

**ASSOCIATES  
IN EXCELLENCE**

*employee benefit consultants*

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**SECTION 125 CAFETERIA PLANS**

**FLEXIBLE BENEFITS**

Prepared by

Associates In Excellence, Inc.

## FLEXIBLE BENEFITS PLAN INSTALLATION AND ADMINISTRATION FEE SCHEDULE

<b>Initial Plan Installation (Document and Plan Design)</b>	
<b>One Time Fee – First Year Only</b>	
Consultation, Employee Survey, Proposal, Customized Plan Design, Plan Document, Summary Plan Description and Master Forms. Broker, CPA & Attorney Contact.	\$1,000
<b>Monthly Services</b>	
Base Fee	\$100
Additional monthly fee for checks issued twice/month	\$35-\$75
Per FSA Participant Fee	\$5
Per POP Participant Fee	\$2
Per New Participant Set-up Fee	\$5
Per Participant Election Change Fee	\$2
Tracking of monthly benefit payroll, adjudication and tracking of Reimbursement Requests and documentation, participant telephone calls and inquiries about account activity, printing participant checks, overnight delivery of checks and supporting documents. (Minimum monthly billing \$125)	
<b>Annual Services</b>	
Re-enrollment per participant Fee	\$5
Non-discrimination Testing, Form 5500 and all necessary schedules when applicable (100 or more participants), new plan year forms and updates of any legal changes to the Internal Revenue Code (ongoing), notification to each participant of account balances at plan year final quarter, local enrollment meeting.	
<b>Miscellaneous Charges</b>	
Grace Period reimbursement checks (each)	\$5
Interim reimbursement checks (each)	\$10
Small Amendment (name change, plan year end changes or additions and plan termination) No limit on number of changes.	\$175
Large Amendment (add a flexible spending account)	\$650
Non-Discrimination Testing Only (No annual administration) (Per hour)	\$135

## **WHAT IS A FLEXIBLE BENEFITS PLAN?**

A Flexible Benefits Plan (Cafeteria Plan) is a written plan, which qualifies under Section 125 of the Internal Revenue Code. Through such a plan, an individual employee can exchange taxable compensation for non-taxable benefits. He chooses the benefits he needs from a "menu" of benefit choices and pays for them through voluntary salary reductions, with credits allocated by his employer, or both.

## **WHY ARE FLEX PLANS SO POPULAR?**

**EMPLOYEE APPRECIATION** - A single benefits package can no longer satisfy today's diversified work force, which includes singles, working couples and single parents, as well as the traditional family man. Flex plans offer employees a chance to tailor their benefits to their individual needs.

**COST CONTROL** - The cost of benefits is soaring, especially for health insurance. Flex plans offer employers a way to control costs and to shift part of those costs back to their employees on a tax-free basis.

**TAX SAVINGS** - Payroll taxes are heavy for both employers and employees. Flex plans allow employees to increase their benefits while lowering their taxable gross income, thus reducing payroll taxes for both themselves and their employers. Additionally, employers experience savings on other costs, which are based on taxable compensation, such as worker's compensation.

## **SIMPLE OR COMPLEX FLEX?**

Flexible Benefits Plans can be as simple or as comprehensive as the employer desires. "SIMPLE FLEX" plans can be as basic as deducting employees' premium contributions from their paycheck on a pre-tax basis. "FULL FLEX" plans often involve benefit credit formulas and a wide range of benefit options.

**A Flexible Benefits Plan can help you attract and keep good employees while cutting costs and maintaining profitability.**

## **SIMPLE FLEX PLANS**

**PREMIUM CONVERSION ONLY PLAN** - Any premiums paid by employees for the employer's group medical, dental, optical, disability, or group term life insurance (up to \$50,000) are deducted from the employees' gross compensation before any taxes are calculated. The employer then includes this amount in the premium payment to the insurance carrier just as he would without a plan.

