

## Entertaining costs

**(Lecture P1227 – 15.35 minutes)**

### *Business entertaining*

The basic principle is that the costs of business entertaining are disallowable.

This seems straightforward but there are grey areas.

Firstly, there is the situation when we have the costs of refreshment/hospitality at what is, in reality, a business meeting but where a meal or other refreshments are taken at the same time. In this case, it is the motive behind the arrangement that is critically important. If the motive is to entertain someone, a discussion about business does not remove that from the definition of entertainment. If the motive is to discuss business, then the provision of some hospitality does not make that entertainment.

Clearly the motive is not always going to be apparent. Any invoice that could potentially be either should be annotated with the customer and purpose of the meeting. However, this is not going to be sufficient if the information provided is inconsistent with the described purpose. HMRC will be looking for things like:

- Number of people
- Extent of hospitality provided
- Regularity of meetings with particular clients
- Time of day and day of week
- Vague or implausible descriptions of purpose.

It is important to note that where something is clearly entertaining, then the fact that there might be a business motive is irrelevant; it is still always going to be disallowed as business entertaining.

The second situation we have is where there is sponsorship involved. It is legitimate for a business to advertise and they might do this by sponsorship of a leisure activity. As part of that, there may be hospitality involved.

With sponsorship, there are two issues. Generally, it is incurred wholly and exclusively for the purposes of the trade.

However, there could be a problem where there is an alternative motive for the sponsorship and it is not really linked to any benefit to the trade. In this case it would be disallowed in the corporation tax computation. There is a body of case law that considers some of the issues that need to be considered. It can be a hugely contentious area for clients because they will, rightly, assume that large companies will get tax relief for the costs of sponsoring TV programmes or sporting events but they will have done that by looking a detailed business case for the effectiveness of the cost as part of a larger advertising budget. Such cost benefit analysis is rare in smaller businesses and may be much more closely aligned with the interests of the business owners.

The second issue is if the hospitality is provided at a cost, as this would need to be identified, although it will depend on who is using that hospitality. In most situations, it would be difficult to argue that there is any specific cost related to any entertaining element. So for example if you were to sponsor a local football club and get two season tickets, unless HMRC could show that the sponsorship was more expensive because of the season tickets (i.e. there was a cheaper option which did not include those), then normally the cost would not be disallowed as entertaining.

If there was a cost involved in the hospitality, then you would need to consider who is using that product (the season tickets in the above example – are you taking clients, do staff use them etc.) and then determine the tax treatment on first principles.

In reality, with sponsorship, it is the first aspect that is more problematic.

### *Entertaining of employees*

The costs of entertaining employees, including directors, is generally allowable for the company but the costs would then have to go on a P11d as a benefit in kind for the individuals.

There are exceptions where:

- there is a specific exemption such as an annual party or parties (as long as cost per head is less than £150 p.a.);
- the amount falls within the trivial benefits exemption (where cost is less than £50 but if the benefit is a reward for services it will not benefit from exemption);
- the entertaining of the employee is incidental to the entertaining of others and the employee is obliged to attend as part of their job in which case it is disallowed for the company as entertaining and no P11d benefit arises;
- the employee has paid for the costs themselves, and amounts are then reimbursed, then there is no employment charge on the employee as long as it is identified as entertaining (and disallowed in the company accounts) and it is part of their duties to entertain clients.

Where a P11d benefit arises, the company could decide to pay the tax instead via a PAYE Settlement Agreement.

On the face of it, it would appear that there are no situations where there would be a double tax charge i.e. where it is disallowed for corporation tax purposes and there is also a P11d issue but that is, in reality, not true.

### *Entertaining of employee not incidental*

If HMRC were to consider that the entertaining of the employees was not incidental to the entertaining of others, then there would be a possibility that something could be both disallowed for corporation tax purposes as entertaining generally and give rise to a benefit in kind to the employee. This could also cover directors as well as employees.

