

Entertaining for the whole Company (Lecture B1413 – 15.20 minutes)

It is that time of year when companies tend to provide entertainment for all of their staff in the form of the Christmas party. I will not deal with the HR complications which could fill many pages of interesting examples involving employer liabilities resulting from wild behaviour. Instead, I will look at the tax consequences of entertaining staff at the annual party.

Entertaining staff – the good news

When entertaining staff, companies can take the VAT and obtain a deduction for the input tax on the entertainment. The second piece of good news is that unlike client entertainment, staff entertaining is generally deductible for Corporation Tax purposes.

The bad news

The bad news is that the default position is that staff entertaining constitutes a taxable benefit in kind if it does not fall into one of the exemptions. This will either result in a tax liability for the employee, normally via a P11D charge, and then a class 1A charge on the employer. Many employers take the reasonable attitude that staff entertaining would hardly be motivating if the employees are left with a tax bill to pick up. So therefore, most companies where there is taxable staff entertaining would enter into a PAYE settlement agreement under which the company picks up not only the cost of the benefit but the grossed-up tax and class 1B national insurance on the lot.

Clearly, a grossed-up tax liability where there is a significant number of higher and additional rate taxpayer would lead to the cost to the employer almost doubling. Therefore, for companies that are likely to undertake lavish entertaining, this should be factored into the budget.

Exemptions

There are two significant exemptions from this benefit in kind charge. The first and arguably the more important at this time of year is the £150 exemption per person which is known as the annual function but is often deployed to cover the Christmas party. A few points should be made:

The £150 has not been increased since the millennium and therefore has fallen in value as inflation has taken its toll/particularly in the hospitality industry.

The exemption is per participant, not per employee, therefore if spouses/partners/significant others etc. and others, the amount spendable goes up by £150 per extra person.

The other side of this is that HMRC will sometimes ask for a list of attendees at these functions as if there are last minute cancellations, a reduction in the number of participants could push the expenditure above the £150 per person level. Accordingly, it is a good idea to leave some margin for no-shows.

The £150 includes VAT.

The annual function does not need to take place at this time of year. One could have an annual function at any time of year.

The annual function could be split into two functions e.g. with one costing £85 and the other costing £65.

HMRC have been known to look at the list of participants to see whether any contractors have been invited. Given that this is an employee type benefit, the inclusion of contractors could muddy the waters when it comes to any disputes over status. Generally, it is not advisable to invite contractors to what should be a staff function (unless they are a significant other to an employee!).

The £150 per person does need to include all the costs of running the function. This includes accommodation and travel. So, if more than a few people stay overnight, the £150 average is likely to be breached.

All employees must be invited to either the annual function or an equivalent, which means that if the parties are organised on a divisional or geographic basis, there needs to be an equivalent for all UK resident employees.

Trivial benefits

For those envisaging a more modest celebration, where the cost per person is £50 a head or lower, the trivial benefits exemption can be deployed. Again, this is based on an average of £50 so if one went to a restaurant and the total bill per person came to an average of £50 or less, one does not need to enquire as to whether one person had the desert and someone else didn't!

There is an additional requirement in terms of the trivial benefit that it is not seen as a reward for work performed. Therefore, there is no problem in linking it to a time of year, festival, holiday etc. but it cannot be seen as part of someone's earnings or reward for their efforts. It would be possible to use the trivial benefit rule to provide staff with a turkey, assuming that cost less than £50 or other items. Again, it must not be seen as a reward for effort.

Taxable entertainment

As stated above, most entertainment which is taxable will appear either on the P11D or the PSA, but most of it will appear on a PSA. The area that companies need to be very careful about is whether the expenditure is directly incurred between the company and the supplier or whether it is in the form of a reimbursement of an expense which an employee has laid out. If the employee has laid out the expense and it is a taxable element, then the amount reimbursed should go through payroll with PAYE being deducted and Class 1 NIC being applied on both the employer and employee.

Client vs Staff entertaining

It is often the case that it is difficult to immediately identify the tax treatment of entertainment. However, it is important to look at what the primary purpose of the entertainment is. The annual function is relatively clear. It is for the purposes of staff entertaining and is treated accordingly.

Where there is a mixture of staff and business entertaining, then one has potential significant challenges in determining the primary purpose of the entertainment and whether the staff were an extra or whether the business clients were the extra.

In addition, it is in those cases important to distinguish between subsistence which may apply to food consumed by individuals who are a significant distance away from their home base and drinks on their own. For example, if a conference was organised and everyone was invited to dinner, that would normally be seen as part of the conference subsistence expenses. Reasonable alcohol consumed within the meal (HMRC definition of half a bottle of wine per person) would be generally allowed, however once the dinner is finished and everyone repairs to the bar then this becomes pure staff entertaining and then taxable in full if it does not fall into either the trivial benefits exemption (unlikely) or the annual function.

The UK does offer significant tax reliefs for staff entertaining which reflect the work culture in the UK. However, the government could spread a bit more cheer to staff, companies and the hard-pressed hospitality industry by uplifting the threshold which has been the same for nearly a quarter of a century.

Contributed by Jeremy Mindell