

Fringe benefits reporting

Frequently asked questions for 2025

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Fringe benefits reporting: our frequently asked questions for 2025

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As you review transactions in preparation for the 2024 Form W-2 reporting season, we thought it might be helpful to share the questions we were asked most frequently this year about the taxation and reporting of fringe benefits and other wage payments. See also our federal fringe report chart that begins on page 14.



Included in this year's top 10 frequently asked questions (FAQs):

- ▶ [FAQ 1: Gift cards](#)
- ▶ [FAQ 2: Moving expenses](#)
- ▶ [FAQ 3: Cell phones](#)
- ▶ [FAQ 4: Employee loans](#)
- ▶ [FAQ 5: Day care](#)
- ▶ [FAQ 6: Educational assistance](#)
- ▶ [FAQ 7: Nonqualified deferred compensation](#)
- ▶ [FAQ 8: Wellness benefits](#)
- ▶ [FAQ 9: Former employee group-term life](#)
- ▶ [Federal reporting for fringe benefits for 2025 \(reference chart\)](#)

For more information, or if you require any additional assistance with year-end reporting, contact Debera Salam at debera.salam@ey.com or Kenneth Hausser at kenneth.hausser@ey.com.



FAQ 1: **Gift cards**

Are gift cards considered wages subject to employment tax and withholding?

Facts: We distribute grocery store gift cards each December that are redeemable only for specific food items such as a holiday turkey, ham or fruit basket. Since these gift cards are redeemable for items that are otherwise considered de minimis and cannot be exchanged for cash, is their value subject to employment tax and withholding?

Answer: IRS regulations clearly state that fringe benefits provided to employees through a gift card represent “cash-in-kind” and must be included in wages subject to federal employment tax and withholding. It does not matter that the employee is not allowed to redeem the card for cash. Furthermore, the doctrine of constructive receipt applies, meaning the cash value of the gift cards is subject to federal income tax (FIT), federal income tax withholding (FITW), Social Security/Medicare (FICA) and federal unemployment insurance (FUTA) at the time they are made available to employees.

The same tax treatment applies to gift cards issued to employees throughout the year and when employees are allowed to visit a third-party website to select items of merchandise/store cards for the purpose of redeeming company recognition awards.

The requirement that gift cards be taxed and reported immediately when made available can be problematic for those employers that reimburse managers and supervisors for the purchase of gift cards through the expense reimbursement process (i.e., December expense reports are not submitted until January). For this reason, many companies require that gift cards be issued through Human Resources or another appropriate department so that payroll can be notified immediately of the wage transaction for timely tax and reporting. (*IRS Reg. §1.132 6(c); TAM 200437030 IRC §451.*)

Fringe benefits reporting: our frequently asked questions for 2025

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FAQ 2: Moving expenses

What is the tax treatment of moving expenses paid on behalf of employees assuming we are a civilian employer?

Facts: We have a policy that when we ask employees to transfer to another of our store locations we reimburse them for the cost of moving their household goods and personal effects and lodging and meal expenses they incur in their final trip from the old work location to the new.

Answer: Whether moving expense reimbursements are subject to FIT, FITW, FICA and FUTA depends on when the expenses were incurred.

- **Moving expenses incurred through December 31, 2017:** For moving expenses incurred through December 31, 2017, IRC §132(g) allows an exclusion from wages for FIT, FITW, FICA and FUTA purposes for moving expenses reimbursed or paid directly by the employer to the extent those moving expenses were deductible under IRC §217. Through December 31, 2017, IRC §217 excludes from taxable income the cost of moving household goods and personal effects from the former residence to the new, the first 30 days of storage for a domestic move, and lodging and mileage expenses incurred during the period of travel from the former residence to the new place of residence. An exclusion was not allowed for meal expenses incurred during the period of travel from the old location to the new. Special rules apply to foreign moves.

- **Moving expenses on and after January 1, 2018:** Under the Tax Cuts and Jobs Act (TCJA) and the One Big Beautiful Bill Act (OBBBA), effective January 1, 2018, all moving expense reimbursements paid to employees or directly to third parties on behalf of employees are included in wages subject to FIT, FITW, FICA and FUTA. An exception to this provision applies to members of the Armed Forces on active duty moving pursuant to a military order and incidental to a permanent change of station. ([TCJA §11048](#); [OBBBA](#).)

For more information, see the IRS' frequently asked questions about [moving expenses](#).





FAQ 3: Cell phones

What is the tax treatment of employer-provided cell phones and cell phone allowances?

Facts: We provide cell phones to our field engineers and sales staff for which we pay all monthly charges incurred and for our administrative staff we provide a monthly cell phone allowance. What is the federal tax treatment of both options?

Answer: In response to the law change in 2010 that removed cell phones from listed property, the IRS issued guidance explaining the revised rules governing the tax treatment of employer-provided cell phones and other similar telecommunication equipment fees. (*IRS Notice 2011-72*.)

Note that the guidance deals only with telecommunication fees. If the employer purchases a cell phone and transfers ownership of the device to the employee, the value of the cell phone itself is treated as taxable wages. (*IRC §83, IRS Reg and §1.482-3*.)

Under IRS guidance pertaining to monthly cell phone fees, the portion of qualified employer-provided cell phone usage that is not connected to business is treated as a de minimis fringe benefit exempt from FIT, FITW, FICA and FUTA. Additionally, the portion of qualified employer-provided cell phone usage having a business connection need not meet the substantiation requirements of IRC §162.