This could cover a variety of situations, for example where an employee attends an event because there is no client who wants to attend an event but the company has already paid for a ticket. It is still entertaining (of the employee rather than a client) and it is not part of the duties for the employee to be there.

A more complex example would be where there is an alternative reason why the employee is attending which is not linked to their employment. This is a much more difficult area.

Let's just think about an example.

A company pays for shooting events, which are attended by clients but also by Nigel who is the current MD, and his father Eric who was the founder of the business so has many years' experience in the industry but who no longer has a formal role. These are clearly business entertaining, notwithstanding that much business is done at these meetings. The costs will be disallowed for corporation tax purposes.

However, both Nigel and Eric are keen shooting enthusiasts and so HMRC might take the view that their attendance at this is not incidental to the entertaining of others but are due to a personal desire to attend such meetings.

Both Nigel and Eric believe that there is added value to their business by attending such events but the costs are significant and it is not possible for them to state categorically that they have increased their business or taken on new clients simply by virtue of the costs incurred. This could well be something that HMRC might look at.

This is a particularly relevant point in relation to Eric as he is no longer an employee. His participation would appear to have nothing to do with the business as he is no longer working for it. Whilst he may have a long-standing association with the company the general analysis relating to entertaining of employees only works if it is part of your job to be entertaining clients. If you don't have a job, then it can't be part of a job. The cost would definitely be taxed on someone – probably Nigel – as a benefit in kind.

If they can demonstrate that there is real value (which can be demonstrated by hard facts) then they might be able to argue that their attendance is untrammelled by their own personal hobbies but this could well be a very difficult argument to win with HMRC once they know of the personal involvement.

This sets the parameters of any arguments. Any event that is attended by directors, employees and clients needs to be scrutinised. If there is no particular link between a main director and a particular activity – if they are attending horse racing, sport events or similar – then you may have a stronger argument about the fact that attendance is incidental to the entertaining of clients. However, each case must be looked at carefully to make sure those arguments are sustainable.

The other area that needs to be looked at carefully is where there is significant cost involved. In a recent case, the director had taken his two best customers (who were also good friends) to the Rugby World Cup final in Japan. They had stayed in a posh hotel and had a very pleasant time over in Japan at the cost of the company. It is probably not feasible to consider that HMRC would accept that there is no benefit arising to those who attend because it can be justified from a business perspective. Unless there is a unique reason why they needed to go to these events, it is likely that HMRC would just view it as a personal trip for everyone. Again, these would clearly be disallowed as

business entertaining but HMRC would want to tax the cost relating to the director as a benefit in kind.

To conclude, there is a real risk that HMRC would look to charge a benefit on attendees at events where there is a question over whether the director's (or employee's) involvement is actually incidental to the entertainment of others. If HMRC were to pick this and challenge it, which they might do if large amounts of high level of entertaining costs are being shown in the company accounts, then they could go back into earlier years to collect any tax and NICs that were due. The tax would be the liability of the director/employee (although it could be met by the company) but there would be NICs costs for the company. It is likely that HMRC would go back 6 years.

Arguments are often made by clients that they have to do these types of events because their clients expect it. However, this has not really got anything to do with the type of clients they have as it is acknowledged that it is legitimate for them to be doing this entertaining and that is dealt with by the corporation tax disallowance.

Finally, it is worth mentioning that there is an exemption for the provision of entertainment to an employee or members of their family where the entertaining is provided by a third party. There are conditions to be met though:

- (a) The person providing the entertainment is not the employer or a person connected with the employer;
- (b) Neither the employer or a person connected with the employer has directly or indirectly procured its provisions;
- (c) The entertainment is not provided in recognition of particular services that the employee has performed in the course of their employment or in anticipation of particular services that are to be performed in the course of their employment.

The only common situation where this exemption does not apply would be where attendance at an event is part of a performance related competition – so a third-party supplier has offered to take an employee to the FA Cup final and the employer decides it will be the individual who has the best sales figure in the month prior to this. That would be quite an unusual situation.

*Contributed by Ros Martin*