

Section 125 Compliance Checklist

Everything You Need to Verify for a Compliant Cafeteria Plan

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Compliance Verification Guide

Section 125 Compliance Checklist

Use this checklist to verify that your Section 125 plan meets all IRS and Department of Labor requirements. Each item should be completed before launch and reviewed annually thereafter.

Plan Document Requirements

- Written plan document exists and is signed
- Plan document specifies eligible employees
- Plan document lists all available benefits
- Election change procedures are documented
- Plan year dates are clearly stated
- Plan document is updated for current tax year

Eligibility & Enrollment

- Eligibility rules are clearly defined
- All eligible employees have been notified
- Open enrollment window is properly scheduled
- New hire enrollment process is in place
- Qualifying life event procedures are documented

Nondiscrimination Testing

- Eligibility test completed (not favoring highly compensated employees)
- Benefits test completed (benefits don't disproportionately favor HCEs)
- Key employee concentration test completed (if applicable)
- Dependent care FSA 55% average benefits test (if offering DCFSA)

Payroll & Administration

- Payroll system configured for pre-tax deductions
- Employee elections are processed before effective date
- FICA, federal, and state taxes correctly calculated on reduced wages
- Employee pay stubs accurately reflect pre-tax deductions
- Year-end W-2s properly exclude pre-tax amounts from taxable wages

FSA Specific (If Applicable)

- Annual contribution limits set correctly (\$3,050 health FSA for 2024)
- Use-it-or-lose-it or grace period/rollover provision documented

- Claims substantiation procedures in place
- Uniform coverage rule applied (health FSA)
- COBRA compliance for health FSA

HSA Specific (If Applicable)

- Employees are enrolled in qualifying HDHP
- Annual contribution limits set correctly (\$4,150 individual / \$8,300 family for 2024)
- Catch-up contributions tracked for employees 55+
- Employer contributions are uniform

Record Keeping

- Plan document retained for at least 6 years
- Employee election forms on file
- Nondiscrimination test results documented
- Summary Plan Description (SPD) distributed to participants

Common Compliance Pitfalls

Even well-intentioned employers can make mistakes with Section 125. Watch out for these common pitfalls:

1. No Written Plan Document

Many employers fail to document their Section 125 plan in writing. The IRS requires a formal plan document that specifies eligibility, benefits, and procedures. Without it, your plan may not qualify for favorable tax treatment.

2. Allowing Mid-Year Changes Without Qualifying Events

Employees must lock in their elections for the full plan year. Changing elections mid-year is only allowed for specific qualifying life events. Allowing arbitrary changes creates compliance and audit risk.

3. Failing to Run Nondiscrimination Tests

Section 125 plans must satisfy nondiscrimination tests to ensure they don't favor highly compensated employees (HCEs). Skipping or ignoring these tests can result in plan disqualification.

4. Excluding Eligible Employees

If you have a Section 125 plan, all eligible employees must have the opportunity to participate. Excluding a group of employees (e.g., part-time workers, contractors) may violate nondiscrimination rules unless the exclusion is clearly documented in the plan.

5. Not Updating Plan Limits for New Tax Years

IRS contribution limits for FSAs and HSAs change annually. Failing to update your plan document and payroll system for the new limits can create overfunding or underfunding issues.

6. Incorrect W-2 Reporting

Pre-tax benefit contributions must be excluded from Box 1 (wages) on the employee's W-2. If your payroll system incorrectly reports pre-tax amounts as wages, employees will overpay taxes.

Proactive compliance planning and partnering with a qualified Third-Party Administrator (TPA) can prevent these pitfalls.

Next Steps & Resources

1. Review This Checklist Annually

Even if your plan was compliant last year, changes in regulations, IRS limits, or your workforce may affect compliance going forward. Schedule an annual review to ensure nothing has changed.

2. Read the Full Section 125 Comprehensive Guide

For detailed explanations of nondiscrimination testing, FSA rules, HSA coordination, and plan design options, visit benefitsgenius.com/learn/section-125-comprehensive-guide.

3. Consult with a TPA or ERISA Counsel

A qualified Third-Party Administrator or ERISA attorney can conduct a compliance audit, prepare nondiscrimination testing, and ensure your plan document is current.

4. Schedule a Free Consultation

Talk to a Benefits Genius specialist about your plan's compliance status. Visit benefitsgenius.com/contact to schedule a 30-minute consultation.

Important Disclaimers

Educational Content Only

This checklist is for educational purposes and does not constitute legal or tax advice. Section 125 regulations are complex and your specific situation may require professional guidance. Always consult with qualified tax and legal professionals before implementing or modifying a Section 125 plan.

Compliance Responsibility

Your organization is responsible for ensuring its Section 125 plan complies with all applicable federal, state, and local laws. This checklist is a general guide only and may not cover all compliance requirements.

Annual Updates Required

IRS regulations, contribution limits, and compliance requirements change annually. This checklist reflects 2024 limits and current regulations. Update your plan annually for new tax years and regulatory changes.