► **What is “qualified” cell phone usage?** Qualified cell phone usage is defined as cell phone services that are provided for “noncompensatory business reasons.” Cell phone services are considered provided for noncompensatory business reasons if there are substantial reasons relating to the employer’s business (other than providing compensation) for providing the employee with cell phone services. IRS guidance gives the following examples of noncompensatory business reasons for furnishing cell phone services to employees:

- The employer needs to contact the employee at all times for work-related emergencies.
- The employee is required to be available to speak with clients at times when the employee is away from the office.
- The employee needs to speak with clients in other time zones at times outside of the employee’s normal work day.

Examples of cell phone services not provided to employees primarily for noncompensatory business reasons include:

- To promote the morale and good will of an employee
- To attract a prospective employee
- As a means of furnishing additional compensation to an employee



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- ▶ **Cell phone allowances.** If employees are reimbursed for their cell phone expenses, IRS field guidance indicates that its examiners should analyze the reimbursement arrangement in keeping with Notice 2011-72 provided that the employee maintains the type of cell phone coverage reasonably related to the employer's business needs and that the reimbursement is reasonably calculated not to exceed the employee's actual expenses for maintaining the cell phone. Furthermore, the reimbursement cannot be a substitute for regular wages. In addition, the field guidance instructs examiners to look more closely at arrangements allowing for reimbursement of unusual or excessive expenses. (*SBSE-04-09110083, 9-14-2011*)

Examples of reimbursement arrangements that may be excessive and that IRS examiners are instructed to review closely include:

- ▶ Reimbursement for international or satellite cell phone coverage to a service technician whose business clients and other business contacts are all in the local geographic area where the technician works.

- ▶ A pattern of reimbursements that deviates significantly from a normal course of cell phone use in the employer's business (e.g., an employee received reimbursements for cell phone use of \$100 per quarter in quarters 1 through 3 but receives a reimbursement of \$500 in quarter 4).

A policy of providing employees with cell phone allowances wherein employees are not required to periodically provide a monthly statement detailing the type and amount of expenses incurred presents the risk that the allowance could be considered excessive in relationship to employees' job duties and the type of services purchased or the actual usage fees incurred.

For this reason, it is prudent to establish allowances and reimbursements for cell phone usage based on periodic substantiation from employees that includes a copy of their monthly cell phone statements and an explanation of how those expenses are connected to their current job duties.



FAQ 4: Employee loans

What is the federal tax treatment of the portion of an employee loan balance that is later forgiven?

Facts: Last year we entered into a loan agreement with one of our employees requiring that he repay, in 24 monthly installments, the principal portion of a loan we provided to him of \$5,000. He has been on disability leave since the time the loan was granted and it was determined that the loan balance would be forgiven. What is the federal tax treatment of this \$5,000 forgiven loan balance?

Answer: The outstanding loan balance is subject to FITW, FITW, FICA and FUTA on the day that it is forgiven. Any unpaid interest that may have applied is included in taxable wages subject to FIT, FICA and FUTA but it is not subject to FITW. (*IRS §7872; IRS Publication 525.*)

Note that under IRC §3121(a)(15) if the wages are considered paid at the time the individual is entitled to disability insurance benefits under [section 223\(a\) of the Social Security Act](#), the entitlement began prior to the calendar year in which such payment is made, and if the employee did not perform any services for the employer during the period for which such payment is made, the wages attributable to the forgiven loan balance may be excluded from FICA.



FAQ 5: Day care

Are employer-paid emergency day care expenses considered in the annual \$5,000 tax-free limit?

Facts: Under our fringe benefits policy, we offer two types of dependent care assistance benefits: (1) all employees may elect to contribute to a dependent care flexible spending account on a pretax basis under our cafeteria plan but their pretax election cannot exceed \$5,000 per year (or \$2,500 if they are married, filing separately and their spouse also has the same benefit) and (2) we have contracts with two area day care facilities that employees may use in the event of an emergency or a work scheduling conflict (e.g., the regular day care provider is ill, or the employee is asked to work at a time when the regular day care provider is not expected to be available).

Answer: Qualified dependent care assistance benefits over \$5,000 per employee per year (\$2,500 in the case of a married taxpayer filing separately) are included in wages subject to FIT, FITW, FICA and FUTA. Qualified dependent care assistance benefits include pretax contributions made to a dependent care assistance flexible spending account and the fair market value of employer-provided day care facilities, whether those facilities are located at or away from the workplace.

Under your policy, you make direct payment to the childcare facility on behalf of your employees.)

When determining an employee's total annual dependent care assistance benefit, all qualified benefits are considered. Hence, in determining an employee's total annual dependent care assistance benefit, the company must take into account the amount the employee elected to contribute on a pretax basis to the dependent care assistance flexible spending account for the calendar year and any fees incurred by the employer in providing child care services under the emergency day care policy.

There is no exclusion from taxable wages for "emergency" day care services that are required because of a work emergency. (*IRC §129(a)(2)(A)*; *IRS Notice 89-111, 1989-2 CB 449, as supplemented by IRS Notice 90-66, 1990-2 CB 350, as corrected by IRS Announcement 90-136, 1990-50 IRB 19.*)

Note that under the [OBCCA](#) and effective January 1, 2026, the maximum tax-free dependent care assistance benefit is increased from \$5,000 to \$7,500.



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Dependent care assistance – Form W-2 reporting

Example: Assume that emergency day care services are provided in December 2025 totaling \$1,000, but this amount is not paid to the day care facility until January 2026. The \$1,000 is treated as benefits provided in 2025. Further assume that this same employee set aside in 2025, on a pretax basis, \$5,000 into his dependent care assistance reimbursement account. Qualified dependent care assistance benefits over \$5,000 per employee per year (\$2,500 in the case of a married taxpayer filing separately) are included in wages subject to FIT, FITW, FICA and FUTA; therefore, in this example, the employee received dependent care benefits in 2025 totaling \$6,000. The excess, or \$1,000, is treated as wages subject to FIT, FITW, FICA and FUTA. There is no exclusion for “emergency” day care services that are required because of a work emergency.

