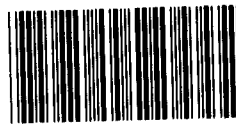


June 1989

# TAX POLICY

## Insufficient Information to Assess Effect of Tax Free Education Assistance

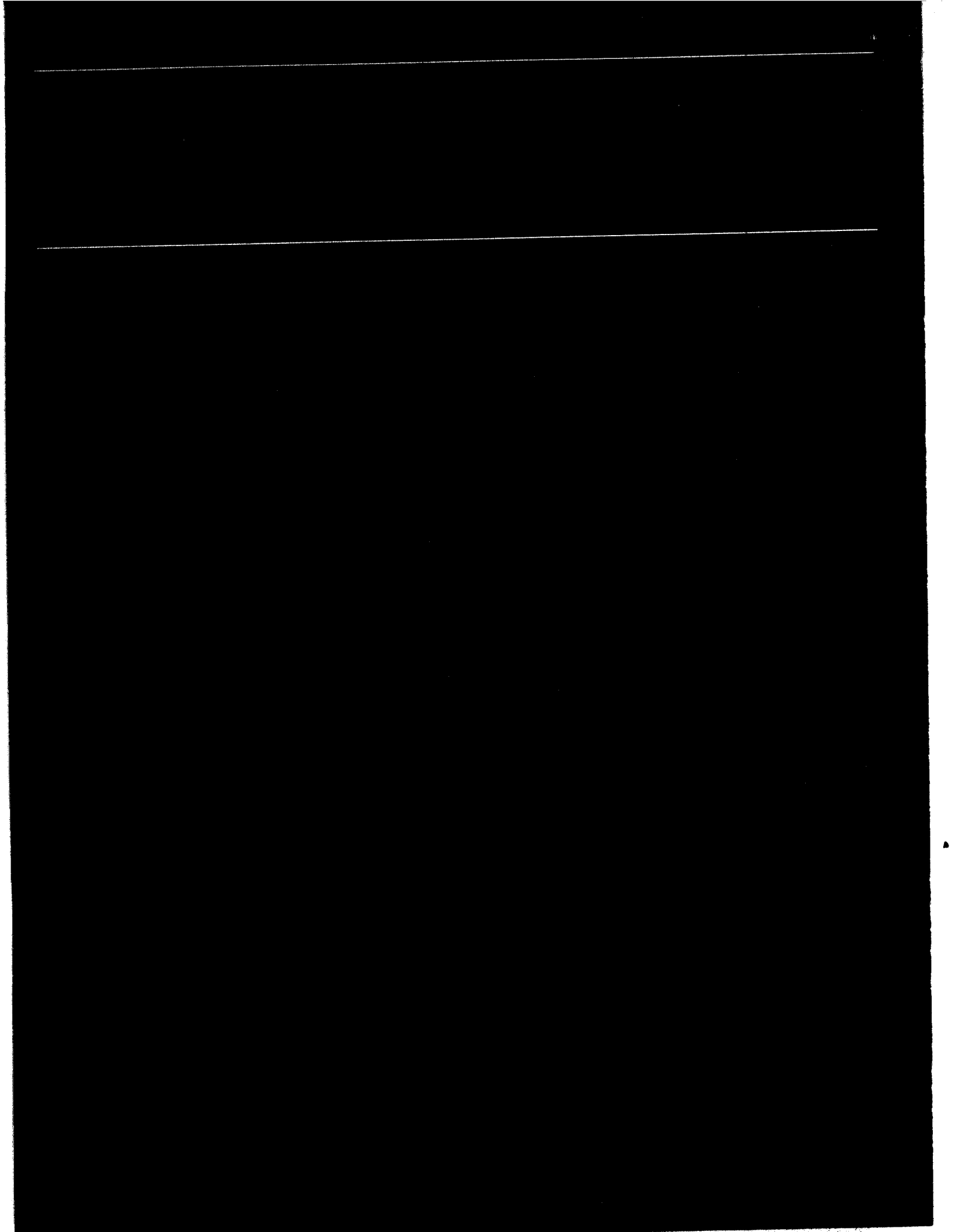


139031

**RESTRICTED**—Not to be released outside the  
General Accounting Office unless specifically  
approved by the Office of Congressional  
Relations.

