

Hand Out Tax-Free Achievement Awards to Top Workers

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It's easy for employees to fall into the trap of going through the motions. But there's a way that employers can break the routine without breaking the bank.

Strategy: Establish a program of achievement awards. If you handle things the right way, the awards are tax-free to the employees and fully deductible by your company. What's more, the program can increase productivity and boost morale.

However, an awards program can't be used as a means to disguise taxable compensation. For example, employee awards that are handed out at the same time as annual salary reviews may be suspect. Similarly, the program cannot be substituted for a cash bonus plan that previously existed.

Here's the whole story: Under the tax-law definition, an "achievement" award is an item of tangible personal property granted to an employee for either length of service or promoting safety. This includes gifts such as watches, necklaces, televisions, iPods, DVD players, golf clubs, etc. However, cash and equivalent gifts (e.g., gift certificates) do not qualify as tangible personal property.

In addition, the plan must meet a few other key requirements to qualify for favorable tax treatment. For instance:

Any employee may receive a length-of-service award, but safety awards cannot be made to managers, administrators, clerical workers and other professional employees. *Reason:* These positions generally don't involve safety issues. Furthermore, the award does not qualify if the company granted safety awards to more than 10% of the eligible employees during the same year.

The award must be part of a "meaningful presentation." This doesn't mean your company has to throw a lavish affair, but the occasion should be marked by a ceremony befitting of the occasion.

An employee must have worked for the company a minimum of five years to receive a length-of-service award. *Note:* An employee isn't eligible for this type of award if he or she received a length-of-service award during the current year or the previous four years.

How much can an employee receive tax-free? It depends on whether the award is nonqualified or qualified. With a qualified award (*see box below*), the maximum is \$1,600 (incl. any nonqualified awards). Any amounts over these limits cannot be deducted by the company and are taxable to the employee.

Tip: Your employees will probably be more motivated if there's a prize for achievement.

Tax strings to qualified awards

To be a "qualified" award, two additional requirements must be met:

1. The award must be paid under a written plan that does not discriminate in favor of highly compensated employees.
2. The average cost of all employee achievement awards granted during the year cannot exceed \$400. In determining the average cost, awards of nominal value (i.e., \$50 or less) are not included.

Example: Your company gives out two awards to the same employee at this year's holiday party. The awards have a combined value of \$1,000. In that case, the employee owes tax on \$200 of income in 2009 and your company's deduction for the awards is limited to \$800.