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DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Date: JUN 25 2002

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Dear Sir or Madam:

This is in reference to your letter of May 23, 2002, requesting advance approval of your grant procedures under section 4945(g) of the Internal Revenue Code.

The information submitted shows that the grants will be administered by F, a publicly supported organization, under its B program. Organizations operating under the B program may elect the C and/or the D option.

For purposes of the C scholarship awards option, F selects individual scholarship recipients in the B program through a competition. The initial phase of the competition is the X Test, which is given annually in participating high schools by high school officials. After the test, F identifies and honors students scoring in a group that represents the top two percent of graduating high school seniors nationwide, and designates a number that represents less than one percent of the graduating high school seniors in each state as semifinalists. The semifinalists then take a second test (Y) to "confirm" their earlier performance. Those who repeat their prior performance, who demonstrate high academic standing in high school and who meet other standard requirements are designated as finalists.

F's selection procedures in its D scholarship awards option generally parallel those applied in the C option; however eligibility in the D option is limited to the top-scoring Black students. Semifinalists in the D option are designated in at least four geographic regions, each consisting of several states, according to the distribution of the Black population throughout the United States.

You have entered into an agreement with F whereby you have agreed to sponsor a specific number of scholarships each year, to be awarded to children and/or relatives of employees of E. Under the B program, F may award scholarships only to students who are designated as finalists. The actual number of B scholarships to be supported by you will not exceed the number of employees' children who qualify as finalists in their respective competitions. After the list of finalists is obtained, F reviews the finalist group to determine which students are eligible for grants under an employer related scholarship program. No application is required from the students to enter the B program; therefore, neither you nor F can determine the number of "eligible" applicants. If there is an insufficient number of employees' children who qualify as finalists, the total number of scholarships to be awarded in a particular year is automatically reduced, or some foundations may permit scholarships to be offered to finalists who are not children of employees. F monitors participating employers to ensure a sufficiently large base of employees' children from which at least one or more B finalists would ordinarily be expected to emerge. This is necessary since fewer than one out of one hundred seventy-five students in a senior class achieves the B finalist level.

The selection of individual grant recipients is made by selection committees designated by F. The members of the selection committee are totally independent and separate from you. F confirms the individual scholarship recipient's enrollment at the educational institution, makes payment of the award through the appropriate financial aid office of the educational institution, and supervises and investigates the use of the grant funds by the recipients in their educational program.

The scholarships will not be used as a means of inducement to recruit employees nor will a grant be terminated if an employee parent leaves the company. Scholarships will only be awarded to students who plan to enroll in an institution that meets the requirements of section 170(b)(1)(A)(ii) of the Code and which may further be limited by F. After the scholarship is awarded, the recipient will not be restricted in his/her course of study. In rare cases, sponsors may ask F to give preference in selection to individuals who propose to study in certain broad fields. F will supply statistical information to you which will enable you to maintain the records required by Rev. Proc 76-47, 1976-2 C.B. 670.

Section 4945 of the Code provides for the imposition of taxes on each taxable expenditure of a private foundation.

Section 4945(d)(3) of the Code provides that the term "taxable expenditure" means any amount paid or incurred by a private foundation as a grant to an individual for travel, study, or other similar purposes by such individual, unless such grant satisfies the requirements of section 4945(g).

Section 4945(g)(1) of the Code provides that section 4945(d)(3) shall not apply to an individual grant awarded on an objective and nondiscriminatory basis pursuant to a procedure approved in advance by the Secretary, if it is demonstrated to the satisfaction of the Secretary that the grant constitutes a scholarship or fellowship grant which is subject to the provisions of section 117(a) and is to be used for study at an educational organization described in section 170(b)(1)(A)(ii).

Rev. Proc. 76-47, 1976-2 C.B. 670 sets forth guidelines to be used in determining whether a grant made by a private foundation under an employer-related program to a child of an employee of the particular employer to which the program relates is a scholarship grant subject to the provisions of section 117(a). If a private foundation's program satisfies the seven conditions set forth in sections 4.01 through 4.07 of Rev. Proc. 76-47 and meets the percentage test described in section 4.08, the Service will assume the grant will be subject to the provisions of section 117(a).

