



White Paper: Taxation of Educational Assistance



Introduction

Employers may offer many different fringe benefits for a variety of reasons. These reasons may include wellness programs, employee morale, employee improvement through education, employee retention or to increase recruiting of qualified employees. This white paper discusses the taxation requirements for an educational assistance program.

Educational Assistance

An educational assistance program is a benefit offered to employees to pay the tuition for college course working towards a degree program. The degree can be undergraduate or the graduate level. Educational assistance provided to employees under an educational assistance program can be excluded from employees' wages. An educational assistance program is a separate written plan - sponsored by an employer - that provides educational assistance only to its employees.



Educational assistance means the amounts an employer pays or incurs for employees' education expenses. These expenses generally include the cost of books, equipment, fees, supplies, and tuition.

These expenses do not include the cost of a course or other education involving sports, games, or hobbies, unless the education:

- Has a reasonable relationship to the employer's business, or
- Is required as part of a degree program

Education expenses do not include the cost of tools or supplies (other than textbooks) the employee is allowed to keep at the end of the course. Nor do they include the cost of lodging, meals, or transportation. This applies even if the employee is taking attending an online college or program and must travel to attend live classes or to take live tests during the semester.

Employers can exclude up to \$5,250 of educational assistance provided to an employee under an educational assistance program from the employee's wages each year.



Example 1: Employee F is attending the local university working towards a degree in accounting. Her company has an educational program that reimburses her for the cost of the tuition at the end of each semester after she submits a final grade of B or higher. She has taken four courses this year for a total of \$2,985.00. The reimbursement has not exceeded the \$5,250 limit, so none of the payment is taxable income to the employee.

If an employer does not have an educational assistance plan, or provides an employee with assistance exceeding \$5,250, they can exclude the value of these benefits from wages if they are working condition benefits.

Property or a service provided is a working condition benefit to the extent that if the employee paid for it, the amount paid would have been deductible as a business or depreciation expense.



Example 2: Employee R has a degree in accounting and works in the finance department of the company. The company does not have an educational assistance program. Employee R needs to take a refresher finance course at the local university to prepare for a new project she will be working on. Since the course is strictly job related, the employer may pay for the course and it will not be considered taxable income.

Educational Assistance Program

An educational assistance program is a separate written plan sponsored by an employer that provides educational assistance only to its employees. The program qualifies only if all of the following tests are met:



- The program benefits employees who qualify under rules set up by the employer that do not favor highly-compensated employees. To determine whether a program meets this test, employers should not consider employees excluded from the program who are covered by a collective bargaining agreement if there is evidence that educational assistance was a subject of good-faith bargaining.
- The program does not provide more than 5% of its benefits during the year for shareholders or owners. A shareholder or owner is someone who owns (on any day of the year) more than 5% of the stock or of the capital or profits interest of the business.
- The program does not allow employees to choose to receive cash or other benefits that must be included in gross income instead of educational assistance.
- An employer must give reasonable notice of the program to eligible employees.

The program can cover former employees if their employment is the reason for the coverage.

For this exclusion, a highly compensated employee for 2016 is an employee who meets either of the following tests:

1. The employee was a 5% owner at any time during the year or the preceding year.
2. The employee received more than \$120,000 in pay for the preceding year.

Employers can choose to ignore test 2 above if the employee was not also in the top 20% of employees when ranked by pay for the preceding year.