

PROPOSED RULEMAKING

DEPARTMENT OF REVENUE

[61 PA. CODE CH. 101]

Payments for Employee Welfare Benefit Plans and Cafeteria Plans

The Department of Revenue (Department), under authority contained in section 354 of the Tax Reform Code of 1971 (TRC) (72 P. S. § 7354), proposes amendments to §§ 101.1, 101.6 and 101.7 (relating to definitions; compensation; and receipt of income) to read as set forth in Annex A.

Purpose of Proposed Amendments

The amendments to §§ 101.1, 101.6 and 101.7 are being proposed 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 TRC (72 P. S. § 7301(d)) under Act 7-1997.

Explanation of Regulatory Requirement

The proposed 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.

The proposed amendments are also being added to notify employers and employees how the provisions of the Personal Income Tax relating to employee compensation in the form of employer-provided facilities or services will be enforced by the Department. There is no constitutional or statutory basis for exempting these noncash fringe benefits from Personal Income Taxation. To be taxable, the benefit has to constitute a foregone profit or additional monetary cost or expense to the employer that is sufficiently substantial in amount to make accounting for it reasonable and practical.

Excluding an item of income from tax merely because it was paid in a form other than money or property raises serious constitutional issues. Utilizing the personal use of the employer's auto as an example, assume that A, B, C and D have the same annual cash compensation (\$50,000), the annual rental cost of the cars in question is each \$3,600, and the following situations apply:

Example 1. A is permitted personal use of his employer's auto at no cost for the entire taxable year.

Example 2. B is directly reimbursed by his employer for the cost B incurred in renting an auto for 1-year's personal use.

Example 3. C is indirectly reimbursed by his employer for the cost C incurred in renting an auto for 1-year's personal use, the employer paying the bill rather than C.

Example 4. D incurs the cost of renting an auto for personal use for the entire taxable year.

Unless the personal use of the employer's auto is included in A's income, B and C would each have \$3,600 more taxable income than A, even though the amounts of their regular pay are identical and each has the benefit of

having free personal use of an auto for a year; and, unless the personal use of the employer's auto is included in A's income, A and D would each have identical taxable incomes and the exclusive, unrestricted possession, use and control of an auto, even though D's disposable income would be \$3,600 less than A's. These are the kinds of results that would cause taxpayers like B, C and D rightly to question whether they are paying more than their fair share of State taxes and what public purpose would be served by excluding the remuneration from tax.

Moreover, unlike the income tax imposed under The Local Tax Enabling Act, there has never been any Personal Income Tax exclusion from "compensation" for payments made by employers and labor unions for wage and salary supplemental programs such as those addressed in the amendments. For example, § 101.6(a) has, since 1972, provided that taxable compensation includes "tax assumed by an employer." Similarly, § 101.6(c)(7) excludes the value of lodging furnished for the convenience of an employer, not the value of lodging furnished for the convenience of the employee.

If the Personal Income Tax law were to say "received either in cash or in property," it could reasonably be inferred that remuneration received neither in cash nor in property was not to be taxed. However, the General Assembly used the words "whether - or," not "either - or." Thus, even if the uniformity clause of the Pennsylvania Constitution were not implicated, it is reasonable to assume that the General Assembly intended the ordinary meaning and function of the word "whether" when it used it in The Local Tax Enabling Act and the TRC.

Compensation other than in cash or in property has been taxed under the Philadelphia earned income tax for some time without legal challenge. In relevant part, the Philadelphia tax is identical to the Commonwealth's Personal Income Tax. Philadelphia's regulations specifically provide that compensation other than in cash such as the personal use of the employer's auto are taxable. Like the Personal Income Tax law, there is also no exclusion from "compensation" under the Philadelphia ordinance for fringe benefits.

Fiscal Impact

The Department has determined that the proposed amendments will have a positive fiscal impact of \$1.9 million to \$2.2 million on the Commonwealth.

Paperwork

The proposed amendments will not generate significant additional paperwork for the public or the Commonwealth.

Effectiveness/Sunset Date

The proposed amendments will become effective upon final publication in the *Pennsylvania Bulletin*. The regulations are scheduled for review within 5 years of final publication. No sunset date has been assigned.

Contact Person

Interested persons are invited to submit in writing comments, suggestions or objections regarding the proposed amendments to Anita M. Doucette, Office of Chief Counsel, PA Department of Revenue, Dept. 281061, Harrisburg, PA 17128-1061, within 30 days after the date of the publication of this notice in the *Pennsylvania Bulletin*.

