

GEORGE V. DELSON ASSOCIATES
OFFICE MEMORANDUM

TO: JEE

DATE: September 16, 2010

FROM: GVD

PRIORITY STATUS: Routine

COPIES TO:

SUBJECT: Employer tax benefits for education expenses

1. Tax Credits:

In 2010, there are three federal tax credits available to a taxpayer to offset the costs of paying for higher education: The Hope Credit, the American Opportunity Credit, and the Lifetime Learning Credit. A taxpayer may only take one education credit per student per year. There is no restriction on the relationship between the student and the payor; an employer may receive these credits for the payment of tuition of an employee or an employee's family member.

In each case a credit is allowed for payment of "qualified tuition and related expenses," subject to limits, as discussed below. Qualified expenses are defined under IRC §25(A)(f) and Reg 1.25A-2(d) as fees required for enrollment or attendance for courses of instruction. The test is whether the fee is required to be paid to the eligible education institution for enrollment or attendance. Books, supplies and equipment fees qualify if such fees must be paid to the institution for enrollment or attendance. No credit is allowed for the cost of room and board, insurance, medical expenses, transportation and similar personal or living expenses. This is so even if such expenses must be paid to the eligible institution.

Qualified expenses also do not include expenses that relate to any course of instruction that involves sports, games, hobbies or any noncredit course unless the course is part of a degree program. (Reg. 1.25A-2(d)(5))

An eligible education institution is a college, university, or vocational school or other postsecondary educational institution. In general such institutions must be eligible to participate in a federal financial aid program, which excludes most schools located in foreign countries.

(a) Hope Credit:

The Hope Credit can be claimed only for courses in a degree, certificate, or other postsecondary credential program. It may be claimed only for the first two years of undergraduate education. The maximum credit amount is \$2,500

This credit is not available for single taxpayers with modified AGI greater than \$90,000 in 2010. (See IRC §25(A)(d), as adjusted for inflation under Rev. Proc 2009-50).

(b) American Opportunity Credit

The American Opportunity Credit can be claimed only for courses in a degree, certificate, or other postsecondary credential program. It may be claimed for the first four years of undergraduate education. The student must be enrolled at least half time. The maximum credit amount is \$2,500.

This credit is not available for single taxpayers with modified AGI greater than \$90,000 in 2010. (See IRC §25(A)(i), as adjusted for inflation under Rev. Proc 2009-50).

(c) Lifetime Learning Credit

The Lifetime Learning Credit covers not only courses in a degree program, but also expenses incurred for courses to acquire or improve job skills, whether or not part of a degree or credential program. There are no other conditions. The maximum credit amount is \$2,000.

This credit is not available for single taxpayers with modified AGI greater than \$60,000 in 2010. (See IRC §25(A)(d), as adjusted for inflation under Rev. Proc 2009-50).

2. Business expense deduction:

As a general rule, amounts paid by an employer to or for the benefit of an employee are considered additional compensation, not gifts. (See, e.g., *M. Duberstein*, 363 U.S. 278). Thus, if an employer pays the ordinary education expenses of or on behalf of an employee, the payments will be considered compensation to the employee. (The only exception to this rule is if the expenses are for **job related education**; see below.) If the tuition payments are compensation to the employee, they are a deductible business expense by the employer.

As mentioned, if an employer pays for an employee's *job related* education expenses, those payments are excluded from the employee's income under IRC §132(d), as a so-called "working condition fringe benefit." Such expenses must be for education necessary to maintain or improve existing job skills or to remain in the current position, Reg. 1.162-5(a). Although the payments are not compensation, they are still deductible by the employer as a business expense.

3. Scholarships

An employer may also establish a scholarship for the education of an employee, under IRC §117. Payments under such a scholarship are deductible by the employer, and are not be income to the employee. However, to qualify under IRC §117, the scholarship recipient must be a degree candidate and must use the funds for tuition, fees, books, supplies and equipment required for instruction.

Furthermore, if it appears that the amounts represent payments for past, present, or future employment services, they will be considered compensation to the employee. Amounts that enable an employee to pursue studies primarily for the employer's benefit will be deemed taxable income. In addition if it appears future tuition depends on continued employment, the payments will be income to the recipient. (See Reg. 1.117-4(c); Rev. Rul. 76-352.)

To avoid such issues, an employer may establish a private foundation to offer scholarships and have the foundation select the recipients. In those instances the payments may be excludable income if the grants are awarded on an objective and nondiscriminatory basis.