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Employee Benefits

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What is it?

Today, a competitive employee benefit package can play an important role in an individual's employment decision making. An attractive employee benefit package will not only assist you in obtaining services that you might not otherwise be able to afford, but it might also be able to provide you with significant tax benefits.

> **Caution:** This is a highly complex subject and this discussion is intended to provide you with only a general understanding.

Welfare benefit funds

A welfare benefit fund is a method of funding a welfare benefit plan. A welfare benefit plan provides benefits for sickness, accident, disability, death, unemployment, vacation, apprenticeship or other training programs, day care centers, scholarship funds, prepaid legal services, or holiday and severance pay plans. A welfare benefit fund allows your employer to prefund your welfare benefit plan by making deposits into the fund and using those deposits to purchase the welfare benefits at a later date.

There are two types of welfare benefit funds: the welfare benefit trust, also known as a taxable trust, and the voluntary employees' beneficiary association (VEBA), also known as a nontaxable trust. Regardless of the tax status of the employer's welfare benefit fund (i.e., whether a taxable trust or nontaxable trust), you as an employee will be subject to tax with respect to any welfare benefits when the benefit is actually paid or permitted by the trust, or you may exclude the welfare benefit you receive from the trust from your income for tax purposes if and to the extent there is a statutory exclusion for an employer-paid benefit (e.g., the exclusion for health insurance paid for by the employer).

Cafeteria plans

In general

A cafeteria plan allows you to choose from an array of benefits and customize a benefits package based on your individual needs. You can purchase benefits from the plan by using either a flexible spending account or a dollar amount that your employer previously allocates to you. Cafeteria plan benefits are not included in your gross income as wages.

Taxable (cash) versus nontaxable (qualified) benefits

A cafeteria plan allows you to choose from among both taxable (cash) and nontaxable (qualified) benefits. Taxable benefits include not only cash, but also any benefits that you purchase with after-tax dollars or the benefit value that your employer would normally treat as taxable compensation. Taxable benefits can include cash, car or homeowners insurance, and group legal services. Nontaxable benefits are not included in your gross income. Nontaxable benefits can include health insurance, group term life insurance, and dependent care assistance.

Methods of funding cafeteria plans

There are numerous ways for your employer to fund your cafeteria plan. A flexible spending account allows you to contribute pretax dollars to an account that your employer can later use to reimburse you for qualified expenses. A premium-only cafeteria plan allows your employer to pay for a certain amount of your health coverage while you pay the remaining difference with pretax dollars through a salary reduction program. An add-on cafeteria plan provides you with basic low-level benefits and allows you to supplement or add on to those benefits. Under an opt-up/opt-down cafeteria plan, your employer provides both high- and low-level benefits and allows you to either decrease or increase your level of benefits. A core plus option plan allows you to supplement your benefits beyond the core benefits that your employer provides to you under the plan. Under a modular cafeteria plan, your employer combines certain benefits into packages and allows you to choose the benefit package that suits your particular needs. Under a full-flex cafeteria plan, your employer places a price on benefits and then gives you a certain number of credits with which to purchase the benefits.

Flexible spending accounts

A flexible spending account (FSA) allows you to contribute pretax dollars to an account that your employer can later use to reimburse you for qualified expenses. Since contributions are made before taxes, you save Social Security taxes, federal income tax, and, in most cases, state and local income taxes on the money you put into the account. The pretax dollars that you use to fund the account usually come from a salary reduction program.

Health reimbursement arrangements

A health reimbursement arrangement (HRA) is an arrangement that allows you to pay for medical costs using a pool of employer-provided funds. An employer establishes an HRA and contributes funds to it. You cannot make contributions. The HRA reimburses you for qualified medical expenses you've incurred, up to a maximum amount per coverage period. Reimbursements you receive are not taxable income. Unlike flexible spending accounts, HRAs allow employees to carry over unused funds from year to year.

Health savings accounts

If you are covered by a qualified high-deductible health plan at work, your employer may offer you the opportunity to participate in a health savings account (HSA). An HSA is a tax-advantaged savings account with funds earmarked for medical expenses. Amounts contributed to the HSA belong to you and are completely portable, remaining with you if you switch jobs, become unemployed, or retire. Amounts left in your account at your death may be bequeathed to a spouse or other beneficiary. Funds not spent stays in the account from year to year, earning interest tax free, and may be invested in stocks or mutual funds. Withdrawals are tax free if used for qualified medical expenses. If you use the money for non-health expenditures, you pay tax on it plus a 10% penalty. After age 65, a withdrawal used for a non-health purpose will be taxed, but not penalized.

Contributions you make may be either pretax if offered through a cafeteria plan or tax deductible (even if you do not itemize).

Types of employee benefits

In general

Employee benefits can come in the form of either cash or noncash benefits, also known as fringe benefits. Both types of benefits can help you to meet needs that otherwise could not be met. In addition, certain benefits are excludable from your gross income.

Cash compensation

Although cash compensation is not traditionally thought of as an employee benefit, it plays a major role in your overall benefit package. Some employee benefits are valued as to their cash equivalency, and others have contribution schedules that are based upon your rate of pay.

