



## **Payroll & Tax Solutions from Ceridian**

- [Payroll Solutions](#)
- [Tax Filing Service](#)
- [Unemployment Compensation Management](#)

### **[Recent Payroll & Tax News](#)**

## **Employee Retirement and Benefit Plans**

The IRS code establishes a variety of tax-advantaged plans for deferring current income and for funding flexible benefit plans. Generally, these plans are funded with pretax dollars.

### **Deferred Compensation Plans**

Many employers offer their employees the option of putting aside part of their current salary and wages into a retirement account. The main advantage of these deferred compensation plans for the employee is that neither the contributions nor the accumulated worth of the account is taxed until the employee makes withdrawals.

There are two types of deferred compensation plans – qualified and nonqualified.

### **Qualified Deferred Compensation Plans**

The plan is a qualified plan if it complies with the provisions of the IRS code, Section 401. This section lays down the ground rules for plans the IRS considers as exempt from current income tax.

Qualified plans include:

- Profit Sharing Plans
- Defined Contribution Plans
- Defined Benefits Plans
- 401(k) Plans

To comply with IRS code, Section 401, a deferred compensation plan must:

- Be written and communicated to employees
- Be for the benefit of employees or their beneficiaries
- Be nontransferable
- Satisfy minimum eligibility and vesting rules
- Not discriminate in favor of higher paid employees, officers, or shareholders

### **Nonqualified Deferred Compensation Plans**

Nonqualified plans are plans outside the provisions of the IRS Code, Section 401. Even though they are called nonqualified, contributions are generally not taxable. An employer is free to offer a nonqualified plan to only those people it chooses – usually to top executives; it is offered as an extra benefit to key employees. Furthermore, the ability to discriminate is the primary difference between a nonqualified plan and one set up under Section 401.

Nonqualified plans are promises by the employer to pay the employee an amount at a future time. Payments can be in lump sum or over time. Usually there is no special account set up. The amount is not subject to income tax provided that it is nontransferable and that it is subject to substantial risk of forfeiture.

Nonqualified plans are subject to Social Security and Medicare taxes.

#### **Flexible Benefit Plans**

Employers try to meet the diverse needs of employees in varying family situations. The result is flexible benefit plans, also called cafeteria plans.

The cafeteria style benefit package lets employees select the benefits they desire most from among a menu of options.

To qualify under IRS code 125, a menu must include at least two benefits consisting of cash and at least one additional benefit. Examples of these benefits must include the following:

- Medical/Dental Coverage
- Group Life Insurance up to \$50K
- Disability Insurance
- Dependent Care
- 401(k) or other retirement plan

#### **Tax Implications of Cafeteria Plans**

Most provisions of flexible benefit plans are paid with pretax dollars. That is, there is nothing withheld from the paycheck in recognition of the value of these benefits. However, the exception is when a benefit is converted to cash. For example, some employers let employees "sell" vacation days back to the employer. The cash received for selling back a benefit is taxable income.

#### **Flexible Spending Accounts**

A cafeteria plan can include a retirement fund called a flexible spending account. For example, the employee could get reimbursed for uninsured medical expenses or childcare expenses.

The money in flexible spending accounts is pretax money. That is, the amount set aside reduces the employee's taxable earnings.