

Cafeteria Plans

Most cafeteria plans are structured to allow an employee to elect to have money withheld from his or her paycheck which is credited to a bookkeeping account maintained by the employer. The employer then draws upon the account to reimburse employees for a variety of plan benefits such as health insurance, group term life insurance, medical care and dependent care assistance. Money withheld to pay for plan benefits is not subject to federal or state income tax and it is also not subject to social security or medicare tax. A Michigan employee in the 15% tax bracket electing to defer \$5,000 in a given year under a cafeteria plan would increase his take-home pay in that year by \$1,337.50. A Michigan employee in the 27% tax bracket would save approximately \$1,937.50. The employer would save \$382.50 social security and medicare taxes on that employee.

A second form of a cafeteria plan is one where the employer contributes all the funds into the plan. Employees may then elect to receive reimbursement from the plan for the costs that are allowed under the plan or to take their share of the contributions in cash. The contributions made by the employer would be deductible on the employer's income tax return.

Even with expenses that otherwise may be deductible, such as medical expenses, a cafeteria plan can be advantageous for the employee if a floor on deductibility would otherwise apply and because the cafeteria plan saves both state income and social security tax.

A cafeteria plan must comply with basic requirements established by the specific IRS Code sections dealing with cafeteria plans, as well as any section of the Code prescribing rules applicable to the particular benefit being offered. A cafeteria plan must be in writing and nondiscriminatory.

A cafeteria plan may not offer; scholarships or fellowships, educational assistance programs, medical savings accounts, long-term care insurance, or certain fringe benefits such as no-additional-cost services, employee discounts, qualified moving expense reimbursements, and qualified transportation fringes.

Qualified benefits include any other employer-provided welfare benefits that employees are allowed to exclude from their income because of specific provisions of the law. Generally, qualified benefits include accident or health plans, dependent care assistance benefits, group term life insurance, and certain medical reimbursements. The cost of group term life insurance in excess of \$50,000, and employer-provided dependent group term life insurance also may be provided even though they are includible in gross income.

Qualified benefits under a cafeteria plan are not subject to social security, Medicare, and Federal unemployment taxes, or income tax withholding. If an employee elects to receive cash instead of any qualified benefit, it is treated as wages subject to all employment taxes.

The costs incurred by the employer would include monthly/quarterly fees charged by an administrator which are typically hired to setup and administer the plan.

All participants in a cafeteria plan must be employees - either current or former employees. In addition, a cafeteria plan can pay benefits to spouses and other beneficiaries of employees but such spouses and other beneficiaries may not participate in the cafeteria plan.

If, in any plan year, your cafeteria plan discriminates in favor of highly compensated individuals as to eligibility to participate in the plan or as to plan contributions or benefits, highly compensated participants are taxed on the amount of the taxable benefits that could have been elected.