

# FINANCIAL FORUM

**Q** Section 125 of the federal Revenue Act of 1978 established cafeteria plans under which an employee can choose between cash and a variety of employer-provided benefits without having to include the value of the chosen benefits as taxable income.

**Q** Generally, there are two types of cafeteria plans:

1. *Employer-sponsored benefits*—Typical employer-sponsored benefits available under a cafeteria plan can include accident and health insurance, group term life insurance, and/or a dependent care program. Under this type of plan, the employer gives the participating employee a choice between the benefits available under the cafeteria plan and a cash payment. If the participating employee chooses the plan benefits, no cash amount is included in the employee's income. If cash is selected by the employee, the payment is included in the employee's gross income as compensa-

tion. An employer-sponsored cafeteria plan must limit the choices offered to either qualified benefits or cash.

2. *Employee-paid benefits*—This type of cafeteria plan allows the participating employee to establish a flexible spending account to pay for certain benefits with pre-tax dollars. A cafeteria plan for employee-paid benefits can be comprised of one or more of the following:

Employee payment for insurance premiums for health, dental, vision, accidental death and dismemberment, cancer, disability, or group term life insurance (up to \$50,000 coverage);

A flexible spending account into which a portion of the employee's pre-tax wages are placed and are available for reimbursing medical expenses not covered by employer-provided or other insurance.

A flexible spending account into which a portion of their pre-tax wages are placed and are available for reimbursing dependent child care expenses.

In summary, the employer-sponsored cafeteria plan provides a choice of cash in lieu of tax-free employer-provided benefits, whereas an employee-paid benefit cafeteria plan allows an employee to pay with before-tax earnings for certain eligible expenses.

To learn more about the options available when implementing a cafeteria plan, contact your township auditor.

**Q**

Implementing a cafeteria plan can be beneficial for the employer and the em-

ployee. Employees can select their benefits, reduce income taxes, avoid duplicate coverage in dual-income families, and learn more about the value of benefits. Employers can actively manage costs by shifting benefit costs to employees, reducing FICA payroll taxes, offering employees additional benefits without substantially increasing costs, attracting employees by offering a competitive benefits package, and increasing employee awareness and appreciation of employer-provided benefits.

**Q**

Yes, all employers with a Section 125 cafeteria plan must file IRS Form 5500, which is an annual information return that reports the number of employees participating in the plan and the employer's actual costs. This form is typically prepared by the plan administrator or the township's accountants. The IRS imposes penalties for failure to file and late filing of Form 5500. The good news is that the IRS has recently reworked its Form 5500 to make it easier to understand and complete.

**Q**

Yes. There is no minimum number of employees or employer income level required to establish a cafeteria plan. The township board must consider the needs of its employees and the difficulty it experiences in attracting new employees to fill township positions. There are some startup and administrative costs associated with Section 125 cafeteria plans, however these can be minimal compared to the difficulties and costs of replacing experienced employees.



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*Financial Forum is a monthly discussion of current township finance, accounting and budgeting practices. Our forum members this month are Roger Gray, CPA, Yeo & Yeo, Alma, and Larry Merrill, MTA Executive Director. Financial questions are always welcome and may be sent to the editor for forwarding to the panel.*