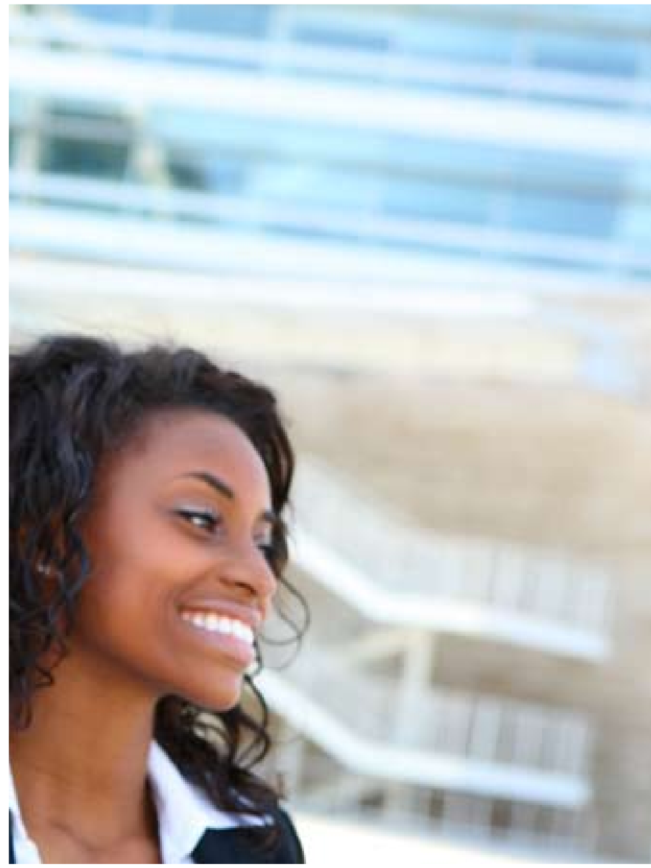

WHO BENEFITS FROM SECTION 127?

A STUDY OF EMPLOYEE EDUCATION ASSISTANCE PROVIDED UNDER SECTION 127 OF THE INTERNAL REVENUE CODE

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NAICU

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Contents

Section 127 of the Revenue Act of 1978 first established employer-sponsored educational assistance as excludable for any type of course, apart from those related to a hobby or sport.

EXECUTIVE SUMMARY

In 1995, the National Association of Independent Colleges and Universities (NAICU) issued a report on full-time employees who use Section 127 benefits.

This report updates the findings of the 1995 report by examining full-time employees who enrolled as students in 2007-08 and benefited from the Section 127 provision.

Section 127 of the Internal Revenue Code enables an employee to exclude from income up to $5,250 per year in employer-provided tuition assistance for any type of educational course at the undergraduate and graduate level. Employers are not required to provide assistance under Section 127. However, if an employer chooses to do so, the benefit must be offered to all employees on a non-discriminatory basis that does not favor the highly compensated. Section 127 of the Internal Revenue Code was originally established in 1978 as a five-year provision to give officials time to study it. It has been extended eight times since then, most recently in 2001 for ten years. Absent congressional action to renew it or make it permanent, Section 127 will expire at the end of 2010.

Prior to 1978, only specifically "job-related" educational assistance could be excluded from gross taxable income, under sections 61 and 162 of the Internal Revenue Code.

Section 127 of the Revenue Act of 1978 first established employer-sponsored educational assistance as excludable for any type of course, apart from those related to a hobby or sport. Tuition, fees, and books were covered under the new law, while transportation and meals were not.

In making this change, Congress addressed three broad policy goals:

1. *Reduce administrative inequities arising from uncertainties* – often reflected in conflicting court decisions – over what constituted "job-related" education. Entry-level employees, for example, rarely had job descriptions broad enough to claim an exemption for legitimate educational assistance paid for by an employer.

2. *Reduce the complexity of the tax code.* As the congressional Joint Committee on Taxation wrote, "the previous 'job-related' distinction often seems both ambiguous and restrictive.... Not only must the IRS use valuable personnel time in making [case by case] determinations of taxability, but employees and employers also must justify their positions."[1]

3. *Remove disincentives to upward mobility.* "The tax law has required out-of-pocket tax payments for employer-provided educational assistance from those least able to pay, even though they receive only services, not an increased paycheck."[2] The new law was expected to promote self-improvement and job advancement among lower-paid and less-skilled workers. It also provided incentives to employers, who benefit from reduced administrative costs and are more likely to provide educational assistance as a benefit when it compares favorably with taxable wage increases.

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[1] "General Explanation of the Revenue Act of 1978," p. 126, March 12, 1979.
[2] ibid.

The data contained in this report shows that use of Section 127 benefits has almost doubled between 1993 and 2007, with nearly one million individuals using this benefit. Section 127 benefits are used by recipients to obtain an education in fields that support U.S. competitiveness and address shortages in key workforce skills.

This report will also demonstrate that employer provided educational assistance under Section 127 is not only meeting the three policy goals established by Congress, but exceeding them as evidenced by key findings:

1. *Reduce administrative inequities.* By reducing administrative inequities arising from what is considered "job-related" education, to eliminating the confusion created by overlapping provisions in the tax code, Section 127 has reduced if not eliminated the administrative inequities found previously in the tax code.
2. *Reduce the complexity of the tax code.* As the report data indicates, **approximately 913,100 students received Section 127 benefits**, compared to 431,500 in 1992, a 112 percent increase and a clear indication that the previous uncertainty surrounding the complexity of what training assistance satisfied the job-relatedness test and the certainty provided to employees and employers has been addressed through Section 127.
3. *Remove disincentives to upward mobility.* **The average annual employment earnings of Section 127 recipients were $42,711 for the 2007-08 academic years.** As the data indicates, Section 127 benefits were used by individuals that are not considered highly compensated and in many instances, would be unable to afford attending college but for the support provided by Section 127 benefits. Section 127 benefits not only benefit students' careers but also employers and the nation's economic development. Without employer-provided education assistance, employees would be less likely to return to school for professional development and advancement, which would result in a significant loss for U.S. industries and economy.

Finally, while not an original stated goal of Congress in enactment of Section 127 -- but one that has become increasingly important to policy-makers -- is that Section 127 beneficiaries are being prepared for careers that will benefit the economy and promote U.S. competitiveness. For example, almost one in five individuals using Section 127 benefits are pursuing a degree in the sciences, technology, engineering, and mathematics – so called "STEM" degrees. Teachers working on their master's degree account for almost 30 percent of the Section 127 benefits received by graduate students. The top four degree fields Section 127 recipients are enrolled in – accounting for almost 75 percent of all beneficiaries – are in business (28 percent); STEM degrees (17 percent); education degrees (15 percent); and health degrees (13 percent).

The following are additional highlights from the updated report, based on data obtained in 2007:

- **Thirty-six percent of Section 127 recipients are pursuing a master's degree**, as compared to 21 percent in 1992.
- **The average age of an undergraduate student receiving Section 127 benefits was 37 years old**, compared to 36 years old in 1992.
- **Almost a quarter of Section 127 recipients were either between the age groups: 24-28 years old or 44 years old and older.**
- **Fifty-one percent of all employers offering Section 127 beneficiaries were from the for-profit industry.**
- **The military provides the largest amount of average assistance to undergraduates** ($2,547). Colleges and universities offer the largest average assistance to graduate students ($3,277).
- **The average annual employment earnings of Section 127 recipients were $42,711 for the 2007-08 academic years.** Demonstrating that this benefit was used by individuals that were not highly compensated. This salary data point coincides with 2007 U.S. Census Bureau data that shows average earnings of full-time, year-round employees to be $50,233.
- **The average Section 127 benefits received was $2,700**, with graduate students receiving more ($3,701) than undergraduate students ($1,849).
- **Of Section 127 beneficiaries, more than a quarter of all undergraduate and more than half of graduate beneficiaries received more than $2,500.**

Section 127 provides employers with the opportunity to invest in their workforce, while allowing employees the ability to advance their education and experience. Permanency or extension of this provision will provide stability and certainty to employers and employees as both parties look to increase their competitiveness. Certainly, a more educated workforce can build opportunities for advancement and development, particularly in the industries of science, technology, and health care.

