



## Taxability of Graduate Tuition Remission for Employees

Willamette University offers employees the opportunity to pursue higher education free of charge. This exceptional benefit is offered for both undergraduate and graduate coursework. While undergraduate tuition remission is generally not taxed, the Internal Revenue Service has ruled that the graduate tuition benefit is taxable income.

### WHEN IS TUITION REMISSION TAXED?

In general, IRS regulations consider anything of value provided to an employee by an employer to be a form of compensation. All compensation must be reported as taxable wages and is subject to income tax withholding, unless specifically excluded by the Internal Revenue Code.

Under section 117(d) of the Internal Revenue Code, educational institutions offering a full reduction of tuition charges to employees, their spouses and dependent children for undergraduate coursework may exclude the value of this education from their employees' taxable wages. The exclusion under this section *does not extend to graduate coursework*.

Section 127 of the Code allows all employers, whether or not they are an educational institution, to provide their employees with educational assistance for both undergraduate and graduate work. Employers may provide each employee with up to \$5,250 of graduate educational assistance per year on a tax-free basis. The tuition remission that the University offers employees for graduate-level education is eligible for this exclusion.

The Internal Revenue Code requires that educational assistance in excess of the \$5,250 exclusion must be added to employees' taxable wages and employment taxes must be withheld.

### WHAT HAPPENS TO THE TAXES THAT ARE WITHHELD?

The additional taxable income and taxes withheld are reported on the W-2 form. The University is required to issue W-2 forms to employees by January 31<sup>st</sup> to provide the information necessary for completing their tax returns. Educational assistance in excess of the excludable amount is subject to federal, Social Security and Medicare taxes. The table below shows how the taxable tuition remission and taxes are reported on the W-2 Form for a tuition benefit worth \$5,000 over the \$5,250 exclusion.

Type of Tax	W-2 Taxable Wages		W-2 Taxes Withheld		Percent
Federal Income Tax	Box 1	\$5,000	Box 2	\$1,250	25% Supplemental Rate
Social Security	Box 3	\$5,000	Box 4	\$ 310	6.2% up to \$6,324/year
Medicare	Box 5	\$5,000	Box 6	\$ 72.50	1.45% unlimited
<b>Total Taxes</b>				<b>\$1,632.50</b>	<b>32.65%</b>

**Example:** An employee who has received \$10,250 in tuition remission benefits for graduate-level coursework would have \$5,000 of additional taxable income reported in boxes 1, 3 and 5 of his/her W-2 (\$10,250 tuition remission received less \$5,250 exclusion) at the end of the year.

Federal income tax withheld for the year (reported in box 2) would be \$1,250 (\$5,000 additional taxable wages \* 25% withholding rate) more than the amount withheld against wages alone. Social Security tax withheld for the year (reported in box 4) would be \$310 (\$5,000 additional

taxable wages \* 6.2% tax rate) more than the amount withheld against wages alone, and Medicare tax withheld for the year (reported in box 6) would be \$72.50 (\$5,000 additional taxable wages \* 1.45% tax rate) more than the amount withheld against wages alone.

The additional \$1,632.50 in taxes (\$1,250 federal + \$310 Social Security + \$72.50 Medicare) due on the additional income must be withheld from the employee's paychecks.

### **HOW IS THE TAXABLE BENEFIT DETERMINED?**

Payroll receives a report indicating the total dollar amount of tuition remission received by employees for graduate-level education during the current calendar year. This report totals tuition remission for the winter, spring, summer and fall terms, as applicable. If the amount received by an employee exceeds the annual excludable amount (\$5,250), the excess must be added to the employee's taxable wages when the employee receives the benefit. Most often this occurs during the fall semester, but it can occur earlier depending on the number of graduate courses an employee takes during any given semester. The increase in taxable wages also increases the taxes withheld and reduces net pay.

### **WHEN ARE THE TAXES WITHHELD FROM EMPLOYEES' PAYCHECKS?**

To minimize the impact of this additional income tax withholding, the additional income will be spread out evenly across the number of paychecks received during the calendar quarter. As a courtesy, the Payroll Department will notify employees via e-mail of the amount of their taxable graduate tuition remission. The taxable income, tax withholding required and the pay periods affected will be detailed in the e-mail. Every attempt is made to notify employees in advance of the first pay in which the taxes will be withheld.

All income is considered taxable when the benefit is received by the employee. The Payroll Office is required to withhold the taxes in the calendar quarter in which the benefit is received. Taxes on your graduate tuition benefit must be recorded and collected by the end of the calendar quarter in which the benefit is reported. Tracking the amount of your graduate tuition benefit in excess of \$5,250 will enable you to plan in advance for the taxes to be withheld.

Tuition remission you receive at the beginning of the year is not taxed under the \$5,250 exclusion. Once you exceed that amount, every dollar of the graduate-level tuition remission benefit is taxable. If you are taking graduate courses throughout the year, this means that the additional income and additional taxes will always occur in the latter part of the year. All employees are encouraged to track their tuition remission benefit for the year and plan accordingly. In addition, all employees are encouraged to sign up for tuition remission at the beginning of the academic period in order to spread their tax withholding over as many pay periods as possible. The Tuition Remission Application is available on the Human Resources web site: <http://www.willamette.edu/dept/hr/benefits/tuition/index.html>.