



# Employer Guide to **Section 125 Cafeteria Plans**

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## SECTION 125 OVERVIEW

### Key Points

A Section 125 plan, also known as a cafeteria plan, allows employees to pay for certain benefits on a pre-tax basis. Employers use these plans to provide their employees with a choice between cash (a taxable benefit) and certain qualified benefits (such as health insurance) without adverse tax consequences.

According to the IRS, a Section 125 plan is the **only means** by which an employer can offer employees a choice between certain taxable and nontaxable benefits without the choice causing the benefits to become taxable. Employers may also make nontaxable contributions to a Section 125 plan for their employees.

Paying for benefits on a pre-tax basis:

- ✓ Reduces the employee's taxable income, which increases their take-home pay
- ✓ Reduces both the employee's and employer's tax liability

To receive these tax advantages, a cafeteria plan must comply with the specific requirements and regulations of Section 125 of the Internal Revenue Code (Code).

### TAX RULES

Employees who elect to participate in a Section 125 plan agree to contribute a portion of their salaries on a pre-tax basis to pay for the qualified benefits. These contributions, which are called "salary reduction contributions," are not considered wages for federal income tax purposes and are generally not subject to Social Security and Medicare tax (FICA) or federal unemployment tax (FUTA). This reduces employees' taxable income, which results in savings for both employees and employers. If the employee elects to receive cash instead of any qualified benefit, the cash is treated as wages subject to all employment taxes.

### What This Guide Covers

This guide provides answers to common questions regarding cafeteria plans, including the following:

- ✓ Who can sponsor a Section 125 plan, and how are they implemented?
- ✓ What types of Section 125 plans can be offered?
- ✓ Who is eligible to participate in a Section 125 plan?
- ✓ What are the advantages and disadvantages of participating in a Section 125 plan?
- ✓ What benefits can be offered under a Section 125 plan?

- ✓ What nondiscrimination rules apply to a Section 125 plan?

#### *Why This Guide Is Useful*

This guide is intended to help employers understand why Section 125 plans are necessary and how they work. It provides detailed information on cafeteria plan design and other requirements of Internal Revenue Code Section 125. Employers should have their plan designs analyzed by qualified specialists to ensure full compliance with these rules, including when they perform cafeteria plan nondiscrimination testing.

#### **Additional Resources**

- [IRS Publication 15-B](#), Employer's Tax Guide to Fringe Benefits (contains information for employers on the employment tax treatment of fringe benefits, including cafeteria plans)
- [Final regulations](#) on Section 125 permitted election changes
  - [IRS Notice 2014-55](#), which expanded the mid-year election change rules in response to the Affordable Care Act (ACA)
  - [IRS Notice 2022-41](#), which expanded the mid-year election change rules to allow family members to enroll in ACA Exchange coverage
- 2007 [proposed regulations](#) on cafeteria plans, upon which taxpayers may rely

## SECTION 125 BASICS

### Legal Requirements

Under Section 125 rules, a cafeteria plan must have a written plan document and can only offer certain qualified benefits on a tax-favored basis. There are also eligibility rules, election rules and various nondiscrimination tests that the plan must comply with.

Steps to implement a Section 125 plan:

- ✓ Adopt a **written plan document** that reflects the plan's design and complies with Section 125;
- ✓ Update **plan enrollment forms** to include the rules for Section 125 plan elections; and
- ✓ Select a vendor to perform **nondiscrimination testing**.

**Compliance Tip:** Many of the benefits that may be provided through a Section 125 plan are subject to the Employee Retirement Income Security Act (ERISA). ERISA includes its own set of requirements for written plan documents and summary plan descriptions (SPDs), which are different from the Section 125 plan document requirements. Employers should confirm that their employee benefits documents comply with both sets of requirements, as applicable.

### Written Plan Document

A Section 125 plan must be maintained pursuant to a **written plan document** that is adopted by the employer **on or before the first day of the plan year**. The plan document for a Section 125 plan must address certain topics, including the following:

- ✓ A description of the benefits available under the plan, including the periods of coverage
- ✓ The plan's rules for employee eligibility
- ✓ The procedures governing employees' elections under the plan, including when elections may be made, when they are effective and any exceptions to the irrevocability rule
- ✓ The manner for making contributions (e.g., pre-tax employee contributions, employer contributions or both) and the maximum amount of contributions
- ✓ A description of the special rules that apply to flexible spending accounts (FSAs) (e.g., the uniform coverage and use-or-lose rules for health FSAs), if the plan includes such an account

The plan document for a Section 125 plan may be comprised of more than one document. For example, the Section 125 plan document may incorporate by reference benefits that are offered through separate written plans, such as a health FSA, without describing these benefits in full. Also, other Code sections require plan documents for certain qualified benefits, including a health FSA, dependent care assistance

program (DCAP) and adoption assistance. These requirements can be satisfied by including these benefits in the Section 125 plan document.

**Impact of Noncompliance:** *According to the IRS' 2007 proposed regulations, if there is no written plan document in place or if the written plan document does not comply with the content or timing requirements, employees' elections between taxable and nontaxable benefits will result in taxable income to the employees.*

A Section 125 plan may be amended, or changed, at any time during a plan year. However, amendments must be made in writing and can only be effective for periods after the later of the adoption date or the effective date of the new amendment, unless otherwise permitted by the IRS.

### Types of Cafeteria Plans

There are different types of plans that employers can choose from when setting up their cafeteria plans. The four basic forms of Section 125 plans are as follows:

Type of Plan	Description
Premium payment plans	A premium payment plan is the most basic—and most popular—type of Section 125 plan. It is also called a “premium only plan” or “premium conversion plan.” A key feature of this type of plan is that it allows employees to pay their portion of premiums for qualified benefits with pre-tax dollars. Premium payment plans may also offer a cash-out option (additional taxable wages) for employees who decline insurance coverage.
Flexible spending arrangements	A Section 125 plan may allow employees to purchase benefits under a flexible spending arrangement (a health FSA, DCAP or both) on a pre-tax basis. A health FSA reimburses eligible out-of-pocket medical care expenses. A DCAP reimburses expenses that are for the care of one or more qualifying individuals and that enable the employee (and the employee's spouse) to be gainfully employed. Additional legal requirements apply to health FSAs and DCAPs. This type of Section 125 plan may also incorporate a premium payment component, or the flexible spending arrangement may be the only benefit offered under the plan.
Full cafeteria plan (full flex plan)	Under a full cafeteria plan, the employer makes contributions for eligible employees. Employees may spend the employer contribution, sometimes called “flex credits,” to purchase any of the benefits offered within the cafeteria plan, such as premium payments for qualified benefits, a health FSA or a DCAP. If the plan includes a cash-out option and the employer's contribution exceeds the cost of the benefits selected by an employee, then the employee may take the excess amount as additional taxable wages. In addition, the employee may contribute pre-tax dollars to



	purchase additional benefits beyond what they can purchase with the employer's contributions.
Simple cafeteria plan	Eligible small employers (100 or fewer employees) may establish "simple cafeteria plans" to avoid the nondiscrimination rules for Section 125 plans and certain component benefits offered under the plan. A plan qualifies as a simple cafeteria plan if it meets certain contribution, eligibility and participation requirements.

