# ERISA Roundup

A quarterly recap of recent publications from BDO's ERISA Center of Excellence

Q4 2024

BDO

# A Note from BDO's ERISA Practice Leaders

The start of a new year is a great time to take a moment and check and evaluate your total employee benefit plan package. Through BDO's ERISA Center of Excellence and this publication, we discuss trends impacting the industry and regulations to keep top of mind, especially as there are new employee benefit plan provisions taking effect in 2025 driven by existing laws and the Setting Every Community Up for Retirement Enhancement Act of 2022 (SECURE 2.0).

Our ERISA practice leadership team is also thrilled to welcome Karolyn Ladas to BDO. Karolyn is an Assurance Principal specializing in Employee Benefit Plan Audits and brings over 20 years of experience. We look forward to continuing to serve our clients by providing valuable guidance and are excited about Karolyn's fresh perspective and leadership.

Staying current on ERISA topics is simplified with BDO: Follow along with our regular insights at our BDO ERISA Center of Excellence and our podcast series BDOTalksERISA. We welcome your feedback on our content at BDOTalksERISA@BDO.com.

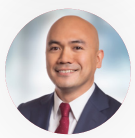
**MARY ESPINOSA**
Assurance Principal
Employee Benefit Plans

**ERIN BREIT**
Assurance Principal
Employee Benefit Plans

**LUANNE MACNICOL**
Assurance Principal
Employee Benefit Plans

**JESSICA FRIEDLY**
Assurance Principal
Employee Benefit Plans

**KAROLYN LADAS**
Assurance Principal
Employee Benefit Plans



**MICHAEL BELONIO**
Assurance Principal
Employee Benefit Plans

BDO's ERISA Center of Excellence is your source for insights on emerging regulations, industry trends, current topics, and more. Visit us at www.bdo.com/erisa or follow along on Twitter: @BDO_USA and #BDOERISA.

# In this Issue

# 2025 Deadlines and Important Dates

Sponsors of defined benefit and defined contribution retirement plans should keep the following deadlines and other important dates in mind as they work toward ensuring compliance for their plans in 2024. Dates assume a calendar year plan. Some deadlines may not apply, or dates may shift based on the plan sponsor's fiscal year. For additional support, please contact your BDO representative.

**DOWNLOAD THE FULL CALENDAR YEAR ▶**

## JANUARY

- **15** / **Fund:** Possible fourth quarter 2024 contribution due for defined benefit pension plans.
- **31** / **Action:** File IRS Form 945, Annual Return of Withheld Federal Income Tax, by January 31 for non-payroll income taxes, such as taxes withheld by retirement plans, during 2024.
- **31** / **Action:** Distribute IRS Form 1099-R to participants by January 31 for 2024 retirement plan distributions.

## FEBRUARY

- **10** / **Action:** File IRS Form 945 for 2024 non-payroll withholding if taxes were paid in full and deposited on time.
- **28** / **Action:** File IRS Form 1096, Annual Summary and Transmittal of US Information Returns, with IRS if using paper transmittal by February 28 for 2024 tax year.
- **28** / **Action:** File IRS Form 1099-R in paper format with the IRS by February 28 for 2024 retirement plan distributions.

**Best Practice:** Review and approve compliance testing results sent by plan administrator.

## MARCH

- **15** / **Action:** Highly compensated employees who fail ADP/ACP test for prior plan year must have refunds processed by March 15 (other than eligible automatic contribution arrangements).
- **15** / **Fund:** Partnerships and S Corporations that are not getting an extension must fund employer contributions to receive tax deduction for the prior year.
- **31** / **Action:** Electronic filing deadline for Form 1099-R
- **31** / **Action:** File IRS Form 5330 excise tax return and payment for excess 2023 ADP/ACP contributions.

## APRIL

- **1 / Action:** 401(k) plans with publicly traded employer stock that follow Article 6A of the Regulation S-X (SEC format) must file Form 11-K with the Securities and Exchange Commission by April 1.

- **1 / Action:** Recordkeeper (or other responsible party) completes and files Form 1099-R electronically with the IRS by April 1 for 2024 retirement plan distributions.

- **1 / Action:** April 1 deadline for 5% business owners and terminated participants who turned 73 in 2024 to receive their required minimum distribution (RMD).

  **Note:** The IRS "weekend rule" does not roll the April 1 deadline to the next business day if April 1 falls on the weekend or holiday.

- **15 / Distribute:** Possible first quarter 2025 contribution due for defined benefit pension plans.
- **15 / Fund:** April 15 possible first quarter 2025 contribution due for defined benefit pension plans (i.e., contribute by April 15 before the weekend, as contribution deadlines are not extended to the next business day).
- **15 / Distribute:** Participants who contributed over 402(g) or 415 limits in the previous year must be refunded the excess amount by April 15.
- **15 / Action:** File PBGC Form 4010, Notice of Underfunding for single-employer defined benefit plans with more than $15 million aggregate underfunding by Monday, April 15.
- **15 / Fund:** C-Corporations and Sole Proprietors that are not getting an extension must fund employer contributions by April 15 to receive tax deduction for the prior year.
- **15 / Fund:** IRA contributions for the prior tax year must be funded by April 15.
- **30 / Action:** Send annual funding notice to participants of single and multi-employer defined benefit plans over 100 participants by April 30.

