

Regulatory Analysis Form		RECEIVED This space for use by IRRC 2000 MAY 19 AM 11: 25 INDEPENDENT REGULATORY REVIEW COMMISSION
(1) Agency Revenue		IRRC Number: 1942
(2) I.D. Number (Governor's Office Use) 15-402		
(3) Short Title Payments For Employee Welfare Benefit Plans and Cafeteria Plans		
(4) PA Code Cite 61 Pa. Code §§ 101.1, 101.6, 101.6a, 101.7 and 125.21 - 125.33	(5) Agency Contacts & Telephone Numbers Primary Contact: Anita M. Doucette (717) 787-1382 Secondary Contact: Douglas A. Berguson (717) 787-1382	
(6) Type of Rulemaking (check one) <input type="checkbox"/> Proposed Rulemaking <input checked="" type="checkbox"/> Final Order Adopting Regulation <input type="checkbox"/> Final Order, Proposed Rulemaking Omitted	(7) Is a 120-Day Emergency Certification Attached? <input checked="" type="checkbox"/> No <input type="checkbox"/> Yes: By the Attorney General <input type="checkbox"/> Yes: By the Governor	
(8) Briefly explain the regulation in clear and nontechnical language. <p>The amendments to §§ 101.1, 101.6, 101.6a and 101.7 are made to explain how employe welfare benefit programs and other wage and salary supplemental programs are taxed and to implement amendments to section 301(d) of the Tax Reform Code of 1971 (72 P.S. § 7301(d)) under Act 7-1997 and Act 48-1998.</p> <p>The amendments provide employers and employees with a detailed explanation of how nondiscriminatory employee welfare benefit programs such as self-insured medical reimbursement accounts or cafeteria plans are taxed under the Commonwealth's personal income tax. They also provide a detailed explanation of how programs that discriminate in favor of officers, owners, and key employees are taxed.</p>		
(9) State the statutory authority for the regulation and any relevant state or federal court decisions. Statutory authority for the regulation is contained in section 354 of the TRC (72 P.S. § 7354).		

Regulatory Analysis Form

(10) Is the regulation mandated by any federal or state law or court order, or federal regulation? If yes, cite the specific law, case or regulation, and any deadlines for action.

The regulation is not mandated by federal or state law, court order, or federal regulation.

(11) Explain the compelling public interest that justifies the regulation. What is the problem it addresses?

The amendments to §§ 101.1, 101.6, 101.6a and 101.7 are made to explain how employee welfare benefit programs and other wage and salary supplemental programs are taxed and to implement amendments to section 301(d) of the Tax Reform Code of 1971 (72 P.S. § 7301(d)) under Act 7-1997 and Act 48-1998.

The amendments provide employers and employees with a detailed explanation of how nondiscriminatory employee welfare benefit programs such as self-insured medical reimbursement accounts or cafeteria plans are taxed under the Commonwealth's personal income tax. They also provide a detailed explanation of how programs that discriminate in favor of officers, owners, and key employees are taxed.

(12) State the public health, safety, environmental or general welfare risks associated with nonregulation.

There are no public health, safety, environmental or general welfare risks associated with nonregulation.

(13) Describe who will benefit from the regulation. (Quantify the benefits as completely as possible and approximate the number of people who will benefit.)

Employers and employees will benefit from the regulation because it provides a detailed explanation of how nondiscriminatory employee welfare benefit programs such as self-insured medical reimbursement accounts or cafeteria plans are taxed under the Commonwealth's personal income tax. The regulation also provides a detailed explanation of how programs that discriminate in favor of officers, owners, and key employees are taxed.

Regulatory Analysis Form

(14) Describe who will be adversely affected by the regulation. (Quantify the adverse effects as completely as possible and approximate the number of people who will be adversely affected.)

No parties should be adversely affected by the regulation.

(15) List the persons, groups or entities that will be required to comply with the regulation. (Approximate the number of people who will be required to comply.)

Most employers will be affected by one or more provisions of this regulation.

(16) Describe the communications with and input from the public in the development and drafting of the regulation. List the persons and/or groups who were involved, if applicable.

The regulation was published in the Pennsylvania Bulletin and the public was invited to comment. The Department received one public comment. Comments were also received from the Independent Regulatory Review Commission. The Department considered the comments in preparing the final form regulation. In addition, the regulation was forwarded to the Pennsylvania Bar Association; the Pennsylvania Institute of Certified Public Accountants; the Pennsylvania Chamber of Business and Industry and all parties who commented on the proposal. The regulation was listed in the Department's Agenda of Regulations published at 30 Pa.B. 690 (February 5, 2000) and was forwarded to interested parties upon request.

(17) Provide a specific estimate of the costs and/or savings to the regulated community associated with compliance, including any legal, accounting or consulting procedures which may be required.

No significant costs will be associated with compliance.

Regulatory Analysis Form

(18) Provide a specific estimate of the costs and/or savings to local governments associated with compliance, including any legal, accounting or consulting procedures which may be required.

This regulation does not increase costs or savings to local governments.

(19) Provide a specific estimate of the costs and/or savings to state government associated with the implementation of the regulation, including any legal, accounting, or consulting procedures which may be required.

This regulation does not increase costs or savings to state government.

Regulatory Analysis Form

(20) In the table below, provide an estimate of the fiscal savings and costs associated with implementation and compliance for the regulated community, local government, and state government for the current year and five subsequent years.

	Current FY Year	FY +1 Year	FY +2 Year	FY +3 Year	FY +4 Year	FY +5 Year
SAVINGS:	\$	\$	\$	\$	\$	\$
Regulated Community						
Local Government						
State Government						
Total Savings	N/A					
COSTS:						
Regulated Community						
Local Government						
State Government						
Total Costs	N/A					
REVENUE INCREASE:						
Regulated Community						
Local Government						
State Government						
Total Revenue Increase	N/A					

(20a) Explain how the cost estimates listed above were derived.

There are no fiscal costs, savings or revenue losses associated with this regulation.

Regulatory Analysis Form

(20b) Provide the past three year expenditure history for programs affected by the regulation.

Program	FY -3	FY -2	FY -1	Current FY
N/A	N/A	N/A	N/A	N/A

(21) Using the cost-benefit information provided above, explain how the benefits of the regulation outweigh the adverse effects and costs.

N/A

(22) Describe the nonregulatory alternatives considered and the costs associated with those alternatives. Provide the reasons for their dismissal.

The Department exercised its nonregulatory alternative with the use of a pronouncement to set forth its interpretation of Act 7-1997 in 1997.

(23) Describe alternative regulatory schemes considered and the costs associated with those schemes. Provide the reasons for their dismissal.

There are no alternative regulatory schemes associated with the regulation.

Regulatory Analysis Form

(24) Are there any provisions that are more stringent than federal standards? If yes, identify the specific provisions and the compelling Pennsylvania interest that demands stronger regulation.

Pennsylvania law is more stringent than Federal standards. The Pennsylvania Personal Income Tax law has no provisions similar to section 21 of the IRC ("Expenses for household and dependent care services necessary for gainful employment"), section 105(b) of the IRC ("Amounts expended for medical care"), section 120 of the IRC ("Amounts received under qualified group legal services plans"), section 127 of the IRC ("Educational assistance programs"), section 129 of the IRC ("Dependent care assistance programs"), section 137 of the IRC ("Adoption assistance programs") or section 213 of the IRC ("Medical, Dental, etc., expenses").

(25) How does this regulation compare with those of other states? Will the regulation put Pennsylvania at a competitive disadvantage with other states?

Pennsylvania's broader tax base allows a lower tax rate. The regulation will not put Pennsylvania at a competitive disadvantage with other states.

(26) Will the regulation affect existing or proposed regulations of the promulgating agency or other state agencies? If yes, explain and provide specific citations.

This regulation does not affect any other existing or proposed regulations of the Department or any other state agencies.

(27) Will any public hearings or informational meetings be scheduled? Please provide the dates, times, and locations, if available.

The regulation was presented to the House and Senate Finance Committees and the Independent Regulatory Review Commission. At the same time the regulation was presented to the Committees and the Commission, the regulation was published in the Pennsylvania Bulletin and the public was invited to comment.

The Committees and the Commission may hold hearings or meetings to consider the final form regulation. The date, time and location of such hearings or meetings can be ascertained by contacting the Committees and the Commission. Notice of the Commission's public meeting to formally consider the final form regulation will be published in the Pennsylvania Bulletin prior to the meeting date.

