



UNITED STATES OFFICE OF PERSONNEL MANAGEMENT  
Washington, DC 20415

The Director

Friday, April 13, 2001  
MSG 2001-033

**MEMORANDUM FOR: Human Resources Directors**

FROM: Richard A. Whitford, Acting Associate Director For Employment

Subject: Student Loan Repayment

The Employment Service is pleased to provide you with questions and answers about Student Loan Repayment. They contain guidance developed by the Internal Revenue Service. We recommend that you share them with your Chief Financial Officer and Payroll Office staff. We will add them to our materials at [opm.gov/studentloan/](http://opm.gov/studentloan/).

On March 16, 2001, the Office of Personnel Management (OPM) published in the Federal register proposed regulations implementing the Floyd D. Spence National Defense Authorization Act for Fiscal Year 2001, which amended 5 U.S.C. 5379. These amendments:

- Remove the restriction of this incentive to professional, technical, or administrative personnel;
- Remove the limitation of this incentive to employees covered under General Schedule pay rates;
- Broaden the types of loans which qualify under this part under the Higher Education Act of 1965 and the Public Health Service Act;
- Require agencies to report annually to OPM on their use of this incentive; and
- Require OPM to report annually to Congress on agencies' use of this incentive.

We will update these questions and answers when the proposed regulations become final. Comments on the proposed regulations are due to us by May 15. We intend to publish the final regulations as soon thereafter as possible. If you have any questions, please call Michael Mahoney on 202-606-1142.

Attachment

## Student Loan Repayment

### Questions and Answers

The Office of Personnel Management consulted with the Internal Revenue Service (IRS) on these questions and answers. The first section relates to the regulations codified in 5 CFR part 537. Section II was provided by the IRS. It discusses the income and employment tax consequences to the employee and the employer and the alternative methods available for calculating the correct amount of employment tax withholding due. The IRS section then discusses three alternative methods for paying the income tax withholding and the employee's share of social security and Medicare taxes attributable to the loan repayment, and pertains to agencies' tax obligations when using this incentive.

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### **Section I: OPM developed Questions and Answers**

#### **General**

Q1. What is the Student Loan Repayment authority?

A1. The student loan repayment authority permits agencies to repay the student loans of Federal employees in order attract or keep highly qualified individuals. In order to receive student loan repayment benefits, an employee must sign a service agreement to remain in the service of the agency for a period not less than 3 years.

This authority is not an entitlement program. As with any incentive, it is used at the discretion of the agency. If an agency chooses to use it, they will need to develop a plan which describes how it will be implemented within that agency.

Q2. How do people go about participating in this program?

A2. People interested in participating in this program must contact the agency in which they work or wish to work for further details. Agencies choosing to use this flexibility must establish a plan which describes how this incentive will be implemented within that agency.

Q3. Has the statute which authorizes repayment of student loans (5 U.S.C. 5379) been amended?

A3. Yes. The Floyd D. Spence National Defense Authorization Act for Fiscal Year 2001 (Public Law 106-398) amended 5 U.S.C. 5379 in several ways. The amendments

- Remove the limitation of this incentive to professional, technical, or administrative personnel;
- Remove the limitation of this incentive to employees covered under General Schedule (GS) pay rates;
- Broaden the types of loans that qualify under this part under the Higher Education Act of 1965 and the Public Health Service Act;
- Require agencies to report annually to OPM on their use of this incentive; and
- Require OPM to report annually to Congress on agencies' use of this incentive.

OPM published proposed regulations on March 16, 2001, to amend 5 CFR part 537. Comments are due May 15, 2001. OPM will publish final regulations as soon as possible.

Q4. Are the amendments to 5 U.S.C. 5379 reflected in the final regulation published on January 11, 2001?

A4. No. Language in the DoD Authorization Act requires OPM to issue proposed regulations, with an open comment period, to implement the amendments to 5 U.S.C. 5379. OPM published proposed regulations on March 15, 2001, to amend 5 CFR part 537. Comments are due May 16, 2001. OPM will publish final regulations as soon as possible.

