

What is a Section 125 Plan?

The term section 125 refers to the section of the Internal Revenue Code that specifically pertains to these types of plans. A section 125 plan is a written benefit plan maintained by a company for the benefit of its employees. The plan must meet all of the requirements of section 125 for employers to enjoy the tax benefits associated with these plans.

Section 125 plans offer employees a choice in the way they select and pay for employee benefits offered by their employers. They include:

- [Premium Only Plans](#)
- [Flexible Spending Accounts](#)

Other Products Of Interest

- [Benefit Administration](#)

Premium Only Plan (POP)

A premium only plan allows employees to make their contributions to group health and group term life insurance with pretax dollars. This plan is a benefit to both employers and employees because it provides the opportunity to obtain favorable tax treatment on benefits already offered. Here's how it works:

- Employees' premium contributions are automatically deducted from their salaries before taxes are taken out.
- Taxable income is reduced by the amount contributed, so employees pay less in taxes and have more take-home pay.
- With employee pretax income lowered, employers pay less in social security (FICA) payroll taxes. (A business should consult their tax advisor for applicable state legislation.)

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Flexible Spending Account (FSA)

A flexible spending account (FSA) offers a budgeting tool that helps pay for out-of-pocket medical, dental, and dependant care expenses not covered by employer benefit plans. Also, like a premium only plan, an FSA helps pay for itself by increasing employee take-home pay while decreasing employer payroll taxes. Here's how it works:

- An employee decides how much of their salary should be set aside before taxes are calculated.
- This amount is automatically deducted from their paycheck every pay period, just like any other payroll deduction, and is credited to their FSA account.
- The employees would pay their out-of-pocket expenses upfront, then submit a claim and documentation and a reimbursement is made from their own account.

Some common out-of-pocket expenses include:

- Eyeglasses and contact lenses
- Medical insurance deductibles
- Prescriptions
- Co-payments
- Orthodontia
- Chiropractic services
- Dental treatments
- X-ray and laboratory services
- Certain over-the-counter medications

Dependent care expenses include:

- Care for a child under the age of 13
- Care for a disabled spouse or dependent incapable of caring for him/herself
- Household-related services (i.e., visiting nurse)

The flexibility of an FSA plan makes it the best option for small- to medium-sized businesses.

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