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Memorandum

To: Senate Committee on Economic Development, Housing and General Affairs
From: Thomas A. Little, General Counsel, Vermont Student Assistance Corporation (VSAC)
Date: March 12, 2020
Re: S. 331 and the Income Tax Treatment of Two Scenarios Where Vermont Higher Education Investment Plan (VHEIP) Accounts Might Be Used by Employers to Provide Student Loan Repayment Benefits to Employees

The Memorandum presents scenarios for how Vermont employers and employees might use college savings plan accounts established under the Vermont Higher Education Investment Plan ("VHEIP," 16 V.S.A, Chapter 87, Subchapter 7), and explains the likely income tax treatment associated with each scenario. The income analysis is my own but reflects discussions with the Vermont Department of Taxes and those versed in college savings plans.

The principal variable in the scenarios is who owns the VHEIP account, i.e., who is the account owner?

Scenario 1. The employee is the VHEIP account owner and beneficiary; the employer contributes to the employee's account under an employer-sponsored program intended to help the employee repay the employee's student loans. The expectation is that the employee will use the contributed funds to make payments on the employee's student loans. The employer may impose requirements on the sponsored program, e.g., making the contribution only after the employee completes a certain minimum length of time on the job (for example, a contribution at the end of every X months).

a. At the time the employer makes a contribution to the account, is the contribution a tax-deductible expense to the employer?

   Answer: Yes, it is classified as compensation or salary, which is a form of business expense.

b. At the time the contribution is made, is the contribution taxable income to the employee?

   Answer: Yes, because it is classified as compensation.

c. When a loan payment is made from the VHEIP account, does that make the amount of the payment taxable income to the employee, and a deductible expense to the employer?

   Answer: It would not be taxed as income twice. The trigger for compensation is when it is placed in the account for the employee's use. It is comparable to a payroll check being deposited into an employee's checking account.

Thus, when the employee is the account owner, the tax impact of the contribution occurs when the contribution is made, not when the contribution is used.

In this scenario, when is the employer required to report the taxable income to the IRS and the Vermont Department of Taxes? Answer: During the annual W-2 process in Box 1: "other compensation."

Scenario 2. The employer is the VHEIP account owner and the employee is the beneficiary of the account. The employer contributes to the account under a program intended to help repay the employee's student loans. The expectation is that the employee will use the contributed funds to make payments on the employee's student loans. As in Scenario 1, the employer may impose requirements on the sponsored program, e.g., making the contribution only after the employee completes a certain minimum length of time on the job (for example, a contribution is made to the VHEIP account at the end of every X months, or at the end of each year of employment).

a. At the time the contribution is made, is the contribution a tax-deductible expense to the employer?
   Answer: Probably not, since the funds haven't left the employer's control as the employer is the account owner.
b. At the time the contribution is made, is the contribution taxable income to the employee?
   Answer: Probably not, for the same reason – the employer has no access to the funds.
c. When a loan payment is made from the VHEIP account, does that make the amount of the payment taxable income to the employee, and a deductible expense to the employer?
   Answer: Generally, yes – at that point the amount of the student loan payment would become taxable income to the employee and a deductible expense of the employer.

In other words, under Scenario 2 the tax impact of the contribution occurs not when the contribution is made, but when the contribution is used for the employee's benefit. The employer would include the dollar value of the student loan payments in the employee's W-2 income.

3. Is the Vermont tax credit (32 V.S.A. sec. 5822a) available to the employer under either of these scenarios? No, except in the (likely) very limited circumstances where the employer is a qualified taxpayer under the tax credit provision (Section 5822a of Title 32), i.e., an individual, trust or estate. It appears that an employer that is a corporation or LLC, or other business entity, is not a "person" under Section 5822a.

4. Below is a *very* high level summary of the state income tax incentives from seven other states for employers who provide student loan repayment benefits to employees. I just came across this information and am sharing it because of the Committee's interest in this area. I can research the answers to Committee member questions about the details of each state's incentive program and get back to the Committee.

State Income Tax Deduction

Arkansas: Maximum deduction of $500 per employee; no sunset

Utah: Maximum deduction of $2,000 per year per beneficiary; no sunset

State Income Tax Credit

Colorado: Credit is based on 20% of employer contributions; maximum credit of $500 per employee; sunsets 1/1/22.

Illinois: Credit is based on 25% of employer contributions; maximum credit of $500 per year; sunsets 12/3020.

Nebraska: Effective 1/1/22, credit is based on 25% of employer contributions; maximum credit is $2,000 per employee per year; program may award up to $250,000 total incentives per year; matching contributions may not be used for K-12 contributions; no sunset.

Nevada: Credit is based on 25% of employer contributions; maximum credit amount of $500 per year, five-year carry-forward; no sunset.

Wisconsin: Credit is based on 25% of employer contributions; maximum credit amount of $820 per year (adjusted annually for inflation); no sunset.