### Reporting and Disclosure

Because a Section 125 plan is a tax-savings arrangement, it generally is not subject to the reporting and disclosure requirements that apply to employee benefit plans under federal law. This means, for example, that a Section 125 plan is not required to file an annual Form 5500 with the U.S. Department of Labor and is not required to have an SPD. However, many of the benefits that can be purchased on a tax-free basis through a Section 125 plan (e.g., a health FSA) are subject to the federal reporting and disclosure requirements for employee benefit plans, unless an exception applies.



## ELIGIBILITY RULES

### Who Can Sponsor

Any employer may sponsor a Section 125 plan for its eligible employees. This includes private sector businesses—which encompasses corporations, partnerships, limited liability companies and nonprofit organizations—as well as public sector employers.

### Who Can Participate

As a general rule, an employer may allow any **common law employee** to participate in its Section 125 plan. In addition, former common law employees (for example, Consolidated Omnibus Budget Reconciliation Act (COBRA) participants receiving severance pay) and leased employees, as defined under Code Section 414(n), may participate in an employer's Section 125 plan.

While there are some exceptions, an employer can generally define which classes of employees and former employees are eligible to participate in a Section 125 plan. Some employers impose a waiting period before new employees are eligible to participate. In addition, some employers allow employees to participate in the Section 125 plan immediately but impose a waiting period on participation in the FSA portion of the Section 125 plan.

### Who Cannot Participate

The Section 125 rules specifically prohibit the following individuals from participating (although they can sponsor a Section 125 plan for their employees):

- Self-employed individuals
- Partners within a partnership
- More than 2 percent shareholders in a subchapter S corporation (S corporation)
- Directors of corporations who are not also employees

**Special Rules for “Dual Status” Individuals:** *The Section 125 regulations provide rules for individuals moving between employee and non-employee status. If an individual is an employee of an employer and also provides services to that employer as an independent contractor or director (for example, an individual is both a director and an employee of a C Corporation), the individual is eligible to participate in that employer's cafeteria plan **solely in their capacity as an employee**. This rule **does not apply** to partners or to 2% shareholders of an S Corporation.*

### Spouses, Dependent Children and Other Dependents

While only employees are allowed to make elections under a Section 125 plan, a Section 125 plan may provide nontaxable benefits for an employee's spouse, a dependent child who is under age 27 or a tax dependent. A “spouse” means an employee's spouse as defined under federal tax law, including same-sex and opposite-sex spouses. This definition, however, does not include domestic partners. Thus, a Section 125 plan **cannot** provide nontaxable benefits for an employee's domestic partner who is not a tax dependent.

### Relationship to Health Plan Eligibility

- ✓ An employer's group health plan may be designed to cover individuals who do not qualify for tax-free health coverage (for example, children who are older than age 27, grandchildren or domestic partners).
- ✓ Under the Section 125 rules, an employee may only pay pre-tax for coverage of a spouse, a child under age 27 or a tax dependent.
- ✓ As a general rule, coverage for other individuals should be paid for on a post-tax basis.

### Advantages of Participation

Employees who participate in a Section 125 plan receive the following advantages:

- An employee realizes an increase in their spendable income by:
  - Paying their portion of insurance premiums with pre-tax dollars
  - Paying out-of-pocket medical and/or dependent care expenses with pre-tax dollars set aside in an FSA
- Where an employer offers a full cafeteria plan, an employee is provided an opportunity to elect only those benefits that they deem most valuable.

### Disadvantages of Participation

Before an employee participates in a Section 125 plan, they should be aware of the following disadvantages. First, an employee may not change their elections throughout the plan year unless they experience a permitted mid-year election change event (for example, the birth of a child or marriage). Also, while participation in a Section 125 plan reduces the employee's taxable income, it may reduce other benefits. Benefits that are calculated using the employee's income (for example, Social Security or retirement benefits) will, in turn, be reduced.

## QUALIFIED BENEFITS

A Section 125 plan must offer employees a choice between taxable benefits and certain **qualified benefits**. If an employee chooses to receive a qualified benefit under the plan, the fact that the employee could have received cash or a taxable benefit instead won't make the qualified benefit taxable.

### Benefits That Can Be Offered

There are many different types of qualified benefits that can be offered under a Section 125 plan. The following table lists commonly offered qualified benefits under a Section 125 plan.

Qualified Benefits	
<ul style="list-style-type: none"> <li>• Accident or health plan coverage</li> <li>• Accidental death and dismemberment (AD&amp;D) coverage</li> <li>• Adoption assistance benefits*</li> <li>• COBRA coverage (if participant has compensation that can be used to pay for COBRA pre-tax)</li> <li>• DCAP benefits</li> <li>• Dental benefits</li> </ul>	<ul style="list-style-type: none"> <li>• Disability benefits* (short-term or long-term coverage)</li> <li>• Health FSA benefits</li> <li>• Health savings account (HSA) contributions</li> <li>• Group-term life insurance coverage (on employee's life, the cost of insurance coverage in excess of \$50,000 is taxable)</li> <li>• Vision benefits</li> <li>• 401(k) contributions</li> </ul>
<p>*Adoption assistance benefits provided through a Section 125 plan are not subject to federal income tax, but they are subject to federal employment taxes (such as FICA and FUTA). Also, the additional Section 125 rules for FSAs generally apply to adoption assistance benefits.</p>	<p>*The tax rules for payment of disability benefits depend on how premiums for the coverage are paid. If premiums are paid on a pre-tax basis, disability benefits are taxed when an employee becomes disabled.</p>

### Benefits That Cannot Be Offered

Benefits that are not qualified benefits cannot be offered under a Section 125 plan. According to the IRS, a plan that offers one or more of these benefits is not a cafeteria plan. This means that employees' elections under the arrangement will result in the taxation of any benefit elected.

The following table lists benefits that may not be offered under a Section 125 plan.

Non-qualified Benefits	
<ul style="list-style-type: none"> <li>• Archer medical savings accounts (Archer MSAs)</li> <li>• De minimus (minimal) benefits</li> <li>• Educational assistance plans*</li> <li>• Employee discounts</li> <li>• Employer-provided cellphones</li> </ul>	<ul style="list-style-type: none"> <li>• Individual insurance policies* (major medical coverage)—Exchange or non-Exchange plans</li> <li>• Life insurance on a spouse's or dependent's life</li> <li>• Long-term care insurance or services</li> </ul>

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- Employer-provided meals and lodging
- Fringe benefits (transportation fringe benefits\*\*, moving expense reimbursements, retirement planning services)
- Health reimbursement arrangements (HRAs)

\*Employers may offer tax-free educational assistance benefits (up to \$5,250) to employees through a qualified educational assistance program under Code Section 127.

\*\*Employers may offer tax-free transportation benefits, such as parking and transit passes, to employees through a qualified transportation plan, up to certain annual limits.

- Scholarships or fellowships
- Tuition reduction
- 403(b) contributions

\*Employers may offer an individual coverage HRA (ICHRA) to reimburse eligible employees' individual health insurance premiums. If an ICHRA does not cover employees' full premiums for individual coverage, the employer may permit employees to pay the balance of the premiums on a pre-tax basis through its Section 125 plan, provided the individual coverage is not purchased on an ACA Exchange. The Code prohibits employers from allowing employees to pay for Exchange coverage on a pre-tax basis.

