

Contracting mindset tips: contractors can claim expenses formerly paid by themselves

Once you start contracting, you can [claim business expenses](#) in a way that permanent employees can't, even if you are employed by an [umbrella company](#). Many expenses you pay out of your own pocket as an employee come directly out of your fees when you contract and can help reduce your tax bill.

How would you like to offset travel, computers and even household bills against tax?

Wouldn't you think it was great if your employer offered to subsidise your travel, home office equipment and a proportion of your household bills?

Ask yourself how much of your own money you spend improving your work and business skills. Wouldn't it be great to buy all these items at a massive discount?

Work out how much gross income you have to earn as an employee to pay for a £1,000 laptop after you've paid tax in your salary. But what would it cost you if your employer deducted the cost from your pre-tax salary and excluded the VAT?

Employees pay for everything net of taxes; contractors pay for many things pre-tax

As an employee, all your home office needs and household bills are paid out of your personal income after you've paid your taxes. You also personally pay to travel into work each day and pay for your lunch (subsistence).

When you buy a book about management to improve your business skills, or the latest how-to software manual, you also bear these costs from your net income.

When you are contracting you can claim these costs as tax-free expenses – meaning they are paid for from your gross earnings, before taxes are applied. This effectively reduces the cost to you. And not only that, you can claim the VAT back, reducing the cost even further.

Contractors claim business expenses before tax, and use expenses to reduce tax

As a contractor, your place of work is your home office. That means that when you start work at your client's location, you're working in a temporary workplace. HMRC has rules about temporary workplaces that allow you to claim back some of the costs of travel, meals and hotels when working away from home.

You claim expenses, which can also include the cost of office equipment, furniture, computers, books, training courses and many other business expenses, out of your gross fees before tax. That means not only do you need to earn less to pay for these items, but as a cost to your business they are offset against your profits and reduce your tax bill.

If your contracting business has fees that are greater than the VAT threshold, then you can register for VAT and claim back the VAT you pay out on business expenses. That means a laptop retailing at £1,200 costs your business only £1,000 ex-VAT (based on the post-January 2010 VAT rate of 20%). Plus, that's £1,000 paid out of pre-tax earnings, in other words £1,000 off your business profits, potentially saving you £200 in corporation tax. That laptop, and any other expenses for that matter, is suddenly costing you a lot less than it would if you were an employee.

Contractor mindset tip:

Contractors can claim business expenses before tax and VAT that, as employees, they would pay for out of personal net earnings.

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