UPCOMING WEBCAST

# Accounting, Audit, and Regulatory Updates Impacting Retirement Plans

**MARCH 26, 2025 | 12-1 PM ET**

**Presented by:**

**ERIN BREIT**
Assurance Principal, Employee Benefit Plans

**KAROLYN LADAS**
Assurance Principal, Employee Benefit Plans

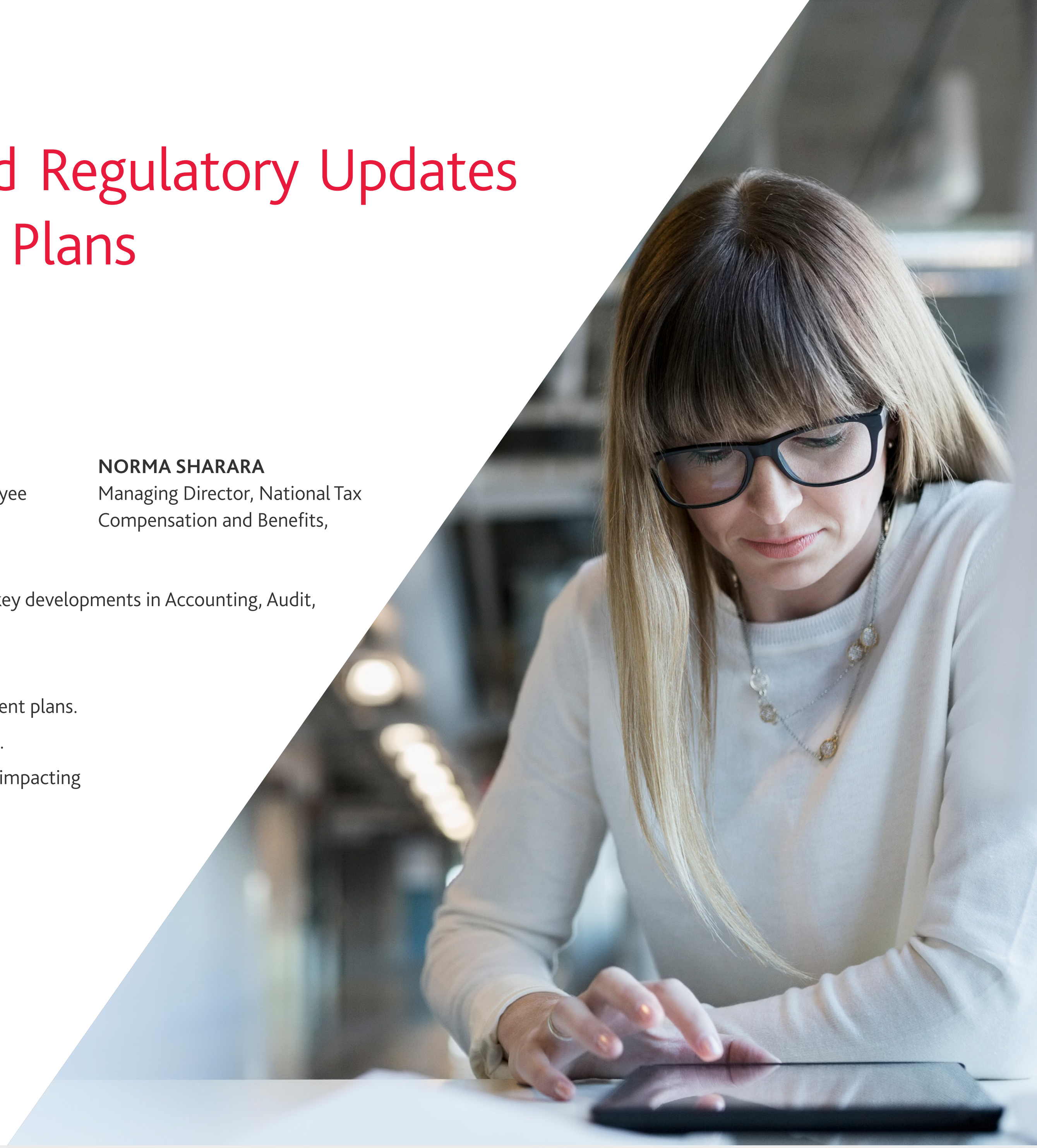
**NORMA SHARARA**
Managing Director, National Tax Compensation and Benefits,

Join BDO and our thought leaders who will provide an update on key developments in Accounting, Audit, and Regulatory Guidance pertaining to retirement plans.

At the end of this session, participants will be able to:

- Identify impact of recent accounting developments on retirement plans.
- Discuss newly effective auditing standards on retirement plans.
- Demonstrate knowledge of legislative and regulatory changes impacting retirement plans.

**CLICK HERE TO REGISTER ▶**



# Stay Up to Date with Our Podcast, *BDO Talks ERISA*

BDO TALKS ERISA

Our ERISA Center of Excellence hosts a podcast — *BDO Talks ERISA!* This series covers best practices around all things ERISA and any other HR-related topics, including:

- How to avoid common compliance issues
- How to navigate the ins-and-outs of ERISA's fiduciary provisions
- Our own experiences working for BDO's ERISA Services group
- A deeper dive into the insights we share through our BDO ERISA Center of Excellence

Listen to new episodes of *BDO Talks ERISA* **here** or subscribe on **Apple Podcast** or **Spotify**. If you have suggestions for future topics or have a question for us to answer, please **send us an email**.

# Timing is Everything: Evaluating When to Mitigate Risk with Your Pension Plan

Approximately [46,500 defined benefit pension plans] existed as of 2022, according to the Employee Benefits Security Administration. Each plan carries inherent risk because assets, liabilities, and funding costs to employers are dependent on market trends, economic conditions, and interest rates.

"De-risking" a defined benefit pension plan is a common way for companies and pension plan administrators to mitigate such risk while balancing plan liabilities and assets. When determining whether to de-risk or terminate a pension plan, sponsors will want to consider the effect that significant rate changes could have on the timing and cost of payouts.

While various de-risking strategies exist — including buy-in agreements and liability-driven investments — this insight will focus on approaches involving the termination of the plan and annuity buy-outs. We will look at why this may be a prime time to consider these pension stripping strategies because current economic conditions, such as higher interest rates, could offer a more cost-effective option for plan sponsors to mitigate financial risk.

## INTEREST RATES: CATALYST FOR DE-RISKING?

Pension plan sponsors are tasked with monitoring any economic conditions that might affect their ability to balance plan assets and liabilities. This includes interest rates, where fluctuations and trends can cause corresponding fluctuations in a pension plan's liabilities, assets, and costs.

Interest rates can have both positive and negative impacts on a pension plan. When rates drop, pension obligations may rise. Future pension plan payments may be discounted to today's rates, which, in turn, changes the lump sum payment or annuitization for participants. But lower interest rates can increase the plan's costs for de-risking. On the other hand, higher interest rates tend to decrease the costs associated with cashing out or annuitizing pensions.

Navigating the ebb and flow of interest rates can be a constant challenge. While economic conditions cannot be predicted, rates over the past year or so have remained higher than anticipated by those in the pension plan industry. Even a slight increase or decrease can have a significant effect on a plan's liabilities and costs, making plan termination or participant cash outs and annuitizations more favorable. Just as varying obligations affect plan termination costs, the plan's asset valuation is equally important and is also subject to interest rates.