Dependent care assistance benefits are reported on Form W-2 as follows:

- ▶ **Form W-2, box 1** – federal taxable wages: report here only qualified dependent care assistance benefits over \$5,000 in the calendar year.
- ▶ **Form W-2, box 2** – federal income tax withholding: report here the federal income tax withheld on qualified dependent care assistance benefits over \$5,000 for the year.
- ▶ **Form W-2, box 3** – Social Security wages: report here only dependent care assistance benefits over \$5,000 in the calendar year. The total in this box should not exceed the 2025 maximum of \$176,100.

- ▶ **Form W-2, box 4** – Social Security tax withheld: report here the Social Security tax withheld on qualified dependent care assistance benefits over \$5,000 in the calendar year.
- ▶ **Form W-2, box 5** – Medicare wages: report here only the dependent care assistance benefits over \$5,000 in the calendar year.
- ▶ **Form W-2, box 6** – Medicare tax withheld: report here the Medicare tax withheld on qualified dependent care assistance benefits over \$5,000 for the calendar year.
- ▶ **Form W-2, box 10** – All dependent care assistance benefits provided in the tax year are reported in Form W-2, box 10, even if the total benefits exceed \$5,000. (*2024 Form W-2/W-3 reporting instructions, IRS Publication 15-B, Employer’s Tax Guide to Fringe Benefits, rev. 2025.*)

Note that the IRS allows employers the flexibility of either using the cash reimbursements made from the employee’s flexible spending account or the contributions the employee elected to make for the calendar year in determining the annual dependent care assistance benefit under the cafeteria plan’s reimbursement arrangement. Most employers use the pretax contribution amount as this information is generally the easiest to obtain. (*IRS Notice 2005-61, 2005-39 IRB 1; IRS Notice 89-111.*)



FAQ 6: Educational assistance

How do we determine the tax treatment of educational expense reimbursements?

Facts: We make various reimbursements to employees and direct payments to universities and other organizations for educational expenses. Some of this educational expense is covered under a policy that provides employees with financial assistance toward an undergraduate or graduate degree. Other educational expenses reimbursed or paid directly to educational organizations include continuing education and courses connected to licensing and technical skills training. What is the tax treatment of these educational expenses, and what kind of documentation should be maintained for tax and reporting purposes?

Answer: There are two exclusions available for the educational expenses of employees: qualified educational assistance (*IRC §127*) and working condition fringe benefits (*IRC §132*¹). The distinction between these two exclusions is significant because an annual limitation of \$5,250 applies to qualified educational assistance, while education that meets the definition of a working condition fringe is excluded from federal taxable wages without limitation.

The challenge facing employers arises both in determining which of the exclusions apply and maintaining documentation consistent with the exclusion being claimed.

► **Working condition fringe.** In general, educational expenses fall within the category of a working condition fringe and are excluded from wages if the education assists employees in improving skills or in performing the duties they were assigned at the time of the educational event. (*Treas. Reg. §§1.162-5(a)(1) and (2)*.) For instance, mandatory instruction in independence guidelines for financial statement auditors, attendance at an employment tax conference by members of the employment tax staff or required attendance by manufacturing plant workers in a safety program will most likely meet the definition of working condition fringe benefits.

► **Educational assistance.** In contrast, education expenses incurred on behalf of, or reimbursed to, employees do not meet the definition of a working condition fringe benefit if the education enables employees to (1) meet the minimum educational requirements for qualification in their current jobs, (2) qualify for a promotion or salary increase or (3) qualify for a different position (transfer) or for a new trade or business. Education used to pursue a hobby does not qualify for the exclusion. (*Treas. Reg. §1.162-5(b)(2) and (3)*.)

Except for education used to pursue a hobby of the employee, the above-referenced educational expenses may qualify for exclusion from federal taxable wages of up to \$5,250 per year if provided under a written plan of the employer that meets the requirements of *IRC §127*.

► **Degree programs.** Difficulty generally arises in determining whether education pursuant to a degree program meets the definition of a working condition fringe. As previously explained, to meet the definition of a working condition fringe benefit, the education connected to the degree program must support the position that the employee was not eligible for a promotion, transfer or a new trade or business because of completing the course of study. A number of courts have reviewed this issue and have favorably concluded that employees' expenses incurred for higher education were job-related in nature and were deductible as a working condition fringe. (See, e.g., *Blair v. Commissioner*, T.C. Memo., 1980-488 and *Beatty v. Commissioner*, T.C. Memo. 1980-196) while other courts have rejected such expenses as qualifying the individual for a new trade or business, e.g., *McIlvoy*, T.C. Memo 1979-248, requiring careful consideration of the facts in each particular case.)

¹ Much of the guidance on this issue has arisen in relation to individual taxpayers seeking to claim education as an ordinary and necessary business expense under §162, an option

currently unavailable to employees. §132 borrows these principles to determine whether paying or reimbursing for an employee's education is excludable as a working condition fringe.

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In *Allemeier, Jr. v. Commissioner* the court explained that in determining if educational expenses are deductible under IRC §162, the facts and circumstances of each benefit recipient must be evaluated. The court further explained that in making this determination, a “common sense approach” should be applied. In other words, the employer needs to compare the job duties of employees before completion of the education program with the duties after completion of the educational program. If the job duties are substantially the same, the educational expenses are excluded from wages, without limitation, as a working condition fringe benefit.

- **Documenting education expenses.** As a practical matter, employers should gather information at the time educational expenses are incurred or reimbursed that lays out the details needed to determine whether the education is a working condition fringe benefit or is subject to the employer’s written plan for educational assistance. As a leading practice, such documentation is maintained in the form of a transmittal document that assists accounts payable and payroll in determining the appropriate tax treatment of the benefit. This same transmittal document can also be referred to if the employer is asked to justify its tax treatment of the education benefit (e.g., a tax audit).