Regulatory Analysis Form

(28) Will the regulation change existing reporting, record keeping, or other paperwork requirements? Describe the changes and attach copies of forms or reports which will be required as a result of implementation, if available.

N/A

(29) Please list any special provisions which have been developed to meet the particular needs of affected groups or persons including, but not limited to, minorities, elderly, small businesses, and farmers.

No special groups are affected by the regulation.

(30) What is the anticipated effective date of the regulation; the date by which compliance with the regulation will be required; and the date by which any required permits, licenses or other approvals must be obtained?

This regulation will be effective upon final publication in the Pennsylvania Bulletin. Compliance with the regulation is required upon publication. There are no permits, licenses or other approvals required by this regulation.

(31) Provide the schedule for continual review of the regulation.

This regulation is scheduled for review within five years of final publication. No sunset date has been assigned.

DL-1

FACE SHEET
FOR FILING DOCUMENTS
WITH THE LEGISLATIVE REFERENCE BUREAU
(Pursuant to Commonwealth Documents Law)

RECEIVED

2000 MAY 19 AM 11:25

LEGISLATIVE REFERENCE BUREAU
REVIEW COMMISSION

4/27/00

1942

DO NOT WRITE IN THIS SPACE

Copy below is hereby approved as to form and legality. Attorney General

By: _____
(DEPUTY ATTORNEY GENERAL)

DATE OF APPROVAL

Check if applicable
Copy not approved. Objections attached.

Copy below is hereby certified to be true and correct copy of a document issued, prescribed or promulgated by:

PA Department of Revenue

(Agency)

Document/Fiscal Note No. 15-402

Date of Adoption: _____

By: Robert A. Judge, Sr.
Secretary of Revenue

Title: _____
(Executive Officer, Chairman or Secretary)

Copy below is hereby approved as to form and legality. Executive or Independent Agencies.

By: John V. Turner

5/1/00
Date of Approval

(Deputy General Counsel)
(~~Chief Counsel, Independent Agency~~)
(Strike inapplicable title)

Check if applicable. No Attorney General approval or objection within 30 days after submission

NOTICE OF FINAL RULEMAKING

DEPARTMENT OF REVENUE

61 Pa. Code §§101.1, 101.6, 101.6a, 101.7 and 125.21 -125.33

Payments For Employee Welfare Benefit
Plans and Cafeteria Plans

PREAMBLE

The Department of Revenue (Department), under the authority contained in section 354 of the Tax Reform Code of 1971 (TRC) (72 P.S. § 7254), by this order amends 61 Pa. Code Chapter 101. General Provisions, sections 101.1, 101.6, 101.6a, 101.7 (relating to definitions; compensation; fringe benefits in the form of use of property or services; and receipt of income) to read as set forth in Annex A and amends Chapter 125. Personal Income Tax Pronouncements - Statements of Policy, by deleting §§ 125.21 - 125.33 (relating to payments for employe welfare benefit plans and cafeteria plans).

Purpose of Regulation

The amendments to §§ 101.1, 101.6, 101.6a and 101.7 are made to explain how employe welfare benefit programs and other wage and salary supplemental programs are taxed and to implement amendments to section 301(d) of the TRC (72 P.S. § 7301(d)) under Act 7-1997 and Act 48-1998.

Explanation of Regulatory Requirements

The amendments provide employers and employes with a detailed explanation of how nondiscriminatory employe welfare benefit programs such as self-insured medical reimbursement accounts or cafeteria plans are taxed under the Commonwealth's Personal Income Tax. They also provide a detailed explanation of how programs that discriminate in favor of officers, owners and key employes are taxed.

The amendments are also added to notify employers and employes how the provisions of the Personal Income Tax relating to employe compensation in the form of employer-provided facilities or services will be enforced by the Department.

With the adoption of this rulemaking, the Department is deleting the statement of policy set forth at §§ 125.21 - 125.33. The statement of policy provided the public with an explanation of the Department's policy on payments for employe welfare benefit plans and cafeteria plans pending the adoption of this regulation.

Affected Parties

All wage earners, employers and tax practitioners/preparers may be affected by the regulation in that they will need to know

what is subject to withholding and how to complete their tax return.

Comment and Response Summary

Notice of proposed rulemaking was published at 28 Pa. B. 1946 (April 25, 1998). This proposal is being adopted with changes as set forth in Annex A.

The Department received one comment from the public during the public comment period. The Department also received comments from the Independent Regulatory Review Commission (IRRC). No comments were received from the Senate and House Finance Committees.

Amendments to the proposed rulemaking in response to comments are as follows:

(1) IRRC suggested that the Department clarify its use of the term "cafeteria plan." In response, the Department amended the definition of "cafeteria plan" to mean only plans qualifying under section 125 of the IRC (26 U.S.C.A. § 125).

(2) IRRC suggested that the terminology "taxable compensation" was redundant and that the regulation be consistent in its references to compensation. The terminology "taxable compensation" has been amended to "compensation" throughout the regulation.

(3) IRRC suggested that the definitions of "employee benefit plan," "employee welfare benefit plan," and "cafeteria plan" in the proposed rulemaking overlap. The definitions have been amended to eliminate the definition of "employee benefit plan." Although cafeteria plans can offer the same benefits as employee welfare benefit plans (e.g., health, accident or death plan benefits or dependent care assistance), they can also offer 401(k) plan benefits.

(4) IRRC noted in its comments that the definition of "cafeteria plan" used the undefined term "flexible benefit plans" and suggested that the term be defined in the final rulemaking. The revisions to the definition of "cafeteria plan" previously discussed have addressed this concern.

(5) In response to IRRC's comment and Act 45-1998, several of the examples set forth in the definition of "employee welfare benefit plan" are deleted.

(6) IRRC recommended that the proposed rulemaking be amended to add definitions of the terms "working condition fringes," "qualified transportation fringes," and "de minimis fringes" for purposes of § 101.6(c)(10) and the definition of "poverty income." The terms are eliminated in final-form regulations and will be addressed in a future rulemaking.

(7) IRRC noted that the criteria set forth in the definition of "program covering hospitalization, sickness, disability or death" were confusing and questioned the need for the language. IRRC suggested that if the Department retained the language in the final rulemaking, the Department should explain why the criteria were necessary. The Department recognizes the concern raised by IRRC and deleted the proposed definition and added a new definition for "health, accident or death plan." The definition includes an example to add clarity.

(8) IRRC and a public comment suggested that the proposed rulemaking be amended to reflect the exclusion of the personal use of an employer's property and employer-provided services under Act 45-1998. The Department acknowledges the need, deletes those provisions in the proposed rulemaking that consider employer provided service or property to be compensation, and adds a new section, § 101.6a, to explain the new exclusions.

(9) IRRC questioned why the Department included the term "collectively bargained" in subsection (c)(9) and recommended that the Department either delete or explain the need for the terminology. Although collectively bargained for supplemental unemployment benefit pay arrangements would seldom be discriminatory, the language has been deleted.

(10) IRRC and a public comment questioned whether the proposed rulemaking referred not only to qualified and unqualified stock options and restricted stock options but also to incentive stock options (ISOs), noting that there is confusion in the community as to whether the current 61 Pa. Code § 101.6(b) includes ISOs. The Department acknowledges that, because the Federal tax treatment of ISOs varies from the Federal treatment of other stock options, it would be helpful to clarify that they are taxed the same as other stock options for personal income tax purposes. The Department amended § 101.6(f) for that purpose.

(11) IRRC recommended that the words "they" and "conditions," in § 101.6(i)(1)(i) and (ii) be clarified. The terminology has been clarified by referencing the payments in question and the requirements of paragraph (1). The word "rules" in paragraph (2) refers to all personal income tax regulatory provisions relating to employer payments for employe welfare benefit plans.

(12) IRRC raised several clarity concerns regarding § 101.6(i)(2) and suggested that the provision should be redrafted. The Department recognizes IRRC's concerns and revised the paragraph accordingly.

(13) IRRC recommended changes to the first, fifth, and sixth examples under Subsection 101.6(i)(3). After consideration, the Department deleted paragraph (3) in its entirety.

(14) Section 101.7(f) is amended in response to IRRC's request for clarity.

