MD ACCOUNTANCY
TEAM LIMITED

SELF EMPLOYMENT/ PARTNERSHIPS

Record Keeping & Allowable Expenses

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RECORD KEEPING & TAX ADMINISTRATION

If you run your business as a Sole Trader (or a partner in a business Partnership) you need to keep accurate records to work out your profit and loss for your Self-Assessment Tax Return (SATR). You must register with HMRC as a sole trader and submit a Self -Assessment Tax Return every year.

You need to account for all your sales / income as well as all your business expenses. This includes keeping all your paperwork for purchase receipts/bills, bank statements and sales invoices.

Your also need to keep records of your personal income.

Records need to be kept for **at least 5 years** after the date of the January 31st Self-Assessment Tax Return deadline.

You need to decide if you are using **Cash Accounting** or **Traditional (Accrual) Accounting**.

Cash Accounting is simpler and is based on your bank and cash transactions but can only be used if your annual income is less than £150,000.

If you use **Traditional Accounting** (where you record income and expenses by the date you were invoiced or were billed, not money paid or received) you need to keep further records:

- what you're owed but have not received yet
- what you've committed to spend but have not paid out yet, for example you've received an invoice but have not paid it yet
- the value of stock and work in progress at the end of your accounting period
- your year end bank balances
- how much you've invested in the business in the year
- how much money you've taken out for your own use

The benefit for Traditional Accounting is you get tax relief based on the date of invoices rather than payment date.

VAT

If your turnover is over £90,000 for any rolling 12 months period, you must also register for VAT - See separate VAT guide.

CIS

If you're working in the construction industry as a subcontractor or contractor you need to register for CIS - See separate CIS guide.

SELF EMPLOYMENT ALLOWANCE EXPENSES

What expenses are tax deductible?
An expense, or part of an expense (when you can identify a suitable proportion), can be claimed as a deduction from taxable income when it is incurred **wholly and exclusively** for the purposes of your business.

Specific rules in statute and almost 100 years of tax case law have made this topic very complicated.

Usual expenses for small businesses

We have listed some more common expenses that are tax deductible below:

Cost of Goods Sold
Subcontractor Costs
Small Tools
Protective clothing and Uniform
Advertising & Marketing
Subscriptions and professional memberships
Insurance
Accountancy Costs
Computer Software and consumables
Rent
Telephone & Internet
Printing, Postage & Stationery
Bank Fees
Travel & Subsistence (1)
Motor Expenses (1)
Training & Professional Development (1)
Office Consumables (1)
Working from Home (1)

(1) the rules are complex – see specific sections below

Expenses that are not tax deductible:

Entertaining clients, suppliers, customers
Fines & Penalties
Clothing - unless it is protective for example steel toe-capped boots or branded uniforms
Repayments of loans, overdrafts, finance arrangements (only the interest may be deductible)
Training (if you are learning a new skill)
Event hospitality
Gym membership fees
Donations to charities/political parties
Depreciation of Equipment

MOTOR EXPENSES

There are two ways of claiming motor expenses if you are self-employed. You can choose either, but once you have chosen you should keep the same method throughout the life of that vehicle.

1. Claiming a mileage allowance (simplified expenses): you can claim a mileage allowance of 45 pence per mile (25p after the first 10,000 miles) for a car, or 24p per mile for a motorbike.
2. Using actual expenses:
    - Petrol, oil and other consumables, such as anti-freeze and tyres
    - Repairs and insurance excess
    - Road fund licence, servicing and MOT
    - Tolls and road charges

However, you can only claim the business element, so if you use your car 50% for personal use you can claim 50% of actual expenses. You should keep a mileage log to justify the % allocated – If you can't do it for the whole year, do it part of the year use that % for the year.

You can claim the cost of buying a car for your business as a capital allowance. The amount you can claim depends on whether you use cash accounting or traditional accounting, on how much you use the car for private purposes, and on the car's emission levels. Always check with your accountant first.

TRAINING COSTS

A sole trader or partner is able to claim the costs of training if it improves the skills and knowledge you use in your business.