Note that qualified educational assistance also includes an employer’s repayment of a student loan. Additionally, under the [OBCCA](#), and effective January 1, 2027, the maximum exclusion of \$5,250 is indexed for inflation.

This document, which is approved by Human Resources and the Benefits and Tax departments, should answer the following questions:

- What are the employee’s current primary job duties?
- How does the education support the employee’s current primary job duties?
- Is this education necessary to the employee performing his/her current job duties?
- Is this education necessary to the employee qualifying for different primary job duties (e.g., a promotion or transfer?)
- What are the employee’s anticipated primary job duties at the conclusion of this educational program and for the foreseeable future?

Note: Free or discounted education that is provided to students and employees of educational institutions may be excluded from taxable income if it meets the requirements of IRC §132 or IRC §127. For more information, contact an Ernst & Young LLP Employment Tax Advisory Services professional by emailing your request to debera.salam@ey.com.





FAQ 7:
Nonqualified deferred
compensation

How is the distribution for FICA tax owed on nonqualified deferred compensation reported on Form W-2?

Facts: We have two nonqualified deferred compensation (NQDC) plans for our executives, both of which qualify as nonqualified deferred compensation for purposes of IRC §3121(v) and IRC §409A. Under one plan, we pay on behalf of employees any FICA taxes that are due at the time an amount vests in the plan. Under the other plan, we require that employees take a distribution at the time of vesting that is equal to the federal, state and local withholding taxes that are owed due to the vesting. What is the correct way of determining the total distribution that is required for FICA and other tax withholding purposes and how are these amounts reported on Form W-2?

Answer: Under the so-called “special timing rule” under IRC §3121(v)(2) and the IRS regulations, compensation deferred under an NQDC plan must be taken into account as “wages” for FICA purposes when earned or, if later, when no longer subject to a substantial risk of forfeiture (i.e., when “vested”). Thus, amounts deferred pursuant to an NQDC plan are required to be taken into account as wages for FICA tax purposes at the time they are no longer subject to a substantial risk of forfeiture.

Under the so-called “nonduplication rule,” once a deferred amount is taken into account under the special timing rule, neither that amount nor the income attributable to that amount will be subject to FICA taxes at the time of distribution provided the income does not exceed a reasonable rate of return. Thus, benefits under an NQDC plan generally will be subject to federal (and if applicable, state and local) income tax withholding at the time they are actually or constructively paid (typically upon distribution) but will be subject to FICA taxes only to the extent those amounts have not previously been taken into account as FICA wages under the special timing rule

The deferred compensation rules under IRC §409A generally prohibit the acceleration of the time or schedule of any payment from an NQDC plan, without regard to if it is allowed under the terms of the NQDC plan. (*Treas. Reg. §1.409A-3(j)(1)*), *Prohibition on Acceleration of Payments, In general.*) The Treasury Regulations under IRC §409A provide several exceptions to this general rule. (*Treas. Reg. §1.409A-3(j)(4)*.) The implication of making a prohibited acceleration of payments is that all vested compensation deferred under the plan is included in the employee's gross income subject to an additional 20% tax plus potentially an interest payment at the underpayment rate plus 1%. This amount would not only be subject to federal, state and local (if applicable) income taxation, but would additionally be subject to further “pyramiding” (or gross-up) of federal and state income taxes on the additional distribution of amounts to cover these income tax liabilities.

There is a specific exception under the regulations that permits an accelerated distribution from an NQDC plan to pay the FICA tax imposed under the “special timing rule” of IRC §3121(v)(2). This exception also permits an NQDC plan to provide for an additional accelerated distribution “to pay the income tax at source on wages imposed under IRC §3401 or the corresponding withholding provisions of applicable state, local, or foreign laws as a result of the payment of the FICA or RRTA amount, *and to pay the additional income tax at source on wages attributable to the pyramiding IRC §3401 wages and taxes.*” [emphasis added.] (*Treas. Reg. §1.409A-3(j)(4)(vi)*.) (See [IRS Publication 5528](#) for more information.)

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► **Calculation of federal, state and local wages subject to withholding when a distribution is made from NQDC plan for FICA tax obligation:**

As explained previously, IRS regulations allow a plan to make a distribution to cover the FICA tax obligation that occurs at the time of vesting. However, because federal income tax withholding (and state/local income tax withholding, if applicable) is also required at the time of distribution, it is necessary that a gross-up calculation be performed to arrive at the amount that is subject to withholding and reported in Form W-2, boxes 1, 3 and 5 (and the applicable state and local boxes). This gross-up calculation does not take into account any additional FICA taxes because of the nonduplication rule previously explained.

Example: Assume that Jane participates in an NQDC plan under which \$75,445, representing contributions from 2022 to 2024, vests in 2025. The plan document provides that any withholding taxes owed will be distributed from the plan. Assume also that Jane’s year-to-date wages at the time of vesting are \$300,000 and she is subject to state income tax at the rate of 6.25%. Jane’s year-to-date wages at the time of vesting exceeded the 2025 Social Security wage limit; therefore, Jane has a FICA tax obligation at the time of vesting of \$1,772.96 (\$75,445 x Medicare tax of 1.45% and Additional Medicare Tax of 0.9%, or 2.35%).