## CONTRIBUTION & ELECTION RULES

Cafeteria plan benefits can be funded in a variety of ways.

Employee Contributions	Employer Contributions
<p>Employees reduce salary on a pre-tax basis to pay for benefits.</p> <p>Not subject to federal income or employment taxes.</p>	<p>Employers may contribute toward the cost of benefits via:</p> <ul style="list-style-type: none"> <li>• Fixed amount for specific benefits</li> <li>• Matching contributions</li> <li>• Contingent contributions</li> </ul>

### Employer Contributions

The amount an employer contributes to a Section 125 plan typically varies from benefit to benefit. While employers have some flexibility when it comes to this aspect of plan design, certain qualified benefits have legal restrictions on the amount that can be contributed or excluded from an employee's gross income. Cafeteria plan sponsors need to take these legal restrictions into account when establishing the maximum contribution under their plans. For example, the ACA imposes a limit on annual salary reduction contributions to health FSAs offered under cafeteria plans. The limit is indexed for cost-of-living adjustments for subsequent plan years.

Also, employers can generally vary the amount of their contributions for different groups of employees, subject to federal nondiscrimination rules. Employers should have their plan designs analyzed by qualified specialists to ensure full compliance with these rules.

### Employee Elections—Prospective Only

Participant elections under a Section 125 cafeteria plan must be made **before the first day of the plan year or the date taxable benefits would currently be available**, whichever comes first. Typically, employees make their elections each year during an annual open enrollment period, with the elections taking effect on the first day of the upcoming plan year. Employees who become eligible for benefits during a plan year (for example, new hires) will usually make their elections during an initial enrollment period.

There are only two exceptions to the general rule that Section 125 elections must be made on a prospective (not retroactive) basis:

- ✓ **Limited exception for new hires**—Elections that new employees make within 30 days after their hire date can be effective on a retroactive basis. Elections made during this enrollment window can be effective as of the employee's date of hire.
- ✓ **Health Insurance Portability and Accountability Act (HIPAA) special enrollment**—Special enrollment rights apply when an employee acquires a new dependent through marriage, birth, adoption or placement for adoption. When a new dependent is acquired through birth, adoption or placement for adoption, coverage must be effective retroactively to the date of

birth, adoption or placement for adoption. Employees' elections under a Section 125 plan may be retroactive to correspond with this HIPAA special enrollment right.

## Types of Elections

There are a few different types of cafeteria plan election methods:

Affirmative Elections	Automatic Elections	Rolling Elections
<ul style="list-style-type: none"> <li>The most common and straightforward method.</li> <li>Employees complete a written agreement authorizing their cafeteria plan elections.</li> </ul>	<ul style="list-style-type: none"> <li>Employees who do not want to participate must complete a waiver.</li> <li>Employers must provide adequate notice to employees.</li> <li>Employers also must confirm that the default elections do not violate state tax withholding laws.</li> </ul>	<ul style="list-style-type: none"> <li>Current participants' elections continue to the next plan year unless the employee files an election not to participate.</li> <li>The plan's enrollment and election forms should describe how rolling elections work.</li> <li>It's not often used in full flex plans (too many variables from year to year).</li> </ul>

Selecting an election method for a cafeteria plan depends on several factors, including the type of cafeteria plan, the employer's desire for administrative convenience and high participation, and the effect of state tax withholding laws.

## Irrevocable for the Entire Plan Year

Participant elections generally must be **irrevocable until the beginning of the next plan year**. This means that participants ordinarily cannot make changes to their cafeteria plan elections during a plan year. Employers do not have to permit any exceptions to the election irrevocability rule for cafeteria plans. However, IRS regulations permit employers to design their cafeteria plans to allow employees to change their elections during the plan year if certain conditions are met.

Cafeteria plans may recognize certain events as entitling a plan participant to change their elections (if the change is consistent with the event). Although a cafeteria plan may not be more generous than the IRS permits, it may choose to limit to a greater extent the election change events that it will recognize.

For an employee to be eligible to change their cafeteria plan election during a plan year, the following general rules apply:

1. The employee must experience a mid-year election change event recognized by the IRS.

2. The cafeteria plan must permit mid-year election changes for that event.

3. The employee's requested change must be consistent with the mid-year election change event.

Also, employees' mid-year election changes must be effective prospectively. The one exception to this rule is for retroactive election changes that are permissible under the HIPAA special enrollment event for birth, adoption or placement for adoption.

Some of the IRS' mid-year election change events apply to all qualified benefits that can be offered under a cafeteria plan. However, other mid-year election change events only apply to certain qualified benefits—for example, not all of the IRS' mid-year election change events apply to elections for health FSAs.

### ***Special Rule for HSAs***

HSAs are commonly offered with high deductible health plans (HDHPs) under an employer's cafeteria plan. This allows employees to make their HSA and HDHP contributions as pre-tax salary reductions.

**The irrevocable election rules do not apply to a cafeteria plan's HSA benefit.** An employee who elects to make HSA contributions under a cafeteria plan may start or stop the election or increase or decrease the election at any time during the plan year as long as the change is effective prospectively. If an employer places additional restrictions on HSA contribution elections under its cafeteria plan, then the same restrictions must apply to all employees. Also, to be consistent with the HSA monthly eligibility rules, HSA election changes must be allowed at least monthly and upon loss of HSA eligibility.



## MID-YEAR ELECTION CHANGES

Cafeteria plans may recognize certain events where an employee is entitled to make election changes during a plan year. The IRS recognizes three broad categories of mid-year election change events:

- ✓ Change in status events (major life events, such as marriage, birth, adoption and certain employment changes)
- ✓ Changes in cost or coverage for the plan's qualified benefits
- ✓ Other laws or court orders (for example, COBRA, HIPAA and the ACA)

Although a Section 125 plan may not be more generous than the IRS permits, it may choose to **limit to a greater extent** the election change events that it will recognize.

An employer who recognizes one or more mid-year election change events allowed by the IRS should review its plan document to confirm that it addresses the permitted election changes. Also, employers with fully insured plans should confirm that any permitted election change events are consistent with the rules of the underlying insurance policy.

### Permitted Election Change Events

The following chart provides an overview of the IRS' permitted mid-year election change events. Keep in mind that this is a general overview and that more detailed rules may apply to specific situations or certain types of qualified benefits.

