



EMPLOYEE BENEFITS:

A PRIMER ON HOW TO TALK THE TALK

**TAX TREATMENT OF TUITION REMISSION PROVIDED BY
AN ORGANIZATION DESCRIBED IN
INTERNAL REVENUE CODE SECTION 170(b)(1)(A)(ii)**

**National Association of College and University Attorneys
2006 Annual Conference
June 28, 2006**

Elena Langrill
Assistant Attorney General – Educational Affairs Division
Maryland Office of the Attorney General
200 St. Paul Place
Baltimore, MD 21202
410-576-6452
elangril@oag.st.md.us

Tara Schulstad Sciscoe
Ice Miller LLP
One American Square
Suite 3100
Indianapolis, IN 46282-0200
317-236-5888
tara.sciscoe@icemiller.com

**Tax Treatment of Tuition Remission Provided by
an Organization Described in Internal Revenue Code Section 170(b)(1)(A)(ii)¹**

<u>Type of Individual</u>	<u>Undergraduate or Graduate</u>	<u>Dollar Value</u>	<u>Excluded from Gross Income or Taxable</u>	<u>Code Section</u>	<u>Special Notes</u>
Current employee ²	Undergraduate	Any	Excluded from employee's gross income	Code § 117(d)	A reduction in tuition provided by an organization under Code Section 170(b)(1)(A)(ii) for the education below the graduate level at such organization or another Code Section 170(b)(1)(A)(ii) organization for employees is tax-free if it is a "qualified tuition reduction." ³ Nondiscrimination rules apply.
Current employee ² who is a graduate student engaged in teaching or research activities for the educational organization	Graduate	Any	Excluded from employee's gross income	Code § 117(d)	A reduction in tuition provided by an organization under Code Section 170(b)(1)(A)(ii) for the education at the graduate level at such organization or another Code Section 170(b)(1)(A)(ii) organization for employees who are graduate students engaged in teaching or research activities for the organization is tax-free if it is a "qualified tuition reduction." Nondiscrimination rules apply and tuition reduction <i>cannot</i> be payment for services.
Current employee ⁴	Undergraduate or graduate	\$5,250 or less	Excluded from employee's gross income	Code § 127	An employer may pay undergraduate or graduate tuition, books and supplies (but not meals or lodging), or provide tuition reduction on a tax-free basis of up to \$5,250 per calendar year if the Code Section 127 rules for "employer provided educational assistance" are satisfied. Need NOT be employment related. Nondiscrimination rules apply, written plan required, and cannot offer employee a choice between educational assistance and taxable benefit.

<u>Type of Individual</u>	<u>Undergraduate or Graduate</u>	<u>Dollar Value</u>	<u>Excluded from Gross Income or Taxable</u>	<u>Code Section</u>	<u>Special Notes</u>
Current employee ⁵	Undergraduate or graduate	Any	Excluded from employee's gross income	Code § 132	An employer may pay undergraduate or graduate tuition and educational related expenses or provide tuition reduction on tax-free basis if it qualifies as a "working condition fringe benefit" under Code Section 132, <i>i.e.</i> , if it were paid by the employee, it would be deductible under Code Section 162 or 167. The education MUST (i) be required by employer or law for employee to keep present job OR (ii) maintain or improve skills required for employee's current employment and must NOT meet the minimum educational requirements for employee's current trade NOR qualify employee for a new trade or business. <i>Code Section 132 does NOT apply if Code Section 117(d) or 127 applies.</i>
Former employee ²	Undergraduate	Any	Excluded from employee's gross income	Code § 117(d)	A former employee who terminated employment due to retirement or disability is treated as an employee for purposes of Code Section 117(d) qualified tuition reduction.
Former employee ² who is a graduate student engaged in teaching or research activities for the educational organization	Graduate	Any	Excluded from employee's gross income	Code § 117(d)	A former employee who terminated employment due to retirement who is a graduate student engaged in teaching or research activities for the educational organization is treated as an employee for purposes of Code Section 117(d) qualified tuition reduction.
Former employee ⁴	Undergraduate or graduate	\$5,250 or less	Excluded from employee's gross income	Code § 127	A former employee who terminated employment due to retirement, disability or lay-off is treated as an employee for purposes of Code Section 127 educational assistance.
Spouse/widow of employee ² or former employee	Undergraduate	Any	Excluded from employee's gross income	Code § 117(d)	A spouse/widow of an employee or a former employee is treated as an employee for purposes of Code Section 117 qualified tuition reduction.