**RELEASED**

545796



GAO

United States General Accounting Office

Report to the Honorable Frank J. Guarini  
House of Representatives

June 1989

# TAX POLICY

## Insufficient Information to Assess Effect of Tax Free Education Assistance

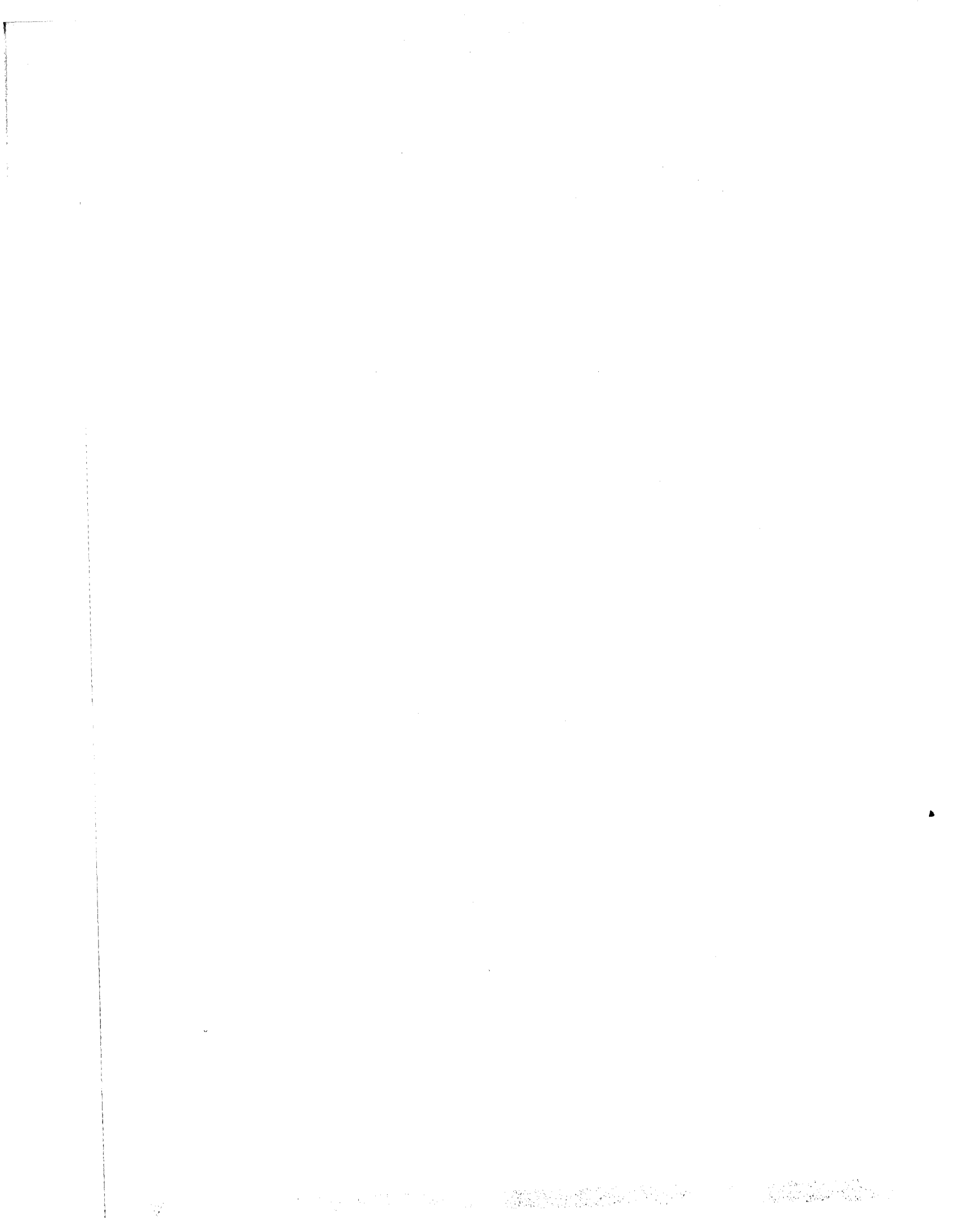


RELEASED

RESTRICTED—Not to be released outside the  
General Accounting Office unless specifically  
approved by the Office of Congressional  
Relations.

