

## Taxability of Tuition Remission for Employees

Drexel 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 for employees of educational institutions, the Internal Revenue Service has ruled that the graduate tuition benefit is not excluded from the income of these employees. Employees who do not work for educational institutions are not eligible for the same income exclusion for undergraduate coursework as those that do.

### 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 and only applies to employees of an educational institution.*

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

Therefore, graduate-level tuition remission received by employees of educational institutions and all tuition remission received by those who are not employees of educational institutions is taxable once the value exceeds \$5,250 per tax year. In addition, all tuition remission received by spouses and dependents of employees who are not employees of educational institutions is fully taxable (no \$5,250 exclusion). The Internal Revenue Code requires that taxable tuition remission 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 following example illustrates how this process works for an employee of an educational institution who received \$10,250 of graduate-level tuition remission during the tax year. It also illustrates how the process works for someone who is not an employee of an educational institution and who receives \$10,250 of undergraduate-level tuition remission during the tax year.

**Example:** An employee who has received \$10,250 in taxable tuition remission benefits 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.

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Federal income tax withheld for the year (reported in box 2) would include \$1,100 (\$5,000 additional taxable wages \* 22% withholding rate) more than the amount withheld against wages alone.

Social Security tax withheld for the year (reported in box 4) would include \$310 (\$5,000 additional taxable wages \* 6.2% tax rate) more than the amount withheld against wages alone.

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

The table below shows where the taxable income and taxes withheld are reported on the W-2 Form.

Type of Tax	W-2 Taxable Wages	W-2 Taxes Withheld	Percent
Federal Income Tax	Box 1 \$5,000.00	Box 2 \$1,100.00	22% Supplemental rate
Social Security	Box 3 \$5,000.00	Box 4 \$310.00	6.2% Up to the annual maximum
Medicare	Box 5 \$5,000.00	Box 6 \$72.50	1.45 % Unlimited
<b>Total Taxes</b>		<b>\$1,482.50</b>	<b>29.65%</b>

The additional \$1,482.50 in taxes (\$1,100 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?

Each month, Payroll runs a report indicating the total dollar amount of tuition remission received by employees during the current tax year. The tax year is not tied to the academic year and includes all tuition remission applied to the student's account for coursework taken in the current calendar year plus all tuition remission applied to the student's account for coursework taken in a previous calendar year which was not used in the calculation of that previous year's taxable income.

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. The increase in taxable wages will increase the taxes withheld from your pay check and reduce your net pay.

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

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To minimize the impact on your net pay, once Payroll determines that additional tax withholding is required, the additional taxes will be spread out evenly across the paychecks issued during the current academic quarter/semester. If you have already received one or more paychecks during the current academic quarter/semester, the additional taxes will be spread out across the *remaining* pay checks that you will receive during the quarter/semester. The following charts indicate which paychecks will be affected by the additional tax withholding. Consult the payroll processing schedule on the [Payroll](#) website for specific pay dates.

### Quarter Programs

Quarter	Paychecks Affected
Winter	January, February and March
Spring	April, May and June
Summer	July, August and September
Fall	October, November and December

### Semester Programs

Semester	Paychecks Affected
Spring	January, February, March and April
Summer	May, June, July and August
Fall	September, October, November and December

All employees are encouraged to track their tuition remission benefit for the year and plan accordingly. In addition, all employees are encouraged to verify that they have received tuition remission at the beginning of each academic term/semester to make sure that Payroll can spread their tax withholding over as many pay periods as possible.

The [Tuition Remission Application](#) is available on the Human Resources website and must be resubmitted each academic year by August 1<sup>st</sup>.

### Frequently Asked Questions

- **Who should I contact with questions regarding tuition remission?**

Questions regarding your eligibility, application for and approval of tuition remission benefits should be directed to the Human Resources Department at [hr@drexel.edu](mailto:hr@drexel.edu).

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Questions regarding the timing and amount of tuition remission credits applied to your student account should be directed to Drexel Central.

Questions regarding the inclusion of tuition remission benefits in your taxable wages should be directed to the Payroll Department at payroll@drexel.edu.

- **What classes and charges make up the amount of tuition remission reported to Payroll? I do not agree with the amount reported to Payroll.**

As a matter of confidentiality and privacy, the Payroll Department does not have access to the details of your student records or your student account. You may view the details of your student account online using the [Drexel One](#) portal. Any changes or corrections to your tuition remission charges must be processed through Drexel Central.

