

Office of Chief Counsel
Internal Revenue Service
Memorandum

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date: July 27, 2010

to: _____, EO Revenue Agent

from: Area Counsel (Mid-Atlantic)
(Tax Exempt & Government Entities)

subject: _____ : Graduate Level Tuition Waivers as Taxable Fringe Benefits

In a memorandum dated April 28, 2010, you requested advice regarding the above issue. This advice may not be used or cited as precedent in other cases. This writing may contain privileged information. Any unauthorized disclosure of this writing may have an adverse affect on privileges, such as the attorney-client privilege. If disclosure becomes necessary, please contact this office for our views.

ISSUE

Whether graduate level tuition waivers provided by an educational institution to its employees qualify for exclusion from gross income or constitute a taxable fringe benefit.

SUMMARY CONCLUSION

Under I.R.C. § 127(a), graduate level tuition waivers provided by an educational institution to its employees are excludable in an amount of up to \$5,250 per calendar year if the tuition waivers are provided as part of an educational assistance program described in I.R.C. § 127(b). Any tuition waiver or reduction provided in excess of this amount is a taxable fringe benefit for income tax purposes, unless the education is necessary for the employee to maintain or acquire skills necessary for their current employment or the education meets an express requirement by their employer, law or regulations, status or rate of compensation and thus would qualify as a deductible business expense under I.R.C. § 162 had the employee paid the tuition himself.

FACTS

adopted a Graduate and Post Graduate Tuition Benefits Program (the “program”) which offers faculty, regular, full-time staff and limited service employees the opportunity to advance their personal and professional development by providing tuition assistance for courses, including several graduate level courses. The program is available to employees who have completed at least one year of full-time employment with . After one year of full-time employment, the employee can receive a waiver benefit of 50% of the cost of tuition. After two years of continuous full-time employment, the employee can receive a waiver benefit of 100% of the cost of tuition. An employee receiving graduate level tuition waivers must complete an Employee Waiver Contract which stipulates that he or she will reimburse if the employee leaves employment within one year of completion of the graduate coursework.

LAW AND ANALYSIS

I.R.C. § 117(d) Qualified Tuition Reduction

A tuition waiver for graduate level courses offered to employees of an educational institution, as described in I.R.C. § 170(b)(1)(A)(ii), is excludable as a qualified tuition reduction only if the recipient of the waiver is a graduate student engaged in teaching or research activities for the institution. I.R.C. § 117(d) provides that any qualified tuition reduction is excludable from gross income. A qualified tuition reduction is the amount of any reduction in tuition provided to an employee of an education institution for education *below the graduate level* at such organization. I.R.C. § 117(d)(2). However, in the case of graduate students who are engaged in teaching or research activities at the educational institution, tuition reduction for graduate level education is considered a qualified tuition reduction. I.R.C. § 117(d)(5). In PLR 9040045, 1990 WL 700556, this section was interpreted narrowly to apply only to teaching and research assistants who are graduate students and not faculty or staff engaged in research or teaching. Therefore, any tuition reductions or waivers for graduate level courses given by to its employees are not excludable under I.R.C. § 117 unless those employees are graduate students acting as teaching or research assistants for .

I.R.C. § 127 Educational Assistance Programs

Amounts paid or expenses incurred by an employer for educational assistance to an employee are not includable in the employee’s gross income, as long as the assistance is part of an educational assistance program as defined by § 127(b). I.R.C. § 127(a). Educational assistance is defined as (A) payment by the employer of expenses incurred by or on behalf of an employee for the education of an employee; and (B) the provision, by an employer, of courses of instruction for such employee. I.R.C. § 127(c). An educational assistance program is a separate written plan for the exclusive benefit of its employees. I.R.C. § 127(b)(1). The plan must not discriminate in favor of highly compensated employees, and no more than 5% of the amounts paid or incurred by the employer may be provided for the class of individuals who are shareholders or owners

holding more than 5% of the stock or interest. I.R.C. § 127(b)(2-3). The plan may not offer alternative benefits to employees who choose not to partake in the educational assistance. I.R.C. § 127(b)(4). Finally, the program need not be funded and reasonable notification must be provided to eligible employees. I.R.C. § 127(b)(5-6). An employee can exclude up to \$5,250 from gross income of educational assistance as defined under this section. I.R.C. § 127(a)(2). Any education assistance furnished to an employee that is greater than \$5,250 per year must be included as taxable income.