### **Employee and Loan Eligibility**

Q5. What types of loans qualify as eligible for this incentive?

A5. The repayment authority, 5 U.S.C. 5379 as amended, is limited to student loans authorized by the Higher Education Act of 1965 and the Public Health Service Act. These are federally insured loans made by educational institutions or banks and other private lenders. The Higher Education Act covers guaranteed student loan programs such as:

- Stafford Loans;
- Supplemental Loans;
- Plus Loans;
- Federal Consolidation Loans;
- Defense Loans (made before July 1, 1972);

- National Direct Student Loans (made between 7/1/72 and 7/1/87);
- Perkins Loans

Loans covered under the Public Health Service Act include:

- the Nursing Student Loan Program loans,
- the Health Profession Student Loan Program loans, and
- the Health Education Assistance Loan Program loans.

The loans listed above will change when OPM's proposed regulations, published on March 16, 2001, become final.

Q6. Does this incentive apply to student loans for academic degrees at all levels?

A6. Yes. The level of academic degree for which a student loan was obtained is not a consideration in determining eligibility for this incentive. However, the loan must be made under the appropriate parts of the Higher Education Act of 1965 or the Public Health Service Act in order to be a qualifying loan for this incentive.

Q7. Does a degree, diploma, or certificate have to have been earned or awarded in order for an individual to be eligible for this incentive?

A7. No. Whether a degree, diploma, or certificate was earned is not a consideration in determining eligibility for this incentive.

Q8. Are individuals in non-General Schedule (GS) pay systems, such as Wage Grade (WG) and Administratively Determined (AD) systems, eligible for the student loan repayments?

A8. No. Use of this program is limited to individuals covered under General Schedule (GS) pay systems.

However, the Floyd D. Spence National Defense Authorization Act for Fiscal Year 2001 (P.L. 106-398) amended 5 U.S.C. 5379 by removing the limitation to GS employees. OPM published proposed regulations on March 16, 2001, to amend 5 CFR part 537 and include non-GS employees. Comments are due May 15, 2001. OPM will publish final regulations as soon as possible.

Q9. Are employees who have defaulted on their student loans eligible for this incentive?

A9. The repayment authority does not exclude employees who have defaulted on their student loans from receiving this benefit. However, agencies may exclude them by specifying so in their agency plan.

Q10. What if a loan is purchased or sold by the original holder? Are these loans still eligible for repayment?

A10. Yes. Loans purchased or sold by the original holder are still eligible for repayment, assuming the other conditions of the regulation are met.

Q11. Are part time employees eligible for student loan repayment benefits?

A11. Yes. Part time employees, assuming they are otherwise eligible, can receive student loan repayment benefits.

Q12. Are excepted Service employees eligible to receive student loan repayment benefits?

A12. Yes. Excepted service employees, except schedule C employees, may receive student loan repayment benefits, assuming they are otherwise eligible.

Q13. Are temporary employees eligible for this benefit?

A13. No. Temporary employees are not eligible for this benefit.

Q14. Are term employees eligible for this benefit?

A14. Term employees with at least 3 years remaining on their appointments are eligible. Term employees with less than 3 years remaining on their appointments are not eligible because they could not meet the 3 year service requirement specified in 5 U.S.C. 5379.

Q15. Are Foreign Service employees eligible to receive this benefit?

A15. No. Since members of the Foreign service are not covered under the General Schedule (GS) pay rates, they are not eligible to receive this incentive.

However, the Floyd D. Spence National Defense Authorization Act for Fiscal Year 2001 (Public Law 106-398) amended 5 U.S.C. 5379 by removing the limitation to GS employees. OPM published proposed regulations on March 15, 2001, to amend 5 CFR part 537. Comments are due May 15, 2001. OPM will publish final regulations as soon as possible. The amended regulations will permit Foreign Service employees to receive this benefit.

### **Criteria for Payment**

Q16. Can an agency use this incentive to retain an individual who may leave the agency for another Federal agency?