Section 127 is scheduled to expire at the end of 2010, unless Congress acts to extend this provision or make it permanent.

SECTION 127 BENEFITS: 2010 STUDY'S KEY FINDINGS

In 1978, Congress established Section 127 of the Internal Revenue Code to allow employers to provide their employees reimbursement for higher education expenses, including tuition, fees and books, without this benefit taxed as income. At that time, Congress capped the assistance at $5,000 per year, and established tests so that all employees would be treated equally under this provision. Congress also placed a five-year limit on this provision, to allow the benefit to be studied. Since 1978, Congress has periodically renewed Section 127 – in some cases retroactively after it had expired. Once again, Section 127 is scheduled to expire at the end of 2010, unless Congress acts to extend this provision or make it permanent.

This report is an update of a 1995 study issued by the National Association of Independent Colleges and Universities (NAICU) examining the use of Section 127 employer-provided education benefits by full-time employees. The report focuses on the recipients of Section 127 benefits rather than organizations offering the benefit. Among the report findings are the following key highlights:

- **The number of individuals receiving Section 127 benefits more than doubled between 1992 and 2007**. Approximately 913,100 students received Section 127 benefits during the 2007-08 academic year, compared to 431,500 students in 1992-93, a 112 percent increase.
- **More than half of the Section 127 recipients were undergraduate students**. While the majority of Section 127 recipients were undergraduates, 46 percent were graduate students.
- **The average Section 127 benefit received was $2,700**. The average assistance was $3,701 for graduate students and $1,849 for undergraduate students.
- **The top four majors among Section 127 recipients were business (28 percent), STEM – sciences, technology, engineering, and mathematics (17 percent), education (15 percent) and health (13 percent).**
- **The average age of a Section 127 recipient has barely changed since 1992**. In 2007, the average age for undergraduate students was 37 years old, compared to 36 years old in 1992. The average age for graduate students has not changed over the years – 35 in both 1992 and 2007.
- **The average annual employment earnings of Section 127 recipients were $42,711 for the 2007-08 academic years**. Demonstrating that this benefit was used by individuals that were not highly compensated. This salary data point coincides with 2007 U.S. Census Bureau data that shows average earnings of full-time, year-round employees to be $50,233.
- **The average Section 127 benefits received was $2,700**, with graduate students receiving more ($3,701) than undergraduate students ($1,849).
- **Almost a million students (913,100)** benefit from the Section 127 provision, with each student averaging $2,700 in Section 127 benefits.

Section 127 allows employees to receive tuition assistance from their employers on a tax-free basis.

INTRODUCTION

This report seeks to answer who benefits from the Internal Revenue Service Section 127 provision also known as the employer-provided educational assistance provision. Using Department of Education data from the 2007-08 National Postsecondary Student Aid Study (NPSAS:08), this study analyzes the characteristics of those who receive employer-provided education assistance. Results will demonstrate that various groups (i.e., people having different education goals, majors, and income levels) all utilize Section 127 benefits if offered by their employer. With the provision set to expire at the end of 2010, this report will demonstrate that Section 127 is a critical provision that develops and advances the U.S. workforce.

SECTION 127: A BRIEF EXPLANATION

Section 127 allows employees to receive tuition assistance from their employers on a tax-free basis. The benefit covers undergraduate and graduate education, which includes tuition, fees, expenses, books, supplies, and equipment. Employees can enroll in job-related or non-job-related courses (except for courses related to sports, games, or hobbies). See Appendix A for further explanation.

LEGISLATIVE BACKGROUND

Prior to 1978, only specifically "job-related" educational assistance could be excluded from gross taxable income, under sections 61 and 162 of the Internal Revenue Code. Section 127 of the Revenue Act of 1978 first established employer-sponsored educational assistance as excludable for any type of course, apart from those related to a hobby or sport. Tuition, supplies, and books were covered under the new law, while transportation and meals were not.

In making this change, Congress addressed three broad policy goals:

1. *Reduce administrative inequities arising from uncertainties* – often reflected in conflicting court decisions – over what constituted "job-related" education. Entry-level employees, for example, rarely had job descriptions broad enough to claim an exemption for legitimate educational assistance paid for by an employer.

2. *Reduce the complexity of the tax code.* As the congressional Joint Committee on Taxation wrote, "the previous 'job-related' distinction often seems both ambiguous and restrictive.... Not only must the IRS use valuable personnel time in making [case by case] determinations of taxability, but employees and employers also must justify their positions."[3]

3. *Remove disincentives to upward mobility.* "The tax law has required out-of-pocket tax payments for employer-provided educational assistance from those least able to pay, even though they receive only services, not an increased paycheck."[4] The new law was expected to promote self-improvement and job advancement among lower-paid and less-skilled workers. It also provided incentives to employers, who benefit from reduced administrative costs and are more likely to provide educational assistance as a benefit when it compares favorably with taxable wage increases.

[3] "General Explanation of the Revenue Act of 1978," p. 126, March 12, 1979.
[4] ibid.

Section 127 was originally established as a five-year provision, to give officials time to study it. When it expired at the end of 1983, a series of reauthorization provisions were passed. See Appendix B for the legislative history of Section 127.

SECTION 127 BENEFITS

This study will demonstrate that tax-free employee education benefits are a significant public good. Given incentives like Section 127, employers will invest in the education and training of employees at all levels, with potential dividends for our society and economy. The return on investment is too great of a loss without the Section 127 provision. With the current economy in a recession, a more educated workforce can build opportunities for advancement and development, particularly in the industries of science, technology, and health care. Employers can increase employee recruitment, loyalty, and retention through Section 127. The federal government should not interfere with this process by taxing employer-provided educational assistance benefits.

As demonstrated over the past ten years, Section 127 has met and exceeded Congressional intent. By reducing administrative inequities arising from what is considered "job-related" education, to eliminating the confusion created by overlapping provisions in the tax code, and finally by giving employees the opportunity to advance themselves within their careers, this provision has provided millions with a unique opportunity and benefit.

Furthermore, an unintended outcome from Section 127 has been the ability of this provision to address the growing concern in America regarding skills shortages in key industries. With the Section 127 recipients taking advantage of the benefit to pursue degrees in the areas of sciences, technology, engineering, mathematics (STEM) as well as in education and health, this provision works to maintain US competitiveness while strengthening the skill sets of US workers.

Section 127 is an efficient and cost-effective provision that deserves to be made a permanent part of the tax code.

METHODOLOGY

This report updates the 1995 report by analyzing data from the 2007-08 National Postsecondary Student Aid Study (NPSAS:08), prepared by the U.S. Department of Education's National Center for Education Statistics (NCES). The NPSAS:08 provides a student-level study of trends in student financial aid among postsecondary education students in the United States and Puerto Rico. In particular, NPSAS data allow analysts to distinguish between reimbursement for coursework and other sources of assistance, such as fellowships, scholarships, grants, and loans. NPSAS data also provide information on costs for tuition, fees, books, and supplies (all of which are tax-free reimbursable expenses under Section 127) and other costs, such as meals and transportation, which are not reimbursable.

This report follows the methodologies used in the 1989 Coopers and Lybrand report, which used NPSAS:87 and the 1995 National Association of Independent College and Universities report, which used NPSAS:94. NPSAS:08 has two student-level datasets, undergraduate and graduate, which are publicly accessible through NCES' Data Analysis System (DAS). NPSAS:08 surveyed approximately 113,500 undergraduate and 14,200 graduate students, who were statistically weighted to represent 20.9 million undergraduate and 3.5 graduate students. Of this weighted number, 913,100 undergraduate and graduate students (3.7 percent) were identified as Section 127 beneficiaries. Data from these students, collected from the NPSAS student questionnaire, served as the basis for this analysis.

Both student-level datasets have the proxy variable "employer aid (student), " which is used to identify recipients of Section 127. This variable provides the dollar amount of employer aid. This report assumes that other school-related costs, such as transportation and meals, are not included in the employer-aid amount.

