Construction accounting:

The ultimate guide to maximising expense deductions and tax savings

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Tax planning — developing strategies that minimise your tax liability and optimise tax savings — is one of the most important parts of construction accounting.

The importance of tax planning won't be lost on you. Get it right, and you can improve your cashflow, buy that new bit of equipment your business could do with, or just treat yourself and your employees with a pay boost (or the Christmas party of the ages).

However, the tax regime, with its rules within rules and exceptions to exceptions, isn't the easiest thing to understand. Sounds like you've made the right decision in downloading this eBook!

In this guide to tax saving opportunities in construction accounting, you'll learn how you can save your business money, from claiming allowable expenses to carrying out R&D and changing your business structure.

We've tried to be as clear and concise in our explanations as possible, while giving you the full picture, so you'll forgive us if we get a little mathsy in parts — it's the only way to demonstrate how much money you could save by adding proper tax planning to your accounting.

Shall we get straight to it, then?

Business deductions explained

The dust still clings to your high-vis. Your thumb still throbs from the splinter you got just before lunch. But the day's over and the barman has just pulled a crisp pint. You fumble for your wallet for a colleague to tell you, half-joking: "Just put it on expenses!"

We've all heard that phrase, but have you ever thought about what that actually means?

In a nutshell, the Government wants businesses to invest so they have equipment and assets they can use to boost their income. Higher income means businesses are more likely to expand their operations.

That's hugely important in the construction industry, because that means more houses built, roads laid, bridges constructed, etc. But it also gets more people into employment, which will help economic growth (as more of the population has extra money to spend), while generating higher tax receipts.

To encourage businesses to invest, politicians let businesses offset certain business costs against their profits before tax, essentially reducing the 'profit' HMRC uses to work out their tax bill. The result? A lower tax liability.

There are three main types of business expenditure that the construction industry of all sectors stand to gain from: allowable expenses, capital allowances, and R&D costs.

Allowable expenses

First, let's go over allowable expenses. These cover the more general types of business expenses that are incurred as part of the day-to-day running of the business — as opposed to long-life assets or ones related to R&D projects (we'll get to them later).

So, the value of anything that you use for business purposes can be deducted from your pre-tax profit to reduce your bill, regardless of whether you're a sole trader, partnership or limited company.

In that case, steel-tipped boots, hard hats, gloves, ear protectors, knee pads, hi-vis jackets and so on – they're all deductible. But the jeans you wear to work? They're not — HMRC is quite explicit about this: "You cannot claim for everyday clothing (even if you wear it for work)".

You can also claim for small tools and equipment that you'll use for less than a couple of years, like paintbrushes, screwdrivers and hammers. Then there's fuel (except for fuel you use to journey to and from "your usual place of work"). You can also claim for motor insurance and the cost of repairs, as long as the vehicle is a dedicated work car or van.

You can also make partial claims for some purchases you make for both business and personal use — your personal telephone, which you probably also use for work, is a great example. The twist is that you can only claim for the cost of an item that relates to your work. Therefore, you need to make sure you're making a reasonable claim and have the records to back it up.

"More expenses are deductible for tax purposes than you might think. For example, did you know you can claim for a tax deduction if you use your home as an office? Even training courses may be tax-deductible as a business expense."

Capital allowances

A capital allowance is a deduction businesses can claim against the cost of an asset that has a long-term benefit to the business. HMRC calls these assets 'plant and machinery'.

What can I claim for?

There are two 'pools' of assets that businesses can claim capital allowances for. The first is the 'main rate pool', which covers:

- machines such as computers, printers, lathes and planers
- office equipment such as desks and chairs
- vehicles such as vans, lorries and tractors (but not cars)
- warehousing equipment such as forklift trucks, pallet trucks, shelving and stackers
- tools such as ladders and drills
- construction equipment such as excavators, compactors,
- and bulldozers
- some fixtures such as kitchen and bathroom fittings and fire alarm systems in non-residential properties.

Then there is the 'special rate pool':

- items with a long life
- solar panels
- thermal insulation you've added to a building
- cars with CO2 emissions over a certain threshold - check the threshold for your car, which depends on the car and when you bought it
- 'integral features'.

That final expenditure — integral features — refers to "parts of a building considered integral". These include lifts, escalators and moving walkways; space and water heating systems; air-conditioning; hot and cold water plumbing (but not toilet and kitchen facilities); electrical circuits, and external solar shading.

How do I claim?

Exactly how you claim depends on the precise asset you've purchased, as there are multiple capital allowance schemes construction companies can benefit from.

A. Annual investment allowance

The most recognisable capital allowance scheme is the annual invest allowance (AIA), which allows businesses to write off the full value of an eligible expense in the same accounting period they purchased it.

It applies to both main and special rate plant and machinery, and is open to sole traders, partnerships and limited companies alike. However, the AIA is capped at £1 million, so may be of limited value to particularly large businesses.

B. Full expensing and 50% first-year allowance

You probably remember Rishi Sunak unveiling the super-deduction all the way back in March 2021 when he was Chancellor of the Exchequer.

