

Input tax on business entertaining (Lecture B1174 – 12.10 minutes)

Basic rules

The starting point with business entertainment is that input tax can only be reclaimed on the cost of hospitality provided to staff. Entertainment given to non-staff members, such as customers, suppliers or the spouses of staff, are blocked and the input tax can't be recovered. Input tax can be claimed on staff entertaining because it is deemed to be a reward for good work and to improve staff morale (VAT Notice 700/65, para 3.1).

Example 1.

Mike is the managing director of ABC Ltd. He has decided to have a big Christmas party at his local Chinese restaurant. The guest list will comprise 20 staff plus one guest each, plus some important suppliers and customers. The total party will comprise 50 people. The company can claim 40% of the VAT on the final bill as input tax – i.e. 20/50 based on the ratio of staff to total guests.

Note - a condition of reclaiming input tax on the staff meals is that the staff must not be acting as host to the guests. This is unlikely to be the case with a staff Christmas party where the aim is for everyone to have a good time to celebrate (hopefully) a good trading year but it might be the case where the primary function of an event is to increase goodwill and potential orders from customers.

Exclusions from the definition of an employee include pensioners (even if they are being paid a company pension as a retired employee) and former employees, as well as shareholders who are not also employees. It is all about people who are currently involved with the business. A self-employed person, such as a contractor, is not an employee for the purposes of business entertainment but there is no problem claiming input tax on subsistence expenses as long as the arrangements are the same as for employees e.g. working on the same project away from base.

Charge to guests

A token charge to guests can produce big VAT savings. This is because a charge to guests means that the input tax block on entertaining is no longer relevant because you are not providing “free” hospitality. The charge can be less than the cost of the food and drink provided to the guests i.e. the output tax declared on the charge is less than the input tax claimed on the costs of the event.

Example 2.

The cost of the Christmas party for ABC from Example 1 is £75 per head plus VAT. Mike has decided to charge the 30 guests a token amount of £6 each – with no charge to the 20 staff.

The company will account for output tax of £30 on the money collected from the guests i.e. £6 x 30 x 1/6. But it can then claim all input tax on the costs of the party - there is no apportionment needed for entertainment of non-employees. So, the token charge has produced a VAT saving of £14 per guest – i.e. input tax of £15 less output tax of £1.

Key point - the charge to the guests needs to be compulsory and properly collected in all cases.

Note - for VAT purposes, there is no monetary limit on the cost of hospitality provided to employees to enable input tax to be claimed. The restriction to £150 per head including VAT (this figure also includes the cost of the spouse/partner meals) only applies for income tax purposes.

Business owners

There can sometimes be a problem with claiming input tax on the cost of directors' meals (or sole trader and partner meals in the case of an unincorporated business). But there is no problem if an event is open to all staff. And there is no problem if the business owners are away from base on company business and incur subsistence expenses.

In the case of, say, a trip for a 'directors strategy meeting' including a weekend hotel and food, input tax would be blocked as well.

Overseas customers

There is a window of opportunity to claim input tax on the cost of entertaining overseas customers but only if the entertaining relates to a business meeting, and the hospitality is not deemed to be excessively lavish – the phrase used by HMRC in the notice below is 'reasonable in scale and character' e.g. sandwiches and soft drinks provided during a meeting. But this is not relevant to a Christmas party, which is clearly a social function. The term 'overseas customer' means any customer not ordinarily resident or carrying on a business in the UK or Isle of Man.

If the entertainment is excessively lavish, then a private use charge will apply i.e. output tax is payable on the cost of the meal/function, effectively cancelling any input tax claimed on the expenditure.

VAT Notice 700/65, para 2.6.

Corporate boxes and golf days

The cost of corporate boxes at e.g. sports functions, or the cost of golf days which involve a round of golf and food and drink afterwards, follows the same rules for business entertainment as the cost of the office Christmas party in the example above. So, if it is a staff event, it can be claimed as a 'team building' day but if it is for customers or non-employees (including staff acting as host) then input tax is blocked.

Contributed by Neil Warren