To accurately select Section 127 recipients as well as to identify individuals who received tax-free or taxable educational assistance, restrictions were implemented to the analysis. This report's sample was restricted to the following conditions:

1. **Full-time employment**. Students must have worked an average of 35 hours per week or more during the 2007-08 academic year. The assumption is that employers were more likely to provide Section 127 aid only to their full-time staff.

2. **Part-time enrollment**. Another assumption was that full-time employees could be enrolled only on a part-time basis.

3. **Financially independent**. Because these students tend to be older than traditional-aged college students, they are much more likely to have jobs that qualify for Section 127 benefits than students who are financially dependent on their parents to meet college costs. Independent students also tend to have higher employment earnings than dependent students.

One additional analytical note: Employee's work earning were used rather than total income or adjusted gross income to measure the distribution of benefits by income level. Work earnings are a better measure of the types of jobs held by beneficiaries. Total income may include income from assets and other non-employment sources, and thus may not be an accurate measure of employees who benefit from Section 127.

Approximately 913,100 students were identified in the NPSAS:08 survey as having received Section 127 benefits at some time during the 2007-08 academic year.

STUDY'S RESULTS

Approximately 913,100 students were identified in the NPSAS:08 survey as having received Section 127 benefits at some time during the 2007-08 academic year. More than half (54 percent) of these students were undergraduates, and 89 percent were enrolled in academic programs that led to degrees or educational certificates.

This section provides information on the educational and demographic characteristics of the undergraduate and graduate students who received Section 127 benefits. To identify section 127 recipients, the sample used in this study was narrowed to examine students that met certain characteristics. This study analyzed students who received employer assistance aid (excludes waivers and tuition remissions), worked full-time, enrolled part-time, and were deemed independent (i.e., no one can claim the student as a dependent).

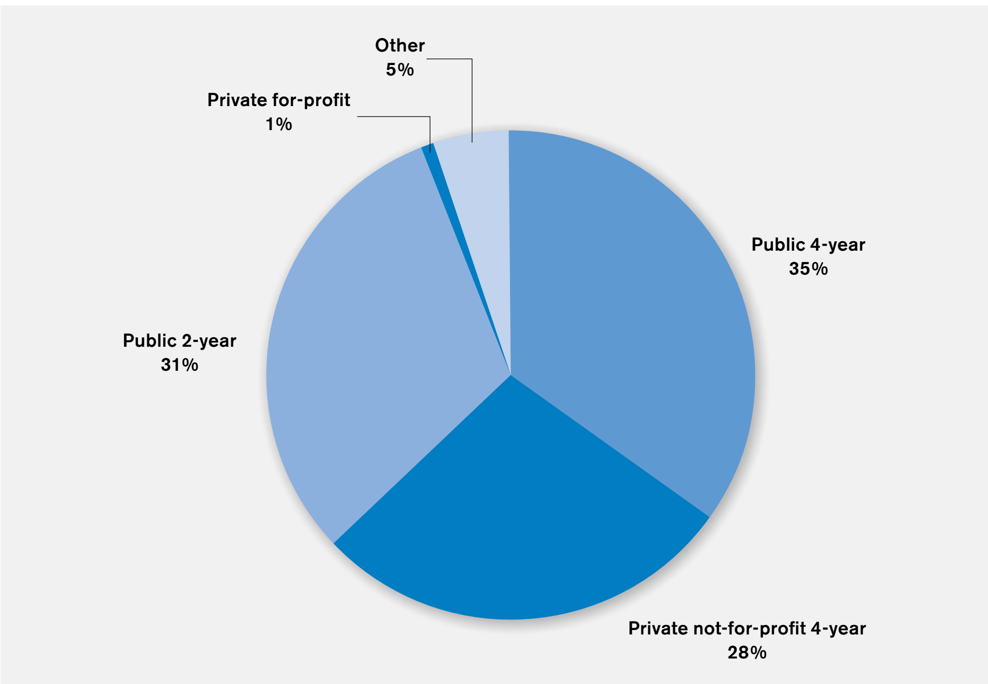
The first section of this report provides details on the types of higher education institutions these students attended, and the students' academic levels. Subsequent sections provide information on the number of recipients by their academic degree programs; major fields of study; age; full-time employment; type of employment; employment earnings levels; and award levels. Each of these sections shows the number of students who received Section 127 awards, and their average award amounts.

RECIPIENTS BY TYPE OF INSTITUTION AND ACADEMIC LEVEL

Section 127 recipients attended a wide variety of postsecondary education institutions – including community colleges (undergraduates only), state colleges and universities, four-year independent (private, non-profit) colleges and universities, and private, for-profit colleges and universities.

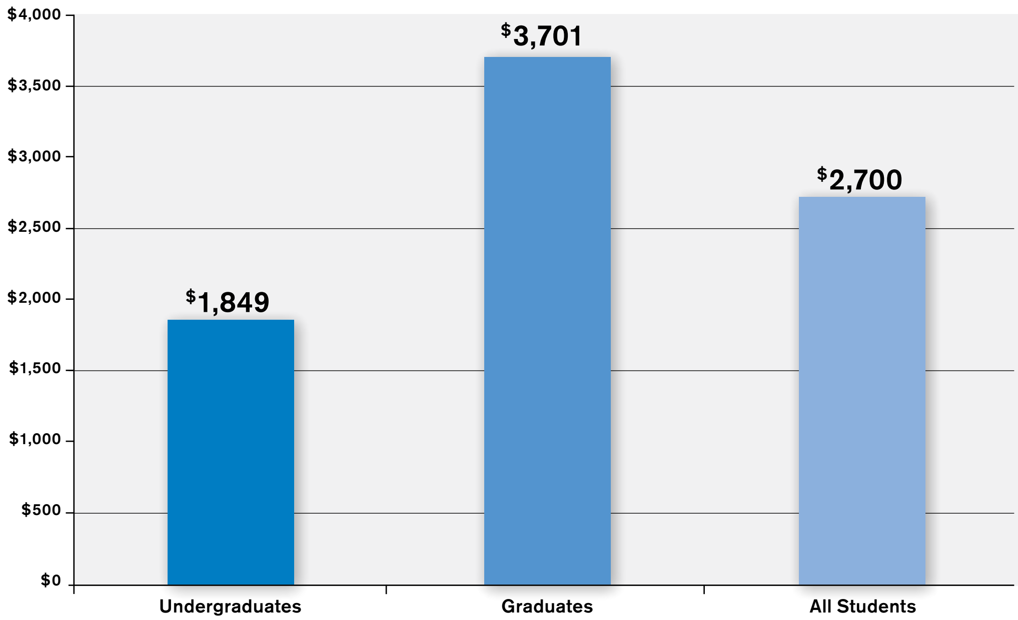
Figure 1 shows that over 30 percent of the beneficiaries attended two-year public colleges (community colleges), 35 percent were enrolled at four-year public colleges, 28 percent attended four-year independent colleges, and 1 percent enrolled in a private, for-profit (proprietary) school.

FIGURE 1: Type of Institution Attended by Recipients of Employee Educational Assistance



The amounts of Section 127 reimbursements varied greatly by institutional type; that is, Section 127 recipients at public institutions generally received smaller average awards than recipients at private institutions. The average award was $1,085 for undergraduate students who attended community colleges, $2,183 for recipients at four-year public colleges, $3,708 for those enrolled at independent colleges, and $4,419 for students at private for-profits.

FIGURE 2: Average Section 127 Benefits, by Grade Level



Average reimbursement amounts differed primarily because the price of tuition and fees charged at each institutional type varied greatly. The NPSAS data show that the average tuition and fees charged to undergraduates who attended a public two-year college was $1,153, compared to $5,506 for those who attended four-year public colleges, $17,804 for those at independent colleges, and $10,168 for those at for-profit colleges.

