

MINISTRY OF FINANCE
INCOME TAX OFFICE



INCOME TAX ACT 2010
GUIDANCE NOTES
BUSINESS ENTERTAINMENT EXPENDITURE

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What legislation?

The guidance being provided is for Paragraph 2(1)(o) of Schedule 3 – Rules for ascertaining profits or gains (Part I) of the Income Tax Act 2010 (“the Act”).

These notes explain our interpretation of the Act and the way the Income Tax Office applies the law in practice. They are not a substitute for the Act and do not, in any way, affect a taxpayer’s right to argue a different interpretation by way of appeal to an independent tribunal.

Based on the outcome of any such appeal referred to above, this Office may wish to either amend our interpretation as set out in these notes or to propose legislative amendments to the Act as required. Any changes to the guidance provided in these notes will be issued publicly by this Office.

What does the legislation aim to achieve?

The aim of the legislation is to limit the deductions being claimed in respect of business entertainment expenditure to those genuinely incurred by the claimant on entertaining both existing and potential clients and/or business introducers for the purposes of the production of the income of the trade, business, profession or vocation.

Any business entertainment costs that are incurred for purposes other than those noted above are clearly outside the scope of the definition of the ‘wholly and exclusively’ principle enshrined in the Act¹.

The legislation sets out initially to disallow all expenditure incurred in respect of business entertainment. The claimant may nevertheless be eligible for the business entertainment expenditure to be claimed as a deduction against assessable profits, so long as the criteria specified in the Act is met (see page 3).

¹The interpretation of the ‘wholly and exclusively’ principle is set out in the Guidance Notes issued by the Income Tax Office on the classes of expenditure allowed as deductions.

Why the introduction of specific legislation in this area?

Prior to the introduction of this Act, there was no specific legislation relating to business entertainment expenditure. Therefore its treatment was the same as for any other type of expenditure – that was dependent on it being incurred ‘wholly and exclusively’ for the production of the income of the trade, business, profession or vocation.

Progressively however, due to changing business practices and environments, business entertaining became more lavish and ultimately led to this type of expenditure being abused under the previous legislation.

What is business entertainment?

Business entertainment means the provision of either free or subsidised hospitality or entertainment and/or gifts. The person being entertained may be a customer, a client or any other person.

How are gifts to be treated?

Business gifts are not allowed as a deduction in computing profits and gains and are therefore treated in the same way as business entertainment expenditure. A gift is something that is given to a person without receiving anything in exchange. It is offered voluntarily and without any expectation of a return.

Gifts carrying a conspicuous advertisement

Gifts, which contain a conspicuous advertisement, are treated as allowable deductions for the purposes of computing the profits and gains under this Act, subject to the following conditions:

- That the gift is neither food, drink, tobacco or a token or voucher exchangeable for goods; and

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- That the cost of the gift (together with the cost of any other such gifts to the same recipient in the same year of assessment or accounting period) does not exceed £100.

Common examples of gifts referred to above include, among other items; diaries, pens, umbrellas, mouse mats, etc. The advertisement should be on the gift itself, and not just on the wrapping.

Are there any exceptions to the business entertainment definition?

Specific legislative exception

The exception to the disallowance, as stated in section 2(o)(v)(bb) of the Act, may be applied where the Commissioner of Income Tax is satisfied that the business entertainment expenditure relates to the entertainment of both existing and potential clients and/or business introducers. Any exception approved by the Commissioner of Income Tax under section 2(o)(v)(bb) of the Act will be determined as a matter of degree and fact.

Any claim for this exception to be applied will need to be supported with sufficient and appropriate evidence, which satisfies the Commissioner of Income Tax as to the genuineness of the business entertainment expenditure.

Given that the burden of proof will lie exclusively with the claimant it is strongly recommended that robust procedures be adopted providing a suitable audit trail.

Sufficient and appropriate evidence together with robust procedures should include a detailed record of all business entertainment expenditure incurred, including documentary evidence and memorandums in respect of the specific purpose of the expense and the staff involved.

Any claim for exception that is accompanied with insufficient evidence will be refused.

The specific legislative exception will not apply however, in instances where any person has made a claim to allow the business entertainment expenditure in three of the previous ten years (either years of assessment or accounting periods) and these claims were ultimately refused, either in whole or part, following an investigation by the Commissioner. Under section 2(o)(vi) the person previously having made the claim shall be restricted from making any further claims of this type for a period of 5 years from the end of the third year (either years of assessments or accounting periods) in which the claim for business entertainment expenditure was restricted or eliminated.

Entertainment of staff members

The tax treatment regarding expenditure in respect of staff members depends on the nature of the expenditure being incurred and whether the entertaining received is merely incidental to the entertainment provided for clients:

The question of whether or not the entertaining is incidental depends upon the nature of the occasion. As a rule of thumb you should consider whether the employer would have paid for the event if only their employees were present. If the employer would not have paid, then the event is business entertainment and the entertainment of the employee is incidental to this. Under this scenario no taxable benefit-in-kind would arise from the incidental benefit derived by the employee.

In the event that the expenditure is not business entertainment then the benefit derived by the employee will be taxable as a benefit-in-kind.

Entertainment provided in the normal course of the trade for a payment or for purposes of advertising to the public

The legislation will allow a deduction of the expenditure incurred where the entertainment is of a kind of which it is his trade to provide, and is provided in the ordinary course of the trade for payment or free of charge with the object of advertising to the public generally.

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Goods and services sold in the normal course of trade are not business entertainment. This means that a person whose business it is to provide hospitality for payment (for instance, a restaurant owner) is able to deduct the cost of goods and services so provided.

It is important to note that this only applies where the goods and services provided are part of the normal trade **and** where payment is made for the goods and services in the normal way.

The cost to a business of giving away its own goods or services for the purpose of advertising those goods or services to the public is allowable as business entertainment expenditure. There are two separate conditions here. Firstly, the goods or services given away must be part of the normal trade and, secondly, they must be given away for the purpose of advertising to the public. This latter condition will be satisfied if they are made available to the public indiscriminately (for instance, by handing out in the street) but it is also acceptable for the trader to be more selective.

Where the trader limits the provision of free goods and services to particular individuals the condition is still satisfied if those individuals have a role to play in promoting the product.

Further help and advice

These notes are issued for guidance purposes and therefore any enquiries on these should be directed to this Office. Contact details are provided below.

The Commissioner Of Income Tax
St. Jago's Stone Block
331 Main Street
Gibraltar

Tel. No: +350 20075260

Email: incometax@gibraltar.gov.gi

Fax No: +350 20042398