Bend The Cost Curve For Employee Benefits

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What's some of the best news you can share with your clients? Offering benefits that don't cost them a dime!

Pipe dream? No—you can share the news with your clients right now. By reducing the amount of Federal Insurance Contribution Act (FICA) tax employers owe to the Internal Revenue Service (IRS) every pay day, their benefits package could be free.

What kind of benefits am I talking about? For starters, there are cafeteria plans and commuter benefits. Then I'll move on to other types of benefits that don't directly save the employer money, but can produce savings when coupled with additional employee offerings.

Cafeteria Plans

Cafeteria plans are not just one benefit, but rather a method of delivering a variety of different benefits. An employer can provide a "menu" of options, thus the reference to "cafeteria." Employers can choose just the benefits they wish to offer and employees pass through the cafeteria plan "line" to select the specific benefits they want on their "tray" based on their individual needs.

Here's the menu of benefits that employers can offer their employees.

Premium Only Plans. Sometimes called POPs, this portion of a cafeteria plan allows employers to reduce a portion of their salary in order to pay for employer-sponsored insurance policies or benefits with pretax dollars. Premium only plans are not considered flexible spending accounts (FSAs) because employees are generally not required to submit claims in order to reimburse their premium expenses and premiums cannot be paid through a health FSA. The employer is the conduit for paying the salary reductions straight to the various insurance carriers.

Flexible Spending Accounts. Other benefits offered through a cafeteria plan are commonly called flexible spending accounts, or FSAs. This means that employee salary reductions are held by the employer for future reimbursements. An employee must incur eligible expenses in order to submit claims for reimbursement. Once a claim is adjudicated and approved for payment, untaxed dollars are returned to the employee as a reimbursement for expenses incurred.

FSA benefits reimbursed from cafeteria plans include medical expenses, dependent or child daycare expenses and adoption expenses.

Medical Benefits. In addition to paying for medical coverage through tax-free salary reductions, an additional medical benefit offered through a cafeteria plan is routinely called a health FSA. This sounds simple enough, but what exactly does the IRS consider to be a "medical expense"?

We'll get the "IRS language" out of the way first. "Eligible medical expenses include amounts paid for the diagnosis, cure, mitigation, treatment or prevention of disease, and for treatments affecting any part of or function of the body."

These expenses are typically what we think of as normal medical charges—trips to doctors, dentists or optometrists—and include eligible fees, prescriptions and medical equipment.

Dependent Care Benefit. This benefit reimburses a participant for daycare expenses. Expenses must be incurred for an eligible child or adult and must allow a participant and spouse, if married, to work or look for work.

This benefit will get more notice as baby boomers age and have responsibility for their parents. An older adult must be a dependent of a participant, be unable to self care, and live with a participant at least eight hours per day.

A dependent care tax credit is available that can be included in a family's tax return filing. Whether to participate in the daycare portion of a cafeteria plan or to take the tax credit depends on an individual's filing status, number of dependents and annual daycare expenses.

Adoption Assistance Benefit. The adoption assistance benefit allows employees to redirect a portion of their salary to pay for most expenses associated with a legal adoption. The 2012 IRS limit on expenses that can be turned in for any one adoption is $12,650. This figure will ordinarily be indexed upward each year. The credit is available to everyone, but will reduce as family income levels increase.

An additional rule to keep in mind for adoption benefits would be the taxation of an employee contribution. Most benefits elected and payroll reduced through cafeteria plans are not subject to federal, Social Security and most state taxes. However, the contributions made to the adoption assistance portion of a plan *will be* subject to the 7.65 percent Social Security, or FICA, taxes. That also means employers will need to pay their matching portion of FICA taxes.

Other Cafeteria Plan Benefits. A cafeteria plan can even offer employees a way to buy and sell vacation days, make contributions to 401(k) plans and deliver employer flex credit contributions. So brush up on these under-utilized benefits and guide employers to expand and update their menu items.

Commuter Benefits allows employees to pay for mass transit or van pooling expenses and parking expenses at or near their place of employment or a location where they take a form of mass transit to work, with pre-tax dollars. The 2012 IRS limit on mass transit and van pooling expenses that may be reimbursed on a tax-free basis per month is $125, and the monthly parking limit is $240.

Although commuter benefits cannot be included in a cafeteria plan, they work much like cafeteria plans except that contributions and reimbursements are monthly limits. Employee salary reductions to the plan escape federal and Social Security taxes, plus employers save on the matching FICA taxes.

All these benefits, with the exception of adoption assistance benefits and 401(k) contributions, add up to big savings for employers. When employers set up cafeteria plans, they reduce the employer portion of FICA. Depending on the number of participants and the amount of their salary redirections—the plan can literally pay for itself—with savings left over.

Table 1 shows an example of how a small employer with 100 employees can reap big savings:

Component Plan Savings. Cafeteria plans and commuter benefits are just the beginning. By coordinating a higher-deductible health plan with a health reimbursement arrangement (HRA), premium savings can be substantial. And the benefit to employees could be more than monetary.

By utilizing a higher-deductible health plan with an HRA, employees are afforded a clearer look at the true cost of office visits and prescriptions. Employees are compelled to make wiser choices to help reduce health care spending.

Another plan to consider with a qualified high-deductible health plan is a health savings account (HSA). An HSA is an individually-owned health care spending account that allows pre-tax contributions to be accumulated tax free, and the account balance rolls forward from month to month and year to year. Pre-tax salary reductions for the HSA made through a cafeteria plan mean more tax savings for employees and employers.

And speaking of HSAs—the IRS issued new, indexed figures for 2013 to start employer planning processes. (See last month's article.)

Increase Participation, Increase Employer Savings

Encourage employers to start now to advertise their benefit plans and educate employees to ensure greater participation in the upcoming plan year.

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