

## What Are Employee Discounts Costing Your Practice?<sup>i</sup> ©

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It is fair to say most employees at veterinary practices have pets. Unsurprisingly, it is quite common for employers to offer discounts on services rendered to their employees as fringe benefits. However, there are a few caveats a practice should be aware of or their discounts may end up costing a practice more than anticipated.

*Let's imagine one of your long-time, hardworking paraprofessionals approaches you to ask if you could perform a minor elective surgery on their pet. After checking your schedule, which shows you to be free all day tomorrow, you agree to perform the surgery the following day. Your paraprofessional brings in their pet and asks you how their employee discount will apply to the operation that day. You reply:*

- A) You will receive products at cost, and I will perform the surgery for free.*
- B) You will receive products for free, and 50% off the client surgery price.*
- C) Your pet will receive extra hugs and kisses.*
- D) You will receive a 25% discount on everything today.*
- E) You will receive products at cost and 20% off of the client surgery price.*

Discounts may result in taxable income to an employee if discounts do not meet a set of specified criteria. This results in payroll taxes for both the employee and the employer, and thus it is important for both parties to pay attention to the details of employee discounts. To avoid discounts resulting in taxable income and penalties to employers:

- Services provided to employees cannot be discounted greater than 20% of what is charged to clients.
- Product sales cannot be discounted in excess of the average gross profit percentage from the previous year multiplied by the price charged to clients on the same products (the “at cost” price).
- Discounts must be offered to all of the employees, or a large enough group not to favor already highly compensated employees.

If any of these guidelines are exceeded, the discounts become taxable income and become included on W-2 forms at year-end. Subsequently, payroll taxes must then be withheld from employees and matched by employers. *Thus the best choice answer to scenario above is E – charging for products at cost, and 20% off of client prices for professional services.* This gives your paraprofessional a tax-free benefit, while avoiding payroll tax and paperwork for the

business. If the IRS did not impose these conditions, employers could exchange such benefits for lower wages, resulting in lower employee income taxes and subsequently lower payroll taxes.

Unfortunately, the few instances where fringe benefits may be excluded from an employee's wages do not apply to veterinary practices either.

- **Services at no additional cost:** While slow periods or down time may seem like “free time,” the IRS views any loss of potential revenue as a cost. Thus, time spent on an employee's animal could be spent on other patients and creating revenue. The IRS also considers employee time spent providing services as additional costs regardless of whether they would be outside normal business hours or spent “idle.”
- ***De minimis*:** Use of the company copier or printer from time to time may be one of the small perks where it would be “unreasonable or administratively impractical” to keep track of costs. Regrettably, neither veterinary service nor products fall in this category.
- **Working condition benefits:** These rules apply to property or services provided to employees to enable them to do their jobs. Providing veterinary services or products do not fall under this class of exemption.

The safest and simplest plan is to stick no more than 20% discounts on services and at least “at cost” on products purchased through the practice. One could offer greater discounts, so long as they are included as taxable income on the employee's W-2 forms and ensure proper payment of payroll taxes. One should ensure that whatever discount policies are chosen, that they are clearly described in the employee manual and consistent with the practice's policies and philosophy.

This is an excerpt of an article by Lorraine Monheiser List, CPA, CVA, entitled *Employee Discounts: Do You Know the Rules*. If you are interested in reading more about employee discounts, be sure to look for her article included next month's newsletter!

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<sup>i</sup> Monheiser-List, Lorraine. (2010). *Employee Discounts: Do You Know the Rules*. Practice Pulse, Veterinary Hospital Managers Association. Printed September, 2010.