Section 125, also known as a cafeteria plan, allows employees to pay for certain benefits on a pre-tax basis, reducing their taxable income. This plan offers employees a choice between taxable benefits and certain qualified, non-taxable benefits, such as health insurance, adoption assistance, or dependent care assistance. To maintain tax advantages, these plans must adhere to specific IRS rules and regulations.

How does it work?

Employees can opt to have money deducted from their gross earnings to pay for qualified benefits, such as health insurance premiums, health flexible savings accounts (FSAs), health savings accounts (HSAs) or dependent care assistance programs (DCAPs). The employer deducts the selected benefit costs from the employee's paycheck before taxes are applied. These deductions decrease the employee's taxable income but also reduce the employer's payroll tax liabilities.

Section 125 cafeteria plan qualifying events:

Once employees enroll in a cafeteria plan and make their selections, they generally cannot change them until the next open enrollment period unless they experience a qualifying life event, such as:

- Marriage, divorce or legal separation
- Childbirth or adoption
- Involuntary loss of coverage under another plan
- Change in employment status
- Aging out of a parent's plan

The figures in the sample paycheck below are for illustrative purposes only.

Without S125		With S125	
Monthly Salary	$3,800	Monthly Salary	$3,800
Less Medical Deductions	N/A	Less Medical Deductions	($500)
Taxable Gross Income	$3,800	Taxable Gross Income	$3,300
Less Taxes (Fed/State @ 25%)	($950)	Less Taxes (Fed/State @ 25%)	($825)
Less Estimated FICA (7.65%)	($291)	Less Estimated FICA (7.65%)	($253)
Less Medical Deductions	($500)	Less Medical Deductions	N/A
Take Home Pay	$2,059	Take Home Pay	$2,222

YOU COULD SAVE $163 PER MONTH IN TAXES BY PAYING FOR YOUR BENEFITS ON A PRE-TAX BASIS!