CHANGE IN STATUS EVENTS		
Description	Requirements	Type of Benefits
<p>The IRS considers the following events to be changes in status that may permit a mid-year election change:</p> <ul style="list-style-type: none"> <li>• Change in employee's legal marital status (marriage, death of spouse, divorce, legal separation and annulment)</li> <li>• Change in number of dependents (birth, death, adoption and placement for adoption)</li> </ul>	<p>Employee's requested election change must be on account of and correspond with the change in status event.</p> <p>In general, no election change is allowed unless the event <b>affects eligibility</b> for the coverage. This includes a change in status event that results in an increase or decrease in the number of an employee's family members or dependents who may benefit from the coverage.</p> <p>An election change for dependent care assistance or adoption assistance satisfies the consistency requirement if it is on account of and corresponds with a change in status that affects dependent care or adoption expenses.</p>	<p>Applies to all qualified benefits, including health FSAs</p>

<ul style="list-style-type: none"><li>• Change in employment status of employee, employee’s spouse or employee’s dependent (e.g., a termination or commencement of employment, a strike or lockout, commencement of or return from an unpaid leave of absence or a change in worksite)</li><li>• A dependent satisfies or ceases to satisfy dependent eligibility requirements (including attainment of age, student status or any similar circumstance)</li><li>• Change in place of residence of the employee, spouse or dependent</li><li>• Commencement or termination of adoption proceedings for purposes of adoption assistance benefits</li></ul>	<p>If the change in status is the employee’s divorce, annulment or legal separation from a spouse, the death of a spouse or dependent, or a dependent ceasing to satisfy the eligibility requirements for coverage, an employee’s election to cancel health coverage for any individual other than the spouse involved in the divorce, annulment or legal separation, the deceased spouse or dependent, or the dependent that ceased to satisfy the eligibility requirements for coverage, respectively, fails to correspond with that change in status.</p>	
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COST CHANGES		
Description	Requirements	Type of Benefits
<p><b>Insignificant cost changes</b></p> <p>The cost increase or decrease may be attributable to action by the employee (e.g., switching from full-time to part-time while remaining eligible for coverage) or by the</p>	<p>A cafeteria plan may automatically make a prospective increase or decrease in affected employees’ elective contributions for the plan if:</p> <ul style="list-style-type: none"><li>• The cost of a qualified benefit increases or decreases during a period of coverage; and</li></ul>	<p>Applies to all qualified benefits except health FSAs</p>

<p>employer (e.g., reducing the amount of employer contributions for a group of employees).</p> <p><i>IRS regulations provide little guidance on when a cost change is insignificant or significant. Plan sponsors will need to make that determination based on all the facts and circumstances, including the dollar amount and percentage of increase (or decrease).</i></p>	<ul style="list-style-type: none"> <li>• Employees are required to make corresponding changes in their payments under the terms of the plan.</li> </ul> <p>This change must be made on a reasonable and consistent basis for plan participants.</p>	
<p><b>Significant cost changes</b></p> <p>As with insignificant cost changes, both employer-initiated and employee-initiated cost changes are recognized.</p> <p><i>IRS regulations provide little guidance on when a cost change is insignificant or significant. Plan sponsors will need to make that determination based on all the facts and circumstances, including the dollar amount and percentage of increase (or decrease).</i></p>	<p>If the cost charged to an employee for a benefit package option significantly increases or decreases during a period of coverage, the cafeteria plan may permit the employee to make a corresponding change in election under the cafeteria plan. Changes that may be made include:</p> <ul style="list-style-type: none"> <li>• Electing to participate in the cafeteria plan for the option with a decrease in cost; or</li> <li>• Revoking an election when there is an increase in cost and either: <ul style="list-style-type: none"> <li>○ Electing coverage under another benefit package option providing similar coverage; or</li> <li>○ Dropping coverage if no other benefit package option providing similar coverage is available.</li> </ul> </li> </ul> <p>For example, if the cost of an employer's low-deductible health plan option significantly increases during a period of coverage, employees who are covered by the low-deductible option may make a corresponding prospective increase in their payments or may elect to revoke their elections for the low-deductible option and instead elect coverage under another benefit package option (or drop health coverage if no other benefit package option is offered).</p>	<p>Applies to all qualified benefits except health FSAs</p>

COVERAGE CHANGES		
Description	Requirements	Type of Benefits
<p><b>Significant curtailment of coverage</b></p>	<p>If an employee (or an employee's spouse or dependent) has a significant curtailment of coverage under a plan during a period of coverage that is:</p> <ul style="list-style-type: none"> <li>• <b>Not a loss of coverage</b> (e.g., there is a significant increase in the deductible, the copayment or the out-of-pocket maximum)—The plan may permit the employee to revoke their election for that coverage and elect coverage under another benefit package option providing similar coverage.</li> <li>• <b>A loss of coverage</b>—The plan may permit the employee to revoke their election for that coverage and elect coverage under another benefit package option providing similar coverage or to drop coverage if no similar benefit package option is available.</li> </ul> <p>A "loss of coverage" means a complete loss of coverage under the benefit package option (including the elimination of a benefits package option or an HMO ceasing to be available in the area where the individual resides). In addition, a cafeteria plan may treat the following as a loss of coverage:</p> <ul style="list-style-type: none"> <li>• A substantial decrease in the medical care providers available under the option;</li> <li>• A reduction in benefits for a specific type of medical condition for which treatment is being received; and</li> <li>• Any other similar fundamental loss of coverage.</li> </ul>	<p>Applies to all qualified benefits except health FSAs</p>
<p><b>Addition or significant improvement of benefits package option</b></p> <p><i>IRS regulations do not define a "significant improvement" of coverage. One example from IRS regulations provides that a</i></p>	<p>If a plan adds a new benefit package option or other coverage option (or if coverage under an existing benefit package option or other coverage option is significantly improved during a period of coverage), the plan may permit eligible employees to revoke their elections under the cafeteria plan and to make</p>	<p>Applies to all qualified benefits except health FSAs</p>

<p><i>decrease in copayments under an indemnity health insurance plan is a significant benefit improvement.</i></p> <p><i>Also, in <a href="#">Notice 2015-86</a>, the IRS confirmed that changing the eligibility criteria for a qualified benefit during a plan year to add eligibility for same-sex spouses is a significant improvement in coverage.</i></p>	<p>elections for coverage under the new or improved benefit package option.</p> <p>Employees can elect the new (or improved) benefit regardless of whether they have previously made an election under the cafeteria plan or previously elected the benefit package option.</p>	
<p><b>Change in coverage under other employer plan</b></p>	<p>A cafeteria plan may permit an employee to make an election change that is on account of, and corresponds with, a change made under another employer plan (including a plan of the same employer or of another employer) if:</p> <ul style="list-style-type: none"> <li>• The other cafeteria plan or qualified benefits plan allows an election change that is permissible under IRS regulations; or</li> <li>• The other cafeteria plan has a different period of coverage.</li> </ul>	<p>Applies to all qualified benefits except health FSAs</p>
<p><b>Loss of health coverage sponsored by governmental or educational institution</b></p>	<p>A cafeteria plan may permit an employee to make an election to add coverage under a cafeteria plan for the employee, spouse or dependent if the employee, spouse or dependent loses coverage under any group health coverage sponsored by a governmental or educational institution. This includes coverage under a state Children's Health Insurance Program (CHIP).</p>	<p>Applies to all qualified benefits except health FSAs</p>

