Health Insurance, Cafeteria Plans, and Pre-Tax Deductions

What is a Cafeteria Plan, also known as a Section 125 Plan? It's a plan where an employee is allowed to have monies deducted from their paychecks on a pre-tax basis. This is most commonly done with Health Insurance (also Vision/Dental), 401ks, as well as with Health Savings accounts. The best way to explain is with an example.

Taxpayer makes $32,000 a year and has $2000 deducted from pay for health insurance on a pre-tax basis. The box 1 of the W2 will only have $30,000 of wages. This is because the $2000 is a pre-tax benefit and reduces the W2 wages. This is a great benefit.

What does this mean for us? It means we CANNOT then deduct that $2000 on the tax return as medical insurance. Why? That would be double dipping and basically tax fraud.

This same thing occurs when someone puts money in a HSA, code W in box 12 of the W2. The amount the person puts in the HSA is subtracted from box 1 wages as a huge tax benefit. When you are in the HSA section, Profiler will ask you about HSA contributions. Do NOT enter the amount on the w2 box 12 code W!! Why? It has already been deducted from the box 1 of the W2, and if you enter it again, you are double dipping.

Pre-tax deductions means the tax savings will have been reflected on the W2 and Pre-tax deductions are great for the client - a huge tax benefit. What this means to us is do NOT then try to deduct that same thing again on the tax return. The IRS does not take kindly to double dipping.

Keep in mind that 99% of all companies who provide health insurance do it on a Pre-tax basis. Also keep in mind that 99% of our clients do NOT understand this at all, and they all think that you should deduct the pre-tax health insurance on their return, thus double dipping. You need to explain pre-tax to them and not double dip.