

Fringe Benefits and Federal Employment Tax Overview

Fringe benefits and payroll taxes are everyday issues for CPAs who handle business clients or individual returns. This course covers the tax treatment of common fringe benefits—including how they interact with employment taxes and where exceptions apply—and provides a foundational overview of federal employment taxes. Clear examples help translate the rules into practical application. If you regularly advise employers or prepare business returns, this course reinforces the core concepts you need to stay sharp.

CREDIT HOURS 2 | FIELD OF STUDY BUSINESS | 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 how certain fringe benefits should be treated for tax purposes.
- Recognize federal employment tax obligations of employers.

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Chapter 1: FRINGE BENEFITS

Chapter Objective

After completing this chapter, you should be able to:

- Identify how certain fringe benefits should be treated for tax purposes.

I. OVERVIEW

A fringe benefit is a form of pay for the performance of services. For example, an employer provides an employee with a fringe benefit when they allow the employee to use a business vehicle to commute to and from work. Fringe benefits can also be provided to independent contractors, who are not technically employees but provide specified services to the business pursuant to a contract.

A. TAXATION OF FRINGE BENEFITS

As a general rule, any fringe benefit that is provided by an employer must be included in the recipient's pay unless the law specifically excludes it. The exclusions that apply to certain fringe benefits are discussed below. Any benefit not excluded under the rules discussed below is taxable. Employers 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; and
- Any amount the recipient paid for the benefit.

The rules used to determine the value of a fringe benefit are discussed later in this section.

If the recipient of a taxable fringe benefit is an employee, the benefit is subject to employment taxes and must be reported on Form W-2, Wage and Tax Statement. However, employers may use special rules to withhold, deposit, and report the employment taxes.

If the recipient of a taxable fringe benefit is not an employee, the benefit is not subject to employment taxes. However, the business owner 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-MISC
A partner	Schedule K-1 (Form 1065)
An S corporation shareholder	Schedule K-1 (Form 1120S)

B. CAFETERIA PLANS

A cafeteria plan, including a flexible spending arrangement, is a written plan that allows 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.

1. Qualified Benefits

Qualified benefits include the following benefits:

- Accident and health benefits (but not medical savings accounts or long-term care insurance);
- Adoption assistance;
- Dependent care assistance; and
- Group-term life insurance coverage (including costs that cannot be excluded from wages).

2. Benefits Not Allowed

A cafeteria plan cannot include the following benefits:

- Archer medical savings accounts;
- Athletic facilities;
- De minimis (minimal) benefits;
- Educational assistance;
- Employee discounts;
- Lodging on your business premises;
- Meals;
- Moving expense reimbursements;

- No-additional-cost services;
- Transportation (commuting) benefits;
- Tuition reduction; and
- Working condition benefits.

It also cannot include scholarships or fellowships.

3. Employees Included

For cafeteria plans, the following individuals are treated as employees:

- A current common-law employee;
- A full-time life insurance agent who is a current statutory employee; and
- 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.

a. Exception for S Corporation Shareholders

Employers are not allowed to treat a 2% shareholder of an S corporation as an employee of the corporation.

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.

b. Plans That Favor Highly Compensated Employees

If a plan favors highly compensated employees as to eligibility to participate, contributions, or benefits, the employer must include in their wages the value of taxable benefits they could have selected.

A plan maintained under a collective bargaining agreement does not favor highly compensated employees. A highly compensated employee for this purpose is any of the following employees:

- An officer;
- A shareholder who owns more than 5% of the voting power or value of all classes of the employer's stock;
- An employee who is highly compensated based on the facts and circumstances; or
- A spouse or dependent of a person described above.

c. Plans That Favor Key Employees

If a plan favors key employees, the employer 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 it provides for all employees under the plan go to key employees. However, a plan maintained under a collective bargaining agreement does not favor key employees.

C. FRINGE BENEFIT EXCLUSION RULES

This section discusses the exclusion rules that apply to fringe benefits. These rules exclude all or part of the value of certain benefits from the recipient's pay. The excluded benefits are not subject to Federal income tax withholding.

Also, in most cases, they are not subject to social security, Medicare, or Federal unemployment (FUTA) tax and are not reported on Form W-2. This section discusses the exclusion rules for the following fringe benefits:

- Accident and health benefits;
- Achievement awards;
- Adoption assistance;
- Athletic facilities;
- De minimis (minimal) benefits;
- Dependent care assistance;
- Educational assistance;
- Employee discounts;
- Employee stock options;
- Employer-provided cell phones
- Group-term life insurance coverage;
- Health savings accounts (HSAs)
- Lodging on your business premises;
- Meals;
- Moving expense reimbursements;
- No-additional-cost services;
- Transportation (commuting) benefits;
- Tuition reduction; and
- Working condition benefits.

Table 14.1, next, provides an overview of the employment tax treatment of these benefits.

TABLE 14.1. SPECIAL RULES FOR VARIOUS TYPES OF FRINGE BENEFITS

(FOR MORE INFORMATION, SEE THE FULL DISCUSSION IN THIS SECTION.)

(FOR MORE INFORMATION, SEE THE FULL DISCUSSION IN THIS SECTION.)	Treatment Under Employment Taxes		
Type of Fringe Benefit	Income Tax Withholding	Social Security and Medicare (including Additional Medicare Tax when wages are paid in excess of \$200,000)	Federal Unemployment (FUTA)
Accident and health benefits	Exempt[1][2] except for long-term care benefits provided through a flexible spending or similar arrangement.	Exempt, except for certain payments to S corporation employees who are 2% shareholders	Exempt
Achievement awards	Exempt[1] up to \$1,600 for qualified plan awards (\$400 for nonqualified awards).		
Adoption assistance	Exempt[1][3]	Taxable	Taxable
Athletic facilities	Exempt if substantially all use during the calendar year is by employees, their spouses, and their dependent children and the facility is operated by the employer on premises owned or leased by the employer.		
De minimis (minimal) benefits	Exempt	Exempt	Exempt
Dependent care assistance	Exempt[3] up to certain limits, \$5,000 (\$2,500 for married employee filing separate return).		
Educational assistance	Exempt up to \$5,250 of benefits each year. (See Educational Assistance, later in this section.)		
Employee discounts	Exempt[3] up to certain limits. (See Employee Discounts, later in this section.)		

(FOR MORE INFORMATION, SEE THE FULL DISCUSSION IN THIS SECTION.)	Treatment Under Employment Taxes		
Type of Fringe Benefit	Income Tax Withholding	Social Security and Medicare (including Additional Medicare Tax when wages are paid in excess of \$200,000)	Federal Unemployment (FUTA)
Employee stock options	See Employee Stock Options, later in this section.		
Employer-provided cell phones	Exempt if provided primarily for noncompensatory business purposes.		
Group-term life insurance coverage	Exempt	Exempt[1][4][6] up to cost of \$50,000 of coverage. (Special rules apply to former employees.)	Exempt
Health savings accounts (HSAs)	Exempt for qualified individuals up to the HSA contribution limits. (See Health Savings Accounts later in this section.)		
Lodging on your business premises	Exempt[1] if furnished for your convenience as a condition of employment.		
Meals	Exempt if furnished on your business premises for your convenience. Exempt if de minimis.		
Moving expense reimbursements	Exempt[1] if expenses would be deductible if the employee had paid them.		
No-additional cost services	Exempt[3]	Exempt[3]	Exempt[3]