Inland Revenue
Te Tari Taake

LICENSED PREMISES' OPERATORS AND ENTERTAINMENT EXPENDITURE

PUBLIC RULING - BR Pub 99/3

Note (not part of ruling): This ruling is essentially the same as public ruling BR Pub 96/5 which was published in TIB Volume Seven, No.12, April 1996, but its period of application is from 1 April 1999 to 31 March 2004 and some minor wording and formatting changes have been made. BR Pub 96/5 applied up until 31 March 1999.

This is a public ruling made under section 91D of the Tax Administration Act 1994.

Taxation Laws

All legislative references are to the Income Tax Act 1994 unless otherwise stated.

This Ruling applies in respect of section DG 1 and Schedule 6A of the Act.

The Arrangement to which this Ruling applies

The Arrangement is the incurring of expenditure by any person who carries on business as a licensed premises' operator ("licensee") and who, in the ordinary course of that business:

- Incurs that expenditure on food or beverages and makes special offers of that food or beverage in arm's length transactions with members of the general public. The special offers of food or beverages to which this Ruling applies include:
    - Happy hours where a licensee offers drinks to customers at reduced prices during a particular time period:
    - Offers of free drinks on certain days or at certain times to customers or categories of customers selected from the general public:
    - Two meals offered to customers for the price of one:
    - "Toss the boss" competitions where for every drink purchased, the customer can toss a coin and has the chance to win a free drink; or

- Pays an allowance to an employee (such as a bar manager) to cover the costs of the employee providing in the ordinary course of business, free drinks to customers on the licensee's business premises but not at a party or similar social function or in a reserved area, or where there is other than an arm's length relationship with the customer.

How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows:

- The deduction available for expenditure on the special offers of food or beverages is not limited to 50% under section DG 1.

- The deduction available for expenditure on the allowance paid to an employee is not limited to 50% under section DG 1.

The period for which this Ruling applies

This Ruling will apply for the period 1 April 1999 to 31 March 2004.

This Ruling is signed by me on the 17th day of May 1999.

Martin Smith
General Manager (Adjudication & Rulings)

Inland Revenue
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COMMENTARY ON PUBLIC RULING BR Pub 99/3

This commentary is not a legally binding statement, but is intended to provide assistance in understanding and applying the conclusions reached in public ruling BR Pub 99/3 ("the Ruling").

All references to a "licensee" are to any person who carries on business as a licensed premises' operator.

Background

Under section DG 1, the deduction allowed for expenditure or loss on "specified types of entertainment" set out in Part A of Schedule 6A is limited to 50% of that expenditure, unless the entertainment or benefit is "excluded entertainment" under Part B of the Schedule. If the entertainment or benefit is excluded entertainment under Part B, the expenditure or loss is fully deductible, provided it is incurred in deriving the taxpayer's gross income or it is necessarily incurred in carrying on a business for the purpose of deriving the taxpayer's gross income.

Section DG 1 also treats an allowance paid to reimburse expenditure by an employee on specified types of entertainment that fall within Part A, as being expenditure by the taxpayer on the particular specified type of entertainment.

Legislation

Section DG 1 states:

(1) This section and Schedule 6A are intended to limit the amount of the deduction allowed for expenditure or loss incurred on certain types of entertainment, being entertainment that generally involves a significant element of private benefit, to 50% of that expenditure or loss (but subject always to the express provisions of this section and Schedule 6A).

(2) If a taxpayer incurs expenditure or loss on a type of entertainment or benefit (whether consumed or enjoyed by the taxpayer or anyone else) specified in Part A of Schedule 6A then, unless and to the extent that the entertainment or benefit is specified as excluded entertainment in Part B of that Schedule, the deduction allowed for that expenditure or loss will be limited to 50% of the amount that would be allowed as a deduction but for this section.

(3) For the purposes of this section -

(a) A taxpayer will be treated as incurring expenditure on a specified type of entertainment to the extent that the taxpayer pays an allowance for, or reimburses an employee's expenditure on, the specified type of entertainment and the allowance or reimbursement is exempt income under section CB 12:

….

Part A of Schedule 6A lists four "specified types of entertainment":

- Corporate boxes
- Holiday accommodation
- Pleasure craft
- Food or beverages.

Effectively, a description of "food or beverages" for the purposes of Part A of Schedule 6A is contained in Clause 4 of Part A, which states:

Food or beverages -
(a) Provided or consumed as an incidence of any of the types of entertainment specified in clauses 1 to 3; or
(b) Provided or consumed off the business premises of the taxpayer; or
(c) Provided or consumed on the business premises of the taxpayer -
  (i) At a party, reception, celebration meal, or other similar social function; or
  (ii) In an area of the premises, such as a boardroom or an executive or client dining room, reserved for use at the time only by those at a certain level of seniority and their guests and not open to all employees of the taxpayer working in the premises.

The Schedule defines "Business premises" as:

(a) The normal business premises; or
(b) A temporary workplace,-

of the taxpayer or of an associated person (not being premises or a workplace established principally for the purposes of enjoying entertainment).

Part B of the Schedule lists *excluded entertainment* (i.e. entertainment which, being one of the *specified types of entertainment* under Part A of the Schedule, would otherwise be subject to the 50% deduction limit). Clause 9 of Part B states:

Entertainment that is provided by the taxpayer for market value (or otherwise in an arm's length transaction) in the ordinary course of the taxpayer's business which consists of providing one or more specified types of entertainment.

