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Private expenditure: business expenditure

Which is which - and why it matters.

It matters because some expenses are tax deductible, and others are not. Expenses that are wrongly treated mean the tax liability is misstated - and that makes it a priority area for HMRC.

HMRC compliance

HMRC believes that failure to get the classification between private and business expenditure right is a major contributor to the small business tax gap. Small in this context is a business with anything up to 20 employees, with turnover below £10 million.

One of HMRC's key worries is that smaller businesses can lack 'clear financial boundaries between their business and personal or family life', and HMRC has recently published research that seems to support this.

The research involved business owners being asked to respond to various scenarios, and some of the feedback will certainly have rung the alarm bells at HMRC. Paying family in cash, without regard to the payroll rules, for example:

'It's almost like paying your kids pocket money, isn't it?' commented one interviewee. 'You'll pay your kids . . . to do some little jobs around the house. That's absolutely fine, isn't it? It's almost like that . . . kind of one step removed.'

As a result of this type of misunderstanding, HMRC is increasing compliance activity, and is planning to open more enquiries to check claims for business expenses. At the end of 2025, it ran a campaign to underline the fact that tax relief should not be claimed for private expenditure.

It's worth noting that the last time HMRC did something like this, it raised over £27 million in tax, and highlighted significant numbers of ineligible claims for tax relief. With the potential for penalties and interest where tax is underpaid, it's not an area to leave to chance.

Priorities for director-shareholders

Considerable recent HMRC compliance has focussed on the correct treatment of directors' loan accounts. This is an area that has compliance implications for individual directors, in terms of their personal tax, and also for the company in terms of employment taxes and Corporation Tax.

The trend of increasing scrutiny looks set to continue, with the Autumn Budget 2025 announcing that the government intends to explore introducing new requirements to report transactions between close companies and their shareholders to HMRC. We can help you make sure that you have the right processes in place to deal with these issues. Please talk to us for in-depth advice.

The basic test

The same basic rule applies for both companies and unincorporated businesses. An expense is deductible only if it is incurred wholly and exclusively for the purposes of the trade.

In practice, expenses are likely to fall into one of the following categories:

- business expenses
- private expenses
- mixed use expenses.

Capital expenses

Note that this is an area in its own right. Separate rules cover the tax treatment of capital expenses, with capital allowances available for qualifying expenditure on plant and machinery. Adjustment is needed in an unincorporated business where there is personal use - typically for a vehicle. We are not able to cover this here, so do talk to us for more advice.

Business expenses

This category includes things like raw materials for manufacturing businesses; employment costs; and purchase of trading stock. Such business expenses are deductible.

Note that where the Trading Allowance or Property Allowance is used, actual expenses cannot be claimed. If expenses are more than your income, it may be preferable to claim expenses instead.

Private expenses

This category includes anything from personal spending on holidays, to clothes or family groceries. These expenses are not deductible. If paid out of business monies, they fall to be treated as drawings (for the unincorporated business owner) or as directors' remuneration (in the case of a company).

Mixed use

Expenses with both a business and a private element are mixed use expenses.

Expenses that have a dual purpose (in other words, they have both a private and business element), for which no separate business element can be identified, are not allowable. But if an identifiable part of such an expense is incurred for trade purposes, that part is an allowable deduction: though the private element is not. This means the need to make an adjustment to cover the private use.

Adjusting the figures

Working out a satisfactory way to split the cost between the business element and the private element is known as apportionment. Accurate records are needed to underpin the apportionment, showing how and why the costs have been divided up in this way.

Example: Working out proportions for use of home as the business office base

If you use your home as the office base for your business, you may be able to justify claiming a proportion of costs for things like heating; electricity; Council Tax; mortgage interest or rent; internet; and phone use.

Where there is only very minor use of the home, perhaps if it is only used to write up trade records, HMRC may accept a reasonable estimate. Generally, however, working out a reasonable proportion is more complex, and will involve considering how many rooms or how much floor area is used for the business; and how much time this space is used for business; and setting this against costs for the home as a whole.

The calculation might look something like this.

Method to apportion costs

There are four rooms in the house. One is used primarily as an office. Total electricity costs for the year are £1,120.

Assuming all rooms use the same amount of electricity, HMRC might accept that dividing the costs by the number of rooms used for business represented a reasonable method of apportionment.

This would allow a claim of up to £1,120/4 = £280 as an allowable business expense.

The next step would be to consider how much time the room was used for the business. If used on average one day a week, this would mean restricting the claim to £280/7= £40.

The amount of care needed to prove that apportionments are reasonable cannot be overstated. The type of detail needed is shown in the following example (adapted from HMRC):

Factors to consider: Gordon is an architect. He uses one room as a dedicated office space between 9am and 5pm each day. Outside that time, the family uses it regularly, for about two hours every evening.