Assuming the tuition waiver program at _____ meets the requirements of an educational assistance program listed above, it should qualify for an exclusion of up to \$5,250 under I.R.C. § 127, even for graduate level education. Prior to amendment in 2001, educational assistance under this section did not include payment for “any graduate level course of a kind normally taken by an individual pursuing a program leading into law, business, medical, or other advanced academic or professional degree.” For courses beginning after 12-31-2001, educational assistance is excludable for graduate programs. Therefore, the graduate level educational assistance provided by the educational institution employer is excludable up to \$5,250 as long as the courses began after 12-31-2001 and the educational assistance program meets the requirements in I.R.C. § 127(b).

Both §§ 127 and 117 can be applied to exclude from an employee’s income funds paid out for an employee’s education, and tuition waived for an employee of an educational institution. I.R.C. § 127(c)(6) states that this section shall not be construed to affect the deduction or inclusion in income of amounts which are paid or incurred, or received as reimbursement under §§ 117, 162 or 212. In addition, I.R.C. § 127’s definition of educational assistance includes courses provided directly by the employer, as an educational institution would do in the case of tuition reduction or waiver.

Treas. Reg. § 1.127-1(a) provides that

[t]he gross income of an employee does not include—(a) Amounts paid to, or on behalf of the employee under a qualified educational assistance program as described in § 1-127.2, or (b) The value of education provided to the employee under such a program.

Treas. Reg. § 1.127-2(c)(4) provides that

[e]ducation paid for or provided under a qualified program may be furnished directly by the employer, either alone or in conjunction with other employers, or through a third party such as an educational institution. Education is not limited to courses that are job related or part of a degree program.

A tuition reduction or waiver offered by an educational institution to its employees may be excludable under § 127 even if it is not excludable under § 117. For example, in

P.L.R. 9616014, 1996 WL 188048, the Service stated that a tuition reduction for graduate-level courses paid by a university to faculty by reason of the employer-employee relationship was not a “qualified” tuition reduction for tuition below the graduate level and would be includible in gross income “unless excluded by some other provision, e.g., expired section 127.”

Finally, the legislative history of § 127 gives no indication that educational institution employers are precluded from offering qualifying educational assistance programs even where they waive tuition rather than paying out funds for their employee’s education. The stated purpose for the exclusion under § 127 is two-fold: (1) to increase the levels of education and training in the workforce and (2) to eliminate the potential complexity of determining whether training and education benefits provided by an employer constitute job-related expenses that are deductible by the employee. S. REP. 102-300, at 3 (1992). Neither of the stated purposes for the exclusion under I.R.C. § 127 indicate any reason why educational institution employers would not be included as beneficiaries of this exclusion. In 1999, the Senate pushed to include graduate education in the § 127 exclusion, stating that employers benefit substantially from the approximately one million persons per year participating in employer educational assistance programs. S. REP. NO. 106-54, at 51 (1999). It appears that Congress intended to support all educational assistance programs under § 127 and not just those offered by non-educational institution employers.

We note that there are some significant distinctions between §§ 117(d) and 127. For example, § 117(d) encompasses scholarships provided to the spouse and dependents of the employee who are not themselves employees and to retired employees. Only the employee, not the employee’s dependents, can obtain the benefits of § 127. See § 127(c)(2). However, § 127 can apply to self employed individuals. A § 127 plan must be a separate plan in writing, (see §127(b)(1)); reasonable notification of the plan must be made to eligible employees (see § 127(b)(6)); and the plan cannot offer the employee a choice between educational benefits and includable compensation (see § 127(b)(4)). Thus, not every tuition reduction agreement provided by an educational institution to its employees will meet the requirements of an educational assistance program under § 127.

I.R.C. § 132 Certain Fringe Benefits

The Code provides that amounts paid or expenses incurred by an employer for education or training provided to an employee which are not excludable under § 127 shall be excluded from gross income if (and only if) the payments constitute a working condition fringe. I.R.C. § 132(j)(8). Because I.R.C. § 127 allows only for an exclusion of up to \$5,250 per year, I.R.C. § 132(j)(8) may allow for any educational assistance above that amount to be excluded from the employee’s gross income. A working condition fringe benefit is any property or services provided to an employee to the extent that, if the employee had paid for it, the payment would be allowable as a deduction under I.R.C. §§ 162 or 167. I.R.C. § 132(d).

Generally, expenditures for education are deductible under § 162 if the education (1) maintains or improves skills required by an individual in his employment, trade or business; or (2) meets the express requirements of the individual's employer, law or regulations, status or rate of compensation. Treas. Reg. § 162-5(a). Educational expenses are not deductible if they are incurred to meet minimum educational requirements for the individual's current position or to qualify the individual for a new trade or business. Treas. Reg. § 1.162-5(b).

