

Bonuses, Prizes and Awards

How to tax 2012 bonuses, gifts, prizes and awards

Withholding on cash—or cash equivalent—bonuses

Treat any cash bonus as wages: Apply FITW, FICA, FUTA and applicable state and local payroll taxes. If the bonus was paid separately from regular wages—or with regular wages but identified as separate—and FIT was withheld from the employee's current or prior year wages, you can use the supplemental withholding rate of 25% for 2012. [26 CFR 31.3402(g)-1]

Discretionary bonuses. These are lump sums. To be excluded from O.T. pay calculations, it is crucial that the employer decide when and how much to give. It can't be required by a contract, agreement or promise nor be part of a pattern that leads employees to expect it. To be *discretionary*, the bonus must be a *complete surprise* to the employee.

Exception. A holiday bonus can be discretionary even if it is given each year, leading employees to expect it. [29 CFR 778.211]

Nondiscretionary bonuses. These are required under a contract, agreement or promise, express or implied—e.g., for higher or faster production, as inducements to take a job or stay with the company—or a bonus employees have come to expect (except for 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 778.209]

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

Lee's normal pay: \$588 for the week (\$14 x 42 hrs) + \$50 bonus = \$638 straight-time pay.

Lee's overtime pay: \$638 for the week (including the nondiscretionary bonus) ÷ 42 hours worked = \$15.19 regular rate of pay x 50% premium rate = \$7.60 (rounded) x 2 hours' overtime = \$15.20 (rounded) premium pay.

Lee'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 an employment contract or in connection with cancellation of 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 regular hourly rate to compute the O.T. premium, as in the example of Lee, above.

Length-of-service or safety awards. [IRC §3121 (a) (20)] To be excluded from federal taxable wages, an award must be given as "part of a meaningful presentation," not be "disguised compensation" and:

- ✓ given under a written, qualified plan or program that does not favor highly compensated employees;
- ✓ if not given under a written, qualified plan, then not exceed \$400 per employee for the year;
- ✓ not exceed an average of \$400 per employee or a total of \$1,600 per employee;
- ✓ 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 included in 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 included in federal taxable wages if also given to management, administrative, professional, clerical or part-time employees and not given to 10% or more of eligible employees during the taxable year—i.e., if 12% of employees qualify, the award cannot be given tax-free to any employee.

Suggestion awards need not be included in an employee's hourly pay rate—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 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 such as to a show or sporting event generally are *de minimis* (nontaxable) fringes if they have a nominal value and are given infrequently.

Taxable gifts: Gift certificates ("cash in kind") are wages 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 are taxable as wages. [26 CFR 1.132-6(e); TAM 200437030]

Parties and picnics. The cost of employee parties is fully 100% (not 50%) deductible to the business and nontaxable to employees and their families as a *de minimis* fringe—if infrequent and given to promote employee health, goodwill, contentment or efficiency. Examples: Holiday parties, cocktail parties and company picnics. [IRC §132] [Rev. Rul. 2004-109 and Rev. Rul. 2004-110]