

ATTORNEY-CLIENT PRIVILEGED COMMUNICATION ATTORNEY WORK PRODUCT CONFIDENTIAL

Background:

We understand that the City of Stamford Board of Finance has recently inquired to the Stamford Board of Education (BOE) about the tax treatment of the Professional Courtesy Tuition Waiver Benefit provided by the BOE to its nonresident and resident employees. In particular, the following was noted by one or more members of the Board of Finance:

The Advocate reported that the BOE added or updated their "Professional Courtesy" policy allowing the children of non-resident teachers to attend the Stamford Public Schools displacing residents' children from sought after magnet programs. During the budget review process this benefit was valued at \$20.5K per pupil. The article was unclear as to how this benefit was handled in Stamford where payroll is concerned. I believe IRS regulations require that such a fringe benefit be reported as income on the employees' W2s and obligates the City to pay FICA taxes on those same earnings. Failure to pay FICA can subject the City to significant fines.

Specifically, I would like the BOE to identify the additional income they are reporting, whether or not they use a standard figure for all grades, and what that standard amount is. If the BOE differentiates by grade level, what is the breakdown by grade level, and how did BOE arrive at the value(s) that are being reported. If the BOE/City is not reporting this benefit as income to our nonresident employees, I would like them to identify the specific guidance they are using to justify their approach.

Nature of the Professional Courtesy Tuition Waiver Benefit

Children residing in the City of Stamford (Stamford) may attend the Stamford Public Schools (SPS) from kindergarten through twelfth grade free of charge pursuant to Connecticut state law. Accordingly, for employees of the SPS who are residents of Stamford, even though they are eligible for the Professional Courtesy Tuition Waiver Benefit, since, under state law, their children qualify for a free public school education, their receipt of the Professional Courtesy Tuition Waiver Benefit has no taxable value to them. SPS's Professional Courtesy Tuition Waiver Benefit also allows children of eligible non-resident BOE employees to attend public schools in Stamford. Typically, if a Stamford non-resident wished to attend a SPS school (provided there was space for the student),

tuition would have to be paid. As a benefit to SPS certified employees, a Professional Courtesy Tuition Waiver Benefit is offered by the BOE, thereby allowing SPS eligible employees to have their children attend SPS schools for free. This SPS policy (referred to as the Professional Courtesy Tuition Waiver Benefit) has been in place in Stamford for many years and has been viewed by the SPS as an important recruitment and retention tool. All certified employees of the SPS are eligible for the Professional Courtesy Tuition Waiver Benefit, whether or not the employee lives in Stamford. Those employees whose children are enrolled pursuant to the Professional Courtesy Tuition Waiver Benefit pay no tuition to the SPS, which essentially has a compensatory value to the employee equal to the tuition rate (e.g., the per pupil rate) that other non-resident, non-SPS certified employees who send their children to the SPS system would otherwise be charged.

Based on the Q & A responses in the memo from Dr. Lucero, dated June 16, 2023, it is our understanding that all SPS certified staff (e.g., certified teachers and certified administrators) are eligible for the Professional Courtesy Tuition Waiver Benefit. The Professional Courtesy Tuition Waiver Benefit is available on substantially the same terms to all members of a group of employees which is defined under a reasonable classification set up by the BOE (e.g., all certified staff of the BOE) that does not discriminate in favor of “highly compensated employees,” as defined in Section 414(q) of the Internal Revenue Code (i.e., employees earning more than \$150,000 in 2022). According to current employee total headcounts provided to Shipman by the BOE, the BOE employs (a) 1513 certified teachers who are all eligible for the Professional Courtesy Tuition Waiver Benefit, and all of these BOE teachers earn below \$150,000; accordingly, these teachers are all considered non-highly compensated employees under Code Section 414(q); and (b) approximately 88 certified administrators who are all eligible for the Professional Courtesy Tuition Waiver Benefit, all of whom we understand earn above \$150,000. Based on this employee data and compensation, of the 1600 or so eligible employees of the BOE who are eligible for the Professional Courtesy Tuition Waiver Benefit, 94% are non-highly compensated employees.

Answer: The Professional Courtesy Tuition Waiver Benefit can be treated as a non-taxable employee benefit received by each certified employee of the BOE that elects to enroll their children in the SPS system.

