Welcome! We will begin at 3 p.m. ET.

There will be no sound until we begin the webinar.

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Taxation of Benefits

Presented by Benefit Comply

April 2025

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Taxation Of Benefits

- Default rule
  - Anything of value provided by an employer to an employee is taxable unless there is a specific provision in the tax code that makes it tax free.
- Generally, if a benefit is tax-free, it is not subject to either state or federal income taxes or FICA taxes but there are exceptions, e.g.
  - Adoption assistance is not subject to income taxes but is subject to FICA taxes
  - HSA contributions are subject to state income taxes in California and New Jersey
- Three issues when discussing taxation of benefits.

Are employer contributions tax-free or taxable?

Are employee contributions tax-free (pretax) or taxable (after tax)?

Are benefit payments tax-free or taxable?

  - Special case: life insurance.

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Medical, Dental, and Vision Coverage

Employer Contributions	Employee Contributions	Benefits
Tax-free [1]	Tax-free / pretax [2]	Tax-free [3]

[1] Slide 4,5
[2] Slide 4,5,6
[3] Slide 7

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Medical, Dental, and Vision Coverage

- Coverage is tax free for:
  - Current and former employees;
  - Spouses;
  - Children under age 27 as of the last day of the year;
  - Tax dependents

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Medical, Dental, and Vision Coverage

- Coverage is not tax free for:
  - Independent contractors, board members, other non-employee workers
  - Domestic partners and children who are not employee's tax dependents
  - Children over age 27 who are not employee's tax dependent, e.g. disabled adult children
  - Ex-spouses
- For these individuals:
  - Value of coverage paid by employer must be reported as taxable income to the employee/ worker (imputed income)
  - Portion of coverage paid by employee / worker must be paid after tax.
    - Alternatively employee (*not* non-employee workers) can pay dependent premium pretax but full value of coverage must be reported as imputed income.

Medical, Dental and, Vision Coverage

- Owners & Family Members
  - Sole proprietors, partners in a partnership, members of LLC taxed as a partnership, 2%+ S-corp owners cannot participate in cafeteria plan
    - Any medical, dental and vision premium must be paid after tax.
  - Spouse, children, parents, and grandparents of 2%+S-corp owner also cannot participate in cafeteria plan.
    - If employees, these individuals must also pay medical, dental and vision premiums after tax.

Medical, Dental, and Vision Coverage

- If plan is self-funded (including level funded plans) §105(h) nondiscrimination rules apply.
- If plan favors highly compensated individuals (HCI), some or all of the benefits may be taxable
  - HCI:
    - Five highest paid officers.
    - 10%+ shareholder
    - Highest paid 25% of all employees
  - Examples:
    - Non-HCIs cannot participate in plan
    - HCIs pay less for coverage
    - HCIs receive better benefits, e.g. lower deductible or max OOP

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HRA

Employer Contributions	Employee Contributions	Benefits
Tax-free [1]	N/A	Tax-free [2]

[1] Slide 9,10
[2] Slide 9,10

HRA

- Coverage is tax free for same groups as medical, dental and vision (see slide 4).
  - Domestic partners and their children can participate in HRA but value of coverage must be reported as taxable income if they are not tax dependents.
  - Unclear if other individuals can participate in HRA if they are taxed or must simply be excluded from the plan

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HRA

- Owners
  - Sole proprietors; partners in a partnership; members in LLC taxed as a partnership; 2%+ S-corp owners; and spouse, children, parents, and grandparents of 2%+S-corp owner cannot participate in HRA
  - Unclear if these individuals can participate if they are taxed on the value of the benefit.
- Non-discrimination
  - HRAs are self-funded plans so §105(h) nondiscrimination rules apply
  - HCIs are taxed on value of excess benefit under HRA, e.g. larger HRA contributions.

