Find, Attract, and Retain Workers With Affordable Benefits

by Mark E. Battersby

How can any child care center, for-profit or non-profit, hope to compete with large companies whose compensation and motivation programs have grown so complex that a whole new category of software, incentive compensation management, is required? Many child care center owners and directors have discovered that employee benefits can often eliminate the need for incentive compensation or even time sheets or time cards. Providing benefits, things for employees that, if they purchased them for themselves, would normally be considered personal or family expenses, are well-proven motivators. And, best of all, the cost of providing employee benefits, a special type of fringe benefit, is often tax deductible.

Whether for-profit or non-profit, a child care center can usually deduct the cost of providing benefits such as accident and health plans, group term life insurance, adoption assistance, dependent care assistance, and educational assistance. Adding to the value of many of these benefits is the fact that the cost of many of them can often be excluded from the recipient's income.

Mark E. Battersby is a tax and financial writer, columnist, author, and adviser with offices in the suburban Philadelphia community of Ardmore, Pennsylvania. For more than 25 years, Mr. Battersby's features and columns have appeared in leading trade and professional journals. His topical columns are syndicated to over 65 publications each week. He has authored four books.

Surprisingly, survey after survey shows that it is not money alone that attracts new workers and keeps existing employees on the job. It is the benefits. And now, thanks to our unique tax laws, every smart director and owner can not only afford to offer fringe benefits to their workers, they may even be able to benefit themselves.

That's right, our tax laws merely prevent an employer from discriminating in favor of owners, key employees, or other highly-compensated individuals when setting up any benefits plan that is to be tax deductible by the child care business and tax-free to the recipient. Those laws do not say that the key employees and owners cannot also benefit from the same *perks* offered every other employee.

Proceed cautiously

Fringe benefits that are not specifically excluded from employees' income must be included in the employees' taxable income, at their value, as well as subject to the payroll taxes that the employer pays. This is also true when the benefits don't meet the federal requirements. Some types of benefit plans, for instance, are not permitted to discriminate in favor of highly compensated employees, such as the child care business' director or owner. This is particularly true of not-for-profit or non-profit operations.

If the plan is found by the Internal Revenue Service to discriminate, the value of the benefits will generally be treated as taxable compensation to the highly compensated employee who receives them. Of course, the cost of the benefit to the child care business remains tax deductible even if found to discriminate.

What do they want?

According to the results of one widely-publicized survey (US Chamber of Commerce, Washington, DC), the best perk that any employer can give an employee is one that she wants and that costs you little or nothing. Thus, while stock options and big salaries may be needed to lure higher level employees, the average child care center can get some pretty good mileage out of some inexpensive perks. A few common ones that consistently get high marks are:

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- Flex time
- Company discounts
- Free food and free beverages
- Casual dress Fridays (or full time)
- Education or personal development training (on or after company time).

Notice that among the perks most often chosen by employees only one, education or personal development, actually costs the employer. That's when our tax rules step in to provide a helping hand.

When education is offered as a fringe benefit by a child care center, the payments received by an employee for tuition, fees, books, supplies, etc., under the employer's educational assistance program may be excluded from the employee's income up to $5,250 per year. Although the courses covered by the plan need not be job related, courses involving sports, games, or hobbies may be covered only if they involve the employee's business or are required as part of a degree program.

And, best of all, the child care business, whether for-profit or non-profit, may claim a full tax deduction for the amounts paid. Drawbacks include the necessity of a formal tuition reimbursement plan and, obviously, sufficient cash flow to fund that program.

The basics

First, small employers such as most child care centers must:

- Allow employees time off to:
  - — vote
  - — serve on a jury
  - — perform military service
- Comply with all requirements of workers' compensation
- Withhold for FICA and FUTA
- Contribute to state disability programs in states where such programs exist (California, Hawaii, New Jersey, New York, Puerto Rico, and Rhode Island).

Those child care centers do not, obviously, have to offer their employees special or unique benefits.

Benefits from benefits

No matter which specific benefits your employees may be clamoring for or which benefits the competition is offering, you need to assess how those benefits will impact on your child care center or business. If, for example, you offer popular benefits such as generous time-off policies or health insurance, you are going to be able to attract — and keep — more and better employees. But will it be worth the cost?

