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## **Premium Only Plan (POP)**

This plan allows employees to make their contributions to group health and group term life insurance with pre-tax dollars. A Premium Only Plan creates no new benefits. The employer is simply offering a way to obtain favorable tax treatment on benefits already offered. Here's how the Premium Only Plan works:

- Employees' premium contributions are automatically deducted from their salaries before taxes are taken out.
- Taxable income is reduced by the amount contributed, so employees pay less in taxes and have more take-home pay.
- With employee pre-tax income lowered, employers pay less in Social Security (FICA) payroll taxes. (A business should consult their tax advisor for applicable state legislation.)
- A POP is the simplest type of Section 125 plan, and it requires low maintenance once it has been set up.

## **Flexible Spending Account (FSA)**

This plan allows employees to use pre-tax dollars to pay dependent care expenses and medical bills not covered by their insurance. Usually offered in conjunction with a POP, the FSA is a budgeting tool that can help take care of out-of-pocket expenses such as day care, dental and optical care deductibles, co-pays, and prescription drugs. Like a POP, an FSA helps pay for itself by increasing employee take-home pay while decreasing employer payroll taxes. Here's how it works:

- An employee decides how much of their salary should be set aside before taxes are calculated.
- This amount is automatically deducted from their paycheck every pay period, just like any other payroll deduction, and is deposited into their FSA account.
- The employees would pay their out-of-pocket expenses up-front, and then submit a claim and documentation and a reimbursement is made from their own account.

### ***Out-of-pocket expenses include:***

Eyeglasses and contact lenses  
Medical insurance deductibles  
Prescriptions  
Co-payments  
Orthodontia  
Chiropractic services  
Dental treatments  
X-ray and laboratory services

### ***Dependent care expenses include:***

Care for a child under the age of 13  
Care for a disabled spouse or dependent incapable of caring for him/herself  
Household-related services (i.e., visiting nurse)

The flexibility of an FSA plan makes it the best option for small to medium sized businesses.

## **Full Cafeteria Plan**

A full cafeteria plan usually includes POP and FSA features. Under this plan, employees receive a lump sum of money to spend on their benefits and the employer provides a menu of benefit options for employees to choose from. If the employee does not use all of their allotted money towards benefit costs, whatever is leftover will be included in the employee's taxable income for the year.

## **Flexible Spending Account Administration**

Since individual accounts must be maintained, the medical benefit portion of a Cafeteria Plan will require administration by the employer. The employer will need to account for the following:

- Additions to each employee account. These additions result from redirected payroll amounts each pay period.
- Employee requests for reimbursement. The employee could request an amount in excess of his or her current account balance. The excess request must be recorded by the employer, so that it can be reimbursed when the employee's account receives future redirected payroll amounts.
- Employee reimbursements. Normally are paid to the employee, but can be paid directly to the provider of the benefit, if requested by the employee, and if the plan provisions provide for this administrative increase.

## **Advantages of Including the Medical Expense Reimbursement Option**

- Employees recognize significant tax savings. Employees save income taxes as well as the FICA (Social Security) tax on the portion of income deferred.
- Administrative costs will be slightly more per month. Generally, this is so for each employee. The employer may wish to deduct the administrative costs from the employee's paycheck. Such a deduction would still be just a fraction of the employee's overall savings.
- A means is provided for employees to deduct expenses. These expenses may otherwise be non-deductible.
- Employees are encouraged to seek regular medical care. This occurs because of the simplicity with which medical expenses are paid.

## **Advantages of Including Dependent Care Option**

The dependent care benefit option is comparable to the medical benefit option discussed previously. The similarities are:

- An estimate of dependent care expenses must be made. The estimate must be done by the employee prior to the plan year.
- The estimated dependent care expenses are redirected. They are moved from the employee's salary to the individual's Cafeteria Plan account. Reimbursements are made from this account to the extent of the account balance.
- Individual accounts require employer administration.
- Income and Social Security taxes are reduced. They are not paid on the amount of salary redirected.

## **Administrative Costs**

Administrative costs will vary significantly between plans. As discussed previously, a plan which offers insurance only would require virtually no administrative costs. (The Cafeteria Plan deduction is handled in a manner similar to payroll deductions for insurance premiums.) On the other hand, the remaining benefits would require additional expense. The amount of administrative expense that an employer is willing to absorb may be affected by one of the following factors:

- Will the tax savings pay for the administrative costs?
- Does the employer have sufficient payroll/accounting staff? Extra staff may be required to handle the administrative work.
- Can the company do the administrative work in-house?