Section 4.08 of Rev. Proc. 76-47 provides a percentage test guideline. It states that in the case of a program that awards grants to children of employees of a particular employer, the program meets the percentage test if the number of grants awarded under that program in any year to such children does not exceed 25 percent of the number of employees' children who (i) were eligible, (ii) were applicants for such grants, and (iii) were considered by the selection committee in selecting the recipients of grants in that year, or 10 percent of the number of employees' children who can be shown to be eligible for grants (whether or not they submitted an application) in that year.

As stated in section 4 of Rev. Proc. 76-47, if a sponsor's program satisfies the seven conditions set forth in sections 4.01 through 4.07, but does not meet the percentage test of section 4.08 applicable to grants to employees' children, the question whether the grants are scholarship or fellowship grants subject to the provisions of section 117(a) of the Code will be resolved on the basis of all the facts and circumstances. In making this determination the Service will consider as a substitute for the percentage test of section 4.08 all the relevant facts and circumstances to determine whether the primary purpose of the program is to provide extra compensation or other employment incentive, or whether the primary purpose is to educate recipients in their individual capacities. These facts and circumstances will be considered in the context of the probability that a grant will be available to any eligible applicant.

Such relevant facts and circumstances could include the history of the program (such as the source of the program's funding), the courses of study for which the grants are available, any eligibility requirements imposed by the program (other than employment of the applicants or their parents and the age and grade level prerequisites for the studies for which the grants are available), the publicity given the grant program, the degree of independence of the selection committee, the particular standards used for selection, the specific means used to determine whether those standards have been met, the precise nature of the employee limitation or preference, the number of grants available, the number of employees or their children who would be eligible for them, the percentage of eligible employees or their children applying for grants who normally (e.g. on an average basis), receive grants under the program, and whether and how many grants are awarded to individuals who do not qualify as employees or children of employees.

In this instance the following facts and circumstances are considered relevant. Aside from the employment preference, F, a public charity, operates its private foundation sponsored B program in a substantially similar manner to its nationwide college scholarship program for academically talented high school students. No application is required. Individuals must achieve finalist status in their respective competitions. Recipients are chosen by selection committees totally independent of the private foundation or the employer involved. No limitations are placed on the recipients' choice of course of study after the grant is awarded. The number of actual grants made may not exceed the number of employees' children who qualify as finalists. In 1998, F provided an average of one scholarship for every 7,300 employees children in its programs.

Under the facts and circumstances as stated above, there is only an insignificant probability that any particular employee's child will be selected and, thus, the grant's primary purpose is not one of providing extra compensation or other employment incentive, and the facts and circumstances test of Rev. Proc. 76-47, section 4, is met.

Accordingly, based upon the information presented, and assuming your scholarship program will be conducted as proposed, with a view to providing objectivity and non-discrimination in the awarding of scholarship grants, we rule that your grants to F for the awarding of scholarship grants to children of employees of E comply with the requirements of section 4945(g)(1) of the Code. Thus, such expenditures made in accordance with those procedures will not constitute "taxable expenditures" within the meaning of section 4945(d)(3) of the Code.

The recipient of the scholarship is responsible for determining whether all or part of the scholarship is includible in gross income under section 117 of the Code. We understand that F will advise the recipient that amounts granted are taxable income, if the aggregate scholarship amounts received by the recipient exceed tuition and fees (not including room and board) required for enrollment or attendance at the educational institution and fees, books, supplies, and equipment required for courses of instruction.

This ruling will remain in effect as long as the procedures in awarding grants under your program remain in compliance with sections 4.01 through 4.07 of Rev. Proc. 76-47.

Please note that this ruling is only applicable to grants awarded under the B program. Before you enter into any other scholarship or educational loan program you should submit a request for advance approval of that program. Your procedures for awarding grants under the B program are considered to satisfy the facts and circumstances test of Rev. Proc. 76-47 and, therefore, will not be counted in determining whether the percentage test of Rev. Proc. 76-47 is met with respect to any other such program for which prior approval has been granted.

We are informing the TE/GE office of this ruling. Please keep a copy of this ruling with your organization's permanent records.

This ruling is directed only to the organization that requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Sincerely,

Gerald V. Sack

Gerald V. Sack
Manager, Exempt Organizations
Technical Group 4