



SECTION 125

CAFETERIA PLAN

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INTRODUCTION:

In the dynamic landscape of business benefits, savvy entrepreneurs are turning to Section 125 cafeteria plans as a strategic tool to enhance the financial well-being of both employers and employees. This comprehensive guide explores reasons for implementing a Section 125 plan and presents a real-world case study illustrating its tangible benefits.

Section 125 Plans: A Business Game-Changer

- **Tax Savings: Slash** payroll taxes and elevate financial efficiency for both employers and employees by leveraging pre-tax contributions for eligible benefits.
- **Enhanced Employee Satisfaction:** Boost workforce morale by offering customizable benefits, aligning with individual needs, and fostering a satisfied, motivated team.
- **Cost Control: Establish** a predictable benefits budget, empowering employees to contribute to their benefits, and enabling effective cost management for businesses.
- **Attract and Retain Talent:** Stand out in the competitive job market by showcasing a robust benefits package, attracting top talent, and retaining valuable employees.
- **Flexibility in Benefit Options:** Provide diverse benefit choices, from health insurance to flexible spending accounts, catering to the diverse needs and preferences of your workforce.

- **Employee Wellness:** Prioritize employee health and well-being, fostering a more productive and engaged workforce.
- **Compliance and Legal Protection:** Safeguard your business by adhering to IRS regulations, ensuring compliance with tax codes, and minimizing legal risks related to benefit administration.
- **Administrative Ease:** Streamline benefit administration, reduce burdens, and ensure smoother operations by consolidating various benefits under one comprehensive plan.
- **Longevity and Stability:** Leverage the time-tested framework of Section 125, established in 1978, offering stability and reliability for both businesses and employees.
- **Financial Education and Empowerment:** Encourage financial responsibility among employees through tax-efficient savings opportunities, such as flexible spending accounts and retirement plans.

CASE STUDY: UNLEASHING THE POWER OF SECTION 125

Let's consider an example with a hypothetical employee, Jane, earning an annual salary of \$50,000 and an employer who offers a Section 125 cafeteria plan.

SCENARIO WITHOUT A SECTION 125 PLAN:

Jane's Salary: \$50,000

Tax Rate: Let's assume a 20% tax rate for simplicity.

- Taxable Income: \$50,000
- Taxes (20%): \$10,000
- Take-Home Pay: \$40,000

WITH THE PLAN:

- Jane's Contribution: \$3,000 (pre-tax)
- Adjusted Taxable Income: \$47,000 (\$50,000 - \$3,000)
- Taxes (20%): \$9,400 (20% of \$47,000)
- Take-Home Pay: \$40,600 (\$50,000 - \$9,400)

Benefits for Jane

Tax Savings: Jane saves \$600 in taxes (\$10,000 - \$9,400) by contributing to the plan pre-tax. More Take-Home Pay: Jane's take-home pay increases to \$40,600 compared to \$40,000 without the plan.

Benefits for the Employer

Tax Savings: Employers also save on payroll taxes for the \$3,000 that Jane contributes pre-tax.

In this hypothetical scenario, we witness firsthand how a Section 125 plan transforms financial outcomes for both employer and employee. By contributing to the plan, Employee A not only reduces taxable income but also generates substantial savings for both parties, creating a true win-win scenario.

IMPLEMENTATION

Navigating the implementation of a Section 125 cafeteria plan requires strategic planning. By considering plan design, documentation, employee communication, payroll setup, and compliance, businesses can unlock the full potential of this financial tool.

Section 125 Cafeteria Plan Setup Costs

The costs associated with setting up a Section 125 cafeteria plan can vary based on several factors, including the size of the company, the complexity of the plan, and whether the setup is handled internally or with professional assistance.

Internal Costs:

1. **Administrative Time:** Designing the plan, educating employees, and adjusting payroll systems can consume internal resources and time.
2. **Documentation:** Creating the plan document that complies with IRS regulations might require legal or HR expertise.
3. **Training and Communication:** Costs related to educating employees about the plan, its benefits, and enrollment procedures.

External Costs

1. **Third-Party Administrators (TPAs):** Hiring a TPA can streamline the process and ensure compliance, but this might come with service fees.
2. **Legal and Consulting Fees:** If legal counsel or benefits consultants are hired to assist with plan setup, there could be associated fees.
3. **Software or Systems:** Purchasing or upgrading payroll systems to accommodate pre-tax deductions might have associated costs.

Overall Expense

In terms of overall expenses, small businesses may face higher setup costs compared to large corporations due to their size and resources. Setup costs are typically one-time expenditures, while ongoing administrative fees, especially with Third Party Administrators (TPAs), can be recurring.

Businesses often weigh these upfront costs against potential tax savings and benefits. On the cost spectrum, smaller companies with simpler plans and internal setup incur minimal expenses, while larger enterprises or those utilizing external assistance may face higher costs due to professional service fees.

While there are expenses associated with setting up a Section 125 cafeteria plan, the long-term benefits, including potential tax savings and employee retention, often outweigh the initial setup costs. Businesses should consider conducting a cost-benefit analysis to evaluate the return on investment before implementing such a plan. Consulting with HR professionals, benefits consultants, or financial advisors can provide insights into the most cost-effective approach for a specific business.

IMPORTANT NOTICE:

This information was developed as a general guide to educate. It is not intended as authoritative guidance or tax/ legal advice. Each plan has unique requirements. Use of the information provided does not ensure compliance with ERISA regulations. You should consult your attorney or tax advisor for specific guidance on your plan. This information, including any letters, attachments, and/or other materials designed for potential use with plan sponsors, fiduciaries, plan participants, et al must be reviewed and approved by the compliance and legal department(s) of the Financial Professional's firm prior to any use to confirm that they meet the firm's legal and compliance policies and standards. The Financial Professional and his/her firm are solely responsible for the Financial Professional's use of this information and any materials included herein, and for ensuring that all services provided by the Financial Professional conform to the firm's legal and compliance policies and standards.



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