

That's entertainment...(Lecture B1393 – 11.35 minutes)

Football. "The working man's game". Well, it used to be.

Nowadays it seems that more and more of us 'working folk' do like to attend an event and be "entertained". Not necessary by the teams on the pitch (that's often secondary), but by our "host" in an air-conditioned box, with a glass of Sauvignon Blanc and a salmon and dill blini. It's football Jim, but not as we know it.

For the host, it can be argued that hospitality of this kind can strengthen business relationships with clients and customers, increase customer retention, create networking opportunities and improve in-work relations with employees. And you could get to watch Aston Villa at the same time. It's a win-win.

The next question is whether the host can set the costs of the event against business profits and recover the input VAT which has been added to their invoice. Like many tax questions, the answer is..."it depends".

This article will look at the provision of business entertaining by way of hospitality at sporting or other cultural events from three angles:

- The corporation tax deduction position for the provider.
- The benefit-in-kind position for employees attending the event (and third-party benefit issues for non-employees).
- The VAT position with regard to input tax recovery.

The Corporation Tax deduction

Putting aside certain exceptions for a moment, the general rule is that expenditure on business entertainment is not allowable as a deduction against profits, even if it is a genuine expense of the business.

"Business entertainment" means the provision of free or subsidised hospitality or entertainment of any kind. The definition is deliberately wide and no further meaning is provided. The person being entertained may be a customer, a potential customer or any other person.

The purpose of the entertainment is irrelevant. The provider of the entertainment or hospitality may, in good conscience, believe that the costs are incurred wholly and exclusively for the purposes of the business. Nevertheless, such costs will still be disallowed by virtue of S.45 ITTOIA 2005 (for sole traders and partnerships) and S.1298 CTA 2009 for companies.

Costs which are incidental to disallowable business entertainment costs are also disallowable. These include payments to a third party for the organisation of entertainment, and travelling costs incurred in connection with the business entertainment (for example, where a company pays for clients to travel to and from an event).

There are a handful of exceptions to this general rule, the main one concerning the entertainment of employees.

An employee is someone on payroll being paid a salary. This includes directors and other persons engaged in the management of the company, partners of employees and retired members of staff. It does not include contractors or shareholders who do not work in the business.

Staff entertaining is an allowable deduction so long as:

- The costs are incurred 'wholly and exclusively for the purposes of the trade' (which they generally will be as we can file this under 'employee welfare'); and
- The entertaining of staff is not 'merely incidental to entertainment which is provided for customers' (which is a potentially sticky one where 'mixed' staff and client events are concerned).

Whether or not the staff entertaining is 'incidental' to the entertainment of clients depends upon the nature of the occasion (the "primary purpose" test).

The question to ask is: "Would the employer have paid for the event if there had been no external guests present"? If the employer would not have agreed to meet the costs of the event had that event been for staff only, then the event is primarily 'business entertainment' and the entertainment of employees attending the event is incidental to this. The costs are then fully disallowable (there is no apportionment for the staff attendees).

For example, assume a company hires a box at Lords for a Test Match. The box is primarily for use by its employees. The costs of providing that hospitality will be allowable as a corporate tax deduction on the grounds that this is staff entertaining. If a client is invited (making this a mixed event), the cost of the employees' use of the box continues to be allowable on the grounds that the hospitality would have been paid for by the employer anyway, even if that guest had not been present.

However, the cost of providing hospitality to the client remains 'business entertaining' and should be disallowed (BIM45034). Sensible apportionment of costs should therefore be made (and a record kept of all attendees to enable the appropriate adjustments to be made).

On the other hand, if the purpose of hiring the box was primarily for entertaining clients and some staff were allowed to attend (as would be normal for client events), this mixed event would be classed as 'business entertaining' and all costs should be added back.

The benefit position for employees

As a general principle, staff entertaining will be taxed as a benefit for the employee.

Therefore, where an employer provides hospitality for its staff at a sporting or cultural venue, the employees are normally subject to a benefit charge.

The benefit will be based on the employer's cost of providing. This will typically be the cost of hiring the box or equivalent facility (this may be a daily or annual rate), plus any additional entertainment costs incurred (such as food and drink). This total cost should be apportioned between all those who use the facility (staff and non-staff) in order to arrive at a unit cost per person. Apportionment should be "on common sense lines based on the facts of the case".

The unit cost benefit should be reported on form P11D and will be accompanied by a Class 1A NIC charge for the employer. There is no NIC charge for the employee as the provision of hospitality benefits is not earnings. Any hospitality benefits provided to the employee's family or household by reason of the employee's employment will also be taxed on the employee.

There is little scope here for using the “Christmas Party” exemption for staff entertainment as this requires the entertainment to be in the form of an annual event, which is open to all employees and which costs no more than £150 per head per year. A hospitality box will probably fail all three tests.

There is no taxable benefit for the employee if the entertainment is ‘business-related’. Therefore, in the case of a mixed event which is primarily client entertaining, the staff attending would not be burdened with a taxable benefit in kind by reason of enjoying the hospitality as this would be essentially a work event which they are attending by reason of their employment.

Only entertainment or hospitality which is provided as a form of reward to an employee is taxable on the employee as a benefit. It then follows that the cost of providing that benefit will be tax-deductible for the employer being in the nature of remuneration.

It would be a stretch to argue that the provision of primarily staff hospitality at a sporting or cultural venue would ever be wholly business-related (with any personal benefit being incidental to that), but no doubt some have tried.

Where a benefit arises to employees in respect of such events, it is open for employers to approach HMRC and ask for the benefits to be included in a PAYE Settlement Agreement (PSA) or Taxed Award Scheme (TAS) under which the employer will pay Income Tax and NICs on behalf of their employees of a grossed-up basis. This may be appropriate where it is practically difficult to accurately assign the benefit to particular employees.

Clients (being those not treated as employees) in receipt of entertaining or hospitality will normally be exempt from a benefit charge under the third-party entertainment rules in S.265 ITEPA 2003. HMRC takes the view that this exemption covers items such as hospitality (dinners, parties, hospitality tents at sporting events) and theatrical or sporting events where a host invites someone to accompany them as a guest. The exemption also covers costs associated with the entertainment, such as travelling expenses and overnight accommodation.

VAT recovery

When it comes to the VAT treatment, provided that hospitality tickets are used in the business, it would normally be to entertain clients, and that would be disallowed.

But if the tickets etc are only used by the directors of the business would that be deductible staff entertainment? In small businesses HMRC may well argue that “it has no connection to the business”. In other words, it is not used in the business at all. Entertaining the directors who own the business at a sporting event does not really have any connection to making taxable supplies. No input VAT would be recoverable.

Unfortunately, there are just some things that you have to buy with your own money!

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