Tuition and fee costs and average Section 127 reimbursements varied widely by students' academic levels (undergraduate versus graduate). Because graduate students generally were charged higher prices for tuition and fees, they received larger amounts to cover these expenses. The average tuition and fee price charged to graduate students was $9,406, while the average for undergraduates was $5,801. The average amount reimbursed by employers for graduate students was $3,701, compared to $1,849 for undergraduates.

The average price of tuition and fees for all Section 127 recipients was $3,370. This measures closely with the average Section 127 benefit of $2,700. The difference ($670) is probably due to sampling variations within the NPSAS survey. It is likely that a majority of students used most of their employee educational assistance reimbursements to cover the price of tuition and fees at their higher education institutions, and that differences in award sizes were due primarily to different levels of tuition and fees.

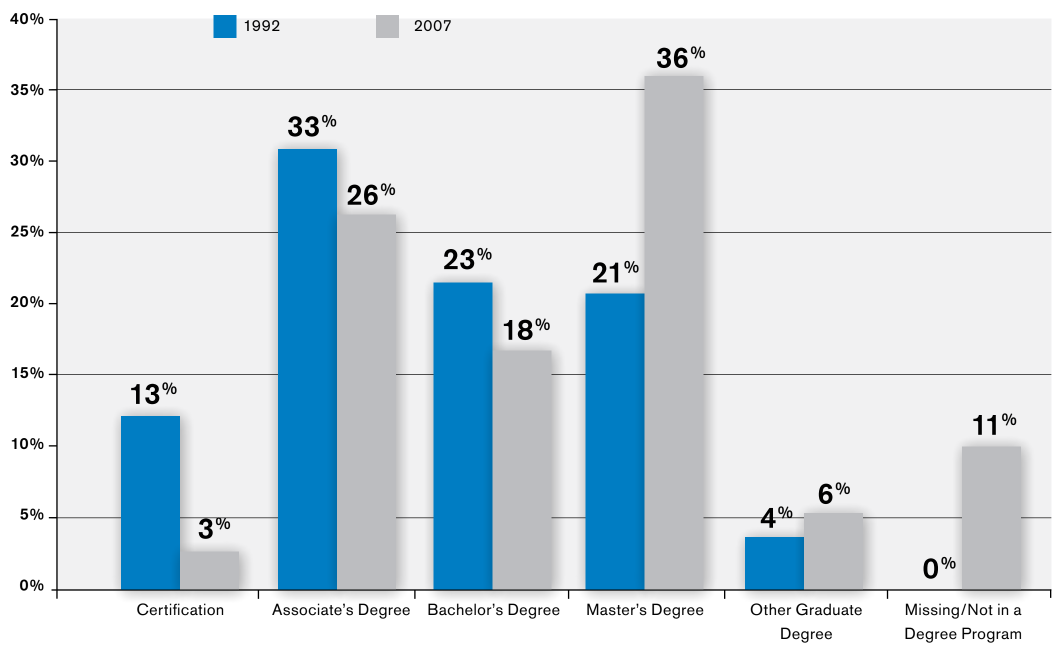
With almost a million students benefiting from the Section 127 provision in 2007-08 and with each student receiving an average of $2,700 in Section 127 benefits, this provision does not only benefits students' careers but also employers and the nation's economic development. Without employer-provided education assistance, employees would be less likely to return to school for professional development and advancement, which would result in a significant loss for U.S. industries and economy.

RECIPIENTS BY DEGREE PROGRAM

The largest change between 1992 and 2007 showed more Section 127 recipients sought advanced degrees; 42 percent in 2007, compared with 25 percent in 1992 (Figure 3). Thus, there was a large decline from 1992 to 2007 in the proportion of Section 127 recipients seeking a certificate, associate's, or bachelor's degree.

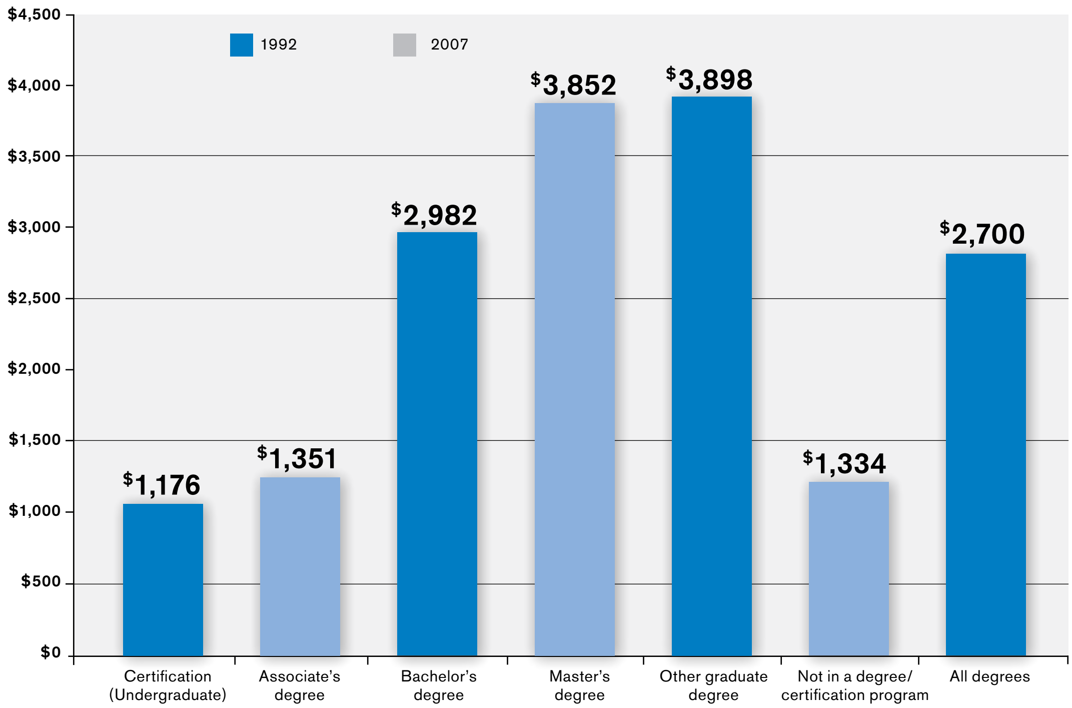
Another interesting finding is that nearly 95 percent of all section 127 recipients said they were pursuing a degree or certificate during the 1992-93 academic year, whereas almost 90 percent of recipients did the same in 2007, resulting in a 5 percent decrease.

FIGURE 3: Section 127 Recipients, by Type of Degree Pursued, 1992 v. 2007



Source for 1992 percentages: National Association of Independent Colleges and Universities, "Who Benefits from Section 127? A Study of Employee Education Assistance Provided under Section 127 of the Internal Revenue Code." December 1995.

FIGURE 4: Average Section 127 Benefits, by Type of Degree



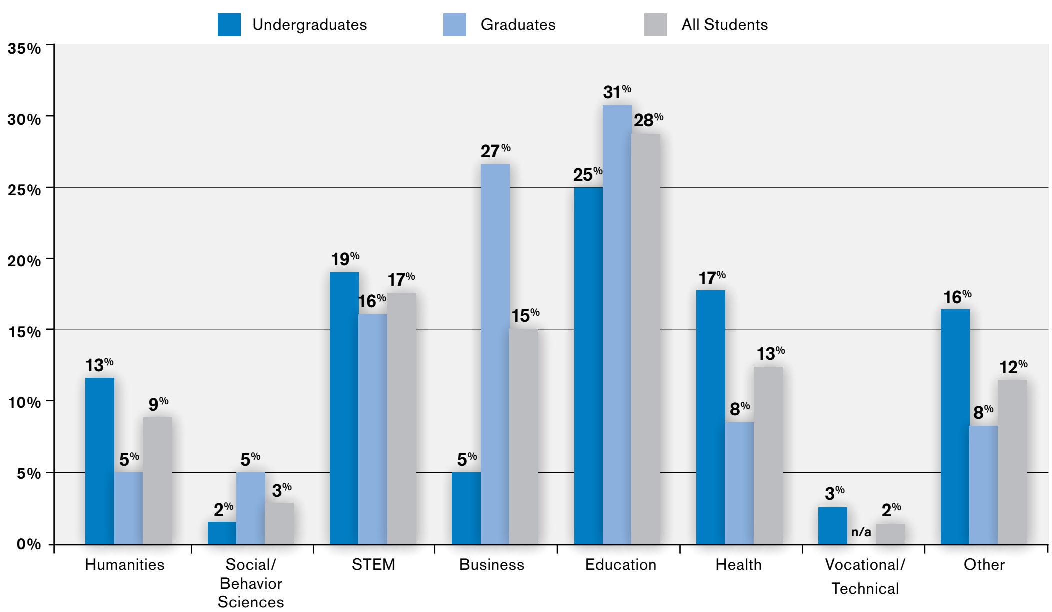
In 2007, students in graduate degree programs received larger reimbursements than those in undergraduate degree programs (see Figure 4). Students in other graduate degree programs received the largest average reimbursements, $3,898, while those seeking bachelor's degrees received $2,982, and those in pursuit of associate degrees received $1,351. As suggested earlier, these award amounts reflect differences in the price of tuition and fees charged to undergraduate and graduate students.