Legal Analysis:

1. In general, any amounts paid by an employer to or for the benefit of an employee are compensatory in nature and includable in gross income as taxable wages; however, “qualified tuition reduction,” such as the Professional Courtesy Tuition Waiver Benefit, is not includable in gross income under IRC 117(d), provided that this benefit is tax-free¹ only where the reduction is available on substantially the same terms to all members of a group of employees which is defined under a

¹ If a tuition reduction plan is determined to be discriminatory in favor of highly-compensated employees, then only the highly compensated employee who receive the benefit are taxed on the benefit, pursuant to section 117(d)(3) of the Code. The tuition reduction received by non-highly-compensated employees continues to be non-taxable to them.

reasonable classification set up by the employer that does not discriminate in favor of “highly compensated employees,” as defined in Section 414(q) of the IRC. For 2023, Section 414(q)(1)(B) defines a “highly compensated employee” as any employee whose compensation in the prior year exceeds \$150,000.²

We believe that the employee eligibility group for the Professional Courtesy Tuition Waiver Benefit – all certified staff – would be considered by the IRS to be a reasonable classification set up by the BOE that does not discriminate in favor of “highly compensated employees,” as defined in Section 414(q) of the IRC. In a Private Letter Ruling³ issued by the IRS (e.g., 2010 private letter ruling 201029003) that analyzes whether actual tuition reduction employee benefits are non-discriminatory within the meaning of Code Section 117(d)(3), the IRS noted the following factors for determining whether a classification was reasonable:

“Section 1.410(b)-4(b) of the Regulations provides that a classification will be reasonable if, based on all of the facts and circumstances, the classification is reasonable and established under objective business criteria that identify the category of employees who benefit under the plan. Reasonable classifications include specified job categories, nature of compensation (i.e., salaried or hourly), geographic location, and other similar bona fide business criteria. The House Ways and Means Committee Report on the Deficit Reduction Act of 1984, H.R. Rep. No. 98-432, Part 2, 98th Cong., 2d Sess. 1606 (1984), provides additional examples of reasonable classifications. The report explains that an employer could establish a classification based on such factors as seniority, full-time vs. part-time employment, or job description, provided that the classification is nondiscriminatory.”

Also, in the same Private letter Ruling 201029003, the IRS concluded that in a case where the employer’s tuition reduction benefit is offered to an employee group that comprises more than a safe harbor percentage of an employer’s non-highly compensated employees, then the plan’s classification of eligible employees is considered by the IRS to be a safe-harbor non-discriminatory group. Applying that analysis to the BOE, given the BOE’s high concentration percentage of non-highly compensated employees as an overall percentage of its total employees (e.g., 90% or higher) the ratio percentage of the BOE’s non-highly compensated employees who are benefitting under the plan must be above 27.50% to qualify for the safe harbor. (In the BOE’s case, the ratio percentage is 83.7%, which is well above the safe harbor range for the Plan to be considered non-discriminatory in favor of highly compensated employees.)

² The Compensation amount may adjust annually in \$5,000 increments depending on cost-of-living adjustments announced by the IRS pursuant to the Internal Revenue Code.]

³ In accordance with Section 6110(k)(3) of the Code, a private letter ruling is specific to the taxpayer who sought the ruling and is not binding on the IRS as authority on which other taxpayers may rely. Nor may private letter rulings be used or cited as precedent by other taxpayers.

2. Because children residing in Stamford may attend the SPS schools from kindergarten through twelfth grade free of charge pursuant to Connecticut state law, then for employees of the SPS who residents of Stamford are and who are eligible for the Professional Courtesy Tuition Waiver Benefit, their receipt of the Professional Courtesy Tuition Waiver Benefit has no taxable value to them. Accordingly, the SPS System does not need to withhold or remit income or employment taxes on the value of the benefit provided to these employees residing in Stamford.
3. "Qualified tuition reduction" is defined as the amount of any reduction in tuition provided to any employee of a section 170(b)(1)(A)(ii) educational organization for the education (below the graduate level) at such organization (or another organization described in section 170(b)(1)(A)(ii)), of (A) such employee, or (B) any person treated as an employee (or whose use is treated as an employee use) under the rules of section 132(h) (generally spouses and dependent children).
4. The Stamford Public School District qualifies as a section 170(b)(1)(A)(ii) educational organization. In general, a public school district is considered part of a governmental entity. However, it is likely that a public school district qualifies also as a section 170(b)(1)(A)(ii). Section 170(b)(1)(A)(ii) describes an educational organization as one that normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on. The term "school" includes primary, secondary, preparatory, high schools, colleges and universities. (See IRS Form 1023 Instructions.) In addition, public schools are referenced in relation to section 170(b)(1)(A)(ii) in the Form 1023 Instructions, which is a good indicator that the IRS would permit a public school to be classified as a section 170(b)(1)(A)(ii) entity for purposes of the qualified tuition reduction.

Conclusion: The Professional Courtesy Tuition Waiver Benefit has been made available by the BOE on substantially the same terms to all members of a group of employees (e.g., all certified teachers and certified administrators of the BOE) which is considered a reasonable classification set up by the employer that does not discriminate in favor of "highly compensated employees," as defined in Section 414(q) of the IRC (i.e., employees earning more than \$150,000 in 2022). Therefore, the reduction in tuition cost to employees that live outside of Stamford qualifies as a qualified tuition reduction that is excluded from gross income for the applicable employee. Accordingly, the BOE does not need to withhold or remit income or employment taxes on the value of the benefit provided to the non-resident employee. Furthermore, the BOE does not need to withhold or remit income or employment taxes on the value of the benefit received by those employees residing in Stamford.