PacificCPE

COURSE
34101C

Employer's Guide to Fringe Benefits

Get a solid foundation in employer-provided fringe benefits, from the ground up. This course walks through the essential framework every payroll and tax professional needs: how fringe benefits are categorized, which exclusion rules apply, how to properly value taxable benefits, and what withholding, depositing, and reporting obligations employers must meet. Whether you're new to fringe benefits or looking to sharpen your compliance skills, this course covers the core rules that apply across virtually every employer situation.

CREDIT HOURS 2 | FIELD OF STUDY TAXES | EXAM QUESTIONS 10

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LEARNING ASSIGNMENTS AND OBJECTIVES

Assignment

- Study the full course materials included here.
- Complete the review questions after each chapter.
- Answer 10 final exam questions.
- Final exam is scored immediately, 70% or better passes.
- Certificate of completion is available in your account.
- Failed exams can be retaken free of charge.

Course Objectives

- Identify various cafeteria plan benefits.
- Identify exclusions that apply to some fringe benefits.
- Recall how to value fringe benefits.
- Recall various requirements for withholding and reporting taxable fringe benefits.

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Chapter 1: FRINGE BENEFIT OVERVIEW

Chapter Objective

After completing this chapter, you should be able to:

- Identify various cafeteria plan benefits.

A fringe benefit is a form of pay for the performance of services. For example, you provide an employee with a fringe benefit when you allow the employee to use a business vehicle to commute to and from work.

Performance of services. A person who performs services for you does not have to be your employee. A person may perform services for you as an independent contractor, partner, or director. Also, for fringe benefit purposes, treat a person who agrees not to perform services (such as under a covenant not to compete) as performing services.

Provider of benefit. You are the provider of a fringe benefit if it is provided for services performed for you. You are considered the provider of a fringe benefit even if a third party, such as your client or customer, provides the benefit to your employee for services the employee performs for you. For example, if, in exchange for goods or services, your customer provides daycare services as a fringe benefit to your employees for services they provide for you as their employer, then you are the provider of this fringe benefit even though the customer is actually providing the daycare.

Recipient of benefit. The person who performs services for you is considered the recipient of a fringe benefit provided for those services. That person may be considered the recipient even if the benefit is provided to someone who did not perform services for you. For example, your employee may be the recipient of a fringe benefit you provide to a member of the employee's family.

ARE FRINGE BENEFITS TAXABLE?

Any fringe benefit you provide is taxable and must be included in the recipient's pay unless the law specifically excludes it. Chapter 2 discusses the exclusions that apply to certain fringe benefits. Any benefit not excluded under the rules discussed in Chapter 2 is taxable.

Including taxable benefits in pay. You must include in a recipient's pay the amount by which the value of a fringe benefit is more than the sum of the following amounts.

- Any amount the law excludes from pay.
- Any amount the recipient paid for the benefit.

The rules used to determine the value of a fringe benefit are discussed in Chapter 3.

If the recipient of a taxable fringe benefit is your employee, the benefit is subject to employment taxes and must be reported on Form W-2, Wage and Tax Statement. However, you can use special rules to withhold, deposit, and report the employment taxes. These rules are discussed in Chapter 4. If the recipient of a taxable fringe benefit is not your employee, the benefit is not subject to employment taxes. However, you may have to report the benefit on one of the following information returns.

If the recipient receives the benefit as	Use
An independent contractor	Form 1099-NEC, Nonemployee Compensation
A partner	Schedule K-1 (Form 1065), Partner's Share of Income, Deductions, Credits, etc.

For more information, see the instructions for the forms listed above.

CAFETERIA PLANS

A cafeteria plan, including a flexible spending arrangement (FSA), provides participants an opportunity to receive qualified benefits on a pre-tax basis. It is a written plan that allows your employees to choose between receiving cash or taxable benefits instead of certain qualified benefits for which the law provides an exclusion from wages. If an employee chooses to receive a qualified benefit under the plan, the fact that the employee could have received cash or a taxable benefit instead will not make the qualified benefit taxable.

Generally, a cafeteria plan does not include any plan that offers a benefit that defers pay. However, a cafeteria plan can include a qualified 401(k) plan as a benefit. Also, certain life insurance plans maintained by educational institutions can be offered as a benefit even though they defer pay.

Qualified benefits. A cafeteria plan can include the following benefits discussed in Chapter 2.

- Accident and health benefits (but not Archer medical savings accounts (Archer MSAs) or long-term care insurance).
- Adoption assistance.
- Dependent care assistance.
- Group-term life insurance coverage (including costs that cannot be excluded from wages).
- Health savings accounts (HSAs). Distributions from an HSA may be used to pay eligible long-term care insurance premiums or qualified long-term care services.