## DECISION TIME: IS PENSION PLAN TERMINATION THE RIGHT MOVE?

Based on recent news, plan sponsors appear favorable to plan termination. In 2023, the [transfer of pension plan assets to group annuity contracts topped $45 billion], with an uptick in other methods of de-risking. For example, a group annuity risk transfer product, such as a buy-out product, allows a sponsor to transfer all or a portion of its pension liability to an insurer. In doing so, a sponsor can remove the liability from its balance sheet and reduce the volatility of the pension plan's funded status. When considering whether to terminate a pension plan by offering to cash out or annuitize participants, strategy is key.

Discussions about potentially terminating a pension plan should be done well in advance since there are a number of considerations to evaluate. It's also important to recognize that a complete termination of a pension plan may take a year or more so shifting economic conditions could impact the resulting cost.

The following actions may be taken when terminating a plan:

- Analyze the current pension plan, including liabilities, assets, and costs.
- Consider current interest rates and the lump sum interest rates dictated in the plan document, as well as the potential for change.
- Consider any administrative costs that might be incurred, including assistance from third-party administrators and ERISA counsel.
- Determine the timing for the plan, while still monitoring market and regulatory environments.
- Amend plan documents as necessary.
- Request required approvals from the Pension Benefit Guaranty Corporation and the IRS.
- Prepare and send appropriate notifications to participants, as required by law, once a de-risking strategy is determined.
- Execute the planned reduction or termination.

Planning is crucial. Generally, we encourage plan sponsors to develop de-risking strategies well before they might be implemented, and then monitor economic triggers before choosing to begin plan termination or cashing out/annuitizing participants. Reversing course is usually possible early in the termination process.

## COULD DE-RISKING BE PART OF YOUR PLAN'S FUTURE?

The decision here depends greatly on the pension plan's individual circumstances. And, yes, any action that changes a pension plan involves complicated financial strategies, as well as the need to comply with applicable laws and regulations. It's important to consider all factors before deciding to terminate a pension plan by cashing out or annuitizing participants, including current economic conditions, upfront costs that might be incurred, and the company's future business plans.

Before stepping through any potential pension-related window of opportunity, talk to professionals whose understanding of the complexities stems from real life experience.

**BDO's Global Employer Services** team helps guide clients as they make tough decisions about their pension plans. We analyze the client's current plan documents, offer recommendations for consideration, and then help them achieve their objectives.

Contact BDO's **Employee Benefit Plan Audit** team for more information.

# Planning for 2025: Employee Benefit Plan Changes Taking Effect

As the new year approaches and the transition to the new administration in D.C. commences, change is inevitable. However, there are new employee benefit plan provisions taking effect in 2025 driven by existing laws such as the Employee Retirement Income Security Act of 1974 (ERISA) and the Setting Every Community Up for Retirement Enhancement Act of 2022 (SECURE 2.0). Here, we will review those changes and offer additional insight.

## MANDATORY AUTOMATIC ENROLLMENT FOR NEW PLANS

SECURE 2.0 established new requirements for new 401(k) and 403(b) plans adopted after December 29, 2022. As of January 1, 2025, employers must automatically enroll eligible employees into these plans with an initial deferral percentage that is between 3% and 10% of compensation. Automatic contributions escalate by at least 1% per year up to a deferral rate of at least 10% but not more than 15% (10% until January 1, 2025). Participants can opt out of automatic enrollment or automatic escalation at any time.

The following may be exempt from the new requirements:

- Plans in effect on or before December 29, 2022.
- Organizations in existence for less than three years.
- Businesses with fewer than 10 employees.
- Church and governmental plans.

## CATCH-UP CONTRIBUTION INCREASES

The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) first introduced catch-up contribution provisions as a way to help older workers increase retirement savings. Under EGTRRA, plan sponsors could voluntarily amend their plans to allow participants aged 50 and older to contribute additional amounts to their 401(k), 403(b), and 457(b) plans. Prior to December 31, 2024, catch-up contributions to these plans were limited to $7,500, as indexed.

For taxable years beginning after December 31, 2024, those contribution limits change. Participants aged 60 to 63 may make additional contributions of either (i) $11,250 or (ii) 150% of their 2024 contribution limit, as indexed for inflation after 2025.

For SIMPLE IRA plans, before December 31, 2024, participants in SIMPLE IRA plans that allow catch-ups could contribute up to $3,500, as indexed. In 2025, such contributions rely on the participant's age (50 to 59, or age 64 or older on December 31, 2025) and the company's number of employees. Depending on these factors, a participant's contributions above regular deferrals can total between $3,850 and $5,250.

## COVERAGE OF LONG-TERM PART-TIME EMPLOYEES

The original SECURE Act required employers to include certain **part-time employees in their 401(k) plans**. To be eligible, the employee must have worked at least 500 hours per year for at least three consecutive years and must be at least 21 years old as of the end of that three-year period. The employee also would earn vesting credits for all years with at least 500 hours of service.

SECURE 2.0 reduces the three-year period to two years for plan years beginning after December 31, 2024. However, service performed before January 1, 2021, is disregarded for both eligibility and vesting purposes.

Although SECURE 2.0 extends this rule to apply to 403(b) plans that are subject to ERISA, the rule does not apply to union plans or defined benefit plans.

## DISTRIBUTIONS FOR CERTAIN LONG-TERM CARE PREMIUMS

Plan participants may receive distributions of up to $2,500 per year to pay for quality long-term care insurance without triggering the 10% early withdrawal penalty that might otherwise apply. This optional change for plan sponsors becomes effective for distributions made after December 29, 2025.

