



Tax Reduction Letter

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Revenue Ruling 76-71

Section 3121.-Definitions

Educational expenses paid by employer; reporting requirements. Amounts an employer pays as tuition reimbursements to employees enrolled, with the approval of their supervisor, in educational courses that will be beneficial to a career in the employer's business are income to the employees and do not qualify as scholarships. However, the amounts are considered business expenses of the employees and, as provided by section 1.162-17 (b) (1) of the regulations, need not be reported.

Advice has been requested whether, under the circumstances described below, amounts paid by an employer to or on behalf of its employees with respect to the tuition payments incurred by such employees for educational courses are income to the employees and, if so, whether they are "wages" for purposes of Federal employment taxes including income tax withholding. Also, advice has been requested with respect to the manner in which these amounts are to be reported on the employees' Federal income tax returns.

The employer, as a matter of policy, encourages its employees to enroll in outside educational courses that will help them to more quickly absorb the employer's business background and discharge the duties of their jobs. On behalf of employees who take the courses and maintain satisfactory grades, the employer either pays the tuition costs directly to the educational institution or reimburses the employee for the cost of the courses taken. The courses are not required of the employee to meet the minimum educational employment requirements and do not qualify the employee for a new trade or business. However, the courses must be of a type that will be beneficial to a career in the employer's business and must have the prior approval of supervisory officials.

Section 61 of the Internal Revenue Code of 1954 provides that unless otherwise excluded by law, gross income means all income from whatever source derived including, but not limited to, compensation for services. Therefore, the amounts paid to the employees as reimbursement for the cost of the educational courses are income to the employees, unless otherwise excluded.

Section 117 (a) of the Code provides, subject to certain limitations and qualifications, that gross income of an individual does not include amounts received as a scholarship at an educational institution or as a fellowship grant. A scholarship or fellowship grant as defined in section 1.117-3 of the Income Tax Regulations is an amount paid to, or for the benefit of, an individual to aid in the pursuit of studies.

Section 1.117-4 (c) (2) of the regulations provides that amounts paid to an individual to enable the individual to pursue studies primarily for the benefit of the grantor are not considered as excludable scholarship. In the present case, since the courses taken by the employees make them

more effective employees, they are primarily for the benefit of the employer-grantor. Accordingly, these amounts do not qualify as scholarships excludable from gross income pursuant to section 117 of the Code.

Section 162 (a) of the Code provides, that, in computing taxable income, there shall be allowed as a deduction "all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business." The educational expense regulations were promulgated under section 162 of the Code in order to differentiate between expenditures for education that are ordinary and necessary expenses paid or incurred in carrying on a business activity and those that are personal in nature.

Section 1.162-5 of the regulations provides, in general, that expenditures made by an individual for the individual's education are deductible if they are for education that (1) maintains or improves skills required by the individual's employment or other trade or business, or (2) meets the express requirements of the individual's employer or the requirements of applicable law or regulations imposed as a condition to the retention by the individual of established employment relationship, status, or rate of compensation. Under these circumstances, educational expenditures are ordinary and necessary business expenses of the employee. No deduction is allowable for expenditures for education required of the individual in order to meet the minimum educational requirements for employment qualification in the individual's employment or other trade or business or for expenditures for education that is part of a program of study being pursued that will lead to qualifying the individual in a new trade or business even though the education may maintain or improve skills required by the individual in the individual's employment or other trade or business or may meet the express requirements of the individual's employer or of applicable law or regulations. Under these circumstances, educational expenditures are personal expenses of the employee.

An employee's educational expenses that satisfy the deductibility requirements of section 1.162-5 of the regulations are considered by the Service as expenses incurred in pursuing the employer's trade or business since the degree to which an employee effectively and successfully performs the duties directly affects the degree to which the employer achieves business objectives.

In view of the foregoing, an educational expense that qualifies as a deductible expense under section 1.162-5 of the regulations as an expense incurred in the trade or business of an employee (rather than a personal expense) is likewise an expense incurred by the employee in the employer's business, and the reimbursement to the employee by the employer for such expense is not "wages" subject to the employment taxes by virtue of the provisions of sections 31.3121 (a)-1 (h), 31.3306 (b)-1 (h), and 31.3401 (a)-1 (b) (2) of the Employment Tax Regulations. These sections provide that amounts paid specifically, either as advances or reimbursements, for traveling or other bona fide ordinary and necessary expenses incurred or reasonably expected to be incurred in the business of the employer are not wages. Such expenses must be identified either by making a separate payment or by specifically indicating the separate amounts when both wages and expense allowances are combined in a single payment.

Accordingly, in the instant case, liability is not incurred by the employer for Federal employment taxes, including income tax withholding, with respect to the reimbursements made to its employees.

Regarding the manner in which an employee should report on the Federal income tax return an amount paid to the employee as reimbursement for tuition expense, section 1.162-17 (b) (1) of the regulations provides that the employee need not report expenses for travel, transportation, entertainment, and similar purposes paid or incurred by the employee solely for the benefit of the employer for which the employee is required to account and does account to the employer and for which the employee is reimbursed, provided the total amount of such reimbursement is equal to such expenses. The section further provides that in such a case the employee need only state in the return that the amounts received as reimbursement did not exceed the ordinary and necessary business expenses paid or incurred by the employee.

Accordingly, in the instant case, since the expense for tuition is considered as an expense incurred in pursuing the employer's trade or business and the employer, after an accounting by the employee, reimburses the employees for the amount of their tuition expenses, the reporting requirements of section 1.162-17 (b) (1) of the regulations are applicable.

With respect to amounts paid by the employer in the present case directly to the educational institution, these amounts are a noncompensatory ordinary and necessary business expense of the employer. They are not regarded for Federal income tax purposes as being compensatory because had the employees paid the expenses themselves such expenses would not have represented personal expenses but would be deductible ordinary and necessary trade or business expenses under section 1.162-5 of the regulations. Therefore, they are not "wages" for purposes of Federal employment taxes.

Furthermore, since, such amounts are not paid to the employees themselves, and are not compensatory, they are not income to the employees, and the reporting requirements of section 1.162-17 (b) (1) of the regulations are not applicable.