54A:6-24

LEGISLATIVE HISTORY CHECKLIST
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(Gross Income Tax--"cafeteria plan")
54A:6-24

LAWS OF: 1995 **CHAPTER:** 111

BILL NO: A1489

SPONSOR(S): Murphy and others

DATE INTRODUCED: March 7, 1994

COMMITTEE: **ASSEMBLY:** Appropriations

SENATE: ---

AMENDED DURING PASSAGE: No Assembly Committee Substitute enacted

DATE OF PASSAGE: **ASSEMBLY:** March 13, 1995

SENATE: May 11, 1995

DATE OF APPROVAL: June 1, 1995

FOLLOWING STATEMENTS ARE ATTACHED IF AVAILABLE:
SPONSOR STATEMENT: Yes

COMMITTEE STATEMENT: **ASSEMBLY:** Yes

SENATE: No

FISCAL NOTE: No

VETO MESSAGE: No

MESSAGE ON SIGNING: No

FOLLOWING WERE PRINTED:
REPORTS: No
HEARINGS: No

KBG:pp

ASSEMBLY SUBSTITUTE FOR

ASSEMBLY, No. 1489

STATE OF NEW JERSEY

ADOPTED FEBRUARY 27, 1995

Sponsored by Assemblywoman MURPHY and
Assemblyman BATEMAN

AN ACT excluding the value of certain qualified employee benefits under cafeteria plans from gross income under the gross income tax, supplementing Title 54A of the New Jersey Statutes.

BE IT ENACTED *by the Senate and General Assembly of the State of New Jersey:*

1. Gross income shall not include the value of an employee's qualified option under a cafeteria plan if the employee does not elect to receive cash and the value of the option is excludable from federal taxable income.

As used in this section:

"Cafeteria plan" means an employee benefit plan that meets the requirements of section 125 of the federal Internal Revenue Code of 1986, 26 U.S.C. §125;

"Qualified option" means an option to receive cash in lieu of a qualified employer-provided benefit which option may only be exercised if the employee derives a substantially similar benefit from a source other than the employer; and

"Qualified employer-provided benefit" means a benefit the value of which is excludable from federal taxable income under a cafeteria plan but which is not a benefit provided pursuant to a salary reduction agreement.

"Salary reduction agreement" means an agreement between an employer and an employee under which the employee individually chooses to reduce the employee's compensation, or to forgo increases in compensation, and to have the amount provided, as an employer-provided benefit, by the employer to the employee; including but not limited to the agreements commonly known as flexible spending accounts and premium conversion options.

2. This act shall take effect immediately and section 1 shall apply to taxable years beginning after its enactment.

STATEMENT

This bill allows a gross income taxpayer to exclude the value of employee "cash-out options" under employer provided cafeteria benefit plans. Cafeteria plans, authorized under section 125 of the federal Internal Revenue Code of 1986, permit an employer to offer employees individual choices among federally nontaxable employer provided benefits and choices between those benefits and cash. The employee must recognize federally taxable income only if receipt of cash is actually chosen. The five permitted benefits are group life insurance, group accident and health insurance, medical cost reimbursement, dependent care services, and cash or deferred arrangements.

This substitute allows the same exclusion from gross income taxation as the bill for which it is a substitute. However, this substitute more clearly states that the value of salary reduction agreements, such as flexible spending accounts, is not allowed as an exclusion from gross income.

Excludes certain cafeteria plan cash-out options from gross income under the gross income tax.

ASSEMBLY, No. 1489

STATE OF NEW JERSEY

INTRODUCED MARCH 7, 1994

By Assemblywoman MURPHY, Assemblymen BATEMAN, Gaffney, Catania, Assemblywoman Vandervalk, Assemblyman DeCroce and Assemblywoman Heck

AN ACT excluding the value of certain qualified employee benefits under cafeteria plans from gross income under the gross income tax, supplementing Title 54A of the New Jersey Statutes.

BE IT ENACTED *by the Senate and General Assembly of the State of New Jersey:*

1. Gross income shall not include the value of an employee's qualified cash election from a cafeteria plan if the employee does not elect to receive cash, the cafeteria plan meets the requirements of section 125 of the federal Internal Revenue Code of 1986, 26 U.S.C.§125, and the value of the cash election is excludable from federal taxable income.

As used in this section:

"Cafeteria plan" means an employee benefit plan that meets the requirements of section 125 of the federal Internal Revenue Code of 1986, 26 U.S.C.§125;

"Qualified cash election" means an election to receive cash in lieu of a qualified employer provided benefit which election may only be exercised if the employee derives a substantially similar benefit from a source other than the employer; and

"Qualified employer provided benefit" means a benefit the value of which is excludable from federal taxable income under a cafeteria plan which mandates that the employee receive a minimum value of benefit, other than as the value of that benefit may be reduced by a qualified cash election. Any value of benefit which exceeds that plan minimum benefit value is not a qualified employer provided benefit.

