Total Compensation – It’s More than Simple Salary

Salary
When is $50,000 not $50,000? When it's in your written job offer. When comparing job offers, it is important to understand the total compensation package of the job you are considering. Rather than being solely-focused on salary or pay, considering total compensation is a more effective method of weighing employment packages. Taking this approach, salary is only the starting point for such a decision.

Salary & Commissions
Certain positions may take monetary compensation a step further than a simple salary. It could also include overtime opportunities, year-end bonuses, commissions, etc. Although these still are included in monetary compensation, they may differ from a simple salary as they are often inconsistent, infrequent, and difficult to plan for.

Total Compensation
While salary and commissions are generally the largest portion of a compensation package, they are not the only factors to consider. In an effort to better acquire and retain the highest quality talent, companies are continuously offering additional benefits to make their compensation packages more attractive. Two of the most common examples are 401(k) plans and employer sponsored Health Insurance. While these don’t make your take home paycheck increase, they are valuable and key to your financial success.

Some benefits are monetary while others are non-monetary. Being happy and feeling secure at work can be as important as your financial compensation. Common examples of non monetary benefits include vacation time, paid sick time, career development opportunities, work-life balance, and even company culture.

Once you have accepted the job offer that best suits you, you will need to select which benefits are most advantageous to your personal situation. With so many benefit options available, industry jargon and confusing acronyms can make these benefits convoluted and confusing. Those first entering the workforce may be given a short amount of time to decipher between a PPO vs HMO, a DC vs DB, or an HSA vs HRA vs FSA in their benefits material. To help alleviate
stress and confusion, below is a breakdown of these as well as helpful hints of commonly offered employee benefits that may help you better understand and recognize total compensation.

### Taxes and Your W-4

With a job offer of $50,000 you may expect a monthly paycheck of $4,166.66. Don’t make this common mistake or you will be very disappointed come payday. You should expect to take home about 75-85% of your total pay. Using California as an example, out of every check you will see the following line items that will reduce your total take home pay.

- **FITW** – Federal Income Tax Withholding
- **CA** – State Withholding
- **CASDI-E** – State Disability Income tax
- **MED** – Medicare Retirement Insurance
- **SS** – Social Security Retirement

No, you cannot get out of paying for any of these, but you can control when and how much will be taken for Federal and State withholding. The W-4 is the tax form that you will fill out for your employer to determine the amount withheld from your check. The W-4 looks like a complex, overwhelming form with its worksheets, credits, dependents and allowances. It’s not. It is simply selecting number of allowances you are choosing to claim. The lower the number you claim, the more of your paycheck will be “withheld”. A higher number claimed means less of your check will be “withheld”. The amount withheld is sent to the IRS for payment of your year’s income tax bill. Remember that if you claim too high of a number and have too little of your paycheck withheld, you could end up owing back taxes at the end of year.

The best approach is to simply follow the Personal Allowances Worksheet. If you are single, have no kids, and have only one job, its actually pretty simple. The goal is to attempt to match your withholdings to your actual year end tax bill.

### Retirement Plans

A retirement plan is typically established by an employer to help the employee replace their paycheck during retirement when they are no longer working. Retirement plans can come in many shapes and sizes, with employers often selecting one or a combination of several that best suits the company needs. The following are some of the most common, plus a few general rules of thumb that should be utilized along the way.

#### Defined Benefit (DB) Plans

Defined Benefit plans are most commonly known as a Pension. These plans are called Defined Benefit because at retirement the employee is guaranteed a specific amount of money for the rest of his or her life. Because these plans are funded and guaranteed by the employer, they are extremely expensive and risky for the employer. Almost no
employers currently offer Defined Benefit Plans. It is far more likely that your employers will be offering you some type of Defined Contribution Plan.

**Defined Contribution (DC) Plans**

401(k)s, 403(b)s, etc. are well known retirement plan options that fall under the Defined Contribution category. Rather than a guarantee benefit amount promised at retirement, DC plans provide a vehicle for employees to make payroll contributions for retirement of the employee.

