

TEXT, EXPLANATION AND INTERPRETATION OF
CHANGES TO UC PROGRAM
MADE BY PUBLIC LAWS 101-239 (OBRA 89)
AND 101-140 (THE DEBT ACT)

I. Section 7101, OBRA 89. Employer Provided Educational Assistance.

A. Text of Section 7101:

(a) EXTENSION.---

(1) IN GENERAL.--Subsection (d) of section 127 (relating to educational assistance programs) is amended by striking "December 31, 1988" and inserting "September 30, 1990".

(2) SPECIAL RULE.--In the case of any taxable year beginning in 1990, only amounts paid before October 1, 1990, by the employer for educational assistance for the employee shall be taken into account in determining the amount excluded under section 127 of the Internal Revenue Code of 1986 with respect to such employee for such taxable year.

(b) CERTAIN OTHERWISE TAXABLE EMPLOYER-PROVIDED EDUCATIONAL ASSISTANCE MAY BE EXCLUDIBLE AS WORKING CONDITION FRINGE.--Subsection (h) of section 132 is amended by adding at the end thereof the following new paragraph:

"(9) APPLICATION OF SECTION TO OTHERWISE TAXABLE EMPLOYER-PROVIDED EDUCATIONAL ASSISTANCE.--Amounts which would be excludible from gross income under section 127 but for subsection (a) (2) thereof or the last sentence of subsection (c) (1) thereof shall be excluded from gross income under this section if (and only if) such amounts are a working condition fringe."

(c) EFFECTIVE DATE.--The amendments made by this section shall apply to taxable years beginning after December 31, 1988.

B. Discussion.

1. Section 3306 (b) (13), FUTA, excludes from the definition of wages "any payment made, or benefit furnished, to or for the benefit of an employee if at the time of such payment or such furnishing it is reasonable to believe that the employee will be able to exclude such payment or benefit from income under section 127 . . ." of the IRC. Section 127, which excludes from gross income certain amounts paid or expenses incurred by the employer for educational assistance to the employee, did not apply to taxable years beginning after December 31, 1988.

Section 7101 (a) (1) of OBRA 89 restores the Section 127 exclusion retroactively to the date of expiration and extends it so that it expires for taxable years beginning after September 30, 1988.

Section 7101 (a) (2) creates a "special rule" for any taxable year beginning in 1990. Under this rule, only amounts paid before October 1, 1990, may be taken into account in determining the amount excludible under Section 127 with respect to any employee for such taxable year.

2. Section 3306 (b) (16), FUTA, excludes from the definition of wages "any benefit provided to or on behalf of an employee if at the time such benefit is provided it is reasonable to believe that the employee will be able to exclude such benefit from income under" Section 132, IRC, which pertains to the exclusion of certain fringe benefits from gross income. Section 132 (h), IRC, is amended by Section 7101 (b), OBRA 89, by adding new paragraph (9). Under new paragraph (9), the exclusion from gross income under Section 132 now applies to certain amounts previously

included in gross income under Section 127(a)(2) and the last sentence of Section 127 (c) (1). Section 127 (a) (2) establishes the maximum amount excludible of \$5,250 from gross income under Section 127 and the last sentence of Section 127 (c) (1) prohibits the exclusion from gross income of "any payment for, or the provision of any benefits with respect to, any graduate level course of a kind normally taken by an individual pursuing a program leading to a law, business, medical, or other advanced academic or professional degree."

Under new Section 132 (h), these amounts are now excludible from gross income under Section 132 if (and only if) these amounts are a "working condition fringe." This term is defined as Section 132 (d) as "any property or services provided to an employee of the employer to the extent that, if the employee paid for such property or services, such payment would be allowable as a deduction"

C. Effective Date. Under Section 7101 (c) of OBRA 89, the provisions of Section 7101 (a) affecting Section 127 and 132 shall apply to taxable years beginning after December 31, 1988. However, Section 127, as amended by Section 7101 (a) (1), does not apply to taxable years beginning after September 30, 1990.

