

## Section 125 Plans

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### Study Findings

Health insurance costs continue to increase. One way to make health insurance more affordable is for more employers to allow employee payment of premiums with pre-tax dollars; which can result in savings of 25 to 40 percent for the employee. According to the Agency for Healthcare Research and Quality, many of the over 400,000 Virginians with employer-sponsored health coverage cannot pay health insurance premiums with pre-tax monies. However, if employers adopt a Section 125 Plan, their employees are allowed to pay their health insurance premiums with pre-tax dollars. Section 125 Plans are defined in the U.S. Internal Revenue Code and are commonly known as “cafeteria plans.” In addition, Section 125 Plans may reduce the payroll taxes owed by employers that offer employee health insurance. (To qualify for the payroll tax reduction, the employer must pay some but not all of the cost of their employees’ health insurance as required by Section 125 of the U.S. Internal Revenue Code.)

***Description of Section 125 Plans.*** Section 125 Plans are detailed documents created by or for employers to enable employees to purchase health insurance policies with pre-tax dollars. (These Plans are designed in conformance with requirements of Section 125 of the U.S. Internal Revenue Code and apply to group insurance plans.) The use of pre-tax dollars reduces FICA (Social Security and Medicare payroll tax) and federal and state income tax liabilities for participating employees; thereby reducing the “experienced” cost of health insurance coverage. An example of the potential savings is shown on the next page.

While there are three versions of pre-tax plans defined in the Internal Revenue Code, the policy options below address the simplest version, the Premium-Only Plan (POP). POPs are plans that allow for pre-taxing for only health insurance premiums. The Internal Revenue Code specifies certain limitations for Section 125 Plans including:

- Plans cannot be set up to cover self-employed individuals, partners in a partnership, and directors and limited partners in a limited liability corporation.
- Employers that do not offer health insurance or that pay 100 percent of their employees’ health premiums would realize no reduction in their payroll tax liability by establishing a Plan.
- While Section 125 Plans can significantly decrease the cost of health insurance for many employees, it does not make insurance inexpensive so many employed Virginians would still be unable to afford health insurance.



Individual Earning \$50,000 Annually		
		Single
VA Small Group avg. monthly premium (2006) (2006)		\$ 246
Payroll deduction amount (through 125 plan)		\$ 246
Reduction in FICA tax	→ 7.65%	\$ 19
Reduction in federal tax liability	→ 18%	\$ 44
Reduction in VA state tax liability	→ 5.2%	\$ 13
Net premium cost to employee		\$ 170
<b>Total Monthly Tax Savings</b>	<b>→ 31%</b>	<b>\$ 76</b>

**Section 125 Plans in Virginia.** As noted, Section 125 Plans can result in significant cost-savings for employees and employers. Despite this fact, many businesses in Virginia, particularly smaller businesses, have not adopted a Plan.

- Sixty-eight percent of small businesses, employing approximately 291,000 individuals, offer health insurance but do not offer a Section 125 Plan. (Small business is defined as having fewer than 50 employees.)
- Only eight percent of larger businesses (with 50 or more employees) employing approximately 139,000 individuals, offer health insurance but do not offer a Section 125 Plan.

There are a number of reasons that Section 125 Plans have not been adopted more broadly. There is a perception that establishing a Plan would result in significant, increased administrative burden, as well as questions regarding the cost and time it would take to understand and develop the Plan. In addition, there are negative tax consequences if a Plan is not set-up correctly. However, the primary reason that more employers have not adopted a Section 125 Plan is that employers lack knowledge about such Plans. When Section 125 Plans are understood, the challenges associated in creating them are generally minor while the benefits are significant.

## Options

**Option 1:** Take no action

**Option 2:** Amend the *Code of Virginia* to mandate that employers offer a Section 125 Plan if all of the following provisions are met:

- Full-time employees,
- Group health insurance is offered, and
- Employee pays some part of the health insurance premium.

*Note: No requirement for employers to provide health insurance or contribute to plan premiums.*

**Option 3:** Request by letter of the JCHC Chairman that the Department of Human Resources Management (DHRM) in consultation with the Department of Business Assistance (VDBA) create a:

- Brief electronic document highlighting Section 125 benefits to post on the VDBA website and on Virginia’s business portal website.

**Option 4:** Request by letter of the JCHC Chairman that the Department of Human Resources Management in consultation with the Department of Business Assistance (VDBA) create a:

- Detailed electronic document highlighting Section 125 benefits; requirements for adoption; and COBRA, ERISA and HIPPA implications to post on the VDBA website and on Virginia’s business portal website.

**Approved**

**Option 5:** Request by letter of the JCHC Chairman that the Department of Human Resources Management in consultation with the Department of Business Assistance (VDBA) create a:

- Detailed electronic document highlighting Section 125 benefits; requirements for adoption; COBRA, ERISA, and HIPPA implications; and a simple Section 125 Plan form to post on the VDBA website and on Virginia’s business portal website.

**Option 6:** Amend the *Code of Virginia* to require employers to affirm on the Virginia Department of Taxation Form VA-6 that:

- Employer has a Section 125 Plan, or
- Employer has read the State-created document regarding Section 125 Plans.

**Option 7:** Request by letter of the JCHC Chairman that the State Corporation Commission consider and report to JCHC on including Section 125 Plan information on both the Health and the Life & Annuity & Health insurance examinations.

**Approved**

**Option 8:** Request by letter of the JCHC Chairman that the Virginia Chamber of Commerce inform its membership of Section 125 Plans and associated benefits through its newsletter.

**Approved**

**Option 9:** Request by letter of the JCHC Chairman that the National Federation of Independent Businesses/Virginia include information on Section 125 Plans as part of the Federation’s Area Action Council meetings with small businesses.