

§ 125. Cafeteria plans

(a) General rule

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 last 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) 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 ^[1] (A), (B), (C), or (D) of paragraph (1).

(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.

(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) Cross reference

For reporting and recordkeeping requirements, see section 6039D.

(i) Regulations

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