



DAWN CLARK NETSCH

Comptroller
State of Illinois

201 State House
Springfield, Illinois 62706
217/782-6000
TDD 217/782-1308

State of Illinois Center
100 West Randolph, Suite 15-500
Chicago, Illinois 60601
312/814-2451

December 15, 1994

P A Y R O L L B U L L E T I N
(7-94)

TO: All State Agencies, Departments, Boards,
Commissions and Universities

SUBJECT: Educational Assistance

The Omnibus Budget Reconciliation Act of 1993 extended the \$5,250 annual income tax exclusion contained in Internal Revenue Code (IRC) Section 127 for employer-provided education assistance through December 31, 1994. To date, this exclusion has not been extended to payments after December 31, 1994. While there is strong bipartisan support in both houses to do so, finding the \$300 million annually to pay for the provision has prevented the extension. If it is not extended, employer reimbursements of educational expenses paid after December 31, 1994, which do NOT qualify as working condition fringe benefits or qualified tuition reductions, must be included in the employee's gross income and payments are subject to federal and state income taxes, Social Security/Medicare taxes and, where applicable, retirement.

Educational expenses qualifying as a working condition fringe benefit under IRC Section 132(d) or paid under a scholarship or tuition reduction program meeting IRC Section 117 requirements are not taxable.

To qualify as a **working condition fringe benefit**, the education must meet all of the following criteria:

- 1) The course must maintain or improve skills necessary for the current employment; or be required for the employee to retain his or her current employment, status, or rate of pay.

- 2) The courses cannot be part of a program that can qualify the employee for a new trade or business, even if the employee does not intend to change occupations.
- 3) The courses cannot enable the individual to meet the minimum education requirements of his or her present trade or business.

For example, the cost of a CPA review course is not excludable because it can lead to a new profession as a CPA. Similarly, the cost of law school or a bar review course is taxable. The cost of courses taken by a licensed practical nurse (LPN) which qualify the employee to become a registered nurse (RN) is taxable because LPNs and RNs are subject to different registration and certification requirements.

If the courses lead to a change of position or promotion within the same occupation, the cost is not taxable if the new duties involve the same general type of work. If the employee is practicing in a profession, the costs of courses leading to a specialty within that profession are not taxable. For example, additional legal education for an attorney is not taxable. Education permitting an elementary teacher to become a secondary school teacher or principal is not taxable because it is considered the same profession. On the other hand, the cost of a college program enabling a teacher's aide to become a teacher is taxable.

If the education qualifies as a working condition fringe benefit, nontaxable expenses include tuition, books, supplies, fees and certain other related costs. In general, education expenses that would be deductible by the employee as ordinary and necessary business expenses if not reimbursed by the employer (without regard to the 2 percent floor for miscellaneous itemized deductions) are not taxable. Further information on education expenses which qualify as ordinary and necessary business expenses can be found in IRS Publication 508, **Educational Expenses**. This publication can be obtained at you local IRS Office or by calling the IRS "Forms Only" number: 1-800-TAX-FORM (1-800-829-3676).

Scholarships and fellowships are nontaxable providing:

- 1) The employee is a candidate for a degree; and
- 2) Past, present or future services are not required as a condition for receiving the scholarship or fellowship.

The part of any grant that represents payment for past, present or future services is taxable. Payments for expenses such as room, board and travel are taxable.

A qualified **tuition reduction** program is a full or partial reduction in tuition that is provided by an educational institution to an employee enrolled in study at the employing institution or another educational institution. It applies only to education below the graduate level unless it is for the education of an employee who is a graduate student engaged in teaching or research. To qualify, the tuition reduction cannot be received in lieu of compensation for the employee's services.

Payroll Procedures - Calendar Year 1995

Beginning January 1, 1995, whether paid directly by the agency or through the Upward Mobility Program, agencies are responsible for identifying taxable educational assistance, withholding and reporting taxes, and paying the employer's share of Social Security/Medicare taxes and, where applicable, retirement. Taxable educational assistance must be noted on the payroll voucher in column 54, Other Compensation Subject to Withholding. In addition, this amount must also be in magnetic tape positions 861 through 867. If the employee is also receiving vehicle usage income, the educational reimbursement must be added to that income. This procedure **MUST** be completed no later than the last payroll for calendar year 1995.

1994 Payments

So that payment can be made before the \$5,250 exclusion expires on December 31, 1994, please voucher all amounts currently due for employer-paid educational assistance as soon as possible and direct them to the attention of Joe DiRocco or Barb Moore, Voucher Pre-Audit. Although we will make every effort to do so, vouchers received after December 27, 1994, may not be paid in calendar year 1994. Vouchers received after December 29, 1994, cannot be paid in 1994.

Questions regarding this Payroll Bulletin should be referred to Nancy Smith or Dan Steven at (217) 782-4758.

Note: The purpose of this Bulletin is to provide payroll procedures for reporting taxable educational assistance and to describe generally the tax treatment of payments for educational assistance. Agencies must consult with their local office of the Internal Revenue Service, tax publications, or a professional tax advisor for specific questions about determining the taxability of educational assistance.