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EDUCATIONAL ASSISTANCE PROGRAMS

By: Matt W. Zeigler, Esq.

How does an employer attract and keep on the payroll highly motivated personnel? How does an employer stimulate employees to improve their own attitude and productivity? One way to do that is to offer a tax-free employee benefit called an Educational Assistance Program.

An Educational Assistance Program under Section 127 of the Internal Revenue Code is a way for an employer to pay for some expenses of an employee to further his or her education. That employee will not have to include such payments in his or her taxable income. Since these payments are not wages to the employee (rather they are treated, for tax purposes, more like the premiums for health insurance), the employer does not have to pay social security taxes (FICA), or Federal Unemployment taxes (FUTA) on the amounts paid.

An Educational Assistance Program is a way for an employee to continue his or her education without some of the limitations that an individual employee faces if he or she were to pay on their own the costs of tuition and books. Those employee paid costs are not tax deductible on the employee's own tax return, that is, such costs are paid with after tax dollars. The only kind of expenses that an employee can deduct on his or her own tax return must be related to the furtherance of a degree that is directly related to the working life of that employee. For example, a person hired as a teacher who is required to complete their degree program will be able to deduct, as an itemized deduction, the costs of that program.

Our U.S. Congress has kept extending the life of this employee benefit program on a year by year basis, and it is currently set to expire December 31, 1991. However, over the past several years, the Congress has routinely continued to extend the tax deductibility of these payments. With the current "crisis" in our educational community, it is expected that Congress will continue to exclude the benefits from taxation.

Covered Expenses. Expenses that can be paid for and deducted under an Educational Assistance Program include the employer payment of tuition, fees, books, supplies and equipment. The employee may retain the textbooks after the completion of the course work without paying tax on them. Expenses that do not qualify for tuition assistance include lessons in sports, games or hobbies not related to the business of the employer. However, if such programs are a required part of a qualified educational degree program, even these expenses would be covered.

The maximum amount of employer-provided expenses that can be paid tax-free on behalf of an employee is any amount up to \$5,250 per year.

The kind of expenses that may not be tax-free are tools or supplies that an employee may retain following the class. However, while tools, supplies, meals, lodging or transportation are not be deductible under Section 127 of the Code (dealing with Educational Assistance Programs), when these

expenses are reimbursed to the employee, they may qualify for deduction under Section 162 of the Code as an ordinary business expense.

Requirements of the Program. The employer's Educational Assistance Program must be evidenced by a separate written plan that does not provide any other employee benefits. The plan must state the requirements for participation or eligibility, such as age, full-time or hours worked per week, or a grade requirement in order to receive the benefit. Further, the program must state the amount of the benefits to be provided and the substantiation required to insure that the institution qualifies as one granting a degree program.

The program must be for the exclusive benefit of employees and may not supply benefits to spouses of employees or their children.

If the program were to provide the employees with a choice between receiving the tuition assistance benefit or cash, as an alternative benefit, the program would not qualify under Section 127.

Another limitation is the amount of benefits that can be paid on behalf of the highly compensated employees. The nondiscrimination rule of Section 127 of the Code requires that no more than 5% of the total of all the benefits paid under the program can be provided to the highly compensated employees. For purposes of this kind of program, a highly compensated employee is defined as a person who has a 5% or more stockholder interest in the employer or holds a more than 5% interest in the profits of the employer.

Another requirement of the program is that notice must be given to the employees of its terms, conditions and limitations. However, the employer is not required to file for a favorable determination letter as required for a profit sharing or other qualified retirement plan program.

The only mandatory governmental filing is the annual 5500 return. However, it is a simplified report. The only information to be required to be reported is the employer identification information, the number of employees receiving the benefits under the plan and the amount of the benefits provided to participants under the plan.

Program Suggestions. A tuition assistance program should state the amount of benefits provided under the plan, employment prerequisites, such as full-time employment, a service requirement, like one year of employment, or a job rating performance standard. In addition, the program should specify that the employer has the right to approve the institution selected by the employee, a grade requirement, for example, "B" or better, or any post service employment requirement prior to reimbursement to insure some benefit to the employer that the employee will not immediately move on to another, greener pasture.

Conclusion. A tuition assistance program can convey to employees that an employer wishes to encourage, train, and advance employees within the organization. It can foster growth and motivation to employees. But perhaps even more than those benefits, you will have employees who find themselves a respected and valued part of your team in providing service, responsibility and a sense of caring to your customers.