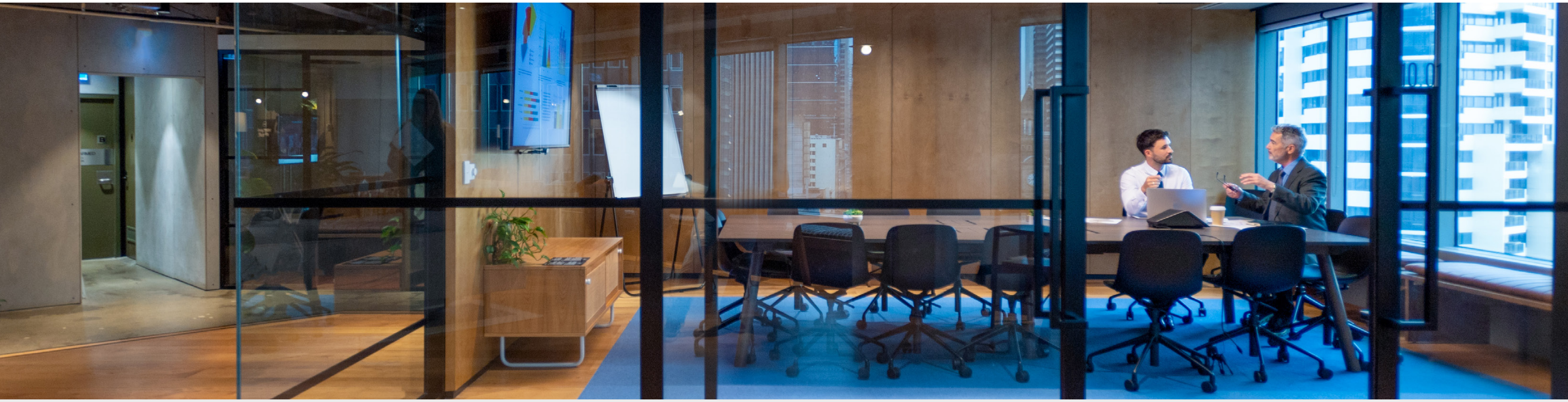
## THE LOST AND FOUND DATABASE

Retrieval or management of retirement funds can be complicated when workers move from job to job. To help reunite participants and their missing retirement plans, SECURE 2.0 required the Employee Benefits Security Administration to provide a search tool or database of benefits by December 29, 2024. At this time, participation is voluntary, with some groups expressing concern about the breadth of information initially requested by the Department of Labor to populate the database.

## IS YOUR PLAN READY FOR 2025?

By staying informed and prepared, plan sponsors can navigate these changes effectively. Plan sponsors should proactively review and adjust their plans accordingly to ensure compliance with these new mandates.

If you have questions about the compliance of your plan or would like more detailed guidance, contact our **Employee Benefit Plan Audit team** for more assistance.



# 2025 Cost-of-Living Adjustments for Qualified Retirement Plans

BDO presents a highlights summary of the significant cost-of-living adjustments (COLA) effective for 2025. These adjustments recently announced by the Internal Revenue Service (IRS) and the Social Security Administration (SSA) have a wide-ranging impact, including the savings rate for retirement plans. All annual compensation amounts and limits for elective deferrals were increased, except for catch-up contribution limits. BDO will continue to provide updates on regulatory matters impacting retirement plans in the coming year – to sign up for BDO newsletters and other insights, visit the ERISA Center of Excellence.

| CODE SECTION | 2025 | 2024 | 2023 |
|---|---|---|---|
| 401(a)(17) /404(l) Annual Compensation | $350,000 | $345,000 | $330,000 |
| 402(g)(1) Elective Deferrals | $23,500 | $23,000 | $22,500 |
| 408(k)(2)(C) SEP Minimum Compensation | $750 | $750 | $750 |
| 408(k)(3)(C) SEP Maximum Compensation | $350,000 | $345,000 | $330,000 |
| 408(p)(2)(E) SIMPLE Maximum Contributions | $16,500 | $16,000 | $15,500 |
| 409(o)(1)(C)(ii) ESOP Limits | $1,415,000<br>$280,000 | $1,380,000<br>$275,000 | $1,330,000<br>$265,000 |
| 414(q)(1)(B) HCE Threshold | $160,000 | $155,000 | $150,000 |
| 414(v)(2)(B)(i) Catch-up Contributions | $7,500 | $7,500 | $7,500 |
| 414(v)(2)(B)(ii) Catch-up Contributions | $3,500 | $3,500 | $3,500 |
| 415(b)(1)(A) DB Limits | $280,000 | $275,000 | $265,000 |
| 415(c)(1)(A) DC Limits | $70,000 | $69,000 | $66,000 |
| 416(i)(1)(A)(i) Key Employee | $230,000 | $220,000 | $215,000 |
| 457(e)(15) Deferral Limits | $23,500 | $23,000 | $22,500 |
| 1.61-21(f)(5)(i) Control Employee | $140,000 | $135,000 | $130,000 |
| 1.61-21(f)(5)(iii) Control Employee | $285,000 | $275,000 | $265,000 |
| Taxable Wage Base for Social Security | $176,100 | $168,600 | $160,200 |

BDO works collaboratively with clients to test retirement plan limits while performing an audit of the qualified retirement plan. For more information about our ERISA audit services, plan administration and actuarial services, visit BDO's **Employee Benefit Plan Audits**.

# 2024 Year-End Reminders Regarding Common Fringe Benefits, Special Rules for 2% S Corp Shareholders

As 2024 draws to a close, employers should review whether they have properly included the value of common fringe benefits in their employees' and (if applicable) 2% S corporation shareholders' taxable wages. This is especially true for 2024 and beyond, as many employers continue to deal with remote or hybrid workforces.

A fringe benefit is a form of pay (including property, services, cash, or cash equivalents) in addition to stated pay for the performance of services. The value of those benefits must be included in an employee's pay unless specifically excluded by law. The actual value of the fringe benefits provided must be determined annually before December 31 to allow for the timely withholding and deposit of payroll taxes. Failure to properly report includible fringe benefits to the recipient and the IRS on Form W-2 or Form 1099 before January 31, 2025, may result in penalties.

Employers have the burden of proving that tax-free treatment of fringe benefits was appropriate. Some people think that fringe benefits can be tax-free to employees if the employer simply forgoes the deduction for those compensation expenses. But that is not correct. Employers have an affirmative obligation to correctly withhold and report income and employment taxes for taxable fringe benefits provided to employees, regardless of whether the employer deducts the cost of the benefit as compensation or fringe benefits or a miscellaneous expense. The employer's inability to deduct the expense – because it's in a loss year or because it's a nonprofit organization, or because it voluntarily forgoes the deduction -- does not offset the requirement to properly report taxable wages to each employee or independent contractor. In some cases, an employer wanting to avoid amending past years' Form W-2s might consider negotiating a voluntary compliance settlement agreement with the IRS. BDO's U.S. Employment Tax group can help with this approach.

This alert provides a review of the rules on the identification of and tax reporting requirements for several fringe benefits that employers typically offer to their employees.

## WELLNESS PLANS

While many wellness plans can provide health or other benefits to employees on a tax-free basis, the IRS has alerted employers several times to beware of companies misrepresenting fringe benefits like nutrition tips, family counseling, gym memberships, fitness classes, and other general wellness benefits as medical care expenses for health flexible spending arrangements (FSAs), health savings accounts (HSAs), health reimbursement arrangements (HRAs), or medical savings accounts (MSAs), collectively wellness plans.

