

Employer Provided Housing for Teachers

This discussion is on the mechanics of Internal Revenue Code (IRC) §119(d), which pertains to “teacher” housing, a commonly misunderstood section. While “teacher” will be used throughout this discussion when referring to the “teacher” housing issue, the tax law applies to any employee to whom an educational institution provides housing.

There are two IRC sections which might allow a teacher to exclude from income all or a portion of the value of employer-provided housing. These are IRC §§119(a) and 119(d). These two sections are very different in their requirements and in the computation of the amount excludable from income, if any.

IRC §119(a)

If certain requirements are met, IRC §119(a) provides an exclusion from gross income for the value of meals and lodging provided by or on behalf of an employer to an employee, his/her spouse, or any of his/her qualified dependents. Meals are excludable if they are furnished 1) for the employer’s convenience and 2) on the employer’s business premises. The value of lodging furnished to the employee is excludable if all three of the following requirements are met:

1. The lodging is furnished on the business premises of the employer (or the employee provides substantial employment related services in the residence),
2. The lodging is furnished for the convenience of the employer, and
3. The employee is required to accept such lodging as a condition of employment.

“For the convenience of the employer” means there must be a substantial business reason for providing the meals and lodging other than to provide additional compensation to the employee. For example, meals provided at the place of work so an employee is available for emergencies during the lunch period are generally considered to be for the employer’s convenience.

“Condition of employment” means the employee is required to accept the lodging in order to enable the employee to properly perform the duties of the position. Lodging is regarded as furnished to enable the employee to properly perform the duties of employment, when, for example, the lodging is furnished because the employee is required to be available for duty at all times or because the employee couldn’t perform the services required unless he/she is furnished such lodging.

Generally, teachers will have a difficult time meeting all three requirements of IRC §119(a). The nexus between the furnishing of lodging and the employer's business allegedly served thereby is not easily established in the educational institution-teacher context. In this scenario, the employer's primary interest is the education of students. That goal is best attained in the classroom.

The grading of papers and classroom preparation teachers typically do at home will not be sufficient to convert an off-campus residence to “functional business premises” of the employer. Also, for both on-campus and off-campus housing, the necessity for providing the lodging generally can’t be sufficiently established to satisfy the “condition of employment” requirement. Thus, it will often be the case that employer-provided housing for teachers is not excludable from income under IRC §119(a).

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IRC §119(d)

To resolve continuing disagreements between teachers and educational institutions, and the Internal Revenue Service concerning the tax treatment of teacher housing, new section 119(d) was added to the Internal Revenue Code to provide an allowance for qualified campus housing for tax years beginning after December 31, 1985. Qualified campus lodging is lodging to which the exclusion under IRC §119(a) does not apply, and which is:

1. Furnished by or on behalf of the educational institution to the employee, his/her spouse, and any of his/her dependents,
2. Furnished for use as a residence, and
3. Located on, or in the proximity of, a campus of the educational institution.

Unlike IRC §119(a), under IRC §119(d), it is not necessary that the lodging be furnished for the convenience of the employer or that the employee be required to accept the lodging as a condition of his/her employment.

Regarding item 1 above, the statute, by its terms, provides the exclusion only for the value of meals and lodging furnished to the employee by or on behalf of his/her employer. Consequently, the lodging must be provided directly by, or indirectly, at the behest of the employer. Otherwise, the lodging will not be qualified campus housing and the IRC §119(d) potential exclusion from income will not apply.

Regarding item 3 above, there has been no published guidance on the "proximity" issue. One private letter ruling issued in 1998 (PLR 9816015) considered housing located two blocks away from an educational institution to be "proximate". However, no temporary or final regulations pertaining to the issue of qualified campus housing under IRC §119(d) have been issued. Therefore, the IRS stated in the private letter ruling that it would be modified or revoked to the extent any subsequently adopted temporary or final regulations are inconsistent with the conclusions in the ruling.

Provided the teacher pays "adequate rent," IRC §119(d) may provide the teacher a partial exclusion from income of employer-provided qualified campus housing. "Adequate rent" is defined as the lesser of 1) five percent of the fair market value of the employer-provided housing or 2) the average rental paid to the educational institution by individuals not affiliated with the institution for lodging that is comparable to that provided to the teacher. If the teacher does not pay adequate rent for the housing, he/she receives additional wage income computed by subtracting the rent paid from the amount determined to be adequate rent.

