

Evaluating the finances of a job offer

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Abstract

The finances presented by an employment contract include the wages offered plus the value of all employment benefits. This session covers the evaluation of a total compensation package against a detailed cost of living assessment to estimate the feasibility of an employment contract of providing a sound financial state.

Key words: compensation, salary, wages, income, benefits, paycheck withholdings, budget, cost of living

Introduction

Most veterinary graduates do not fully comprehend all of the costs associated with their upcoming personal life post-academia. Paying for life expenses, together with the repayment of debt, are usually more expensive than initially assumed. In addition, most also cannot quantify the difference between their projected salary from employment and the actual earnings that their paycheck will provide. Financial hardship and job dissatisfaction can, and will be, created when the finances of a job offer cannot support an individual's cost of living. For this reason, evaluating the finances of a job offer must include an assessment of the cost of living against the true earnings and benefits provided by a job offer's compensation package.

Compensation package

In simple terms, a total compensation package refers to the total costs the employer incurs in employing you, and includes all financial compensation as well as all employer-paid employee benefits. The details of your total compensation package should be included in your employment contract. Not only will your contract delineate the salary you will earn (and how it will be calculated and paid), but also the benefits you will receive as an employee, together with a description of who will pay for these benefits (employer-paid or employee-paid in part or in full with either pre- or post-tax dollars). Note that, secondary to employment, an employee might have the opportunity to participate in an employee-paid benefit that does not create a cost to the employer. Whether this benefit should be considered part of the compensation package or not is up for discussion, but everyone can agree that the opportunity to participate in a group-based employment-provided benefit would either not be available to the employee as an individual or, more likely, would carry a higher financial cost if the employee were to pursue it on their own in the open market. In the author's opinion, these are benefits that should be part of the analysis of the total compensation package.

Salary (gross wages)

Wages are a regular payment by an employer to an employee for services performed on behalf of the business. Your annual salary can be a fixed or a variable amount depending on the method your employer utilizes to calculate your pay. Your total gross wages from employment will include your salary plus any

bonuses, tips, etc. As an employed individual, your employer will withhold some of your wages to pay, on your behalf, your portion of payroll taxes (Social Security and Medicare), Federal and State taxes, and your portion of employer-provided benefits (e.g., your portion of the health insurance premium). Note that, as discussed below, not all wages pay payroll or income tax.

Earnings (income)

Earnings refers to the amount of money you ultimately receive from your gross wages and equates to the net pay presented by your paycheck. This income represents the amount of money available to pay for life expenses not already covered by employment withholdings.

Paycheck withholdings

Paycheck withholdings are what create the difference between the gross wages earned from work and the net income amount that hits your bank account. Some withholdings are required by law and others are for employee-elected participation in employer-sponsored benefits. The dollar difference between salary and income created by withholdings is significant, and understanding and estimating the dollar amount of this difference is essential in the analysis of a compensation package's ability to cover your budgeted and unexpected life expenses.

Some paycheck withholdings reduce the amount of wages that pay different taxes. For an employee, payroll taxes refer to the Federal Insurance Contribution Act (FICA) that mandates a payroll tax to be garnered from employee gross wages (with matching employer contributions) to fund OASDI (Social Security) and Medicare programs. FICA-taxable wages are the result of reducing an employee's gross wages by the amount of a specific employee benefit. The 2 most common employee benefits that reduce the amount of FICA-taxable gross wages are employee contributions to either a Health Savings Account (HSA as a component of a high-deductible health insurance plan) or a Flexible Spending Account (FSA), and withholding for the employee's insurance premium portion of the employer-provided health insurance program.

- $\text{FICA-taxable wages} = \text{gross wages} - (\text{HSA or FSA}) - (\text{employee portion of health insurance premium})$

Payroll (FICA) Tax will be calculated and withheld on your FICA-taxable wages at a rate of 6.2% for Social Security (ceiling on wages taxed for SS in 2023 is \$160,200) and 1.45% for Medicare (no wages ceiling; additional 0.9% surtax on gross wages amounts above \$200,000 for singles and \$250,000 for married couples filing jointly).