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HSA

Employer Contributions	Employee Contributions	Benefits
Tax-free [1]	Tax-free [2]	Tax-free [3]

[1] Slide 12,15
[2] Slide 12,14, 15
[3] Slide 13

HSA

- Employer and employee payroll contributions to HSA are tax-free as long as it is reasonable for the employer to believe the employee is entitled to tax-free contributions at the time the contribution is made.
  - Enrolled in QHDHP
  - Not enrolled in non-HDHP coverage, e.g. Medicare, general purpose Health FSA
  - Contributions have not exceeded annual contribution limit
- Employer only required to monitor coverage and contributions through its own plans, not outside coverage or contributions
- Contributions in excess of maximum contribution limit are subject to income taxes and excise taxes.
  - Excise taxes can be avoided if excess is removed by April 15 of the following year
  - Maximum contribution limit may be prorated if employee is not HSA eligible the entire year

HSA

- Distributions from HSA are tax-free if used to pay:
  - Eligible medical expenses (IRC §213(d))
  - Employee, spouse, and tax dependents
  - **Note:** Medical expenses of adult children, domestic partners, and their children who are not tax dependents are *not* tax-free
- Distributions not used to pay for eligible medical expenses are subject to income taxes and a 20% penalty
  - Penalty no longer applies once account holder reaches age 65, but must still pay income taxes on non-medical distributions

HSA

- Owners
  - Sole proprietors; partners in a partnership; members in LLC taxed as a partnership; 2%+ S-corp owners; and spouse, children, parents, and grandparents of 2%+S-corp owner cannot make or receive pretax payroll contributions to an HSA
  - They *can* make after tax contributions then take a tax deduction at the end of the year.

Health FSA / DCAP

Employer Contributions	Employee Contributions	Benefits
Tax-free [1]	Tax-free [2]	Tax-free [3]

[1] Slide 16
[2] Slide 17
[3] Slide 18, 19

Health FSA / DCAP

- Most employers do not contribute to Health FSA or DCAP. If they do:
  - Employer health FSA contributions must not exceed $500 per year but do not count against employee's annual FSA contribution limit
  - Employer DCAP contributions will count against $5000 annual DCAP contribution limit
- Employee contributions
  - Health FSA – cannot exceed $3,300 (2025)
  - DCAP – cannot exceed $5000 (split between spouses)