(15) IRRC also made a comment relating to the deletion of the Department's statement of policy relating to payments for employe welfare benefit plans and cafeteria plans set forth in §§ 125.21 - 125.33. IRRC notes that the preamble for the proposed rulemaking did not mention the statement of policy, nor did it indicate that the statement of policy would be deleted upon adoption of the proposal; therefore, IRRC suggested that the statement of policy be deleted upon adoption of rulemaking.

It was the Department's intention to delete §§ 125.21 - 125.33 with the adoption of the regulation; therefore, consistent with IRRC's comment and the Department's intent, language has been added to the regulation which deletes §§ 125.21 - 125.33 upon the adoption of the rulemaking.

Revisions initiated during the Department's internal review of the regulation are as follows:

(1) Consistent with the Department's deletion of detailed examples throughout the regulation, the example set forth in proposed § 101.6(g)(3) is deleted.

(2) The example set forth in § 101.6(i)(2) was based on the Federal law in effect at the time the proposal was published. The Federal law subsequently changed requiring the deletion of the example.

(3) As part of the amendments to address Act 45-1998, the Department believed it was necessary to add § 101.6(1) to specifically provide that the form of payment of compensation does not affect its taxable status, except as provided in § 101.6a.

(4) Stylistic changes were made throughout the regulation for clarity.

Comments that did not result in amendments to the regulation are as follows:

(1) IRRC saw a need to specifically address when benefits will be considered compensation. Although the Department understands that need, the proposed rulemaking takes a different approach to meet it, because there are substantially more categories of taxable benefits than excludible categories. It provides the general rule that all wage and salary supplements are taxable. The term "wage and salary supplement" is broadly defined to include any of the following:

(a) Employer-provided coverage under a plan.

(b) An employer payment to provide benefits under a plan, separation, vacation, holiday or guaranteed pay, reimbursement for personal expenses, and any other amount paid, under an agreement, to one or more of the following:

(i) An independently controlled trust or pooled fund established or maintained for the purpose of funding or providing benefits under the plan.

(ii) An insurance company for the purchase of insurance.

(iii) A third party for the benefit of the employee.

(c) Any benefit under a plan to the extent attributable to plan coverage or contributions by the employer which were not includible in income of the employee.

(d) Any benefit under a plan which is paid by the employer.

The regulation also spells out what contributions are deemed to be made by an employer even when deducted from an employee's gross pay. See § 101.6(i). The amendments continue the pattern of spelling out the exceptions, specifically including:

(a) Periodic payments for periods of sickness or disability. See § 101.6(c)(1).

(b) Payments made by an employer or labor union or elective contributions deemed to be made by an employer under a cafeteria plan for a nondiscriminatory health, accident or death plan and program benefits payable on condition of hospitalization, sickness, disability or death under a health, accident or death plan. See § 101.6(c)(6) and (12).

(c) Payments made by an employer or labor union for fringe benefits described in § 101.6a (relating to fringe benefits in the form of personal use of property or services).

(2) In its comments regarding subsection (g), IRRC questioned the relevancy a cafeteria plan has to do with the taxation of vacation benefits and whether it mattered if the vacation benefits are part of a cafeteria plan in order to determine if they are compensation. IRRC suggested the Department explain the intent of this subsection. The inclusion of language relating to vacation benefits in a cafeteria plan was to show that cafeteria plans can cover a multitude of benefits, including vacation benefits.

(3) In its review of § 101.6(c)(5), IRRC questioned how the section would be applied for reimbursements for service or property that involved both personal and business use. The mixed use of property owned by an employee will be addressed in a separate rulemaking. The use of employee-owned property for business use is distinguishable from that addressed by Act 45-1998 which related to the mixed use of property owned or leased by the employer.

(4) With regard to proposed § 101.6(e)(3), now § 101.6(e)(2), IRRC noted that because Federal taxable noncash fringe benefits may include the "personal use of an employer's owned or leased property or of employer provided services," the paragraph needed to be amended to clarify the proper tax treatment for Pennsylvania purposes. In accordance with Act 48-1998, the Department amended § 101.6(c) by adding paragraph (12). The purpose of paragraph (2) in § 101.6(e) is to advise

taxpayers that the Commonwealth will accept the value established for Federal income tax purposes and that no special calculation is required for Pennsylvania tax purposes.

(5) IRRC raised a number of concerns regarding health, accident and death plans. The final-form regulation has been substantially changed to resolve those concerns. However, it is the position of the Department that benefits are not excludible as health, accident or death benefits if they would also be payable under circumstances having no connection with hospitalization, sickness, disability or death. *Bickford v. Comm.*, 533 A.2d 822 (Pa.Cmwlth. 1987).

IRRC's final comment suggested that because the Department would be adding new provisions to the proposal resulting from Act 45-1998, it would be beneficial to allow further public comment prior to the submission of the final-form regulation. Neither the Regulatory Review Act nor the Commonwealth Documents Law provides for the re-publication of a proposed rulemaking. However, pursuant to the Governor's Executive Order 1996-1, the Department has actively sought input from affected parties including professional associations, business associations, all parties who commented on the proposal as well as IRRC and the Legislative Standing Committees. In addition, this regulation is listed in the Department's Agenda of Regulations and will be forwarded to all interested parties upon request. Therefore, the Department believes that its public outreach program sufficiently addresses this concern.

Fiscal Impact

The Department has determined that the amendments will have no fiscal impact on the Commonwealth.

Paperwork

The amendments will not require additional paperwork for the public or the Commonwealth.

Effectiveness/Sunset Date

The amendments will become effective upon final publication in the Pennsylvania Bulletin. The regulation is scheduled for review within five years of final publication. No sunset date has been assigned.

Contact Person

The contact person for an explanation of the amendments is Anita M. Doucette, Office of Chief Counsel, PA Department of Revenue, Dept. 281061, Harrisburg, Pennsylvania 17128-1061.

Regulatory Review

Under section 5(a) of the Regulatory Review Act (71 P.S. § 745.5(a)), on April 15, 1998, the Department submitted a copy of the notice of proposed rulemaking, published at 28 Pa.B. 1946, to IRRC and the Chairpersons of the House Committee on Finance and the Senate Committee on Finance for review and comment. In compliance with section 5(c) of the Regulatory Review Act (71 P.S. § 745.5(c)), the Department also provided IRRC and the Committees with copies of all comments received, as well as other documentation.

In preparing these final-form regulations, the Department has considered the comments received from IRRC, the Committees and the public.

These final-form regulations were (deemed) approved by the Committees on _____ and were (deemed) approved by IRRC on _____, in accordance with section 5.1(e) of the Regulatory Review Act (71 P.S. § 745.5a(e)).

Findings

The Department finds that:

(1) Public notice of intention to amend the regulations has been duly given under sections 201 and 202 of the act of July 31, 1968 (P.L. 769, No. 240) (45 P.S. §§ 1201 and 1202) and the regulations thereunder, 1 Pa. Code §§ 7.1 and 7.2.

(2) The amendments are necessary and appropriate for the administration and enforcement of the authorizing statute.

Order

The Department, acting under the authorizing statute, orders that:

(a) The regulations of the Department, 61 Pa. Code, are amended by amending Chapter 101. General Provisions, sections 101.1, 101.6, 101.6a and 101.7 to read as set forth in Annex A

and amending Chapter 125. Personal Income Tax Pronouncements - Statements of Policy, by deleting sections 125.21 - 125.33.

(b) The Secretary of the Department shall submit this order and Annex A to the Office of General Counsel and the Office of Attorney General for approval as to form and legality as required by law.

(c) The Secretary of the Department shall certify this order and Annex A and deposit them with the Legislative Reference Bureau as required by law.

(d) This order shall take effect upon publication in the Pennsylvania Bulletin.

ROBERT A. JUDGE, SR.
SECRETARY OF REVENUE

03/27/00

CONTINUATION SHEET
FOR FILING DOCUMENTS
WITH THE LEGISLATIVE REFERENCE BUREAU
(Pursuant to Commonwealth Documents Law)

ANNEX A

Title 61. Revenue, Part I. Department of Revenue, Subpart B.
General Fund Revenues, Article V. Personal Income Tax, Chapter
101. General Provisions.

§ 101.1. Definitions.

The following words and terms, when used in this article,
have the following meanings, unless the context clearly indicates
otherwise:

* * *

Cafeteria plan - A plan maintained by an employer for the
benefit of its employes and under which all participants are
employes and may choose among two or more benefits consisting of
cash or benefits such as accident and health plans, dependent
care assistance plans, group term life insurance, adoption
assistance plans and Internal Revenue Code section 401(k) plans.
The term includes flexible benefit plans. QUALIFYING UNDER
SECTION 125 OF THE IRC (26 U.S.C.A. § 125).

