

UI Move to Graduated Withholding Rates on Graduate Tuition Waivers

To comply with Internal Revenue Service code section 127, the value of graduate-level tuition waivers exceeding \$5,250 per year is subject to employment taxes and must be reported as taxable wages on Form W-2. The applicable populations include benefits-eligible employees and graduate students holding appointments as Graduate Assistants or Pre-Professional Graduate Assistants. This taxation does not apply to qualified Teaching Assistants or Research Assistants.

The University must withhold federal and state income taxes on taxable tuition waivers, as required by the IRS and other regulatory agencies. Effective January 1, 2012, federal income taxes will be withheld at graduated federal tax rates rather than the fixed supplemental withholding rate of 25%, on taxable portion of the tuition waiver (the amount in excess of \$5,250).

Key information to share:

1. Why the UI move to graduated withholding rates?

This change is a good news story for affected graduate students.

Based upon the analysis of test data from fall 2011, the University identified that a move to withholding federal taxes at the graduated rates should reduce the amount of tax withholding for about 99% of the students affected. The amount of decrease in tax withholding for each student will vary significantly, based upon rate of pay and the dollar amount of tuition waived. For the population of impacted students studied, there was an average decrease in withholding of around \$140 per pay period.

2. How many students will be impacted by tuition waiver-related tax withholding and will that number change from semester to semester?

Because the first \$5,250 of graduate-level tuition waiver value in each calendar (tax) year is exempt from taxation, the required withholding is expected to impact fewer students in the spring semester and the amount of withholding for those impacted in the spring semester should be less. As we move into the summer and fall semesters, and more student waivers exceed the \$5,250 exemption limit, we expect more students to be impacted by this tax withholding.

Given the combination of the University-currently being in the spring semester, and the move to graduated withholding rates, it is estimated that between 200 and 300 students across the three UI campuses will be taxed this semester. As a frame of reference, in the fall 2011 semester, there were 462 students across the three UI campuses impacted by this tax (200 at Urbana, 233 at Chicago and 29 at Springfield). 109 of the 462 students taxed, experienced a zero net pay check.

3. Do you expect the change to graduated rates to reduce the number of students that will experience a zero dollar net pay event?

The number of students experiencing zero net pay should decrease as a result of the change in withholding rates.

4. Why did it take until now for the University to implement the graduated tax rates?

During the spring 2011 semester, the University identified the full population of students that exceeded the \$5,250 exemption limit and was assessed withholding for a taxable tuition waiver. Soon after that time, it was identified that a move to the graduated federal tax rates might be helpful to these students.

Moving to the graduated withholding rates for tuition waivers was a very complex matter. There were data processing and systems configuration issues to resolve, and systems testing necessary. Additionally, the University was reluctant to change withholding methods during the middle of a tax year.

The necessary systems work, data testing and results analysis was completed during fall 2011 semester, allowing the University to move ahead with the change to graduated rates beginning January 1, 2012.

FAQ - UI Move to Graduated Withholding Rates on Graduate Tuition Waivers

1. How can I determine the tuition waiver impact on my net pay?

Monthly and Bi-weekly Tuition Benefit Net Pay Calculators are available to employees on the OBFS website to assist in determining the effect of the withholding on their pay. The calculators are located at <http://www.obfs.uillinois.edu/payroll/> on the right side of the page.

2. Can I adjust the number of withholding allowances I currently claim on my W-4?

Individuals may change their Form W-4 via NESSIE (https://nessie.uihr.uillinois.edu/cf/comp/index.cfm?Item_id=1056&rlink=674) to adjust their withholding.*

**This statement is provided for information purposes only and is not intended to constitute individual tax advice. Employees and students should consult with their individual tax advisor to assist with calculating their withholdings.*

3. Will I receive a zero net paycheck because of the change in tax withholding methods?

Based on testing conducted during Fall 2011, the impact of the graduated rate taxation method for Graduate Assistants (GA) and Pre-Professional Graduate Assistants (PGA) should result in decreased withholding for federal taxes. The test indicated a decrease in the expected number of GA/PGAs that would receive pay checks resulting in a net pay of zero dollars.

Some individuals in higher income brackets may experience an increase in federal withholding with the move to the graduated rates. In general, GA/PGAs are not found in this population of individuals.

4. Am I responsible for tax withholdings that cannot be collected in entirety from my paycheck due to a zero net?

When an individual does not have enough compensation to satisfy the tax withholding obligations required by law, the taxes that cannot be collected in entirety are considered to be in arrears. University Payroll & Benefits will track and continue to pursue the collection of taxes owed on subsequent pay checks the individuals receive for the calendar year. If the amount of taxes in arrears cannot be collected by the end of the calendar year, the University is required by law to pay the remaining taxes owed on behalf of the individual. This amount paid by the University is a taxable fringe benefit and included as taxable income on the individual's Form W-2 Wage & Tax Statement.

5. When can I expect to see the impact of the graduated rate taxation associated with my Tuition waiver?

The assessment period of tuition waiver tax withholding for calendar year 2012 is as follows:

Spring semester

1 st tuition waiver run	March and April
Spring adjustment run	May

Summer semester

Tuition waiver run	July and August
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Fall semester

1 st tuition waiver run	October and November
Fall adjustment run	December

6. *If there is an adjustment to the taxable amount of my tuition waiver, when can I expect to see the correction?*

All corrections will be processed on the next regularly scheduled tuition waiver assessment period. Any approved exceptions for adjustments outside the normal tuition waiver process will be applied on the next regular payroll cycle.

Example A:

Student A is assessed a taxable tuition waiver amount in March and April (during the first tuition waiver run for Spring semester). On April 4, a full credit of the tuition waiver amount is applied by Financial Aid as a result of all courses being dropped. The tuition waiver credit posted will be processed on the Spring adjustment run. All withheld taxes associated with the waiver in March and April will be refunded and appear on the May pay check.

Example B:

Student A is assessed a taxable tuition waiver amount in March (during the first tuition waiver run for spring semester). On March 16th, it is discovered that the student is a Research Assistant so the waiver should never have been assessed. Because the taxes associated with the reporting of the tuition waiver amount is causing a financial hardship on the employee, an immediate refund of taxes is requested. The request receives the required approval therefore the tuition waiver reversal will be processed on the next regular pay cycle. All withheld taxes associated with the waiver in March will be refunded and appear on the April pay check.

7. *Is the \$5250 exclusion applied each semester?*

No, the \$5250 exclusion allowed by the IRS is based on the calendar year not by semester. Once an individual reaches the \$5250 limit at any point in the year, the dollar value all graduate level educational benefits received thereafter become taxable income and will be assessed during the applicable tuition waiver assessment period.

8. *Why did it take until now for the University to implement the graduated tax rates?*

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9. How will the change in tax withholding methods be communicated to affected employees?

University Payroll & Benefits (UPB) has developed an extensive communication plan to ensure the change in process is heard campus wide.

- The University's Payroll website will reflect changes to the process
- Mass email to all Benefit Eligible Employees, Graduate Students, and Pre-Professional Graduate Students will be mailed late January. Individuals specifically impacted will receive further notification at the beginning of each assessment period, via email and letter.
- UPB will conduct townhall & webinar sessions with more detailed information related to the taxation of tuition waivers in late February.
- Article will be posted in the UPB Newsletter in February.
- UPB will work with University Administration HR and the Grad College to provide information on their website that will link to the Payroll website for more detailed information.