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Treas. Reg. Section 1.127-2

Qualified educational assistance program

(a) In general. A qualified educational assistance program is a plan established and maintained by an employer under which the employer provides educational assistance to employees. To be a qualified program, the requirements described in paragraphs (b) through (g) of this section must be satisfied. It is not required that a program be funded or that the employer apply to the Internal Revenue Service for a determination that the plan is a qualified program. However, under §601.201 (relating to rulings and determination letters), an employer may request that the Service determine whether a plan is a qualified program.

(b) Separate written plan. The program must be a separate written plan of the employer. This requirement means that the terms of the program must be set forth in a separate document or documents providing only educational assistance within the meaning of paragraph (c) of this section. The requirement for a separate plan does not, however, preclude an educational assistance program from being part of a more comprehensive employer plan that provides a choice of nontaxable benefits to employees.

(c) Educational assistance.

(1) In general. The benefits provided under the program must consist solely of educational assistance. The term "educational assistance" means-

(i) The employer's payment of expenses incurred by or on behalf of an employee for education, or

(ii) The employer's provision of education to an employee.

(2) Alternative benefits. Benefits will not be considered to consist solely of educational assistance if the program, in form or in actual operation, provides employees with a choice between educational assistance and other remuneration includible in the employee's gross income.

(3) Certain benefits not considered educational assistance. The term "educational assistance" does not include the employer's payment for, or provision of-

(i) Tools or supplies (other than textbooks) that the employee may retain after completing a course of instruction,

(ii) Meals, lodging, or transportation, or

(iii) Education involving sports, games, or hobbies, unless such education involves the business of the employer or is required as part of a degree program. The phrase "sports, games, or hobbies" does not include education that instructs employees how to maintain and improve health so long as such education does

not involve the use of athletic facilities or equipment and is not recreational in nature.

(4) Education defined. As used in section 127, §1.127-1, and this section, the term "education" includes any form of instruction or training that improves or develops the capabilities of an individual. Education paid for or provided under a qualified program may be furnished directly by the employer, either alone or in conjunction with other employers, or through a third party such as an educational institution. Education is not limited to courses that are job related or part of a degree program.

(d) Exclusive benefit. The program may benefit only the employees of the employer, including, at the employer's option, individuals who are employees within the meaning of paragraph (h)(1) of this section. A program that provides benefits to spouses or dependents of employees is not a qualified program within the meaning of this section.

(e) Prohibited discrimination.

(1) Eligibility for benefits. The program must benefit the employer's employees generally. Among those benefited may be employees who are officers, shareholders, self-employed or highly compensated. A program is not for the benefit of employees generally, however, if the program discriminates in favor of employees described in the preceding sentence (or in favor of their spouses and dependents who are themselves employees) in requirements relating to eligibility for benefits. Thus, although a program need not provide benefits for all employees, it must benefit those employees who qualify under a classification of employees that does not discriminate in favor of the employees with respect to whom discrimination is prohibited. The classification of employees to be considered benefited will consist of that group of employees who are actually eligible for educational assistance under the program, taking into account the eligibility requirements set forth in the written plan, the eligibility requirements reflected in the types of educational assistance available under the program, and any other conditions that may affect the availability of benefits under the program. Thus, for example, if an employer's plan provides that all employees are eligible for educational assistance, yet limits that assistance to courses of study leading to postgraduate degrees in fields relating to the employer's business, then only those employees able to pursue such a course of study are considered actually eligible for educational assistance under the program. Whether any classification of employees discriminates in favor of employees with respect to whom discrimination is prohibited will generally be determined by applying the same standards as are applied under section 410(b)(1)(B) (relating to qualified pension, profit-sharing and stock bonus plans), without regard to section 401(a)(5). For purposes of making this determination, there shall be excluded from consideration employees not covered by the program who are included in a unit of employees covered by an agreement which the Secretary of Labor finds to be a collective bargaining agreement between employee representatives and one or more employers, if the Internal Revenue Service finds that educational assistance benefits were the subject of good faith bargaining between the employee representatives and the employer or employers. For purposes of determining whether such bargaining occurred, it is not material that the employees are not covered by another educational assistance program or that the employer's present program was not considered in the bargaining.

(2) Factors not considered in determining the existence of prohibited discrimination. A program shall not be considered discriminatory under this paragraph (e) merely because-

(i) Different types of educational assistance available under the program are utilized to a greater degree by employees with respect to whom discrimination is prohibited than by other employees, or

(ii) With respect to a course of study for which benefits are otherwise available, successful completion of the course, attaining a particular course grade, or satisfying a reasonable condition subsequent (such as remaining employed for one year after completing the course) are required or considered in determining the availability of benefits.

(f) Benefit limitation.

(1) In general. Under section 127(b)(3), a program is a qualified program for a program year only if no more than 5% of the amounts paid or incurred by the employer for educational assistance benefits during the year are provided to the limitation class described in subparagraph (2). For purposes of this paragraph (f), the program year must be specified in the written plan as either the calendar year or the taxable year of the employer.

(2) Limitation class. The limitation class consists of-

(i) Shareholders. Individuals who, on any day of the program year, own more than 5% of the total number of shares of outstanding stock of the employer, or

(ii) Owners. In the case of an employer's trade or business which is not incorporated, individuals who, on any day of the program year, own more than 5% of the capital or profits interest in the employer, and

(iii) Spouses or dependents. Individuals who are spouses or dependents of shareholders or owners described in subdivision (i) or (ii). For purposes of determining stock ownership, the attribution rules described in paragraph (h)(4) of this section apply. The regulations prescribed under section 414(c) are applicable in determining an individual's interest in the capital or profits of an unincorporated trade or business.

(g) Notification of employees. A program is not a qualified program unless employees eligible to participate in the program are given reasonable notice of the terms and availability of the program.

(h) Definitions. For purposes of this section and §1.127-1-

(1) Employee. The term "employee" includes-

(i) A retired disabled or laid-off employee,

(ii) A present employee who is on leave, as for example, in the Armed Forces of the United States, or

(iii) An individual who is self-employed within the meaning of section 401(c)(1).

(2)Employer. An individual who owns the entire interest in an unincorporated trade or business shall be treated as his or her own employer. A partnership is treated as the employer of each partner who is an employee within the meaning of section 401(c)(1).

(3)Officer. An officer is an individual who is an officer within the meaning of regulations prescribed under section 414(c).

(4)Shareholder. The term "shareholder" includes an individual who is a shareholder as determined by the attribution rules under section 1563(d) and (e), without regard to section 1563(e)(3)(C).

(5)Highly compensated. The term "highly compensated" has the same meaning as it does for purposes of section 410(b)(1)(B).

(i)Substantiation. An employee receiving payments under a qualified educational assistance program must be prepared to provide substantiation to the employer such that it is reasonable to believe that payments or reimbursements made under the program constitute educational assistance within the meaning of paragraph (c) of this section.