**FLEXIBLE SPENDING ACCOUNT PLAN** - Employees redirect part of their income, pre-tax, into Flexible Spending Accounts (FSA's) which are set up to reimburse specific types of expenses as they are incurred:

- Unreimbursed Medical Expenses  
(deductibles, co-payments, non-covered expenses)
- Dependent Care Expenses  
(child care or elder care)
- Premiums for Individual Health Insurance  
(medical, dental, optical and disability policies not sponsored by an employer)

Employees elect how much income they want redirected into each FSA at the beginning of each Plan Year. These elections are irrevocable for the balance of the year, unless the employee has a change in family status (changes in number of dependents, employee's or spouse's employment status, or employee's or spouse's employer provided benefits). In the event an employee overestimates their expenses, the unused portion is forfeited and goes to the employer.

**PREMIUM CONVERSION PLUS FSA PLAN** - A combination of the two above plans gives the employer and employee even greater tax savings.

## **FULL FLEX PLANS**

A Full Flex Plan typically offers several medical plans with varying degrees of coverage, dental, life and disability insurance and spending accounts for the employee to choose from. The employer controls the cost of benefits through plan design and pricing of each benefit. Each employee is allocated benefit credits to use for the payment of the benefits he chooses. If the cost of his benefits exceeds his credits, he can elect salary reduction to pay the difference. If his credits exceed his benefit costs, he can take the difference as taxable compensation.

## DEPENDENT CARE SPENDING ACCOUNT

Employees may choose to set up an FSA for expenses incurred for dependent care, which enables them (and their spouses) to work.

Dependent care expenses must be for a dependent child under the age of 13 who lives with the employee, or for the care of any tax-qualified dependent who lives with the employee and is physically or mentally incapable of caring for himself.

Services must be provided by a non-dependent (unless over age 19) who cares for the employee's dependent either inside or outside the employee's home, or at a licensed day care center. The employee must provide the name, address and tax ID number of the dependent care provider. Supplies, transportation and food expenses, overnight camp and private school tuition do not qualify.

The maximum that may be contributed to a Dependent Care FSA is \$5,000 per calendar year for a single employee or a married employee filing a joint tax return (as long as their spouse works also). If an employee is married but files a separate tax return, the maximum is limited to \$2,500.

Employees are not entitled to the dependent care credit on their tax returns for expenses paid through this FSA, but may receive a tax credit for expenses in excess of the amounts paid through the Plan. Typically, more money is saved by paying dependent care expenses through the Plan than by taking the dependent care credit on a personal tax return. The "break-even point" is usually somewhere around \$14,000 to \$18,000 in annual income. **Employees will need to complete Form 2441 with their personal income taxes return to reflect their Dependent Care expenses.**

Reimbursement of dependent care expenses can only be made after the care has been provided, not before, and are paid directly to the employee rather than the care provider.

Employees can be reimbursed for eligible Dependent Care expenses at any time during the Plan Year up to the amount currently in their accounts. Reimbursements from a Dependent Care Account will never exceed contributions.

Reimbursement of day care expenses can only be made from an employee's Dependent Care FSA. Reimbursements for other types of expenses are not permitted from this Account.

## MEDICAL EXPENSE ACCOUNT

Employees may choose to set up an FSA for health care expenses incurred during the Plan Year for themselves and their families, which are not reimbursed by insurance or any other source.

Most insurance policies do not cover 100% of medical expenses, and many expenses are not covered at all. The following list, while not intended to be complete, illustrates medical or medical-related expenses, which may be claimed through a Medical Expense Account.

Acupuncture	Lead-based paint removal*
Ambulance	Nursing fees
<b>Birth control pills</b>	Obstetrical Care
Braille books & magazines	Operations
Chiropractor	Orthodontia*
Christian Science practitioner	Oxygen
<b>Co-payments</b>	Physicians' fees
Contact lenses <b>and supplies</b>	Physician recommended pool or spa*
Crutches	Prescription medicines
<b>Deductibles</b>	Psychiatric care
Dental fees	Psychologist fees
Dentures	Half-way houses
Diagnostic fees	<b>Routine physicals &amp; care</b>
Glasses	Seeing-eye dogs & upkeep
Health care equipment*	Special communication equipment for the deaf
Hearing aids and batteries	Special education/tuition*
Home modifications*	Sterilization
Insulin	Substance abuse treatment
Laboratory fees	<b>Transportation expense</b>
Laetrile by prescription	<b>Vision care</b>
Laser Eye Surgery	Vitamins by prescription

