

INTERNAL REVENUE SERVICE

August 14, 2000

Number: **2001-0002**

Release Date: 3/30/2001

UIL: 132.03-00

CC:TEGE:EOEG:ET2

COR-113637-00



Dear [REDACTED]:

This relates to your inquiry to Mr. Thomas Burger dated July 5, 2000, regarding the income and employment tax treatment of employer-provided educational assistance. You indicate that, pursuant to an [REDACTED] policy, certain [REDACTED] employees are provided with tuition-free graduate course study at any of [REDACTED] state universities. The fair market value of this tuition reduction is included in the employees' gross income and is treated as wages for employment tax purposes.

As discussed below gross income and wages generally include all compensation for services unless specifically excluded by law. Employer-provided educational assistance may be excludible from gross income and wages, however, if it is provided under an educational assistance program or as a working condition fringe. If the educational assistance is excludible from gross income and wages under either of these provisions, it is irrelevant that the educational assistance would otherwise be includible in gross income and wages. Thus, an employee may concurrently receive employer-provided educational assistance some of which is excludible from gross income and wages and some of which is not.

Gross Income and Wages

Gross income means all income from whatever source derived, including fringe benefits. Similarly, wages subject to Federal employment taxes includes all remuneration for employment unless otherwise excepted. The remuneration may be in cash or in other forms, including fringe benefits. Thus, the fair market value of any fringe benefit received from an employer must be included in an employee's gross

income and must be included in wages for Federal employment tax purposes unless the benefit is specifically excluded by law.

Employer-provided educational assistance may be excludible from an employee's gross income—and, ultimately, from wages—under either section 127 of the Internal Revenue Code (Educational Assistance Programs) or section 132(d) of the Code (Working Condition Fringes.) The value of a fringe benefit properly excluded from an employee's wages is not subject to income tax withholding or to social security, Medicare, or federal unemployment (FUTA) tax. Consequently, an employer should not include the benefit in wages, tips, and other compensation shown in box 1 of an employee's Form W-2. Similarly, the employee does not have to include the benefit in gross income on the employee's income tax return.

Educational Assistance Programs

Educational assistance benefits provided by an employer under an educational assistance program may be excluded both from the employee's gross income and from wages for Federal employment tax purposes. To qualify as an educational assistance program, the plan must be written and must meet certain other requirements. Tax-free educational assistance benefits include payments for tuition, fees, books, supplies, and equipment. The payments must be for undergraduate-level courses that begin before January 1, 2002. The payments do not, however, have to be for work-related courses. For more information on educational assistance programs, see Publication 535, Business Expenses.

Working Condition Fringes

A working condition fringe is a benefit which, had the employee paid for it, the employee could have deducted the cost thereof as an employee business expense. Consequently, to qualify as a working condition fringe, the cost of the education must be a job-related expense that serves a bona fide business purpose of the employer.

1. Qualifying Education

To be able to deduct work-related educational expenses, the qualifying education must meet at least one of the following two tests:

- The education is required by either the employer or the law in order for the employee to keep his or her present salary, status, or job; or
- The education maintains or improves skills needed in the employee's present work.

Once an employee has met the minimum educational requirements for a job, either the employer or the law may require the employee to get more education. The cost of this additional education is deductible if the education is required for the employee to keep his or her present salary, status, or job. However, the education

must not be part of a program that will qualify the employee for a new trade or business.

When an employee gets more education than his or her employer or the law requires, the additional education is qualifying only if it maintains or improves skills required in the employee's present work. This could include refresher courses, courses on current developments, and academic or vocational courses. The employee can deduct the expenses for qualifying education even if the education could lead to a degree.

2. Nonqualifying Education

Even if the education meets both of the tests set forth above, the education is nonqualifying education if it:

- Is needed to meet the minimum educational requirements of the employee's present trade or business; or
- Is part of a program of study that can qualify the employee for a new trade or business.

Education needed to meet the minimum educational requirements for the employee's present trade or business is nonqualifying education. The minimum education necessary is generally determined by laws and regulations, standards of the employee's profession, or the employer's requirements. Once an employee has met the minimum educational requirements that were in effect when he or she was hired, the employee does not have to meet minimum educational requirements again. This means that if the minimum requirements change after the employee was hired, any education the employee needs to meet the new requirements is qualifying education.

Education that is part of a program of study that can qualify the employee for a new trade or business is nonqualifying education. This is true even if the employee does not plan to enter that trade or business. However, for an existing employee, a change of duties that involves the same general kind of work is not a new trade or business.

In conclusion whether employer-provided educational assistance is excludible from an employee's gross income and from wages for employment tax purposes depends on whether the educational assistance is provided under an educational assistance program (section 127 of the Code) or, alternatively, is excludible as a working condition fringe (section 132(d) of the Code.) The fact that an employer provides educational assistance regardless of whether the educational assistance is excludible from gross income and wages under either of these provisions is irrelevant if the educational assistance is in fact excludible. For more information on work-related educational expenses, see Publication 508, Tax Benefits for Work-Related Education.

Please telephone me with any questions you may have of if I may be of further assistance to you in any way.

Sincerely,

JERRY E. HOLMES
Chief, Employment Tax Branch 2
Office of Assistant Chief Counsel
(Exempt Organizations/Employment
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