139031  
545796

GAO/GGD-89-76



---

General Government Division

B-234930

June 23, 1989

The Honorable Frank J. Guarini  
House of Representatives

Dear Mr. Guarini:

Section 127 of the Internal Revenue Code of 1986, which expired on December 31, 1988, allowed individuals to exclude from their gross income the value of educational assistance provided by an employer through an employee educational assistance program. On August 11, 1988, you asked us to (1) evaluate data used by the Department of the Treasury in assessing the effect of Section 127 and (2) assess the availability and reliability of 11 data elements relating to Section 127. On November 3, 1988, we briefed a member of your staff on the results of our work. As requested by your office, this report documents and supplements the information presented at that briefing.

---

## Results in Brief

In June 1988, Treasury concluded that Section 127 should not be extended. In reaching its conclusion, Treasury evaluated data from surveys by two government and two private organizations. Three of the surveys produced overall information on educational assistance but not the kind of specific information needed to assess Section 127. The survey that produced specific information on Section 127 had a low response rate and apparently included in its sample a disproportionate number of large firms. Primarily for these reasons, we believe that the information used by Treasury, although apparently the best available, was insufficient to support its conclusion.

Some of the 11 data elements you asked about in your request would be useful in assessing Section 127 if they were available from reliable sources. None of them were, however. If Congress decides to extend Section 127, it should also consider revising the reporting requirement in Section 6039D of the Internal Revenue Code so as to better ensure that appropriate information is available to assess Section 127's effects.

---

## Objectives, Scope, and Methodology

Our first objective was to evaluate the data Treasury used in analyzing Section 127 as part of its June 1988 report on certain employee benefits.<sup>1</sup> To do this, we discussed the report with Treasury officials responsible for its preparation and reviewed the four studies Treasury evaluated in analyzing Section 127.

We also compared Treasury's estimate of the revenue losses resulting from Section 127 with figures compiled by the Internal Revenue Service (IRS) from reports submitted by employers who provided educational assistance during 1985 and 1986. We discussed the reasonableness of Treasury's estimates with staff from the Joint Committee on Taxation, the Congressional Research Service, and the American Society for Training and Development (ASTD).

Our second objective was to determine the availability and reliability of 11 data elements relating to Section 127. We did this by talking to officials/representatives of ASTD; the Department of Education's National Center for Education Statistics; the Congressional Research Service; and the Department of Labor's Bureau of Labor Statistics, whose surveys and studies were an integral part of Treasury's report. We also reviewed data compiled by IRS from reports submitted by employers providing educational assistance.

We did our work from September to November 1988 and in accordance with generally accepted government auditing standards.

---

## Background

Before it expired on December 31, 1988, Section 127 of the Internal Revenue Code allowed employees to exclude from gross income amounts paid or expenses incurred by their employers for educational assistance provided to the employees. This assistance was generally available for any type of course, except ones related to a sport or hobby, and covered such expenses as tuition, books, supplies, and equipment. Before Section 127 was enacted as part of the Revenue Act of 1978 (Public Law 95-600), decisions as to whether employer-provided educational assistance should be included in an employee's gross income hinged on whether the assistance qualified as a business expense under Section 162 of the Internal Revenue Code. To qualify as a business expense, the employee's education had to meet tests in Treasury regulations regarding the relationship of the education to the person's employment. In its report on

---

<sup>1</sup>U.S. Department of Treasury, Report to the Congress on Certain Employee Benefits Not Subject to Federal Income Tax (Washington, D.C., June 1988).

---

the Revenue Act of 1978, the Senate Committee on Finance said that these tests were often ambiguous and that Section 127 was needed to reduce complexity.

The Committee also said that Section 127 was needed to reduce inequities among taxpayers and to provide less-educated individuals with opportunities for upward mobility. The Committee explained that (1) the business expense deduction available under Section 162 of the Code could not be used much by entry-level employees because "the higher the level of job held by an employee, the greater the variety [of] courses or training likely to qualify as related to the employee's job" and (2) if employers paid for training not covered by Section 162, recipients of that training would be required to pay income tax on the value of that training. The Committee believed that this requirement would impose a burden on less-advantaged individuals who are least able to pay but most in need of education.

