

How to withhold on 2015 bonuses, gifts, prizes and awards

—a free guide from the American Institute of Professional Bookkeepers (www.aipb.org)

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How to tax 2015 bonuses, gifts, prizes and awards

Bonuses: Any cash bonus, no matter how small, is wages subject to FITW, FICA, FUTA and applicable state/local payroll taxes. When FIT has been withheld from the employee's current or prior-year wages and you pay out a bonus separately from regular wages—or with regular wages but identified as separate—you can use the 2015 supplemental withholding rate of 25% (39.6% on supplemental over \$1 million). [26 CFR 31.3402(g)-1]

Discretionary (lump-sum) cash bonuses. To be discretionary and therefore excludable from O.T. pay calculations, the employer must be the one who decides when and how much to give. The bonus cannot be required by a contract, agreement or promise, or be given in a pattern so that employees expect it—to be discretionary, the bonus must be a complete surprise to the employee.

Exception: Holiday bonuses can be discretionary, even if employees expect it each year. [29 CFR 778.211]

Nondiscretionary bonuses are those required under a contract, agreement or promise, express or implied, such as for higher or faster production, as inducements to take a job or stay with the firm, or a bonus that employees have come to expect (with the exception of holiday bonuses). Nondiscretionary bonuses given to hourly employees must be added to weekly gross pay for the week in which they are earned and must be included when computing the week's O.T. [29 CFR 7788.209]

Example: Julio earns \$14/hr. One week he works 42 hours and earns a \$50 prorated production bonus.

Julio's normal pay: \$588 for the week ($\$14 \times 42 \text{ hrs}$) + \$50 bonus = \$638 straight-time pay.

Julio's overtime pay: \$638 for the week (including the nondiscretionary bonus) \div 42 hours worked = \$15.19 regular rate of pay \times 50% premium rate = \$7.60 (rounded) \times 2 hours' O.T. = \$15.20 (rounded) premium pay.

Julio's gross pay: \$638 straight-time pay + \$15.20 premium pay = \$653.20 gross pay for the week.

Signing and related bonuses. A bonus given for signing or cancelling an employment contract is wages subject to FIT, FITW, FICA and FUTA.

Cash prizes and awards

Include the fair market value (FMV)—not the cost—of prizes and awards in wages and apply all taxes. Include the FMV of prizes/awards for production, attendance, efficiency or other on-the-job achievements in that employee's straight-time pay to compute the O.T. premium, as in the example of Julio, above.

Length-of-service or safety awards. [IRC §3121 (a) (20)] can be excluded from federal taxable wages—if given as “part of a meaningful presentation” and if they are not “disguised compensation,” and:

- ✓ be given under a written, qualified plan or program that does not favor highly compensated employees;
- ✓ not exceed an average of \$400 per employee or \$1,600 per employee for the year (if not paid under a qualified plan, not exceed \$400 per employee for the year);
- ✓ not be tangible personal property, cash or cash equivalents, such as stocks, bonds, meals, lodging or sports, or theater tickets; and
- ✓ be given in some kind of ceremony. [IRC §74(c), 274(j)]

Length-of-service awards are federal taxable wages if given before 5 years of service but nontaxable if given after 5 years of service and not more frequently than every 5 years.

Safety awards are excluded from federal taxable wages if also given to management, administrative, professional, clerical and part-time employees and not given to more than 10% of eligible employees during the taxable year —i.e., if 12% of employees qualify, then safety awards are taxable wages for all employees.

Suggestion awards are excluded from an employee’s hourly pay rate (i.e., for both taxes and overtime calculations)—if . . .

- ✓ the employee was not required to take part in the program;
- ✓ the award was not geared to the employee’s salary;
- ✓ no time limit was set for submitting suggestions;
- ✓ offering suggestions is not part of the employee’s job (e.g., the job is not troubleshooting the equipment that the suggestion applies to or surveying employees for ideas on how to improve some procedure);
- ✓ the employee made a suggestion completely on his or her own (no employer input at all); and
- ✓ the employer had no idea that the employee was working on the suggestion.

Noncash gifts and prizes

Include the FMV in wages subject to FIT, FITW, FICA and FUTA. [Rev. Rul. 57-18, CB 1957-1, 35]

Nontaxable gifts: Fruit baskets, hams, turkeys, wine, flowers and entertainment tickets to a show, sporting or other event (but not season tickets) generally are *de minimis* (nontaxable) fringes if they are of nominal value and given infrequently.

Taxable gifts: Gift certificates (“cash in kind”) are wages and therefore subject to FIT, FITW, FICA and FUTA, even for *de minimis* items—e.g., a gift certificate for a turkey is taxable, a turkey is not. Cash gifts of any amount must be treated as taxable wages. [26 CFR 1.1326(e); TAM 200437030]

Parties and picnics. The cost is 100% (not 50%) deductible to the business and nontaxable to employees and their families—if infrequent and given to promote employee health, goodwill, contentment or efficiency—e.g., holiday parties, cocktail parties and company picnics. [IRC §132, Rev. Rul. 2004-109 and Rev. Rul. 2004-110]

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