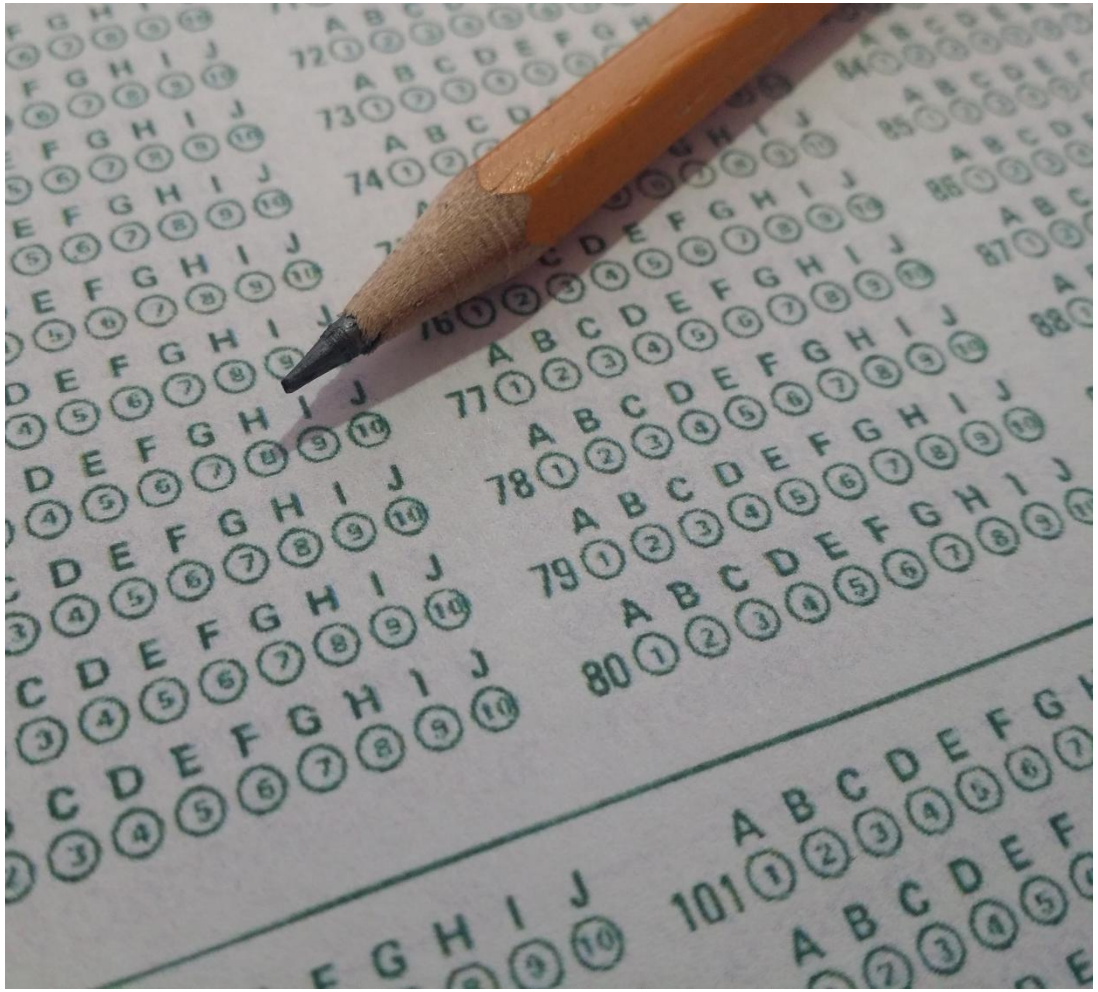
Health FSA / DCAP

- Health FSA
  - Medical expenses of current and former employees; spouses; children under age 27 as of the last day of the year; and tax dependents.
- DCAP
  - Day care expenses for qualified individual incurred to allow employee and spouse to be gainfully employed.

Health FSA / DCAP

- Owners
  - Sole proprietors; partners in a partnership; members in LLC taxed as a partnership; 2%+ S-corp owners; and spouse, children, parents, and grandparents of 2%+S-corp owner cannot make or receive Health FSA or DCAP contributions

Health FSA / DCAP



- Nondiscrimination
  - Health FSA (§105(h)) and DCAP (§129) subject to nondiscrimination testing. Also subject to overall §125 cafeteria plan nondiscrimination testing.
  - Multiple tests under each tax code section
  - Definition of key / highly compensated different under each test.
  - If any of the tests are failed HCI / key employees will lose some or all of the tax benefit of the Health FSA / DCAP.
    - Portion of their pretax contributions will have to be converted to taxable income.