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 these proposed amendments to the Independent Regulatory Review Commission (IRRC) and the Chairpersons of the House Committee on Finance and the Senate Committee on Finance. In addition to submitting the proposed amendments, the Department has provided IRRC and the Committees with a copy of a detailed Regulatory Analysis Form prepared by the Department in compliance with Executive Order 1996-1, "Regulatory Review and Promulgation." A copy of this material is available to the public upon request.

Under section 5(g) of the Regulatory Review Act, if IRRC has objections to any portion of the proposed amendments, it will notify the Department within 10 days of the close of the Committees' review period. The notification shall specify the regulatory review criteria which have not been met by that portion. The Regulatory Review Act specifies detailed procedures for review of objections raised, prior to final publication of the proposed amendments, by the Department, the General Assembly and the Governor.

(Editor's Note: A proposal to amend § 101.1 remains outstanding at 27 Pa.B. 4436 (August 30, 1997).)

ROBERT A. JUDGE, Sr., Secretary

Fiscal Note: 15-4-2. No fiscal impact; (8) recommends adoption.

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:

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Cafeteria plan—A plan maintained by an employer for the benefit of its employees and under which all participants are employees 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.

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Discriminatory plan—An employe benefit plan where excludable employer contributions or the benefits attributable to employer contributions discriminate in favor of highly compensated participants. 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 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) Food, housing, or 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) Employe discounts.

(M) Transportation and parking.

(ii) The term does not include 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.

* * * * *

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.

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Plan—The term includes temporary or permanent programs or arrangements, 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.

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Wage or salary supplement—

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

(ii) An employer payment to provide benefits under an employe benefit 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:

(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 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.

§ 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, 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, **[no] 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:

* * * * *

(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.

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(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 retire-

ment.] 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.

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 employes 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 employe's annual salary.

(ii) P pays the premiums on behalf of all employes 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 employe'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 employe's wages on the paystubs furnished to employes.

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

(iv) Conclusion: For the employes 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.

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(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.

* * * * *

(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) 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) 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 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 exchanged, sold or otherwise disposed of.

(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 cashed 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 employee wishes to purchase benefits which cost in excess of the employer-provided benefit dollars, the employee shall execute a salary reduction agreement. The cafeteria plan contains the following benefits:

<i>Item</i>	<i>Cost</i>
Medical/Accident Insurance	\$2,000 (individual) \$3,250 (family)
Life Insurance	\$ 150
Dependent Care	\$2,000
Additional Vacation Days	\$ 40/day
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 employees. 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 employees for uninsured medical or dental expenses are taxable as compensation if the employee 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 employee under a spending account or otherwise, and credited to a self-insured medical reimbursement account and drawn upon to reimburse the employee 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 employee 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 were not actually or constructively received, after taking section 125 of the IRC into account.

(ii) They 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 are satisfied, cafeteria plan contributions are taxed under the rules as apply to employer payments for employee 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 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 employee 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 employee as an elective contribution is \$2,500.

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

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

(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

<i>If you elect this Coverage:</i>	<i>You receive this number of Flex Dollars each month</i>
Employe Only	\$152.44
Employe + Children	\$247.44
Employe + Spouse	\$298.80
Employe + Family	\$395.56

Medical Plan Features

	<i>Plan A</i>	<i>Plan B</i>
Deductible Per Person/Family	\$150/\$300	\$500/\$1,000
Per Year		
What the Plan Pays		
Network Provider/Other Provider	90%/75%	80%
Out-of-Pocket Maximum (not including deductible) Per Family Unit Per Year	\$1,150/\$2,875	\$5,500
Network Provider/Other Provider		
Accident Coverage	\$500	\$300
Well Baby Care	Yes	No

1. Medical Plan Prices and Election

	<i>Plan A</i>	<i>Plan B</i>
Employe Only	\$168.94	\$142.34
(Your cost/extra pay)	(-\$16.50)	(+\$10.10)
Employe + Children	\$280.94	\$237.34
(Your cost/extra pay)	(-\$33.50)	(+\$10.10)
Employe + Spouse	\$339.30	\$288.70
(Your cost/extra pay)	(-\$40.50)	(+\$10.10)
Employe + Family	\$452.51	\$385.46
(Your cost/extra pay)	(-\$56.95)	(+\$10.10)

2. Dental Election/Flex Dollars

	<i>What You Pay</i>
Basic Plan Coverage	\$ 0.00
Optional Plan Coverage	
Employe Only	\$ 6.02
Employe + Children	\$11.56
Employe + Spouse	\$11.33
Employe + Family	\$18.12

3. Vision Features Prices and Election

	<i>What You Pay</i>
Employe Only	\$ 6.30
Employe + 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

	<i>What You Pay</i>
Basic coverage only	\$ 0.00
Additional Life	
1x base annual pay	\$ 5
2x base annual pay	\$10
3x base annual pay	\$15

6. Dependent Life Prices and Election

	<i>What You Pay</i>
\$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:

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

(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 to 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 a 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:

<i>Benefit</i>	<i>Option</i>	<i>Cost (monthly)</i>
Medical	Plan B	\$237.34
	Employe & Children	
Dental	Employe & Children	\$ 11.56
Vision	Employe Only	\$ 6.30
Dependent Life	\$10,000 spouse/ \$ 5,000 child	\$ 1.49

(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 employe welfare benefit plan.