#### OTHER LAWS OR COURT ORDERS

Description	Requirements	Type of Benefits
<p><b>HIPAA special enrollment rights</b></p>	<p>A cafeteria plan may permit an employee to revoke an election for coverage during a period of coverage and make a new election that corresponds with the special enrollment rights provided under HIPAA.</p> <p>This allows an employee who enrolls during a special enrollment period to elect to pay for the newly elected health plan coverage on a pre-tax basis. The election can include payment for retroactive coverage when the</p>	<p>Group health plans that are subject to HIPAA's portability rules</p> <p>In general, health FSAs are excepted benefits that are not subject to</p>

	special enrollment right is triggered due to birth, adoption or placement for adoption.	HIPAA's portability rules.
<b>COBRA qualifying event (or similar state law continuation coverage event)</b>	A cafeteria plan may permit the employee to elect to increase payments under the employer's cafeteria plan to pay for continuation coverage for which an employee, spouse or dependent has become eligible.	Group health plans subject to COBRA, including health FSAs
<b>Judgments, decrees or orders (including QMCSOs)</b>	<p>A cafeteria plan may change the employee's election to provide coverage for a child if there is a judgment, decree or order resulting from a divorce, legal separation, annulment or change in legal custody (including a qualified medical child support order, or QMCSO) that requires accident or health coverage for the employee's child or for a foster child who is a dependent of the employee.</p> <p>A cafeteria plan may permit an employee to make an election change to cancel coverage for a child if the order requires the spouse, former spouse or other individual to provide coverage for the child and that coverage is, in fact, provided.</p>	Accident or health plan coverage, including health FSAs
<b>Entitlement to Medicare or Medicaid</b>	<p>If an employee, spouse or dependent becomes entitled to coverage under Medicare or Medicaid, the cafeteria plan may permit the employee to cancel or reduce coverage of that employee, spouse or dependent under the accident or health plan.</p> <p>Also, if an employee, spouse or dependent who had been entitled to Medicare or Medicaid loses eligibility for this coverage, the cafeteria plan may permit the employee to commence or increase coverage for that employee, spouse or dependent under the accident or health plan.</p>	Accident or health plan coverage, including health FSAs
<b>FMLA leave</b>	An employee taking leave under the federal Family and Medical Leave Act (FMLA) may revoke an existing election of accident or health plan coverage and make another election for the remaining portion of the period of coverage as may be provided for under the FMLA.	Accident or health plan coverage, including health FSAs

<b>Changes in 401(k) contributions</b>	A cafeteria plan may permit an employee to modify or revoke elections related to a 401(k) plan in accordance with Code Sections 401(k) and (m).	401(k) elections
ACA CHANGES		
Description	Requirements	Type of Benefits
<b>Exchange enrollment</b>	<p>A cafeteria plan may allow an employee to revoke an election of coverage under a group health plan if both of the following conditions are met:</p> <ul style="list-style-type: none"> <li>• The employee (or one or more related individuals) is eligible for special enrollment in an Exchange plan or the employee (or one or more related individuals) wants to enroll in an Exchange plan during the Exchange's annual open enrollment period; and</li> <li>• The revocation corresponds to the intended enrollment of the employee (or related individuals) in an Exchange plan. The Exchange coverage must be effective beginning no later than the day immediately following the last day of the original coverage that is revoked. If the employee does not enroll in an Exchange plan, the employee must elect self-only coverage (or family coverage including one or more already-covered related individuals) under the group health plan.</li> </ul> <p>A cafeteria plan may rely on the reasonable representation of an employee that the employee (and/or related individuals) has enrolled (or intends to enroll) in an Exchange plan for new coverage that is effective within the required time frame.</p>	<p>Group health plans that provide minimum essential coverage</p> <p>Does not apply to health FSAs</p>
<b>Reduction in hours of service</b>	<p>A cafeteria plan may allow an employee to revoke an election of coverage under a group health plan if both of the following conditions are met:</p> <ul style="list-style-type: none"> <li>• An employee who was reasonably expected to average at least 30 hours of service per week has a change in employment status so that the employee will reasonably be expected to average less than 30 hours of service per week</li> </ul>	<p>Group health plans that provide minimum essential coverage</p> <p>Does not apply to health FSAs</p>



after the change (even if that reduction does not result in the employee ceasing to be eligible under the group health plan); and

- The revocation of the election of coverage under the group health plan corresponds to the intended enrollment of the employee (and any related individuals who cease coverage due to the revocation) in another plan that provides minimum essential coverage. The new coverage must be effective no later than the first day of the second month after the month in which the original coverage is revoked.

A cafeteria plan may rely on an employee's reasonable representation that the employee and related individuals have enrolled (or intend to enroll) in another plan that provides minimum essential coverage within the required time frame.

### Impermissible Election Changes

One of the most common questions related to permitted election changes is whether certain events outside those listed in the chart above, such as when an employee experiences a financial hardship, are allowed. The list of permitted cafeteria plan election changes in IRS regulations and guidance is exhaustive—meaning that employers cannot allow for mid-year election changes for any other type of event that is not recognized by the IRS.

There are no Section 125 mid-year election change events specifically for unaffordability or financial hardship; however, if the financial hardship is linked to **another** recognized event (for example, a significant cost change or a spouse's change in employment status), it may qualify as a mid-year election change event. In addition, although the regulations do not address mistakes, the IRS has informally indicated that an election may be corrected when there is clear and convincing evidence that a mistake has been made. For example, if there is clear and convincing evidence that an employer has made an administrative mistake in recording an election or an individual has made a mistake in their election, then it can be retroactively corrected. The decision of whether to correct an error is ultimately the employer's; in the absence of direct guidance on how to fix administrative errors, a best practice is to have clear policies addressing when a mistaken election can be corrected, to administer corrections consistently and uniformly, and to document all decisions. As a general rule, employers should use reasonable best efforts to correct any problem, restore the plan and affected individuals to a position they would have been in had the mistake never occurred, and take steps to prevent any mistake from recurring.

Keep in mind that the mid-year election change events are optional for a Section 125 plan, so ultimately, the terms of the plan need to be reviewed to see what type of mid-year election changes the plan allows.

## NONDISCRIMINATION RULES

### Overview

Section 125 plans must generally pass certain tests designed to ensure that the plan does not discriminate in favor of highly compensated individuals (HCIs). If a cafeteria plan fails to pass nondiscrimination testing, HCIs lose the tax benefits of participating in the plan (that is, they must include the benefits or compensation in their income). However, even if a cafeteria plan is discriminatory, non-HCIs will not lose the tax benefits of participating in the plan.

In general, a Section 125 plan must satisfy the following three nondiscrimination tests:

<b>Eligibility Test</b>	This test looks at whether enough non-HCIs are eligible to participate in the cafeteria plan. If too many non-HCIs are ineligible to participate, the plan will fail this discrimination test.
<b>Benefits and Contributions Test</b>	This test is designed to make sure a plan's contributions and benefits are available on a nondiscriminatory basis and that HCIs do not select more nontaxable benefits than non-HCIs select.
<b>Key Employee Concentration Test</b>	This test examines whether key employees impermissibly use the plan's benefits more than non-key employees. Under this test, key employees must not receive more than 25% of the aggregate nontaxable benefits provided to all employees.