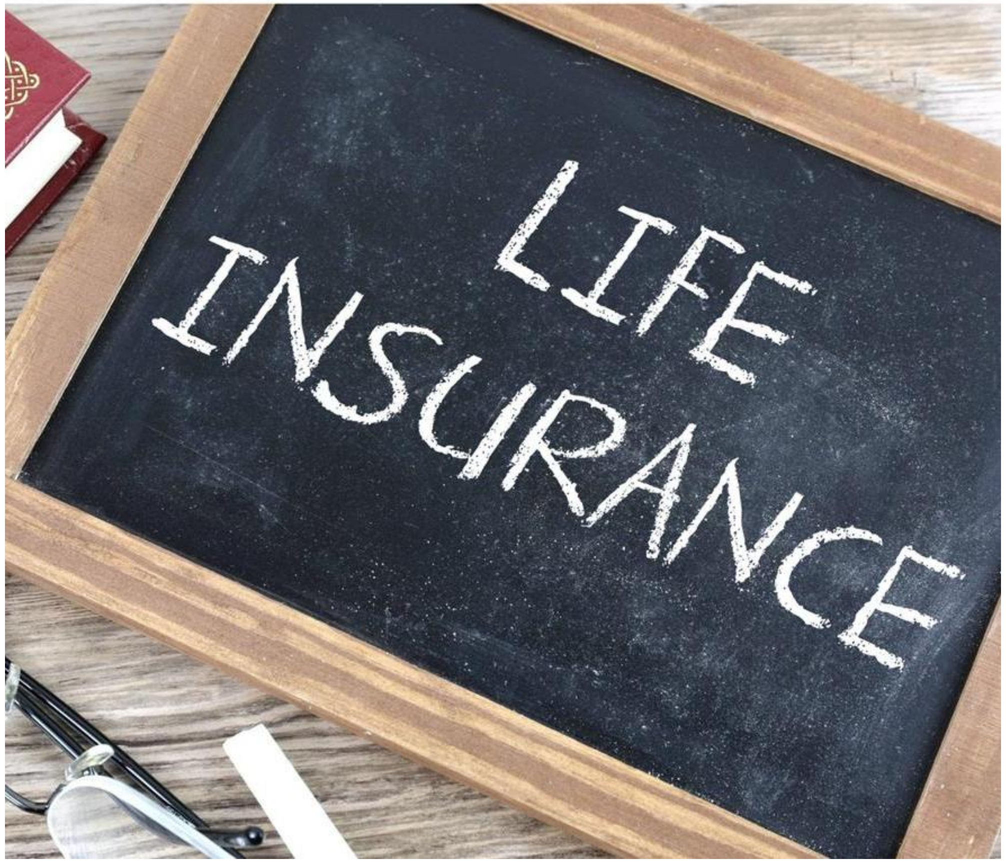
Employee Life Insurance

Employer Contributions	Employee Contributions	Benefits
Tax-free [1]	Can pretax but not recommended [2]	Tax-free

[1] Slide 21, 22, 24
[2] Slide 23

Employee Life Insurance

- First $50,000 of employer carried life insurance can be provided tax free.
  - Amounts in excess of $50,000 result in taxable imputed income based on Table 1 rates (see next slide)
  - Life insurance is “carried” by employer if i) employer pays premiums (including employee pretax premiums); or ii) premiums straddle the Table I rates, i.e. at least one employee’s premium is higher than Table I rates and at least one employee’s premium is less than Table I rates.



Employee Life Insurance – Table I Rates

Age bracket	Monthly Cost per $1,000
Under 25	$0.05
25 to 29	0.06
30 to 34	0.08
35 to 39	0.09
40 to 44	0.10
45 to 49	0.15
50 to 54	0.23
55 to 59	0.43
60 to 64	0.66
65 to 69	1.27
70 and above	2.06

Employee Life Insurance

- If employee pays voluntary life insurance premiums pretax, policy will be carried by employer and count towards $50,000 in tax free coverage.
  - E.g. Employer provides $50,000 in employer paid basic life. 50 yr old employee purchases additional $100,000 voluntary life.
  - Voluntary life premiums paid after tax – no taxable life insurance, $0 imputed income
  - Voluntary life premiums paid pretax - $100,000 in taxable life insurance, $23 / month imputed income

Employee Life Insurance

- Nondiscrimination.
  - If key employees receive discriminatory benefit, they lose tax break on first $50,000 of coverage.
    - Officer w/ compensation in excess of $230,000 (2025)
    - More than 5% owner
    - More than 1% owner w/ compensation in excess of $150,000
  - Employer providers $50,000 basic life to employees; $250,000 basic life to executives, all of whom earn more than $230,000
    - Taxable life insurance = $250,000

Dependent Life Insurance

Employer Contributions	Employee Contributions	Benefits
Tax-free [1]	Taxable/post-tax [2]	Tax-free

[1] Slide 26
[2] Slide 26

Dependent Life Insurance

- $2000 in employer paid life insurance can be provided tax free
    - If employer providers more than $2000 in coverage, entire coverage amount results in taxable imputed income, not just amounts above $2000
- Dependent life insurance premiums cannot be paid pretax.