Because the employee cannot depend on their employer to fund their retirement with a Defined Contribution plan, there is a greater emphasis to begin saving early. The important thing to remember about retirement savings is there is no one-size-fits-all answer. There are rules of thumb and general recommendations, but ultimately each individual should determine what their budget will allow them to utilize for retirement savings. As a starting point, if current cash flow permits, begin contributing at least what the employer offers in a match. If an employer matches dollar for dollar up to 5% of salary, begin contributing at least 5% to take advantage of this “free money”. As a step further, one general rule of thumb that has long been passed around is to find a way to save 10-20% of salary while working. The maximum contribution an employee is allowed to personally make to a Defined Contribution plan is $18,500 (2018). Ideally, this would be the eventual goal as your career and income progress.

**DC CONTRIBUTIONS If cash flow allows...**

- At minimum, contribute employer match
- “Rule of Thumb” would be to contribute 10-20% of Salary
- Ideally, contribute the max ($18,500 in 2018)

**DB & DC Comparison**

**BENEFIT:**

- **DB** – Income is a future benefit amount promised by employer.
- **DC** – Income depends on savings and performance of account, not guaranteed by employer.

**FUNDING:**

- **DB** – Predominantly employer funded
- **DC** – Predominantly employee funded

**MANAGEMENT:**

- **DB** – Professionally managed by pension admin.
- **DC** – Employee manages investment selections

**RISK:**

- **DB** – Employer typically bears risk
- **DC** – Employee typically bears risk
Traditional (Pre-Tax) vs Roth (After-Tax)

Many Defined Contribution plans now offer Roth and Traditional options. Understanding the difference is important when deciding which should be utilized. Contributions made into pre-tax plans require paying ordinary income taxes on withdrawals of those funds in retirement. However, contributions into pre-tax plans do have the benefit of a tax deduction for the amount contributed. Contributions made into Roth plans on an after-tax basis do not have the benefit of any tax-break up-front when contributions are made. Instead, the benefit is realized in retirement, as no tax is owed on qualified distributions. The conventional approach in deciding which plan to contribute into is to compare the current tax bracket with what your anticipated tax bracket would be in retirement. If the tax bracket in retirement is expected to be lower, than contributions made to Traditional plans (pre-tax) may be better. This allows the opportunity to delay having to pay taxes until in a lower anticipated tax bracket. The opposite is typically true; a higher retirement tax bracket may mean Roth contributions are better today. Keep in mind, this decision effects employee personal contributions only. All employer matches or contributions are considered to be made on a pre-tax basis.

Making deductible tax deferred (pre-tax) contributions could be worth $42,189 more than making Roth contributions.
Vesting

One common pitfall to be aware of is a retirement plan’s vesting schedule. A vesting schedule is set up by a company in order to require the employee to wait a predetermined amount of time before acquiring full ownership of the employer contributions to the plan. Although DB and DC plans have different years, both potentially utilize “cliff” and “graduated” vesting schedules. If a plan utilizes a cliff vesting schedule, the employee will gain 100% of the employer contributions in the determined year. Under a graduated vesting schedule, the employee will gain partial ownership over a 5 year period. Keep in mind, any change in employment prior to being fully vested will result in a forfeiture of the remaining benefits. However, this applies exclusively to employer contributed funds. Any personal contributions to a retirement plan are always fully owned by the employee.

### COMMON VESTING SCHEDULES

#### DEFINED BENEFIT PLANS

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#### DEFINED CONTRIBUTION PLANS

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Health Insurance

Health insurance is the most common benefit offered by employers within benefits packages, and is often the most requested by employees. In fact, the Affordable Care Act in 2010 mandated that companies with at least 50 full-time employees offer health insurance benefits or be subject to fines and penalties. There are several different types of health insurance plans available that could be potentially selected.

