Internal Revenue Code

§ 125 Cafeteria plans.

(a) In general.

Except as provided in **subsection (b)**, no amount shall be included in the gross income of a participant in a cafeteria plan solely because, under the plan, the participant may choose among the benefits of the plan.

(b) Exception for highly compensated participants and key employees.

(1) Highly compensated participants.

In the case of a highly compensated participant, **subsection (a)** shall not apply to any benefit attributable to a plan year for which the plan discriminates in favor of—

(A) highly compensated individuals as to eligibility to participate, or

(B) highly compensated participants as to contributions and benefits.

(2) Key employees.

In the case of a key employee (within the meaning of **section 416(i)(1)**), **subsection (a)** shall not apply to any benefit attributable to a plan for which the statutory nontaxable benefits provided to key employees exceed 25 percent of the aggregate of such benefits provided for all employees under the plan. For purposes of the preceding sentence, statutory nontaxable benefits shall be determined without regard to the second sentence of **subsection (f)**.

(3) Year of inclusion.

For purposes of determining the taxable year of inclusion, any benefit described in **paragraph (1)** or **(2)** shall be treated as received or accrued in the taxable year of the participant or key employee in which the plan year ends.

(c) Discrimination as to benefits or contributions.

For purposes of **subparagraph (B) of subsection (b)(1)**, a cafeteria plan does not discriminate where qualified benefits and total benefits (or employer contributions allocable to qualified benefits and employer contributions for total benefits) do not discriminate in favor of highly compensated participants.

(d) Cafeteria plan defined.

For purposes of **this section**

(1) In general.

The term “cafeteria plan” means a written plan under which—

(A) all participants are employees, and

(B) the participants may choose among 2 or more benefits consisting of cash and qualified benefits.

(2) Deferred compensation plans excluded.

(A) In general. The term “cafeteria plan” does not include any plan which provides for deferred compensation.

(B) Exception for cash and deferred arrangements. **Subparagraph (A)** shall not apply to a profit-sharing or stock bonus plan or rural cooperative plan (within the meaning of **section 401(k)(7)**) which includes a qualified cash or deferred arrangement (as defined in **section 401(k)(2)**) to the extent of amounts which a covered employee may elect to have the employer pay as contributions to a trust under such plan on behalf of the employee.

(C) Exception for certain plans maintained by educational institutions. **Subparagraph (A)** shall not apply to a plan maintained by an educational organization described in **section 170(b)(1)(A)(ii)** to the extent of amounts which a covered employee may elect to have the employer pay as contributions for post-retirement group life insurance if—

(i) all contributions for such insurance must be made before retirement, and

(ii) such life insurance does not have a cash surrender value at any time.

For purposes of **section 79**, any life insurance described in the preceding sentence shall be treated as group-term life insurance.

(D) Exception for health savings accounts. **Subparagraph (A)** shall not apply to a plan to the extent of amounts which a covered employee may elect to have the employer pay as contributions to a health savings account established on behalf of the employee.

(e) Highly compensated participant and individual defined.

For purposes of **this section** —

(1) Highly compensated participant.

The term “highly compensated participant” means a participant who is—

(A) an officer,

(B) a shareholder owning more than 5 percent of the voting power or value of all classes of stock of the employer,

(C) highly compensated, or

(D) a spouse or dependent (within the meaning of **section 152**, determined without regard to subsections**(b)(1)** , **(b)(2)**, and **(d)(1)(B)** thereof) of an individual described in **subparagraph (A)**, **(B)**, or **(C)** .

(2) Highly compensated individual.

The term “highly compensated individual” means an individual who is described in **subparagraphs (A)**, **(B)**, **(C)** , or **(D) of paragraph (1)**.

Caution: Code Sec. 125(f), following, is effective for tax. yrs. begin. before 1/1/2014. For Code Sec. 125(f), effective for tax. yrs. begin. after 12/31/2013, see below.

(f) Qualified benefits defined.

For purposes of **this section**, the term “qualified benefit” means any benefit which, with the application of **subsection (a)** , is not includible in the gross income of the employee by reason of an express provision of this chapter (other than **section 106(b)**, **117** , **127**, or **132**). Such term includes any group term life insurance which is includible in gross income only because it exceeds the dollar limitation of **section 79** and such term includes any other benefit permitted under regulations. Such term shall not include any product which is advertised, marketed, or offered as long-term care insurance.

Caution: Code Sec. 125(f), following, is effective for tax. yrs. begin. after 12/31/2013. For Code Sec. 125(f), effective for tax. yrs. begin. before 1/1/2014, see above.

(f) Qualified benefits defined.

For purposes of **this section** —

(1) In general.

the term “qualified benefit” means any benefit which, with the application of **subsection (a)** , is not includible in the gross income of the employee by reason of an express provision of this chapter (other than **section 106(b)**, **117** , **127**, or **132**). Such term includes any group term life insurance which is includible in gross income only because it exceeds the dollar limitation of **section 79** and such term includes any other benefit permitted under regulations.

(2) Long-term care insurance not qualified.

The term “qualified benefit” shall not include any product which is advertised, marketed, or offered as long-term care insurance.