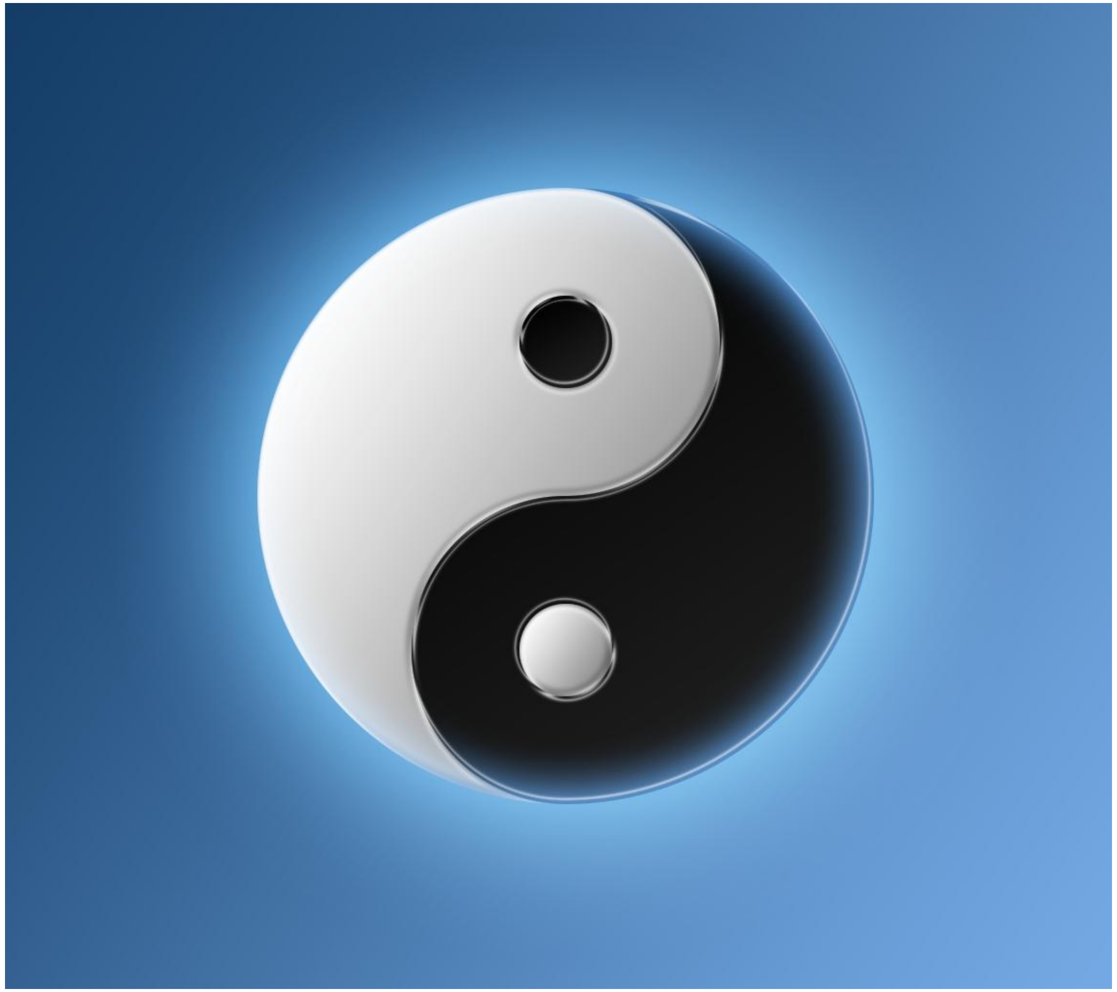
Short & Long Term Disability

Employer Contributions	Employee Contributions	Benefits
Tax-free but can be paid as taxable income	Can pretax but not recommended	Varies [1]

[1] Slide 28, 29

Short & Long Term Disability

- Disability premiums taxed
  - Disability benefits tax free
- Disability premiums not taxed
  - Disability benefits taxed
- Disability premiums in a given plan year are a mix of taxed and not taxed
  - Pro rata amount of disability benefit taxed based on three-year look back of amount of taxed and not taxed premiums.
- Self-funded disability benefits are generally taxable
  - Subject to special rules if employee contributions are required.



Short & Long Term Disability

- Employer premiums can be reported as taxable wages and taxes withheld to make benefits tax free (“gross up”).
- Employee premiums can be paid pretax but generally do not recommend it to avoid taxable benefits
- Disability carrier needs to know if premiums are taxed or not to properly administer tax on benefits
- Withholding and paying payroll taxes on disability benefits is complex and may involve carrier, employer or both.
  - See IRS Publication 15A, 6. Sick Pay Reporting

Indemnity Plans (Hospital, Cancer, AD&D, etc.)

