

# The CFO's Guide to FICA Savings

How Section 125 Plans Reduce Payroll Taxes for Your Organization

By Benefits Genius  
benefitsgenius.com

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# Executive Summary

Section 125 Cafeteria Plans allow employers to offer pre-tax benefit elections to their employees. When employees pay for eligible benefits using pre-tax dollars, those amounts are excluded from federal income taxes, Social Security taxes, and Medicare taxes. This creates significant tax savings—not just for employees, but for employers too.

CFOs should care about Section 125 because it directly impacts payroll tax expenses. Every dollar employees contribute pre-tax toward eligible benefits reduces the employer's FICA (Federal Insurance Contributions Act) tax liability. For companies with 100+ employees, this can mean tens of thousands of dollars in annual savings.

**Employers save an estimated 7.65% on every dollar employees contribute pre-tax through a Section 125 plan**

This guide covers what FICA taxes are, how Section 125 reduces them, real-world savings examples, the implementation roadmap, and key compliance considerations. By the end, you'll have the information needed to evaluate whether Section 125 is the right move for your organization.

# What Are FICA Taxes?

FICA stands for the Federal Insurance Contributions Act. It covers two taxes that fund Social Security and Medicare:

Tax Type	Rate	Wage Cap (2024)
Social Security	6.2%	Applied to wages up to \$168,600
Medicare	1.45%	No wage cap—applies to all wages
<b>Total FICA</b>	<b>7.65%</b>	

**The Key Point:** Both employer and employee pay FICA taxes. That's 15.3% total—employees pay half (7.65%) through payroll withholding, and employers pay the other half (7.65%) as a direct payroll expense. When employees are paid \$100,000, the employer's FICA cost is \$7,650 per year.

Social Security tax has a wage cap (\$168,600 for 2024), meaning it's only applied to the first \$168,600 of each employee's wages. Medicare tax, however, applies to every dollar earned—with no wage cap. Additionally, high-income employees pay an extra 0.9% Medicare tax on wages above \$200,000 (individual) or \$250,000 (married filing jointly).

# How Section 125 Reduces Your FICA Burden

Here's the mechanics: When an employee contributes to a pre-tax Section 125 election (such as health insurance premiums, an FSA, or an HSA), that contribution amount is deducted from their gross wages **before** FICA taxes are calculated. This reduces the wage base subject to FICA tax.

**The employer benefit:** Because the employee's wage base is reduced, the employer's FICA liability on that employee is also reduced. For every dollar an employee contributes pre-tax, the employer saves 7.65% in FICA costs.

	Without Section 125	With Section 125
Employee's Gross Wages	\$50,000	\$50,000
Pre-Tax Benefit Contribution	\$0	-\$3,500
Wage Base (for FICA)	\$50,000	\$46,500
Employer FICA Cost (7.65%)	\$3,825	\$3,557
<b>&lt;b&gt;Employer Savings&lt;/b&gt;</b>		<b>&lt;b&gt;\$268&lt;/b&gt;</b>

In this example, the employer saves \$268 per employee annually for that single pre-tax contribution. Multiply that across your entire workforce, and the aggregate benefit becomes substantial.

## Estimated Savings by Company Size

The following table illustrates estimated annual employer FICA savings based on company size and average pre-tax benefit elections per employee:

Company Size	Avg Pre-Tax Deduction/Employee	Est. Annual Employer FICA Savings
25 employees	\$3,500	\$6,700
50 employees	\$3,500	\$13,400
100 employees	\$3,500	\$26,800
250 employees	\$3,500	\$66,900
500 employees	\$3,500	\$133,900

*Note: These are illustrative estimates based on uniform pre-tax deductions of \$3,500 per employee and a 7.65% FICA rate. Actual savings depend on salary levels, benefit elections, and participation rates. High-wage earners may have reduced savings due to the Social Security wage cap.*

# What Benefits Qualify for Section 125?

Not all employee benefits are eligible for pre-tax treatment under Section 125. The IRS has a specific list of qualifying benefits. Here are the most common:

## Eligible for Pre-Tax Deduction:

- Health insurance premiums (medical, dental, vision)
- Health Savings Account (HSA) contributions
- Flexible Spending Accounts (FSA)—medical and dependent care
- Supplemental coverage (accident insurance, critical illness, hospital indemnity)
- Commuter benefits (parking and transit passes)

## Special Rules or Limitations:

- Life insurance coverage over \$50,000 has different tax treatment under Section 79 (taxable to employee up to a certain amount)
- Employer-provided education assistance has annual limits and specific eligibility requirements

To confirm whether a specific benefit is eligible, consult your ERISA counsel or Third-Party Administrator (TPA). State-mandated coverage (like state disability insurance) may have additional rules.

