

Deductible Expenditure - General Rule

Expenses are deductible if they are incurred wholly and exclusively for the purposes of the trade.

Classes of Allowable Expenditure

Expenses must be wholly and exclusively for trade purposes. Key allowable costs include:

1. **Interest** (except on overdue tax).
2. **Legal & professional fees** (unless for capital items).
3. **Damages & compensation payments.**
4. **VAT unable to reclaim.**
5. **Trade subscriptions.**
6. **Employees' remuneration** (genuine salaries; excessive payments to relatives disallowed).
7. **Theft by staff** (unless they control the business).
8. **Travel expenses** (excluding home-to-work commutes, unless home is the work base).
9. **Patent royalties & trademark registration costs.**
10. **Incidental loan costs** (for business loans).

Current Year Basis

CYB when business profits are taxed in the owner's tax returns.

- During the main years of operation, CYB is the standard method.

Example A trader with a 31st December 2023 year-end would have profits taxed in the 2023/2024 tax year.

Disallowed Expenditure

Certain expenses are disallowed for tax purposes under Case Law or Statute Law:

1. **Capital Expenditure** (ITTOIA 2005) No clear definition, but includes items providing an "Enduring Benefit" (Atherton v British Insulated & Helsby Cables).
2. **Drawings** Owner's personal withdrawals, salary, or benefits (e.g., tax/NI payments).
3. **Provisions** Generally allowed if following accounting standards, but general provisions for bad debts are disallowed.
4. **Entertainment and Gifts** **Customer entertainment** is generally disallowed.

Allowed deductions: Staff parties (employees may be taxed). Gifts to employees (wholly & exclusively for trade). Samples of trading goods (PR exercise).
5. **Political Donations and Subscriptions** Generally not allowed, unless providing a definite trade benefit (Morgan v Tate & Lyle).

Disallowed Expenditure (cont)

6. **Fines and Penalties** Generally **not allowed**, but parking fines for employees using company vehicles are permitted (employee may incur a benefit-in-kind tax).

7. **Illegal Payment** Payments like bribes or blackmail are not allowed.

Expenditure not shown in accounts

Depreciation (a capital item) is added back and replaced with **Capital Allowances**, the tax-equivalent deduction for capital expenditure. Details follow in the next lecture.

Adjustments relating to Income

To calculate taxable profit, income adjustments are needed:

1. Remove Non-Trading Income

Examples:

- Interest and income are taxed elsewhere.
- Profits/losses from capital asset disposal.
- Changes in general provisions (already noted under expenses).

2. Insert Missing Trading Income

- Typically includes owner consumption of own goods, treated at market value (ITTOIA 2005).