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Employee Education Subsidies: Tax Implications

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Educational reimbursement programs are a common employee benefit among health care organizations. Programs can be established to assist employees in paying for tuition, books and fees in the pursuit of continuing education while on the job. If your organization sponsors such an arrangement, is it getting the best bang for its buck? If structured correctly, these arrangements can provide tax-favored benefits from both an employee and employer perspective.

Generally, if an organization pays for an expense on behalf of an employee, the tax rules require the employee be taxed on the amount paid by the organization. If an educational assistance program meets certain requirements, however, the benefits may be tax free to the individual and the employer can avoid paying FICA and FUTA taxes on the value of the expense. There are currently two tax-favored structures available to health care organizations regarding educational assistance.

The first is a formal educational assistance program, often called a 127 plan, named after the section of the Internal Revenue Code which gives it beneficial tax treatment. Generally, a 127 plan must:

1. have a written plan document;
2. provide only educational assistance (i.e. no choice between cash or benefits);
3. limit the amount of tax-free benefits paid on a calendar year basis to \$5,250; and
4. not discriminate in favor of highly compensated employees.

Educational coursework reimbursed under a 127 plan does not have to be work-related but sports, games or hobby-related courses are generally not eligible (unless part of a degree program). Both graduate and undergraduate programs are currently eligible under a 127 plan. In addition, there may be other important provisions that should be included in the written plan to reflect the mutual understanding of the terms between the parties, although not necessarily required from a tax perspective.

The second tax-favored arrangement is an educational reimbursement working condition fringe benefit. Unlike a 127 plan, this type of arrangement does not require a written plan document, does not have an annual dollar limitation and discrimination is not an issue, but the types of eligible activities are narrower in scope. The educational course is required to be job-related and either (1) expressly required by the employer or by law to remain in the occupation, or (2) maintains or improves job skills for

the occupation.

Note that the employer-provided tax benefits under Section 127 are slated to expire on December 31, 2012 unless Congress acts to extend Section 127 as it has done for many years (sometimes retroactively).

If you would like more information on implementation of or compliance with these programs, or would like to discuss the specifics of your organization's arrangements and ways to make them more tax favorable, please contact the Holland & Hart Employee Benefits Practice Group at 303-295-8094, or alternatively at kaselzer@hollandhart.com.

For questions regarding this update, please contact
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