<u>Type of Individual</u>	<u>Undergraduate or Graduate</u>	<u>Dollar Value</u>	<u>Excluded from Gross Income or Taxable</u>	<u>Code Section</u>	<u>Special Notes</u>
Spouse/widow of employee ² or former employee who is a graduate student engaged in teaching or research activities for the educational organization	Graduate	Any	Excluded from employee's gross income	Code § 117(d)	A spouse/widow of an employee or a former employee is treated as an employee for purposes of Code Section 117 qualified tuition reduction.
Child of employee or former employee ²	Undergraduate	Any	Excluded from employee's gross income	Code § 117(d)	An employee's or former employee's dependent child under Code Section 152 ⁶ , or child who has not attained age 25 and whose parents are both deceased, is treated as an employee for purposes of Code Section 117 qualified tuition reduction.
Child of employee or former employee ² who is a graduate student engaged in teaching or research activities for the educational organization	Graduate	Any	Excluded from Employee's gross income	Code § 117(d)	An employee's or former employee's dependent child under Code Section 152 ⁶ , or child who has not attained age 25 and whose parents are both deceased, is treated as an employee for purposes of Code Section 117 qualified tuition reduction.

¹ An organization described in Section 170(b)(1)(A)(ii) is an educational organization which normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on.

² Code Section 117(d) applies to (i) a current employee, (ii) a former employee who retired or left on disability, (iii) the widowed spouse of an employee who died during employment, (iv) the widowed spouse of a former employee who retired or left on disability, and (v) the dependent child or spouse of any person listed in (i) through (iv). A "dependent child" for this purpose is the individual's son, daughter, stepson, stepdaughter, lawfully adopted child or child placed for legal adoption, or eligible foster child who (i) is a dependent under Code Section 152 or (ii) has not attained age 25 and whose parents are both deceased. Under Code Section 152, a child may be a dependent under the "qualifying child" or "qualifying relative" provisions. Note that Code Section 152(e) provides a means for a child of separated or divorced parents to qualify for tax-free undergraduate tuition remission under circumstances where the normal "dependency" tests are not met.

³ Many colleges and universities refer to this benefit as "tuition remission." For purposes of undergraduate tuition (and graduate tuition for teaching and research assistants), the Internal Revenue Code uses the term "qualified tuition reduction." Tuition remission other than undergraduate tuition (and graduate tuition for teaching and research assistants) cannot be a "qualified tuition reduction," so any basis for excluding such amounts from gross income must be based upon a tax provision other than Code Section 117.

⁴ An "employee" for purposes of Code Section 127 includes present, retired, disabled and laid-off employees, as well as employees on leave, but does not include children or spouses.

⁵ Generally, "employee" means current employees only for purposes of the working condition fringe benefit provisions.

⁶ Please refer to the chart "Definition of 'Dependent' Under Internal Revenue Code Section 152 for Purposes of Code Section 117(d)" for detailed information on who qualifies as an employee's dependent. Numerous restrictions involving, age, income, residence, etc. apply, in addition to support tests.

**WORKING FAMILIES TAX RELIEF ACT OF 2004 – DEFINITION OF “DEPENDENT” UNDER INTERNAL REVENUE
CODE SECTION 152 FOR PURPOSES OF CODE SECTION 117(d)¹**

	QUALIFYING CHILD	QUALIFYING RELATIVE
RELATIONSHIP	The person being claimed as a “dependent” is related to the taxpayer as a son, daughter, stepson, stepdaughter, lawfully adopted child or child placed for legal adoption, ² or eligible foster child. ³	The person being claimed as a “dependent” is related to the taxpayer as a son, daughter, stepson, stepdaughter, lawfully adopted child or child placed for legal adoption, ² or eligible foster child. ³
RESIDENCE	The person being claimed as a dependent resides at the same principal place of abode as taxpayer for more than ½ of taxable year. Temporary absences do not affect this determination. [Not applicable if Code Section 152(e) applies.]	N/A
AGE	The person being claimed as a dependent is less than 19 at end of year (24 if a student ⁴) or is “permanently and totally disabled” ⁵ at any time during the calendar year.	N/A
SUPPORT	The person being claimed as a “dependent” provides not more than ½ of his/her support for the calendar year. ⁶	The taxpayer provides over ½ of the person’s support for the calendar year. ^{6,7,8} [Not applicable if Code Section 152(e) applies.]
INCOME	N/A	The person being claimed as a “dependent” has gross income less than \$3,200 for 2005. ⁹
NOT A QUALIFYING CHILD	N/A	The person being claimed as a “dependent” is not a qualifying child of taxpayer or any other taxpayer.