Noncash/fringe benefits

Noncash benefits, also known as fringe benefits, can include the use of a company car, parking, moving expense reimbursement, life, health, and disability insurance, dependent care assistance, adoption assistance, and tuition reimbursement. Unless the fringe benefit that your employer provides to you falls within certain exceptions, your employer must include the value of the fringe benefit in your gross income as wages. Your employer can determine the value of the fringe benefit by using either the general valuation rule or one of the special valuation rules.

General valuation rule and special valuation rules

General valuation rule

Under the general valuation rule, your employer must include, in your wages, any amount over the fair market value of a fringe benefit when it is more than:

- Any amount you paid for the benefit, or
- Any amount the law excludes from income

The fair market value of a fringe benefit is the amount you would have to pay a third party to obtain the fringe benefit.

> **Tip:** When your employer provides you with a company car, the fair market value of the car is the amount you would have to pay a third party to lease the same or a similar car in the same or similar circumstances.

Special valuation rules

Special valuation rules include the annual lease value rule, the vehicle cents-per-mile rule, the commuting rule, and the employer-operated eating facility rule. Your employer can only use the special valuation rules if certain prerequisites are met.

Annual lease value rule

If your employer provides you with a company car for an entire year, he or she can use the car's annual lease value in order to determine its value. If your employer provides you with a car for less than one year, the value of the car is either that of a prorated annual lease or a daily lease value.

If you use the car for business, you may be able to exclude part of the car's value as a working condition fringe benefit.

Vehicle cents-per-mile rule

Another way for your employer to determine the value of a company car is to use the vehicle cents-per-mile rule. Under the vehicle cents-per-mile rule, your employer values the car by using a standard mileage rate and multiplying it by the total miles that you drive for personal reasons. Your employer can use the vehicle cents-per-mile rule if your employer provides you with a vehicle that he or she would reasonably expect you to use in your employer's business or if the vehicle meets certain mileage requirements.

Commuting rule

The commuting rule values the use of a company car at $1.50 per one-way commute for each employee who commutes in the car.

Employer-operated eating facility rule

Under the employer-operated eating facility rule, an employer must include a portion of the total meal value in your gross income. The total meal value is calculated as 150 percent of the direct operating costs of the eating facility, which is considered to be the value of all meals the facility provides to employees during the year.

Section 132 benefits

In general

While your employer must include the value of most fringe benefits in your gross income, there are certain noncash/fringe benefits that the IRS specifically allows your employer to exclude from your wages. These fringe benefits are found in Section 132 of the Internal Revenue Code and include:

- No additional cost service
- Qualified employee discount
- Working condition fringe
- De minimis (minimal) fringe
- Qualified transportation fringe
- Qualified moving expense reimbursement
- Certain athletic facilities

No additional cost service

No additional cost service is service your employer provides you at no substantial additional cost to him or her. No additional cost services are usually found in excess capacity services, such as airlines, trains, buses, and cruises.

For example, an airline allows its employees to fly free on those planes that have empty seats. The airline is providing a no additional cost fringe benefit to its employees. By allowing its employees to fly free of charge on planes with empty seats, the airline provides its employees with a service that they sell to the general public, at no additional cost to the airline.

The no additional cost service that your employer provides is not includable in your gross income if your employer does not incur any substantial costs in providing that service to you.

Qualified employee discount

A qualified employee discount is a price reduction that your employer gives you on the same property or services that your employer offers to his or her customers.

> **Tip:** The no additional cost service and qualified employee discount benefits that your employer provides to you must be for property or services that he or she offers for sale to customers in the ordinary course of business in which you perform substantial services.

Working condition fringe

Working condition fringe benefits include any property or service that your employer provides whereby if you paid for the property or service, you could deduct it as a business expense.

De minimis (minimal) fringe

A de minimis fringe benefit includes any property or service that your employer provides that has so small a value that it would be unreasonable or administratively impracticable to account for it. De minimis fringe benefits include the use of a secretary to type a personal letter, occasional personal use of a copying machine, and occasional tickets to entertainment events.

> **Example(s):** Acme Corp. allows its employees to use the photocopy machine for personal use. Acme estimates that the photocopy machines are used for company business 95 percent of the time and that employees use the photocopy machines for personal use 5 percent of the time. Since

the employees' personal use of the photocopy machine is minimal, it would qualify as a de minimis fringe benefit.

Qualified transportation benefits

Qualified transportation benefits are benefits that your employer provides you with in the form of transportation in a commuter vehicle, bicycle expenses, a transit pass, or qualified parking. Qualified transportation benefits are, within certain limits, excludable from your gross income. The value of a qualified transportation benefit is based on the benefit's fair market value.

Qualified moving expense reimbursement

Qualified moving expense reimbursements are amounts that your employer gives to you, directly or indirectly, as payment for or reimbursement of expenses that would be deductible as moving expenses if you paid for or incurred them yourself. Deductible moving expenses include the moving of household goods and personal effects from the former home to the new home, and traveling from the former home to the new home if such move is in connection with the start of work at a new principal place of employment.

> **Tip:** There is no dollar limit on the exclusion for qualified moving expense reimbursements. However, the expenses must be reasonable and substantiated.

Athletic facilities

Athletic facilities include any on-premises gym or other facility that your employer provides to employees. The exclusion does not apply if your employer makes access to the athletic facility available to the general public.

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