example buying internet domain names, specialist reports or independent testing services on behalf of the client.

Most contractors will be familiar with the first type of expenses. Generally, clients agree to pay a contractor's travel and subsistence expenses when they expect the contractor to visit another site, or attend a meeting away from client offices.

These costs are provided as part of the overall core service the contractor is supplying to the client through their [limited company](#), or [contractor umbrella](#), and considered by HMRC to be part of the cost of supplying core contractor services.

Third party costs may arise when a client asks a contractor to effectively act as an agent on their behalf and order services or products that the client and their employees will use.

The difference is that these additional third party goods and services do not normally form part of the contractor's core service offering to the client. This distinction becomes important when invoicing the client.

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VAT treatment of disbursements on invoicing - core services

At the end of each invoicing period, which might be daily, weekly or monthly depending on the arrangement the contractor has with the client, the contractor should pull together all their receipts for expenses.

Then the contractor should work-out whether the expense is a core cost, like travel and subsistence, or a third-party cost like buying the client's web hosting services.

To reclaim core costs from the client, the contractor should add up all the core cost expenses, which could include items like:

- o Mileage
- o Travel tickets, train tickets, airline tickets
- o Hotel expenses
- o Restaurant and other subsistence bills
- o Telephone and postage expenses (if claimed).

If the contractor is VAT registered, the contractor should add the list of itemised expenses to the regular sales invoice, minus any VAT on those expenses. Valid VAT receipts for expenses will show the contractor how much VAT should be removed.

The VAT registered contractor's invoice should list the core services plus the expenses (net of VAT) and then add VAT to the total of both expenses and services. This way the client only pays for VAT once.

If the contractor is not VAT registered, the expenses including VAT should be itemised on the bill and simply added to the charge for

core services. The client can then claim VAT on each individual expense.

The client may require the contractor to submit original receipts with the expenses claim. HMRC recommends that the contractor keeps copies of any receipts, or the originals if not required by the client, attached to the invoice.

VAT treatment of disbursements on invoicing - third party costs

VAT treatment of third party costs can be much simpler. If the contractor has bought a domain name and internet hosting from a third party on behalf of the client, then this amount should be invoiced separately and without VAT from services and disbursements as part of core services.

For example, in the case of buying the client's web hosting services, the contractor would take the amount on the invoice from the hosting company less VAT and invoice the client the ex-VAT amount. There is no VAT involved at all.

Basically, HMRC considers the product or service to have been directly supplied to the client by the third party, almost as if the contractor was not there.

However, the client may require an original copy of the invoice for their records and HMRC would require a copy of the invoice from the contractor if they were to investigate. Contractors should therefore keep a copy, or the original if not required by the client, of the third party invoice attached to their disbursement invoice.

Different clients may require contractors to invoice in slightly different ways. However the contractor should also invoice for expenses and never use a client or agency expenses form. Contractors should also keep records in case HMRC decides to investigate.

Published: Monday, July 21, 2008

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