# Implementation Roadmap

Setting up a Section 125 plan takes planning, but the process is straightforward. Here's a typical timeline:

## Step 1: Audit Current Benefits

Review what benefits your organization currently offers. Which are already being paid pre-tax (such as health insurance premiums)? Which could be added to Section 125?

## Step 2: Identify Additional Benefits

Work with your benefits team or broker to identify which benefits are not yet in Section 125 but could be offered, such as FSA or dependent care benefits.

## Step 3: Engage a TPA or Administrator

Hire a Third-Party Administrator (TPA) or benefits administrator to manage the plan. They handle nondiscrimination testing, claims, and compliance.

## Step 4: Draft the Section 125 Plan Document

Your legal counsel or TPA will create a formal written plan document that complies with IRS and Department of Labor requirements.

## Step 5: Communicate Changes to Employees

Educate your workforce about the pre-tax benefits available and how elections work. Provide summary plan descriptions and FAQs.

## Step 6: Update Payroll to Process Pre-Tax Deductions

Work with your payroll provider to implement pre-tax deduction processing for the elected benefits effective on the plan's start date.

**Timeline: Typically 4–8 weeks from the decision to implement to the first pre-tax deduction, depending on plan complexity and payroll system capabilities.**

# Compliance Considerations

Section 125 plans are subject to both IRS and Department of Labor regulations. Key compliance points:

## Written Plan Document

Your Section 125 plan must be in writing and signed by authorized representatives. It documents eligible employees, available benefits, election procedures, and plan year dates.

## Nondiscrimination Rules

The plan must offer benefits to all eligible employees on a nondiscriminatory basis. You cannot favor highly compensated employees. Annual nondiscrimination testing may be required.

## Election Periods and Changes

Employees typically lock in their elections for the full plan year. Mid-year changes are allowed only for qualifying life events (marriage, birth, change in dependent care, significant loss of coverage, etc.). Document all changes.

## Use-It-or-Lose-It Rule (FSA)

FSA balances not used by year-end (or during the grace period if offered) are forfeited. Employees must understand this limitation.

## Record Keeping

Keep the plan document, employee elections, nondiscrimination test results, and compliance documentation on file for at least 6 years.

**Recommendation: Work with ERISA counsel for complex situations, especially if your organization has multiple benefit structures or international employees.**

# Next Steps

Ready to explore Section 125 for your organization? Here are three ways to move forward:

## 1. Use the FICA Savings Calculator

Visit [benefitsgenius.com/tools/fica-calculator](https://benefitsgenius.com/tools/fica-calculator) to estimate your organization's potential FICA savings based on your workforce size and current benefit elections.

## 2. Read the Full Section 125 Guide

For a comprehensive deep-dive into Section 125 regulations, nondiscrimination testing, FSA and HSA rules, and plan design options, visit [benefitsgenius.com/learn/section-125-comprehensive-guide](https://benefitsgenius.com/learn/section-125-comprehensive-guide).

## 3. Schedule a Consultation

Speak with a Benefits Genius specialist about your organization's unique needs. Visit [benefitsgenius.com/contact](https://benefitsgenius.com/contact) to schedule a free 30-minute consultation.

Section 125 is a proven strategy for reducing payroll costs while delivering valuable benefits to your employees. The savings are real, the compliance framework is well-established, and the implementation is manageable with the right partner.

# Important Disclaimers

## **Educational Content Only**

This guide is for educational purposes only and does not constitute legal, tax, or professional advice. Section 125 regulations are complex and may vary based on your organization's structure, state of operation, and specific circumstances. Always consult with qualified tax and legal professionals before implementing a Section 125 plan.

## **FICA Savings Estimates**

Savings estimates in this guide are illustrative and based on simplified assumptions. Actual FICA savings will vary depending on employee salaries, elected benefits, participation rates, and whether employees are subject to the Social Security wage cap or additional Medicare tax. Use the FICA Calculator at [benefitsgenius.com](https://benefitsgenius.com) for personalized estimates.

## **Fixed Indemnity and Supplemental Benefits**

If offering supplemental benefits (accident insurance, critical illness, hospital indemnity), these products are not health insurance. They are designed to pay fixed benefits directly to the employee and are subject to their own regulatory requirements.

## **No Warranty**

Benefits Genius makes no warranties regarding the accuracy, completeness, or applicability of the information in this guide. The user assumes all responsibility for the accuracy and appropriateness of any conclusions drawn from this material.