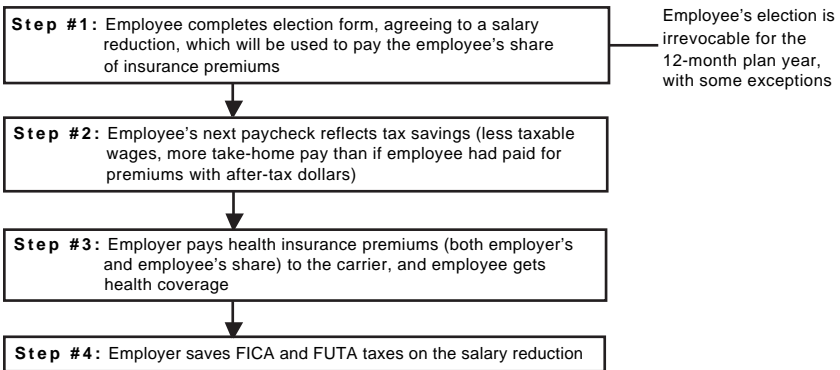


1. Premium-Only Plan (POP) Description

Here's how people save money with a POP:



Mr. DoGood's got it now: a POP really makes sense for a business like his. Employees are already making after-tax payroll deductions to pay for their share of insurance costs. Just setting up the POP and telling payroll to take those same deductions on a pre-tax basis means that everyone gets to save money. A cafeteria plan helps employers in other ways, as well. In addition to enabling the employer to save on its share of FICA (Social Security and Medicare) and FUTA (federal unemployment) taxes, a cafeteria plan can:

- help recruit employees and keep them satisfied;
- increase flexibility to design employee benefits for diverse employee needs;
- in some states, save on state unemployment insurance and workers' compensation taxes;
- cushion the blow of huge premium increases; and
- increase employee awareness of the cost of each benefit.

"I like it," says Mr. DoGood, "but every silver lining's got a cloud. Where is it here?" Well, the IRS doesn't dish out tax goodies without getting some assurances that they're being used properly. So Widgets, Inc. will have to meet some legal requirements, most of which are highlighted in other Sections in this short course. Mr. DoGood should be fine, so long as he gets good legal advice in setting up and operating his plan.

"That's the catch I was worried about," says Mr. DoGood "Attorneys! I'm not MegaCo., you know, I've got a small budget and can't afford more administrative staff right now." No problem. The POP shouldn't cost much out-of-pocket other than set-up costs, which should be minimal. To get things started from an administrative standpoint, Mr. DoGood needs to tell the payroll folks what they have to do and needs to explain the plan to his employees. Someone also needs to handle the distribution and collection of election forms.

2. Setting up a POP

"Okay, I'm sure Widgets, Inc. could use a POP!" says Mr. DoGood. "What do we have to do?" Here's a step-by-step action plan for setting up a POP (a POP Action Plan).

a. Decide Design Features for a POP

Mr. DoGood's already decided on a POP, but he'll have to answer a few questions so that the POP can be designed to fit Widgets, Inc. and its workforce. Who should be eligible to participate? What insurance premiums (e.g., medical, dental, etc.) should be paid pre-tax under the POP? Can employees who don't want health insurance get cash instead? (The employer will not have to make a premium payment for them.) Should employees be able to change their choices outside of open enrollment, if they are permitted to do so under the law? Whatever Mr. DoGood decides, the answers to these questions are subject to some legal restrictions, as discussed later in this short course.

b. Prepare the Plan Documents, Subject to Attorney Review

The plan document must meet specific legal requirements under the Internal Revenue Code ("the Code"), so Mr. DoGood should make sure that the plan document is prepared or reviewed by an attorney. Widgets, Inc. can satisfy the Code's requirements for a POP with a single plan document. The employer should already have separate plan documents for the insurance plans covered under the POP.

c. Adopt the Plan Through Board Resolution, etc.

Widgets, Inc. must adopt the plan before its effective date. Adoption of a plan requires the same kind of documentation that an entity uses for other major business actions. As a corporation, Widgets, Inc. should adopt the plan by a valid board resolution.

d. Distribute the Communication Documents to Employees, etc.