* * *

Discriminatory plan - An employe benefit A plan where
excludable employer contributions or the benefits attributable to
employer contributions discriminate in favor of THAT TREATS
highly compensated participants MORE FAVORABLY IN COVERAGE,
CONTRIBUTIONS OR BENEFITS. In determining whether a cafeteria

plan is discriminatory, the special rules of section 125(g) of the IRC (26 U.S.C.A. § 125(g)) are applicable.

* * *

~~Employe benefit plan — An employe welfare benefit plan, retirement benefit program, or other wage and salary supplemental or replacement program established or maintained by an employer or by an employe organization, or by both, for the benefit of eligible employes or their beneficiaries.~~

Employe welfare benefit plan -

(i) ~~An employe benefit~~ A plan established or maintained to provide to eligible employes or their beneficiaries plan benefits, such as:

(A) Medical, surgical or hospital care or benefits in the event of sickness, accident or disability.

(B) Death benefits.

(C) ~~Unemployment or strike benefits.~~

(D) ~~Vacation benefits and other guaranteed pay.~~

(E) ~~Apprenticeship or other training plans.~~

(F) ~~Scholarships, tuition reductions or educational assistance.~~

(G) ~~Legal, accounting or other professional services or assistance.~~

(H) (D) ~~Food, housing, or food or~~ PERSONAL EXPENSE REIMBURSEMENTS, ADVANCEMENTS OR ALLOWANCES SUCH AS RENTAL VEHICLE, DEPENDENT CARE, FOOD OR housing allowances.

~~(I) Day care centers or dependent care assistance.~~

~~(J) Athletic, recreational or entertainment facilities, services or assistance.~~

~~(K) The personal use of the employer's property or services.~~

~~(L) Employee discounts.~~

~~(M) Transportation and parking.~~

(ii) The term does not include:

(A) plans PLANS that offer a benefit that defers the receipt of compensation or operate in a manner that enables participants to defer the receipt of compensation.

(B) PLANS ESTABLISHED OR MAINTAINED IN ORDER TO PROVIDE FRINGE BENEFITS DESCRIBED IN § 101.6A (RELATING TO FINGE BENEFITS IN THE FORM OF USE OF PROPERTY OR SERVICES).

* * *

HEALTH, ACCIDENT OR DEATH PLAN -

(I) THE TERM MEANS:

(A) AN ACCIDENT, HEALTH OR TERM LIFE INSURANCE POLICY ISSUED BY AN INSURANCE COMPANY.

(B) A SELF-INSURED EMPLOYEE WELFARE BENEFIT PLAN UNDER WHICH BENEFITS ARE PAYABLE UPON HOSPITALIZATION, SICKNESS, DISABILITY OR DEATH OR FOR THE PREVENTION OF SICKNESS OR DISABILITY.

(II) THE TERM SHALL NOT INCLUDE ANY PROGRAM UNDER WHICH BENEFITS ARE PAYABLE EITHER UPON HOSPITALIZATION, SICKNESS,

DISABILITY, DEATH OR FOR THE PREVENTION OF SICKNESS OR DISABILITY; OR UPON SEPARATION FROM EMPLOYMENT OR SOME OTHER CONTINGENCY.

EXAMPLE: UNDER A'S BENEFIT PLAN, B QUALIFIES FOR A LUMP SUM PAYMENT EQUAL TO 26 WEEKS' PAY UPON PROOF OF PERMANENT DISABILITY OR SEPARATION FROM EMPLOYEMENT. THE PLAN DOES NOT CONSTITUTE A HEALTH, ACCIDENT OR DEATH PLAN BECAUSE PROGRAM BENEFITS ARE ALSO PAYABLE UPON SEPARATION FROM EMPLOYMENT. INSTEAD, IT CONSTITUTES A SEVERANCE PAY PLAN.

Highly compensated participant -

(i) A plan participant who is one of the following:

(A) An officer.

(B) A shareholder owning more than 5% of the voting power or value of all classes of stock of the employer.

(C) An individual who, for the preceding taxable year:

(I) Received compensation from the employer in excess of the Federal limitation (after adjustment by the Secretary of the United States Treasury for inflation) set forth in section 414(q)(1)(B) of the IRC (26 U.S.C.A. § 414(q)(1)(B)).

(II) Is in the group consisting of the top 20% of all full-time employes of the employer with at least 3 years of service when ranked on the basis of compensation paid during the taxable year.

(ii) A partner or other self-employed individual.

(iii) A spouse or dependent of a highly compensated individual.

* * *

Plan - The term includes temporary or permanent programs or arrangements, a trust that forms part of a plan and a contract of insurance.

A CAFETERIA PLAN OR OTHER WAGE AND SALARY SUPPLEMENTAL OR REPLACEMENT PROGRAM OR ARRANGEMENT ESTABLISHED OR MAINTAINED BY AN EMPLOYER OR BY AN EMPLOYEE ORGANIZATION, OR BY BOTH, FOR THE BENEFIT OF ELIGIBLE EMPLOYEES OR THEIR BENEFICIARIES. THE TERM INCLUDES TEMPORARY OR PERMANENT PROGRAMS OR ARRANGEMENTS COVERING HOSPITALIZATION, SICKNESS, DISABILITY OR DEATH, SUPPLEMENTAL UNEMPLOYMENT BENEFITS, STRIKE BENEFITS, SOCIAL SECURITY OR RETIREMENT, A TRUST THAT FORMS PART OF A PLAN, AND A CONTRACT OF INSURANCE.

* * *

Poverty income -

(i) For the purpose of determining eligibility for special tax provisions, ~~monies~~ moneys or property, including interest, gains or income derived from obligations which are statutorily free from State or local taxation under any other act of the General Assembly of the Commonwealth or under the laws of the United States, received of whatever nature and from whatever source derived, but not including the following:

* * *

(E) Payments to reimburse actual expenses allowable as an ordinary, reasonable and necessary business expense.

(F) Payments made by employers to labor unions for programs covering hospitalization, sickness, disability or death, supplemental unemployment benefits, strike benefits, social security and retirement and Federally excludable no additional cost services, employe discounts, working condition fringes, qualified transportation fringes and de minimis fringes.

* * *

(iii) The following income may not be included: Social Security and Medicare benefits; periodic payments for sickness and disability; ~~{workmen's}~~ worker's compensation payments; public assistance and relief (welfare); Unemployment Compensation; ~~{reimbursed actual expenses;}~~ pensions or annuities, including Railroad Retirement Benefits received by reason of retirement; and military pay received by servicemen for duty in a combat zone.

* * *

Program covering hospitalization, sickness, disability or death--

{i} An employe welfare benefit plan that satisfies both of the following requirements:

{A} No program benefits are payable or subject to anticipation, assignment or pledge until the commencement of a covered sickness or disability or death, except:

~~(I) The return of the participant's own contributions and taxable income or gains thereon.~~

~~(II) Amounts paid for the prevention of sickness or disability.~~

~~(III) Amounts paid for a policy of insurance.~~

~~(B) The only means of obtaining entitlement to program benefits other than the return of the participant's own contributions and taxable income or gains thereon or amounts paid for the prevention of sickness or disability or for insurance is proof of hospitalization, sickness, disability or death.~~

~~(ii) The term does not include programs under which benefits are payable either upon hospitalization, sickness, disability or death or separation from employment or some other contingency.~~

* * *

Wage or salary supplement -

(i) Employer-provided coverage under an employe benefit A plan.

(ii) An employer payment to provide benefits under an employe benefit plan, separation, vacation, holiday or guaranteed pay, reimbursement for personal expenses, SEPARATION PAY, VACATION PAY, HOLIDAY PAY, GUARANTEED PAY, REIMBURSEMENT FOR PERSONAL EXPENSES, AN EMPLOYER PAYMENT TO PROVIDE BENEFITS UNDER A PLAN and any other amount paid, under an agreement, to one or more of the following:

(A) An independently controlled trust or pooled fund established or maintained for the purpose of funding or providing employe benefit plan benefits under the plan.

(B) An insurance company for the purchase of insurance.

(C) A third party for the benefit of the employe.

