

Employee holiday gifts and the taxman (December 2010)

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, sometimes in unexpected ways.

The general rule is that any gifts received by an employee from his or her employer are considered to constitute a taxable benefit, to be included in the employee’s income in the year the gift is received. However, the Canada Revenue Agency (CRA) makes an administrative concession in this area, allowing non-cash gifts (within a specified dollar limit) to be received tax-free by employees, 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.

Within the last year or so, the CRA has made some significant changes to its policies around employer gifts. As the new policies took effect at the beginning of 2010, this holiday season is the first one which will be governed by those policies. Thankfully, the new policies represent a simplification of the often complex and cumbersome rules which applied for 2009 and previous years. The administration of those rules proved to be more burdensome to employers than the CRA had anticipated, and the Agency was also concerned that that employer gift and award policies were being designed simply to, in effect, circumvent the rules and thereby provide employees with tax-free remuneration.

So, for 2010 and subsequent years, the CRA’s policy with respect to employer gifts to employees is simply that non-cash gifts and non-cash awards to an arm’s length employee, regardless of the number of such gifts or awards, 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’s important to remember the “non-cash” criterion imposed by the CRA, as the \$500 per year administrative concession 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 which 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 result in a taxable benefit, 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, 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.

This time of year, the tax treatment of the annual employee holiday party needs to be considered. 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 extremely ill-advised decision to assess a taxable benefit 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 the cost per employee was "reasonable". In this case, "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. That policy remains in effect for 2010.

It may not seem entirely in the spirit of the season to consider tax benefits and costs when planning holiday gifts and parties. However, especially given that the taxable or non-taxable status of holiday gifts given this year will be governed by different set of rules than applied in the past, it is important to take these rules into account when planning any holiday gifts. At the end of the day, an employer gift that results in an increased tax bill for the employee isn't likely to generate much goodwill or holiday spirit.