



State of Arizona Accounting Manual

Topic 55 Payroll and Personnel
Section 55 **Taxability of Certain Fringe Benefits
Including Awards and Prizes**

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INTRODUCTION

The State of Arizona provides several fringe benefits to employees. While some of the fringe benefits are provided on a statewide basis (such as insurance and the various retirement plans), others are provided to specific employees directly by their respective agencies. Fringe benefits are a form of pay (including property, services, cash or cash equivalent) in addition to salary for the performance of services. These benefits include items such as educational assistance, transportation benefits, uniform or tools allowances, awards, prizes, etc.

Unless expressly and specifically excluded or deferred until a later year under the Internal Revenue Code (IRC), all taxable fringe benefits should be included in the employee's gross income in the year in which they are received.

Some types of fringe benefits may be taxable or non-taxable depending upon circumstances or amounts; these are included in both the non-taxable and the taxable segments below.

This policy does not address retirement and insurance contributions.

This policy has been created to help ensure that tax laws are observed with respect to taxable fringe benefits provided to State of Arizona employees.

Reporting of taxable fringe benefits to agency payroll offices is covered in SAAM 5556.

GAO Central Payroll should be contacted in the event a particular benefit is not listed below or if questions exist as to taxability of a certain benefit. IRS *Publication 5137, Fringe Benefit Guide for Federal, State and Local Governments*, should be consulted for more detailed guidance.

POLICIES

1. Non-taxable fringe benefits. Fringe benefits that are excluded under the IRC are not considered taxable and are not included in gross income.
 - 1.1. De minimis fringe benefits.
 - 1.1.1. *De minimis* fringe benefits include any non-cash property or service provided infrequently to an employee that has a value so small (nominal) that accounting for it is unreasonable and administratively impractical.

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- 1.1.1.1. Cash and cash equivalent awards (such as gift cards), never qualify as *de minimis* and are always taxable as wages.
- 1.1.1.2. Nothing with a fair market value in excess of fifty dollars (\$50) is considered by the State to qualify as *de minimis*.
- 1.1.1.3. Examples of *de minimis* fringe benefits include theater or sporting event tickets, group meals or picnics, a holiday turkey, ham, flowers, plaques, coffee mugs, etc. IRC §132(e); Reg. §1.132-6(b).
- 1.2. Employee achievement and safety awards.
- 1.2.1. Employee achievement and safety awards might be non-taxable provided they comply with the IRC. To be non-taxable, awards must:
- 1.2.1.1. Not be paid in cash or a cash equivalent (e.g., a gift card).
- 1.2.1.2. Be for length of service or safety.
- 1.2.1.2.1. If awarded for length of service, the award cannot be made:
- 1.2.1.2.1.1. For service of less than five (5) years with the employer.
- 1.2.1.2.1.2. To an individual more frequently than every five (5) years.
- 1.2.1.2.2. If awarded for safety:
- 1.2.1.2.2.1. Not be given to a manager, administrator, clerical or professional employee.
- 1.2.1.2.2.2. Be given to a full-time employee who has worked for the employer for at least one (1) full year prior to the award.
- 1.2.1.3. Be awarded at a meaningful presentation.
- 1.2.1.4. Not be wages in disguise.
- 1.2.1.5. Be made pursuant to a written plan that does not discriminate in favor of highly compensated employees.
- 1.2.1.5.1. The definitional threshold of a highly compensated employee changes each year. The definition of a highly compensated employee is contained in definitions that apply to pension plan participants, which can be found at <http://www.irs.gov/Retirement-Plans/Plan-Participant,-Employee/Definitions>.
- 1.2.1.5.2. For 2015, the annual earnings threshold of a highly compensated employee is one hundred twenty thousand dollars (\$120,000).

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1.2.1.6. If the average cost of all awards is greater than fifty dollars (\$50) given during the calendar year by the employer, be less than four hundred dollars (\$400) to a given individual.

1.3. Awards or prizes transferred to charities.

1.3.1. Awards and prizes given over to a qualified charity before being received are generally not taxable to the awardee, if:

1.3.1.1. The awardee agrees to give the award to a qualified charitable organization (under IRC § 170 (c)) before receiving it, and

1.3.1.2. The award is given for achievement, and

1.3.1.3. The recipient was selected without entering any contest, and

1.3.1.4. No substantial future services are required of the awardee or transferee.

1.4. Qualified employee discounts.

1.4.1. An employee discount allows an employee to obtain property or services from the State at a price below that available to the general public. The difference between what an employee pays and what the general public would have to pay is a benefit that is taxable unless one of the following exclusions apply:

1.4.1.1. For merchandise or other property, the discount is less than the gross profit normally realized on the sale of the property.

1.4.1.2. For services, the discount is less than twenty percent (20%) of the price charged the general public for such services.

1.4.2. The exclusion from tax is not available for discounts on personal property of a kind commonly held for investment or on real property.