An employer will also withhold part of your employee wages for the payment of income tax (federal, state and local if applicable). The amount of income tax withheld will depend on the information you provide to the IRS and to the state as part of your employment onboarding process (through form W-4 for the IRS and through a corresponding form to the state). These

forms will serve to indicate the tax allowances, based on personal situation, that will define the applicable federal and state deductions that will ultimately influence the amount of income taxes that need paid; the employer will then withhold from your employee wages a corresponding amount for the payment of income taxes.

Income taxes are calculated on an amount from wages termed taxable income. Within your paycheck, taxable income is the result of reducing the already calculated amount of FICA-taxable wages by withholdings that reduce the amount of wages that pay income tax (note that the amount of FICA taxes calculated does not serve to reduce the wages amount that pays income tax). The most common type of withholding that reduces taxable income is a qualified employee contribution to an employer's retirement plan.

- Paycheck taxable income = FICA taxable wages - employee's retirement account contribution

Note that, while the information you provide through your W-4 and state forms attempts to forecast the amount of income taxes needing withheld from your paycheck, your ultimate taxable income and resulting income tax will be dependent on factors outside of your paycheck which will be ultimately accounted for in your federal and state income tax forms. Other household income, additional deductions, eligible retirement account contributions outside of employment, and tax credits are all situations occurring outside of your paycheck that will affect your ultimate taxable income and tax amount.

An employee can also have paycheck withholdings from wages for the payment of other employee-paid employer-sponsored benefits that do not affect FICA or income tax calculations. Examples include other employee-paid insurances like long-term disability and additional coverage for life insurance. While not a cost to the employer, these represent an additional wages

reduction to the employee's paycheck, thereby further reducing the amount of net earnings available for life expenses.

Table 1. depicts an example of the withholdings taken from total yearly wages to arrive at an employee's net yearly paycheck earnings. This earnings amount presents the ultimate dollar figure that the individual would have to utilize to analyze the feasibility of employee wages meeting their life expenses.

Benefits

The compensation package includes employer-provided benefits that are employer-paid. Some of the most common ones include the employer-paid portion of health/disability/life insurance premiums, matching contributions to retirement accounts, profit sharing plans, student loan repayment assistance, allowance for continuing education, PLIT coverage, paid time off, professional association membership dues, veterinary license, DEA registration, employee pet care plans, and initial hiring allowance for travel/moving/signing bonus. Evaluating the finances of a job offer includes accounting for the significant financial value provided by benefits that the employee gets to enjoy or utilize but whose cost is completely absorbed by the employer as a business expense. If an employee were, for example, to pay for CE credits out-of-pocket, they would have to earn more in wages than the CE would cost because those wages would have to pay FICA and income taxes before the left-over dollars could cover the CE invoice. Note that whether the employer pays directly for the benefit, or pays for the benefit by reimbursing the employee, the value of the benefit does not change as any reimbursement is not considered taxable income to the employee. The author prefers employer-paid benefits rather than reimbursements based on the concept of cash flow. For a reimbursement, the employee needs to submit a receipt after paying an invoice and wait for the reimbursement (usually in a following pay period). Of potential detriment is the

Table 1: Example of net earnings calculation from yearly gross wages after accounting for tax and benefit paycheck withholdings for Wisconsin individual filing as single in 2023.

Total Yearly Gross Wages	Salary, bonuses, tips	\$100,000
- FICA reducing withholdings	HSA or FSA contributions and employee portion of health insurance premium	\$2,500 (HSA) \$3,000 (health insurance premium)
= FICA Taxable Wages	FICA Taxes calculated on this number	
	FICA Taxes	\$5,859 (6.2% on \$94,500 gross wages) \$1,370 (1.45% on \$94,500 gross wages)
- Taxable Income reducing withholdings	Employee contribution to employer's retirement plan	\$6,000
= Taxable Income	Income Tax calculation uses this number; amount of income taxes depending on individual W-4 filing	
	Income tax ^{5,a}	\$11,731 (Federal) \$4,383 (State)
- withholding for additional employee-paid benefits		\$2,500 (LT disability insurance) \$120 (group life insurance)
Net pay	Amount available for budgeting for life expenses	\$62,537

misplacement of an invoice or the forgetting to submit one for reimbursement, at which point the employee would unintentionally cover the cost of the benefit themselves.