II. Section 7102, OBRA 89. -Employer Provided Group Legal Services.

A. Text of Section 7102:

(a) EXTENSION.---

(1) IN GENERAL.--Subsection (e) of section 120 (relating to group legal service plans) is amended by striking "ending after December 31, 1988" and inserting "beginning after September 30, 1990".

(2) SPECIAL RULE.--In the case of any taxable year beginning in 1990, only amounts paid before October 1, 1990, by the employer for coverage for the employee, his spouse, or his dependents under a qualified group legal services plan for periods before October 1, 1990, shall be taken into account in determining the amount excluded under section 120 of the Internal Revenue Code of 1986 with respect to such employee for such taxable year.

(b) EFFECTIVE DATE.--The amendment made by subsection (a) shall apply to taxable years ending after December 31, 1988.

B. Discussion. Section 3306 (b) (12), FUTA, excludes from the definition of wages "any contribution, payment, or service, provided by an employer which may be excluded from the gross income of an employee, his spouse, or his dependents, under the provisions of section 120[IRC] (relating to amounts received under qualified group legal services plans)". Section 120, which excluded from an employee's gross income amounts contributed by an employer to a qualified group legal services plan for an employee or amounts reimbursed to an employee for legal services under such a plan did not apply to taxable years ending after December 31, 1988.

The amendments made by OBRA restore the Section 120 exclusion retroactively to the date of expiration. The extension does not, however, apply to taxable years beginning after December 31, 1990. In addition, Section 7102(a)(2), OBRA, creates a "special rule" for any taxable years beginning in 1990. Under this rule, for taxable years beginning in 1990, the exclusion is limited to "amounts paid by the employer for coverage for the employee, his spouse, or his dependent under a qualified group legal services plan" for periods on or before September 30, 1990.

C. Effective Date. Under Section 7102 (b), OBRA, the provisions of Section 7102 (a) affecting Section 120 shall apply to taxable years beginning after December 31, 1988. However, Section 120, as amended by Section 7102 (a) (1), does not apply to taxable years beginning after September 30, 1990.

III. Section 10202 (c) (1), OBRA. Federal Unemployment Tax.

A. Text of Amendment:

(C) FEDERAL UNEMPLOYMENT PROGRAMS.--

(1) FEDERAL UNEMPLOYMENT TAX.-- For purposes of chapter 23 of the Internal Revenue Code of 1986, the term "wages" shall not include the amount of any refund required under section 421 of the Medicare Catastrophic Coverage Act of 1988.

B. Discussion. Section 421 of the Medicare Catastrophic Coverage Act of 1988, P.L. 100-360, requires that, when an employer provides health care benefits to an employee or retired former employee that duplicate certain Medicare benefits, the employer must provide an amount of additional benefits, refunds, or combination thereof, that total at least the actuarial value of the duplicative Medicare benefits during the period defined in Section 421. Section 10202(c)(1), OBRA, provides for an exclusion (which does not amend any existing law) from the FUTA definition of wages for refunds required under Section 421.

C. Effective Date. Under Section 10202 (e), OBRA 89, the provisions of Section 10202 (C) (1) apply with respect to refunds provided on or after January 1, 1989.

IV. Sections 202 and 203 (a) (2) of Debt Act. Repeal of Section 89 Nondiscrimination Rules.

A. Text of Amendments.

1. Section 202:

(a) IN GENERAL.-- Section 89 (relating to benefits provided under certain discriminatory employee benefit plans) is hereby repealed.

(b) CLERICAL AMENDEMENT.-- The table of sections for part II of subchapter B of chapter 1 is amended by striking the item relating to section 89.

(c) EFFECTIVE DATE.-- The amendments made by this section shall take effect as if included in section 1151 of the Tax Reform Act of 1986.

2. Section 203(a)(2):

Each provision of law amended by paragraph (22), (27), or (31) of section 1011B(a) of the Technical and Miscellaneous Revenue Act of 1988 is amended to read as if the amendments made by such paragraph had not been enacted.