Application of the Legislation

The 50% deduction limit in section DG 1 applies to expenditure that is otherwise fully deductible but which is a "specified type of entertainment" under Part A and not "excluded entertainment" under Part B of Schedule 6A.

Special offers of food or beverages to the public:

A. As a "specified type of entertainment"

When a licensee makes a special offer of food or beverages to the public, the expenditure on that food or beverages is, in most cases, not a *specified type of entertainment* under Part A of the Schedule (and thus not subject to the 50% deduction limit). This is despite the food or beverages being provided or consumed on the "business premises" of the licensee, in terms of clause 4(c) of Part A.

Clause 4(c) has two sets of criteria, both of which must be met before such expenditure falls within a *specified type of entertainment*:

- The first requires that the food or beverages are provided or consumed on the "business premises" of the taxpayer; and

- The second contains two alternatives, which require that the food or beverages be provided or consumed, either at a party [clause 4(c)(i)], or in a reserved area of the premises [clause 4(c)(ii)].

The special offers of food or beverages made to the public by licensees, although meeting the first set of criteria in clause 4(c), do not ordinarily come within either of the alternatives in the second set.

In relation to the first set of criteria in clause 4(c), the licensed premises where the offer occurs are the licensee's "business premises" as they are the normal business premises of the licensee. The definition of "business premises" in the Schedule excludes "premises or a workplace established principally for the purposes of enjoying entertainment". It could be argued that licensed premises are established principally for the purposes of enjoying entertainment and so would not be the licensee's "business premises". However, it is considered that from the licensee's perspective, the licensed premises are established principally for the purpose of running a business and not for the purposes of enjoying entertainment, and so are the licensee's "business premises" in terms of the Schedule.

Note that, for the purposes of the definition of "business premises", licensed premises are not a temporary workplace of a person who merely conducts a business meeting at the licensed premises because, from that person's perspective, the licensed premises are a workplace established principally for the purposes of enjoying entertainment.

As already indicated in relation to the second set of criteria in clause 4(c), food or beverages provided or consumed on "business premises" (apart from food or beverages consumed in a corporate box, holiday accommodation, or a pleasure craft) are only included as a *specified type of entertainment* if the food or beverages are consumed either at a party or similar social function, or in a reserved area of the premises. In some situations, food and beverages consumed on licensed premises may be consumed at a party or similar social function or in an area reserved at the time for use by certain employees and guests. However, special offers of food and beverages of the type to which the Ruling applies that are made to the public by the licensee during ordinary opening hours of the licensed premises, would not ordinarily be consumed at a party or similar social function, or in an exclusive area as contemplated in clause 4(c) of the Schedule.

B. As "excluded entertainment"

Quite apart from the position outlined above, special offers of food or beverages of the type referred to would be *excluded entertainment* under Part B of the Schedule (and thus not be subject to the 50% deduction limit).

This is because those special offers of food or beverages would usually come within clause 9 of Part B. Clause 9 applies to expenditure on entertainment that is provided at market value, or otherwise in an arm's length transaction, in the ordinary course of a taxpayer's business where that business consists of providing one or more of the specified types of entertainment. Expenditure on such *excluded entertainment* is therefore fully deductible if the entertainment is provided by a business at market value or in an arm's length transaction.

It follows that clause 9 applies to special offers of food or beverages made by a licensee to members of the general public if the food or beverages are provided either at market value, or are otherwise provided in an arm's length transaction in the ordinary course of the licensee's business. In particular:

- The cost to the licensee of "happy hours", where reduced price drinks are provided to customers during a particular time period in an arm's length transaction in the ordinary course of the licensee's business, will be fully deductible.

- The cost to the licensee of free drinks, provided on certain days or at certain times to customers or categories of customers selected from members of the general public, is fully deductible if the provision of such free drinks occurs in an arm's length transaction in the ordinary course of the licensee's business.

- The cost of providing meals, offered in a "two meals for the price of one" deal, is fully deductible if the meals are provided in an arm's length transaction with customers in the ordinary course of the licensee's business.

- The cost to the licensee of drinks provided to customers in "toss the boss" competitions is also fully deductible if the competitor and the licensee have an arm's length relationship. Where this occurs, the free drink prizes are provided in an arm's length transaction in the ordinary course of business.

Allowances for free drinks for customers

A licensee may pay a hospitality allowance to an employee, such as a bar manager, to cover the costs of providing free drinks to customers in the ordinary course of business. The expenditure on such an allowance is not subject to the 50% deduction limit. This is because the drinks are being provided or consumed on the licensee's business premises but not at a party or similar social function or in a reserved area of the premises as contemplated under clause 4(c) of Part A to the Schedule, or are not being provided where there is other than an arm's length relationship with the consumer.

The allowance is fully deductible if it is incurred by the licensee in deriving the licensee's gross income or if it is necessarily incurred by the licensee in carrying on a business for the purpose of deriving gross income.

Examples

Example 1

A licensee offers half-price drinks on Saint Patrick's day to all patrons who wear a green hat. All other drinks are provided at full price.

As the half-price drinks are provided to the green hat wearers in arm's length transactions in the ordinary course of the licensee's business, the expenditure on the drinks is excluded from Part A of the Schedule and is fully deductible to the licensee.

Example 2

A licensee offers the next round of drinks free for a period of one hour on a Friday night to any customer who, following the purchase of a round, is able to score more than 10 by throwing a single dart at a dartboard.

As the free rounds of drinks are available to all customers in arm's length transactions in the ordinary course of the licensee's business, the expenditure on the drinks is excluded from Part A of the Schedule and is fully deductible to the licensee.