UNDERSTANDING YOUR BENEFITS/PAYCHECK

Please note that policies and rules change regularly. This Tip Sheet is available to introduce you to typical information related to your benefits and what you may see on your paycheck.

PAYCHECKS

Gross v. Net Salary

- **Gross Salary** – Includes all earnings before mandatory and voluntary deductions are taken.
- **Net Salary** – Is your take home pay after all mandatory and voluntary deductions are taken. Deductions may include federal/state income taxes, Social Security taxes, benefits premiums, retirement contributions and other voluntary deductions.
- **Salary Adjustments** – May be made to your gross income in an effort to reduce your tax liability. Some such adjustments are retirement contributions, pre-tax health insurance premiums, student loan interest payments, etc.
- **Taxable Income** – The amount of your salary that is subject to tax. This amount can be lowered if you take credits on expenses such as childcare, eldercare or health care, which will increase your net salary.

Taxes

- **FICA Tax** – Federal Insurance Contributions Act tax – A payroll tax imposed on employees and employers to fund Social Security and Medicare. The amounts taken throughout a person's working lifetime will indirectly affect how much benefit one receives upon retirement. The total tax liability is 15.3% of your salary with half (7.65%) paid by you and half paid by your employer. If self employed, you are responsible for the entire 15.3%.

  Social Security – Includes benefits for old-age (retirement), survivors and disability insurance (OASDI). Your part of this portion of the FICA tax is generally 6.2% of gross compensation. This tax is paid on the first $110,100 (the Social Security Wage Base) for 2012, so the maximum employee deduction for 2012* would be $6,621.60*. This means that someone making $1 million in salary in 2012 pays the same amount in Social Security tax as someone making $110,100. The Social Security Wage Base may change from year to year.

  *Note that for 2011 and through February 2012, the Social Security portion of FICA for the employee only has been temporarily dropped to 4.2% (the employer still pays 6.2%). The maximum deduction for the first 2 months of 2012 is the annualized amount of $4624.20. If the temporary reduction is not extended and the rate returns to 6.2%, the maximum employee deduction for the remainder of 2012 will rise to $6,621.60.

  Medicare – Provides hospital benefits for the elderly. This portion of the FICA tax is 1.45% of gross compensation. There is no limit to the amount of salary that is subject to this portion of the FICA tax.

  A special case in FICA regulations includes exemptions for student workers. Students enrolled at least half-time in a university and working part-time for the same university are exempted from FICA payroll taxes, so long as their relationship with the university is primarily an educational one. In order to be exempt from FICA payroll taxes, a student's work must be "incident to" pursuit of a course of study, which is rarely the case with full-time employment.

- **Income Taxes** – Federal and State income taxes and possibly various local taxes are withheld from your paycheck and sent to the appropriate government agencies. At the end of the year, your employer will issue you a W-2 which will detail how much you earned and how much income tax was withheld from your pay.

  Federal Tax – Upon hire, you will be asked to complete a W-4 form. This will tell your employer how much federal income tax to withhold from your paycheck and remit to the IRS under your Social Security Number. Visit **irs.gov/individuals** to access an interactive tool that can help you determine how to complete your W-4.

  State Tax – At hire, you will be asked to complete a state tax form – in Alabama, it is called the A-4. Similar to the W-4, the completion of this form tells your employer how much to withhold in state tax.

  Local Tax – If you work in a city or county that has a corresponding tax, your employer will also be required to withhold the appropriate tax amount based on the rules/guidelines of your particular locality.

  Voluntary Deductions – These deductions are optional, which means you must agree to have these deductions taken. Such deductions may be to pay for benefits, like health insurance, that you may enroll in or may be for contributions you choose to make for other purposes (United Way, gym memberships, etc.). They may be pre- or post-tax.

  Pre-tax deductions– Tax laws have been created that allow you to pay for certain employment benefits with pre-tax dollars. These deductions are funds taken from your gross income that reduce your taxable wages. Some such benefits include voluntary retirement plan deductions, health insurance premiums as well as qualified health care or dependent care expenses.

  Post-tax deductions – Deductions taken from net pay after taxes.

Section 125 of the IRS Code (Cafeteria Benefit Plans or Flexible Spending Plans) – A cafeteria plan is a separate written plan maintained by an employer for employees that meets the specific requirements and regulations of section 125 of the Internal Revenue Code. It provides participants an opportunity to receive certain benefits on a pretax basis. Participants in a cafeteria plan must be permitted to choose among at least one taxable benefit (such as cash) and one qualified benefit. Qualified benefits may include accident and health benefits, dependent care assistance, group term life insurance and health savings accounts.

