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TREASURY SEC. BRADY ANNOUNCES A DELAY FOR SECTION 89, BUT NOT REPEAL; SUPPORTS EXEMPTION FROM TESTING FOR SMALL EMPLOYERS

By: Matt W. Zeigler, Esq.

On Monday, May 1, 1989, in a speech before the U. S. Chamber of Commerce, Secretary Brady announced that he had ordered a delay from July 1 to October 1, 1998 in the beginning date for testing plans for compliance with Section 89 regulations. Further he said: "The cost of compliance with Section 89, as it presently stands, is excessive. The law needs to be changed, and we stand ready to encourage, support and work with Congress to revise and improve it".

The Treasury Department has issued a clarifying Notice 89-65, scheduled for publication June 12, 1989, which has officially delayed compliance for both the nondiscrimination testing and the written reasonable notification rules of Section 89 from July 1, 1989 until October 1, 1989. Treasury stated that this announcement may be relied on until final Regulations are published. Under the law up until July 1, 1989, and now through October 1, 1989, Employers can essentially ignore the facts in existence up to that time under special rules set out in the proposed Regulations for Section 89.

A Treasury representative stated, before the Senate Finance Committee, on May 9, 1989, that the reasons for the delay "...are designed to provide Congress with sufficient opportunity to develop legislation before employers are required to expend substantial further resources to comply with the statute".

Secretary Brady, in his testimony before a Senate Postal Subcommittee said that he would support amendment of the present Section 89 Regulations regarding some kind of exemption for small employers from compliance with the nondiscrimination testing of their benefit plans. This would not include exemption from the written documentation requirements of Section 89(k).

As of the time of the writing of this Article, testimony on Section 89 has been taken has been taken by the House Ways and Means Committee and the Senate Finance Committee. Both Chairman Daniel Rostenkowski and Chairman Lloyd Benson support simplification of Section 89. The Bush Administration, in the Treasury Department's prepared testimony before the House said: "The Administration recognizes the enormous administrative burdens imposed on many employers by Section 89...Consequently we agree with (Rostenkowski) that a complete revision of Section 89 is necessary...However, repeal is not a viable option at this time".

Employers have been hopeful for some relief from the stringent requirements of Section 89 and it may come yet this year. However, the idea that tax and simplification legislation could be passed this summer failed to pass the "laugh test" at an ERISA Industry meeting on May 4th. Senate Finance Committee member David Pryor (D-Ark) speculated that such legislation would probably

Michigan Food News, Personnel Notes, published June, 1989: Vol. 43, No. 6

emerge closer to November. This means that the delay to October 1 will likely run out before employers have answers from Congress.

Proposed Simplification.

Both the Senate and the House have introduced Bills designed to simplify Section 89 and which, if passed, would be effective in 1989.

Both Bills as they presently stand keep the written plan qualification standards as required by Section 89(k). Both Bills keep, as an option, the present law rules for testing plans for compliance with the nondiscrimination rules; the employee exclusion rules; the employee eligibility concepts; many of the same definitions and eliminate much of the recordkeeping requirements, at least for nonhighly compensated employees. The House Bill would limit its scope to the testing of health plans and limit penalties to employer-only (not employee) taxes.

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 Section 89. The House's present version of a single "safe harbor" or "cliff effect" plan would require 90% of all employees be eligible to participate in the health plan with a maximum after-tax employee cost of $10.00 per week for the employee-only coverage, and of $25.00 per week for the family coverage. If an employer's plan met the "cliff", then the plan would pass the tests; if not, then the highly compensated employees would have to pay tax on their fringe benefits.

Other proposed changes include raising the definition of part-time employees from the present 17 1/2 hours worked per week to at least 25 worked hours per week. There is an intense lobbying effort to exempt small employers from the testing requirements.

It is important to note that the simplification bills do not delay the revenue raising aspect of Section 89, in the present drafts. It still must be addressed this year. Under the proposed bills, the employer is offered a choice: either use the existing Section 89 law to test and calculate the tax due for 1989 or, if passed, use the methodology of the simplification bills to test and calculate the tax due for 1989 and thereafterwards.

Since the House, the Senate and the Administration all support simplification of Section 89 (and not repeal), it is likely that some change will occur this year. However, in just what form or when that will take place it not certain. On May 9th, the Treasury supported this consensus and stated, before the Senate Finance Committee, that any change must still "...address the major concerns of employers while serving the basic tax policy objectives of the nondiscrimination rules".

For all the confusion that has been created, the Treasury representatives stated before the House on May 2: "...the proposed regulations provide that employers who reasonably and in good faith comply with Section 89 and its legislative history in 1989 will be treated as having satisfied Section 89".