The Magic of Cafeteria Plans

Offering voluntary health, life and accident benefits through a cafeteria plan can help both employers and employees save on taxes.

It might sound too good to be true. With a voluntary benefit plan, employees pay the premiums — and employers get a tax break! But if employers offer a cafeteria plan and allow employees to use cafeteria dollars to buy certain voluntary benefits, both the employer and employee will enjoy lower taxes. Here’s how it works.

Step 1: Create a Written Plan

A cafeteria plan must meet the specific requirements and regulations of section 125 of the Internal Revenue Code. For this reason, you might hear these plans called “Section 125 plans.”

The two most common types of cafeteria plans are premium-only plans (POPs) and flexible spending accounts (FSAs). POPs require less setup and administration on the employer’s part. They allow employees to use pre-tax dollars to pay premiums for qualified accident and health and group term life insurance. For purposes of this article, we’ll assume you’re setting up a POP plan. (The new $2,500 limit on Section 125 plans applies only to salary reduction contributions under a health FSA cafeteria plan, not to premium-only plans.)

To create a cafeteria plan, the employer must put it in writing. There is generally no filing requirement for a cafeteria plan. Employers that only have a cafeteria plan generally do not have to file Form 5500 or Schedule F.

Step 2: Find a Voluntary Benefits Broker

The cafeteria plan must allow participating employees to choose among at least one taxable benefit (such as cash) and one qualified benefit. A “qualified” benefit is a benefit that does not defer compensation and is excludable from an employee’s gross income. Qualified benefits include:

- Accident and health benefits. This would include most accidental death & dismemberment insurance, accident insurance, hospital indemnity insurance, cancer insurance, dental insurance and

This Just In

Not surprisingly, more Americans are experiencing financial stress now than did before the Great Recession. The Personal Finance Employee Education Foundation (PFEEF) conducted a nationwide survey to assess financial distress/financial well-being. Among respondents, 24 percent reported their financial well-being was good to very high, a 20 percent drop from 2004, when 42 percent of respondents rated their financial well-being as good to very high.

The survey points out how many Americans are living on the edge financially. This financial stress affects productivity and performance in all areas of life, including work.

The PFEEF is a nonprofit organization that promotes and facilitates financial education in the workplace. It has developed a Personal Finance Wellness Scale™ that employers can use to examine the effectiveness of financial program providers and to encourage participation in the retirement plans offered by the company. (www.pfeeef.org)

Voluntary and worksite programs can help employees increase their feelings of financial well-being. In fact, just the fact of participating in a voluntary benefit can help employees get on the right financial track. According to a recent MetLife survey, 55 percent of employees feel that payroll deductions for voluntary benefits help them to be more disciplined about saving.
How Do Your Voluntary Benefits Compare?

Among employers of any size that offered voluntary benefits in 2011, most offered between three and five products. (Eastbridge Consultants, Inc., Trends in Voluntary Benefits) Experts agree that it’s important not to overwhelm employees with too many choices. If you’re considering offering or adding to your voluntary benefits, where do you begin?

What are the most popular voluntary benefit offerings?
You might think “traditional” benefits, such as life insurance, dental insurance and long-term disability insurance, would top the list. However, an employer survey by Eastbridge Consultants came up with some rather unexpected results. The research organization found that employers were more likely to offer their employees voluntary benefits that supplement traditional major medical plans, such as hospital indemnity insurance, accident insurance and cancer insurance, than voluntary dental or life insurance.

