

Canada Revenue Agency Changes the Rules on Employee Gifts

The taxation of employee gifts has always been something of a headache for Canadian revenue authorities. On the one hand, the amounts involved for each employee are rarely large, so the revenue received or forgone in relation to their taxation is insignificant in the larger scheme of the Canadian tax system. On the other hand, the number of taxpayers who receive gifts or awards from an employer during the course of a tax year can number in the millions, so that even those small amounts, when multiplied by that large number of taxpayers, can add up. Finally, the number of ways in which a employee gift or award program can be structured is virtually limitless, and the CRA has had some difficulty over the years in formulating a set of rules that will cover most situations in a common-sense way, without incurring administrative costs that outstrip the revenue generated or risking non-compliance as a result of taxpayer resentment of rules that are perceived as petty or punitive in nature. Recently, the CRA deemed it necessary to go back to the drawing board with respect to the rules governing the taxation of employee gifts, and the Agency has now announced new rules, which will take effect for 2010 and later years.

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, under the rules that will now apply to 2009 and previous years, the CRA made an administrative concession, allowing two non-cash gifts (within a specified dollar limit) per employee per year, tax free, as long as such gifts were given on occasions such as Christmas or Hanukkah, or following a significant life event, such as a marriage or the birth of a child. If an employee was given a non-cash gift or award for any other reason, this policy did not apply and the employer was required to include the fair market value of the gift or award in the employee's income.

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

In addition, the "non-cash" criterion imposed by the CRA, as part of the two-gift/\$500 administrative concession, did not apply to what the CRA termed "cash or near-cash" gifts, and all such gifts were considered to be a taxable benefit and included in income for tax purposes, regardless of cost. For this purpose, the CRA considered anything that could be easily converted to cash as a "near-cash" gift, which included such items as gift certificates. In addition, the following types of gifts were considered to be taxable benefits, regardless of cost:

- points that could be redeemed for air travel or other rewards;
- reimbursements from an employer to an employee for a gift or award that the employee selected, paid for, and 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.

In 2007, the CRA began a review of its policies relating to taxable benefits provided to employees and the related administrative costs to employers. As a result of that review, the Agency has determined that changes were needed to the rules governing employee gifts. In its view, the former rules, which were intended to recognize common business practices and remove from employers the administrative burden of determining the fair market value of small gifts and awards, had not met its objectives, at least with respect to the administrative burden shouldered by employers. In addition, the CRA was concerned that gift and award policies were being designed simply to provide employees with tax-free remuneration. As a consequence of those concerns, the CRA has formulated the following new policy:

- 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 non-cash gifts and awards to that employee is less than \$500 annually. The total value over \$500 annually will be taxable.
- A separate non-cash long-service/anniversary award provided to an employee may also qualify for non-taxable status to the extent its total value is \$500 or less. Once again, the value over \$500 will be taxable. In order to qualify, the anniversary award cannot be for less than five years of service or for five years since the last long-service award had been provided to the employee. For the purposes of applying the \$500 thresholds, the annual gifts and awards threshold and the long-service/anniversary awards threshold are separate. In other words, a shortfall in value under one policy cannot be used to offset an excess value of the other.
- The employer gift and award policy will not apply to non-arm's length employees (e.g., relative of proprietor, shareholders of closely held corporations) or related persons of the non-arm's length employee.
- Items of an immaterial or nominal value, such as coffee, tea, T-shirts with employer logos, mugs, plaques, trophies, etc., will not be considered a taxable benefit to employees. The CRA has not imposed any defined monetary threshold that determines an immaterial amount, but it indicated that factors that may be taken into account include the value, frequency, and administrative practicability of accounting for nominal benefits.

Finally, the CRA's administrative policies as to the qualifying nature of gifts and awards will not change. For example, performance-related rewards (e.g., sales targets) or cash and near-cash awards (e.g., gift certificates), as listed above, will continue to fall outside the administrative policy and will be required to be included in the taxable income of the employee who receives them.

A summary of the CRA's new policies on employee gifts and awards can be found on the Agency's Web site at <http://www.cra-arc.gc.ca/tx/bsnss/tpcs/pyrll/bnfts/gfts/nwplcy2010-eng.html>.