BoardmanClark

School Law FYI

MAY 2019

Tax Consequences of Tuition Reimbursement Agreements

Many districts have entered into formal or informal Tuition Reimbursement Agreements with some of their teachers or administrators. Sometimes the purpose of the reimbursement agreement is so individuals can obtain a new certification or skill which will hopefully benefit the district at some point down the road. Other times the purpose is to provide an incentive to retain existing employees, or attract new employees.

One compliance concern for a district is making sure that the amounts reimbursed or paid are treated appropriately as either taxable or nontaxable income. From a tax perspective, there are two ways under the Internal Revenue Code (IRC) that reimbursements for education expenses under reimbursement agreements can be excluded from income and not become taxable wages for either the employee or the employer:

1. Educational Assistance Program (IRC Section 127)
2. Working Condition Fringe Benefit (IRC Section 132)

If the reimbursement does not meet the requirements of either of those sections, then the reimbursement paid will be treated as a taxable benefit subject to income tax, FICA, and other withholdings.

For both of the above paths, whether a district reimburses the employee directly or pays the expenses directly to a college or university does not affect the taxability of the reimbursement. Also, the district can place additional requirements on employees without affecting the taxability of the reimbursement. For example, a district can require that an employee receive a certain academic grade in order for the district to reimburse the employee, such as requiring a "B" or higher.

EDUCATIONAL ASSISTANCE PROGRAM

IRC Section 127 allows districts to reimburse up to $5,250 per employee, per year, for educational expenses, and these reimbursements will be excluded from wages and not be taxable to the employee who received the reimbursement.

The main requirements under Section 127 are:

1. The terms of the reimbursement arrangement must be in a written document. Generally these are part of a separate plan document for a larger class of employees rather than a one-off benefit provided to a single employee. These plans are supposed to be open to all employees or at the very least an entire class of employees.
2. The district cannot provide the benefit to dependents or spouses of employees.

3. The district cannot discriminate in favor of highly compensated employees.

4. Employees eligible for the plan must have reasonable notice of such eligibility.

WORKING CONDITION FRINGE BENEFIT

Amounts reimbursed or paid for education can also be excluded as a working condition fringe benefit under IRC Section 132(a)(3). Under this section, there is no IRS imposed cap on the maximum amount that can be reimbursed in a year (the expenses must just be reasonable).

To qualify as a working condition fringe benefit, the following requirements must be met:

1. The education the employee is being reimbursed for must maintain or improve skills required by the individual in his or her employment, or meet the express requirements of the individual's employer, or the requirements of applicable law or regulations, imposed as a condition to the individual's retaining an established employment relationship, status, or rate of compensation.

2. The education the employee is being reimbursed for **cannot** be required in order to meet the minimum educational requirements for qualification in the employee's employment or other trade or business, or **cannot** lead to the employee qualifying for a new trade or business.

If the education is to allow an employee to obtainthe minimum requirements to teach [for instance a bachelor's degree is required by law or by the employer, and the employee does not have a bachelor's degree] or allows the employee to qualify for a non-teacher job [such as a business teacher taking classes to qualify as an accountant], there is a risk that any reimbursement for education for such purposes would not meet the requirements as a working condition fringe benefit and would be taxable compensation, unless part of a Section 127 plan (as discussed above).

If, however, the education is to add new skills or maintain old ones (a teacher or administrator getting a master's degree in education for instance), and the education is not being obtained to qualify for a new non-teaching position, then the reimbursement could qualify as a working condition fringe benefit.

Even where someone is taking classes toward a new position within the district, the IRS has interpreted this fairly generously. In one case a college professor took a tax deduction for getting his PhD which was required for him to be a college president. The IRS explained that the PhD is a course of study that maintains or improves skills required in his current employment. His potential employment as college president was not a new trade or business, but rather a change of duties in the same general type of work involved in his current employment as a professor. IRS Rev. Rul. 68-580, 1968-2 CB 72.

Based on this IRS Revenue Ruling, if a district pays a teacher or principal to obtain their PhD (or other training) to become a district administrator, the district could likely exclude this payment from the individual's wages.

Since the working condition fringe benefits tests are fact intensive, it might be worth it for a district offering these benefits to do a quick review with counsel to make sure that the expenses would qualify and not be taxable benefits.

OTHER CONSIDERATIONS

One question that comes up in these circumstances is the treatment of food, travel, and lodging expenses that might be incurred and the employee would like them reimbursed. If the individual is incurring these expenses primarily to obtain education (and this education qualifies as non-taxable under the IRC minimum qualifications), expenses for travel, meals, and lodging can be reimbursed without it being taxable income.

Another area school districts are frequently concerned about is whether they can recoup some or all of the payments made to employees back from such employees who either fail to complete a program or leave the

district shortly after they complete a program. The answer is yes; however, repayment obligations need to be spelled out and structured correctly. For example, repayment for someone who leaves generally has to be graduated, such as the employee agrees to repay 1/3 of the cost of the program for each year the employee leaves before the employee has worked three years after finishing the program.

Tuition Reimbursement Agreements can be a useful tool for school districts. Taking time to structure such agreements properly can help avoid undesirable tax consequences for the employee and the district, and avoid other potential issues as well.

PRIMARY AUTHORS

Chris Schmidt

(608) 286-7157
CSCHMIDT@BOARDMANCLARK.COM

Brian Goodman

(608) 283-1722
BGOODMAN@BOARDMANCLARK.COM

■ Michael J. Julka	(608) 286-7238	■ Richard Verstegen	(608) 283-7233	■ JoAnn M. Hart	(608) 286-7162
■ Doug E. Witte	(608) 283-7529	■ Eileen A. Brownlee	(608) 822-3251	■ M. Tess O'Brien-Heinzen	(608) 283-1798
■ James K. Ruhly	(608) 283-1738	■ Steven C. Zach	(608) 283-1736	■ Brian P. Goodman	(608) 283-1722