CHRISTIAN MANAGEMENT ASSOCIATION

November 1, 2015

Gifts to Employees
When are they Taxable?

Christmas Season is just around the corner and your ministry wishes to give “gifts” to the staff in appreciation for their services throughout the year. Will the generosity of the gift be undercut if the IRS taxes it as additional compensation?

The parent of an employee dies suddenly. The ministry, knowing that the employee would have a difficult time paying for the cost of the flight to return home, takes up an offering from among the staff and even contributes some of its own money to assist the employee. Is their “gift” considered taxable to the employee?

Many employers form good relationships with their employees and like to show their personal appreciation and respect, unrelated to job performance, with a gift, but hesitate in doing so because of possible taxation issues.

The complication with employee gifts arises out of the interplay between Section 102(a) of the Internal Revenue Code (IRC), which states that “...gross income does not include the value of property acquired by gift,” and IRC 102(c) which provides that as a general rule the employer “...shall not exclude from gross income any amount transferred by or for an employer to, or for the benefit of, an employee.”

“Donor Intent”

The rule for determining whether a gift to an employee is excludable from income was set out by the Supreme Court in Commissioner v. Duberstein, 363 U.S. 278 (1960). In that case, a corporate president gave a Cadillac to another firm’s president in gratitude for his business referrals. The Supreme Court ultimately decided that the car was not a “gift” as defined in the tax code, despite the donor’s characterization of it as such, because the donor’s intent was ultimately to recompense Duberstein for past services and/or induce him to be of further service in the future. The Court went on to say that “...a true gift must proceed from a “detached and disinterested generosity...out of affection, respect, admiration, charity or like impulses.” Thus the most critical consideration for the Court and the IRS was, and has continued to be, the donor’s actual intent in giving the item.

To discover the donor’s intent the IRS will often look at the circumstances surrounding the gift. If the gift is given in the context of an employment relationship, there is a presumption that the gift is compensation for services and therefore includable as income. The presumption becomes stronger if either party treated the gift as compensation; for example, the employee included the same type of gift as income in previous years, or if the employer deducted the gift as a business expense. If it can be shown however, that the gift was given for other reasons and that it is not tied in any way to appreciation for past or future services (except for certain “de minimis” employee achievement awards) it can be excluded from gross income.

De Minimis Compensation

Even if a gift to an employee is considered compensation, it may be excludable if it is of such small value that it would be too costly for the IRS to track the transfer. These bonuses, fringe benefits, and gifts are called "de minimis" compensation and, though they are in fact employment-related compensation, they are excludable from taxable income by statues. For example, tickets to a sporting event, flowers, books, and similar benefits provided to employees under special circumstances are excludable because they are de minimis; however, cash (or a cash equivalent) is never considered de minimis. There is no defined value for a de minimis employee benefit in the tax code, but courts have ruled that season tickets (as opposed to an event), continual use of a ministry car, and membership in a country club or athletic facility are not de minimis and their value must be included in taxable income.

Examples of Common Employee Gifts

1. End of Year Christmas Gifts

Holiday gifts of personal property with a low market value would be excludable as de minimis (i.e. traditional ham or turkey). However, cash or cash equivalents which could be easily converted into cash would not be. For example, cash gifts by an employer based upon a percentage of the employee's monthly income would be considered income even though the gift was not based on the quality of work done or length of service. he employer's distribution of gift certificates to be used in the company store however, were deemed excludable because the gifts certificates were not readily convertible to cash and were relatively small in value.

2. Gifts for Employee Appreciation

Gifts to employees to express appreciation for past or future services are normally considered taxable compensation. Section 74(c) of the IRC, however, makes a special exception for certain "employee achievement awards." These awards must be given (1) for length of service or safety achievement, (2) as part of a meaningful presentation, and (3) under conditions and circumstances, that do not create a significant likelihood of disguised compensation. The total value of these awards must not exceed $400 per tax year for any given employee.

Ques: What about the annual collection of a cash gift by members of the choir that is given directly to the music minister?

Ans: Very likely taxable income...if gift collection was routine, gathered in a structured manner, & donations substantial it would be considered income, even if the gift goes directly to the minister from the choir.

3. Death Benefits

Code Section 101 provides for the exclusion from gross income, not to exceed $5,000 of payments to a widow or other beneficiary by or on behalf of an employer by reason of death of an employee. (These death benefits are distinguishable from life insurance policies, which are normally excludable from income). This exclusion would not apply however, to amounts constituting income payable to the employee during his life as compensation for services. For example, bonuses, unused vacation and sick time, uncollected salary, or termination pay.

4. Interest Free Loans

The money the employee saves by getting interest-free loans (or loans for less than the market rate of interest) from the employer is considered extra compensation, and therefore taxable.

5. Gifts of Benevolence

The parent of an employee dies suddenly. The ministry, knowing that the employee would have a difficult time paying for the cost of the flight to return home, takes up an offering from among the staff and even contributes some of its own money to assist the employee. An employee has a sudden and unusual financial need, the ministry provides them with a "gift" out of the benevolence fund to meet the need.

The money an employee receives to meet such benevolence needs may be excludable from income under some circumstances, especially if the employer makes similar gifts to non-employees. However, to disburse a charitable grant through a benevolent fund of a 501(c)(3) organization, the Code does stipulate that the gift must (1) be in furtherance of the organization's tax- exempt purposes, and (2) serve a public rather than a private purpose. Beyond this, there are currently no specific guidelines in the tax code governing such practices among 501(c)(3) organizations.

The Code does specify certain requirements for private foundation making such gifts however, which may serve as a safe harbor for ministries wanting to make use of such a fund. There are three major requirements: (1) the program should have a formal policy and procedure in place for assisting staff in such circumstances that outlines objective, charitable standards by which the gifts are made, (2) the policy covers all employees of the ministry and is not strictly for the benefit a few, and (3) donations to the fund must always be used for the identified charitable purposes (i.e. for use by the organization and not as a gift from the donor to the individual). I would add these additional items...(4) the benevolence is truly in the form of a gift and the employee is not expected to repay the money to the fund sometime in the future, and (5) the benevolence is clearly "need" based and tied to a specific event and not ongoing.

Employer Liability When Gifts are Deemed Compensation

1. Failure to Withhold

If a gift is deemed taxable income and the employer has failed to withhold proper taxes, the employer is liable for the amount of tax owed by the employer until and unless the employee pays the tax.

The employer may deduct the amount of tax liability from future wages. The employer is, however, still liable for any penalties and additions that may be incurred for originally failing to withhold. The penalties for willfully failing to properly withhold employee income can be sever and the "responsible person" who is in control of the finances of the organization may be personally liable for payment of 100% of the penalty.

2. The Risk to Tax-Exempt Status – Unreasonable Compensation

Every tax exempt organization's 501(c)(3) status is dependent upon, among other things, not paying any of its employees more than "reasonable compensation." If the total amount of an employee's salary, fringe benefits, pension contributions, bonuses, etc. is deemed by the IRS to be in excess of what would be "ordinarily paid for like services by like enterprises," the compensation package will be considered unreasonable and the organization's tax-exempt status will be in jeopardy. Therefore, exempt organizations must be especially scrupulous in giving "gifts" to employees, particularly executives, if the gifts are actually additional compensation and add significantly to total compensation.

Conclusion

Evaluate your gift giving practices to avoid the triple risks of creating (1) unintended taxable compensation, (2) excessive compensation, and (3) private inurement. Some gifts at traditional occasions will most likely not be viewed as compensation for services but employers should be prudent in making gifts and consult with counsel if they are unsure about legal or tax consequences.
