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SECTION 89 NEWS

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OCTOBER 1, 1989 IS STILL THE EFFECTIVE DATE FOR BOTH THE WRITTEN PLAN RULES AND THE NONDISCRIMINATION TESTING OF EMPLOYEE BENEFITS. BUT A ONE-YEAR DELAY IN IRS ENFORCEMENT HAS PASSED BOTH THE SENATE AND HOUSE. WRITTEN PLAN RULES SURVIVE REFORM EFFORTS.

As the United States Congress goes out on its August recess there is still no final relief for employers from the requirements of §89 of the Internal Revenue Code for both the written plan qualification rules and the nondiscrimination testing procedures.

Present Effective Date. The present effective date of the law is October 1, 1989 as set out in IRS Notice 89-65 which has delayed compliance for both the nondiscrimination testing and the written reasonable notification rules of §89 from July 1, 1989. The economic effect of this is that Employers will test for discrimination all of their employee benefits paid during the fourth quarter of 1989 (for calendar year plans) as if they were paid at that rate throughout all of 1989 essentially ignoring the facts in existence prior to October 1st. This allows employers to change benefit packages now and not be penalized for facts occurring prior to October 1st.

House And Senate Bills Prohibit IRS Enforcement. Since January 1, 1989, there have been no fewer than sixteen proposals that would impact on §89. Both Daniel Rostenkowski, Chairman of the House Ways and Means Committee, and Lloyd Bentsen, Chairman of the Senate Finance Committee, have introduced and amended their bills to alter §89. The present status of the proposed Senate Bill is that the Senate has passed a version of amendments to §89 and attached it to the *Child Care and Health Insurance Bill of 1989*, S. 1185. President Bush opposes this Child Care bill in its present form. On August 4, 1989, Rostenkowski introduced H.R. 3150, the *Revenue Reconciliation Bill of 1989*, which contains House The Ways and Means Committee's modified §89 changes. In addition, the House and Senate have approved, separately, an appropriations provision which would prohibit the use of any funds allocated to the IRS for the implementation or enforcement of the nondiscrimination rules or the issuance of any new regulations of §89 for the fiscal year beginning October 1, 1989. Since the House and Senate versions differ slightly, there must be a House/Senate Conference Report to reconcile the Bills.

IRS Underestimates Compliance Costs. One reason for all of the activity in Congress is that the IRS and the Treasury Department estimates of the cost of complying with §89 as origi-

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nally set forth in the statute of 9 million hours is drastically underestimated. The Office of Management and Budget estimated that the amount of time to comply is really 69 million hours. Treasury missed the mark by 800%. In addition, it is estimated that the cost to comply with the law will far exceed the expected revenue gain and, thus, the Treasury will ultimately lose revenue. The American Institute of Certified Public Accountants estimated the cost of compliance annually at $270 million as opposed to a Treasury estimate of revenue to be received this year of $120 million.

Employers Criticize New Tests. Employers have resisted some of the proposed changes to §89 because the new proposals are more restrictive than those of the present law. For example, some employers will pass the 80% Test under the current rules, but will not pass the more stringent 90% Test under the proposed rules.

Plan Design is Tested. The basic idea of the present proposed changes is to provide a design-based simple "safe harbor" plan that employers could adopt and then be deemed to have passed the nondiscrimination testing portion of §89. An employer could know then at the time of the adoption of the plan whether or not the plan would pass the §89 rules rather than waiting for the results of after-the-fact employee demographic testing. The present version of a single "safe harbor" or "cliff effect" plan would require 90% (both Bills) of all employees be eligible to participate in the health plan with a maximum after-tax employee cost not exceed 50% (House version) and 40% (Senate version) of the total cost. Group term life insurance and accidental life and dismemberment insurance would not be tested under §89 and would be tested under pre-1986 §79(d) nondiscrimination rules under both Bills.

Plan Documentation Rules Survive. Both Bills as they presently stand keep the written plan qualification standards as required by the original §89(k). Despite efforts to eliminate the requirements for written plan disclosure, these rules have survived the reform efforts and mandate timely written notification to all eligible employees of their entitlement to employer-provided benefits. The employers compliance date is presently October 1, 1989, and is proposed to be January 1, 1990 for these rules.

Employees Excluded. Both Bills keep the existing employee exclusion rules, except that a part-time employee is one who works less than 30 hours per week rather than 17 1/2 hours. There are some other areas where the employee exclusion rules are expanded; for example, employees of units of state and local government. Union employees have new delayed compliance dates of January 1, 1993. Many of changes will eliminate the sworn statements and reduce recordkeeping requirements, at least for nonhighly compensated employees.

Effective 1/1/90. Both Bills as they presently stand have an effective date of January 1, 1990 for both the plan qualification rules and the nondiscrimination rules.

Present Law Option. Both Bills keep, as an option, the present law for testing plans for compliance with the nondiscrimination rules: they allow an employer to use the present law for 2 years (Senate version) or 1 year (House version) in order to demonstrate compliance with §89.

Penalties Shifted From Employees to Employer. Both Bills propose changes that shift the penalty for the failure to meet the written plan documentation rules from the employee to the employer. The penalty, called an Excise Tax, is 34% of the employer's total benefit payments for certain specified plans including health, group term life insurance, cafeteria plans, VEBAs, etc. The Bills contain provisions which mitigate these penalties for unintentional errors which are timely corrected.

Small Employer Exemption. Both Bills include special rules for an employer with 20 or less employees. The House version exempts such employers from the testing requirements if it has only one health plan available to all employees on the same basis and at the same cost. (The Senate Version has an 80% Test for small employers.) Both versions permit, for such a qualifying employer, that health plan to satisfy one of the five §89(k) written documentation requirements, the written, single plan document rule, by a plan document issued by a third party insurer.

Conclusion: Good Faith Rule. After Congress returns from its August recess, it is still not likely that employers will have an answer before the end of September or perhaps October. It is likely that §89 will, at a minimum, be delayed to January 1, 1990. However, if an answer is not provided before the end of September or October, the proposed regulations provide that employers who reasonably and in good faith comply with §89 and its legislative history in 1989 will be treated as having satisfied §89.