Flexible Benefits - Section 125

The Flexible Benefits Program is an employee benefit program designed to take advantage of provisions contained in Section 125 of the Internal Revenue Code. The plan helps you save money by converting group insurance premiums, unreimbursed medical expenses and dependent care expenses from an after-tax to a before-tax basis.

Because you reduce your taxable income by using The Flexible Benefits Program, you will pay lower Federal, State and Social Security taxes, increasing your take-home pay.

What is Section 125?
Section 125 is part of the Internal Revenue Code that allows for Flexible Benefits Programs (Cafeteria Plans).

What are the advantages?
The advantages of the plan are to save you money on taxes.
- Increases take-home pay
- Reduces Federal and State Income Tax
- Reduces Social Security Tax

What is the Flexible Benefits Program?
The Flexible Benefits Program is a separate written benefit plan maintained by an employer for the benefit of employees under which all eligible employees have the opportunity to select one or all of the following three options:

1) Premium Conversion — amounts you pay for insurance premiums are set aside in before-tax dollars for the following Group Sponsored Insurance Programs:
- Health
- Dental
- Vision
- Prescription Drug
- Term Life Insurance up to $50,000
- Long-Term Disability*
- Short-Term Disability*
- Indemnity Plans (Hospital/Cancer)

2) Medical Spending Account — allows you to set aside before-tax dollars to pay for medical expenses which are not paid by insurance or the employer. These expenses include medical, vision and dental expenses normally allowed by the IRS as deductions. IRS Publication 502 lists the eligible medical expenses.

3) Dependent Care Spending Account — allows you to set aside before-tax dollars to pay for day care expenses for children under the age of 13 or for adult day care for a disabled spouse or other disabled dependent. The usual IRS rules about what constitutes eligible dependent care expenses apply. A maximum of $5,000 can be set aside in a Dependent Care Spending Account for each plan year for married couples filing joint tax returns and single head of household tax returns.

The amount you designate for the Medical or Dependent Care Spending Account should be about the same amount you would normally pay for services out of your take-home pay and for which you are not reimbursed by insurance.

Contributions to a Medical or Dependent Care Spending Account are made automatically from your paycheck each pay period before income taxes are deducted from your gross salary.

Once money is set aside in a Spending Account, it is not subject to Federal, State or Social Security Taxes.

*NOTE: Benefit payments on long-term and short-term disability will be taxable to the recipient if the premiums are paid in before-tax dollars.

1
**Here is how the tax savings work.**
The following is an example of what you may save by participating in premium conversion:

Let’s assume you are married with two children and claim four exemptions. Your monthly salary is $1,300 and out of this salary, pay $100 in insurance premiums each month.

**Without Premium Conversion:**

- **Monthly salary** $1,300.00
- Less: Federal Withholding Taxes .......... 43.00
- State Tax (14% of Federal) ............... 6.02
- Social Security Tax .................. 99.45
- Take-home pay ................................ $1,151.53
- Less: Employee’s Insurance Premium .... 100.00
- Net Take-home pay .......................... $1,051.53

**With Premium Conversion:**

- **Monthly Salary** $1,300.00
- Less: Employee’s Insurance Premium .... 100.00
- New Salary For Withholding Taxes .. $1,200.00
- Less: Federal Withholding Tax .......... 31.00
- State Tax (14% of Federal) ............... 4.34
- Social Security Tax .................. 91.80
- New Net Take-home pay ................... $1,072.86

With premium conversion, there was an increase in take-home pay of $21.33 a month or $255.96 per year.

The savings are increased with the use of flexible spending accounts for dependent care expenses and unreimbursed medical expenses.

In the next example, let’s say that in addition to the $100 paid in insurance premiums each month, you also spend $240 per month on child care expenses and $40 a month on out-of-pocket medical expenses.

**Without Flexible Benefits:**

- **Monthly salary** $1,300.00
- Less: Federal Income Tax .......... 43.00
- State Tax (14% of Federal) ............... 6.02
- Social Security Tax .................. 99.45
- Take-home pay .................... $1,151.53
- Less: Insurance Premiums .......... 100.00
- Dependent Care Expenses .......... 240.00
- Medical Expenses .................. 40.00
- **Net Take-home pay** .............. $771.53

**With Flexible Benefits:**

- **Monthly Salary** $1,300.00
- Less: Insurance Premiums .......... 100.00
- Dependent Care Expenses .......... 240.00
- Medical Expenses .................. 40.00
- Adjusted Taxable Salary .......... $920.00
- Less: Federal Income Tax .......... 0.00
- State Tax (14% of Federal) ............... 0.00
- Social Security Tax .................. 70.38
- **Adjusted Net Take-home pay** .......... $849.62

Using both premium conversion and flexible spending accounts, there is an increase in take-home pay of $78.09 per month or $937.08 per year.