Although that's ended, current Chancellor Jeremy Hunt has replaced the scheme with a less generous system that is scheduled to end in 2026. Dubbed as 'full expensing', this scheme works much like the AIA in that businesses can use it to claim for all their eligible costs in the same accounting period they bought it. There's no limit to what you can claim, but it is only available to limited companies.

Furthermore, only new, main rate assets qualify for the scheme. However, this is where the 50% first-year allowance — launched in conjunction with full expensing — comes in. With this scheme, businesses can claim half the value of a new, special rate asset in one go, and claim the remainder with a writing-down allowance at 6% in subsequent accounting periods.

C. Writing-down allowances

Usually used by companies that have used their annual AIA, writing-down allowances apply to all plant and machinery, as well as assets that the AIA and full expensing do not apply to, such as cars and gifts.

However, they are far less generous, allowing businesses to claim 6% per accounting period for special rate expenditure and 18% for main rate items.

D. First-year allowance

Finally, there's the first-year allowance, which should not be confused with the temporary 50% first-year allowance. Similar to the AIA, you can use the first-year allowance to claim the full cost of eligible assets in the same accounting period. In contrast, though, the first-year allowance applies to very specific types of expenditure, including:

- electric cars and cars with zero CO2 emissions
- plant and machinery for gas refuelling stations, such as storage tanks, pumps
- gas, biogas and hydrogen refuelling equipment.

Tax relief for R&D costs

R&D tax relief is another way you may be able to reduce your tax bill by claiming costs related to research projects — although it is exclusively limited to companies.

What is R&D tax relief?

The Government grants R&D tax relief to companies that carry out a research project that makes a unique contribution to, or advancement in, science or technology.

An advance in science or technology may have tangible consequences (such as a new, more energy-efficient construction material), or intangible ones (new knowledge or cost improvements, for example).

Even if you didn't make the advance you sought, however, but still advanced knowledge by ruling a method or theory out, then R&D has taken place.

Moreover, if you're researching into something for which details are not publicly available (for example, if it's a trade secret), work to extract those details through science and technology also counts as R&D.

However, for construction firms, projects must be relevant to the construction industry — unless you plan on branching out into the sector your project relates to.

As you can see, defining what counts as R&D is a tall order; HMRC's document on the topic reaches nearly 4,500 words, so if you want clarity on whether your construction project counts as R&D, we recommend you speak with an R&D tax specialist.

What can you claim?

Under the UK R&D tax relief schemes, companies can claim for eligible expenditure related to qualifying R&D projects.
These include:

- **Staff costs**: This includes salaries, wages, employer's National Insurance contributions, and pension contributions of employees who are directly engaged in carrying out R&D activities.
- **Subcontractor and externally provided workers (EPWs) costs**: The cost of hiring subcontractors or EPWs to carry out R&D activities on behalf of the company is eligible for relief.
- **Consumables**: This includes the cost of materials, water, fuel, and power that are consumed or transformed during the R&D process.
- **Software**: The cost of purchasing or licensing software that is used directly in the R&D process.
- **Capital expenditure**: This includes the cost of equipment and facilities used directly in the R&D process.

R&D tax relief schemes

There are two types of R&D tax relief that companies can claim, each one tailored to companies of different sizes.

SME R&D tax relief scheme

As the name suggests, this scheme is available to small companies with both of the following:

- fewer than 500 staff
- a turnover of under €100 million or a balance total sheet under €86m.

Through the scheme, SMEs can deduct 86% of their qualifying R&D costs from their yearly profit, on top of the regular 100% deduction, to give a 186% enhanced deduction.

But what does that even mean?

Let's assume your business has made profits of £650,000 for the year. You would pay corporation tax at 25%, which comes to a tax bill of £162,500. However, your business spent £120,000 on R&D expenditure, so you're entitled to tax relief.

What happens is that the enhanced deduction is multiplied by your expenditure (£120,000 x 186% = £223,200). You then deduct your expenditure from the total, giving you £103,200, which is what you deduct from your pre-tax profit. In this example, that leaves you with £547,800, which is the figure HMRC would use to work out your tax bill — £136,700. That's a saving of almost 16%.

If the company is loss-making, however, things are different. In this case you can instead claim a tax credit worth up to 10% of the surrenderable loss — although if at least 40% of your expenditure is related to R&D, the credit is worth 14.5%. We're going to need another explanation, aren't we?

Imagine your SME made a loss for the year and spent £100,000 on R&D. You would multiply the 186% enhanced deduction by your expenditure (186% x £100,000 = £186,000). You would then multiply your £186,000 by 10% to give your tax refund: £18,600.

R&D expenditure credit (RDEC)

The RDEC is open to large companies and smaller ones that cannot claim SME R&D tax relief.

Under the relief, companies can get a 20% credit on their qualifying R&D expenditure incurred on or after 1 April 2023. However, the credit is subject to corporation tax, which slides between 19% and 25%, depending on your profits.