Health Maintenance Organizations (HMOs)

HMOs are probably the most common type of health insurance offered. With an HMO, the employee chooses their own primary care physician. The primary care physician is then responsible for referring to other doctors or specialists within the HMO network. Unlike other plans, medical care is only covered when utilizing a doctor or specialist within the HMO’s network. As a result, these plans are generally less expensive than alternatives at the expense of fewer options.

Preferred Provider Organizations (PPOs)

PPOs typically carry higher premiums than HMOs, however, provide more flexibility when selecting a doctor. PPOs still maintain a network of providers, and coverage and benefits are typically better within network. In addition, unlike HMOs, PPOs will still pay if a doctor outside of the network is selected – although it may be at a lower covered rate. PPOs also offer the ability to see a doctor or specialist without having to be referred to by a primary care physician first.
Point of Service Plans
Point of Service Plans are essentially hybrids of HMOs and PPOs. Similar to HMOs, Point of Service plans designate a primary care physician who refers within network. But like a PPO, someone covered under a Point of Service plan is also able to seek care outside of their network while maintaining coverage as well. In certain circumstances, the primary care physician may be able to refer out of network as well. While coverage is still available out of network, costs paid out of pocket tend to be higher compared to staying within network.

High Deductible Plans & HSAs
High Deductible Plans are healthcare plans that have been increasing in popularity in recent years, often coupled with a Health Savings Account (HSA). High Deductible Plans have been used with more regularity recently as they are a means for an employer to still offer health insurance coverage, with lower expenses for the company itself. These plans trade considerably higher annual deductibles for lower monthly premiums. Because of the potentially high deductible, these plans are generally only recommended to younger workers or those in above average health. A Health Savings Account allows the employee to set aside money tax-free to be utilized for medical expenses. In some cases, employers could potentially contribute to an employee’s HSA as well. For those in good health with little to no medical care required throughout the year, a High Deductible plan could be a great way to save money through lower premiums while still retaining coverage. The HSA will provide the ability to pay for unexpected medical expenses in a tax-advantaged way. However, for those that will require medical care throughout the year, these plans are not appropriate due to the much higher deductibles.

Dental Insurance
Dental Insurance is another common benefit offered, although it is not mandated or required by law like health insurance. Just like health insurance plans, dental insurance plans may come as an HMO or PPO as well. HMOs require utilizing a dentist, orthodontist, etc. from within the insurance network, while a PPO will be less restrictive. Generally, an employer offering dental insurance will pay a portion of the monthly premiums with the remaining coming from the employee paycheck. The insurance will typically offer varying percentages of coverage for different levels of procedures. For example – 100% of preventive cleanings and care, 80% of common procedures such as cavity fillings, and 50% of major work such as tooth extraction.

Vision Insurance
Although offered less frequently than dental insurance or other benefits, vision insurance is another perk that could come as a part of an employment package. If vision insurance is offered, be sure to check to see what is offered and covered through insurance. Most plans offer discounts on annual eye exams, contacts, or prescription eye glasses. More comprehensive plans may offer coverage for larger procedures as well, such as laser correction surgery. Similar to dental or health insurance, vision insurance may not cover every optometrist or ophthalmologist. Instead, a vision care professional within the network will have to be utilized. Before signing up for vision insurance, look through the detailed plan benefits thoroughly; weighing how much vision care insurance will cost per year vs. annual vision care expenses if paying out of pocket. Since new eye glasses are not typically needed every year, many people only require annual eye exams with no further expenses. Because of this, the discounts and benefits offered often do not outweigh the necessary premiums.
Flexible Spending Account (FSA)

FSAs are employee owned accounts used to pay for any medical expenses that are not covered by a health insurance plan. Employees can contribute to FSAs in order to “pre-fund” expenses such as copayments, deductibles, and prescriptions. In addition, it can be used for other healthcare specialty services as well, such as vision and dental expenses or even first-aid supplies. Any contributions an employee makes into their FSA are tax-deductible for that year up to the $2,650 limit (in 2018). These plans are not portable, meaning contributions are lost with a change of employment. If an employer offers the ability to use an FSA within their benefits package, be aware of the major caveat; all contributions are known for the slogan “use it or lose it” - meaning contributions made to the account that are not spent by the end of the year are typically forfeited. Some plans allow up to $500 of unused funds to carry over to the following year or extend a grace period of a certain number of months, however these exceptions are on a plan-to-plan basis.

