

# Section 125 cafeteria plans: Everything to know in 2024

In This Article



Last updated April 27, 2022

**Bob Phillips**



Reviewed by

**Jack Wolstenholm**



Read time

**7 mins**

It's no secret that the employment landscape in America has changed dramatically because of the pandemic. Massive layoffs, employees having to work from home, the Great Resignation, and companies experiencing labor shortages are some of today's workplace challenges.

Because of this, employees and potential employees are looking at their benefits with a more critical eye than ever before. While they expect health, life, and disability insurance to be included, they're also looking for other benefits.

What can we help you with today?

fering  
id  
inc

2

- [What is a Section 125 plan?](#)
- [Types of Section 125 plans](#)
- [Section 125 qualifying events](#)
- [Pros & cons of Section 125 plans](#)
- [Eligibility for Section 125 plans](#)

## What is a Section 125 plan?

A Section 125 plan is an employer-provided plan named after a section of the IRS code that allows employees to choose between two or more benefits (hence the nickname “cafeteria plan”), such as health insurance, dental insurance, [disability income insurance](#), [life insurance](#), dependent child care, etc.

Qualified benefits for Section 125 plans include:

- Group health insurance
- Vision insurance
- Dental insurance
- Disability insurance
- Life insurance
- Flexible spending accounts (FSAs)
- Health Savings Accounts (HSAs)
- Dependent care assistance programs (DCAPs)

The contributions you make as an employee into a Section 125 plan are made “pre-tax,” meaning the money deposited into your account is taken out of your paycheck before you pay taxes. This means you pay less each paycheck in federal income and FICA (Social Security and Medicare) taxes. Some states also allow participants a reduction in their state income taxes.

For example, let’s say you’re taxed on 30 percent of every dollar you make. If you choose to direct \$100 of your pre-tax income to your Section 125 account, you’ll be able to spend the full \$100 on qualified expenses instead of only \$70 if you had received all of your pay on an after-tax basis.

[ [Related: 20 best employee benefits in 2022](#) ]

## Types of Section 125 plans

## • **Health Savings Plan (HSA)**

This plan lets an employee choose to receive their entire salary in cash or pay for their group insurance on a pre-tax basis. Group insurance products included in this plan are health, disability, dental, vision, and term life.

## **Simple cafeteria plan**

A simple cafeteria plan protects an employer with 100 or fewer employees from “non-discrimination” requirements in exchange for contributing to their employee benefit plan.

## **Full flex plan**

With a full flex plan, employers contribute to a separate account for all eligible employees; the employees then use their contributions to choose from various benefits offered. Any portion of a benefit’s cost that exceeds the employer’s contribution can be paid by the employees pre-tax.

## **Flexible spending account (FSA)**

FSAs allow employees to contribute part of their pay before taxes to cover eligible health care and dependent care expenses. In 2022, employees can contribute up to \$2,850 to a cafeteria plan.

[ [Related: 2022 flexible spending account rules, limits & expenses](#) ]

## **Health savings accounts (HSAs)**

Another benefit that some employees can take advantage of under Section 125 is the health savings account (HSA). Only employees who choose to use a high-deductible health plan (HDHP) are eligible for an HSA (an HDHP must have an annual deductible of \$1,400 individual/\$2,800 family). HSA contributions in 2022 are limited to \$3,650 for individuals and \$7,300 for families.

[ [Related: 2022 health savings account rules, limits & expenses](#) ]

## **Section 125 qualifying events**

There are dozens of medical expenses eligible for reimbursement under a Section 125 plan, including:

- Acupuncture
- Treatment for alcoholism

- Hearing aids
- Long-term care services
- Nursing homes
- Operations
- Prescription drugs
- Psychiatric services
- Sterilization
- Wheelchairs

There are also many over-the-counter items that are eligible:

- Allergy meds
- Cold meds
- Contact lens solutions
- First-aid kits
- Pain relievers
- Pregnancy tests
- Sleep aids
- Throat lozenges

Many items that serve dual purposes are also eligible, such as orthopedic shoes, prenatal vitamins, dietary supplements, and sunscreen.

## Pros & cons of Section 125 plans

Not only can employees better control their tax liability with a Section 125 plan, but employers also defray some of their costs. However, like all plans, Section 125s have their pros and cons.

### Pros

- Tax savings for employees: Pre-tax contributions for employees means saving on federal income and FICA taxes, and usually state income tax as well, while helping them pay for eligible out-of-pocket expenses.
- Lower taxable income: reduces the taxable income reported by employees on Form W-2.

- “Use it or lose it”: employees must use the money they contributed to the plan during the plan year, or those funds will be lost. This requires planning and awareness on the part of the employees.
- Employees can’t change elections during the year: changes can only be made if certain qualifying life events occur.
- Employees must fund expenses upfront: for certain expenses, employees have to pay their costs upfront and then file a claim for reimbursement.
- An employee’s future Social Security benefit may be reduced.
- Employers must pay setup and administration fees to set up a Section 125 plan, which can be minimized if they do some of the setup themselves. The plan’s long-term savings helps minimize these expenses.

## Eligibility for Section 125 plans

Internal Revenue Service regulations prevent you from participating as an employee in a Section 125 plan if you’re self-employed, a partner in a partnership, or own more than 2 percent of a subchapter S corporation.

The tax code also stipulates that employers offering a cafeteria plan to their employees must include all employees with 1,000 hours or more of service in a plan year. However, employers can exclude employees who are under the age of twenty-one when a plan year ends or who have less than one year of employment with the employer during the plan year.

[ [Related: Insurance for self-employed individuals](#) ]

## Bottom line

If your employer offers a Section 125 plan, enroll in it. There’s no cost to you for participating, and you can reduce the tax bite taken out of your paycheck.

But, be sure to keep an eye on your FSA account during the year. Don’t leave unspent money in it on December 31st because you’ll be forfeiting it to your employer (your FSA balance can be rolled over from year-to-year).

*The information and content provided herein is for educational purposes only, and should not be considered legal, tax, investment, or financial advice, recommendation, or endorsement. Breeze does not guarantee the accuracy, completeness, reliability or usefulness of any testimonials, opinions, advice,*