The compensation package also includes employment benefits that are fully or partially paid by the employee. Some of these are paid with pre-FICA and pre-income tax dollars, some with post-FICA but pre-income tax dollars, and some with dollars that are fully subject to taxation. The tax minimization advantage provided by some employee-paid benefits and the ability to participate in some employer-sponsored benefit programs are significant advantages provided by the employment that must be accounted for in the financial evaluation of a job offer.

The example in Table 1 presents 3 different scenarios that provide substantial value to the employee:

The \$5,500 total contributed to the HSA and health insurance premium do not pay FICA or income taxes. The employee needed exactly \$5,500 in earned wages to garner \$5,500 of benefits. Tax minimization is an advantage provided by the employee's ability to participate in these employer-provided benefits; the employee saved 7.65% in FICA taxes plus whatever their income tax rate would have been for federal and state.

1. The \$6,000 contributed to the retirement plan will pay 7.65% in FICA taxes but avoids income taxes on the contribution amount in the year of contribution. While tax minimization in this instance is limited to minimizing income taxes only, this tax minimization is significant on its own, and is also usually accompanied by free money provided by the employer's matching contribution. Note that the employee needs to earn more than \$6,000 to have that amount left over post-FICA to contribute to the retirement account and secure whatever free money is provided by the employer matching. The amount of wages needed earned in this instance being \$6,497 ($6497 - 6497 * 7.65\% = 6000$).^b
2. The ability to participate in the employer-sponsored program for LT disability and for group life insurance is the benefit provided as part of the compensation package. Though the employee would pay the benefits with wages that would have to pay both FICA and income taxes, the same would be true if they pursued these coverages outside of employment, except that the cost would most likely be higher.

The financial value of these benefits needs accounted for in the calculation of the total compensation package, especially when considering that employer-paid benefits are free and that for the employee to pay for most of these benefits outside of their employment would require not only the amount of the invoice for the benefit, but also the amount needed earned in wages to cover the FICA and income taxes that would come secondary to the earnings.

Budget

Veterinarians entering the job market cannot begin to consider jobs or job offers until they have calculated their personal budgets.⁶ A personal budget is required to forecast financial needs and is essential for the analysis of a job offer. Essentially, the post-withholdings earnings from earned wages provided by the compensation package must meet the projected financial needs of the individual in order to avoid financial hardship. If employment earnings will not meet the needs of the budget, either the income needs increased or the spending must be decreased. While increasing income depends on the negotiated base pay provided by the employment or the ability to produce practice

revenue if paid as a percentage of production, control of spending requires a differentiation between necessary and discretionary spending, and will most likely necessitate personal sacrifices around non-essential costs.

Budgeting

There are several steps required for the creation of a personal budget.¹ Understand that your budget will be a living/breathing document that needs to constantly change and adapt in response to life changes.

1. **Estimate your net income:** Utilize the information provided by your compensation package to determine the net earnings provided by the job after accounting for required and elected withholdings. It is essential that a proper estimation of taxes (FICA and income tax) and of the employee portion of health insurance premiums be done to adequately arrive at a proper estimation of income. Websites like that used for the tax estimation example previously presented are widely available.^{3,5} Evaluation of this projected income against budgeted expenses will provide information regarding the financial ability to participate in elective employee benefits that will result in further withholdings (specifically HSA/FSA and retirement contributions).
2. **Determine expenses:** It is essential that forecasted expenses be labeled as either necessary spending (money required to cover essential needs, such as food, housing and existing debt obligations, which present necessary costs that cannot be avoided) or discretionary spending (money for non-essential costs like recreation, entertainment, and non-essential consumer purchases that should only be pursued after necessary expenses are covered). Expenses should be listed in order of decreasing importance to help the process of budget balancing when the amounts of forecasted income and expenses don't match. Value is presented in a job offer when a required or desired expense is an employer-paid benefit within the employment offer. While the employer-covered expense will no longer form part of the individual's expense forecast, a "what if I had to pay it" analysis will further add information for the evaluation of the finances of the job offer.
3. **Manage your cash flow:** Understand that the inflow and outflow of cash have different timing, amount and frequency which could affect the availability of cash to timely meet obligations. Some expenses will be fixed and occur monthly at the same amount, some expenses are monthly but variable in amount, and some expenses might get paid once or twice per year. Inflow of income can be equally variable. For example, under a production-based compensation model that reconciles quarterly, an employee won't see the forecasted yearly income spread evenly over every paycheck and the timing of cash inflow can create a tight-budget situation when addressing essential expenses occurring monthly like rent, food and student debt repayment.
4. **Balance your budget:** The crux of evaluating the finances of a job offer relates to the ability to create a balanced personal budget. The potential to increase your income will be very dependent on your years of professional experience and ability to provide value and generate revenue. For this reason, the initial step in balancing a budget mostly relies on the reduction of expenses.
5. **Record, calculate and revise:** Once you achieve a balanced budget, you must keep track of actual income and expenses, calculate any expected changes to the budget based on expected changes to your finances, and revise your financial plan based on the updated budget.