Health Reimbursement Account (HRA)

HRAs are plans in which an employer reimburses an employee for healthcare premiums or out of pocket medical expenses. Whereas an FSA is owned and contributed to by the employee, HRAs are completely employer owned and funded. Because they are reimbursement accounts, it does require the employee to actually incur the expense initially. HRAs may be used to reimburse medical expenses for the employee and dependents, but will not cover any insurance premiums. Since they are employer owned, an employee is not able to transfer anything if they change from one employer to another.

In order to maximize the benefit of employer-sponsored insurance, it is important to understand how much of each insurance they cover. Some employers may only cover small portions of the benefit and require that the remainder of the premiums be paid out of the employee paycheck.

Life and Disability Insurance

Life Insurance

Employers often provide a small amount of life insurance coverage to their employees. This can range from a small amount (typically up to $50,000) or a more generous offering of a multiple of the employee’s salary. If fortunate enough to have employer sponsored life insurance, be aware that premiums for coverage in excess of $50,000 will count as employee income. In addition to what an employer offers as a benefit, there may be the option to purchase additional coverage through the group policy. If this benefit is available, compare the premium costs with those of purchasing an individual policy. For some, it may be more affordable to purchase adequate life insurance on their own. However, for those in poor health, it is probably more affordable to purchase additional life insurance coverage through their employer group plan. In addition, for those with any serious medical conditions, group plans do not require medical exams, so qualifying is easier than with an individual plan. If relying on life insurance coverage through an employer group plan, be mindful that the plan will typically end if there is a change in employment. Some group plans
offer the ability to convert to an individual plan, however, more often than not a new plan will be necessary to maintain coverage.

Disability Insurance
According to the Social Security Administration, as of 2017 an employee is over 4 times more likely to become disabled than they are to die before reaching normal retirement age. There are two types of disability insurance to cover such an event: short-term and long-term.

Short-term Disability Insurance
Short term disability (STD) pays a percentage of an employee’s salary for a designated amount of time if an illness or injury leaves them unable to perform the duties of the job. STD generally begins 14 days after the incident, and coverage varies usually between 9 and 52 weeks. Depending on the plan, the benefit typically covers 40-60% of the employees' income. Short-term disability insurance is often cost prohibitive to acquire through an individual policy, so employees commonly find coverage through their employer is most cost effective.

Long-Term Disability Insurance
Long-term disability insurance (LTD) picks up where short term disability leaves off, generally after 3 to 6 months. LTD usually ensures 40-60% of salary for either a defined period of time, until the employee can return to work, or until retirement. The longer the time of coverage or more salary ensured, generally the more expensive the premiums are. While group long term disability insurance through an employer may save the employee premiums of obtaining their own policy, there are tax implications down the road that should be considered. When the employer pays the premium on behalf of the employee, the resulting benefit when utilized is taxable. Since LTD typically only covers 40-60% of salary, this may further reduce income at a time it is most needed. If this benefit amount does not seem to be sufficient to sustain current expenses, it may be appropriate to get a supplemental long term disability policy. Through a supplemental disability plan, it may be possible to get combined coverage up to 80% of salary for a discounted premium rate.

Conclusion
When looking at total compensation, these are some of the more common types of benefits offered. Typical compensation packages often include many of the items detailed above; health insurance, retirement plans, etc. These benefits provide some type of monetary value to the employee. However, there are many benefits that are difficult to put a monetary value to. Although they do not necessarily show up on a paycheck, many employees value personal development, career opportunities, flexible work schedules, the ability to work from home, work-life balance, commute, and company culture even more than monetary benefits. The compensation of these types of benefits may take the form of time savings or less worry and stress. Ultimately, when weighing job offers and employment packages, it is important to weigh which type of benefit is of the greatest personal importance.