PRIZES AND AWARDS

Prizes and awards given by an employer to employees for outstanding achievement, money-saving suggestions, etc. are generally taxable and included in employee's income subject to federal income tax withholding, social security, Medicare, and FUTA taxes. There are exceptions for certain noncash awards that comply with several restrictions.

Employers do not include awards for length of service or safety achievement in an employee's income if the amount of the award is deductible to the employer as a business expense. The extent to which the award is deductible to the employer depends on whether the award meets several general and specific requirements and whether it is granted under a qualified or nonqualified plan.

General requirements:

- The award must be an award of "tangible personal property", which does not include cash or cash equivalents, stocks, bonds, vacations, meals, lodging, or tickets to theater or sporting events
- The award must be presented in a "meaningful presentation" that does not need to be elaborate but must emphasize the employee's achievement
- The award must not be "disguised compensation", which might be shown by an award made at the time of a salary review or by an award that cost the employer much less than its fair market value

Specific length of service award requirements:

- Must not be presented for less than five years on the job
- Must not have been awarded to the same employee within the last four years

Specific safety award requirements:

- Will not qualify as a deductible achievement award if the employer has already presented them to 10% of its eligible employees during its taxable year
- Managers, administrators, professional employees, or clerical employees are not eligible
- The employee must work full-time with at least one year of service

Qualified plan awards – achievement awards that meet the general requirements are awarded under a qualified plan if:

- The employer has a written plan that does not discriminate in favor of highly compensated employees

- The **average cost** of all qualified plan awards presented by the employer during its tax year (except those costing the employer $50 or less) **may not exceed $400**, or none of them will be considered qualified plan awards
- The **total deduction allowed** to the employer for qualified plan awards granted **to one employee is $1,600 per year**

Nonqualified plan awards – the employer is limited to a total deduction of $400 per employee per year for awards that are not granted under a qualified plan but meet the general and specific requirements for deductibility.

If the achievement award exceeds the limit on the employer's deductibility, the amount that must be included in the employee's income is the greater of:

1. The difference between the employer's cost and the deduction limitation and;
2. The difference between the award's fair market value and the deduction limitation.

If the award is given before the required number of years of service, the entire amount is taxable and included in income.