Any student entering the job market needs to understand their personal financial picture before entering any contract negotiation. Working backwards, a budgeted list of necessary cost-of-living expenses that includes a reasonable figure for discretionary expenses should provide information about the amount of earnings required to meet their budget. Because net earnings arise from the wages left over after paycheck withholdings and deductions, the accounting for taxes and elected employee benefits will provide the wages amount that the job applicant would need to earn to achieve a balanced budget.

Cost-of-living assessment

Accounting for forecasted taxation on earned wages and for elected participation into employer benefit plans covers the expenses presented within the paycheck, but estimation of necessary and discretionary costs for living requires further research based on individual needs. Cost for housing can be researched by window shopping for apartments or houses through a multitude of available real estate websites. Cost of debt repayment can be analyzed by utilizing simple debt amortization calculators. For students looking at options for the repayment of student debt, the Federal Student Loan Simulator serves as an invaluable tool to forecast monthly loan repayment costs.⁴ Food costs can be analyzed by creating a fictional online shopping cart at grocery store local to the future place of employment and comparing the price of a known basket of goods between what you are used to paying now against what the same basket would cost at the new place.

For a more generalized calculation of expected expenses at a new location, an individual can utilize a cost-of-living comparison calculator to assess the cost of living at a new place in contrast to the known cost of living at the current location. For example, when the author moved from Kentucky to New York, he utilized a comparison calculator to forecast the expected change in living expenses associated with the change created by relocation for employment; a quick look at a cost-of-living comparison calculator suggests the current cost of living to be 8.49% higher in Ithaca, N.Y. than in Lexington, Ky.,² which is a significant number to be taken into consideration when deciding if the wages provided by a new job can help sustain the known standard of living. Note that these calculators usually do not include expected costs for local taxes related to home ownership or other personal property (city, town, county, school, etc.), which are significant costs that must also be part of the analysis (for example, the author's Kentucky home paid around 0.62% of the property's assessed value as yearly property tax, but his current New York home pays closer to 2.35%). City, town, or county websites usually provide generalized tax information.

The budget created for the determination of personal expenses can now be adjusted by the expected change in cost of living at the new place. The comparison calculators provide not only an

overall percentage of increase or decrease cost, but they also detail different line items which will make your budget forecasting a more feasible exercise that will provide a better estimation of living costs.

Conclusion

To properly evaluate the finances of a job offer, a potential employee needs to follow a multi-part process to define the feasibility of the employment contract providing a sound economic state void of financial hardship. Costs for necessary and discretionary expenses need evaluated under the lens of a cost-of-living adjustment to arrive at the net earnings required from a paycheck. Accounting for the tax and benefit withholdings found within the paycheck will inform the individual of the salary required to achieve a balance to their budget.

Endnotes

^a Sample calculations for federal and state income tax withholdings on Table 1. relied on a fictitious Wisconsin resident filing as single in 2023 and utilizing the gross wages and deductions presented in the table.

^b A crude but quick way to calculate wages required to cover a specific post-tax amount is through the use of the formula:

$$\text{Wages required: } \frac{\text{Post-tax amount needed}}{(1 - \text{tax \%})};$$

for example, the wages required earned to cover a \$6,000 invoice that pays FICA would be $\frac{6000}{(1 - 7.65\%)} = \$6,497$. But a \$6,000

invoice to be paid with dollars that pay FICA and, for example, 15% total in income taxes, would require $\frac{6000}{(1 - 7.65\% - 15\%)} = \$7,757$ in earned wages.

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