- **I am a graduate student. Are undergraduate-level courses counted toward the \$5,250 annual exclusion?**

Yes. Graduate tuition remission is *not* covered under section 117(d) of the Internal Revenue Code, which fully excludes undergraduate coursework. Graduate tuition remission is, instead, covered under section 127 of the Code, which sets an annual limit of \$5,250 for the exclusion of employer-paid tuition expenses for both undergraduate and graduate coursework. Therefore, all coursework taken by a graduate student, regardless of the level, counts toward the annual exclusion.

- **I believe the graduate-level courses I am taking are related to my job and, therefore, qualify as a “working-condition fringe benefit”. Why can’t I be exempt from tax withholding on my graduate courses?**

The IRS’ position is that the value of job-related graduate tuition reductions and/or waivers by colleges and universities do not qualify as working condition fringe benefits because the tax treatment of this item is addressed elsewhere in the tax code [e.g. § 117(d) or § 127](FSA 200231016, August 2, 2002, IRS Office of Chief Counsel). For this reason, Drexel may not exclude the value of the graduate tuition reduction or waiver in excess of the \$5,250 limit from your gross income.

- **If I add or drop a course, how will an adjustment to the amount of tuition remission affect my paycheck?**

The adjustment will be pulled into the next monthly tuition remission report run by Payroll and used to recalculate your taxable income. Although the tax withholding per pay may increase or decrease, the total amount required must still be

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withheld by the end of the quarter/semester. Please see the schedule above for details of which month's paychecks will be affected by the change.

- **Can I spread the collection of the additional tax withholding out beyond the scheduled timeframe?**

All income is considered taxable when the benefit is received by the employee. The Payroll Office is required to withhold the taxes in the quarter/semester in which the benefit is received.

- **Can I delay the start of the additional tax withholding to a future paycheck?**

Unfortunately, we cannot accommodate this request. Taxes on your tuition benefit must be recorded and collected by the end of the quarter/semester in which the benefit is received. Tracking the amount of your tuition benefit in excess of \$5,250 will enable you to plan in advance for the taxes to be withheld.

- **Can I pay these taxes directly to the University rather than have them withheld from my paychecks?**

The IRS does not permit the University to accept payments directly from an employee toward the employee's income tax withholding. Income taxes required to be withheld must be withheld from an employee's paychecks.

- **Can the University record the additional taxable income on my W-2 but not withhold any additional taxes? I will pay them myself when I file my return.**

While the IRS does allow employers to record the taxable income associated with certain benefits without requiring additional income taxes to be withheld, educational assistance is not one of these benefits. The University is required to withhold taxes for this additional income.

- **Why is the federal tax withholding rate so high? Can I change the withholding rate?**

Income earned in addition to (supplemental) your regular salary is subject to the highest tax rate that you pay on the federal graduated tax tables. The IRS defines a flat supplemental tax withholding rate, to be used for income over and above an employee's regular salary, which is pegged to the third lowest tax rate of the federal graduated tax tables. This is currently set at 22%.

We cannot change the rate of withholding on this additional income. If you feel that your total federal income tax withholding for the year will exceed your tax liability, you may submit a new W-4 Form. Please see IRS Publication 505, available on the [IRS](#) website, for instructions on how to estimate

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your income tax liability and update your W-4 Form.

- **Why can't Payroll estimate the amount of additional income I will incur and spread it across all of my paychecks for the entire year, reducing the amount of additional tax withheld from each check?**

Tuition remission becomes taxable to the employee when the benefit is received. Until that happens, no taxable event has been triggered. No additional income can be reported for you until a taxable event has been triggered.

- **Why are the withholding amounts always higher at the end of the year, when I need money the most?**

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 tuition remission benefit is taxable. If you are taking courses throughout the year, this means that the additional income and additional taxes will always occur in the latter part of the year. Employees receiving this taxable benefit should plan accordingly for the decrease in net pay that will occur when the additional taxes are withheld.

- **Who should I contact if I have taken classes but not received the tuition remission credit on my student account?**

Please contact the Human Resources Department at [hr@drexel.edu](mailto:hr@drexel.edu). If the tuition remission application has been processed by Human Resources but has not yet appeared in your student account, please contact Drexel Central concerning your tuition remission application.