Employer Contributions	Employee Contributions	Benefits
Tax-free but can be paid as taxable income	Can pretax but not recommended	Varies [1]

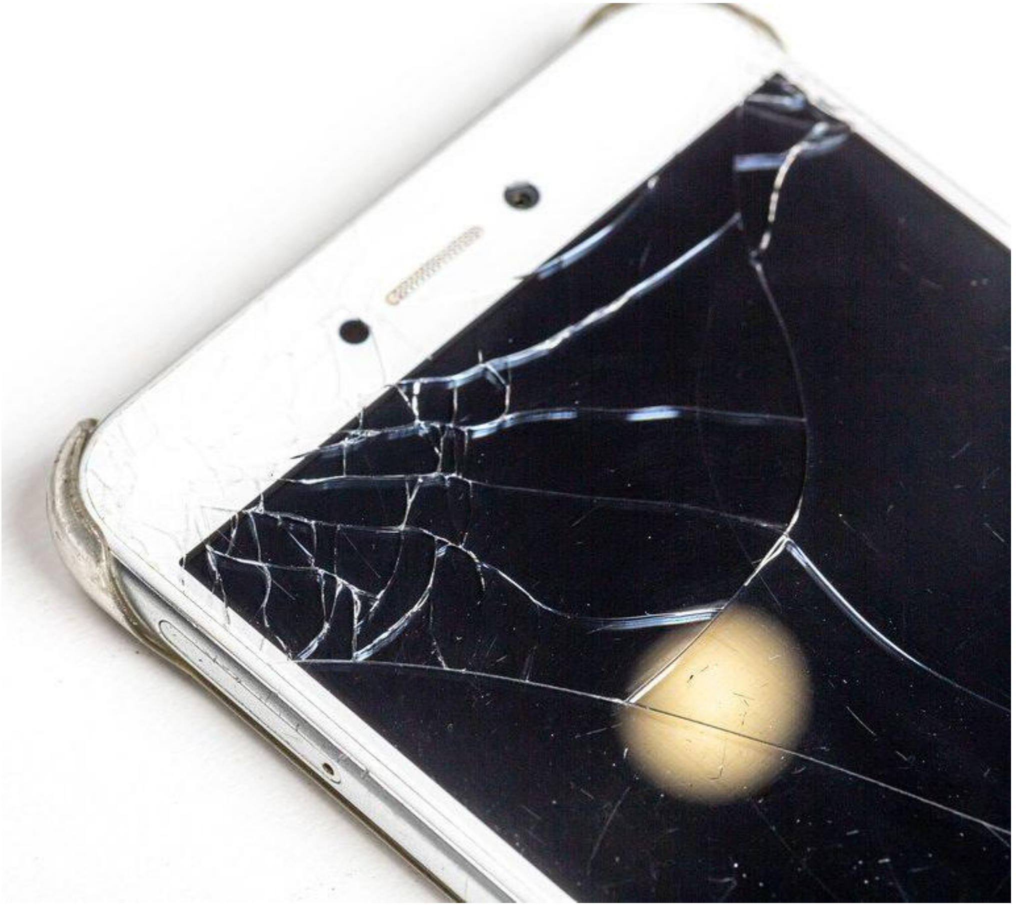
[1] Slide 28, 29

Indemnity Plans (Hospital, Cancer, AD&D, etc.)

- Premiums taxed
  - Benefits tax free
- Premiums not taxed
  - Benefits taxed to the extent they exceed actual out of pocket medical costs
  - Currently no procedures for carrier or employer to report or withhold taxes on benefits
  - Employees must report and pay any such taxes on their own

Indemnity Plans (Hospital, Cancer, AD&D, etc.)

- Wellness Tax Schemes
  - Take different forms but often rely on indemnity plans.
  - Basic structure
    - Employees pay large monthly pretax premiums (~$1000)
    - Employee completes various health related activities, often nothing more than wellness coaching with a dietitian or nurse for which they are paid amount close to premiums supposedly tax free.
    - Net effect is significant reduction in taxable income and increase in take home pay.
  - IRS has stated repeatedly these schemes do not work – back end payments are not, in fact, tax free and result in taxable income.



Other Benefits

- Tax free
  - Qualified transportation plans
  - Long term care (but not employee premiums)
  - Adoption assistance (but subject to FICA taxes)
  - Educational assistance (up to $5,250)
- Taxable
  - Cash and cash equivalents (e.g. gift cards)
  - Wellness rewards (unless otherwise tax free, e.g. HSA / HRA contributions)
  - Lifestyle Accounts

Questions

Webinar Wrap-Up

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