While each employee has different needs, the recent trend has been pointing toward health insurance as the most important and highly valued benefit for employees. Health insurance is tax-deductible to the employer and tax-free for the employee. What's more, a child care business can frequently purchase it at a lower cost than the employee would ordinarily pay for an individual policy.

Some child care centers have discovered that, especially if they employ a lot of part-timers, health benefits may not be that important because the employee is getting health benefits from another source (from another full-time job, through a spouse's employer, or through a parent's health insurance). In that case, a smart owner or director would focus on offering other, less expensive benefits, that would still be considered valuable by employees. Or, you may find that employees would prefer more cash compensation rather than any particular benefit.

Keep in mind, however, that although that cash paid in lieu of fringe benefits remain a legitimate, tax deductible business expense for the child care operation, the employee is required to include the amount in his or her income and pay taxes on it. This illustrates the often-overlooked value of fringe benefits programs offered by employers. In addition to the child care operation's tax deduction for the expense of providing fringe benefits, those benefits are usually tax-free to the recipient.

The cheapest may be the most expensive

Bonuses and awards must, as mentioned, be included in an employee's taxable income. Should the bonus or award be in the form of goods or services, employees must include the fair market value of the goods or services in their income. The same applies to holiday gifts. However, employees who receive turkeys, hams, or other similar items of nominal value from their employers at Christmas or other holidays may exclude the value of the gift from their income.

On a similar note, so-called *de minimis* benefits may be worth little or nothing in the eyes of our lawmakers, but can go a long way toward making an employee happy — without an accompanying bill. Under the rules, employees may exclude from their gross income the value of fringe benefits that qualify as de minimis.

De minimis fringe benefits mean any property or service that is so small in value that accounting for it is unreasonable or administratively impractical. Examples include:

- occasional meal money or local transportation fare
- occasional personal use of an employer's copy machine
- occasional cocktail parties, group meals, or picnics for employees and their guests

- inexpensive birthday or holiday gifts (except cash)
- coffee, doughnuts, and soft drinks
- local telephone calls
- flowers, fruit, books, or other similar items given to employees for special occasions or under special circumstances.

If you do go the retirement benefits route

While 401(k) plans are popular with large corporate employers, they are not the most popular plans for small business owners since they severely limit the amount of money that a business owner can sock away on his own behalf. For those child care center owners who are going to the trouble and expense of setting up a pension plan, a money-purchase plan would generally offer more flexibility and the opportunity to defer tax on a much larger nest egg.

In a money-purchase plan, the employer is obligated to contribute each year even if the child care center didn't make a profit (taxable or nontaxable). The contributions are determined by a specific percentage of each employee's compensation and must be made annually. The employer may contribute up to the lesser of (1) 25% of the employee's compensation (up to $205,000 maximum deduction); or (2) $42,000 in 2005. For yourself, you can contribute up to $14,000 to a 401(k)-type plan.

Other, less expensive alternatives include:

- **Simplified Employee Pensions** (SEPs), is a written arrangement that allows an employer to make contributions toward his own and employees' retirement without becoming involved in more complex retirement plans. The contributions are made to special IRAs (SEP-IRA) set up for each individual qualifying employee.
- **SIMPLE Plans**. A child care center can adopt a relatively new type of simplified retirement plan, the Savings Incentive Match Plan for Employees (SIMPLE). If you want to establish a SIMPLE, it must be the only retirement plan you have; if you've already established another plan you'd have to terminate it or convert it to a SIMPLE.

The plan (SIMPLE Plan) allows employees to make elective contributions of up to $10,000 in 2005 and usually requires employers to make matching contributions — up to 3% of each employee's pay. Alternately, you can decide to make a blanket contribution of 2% of each participating employee's pay regardless of whether they make any elective contributions. These are the only contributions permitted. You cannot opt to contribute more for older employees, managers,
or the business owner.

The bottom line

In putting together a benefits package, you need to weigh a number of factors: what benefits are of high value to employers and employees alike; what benefit the employees prefer; what benefits competing centers are offering; and finally, what benefits your center can afford.

Wouldn't it be ironic in this day and age of escalating costs and increased competition for good, qualified employees, if those benefits that offered the most reward to both the child care business' employees and its owners, turned out to be the ones which cost the least?