1.4.3. The exclusion from tax does not apply to discounts that are only available to or favor highly compensated employees.

1.5. Qualified transportation fringe benefits.

1.5.1. Qualified transportation fringe benefits are designed to help meet an employee's personal transportation needs, such as commuting to and from work. Examples include qualified parking and qualified transportation such as the Platinum Pass Program offered through Capitol Rideshare.

1.5.2. The portion of the transit cost covered by the State is a non-taxable fringe benefit.

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- 1.5.3. The portion of the transit cost deducted from the employee's pay is a pre-tax qualified transportation deduction.
- 1.6. Conferences and training. See SAAM 5040.
- 1.7. Meals, lodging, transportation and other expenses involving travel. See the appropriate section of SAAM, Topic 50, Travel.
- 1.8. Meals and lodging (not travel related). Meals and lodging, not related to travel, provided to an employee may be non-taxable under certain circumstances. To qualify as non-taxable, the benefits must be in-kind (cash allowances do not qualify), provided for the State's convenience and on the State's premises. An additional requirement for State provided housing is that it must be required as a condition of employment for the employee to properly fulfill the duties of his/her employment. *IRC §119*.
- 1.9. Uniforms. The provision of or payment for uniforms is covered in SAAM 5540. Uniform reimbursements paid under an accountable plan are frequently non-taxable.
- 1.10. Educational assistance. Some educational assistance is non-taxable and some is taxable. See *GAO Agency Payroll Guide, III.K, Employee Training and Educational Assistance* at <https://gao.az.gov/payroll-rasl/payroll-guide>.
- 1.11. Relocation expenses. See SAAM 5535.
- 1.12. Professional certifications and licenses. Amounts reimbursed to or paid on behalf of an employee for the cost of his professional licenses, certificates and professional organization dues may be excludable if they are directly related to the employee's job.
- 1.13. Tools. The payment of a tools reimbursement under an accountable plan is generally non-taxable. See SAAM 5536.
- 1.14. Working condition fringe benefits. Working condition fringe benefits are any property or service provided to an employee that if the employee had paid for it, the payment would be deductible as a business-related expense.
2. Taxable fringe benefits. Fringe benefits that are not excluded under any IRC section are considered taxable and included in gross income. If the recipient is an elected official, board or commission member, or other State employee, this amount is includible as wages and reported on Form W-2, Wage and Tax Statement, and generally is subject to Federal income tax withholding, State income tax withholding, Social Security (unless the employee has already reached the current year Social Security wage base limit), and Medicare.
- 2.1. Cash. A fringe benefit paid in cash is always taxable, no matter the amount.

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- 2.2. Gift cards and gift certificates. Gift cards and gift certificates are considered cash equivalents and are always taxable, no matter the amount.
- 2.3. Educational assistance. Some educational assistance is non-taxable and some is taxable. See *GAO Agency Payroll Guide, III.K, Employee Training and Educational Assistance* at <https://gao.az.gov/payroll-rasl/payroll-guide>.
- 2.4. Uniforms. The provision of or payment for uniforms is covered in SAAM 5540. Uniform allowances not paid under an accountable plan are generally taxable.
- 2.5. Tools. The payment of a tools allowance under a non-accountable plan is taxable.
- 2.6. State-provided vehicles. The value of personal use of a State-provided vehicle is taxable.
- 2.7. State-provided housing. The market value of housing provided by the State that does not meet the IRS criteria for exclusion is taxable. Lodging is excludable from wages only if it meets all of the following conditions:
 - 2.7.1. It is on the State's business premises, and
 - 2.7.2. It is arranged for the convenience of the State, and
 - 2.7.3. It is a condition of employment.
- 2.8. Awards and prizes. Awards and prizes that are not specifically excludable (viz., they do not fall under the *de minimis* limit, are not covered by an employee achievement or safety program, or are not excluded by virtue of their transfer to charity) are taxable to the employee at the fair market value of the award or prize.
- 2.9. Benefits provided by third parties.
 - 2.9.1. Generally, if a third party pays or provides a fringe benefit to the State for redistribution to a State employee in connection with the employee's performance of services for the State, the payment is considered taxable income to the employee.
 - 2.9.1.1. State imposed withholding and reporting is required when the benefit is part of the employee's employment contract, contemplated during the employment process, or provided by a third party via agreement with the State.
 - 2.9.1.2. If any outside party gives funds or awards to the employer to select and distribute to employees, the funds or awards are taxable just as if the employer provided it directly.

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- 2.9.2. Where a third party independently provides, selects, and distributes an award directly to a State employee without any assistance, direction, or decision making from the State, then the outside party would retain any reporting obligations for the payment.
- 2.9.2.1. In this case, it would not be considered taxable wages, and the State would have no withholding or reporting obligations with regard to the benefit.
- 2.9.2.2. The employee should be aware that there still may be income tax consequences from such an arrangement and also that the third party may be obligated to report the payment via a 1099-MISC.