(k) Contributions made by an employer for IRC 401(k) plans under a cafeteria plan under which the employe 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 employe or to the employe directly in cash are not excludable from the employe's taxable compensation.

§ 101.7. Receipt of income.

* * * * *

(e) *Present economic benefit.* An amount paid as a contribution shall be considered as received when an employe receives rights, such as coverage under an employe benefit 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 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 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 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.

[Pa.B. Doc. No. 98-631. Filed for public inspection April 24, 1998, 9:00 a.m.]

FISH AND BOAT COMMISSION

[58 PA. CODE CH. 109]

Personal Watercraft

The Fish and Boat Commission (Commission) proposes to amend § 109.3 (relating to personal watercraft). The Commission is publishing this amendment as a notice of proposed rulemaking under the authority of 30 Pa.C.S. (relating to Fish and Boat Code) (code). The proposed amendment relates to the operation of personal watercraft (PWC).

A. *Effective Date*

This proposed amendments will, if approved on final rulemaking, go into effect upon publication of an order adopting the amendment.

B. *Contact Person*

For further information on the proposed change, contact Laurie E. Shepler, Assistant Counsel (717) 657-4546, P. O. Box 67000, Harrisburg, PA 17106-7000. This proposal is available electronically through the Commission's Web site (<http://www.fish.state.pa.us>).

C. *Statutory Authority*

This proposed amendment is published under the statutory authority of section 5123 of the code (relating to general boating regulations).

D. *Purpose and Background*

The proposed amendment is designed to update, modify and improve Commission regulations pertaining to boating. The specific purpose of the proposed amendment is described in more detail under the Summary of Proposal of this Preamble. Prior to consideration by the Commission, the Commission's Boating Advisory Board (Board) considered the proposed amendment and recommended adoption by the Commission.

E. *Summary of Proposal*

PWCs are the fastest growing segment of recreational boating in this Commonwealth. In 1997, the Commission registered about 21,000 PWCs, about 6% of the total number of boats. It is projected that by the year 2000, there will be over 23,000 registered PWCs in this Commonwealth.

The PWC operators are involved in a disproportionate number of boating accidents. In 1996, one third of all reported boating accidents involved at least one PWC, and 61% of all reported collisions between boats involved

at least one PWC. Collisions are the most common type of accident reported, and they are usually caused by the operator not keeping a proper lookout or operating the boat in a reckless manner. Many of the accidents are caused by people new to PWC operation, and nearly all of these accidents are avoidable.

Some PWC operators do not seem to realize that they are operating boats when they operate PWCs. Some do not appear to understand that PWC operators must follow the same laws and regulations as other power boaters. As a result, a disproportionate number of boating regulation violations are by PWC operators. At a recent Commission meeting, over half of all proposed revocations of boating privileges that were considered were for violations by operators of PWC. The majority of the violations were for negligent operation of watercraft. In addition, a high percentage of complaints relate to actual or perceived PWC operational deficiencies. A number of the complaints concern noise issues which, although usually not a violation of Commission regulations, could be avoided if the PWC operator understood ethical operation of these watercraft. Many of the complaints pertain to wake violations and reckless operation.

Boating ethics are an important part of PWC operation that all operators must understand to reduce conflicts on waters of this Commonwealth. Courtesy toward others on the water and people living along the shore cannot be overemphasized. Inconsiderate PWC operators prevent others from enjoying the same rights as they do. Spraying someone on shore, jumping another boat's wake too closely or riding near someone who is fishing have created hard feelings. Once negative opinions are formed, they are difficult to change. "Perception" of wrong doing can be just as strong as actually doing something wrong. PWC operators must be responsible and understand how their activity is being viewed by others.

If everyone who operates a PWC (or any boat for that matter) took a boating course, there would still be some accidents and conflicts. However, there is no question that the information that operators learn in an approved boating course provides operators with information that they would not learn on their own. Presumably, this education will give the operator information that will result in proper boating procedures and ethics. States, such as Connecticut, have indicated that they have had a proportional drop in accidents once they initiated mandatory boating education. Therefore, the Commission proposes to institute a mandatory education program for operators of PWCs and to amend its regulations to provide that effective January 1, 2000, a person may not operate a PWC on the waters of this Commonwealth unless that individual has obtained a Boating Safety Education Certificate.

