

Christmas gifts and VAT

BACKGROUND

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, is blocked and the input tax can't be recovered.

Example. Mike is the managing director of Acom 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.

Pro advice 1. Be aware that a condition for reclaiming input tax on 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.

Pro advice 2. In some situations, there can 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. There is further detail in [VAT Notice 700/65](#) (see **Follow up**).

Pro advice 3. 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.

OVERSEAS CUSTOMERS

To extend the previous example, what would the situation be if one of the guests is an employee (or business owner) of a customer based outside the UK, let's say in France? Is there scope to claim input tax on the cost of his meal and also a hotel room being paid for by Acom as an extra treat?

There is a window of opportunity to claim input tax on the cost of entertaining overseas customers but only if it relates to a business meeting, and the hospitality is not deemed to be excessively lavish. But this is not relevant to a Christmas party, which is clearly a social function.

CHARGE TO GUESTS?

It might sound a bit mean but a token charge to your guests can produce big VAT savings. This is because the input tax block on entertaining is no longer relevant as you are not providing "free" hospitality. The charge can be less than the cost of the food and drink provided to the guests.

Example. The cost of the Christmas party for Acom 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.

Pro advice. Encourage the guests to make a charitable donation to a good cause when they arrive at the party. This is not acceptable from a VAT perspective. The charge to the guests needs to be compulsory and properly collected in all cases.

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 and means that the whole amount will be assessed as a benefit in kind for the employee if the £150 limit is exceeded.

DISCRETIONARY SERVICE CHARGE

Many restaurants add a service charge to the cost of a meal when they present their bill. The input tax on this charge will follow the same treatment as for the food and drink, i.e. a percentage will be claimed based on the number of employees attending the event. However, be aware that some restaurants apply a discretionary service charge which means the customer has the choice of paying it. These charges are outside the scope of VAT, so there is no output tax liability for the restaurant but no input tax to claim by the customer.

BUSINESS GIFTS

Imagine that Acom has decided to give champagne and wine as Christmas gifts to its best customers. Can input tax be claimed on the purchases of the goods from the wine merchant, without any need to account for output tax on the onward supply to the customers?

The VAT rules allow a business gift to be given away VAT free (and input tax claimed on the related cost) as long as it cost less than £50 excluding VAT. However, the £50 figure is an annual limit per person, so it is important to keep a record of who is receiving the gift, its total value and the date it was given.

If the £50 limit is exceeded in any twelve-month period, then output tax is payable on all of the gifts as if they had been sold, effectively disallowing the input tax claimed on the original purchase. Refer to *HMRC Notice 700/7* for further information (see **Follow up**).

Example. Mike is unsure whether to give his customers a bottle of vintage wine costing £55 including VAT, or a bottle of quality champagne costing £65.

From a VAT perspective, it makes sense to give them the wine because the VAT-exclusive cost is less than £50, so it is within the business gift limits. This assumes, of course, that the same customers have not received other gifts within the previous twelve months that mean the annual limit is exceeded.

If you give a gift to different employees who work for the same organisation, then each “natural person” (i.e. not a company) is entitled to receive £50 worth of gifts under the VAT rules. If HMRC tells you the person is the business rather than the individual, you should challenge its thinking.

BUSINESS OWNER TRIPS

What would the situation be if, say, the directors of Acom decided to have a three-day strategy meeting at a nice hotel in Scotland? The company is based in London so this is definitely a long way from the main trading base. Could input tax be claimed on the cost of food, drink and accommodation incurred by the directors on the basis that the event has a business purpose? There will only be the directors present (no spouses).

Pro advice. A potential VAT saver is to combine the trip with an opportunity to visit customers or meet suppliers who are based in Scotland; it will then be partly linked to purposes other than the strategy meeting.

A partial input tax claim on hotel, food and travel costs would then be fine (based on a fair and reasonable apportionment) because the expenses would be classed as subsistence costs and the trip would be for a clear business purpose.

However, HMRC does not accept that food and drink provided to directors only can be a legitimate business expense because the directors (or sole traders and partners in an unincorporated business) do not need to reward or motivate themselves in the same way that they would for staff.

Pro advice. It is only when an event is open to all staff that a claim can be made on the directors' costs, as with the Christmas party considered earlier.

FOLLOW UP:

<https://www.gov.uk/guidance/business-promotions-and-vat-notice-7007>

<https://www.gov.uk/guidance/business-entertainment-and-vat-notice-70065>