



# What's News in Tax

Analysis that matters from Washington National Tax

## Employer Provided Student Loan Repayments Graduate to Tax-Free Benefits for the Next Several Years

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Recent legislation allows employers to assist employees with repayment of their student loans on a tax-free basis through the end of 2025, up to an annual section 127 limit—currently \$5,250 per employee.

Employers have long had the flexibility to exclude assistance for current educational expenses from employee income, up to \$5,250 each calendar year, if provided through a qualified educational assistance program under section 127 of the Code.<sup>1</sup> This benefit is often viewed as a valuable component to the overall compensation and benefits package made available to attract and retain a talented workforce. However, exclusion from employee income has only been available for current educational expenses so employees who are not currently enrolled in courses could not benefit. The Coronavirus Aid, Relief, and Economic Security (“CARES”) Act added a temporary provision to include student loan repayment as an alternative to assistance with expenses for current education. In other words, employers could help employees pay down student loans for prior educational expenses on a tax-free basis. This revision can significantly open up opportunities to provide meaningful tax advantaged benefits to the entire workforce to the extent they are repaying qualified student loans.

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<sup>1</sup> Unless otherwise indicated, section references are to the Internal Revenue Code of 1986, as amended (the “Code”) or the applicable regulations promulgated pursuant to the Code (the “regulations”).

## Student Loan Repayment Assistance

The CARES Act expanded the flexibility and relevance of the educational assistance benefit to a greater cross-section of the workforce by adding student loan repayments made before January 1, 2021, to the definition of “educational assistance” that can be excluded from employee income if provided under a section 127 qualified educational assistance program. This includes payments made by an employer to an employee or directly to a lender, consisting of principal and/or interest on any qualified education loan incurred by an employee for his or her own education. This change to the definition of educational assistance applied to existing educational assistance programs as well as new programs established after the CARES Act was signed into law in March 2020. The Taxpayer Certainty and Disaster Tax Relief Act of 2020, enacted on December 27, 2020, extended this amendment to include payments made through the end of 2025.

When considering adding this benefit to the array of compensation made available to employees, it is important to remember that only payments offered through a section 127 qualified educational assistance program can be excluded from employee income under the new provision. For employers with an established qualified educational assistance program, adding student loan repayment as a reimbursable expense can typically be accomplished with minimal additional complication. Employers without an existing program, on the other hand, first must take steps to implement a qualified educational assistance program before offering the student loan repayment benefit to employees.

### Section 127—Educational Assistance Program Requirements

To qualify as an educational assistance program under section 127 (and allow the educational benefits to be excluded from employee compensation), a number of requirements must be met. These requirements include:

- **Written Plan.** A qualified educational assistance program must be established under a separate written plan of the employer. While documentation under a separate plan is an important step for qualification, the plan does not need to be lengthy or complex.
- **Solely Educational Assistance.** A qualified educational assistance program may only provide benefits that meet the definition of “educational assistance.” This generally means the employer’s payment of expenses incurred by the employee for education, or the employer providing education directly to the employee. Certain expenses are specifically excluded from this definition (e.g., meals, lodging, supplies other than textbooks). Under the CARES Act, as amended, this definition now includes payments of a qualified education loan made after March 27, 2020, and before January 1, 2026.

Note that this requirement is not satisfied when employees have a choice between educational assistance and a taxable benefit. In other words, employees cannot be provided an opportunity to elect (in form or actual operation) between the educational assistance and other remuneration that would be includible in their income. For example, an employer cannot offer the educational assistance through a section 125 cafeteria plan or allow employees to elect educational assistance in lieu of a bonus.

- **Exclusive Benefit.** A qualified educational assistance program may only benefit *employees* of the employer. For purposes of section 127, the term “employees” includes: retired, disabled, or

laid-off employees; present employees on leave; and self-employed individuals. A program is not qualified under section 127 if it provides benefits to spouses or dependents of employees.

- **Nondiscriminatory**. A qualified educational assistance program must benefit the employees generally; it may not discriminate in favor of officers, shareholders, self-employed, or highly compensated employees. However, eligibility for benefits under the program can be limited to a certain classification of employees (i.e., not made available to all employees), but that classification may not discriminate in favor of the officers, highly compensated, etc.
- **Benefits Limitation**. To be considered a qualified educational assistance program under section 127, there are certain limitations around providing benefits to more-than-five-percent shareholders and owners.” No more than five percent of the amounts paid or incurred by the employer to provide benefits during the year may be provided to more-than-five-percent shareholders or more-than-five-percent owners (including their spouses and dependents who are also employees).
- **Notice**. An educational assistance program is not qualified under section 127 unless all eligible employees are given reasonable notice of the terms and availability of the program. Employers should also provide notice to eligible employees if any terms of the program change (e.g., adding student loan repayment as an available benefit).
- **Substantiation**. Employees who receive benefits under an educational assistance program will generally need to provide substantiation that makes it reasonable for the employer to believe the payments or reimbursements are for educational assistance. Employers should consider establishing operational policies and guidelines for their programs to ensure adequate substantiation is received and maintained whenever assistance is provided.

To qualify for beneficial tax treatment under section 127, the educational assistance program does not need to be funded and the employer does not need to apply to the IRS for any determination as to qualified status of the program. Employers that pay more than the annual limit, or that provide educational assistance that is not provided under a section 127 qualified program, should consider whether another exclusion may apply (e.g., working condition fringe benefit, qualified scholarship, qualified tuition reduction) or whether the amount must be treated as taxable compensation subject to applicable withholding and reporting.

## Tax Treatment of Qualified Educational Assistance

Amounts paid for educational assistance under a section 127 qualified educational assistance program are excludible from employee income, up to \$5,250 annually. Because the payments are excluded from compensation, these amounts are not subject to payroll withholding or reporting. Further, amounts paid under a qualified educational assistance program are generally deductible by the employer as a business expense.

## Next Steps

Employers that have existing qualified educational assistance programs, should consider:

- How offering student loan repayment assistance may complement the overall compensation program offered to their workforces
- Whether student loan repayment assistance will be offered as a tax-efficient benefit for all employees or only to limited classifications of employee (e.g., limited to certain departments, functions, or new hires)
- Updating employee communications to notify employees of this new benefit
- Update payroll procedures, documentation requirements, and other operational matters to ensure continued compliance with section 127

Employers that do not currently have a qualified educational assistance program should consider whether it makes sense to establish a qualified educational assistance plan, given that it may benefit a broad group of employees for the next few years, and if so:

- Draft plan documentation and employee communications
- Establish enrollment and payroll procedures
- Develop process to collect and maintain necessary documentation

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