DEPENDENT OF DEPENDENT	If a person is a dependent, that person cannot claim a qualifying child. ¹⁰	If a person is a dependent, that person cannot claim a qualifying relative. ¹⁰
NO JOINT RETURN	The person does not file a joint return.	The person does not file a joint return.
CITIZENSHIP OR RESIDENCY	The person is a citizen/national/resident of U.S. or a resident of Canada or Mexico. There is an exception for adopted children. ¹¹	The person is a citizen/national/resident of U.S. or a resident of Canada or Mexico. There is an exception for adopted children. ¹¹
TIE-BREAKING RULES	If two or more taxpayers may claim a child as a qualifying child, the parent may claim the child. If neither is a parent, the taxpayer with the highest adjusted gross income may claim the child. If both are parents, the parent with whom the child resided longest during the year or, if the child resided equally with both parents, the parent with the highest adjusted gross income may claim the child. [Not applicable if Code Section 152(e) applies.]	N/A

SPECIAL RULE FOR DIVORCED PARENTS

CODE SECTION 152(e)

Child of divorced or separated parents is treated as the dependent of both parents if:

1. The child is in the custody of one or both parents for more than ½ of the calendar year;
2. The child receives over ½ of the child's support during the calendar year from the child's parents; and
3. The parents are:
 - a. Divorced or legally separated under a decree of divorce or separate maintenance;
 - b. Separated under a written separation agreement; or
 - c. Living apart at all times during the last six months of the calendar year.

NOTE: These provisions do not apply if over ½ of the support of the child is treated as being received under a multiple support agreement.¹²

¹ Code Section 152 applies differently to various employer-provided fringe benefits. This chart has been modified for Code Section 117 purposes.

² Code Section 152 does not define “placed for adoption,” but regulations under the previous version of the statute indicated that the child must be “placed with the individual by an authorized placement agency for legal adoption pursuant to a formal application filed by the individual with the agency.” A similar definition will likely apply under the new statutory language.

³ An eligible foster child is an individual who is placed with the taxpayer by an authorized placement agency or by judgment, decree or other order of a court of competent jurisdiction. Depending upon the applicable state law and procedures, this may include both those who would typically be referred to as “foster children” and children who are under the taxpayer’s legal guardianship.

⁴ An individual is a student for these purposes if the individual is a full-time student at a Code Section 170(b)(1)(A)(ii) educational organization (or in certain institution on-farm training programs) for at least 5 months of the calendar year. A Code Section 170(b)(1)(A)(ii) educational organization is one which normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on.

⁵ Permanently and totally disabled means unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or which has lasted or can be expected to last for a continuous period of not less than 12 months.

⁶ Support for these purposes does not include scholarships for study at an educational organization described in Code Section 170(b)(1)(A)(ii) received by a student child of the taxpayer.

⁷ Where no one provides over ½ of the person’s support for the calendar year, but two or more persons together provided over ½ of the person’s support and would otherwise be able to claim the person as a dependent, the taxpayer is treated as providing over ½ of the person’s support for the calendar year if the taxpayer did provide over 10% of the person’s support and every other person who provided over 10% of the person’s support files a written declaration that he/she will not claim the person as a dependent for any tax year beginning in that calendar year.

⁸ Alimony and separate maintenance payments pursuant to Code Section 71 and certain trust income covered by Code Section 682 are not treated as support of a dependent. Where a parent remarries, support received from a parent’s spouse is treated as received from the parent.

⁹ The income earned at a sheltered workshop by a person who is permanently and totally disabled at any time during the taxable year will not be included for these purposes if the person attends the workshop primarily due to the availability of medical care and the income arises from activities incidental to such medical care. A sheltered workshop is a school which provides special instruction or training designed to alleviate the disability of the person and which is operated by a State, a possession of the U.S., a political subdivision of either, the U.S., the District of Columbia, or an organization described in Code Section 501(c)(3) and exempt under Code Section 501(a).

¹⁰ For example, if the taxpayer/employee is a dependent of his father, he cannot claim a Code Section 152 dependent (either as a qualifying child or as a qualifying relative).

¹¹ This requirement will not apply to an adopted child who has the same principal place of abode as the taxpayer and is a member of the taxpayer's household for the taxable year, provided the taxpayer is a citizen or national of the U.S.

¹² A multiple support agreement is an arrangement whereby two or more individuals contribute to the support of an individual. A taxpayer may be treated as providing more than one-half of the support of the individual if (i) no one person contributed over one-half of the individual's support, (ii) over one-half of the individual's support was received from two or more persons who would have been entitled to claim the individual as a dependent except that none of them provided more than one-half of the individual's support, (iii) the taxpayer contributed over ten percent of the individual's support, and (iv) each person described in (ii) who contributed over ten percent of the individual's support files a written declaration that that person will not claim the individual as a dependent for that year.

I/1798227v1

I/1798227.1