To arrive at the federal and state wages subject to income tax withholding:

- 1. 100% - federal income tax rate of 22% - state income tax rate of 6.25% = 71.75%
- 2. \$1,772.96/71.75% = \$2,471.02

Form W-2 for FICA distribution paid by employee:

Federal taxable wages (box 1)	\$ 2,471.02
Federal income tax withholding (box 2)	\$ 543.62 (\$2,471.02 x 22%*)
Medicare taxable wages (box 5)	\$75,445.00
Medicare tax (box 6)	\$ 1,772.96
Box 11 (amounts earned in 2017-2018)	\$75,445.00
State taxable wages (box 16)	\$ 2,471.02
State income tax withholding (box 17)	\$ 154.44 (\$2,471.02 x 6.25%)

**Note that if supplemental wages for the year exceed \$1 million, a federal flat tax rate of 37% applies.*

► **A tax obligation at time of vesting:**

A plan may also provide that the employer will pay any withholding tax obligations that are incurred by its employees at the time of vesting. In this case, the payment of the employees' FICA tax obligation by the employer represents wages subject to federal income tax (and state/local income tax as applicable), Social Security (up to the wage limit) and Medicare tax withholding. As in our previous example, a gross-up calculation is needed to arrive at the amount that is subject to withholding and reported in Form W-2, boxes 1, 3 and 5 (and the applicable state and local boxes). This gross-up calculation must take into account any additional FICA taxes that are owed as a result of the employer's payment of the employee's FICA, federal and state income tax obligations.

Example: Assume that Randy participates in an NQDC plan under which \$36,938, representing contributions from 2024, vests in 2025. The plan document provides that any withholding taxes owed will be paid by his employer. Assume further that Randy's year-to-date wages at the time of vesting are \$250,000 and he is subject to state income tax at the rate of 7.35%. Randy's year-to-date Social Security wages at the time of vesting exceeded the 2025 wage limit; therefore, the FICA tax obligation is \$868.04 (\$36,938 x Medicare tax of 1.45% x Additional Medicare Tax of 0.9%, or 2.35%).

To arrive at the federal and state wages subject to income tax withholding:

1. $100\% - \text{federal income tax rate of } 22\% - \text{Medicare tax of } 1.45\% - \text{Additional Medicare Tax of } 0.9\% - \text{state income tax rate of } 7.35\% = 68.3\%$
2. $\$868.04 / 68.3\% = \$1,270.92$

Form W-2 for FICA distribution paid by employer (gross-up):

Federal taxable wages (box 1)	\$ 1,270.92
Federal income tax withholding (box 2)	\$ 279.60 (\$1,270.92 x 22%*)
Medicare taxable wages (box 5)	\$38,208.92 (\$36,938.00 + \$1,270.92)
Medicare tax (box 6)	\$ 897.91 (\$36,938.00 + \$1,270.92 x 2.35%)
Box 11 (amount earned in 2018)	\$36,938.00
State taxable wages (box 16)	\$ 1,270.92
State income tax withholding (box 17)	\$ 93.41 (\$1,270.92 x 7.35%)

**Note that if supplemental wages for the year exceed \$1 million, a flat tax rate of 37% applies.*

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FAQ 8: Wellness benefits

What is the federal tax treatment of wellness benefits and can they be part of our cafeteria plan?

Facts: We offer employees various incentives under our health plan, including free annual health screenings, cash incentives for weight loss and smoking cessation, and free gym membership subsidies. Are these benefits excluded from federal taxable wages?

Answer: In a 2016 Technical Advice Memoranda (TAM), the IRS clarified the extent that employer-provided wellness benefits are included in wages subject to FIT, FITW, FICA and FUTA. The TAM gave particular focus to wellness benefits provided under an IRC §125 cafeteria plan, but it is also instructive about wellness benefits generally. ([TAM No. 201622031, 4-14-2016](#).)

While a TAM, or information letter, may not be cited as precedent it does provide insight into how the IRS may rule under similar facts and circumstances.

- **Free health screenings.** Under the facts in the ruling, an employer's wellness program provided employees with free health screenings as well as other accident and health plan benefits such that the coverage is excluded from taxable wages under IRC §106, and the benefits that constitute medical care are excludable from income under IRC § 105(b). These wellness benefits are available to employees even if they are not enrolled in the employer's group health plan. The IRS held that the value of employer-provided health screenings is excluded from wages subject to FIT, FITW, FICA and FUTA.

Under IRC §105(b), an employee may exclude from taxable income amounts to reimburse expenses incurred by the employee (including the employee's spouse, dependents and children under age 27) for medical care.

- **Wellness benefits under a cafeteria plan and gym memberships.** Under the facts in the ruling, all employees, including those who are not covered under the employer's group health plan, may elect to buy into the wellness program by making a pretax contribution through the employer's IRC §125 plan. In addition, employees who participate in the wellness program may receive benefits that do not qualify as medical expenses under IRC §213(d), such as gym memberships.

The IRS held that benefits offered under an employer's wellness program that provide medical care as defined under IRC §213(d) are generally excluded from income and wages subject to FIT, FITW, FICA and FUTA under IRC §105(b). Under IRC §125, an employee's pretax contributions for coverage under the plan are also excluded from wages subject to FIT, FITW, FICA and FUTA.

- **Taxable wellness benefits.** Any other benefit provided by the wellness program that is not medical care as defined under IRC §213(d) is included in taxable wages subject to FIT, FITW, FICA and FUTA unless it qualifies as an exempt fringe benefit under IRC §132.

For example, the value of an athletic facility operated by or on behalf of the employer and available on the employer's premises is excluded from wages subject to FIT, FITW, FICA and FUTA. However, reimbursement of an employee's cost for athletic facilities not operated by the employer is included in income and wages subject to FIT, FITW, FICA and FUTA. (*IRS Reg. §1.132-1(e).*)

- **Reimbursement of pretax contributions for the wellness program.** Under the facts in the ruling, employees may be reimbursed for all or a portion of their cafeteria plan pretax contribution toward the cost of the wellness program.

The IRS held that any employer reimbursement of employee pretax contributions toward the cost of the wellness program is included in income and wages subject to FIT, FITW, FICA and FUTA.