In **IR-2024-65**, a May 2024 news release, the IRS expresses concern that people are being misled by promoters of health spending plans as to which general health and wellness expenses can be reimbursed to employees tax-free. It points out that personal expenses are not considered medical expenses under Internal Revenue Code Section 213(d) and therefore are not deductible or reimbursable under FSAs and other health spending plans.

The promoters, some of which are former employee retention credit promoters, typically provide seemingly credible materials that often include a legal opinion on the validity of the tax savings generated when employees make elective deferrals to health care arrangements under Section 125. However, the legal opinion usually does not opine on the type of expenses discussed by the promoter or address how the payment of "wellness" expenses impacts the intended tax benefits.

Find the IRS warnings and practical suggestions on what employers should look for when approached by salespeople promoting tax savings from so-called wellness plans.

## REMOTE WORKFORCE FRINGE BENEFITS

### Transportation and Travel to the Office

Many businesses now allow employees significant flexibility in choosing their work location. A common work arrangement allows an employee to regularly work from their personal residence and to work in the employer's office as needed. Employers have asked whether the expenses incurred by those employees to travel to the office can be reimbursed on a tax-free basis. The employee's personal residence might be in the same or different geographic area as the office.

The answer hinges on whether the travel from the employee's workplace in their personal residence to the employer-provided office is considered a personal commute or a business trip. A trip to the office because the employer requested or required it does not alone change the character of the trip from a personal commute to a business trip. Also, any commuting expense paid by the employer is nondeductible, even when included as taxable compensation to the employee. Commuting expenses that qualify as tax-free under Section 132 but are in excess of the annual limits are excepted from the provision and are deductible if taxed to the employee. This **BDO Tax Strategist article** explains that employers should exercise caution when determining the tax consequences of costs incurred for employee travel between their personal residence and the employer's office or another work location.

### Home Office Expenses

Many employers reimburse employees for their reasonable expenses incurred while working from home. For these reimbursements to be tax-free (as a Section 132 working condition fringe benefit), employees must provide receipts for amounts over $75 to substantiate the business expenses, which might include the cost of a desk, chair, equipment, internet, and utilities. Some employers prefer to pay a periodic flat dollar "allowance." But such allowances are treated as taxable wage income (i.e., subject to both income and employment tax withholding and the employer's share of employment taxes) if employees do not substantiate how the funds were used. IRS rules require that the employer maintain an "accountable plan" for such reimbursements to be tax-free (see "Employee Business Expense Reimbursements and Allowances" below).

Reimbursements must be for business expenses (not personal expenses). To constitute a business expense, the employee's home workspace must be used exclusively as such, for the convenience of the employer, not the employee. Also, when an employer reimburses an employee for furniture or equipment, those items belong to the employer. Ownership of business property could create "nexus" with the state or local area where the items are located, possibly subjecting the employer to tax or other rules in that area. When an employee terminates employment, the fair market value of the property would be imputed taxable wage income to the employee if the employee does not return the property to the employer.

### Meals for Remote Employees

Many employers provide in-office meals tax-free to employees during meetings or when they are working on pressing projects. In addition, many employers provide tax-free snacks and beverages in an office break room. Some employers want to continue to provide such tax-free meals or snacks to remote employees who generally work from their personal residence. Under current IRS rules, it is difficult to justify the business purpose of such meals or snacks. Each situation depends on its own facts and circumstances. Additionally, meals for employees that travel a long distance from their personal residence when called to the office might not qualify for treatment as tax-free meals while away from their home on business if the employer derives no benefit from the employee living a long distance from the office.

## EMPLOYER-PAID GROUP TERM LIFE INSURANCE COVERAGE

Up to $50,000 of group term life insurance coverage is excluded from tax. Any amount in excess of $50,000 must be included in an employee's taxable income and is subject to Social Security and Medicare taxes (FICA). Even though any amount of coverage exceeding $50,000 is included in taxable wages, withholding of federal income tax (FIT) and state income tax (SIT) is not required. However, employers may withhold at their option. The amount of coverage must be reported as wages in Boxes 1, 3, and 5 of the employee's Form W-2 and in Box 12 with code "C."

## GROUP LONG- AND SHORT-TERM DISABILITY

If premiums for group long-term disability (LTD) or short-term disability (STD) are paid with pre-tax dollars, generally, the proceeds received by employees who become disabled will be taxable income. Conversely, if LTD or STD premiums are paid with after-tax dollars, generally, the proceeds would be tax-free. Combination funding is also possible. Employers may pay some, all, or none of the premiums. Complex tax rules apply to these situations that are beyond the scope of this summary.

## EMPLOYEE BUSINESS EXPENSE REIMBURSEMENTS AND ALLOWANCES

Any payments of an allowance or the reimbursement of business expenses for which the employee does not provide an adequate accounting (i.e., substantiation with receipts or other records), or for which the employee does not return any excess allowance or reimbursement to the company, are considered to have been provided under a non-accountable plan and are required to be treated as taxable wages for purposes of federal and applicable state and local income tax withholding, employer and employee FICA tax, and federal and state unemployment taxes (FUTA and SUTA).

However, if the employee provides an adequate accounting of the expenses incurred, or is "deemed" to have substantiated the amount of expenses under a per diem arrangement, the reimbursement amounts are excludable from taxable income and wages.

Determining whether expenses incurred by employees that voluntarily elect to work from their personal residence are business expenses incurred for the benefit of the employer requires additional scrutiny before treating the reimbursements as tax-free under an accountable plan.

Employers that fail to withhold on payments that are erroneously treated as tax-free will most likely be liable for the income taxes that they failed to withhold if audited by the IRS.

## EMPLOYER-PAID EDUCATIONAL ASSISTANCE

### For Active Employees

Employers may provide tax-free education to current employees as a working condition fringe benefit under Section 132. There is no specified limit on the amount of education expenses that can be paid or reimbursed on a tax-free basis, but the course or training must be job-related and satisfy other IRS requirements.

Expenses up to $5,250 per year (a static statutory limit that is not adjusted for inflation) that don't satisfy the requirements as a working condition fringe benefit can be paid or reimbursed as tax-free employee education assistance under a Section 127 plan that meets the following requirements:

- The tuition plan must be in writing and communicated to the employees with reasonable notice;
- Payments cannot discriminate in favor of highly compensated employees, and no more than 5% of the amounts paid can go to shareholders or owners (i.e., those who own more than 5% of the company's stock or capital interests on any day of the year); and
- Employers cannot give employees a choice between educational assistance and other compensation.