(\*Some conditions apply)

The following are specifically disallowed under Flex Plans unless prescribed for the treatment of a specific medical condition:

Health club membership    Weight loss programs    Cosmetic procedures

**In general, any expense that could be deducted on an individual's tax return qualifies as an eligible expense for a Flex Plan.**

Money deferred into this account may not be used to pay any other type of expense.

Unlike the Dependent Care FSA, employees are entitled to reimbursement, up to their full annual election amount, at the time they incur eligible expenses, regardless of the amount in their Medical Expense FSA at that time. The employer, then, may have to advance contributions to the Plan. Though this occurs **very** infrequently, should the employee terminate employment before this advance has been recouped through the employee's contributions, the employer could experience a loss.

## HOW EMPLOYERS SAVE MONEY

One of the most attractive features of a Flexible Benefits Plan is that it provides the employee with a valuable benefit and saves the employer money at the same time. Under Section 125 rules, the employer does not have to pay payroll taxes on the salary reductions that the employees elect. The savings include the employer's portion of Social Security, federal and state unemployment taxes, worker's compensation premiums and any other costs based on taxable salary. The savings usually average from 10% to 15% (depending on worker's compensation premiums) of all employee salary reductions and typically more than offset all installation and administration fees.

EXAMPLE:	Annual Salary Reduction (35 employees x \$1,500 each)	\$52,500
	FICA saved (\$52,500 x 7.65%)	4,016
	Estimated other savings (3%) (worker's comp. premiums, unemployment taxes, other costs based on wages)	<u>1,575</u>
	<b>TOTAL BENEFIT TO EMPLOYER</b>	<b>\$ 5,591</b>

## HOW EMPLOYEES SAVE MONEY

The simplest Flex Plan allows employees to pay for their Group Health Insurance premiums by making the premium deduction from their gross salary before taxes are calculated. If your company's Flex Plan offers the choice of Flexible Spending Accounts, your employees can also elect to have pre-tax dollars deducted to pay for Dependent Care expenses and Medical Expenses not reimbursed by insurance.

<b>EXAMPLE:</b>	<b>Without Flex</b>	<b>With Flex</b>
Monthly salary	\$1,600.00	\$1,600.00
FSA elections:		
Med. premium		-100.00
Med. expense		- 50.00
Child care		-250.00
<b>Taxable Salary</b>	<b>\$1,600.00</b>	<b>\$1,200.00</b>
Payroll taxes:		
FICA (7.65%)	-122.40	- 91.80
Fed. income tax (15%)	-240.00	-180.00
State & Local tax (3%)	<u>- 48.00</u>	<u>- 36.00</u>
<b>Net Salary</b>	<b>\$1,189.60</b>	<b>\$ 892.20</b>
After tax expenses:		
Med. premium	-100.00	paid by FLEX
Med. expense	- 50.00	paid by FLEX
Child care	-250.00	paid by FLEX
<b>Spendable Income</b>	<b><u>\$ 789.60</u></b>	<b><u>\$ 892.20</u></b>

**ADDITIONAL MONTHLY INCOME** **\$ 102.60**

**ADDITIONAL YEARLY INCOME** **\$1,231.20**

## **TOO GOOD TO BE TRUE?**

With a Flexible Benefits Plan employees gain additional spendable income while the employer saves payroll costs. If this sounds too good to be true, remember that every good concept has some potential pitfalls. Good communication and planning can help you and your employees avoid these common concerns:

**EMPLOYEE ACCEPTANCE** - Employees at all levels quickly understand the concept of lower taxes and increased benefits. Flex Plans also make it easier to shift some benefit costs to the employees; who are much more willing to accept higher premiums and out-of-pocket expenses when they can pay them with pre-tax dollars.

