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IRS Guidance for Holiday Gift Giving

In light of the season and in view of your desire to comply with the law, we thought it wise to share with you once again some of the highlights associated with guidance issued by the Internal Revenue Service in connection with gifts to employees. In general, the guidance covers the circumstances under which such gifts are includable in the employees' gross income and reportable on their forms W-2.

Code § 61(a)(1) indicates that gross income means any income from whatever source derived, including, but not limited to, compensation for services including fringe benefits.

Code § 3121(a) defines the term "wages" for FICA purposes as all remuneration for employment, including the cash value of all remuneration (including benefits) paid in any medium other than cash, with certain specific exceptions.

Code §§ 3121(a)(20) and 3401(a)(19) provide that for purposes of FICA and income tax withholding, respectively, the term "wages" shall not include any benefit provided to or on behalf of an employee if at the time such benefit is provided it is reasonable to believe that the employee will be able to exclude such benefit from income under Code § 132.

Code § 132(a)(4) provides that gross income does not include any fringe benefit that qualifies as a de minimis fringe benefit. Code § 132(e)(1) defines a de minimis fringe benefit as any property or service the value of which is (after taking into account the frequency with which similar fringes are provided by the employer to the employer's employees) so small as to make accounting for it unreasonable or administratively impracticable.

Income Tax Regulation § 1.132-6(c) provides that, except for special rules that apply to occasional meal money, the provision of any cash fringe benefit is never excludable as a de minimis fringe benefit. Income Tax Regulation § 1.132-6(e)(1) provides examples of de minimis fringe benefits that are excludable from an employee's gross income. These include picnics for employees and their guests; traditional birthday or holiday gifts of property (not cash) with a low fair market value; coffee, doughnuts, and soft drinks; local telephone calls; and flowers, fruit, books, or similar property provided to employees under special circumstances (e.g., on account of illness, outstanding performance, or family crisis). In addition, in the legislative history of the Deficit Reduction Act of 1984 (DEFRA 1984), pursuant to which Code § 132 was enacted, Congress provided illustrations of benefits that are excludable as de minimis fringe benefits, such as "traditional gifts on holidays of tangible personal property having a low fair market value (e.g., a turkey given for the year-end holidays)."

However, according to the IRS, because cash and cash equivalent fringe benefits such as gift certificates have a readily ascertainable value, they do not constitute de minimis fringe benefits because these items are not unreasonable or administratively impracticable to account for.

Accordingly, it is the view of the IRS that employer-provided "gift coupons" operate in essentially the same way as a cash equivalent fringe benefit. It is simply not administratively impracticable to account for the employer-provided gift coupons. Thus, gift coupons are taxable to employees and reportable on their W-2s.

While the guidance discussed coupons valued at \$35, it gave no indication that coupons valued at less than \$35 would be excludable from gross income.

If you have questions, please feel free to contact Vincent Ruocco, LLC, CPA at (203) 932-2931 or vuocco@artcpas.com.

Happy Holidays!

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