RECIPIENTS BY ACADEMIC MAJOR

The top four majors among all Section 127 recipients were business (28 percent), STEM – sciences, technology, engineering, and mathematics (17 percent), education (15 percent), and health (13 percent) (Figure 5). "Business" included fields such as management, accounting, finance, marketing, business administration, etc. While there were more graduate students majoring in business and education than undergraduates, there were slightly more undergraduates majoring in STEM than graduate students.

Majors that had substantially more undergraduate recipients than graduate recipients were health (17 percent), other (16 percent), and humanities (12 percent). "Other" includes undeclared, agriculture, communication, public administration, library science, mechanical technologies, and criminology majors.

FIGURE 5: Section 127 Recipients, by Type of Degree Pursued, 1992 v. 2007



Business and social/behavioral sciences majors received the largest average reimbursements – $3,595 and $3,193, respectively. Students that majored in vocational or technical fields received the smallest average reimbursements, $1,369, of all the major fields.

RECIPIENTS BY AGE

Section 127 recipients are generally older than "traditional age" college students. This is probably because Section 127 students are more likely to be financially independent – that is, they are more likely to pay their college and other expenses from their own wages and savings – and they are more likely to work full-time while they attend college part-time. Students of "traditional" college age – 18 to 22 years old – are more likely to depend on their parents to pay their college tuition, fees and other expenses; are more likely to be enrolled full-time; and are more likely to work part-time.

In 2007, the average age for undergraduate students was 37 years old compared to the average age in 1993, which was 36 years old. The average age for graduate students has not changed over the years as the average age was 35 in both 1993 and 2007.

Figure 6 shows the age distribution of those who received Section 127 benefits by attendance level. At the youngest age range, 24-28, there were more graduate students (28 percent) than undergraduate students (20 percent). At the other end of the age spectrum, 44 and older, there were more undergraduate students (27 percent) than graduate students (23 percent). Thus, the age distribution shows a general pattern of a slight inverse relationship between undergraduate and graduate age ranges. That is, graduate students were younger and undergraduate students were older than their counterparts.

FIGURE 6: Section 127 Benefits Recipients, by Age

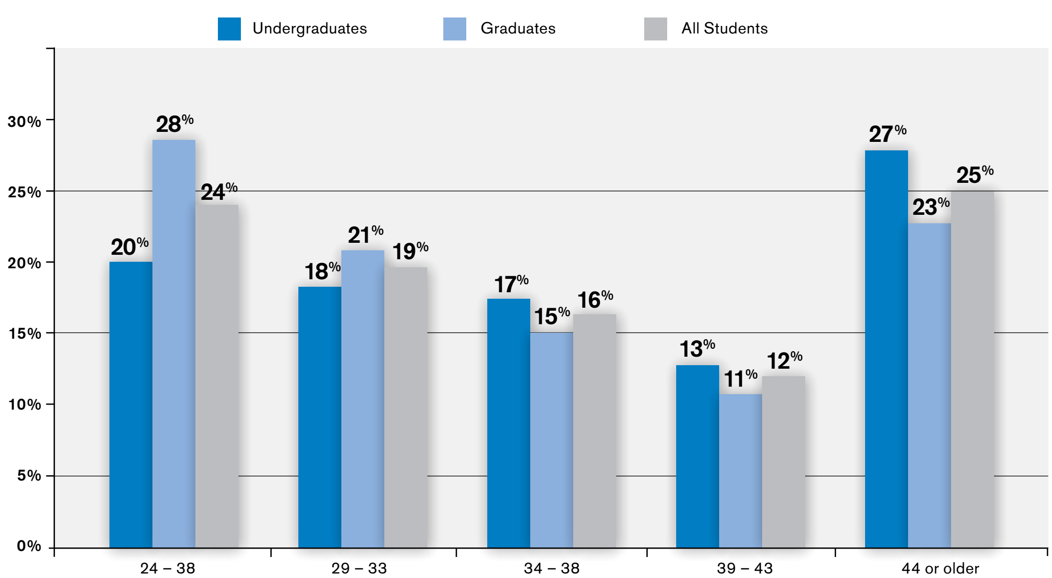
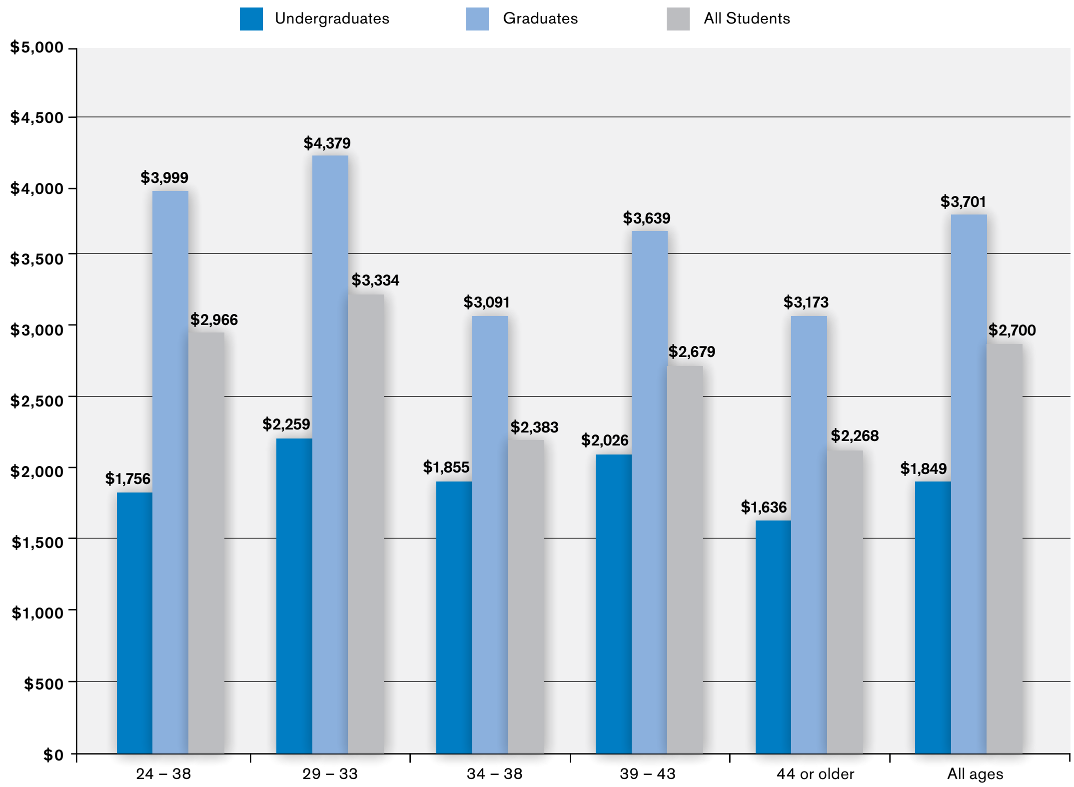


FIGURE 7: Average Section 127 Benefits, by Age



Relatively younger students received the largest average reimbursements, mainly due to the large proportion of graduate students who fall within that age group and the cost of graduate tuition. Students 24-28 years old received an average of $2,966, while those between 29 and 33 received $3,334 (Figure 7). Students ages 39-43 years old received $2,679, while the average award for those 44 and older was $2,268.