Certain exceptions and safe harbors apply to the cafeteria plan nondiscrimination tests. For example, a Section 125 plan that is a premium only plan is deemed to satisfy the cafeteria plan nondiscrimination requirements if it passes the eligibility test. In other words, the plan will automatically satisfy the contributions and benefits test and the key employee concentration test if it passes the eligibility test. In addition, simple cafeteria plans are treated as meeting the Section 125 nondiscrimination requirements if certain eligibility, participation and minimum contribution requirements are met. Also, note that other nondiscrimination tests will apply if the cafeteria plan includes a health FSA or a DCAP.

**Compliance Tip:** *Because these tests are so complex, employers should work with their benefit advisors or legal counsel when performing cafeteria plan nondiscrimination testing.*

### Highly Compensated Individual

An HCI generally includes any individual who is:

- ✓ An officer;
- ✓ A shareholder owning more than 5% of the voting power or value of all classes of stock of the employer;
- ✓ Highly compensated; or
- ✓ A spouse or dependent of any of these people.

An employee is generally considered “highly compensated” if they had compensation in excess of a specified dollar threshold for the preceding plan year (**\$155,000** if the preceding plan year is 2024, and

**\$160,000** if the preceding plan year is 2025) and, if elected by the employer, was also in the “top-paid group” of employees (that is, the top 20%).

### Eligibility Test

A cafeteria plan’s eligibility rules may not discriminate in favor of HCIs. The eligibility test determines whether enough non-HCIs are eligible to participate in the cafeteria plan. If too many non-HCIs are ineligible to participate, the plan will fail this discrimination test. Under the eligibility test, a plan does not discriminate in favor of HCIs if it meets all the following requirements:

Employment Requirement	Entry Requirement	Nondiscriminatory Classification Requirement
The same employment requirement applies to all employees, and the plan does not require more than three years of employment to participate.	Entry into the plan is not delayed.	The plan benefits a classification of employees that does not discriminate in favor of HCIs.

The ACA prohibits group health plans from applying any waiting period that exceeds **90 days**. This ACA provision affects cafeteria plans because employers generally want to allow employees to pay for their health plan coverage on a pre-tax basis, starting when they first become eligible for health plan coverage. Thus, employers will typically align their health plans’ and cafeteria plans’ waiting periods, which means a cafeteria plan will rarely have a waiting period that exceeds 90 days.

### Benefits and Contributions Test

A cafeteria plan may not discriminate in favor of highly compensated participants regarding benefits or contributions. This test is designed to make sure that a plan’s contributions and benefits are available on a nondiscriminatory basis and that highly compensated participants do not select more nontaxable benefits than non-highly compensated participants.

Highly compensated participants are HCIs who participate in the plan.

A plan will pass or fail the benefits and contributions test based on the facts and circumstances of each case. The factors the IRS considers when reviewing the facts and circumstances are:

- ✓ **Availability**—A plan must give each participant an equal opportunity to select nontaxable (qualified) benefits.
- ✓ **Utilization**—The IRS will review whether HCIs elected benefits to a greater extent than non-HCIs. For example, a plan would likely fail this test if benefits were so expensive that only HCIs could afford to elect the benefits.
- ✓ **Nondiscrimination in operation**—A plan may not discriminate in favor of HCIs in operation.

### Key Employee Concentration Test

Under a Section 125 plan, key employee contributions cannot exceed 25% of the total contributions into the plan. Only cafeteria plan participants who have elected one or more nontaxable benefits under the plan are included in the testing group. The test is performed by calculating the aggregate nontaxable benefits provided to key employees and the aggregate nontaxable benefits provided to all employees (key employees and non-key employees). Key employees must not receive more than 25% of the aggregate nontaxable benefits provided to all employees.

A **key employee** is generally an employee who is:

- ✓ An officer whose annual pay exceeds \$230,000 in 2025 (up from \$220,000 in 2024); or
- ✓ An employee who is either of the following:
  - A 5% (or greater) owner of the business; or
  - A 1% (or greater) owner whose annual pay is greater than \$150,000.

## APPENDIX A – SAMPLE FORMS

### Section 125 Plan Enrollment Form

Employer	Division	Effective Date
<input type="text"/>	<input type="text"/>	<input type="text"/>

Employee's Name (Last, First, Middle)

Street Address	City	State	Zip
<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>

Date of Birth	Date Employed	Dependent Coverage
<input type="text"/>	<input type="text"/>	<input type="text"/>

#### Spouse and Dependent Information (If Applicable)

Spouse Name	Date of Birth
<input type="text"/>	<input type="text"/>

Dependent Name	Date of Birth
<input type="text"/>	<input type="text"/>
<input type="text"/>	<input type="text"/>
<input type="text"/>	<input type="text"/>
<input type="text"/>	<input type="text"/>

I authorize payroll deduction of \$  from my earnings per pay period. I request that my salary be reduced as follows:

Premiums (medical, dental, etc.)	Automatic*
Health flexible spending account	\$ <input type="text"/> annually
Dependent care spending account	\$ <input type="text"/> annually
<b>Total:</b>	\$ <input type="text"/> annually

\*Your employer has elected to deduct your insurance premiums on a pre-tax basis unless written notification is received waiving this benefit.

#### Authorization

This toolkit is not intended to be exhaustive nor should any discussion or opinions be construed as legal or tax advice. Readers should contact legal counsel or tax professionals for legal or tax advice. ©2024 Zywave, Inc. All rights reserved.

I certify the above information to be correct and true to the best of my knowledge and that the children listed under "Dependent Coverage" qualify as my dependents under the plan (generally, for group health plan coverage, a dependent is your child who is under age 26, and for other benefits, a dependent is an individual who depends on you for financial support and maintenance). I understand that any amounts remaining in my account(s) not used for eligible expenses incurred during the plan year may be forfeited and not returned to me unless a grace period or carryover applies. I further understand that my elections will remain in effect for the entire plan year and cannot be revoked unless I experience a change in my status or termination of either my employment or my spouse's employment.

Signature

Date

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**If you decline participation:**

The benefits of the medical and dependent care flexible spending accounts have been thoroughly explained to me, and I decline to participate but wish to have my premiums paid pre-tax.

Signature

Date

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## Section 125 Plan Election Change Request Form

Employee Name

Employee Number

Employee Address

Employer Name

I hereby request that the following election(s) be changed to reflect the following:

Type of Deduction	Existing Election (monthly)	New Election (monthly)
Insurance premiums (health, dental, life)		
Health Flexible Spending Account		
Dependent Care Spending Account		
Health Savings Account (HSA)		
Other		

Date of the event causing reason for requested change in election:

### Reason for Requested Change

Change in status of (select status below):

- ☐ Marriage
- ☐ Divorce or annulment
- ☐ Legal separation
- ☐ Death of spouse
- ☐ Birth
- ☐ Commencement or termination of adoption proceedings
- ☐ Death of dependent
- ☐ Dependent satisfies or ceases to satisfy eligibility requirements
- ☐ Change in employment status that affects eligibility
- ☐ Change in residence

Significant cost increase: ☐



Significant curtailment of coverage: ☐

Addition or significant improvement of benefit package: ☐

Change in employment status so that the employee will reasonably be expected to average less than 30 hours of service per week (for employees previously in an employment status reasonably expected to average at least 30 hours of service per week): ☐

Change in coverage under other employer plan: ☐

FMLA leave: ☐

COBRA event: ☐

Judgment, decree or court order (for example, qualified medical child support order): ☐

Medicare or Medicaid entitlement: ☐

Pre-tax HSA contribution election change: ☐

Employee and/or one or more related individuals is eligible for a Special Enrollment Period to enroll in a Qualified Health Plan through a Marketplace or seeks to enroll in a Qualified Health Plan through a Marketplace during the Marketplace's annual open enrollment period: ☐

**Please provide any additional details that you feel will help the Section 125 plan administrator review your request for a change in election.**

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**I certify the information to be true and correct to the best of my knowledge. I understand that the Section 125 plan administrator will review my request for a change in election in accordance with the laws governing Section 125 plans and the plan documents.**

Employee Signature

Date

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**Section 125 plan administrator use only:**

<input type="checkbox"/> Approved—Effective date:	<input type="checkbox"/> Denied—Reason:
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## Cafeteria Plan Pre-tax Salary Reduction Agreement

Select only one of the following options.