(iii) Any benefit under ~~an employe benefit~~ A plan to the extent attributable to plan coverage or contributions by the employer which were not includible in income of the employe ~~or are paid by the employer.~~

(IV) ANY BENEFIT UNDER A PLAN WHICH IS DIRECTLY PAID BY THE EMPLOYER.

§ 101.6. Compensation.

(a) Compensation includes items of remuneration received by an employe, whether directly or through an agent, in cash or in property, or based on payroll periods or piecework, for services rendered as an employe, agent or officer of an individual, partnership, but not guaranteed payments to a partner for services rendered to the partnership, business or nonprofit corporation, or government agency. These items include salaries, wages, commissions, bonuses, stock options, incentive payments, fees, tips, termination or severance payments, rewards, vacation and holiday pay and other wage and salary supplements, tax assumed by the employer, THE ENTIRE COST OF EMPLOYER-PROVIDED COVERAGE PROVIDED TO A HIGHLY COMPENSATED PARTICIPANT UNDER ANY

DISCRIMINATORY EMPLOYEE WELFARE BENEFIT PLAN, and other remuneration received for services rendered.

(b) Scholarships, stipends, grants and fellowships shall be taxable as compensation, if services are rendered in connection therewith. [Compensation paid in a medium other than cash shall be valued at its current market value. Stock options shall be considered to be received when the option is exercised, exchanged, sold or otherwise disposed.]

* * *

(c) Compensation does not mean or include any of the following:

(1) Periodic payments for periods of sickness or disability paid by or on behalf of an employer under a program or plan unless the payments are regular wages. Additionally, not amount of damages received (whether by suit or agreement and whether as lump sums or as periodic payments) on account of physical injuries or sickness if pain and suffering, emotional distress or other like non-economic element was, or would have been, a significant evidentiary factor in determining the amount of the taxpayer's damage. No payments made by third-party insurers for periods of sickness or disability would be considered payments of regular wages. A program or plan where any of the following occur would not be considered payment of regular wages:

(i) The periodic payments have no direct relationship to the employe's usual rate of compensation.

(ii) [Employes or employes in the same job classification receive substantially identical periodic payments.] The periodic payments are computed with reference to the nature of the sickness or disability and without regard to the employe's job classification.

(iii) Periodic payments would be reduced by payments arising under Workmen's Compensation Acts, Occupational Disease Acts, Social Security Disability or similar legislation by any government.

(iv) The periodic payments [would in no event] exceed the employe's usual [rate of] compensation for the period.

* * *

(5) Payments made by employers to employes to reimburse actual expenses allowable as an ordinary, reasonable and necessary business expense. [Examples of these expenses are the following:

(i) Traveling expenses, including the cost of transportation, meals, lodging, tips and phone calls.

(ii) Moving expenses, which shall include the following:

(A) The following types of expenses and for which the employe is reimbursed in the exact amount by the employer will not be considered compensation:

(I) The expenses incurred in settling an unexpired lease on an old residence or acquiring a lease on a new residence.

(II) The expenses related to premove house hunting trips by the employe.

(III) The cost of transporting the employe and members of his household to the new location by the shortest and most direct route available and in the shortest period of time commonly required to travel the distance involved.

(IV) The temporary living expenses for the employe and members of his household while waiting to move into permanent quarters.

(V) The cost of moving household goods, if paid directly by the employe.

(VI) The expenses related to return trips to former residence.

(VII) The storage charges, if paid directly by the employe.

(B) The costs of moving the employe's personal belongings and household furnishings, including intransit storage charges, even if paid directly by the employer to the carrier are not includable as compensation.

(C) The following types of payment made to an employe by the employer in connection with the employe's move to a new principal place of employment within this Commonwealth shall be considered to be compensation and reportable as gross wages for Commonwealth income tax purposes:

(I) Additional compensation realized to the extent that the price paid by an employer for the residence of an employe exceeds the fair market value of the property.

(II) Allowances paid to the employe in lieu of transporting his automobile to the new location.

(III) Allowances equivalent to 1 month's average earnings paid an employe to cover certain unreimbursable expenses.

(IV) Allowance for employe's Federal income tax applicable to certain taxable moving expenses.]

(6) [Payments made by employers or labor unions for programs covering hospitalization, sickness, disability, death, supplemental unemployment benefits, strike benefits, social security and retirement.] Payments made by an employer or labor union or elective contributions deemed to be made by an employer under a cafeteria plan qualifying under section 125 of the IRC (26 U.S.C.A. § 125) for a nondiscriminatory employe welfare benefit plan covering hospitalization, sickness, disability or death HEALTH, ACCIDENT OR DEATH PLAN.

Example.

(i) P is a Philadelphia-based partnership that is engaged in providing accounting services. On a nondiscriminatory basis, it offers the following fringe benefits to both employees and partners of the firm:

(a) Blue Cross/Blue Shield medical coverage.

(b) Dental and eyeglass coverage with a deductible.

(c) Group term life insurance with coverage up to the equivalent of the employee's annual salary.

(ii) P pays the premiums on behalf of all employees and partners for all medical, dental, eyeglass and insurance coverage directly to the insurance carrier or benefit provider. P does not add the premium costs for the benefits to any employee's gross wages and it accounts for the benefit costs as nonsalary fringe benefit expenses. In other words, the value of the benefits are not shown as an addition to any employee's wages on the paystubs furnished to employees.

(iii) The plan is not a Federally qualifying cafeteria or flexible benefit plan.

(iv) Conclusion: For the employees of P ~~(but not partners)~~, the employer-provided hospitalization (Blue Cross/Blue Shield), eyeglass, dental coverage and group life insurance benefits are excludable from compensation and are therefore not subject to withholding. THE PREMIUMS PAID ON BEHALF OF THE

PARTNERS, HOWEVER, ARE NOT DEDUCTIBLE OR EXCLUDABLE FROM THE INCOME OF THE PARTNERSHIP OR THE PARTNERS.

* * *

(9) Payments made by an employer or labor union for a collectively bargained for or nondiscriminatory supplemental unemployment benefit or strike benefit plan.

(10) Federally excludable no-additional-cost services, employe discounts, working condition fringes, qualified transportation fringes, and de minimis fringes or benefits provided for the convenience of the employer.

(11) Benefits realized from an employe's personal use, before January 1, 1998, of his employer's property or services.

FRINGE BENEFITS DESCRIBED IN § 101.6A (RELATING TO FRINGE BENEFITS IN THE FORM OF PERSONAL USE OF PROPERTY OR SERVICES.

(12) PROGRAM BENEFITS PAYABLE ON CONDITION OF HOSPITALIZATION, SICKNESS, DISABILITY OR DEATH UNDER A HEALTH, ACCIDENT OR DEATH PLAN.

* * *

(e) Compensation paid in a medium other than cash shall be valued at its current market value. Compensation paid in the form of employer-provided coverage under an employe welfare benefit plan shall be valued at cost. The cost shall be the total amount of payment made during the year by the employer on account of the plan and plan participant, except in the following situations:

(1) In the case of tangible property owned or leased by the employer and personally used by a participant or beneficiary after December 31, 1997, the cost shall be its current fair rental value.

(2) In the case of self-insured insurance plans, the cost shall be the annual cost for financial accounting purposes.

(3) (2) The amount of taxable compensation paid in the form of Federally taxable noncash fringe benefits shall be determined in the same manner as is prescribed by the Internal Revenue Service under Federal statutes and regulations.

(4) (3) In the case of IRC section 125 cafeteria plans, amounts specified in the plan document as being available to the participant for the purpose of selecting or purchasing benefits, when so used, shall be included in the total amount of payment made during the year by the employer on account of the plan and plan participant.

(f) ~~Stock~~ COMPENSATION IN THE FORM OF INCENTIVE, QUALIFIED, RESTRICTED OR NONQUALIFIED STOCK options shall be considered to be received:

(1) When the option is exercised if the stock subject to the option is free from any restrictions having a significant effect on its market value.

(2) When the restrictions lapse if the stock subject to the option is subject to restrictions having a significant effect on its market value ~~or when.~~

(3) WHEN exchanged, sold or otherwise disposed of
CONVERTED INTO CASH OR OTHER PROPERTY.

(g) The following rules apply if, under a cafeteria plan,
plan participants may choose between benefits consisting of cash,
additional paid vacation days, and other benefits; or if, outside
a cafeteria plan, plan participants can purchase additional paid
vacation days:

(1) If additional paid vacation days are elected or
purchased and they are used before the next calendar year, the
following apply:

(i) The amount of cash foregone in exchange for
the paid vacation day is excluded from income.