The room contains a workstation, office furniture and storage for architectural drawings. Gordon uses the room for an average of four hours every day. This is often spread over an eight-hour working day, as he makes site visits outside the home as well. The room is also used for technical meetings with clients, outside normal hours, and on a regular basis.

After apportioning costs by reference to the number of rooms in the house, Gordon calculates the room uses £300 of variable costs (electricity and oil): and £600 of fixed costs (council tax, mortgage interest, insurance). In apportioning these costs by time, Gordon claims £680 in total, made up of 4/6 of variable costs (£200) and 8/10 of fixed costs (£480).

The claim equates to 75% of the total costs attributable to the room (£680/£900), which Gordon views as a more straightforward, but equally reasonable basis for future claims, should his circumstances remain unchanged.

If Gordon operated his business as a limited company, he would need to charge the company rent to cover these costs, and this would have different repercussions.

What HMRC is looking for

Current HMRC compliance is centred on private use adjustments. With this in mind, it is essential to be able to show that:

- care has been taken to apportion the split between the business and the private element on a reasonable basis
- there are records to support the apportionment
- the method of apportionment has been applied consistently from one tax year to the next.

Tip: It shows you take reasonable care

Latest figures for the tax gap pointed to failure to take 'reasonable care' as a major issue for small businesses.

Reasonable care is not a term defined in statute, but as a minimum, HMRC expects it to involve keeping records to make correct and complete returns. Being able to demonstrate that you have a comprehensive record of expenses, accurately analysed, is a major safeguard in the event of HMRC scrutiny.

Getting the underlying records right

It is important that expenses are correctly analysed in your records. Areas where HMRC often checks and finds errors include:

- private expenses wrongly classified as business expenses, for example personal expenditure analysed as repairs, travel, sundries or staff welfare
- drawings in unincorporated businesses recorded as wages or salary
- personal spending by directors coded as 'expenses'
- use of credit card for both business and personal expenses, without identifying and excluding the private element
- failing to restrict interest and finance costs on loan, hire purchase or finance agreements where there is mixed use
- personal expenses such as utility bills, mortgage, or insurance paid out of a business bank account without adjusting the drawings figure for unincorporated businesses: or charging them to a director's loan account in a company
- including professional fees for personal tax advice as a business expense: only the business element of professional fees is allowable - though for the self-employed, normal self assessment filing is treated as an allowable business expense.

Alternative to apportionment

Sole traders and partnerships (but not companies or business partnerships with a corporate partner) have the option to use what are known as simplified expenses for some sorts of expenditure. This is instead of apportioning actual expenditure: simplified expenses give flat rate deductions, instead.

Simplified expenses can be used for motor costs; working from home; and for private use of business premises if you live in them as your home. Other expenses still require apportionment based on the actual costs involved.

Motor expenses: These are calculated by using a flat rate for mileage, rather than actual costs, such as insurance, repairs, servicing and fuel.

Use of home for business: Records of the number of hours worked from home each month are needed, and note that simplified expenses can only be used if you work a minimum of 25 hours at home each month. The flat rate does not include telephone or internet expenses: the business proportions here can be claimed by working out actual costs.

Living at business premises: This can be used, for example, if you run your house as a guesthouse, bed and breakfast, or small care home. Rather than working out a split between what is spent for business use of the premises, and what for private use, you calculate the total expenses for the premises: and subtract a flat rate amount, based on the number of people living there. This figure is used to cover personal use, with the rest claimed as the business element.

Common areas of confusion

Motor and travel expenses: Whether it's a business vehicle that's also used for non-business travel, or a private vehicle also used for the business, only the business element of costs is allowable. This applies to the range of costs from rental and lease costs, to running costs such as repairs and servicing, vehicle licence, fuel and insurance (providing this covers business use). Directors are covered by the rules for company cars and the benefit in kind charge. Non-business driving or travel costs; fines or penalty charges are not allowable; neither is the cost of travel between home and your business 'base of operations'.

Travel and subsistence: In general, the cost of meals is not allowable. Where there are occasional journeys outside the normal pattern of travel, however, or for itinerant trades, the cost of meals and accommodation may be allowable. Please talk to us for more information.

Entertaining: The cost of business entertainment is generally not allowable, though there is an exception for staff entertainment. We can advise further here.

Training expenses for the business owner: Costs incurred to enhance skills and knowledge that you already need to run the business are generally allowable. Training costs relating to starting up a new business, or expanding into a new area, unrelated to your current trade, are not.

We can help

Getting these fundamentals right will go a long way to safeguarding your business in the event of any HMRC intervention. In view of HMRC's current interest in this area, it may be prudent to check current and previous claims, and we are on hand to help. Please contact us with any queries you may have.