Complete guide to claiming expenses for small business

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Claiming business expenses can make a huge difference come the end of your tax year. Just visualise that stack of receipts you've collected over the last 12 months alone!

With the after-effects of the pandemic and now the cost of living crisis, we know a lot of businesses are feeling the pinch. But there are ways you can try and make the best of a bad situation.

During your business year, you'll probably have racked up a substantial amount of expenses. Even the smallest purchases can add up: if you were to count up all of the money you've spent over the year, you'd probably be pretty surprised at the outcome.

Thankfully, that's where allowable business expenses come in. Small businesses like yours have the opportunity to claw back some of the pennies and pounds. And, as you usually claim these at year-end, it can be a helpful boost when you need it most.

In 2018, up to £962 million in expenses was not offset against businesses' profits in the UK. That's a staggering amount, even pre-Covid, and just goes to show how important it is for you to claim back everything you can.

If you haven't made a claim before (either because you're a new business or not 100% sure of the process), don't worry – we don't think you should go it alone.

That's why we've put together this complete guide to claiming business expenses.

What are business expenses and why are they important?

Business expenses are costs you build up throughout the year, which help you carry on your work. It could be something as simple as office supplies or even uniforms for your team.

In the words of Investopedia, business expenses are:

“Costs incurred in the ordinary course of business... expenses are subtracted from revenue to arrive at a business’s taxable net income. [They] may also be referred to as deductions.”

While that sounds a bit like jargon, there’s a far simpler way to look at it.

Allowable expenses act as a tax deduction, reducing the amount of your income that’s subject to tax, and in turn, lowering your tax bill.

But don’t start rifling through your receipts just yet. In the eyes of HMRC, expenses must be “wholly and exclusively” for business purposes. So you probably can’t claim for your morning cappuccino – sorry!

Thankfully, there is a fairly sizable list of items HMRC will allow you to claim (more on that later).

What can I claim as a business expense?

As mentioned above, the term “wholly and exclusively” is one of the main conditions for expenses to be deductible, applying to both income tax & corporation tax.

That said, the term is complex and up to interpretation. For a more in-depth explanation, read the HMRC internal manual.

As HMRC explains:

"The words "wholly" and "exclusively" prevent a deduction for expenditure that serves a dual purpose, a business purpose and a non-business purpose."

There are different rules for self-employed people and those who run limited companies: we'll briefly cover the differences here, but if you're in doubt, it's best to get advice on what you can and can't claim.

As there's a long list of allowable expenses, we'll go through the most relevant. For any others, visit the Government website.

Self-employed expenses

Some examples of expenses that sole traders can claim include:

- **Stationery**, such as pens and paper you use in the office, as well as postage, printing.
- **Rents, rates and utilities**, like rent for business premises, water rates, phone, mobile and internet bills.
- **Travel expenses**, such as mileage (for business purposes), public transport costs and parking.
- **Uniforms**, for example, protective equipment, costumes for actors and work uniforms.

For each of these categories, you'll need to keep the "wholly and exclusively" rule in mind and apply it realistically.

You can't claim for clothes you wear to work, for example, if you could also wear them in your day-to-day life (so no bargain hunting at Primark, but you should be fine to claim a hi-vis jacket for construction work).

In fact, you'd be surprised what some people have tried to get away with claiming in the past.

HMRC once reported, for instance, that a taxpayer tried to claim £4.50 for sausage and chips meal expenses for 250 days. Perhaps even more bizarrely, another attempted to claim the cost of dog food for their Shih Tzu 'guard dog'.

A general rule of thumb in these situations is not to make a claim unless you genuinely need an expense for business purposes: if it feels like you're attempting to cheat the system, don't bother trying.

Limited company expenses

As a limited company, you can claim a few extra costs back from HMRC, some of which you might not expect.

Business expenses you can claim include:

- Christmas parties (up to £150 per head incl VAT, subject to certain requirements)
- formation fees and other company setup costs
- gifts and trivial rewards to your employees
- some training expenses
- charitable donations.

So if you throw a Christmas bash at the end of the year or celebrate your team's achievements with the occasional gift or reward (within reason), not only are you being generous, but tax-savvy too.

Capital allowances

The examples we've covered so far are all typical trading expenses – things you might buy in your day-to-day. Capital allowances work differently to this, and can be claimed on purchases of long-term assets.

Both sole traders and limited companies can take advantage of capital allowances – a Government tax relief for businesses which allows a business to deduct some or all of a qualifying cost from its profits.