F. *Paperwork*

The proposed amendment will increase paperwork and will create new paperwork requirements in that, after January 1, 2000, all persons who wish to operate a PWC on Commonwealth waters will need to complete an appropriate boating safety course and receive a certification of completion of the course. The Commission's estimates that there are about 60,000 operators of PWC. They will need to complete a safe boating course and apply for and receive a safe boating certificate prior to January 1, 2000. After the initial response to the training requirement, the Commission estimates that about 20,000 operators of PWC will seek certification each year. In addition to this paperwork requirement, enforcement of this regulation may result in an increase of applications

for duplicate or replacement boating safety certificates, which will have to be carried by operators of PWCs.

G. *Fiscal Impact*

The proposed amendment will have no adverse fiscal impact on political subdivisions. The proposed amendment will impose some new costs on the Commonwealth, acting through the Commission. Conducting additional boating safety courses will result in some additional costs for time and materials. Many of these courses are conducted by Commission volunteers as well as the United States Coast Guard Auxiliary and the United States Power Squadron, but there will be some additional costs for administrative functions related to the increased number of persons completing boating safety courses, as well as overtime for instructors. We estimate that the additional personnel costs should total about \$25,000 per year from the Boat Fund for FY 98-99 and FY 99-2000. After the initial response to the training requirements, the annual additional personnel costs should be about \$10,000 per year. The additional costs for course materials will total about \$7,500 per year for FY 98-99 and FY 99-2000 and \$5,000 per year thereafter. In addition, issuance of approximately 50,000 additional boating safety certificates will impose additional costs of about \$20,000 in FY 98-99 and \$30,000 in FY 99-2000. Thereafter, the cost of printing, issuing and distributing certificates should level off at about \$15,000 per year. All the costs described previously will be paid from the Boat Fund, a special fund administered by the Commission.

The proposed amendment will also impose additional costs on the private sector. Although the number of power boats registered as rental boats by boat liveries totals only about 100 in the entire Commonwealth, those businesses that rent PWCs will face a reduction in business at least in the initial stages of implementation of the mandatory education requirement. If a person cannot rent a PWC unless the person has first completed a boating safety course, some potential customers may be discouraged from renting the watercraft.

The proposed amendment will impose additional costs on the general public. Many boating safety courses are free, but some providers do charge a fee to take a course. It is expected that the private sector (community colleges, private schools, and the like) will come forward to meet some of the demand for boating safety courses and that these costs will be passed on to the members of the general public who take a course.

H. *Public Comments*

Interested persons are invited to submit written comments, objections or suggestions about the proposed

amendment to the Executive Director, Fish and Boat Commission, P. O. Box 67000, Harrisburg, PA 17106-7000, within 60 days of publication of this notice in the *Pennsylvania Bulletin*. Comments submitted by facsimile will not be accepted.

Comments also may be submitted electronically at regulations@fish.state.pa.us. A subject heading of the proposal and a return name and address must be included in each transmission. If an acknowledgment of electronic comments is not received by the sender within 2 working days, the comments should be retransmitted to ensure receipt.

PETER A. COLANGELO,
Executive Director

Fiscal Note: 48A-78. (1) Boat Fund; (2) Implementing Year 1998-99 is \$52,500; (3) 1st Succeeding Year 1999-00 is \$62,500; 2nd Succeeding Year 2000-01 is \$30,000; 3rd Succeeding Year 2001-02 is \$30,000; 4th Succeeding Year 2002-03 is \$30,000; 5th Succeeding Year 2003-04 is \$30,000; (4) Fiscal Year 1997-98\$N/A; Fiscal Year 1996-97\$N/A; Fiscal Year 1995-96\$N/A; (8) recommends adoption.

Annex A

TITLE 58. RECREATION

PART II. FISH AND BOAT COMMISSION

Subpart C. BOATING

CHAPTER 109. SPECIALTY BOATS AND WATERSKIING ACTIVITIES

§ 109.3. Personal watercraft.

* * * * *

(h) [**A person 15 years of age or younger may not operate a personal watercraft on the waters of this Commonwealth, except a person 12 to 15 years of age may operate a personal watercraft if there is a person at least 18 years of age on board the personal watercraft or if the person operating the personal watercraft has obtained a boating safety certificate issued or recognized by the Commission and there are no passengers on board the personal watercraft.**] Effective January 1, 2000, a person may not operate a personal watercraft on the waters of this Commonwealth unless the person has obtained a Boating Safety Education Certificate as defined in § 91.6 (relating to certificates).

[Pa.B. Doc. No. 98-632. Filed for public inspection April 24, 1998, 9:00 a.m.]