Here are the most popular voluntary benefit offerings, ranked by percentage of surveyed employers that offered them:

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<tr>
<th>Benefit Offering</th>
<th>Percentage of Employers</th>
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<tbody>
<tr>
<td>Accidental death and dismemberment insurance (AD&amp;D)</td>
<td>37 percent</td>
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<tr>
<td>Hospital indemnity insurance/supplemental medical</td>
<td>29 percent</td>
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<tr>
<td>Accident insurance</td>
<td>27 percent</td>
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<tr>
<td>Cancer insurance</td>
<td>26 percent</td>
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<tr>
<td>Dental insurance</td>
<td>18 percent</td>
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<tr>
<td>Long-term disability</td>
<td>18 percent</td>
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<tr>
<td>Vision insurance</td>
<td>16 percent</td>
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<tr>
<td>Short-term disability</td>
<td>15 percent</td>
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<tr>
<td>Life insurance</td>
<td>11 percent</td>
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The Widening Gap in Employer Medical Coverage

One reason for the popularity of supplemental medical benefits, such as hospital indemnity, cancer insurance and accident insurance, is that they can help employers take some of the sting out of cost increases and benefit cutbacks in major medical plans.

Between 2002 and 2012, premiums for family coverage under an employer-sponsored plan have increased an eye-popping 97 percent, according to the Kaiser Family Foundation’s Annual Survey of Employer Health Benefits. In response to these escalating costs, employers are passing along some of the costs to employees in the form of increased deductibles and copayments and by increasing employees’ share of premium payments.

The 17th Annual Towers Watson/National Business Group on Health Employer Survey found that employees’ contributions toward their healthcare costs have increased 40 percent over the last five years.

- Employees’ share of medical insurance premiums increased 9.3 percent between 2011 and 2012, to a total of $2,764. (Source: Towers Watson/NBGH)
- Employers are passing along more of the cost of dependent coverage, with 24 percent adding surcharges for spousal coverage in 2012, and another 13 percent planning to do so in 2013. (Source: Towers Watson/NBGH)
- The percentage of covered workers with a deductible of at least $1,000 for single coverage increased from just 10 percent in 2005 to 34 percent in 2012. (Kaiser)

The Gap Between What Employees Want and What They Get

In another study, Mercer asked employees in several countries around the world which voluntary benefits they’d be willing to pay for. In the U.S., employees listed disability, life and auto insurance, in order of preference. Interestingly enough, the Eastbridge survey found fewer than 10 percent of employers surveyed offered disability insurance on a voluntary basis, and only 11 percent offered life insurance.

The fact that many employers contribute toward life and disability plans could partly account for the relatively low percentage of employers offering them as a voluntary benefit. However, if your organization does not currently offer employer-paid disability, life or auto, you might want to add them to your benefits lineup.

In fact, many experts predict that “non-traditional” benefits will become more popular in the future. Consider your employees’ needs: most working adults today cite finances and planning for retirement among their top worries. Voluntary products such as financial planning services, prepaid legal plans, short- and long-term disability insurance and long-term care plans can help employees achieve personal financial security, while supplemental medical plans can help fill gaps in major medical plans.

For more information on voluntary benefits, please contact us.
Plans cannot discriminate in favor of key employees in terms of eligibility, benefits or contributions allowed. In addition, key employees cannot receive more than 25 percent of all benefits under the plan.

Employees can enroll in a cafeteria plan during an annual open enrollment period or within a specified time following date of hire, as determined by your plan documents. Any employee wanting to participate must complete a salary reduction agreement with the employer. The form should confirm that the employee wants to pay for health insurance on a pre-tax basis, and it should also note that doing so may affect an employee’s Social Security benefits.

**Step 4: Save on Taxes**

The employer makes contributions to the cafeteria plan in accordance with employees’ salary reduction agreements. According to the IRS, “Salary reduction contributions are not actually or constructively received by the participant. Therefore, those contributions are not considered wages for federal income tax purposes.” Translated, this means the employee does not pay federal (and usually state) income taxes on amounts contributed to the cafeteria plan. Salary reductions are also not subject to Social Security and federal unemployment taxes. Depending on the employee’s tax bracket, savings could equal 20 or more percent of contributions.

Employers pay no Social Security or federal unemployment taxes (and usually state unemployment taxes) on amounts employees contribute to their cafeteria plan. This can save employers 7 to 10 percent on amounts their employees contribute.

