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Understanding Section 125 Plans (Cafeteria Plans): Overview, Usage, and Establishment

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Section 125 Plans, also known as Cafeteria Plans, offer employers and employees a way to manage employee benefits while saving on taxes.

Updated over a week ago

What are Section 125 Plans (Cafeteria Plans)?

- Section 125 Plans, established under Section 125 of the Internal Revenue Code, allow employees to choose between taxable and nontaxable benefits. These benefits include health insurance, flexible spending accounts (FSAs), dependent care assistance, and other qualified benefits.
- Employers establish Section 125 Plans to offer employees a menu of benefit options, resembling a cafeteria where employees can select the benefits that best suit their needs.

How are Section 125 Plans Used?

- Employees elect to participate in a Section 125 Plan during open enrollment or when experiencing a qualifying life event (e.g., marriage, birth of a child).
- Employees make pre-tax contributions to their chosen benefits, reducing their taxable income and saving on federal income tax, Social Security tax, and Medicare tax.
- Employers may also contribute to employees' benefits through employer-sponsored contributions or matching contributions.

Are my company's benefits under a Section 125 Plan? Check your Summary Plan Description

- Summary Plan Description (SPD): The Summary Plan Description (SPD) is a document required by the Employee Retirement Income Security Act (ERISA) that provides detailed information about an employer's benefits plans, including eligibility, participation rules, and benefits available under each plan. Section 125 plans should be described in the SPD, typically under a section dedicated to cafeteria plans or flexible benefits arrangements.

Establishing a Section 125 Plan:

- Employers can establish a Section 125 Plan by adopting a written plan document that complies with IRS regulations.
- The plan document outlines the benefits offered, eligibility criteria, enrollment procedures, and other plan details.
- Employers must communicate plan details to employees and provide annual enrollment opportunities.
- Compliance with IRS regulations, nondiscrimination rules, and reporting requirements is essential to maintain the plan's tax-advantaged status.

Resources for More Information:

- Internal Revenue Service (IRS): The IRS provides guidance on Section 125 Plans, including Publication 15-B ([Employer's Tax Guide to Fringe Benefits](#)) and relevant sections of the Internal Revenue Code.
- Department of Labor (DOL): The DOL oversees compliance with employee benefit laws and regulations, including provisions related to Section 125 Plans.
- Qualified Third-Party Administrators (TPAs): TPAs specialize in administering Section 125 Plans and can provide guidance on plan design, compliance, and administration.
- Employee Benefits Consultants: Employers may consult with benefits consultants or legal advisors specializing in employee benefits to ensure compliance and optimize plan design.

Section 125 Plans offer employers and employees a tax-efficient way to structure employee benefits, providing flexibility and cost savings for both parties. Employers should carefully establish and administer Section 125 Plans in compliance with IRS regulations and seek guidance from qualified professionals when necessary. For detailed information and assistance, employers and employees can refer to resources provided by the IRS, DOL, TPAs, and benefits consultants.

Is there official documentation an employer needs to possess concerning Section 125?

Employers offering a Section 125 cafeteria plan are required to establish a written plan document and may need to file certain forms with the Internal Revenue Service (IRS) to maintain compliance. Here are the key documents and filings associated with Section 125 plans:

- **Written Plan Document:** Employers are required to establish a written plan document that outlines the terms and conditions of the Section 125 cafeteria plan. This document should detail the benefits offered, eligibility criteria, enrollment procedures, employee contributions, and any other plan provisions. The written plan document must comply with IRS regulations and be made available to employees upon request.
- **Form 5500:** Employers sponsoring Section 125 plans may be required to file Form 5500, Annual Return/Report of Employee Benefit Plan, with the IRS and the Department of Labor (DOL) each year. The filing requirements for Form 5500 depend on the size of the plan and the number of participants. Small plans with fewer than 100 participants may be eligible to file Form 5500-SF, while larger plans must file the full Form 5500.
- **Form 1094-C and Form 1095-C:** Employers subject to the Affordable Care Act (ACA) employer mandate may need to report information about their Section 125 plans on Form 1094-C (Transmittal of Employer-Provided Health Insurance Offer and Coverage Information Returns) and Form 1095-C (Employer-Provided Health Insurance Offer and Coverage). These forms are used to report offers of health coverage to full-time employees and are filed annually with the IRS.
- **Non-Discrimination Testing:** Employers sponsoring Section 125 plans must also comply with non-discrimination testing requirements to ensure that the plan does not discriminate in favor of highly compensated employees. Non-discrimination testing may include tests related to eligibility, contributions, and benefits available under the plan.

It's important for employers to work with legal counsel or benefits professionals familiar with Section 125 plan requirements to ensure compliance with IRS regulations and other applicable laws. Failure to comply with Section 125 plan requirements can result in penalties and adverse tax consequences for both employers and employees.

Did this answer your question?