Disallowance of certain employee achievement award expenses.

(a) In general. No deduction is allowable under section 162 or 212 for any portion of the cost of an employee achievement award (as defined in section 274(j)(3)(A)) in excess of the deduction limitations of section 274(j)(2).

(b) Deduction limitations. The deduction for the cost of an employee achievement award made by an employer to an employee: (1) Which is not a qualified plan award, when added to the cost to the employer for all other employee achievement awards made to such employee during the taxable year which are not qualified plan awards, shall not exceed $400, and (2) which is a qualified plan award, when added to the cost to the employer for all other employee achievement awards made to such employee during the taxable year (including employee achievement awards which are not qualified plan awards), shall not exceed $1,600. Thus, the $1,600 limitation is the maximum amount that may be deducted by an employer for all employee achievement awards granted to any one employee during the taxable year.

(c) Definitions.

(1) Employee achievement award. The term "employee achievement award", for purposes of this section, means an item of tangible personal property that is transferred to an employee by reason of the employee's length of service or safety achievement. The item must be awarded as part of a meaningful presentation, and under conditions and circumstances that do not create a significant likelihood of the payment of disguised compensation. For purposes of section 274(j), an award made by a sole proprietorship to the sole proprietor is not an award made to an employee.

(2) Tangible personal property. For purposes of this section, the term "tangible personal property" does not include cash or a certificate (other than a nonnegotiable certificate conferring only the right to receive tangible personal property). If a certificate entitles an employee to receive a reduction of the balance due on his account with the issuer of the certificate, the certificate is a negotiable certificate and is not tangible personal property for purposes of this section. Other items that will not be considered to be items of tangible personal property include vacations, meals, lodging, tickets to theater and sporting events, and stocks, bonds, and other securities.

(3) Meaningful presentation. Whether an award is presented as part of a meaningful presentation is determined by a facts and circumstances test. While the presentation need not be elaborate, it must be a ceremonious observance emphasizing the recipient's achievement in the area of safety or length of service.
(4) Disguised compensation. An award will be considered disguised compensation if the conditions and circumstances surrounding the award create a significant likelihood that it is payment of compensation. Examples include the making of employee achievement awards at the time of annual salary adjustments or as a substitute for a prior program of awarding cash bonuses, the providing of employee achievement awards in a manner that discriminates in favor of highly paid employees, or, with respect to awards the cost of which would otherwise be fully deductible by the employer under the deduction limitations of section 274(j)(2), the making of an employee achievement award the cost of which to the employer is grossly disproportionate to the fair market value of the item.

(5) Qualified plan awards.

(i) In general. Except as provided in paragraph (c)(5)(ii) of this section, the term "qualified plan award" means an employee achievement award that is presented pursuant to an established written plan or program that does not discriminate in terms of eligibility or benefits in favor of highly compensated employees. See section 414(q) of the Code for the definition of highly compensated employees. Whether an award plan is established shall be determined from all the facts and circumstances of the particular case, including the frequency and timing of any changes to the plan. Whether or not an award plan is discriminatory shall be determined from all the facts and circumstances of the particular case. An award plan may fail to qualify because it is discriminatory in its actual operation even though the written provisions of the award plan are nondiscriminatory.

(ii) Items not treated as qualified plan awards. No award presented by an employer during the taxable year will be considered a qualified plan award if the average cost of all employee achievement awards presented during the taxable year by the taxpayer under any plan described in paragraph (c)(5)(i) of this section exceeds $400. The average cost of employee achievement awards shall be computed by dividing (A) the sum of the costs to the employer for all employee achievement awards (without regard to the deductibility of those costs) by (B) the total number of employee achievement awards presented. For purposes of the preceding sentence, employee achievement awards of nominal value shall not be taken into account in the computation of average cost. An employee achievement award that costs the employer $50 or less shall be considered to be an employee achievement award of nominal value.

(d) Special rules.

(1) Partnerships. Where employee achievement awards are made by a partnership, the deduction limitations of section 274(j)(2) shall apply to the partnership as well as to each member thereof.

(2) Length of service awards. An item shall not be treated as having been provided for length of service achievement if the item is presented for less than 5 years employment.
with the taxpayer or if the award recipient received a length of service achievement award (other than an award excludable under section 132(e)(1)) during that year or any of the prior 4 calendar years. An award presented upon the occasion of a recipient's retirement is a length of service award subject to the rules of this section. However, under appropriate circumstances, a traditional retirement award will be treated as a de minimis fringe. For example, assume that an employer provides a gold watch to each employee who completes 25 years of service with the employer. The value of the gold watch is excluded from gross income as a de minimis fringe. However, if the employer provides a gold watch to an employee who has not completed lengthy service with the employer or on an occasion other than retirement, the value of the watch is not excludable from gross income under section 132(e).

(3) Safety achievement awards.

(i) In general. An item shall not be treated as having been provided for safety achievement if:

(A) During the taxable year, employee achievement awards (other than awards excludable under section 132(e)(1)) for safety achievement have previously been awarded by the taxpayer to more than 10 percent of the eligible employees of the taxpayer, or

(B) Such item is awarded to a manager, administrator, clerical employee, or other professional employee.

(ii) "Eligible employee" defined. An eligible employee is one not described in paragraph (d)(3)(i)(B) of this section and who has worked in a full-time capacity for the taxpayer for a minimum of one year immediately preceding the date on which the safety achievement award is presented.

(iii) Special rules. Where safety achievement awards are presented to more than 10 percent of the taxpayer's eligible employees, only those awards presented to eligible employees before 10 percent of the taxpayer's eligible employees are exceeded shall be treated as having been provided for safety achievement. Where the only safety achievement awards presented by an employer consist of items that are presented at one time during the calendar year, then, if safety achievement awards are presented to more than 10 percent of the taxpayer's eligible employees, the taxpayer may deduct an amount equal to the product of the cost of the item (subject to the applicable deduction limitation) and 10 percent of the taxpayer's eligible employees. Except as provided in the preceding sentence, no award shall be treated as having been provided for safety achievement except to the extent that it can be reasonably demonstrated that that award was made before the 10 percent limitation was exceeded.