The scheme whereby employers reimburse employees for a portion of their pretax contributions, also referred to as “double dipping,” was addressed in [Rev. Rul. 2002-3](#) (2002-3 I.R.B. 316). In that ruling, the IRS states that if an


employer makes payments to employees that reimburse a portion of the health insurance premiums paid by an IRC §125 pretax deduction, such payments fail to meet the exclusions under IRC §106(a) and IRC §105(b) and are therefore included in taxable income and wages subject to FIT, FITW, FICA and FUTA.

- **Cash incentives under a wellness plan.** The IRS held that cash incentives are included in income and wages subject to FIT, FITW, FICA and FUTA because under IRS Reg. § 1.132-6(c), a cash award (other than overtime meal money and local transportation fare) never qualifies as an exempt de minimis fringe benefit.



Fringe benefits reporting: our frequently asked questions for 2025

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FAQ 9:
Former employee
group-term life

How are former employees' group-term life insurance reported on the Form W-2?

Facts: We provide group-term life insurance to our retirees, but because they are former employees, we are unable to withhold FICA taxes. How is this reported on Form W-2?

Answer: The employer is relieved of collecting or paying a former employee's share of FICA on group-term life insurance over \$50,000, but only to the extent it was provided to employees during periods in which there was no longer an employment relationship. If the employer failed to collect FICA for taxable group-term life insurance while the employee was still actively employed, it remains the employer's obligation to withhold or pay the employee's share of FICA.

Example. Employee John receives taxable group-term life insurance valued at \$10 per month. He worked for the employer through September 30, 2025, when he was laid off. His employer agreed to provide his life insurance benefits through December 31, 2025. The employer must collect or pay John's share of FICA for taxable group-term life insurance

provided through September 30. John may be responsible for paying his share of FICA for taxable group-term life provided in October through December. The employer will match the FICA that John pays.

► **Form W-2 reporting is required.** The employer is required to report FICA taxes it fails to withhold from a former employee's taxable group-term life insurance on the Form W-2 in the year in which the obligation was incurred.

For 2025, the value of the group-term life over \$50,000 is reported in Form W-2, box 12, code c. In Form W-2, box 12, code M the employer reports the Social Security tax not withheld and in Form W-2, box 12, code N the employer reports the Medicare tax not withheld. Note that the IRS may assess penalties for Forms W-2 on which amounts are reported in box 12, codes M and N but no amount is reported in box 12, code C.

Federal reporting for fringe benefits – 2025

Benefit type	W-2 Box 1	W-2 Boxes 3 and 5	W-2 Box 10	W-2 Box 12 ¹⁰	W-2 Box 13 ⁶	W-2 Box 14	941 Line 2 ⁷	941 Lines 5a and 5c	940 Part 2, Line 3	940 Part 2, Line 4 ⁹
Adoption assistance not more than \$17,280 per adoption	No	Yes	No	Yes ¹⁴ (code T)	No	No	No	Yes	Yes	No
Automobile, personal use	Yes	Yes	No	No	No	Yes ¹⁵	Yes	Yes	Yes	No
Business expenses: unsubstantiated or excess payments ¹	Yes	Yes	No	Yes (code L)	No	No	Yes	Yes	Yes	No

Federal reporting for fringe benefits – 2025 *(continued)*

Benefit type	W-2 Box 1	W-2 Boxes 3 and 5	W-2 Box 10	W-2 Box 12 ¹⁰	W-2 Box 13 ⁶	W-2 Box 14	941 Line 2 ⁷	941 Lines 5a and 5c	940 Part 2, Line 3	940 Part 2, Line 4 ⁹
Dependent care assistance not more than \$5,000	No	No	Yes ²	No	No	No	No	No	Yes	Yes
Group-term life over \$50,000	Yes	Yes	No	Yes (code C)	No	No	Yes	Yes	Yes	Yes
Group-term life over \$50,000, former employees	Yes	Yes	No	Yes ⁸ (code M,N)	No	No	Yes	Yes ¹²	Yes	Yes
Health plan, aggregate employer cost ¹⁶	No	No	No	Yes (code DD)	No	No	No	No	No	No
Health insurance-employer provided ¹⁶	No	No	No	Yes (code DD)	No	No	No	No	No	No
Health savings account - employer contributions and employee pretax contributions	No	No	No	Yes (code W)	No	No	No	No	Yes	No
Nonqualified deferred compensation-distribution ¹⁷	Yes	No	No	No	No	No	Yes	No	Yes	Yes
Nonqualified deferred compensation - vest ¹⁷	No	Yes	No	No	No	No	No	Yes	Yes	No
Third-party sick pay: taxable portion ¹¹	Yes	Yes	No	No	No	Yes (optional)	Yes	Yes	Yes	No
Third-party sick pay: nontaxable portion ¹¹	No	No	No	Yes (code J)	No	No	No	No	Yes	Yes
Tips: FICA not withheld ³	Yes	Yes	No	Yes (code A,B)	No	No	Yes	Yes ¹²	Yes	No

