

## Office of the State Controller

### Self-Assessment of Internal Controls

#### Tax/Payroll Compliance

##### Educational Assistance Plan Payments

### EDUCATIONAL ASSISTANCE PLAN

The Office of State Personnel (OSP) is responsible for administering the educational assistance plan for the State of North Carolina. The policy is set forth in the OSP Personnel Manual and outlines the situations in which it is permissible to pay for or reimburse the employee for expenses incurred in furthering the employee's education or improving their job skills. The tax status of educational assistance payments is determined by reference to the Internal Revenue Code Section 127 and the applicable IRS Regulations. The tax status of the Educational Assistance Plan has been an unsettled issue for several years. Therefore, caution should be used when making decisions as to whether an item is subject to taxation or not.

Gross income of an employee does not include amounts paid or expenses incurred by the employer for educational assistance to the employee if the assistance is furnished pursuant to a program which is described as follows:

1. A separate written plan of an employer for the exclusive benefit of his employees to provide these employees with educational assistance.
2. The program shall benefit employees who qualify under a classification set up by the employer and found by the Secretary of Labor not to be discriminatory in favor of employees who are highly compensated or their dependents.
3. The program must not provide eligible employees with a choice between educational assistance and other remuneration includible in gross income.

Payment by the employer may include expenses incurred by or on behalf of an employee for their education. This includes, but is not limited to, tuition, fees and similar payments, as well as, books, supplies and equipment. Payment may not include expenses incurred by or on behalf of an employee for tools or supplies retained by the employee after completion of a course of instruction, or meals, lodging or transportation.

The term "educational assistance" does not include any payment for, or the provision of any benefits with respect to, any course or other education involving sports, games or hobbies unless such education involves the business of the employer or is required as part of a degree program. The phrase "sports, games or hobbies" does not include education that instructs employees on how to maintain and improve health so long as such education does not involve the use of athletic facilities or equipment and is not recreational in nature.

Education (under an educational assistance plan) is not limited to courses that are job related or part of a degree program. It also does not matter whether the education paid for or provided under a plan is furnished directly by the employer, either alone or in conjunction with other employers, or through a third party, such as an educational institution.

In addition to the **Code Section 127, Educational Assistance Plan** exclusion, **IRS Regulation 1.162-5** provides that there should be no tax consequences to recipient of education expense reimbursements at the graduate **or** undergraduate level as long as the following rules are met:

1. The education maintains or improves skills required by the individual in his employment or other trade or business. Examples include refresher courses, current developments and continuing education courses.
2. The education meets the express requirements of the individual's employer, of the requirements of applicable law or regulations, imposed as a condition to the retention by the individual of an established employment relationship, status or rate of compensation. Requirements must be imposed for a bona fide business purpose of the employer.

The following educational expenses are not deductible by the employer as an ordinary and necessary business expense as defined by IRS Regulation 1.162-5. However, these expenses may be nontaxable to the employee as an allowable under Code Section 127.

1. Education to meet minimal educational requirements of the job.
2. Qualifies the individual for a new trade or business. A change of duties does not constitute a new trade or business if the new duties involve the same general type of work as is involved in the individual's present employment.

### **LIMITATION OF BENEFITS**

To the extent that they do not exceed \$5,250 for the tax year, employee benefits provided under an employer's nondiscriminatory educational assistance plan are not includible in the employee-recipient's gross income. This includes both graduate and undergraduate courses.

### **REPORTING RULES FOR EDUCATIONAL ASSISTANCE PLANS**

Any employer maintaining an educational assistance plan for tax years beginning after 1984 must file an information return with respect to the program as prescribed by regulations. The return must include:

1. The number of employees of the employer;
2. The number of employees of the employer to participate under the plan;
3. The number of employees participating under the plan;
4. The total cost of the plan during the year;
5. The name, address, and taxpayer identification number of the employer and the type of business in which the employer is engaged; and
6. The number of highly compensated employees of the employer, including those eligible to participate in the plan and those actually participating in the plan.

**Office of the State Controller**

Self-Assessment of Internal Controls

**Tax/Payroll Compliance Cycle**

Educational Assistance Plan Payments

Control Policies and Procedures

Agency \_\_\_\_\_

Year-End \_\_\_\_\_

**A. Documentation**

Yes No N/A

- \_\_\_ \_\_\_ \_\_\_ 1. Is there a formal plan of organization under which responsibilities are assigned to identify an employee as having received Educational Assistance Plan payments?

Name of person responsible: \_\_\_\_\_

Title: \_\_\_\_\_

- \_\_\_ \_\_\_ \_\_\_ 2. Does the agency have written instructions available for responsible agency personnel to use as a guide for consistent and accurate application of State and Federal policies on Educational Assistance Plan payments?

**B. Recording and Execution of Transaction and Events**

- \_\_\_ \_\_\_ \_\_\_ 3. Does the agency restrict educational assistance payments to those courses that are required by the employer to maintain or improve skills required by the individual in his/her employment?

- \_\_\_ \_\_\_ \_\_\_ 4. Is the tax status of courses reimbursed by the agency reviewed, and for those courses identified that might lead to a higher status or rate of pay for the employee, is the status of the Code Section 127 exclusions checked for availability so that a determination of whether or not the payment must be taxed to the employee?