(ii) The vacation pay is includable in income
when paid.

(2) If additional paid vacation days are purchased
outside a Federally qualifying cafeteria plan and they are not
used before the next calendar year, the amount of cash foregone
in exchange for the paid vacation days is excludable for
Pennsylvania Personal Income Tax purposes only if both of the
following apply:

(i) The value of the vacation day cannot be
cashied out or used for any other purpose.

(ii) The vacation day cannot be carried over to
the next taxable year.

~~(3) Example.~~

~~(i) Under the Federally qualified cafeteria plan offered by F's employer, employees are provided with \$4,500 in benefit dollars that can be used to purchase benefits. If the employe wishes to purchase benefits which cost in excess of the employer provided benefit dollars, the employe shall execute a salary reduction agreement. The cafeteria plan contains the following benefits:~~

Item	Cost
Medical/Accident Insurance	\$2,000 (individual)
	\$3,250 (family)
Life Insurance	\$ 150
Dependent Care	\$2,000
Additional Vacation	\$ 40/day
Days	
Cash	\$2,000 (cash limit)

~~(ii) F selects individual medical coverage, dependent care and purchases 3 additional paid vacation days for the 1997 taxable year. F's employer provides 2 weeks of paid vacation to all employes. The total cost of F's benefits is \$4,120 and, F received benefit dollars totaling \$4,500 from his employer.~~

~~(iii) During 1997, F uses his 2 weeks of vacation time and the 3 additional vacation days that he purchased under the cafeteria plan.~~

~~(iv) Conclusion: The employer is not required to withhold Personal Income Tax on \$2,000 which represents the employer-provided benefit dollars F used for medical/accident insurance, a nontaxable benefit. This amount is excludable from compensation even if F's employer shows or otherwise accounts for it as a periodic deduction from F's wages or a reduction of gross wages.~~

~~(v) The employer shall withhold tax on the employer-provided benefit dollars totaling \$2,380. This represents the amounts paid for dependent care (\$2,000) and the extra benefit dollars that were paid to F in the form of cash (\$380). However, the benefit dollars totaling \$120 that were used to purchase the extra paid vacation days are not subject to tax. F is taxed on the 3 paid vacation days when the days are used in 1997.~~

(h) Employer payments to reimburse employes for uninsured medical or dental expenses are taxable as compensation if the employe is assured of receiving (in cash or any other benefit) amounts available but unused for covered reimbursement during the year without regard to whether he incurred covered expenses or not. If the amounts available for covered reimbursement cannot be cashed out or used for any other purpose during the taxable year or be carried over to any other taxable year, normal cash compensation that is forgone by an employe under a spending account or otherwise, and credited to a self-insured medical

reimbursement account and drawn upon to reimburse the employe for uninsured medical or dental expenses to which section 105(b) of the IRC (26 U.S.C.A. § 105(b)) applies is excludable from tax.

(i) After December 31, 1996:

(1) Payments made after December 31, 1996, for employe welfare benefit plans under a cafeteria plan ~~qualifying under section 125 of the IRC~~ will be deemed to be an "employer contribution" for Pennsylvania Personal Income Tax purposes if the following apply:

(i) ~~They~~ THE PAYMENTS were not actually or constructively received, after taking section 125 of the IRC (26 U.S.C.A. § 125) into account.

(ii) ~~They~~ THE PAYMENTS were specified in a written cafeteria plan document as being available to the participant:

(A) For the purpose of selecting or purchasing benefits under a plan.

(B) As additional cash remuneration received in lieu of coverage under a plan.

(iii) The benefits selected or purchased are nontaxable under the IRC when offered under a cafeteria plan.

(iv) The payments made for the plan would be nontaxable under the Pennsylvania Personal Income Tax if made by the employer outside a cafeteria plan.

(2) If these conditions THE REQUIREMENTS OF PARAGRAPH (1) are satisfied, cafeteria plan contributions are taxed under the rules as apply to employer payments for employe welfare benefit plans. However, if the benefits are taxable for Federal Income Tax purposes when offered under a cafeteria plan, the payments will also constitute taxable compensation for Pennsylvania Personal Income Tax purposes. For example, coverage under a section 132(f) of the IRC (26 U.S.C.A. § 132(f)) transportation plan is nontaxable under the IRC when offered separately but is taxable for both Federal Income Tax and Pennsylvania Personal Income Tax purposes if offered under a cafeteria plan. Payments also will constitute taxable compensation if they would be taxable under the Pennsylvania Personal Income Tax if made by the employer outside a cafeteria plan. For example, although not taxable under the IRC, coverage under a dependent care plan PROVIDING FOR THE REIMBURSEMENT OF EXPENSES FOR HOUSEHOLD OR DEPENDENT CARE SERVICES would constitute taxable compensation under the Pennsylvania Personal Income Tax because it would be taxable if made by an employer outside a cafeteria plan.

(3) Examples are as follows:

Example 1. Under his employer's Federally qualifying cafeteria plan, A has the option of receiving his normal cash compensation or reducing his gross pay requirements and having the amount of that reduction applied by the employer toward

~~health insurance in lieu of normal cash compensation payments.~~
~~Conclusion: For Personal Income Tax purposes, A is taxable only~~
~~if he opts to receive his normal cash compensation.~~

Example 2.

~~(i) Under the Federally qualifying cafeteria plan~~
~~offered by B's employer, amounts are available as an addition to~~
~~B's normal cash compensation which, at the option of B, are~~
~~either applied by the employer toward providing day care~~
~~facilities and services or paid directly to B in cash as~~
~~additional gross pay. Conclusions: For Personal Income Tax~~
~~purposes, the benefit selected by B is taxable if:~~

~~(A) He opts to receive the additional gross~~
~~pay.~~

~~(B) The amount is applied in reimbursement~~
~~of an expense B incurred for household or dependent care~~
~~services.~~

~~(C) The amount is applied in discharge of a~~
~~payment required from B for household or dependent care services.~~

~~(ii) B's benefits will also be subject to~~
~~Personal Income Tax if he opts to receive employer-provided day~~
~~care facilities and services after January 1, 1998.~~

Example 3.

~~(i) Under C's Federally qualifying cafeteria~~
~~plan, amounts are available as an addition to C's normal cash~~
~~compensation, which at the option of C, are either applied by the~~

~~employer toward providing adoption assistance or paid directly to C in cash as additional gross pay.~~

~~(ii) Conclusions: For Personal Income Tax purposes, C is taxable if:~~

~~(A) He opts to receive the additional gross pay.~~

~~(B) The amount is applied in reimbursement of an adoption expense C incurred.~~

~~(C) The amount is applied in discharge of any payment required from C related to the adoption of a child.~~

Example 4.

~~(i) Under the Federally qualifying cafeteria plan of D's employer, each employe is provided with \$4,000 in flexible dollars that can be used to purchase certain benefits or which can be taken in cash in lieu of benefits. An individual who elects no benefits can receive cash only in an amount not exceeding \$2,000. An individual who elects benefits which have a total cost for the taxable year that does not equal or exceed \$4,000 shall allocate the flex dollars first to the selected benefits and any remaining flex dollars can be received as cash but only up to \$500. In addition, the plan specifies that the maximum amount that can be contributed by an employe as an elective contribution is \$2,500.~~

~~(ii) For the 1997 taxable year, D's employer offers the following benefits under its cafeteria plan:~~

<u>Benefit</u>	<u>Cost</u>	
	<u>Individual</u>	<u>(Individual and Spouse)</u>
<u>Medical Insurance</u>	<u>\$2,500</u>	<u>\$4,000</u>
<u>Dental Plan</u>	<u>\$500</u>	<u>\$ 750</u>
<u>Group Life Insurance</u>	<u>\$500</u>	<u>\$ 750</u>
<u>Dismemberment/</u>	<u>\$500</u>	<u>\$ 750</u>
<u>Disability Insurance</u>		
<u>Dependent Care</u>	<u>\$1,500</u>	<u>\$1,500</u>
<u>Service</u>		
<u>Cash</u>	<u>\$2,000</u>	<u>\$2,000</u>

(iii) Employees who elect benefits with a total cost exceeding the allocated flex dollars (\$4,000) agree to have the necessary additional amounts deducted from their base salary or wages each payroll period during 1997 to pay for the benefits.