The costs of obtaining a <u>new</u> skill or qualification <u>cannot</u> be claimed as an allowable expense as it is considered an investment. However the costs of maintaining work-related training and professional development is allowable. If the training has mixed purposes it is not allowable either.

The costs of travelling to a training course will also only be allowable if the cost of training itself is allowable.

REPAIRS, MAINTENANCE AND IMPROVEMENTS

You can generally claim repair and maintenance costs as an expense, but any enhancements or improvements to an asset is a capital expenditure – you may be able to claim tax deductions for these separately

The rules are quite complex, so where repairs are likely to be substantial, discuss the tax implications of what is being done prior to commencing work. Builders and architects are not tax advisers, so best discuss it with your accountant!

EQUIPMENT VS. OFFICE CONSUMABLE COSTS

You need to distinguish your expenditure between Office Equipment & Furniture which typically have a useful life of more than 2 years and Office consumable items (less than 2 years useful life):

If the item purchased is small and/or its useful life is short then it will be an expense (Office Consumable)

If it has a longer useful life it is an Asset (Computer & Office Equipment / Furniture & Fittings)

Remember you cannot claim for any non-business use of these expenses – and it is useful to have a written policy for small items.

ENTERTAINING

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

Entertaining clients, customers or third parties

- The cost of entertaining clients, customers or third parties in relation to the business is specifically disallowed as a deduction 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.

NB: The cost of entertaining should be separately analysed in the accounts so that it can be added back for tax purposes.

EMPLOYING THE SPOUSE AND FAMILY

- A spouse or other family members may be employed by a sole trader.
- Wages must equal to or be above the current National Minimum Wage.
- Ensure that remuneration paid is reasonable for the work undertaken as HMRC may otherwise challenge it.
- Employers National Insurance is at 13.8%, with an additional levy at 1.25% announced from April 2022- it may be cheaper to bring a spouse into the business as a partner so that profits can be shared.
- Ensure wages are physically paid, and paid into the spouse's own bank account.
- Review additional benefits that may also be paid as part of the whole package such as pension, mobile phone, life insurance, trivial benefits etc (See our guide to tax free benefits for employees);
- Similar principles apply to other family members as to spouses
- If you employ anyone (including your family) you must register as an employer and run a payroll – *see our payroll guide*

WORKING FROM HOME
(NOT FROM BUSINESS PREMISES)

If you are self-employed and work from home:

- You can claim all the costs that are incurred wholly for business purposes.
- You may also claim a proportion of all the other costs of running your home, such as light and heat, insurance, council tax, allowable repairs and rent.
- There is no set method of apportioning these other costs; it depends on what work is carried on at home. An element of judgement is needed but any amount claimed must be reasonable.
- When you are claiming expenses then ensure that you pay for them (they can't be paid by someone else).
- You cannot rent yourself your own home, but you can rent a jointly owned asset.

If a part of your home is used exclusively for business, then you are likely to have to pay Capital Gains Tax on part of the profits when you sell it. You may also be assessed for business rates and there may also be planning issues

Actual Costs – How do you calculate it?

There is <u>no</u> set formula; you must use <u>actual costs</u> (for which you need receipts) and should use the method which you consider is most fair. For example:

1. By no. of rooms.
2. By sq. metre, of floor area, if you have the measurements to hand.
3. By electricity /gas metre, if it is possible to make test readings with all other household appliances switched off.
4. By water meter, if metered, not if unmetered.
5. By proportion of time in use.

Fixed Rate Allowance – simplified expenses

If a sole trader works from home for at least 25 hours a month, they may claim a monthly fixed rate allowance for home working <u>instead of</u> making a claim for their actual expenditure. This may be beneficial if you do not spend a large part of your working day at home or if you wish to cut down on bookkeeping

The rate is based on your calculation of the number of hours that you work at your home "wholly and exclusively" for the purposes of your trade.

No of hours worked (per month)	25 to 50	51 to 100	101 +
Amount (per month)	£10	£18	£26

- You will need to retain some sort of log to establish how many hours you are working, and if the period is less than a month reduce it pro-rata.
- You can use the Fixed Rate Allowance one year and then actual expenses the next if your working hours at home change.

NB: this flat rate does not include telephone or internet expenses which can be claimed for separately

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