**"USE IT OR LOSE IT"** - All contributions to a Flex Plan not spent by the end of the Plan year must be forfeited. When this feature is clearly explained to employees, they rarely defer too much money into their Spending Accounts. Account balance information is available at anytime and all participants receive a statement of their account before the close of the Plan Year.

**EMPLOYER RISK** - If the Plan includes an FSA for Unreimbursed Medical Expenses, an employee is entitled to reimbursement of up to his total annual election at any time, regardless of the amount he has currently contributed. Should this occur and there are not sufficient funds in the Cafeteria Plan, the employer is required to advance the necessary amount to the Plan. Additionally, if the employee terminates employment for any reason, the employer may suffer a loss.

**REDUCED SOCIAL SECURITY** - It is possible that a Plan participant could receive a slightly reduced Social Security benefit, because they are paying less Social Security taxes. In actuality, someone would have to participate for many years at a substantial level in order to noticeably affect their benefit.

**COMPLICATED ADMINISTRATION** - Associates In Excellence can easily implement a Flex Plan designed around your benefits package. A simple change in your payroll processing will convert your employees' contributions to a pre-tax status. We will process all reimbursement requests, issue the checks, maintain all records of contributions and reimbursements, provide you with reports each month, perform the required discrimination tests, and prepare the required annual government returns. Your payroll savings should more than offset the installation and administration fees.

## **FLEXIBLE BENEFITS PLAN RESTRICTIONS**

Owners of a sole proprietorship or S corporation, partners of a partnership and members of an LLC may not participate in a Flexible Benefits Plan although they may sponsor a Plan for their employees.

### **DISCRIMINATION TESTS**

25% CONCENTRATION TEST - No more than 25% of the total benefits provided to all employees under the Plan may be provided to Key Employees.

55% AVERAGE BENEFITS TEST - The average dependent care benefit for non-highly compensated employees must be equal to at least 55% of the average dependent care benefit for highly compensated employees.

5% OWNER TEST - The percentage of dependent care benefits paid to 5% owners must not be greater than 25% of the total dependent care benefits paid to all employees.

#### **Key Employees - Code Section 416(i)(A)**

1. Any employee owning more than 5% of the voting power or value of all classes of stock of the employer, and any family member\* of such employee;
2. Any employee who owns more than 1% interest in the employer, and any family member\* of such an employee, whose annual compensation exceeds \$150,000;
3. An officer having annual compensation in excess of \$135,000.\*\*

\*Family member - any employee who is the spouse, lineal ascendant or descendent, or spouse of a lineal ascendant or descendent

#### **Highly Compensated Employees - Code Section 414(q)**

1. Same as #1 above;
2. Employees whose annual compensation exceeds \$90,000\*\*;

\*\* Indexed annually for cost of living, amounts shown are for 2005.

## **FLEXIBLE BENEFITS PLAN ADMINISTRATION SERVICES**

We believe that the key to a successful relationship with our clients is offering a highly personalized service at a very reasonable fee.

When you become a client, you will be assigned one consultant and one administrator who will coordinate the following services for your Flexible Benefits Plan:

- \* Plan design
- \* Plan Document
- \* Summary Plan Description for participants
- \* All necessary forms
- \* All non-discrimination testing
- \* Full services of our professional staff to interpret the effects of changing legislation
- \* Telephone support for your technical questions

If your Plan includes Flexible Spending Accounts, the following services are also provided:

- \* Employee meetings to explain how your Plan works and to answer questions
- \* Worksheets and examples to assist employees in making their elections
- \* Written confirmation of elections for each participant upon request
- \* All necessary forms for requesting reimbursement and reporting changes in family status
- \* Review and audit of reimbursement requests
- \* Preparation of all reimbursement checks
- \* Statement of employee's account provided with each check
- \* Monthly employer reports of employees' account balances and pending requests
- \* Maintenance of computer records of all elections, contributions and reimbursements
- \* Year-end statement of accounts
- \* Individualized re-enrollment forms for each participant upon request
- \* Notification of amounts to report on Form W-2 for Dependent Care