Benefits not allowed. A cafeteria plan cannot include the following benefits discussed in Chapter 2.

- Archer MSAs. See Accident and Health Benefits in Chapter 2.
- Athletic facilities.
- De minimis** (minimal) benefits.
- Educational assistance.
- Employee discounts.
- Employer-provided cell phones.
- Lodging on your business premises.
- Meals.
- No-additional-cost services.
- Retirement planning services.
- Transportation (commuting) benefits.
- Tuition reduction.
- Working condition benefits.

It also cannot include scholarships or fellowships.

Contribution limit on a health flexible spending arrangement (FSA). For plan years beginning in 2026, a cafeteria plan may not allow an employee to request salary reduction contributions for a health FSA in excess of $3,400.

A cafeteria plan that does not limit health FSA contributions to the dollar limit is not a cafeteria plan, and all benefits offered under the plan are includible in the employee’s gross income. “

Use-or-lose" rule for health FSAs. Instead of a grace period, you may, at your option, amend your cafeteria plan to allow an employee's unused contributions to carryover to the immediately following plan year.

Employee. For these plans, treat the following individuals as employees.

- A current common-law employee.
- A full-time life insurance agent who is a current statutory employee.
- A leased employee who has provided services to you on a substantially full-time basis for at least a year if the services are performed under your primary direction or control.

Exception for S corporation shareholders. Do not treat a 2% shareholder of an S corporation as an employee of the corporation for this purpose. A 2% shareholder for this purpose is someone who directly or indirectly owns (at any time during the year) more than 2% of the corporation's stock or stock with more than 2% of the voting power. Treat a 2% shareholder as you would a partner in a partnership for fringe benefit purposes, but do not treat the benefit as a reduction in distributions to the 2% shareholder.

Plans that favor highly compensated employees. If your plan favors highly compensated employees as to eligibility to participate, contributions, or benefits, you must include in their wages the value of taxable benefits they could have selected. A plan you maintain under a collective bargaining agreement does not favor highly compensated employees.

A highly compensated employee for this purpose is any of the following employees.

1. An officer.
2. A shareholder who owns more than 5% of the voting power or value of all classes of the employer's stock.
3. An employee who is highly compensated based on the facts and circumstances.
4. A spouse or dependent of a person described in (1),(2), or (3).

Plans that favor key employees. If your plan favors key employees, you must include in their wages the value of taxable benefits they could have selected. A plan favors key employees if more than 25% of the total of the nontaxable benefits you provide for all employees under the plan go to key employees. However, a plan you maintain under a collective bargaining agreement does not favor key employees.

A key employee during 2026 is generally an employee who is either of the following.

1. An officer having annual pay of more than $235,000.
2. An employee who for 2026 is either of the following.
    a) A 5% owner of your business.
    b) A 1% owner of your business whose annual pay was more than $150,000.

SIMPLE CAFETERIA PLANS FOR SMALL BUSINESSES

Eligible employers meeting contribution requirements and eligibility and participation requirements can establish a simple cafeteria plan. Simple cafeteria plans are treated as meeting the nondiscrimination requirements of a cafeteria plan and certain benefits under a cafeteria plan.

Eligible employer. You are an eligible employer if you employed an average of 100 or fewer employees during either of the 2 preceding years. If your business was not in existence throughout the preceding year, you are eligible if you reasonably expect to employ an average of 100 or fewer employees in the current year. If you establish a simple cafeteria plan in a year that you employ an average of 100 or fewer employees, you are considered an eligible employer for any subsequent year until the year after you employ an average of 200 or more employees.

Eligibility and participation requirements. These requirements are met if all employees who had at least 1,000 hours of service for the preceding plan year are eligible to participate and each employee eligible to participate in the plan may elect any benefit available under the plan. You may elect to exclude from the plan employees who:

1. Are under age 21 before the close of the plan year,
2. Have less than 1 year of service with you as of any day during the plan year,
3. Are covered under a collective bargaining agreement if there is evidence that the benefits covered under the cafeteria plan were the subject of good-faith bargaining, or
4. Are nonresident aliens working outside the United States whose income did not come from a U.S. source.

Contribution requirements. You must make a contribution to provide qualified benefits on behalf of each qualified employee in an amount equal to:

1. A uniform percentage (not less than 2%) of the employee’s compensation for the plan year, or

2. An amount which is at least 6% of the employee’s compensation for the plan year or twice the amount of the salary reduction contributions of each qualified employee, whichever is less.

If the contribution requirements are met using option (2), the rate of contribution to any salary reduction contribution of a highly compensated or key employee cannot be greater than the rate of contribution to any other employee.