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Keeping the Christmas party tax-free

The Christmas party is an annual tradition for many companies, but the frivolities would be somewhat reduced if the employees are left with a tax bill as a reminder of the evening. So what can be done to ensure that the Christmas party remains tax-free?

Keep it simple

The taxman does have some Christmas cheer and the statute books contains a tax exemption for annual parties and functions. However, there are limits to the extent of the taxman's goodwill. The exemption is only available for modest functions where the cost per head is not more than £150. The sting in the tail is that if this figure is exceeded, even by one measly pound, the whole amount – not just the excess over £150 – is taxable.

Don't forget guests

The crucial figure is the cost per head. This is not the same as the cost per employee. Fortunately, guests are included in working out the all-important cost per head figure. This is the total cost of the function (including any transport or accommodation that is also provided) divided by the number of attendees (employees plus guests). So, for example, the cost per head of a function costing £9,250, which is attended by 40 employees and 27 guests is £137.91 (£9,250 divided by 67). This would fall within the tax-free limit.

Trap

If the cost per head figure exceeds £150 and the employee has bought a guest, the cash equivalent of the benefit is the cost of the employee and the employee's guest attending. For example, if a company throws a lavish party costing £300 per head and an employee brings a guest, the cash equivalent of the benefit is £600 (employee plus guest) and the associated tax bill for a higher rate taxpayer is £240 (£600 @ 40%).

More than one function

The £150 per head limit can apply to more than one function, but a function is only tax-free if the whole cost per head figure falls within the available limit. For example, if a company has three functions a year costing £100 per head, £40 per head and £20 per head, the exemption could be utilised to cover the functions costing £100 per head and £40 per head.

Trap

The remaining £10 cannot be used to partially offset the cost of the £20 per head function – a function is either fully exempt or fully taxable.

Tip

If functions costing less than £50 per head fall outside the scope of the annual party exemption, they can still be provided tax free by using the trivial benefits exemption that applies for 2016/17 onwards.

All inclusive

The exemption is also conditional on the event being open to all employees generally or all those at a particular location. Select little gatherings for the favoured few do not cut it.

Picking up the tab

If the party cannot be provided within the terms of the exemption, the employer could consider meeting the associated tax liability by means of a PAYE Settlement Agreement so that the employees can enjoy the event tax-free. Where this route is taken, Class 1B NICs will also be payable.

Practice note: ITEPA 2003, s. 264; HMRC's Employment Income Manual at EIM21690.

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