

Frequently Asked Questions About Educational Assistance Programs

The Internal Revenue Service (“IRS”) released a fact sheet which provides answers to frequently asked questions (“FAQs”) related to employer educational assistance programs created under Section 127 (“§ 127”) of the Internal Revenue Code (“the Code”). In addition, the IRS provided a sample plan document for an educational assistance benefit plan that employers can utilize when designing a program.

■ Background

Employees may exclude certain educational assistance benefits from gross income if they are provided under an employer sponsored § 127 educational assistance program. This means an employee will not have to pay income tax on the amount of benefits up to \$5,250 per calendar year and the employer should not include the benefits in the calculation of wages, tips and other compensation shown in box 1 of the employee’s W-2 form.

Amounts paid under a § 127 educational assistance program are generally deductible by the employer as a business expense under § 162.

As part of the Coronavirus Aid, Relief and Economic Security Act of 2020 (“CARES Act”), § 127 was expanded to include student loan payments through 2025.

■ Q&A on Educational Assistance Programs

What is an educational assistance program?

§ 127 educational assistance program is a separate written plan of an employer for the exclusive benefit of its employees to provide employees with educational assistance. To qualify, the program must be **written**, may not discriminate in favor of officers, shareholders, self-employed or highly compensated employees, and satisfy other requirements.

The IRS provides a sample plan document to assist employers in establishing a qualified educational assistance program under § 127. An employer may tailor its plan to include, for example, conditions for eligibility, when an employee’s participation in the plan begins, and prorated benefits for part-time employees. The sample plan document can be found at

<https://www.irs.gov/pub/irs-pdf/p5993.pdf>



What are educational assistance benefits?

§ 127 benefits include payments for tuition, fees and similar expenses, books, supplies and equipment, and the payments may be for either undergraduate or graduate-level courses. The payments do not have to be for work-related courses.

§ 127 benefits also include principal or interest payments on qualified education loans incurred by the employee. These payments must be made by the employer after March 27, 2020, and before January 1, 2026, to qualify (unless extended by future legislation).

§ 127 benefits do not include payments for the following items:

- Meals, lodging or transportation.
- Tools or supplies (other than textbooks) that the employee can keep after completing the course of instruction (for example, educational assistance does not include payments for a computer or laptop that the employee keeps).
- Courses involving sports, games, or hobbies unless they:
 - Have a reasonable relationship to the business of the employer, or
 - Are required as part of a degree program.

An employer may choose to provide some or all of the educational assistance described above. The terms of the plan may limit the types of assistance provided to employees.

What is the total amount that an employee can exclude from gross income under § 127?

Under § 127, the total amount that an employee can exclude from gross income for payments of principal or interest on qualified education loans and other educational assistance combined is \$5,250 per calendar year on a “use it or lose it” basis.

What is a qualified education loan?

A qualified education loan is a loan for education at an eligible educational institution. Eligible educational institutions include any college, university, vocational school, or other postsecondary educational institution. The Department of Education determines whether an organization is an eligible education institution. A loan does not have to be issued or guaranteed under a federal postsecondary education loan program to be a qualified education loan.

How can payments of qualified education loans be made?

An employer may provide § 127 payments of principal or interest on an employee’s qualified education loans for the employee’s own education directly to a third party, such as an educational provider or loan servicer, or make payments directly to the employee.

Are employer payments of qualified education loans for an employee’s spouse and/or dependents excluded from gross income under § 127?

No. Under § 127, an educational assistance program must be provided for the exclusive benefit of the employee and not for the education of a family member such as a spouse or dependent. If a spouse or dependent is also an employee of the employer, they may be able to receive benefits under the program as an employee.

Can student debt be reimbursed under a § 127 educational assistance program?

It can be reimbursed if the debt was incurred as a result of expenses that are permissible benefits under § 127 of the Code (such as tuition, books, equipment, qualified education loans). The employer may reimburse the employee for these expenses as educational assistance benefits, and the employee could then use those funds to help satisfy his or her debt. To be excluded from the employee's gross income, the employee must be prepared to substantiate the expenses to the employer.

Can self-employed individuals, shareholders and owners received educational assistance under a § 127 educational assistance program?

While there are no specific income limits for receiving educational assistance benefits, an educational assistance program must satisfy certain nondiscrimination requirements, including not being discriminatory in favor of employees who are highly compensated employees.

An individual who is self-employed within the meaning of § 401(c)(1) may receive educational assistance. Shareholders and owners (or their spouses or dependents) may receive educational assistance as long as total contributions to the shareholder/owner class does not exceed 5 percent of the amounts paid or incurred by the employer for educational assistance during the year.

As a practical matter, if the owners are the only employees, they cannot receive educational assistance under § 127 because of the 5 percent benefit limitation described above.

Are there other exclusions from gross income for educational assistance?

There may be other exclusions under the tax code that can apply for educational assistance, including an exclusion for working condition fringe benefits and an educator expense deduction. Discussion of these exclusions is beyond the scope of this article.

■ Employer Action

Employers that have (or are considering) an education assistance program should review these IRS FAQs and should note the following:

- Any education assistance program should be a separate written plan to take advantage of the tax benefits.
- The combined total amount of the exclusion is \$5,250 per calendar year.
- Only eligible expenses can be provided on a tax favored basis. For a limited time, this includes assistance for principal and interest payments on qualified education loans when the payments are made after March 27, 2020, and before January 1, 2026.
- The program is provided for the exclusive benefit of the employee and does not include the employee's spouse or family members.