In Chief Counsel Advice 200231016, 2002 WL 1773839, the Service considered these authorities along with the enactment of I.R.C. § 132(j)(8) and determined that tuition reductions provided for graduate level education by an educational institution employer that do not qualify for exclusion under § 117(d) cannot be excluded as a working condition fringe benefit under § 132.

However, if the tuition reductions qualify as educational assistance program benefits (including graduate level classes) that can be excluded under § 127 up to the \$5,250 cap, then the excess amount over the \$5,250 cap could be excluded as a working condition fringe under § 132, if it meets the requirements of that section. The regulations under § 1.132 provide that, "if the amounts paid by the employer are for education relating to the employee's trade or business of being an employee of the employer so that, if the employee paid for the education, the amount paid could be deducted under section 162, the costs of the education may be eligible for exclusion as a working condition fringe." Treas. Reg. § 1.132(f)(1) (emphasis added). Although tuition reduction for graduate education would not qualify for exclusion under I.R.C. § 117(d), in the specific case where the tuition reduction meets the requirements for exclusion under § 127, and amounts exceeding the \$5,250 cap qualify as a working condition fringe benefit, such amounts would be excludible. This result would be consistent with I.R.C. § 132(j)(8) and Treas. Reg. § 132-1(f)(2), which provides that:

[i]f another section of Chapter 1 of the Internal Revenue Code of 1986 provides an exclusion from gross income based on the cost of the benefit provided to the employee and, such exclusion is a limited amount, section 132 and the regulations thereunder may apply to the extent the cost of the benefit exceeds the statutory exclusion (*such as in the case of educational assistance plans under section 127*) (language added).

This regulation is very similar to the exclusion allowed by I.R.C. § 132(j)(8); in fact, I.R.C. § 132(j)(8) reinforces this principle. In enacting I.R.C. § 132(j)(8), Congress explained that:

[t]he provision clarifies that, to the extent employer-provided educational assistance is not excludable under section 127 because it exceeds the maximum dollar limitation or because of the limitation on graduate-level courses, it may be excludable from income as a working condition fringe

benefit (132(d)), provided the requirements of that section are otherwise satisfied.

H.R. REP. 101-247, at 1172 (1989).

However, § 132(l) does not allow for exclusion of fringe benefits for which the tax treatment is expressly provided in any other section of the Code. I.R.C. § 132(l).

Treas. Reg. § 1.132-1(f)(1) provides that

[i]f the tax treatment of a fringe benefit is expressly provided for in another section of Chapter 1 of the Internal Revenue Code of 1986, section 132 and the applicable regulations (except for section 132(e) and the regulations thereunder) do not apply to such fringe benefit. For example, . . . because section 117(d) applies to tuition reductions, the exclusions under section 132 do not apply to free or discounted tuition provided to an employee by an organization operated by the employer, whether the tuition is for study at or below the graduate level. Of course, if the amounts paid by the employer are for education relating to the employee's trade or business of being an employee of the employer so that, if the employee paid for the education, the amount paid could be deducted under section 162, the costs of the education may be eligible for exclusion as a working condition fringe.

Additionally, the House Report for the Deficit Reduction Act of 1984, which enacted § 132, indicates that § 132 is not applicable if another code section provides rules for the "general type of benefit" at issue. H.R. REP. 98-432 (II), at 1608 (1984).

However, § 117(d) does not apply in this particular case because § 117(d) applies only to "qualified tuition reductions". The arrangements in this case are not "qualified tuition reductions" as defined in § 117(d)(2) because this arrangement provides for education at the graduate level. Instead, the benefit provided may be an educational assistance program under § 127, as long as it meets the additional requirements imposed by § 127(b). As noted above the regulations state that those amounts that exceed the cap of § 127 can be deducted as a working condition fringe as long as the educational assistance meets the requirements of § 127 and would qualify as a working condition fringe under § 132. While § 132 cannot be used to exclude graduate level tuition reductions that fail the requirements of §§ 117(d) and 127, educational assistance (including graduate level classes) that would qualify for exclusion under § 127 but for the statutory cap of \$5,250 can be excluded as a working condition fringe if the assistance meets the requirements of §§ 127 and 132.

CONCLUSION

Graduate level tuition waivers are not excludible under I.R.C. § 117(d) unless the employees are graduate students working as research or teaching assistants. On the other hand, graduate level tuition waivers are excludible under I.R.C. § 127 up to \$5,250 per year, provided the program meets the requirements in I.R.C. § 127(b). Finally, graduate level tuition waivers which exceed the limitations of I.R.C. § 127 may be excludible under I.R.C. § 132 as long as the courses are part of an educational assistance program under § 127 and the tuition would be deductible under § 162 if the employees paid it themselves.

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