A16. No. The intent of this program is to help agencies retain individuals for Federal Service. Agencies should not use this incentive to retain employees who leave for positions in other Federal agencies.

Q17. Can an agency use this incentive to recruit an individual from another Federal agency?

A17. No. The intent of this program is to help agencies recruit individuals for Federal Service, not for agencies to be competing with one another for employees. So, agencies should not use this incentive to recruit current Federal employees from other agencies.

Q18. If an employee leaves the paying agency for another Federal agency before the employee satisfies the service agreement with the paying agency, is the gaining agency obligated to offer this benefit and/or continue making payments?

A18. No. The gaining agency is not obligated to complete any payments made by another agency.

### **Procedures for Making Payments**

Q19. Are agencies required to make student loan repayment benefit payments in one lump sum (e.g., if an agency wants to offer \$6,000 in loan repayment benefits, must the entire amount be paid at one time)?

A19. No. Agencies are not required to make payments in one lump sum. They may if they choose, but doing so may result in a huge tax liability for the recipient of the student loan repayment benefit. For more details, consult the IRS section below (IRS Q9 through Q16).

Q20. Can agencies offer the Repayment of Student Loan benefit in addition to existing bonuses and incentives?

A20. Yes. Agencies can use this incentive in conjunction with other recruitment and retention incentives. However, use of this incentive is subject to the aggregate limitation on pay. See below.

Q21. When are taxes withheld from a student loan repayment?

A21. Tax withholdings must be deducted or applied at the time any loan repayment is made. Tax withholdings may not be amortized or assessed at a date later than when the loan repayment is made.

Q22. Are agencies responsible for reporting their student loan repayments to the Internal Revenue Service?

A22. Yes. Agencies must report the amount of their loan repayments to the IRS (see IRS Q2 and Q3 in Section II below).

Q23. Are agencies responsible for any late fees assessed by the lender if the agencies' student loan repayment is not received on time?

A23. No. Agencies are not responsible for late fees assessed by the holder of an employee's student loan. Agencies should state this in their agency plans and/or in the individual service agreements with employees. Agencies should, to the extent possible, ensure that the timing of their payments to the lender coincides with the date the loan payment is due.

Q24. What options are available to agencies for easing the tax liability on a recipient of the student loan repayment benefit?

A24. Agencies have several options for easing the tax liability on their employees. See IRS Q9-16 in Section II below.

Q25. Is the \$6,000 limitation before or after taxes? For example, if taxes are withheld before the loan payment is made, does that mean if an employee is eligible for a \$6000 loan repayment, a check for say \$3,712 dollars is sent to the lender? Or is the employee given a tax statement for say \$8,416 dollars with a net to the lender of \$6,000?

A25. The \$6,000 calendar year limitation per employee means before taxes.

### **Service Agreements**

Q26. If an employee fails to complete the service requirement because of disability retirement or leaves Federal service because of a disabling condition is the employee still subject to the reimbursement requirements?

A26. Yes. Any employee who does not meet the service requirement is required to reimburse the government. However, agencies may waive recovery if they determine it to be against equity and good conscience or contrary to the public interest.

Q27. If an agency extends or renews loan repayments after the initial service agreement was satisfied, is a new service agreement required for the additional loan repayments?

A27. No. A new service agreement is not needed for extensions or renewals. However, agencies should mention this in the original service agreement and in their agency plans.

Q28. Can the 3-year service agreement be pro-rated according to the dollar amount of the incentive offered?

A28. No. The 3-year service agreement is established in statute and may not be pro-rated.

Q29. If an employee does not satisfy the terms of the service agreement, how much of the student loan repayment incentive are they required to reimburse the paying agency? In other words, if an individual gets \$6,000 per year for three years but leaves with 6 months left on the service agreement, must the employee reimburse the paying agency for \$18,000 or just \$3,000 (half of the final year's \$6,000)?

A29. If an employee voluntarily separates and does not complete the terms of the service agreement, the employee is obligated to reimburse the paying agency for all benefits received.

