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VAT: Change in the tax treatment of business entertainment of overseas customers

Revenue & Customs Brief 44/10

HM Revenue & Customs (HMRC) has reviewed its policy on the treatment of business entertainment provided to overseas customers in the light of the European Courts of Justice (ECJ) judgment in the joined case of Danfoss and AstraZeneca (Case-371/07).

The UK position on the entertainment of overseas customers

The UK has blocked the recovery of input tax on business entertainment since the inception of VAT. The terms of the block denied recovery of such input tax except where the business entertainment was provided to an overseas customer. In 1988 UK law was amended to extend the block to cover all business entertainment including that provided to overseas customers. This change was made to align VAT law with changes introduced in relation to direct tax.

In the light of recent ECJ judgments HMRC has concluded that the UK's block on the recovery of input tax on the business entertainment of overseas clients is inconsistent with EU law. The Government intends to amend UK law shortly. In the meantime HMRC will consider claims for previously restricted VAT in respect of the entertainment of overseas customers, as a direct effect of EU law.

The block on recovering input tax on entertainment provided to anyone other than an overseas customer, for example, UK customers and non-UK business contacts who are not customers, remains effective and any VAT incurred on the costs of such entertainment cannot be recovered.

Making claims: time limits

You may make claims in respect of input tax on the costs of entertaining overseas business customers, subject to the normal four year cap. HMRC announced in March 2009 that, pending the outcome of its review of policy in this area, it was inviting claims for such input tax incurred between 1 August 1988 (the date when UK law was amended) and 30 April 1997 (as prescribed following the Fleming judgement). HMRC will no longer accept claims for this period.

VAT incurred in future tax periods in respect of the entertainment of overseas business customers can be recovered in the usual way.

All claims are subject to the qualifications set out below.

Making claims: evidence required

HMRC expects that, as a minimum, claims are supported by the following evidence:

- details of the overseas customers
- the type of expenditure, for example, meals to support business meetings, etc.
- the amount of VAT claimed
- evidence that VAT has been incurred and not previously been deducted
- if required for historical claims, evidence of the type of business entertainment the business normally excludes from recovery by reference to recently rendered tax periods.

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What VAT can be recovered in respect of entertainment?

HMRC now takes the view that VAT incurred on the entertainment of overseas customers may be recovered under the terms of EU law. However, in some circumstances an output tax charge to reflect private use arises and cancels out any deductible input tax. Where that is the case, there is no benefit in making a claim, so in considering whether to claim you should also consider whether there is a charge to output tax.

Private use charge

The charge that taxes private use is intended to ensure that the taxable person, his/her staff and others do not achieve an advantage over private individuals simply because the taxable person is registered for VAT and can recover VAT incurred on costs. The ECJ has addressed the question of the applicability of such a charge and it is clear from two particular decisions that the circumstances under which an individual can benefit privately from a business expense without a private use charge arising should be very narrowly defined. The two cases – Julius Fillibeck Sohne C-258/95 and Danfoss and AstraZeneca C-371/07 – introduce separate tests that should be applied to private use of business expenditure; these are set out in more detail below. As no advantage arises if the VAT is not recovered by the taxable person there is no need to consider the applicability of the private use charge unless you intend to recover the VAT paid.

In the Fillibeck Sohne case an employer provided transport to his staff to get them from their homes to a construction site. As commuting expenditure is private, the Court was asked to consider whether having recovered tax on the cost of the transport it was appropriate to apply a charge to reflect the private use by the employees. The Court's starting point was that a charge applied in principle but they considered the particular facts of the case and concluded that because it was practically impossible for the employees to get to the site on their own a private use charge should not be applied. From this judgment we must therefore consider whether it is necessary for the taxable person to provide goods or services that are enjoyed privately in order for him to make his taxable supplies; this is **the necessity test**.

The joined case of Danfoss and AstraZeneca involved the provision of free meals to both employees and business contacts. In the context of the business having recovered VAT on the meals, the ECJ was asked to consider whether it was appropriate to apply a private use charge. The Court concluded that where the meals were provided for a strict business purpose no such charge should arise. In reaching this conclusion they carefully considered the circumstances of the free meals. In particular the lack of choice by the recipient of what, when and where to eat, the relatively basic nature of the fare and crucially the fact that the meals were provided to ensure the smooth running of business meetings; this is **the strict business purpose test**.

These cases set out the circumstances where it is and is not appropriate to apply a private use charge to a benefit provided by the business. HMRC considers that unless there is a necessity for the business to provide entertainment or there is a strict business purpose behind it, such as the facilitation of a meeting, it is appropriate to apply a private use charge to entertainment provided to overseas customers.

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If you conclude that the entertainment you provide should trigger such a private use charge, HMRC suggests that you treat the VAT incurred as non-deductible instead, rather than claiming a deduction and offsetting this with an output tax charge. This approach is consistent with the view that VAT incurred on the entertainment of overseas customers should only be recovered where it is clearly used for the making of taxable supplies as well as being reasonable in scale and character.

We set out below a number of scenarios that should assist in deciding the correct VAT treatment of any expenditure that you have incurred on entertaining overseas customers.

Meetings in your office

HMRC considers that where you entertain overseas customers in your staff canteen or similar, and the entertainment is provided to facilitate a business meeting, then the VAT on such expenditure will be recoverable and no charge to reflect the private use will arise; we take the view that any private benefit derived by your overseas customer is accessory to the needs of your business. This approach satisfies the basic input tax recovery test by establishing a link between the expense and the taxable supplies that your business makes. It is also consistent with the approach adopted by the ECJ in assessing the applicability of any private use charge in that this expense has a strict business purpose.

External meetings/events

Where you cannot host meetings in the office because, for example, you have a large number of attendees or you have no in-house facilities, then you can still use the principles set out above to determine if your input tax is recoverable or there is a charge to output tax under the private use charge. The provision of basic refreshments at, for example, a training event or a meeting will be treated as if it were supplied by your own in-house canteen. However, where the provision goes beyond merely providing basic food and refreshment to facilitate the smooth running of the event, then you should not recover any input tax or, failing that, account for output tax under the private use charge.

Corporate hospitality events

Many businesses offer their customers or potential customers general entertainment and hospitality, for example, golf days, track days, trips to sporting events, evening meals, trips to night clubs. HMRC will generally not allow deduction of VAT in respect of these events or will require you to account for output tax, as such events are unlikely to have a strict business purpose and be necessary for the business to make its supplies.

HMRC – November 2010.

Notes

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