**Exactly how does the FSA work?**

With an FSA, you instruct your employer to set aside a specific portion of your salary into one or both flexible spending accounts:

1. Dependent care spending account
2. Medical spending account

The amount you designate for your FSA should be about the same amount you would normally pay for such services out of your take-home pay and for which you are not reimbursed by insurance.
Then what happens?
Deposits will be made automatically from your paycheck each pay period before income taxes are deducted from your gross salary.

Once money is set aside into your FSA, it's not subject to federal or state income tax or FICA taxes. Since your taxable income is lower, you'll pay fewer taxes. The difference is extra income for you to spend any way you like.

How do I decide whether or not to participate?
Prior to the start of the flex plan year you will have an opportunity to meet with a Flexible Benefits Enroller to discuss the program and complete a Flexible Benefits enrollment form.

What is a flex plan year?
The plan year is a 12-month period set by your employer that begins with the effective date of the plan.

Since I am saving Social Security taxes by participating in the program, will Social Security benefit payments to me upon retirement be reduced?
Yes, personal insurance plans, retirement plans and savings plans can offset any reduction.

How do I know how much to set aside into my FSA?
Our confidential employee worksheet helps you. Basically, you should estimate how much you would normally pay for the designated expenses out of after-tax income and designate that amount for your FSA. Be conservative, though. The IRS has a "use it or lose it" rule.

"Use it or lose it" – What does that mean.
It means that if there's anything left in your account at the end of the plan year, you will forfeit that amount. You can carry balances from your account forward from month to month, but you have to incur expenses for all your designated dollars by the end of the plan year. That's why it pays to be conservative about variable or unknown expenses. Keep in mind that funds allocated to one account cannot be moved to another account (for instance, you can't use funds from a dependent care account to pay for health care expenses).

How do I get my money out of my FSA?
When your employer deducts the money from your paycheck, it is placed in a special account. That account is used to reimburse you for your expenses. Instructions for requesting reimbursement are included later on in this information packet.

Can I drop out of the program during the plan year, if I decide I don't like it?
Generally no. If an employee participates in the flexible benefits program, the benefit elections must remain the same until plan year renewal unless the participant experiences a lifestyle change.

What are considered "Lifestyle" Changes?
Changes in employee elections are not permitted during the plan year unless there is a change due to one or more of the following:

- The employee's marriage
- The employee's divorce
- Death of an employee's spouse or child
- Birth or adoption of a child by the employee
- Termination or commencement of employment by the employee's spouse
- The employee or employee's spouse switching from part-time to full-time or from full-time to part-time employment
- The employee or the employee's spouse taking an unpaid leave of absence
- Significant changes in the health coverage of the employee or the employee's spouse attributable to the spouse's employment.

A Lifestyle/Status Change Form must be completed within 30 days of the Lifestyle/Status Change.
When are medical and dependent care expenses “incurred?”
Expenses are treated as incurred when the participant is provided with the medical care or the dependent care that gives rise to the expense and not when the participant is formally billed, charged for or pays for the expense.

Expenses must have been incurred during the flex plan year in order to be reimbursed. The participant has 90 days from the end of the flex plan year to request reimbursement for the incurred expenses during that plan year.

What constitutes eligible expenses?
The following is a partial list of eligible expenses from the Flexible Spending Accounts.

- Adult day care expenses for disabled dependent or spouse
- Ambulance
- Artificial limbs
- Birth control pills
- Braces
- Braille books and magazines
- Car controls for handicapped child
- Child care expenses
- Chiropractors’ fees
- Christian Science practitioners’ fees
- Coinsurance
- Contact lenses
- Crutches
- Deductibles
- Dental fees
- Dentures
- Diagnostic fees
- Drug addiction treatment
- Eyeglasses
- Eye examinations
- Fertility drugs
- Hearing aids and batteries
- Home improvements for medical reasons
- Hospital bills
- Immunizations

- Insulin
- Laboratory fees
- Maternity care
- Obstetrical services
- Operations
- Orthopedic shoes
- Oxygen
- Physicians’ fees
- Prescription Drugs
- Psychiatric care
- Psychologists’ fees
- Routine physicals
- Surgeons’ fees
- Telephone designed for deaf person
- Television audio display equipment for the deaf
- Therapeutic care for drug and alcohol addiction
- Transportation expenses used for medical purposes
- Well-baby and well-child care
- Wheelchair
- X-rays

*Insurance premiums are not eligible for reimbursement from flexible spending accounts.*