☐ **Election of Pre-tax Benefits**—I elect to receive benefit coverage under the [insert plan name]. I understand that an amount equal to the annual contributions for the coverage I elect, divided by the number of pay periods in the Plan Year, will be deducted on a pre-tax basis from each of my paychecks to pay for my elected coverage.

☐ **Waiver of Pre-tax Benefits**—I elect to waive all pre-tax benefits under the [insert plan name]. Except for a Change in Election Event for the applicable benefit, I understand that I cannot elect pre-tax benefits until the next Open Enrollment Period, and any after-tax coverage permitted by [insert employer name] shall be outside the plan.

### Election Irrevocable Unless Exception Applies

I understand that I cannot change or revoke this agreement as of any date prior to the next Plan Year unless a Change in Election Event occurs as defined in the Plan (e.g., termination of employment, divorce, marriage), and the election change is on account of and consistent with the Change in Election Event, as described in the Plan. However, any health savings account (HSA) contribution election can be changed at any time, for any reason, effective no later than the first day of the calendar month after the change request is filed.

### Additional Terms

I agree that my compensation will be reduced by the amount of my required contribution for the benefits that I have elected under the Plan and that such salary reductions will continue for each pay period until this agreement is amended or terminated. I understand that my contributions for Medical and Dental Insurance Benefits may be automatically increased or decreased for changes by the Plan Administrator.

I have read and agree to the terms of participation and to any applicable certifications set forth in this agreement. Any previous election and agreement under the Plan relating to the same benefits, including any prior Cafeteria Plan Pre-tax Salary Reduction Acknowledgement Agreement, is hereby revoked.

Employee Signature

Date

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Plan Administrator Signature

Date

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## APPENDIX B – MID-YEAR ELECTION CHANGE CHART

### CHANGE IN STATUS EVENTS

Description	Requirements	Type of Benefits
<b>Change in employee's legal marital status</b> (marriage, death of spouse, divorce, legal separation and annulment)	Employee's requested election change must be on account of and correspond with the change in status event.	Applies to all qualified benefits, including health FSAs
<b>Change in number of dependents</b> (birth, death, adoption and placement for adoption)	In general, no election change is allowed unless the event <b>affects eligibility</b> for the coverage:	
<b>Change in employment status of employee, spouse or dependent</b> (e.g., a termination or commencement of employment, a strike or lockout, commencement of or return from an unpaid leave of absence, or a change in worksite)	<ul style="list-style-type: none"> <li>If the change in status is the employee's divorce, annulment or legal separation from a spouse, the death of a spouse or dependent, or a dependent ceasing to satisfy the eligibility requirements for coverage, an employee's election to cancel health coverage for any individual other than the spouse involved in the divorce, annulment or legal separation, the deceased spouse or dependent, or the dependent that ceased to satisfy the eligibility requirements for coverage, respectively, fails to correspond with that change in status.</li> </ul>	
<b>Change in place of residence of the employee, spouse or dependent</b>	<ul style="list-style-type: none"> <li>An election change for dependent care assistance or adoption assistance satisfies the consistency requirement if it is on account of and corresponds with a change in status that affects dependent care or adoption expenses.</li> </ul>	
<b>Dependent satisfies or ceases to satisfy dependent eligibility requirements</b> (including attainment of age, student status or any similar circumstance)		
<b>Commencement or termination of adoption proceedings for purposes of adoption assistance benefits</b>		

## COST CHANGES

Description	Requirements	Type of Benefits
<p><b>Insignificant cost changes</b></p> <p>The cost increase or decrease may be attributable to action by the employee (for example, switching from full time to part time while remaining eligible for coverage) or by the employer (for example, reducing the amount of employer contributions for a group of employees).</p> <p><i>IRS regulations provide little guidance on when a cost change is insignificant or significant. Plan sponsors will need to make that determination based on all the facts and circumstances, including the dollar amount and percentage of increase (or decrease).</i></p>	<p>A cafeteria plan may automatically make a prospective increase or decrease in affected employees' elective contributions for the plan if:</p> <ul style="list-style-type: none"> <li>• The cost of a qualified benefit increases or decreases during a period of coverage; and</li> <li>• Under the terms of the plan, employees are required to make corresponding changes in their payments.</li> </ul> <p>This change must be made on a reasonable and consistent basis for plan participants.</p>	
<p><b>Significant cost changes</b></p> <p>As with insignificant cost changes, both employer-initiated and employee-initiated cost changes are recognized.</p> <p><i>IRS regulations provide little guidance on when a cost change is insignificant or significant. Plan sponsors will need to make that determination based on all the facts and circumstances, including the dollar amount and percentage of increase (or decrease).</i></p>	<p>If the cost charged to an employee for a benefit package option significantly increases or decreases during a period of coverage, the cafeteria plan may permit the employee to make a corresponding change in election under the cafeteria plan. Changes that may be made include:</p> <ul style="list-style-type: none"> <li>• Electing to participate in the cafeteria plan for the option with a decrease in cost; or</li> <li>• Revoking an election when there is an increase in cost and either: <ul style="list-style-type: none"> <li>○ Electing coverage under another benefit package option providing similar coverage; or</li> <li>○ Dropping coverage if no other benefit package option providing similar coverage is available.</li> </ul> </li> </ul>	<p>Applies to all qualified benefits, except health FSAs</p>

Description	Requirements	Type of Benefits
	For example, if the cost of an employer's low-deductible health plan option significantly increases during a period of coverage, employees who are covered by the low-deductible option may make a corresponding prospective increase in their payments or may elect to revoke their elections for the low-deductible option and instead elect coverage under another benefit package option (or drop health coverage if no other benefit package option is offered).	