RECIPIENTS BY FULL-TIME EMPLOYMENT

Who are the employers that are most likely to offer Section 127 benefits? The majority of Section 127 recipients were concentrated in the following organizational sectors: government, for-profit, and non-profit organizations (Figure 8). The largest share of recipients worked in the for-profit sector (51 percent). Students who work for for-profit companies are more likely to be professionals (e.g., teachers, nurses, engineers, etc); managers or administrators; clerical; and technical occupations, which generally require continuing education for certification or licensure. A fifth of recipients worked for a local, state, or federal government agency.

FIGURE 8: Section 127 Benefits Recipients, by Type of Employer

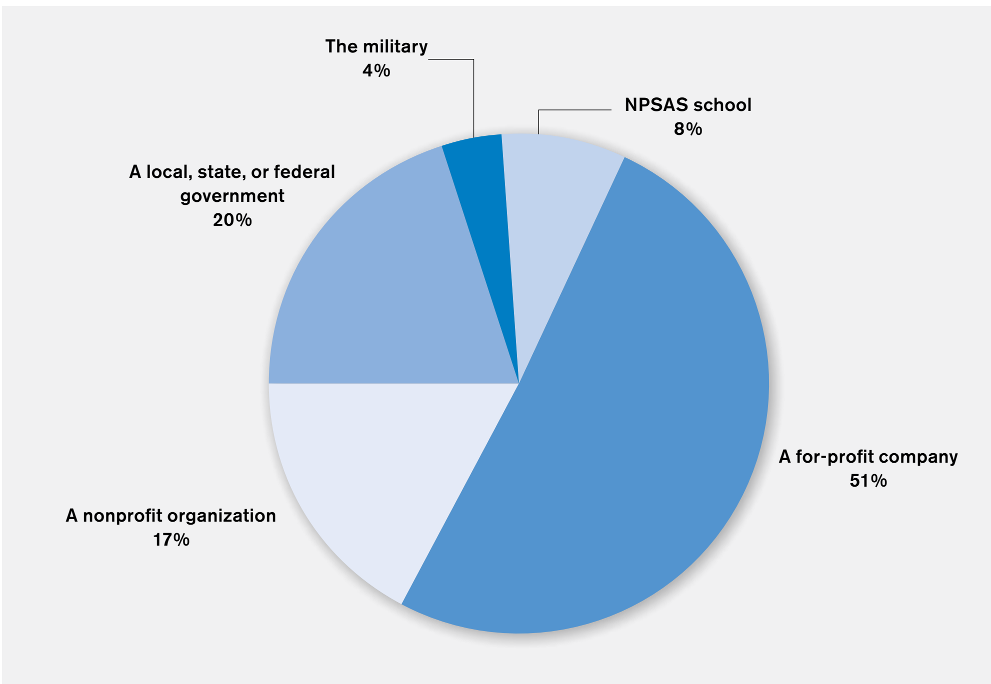


FIGURE 9: **Average Section 127 Benefits, by Type of Full-Time Employer**

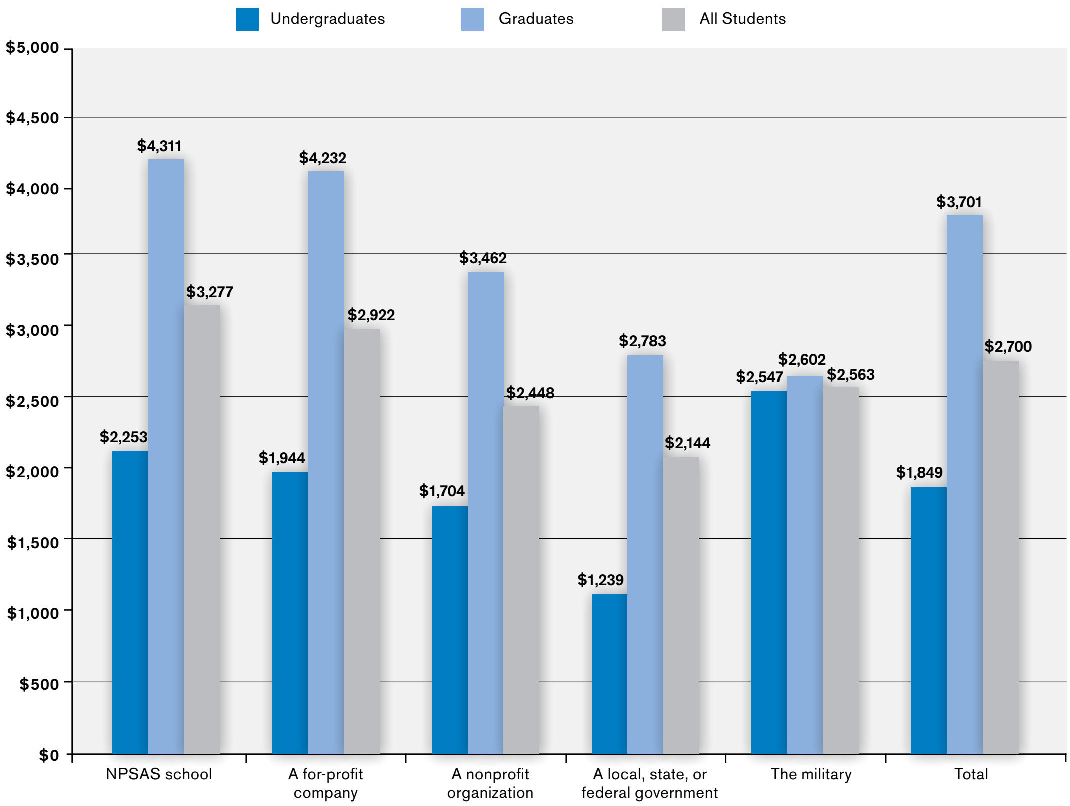


Figure 9 shows the average Section 127 benefit received from the type of employer. The employers that provided the most benefits to their employees were National Postsecondary Student Aid Study (NPSAS) schools (i.e., a college or university), offering an average of $3,277. For-profit companies, while they have the largest share of Section 127 recipients, offered their employees $2,922. Students employed by the military receive relatively the same amount regardless of level (i.e., undergraduate or graduate level).

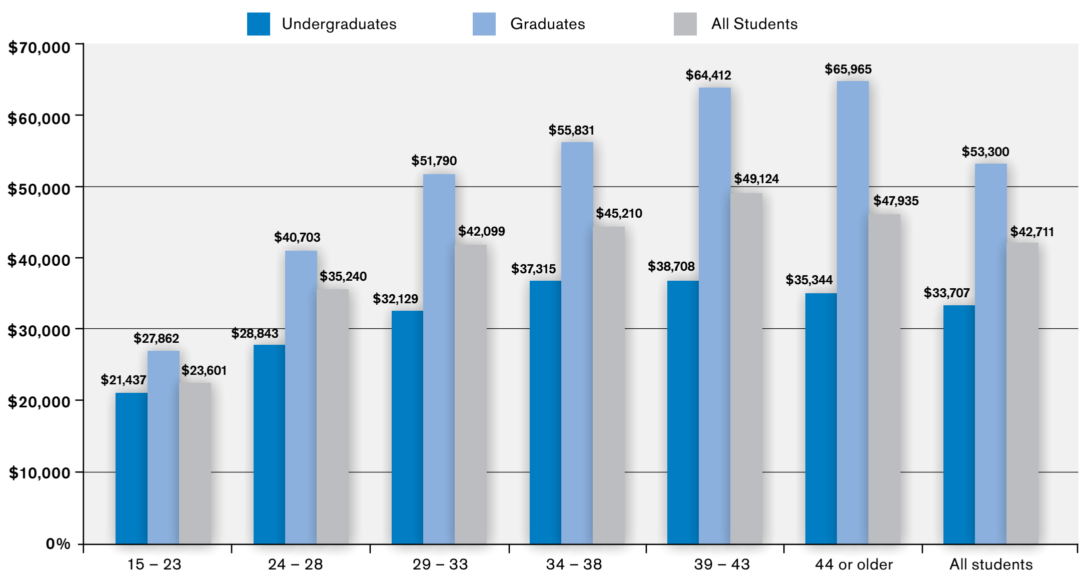
There were differences in benefit levels between undergraduates and graduates depending on employer. Overall, graduate students received more Section 127 aid than undergraduate students. Graduate students employed by a university or college (i.e., NPSAS school) received the most Section 127 amount, $4,311, which is not much more than the benefits received by for-profit companies, $4,232. While graduate students received more in Section 127 aid due to the fact that graduate education costs more than undergraduate education, undergraduate Section 127 recipients appears to receive more aid ($2,253) if employed by a university or college (i.e., NPSAS school) than any other industry in this study