When first enacted, Section 127 applied to tax years beginning after December 31, 1978, and ending before January 1, 1984. Public Law 98-611, enacted in 1984, extended the provision through December 31, 1985, and imposed a \$5,000 annual limit per employee on excludable educational assistance. The Tax Reform Act of 1986 (Public Law 99-514) raised the annual limit to \$5,250 and extended Section 127 through December 31, 1987. The Technical and Miscellaneous Revenue Act of 1988 (Public Law 100-647), enacted on November 10, 1988, extended the provision through December of that year, and excluded graduate level courses of a kind normally taken by an individual pursuing a program leading to a law, business, or other advanced academic or professional degree. A bill (S. 260) was introduced in the Senate in January 1989 to make Section 127 permanent. Your office has advised us that you will also be introducing legislation to make the provision permanent.

In 1984, Congress also (1) imposed an annual reporting requirement on employers to provide a basis for assessing Section 127 and (2) required a study of the effect of Section 127 by Treasury. The reporting requirement, which is codified in Section 6039D of the Internal Revenue Code, provides that, beginning January 1, 1985, each employer maintaining an educational assistance plan under Section 127 report to IRS annually the (1) employer's name, address, and taxpayer identification number; (2) type of business in which the employer is engaged; (3) number of employees; (4) number of employees eligible to participate under the

plan; (5) number of employees participating under the plan; and (6) total cost of the plan during the year.

In 1986, Congress amended the reporting requirement to include information on the number of highly compensated employees among (1) the employees in the reporting organization, (2) the employees eligible to participate under the organization's educational assistance plan, and (3) the participating employees. As defined in Section 414(q) of the Internal Revenue Code, "highly compensated employees" are, in general, those who receive compensation in excess of \$50,000.

## Assessment of Treasury's Study

In June 1988, Treasury reported to Congress on the results of its study of Section 127 as required by the 1984 amendment. In its report, Treasury concluded that while Section 127 had reduced complexity and inconsistency, it had not encouraged upward mobility of lower paid and lesser educated workers through skill acquisition. Treasury concluded, therefore, that Section 127, which had expired at the end of 1987, should not be reinstated. In assessing Section 127, Treasury relied entirely on an analysis of data from surveys taken or sponsored by four organizations—the Department of Education, the Department of Labor, the Chamber of Commerce, and ASTD.<sup>2</sup>

Treasury did not use any information reported to IRS by employers under Section 6039D of the Internal Revenue Code, nor did Treasury solicit first-hand information from employers who provided assistance under Section 127 or employees who received such assistance. Treasury did not use the information because it was not available in time. A Treasury official said that a later review of the information showed "serious inconsistencies" in the data being reported. At that time, Treasury said it was working with IRS to resolve the inconsistencies.

Our review did not identify any published information that would have been more appropriate for assessing Section 127 than the information on which Treasury based its conclusions. On the other hand, we believe that the information Treasury used, while raising questions about the effect of Section 127, was insufficient to support a conclusion that the

<sup>2</sup>American Society for Training and Development, Employee Educational Assistance (Alexandria, VA, May 1985); U.S. Chamber of Commerce, Employee Benefits 1985 (Washington, D.C., Oct. 1986); U.S. Department of Education, Center for Education Statistics, Trends in Adult Education 1969-1984 (Washington, D.C., 1987); and U.S. Department of Labor, Bureau of Labor Statistics, Employee Benefits in Medium and Large Firms, 1985 (Washington, D.C., July 1986).



---

section not be reinstated. The data Treasury analyzed to reach its conclusions and our views on those data are discussed in the following sections.

