Certified Financial Planner Board of Standards, Inc.

Employee Benefits Offer Myriad Financial Advantages

While the type and range of employee benefits vary by company, even the smallest organizations may offer plans that can mean significant tax breaks and savings for workers. Familiarizing yourself with programs and taking full advantage of available options can help you lay the groundwork for a solid financial future. Some major categories of benefits are described below.

Health and Life Insurance Plans

Foremost among benefits is group medical insurance, through which employers offer a range of health insurance options for employees and their families. In most cases, employees pay a percentage of the cost of premiums, which vary according to the type and extent of coverage selected.

- **Common medical plan types include:**

  - Health Maintenance Organizations (HMO) - Members' health care is provided by doctors and hospitals within a defined network and coordinated by a primary care physician.

  - Preferred Provider Organizations (PPO) - PPOs give members access to several networks of doctors and hospitals and allow them to visit out-of-network physicians for a higher fee.

  - Point of Service (POS) - These plans offer a high degree of flexibility by combining features of both HMOs and PPOs.

  - Indemnity - Subscribers choose their physicians without restriction and are reimbursed for medical expenses after the fact.

- Some employers offer cafeteria or "flexible benefit" plans, which allow employees to choose between a set amount of cash and a benefit package of equal value. Employees may assemble the package themselves from a menu of options, usually consisting of core benefits and elective, secondary programs.

- Flexible Spending Accounts (FSAs) allow employees to reduce taxes on money spent for uninsured health care or dependent care. Employees estimate the amount they will spend on related services and products for a given year; a percentage of the total is deducted before taxes from every paycheck. For example, on average for every $100 you contribute to a plan, you will save approximately $28 in taxes, which is based on paying 15% for federal income tax, 7.65% for FICA tax and 5% for state income tax. As expenses are incurred, the employee files receipts, and reimbursements are made for qualified purchases. Money remaining in the account at the end of the year is forfeit.

- Group life insurance is often provided at no charge to employees. In general, policies provide coverage equal to one year's salary. Depending on the plan, the policy may encompass accidental death and dismemberment. The employer may give employees the option of purchasing supplemental coverage for himself/herself as well as for eligible family members.

- Group disability insurance provides income in case of non-work related illness or injury. While specific provisions vary by plan and company, most disability plans provide at least 60 percent of an employee's base pay. Some employers provide disability coverage at no charge, and others offer it to employees willing to pay the cost. There are two basic types of coverage:

  - Short-Term Disability applies when an employee is unable to work for eight days to six months.

  - Long-Term Disability applies when an employee is totally disabled and unable to work for more than six months.

Employee Stock Options

Many corporations offer stock option plans, which allow employees to purchase prescribed blocks of company stock at a specific price within a given timeframe. If the stock price rises during the period, employees may choose to "exercise the option" and sell the stock at a profit. There are several types of stock options, which are also known as "equity compensation"; some are available only to corporate executives.

- Incentive Stock Options (ISOs) qualify for favorable tax treatment; i.e., employees who purchase company stock under the auspices of an ISO do not pay tax on profits until the stock is sold.

- Nonqualified Stock Options have two disadvantages in comparison to ISOs:

  - An employee exercising nonqualified stock options must report taxable income when he/she exercises the option to buy.

  - Income from nonqualified stock options is treated as compensation, which typically carries a higher tax rate than capital gains.

Employee Stock Plans

Employees in many companies have the opportunity to purchase shares of the company's stock at a discounted price during a specified period of time. Such programs are called Employee Stock Purchase Plans (ESPPs). Under the terms of an ESPP, an employee may receive a discount of as much as 15 percent. Plans also provide favorable tax treatment if they meet legal standards.

The "offering period," during which discounted stock may be purchased, may be as short as three months, but usually lasts between six and 24 months. Employees must use their own cash to buy stock through an ESPP, and they are subject to financial loss if the value of the stock declines. There are several types of stock plans, some of which are described below.

- A qualified 423 ESPP enables employees to purchase company stock at a discount without paying tax on the discount at the time of purchase.

- A nonqualified ESPP does not provide the tax advantages of a qualified plan.

- Employee Stock Ownership Plans (ESOPs) are qualified benefit plans that consist mostly or entirely of company stock. Employees do not purchase shares; rather, the employer contributes shares to an account, which vests and increases as the employee's seniority with the firm grows. Employees usually receive accumulated stock shares when they leave the company, although distribution may take place earlier.

- Phantom stock plans, also called "shadow" or "unit" plans, are stock-based incentive programs usually restricted to a corporation's executives. The plans provide bonuses, based on increases in the market price of the company's stock, that offer many of the same tax benefits as qualified stock option plans. Companies usually place a limit on the number of units that may be awarded to an employee.

Deferred Compensation Plans

Deferred compensation plans enable an employee to defer the payment of earned wages until a given date in the future. In many cases, the money is invested in cash value life insurance in the employee's name. The accrued funds are usually made available to the employee upon retirement. If the insured dies before retirement, the policy pays the beneficiary.

- Qualified Deferred Compensation Plans provide tax benefits for both employers and employees. Employers can deduct the amount contributed to the plan, while employees pay no tax on the funds until they are distributed. Further, distributed money from a qualified plan is usually eligible for rollover to an IRA or other qualified plan. Qualified Deferred Compensation Plans must be made available to all employees, and the amount of employer contributions is limited.

- Nonqualified Deferred Compensation (NQDC) plans lack many of the tax benefits of qualified plans, but they allow employers to contribute an unlimited amount to the plan and to designate specific employees - usually top executives - as participants. For that reason, large corporations generally use the plans as incentives for executives.

Types of NQDC plans include the following.

- Section 457 plans are similar to 401(k) plans, but may be offered only by eligible employers, such as government and tax-exempt organizations. The programs provide supplements to pension plans for select employees.

- Top-Hat plans are reserved for a company's senior, most highly paid executives as a means of attracting and maintaining executives.

- A Rabbi Trust, named for the first such arrangement, involves creation of a trust whose assets are subject to claims by the employer's creditors.

- A Taxable Trust is protected from creditors, but taxes must be paid on income at the time contributions are made.

Understanding Your Options

To ensure that you get the maximum advantages from employer benefits available to you, take the following steps.

- Read all benefits-related material as it is provided.
- Consult your human resources representative or benefits office with questions about benefits plans.
- Discuss options with your family, and select the most relevant coverage offered.
- Periodically review your active benefits selections to guarantee that they suit your current circumstances.

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