Internal Revenue Service

Department of the Treasury

Washington, DC 20224

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Person to Contact:

Telephone Number:

Refer Reply To:
CC:ITA:4 – PLR-101681-02
PLR-112282-02
Date: November 26, 2002

In Re:

LEGEND:

X =

M =

Y =

Z =

A =

Dear :

This letter responds to your letters of December 18, 2001, and February 14, 2002, and to subsequent correspondence and submissions. In these submissions, you requested rulings under various sections of the Internal Revenue Code regarding the proper federal income tax treatment (including any reporting and/or withholding obligations) of certain transactions between X, M, and Y (X's employee), as described more fully below.

The information submitted indicates that X, the grantor, is a large multinational corporation organized and operating under the laws of the state of A. X is engaged in business activities worldwide. Y and Z are a married couple who file a joint return of tax for federal income tax purposes. Y is an employee of X and works outside the United States. The children of Y and Z are eligible applicants and potential recipients of grants to be awarded under the scholarship program described below.

M is a domestic organization recognized as exempt from federal income tax under § 501(c)(3) of the Internal Revenue Code and is a public charity described in §§ 509(a)(1) and 170(b)(1)(A)(vi). The principal activity of M is to promote international schools that provide an American-style education through programs of grant making as well as through providing consultative and management services.

Under the transaction proposed, M will conduct a program, funded by X, for the awarding of scholarship grants to children of expatriate employees of X attending educational institutions that are both described in § 170(b)(1)(A)(ii) and located outside the United States. M will award such scholarship grants to the children of X employees in substantial compliance with the guidelines set forth in Rev. Proc. 76-47, 1976-2 C.B. 670, including satisfying the percentage tests of section 4.08 of that revenue procedure.

The federal income tax treatment of scholarships and fellowship grants is addressed in § 117. Section 117(a) provides that gross income does not include any amount received as a qualified scholarship or fellowship grant by an individual who is a candidate for a degree at an educational organization described in § 170(b)(1)(A)(ii). Under § 1.170A-9(b)(1) of the Income Tax Regulations, the term "educational organization" includes primary, secondary, preparatory, and high schools.

However, excludible grants are generally limited to "relatively disinterested, 'no-strings' educational grants, with no requirement of any substantial *quid pro quo* from the recipient." Bingler v. Johnson, 394 U.S. 741, 751 (1969). Generally, amounts paid to or for the benefit of employees are presumptively compensatory in nature and, absent a statutory exclusion, ordinarily includible in gross income as wages. Thus, if grants are made available to or for the benefit of employees on a preferential basis, the employer-employee relationship immediately suggests that the grants are compensatory. These suggestions are not dispelled simply because the grantor is an independent third party, such as a private foundation or public charity.

Whether a particular amount is received as a scholarship or fellowship grant is an inherently factual question to be resolved from the circumstances of each case. Although a scholarship need not be formally designated as such, the mere designation of a payment as a "scholarship" or fellowship grant will not govern tax treatment. Thus, for example, the exclusion has no application to amounts designated as scholarships that in fact constitute taxable payments, distributions, or wages. If educational grants are awarded in an employment context, they must generally be shown to fall outside the "pattern of employment" before "scholarship" treatment or wage exclusion is permitted.

Rev. Proc. 76-47 provides guidelines for determining whether grants made by private foundations under employer-related scholarship programs to employees and/or children of employees will be treated as scholarships or fellowship grants subject to the provisions of § 117(a). The guidelines are directed at determining whether a particular program's grants could fail to be § 117 scholarship or fellowship grants because, for example, the purpose of the program is to provide extra compensation, an employment incentive, or an employee fringe benefit for the employees generally or for a particular class of employees. The described scholarship program to be funded by X and conducted by M is an employer-related program within the contemplation of Rev. Proc. 76-47 because it gives children of employees of a particular employer, X, a preference or priority over others in being selected as grantees of some or all of the organization's grants.

The guidelines set forth in Rev. Proc. 76-47 are specifically applicable to private foundations and do not directly apply in this situation. However, the guidelines are relevant in this situation because their purpose is to determine whether grants awarded under programs that treat some or all of the employees or children of employees of a particular employer or employers as a group from which some or all of a grantor's awards will be selected (or give a preference to such individuals) fall outside the pattern of employment.

The revenue procedure states that in order to fall outside the pattern of employment the availability of grants to employees or their children must be controlled and limited by substantial nonemployment related factors to such an extent that the preferential treatment derived from employment does not continue to be of any significance beyond an initial qualifier. Further, such qualification must not lead to any significant probability that employment will make grants available for a qualified employee or his or her children interested in applying for one. The revenue procedure establishes seven conditions (all of which must be met), as well as a number of percentage tests (at least one of which must be met), for making such a determination. In the absence of satisfying a specific percentage test, a "facts and circumstances" determination will be substituted; however, the facts and circumstances are considered in the context of the probability that a grant will be available to any eligible applicant.

X has represented that its awards program to be conducted by M will be operated in substantial conformity with the guidelines and percentage limitations of Rev. Proc. 76-47. Y and Z have represented that the school their children are attending encompasses pre-kindergarten through high school.

Based on the facts presented and the representations made, we conclude that grants awarded under these procedures fall outside the pattern of employment and are not compensatory in nature. Grants awarded under these procedures constitute scholarship or fellowship grants within the meaning of § 117(a). The scholarships thus are excludible from the gross income of the recipients to the extent of the recipients' qualified tuition and related expenses. The scholarships are also excludible from the gross income of Y (the employee by reason of whose employment the scholarship

recipient was eligible for consideration for an award) and of Z (Y's spouse). To the extent amounts are received in excess of the student's qualified tuition and related expenses, such amounts are includible in the student's (or parents') gross income, but not as compensation or wages. (X or M may wish to advise employees whose children participate in the described scholarship program that the amount of scholarship receipts that exceeds their qualified tuition and related expenses is generally includible in gross income for federal income tax purposes.)

We rule further that neither the amounts awarded by X to M to fund the described scholarship program, nor amounts awarded to recipients under the described program, constitute wages for purposes of § 3401(a). Additionally, such amounts are not subject to § 3402 (relating to withholding for income taxes at source), § 3102 (relating to withholding under the Federal Insurance Contribution Act (FICA)), or § 3301 (relating to the Federal Unemployment Tax Act (FUTA)). Neither X nor M is required to file Forms W-2, or any returns of information under § 6041, with respect to such grants.

CAVEATS:

A copy of this letter must be attached to any income tax return to which it is relevant. Enclosed is a copy of the letter ruling showing the deletions proposed to be made in the letter when it is disclosed under § 6110.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any item discussed or referenced in this letter. This ruling is directed only to the taxpayers requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely,

Robert A. Berkovsky
Branch Chief
Office of Associate Chief Counsel
(Income Tax & Accounting)

Enclosure:
Copy for § 6110 purposes