(iv) Employee D selects individual coverages under the medical insurance, the dental plan and group term life insurance and \$500 in cash for the 1997 taxable year. The total cost for these benefits is \$3,500.

(v) Conclusions: The \$3,500 of employer-provided flex dollars used to purchase nontaxable benefits are not compensation and are not subject to withholding notwithstanding that D could have applied the flex dollars toward dependent care (a taxable benefit) or taken the benefits in the form of cash up to \$2,000. The \$500 D received as cash in lieu of benefits under the cafeteria plan is taxable compensation.

~~Example 5. Assume the same facts as in Example 4, except that Employee D is married and selects the following benefits for both his spouse and himself: 1) medical insurance; 2) dental; 3) group life insurance; and 4) dismemberment/disability insurance. Conclusions: For D, the employer is not required to withhold Pennsylvania Personal Income Tax on the flexible dollars totaling \$4,000. Because the total cost of benefits selected by D is \$6,250 and the employer-provided flexible dollars (\$4,000) are insufficient to pay for all of the benefits, D agrees to have additional sums deducted from his salary. D's employer pays him biweekly and the employer must deduct an amount totaling \$86.54 ($\86.54×26 pay periods = \$2,250) from D's biweekly salary to pay for the benefits. The \$86.54 deducted from the salary of D each payroll period, which totals \$2,250 for the calendar year, is not subject to Pennsylvania Personal Income Tax and withholding.~~

~~Example 6.~~

~~(i) Assume that E's employer offers a Federally qualified flexible benefits plan under which an employe is required to select some level of medical coverage unless the employe can provide the company's benefits administrator with proof of coverage under another medical insurance plan, for example that of a spouse's employer. The monthly benefit is based upon the number of family members whom the employe chooses~~

~~to cover under a medical plan. The flexible benefits plan contains the following features:~~

Flex Dollars to Purchase Benefits

~~If you elect this Coverage: You receive this number of Flex Dollars each month~~

~~Employee Only \$152.44~~

~~Employee + Children \$247.44~~

~~Employee + Spouse \$298.80~~

~~Employee + Family \$395.56~~

Medical Plan Features

~~Plan A Plan B
Deductible Per Person/Family \$150/\$300 \$500/\$1,000~~

~~Per Year~~

What the Plan Pays

~~Network Provider/Other 90%/75% 80%~~

Provider

~~Out of Pocket Maximum \$1,150/\$2,875 \$5,500~~

~~(not including deductible) Per Family Unit Per Year~~

Network Provider/Other Provider

~~Accident Coverage \$500 \$300~~

~~Well Baby Care Yes No~~

1. Medical Plan Prices and Election

~~Plan A Plan B
Employee Only \$168.94 \$142.34
(Your cost/extra pay) (-\$16.50) (+\$10.10)~~

Employee + Children	\$280.94	\$237.34
(Your cost/extra pay)	(-\$33.50)	(+\$10.10)
Employee + Spouse	\$339.30	\$288.70
(Your cost/extra pay)	(-\$40.50)	(+\$10.10)
Employee + Family	\$452.51	\$385.46
(Your cost/extra pay)	(-\$56.95)	(+\$10.10)

2. Dental Election/Flex Dollars

	What You Pay
Basic Plan Coverage	\$ 0.00
Optional Plan Coverage	
Employee Only	\$ 6.02
Employee + Children	\$11.56
Employee + Spouse	\$11.33
Employee + Family	\$18.12

3. Vision Features Prices and Election

	What You Pay
Employee Only	\$ 6.30
Employee + Family	\$13.86
No coverage	\$ 0.00

4. Spending Accounts Health Care Account Election

~~You may deposit from \$10 to \$208.33 per month in this Account Dependent Care Account Election (Child Care or Elder Care) You may deposit from \$10 to \$416.66 per month to this Account if you are single or married.~~

5. Life Insurance

Prices and Election

What You Pay

Basic coverage only \$ 0.00

Additional Life

1x base annual pay \$ 5.00

2x base annual pay \$10.00

3x base annual pay \$15.00

6. Dependent Life

Prices and Election

What You Pay

\$10,000 spouse/\$5,000 child \$1.49

\$20,000 spouse/\$5,000 child \$2.34

No coverage \$0.00

(ii) Under the plan, the maximum amount available as elective contributions is \$20,000.

(iii) E is married and has one child. E receives flex dollars totaling \$395.56 each month or (\$395.56 × 12 mo. = \$4,746.72 annually). E elects the following benefits:

<u>Benefit</u>	<u>Option</u>	<u>Monthly Cost</u>
<u>Medical</u>	<u>Plan A</u>	<u>\$452.51</u>
<u>Dental</u>	<u>Employee &</u>	<u>\$ 18.12</u>
	<u>Family</u>	
<u>Life</u>	<u>Basic Coverage</u>	<u>\$ 0.00</u>
<u>Insurance</u>	<u>Only</u>	

~~(v) Conclusion: Because E selected excludable benefits for Pennsylvania Personal Income Tax purposes, the monthly, employer-provided flex dollars in the amount of \$395.56 are not subject tax or withholding. The monthly flex dollars are not subject to tax or withholding irrespective of whether they are added to E's salary or shown as a deduction from his gross pay on each pay stub.~~

~~(vi) Because the total monthly cost of the benefits selected is \$470.63 and the allotted flex dollars are \$395.56, E makes up the difference by agreeing to have the additional necessary funds (\$75.07) deducted from his pay each month as an elective contribution. The \$75.07 is excludable from tax because:~~

~~(A) It was not actually or constructively received by E, after taking section 125 of the IRC into account.~~

~~(B) It was specified in a written cafeteria plan document as being available to E for the purpose of selecting or purchasing benefits under the plan and as additional cash remuneration received in lieu of coverage under the plan.~~

~~(C) The benefits selected or purchased are nontaxable under the IRC when offered under a cafeteria plan.~~

~~(D) The payments made for the plan would be nontaxable under the Pennsylvania Personal Income Tax if made by the employer outside a cafeteria plan.~~

Example 7. Assume that the employer offers the same flexible benefits plan as in Example 6, except that employe E is a single individual with no dependents and he selects the least expensive medical plan for an single individual, Plan B. E places the leftover flex dollars into the spending account to help defer the cost of medical expenses not paid for by Plan B. Under the flexible benefits plan, E may not withdraw funds from the spending account for any purpose other than to pay for uninsured medical expenses. If E does not utilize the amounts placed into the spending account during the calendar year, he forfeits the benefits. Conclusion: The flex dollars totaling \$152.44, which includes the monthly contribution of \$10.10 to the spending account, are not subject to tax or withholding.

Example 8.

(i) Assume that the employer offers the same flexible benefits plan as in Example 6, except that employe E has a husband and two children. E's husband, but not the children, is covered under the husband's employer's health insurance plan. E receives monthly flex dollars for herself and children (\$247.44) and selects the following items under the employer's plan:

<u>Benefit</u>	<u>Option</u>	<u>Cost (monthly)</u>
<u>Medical</u>	<u>Plan B</u>	<u>\$237.34</u>
	<u>Employe &</u>	
	<u>Children</u>	

<u>Dental</u>	<u>Employee &</u>	
	<u>Children</u>	<u>\$ 11.56</u>
<u>Vision</u>	<u>Employee</u>	
	<u>Only</u>	<u>\$ 6.30</u>
<u>Dependent Life</u>	<u>\$10,000 spouse/</u>	
	<u>\$ 5,000 child</u>	<u>\$ 1.49</u>

(ii) Conclusion: The employer provided flex dollars in the amount of \$247.44 are not subject to tax because E selected medical insurance coverage and dental coverage for herself and the children and the cost of these benefits exceeded the amount of employer provided flex dollars.

(iii) E shall contribute the sum of \$9.25 each month toward the purchase of benefits not paid for the employer provided flex dollars. Therefore, \$7.76 of the \$9.25 monthly contribution is excludable from tax because:

(A) It was not actually or constructively received by E, after taking section 125 of the IRC into account.

(B) It was specified in a written cafeteria plan document as being available to the participant for the purpose of selecting or purchasing benefits under the plan and as additional cash remuneration received in lieu of coverage under the plan.

(C) The benefits selected or purchased are nontaxable under the IRC when offered under a cafeteria plan.