Generally, qualified benefits under a cafeteria plan are not subject to FICA, FUTA, Medicare tax, or income tax withholding. However, group-term life insurance that exceeds $50,000 of coverage is subject to Social Security and Medicare taxes, but not FUTA tax or income tax withholding, even when provided as a qualified benefit in a cafeteria plan.

S125 Pretax benefit plans have specific enrollment periods that must be honored. Once you enroll, you can't end or change your coverage until the next open enrollment period unless you have a qualifying event that could affect the coverage (marriage, divorce, birth, death, loss of access to other coverage, loss of eligibility, among others). *Be aware of deadlines within your plan!*

BENEFITS

Health Insurance

- **Premiums** – Premiums are the amount you pay, typically from your paycheck, for your insurance coverage. Premiums tend to be lower when copays, deductibles, coinsurance and the out of pocket maximum are higher.
- **Copays** – A payment made as part of an insurance policy that is paid each time you receive treatment or other medical service. Some plans will have a separate copay amount for prescription drugs, with the generic copay being less than the copay for a brand name drug. Copays are meant to discourage subscribers from seeking unneeded medical treatment or to encourage them to opt for the less expensive generic medications when an option is available.
- **Deductibles** – The amount of the cost of medical treatment that must be paid out of pocket before insurance begins to pay. Deductibles are usually fixed amounts and may be applied per covered incident or per year, per individual or per family.
- **Coinsurance** – A percentage of the cost of medical treatment that you must pay (after the deductible is met) up to a certain limit before the insurance policy pays towards the cost of that treatment. May be a 90/10 plan (plan pays 90%, you pay 10%), 80/20, etc.
- **Out of Pocket Maximum** – The greatest amount you will have to pay in a plan year. You must pay coinsurance amounts until you reach your out-of-pocket maximum. Once you reach it, the health insurance company will pay the cost of your covered health care in full for the remainder of the year. For example, if your out-of-pocket maximum is $2,000, you are not obligated to pay more than that amount. Copays typically do not apply to the out of pocket maximum. Self-funded health plan – a health insurance plan where the costs of the plan that aren't paid by the subscriber are incurred by the employer. The risk is assumed by the employer. Cost containment is critical to keep premiums low and to retain plan benefits
- **Fully-funded health plan** – a health insurance plan in which the employer contracts with an insurance carrier to cover employees and their dependents. The risk is assumed by the insurance company.

Flexible Spending Accounts

An FSA allows an employee to set aside a portion of earnings to pay for qualified expenses, most commonly for medical expenses but often for dependent care or other expenses. Money deducted from an employee's pay into an FSA is not subject to payroll taxes, resulting in substantial payroll tax savings. One significant disadvantage to using an FSA is that funds not used by the end of the plan year are lost to the employee – this is known as Use It or Lose It.

- **Medical FSA** - The most common type of FSA is used to pay for medical expenses not paid for by insurance, usually deductibles, copayments, and coinsurance for the employee's health plan. Other items eligible for reimbursement include such over-the-counter (OTC) items as bandages, rubbing alcohol, first aid kits, and other medical expenses not distinguished as a drug or medicine. Prior to January 1, 2011, OTC medications were also reimbursable under health care FSA plans; however, the Patient Protection and Affordable Care Act changed the rules regarding these OTC expenditures, allowing reimbursement for these items only when purchased with a doctor's prescription, with the exception of insulin. Generally, allowable items are the same as those allowable for the medical tax deduction, as outlined in IRS publication 502.

  Prior to the enactment of the Patient Protection and Affordable Care Act, the Internal Revenue Service permitted employers to enact any maximum annual election for their employees. Patient Protection and Affordable Care Act amended Section 125 such that FSAs may not allow employees to choose an annual election in excess of $2,500. Employers have the option to limit their employees' annual elections further. This change starts in tax years that begin after December 31, 2012.

  Medical FSAs are "pre-funded"; this means that an employee can receive reimbursement for the full amount of the annual contribution for that plan year on day one, whether the deduction has been withheld from pay or not.

- **Dependent Care FSA** - May be established to pay for certain expenses to care for dependents who live with someone while that person is at work. While this most commonly means child care, for children under the age of 13, it can also be used for children of any age who are physically or mentally incapable of self-care, as well as adult day care for senior citizen dependents who live with the person, such as parents or grandparents. Additionally, the person or persons on

whom the dependent care funds are spent must be able to be claimed as a dependent on the employee's federal tax return. The funds cannot be used for summer camps (other than "day camps") or for long term care for parents who live elsewhere (such as in a nursing home).

The dependent care FSA is federally capped at $5,000 per year, per household. Married spouses can each elect an FSA, but their total combined elections cannot exceed $5,000. At tax time, all withdrawals in excess of $5,000 are taxed.