3. Section 203(b)(2) relating to cafeteria plans may be found in Attachment II.

B. Discussion.

1. Nondiscrimination Plans. Section 3306 (t), FUTA, included in the definition of wages any amount which is includible in gross income by reason of Section 89, IRC, relating to certain discriminatory employee benefit plans. (See UIPL 24-89, dated April 4, 1989, for a discussion of Section 89.) Section 202 (a) of the Debt Act repealed Section 89. Section 203 (a) (2) of the Debt Act repealed Section 1011B (a) (22) (C) of the Technical and Miscellaneous Revenue Act of 1986. That section created Section 3306 (t) which is, therefore, now eliminated.

2. Cafeteria Plans. Section 3306 (b) (5) (G), FUTA, excludes from wages certain payments made to, or on behalf of, an employee or his/her beneficiary under a cafeteria plan within the meaning of Section 125, IRC. Section 203 (b) (2) of the Debt Act amended Section 125 (d) (as in effect on the day before the date of the Tax Reform Act of 1986) to provide that the term "cafeteria plan" does not include "any plan which provides for deferred compensation." Under the amended Sections 125 (d) (2) (B) and (C), exceptions to this general rule are now provided for certain cash and deferred arrangements and for educational plans maintained by certain educational organizations. The full text of Section 203 is contained in Attachment II.

C. Effective Date. Under Sections 202 (c) and 203 (c), the amendments made by Section 202 and Section 203 of the Debt Act "shall take effect as if included in section 1151 of the Tax Reform Act of 1986." Under Section 1151 (k) of the Tax Reform Act, the amendments relating to Sections 89 and 125, IRC, were effective for years beginning after the later of December 31, 1987, or the earlier of (i) the date which is three months after the issuance of regulations pertaining to Section 89 or (ii) December 31, 1988.

In other words, Sections 89 and 125, as amended by the Tax Reform Act of 1986, would have been effective for tax year 1989, but for their repeal by the Debt Act. Section 125, as amended by the Debt Act, is effective for tax year 1989.

V. Section 204 (a) of the Debt Act. Dependent Care Assistance.

A. Text of Amendments.

(a) DEPENDENT CARE ASSISTANCE.--

(1) IN GENERAL.-- Paragraph (1) of Section 129 (d) (as in effect on the day before the date of the enactment of the Tax Reform Act of 1986) is amended by adding at the end thereof the following new sentence: "If any plan would qualify as a dependent care assistance program but for a failure to meet the requirements of this subsection, then, notwithstanding such failure, such plan shall be treated as a dependent care assistance program in the case of employees who are not highly compensated employees."

B. Discussion. Section 3306 (b) (13), FUTA, excludes from the definition of wages "any payment made, or benefit furnished, to or for the benefit of an employee if at the time of such payment or such furnishing it is reasonable to believe that the employee will be able to exclude such payment or benefit from income under Section 127 or 129" of the IRC. Section 129 provides that an employee's gross income does not include certain amounts paid or incurred by the employer for dependent care assistance provided under a program described in Section 129 (d). Section 129 (d) (1) (A) provides that a dependent care assistance program is an employer plan under which the employer provides employees with dependent care assistance. Section 129 (d) (1) (B) further provides the employer's plan must meet the requirements of certain paragraphs of Section 129 (d).

Section 204 (a) (1) of the Debt Act amends Section 129 (d) (1) to provide that a plan which fails to meet the requirements of Section 129 (d) (1) shall nevertheless continue to be treated as a dependent care assistance program in the case of employees who are not highly compensated employees.

Sections 204 (a) (2) and (3) of the Debt Act also make various amendments to Section 129 (d). (The text of these amendments is contained in Attachment II.) Specifically, Section 204 (a) (2) amends Section 129 (d) by adding a new paragraph which excludes certain employees from consideration for dependent care assistance programs. Section 204 (a) (3) provides for a delay in the application of the benefits test under Section 129 (d) (8), which was Section 129 (d) (7) prior to the amendments made by Section 204 (a) (3).

C. Effective Date. Under Section 204 (d) (1) of the Debt Act, the amendments to Section 129 (d) apply to years beginning after December 31, 1988. However, under Section 204 (d) (2), the amendments pertaining to the delay in the application of the benefits test apply to plan years beginning after December 31, 1989.