Q30. Can employees credit prior Federal experience towards the 3 year service requirement?

A30. No. Employees must agree to remain in the service of the agency from the time specified in their service agreement.

Q31. When does the 3 year service requirement begin?

A31. The 3-year service requirement begins when the first payment is made by the agency to the holder of the loan. Agencies should specify this in their agency plans and in their individual service agreements.

### **Employee Reimbursements**

Q32. The regulations say that an agency may waive the right of recovery in the interest of "equity and good conscience". What is meant by "equity and good conscience"?

A32. Agencies have the discretion to make their own determinations of equity and good conscience. When doing so agencies should take into account consistency, fairness, and the cost to taxpayers of recovering monies owed to the Government.

### **SECTION II: IRS Questions and Answers**

The following Questions and Answers were provided by the Internal Revenue Service (IRS). For further guidance/clarification on IRS Q&As 1-16, agency representatives should contact Mr. Allen Jones at the IRS on 202-283-9818.

#### **Employer's Tax, Withholding, and Reporting Obligations**

Q1: If an agency repays the student loan incurred by an agency employee, is the repayment includible in the employee's gross income and in wages for federal employment tax purposes?

A1. Yes. The repayment is includible in the employee's gross income and in wages for federal employment tax purposes notwithstanding the agency's repayment of the loan directly to the lender.

Q2: What are the federal employment tax obligations of an agency that repays a student loan incurred by an agency employee?

A2: The agency must:

- Pay the employer's share of social security and Medicare taxes on the loan repayment;
- Withhold and pay federal income tax withholding (and appropriate state and local income tax withholding) on the loan repayment;
- Withhold and pay the employee's share of social security and Medicare taxes on the loan repayment; and
- Report the loan repayment and taxes withheld and paid as required under federal law and applicable state and local laws.

Q3: On what form must an agency report the repayment of a student loan incurred by an agency employee?

A3: The loan repayment is reported as wages in Box 1 of Form W-2, Wage and Tax Statement, and as Medicare wages in Box 5 of Form W-2. If wages paid to an agency's employee are subject to social security taxes, the repayment is also reported as social security wages in Box 3 of Form W-2. The repayment is includible in social security



wages, however, only to the extent that the repayment together with other wages previously paid during the calendar year does not exceed the social security wage base for that year.

Q4: How does a federal employee report the repayment of a student loan by his or her employer?

A4: The repayment is reported as wages on line 7 of Form 1040 or, alternatively, on line 1 of Form 1040EZ.

### **Calculation of Employment Taxes**

Q5: How does an agency calculate the amount of employment tax withholding due with respect to a loan repayment?

A5: One of two methods may be used: (1) the regular method or (2) the flat rate method. These methods apply because the loan repayments are supplemental wages paid in addition to regular wages. These two methods are described below and, more specifically, in Publication 15, Circular E, *Employer's Tax Guide*.

Q6: How does an agency calculate the amount of employment tax withholding due on supplemental wages (such as the loan repayment) under the regular method?

A6: To use this method the agency follows these steps:

1. The Federal agency calculates the correct amount of employment tax withholding on all wages paid during the payroll period by treating the supplemental wages and the regular wages as a single wage payment for the payroll period.
2. The Federal agency calculates the correct amount of employment tax withholding on the regular wages paid to the employee during the payroll period.
3. The Federal agency subtracts the amount determined in step 2 from the amount determined in step 1 to calculate the amount of employment tax withholding due with respect to the supplemental wages.

Q7: How does an agency calculate the amount of employment tax withholding due on supplemental wages under the flat rate method?

A7: The correct amount of income tax withholding is calculated by taking a flat 28 percent of the supplemental wages. Social security tax and Medicare tax withholding are calculated at the usual rates and are in addition to the 28 percent income tax withholding.

Q8: When can an agency use the flat rate method of withholding on supplemental wages?

A8: The flat rate method of withholding on supplemental wages can be used if income tax has been withheld from the regular wages of the employee.

