



Honorable Mayor and Members of the Hermosa Beach City Council

**ADOPT A RESOLUTION TO RETROACTIVELY APPROVE A SECTION 125
CAFETERIA PLAN AND ADOPTION AGREEMENT**

(Human Resources Manager Tiffany Nguyen)

Recommended Action:

Staff recommends City Council:

1. Adopt a Resolution to approve a Section 125 Cafeteria Plan, retroactive to January 1, 2023; and
2. Authorize the City Manager to execute a Section 125 Cafeteria Plan Adoption Agreement, subject to approval by the City Attorney.

Executive Summary:

In January 2023, the City implemented a “Cafeteria Plan” under Section 125 of the Internal Revenue Services (IRS) Code. The IRS Code Section 125 permits an eligible employer to implement a “Cafeteria Plan” for the benefit of its eligible employees. This plan allows for payroll deductions for healthcare plans, other medical out-of-pocket expenses and dependent care expenses on a pretax basis.

Through a recent audit of files, it was recently discovered that the adoption of the City’s Section 125 Cafeteria Plan was not previously brought to Council for approval. As such, it is prudent for the City to obtain Council approval on this item as soon as possible.

Background:

A Section 125 Plan allows for pretax payroll deductions for healthcare plans, other medical out-of-pocket expenses and dependent care expenses. It also allows for employers to offer “cash-in-lieu” if employees opt out of medical coverage. To implement a Section 125 Cafeteria Plan, employers are required to follow a series of steps to ensure compliance with IRS regulations, labor laws, and best practices.

In 2023, the City followed required steps and established and implemented a Section 125 Cafeteria Plan. Employees now have the flexibility to utilize pre-tax dollars to pay for eligible healthcare plan, medical, and dependent care expenses. Additionally, based on existing MOUs between the City and certain bargaining units, employees may have the ability to receive cash-in-lieu if they were to opt out of medical coverage through the City.

Analysis:

One of the requirements to adopt a Section 125 Cafeteria Plan is to obtain governing body (i.e., City Council) approval to adopt the plan, to include a staff report and resolution. However, a recent audit of files revealed that this step had not been completed prior to the implementation of the plan. As such, the City is currently not in compliance with IRS regulations. Therefore, it is imperative for the City to obtain approval for the adoption of this plan as soon as possible, so that the City can be in compliance with IRS regulations.

Fiscal Impact:

There is no immediate fiscal impact to the City associated with the recommended actions, as the plan was previously set up and implemented in Calendar Year 2030.

A Section 125 plan allows employees to receive certain health benefits on a pretax basis. Generally, qualified Section 125 benefits are not subject to FICA, FUTA, Medicare or income tax withholding.

Attachments:

1. Resolution to Approve the City of Hermosa Beach Cafeteria Plan
2. Section 125 Cafeteria Plan Adoption Agreement

Respectfully Submitted by: Tiffany Nguyen, Human Resources Manager

Noted for Fiscal Impact: Henry Chao, Finance Manager

Concur: Brandon Walker, Administrative Services Director

Legal Review: Isabel Safie, BBK Law

Approved: Steve Napolitano, Interim City Manager