

Contractor travel expenses, tax relief and the 24-month rule explained

One of the great attractions of contracting is the tax efficiency that leaves most contractors with greater take home pay than if they were in permanent employment.

A key tactic contractors can apply to legitimately reduce their tax payments to [HMRC](#) is to claim tax relief on travel expenses, which means they pay less tax on profits and pay less cash out of their own pockets on the costs of travel.

Both contractors who work through their own [limited company](#) and those working through an [umbrella company](#) can benefit from claiming tax relief on travel expenses – the rules and record keeping requirements are the same.

However, HMRC has strict rules about the circumstances under which contractors can claim travel expenses, depending on the type and location of the contract and the time spent working at each client site.

Claiming travel expenses - the benefits

There are two ways in which contractors can benefit from claiming travel expenses:

- o By claiming the costs of travel as a legitimate business expense and so paying less tax on the profits of their business
- o By paying for travel using the company's money and not their own cash, unlike a permanent employee who must pay their own commuting costs.

Contractors can claim the full range of travel expenses incurred travelling to and from a client's site, which may involve:

- o Train, coach or bus journeys
- o Car journeys, including mileage
- o Taxi fares
- o Air fares.

As with all expenses, contractors should keep accurate records of their business travel expenses, including all receipts and vehicle mileage logs. Although some umbrella companies and other trading vehicles may claim contractors do not have to keep records, this is not the case: records must be kept and contractors may only claim for legitimate expenses they have actually incurred.

The 24-month rule

The first thing a contractor must do is check whether they are eligible or not to claim the expenses. For most contractors their permanent place of work is their home office. Daily travel to a client's site is considered legitimate business travel as long as the contractor satisfies the criteria laid down by HMRC.

The first test is called the 24-month rule. Contractors can claim tax relief on their travel expenses up to the point when they know that their contract at the client's site is over 24 months. The period starts from the day that the contractor starts working at the new site.

So, if they start off on a 12-month contract, have a six-month renewal and then have another six-month renewal, to take the total contract length to 24 months, they have to stop claiming expenses after 18 months when they know the total contract length at that site will be more than 24 months.

Similarly, if the contractor starts off with a 24-month contract at a client's site then they know from the start that the contract will be 24 months or greater and should not claim any travel expenses for the entire contract.

The lesson for contractors is to keep first-time contracts with a client below 24 months, and to think about the length of the final contract before they reach 24 months on-site – should that final six-month contract in fact be for five months and three weeks, which will enable contractors to claim tax relief on travel for the duration of the contract?

The 40% rule

Of course, many contractors work to more flexible regimes where they might be spending time at a number of client sites during the course of a working month.

HMRC has a rule for this scenario – the 40% rule. Basically, if a contractor is spending three days at one site and two days at another,

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they can continue to claim travel expenses up to the point that they know they will be spending 40% or more of their time at a particular client site.

As soon as they know that, then they cannot claim tax relief on travel expenses to and from that particular site, although if they have individual trips to different locations they can still claim for these.

This also applies if a contractor takes a break for a month or more – the time period that would otherwise be used to calculate the 24 month rule is not 'reset'; the contractor should use the 40% rule instead.

Same building, different client

If a contractor has been working for one client in a building with other tenants, and wins a contract with one of the other tenants, which is genuinely a completely separate company in different offices in the building, then the 24-month rule is reset and the contractor can claim travel expenses.

When a contractor finishes work with their old employer and comes back as a contractor, they can in theory claim travel expenses, but they would be waving a red flag at HMRC, effectively saying, "I'm a disguised employee; please come and make me pay more tax inside of IR35!"

Some contractors try and dodge the 24-month and 40% rules by, for example, changing their umbrella company. This won't wash with HMRC, who will see the contractor as working for the same client at the same location, even if they have changed their trading vehicle.

Many contractors find that some time after a contract has been completed that they were able to claim relief on their travel expenses. In the same way that HMRC can go back six years to investigate contractors, so contractors can claim unclaimed allowances for contracts up to six years old, as long as they have all the records to prove their claims.

Contractors who break the rules and are found to have paid themselves travel expenses when they were not eligible will be forced by HMRC to pay tax and National Insurance Contributions on the value of the expenses, and may also be liable to interest and penalty charges.

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