Employee Holiday Gifts and the Taxman

The time of year is approaching when many Canadian employees look forward to something "extra" from their employer – a Christmas or Hanukkah gift, a year-end bonus, or an invitation to the annual employer-sponsored holiday party. While it doesn't necessarily fit well with the holiday spirit, it's a fact that many such gifts, or even the annual employee holiday party, may have tax consequences, and the tax rules governing employer gifts can be surprisingly complex.

The starting point is the general rule that all gifts given by an employer to its employees are considered to constitute a taxable benefit. However, the CRA makes an administrative concession in this area, allowing non-cash gifts (within a specified dollar limit) per employee per year to be tax free, as long as such gifts are given on occasions such as Christmas or Hanukkah, or following a significant life event, like a marriage or the birth of a child.

Under the rules that will now apply to 2009 and previous years, the CRA's administrative concession allows for two non-cash gifts (within a specified dollar limit) per employee per year to be tax-free. If an employee is given a non-cash gift or award for any other reason than the "special occasion" events outlined above, this policy does not apply, and the employer is required to include the fair market value of the gift or award in the employee's income.

The CRA's policy limits the cost of tax-free, special-occasion gifts to $500 (including taxes). Therefore, if a single non-cash gift is given and the total cost is more than $500, the employee is required to include the fair market value of the entire gift in taxable income. If the total cost of more than one non-cash gift given to an employee in a year is more than $500, the employer is allowed to choose which of the gifts is to be excluded from the employee's income, as long as the total cost of the excluded gifts is not more than $500. The fair market value of the remaining gifts must be included in the employee's income. If the employer gave more than one non-cash gift per year, and the total cost was $500 or less, the employer is allowed to exclude the cost of any two of the gifts from the employee's income. The employer is then required to include the fair market value of the remaining gifts in the employee's income.

The current year is, thankfully, the last one that such cumbersome calculations will be required. Not surprisingly, the administration of the rules proved to be more burdensome to employers than the CRA had anticipated, and the Agency was concerned as well that that employer-gift-and-award policies were being designed simply to provide employees with tax-free remuneration. Therefore, earlier this year, the Agency announced a new, more straightforward policy with respect to non-cash gifts from employers to employees. Effective as of January 1, 2010, non-cash gifts and non-cash awards to an arm's length employee, regardless of number, will not be taxable to the extent that the total value of all such gifts and awards to that employee is less than $500 annually. The total value over $500 annually will be taxable.

It is important to remember the "non-cash" criterion imposed by the CRA, as the $500 per year administrative concession, under either the old or the new rules, does not apply to what the CRA terms "cash or near-cash" gifts, and *all* such gifts are considered to be a taxable benefit and included in income for tax purposes, regardless of cost. For this purpose, the CRA considers anything that could be easily converted to cash as a "near-cash" gift, which includes such things as gift certificates. In addition, the following types of gifts are considered to be taxable benefits, regardless of cost:

• points that can be redeemed for air travel or other rewards;

• reimbursements from an employer to an employee for a gift or award that the employee selected and paid for, and for which the employee then provided a receipt to the employer for reimbursement;

• hospitality rewards, such as employer-provided team-building lunches and rewards in the nature of a thank you for doing a good job;

• disguised remuneration, such as a gift or award given as a bonus;

• gifts and awards given by closely held corporations to their shareholders or related persons; and

• manufacturer-provided gifts or awards given directly by the manufacturer to the employee of a dealer.

The annual employee holiday party falls into a separate category altogether. For many years, there was no question but that such an occasion had no tax consequences to the employees. However, in 1998, the CRA made an ill-advised decision to assess a taxable benefit of $200 in relation to an employee's attendance at an employer-sponsored Christmas party, and that assessment was upheld by the Tax Court of Canada. The public reaction to the news that employee Christmas parties would henceforth be taxed was entirely predictable, and the CRA issued a clarification of its position. That clarification indicated that no taxable benefit would be assessed in respect of employee attendance at an employer-provided social event where attendance at the party was open to all employees and where the cost per employee was "reasonable". In this case, a "reasonable" cost was determined by the CRA to be $100. The $100 cost is meant to cover the party itself, not including any ancillary costs, such as transportation home, taxi fare, and overnight accommodation. Where the total cost of the party exceeds the $100 per person threshold, the CRA may assess the employee as having received a taxable benefit.

It may not seem entirely in the spirit of the season to consider tax benefits and costs when planning holiday gifts and parties. However, an employer who inadvertently increases an employee's tax bill for the year as a result of a lack of planning around holiday gifts or invitations may end up looking less like Santa and more like Scrooge.