



# Compensation and Benefits Checkup

## Insights

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Schools are beginning to realize that the laws applicable to their operations are much more complicated than the Heads, Boards, and Business Managers thought. From 403(b) issues, to health insurance deviations, to wage-hour classifications, to stipends for coaching activities, each of these decisions has a specific impact on the school that could create large liability.

More than ever, school administrators and business managers must understand how to properly pay and assess the taxability of benefits or risk liability for non-compliance. This article will point to several common problem areas that schools should be assessing internally and addressing with their counsel.

### Housing Benefits

Many schools provide free housing as a perk to employees. The policy (or practice) at many schools is to provide new employees who have moved to the area with free housing for a one- or two-year period of time. Other schools simply permit the Head to hand out free housing as a perk for valued service. If this is how your housing is distributed, it is unlikely that the perk or benefit is a tax-free benefit. In such case, the School should be taxing the employee at the level of 5% of the fair market or fair rental value, as determined yearly by an outside professional.

Some schools actually tie the free housing benefit to some level of service (especially in boarding schools), but the level of service may not meet the strict requirements set by the Internal Revenue Service for the housing benefit to be tax free, especially if the housing is not actually on the campus of the employer. The IRS test is that to be tax free, housing must meet all three of these tests as interpreted by the IRS: 1) the housing must be furnished *on the business premises* of the employer; 2) the housing must be furnished for the convenience of the employer; and 3) the employee must be required to live in the housing as a condition of employment.

Housing that is next door, down the street, or across the street is presumptively not going to be a tax-free benefit. In addition, to meet the requirement that the housing is furnished for the convenience of the employer, the school has to have an objective business necessity for requiring the employee to live in the school-owned property. This is a very factual test that you should have analyzed by your school counsel.

### Health Insurance Benefits

It's not unusual for a Board to negotiate a special perk for the Head of School in the form of extra paid health insurance benefits. The most common scenario is that, pursuant to the School's health insurance plan, the school pays only for employee-only health coverage. Employees may purchase family coverage on their own. Yet, for the new Head of School, the Board agrees to pay for 100% of the full family coverage. Boards typically do not realize that deviating from the standard plan creates a discrimination issue in that the Head, as a highly-compensated individual (assuming the Head receives more than \$110,000 in gross compensation from the school) receives a greater benefit than non-highly compensated individuals (those making less than \$110,000 in gross compensation).

This is not an unusual problem and, when discovered, needs to be resolved with the school's lawyer by either simply increasing the Head's salary to account for the cost of family coverage (and then letting the Head pay for the coverage from pre-tax dollars) or by ensuring that the school meets one of the safe-harbor requirements under the tax code. If the School does not correct the error properly, the impact is that *all* of the premiums paid by the school toward the highly-compensated employee's health insurance (both employee coverage and family coverage) become taxable income to the Head.

### **Deviations from the School's 403(b) Plan**

Another common error is that the school sometimes deviates from the terms of its 403(b) benefit plan. The plan provides for a set employer contribution (5%) after a certain term of service but the school provides a larger benefit to certain employees, typically the Head. The problem here, again, is that these deviations often benefit highly-compensated employees.

If that is the end result (after testing the plan), then the school will either have to disgorge (take back) the additional contribution from the highly-compensated employee or give enough of the non-highly compensated employees the same additional benefit so that the plan no longer reflects a discriminatory component.

Additionally, the increased employer contribution is not provided for in the plan document and giving the Head a greater benefit causes the plan to be operated outside the terms of the plan document, which is a fiduciary breach under ERISA.

### **Tuition Remission Deviations**

Under the Internal Revenue Code, tuition remission may be a tax-free benefit to employees as long as the school has a plan that is reasonable in classification (i.e., regarding the employees who receive the benefit and the levels of benefit) and the school complies with its plan. Again, as with the other deviations from benefit plans, if the school deviates from the tuition remission plan, it has created a taxable benefit to the recipient of the extra benefit and may have created a discrimination concern.

The other common problem with tuition remission is that many schools mistakenly believe that they can provide free tuition to the grandchildren of employees. Grandchildren are not covered. Thus, any "free" tuition for grandchildren is a taxable benefit to the employee.

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## **Wage-Hour Misclassifications**

One of the largest areas of non-compliance for Schools is the misclassification of employees as exempt under the wage-hour laws (either federal or state), thereby failing to have employees maintain time records and receive overtime for hours worked over 40 in a workweek. Schools have many employees, typically in the admissions, development, and business offices, that are improperly classified and who often work many more than 40 hours in a workweek.

Schools often "compensate" for this by either increasing the employee's salary or providing an extra week or two of vacation each year. The increase in salary actually exacerbates the problem because, once it is determined that the employee should have been receiving overtime, the higher salary simply increases the amount of overtime pay due. Giving extra vacation or time off (often called "comp time") does not resolve the problem either. The employee is still entitled to be paid overtime for the hours worked over 40 during the workweek in which the extra hours were worked, even if you choose to also give time off later.

A similar problem occurring in schools is the awarding of extra pay for extra jobs. Often schools will want to offer the lower compensated employees (teaching assistants, security personnel, facilities personnel) the opportunity to work in the after-school program or coach a sport for extra money (usually a \$2,000 to \$3,000 stipend). This extra work, when combined with the employee's hours worked in their primary job, puts the employee in an overtime situation (i.e., all hours combined exceed 40 hours in a workweek, causing an overtime issue).

The stipend does not pay for the overtime. Rather, just like the increased salary in the example above, the stipend increases the total compensation and the total overtime liability. Again, like with the benefits analysis, wage-hour compliance can be complicated and is an exercise you should address with your school's counsel.

## **Misclassification Of Workers As Independent Contractors**

The last common problem we see in schools is the misclassification of many workers as independent contractors rather than properly classifying them as employees. The areas to be watchful for are coaches, substitute teachers, and tutors. Each of these individuals often work only for your school in this function, work the hours and at the location the school desires, are dependent on the school for the income, do not have an investment in their business, and are controlled and supervised by school personnel.

Although there may be some exceptions to the rule at times, the individuals working under the above parameters are typically going to be viewed by the IRS, the Department of Labor, workers' compensation boards, and the state's unemployment division, as employees.

Should you have any questions on this article or need assistance in resolving your misclassifications or deviations, just let us know.

For more information contact the author at [SBogdan@fisherphillips.com](mailto:SBogdan@fisherphillips.com) or 954.525.4800.

## ***Related People***

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**Suzanne K. Bogdan**

Partner

954.847.4705

Email