To help clarify, here's an example of an RDEC calculation: if a company has £1,000,000 worth of qualifying R&D costs after 1 April 2023, they will receive a 20% credit (£200,000). That credit will be taxed at the 25% corporation tax rate (£50,000), leaving the business with a tax rebate of £150,000.

Other tax savings

Claiming your business and R&D expenses isn't the only way you can reduce your tax bill. Have you thought about these other methods?

Tax-efficient structures

Unless you're in a partnership, you probably run your business as a sole trader or limited company. Each has its advantages and disadvantages, from directors of companies enjoying limited liability to sole traders benefitting from fewer registrations and filing requirements.

But we're here to talk about tax.

Sole traders pay income tax. As you'll know, incrementally increasing tax rates are applied to different bands of income. So, the first £12,570 is tax-free because of the personal allowance; income up to £50,270 is taxed at 20%. Then it's 40% for the portion of profits between £50,721 to £125,140 and 45% for the chunk of earnings above £125,140.*

*Income tax rates in England, Wales and Northern Ireland as of the 2023/24 tax year. Income bands and tax rates are different in Scotland.

Meanwhile, if their profits are above £250,000, companies pay corporation tax at 25%. If they are below £50,000, they pay 19%. If between the two limits, companies will pay 25% but can claim marginal tax relief to set their effective tax rate between the two headline tax rates.

What does this mean for your construction business?

As you'll see, businesses that make big profits might benefit from incorporating as they won't have to pay 40% and 45% on significant portions of their profits (plus, they'll be eligible for schemes like full expending and R&D tax relief).

However, if you're a small business with profits hardly or entirely untouched by the higher rates of income tax, you may benefit more from remaining a sole trader. Sure, you'll pay a percentage point more than companies in tax, but they don't get the tax-free personal allowance — an allowance that means a company making £50,000 a year would pay £9,500, while a sole trader making the same would pay £7,486.

However, there's still the question of your personal pay, for which a company might be better for you, depending on your situation. That's because company owners can pay themselves a low salary that allows them to escape income tax and National Insurance. They can then top up their pay with dividends, which are taxed more generously than regular income.

A word of warning: choosing a business structure is about more than tax. Always talk to an adviser before you change yours.

Employment allowance

Employment allowance allows eligible employers to reduce their annual National Insurance liability by up to £5,000, making it cheaper to employ employees.

Through the scheme, you pay less employers' Class 1 National Insurance each time you run your payroll until the £5,000 has gone or the tax year ends (whichever is sooner).

You can claim the allowance if your Class 1 National Insurance liability was less than £100,000 in the previous tax year.

Party the right way

If you provide social functions and parties for employees, you have certain National Insurance reporting requirements. However, you're exempt if your party:

- is open to all employees
- is an annual event
- costs £150 or less per person.

If you have more than one location, an annual event that's open to all your staff still counts as exempt. Alternatively, you can put on separate parties for different departments.

You can exempt multiple events from National Insurance as long as the combined cost of the events is no more than £150 per head.

Maximising expense deductions and tax savings

So, we've seen some of the ways a construction firm can make tax savings. But simply knowing about these methods isn't enough — you need to make your claims as water-tight as possible to increase the chances of HMRC accepting the tax relief.

To do that, you first need to have up-to-date financial records. This involves regularly updating records of all income and expenses. By doing this, you can be sure you've included every transaction and the correct value. This is essential — underestimating expenses can result in missed tax savings, while overestimating could lead to a costly audit.

The best way to keep up-to-date records is to take some time out of each day to focus on your bookkeeping. It might feel like that will take too long, but the alternative is catching up on unlogged income and expenses at the end of the month.

However, it will still take a significant amount of time to do the books properly — especially to carefully review, double-check entries and separate expenses (getting R&D costs mixed in with your AIA assets, for instance, will hurt your project management). Therefore, you'd probably benefit from hiring an accountant to divert all their attention to the books while you focus on the wider business.

Finding one who specialises in construction accounting is an especially smart move, as someone used to it won't only be able to look after the books, but advise you on which expenses and assets are tax-deductible. A construction accountant will also be able to help you with your tax returns, making sure that your business claims every allowable expense, capital allowance and tax relief you're eligible for.

What makes a good construction accountant? Aside from the usual — experience in the sector, communication skills, attention to detail, etc. — we would recommend that you search for an accountant that works with cloud-based software.

A true game changer in the industry, cloud construction accounting software pulls all your financial information into one space on an online accounting platform, like Xero or Sage.

That makes your bookkeeping far simpler to do with astonishing accuracy — with some apps, you only need to upload a photo of a receipt or invoice for it to be transcribed, sorted and put onto the books. Then, you can log on to your account on your phone to view and update your finances from wherever you are.

Add a financial professional proficient in construction accounting to the mix (who can also see your information in real-time), and you unlock far more timely and relevant advice about tax savings than you're probably used to!

Looking for assistance getting the most out of your tax savings. At Coveney Nicholls, we're experts in construction accounting; get in touch with us today to find out how we can help you.

Ready to find out more?

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