

Section 125 Cafeteria-style benefits.

Here, employees are able to withhold a portion of their salary on a pre-tax basis to cover certain medical or child-care expenses. Because these benefits are free from federal and state income taxes, an employee's taxable income is reduced, which increases their take-home pay. Also, since these pre-tax benefits aren't subject to federal social security withholding taxes, the employer saves by not having to pay his portion of FICA taxes on the employee.

Section 125 Cafeteria Plan:

	Pre-tax Medical Plan	No Pre-tax Medical Plan
Salary	\$4,000.00	\$4,000.00
Less		
Medical Expenses	(\$200.00)	\$0.00
Child Care Expenses	(\$400.00)	\$0.00
Taxable Income	\$3,400.00	\$4,000.00
Less Federal Tax @ 15%	(\$510.00)	(\$600.00)
Less State Tax @ 6%	(\$204.00)	(\$240.00)
Less Social Security @ 7.65 %	(\$260.10)	(\$306.00)
Less Medical Expenses	\$0.00	(\$200.00)
Less Child Care Expenses	\$0.00	(\$400.00)
Net take home pay	\$2,425.90	\$2,254.00
Monthly tax savings	\$171.90	\$0.00
Annual tax savings	\$2,062.80	\$0.00