

How can contractors identify deductible contracting expenses?

With HMRC becoming ever tougher on [contractors' expenses](#), it's important to understand what you can and can't claim for.

Contractors who use [limited companies](#) are entitled to offset [legitimate business expenses](#) against tax. However, according to Barry Roback, Chief Executive Officer of [JSA Group](#), which specialises in accountancy for contractors, there is no simple explanation: "The law says that expenses are deductible if incurred wholly, necessarily and exclusively in the performance of duties."

So, what does this mean, exactly? "If I am working in our Watford office, and this is my permanent place of work, and I decide to go out for lunch, then I cannot claim lunch as a business expense – the decision to go out for lunch was personal and from my permanent place of work," explains Roback.

"If I take a client and pay for their lunch, I cannot claim the cost of the meal as a deductible business expense as HMRC would view this lunch as [entertainment](#), which is not tax deductible." However, if Roback went for lunch when visiting a client's office away from JSA Group's Head Office in Watford, this expense is deductible.

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Barry Roback Chief Executive Officer JSA Group

Increased scrutiny

Contractor expenses have become an issue for the taxman, with HMRC having created a task force earlier this year to investigate umbrella companies, and specifically the way in which they treat [dispensations and expenses](#). Dispensations are agreements with HMRC that allow [contractor umbrella](#) firms to process contractors expenses without receipts, up to set limits - but the expenses must be incurred.

Roback's advice to contractors with their own limited companies is to claim with caution. And for contractors working for umbrella companies to follow their guidelines carefully and understand exactly what the dispensation covers. "There's no definitive list of items that can be claimed as business expenses," says Roback. "That's why it is so important to understand what the law says."

Place of work

HMRC also has rules that enable contractors to determine their permanent location of work. The '[24-month rule](#)' states that if a contractor is based, or expects to be based, at a location for 24 consecutive months, that location is deemed to be their permanent place of work. Another rule that affects contractors is the 40% rule. This states that if, over the course of employment with one employer, they spend more than 40% at any given location, this becomes their permanent place of work.

Why is this important? "The cost of travel to your permanent place of work cannot be deducted as a business expense," continues Roback, "However with a few notable exceptions, the cost of travel to a location that is not your permanent place of work can be claimed." Contractors who work for umbrella companies technically have no permanent place of work and can claim for all their business travel, providing that they do not breach 24-month and 40% rules.

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Processing expenses

Keeping a meticulous paper trail is essential. If HMRC does investigate, then contractors need to be able to substantiate their deductions – inspectors will not be sympathetic to missing records. And remember: accounting and tax records must be kept for seven years.

There are two broad types of deductible expenditure:

- o Expenditure by the company which reflects direct payments for goods and services; and
- o Spending your own money on business costs, which are expenses you need to claim back from your company.

Although there is no statutory system for processing expenses, keeping up-to-date records is important if the taxman comes to call, and also helps your accountant, particularly at year-end when a breakdown of expenses must be submitted to HMRC. Expenses can be submitted daily, weekly, monthly or quarterly, whichever suits you best. Many contractors opt to complete their expenses quarterly at the same time as their VAT return, and to send the details to their accountant at the same time.

Expenses forms

Some accountants provide software or spreadsheet templates for contractors to complete – check with your accountant about how they prefer to work as they may vary. And making things easier for your accountant is likely to reduce your accountancy bill. As a

minimum, list the expenses in a spreadsheet with the total and ensure that all the receipts are attached.

The totals on expenses forms should match transfers you make from your [business bank account](#) to your personal account, whether they be by cheque or bank transfer.

Don't attract attention

HMRC has made it clear it is looking hard at contractors' expenses, and particularly at those contractors working for umbrella companies. "Unfortunately, people working for some umbrella companies are taking advantage of the dispensations awarded by HMRC to claim potentially excessive business expenses," says Roback, "and the resulting interest from HMRC could affect everyone in the sector."

If in doubt about whether an item is legitimate, Roback's advice is to consult an expert and not risk falling foul of the rules.

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