

MEMORANDUM OF LAW

DATE: January 27, 1989

TO: Lawrence Grissom, Retirement Administrator
FROM: City Attorney
SUBJECT: Applicability of Section 125 Cafeteria Plan
Benefits to Retirees

A retired City employee has requested that you study the possibility of establishing a cafeteria plan for retirees that would allow health care premiums to be paid with pre-tax dollars. You initially indicated your belief that Internal Revenue Code section 125 restricts cafeteria plans to active employees. We agree.

Section 125 of the Internal Revenue Code authorizes employers to establish cafeteria plans which permit certain qualified employee benefits to be paid for by the employer with pre-tax dollars. The term "qualified benefits" is defined in section 125(f), as follows:

For purposes of this section, the term "qualified benefit" means any benefit which, with the application of subsection (a), is not includable in the gross income of the employee by reason of an express provision of this chapter (other than section 117, 124, 127 or 132).

...

The term "employee" is defined in 26 Code of Federal Regulations 31.3401(c)-1 as follows:

a. the term "employee" includes every individual performing services if the relationship between him and the person for whom he performs such services is the legal relationship of employer and employee. ...

Retired employees do not fit this definition. Therefore, retired City employees are not eligible to participate in a cafeteria plan under the current regulations. However, this fact does not affect the ability of the City Employees'

Retirement System to pay for an eligible retired employee's health insurance pursuant to section 401(h) of the Internal Revenue Code.

JOHN W. WITT, City Attorney

By

John M. Kaheny

Chief Deputy City Attorney

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