In June 2024, the IRS issued a **sample education assistance plan** designed to satisfy the written plan document requirements of Section 127. Having a model plan document may encourage more employers to offer tax-free educational assistance benefits to their employees.

COVID-19 relief legislation expanded Section 127 tax-free benefits to include student loan debt repayments, but that provision is scheduled to expire on December 31, 2025. The student loan debt must be for the employee's own education (in other words, student loan debt payments cannot be made toward the education of an employee's spouse or child).

### For Future Employees

To recruit new employees and hopefully create loyalty that improves retention, businesses are increasingly interested in paying for education expenses of prospective employees. For example, some businesses pay for nursing, engineering, business, or other schooling, provided the individual agrees to accept employment for a specified period after graduation. Many companies are surprised that even though the individual is not an employee when the payment is made, and even if the tuition is paid directly to the school, such payments must be treated as taxable wage income for the individual, reportable on Form W-2 (not on Form 1099). Such payments are subject to income and employment tax withholding, which might require an additional payment by the company via a gross-up calculation, since there is no cash associated with the taxable wage calculation.

Bona fide loans may not generate current taxable compensation. But if the bona fide loan is forgiven and the individual accepts employment, the employee will have taxable wages from the forgiveness of debt, reportable on Form W-2 and subject to all income and employment tax withholdings.

## PTO LEAVE DONATION

Many people are now working from their personal residence and have greater flexibility to spend time on personal matters without being charged for paid time off (PTO). Even routine doctor visits require less time off due to the widespread availability of virtual, on-line medical services. At the opposite end of the spectrum, essential employees might not have PTO approved because there is no one to perform their duties while they are away. For these and many other reasons, employees are taking fewer PTO days and therefore are at risk of forfeiting some of their accrued PTO.

While most employers hate to see employees forfeit earned PTO, there is no single approach to avoid this situation that is agreeable to all employees. Mandatory cash-outs are not always well received, because every employee has a different plan for PTO usage. Voluntary cash-out programs can have unexpected tax consequences to employees that prefer to keep their PTO for future use.

As an alternative to forfeiting excess PTO accruals, some employers facilitate donation of unused PTO either to charity or to other employees who need it.

### Leave-Sharing Plan

If handled incorrectly, both the donating employee and the recipient employee may have taxable income. However, properly following the rules regarding paid leave donation programs avoids inclusion of the donated PTO in the donor's Form W-2 and treats it as taxable W-2 compensation only to the recipient employee.

Employers can create leave-sharing programs for medical emergencies (including extended time off due to the death of a spouse, child, or parent), for federally declared disasters, or for both (although slightly different rules apply to disaster relief plans). The plan(s) should set limits on how much leave any employee can donate each year and include a detailed procedure for employees to submit a written request for leave (and the request should describe the specific circumstances that necessitate the leave). Donors generally cannot specify who will receive their donated leave. Typically, recipients can receive donated leave only after exhausting all other PTO. Recipients are paid for the donated leave at their regular rate of compensation. The employer should confirm that all leave transferred under the plan is used for the specified situation. Generally, donated disaster PTO that is not used by the end of the disaster period must be returned pro rata to the donors who are still employed by the employer.

## PERSONAL USE OF COMPANY CAR

The value of a company car used for personal travel must be treated as additional wages at a frequency chosen by the employer--up to and including on an annual basis—unless the employee reimburses the employer for such personal use.

FIT withholding on fringe benefit wage additions can be calculated as a combined total with regular wages or generally can be withheld at a flat 22% supplemental wage rate if the employee earns under $1 million.

Alternatively, employers can choose not to withhold FIT if the employee is properly notified by January 31 of the year in which imputed income for personal use of a company car will arise or 30 days after a vehicle is provided and the value is properly reported on a timely filed Form W-2. But employers must withhold FICA taxes on such benefits.

For administrative convenience, an employer can calculate the value of personal use of a company vehicle for the current year based on the 12-month period beginning November 1 of the prior year and ending October 31 of the current year (or any other 12-month period ending in November or December) if the employee is properly notified no earlier than the employee's last paycheck of the current year and no later than the date the Forms W-2 are distributed. Once this valuation period is elected, the same accounting period generally must be used for all subsequent years with respect to the same automobile and employee.

Many companies have moved away from providing company cars and instead make cash payments to reimburse employees for the business use of their personal vehicle. Car allowances paid in cash without any substantiation of business use are fully taxable and subject to FICA, FUTA, FIT, and SIT withholding.

**Caution:** If the employer reimburses the employee for business use of their personal vehicle (using the IRS "cents-per-mile" or other rule), the employee should not also be reimbursed for fuel costs.  For example, if an employee gets reimbursed for business use of their personal car using the cents-per-mile rule, the employee should not use the company credit card to fill up the gas tank of their personal car for that business trip, since the cents-per-mile reimbursement includes fuel, wear and tear on the vehicle, etc.). Employers often do not realize that this is "double dipping" and not allowed under IRS fringe benefit rules. In some cases, employers lease vehicles for employees, and reimburse them using the cents-per-mile rule and allow the employee to use the company credit card for fuel and other costs (this is impermissible "triple dipping").

Find the explanation on the **tax treatment of employees' personal use of company cars**.

## PERSONAL USE OF COMPANY AIRCRAFT

This fringe benefit (unless reimbursed by the employee to the extent permitted under FAA rules or necessary for security reasons) generally is subject to FICA, FUTA, FITW, and SITW. The value of the benefit is calculated based on the Standard Industry Fare Level formula provided by the IRS. Expenses related to personal entertainment use by officers, directors, and 10%-or-greater owners that exceed the value treated as compensation to key employees are nondeductible corporate expenses.

## BENEFITS THAT EXCEED DE MINIMIS EXCLUSION

De minimis benefit amounts can be excluded when the benefit is of so little value (taking into account their frequency) that accounting for it would be unreasonable or administratively impractical. It is a common misconception that if a fringe benefit amounts to less than $100, it is automatically considered a de minimis benefit. However, there is no authority for this position.