---

## Department of Education Survey

The information Treasury cited most in reaching its conclusions was compiled by the Department of Education from triennial surveys of participation in adult education by a national sample of households.<sup>3</sup> As summarized by Treasury in its report, those surveys showed that (1) the number of job-related adult education courses taken increased from 15 million in 1978 to 26 million in 1984; (2) the employer share of payments for job-related and non-job-related courses rose by about 60 percent between 1969 and 1984; and (3) adult education participants in 1969 and 1984 were "typically from families with incomes well above the median," which, according to Treasury, might "suggest that participants were likely to be better educated than the average or marginal employee at whom section 127 was targeted."

As Treasury noted, however, Education's triennial surveys did not include information on the extent to which adult education was provided through an employer educational assistance program, which makes it impossible "to determine precisely how much of the post-1978 increase in adult education, and in the employer share of payment, can be attributed to section 127."

---

## Department of Labor Survey

Treasury also used data from what it characterized as "the most nearly representative of the employer surveys"—a 1985 Labor Department survey of the incidence and characteristics of employee benefit plans in 1,509 medium and large firms. Labor's analysis of data from 1,325 respondents to the survey (about an 88-percent response rate) showed that (1) 76 percent of the employees in medium and large firms were eligible for full or partial defrayment of education expenses through employer-paid assistance; and (2) professional, administrative, technical, and clerical employees were more likely than production workers to be eligible for participation in employer-provided education assistance.<sup>4</sup>

As Treasury noted in its study, Labor's survey collected data on eligibility only; it did not collect data on actual participation or reimbursement.

---

<sup>3</sup>Trends in Adult Education 1969-1984.

<sup>4</sup>Employee Benefits in Medium and Large Firms, 1985, pp. 81-88.

---

In our opinion, that focus on eligibility limits the usefulness of Labor's data in assessing the actual impact of Section 127.

---

### Chamber of Commerce Survey

Another employer survey that Treasury cited in its report was a 1985 Chamber of Commerce survey of employee benefit practices in 7,807 firms. Of the firms surveyed, 1,000 responded—about a 13-percent response rate. The Chamber's survey showed that (1) 69 percent of the respondents reported expenditures for employee education, with the proportion varying from 30 to 91 percent depending on the type of industry; and (2) the average annual expenditure amounted to \$63 per employee, with the amount per employee varying from \$6 to \$101 depending on the type of business.<sup>5</sup>

In summarizing the Chamber's survey, Treasury concluded that "workers in manufacturing, who may need greater access to training for new occupations in response to structural changes in the economy, are less likely to work for employers who pay for employee training than are workers in nonmanufacturing." Treasury noted also that the survey results would appear to be overstated because the Chamber collected data on all employee educational expenditures, not just those provided under formal employee educational assistance plans. In our opinion, the survey's focus on all educational expenditures rather than those covered by Section 127 and the low rate of response to the survey raise questions about the value of that information in assessing Section 127.

---

### ASTD Survey

The final source cited by Treasury was ASTD's 1985 survey of employer-provided educational assistance plans. ASTD had mailed questionnaires to 1,000 public and private employers who had been selected from among its 50,000 members. After analyzing the 319 returned questionnaires (about a 32-percent response rate), ASTD concluded that employer-provided educational assistance was a "small but important part of work place training and retraining," and was "especially significant for upgrading employees, creating incentives for upward mobility, and providing remediation and basic skills training." Among other things, ASTD reported that (1) 97 percent of responding employers offered educational assistance plans, (2) 96.6 percent of employees in those firms were eligible to participate in educational assistance, (3) 5.6 percent of

---

<sup>5</sup>Employee Benefits 1985, pp. 13, 21, and 33.

---

eligible employees actually participated, and (4) 71 percent of the participating employees had salaries of under \$30,000.<sup>6</sup>

Although ASTD interpreted its data to show that Section 127 was having a positive effect, Treasury's report cautioned that ASTD's sample included a disproportionate representation of large firms (those with more than 500 employees) and firms involved in manufacturing. In addition to any impact caused by the composition of ASTD's sample, the survey's low response rate would also affect the reliability of ASTD's data.

---

## Estimated Revenue Loss

Treasury's report also included estimates of the loss in tax revenue resulting from the exclusion of educational assistance from gross income. Treasury estimated a loss of \$210 million in income taxes and \$125 million in Social Security taxes in 1987 and a total revenue loss of \$300 million in 1988. Treasury did not provide a breakdown between income taxes and Social Security taxes for 1988. According to Treasury, however, the lower estimate for 1988 was due in part to lower income tax rates.

