

Is the Christmas party tax-free?

Introduction

A statutory exemption exists, which allows employers to meet the cost of certain social events for staff without triggering a liability to tax or NICs, providing certain conditions are met.

The legislation refers to ‘an annual party or similar annual function’. Although HMRC do not seem to interpret this to mean that the same event must be held every year, it may be prudent to check the issue in advance where a one-off event is planned.



Conditions

A staff event will qualify as a tax-free benefit if the following conditions are satisfied:

- the total cost must not exceed £150 per head, per year
- the event must be primarily for entertaining staff
- the event must be open to employees generally, or to those at a particular location, if the employer has numerous branches or departments

The ‘cost per head’ of an event is the total cost (including VAT) of providing:

- a. the event, and
- b. any transport or accommodation incidentally provided for persons attending it (whether or not

they are the employer's employees), divided by the number of those persons.

Provided the £150 limit is not exceeded, any number of parties or events may be held during the tax year, for example, there could be three parties held at various times, each costing £50 per head.

The £150 is a limit, not an allowance - if the limit is exceeded by just £1, the whole amount must be reported to HMRC.

If there are two parties, for example, where the combined cost of each exceeds £150, the £150 limit is offset against the most expensive one, leaving the other one as a fully taxable benefit.

Example

ABC Ltd pays for an annual Christmas party costing £150 per head and a summer barbecue costing £75 per head. The Christmas party would be covered by the exemption, but employees would be taxed on summer barbecue costs, as a benefit-in-kind.

Tax treatment for employers

The cost of staff events is tax deductible for the business. The legislation provides a let-out clause, which means that entertaining staff is not treated for tax in the same way as customer entertaining. The expenses will be shown separately in the business accounts – usually as ‘staff welfare’ costs or similar.

There is no monetary limit on the amount that an employer can spend on an annual function. If a staff party costs more than £150 per head, the cost will still be an allowable deduction, but the employees will have a liability to pay tax and National Insurance Contributions (NICs) arising on the benefit-in-kind.

The employer may agree to settle any tax charge arising on behalf of the employees. This may be done using a HMRC PAYE Settlement Agreement (PSA), which means that the benefits do not need to be taxed under

PAYE, or included on the employees' forms P11D. The employer's tax liability under the PSA must be paid to HMRC by 19 October following the end of the tax year to which the payment relates.



It should also be noted that whilst the £150 exemption is mirrored for Class 1 NIC purposes, (so that if the limit is not exceeded, no liability arises for the employees), Class 1B NICs at the current rate of 13.8%, will be payable by the employer on benefits-in-kind which are subject to a PSA.

The full cost of staff parties and/or events will be disallowed for tax if it is found that the entertainment of staff is in fact incidental to that of entertaining customers.

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VAT-registered businesses can claim back input VAT on the costs, but this may be restricted where this includes entertaining customers.

Recommendation

It is important while budgeting for these events, the potential tax position of your employees. Your employees will not thank you for an unexpected tax charge for a Christmas present.

The limits are very strict so careful cost control will be required, while your budget may have been below £150/head, it's the actual cost which could become assessable.

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