Be Aware of the Federal Employment Tax Treatment of Holiday Gifts to Employees

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'Tis the season for gift giving. Employers should be aware, however, that holiday "gifts" to employees may be taxable wages for federal income and employment tax purposes. This means that federal withholding and reporting requirements applicable to wages may apply. If an employer fails to comply with these requirements, the employer could be liable for unpaid federal income and employment tax as well as civil penalties and interest. Thus, it is important to have a basic understanding of the federal tax treatment of employer "gifts" to employees.

As a threshold matter, for federal income and employment tax purposes there is no such thing as a "gift" from an employer to an employee. There are only "wages," which are taxable, and "fringe benefits," which are not taxable. Unless a transfer of value to an employee is expressly excluded from wages as a fringe benefit, the transfer is taxed as wages.

With regard to common holiday season "gifts" to employees, cash and cash equivalents will never be excluded from taxable wages. Cash equivalents are things like gift certificates or gift cards that the employee can use like cash with the issuing merchant. In other words, a $25 gift card to the local discount store must be handled for federal employment tax purposes by the employer in the same fashion it would handle a $25 paycheck issued to the employee. This means that the employer is required to withhold income and employment tax, to remit all applicable employment tax deposits, and to report the value of the gift card on the employee's Form W-2.

Low value "gifts" to employees that are ***not*** cash or a cash equivalent will not be treated as wages if the gift is so small as to make accounting for it unreasonable or impractical, considering its value and the frequency with which it is provided (i.e., a "de minimis fringe benefit"). A holiday turkey given to an employee at Thanksgiving is a good example of a de minimis fringe benefit. Because cash and cash equivalents are not unreasonable or impractical to account for, they never qualify as de minimis fringe benefits. Likewise, if the gift is more

than a “de minimis” value, it will not qualify as a de minimis fringe benefit. The IRS has not specified what it considers to be the limit of “de minimis” value. However, it has indicated informally that a gift with a value exceeding $100 will not qualify as a de minimis fringe benefit. Lastly, employers should bear in mind that the determination of whether the value of a gift is “de minimis” is made on an annual, aggregate basis. For example, a gift of a single, $30 holiday turkey could safely be excluded as a de minimis fringe benefit, but if similar gifts are made to the employee monthly, ***none*** of the gifts would be excludible.

If you have questions about holiday gifts to employees, contact Jeffrey Allen Miller or your Vorys attorney.