RECIPIENTS BY EARNING LEVELS

The average annual employment earnings of Section 127 recipients were $42,711 for the 2007-08 academic years, demonstrating that this benefit was used by individuals that were not highly compensated. This salary data point coincides with 2007 U.S. Census Bureau data that shows average earnings of full-time, year-round employees to be $50,233.

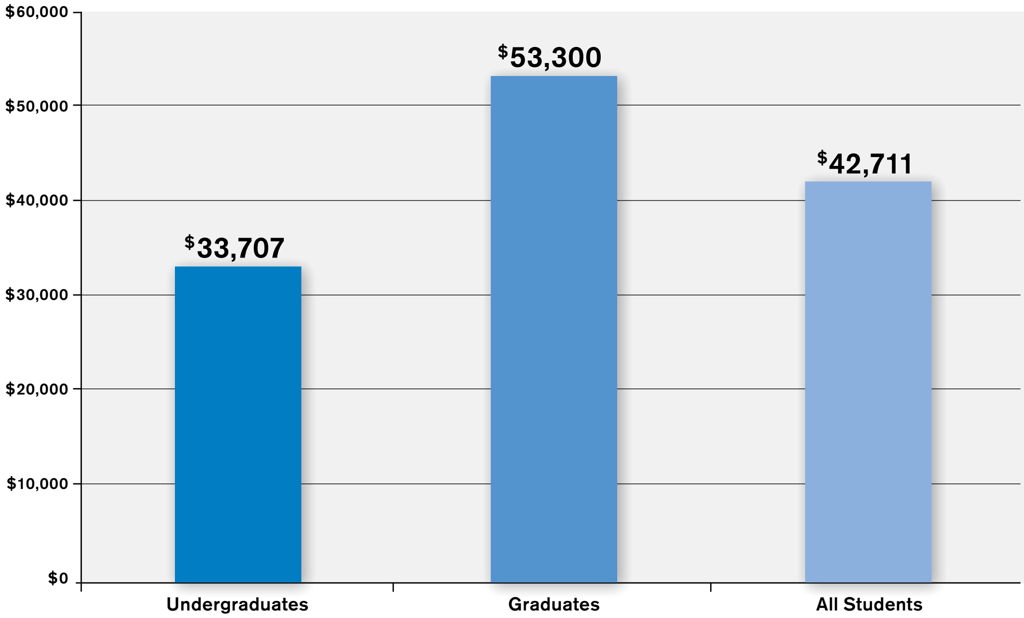
On average, older Section 127 recipients had higher employment earnings than younger recipients. Section 127 recipients ages 24 to 28 had average earnings of $35,240, compared to $49,124 for those ages 39 to 43. This finding is not unusual because earnings of older workers are generally higher than those of younger ones due to a variety of elements including experience and time in the workforce.

FIGURE 10: Average Annual Earnings of Section 127 Recipients by Age



U.S. Census Bureau (2008) "Income, Poverty, and Health Insurance Coverage in the United States: 2007." Washington, DC. http://www.census.gov/prod/2008pubs/p60-235.pdf

FIGURE 11: Average Annual Earnings of Section 127 Recipients, by Grade Level



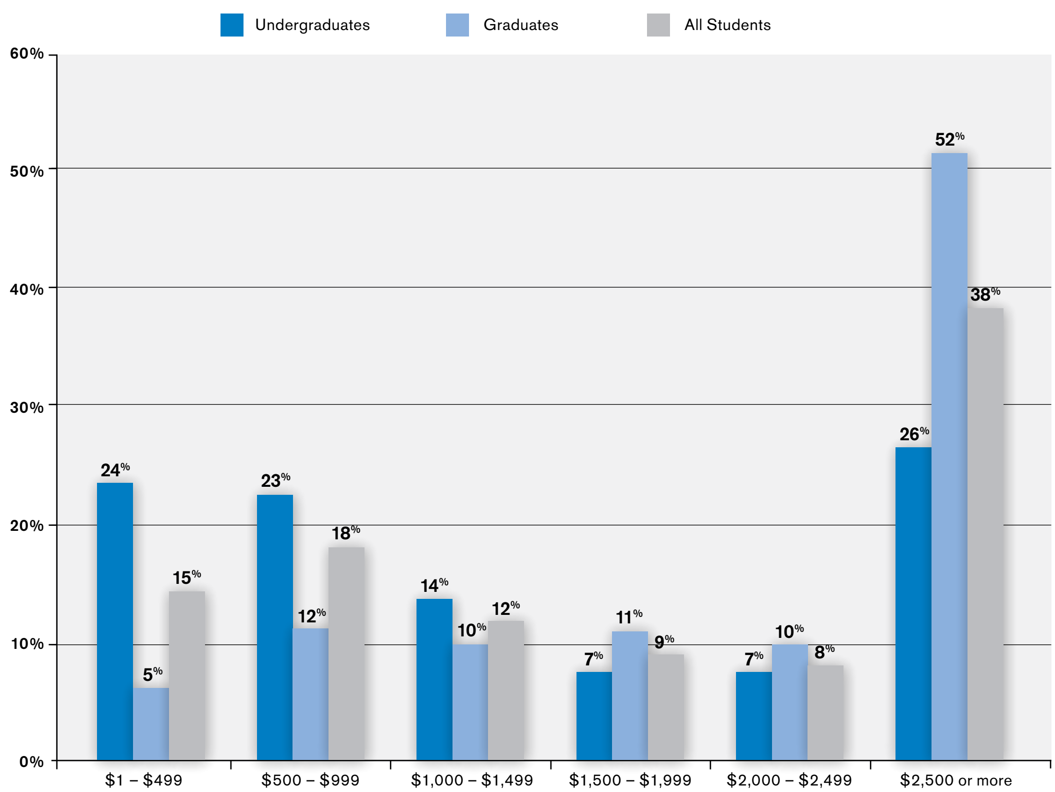
The average annual earning was $53,300 for graduate students and $33,707 for undergraduates (Figure 11). This finding is not surprising considering that many Section 127 graduate students are older and most likely have been in the workforce longer than undergraduate students.

RECIPIENTS BY ASSISTANCE LEVELS

Thirty-eight percent of Section 127 beneficiaries received awards of $2,500 or more (Figure 12). This is primarily due to the large proportion of graduate students. More than half of the graduate student recipients received an award greater than $2,499. The average award for those who received at least $2,500 was $5,980.

Undergraduates are more likely to receive smaller awards. Forty-seven percent of undergraduates received reimbursements of less than $1,000, while 26 percent received $2,500 or more. The average undergraduate award for those who received at least $2,500 was $4,753.

FIGURE 12: Section 127 Benefits, by Level of Assistance Payments



With almost a million students benefiting from the Section 127 provision and with each student averaging $2,700 in Section 127 benefits, this provision is proven to be an important tool for employers and employees.

CONCLUSION

Section 127 is an important provision that needs to not only be extended after 2010, but to be made permanent. This study shows that several groups of various backgrounds (i.e., people with different education goals, majors, and income levels) all benefit from Section 127.