Setting up a POP plan should cost an employer very little. In terms of administration, your benefits broker handles it all. The employer simply has to adjust payroll for participating employees to ensure employee contributions are made with pre-tax dollars.

For more information on using a premium-only cafeteria plan to enhance your benefit offerings and reduce taxes, please contact us.

in the group, no matter what his/her health, can obtain coverage.

The same does not hold true for group property/casualty coverages. When you offer a voluntary group auto or home program to your employees, the insurer will underwrite applications individually to the extent allowed by law. This means the insurer could refuse to cover an employee based on driving record, credit risk or other factor. Still, for the majority of employees who will qualify, a voluntary group auto or home policy offers significant savings, convenience and features they might not find under individual insurance programs.

For more information on enhancing your benefit portfolio with group auto, home or other voluntary coverages, please contact us.

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**Average Auto and Home-owners Insurance Rates**

**Average auto insurance premium in 2012, U.S.: $839*  
This figure represents a significant decline in inflation-adjusted costs over the last decade, with inflation-adjusted premiums averaging $1,007 in 2002. The Insurance Information Institute attributes the decline to improved underwriting techniques, which allow insurers to better predict which drivers will experience accidents and price products accordingly.**

**Average homeowners premium, 2012: $1,004*  
This represents a 5 percent increase over the average premium in 2011. Declining rates on investments caused insurers to increase premiums to maintain earnings levels. High catastrophe losses in 2012 will likely push rates higher in 2013, particularly in storm-prone areas of the U.S.**

*Projected figure, Insurance Information Institute
Group Savings Available on Auto and Home Coverages

Voluntary insurance isn’t just for life and health. You can help your employees save significantly on their auto and home insurance by offering coverage through a voluntary employer group plan.

According to a survey on insurance literacy conducted by Zogby International for MetLife, only 19 percent of consumers surveyed knew they could get a discount by buying their auto insurance through an employee group. That’s too bad, because members of an employer or other legitimate group, such as a nonprofit service organization, might save 20 percent or more off what they would pay for auto insurance as an individual.

Group auto and home insurance offers other advantages in addition to savings:

- Other family members residing at the employee’s home also qualify for group rates.
- You can offer employees the option of paying premiums through payroll deduction, making payments easy and convenient. The insurer will work with you to make administration simple.
- Most programs allow members to select other forms of payment, such as automatic credit card payments, etc. Many also allow flexible payment terms to meet the insured’s financial preferences, such as monthly or quarterly billing.
- Employees can retain coverage if they retire or leave your organization, as long as that policy is available in their state of residence.
- Participation is always voluntary. If your employees opt not to participate or find better rates elsewhere, they can cancel their coverage.
- As a voluntary program, group auto and home insurance cost you, the employer, nothing. Participating employees pay 100 percent of premiums.
- Shopping for auto and home insurance isn’t fun. It takes time and research, but if employees can buy coverage through an employer group and get a discount as well, they can save both time and money.

Group property/casualty coverages differ from group life and health coverages in one significant way. Federal and state laws require all health insurance plans sold to small groups (employers with 2-50 employees) to be sold on a guaranteed issue basis. This means the insurer cannot turn down any group based on health status. Any individual understanding of their coverage. Now, consumers will be able to receive the critical information on their choices upfront, before they buy coverage, helping them to choose the coverage that best meets their needs.

- Information when coverage is renewed: Consumers will receive the SBC before each new plan or policy year so they can see how their coverage is changing before deciding whether to renew or re-enroll.
- Information when coverage changes: If there are any significant changes in coverage in the middle of the plan or policy year, health plans and insurers must notify enrollees and policyholders at least 60 days before the changes take effect.
- Information on demand: Whether shopping for health insurance or already enrolled in coverage, consumers will be able to request the SBC at any time, and health plans will have to provide it within seven business days.

The administrator or insurer for your employees’ group voluntary health insurance will provide the SBCs and glossary, as well as handling enrollment and any employee inquiries. For more information, please contact us.