If a fringe benefit does not qualify as de minimis, generally the entire amount of the benefit is subject to income and employment taxes (FICA, FUTA, FITW, and SITW). Season tickets to sporting or theater events; use of an employer's residence, apartment, boat or vacation home; and country club or athletic facility memberships do not qualify as de minimis benefits. De minimis benefits have never included cash, gift cards, or cash-equivalent items, regardless of their amount. Gift cards that cannot be converted to cash and that are otherwise a de minimis fringe benefit redeemable only for specific merchandise such as a ham, a turkey, or another item of similar nominal value might be excludable from income. However, gift cards that are redeemable for a wide variety of items are deemed to be cash equivalents. Any portion of a gift card that is considered a cash equivalent should be included in employees' Forms W-2 and subject to income and employment taxes as detailed above.

While snacks and meals provided to employees can meet the de minimis requirements, they often do not. Still, most employer-provided meals are excluded from employees' taxable income under the accountable plan rules for working condition fringe benefits. The employer's deduction for these meals generally is limited to 50% of food and beverage expense for quiet business meals with customers and clients (i.e., no entertainment is involved). Entertainment expenses, even with a business purpose, generally are not deductible. But food or beverage expenses related to employee recreation, such as holiday parties or annual picnics, are fully deductible when provided primarily for the benefit of rank-and-file employees.

**Caution:** We have seen the IRS take an aggressive position on examination on this issue, with the agent proposing that a company's expenditure for on-site food and beverages regularly furnished to employees should be treated as employee compensation because it is too frequent or extravagant to be excludible as a working condition or de minimis fringe benefit.

## EMPLOYEE ACHIEVEMENT AWARDS, GIFTS, AND PRIZES

This fringe benefit is subject to FICA, FUTA, FITW, and SITW. In general, employee achievement awards, gifts, and prizes that do not specifically qualify for exclusion are deductible by the employer only up to $25 per person per year, unless the excess is included as taxable compensation to the recipient. Any gifts to employees in excess of $25 per person per year in the form of tangible or intangible property are taxable wage income for employees. There are two exceptions to the general rule: (i) achievement awards for length of service or safety and (ii) certain non-cash achievement awards, such as a gold watch at retirement or nominal birthday gifts, which fall within the exclusion for de minimis benefits.

For a length of service or safety award to be considered excludible, there must be a meaningful presentation of the award, the employee being recognized must have at least five years of service, and the award cannot have been granted to the same employee in any of the prior four years. The exclusion applies only for awards of tangible personal property and is not available for awards of cash, gift cards, or equivalent items. The exclusion for employee achievement awards is limited to $400 per employee for nonqualified plans (unwritten and discriminatory plans) or up to $1,600 per employee for qualified plans (written and nondiscriminatory plans).

## JOB-RELATED MOVING EXPENSES PAID BY EMPLOYER

Moving expenses incurred during 2024 that are paid by an employer must be included in the employee's taxable compensation unless the employee is an active duty member of the U.S. Armed Forces and is moving to a permanent change of station. The exclusion from employee income is scheduled to be reinstated on January 1, 2026. Employers can still pay (and obtain a deduction for paying) employee moving expenses, but those amounts are now taxable wages paid to the employee, due to the changes in the law made by the Tax Cuts and Jobs Act (TCJA) of 2017.

## QUALIFIED TRANSPORTATION FRINGE BENEFITS

Employers cannot deduct expenses incurred in providing qualified transportation fringe benefits to employees. Tax-free transportation fringe benefits may still be provided to employees, but the employer will not get a deduction for providing such tax-free benefits. The **final regulations** on how to calculate the disallowed deduction for employee qualified transportation costs include some helpful positions and simplified methodologies on how to determine the cost of employee parking. For example, parking in some remote areas may be treated as having no value, so the deduction is not disallowed. The payroll tax treatment of employee parking, van pool, and mass transit benefits remains unchanged.

Qualified commuting and parking amounts provided to the employee by the employer in excess of the monthly statutory limits are subject to FICA, FUTA, FITW, and SITW. For 2024, the statutory limits are $315 per month for qualified parking and $315 for transit passes and van pooling. An employee can be provided both benefits for a total of $630 per month, tax-free, with the excess included in Form W-2. Amounts exceeding the limits cannot be excluded as de minimis fringe benefits.

**Caution:** Mileage reimbursement to employees for commuting is not excludable as a qualified transportation fringe benefit. Business use of a personal car must qualify as a working condition fringe benefit to avoid taxation. Going from home to work is generally not a business expense, since commuting is a personal expense (because it is a personal decision made by the employee when the employee decides where to live).

For 2018 through 2025, bicycle commuting benefits that are qualified transportation fringe benefits are included in taxable wages subject to FIT, FITW, FITA, and FUTA. Because these benefits are taxed to the employee as regular compensation, the benefits are deductible by the employer.

The value of any de minimis transportation benefit provided to an employee can be excluded from Form W-2. For example, an occasional taxi fare home for an employee working overtime or departing a business function such as a holiday party may be provided tax-free.

Please note that some local jurisdictions require employers to provide mass transit options. For instance, the District of Columbia (D.C.) requires employers with 20 or more employees to offer qualified transit benefits. While D.C. employers are not necessarily required to subsidize the cost of their employees' commuting expenses under the law, they are required to provide the option for employees to make a pre-tax election to take full advantage of the maximum statutory limits for transit, commuter highway, or bicycling benefits. San Francisco and New York City have adopted similar laws in an attempt to promote the use of available mass transit options and to reduce automobile-related traffic and pollution. Employers should confirm that they are in compliance with local requirements regarding mass transit options for each employee location.

## NONCOMPENSATORY CELL PHONES AND OTHER DEVICES

The value of the business use of an employer-provided cell phone (and other communications devices) provided primarily for noncompensatory business reasons is excludable from an employee's income as a working condition fringe benefit. If the cell phone, tablet, or other device is provided to the employee as a "welcome aboard" or other bonus, and the item is not linked to the employer's business, the fair market value of the item is treated as imputed taxable compensation to the employee.

Personal use of an employer-provided cell phone given to the employee primarily for noncompensatory business reasons is excludable from the employee's income as a de minimis fringe benefit. Employers provide a cell phone primarily for noncompensatory business purposes if there are substantial business reasons for providing the phone. Examples of substantial business reasons include the employer's need to contact the employee at any time for work-related emergencies, the requirement that the employee be available to speak with clients at times when the employee is away from the office, and the need to speak with clients located in other time zones at times outside the employee's normal workday.

Employers cannot exclude from an employee's wages the value of a cell phone or tablet or other device provided to promote the goodwill of an employee, to attract a prospective employee, or as a means of providing additional compensation to an employee.

