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Employee Tax Matters and Planning For 1991

By: Matt W. Zeigler, Esq.

The Omnibus Budget Reconciliation Act of 1990 signed into law on November 5, 1990 by President Bush represents yet another piece of legislation with significant impact on personnel matters and employee benefits.

The areas addressed here are:

- New Medicare tax on wages above \$53,400.
- 50% tax credit for costs of improvements for the handicapped.
- Repeal of the estate tax freeze, Code Section 2036(c).
- Renewal of educational assistance program.
- Renewal of the 25% deduction for health insurance costs for the self-employed.
- Planning for 1991:
 - Qualified Retirement Plans – restatement required.
 - Higher penalties: 20 – 50% tax on reversions to employers for excess assets of terminated defined benefit plans.
 - The Non-Qualified Retirement Plan alternative.
 - Tax exempt interest on savings bonds for educational expenses.
 - 10% luxury tax.

New Medicare Tax. In 1991, the taxable wage base increases from \$51,300 to \$53,400 as a result of inflation. So employer's will pay a 7.65% social security tax for both the employee and the employer on an additional \$2,100 for a total tax increase of \$321.30.

The Medicare Tax of 1.45% is an element of the 7.65% FICA taxes paid by the employer and the employee. The new provision of the law is that the 1.45% Medicare Tax portion of the FICA tax continues to apply on earned income in excess of the 1991 taxable wage base of \$53,400 up to \$125,000. For highly compensated employees earning \$125,000 or more, the amount of additional tax paid by the employee is \$1,038. This amount is matched by the employer for another \$1,038 for a total new tax of \$2,076. This amount is in addition to the full 7.65% tax already paid on the first \$53,400 of wages. (This is also applicable to self-employed persons.)

New 50% Tax Credit For Handicap Expenditures. The new Americans with Disabilities Act of 1990 ("ADA"), enacted last summer, requires employers to make certain improvements to their facilities to accommodate handicapped employees if they are reasonable. (See this column, October, 1990 issue for a discussion of the requirements of that Act.)

OBRA, 1990 permits a 50% business tax credit for certain qualifying small businesses for an amount of such expenditures of at least \$250 but less than \$10,250. To be able to utilize such a credit, the

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small business/employer must (1) have annual gross receipts of less than \$1,000,000, or (2) employ less than 30 full-time employees working 30 hours or more per week for 20 or more calendar weeks in a year. These expenditures must be related to complying with the ADA, for example, removing architectural barriers, providing interpreters or oral aid to the orally impaired, interpreters or visual aid to the visually impaired, equipment purchases or modification to disabled persons, or related materials or equipment.

Repeal of the estate tax freeze, Code Section 2036(c). This controversial tax provision which taxes the transfer of wealth of a family owned business from parents to their children was repealed by OBRA, 1990. A replacement piece of legislation was drafted by Congress in with the American Institute of Certified Public Accountants in conjunction with the American Bar Association. The replacement legislation deals with the issues of transfer of wealth in terms of a gift taxes and more accurately reflects the extent of control of parents over a business "sold" to their children. There are many planning opportunities for business owners who plan to have their children carry on the family business.

Renewal of Expiring Tax Provisions:

Educational assistance programs. The Internal Revenue Code, Section 127, excludes from tax each year up to \$5,250 in payments by an employer to an employee for educational assistance. Such assistance can include, for example, reimbursement for tuition, books or supplies. The sunset date for this tax free benefit was September 30, 1990. The new sunset date is December 31, 1991.

25% Deduction for health insurance cost for the self-employed. Section 162(l) of the Internal Revenue Code exempts from tax up to 25% of the health insurance costs for a self-employed individual, his spouse and family. This provision was set to expire September 30, 1990. The exemption has been extended to December 31, 1991.

Planning for 1991.

Qualified Retirement Plans. All retirement programs must be amended to comply with the Tax Reform Act of 1986, and the 1987, 1988 and 1989 Tax Acts. That restatement process must be accomplished in the 1991 plan year.

Higher Excise Tax On Defined Benefit Plan Terminations. There is a higher excise tax on reversions to employer-sponsor for the termination of defined benefit plans. The 15% excise tax was increased to 20% so long as the employer establishes a qualified replacement plan or amends the terminating plan to provide for pro rata benefit increases. If an employer fails to establish a plan that meets either of those requirements, then the reversion is taxed at the rate of 50%.

Non-qualified Retirement Plans. Because of the amount of regulations and limitations that are involved in the development and maintenance of qualified retirement plans, some employers are turning to the non-qualified deferred compensation programs as a way to provide extra compensation to themselves or to their highly qualified employees. That alternative is a non-qualified deferred compensation plan. Other than a simple one-page filing with the Department of Labor, there are no government filings. An employer can develop a written plan that will set aside funds each year to be distributed to a key employee upon retirement. In order to not have that income taxed as wages for that year, the funds set aside for the future payment of the benefit cannot be allocated or segregated for that employee and must be reachable by the general creditors of the corporation. Still, it is a tool still available to employers who wish to reward themselves or their valuable employees.

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Tax Exempt Interest On US Savings Bonds For Expenses of Higher Education. Effective beginning in 1990, interest earned on certain US Savings Bonds is exempt from tax if a taxpayer redeems a Bond, for example in 1991, and pays for expenses of higher education during that year. Such educational expenses include tuition and fees for the taxpayer, his or her spouse and dependents. The exemption is a formula that is related to the amount of educational expenses and the amount of Savings Bond interest earned.

10% Luxury Tax. OBRA, 1990 imposed a new 10% luxury tax on the purchase of certain "luxury" goods. This new tax is effective for purchases beginning in 1991. The idea is a tax on the excess of the purchase price above certain floors. A 10% tax is imposed on the excess of the purchase price on automobiles over \$30,000; on boats over \$100,000, jewelry that costs more than \$10,000; furs over \$10,000, and airplanes over \$250,000. For example, if you were to purchase an automobile for \$35,000, a 10% tax would be charged on the \$5,000 over the floor of \$30,000, or a tax of \$500.