### **Withholding of Employment Taxes**

Q9: What methods may an agency use to withhold income tax and the employee's share of social security and Medicare taxes (employment taxes) when the agency repays a student loan incurred by its employee?

A9: An agency may use any of the following methods. Different methods may be used for different groups of employees. The agency may:

- Withhold employment taxes from regular wages paid to the employee as described in Question 10;
- Withhold employment taxes from the loan repayment as described in Question 12; or
- Require a separate tax payment from the employee as described in Question 15

### **Withholding from Regular Wages**

Q10: How does an agency withhold and pay employment taxes from regular wages paid to the employee?

A10: To use this method the agency:

- Determines the correct amount of employment tax withholding on all wages paid to the employee during the payroll period, including both the loan repayment and regular wages. (The agency may use either the regular method described in Question 6 or the flat rate method described in Question 7 to calculate the correct amount of employment tax withholding on the loan repayment);
- Deducts the total amount of employment tax withholding from the employee's regular wages; and
- Deposits the amounts withheld and reports them on Form 941, Employer's Quarterly Federal Tax Return, and Form W-2 in accordance with normal depositing and reporting procedures.

Q11: What if the agency does not process its own payroll but, instead, contracts with another agency to process the payroll?

A11: The agency making the loan repayment is responsible for transmitting the necessary information to the payroll agency and for ensuring that the withholding is properly implemented. If the agency processing the payroll is unable or unwilling to implement withholding, the agency repaying the loan must use one of the alternative withholding methods listed in Question 9.

### **Withholding from Loan Repayment**

Q12: How does the agency withhold employment taxes directly from a loan repayment?

A12: To use this method the agency:

- Calculates the correct amount of employment tax withholding on the loan repayment using one of two methods, the regular method described in Question 6 or the flat rate method described in Question 7;
- Deducts the amount of employment tax withholding from the loan repayment; and
- Deposits the amounts withheld and reports the employment tax withholding and wages on Forms 941 and W-2 in accordance with normal deposit and reporting procedures.

Q13: Can an agency that deducts the amount of employment tax withholding from loan repayments repay the \$6,000 annually that is permitted?

A13: No. The deduction for employment tax withholding reduces the maximum loan repayment.

Q14: If an agency deducts the amount of employment tax withholding from the gross loan repayment, is the amount of the employment tax withholding and the net loan repayment includible in the employee's gross income and in wages for federal employment tax purposes?

A14: Yes. However, the amount of income tax withheld is credited against the employee's income tax liability for the year.

### **Withholding from Separate Tax Payment**

Q15: What are the obligations of an agency that requires employees to pay the agency an amount equal to employment tax withholding before the agency repays a student loan?

A15: The agency is obligated to pay amounts required to be withheld from an employee's wages even if those amounts are not actually withheld. Federal tax law requires agencies, like other employers, to withhold employment taxes from employees' wages. The repayment of student loans, however, may be subject to such terms, limitations, or conditions as the agency and the employee may mutually agree. Consequently, the agency's repayment of the student loan may be made contingent on the employee's payment of employment taxes (including income tax and the employee's portion of social security tax and Medicare tax) to the agency. In this case, to fulfill its tax obligations the agency:

- Determines the correct amount of employment tax withholding on the loan repayment using either the regular method described in Question 6 or the flat rate method described in Question 7;
- Obtains a check or other payment from the employee for the amount determined above;
- Makes the loan repayment and deposits and reports on Form 941 an amount equal to the payment received from the employee in accordance with normal deposit and reporting procedures; and
- Reports the income, social security, and Medicare tax components paid by the employee in the appropriate boxes of Form W-2. These amounts are not included as income or wages in Boxes 1, 3, and 5 of Form W-2.

Q16: May the agency treat the loan repayment as a noncash fringe benefit and use the withholding rules applicable to noncash fringe benefits?

A16: No. The rules for withholding on noncash fringe benefits do not apply to the employer's repayment or forgiveness of an employee's loan obligation.