Unlike medical FSAs, dependent care FSAs are not "pre-funded"; employees cannot receive reimbursement for the full amount of the annual contribution on day one. Employees can only be reimbursed up to the amount they have had deducted during that plan year.

– **Health Savings Accounts** (HSA) - A health savings account is a tax-advantaged medical savings account available to taxpayers in the United States who are enrolled in a high-deductible health plan (HDHP). The funds contributed to an account are not subject to federal income tax at the time of deposit. Unlike a flexible spending account (FSA), funds roll over and accumulate year to year if not spent. HSAs are owned by the individual, which differentiates them from company-owned Health Reimbursement Arrangements (HRA) that are an alternate tax-deductible source of funds paired with either HDHPs or standard health plans.

– **Health Reimbursement Accounts** (HRAs)- Health Reimbursement Accounts or Health Reimbursement Arrangements (HRAs) are Internal Revenue Service (IRS)-sanctioned programs that allow an employer to set aside funds to reimburse medical expenses paid by participating employees resulting in tax benefits for both employees as well as employers.

Health Reimbursement Accounts are initiated by the employer and serviced by a third-party administrator or plan service provider. The employer may provide in the HRA plan document that a credit balance in an employee's HRA account can be rolled over from year to year like a savings account. The employer decides if the funds are rolled from year to year and how much rolls over (which can be either a flat amount or a percentage).

An HRA "must be funded solely by an employer," and contributions cannot be paid through a voluntary salary reduction agreement (i.e., a cafeteria plan). There is no limit on the employer's contributions, which are excluded from an employee's income.

With an HRA, employers fund individual reimbursement accounts for their employees and define what those funds can be used for – i.e., specified out-of-pocket expenses such as deductibles and copays. Employees do not have to be covered under any other health care plan to participate, unlike (for example) a Health Savings Account (HSA) which requires a High Deductible Health Plan.

Disability Insurance

– **Short term disability -** A type of insurance that pays a percentage of an employee's salary for a specified amount of time, if he/she is ill or injured, and cannot perform the duties of their job. Coverage usually starts anywhere from one to 14 days after an employee suffers a condition that leaves him/her unable to work. Many times, employees are required to use sick days before short term disability kicks in, if it's an illness that keeps them out of work for an extended period of time. This is why there is usually a different policy for short term disability for sickness versus an injury.

According to Unum, a major provider of disability insurance, 3 out of every 10 workers between the ages of 25 and 65 will experience an accident or illness that keeps them out of work for 3 months or longer, with nearly 60% of these injuries occurring off the job. If an employee is hurt off the job, worker's compensation will not cover them.

– **Long term disability** - When an employee cannot work for an extended period of time, a long term disability plan can help cover a portion of the employee's salary. LTD will usually kick in after a short term disability policy has run out, typically after 90-180 days.

Most plans cover 50-70% of monthly salary. The duration of plan benefits can also extend for awhile. Some plans only pay out 5-10 years worth of disability to anyone qualified, while others will pay out till age 65, based on a rate schedule.

– **Life Insurance** – Life insurance is a contract between an insurance policy holder and an insurer, where the insurer promises to pay a designated beneficiary a sum of money upon the death of the insured person.

Life insurance tends to fall into two major categories:

- **Protection policies** – designed to provide a benefit in the event of specified event, typically a lump sum payment – usually called term insurance.
- **Investment policies** – the main objective is to generate earnings, and are commonly issued as whole life, universal life and variable life policies.

The three main factors used to determine risk and cost of a policy are generally **age**, **gender** and **use of tobacco**. These factors are used in conjunction with the health and family history of the individual applying for a policy to determine premiums and insurability. Rates charged for life insurance increase with the insurer's age because, statistically, people are more likely to die as they get older.

– **Guaranteed Issue** – Insurance issued to you without requiring you to answer any health questions or have a medical exam. Such policies are generally offered only upon hire, and if you miss out on the opportunity to enroll then, you will have to answer health questions or submit to a medical exam later in order to be covered.

– **Evidence of Insurability/Proof of Good Health/Medical Underwriting** – In order to qualify for some insurance policies, you may have to submit to a medical exam or answer health questions before being deemed insurable.

Insurance companies alone determine insurability, and some people, for their own health or lifestyle reasons, are deemed uninsurable. The insurance company will investigate the health of an applicant for a policy to assess the likelihood of incurring a claim, in the same way that a bank would investigate an applicant for a loan to assess the likelihood of a default.

Two Primary Types of Life Insurance

- **Term Life**
- **Permanent Life**
  - Whole Life
  - Universal Life
  - Limited Pay
  - Endowment
- **Accidental death and dismemberment insurance (AD&D) policy** - In an AD&D policy, benefits are available not only for accidental death, but also for the loss of limbs or bodily functions, such as sight and hearing.

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