Business point

Fringe benefits attract employees

Offering benefits can keep workers satisfied and productive.

Editor's note: *Kent Vickre and Chuck Cagley write a tax and finance column for each issue of Pioneer* GrowingPoint® *magazine. Vickre is state coordinator of the Iowa Farm Business Association. Cagley is state coordinator of Illinois Farm Business Farm Management. They address issues that influence agribusiness success.*

Many growers struggle to find ways to retain valuable employees without breaking the bank through salary increases. Fringe benefits may provide some of the most valuable parts of your employee compensation package.

Surveys indicate pay isn't always the top factor in worker satisfaction. In fact, it often ranks third or lower. You might be able to improve employee attitudes by providing some relatively affordable benefits. However, you need to understand the regulations and limits involved in offering such benefits.

Fringe benefits are taxable: You must include them in the employee's income **unless a specific exclusion allows tax-free treatment.** Such benefits are called qualified

fringe benefits. A business generally can deduct the cost of providing qualified fringe benefits.

Noncash and nontaxable fringe benefits — both formal and informal — can affect both employee job satisfaction and worker retention. Let's take a look at formal benefits, then a brief look at informal benefits.

A menu of benefits

On the formal side, Section 125 of the Internal Revenue Service (IRS) Code addresses the bulk of fringe benefits with regulations on "cafeteria" plans. In such plans, the employer maintains a written plan for employees who meet specific requirements and regulations of Section 125 of the code.

Cafeteria plans provide participants an opportunity to receive certain benefits on a pretax basis. Some benefits may be entirely paid by the employer. Others may be jointly paid by the employer and the worker. Still others may be paid entirely by the worker.

When employers pay employee benefits directly, both the employer and the employee pay taxes. Wages are subject to income taxes, and both parties must pay their share of Social Security and Medicare taxes.

Cafeteria plans provide a means to exclude the government from a part of the payroll transaction. For example, if a person in the 15 percent tax bracket pays $2,000 for day care through a cafeteria plan (rather than making the payments out of earned income), he'll save $300 in federal income tax, $153 in Social Security tax and some percentage of his state tax bill. The employer also saves $153 in Social Security taxes.

As the name implies, a cafeteria plan enables an employee to choose where some of his benefit dollars are spent. Participants must be permitted to choose from at least one taxable benefit (such as cash) and one qualified benefit. A qualified benefit is a benefit that does not defer compensation and is excludable from an employee's gross income under a specific provision of the code. Qualified benefits include:

- Accident and health benefits
- Group-term life insurance coverage
- Dependent care assistance
- Health savings accounts
- Adoption assistance
- Educational assistance.

A Section 125 plan is the only way an employer can offer employees a choice between taxable and nontaxable benefits without the choice causing the benefits to be taxable. It would be best to seek qualified providers before implementing a plan.

Health insurance issues

If you're a C corporation, fringe benefits, such as health insurance, are deductible, and the owner-employee can't be taxed. However, fringe benefits paid by a sole-proprietor and certain fringe benefits paid on behalf of a partner or a subchapter S shareholder are not tax deductible.

If a partnership pays health insurance premiums for its partners, their spouses or dependents, the partnership generally can deduct the costs as guaranteed payments — if the benefits are compensation for services rendered to the partnership. The partners would then have to include guaranteed payment amounts as taxable income. The partners can deduct 100 percent of the partnership-paid health insurance premiums to determine adjusted gross income.

Other benefits in the above list cannot be deducted on the individual's tax return. Technically, partners cannot participate in a partnership-provided Section 125 cafeteria plan, because they're considered self-employed. The exception to this would be dependent care assistance as noted in Section 129.

In the case of a C corporation, the above fringe benefits can be provided tax-free to shareholder-employees if they meet the basic tax qualification rules.

Consider informal benefits

The other category of benefits, informal benefits, is worth considering. For instance, "events and experiences" can be instrumental in creating memories that are far more valuable for employee retention than higher compensation. These are called *de minimis* fringe benefits.

An employer who is communicating with his employees and is perceptive to their interests can identify items of interest. Items of interest can include occasional tickets to an area college or even high school athletic event, employee holiday parties or the seasonal turkey.

However, the de minimis fringe benefit rules are rather stringent. You cannot provide cash under these rules. For more details on what items of interest quality as fringe benefits, talk to a tax professional.