The data Treasury used to develop its revenue estimates were not available for our review. We could not, therefore, independently assess the reliability of those estimates. We tried, instead, to assess the reasonableness of the estimates. One source that we consulted was information compiled by IRS from reports submitted by employers under Section 6039D. IRS personnel responsible for compiling the information said, however, that they have no way of knowing whether all employers who should file reports are doing so. That could explain why the data from those reports point to a much smaller revenue loss associated with Section 127 than the loss estimated by Treasury.

For example, Treasury's estimated income tax loss of \$210 million in 1987 would equate to about \$1.4 billion in distributions for educational assistance—assuming a minimum tax rate of 15 percent. IRS' information, however, shows total distributions of \$231.4 million in 1985 and \$248.9 million in 1986. Representatives from the staff of the Joint Committee on Taxation, the Congressional Research Service, and ASTD said that they thought, on the basis of their knowledge of the issue, that Treasury's estimates were more realistic than those derived from IRS' data.

---

<sup>6</sup>Employee Educational Assistance, pp. 1 and 13-15.

In March 1989, the Joint Committee on Taxation developed preliminary estimates of the revenues that would be lost if various expired or expiring provisions of the Internal Revenue Code were permanently extended. The Joint Committee's preliminary estimates for extending Section 127 were \$497 million in fiscal year 1990 and a total of \$1.847 billion over the 5 years ending September 30, 1994. We do not know how those estimates were computed.

## Availability/ Reliability of Information on Section 127

You asked us to assess the availability and reliability of 11 data elements relating to Section 127. As noted in the rest of this section, some of the data in which you expressed an interest were not available. Although other data were available, at least in part, from ASTD or IRS, we cannot attest to the information's reliability. As noted previously, ASTD's data must be qualified by reservations about the composition of ASTD's sample and by the low response rate to its survey. IRS' data must be qualified by the fact that IRS has no assurance that all employers are complying with the reporting requirements in Section 6039D.

Number of people using Section 127—There were 1,717,483 participants in tax year 1986 according to data compiled by IRS from reports submitted by employers under Section 6039D.

Number of courses eligible for Section 127—This information was not available in any of the documents we reviewed or from any of the sources we contacted.

Average benefit per person—In its 1985 report, ASTD estimated the average amount of educational assistance in 1984 to be about \$491.

Total qualified expenditures—IRS data compiled from employer reports for tax year 1986 submitted under Section 6039D show total Section 127 distributions of \$248.9 million. Other sources we contacted, such as ASTD, the Congressional Research Service, the Joint Committee on Taxation, and Treasury, cited estimates of over \$1 billion annually. As noted earlier, we have no basis for assessing the reliability of any of those estimates.

Average income of participants—ASTD's 1985 report showed that in those firms that responded to ASTD's survey, employees earning less than \$15,000 accounted for 22 percent of the participants in 1984; those earning between \$15,000 and \$29,999 accounted for 49.1 percent; those

---

earning between \$30,000 and \$49,999 accounted for 24.3 percent; and those earning \$50,000 or more accounted for 4.6 percent.

Number and average income of participants who receive more than \$1,500 in benefits—According to data in ASTD's 1985 report, the only participants who received more than \$1,500 in benefits were employees earning \$50,000 or more. Those employees received an average of \$1,710 in benefits.

Number and average income of participants who receive less than \$1,500 in benefits—Again, the only information we found related to this item was in ASTD's 1985 report. That report showed an average benefit of \$400 for employees whose salary was under \$15,000. The average increased to \$596 for employees in the \$15,000 to \$29,999 salary range and \$870 for those in the \$30,000 to \$49,999 salary range.

Average course load and course cost per participant—This information was not available in any of the documents we reviewed or from any of the sources we contacted.

Number of companies with employer educational assistance plans—Data compiled by IRS from employer reports submitted under Section 6039D show that 1,178 employers had plans in 1985 and 1,197 had plans in 1986.

Average employer cost—In its 1985 report, ASTD cited an average cost of \$624,833 for the respondents to its survey.

