Cafeteria and 401 (k) Plans

Cafeteria Plans

A "Cafeteria Plan" is defined in the Internal Revenue Code (IRC) Section 125. It is an employer-provided benefit plan under which employees may choose among two or more fringe benefits, one of which must be cash.

Employment Department Law generally considers fringe benefits as wages. However, it excludes payments for several types of benefits. For example, payments made under an employer's plan to provide employees, employees' dependents, or domestic partners with medical insurance, life insurance, or retirement are not reportable if the payments are made directly by the employer. Dependent care benefits which additionally meet the requirements of IRC section 129(b) and (d) are also excluded from wages.

Generally, if a fringe benefit is deducted from the employee's pay, the amount is subject (or taxable) wages. That is because the employer is not paying the benefit; it is merely being passed through the employer's hands by the direction of the employee.

The one exception to this general rule is when a fringe benefit is given to an employee under a Cafeteria Plan. If the benefit is deducted from the employee's pay under an IRC Section 125 plan and the benefit is described in ORS 657.115 through 657.140, then it is considered paid by the employer and excluded from subject wages.

Example 1 (no Section 125 plan): Mary gets a monthly salary of $1,000. She chooses health insurance coverage and the employer withholds the $100 monthly premium from her check and sends it to the insurance company.

Example 1

Salary	1,000
Section 125 Benefit	+ n/a
	1,000
Insurance Premium	- 0
Reportable Wages	1,000

Example 2 (has a Section 125 plan): Mary gets a monthly salary of $1,000. The employer has a Section 125 plan and Mary chooses to take the $200 monthly benefit as follows: $100 cash and $100 health insurance premium. The employer withholds the health insurance premium from her check and sends it to the insurance company.

Example 2

Salary	1,000
Section 125 Benefit	+ 200
	1,200
Insurance Premium	- 100
Reportable Wages	1,100

In both examples the employee's base salary is $1,000 and $100 is deducted from her check for health insurance. In example 1, there is no effect on the reportable wages because the health insurance premium is not deducted under a Section 125 plan.

In example 2, the health insurance premium is deducted under a Section 125 plan. Therefore, that portion of the benefit is excluded and considered paid by the employer on behalf of the employee. The portion received as cash is added to wages.

This is not the only way to meet the "cash" requirement in a Section 125 Cafeteria plan. Voluntary withholding from wages for excludable fringe benefits also meets the cash requirement. See this in Example 3 below.

Example 3 (has a Section 125 plan): Mary gets a monthly salary of $1,000. The employer has a Section 125 plan giving her an additional $200 toward benefits. Mary chooses to take $300 in monthly benefits as follows: $150 health insurance premium and $150 dependent care expenses. The employer withholds the fringe benefits from her check and sends it to the appropriate organization.

Example 3

Salary	1,000
Section 125 Benefit	+ 200
	1,200
Insurance Premium	- 150
Dependent Care	- 150
Reportable Wages	900

Example 3 reflects the legislative change to ORS 657.115 made in 2006. Dependent care programs meeting IRC sections 129(b) and (d) will not be included in wages.

The payroll deduction constitutes the cash election of the cafeteria plan. Mary could have elected to keep all her pay, but voluntarily chose to apply it to benefits available under the cafeteria plan.

If Mary is required to select benefits and cannot elect cash, the plan fails to meet the requirements of Section 125 and the fringe benefits may be subject to tax.

401(K) PLANS

A 401(k) plan is defined in federal law. It is a plan under which an employee may choose to receive cash or to defer compensation into a qualifying trust.

Optional pre-tax (elective) employee cash contributions deferred into a trust are considered wages. Any part of an employer contribution reducing employee salary is wages. Voluntary after-tax (additional employee contributions) are wages. Cash paid to the employee in lieu of deferred compensation is wages.

Employer paid contributions, which match employee contributions (matching), and employer paid contributions that do not depend on any election or contribution by the employee are not wages.

The above applies regardless of whether or not the 401(k) plan is offered as a separate plan.

Questions

If you have questions or need additional information, please contact the Employment Department tax representative in your area or call 503-947-1488; TDD/Nonvoice Users 711 or by email at taxinfo@emp.state.or.us
You may also visit our web site at www.Oregon.gov/employ/tax