You can claim capital allowances on the following:

- equipment
- machinery
- business vehicles: for example, vans, lorries or business cars

Types of capital allowances for plant and machinery

You can claim different amounts of tax relief, depending on which capital allowance you use. These could include the following:

- **Annual investment allowance (AIA)**: up to £1 million on certain plant and machinery.
- **100% first-year allowances**: you can claim the full amount for certain plant and machinery in the year that it was bought.
- **The super-deduction or 50% special rate first-year allowance**: you can claim these for certain plant and machinery you buy from 1 April 2021 up to and including 31 March 2023.
- **Writing-down allowances**: you can claim these if your plant and machinery do not qualify for the AIA or you've already claimed the maximum amount.

How can I claim business expenses?

The way you claim your business expenses will differ depending on whether you're a sole trader or running a limited company.

Sole trader

If you're self-employed, you'll already know you need to submit a self-assessment tax return every year – by 31 January, to be precise.

To claim your expenses, you'll have to run through your records and add up your total **allowable** expenses (if you're using online accounting software, these should already be organised for you) and calculate your total.

Once you've done this, you can enter the final total on your self-assessment tax return.

Depending on the type of expense, you might need to work out exactly which portion of it counts towards this total.

If that sounds a bit too drawn out, you could always go down the route of claiming simplified expenses.

Simplified expenses

What are simplified expenses? The clue is in the name. Rather than calculating an exact total of your costs for certain expenses, you can use a flat rate to make things more straightforward.

Only sole traders and partners can take advantage of this system – limited companies, or partnerships that involve a limited company, can't use this method.

Self-employed people can use flat rates for:

- business costs for some vehicles
- working from home
- living in your business premises (for instance, if you own a B&B or guest house).

Just to give you an idea of how simplified expenses work, we'll focus on the flat rate for vehicles.

You can calculate your flat rate from your mileage rather than the actual cost of running and maintaining your car (or other eligible vehicles).

Vehicle	Flat rate per mile with simplified expenses
Cars and goods vehicles first 10,000 miles	45p
Cars and goods vehicles after 10,000 miles	25p
Motorcycles	24p

So, to borrow HMRC's example, your calculation if you were to drive 11,000 miles over the year would be:

10,000 x 45p = £4,500
1,000 x 25p = £250
Your total claim = £4,750.

While you might not be claiming for every penny you've put into running your business vehicle, simplified expenses can be a much easier and less time-consuming way of working things out.

Whichever method you choose to calculate your business expenses, you must include your final figure in your self-assessment come 31 January after the relevant tax year.

Limited companies

As a limited company director, you'll follow different rules to sole traders, filing your accounts with Companies House and a corporation tax return with HMRC every year.

You can deduct qualifying business costs from your company's profits before tax.

As a company director, you can pay your company's expenses directly from yourcorporate bank account or as a reimbursed expense (this is when you pay for it out of your own pocket and repay yourself).

Be mindful that you must keep a constant and accurate record of your reimbursed expenses, alongside your other limited company records. At best, forgetting to do this might mean HMRC denies your expense request; at worst, you could face penalties for failing to keep adequate records.

Your employees can also claim expenses, so make sure you have company expense procedures and policies on how much they can spend and in what situation. And, at risk of sounding like a broken record, make sure they keep their receipts!

You must include your total allowable business expenses in your corporation tax return, which you usually have to file within 12 months after the end of your accounting period.

Again, keeping records and claiming expenses should be a straightforward process if you're using online accounting software, especially in combination with dedicated expense management apps. With your records stored in the cloud and automatically categorised, you can check back over them at any time.

Keeping records

You might have picked up from the previous section just how important it is to keep receipts when claiming expenses.

In fact, it's your legal responsibility to hold records of your business transactions and expenses **for at least six years as a limited company, or five years from 31 January after the relevant tax year if you're self-employed**. If HMRC ever happens to look into your tax affairs, you'll need to have those records to hand.

This isn't just for the benefit of HMRC, though – it's helpful for you too.

Keeping accurate and up-to-date records on your accounting software means you'll be ready to calculate your expenses and make a claim on your tax return when the time comes.

It also gives you a clear picture of your profits as you go, an accurate view of your business's cash position, and visibility on the different areas you're spending on.

Organising and filing your expense receipts throughout the year may seem trivial, even if it's for something as small as a new box of pens, but it all adds up. Keep on top of everything, or even ask your accountant to do it for you. You'll thank yourself later.

Keep on top of your business expenses

As a small business owner facing whatever the economy throws at you next, every penny helps.

By recording every purchase your business makes, you'll make things easy for yourself at the end of the year, as well as boosting your cashflow by lowering your tax bill.

The days of rummaging around for a paper receipt or bringing them in a shoebox to your accountant's office are over – with the right technology, it's now simple and easy to keep your expenses in order.

So, rather than burying yourself under a pile of business expenses, get in touch with an accountant who can help through expert advice and the latest software.

At Lumin, we've worked closely with clients over the last decade to provide technological solutions to any and all of their accounting problems.

Ready to find out more?

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