Employers can make tax-free reimbursements to employees for their business use of their personal cell phones (or other devices) if the employee submits an expense report under the **IRS's "accountable plan" rules**. Generally, receipts for non-lodging expenses are not necessary unless the amount exceeds $75. The rules require that the expense report must be submitted within a "reasonable time" after the expense is incurred. Expense reports filed within 60 days after incurring the expense are deemed to be within a reasonable period of time. The expense report generally must include the business purpose for the expense. If the employer simply provides a monthly allowance for business use of personal cell phones (or other devices) without any substantiation, then the allowances are taxable wage income, subject to FICA, FUTA, FIT, and SIT withholding and reporting.

## SPECIAL RULES FOR TAXING CERTAIN EMPLOYEE FRINGE BENEFITS TO 2% S CORPORATION SHAREHOLDERS

Certain otherwise excludable fringe benefit items are required to be included as taxable wages when provided to a 2% shareholder of an S corporation or of an LLC that elects to be taxed as an S corporation. A 2% shareholder is any person who owns, directly or indirectly, on any day during the taxable year, more than 2% of the outstanding stock or stock possessing more than 2% of the total combined voting power of the corporation. These fringe benefits are generally excluded from the income of other employees but are taxable to 2% S corporation shareholders similar to the way they are taxed if received by partners. If these fringe benefits are not included in the shareholder's Form W-2, they are not deductible for tax purposes by the S corporation. The disallowed deduction creates a mismatch of benefits and expenses among shareholders, with some shareholders paying more tax than if the fringe benefits had been properly reported on Form W-2.

## TAXABLE FRINGE BENEFITS

The following describes fringe benefits paid for by an S corporation that are includable in the 2% shareholder's taxable income.

## HEALTH, DENTAL, VISION, HOSPITAL, AND ACCIDENTAL DEATH AND DISMEMBERMENT INSURANCE PREMIUMS AND QUALIFIED LONG-TERM CARE (LTC) INSURANCE PREMIUMS PAID UNDER A CORPORATE PLAN

These fringe benefits are subject to FITW and SITW but not to FICA or FUTA. The amounts include premiums paid by the S corporation on behalf of a 2% shareholder, as well as amounts reimbursed by the S corporation for premiums paid directly by the shareholder. If the shareholder partially reimburses the S corporation for the premiums using post-tax payroll deductions, the net amount of premiums must be included in the shareholder's compensation. Pre-tax payroll deductions cannot be used by 2% shareholders to reimburse premiums paid by the S corporation. However, 2% shareholders can deduct the premiums using the self-employed health insurance deduction in their personal federal income tax return (i.e., on Form 1040).

## CAFETERIA PLANS

A 2% shareholder is not eligible to participate in a cafeteria plan created under Section 125, nor can the shareholder's spouse, child, grandchild, or parent participate. If a 2% shareholder (or any other ineligible participant, such as a partner or nonemployee director) is allowed to participate in a cafeteria plan, the cafeteria plan will lose its tax-qualified status, and the benefits provided will therefore be taxable to all participating employees, nullifying any pre-tax salary reduction elections to obtain any benefits offered under the plan.

## EMPLOYER CONTRIBUTIONS TO HEALTH SAVINGS ACCOUNTS AND OTHER TAX-FAVORED HEALTH PLANS

This fringe benefit is subject to FITW and SITW but not FICA or FUTA. If the shareholder partially reimburses the S corporation for the health plan contribution using post-tax payroll deductions, the net amount of the contribution must be included in the shareholder's compensation. Pre-tax payroll deductions cannot be used by 2% shareholders to reimburse plan contributions paid by the S corporation. However, 2% owners can take a corresponding self-employed deduction for the cost of their health savings account contributions on their Form 1040.

## SHORT-TERM AND LONG-TERM DISABILITY PREMIUMS

For 2% shareholders of an S corporation, employer-paid short- and long-term disability premiums are subject to FITW and SITW, but not to FICA or FUTA. Because the disability insurance premiums are paid with after-tax dollars, any disability insurance proceeds generally would be tax-free.

## GROUP TERM LIFE INSURANCE COVERAGE

Group term life insurance premiums should be included in Boxes 1, 3, and 5 of a 2% shareholder's Form W-2. The entire premium paid on behalf of a 2% shareholder under a group term life insurance policy is treated as taxable, not just the premium for coverage in excess of $50,000. Although the value is taxable income to the 2% shareholder, the cost of the insurance coverage (that is, the greater of the cost of the premiums or the Table I rates) is subject only to FICA tax withholding. The cost of the insurance coverage is not subject to FUTA, FITW, or SITW. It should be noted that any life insurance coverage for which the corporation is both the owner and beneficiary (such as key man life insurance) does not meet the definition of group term life insurance and, therefore, there is no income inclusion in the shareholder's Form W-2.

## OTHER TAXABLE FRINGE BENEFITS

Employee achievement awards, qualified transportation fringe benefits, qualified adoption assistance, qualified moving expense reimbursements, personal use of employer-provided property or services and meals and lodging furnished for the convenience of the employer must be included as compensation when made available to 2% shareholders of an S corporation. All the above fringe benefits are subject to FICA, FUTA, FITW, and SITW.

## NONTAXABLE FRINGE BENEFITS

The following fringe benefits are not includible in the compensation of 2% shareholders of an S corporation:

- Qualified retirement plan contributions
- Qualified educational assistance up to $5,250 (but tax-free benefits are not available if more than 5% of the educational assistance benefits are provided to 2% S corporation shareholders, their spouses, or dependents)
- Qualified dependent care assistance up to $5,000 (but tax-free benefits are not available if more than 25% of benefits paid during the year are provided to individuals who own more than 5%)
- Qualified retirement planning services
- No-additional-cost services
- Qualified employee discounts
- Working condition fringe benefits
- De minimis fringe benefits
- On-premises athletic facilities

Please visit BDO's **Global Employer Services page** for more information on how BDO can help.

## CONTACT US

**ERIN BREIT**
Assurance Principal
Employee Benefit Plans
ebreit@bdo.com

**KAROLYN LADAS**
Assurance Principal
Employee Benefit Plans
kladas@bdo.com

**NORMA SHARARA**
National Tax Managing Director
Compensation and Benefits
nsharara@bdo.com

**NICOLE PARNELL**
Global Employer Serices Principal
Retirement Plan Services Leader
nparnell@bdo.com

**BOB HAMILTON**
Senior Director
Employee Benefit Plans
bhamilton@bdo.com