The appraised value of the qualified campus housing is determined as of the close of the calendar year in which the taxable year begins. However, if the rental period is not greater than one year, the appraised value may be determined at any time during the calendar year in which the rental period begins. The fair market value of qualified campus housing is to be determined on an annualized basis. The appraisal must be made by a qualified independent appraiser. It may not be made by the employer institution, or any of its officers, trustees, or employees.

A new appraisal need not be obtained each year, however, it must be reviewed annually. If no appraisal is obtained meeting these requirements, then the fair rental value is to be determined in the manner as would be done absent a special rule, taking into account all the relevant facts and circumstances.

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IRC §119(d) Examples

The following Examples illustrate the correct application of IRC §119(d). Assume the teacher's employment contract provides for \$40,000 of normal wages for the year, exclusive of any affect from the teacher housing issue.

EXAMPLE 1:

Facts: A teacher is provided qualified campus housing by his/her employing school. The teacher must pay \$500 per month for the housing, or \$6,000 per year. The appraised value of the residence is \$130,000. Five percent of this is \$6,500. The amount of rent for comparable housing paid by those not employed by the school is \$700 per month, or \$8,400 per year.

Tax Treatment: Adequate rent is \$6,500, which is the lower of 5% of the appraised value of the housing (\$6,500) or the amount paid for comparable lodging by those not affiliated with the school (\$8,400). Since the teacher is only paying \$6,000, the teacher isn't paying adequate rent. As a result, the teacher will be taxed on the \$500 difference between the \$6,500 adequate rent and the \$6,000 rent paid. In this example, IRC §119(d) excludes from income the excess of the fair market value of the housing received over the amount deemed to be adequate rent. The exclusion is \$1,900 (\$8,400 rental value received less \$6,500 of adequate rent). The actual \$6,000 rent paid is not deductible or excludible by the teacher.

Form W-2 Preparation: The employer will include \$500 in taxable wage income and will withhold the applicable Federal Income Tax Withholding, Social Security and Medicare taxes on these additional wages. The total wages reported on the Form W-2 will be \$40,500 (\$40,000 normal wages + \$500 rent-related wages). The \$1,900 excludable from income will have no effect on the employee's W-2; it represents the amount of rent the employee was not required to pay and which is excludable from income.

EXAMPLE 2:

Facts: Same as Example 1 except that the appraised value of the residence is only \$100,000, resulting in adequate rent of \$5,000 (\$100,000 x 5%).

Tax Treatment: The employee has no additional rent-related wages since the \$6,000 of rent paid exceeds the \$5,000 of adequate rent. In this example, IRC §119(d) excludes from income the excess of the fair market value of the housing received over the rent paid to the employer. The exclusion is \$2,400 (\$200/month rent break x 12 months = \$2,400 yearly rent break). The actual \$6,000 rent paid is not deductible or excludible by the teacher.

Form W-2 Preparation: The employer will include \$40,000 in taxable wage income. The \$2,400 excludable from income will have no effect on the employee's W-2; it represents the amount of rent the employee was not required to pay and which is excludable from income.

EXAMPLE 3:

Facts: Same as Example 1 except that the teacher is required to pay \$700 per month for the housing, or \$8,400 per year.

Tax Treatment: The teacher is not receiving a rent break since he/she is paying the same rent as those not employed by the school. As a result, the teacher has realized no taxable benefit. In this example, there is no IRC §119(d) exclusion from income. The actual \$8,400 rent paid is not deductible or excludible by the teacher.

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Form W-2 Preparation: The employer will include \$40,000 in taxable wage income. The W-2 will not include any rent-related wages because the employee received no taxable benefit.

Recent Proposed Regulation §1.162-31:

(See full text in separate handout.)

These regulations provide additional guidance: Local lodging expenses are deductible if incurred in carrying on the taxpayer's trade or business, based on all the facts and circumstances. This impacts fringe benefits as Working Condition fringe benefits are defined as those that, if the employee had paid for the property or service, it would have been deductible on the employee's individual income tax return. Therefore, if the cost of an item is deductible by an employee as a business expense, it may be excludable from the employee's wages as a working condition fringe benefit if provided by the employer. IRC §132(d)

General Rules for Working Condition Fringe Benefits

- Benefit must relate to employer's business
- Employee would have been entitled to an income tax deduction if bought personally
- Business use must be substantiated with records

Hopefully this information will clarify the rules for the teacher housing issue. If you have any questions on this matter, please feel free to contact Thomas Mansell, FSLG Specialist at (707) 535-3830.