With almost a million students benefiting from the Section 127 provision and with each student averaging $2,700 in Section 127 benefits, this provision is proven to be an important tool for employers and employees. Employer-provided education assistance benefits not only students' careers but also the employers' workforce and nation's economic development. Without this benefit, employees would be less likely to return back to school for professional development and advancement, which would be a considerable loss for U.S. industries and economy.

As demonstrated over the past ten years, Section 127 has met and exceeded Congressional intent. By reducing administrative inequities arising from what is considered "job-related" education, to eliminating the confusion created by overlapping provisions in the tax code, and finally by giving employees the opportunity to advance themselves within their careers, this provision has provided millions with a unique opportunity and benefit.

With the current economy in a recession, a benefit like Section 127 provides the workforce with the opportunity for advancement and development within their careers. Likewise, employers can utilize Section 127 to increase employee recruitment, loyalty, and retention, increasing their global competitiveness and strengthening the skill sets of their workforce. Section 127 is a critical provision that develops and enhances the U.S. workforce and economy and cannot be overlooked.

Section 127 is an efficient and cost-effective provision that deserves to be made a permanent part of the tax code.

With the current economy in a recession, a benefit like Section 127 provides the workforce with the opportunity for advancement and development within their careers.

Appendix A

Differentiating Between Job-Related and Non-Job-Related Educational Benefits

SECTION 127: NON-JOB-RELATED BENEFITS

Section 127 allows an employee to exclude from income up to $5,250 per year in educational assistance at the undergraduate and graduate level. An exclusion is allowed for any educational course except those involving sports, games, or hobbies.

Employers are not required to provide Section 127 assistance to their employees. However, if an employer chooses to do so, the benefit must be offered to all employees on a nondiscriminatory basis that does not favor the highly compensated. Only employees, including retired, disabled, or laid-off employees, can benefit.

SECTION 162: JOB-RELATED BENEFITS

Section 162(a) of the Internal Revenue Code allows as a deduction "all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business." Although education expenses are not mentioned in the statute, Treasury regulations

(24 CPR 1.162-5) define the "job-relatedness" test by specifically including education expenses as ordinary and necessary deductible business expenses.

An employer may exclude from an employee's taxable income the costs for job-related educational courses as a "working condition fringe benefit" under section 132(d) of the code. Section 132(d) defines a working condition fringe benefit as "any property or services provided to an employee of the employer to the extent that, if the employee paid for such property or services, such payment would be allowable as a deduction under section 162 or 167."

Under Treasury regulation 1.162-5, an employer or individual may be able to deduct educational expenses as "ordinary and necessary business expenses" if the education is for:

1. Employees who maintain or improve skills required by the individual in his or her employment or other trade or business; or

2. Employees who meet the express requirements of the individual's employer or the requirement of an applicable law or regulation, imposed as a condition of employment.

However, under 1.162-5, expenses are not deductible if the education is:

1. Needed to meet the minimum educational requirement to qualify the individual for employment in a new trade or business; or

2. Required as part of a program of study that can qualify the individual for a new trade or business.

SECTION 162 VS. SECTION 127

The allowable deductions for educational expenses under section 162 are much narrower than in Section 127. In practice, the narrowness of the job-relatedness test means that most entry-level employees who are broadening their skills and knowledge to qualify for an advanced or more responsible position are unlikely to meet the requirements of section 162. Conversely, education undertaken by more highly skilled employees, or those with broader job descriptions, are more likely to meet the job-relatedness test under section 162.

Section 162 is also more cumbersome for employers to administer than Section 127. To make reimbursements under section 162, the employers must determine that the course meets the job-relatedness test. The test is both ambiguous and narrow. As a result, the Internal Revenue Service and the courts have made arbitrary decisions about what types of employer-provided educational assistance qualify for reimbursement.

An employer who chooses not to assume the liability of applying the job-relatedness test would include the cost of the benefit in the employee's compensation. However, it would then be subject to federal and state taxes, significantly increasing the employee's tax burden.

If the employee determined that his or her educational costs met the requirements of Treasury regulation 1.162-5, they could be deducted from taxable income – if the employee files an itemized federal tax return and the miscellaneous itemized deductions exceed 2 percent of adjusted gross income.

Appendix B

Section 127: Legislative History

1978: Congress passes the Revenue Act of 1978 (Public Law 95-600), creating Section 127 of the Internal Revenue Code. The initial provision is effective for five years, beginning on January 1, 1979.

1984: Public Law 98-611 retroactively extends Section 127 from January 1, 1984, to December 31,1985. The extension set a $5,000 annual limit on the amount that can be deducted from income taxes and establishes an annual reporting requirement under section 6039D of the Internal Revenue Code.

1986: Public Law 99-514 retroactively extends Section 127 from January 1, 1986, to December 31, 1987. The annual exclusion limit is raised to $5,250; employers are required to report the number of highly compensated employees participating in the plan.

1988: Public Law 100-647 retroactively extends Section 127 from January 1, 1988, to December 31, 1988. The extension disqualifies formerly eligible graduate courses.

1989: Public Law 101-239 contains a retroactive 19-month extension of Section 127, from January 1, 1989, to September 30, 1990.

1990: Public Law 101-508 retroactively extends Section 127 from October 1, 1990, to December 31, 1991. The extension reinstates the eligibility of graduate-level courses, effective for taxable years beginning after December 31, 1990.

1991: Public Law 102-227 contains a retroactive six-month extension of Section 127, from January 1, 1992, to June 30, 1992.

1993: Public Law 103-66 contains a retroactive 18-month extension of Section 127, from July 1, 1992, to December 31, 1994.

1994: Public Law 85-536 retroactively extends Section 127 as part of the Small Business Job Protection Act from January 1, 1995, through June 2007.

1995: H.R. 127 introduced on January 3, 1995, by Representatives Sander M. Levin (D-Mich.) and E. Clay Shaw, Jr. (R-Fla.). S. 1095 introduced on August 1, 1995, by Senators Daniel Patrick Moynihan (D-N.Y.) and William V. Roth, Jr. (R-Del.). Both bills would make Section 127 a permanent part of the tax code.

1997: H.R. 127 introduced on January 7, 1997, by Representative Sander M. Levin (D-Mich.) and included 149 cosponsors. H.R. 430 introduced on January 9, 1997, by Representative Owen Pickett (D-Va.). S. 127 introduced on January 21, 1997, by Senator Daniel Patrick Moynihan (D-N.Y.) and included 49 cosponsors. Both bills would make Section 127 a permanent part of the tax code.

1999: H.R. 323 introduced by Representative Sander M. Levin (D-Mich.) and contained 136 cosponsors. H.R. 1014 introduced March 4, 1999, by Representative Owen Pickett (D-Va.). S. 211 introduced on January 19, 1999, by Senator Daniel Patrick Moynihan (D-N.Y.) and included 26 cosponsors. Both bills would make Section 127 a permanent part of the tax code.

1999: S. 1972, The Tax Relief Extension Act of 1999 passed Congress and extended only the undergraduate portion of employer-provided education assistance.

2001: H.R. 1483 introduced on April 4, 2001, by Representative Sander M. Levin (D-Mich.) and included 49 cosponsors. S. 133 was introduced on January 22, 2001, by Senator Max Baucus (D-Mont.) and contained 18 cosponsors. The bills were ultimately incorporated in the Economic Growth and Tax Relief Reconciliation Act of 2001 (Public Law 107-16), which was signed into law on June 2, 2001. This new extension pertained to both undergraduate and graduate studies that began after December 31, 2001. The provision is set to expire on December 31, 2010 and makes employer-provided education assistance tax deductible.

2007: H.R. 3418 was introduced on August 3, 2007, by Representative Sander M. Levin (D-Mich.) and contained 51 sponsors. S. 454 was introduced on January 31, 2007, by Senator Susan Collins (R-Maine). Both bills would make Section 127 a permanent part of the tax code.

2010: H.R. 5600 was introduced on June 25, 2010, by Representatives Earl Pomeroy (D-ND) and Sam Johnson (R-TX). The bill would make Section 127 a permanent part of the tax code.

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