2. This act shall take effect immediately and section 1 shall apply to taxable years beginning after its enactment.

STATEMENT

This bill provides for an exclusion of the value of employee "cash-out options" under employer provided cafeteria benefit plans. Cafeteria plans, authorized under section 125 of the federal Internal Revenue Code of 1986, permit an employer to offer employees individual choices both among federally nontaxable employer provided benefits and between benefits and cash. The employee must recognize federally taxable income only if receipt of cash is actually chosen. The five permitted benefits are group life insurance, group accident and health insurance, medical cost reimbursement, dependent care services, and cash or deferred arrangements.

Currently, employees may exclude the value of cafeteria plan benefits from New Jersey taxable income only to the extent that excludable benefits are offered under the plan. An employee allowed to select a taxable benefit is taxed on the value of the benefit whether or not the taxable benefit is actually taken. That means that to the extent that a New Jersey taxpayer can elect cash the cafeteria plan benefits of all of the employees covered by the plan are taxable, whether or not the taxable benefit is actually chosen.

Some employer benefit plans allow a "cash-out option" to employees who would otherwise have duplicate health care coverage. Under those plans an employee who is, for example, covered under a spouse's health benefits plan and would otherwise receive duplicate coverage for health benefits is encouraged to drop one of the duplicative coverages by the employers offer of a "cash-out" from the plan. The employee receives a taxable cash benefit instead of the unnecessary health coverage and the employer reduces benefit costs. Both employer and employee benefit from the cash-out.

Because New Jersey law taxes the value of the cash-out option whether or not the cash option is actually taken, the efficient use of cash-out options is discouraged. This bill provides a gross income tax exclusion for the value of a cash option. The exclusion is restricted to cash options under plans that only allow cash-outs for employees who demonstrate their other source of coverage, and under this bill such an employee will only recognize income under a cafeteria plan if the cash-out is chosen.

Excludes certain cafeteria plan cash-out options from gross income under the gross income tax.

ASSEMBLY APPROPRIATIONS COMMITTEE

STATEMENT TO

ASSEMBLY, No. 1489

with Assembly committee amendments

STATE OF NEW JERSEY

DATED: JANUARY 19, 1995

The Assembly Appropriations Committee reports favorably Assembly Bill No. 1489, with committee amendments.

Assembly Bill No. 1489, as amended, allows a gross income taxpayer to exclude the value of employee "cash-out options" under employer provided cafeteria benefit plans. Cafeteria plans, authorized under section 125 of the federal Internal Revenue Code of 1986, permit an employer to offer employees individual choices among federally nontaxable employer provided benefits and choices between those benefits and cash. The employee must recognize federally taxable income only if receipt of cash is actually chosen. The five permitted benefits are group life insurance, group accident and health insurance, medical cost reimbursement, dependent care services, and cash or deferred arrangements.

Currently, employees may exclude the value of benefits offered under a cafeteria plan from New Jersey taxable income only to the extent that the benefits would be excluded by a specific provision of New Jersey tax law if offered independently of a cafeteria plan. Employees with cafeteria plans that allow them to select a benefit that would be taxable if offered independently of a cafeteria plan are taxed on the value of the benefit whether or not the taxable benefit is actually taken. To the extent that New Jersey employees can elect to receive cash, the amount of the available cafeteria plan cash election of each of the employees covered by the plan is taxable, whether or not the cash is actually taken.

Some employer benefit plans allow a "cash-out option" to employees who would otherwise have duplicate health care coverage. Under those plans an employee who is, for example, covered under a spouse's health benefits plan and would otherwise receive duplicate coverage for health benefits is encouraged to drop one of the duplicative coverages by the employer's offer of a "cash-out" from the plan. The employee receives a taxable cash benefit instead of the unnecessary health coverage and the employer reduces benefit costs.

This bill provides a gross income tax exclusion for the value of a cash-out option. The exclusion is restricted to cash-out options under plans that only allow cash-outs for employees who demonstrate their other source of coverage. Under this bill such an employee will only recognize income under a cafeteria plan if the cash-out is exercised and cash is actually received.

FISCAL IMPACT:

If New Jersey were an average state then, based on national data, expected revenue loss under the bill would be $3.5 million annually. However, New Jersey has one of the highest percentages of employees who receive employer provided health benefits, 20 percent above the national average, is in region which has the highest health costs, over 10 percent above the national average, and New Jersey wages are generally higher than the national average. Because employers use cafeteria plans and cash-out options to control wage and benefit costs, the distinctive New Jersey factors suggest that the expected revenue loss under the bill could exceed $10 million annually.

However, the theoretical revenue impact is based on the assumption that employers are withholding, and taxpayers are reporting, the value of a cash-out option as taxable income. It is likely that there are substantial numbers of employers and taxpayers who are unaware of their responsibility to report cash-out options as New Jersey taxable income. If there are many taxpayers who are not currently reporting cash-out options as income, $10 million might overstate the effective revenue loss, except as audits might uncover underpayments.

COMMITTEE AMENDMENTS:

The committee made technical amendments that clarify the distinction between the availability of the option to receive cash and the actual election to receive cash.