

Commonly Asked Questions Regarding Cafeteria Plans

1. What is a “Cafeteria Plan”?

A. A Cafeteria Plan is a benefit plan established by an employer which allows each employee to choose from a menu of qualified benefits with the employee cost of selected benefit(s) paid on a pre-tax basis. Examples of qualified benefits are medical, cancer, group term life, accident and dental plans.

You will find Cafeteria Plans called by different names such as “Flexible Benefit Plans,” “Flex”, “Section 125 Plan” among others.

2. Why is it referred to as a Section 125 Cafeteria Plan?

A. Because the Internal Revenue Code Section that governs these plans is Code Section 125.

3. What is meant by pre-tax benefits under a Cafeteria Plan?

A. The employee cost of any qualified benefits are paid from your salary before payroll taxes are calculated, resulting in lower taxes and in some situations, more take-home pay.

4. What taxes are exempt under a flexible benefits plan?

A. Federal, State (where allowed) and FICA

5. Is selecting qualified benefits on a pre-tax basis legal, and if so, how is this handled?

A. Yes, it is legal. Section 125 of the IRS Code allows this. It is accomplished by the employer adopting the Plan and the employee signing a Salary Redirection Agreement authorizing the employer to deduct the employee cost per pay period for qualified benefits selected on a pre-tax basis.

6. What are the flexible spending accounts I have been hearing about under Cafeteria Plans?

A. If the employer’s plan is designed as such, a pre-determined dollar amount (determined by the employee) may be set aside in each of the following spending accounts:

Medical Reimbursement Account - to cover allowable unreimbursed medical expenses (includes dental and vision expenses).

Dependent Daycare Reimbursement Account - to cover the cost of day care for (1) a dependent child under age 13 who qualifies as a tax dependent or (2) anyone you claim as a tax dependent because of physical or mental inability to care for himself/herself.

7. I have heard that qualified benefits elected under a Cafeteria Plan cannot be changed and remain in effect for the entire plan year. Is this true?

Yes. However there is one exception and that is if you experience a qualified status change including marriage, divorce, death of a spouse or child, birth or adoption or termination of employment of the employee or spouse. If a qualified change in status occurs, a change is allowed under the Plan. That change, however, must be consistent with the qualified change in status. For accident and health coverage you must gain or lose eligibility as a result of the change in status. For life coverage, you can only increase coverage if you add a dependent or decrease coverage if you lose a dependent.

8. Since my taxes are reduced under a Cafeteria Plan, will I lose any Social Security Benefits?

A. There could possibly be a slight reduction in Social Security Benefits due to the pre-tax election of qualified benefits allowed by the IRS under a Cafeteria Plan.