~~(D) The payments made for the plan would be nontaxable under the Pennsylvania Personal Income Tax if made by the employer outside a cafeteria plan. However, the dependent life insurance coverage would be taxable as a currently taxable benefit treated as cash for both Federal Income Tax and Pennsylvania Personal Income Tax purposes when offered under a cafeteria plan. Thus, the \$1.49 monthly cost would be taxable even if it had been paid by E's employer.~~

(j) Compensation includes the entire cost of employer-provided coverage provided to a highly compensated participant under any discriminatory employee welfare benefit plan.

(k) Contributions made by an employer for IRC 401(k) plans under a cafeteria plan under which the employee unilaterally may elect to have the employer either make the payments as contributions to a 401(k) plan or other plan on behalf of the employee or to the employee directly in cash are not excludable from the employee's taxable compensation.

(L) EXCEPT AS PROVIDED IN § 101.6A (RELATING TO FRINGE BENEFITS IN THE FORM OF USE OF PROPERTY OR SERVICES), COMPENSATION IS TAXABLE REGARDLESS OF THE FORM OF THE PAYMENT. EXAMPLES OF TAXABLE FORMS OF PAYMENT INCLUDE:

- (1) CASH.
- (2) FOREIGN CURRENCY.
- (3) A CHECK OR OTHER NEGOTIABLE INSTRUMENT.

(4) FREELY TRANSFERABLE, READILY MAREKETABLE OBLIGATIONS OR OTHER CASH EQUIVALENT.

(5) TANGIBLE PROPERTY INTERESTS, INTANGIBLE PERSONAL PROPERTY OR ANY OTHER RIGHT, CLAIM OR THING THAT EITHER:

(I) CAN BE ENFORCED IN COURTS OF EQUITY AND TRANSFERRED AND HAS AN ASCERTAINABLE FAIR MARKET VALUE.

(II) CAN BE REDUCED TO CASH OR ELIMINATE AN EXPENDITURE.

(6) A MONETARY PAYMENT IN REIMBURSEMENT OF A PERSONAL EXPENDITURE OR TO ELIMINATE A PERSONAL EXPENDITURE.

(7) BELOW-MARKET RATE LOANS.

(8) A CANCELLATION OF INDEBTEDNESS CONSTITUTING A QUID PRO QUO OR INCENTIVE THAT WOULD BE TAXABLE HAD THE AMOUNT BY WHICH THE DEBT HAD BEEN FORGIVEN OR DISCHARGED INSTEAD BEEN PAID TO THE DEBTOR IN CASH OR PROPERTY.

§ 101.6A. FRINGE BENEFITS IN THE FORM OF USE OF PROPERTY OR SERVICES.

(A) REMUNERATION FOR SERVICES RECEIVED IN THE FORM OF PERSONAL OR BUSINESS USE OF PROPERTY IS NOT TAXABLE AS COMPENSATION IF THE FOLLOWING REQUIREMENTS ARE MET:

(1) THE PROPERTY BELONGS TO, OR IS HELD UNDER A LEASE BY, THE EMPLOYER AT THE TIME OF USE.

(2) NO TITLE, INTEREST OR ESTATE THEREIN IS CONFERRED UPON, OR VESTED IN, ANOTHER PERSON.

(B) EXAMPLES OF PROPERTY THAT ARE EXCLUDIBLE FROM TAX IF THE REQUIREMENTS OF (A) ARE MET INCLUDE:

- (1) EDUCATIONAL OR TRAINING FACILITIES.
- (2) HOUSING OR CLOTHING.
- (3) DAY CARE FACILITIES.
- (4) PASSENGER CARS AND COMMUTER HIGHWAY VEHICLES.
- (5) AIRCRAFT OR WATER CRAFT.
- (6) CONSTRUCTION OR RECREATION VEHICLES.
- (7) ATHLETIC FACILITIES OR EQUIPMENT.
- (8) RECREATIONAL FACILITIES OR EQUIPMENT.
- (9) ENTERTAINMENT FACILITIES OR EQUIPMENT.
- (10) PARKING FACILITIES.
- (11) EATING FACILITIES.
- (12) OFFICE FACILITIES OR EQUIPMENT.
- (13) TOOLS, EQUIPMENT OR SUPPLIES.

(C) REMUNERATION FOR SERVICES RECEIVED IN THE FORM OF PERSONAL OR BUSINESS USE OF SERVICES IS NOT TAXABLE AS COMPENSATION IF EITHER:

(1) THE SERVICE IS PROVIDED OR SUPPLIED DIRECTLY BY THE EMPLOYER OR A CO-EMPLOYEE.

(2) RIGHTS TO THE SERVICE WERE PROCURED BEFOREHAND BY THE EMPLOYER.

(D) EXAMPLES OF SERVICES THAT ARE EXCLUDIBLE FROM TAX IF THE REQUIREMENTS OF (C) ARE MET INCLUDE:

- (1) THE OPERATION OF AN EATING FACILITY.

- (2) TRANSPORTATION IN A COMMUTER HIGHWAY VEHICLE.
- (3) AIR OR RAIL TRANSPORTATION OF PASSENGERS OR CARGO.
- (4) PARKING.
- (5) EDUCATION OR TRAINING.
- (6) LEGAL, MEDICAL, ACCOUNTING OR OTHER PROFESSIONAL OR TECHNICAL SERVICES OR ASSISTANCE, INCLUDING ADOPTION ASSISTANCE.
- (7) DAY CARE SERVICES OR ASSISTANCE.
- (8) DEPENDENT CARE ASSISTANCE.
- (9) A TUITION REDUCTION PROVIDED TO AN EMPLOYEE OR HIS DEPENDENTS OR TO A TEACHING AND RESEARCH ASSISTANT.

(E) REMUNERATION FOR SERVICES RECEIVED IN THE FORM OF CONSUMPTION OF A CONSUMABLE, SUCH AS FOOD AND SUPPLIES, IS NOT TAXABLE AS COMPENSATION.

(F) THE PROVISIONS OF THIS SECTION SHALL APPLY EVEN IF:

(1) THE USE OR SERVICE IS OFFERED ON A DISCRIMINATORY BASIS.

(2) THE EMPLOYER INCURS SUBSTANTIAL ADDITIONAL COST, INCLUDING FORGONE REVENUE, IN PROVIDING SUCH USE OR SERVICE.

§ 101.7. Receipt of income.

* * *

(e) Present economic benefit. An amount paid as a contribution shall be considered as received where IF an employe receives rights, such as coverage under an employe benefit A plan that are the following:

(1) Of a value which can in no event fall materially below the amount of the contribution.

(2) Presently belong to the employe.

(3) Unequivocally provided for the ultimate benefit of the employe under whatever contingency and whatever circumstance the occasion for the benefit should arise.

(f) Wage and salary deductions; taxability. Any

(1) EXCEPT AS PROVIDED IN (2), ANY amount lawfully deducted and withheld by an employer from the remuneration of an employe and accounted for as a part of the employe's total remuneration shall be considered to have been paid to the employe as taxable compensation at the time the deduction is made unless.

(2) AN AMOUNT SHALL NOT BE CONSIDERED TO HAVE BEEN PAID TO THE EMPLOYEE BECAUSE the amount is specified in a written cafeteria plan document as being available to the participant for the purpose of selecting or purchasing benefits under a plan or as additional cash remuneration received in lieu of coverage under a plan. Whether an amount is specified in a cafeteria plan document as being available to a participant shall be determined using Federal rules.

Example.

(i) Employer M is a manufacturing company situated in this Commonwealth and under its collective bargaining agreement with a union, all nonmanagement personnel must contribute \$15 per week from their gross salary toward the purchase of Blue Cross/Blue

Shield coverage and \$3 per week toward the purchase of group life insurance.

(ii) The plan is not a Federally qualifying cafeteria plan.

(iii) Conclusion: M shall withhold Pennsylvania Personal Income Tax from the \$18 contributed by each nonmanagement employe toward benefits.

CHAPTER 125. PERSONAL INCOME TAX PRONOUNCEMENTS - STATEMENTS OF POLICY.

§ 125.21. RESERVED.

§ 125.22. RESERVED.

§ 125.23. RESERVED.

§ 125.24. RESERVED.

§ 125.25. RESERVED.

§ 125.26. RESERVED.

§ 125.27. RESERVED.

§ 125.28. RESERVED.

§ 125.29. RESERVED.

§ 125.30. RESERVED.

§ 125.31. RESERVED.

§ 125.32. RESERVED.

§ 125.33. RESERVED.

03/27/00