(3) Certain exchange-participating qualified health plans not qualified.

(A) In general. The term “qualified benefit” shall not include any qualified health plan (as defined in section 1301(a) of the Patient Protection and Affordable Care Act) offered through an Exchange established under section 1311 of such Act.

(B) Exception for exchange-eligible employers. **Subparagraph (A)** shall not apply with respect to any employee if such employee's employer is a qualified employer (as defined in section 1312(f)(2) of the Patient Protection and Affordable Care Act) offering the employee the opportunity to enroll through such an Exchange in a qualified health plan in a group market.

(g) Special rules.

(1) Collectively bargained plan not considered discriminatory.

For purposes of **this section**, a plan shall not be treated as discriminatory if the plan is maintained under an agreement which the Secretary finds to be a collective bargaining agreement between employee representatives and one or more employers.

(2) Health benefits.

For purposes of **subparagraph (B) of subsection (b)(1)**, a cafeteria plan which provides health benefits shall not be treated as discriminatory if—

(A) contributions under the plan on behalf of each participant include an amount which—

(i) equals 100 percent of the cost of the health benefit coverage under the plan of the majority of the highly compensated participants similarly situated, or

(ii) equals or exceeds 75 percent of the cost of the health benefit coverage of the participant (similarly situated) having the highest cost health benefit coverage under the plan, and

(B) contributions or benefits under the plan in excess of those described in **subparagraph (A)** bear a uniform relationship to compensation.

(3) Certain participation eligibility rules not treated as discriminatory.

For purposes of **subparagraph (A) of subsection (b)(1)**, a classification shall not be treated as discriminatory if the plan—

(A) benefits a group of employees described in **section 410(b)(2)(A)(i)**, and

(B) meets the requirements of **clauses (i)** and **(ii)**:

(i) No employee is required to complete more than 3 years of employment with the employer or employers maintaining the plan as a condition of participation in the plan, and the employment requirement for each employee is the same.

(ii) Any employee who has satisfied the employment requirement of **clause (i)** and who is otherwise entitled to participate in the plan commences participation no later than the first day of the first plan year beginning after the date the employment requirement was satisfied unless the employee was separated from service before the first day of that plan year.

(4) Certain controlled groups, etc.

All employees who are treated as employed by a single employer under **subsection (b)**, **(c)** , or **(m) of section 414** shall be treated as employed by a single employer for purposes of **this section**.

(h) Special rule for unused benefits in health flexible spending arrangements of individuals called to active duty.

(1) In general.

For purposes of this title, a plan or other arrangement shall not fail to be treated as a cafeteria plan or health flexible spending arrangement merely because such arrangement provides for qualified reservist distributions.

(2) Qualified reservist distribution.

For purposes of this subsection, the term “qualified reservist distribution” means, any distribution to an individual of all or a portion of the balance in the employee's account under such arrangement if—

(A) such individual was (by reason of being a member of a reserve component (as defined in section 101 of title 37, United States Code)) ordered or called to active duty for a period in excess of 179 days or for an indefinite period, and

(B) such distribution is made during the period beginning on the date of such order or call and ending on the last date that reimbursements could otherwise be made under such arrangement for the plan year which includes the date of such order or call.

Caution: Code Sec. 125(i), prior to amendment by Sec. 9005(a)(2), P.L. 111-148, and Sec. 10902(a)

(i) Cross reference.

For reporting and recordkeeping requirements, see **section 6039D** .

Caution: Code Sec. 125(i), following, as added by Sec. 9005(a)

(i) Limitation on health flexible spending arrangements.

For purposes of **this section**, if a benefit is provided under a cafeteria plan through employer contributions to a health flexible spending arrangement, such benefit shall not be treated as a qualified benefit unless the cafeteria plan provides that an employee may not elect for any taxable year to have salary reduction contributions in excess of $2,500 made to such arrangement.

Caution: Code Sec. 125(i), as amended by P.L. 111-148, Sec. 9005(a)(2), Sec. 10902(a) and P.L. 111-152, Sec. 1403(a) generally effective for tax yrs. begin. after 12/31/2012.

(i) Limitation on health flexible spending arrangements.

(1) In general.

For purposes of **this section**, if a benefit is provided under a cafeteria plan through employer contributions to a health flexible spending arrangement, such benefit shall not be treated as a qualified benefit unless the cafeteria plan provides that an employee may not elect for any taxable year to have salary reduction contributions in excess of $2,500 made to such arrangement.

(2) Adjustment for inflation.

In the case of any taxable year beginning after December 31, 2013, the dollar amount in **paragraph (1)** shall be increased by an amount equal to—

(A) such amount, multiplied by

(B) the cost-of-living adjustment determined under **section 1(f)(3)** for the calendar year in which such taxable year begins by substituting “calendar year 2012” for “calendar year 1992” in **subparagraph (B)** thereof.

If any increase determined under **this paragraph** is not a multiple of $50, such increase shall be rounded to the next lowest multiple of $50.

(j) Simple cafeteria plan for small businesses.

(1) In general.

An eligible employer maintaining a simple cafeteria plan with respect to which the requirements of **this subsection** are met for any year shall be treated as meeting any applicable nondiscrimination requirement during such year.

