

Dear Clients and Friends,

This time of the year we often get asked by our clients regarding taxability of employee bonuses. Even though holiday bonuses can seem like a gift, the IRS has ruled time and again that they are income, representing payment for services. Bonuses are payments made to employees in addition to their regular salary. They are generally based on profitability, productivity, length of services and other factors. Gifts of cash or items readily convertible into cash given under the same circumstances are compensation regardless of amount. This additional compensation is tax deductible by the employer and is includable in employee's W-2's subject to all applicable tax withholdings. Here is an excerpt from IRS Reg. § 31.3121(a)-1(c): "The name by which the remuneration for employment is designated is immaterial. Thus, salaries, fees, bonuses, and commissions on sales or on insurance premiums, are wages". All bonuses should be reported to your payroll company prior to issuance so that proper taxes can be withheld on them. An employer who wishes to provide a net bonus to their employees, such as a net holiday bonus of \$100, must give the employees more than \$100 to compensate for income taxes and social security taxes that must be deducted and withheld. Most payroll services and payroll software can handle this calculation. By grossing up the flat dollar net amount, you are including the estimated taxes into the amount so that, after taxes, the amount is what you want to provide your employees.

Please feel free to contact our office if you have any further questions.