Widgets, Inc. needs to tell its employees what the POP does and help them to understand their options. This can be done through a cafeteria plan summary and election form. Mr. DoGood should also confirm that employees have already received summary plan descriptions (SPDs) for all of the insurance benefits that they can choose under the POP.

e. Obtain Signed Election Forms From Employees

Employees should sign election forms reflecting whether they want to pay for their share of insurance costs with pre-tax dollars. The forms should specifically authorize payroll to make those pre-tax deductions.

f. Instruct Payroll to Deduct Premiums Pre-Tax

Upon receiving the signed election forms, Widgets, Inc. should enter the elections into the payroll system. This requires telling the person who prepares payroll (either internal staff or the outside vendor, if any) to start deducting the employees' shares of their insurance premiums on a pre-tax basis. The result is that income tax withholding and FICA withholding will be based on each employee's reduced wages (gross pay, less the pre-tax deductions).

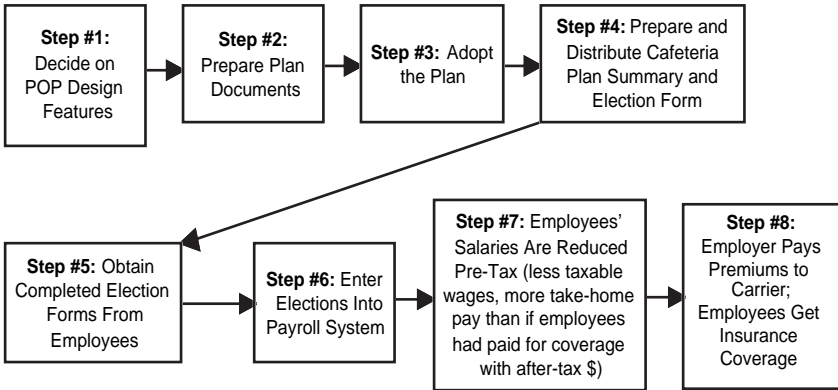
g. Pay Adjusted Salaries

Employees' pay stubs covering the first pay period will look different than they did before. Their salaries will still be reduced to reflect payment for insurance costs. However, the stubs will reflect less taxable wages and more take-home pay than if employees had used their salaries to pay for coverage with after-tax dollars.

h. Provide Insurance Coverage

With the POP, Widgets, Inc. provides the same insurance coverage (e.g. health, dental, etc.) that it did before. The underlying benefits haven't changed, just the way they are financed.

Here's a short summary of the POP Action Plan:



3. Employee Tax Savings With a POP

Now, if Mr. DoGood puts the POP in place, how much will his employees really save on taxes? Let's take Jane as an example. She's married and has one child. The company pays for 80% of Jane's own health insurance but nothing for her family. She pays \$6,400 in premiums (\$700 for her share of the employee-only premium, plus \$5,700 for family coverage) under Widgets, Inc.'s health insurance plan. Jane earns \$75,000 and her husband (a student) earns no income. They file a joint tax return.

	<u>POP Cafeteria Plan</u>	<u>No Cafeteria Plan</u>
1. Adjusted Gross Income	\$75,000	\$75,000
2. Salary Reductions for Premiums	(\$6,400)	\$0
3. W-2 Gross Wages	<u>\$68,600</u>	<u>\$75,000</u>
4. Standard Deduction	(\$10,000)	(\$10,000)
5. Exemptions	(\$9,600)	(\$9,600)
6. Taxable Income (lines 3-4-5)	<u>\$49,000</u>	<u>\$55,400</u>
7. W-2 Gross Wages	\$68,600	\$75,000
8. Federal Income Tax (line 6 @ tax schedule)	(\$6,620)	(\$7,580)
9. FICA Tax (7.65% of line 3)	(\$5,248)	(\$5,738)
10. After-Tax Premium Payments	\$0	(\$6,400)
11. Pay After Taxes and Premium Payments (lines 7-8-9-10)	<u>\$56,732</u>	<u>\$55,282</u>