Number of participants who would be excluded if the cap were lowered from \$5,250—This information was not available in any of the documents we reviewed nor from any of the sources we contacted.

---

## Conclusions

Sufficient information is not available to assess the effect of Section 127. In preparing its report, Treasury relied on the best information available. That information, however, came from surveys that (1) were not specifically focused on gathering data that could be used to measure the success of Section 127, (2) had low response rates, and/or (3) were not considered representative of the population being surveyed. Therefore, we believe that the information used by Treasury provided an insufficient basis for determining whether or not Section 127 had achieved its objectives. Similarly, we believe that the information is

---

insufficient for us to conclude whether or not the section should be reinstated.

If Congress should decide to reinstate Section 127, one question it must address is whether to make the provision permanent or extend it for another temporary term. One reason for making Section 127 permanent would be to provide more stability to the provision. In our opinion, evaluation of the extent to which Section 127 has met its objectives is complicated by the fact that all three extensions of the provision have been enacted after the provision expired, with the last extension occurring 11 months after expiration. Each time Section 127 expires, there is uncertainty as to its future. Employers do not know whether they should start withholding tax on the value of that assistance, and employees do not know whether they will have to pay tax on any assistance they receive.

One reason for temporarily extending Section 127 again would be to allow more time to measure the provision's effects. That was the intent behind the extension in 1984, at which time Congress enacted a reporting requirement with the expectation that the information would provide a basis for assessing Section 127. However, the information being reported does not provide the specificity, such as the salary level of participants and the average benefit at each salary level, needed to help decisionmakers identify those being helped and the extent of help being provided.

---

## Matter for Congressional Consideration

Congress can decide to not reinstate the expired Section 127 or to reinstate it permanently or temporarily. If the decision is to reinstate it, Congress may want to revise the reporting requirement to better assess the provision's effects. This could be done by requiring information on the salary level of participants and the average benefit at each salary level. To help make any further assessment of the section, Congress could also specify that the data be reported for a sufficient length of time to adequately measure any effects.

---

## Agency Comments

We obtained oral comments on a draft of this report from Treasury officials who generally agreed with our assessment of the available data on employer-provided educational assistance. In clarifying why Treasury opposed Section 127, they said that they saw nothing in the evidence they reviewed to cause Treasury to change its opposition to using the tax system to subsidize employer-provided educational assistance

---

through Section 127. They also provided some technical comments, which we incorporated into this report as appropriate.

As agreed with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 10 days from the date of issuance. At that time, we will send copies to congressional committees having an interest in the matters discussed and to other interested parties.

Major contributors to this report are listed in the appendix. If you have any questions, please call me on 275-6407.

Sincerely yours,



Jennie S. Stathis  
Director, Tax Policy and  
Administration Issues

---

# Major Contributors to This Report

---

**General Government  
Division, Washington,  
D.C.**

David J. Attianese, Assistant Director  
Joseph T. Valonis, Evaluator-in-Charge



---

**Requests for copies of GAO reports should be sent to:**

**U.S. General Accounting Office  
Post Office Box 6015  
Gaithersburg, Maryland 20877**

**Telephone 202-275-6241**

**The first five copies of each report are free. Additional copies are \$2.00 each.**

**There is a 25% discount on orders for 100 or more copies mailed to a single address.**

**Orders must be prepaid by cash or by check or money order made out to the Superintendent of Documents.**

United States  
General Accounting Office  
Washington, D.C. 20548

First-Class Mail  
Postage & Fees Paid  
GAO  
Permit No. G100

Official Business  
Penalty for Private Use \$300

---

Requests for copies of GAO reports should be sent to:

U.S. General Accounting Office  
Post Office Box 6015  
Gaithersburg, Maryland 20877

Telephone 202-275-6241

The first five copies of each report are free. Additional copies are \$2.00 each.

There is a 25% discount on orders for 100 or more copies mailed to a single address.

Orders must be prepaid by cash or by check or money order made out to the Superintendent of Documents.

United States  
General Accounting Office  
Washington, D.C. 20548

Official Business  
Penalty for Private Use \$300

First-Class Mail  
Postage & Fees Paid  
GAO  
Permit No. G100