(2) Simple cafeteria plan.

For purposes of **this subsection**, the term “simple cafeteria plan” means a cafeteria plan—

(A) which is established and maintained by an eligible employer, and

(B) with respect to which the contribution requirements of **paragraph (3)**, and the eligibility and participation requirements of **paragraph (4)**, are met.

(3) Contribution requirements.

(A) In general. The requirements of **this paragraph** are met if, under the plan the employer is required, without regard to whether a qualified employee makes any salary reduction contribution, to make a contribution to provide qualified benefits under the plan on behalf of each qualified employee in an amount equal to—

(i) a uniform percentage (not less than 2 percent) of the employee's compensation for the plan year, or

(ii) an amount which is not less than the lesser of

(I) 6 percent of the employee's compensation for the plan year, or

(II) twice the amount of the salary reduction contributions of each qualified employee.

(B) Matching contributions on behalf of highly compensated and key employees. The requirements of **subparagraph (A)(ii)** shall not be treated as met if, under the plan, the rate of contributions with respect to any salary reduction contribution of a highly compensated or key employee at any rate of contribution is greater than that with respect to an employee who is not a highly compensated or key employee.

(C) Additional contributions. Subject to **subparagraph (B)**, nothing in **this paragraph** shall be treated as prohibiting an employer from making contributions

to provide qualified benefits under the plan in addition to contributions required under **subparagraph (A)**.

(D) Definitions. For purposes of **this paragraph**—

((i)) Salary reduction contribution. The term “salary reduction contribution” means, with respect to a cafeteria plan, any amount which is contributed to the plan at the election of the employee and which is not includible in gross income by reason of **this section**.

((ii)) Qualified employee. The term “qualified employee” means, with respect to a cafeteria plan, any employee who is not a highly compensated or key employee and who is eligible to participate in the plan.

((iii)) Highly compensated. The term “highly compensated employee” has the meaning given such term by **section 414(q)**.

((iv)) Key employee. The term “key employee” has the meaning given such term by **section 416(i)**.

(4) Minimum eligibility and participation requirements.

(A) In general. The requirements of **this paragraph** shall be treated as met with respect to any year if, under the plan—

(i) all employees who had at least 1,000 hours of service for the preceding plan year are eligible to participate, and

(ii) each employee eligible to participate in the plan may, subject to terms and conditions applicable to all participants, elect any benefit available under the plan.

(B) Certain employees may be excluded. For purposes of **subparagraph (A)(i)**, an employer may elect to exclude under the plan employees—

(i) who have not attained the age of 21 before the close of a plan year,

(ii) who have less than 1 year of service with the employer as of any day during the plan year,

(iii) who are covered under an agreement which the Secretary of Labor finds to be a collective bargaining agreement if there is evidence that the benefits covered under the cafeteria plan were the subject of good faith bargaining between employee representatives and the employer, or

(iv) who are described in **section 410(b)(3)(C)** (relating to nonresident aliens working outside the United States). A plan may provide a shorter period of service or younger age for purposes of **clause (i)** or **(ii)**.

(5) Eligible employer.

For purposes of this subsection—

(A) In general. The term “eligible employer” means, with respect to any year, any employer if such employer employed an average of 100 or fewer employees on business days during either of the 2 preceding years. For purposes of**this subparagraph** , a year may only be taken into account if the employer was in existence throughout the year.

(B) Employers not in existence during preceding year. If an employer was not in existence throughout the preceding year, the determination under **subparagraph (A)** shall be based on the average number of employees that it is reasonably expected such employer will employ on business days in the current year.

(C) Growing employers retain treatment as small employer.

(i) In general. If—

(I) an employer was an eligible employer for any year (a “qualified year”), and

(II) such employer establishes a simple cafeteria plan for its employees for such year, then, notwithstanding the fact the employer fails to meet the requirements of **subparagraph (A)** for any subsequent year, such employer shall be treated as an eligible employer for such subsequent year with respect to employees (whether or not employees during a qualified year) of any trade or business which was covered by the plan during any qualified year.

(ii) Exception. **This subparagraph** shall cease to apply if the employer employs an average of 200 or more employees on business days during any year preceding any such subsequent year.

(D) Special rules.

(i) Predecessors. Any reference in **this paragraph** to an employer shall include a reference to any predecessor of such employer.

(ii) Aggregation rules. All persons treated as a single employer under subsection **(a)** or **(b) of section 52**, or subsection**(n)** or **(o) of section 414**, shall be treated as one person.

(6) Applicable nondiscrimination requirement.

For purposes of **this subsection**, the term “applicable nondiscrimination requirement” means any requirement under **subsection (b)** of this section, **section 79(d)** , **section 105(h)**, or paragraph **(2)**, **(3)** , **(4)**, or **(8) of section 129(d)**.

(7) Compensation.

The term “compensation” has the meaning given such term by **section 414(s)**.

(k) Cross reference.

For reporting and recordkeeping requirements, see **section 6039D** .

(l) Regulations.

The Secretary shall prescribe such regulations as may be necessary to carry out the provisions of **this section**.