

CAFETERIA PLAN: FREQUENTLY ASKED QUESTIONS FROM IRS.GOV

What is a cafeteria plan? A cafeteria plan is a separate written plan maintained by an employer for employees that meets the specific requirements of and regulations of section 125 of the Internal Revenue Code. It provides participants an opportunity to receive certain benefits on a pretax basis. Participants in a cafeteria plan must be permitted to choose among at least one taxable benefit (such as cash) and one qualified benefit. A qualified benefit is a benefit that does not defer compensation and is excludable from an employee's gross income under a specific provision of the Code, without being subject to the principles of constructive receipt. Qualified benefits include:

- Accident and health benefits (but not Archer medical savings accounts or long-term care insurance);
- Adoption assistance;
- Dependent care assistance;
- Group-term life insurance coverage;
- Health savings accounts, including distributions to pay long-term care services.

The written plan must specifically describe all benefits and establish rules for eligibility and elections.

A section 125 plan is the only means by which an employer can offer employees a choice between taxable and nontaxable benefits without the choice causing the benefits to become taxable. A plan offering only a choice between taxable benefits is not a section 125 plan.

Who may receive benefits under a cafeteria plan? The plan may make benefits available to employees, their spouses and dependents. It may also include coverage of former employees, but cannot exist primarily for them. See the questions below for treatment of benefits made available to individuals who are not spouses or dependents of the employee.

How does a cafeteria plan work? Employer contributions to the cafeteria plan are usually made pursuant to salary reduction agreements between the employer and the employee in which the employee agrees to contribute a portion of his or her salary on a pre-tax basis to pay for the qualified benefits. Salary reduction contributions are not actually or constructively received by the participant. Therefore, those contributions are not considered wages for federal income tax purposes. In addition, those sums generally are not subject to FICA and FUTA. See Sections 3121(a)(5)(G) and 3306(b)(5)(G) of the Internal Revenue Code.

What is a flexible spending arrangement? A flexible spending arrangement (FSA) is a form of cafeteria plan benefit, funded by salary reduction, that reimburses employees for expenses incurred for certain qualified benefits. An FSA may be offered for dependent care assistance, adoption assistance, and medical care reimbursements. The benefits are subject to an annual maximum and are subject to an annual "use-or-lose" rule. An FSA cannot provide a cumulative benefit to the employee beyond the plan year.