Fringe benefits reporting: our frequently asked questions for 2025

Continued

Federal reporting for fringe benefits – 2025 *(continued)*

Benefit type	W-2 Box 1	W-2 Boxes 3 and 5	W-2 Box 10	W-2 Box 12 ¹⁰	W-2 Box 13 ⁶	W-2 Box 14	941 Line 2 ⁷	941 Lines 5a and 5c	940 Part 2, Line 3	940 Part 2, Line 4 ⁹
Tips: allocated ⁴	No	No	No	No	No	No	No	No	No	No
Reimbursed moving expenses: taxable	Yes	Yes	No	No	No	Yes ¹³	Yes	Yes	Yes	No
Reimbursed moving expenses: nontaxable	No ¹³	No	No	Yes (code P)	No	Yes ¹³	No ¹³	No	Yes	Yes
§401(k) pretax contributions	No	Yes	No	Yes (code D)	Yes ⁶	No	No	Yes	Yes	No
Roth §401(k) post-tax contributions	Yes	Yes	No	Yes (code AA)	Yes ⁶	No	Yes	Yes	Yes	No
Roth §457(b) post-tax contributions	Yes	Yes	No	Yes (code EE)	No	No	Yes	Yes	Yes	No
SEP: Employer contributions	No	No	No	No	Yes ⁶	No	No	No	No	No
SEP: Employee contributions	No	Yes	No	Yes (code F)	Yes ⁶	No	No	Yes	Yes	No
§125 pretax contributions	No	No	No	No	No	No	No	No	Yes	No
§501(c)(18)(D) plans	Yes	Yes	No	Yes (code H)	Yes ⁶	No	Yes	Yes	Yes	No
Wages paid after death: year of death ⁵	No	Yes	No	No	No	No	No	Yes	Yes	No
Wages paid after death: year after death ⁵	No	No	No	No	No	No	No	No	No	No

“Yes” indicates that the benefit is reported in this area of the form. “No” indicates that the benefit is not reported in this area of the form.

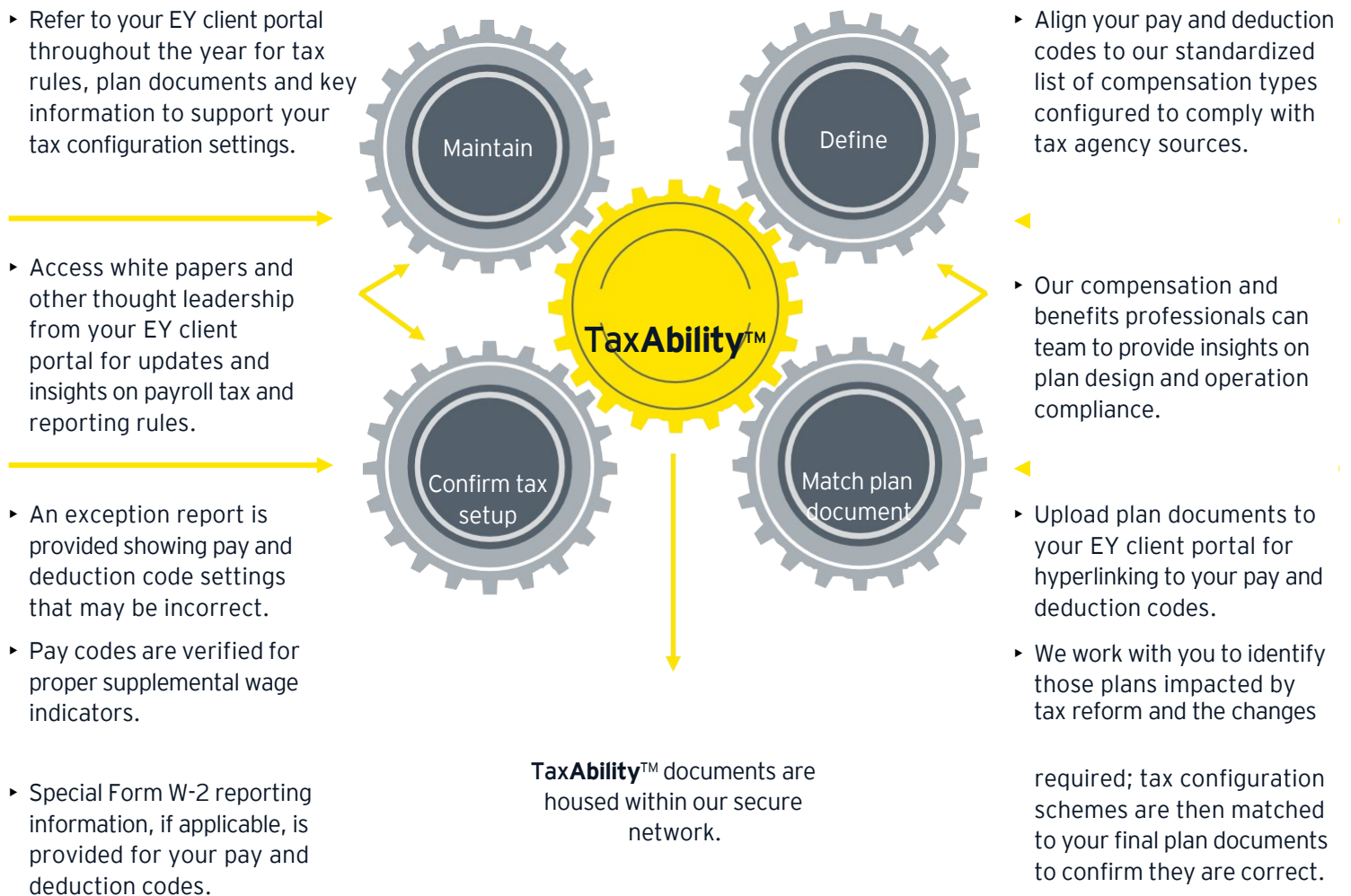
Footnotes:

- ¹ The amount equal to the government-specified rate is reported in the W-2 in box 12; the excess or unsubstantiated reimbursement is reported in boxes 1, 3 and 5.
- ² Report 100% of employer-provided dependent care assistance in Box 10, even if the value exceeds \$5,000. Also report the excess over \$5,000 per year in boxes 1, 3 and 5 of the W-2. Remind dependent care assistance plan participants to include Form 2441 with their federal tax return or the taxpayer may be disallowed the \$5,000 exclusion.
- ³ Report wages even though FICA tax not withheld. Report in box 12 of the W-2 an "A" for Social Security tax not collected from tips and a "B" for Medicare tax not collected and do not report in boxes 4 and 6 of the W-2.
- ⁴ This amount is reported in box 8 only.
- ⁵ The federal taxable amount of the payment should be reported on the 1099-MISC (rather than box 1 of the W-2) and issued to the beneficiary or recipient of the wages. Wages paid after death but in the same year as death are FICA- and FUTA-taxable and reported as such on the W-2, 941, and 940. Wages paid in the year after death are not taxable for FICA or FUTA, and are not reported on the W-2, 941 or 940 but only on the 1099-MISC. Federal taxable income in connection with nonqualified deferred compensation that is paid to the beneficiary of a deceased employee is reported on Form 1099-R.
- ⁶ Box 13, "retirement plan," is checked for all participants in a retirement plan. This may include those employees who are eligible but elected not to participate. Discuss with your organization's benefits consultant.
- ⁷ See the 941 instructions for line 2.
- ⁸ Report taxable group-term life insurance over \$50,000 in box 12 with the amount preceded by a "C." Report uncollected social security tax from former employees' taxable group-term life insurance in box 12 preceded by an "M." Report uncollected Medicare tax in box 12 preceded by an "N." You must show the taxable group-term life in box 12 preceded by Code C to avoid being assessed the amounts reported in box 12, Codes M and N.
- ⁹ Check one of the boxes as appropriate for the wage type that is exempt from FUTA. For instance, check box 4(a), "fringe benefits" for pretax health contributions under a cafeteria plan arrangement and 4(b), "group-term life" for taxable group-term life over \$50,000.
- ¹⁰ Letters shown in this column must precede the dollar amount in box 12. There must be at least one space between the code and the dollar amount.
- ¹¹ Sick pay received in the first six months from the last day of the month that the employee last worked is reported in boxes 1, 3 and 5 of the Form W-2. Sick pay received after this six-month coverage period is reported in box 1 of the W-2 only. Report nontaxable sick pay in box 12 with the code J. Form 8922 is required if Forms 941 and W-2 will not agree (usually applies to the third-party payer).
- ¹² Show a credit for the Social Security and/or Medicare tax not withheld from tips and/or group-term life insurance over \$50,000 on line 9 of the Form 941.
- ¹³ For expenses incurred through December 31, 2017: Exclude nontaxable amounts from box 1 of the W-2 and Line 2 of the 941. Taxable relocation expenses are also reported as Social Security and Medicare wages on the Forms W-2 and 941. Report nontaxable relocation reimbursements made directly to employees in box 12 of the W-2 preceded by a "P." Do not report nontaxable payments made directly to third parties in box 12; however, include these amounts on Form 940, Part 2, Line 3 and Part 2, Line 4 (check box 4e). Box 14 reporting is optional.
- For expenses incurred on and after January 1, 2018: Reimbursements or payments made to third parties for moving expenses are no longer excluded from taxable wages. An exception applies to moving expenses incurred by members of the Armed Forces.
- ¹⁴ When reporting adoption assistance in box 12, exclude amounts forfeited under an adoption assistance flexible spending account.
- ¹⁵ If 100% of a vehicle's use is reported in box 1 of the W-2, show in box 14 the amount included in box 1 of the W-2 or provide a separate statement to employee with this information.
- ¹⁶ Under the Affordable Care Act of 2010 and effective in 2012, employers are required to report in Form W-2, box 12, code DD the aggregate cost of employer-provided group health care if they filed 250 or more Forms W-2 in the previous tax year. This amount is informational only and has no effect on taxable wages.
- ¹⁷ If a nonqualified deferred compensation amount reported as FICA wages in boxes 3 and 5 or as FIT wages in box 1 was earned in prior year, report the amount earned in a prior year in box 11. Do not report in box 11 amounts that were vested and distributed in the tax year (See [IRS Publication 5528](#) for more information.)

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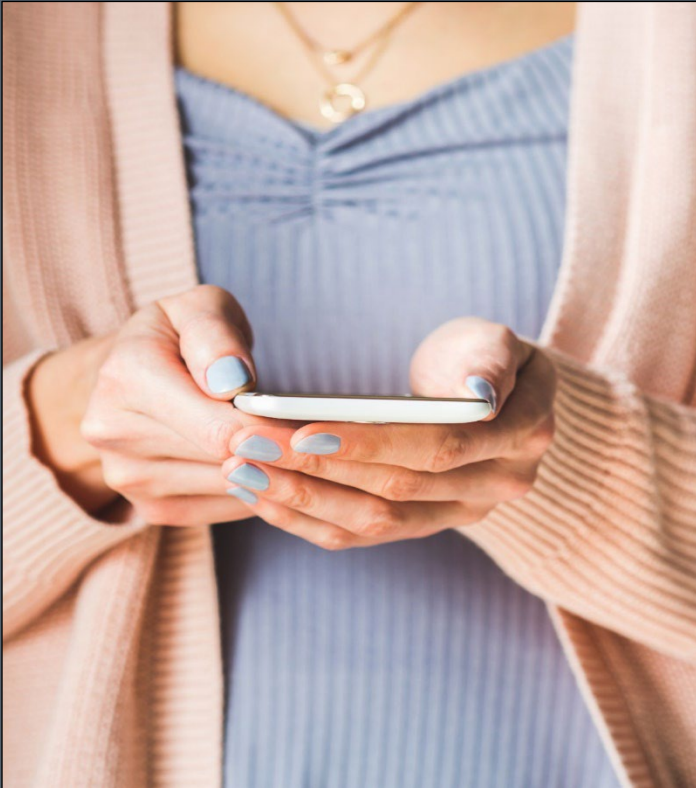
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