## COVERAGE CHANGES

Description	Requirements	Type of Benefits
<b>Significant curtailment of coverage</b>	<p>If an employee (or an employee's spouse or dependent) has a significant curtailment of coverage under a plan during a period of coverage that is:</p> <ul style="list-style-type: none"> <li>• <b>Not a loss of coverage</b> (for example, there is a significant increase in the deductible, the copayment or the out-of-pocket maximum)—The plan may permit the employee to revoke their election for that coverage and elect coverage under another benefit package option providing similar coverage.</li> <li>• <b>A loss of coverage</b>—The plan may permit the employee to revoke their election for that coverage and elect coverage under another benefit package option providing similar coverage or to drop coverage if no similar benefit package option is available.</li> </ul> <p>A "loss of coverage" means a complete loss of coverage under the benefit package option (including the elimination of a benefits package option or an</p>	Applies to all qualified benefits except health FSAs

Description	Requirements	Type of Benefits
	<p>HMO ceasing to be available in the area where the individual resides). In addition, a cafeteria plan may treat the following as a loss of coverage:</p> <ul style="list-style-type: none"> <li>• A substantial decrease in the medical care providers available under the option;</li> <li>• A reduction in benefits for a specific type of medical condition for which treatment is being received; and</li> <li>• Any other similar fundamental loss of coverage.</li> </ul>	
<p><b>Addition or significant improvement of benefits package option</b></p> <p><i>IRS regulations do not define a “significant improvement” of coverage. One example from IRS regulations provides that a decrease in copayments under an indemnity health insurance plan is a significant benefit improvement.</i></p> <p><i>Also, in <a href="#">Notice 2015-86</a>, the IRS confirmed that changing the eligibility criteria for a qualified benefit during a plan year to add eligibility for same-sex spouses is a significant improvement in coverage.</i></p>	<p>If a plan adds a new benefit package option or other coverage option (or if coverage under an existing benefit package option or other coverage option is significantly improved during a period of coverage) the plan may permit eligible employees to revoke their elections under the cafeteria plan and to make elections for coverage under the new or improved benefit package option.</p> <p>Employees can elect the new (or improved) benefit regardless of whether they have previously made an election under the cafeteria plan or previously elected the benefit package option.</p>	
<p><b>Change in coverage under other employer plan</b></p>	<p>A cafeteria plan may permit an employee to make an election change that is on account of, and corresponds with, a change made under another employer plan (including a plan of the same employer or of another employer) if:</p> <ul style="list-style-type: none"> <li>• The other cafeteria plan or qualified benefits plan allows an election change that is permissible under the IRS regulations; or</li> </ul>	

Description	Requirements	Type of Benefits
	<ul style="list-style-type: none"> <li>The other cafeteria plan has a different period of coverage.</li> </ul>	
<b>Loss of health coverage sponsored by governmental or educational institution</b>	A cafeteria plan may permit an employee to make an election to add coverage under a cafeteria plan for the employee, spouse or dependent if the employee, spouse or dependent loses coverage under any group health coverage sponsored by a governmental or educational institution. This includes coverage under a state Children's Health Insurance Program (CHIP).	

## OTHER LAWS OR COURT ORDERS

Description	Requirements	Type of Benefits
<b>HIPAA special enrollment rights</b>	<p>A cafeteria plan may permit an employee to revoke an election for coverage during a period of coverage and make a new election that corresponds with the special enrollment rights provided under HIPAA.</p> <p>This allows an employee who enrolls during a special enrollment period to elect to pay for the newly elected health plan coverage on a pre-tax basis. The election can include payment for retroactive coverage when the special enrollment right is triggered due to birth, adoption or placement for adoption.</p>	Group health plans that are subject to HIPAA's portability rules. In general, health FSAs are excepted benefits that are not subject to HIPAA's portability rules.
<b>COBRA qualifying event (or similar state law continuation coverage event)</b>	A cafeteria plan may permit the employee to elect to increase payments under the employer's cafeteria plan to pay for continuation coverage for which an employee, spouse or dependent has become eligible.	Group health plans subject to COBRA, including health FSAs
<b>Judgments, decrees or orders (including QMCSOs)</b>	A cafeteria plan may change the employee's election to provide coverage for a child if there is a judgment, decree or order resulting from a divorce, legal separation, annulment or change in legal custody (including a qualified medical child support order, or QMCSO) that requires accident or health coverage for	Accident or health plan coverage, including health FSAs



Description	Requirements	Type of Benefits
	<p>the employee's child or for a foster child who is a dependent of the employee.</p> <p>A cafeteria plan may permit an employee to make an election change to cancel coverage for a child if the order requires the spouse, former spouse or other individual to provide coverage for the child and that coverage is, in fact, provided.</p>	
<b>Entitlement to Medicare or Medicaid</b>	<p>If an employee, spouse or dependent becomes entitled to coverage under Medicare or Medicaid, the cafeteria plan may permit the employee to cancel or reduce coverage of that employee, spouse or dependent under the accident or health plan.</p> <p>Also, if an employee, spouse or dependent who had been entitled to Medicare or Medicaid loses eligibility for this coverage, the cafeteria plan may permit the employee to commence or increase coverage for that employee, spouse or dependent under the accident or health plan.</p>	
<b>FMLA leave</b>	An employee taking leave under the federal Family and Medical Leave Act (FMLA) may revoke an existing election of accident or health plan coverage and make another election for the remaining portion of the period of coverage as may be provided for under the FMLA.	
<b>Changes in 401(k) contributions</b>	A cafeteria plan may permit an employee to modify or revoke elections related to a 401(k) plan, in accordance with Code Sections 401(k) and (m).	401(k) elections

## ACA CHANGES

Description	Requirements	Type of Benefits
<b>Exchange enrollment</b>	A cafeteria plan may allow an employee to revoke an election of coverage under a group health plan if both of the following conditions are met:	Group health plans that provide minimum essential coverage

Description	Requirements	Type of Benefits
	<ul style="list-style-type: none"> <li>• The employee (or one or more related individuals) is eligible for special enrollment in an Exchange plan or the employee (or one or more related individuals) wants to enroll in an Exchange plan during the Exchange's annual open enrollment period; and</li> <li>• The revocation corresponds to the intended enrollment of the employee (or related individuals) in an Exchange plan. The Exchange coverage must be effective beginning no later than the day immediately following the last day of the original coverage that is revoked. If the employee does not enroll in an Exchange plan, the employee must elect self-only coverage (or family coverage including one or more already-covered related individuals) under the group health plan.</li> </ul> <p>A cafeteria plan may rely on the reasonable representation of an employee that the employee (and/or related individuals) has enrolled (or intends to enroll) in an Exchange plan for new coverage that is effective within the required time frame.</p>	Does not apply to health FSAs
<b>Reduction in hours of service</b>	<p>A cafeteria plan may allow an employee to revoke an election of coverage under a group health plan if both of the following conditions are met:</p> <ul style="list-style-type: none"> <li>• An employee who was reasonably expected to average at least 30 hours of service per week has a change in employment status so that the employee will reasonably be expected to average less than 30 hours of service per week after the change (even if that reduction does not result in the employee</li> </ul>	

Description	Requirements	Type of Benefits
	<p>ceasing to be eligible under the group health plan); and</p> <ul style="list-style-type: none"><li>• The revocation of the election of coverage under the group health plan corresponds to the intended enrollment of the employee (and any related individuals who cease coverage due to the revocation) in another plan that provides minimum essential coverage. The new coverage must be effective no later than the first day of the second month after the month in which the original coverage is revoked.</li></ul> <p>A cafeteria plan may rely on an employee's reasonable representation that the employee and related individuals have enrolled (or intend to enroll) in another plan that provides minimum essential coverage within the required time frame.</p>	