Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Person To Contact:
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Telephone Number:

Refer Reply To:
CC:ITA:B05 – PLR-101352-04
Date:
June 3, 2004

Attention:

Legend

University =
College =
Program =

Date 1 =
Date 2 =

Dear Taxpayer:

This is in response to your authorized representative's letter and submissions of December 12, 2003 and May 27, 2004, in which he requested on your behalf rulings under section 117(d) of the Internal Revenue Code of 1986 (Code) regarding the proper federal income tax treatment of certain tuition reduction benefits provided by you, the University (sometimes referred to herein as the Taxpayer) under the University's tuition assistance program (the Program). We are pleased to address your concerns.

The information submitted indicates that University is an educational organization described in section 170(b)(1)(A)(ii) of the Code. As of Date 1, the University (including controlled affiliates) employed approximately employees, excluding those employees who are covered by a collective bargaining agreement, employees who do not regularly work 50% time or more and employees who have failed to complete a year of service with 1,000 or more hours of service. Of these employees, are highly compensated within the meaning of Code Section 414(q), and are not highly compensated.

The Program has been created to provide faculty and staff of College with tuition benefits to assist these employees with the cost of tuition for the education of their

dependent children. None of the faulty, administrators and staff who will be eligible for the program is covered by collective bargaining agreements and all have full-time permanent appointments. Under the Program, as amended, eligible employees may apply for assistance with the cost of tuition for their dependent children in first grade though baccalaureate level education. Program will have a uniformly applied ceiling to be established annually. Tuition benefits awarded pursuant to the Program may be paid either directly to the school or by reimbursement to the employee. Eligibility ceases upon retirement (or other employment termination). As of Date 1, highly compensated College employees were eligible for benefits under the Program, as amended, while non-highly compensated employees of College were eligible.

Generally, amounts paid to or for the benefit of employees are presumptively compensatory in nature and ordinarily includible in gross income as wages. Section 117(d)(1) of the Internal Revenue Code, however, provides a special rule in the case of a "qualified tuition reduction": section 117(d)(1) provides that gross income shall not include any "qualified tuition reduction."

Section 117(d)(2) defines a "qualified tuition reduction" as the amount of any reduction in tuition provided to any employee of a section 170(b)(1)(A)(ii) educational organization for the education (below the graduate level) at such an educational organization, of (A) such employee, or (B) any person treated as an employee (or whose use is treated as an employee use) under the rules of section 132(h). Section 132(h) refers, generally, to spouses and dependent children of employees.

Section 170(b)(1)(A)(ii) describes an educational organization as one which normally maintains a regular faculty and curriculum and normally has a regular body of pupils or students in attendance at the place where its education activities are regularly carried on. An entity described in sections 170(c)(1) or (2) of the Code, or an institution that is operated as an activity or function of such an entity, may qualify as an "educational organization" described in section 170(b)(1)(A)(ii) for purposes of section 117(d).

Except for the case of certain graduate teaching and research assistants, the exclusion from income provided by section 117(d) is limited to education "below the graduate level." Section 117(d)(5)[4] provides an exception for individuals who are graduate students at the employing institution and who are engaged in providing teaching or research activities for that educational institution.

Section 117(d)(3) of the Code provides that the exclusion from income of a qualified tuition reduction will apply to highly compensated employees only if such reduction is available on substantially the same terms to each member of a group of employees which is defined under a reasonable classification set up by the employer which does not discriminate in favor of highly compensated employees (within the meaning of section 414(q)).

Section 1.410(b)-4 of the Income Tax Regulations generally provides the test for determining whether a classification is reasonable and nondiscriminatory. That test has two parts: (1) section 1.410(b)-4(b), requiring that a classification established by an employer for its employees be reasonable; and (2) section 1.410(b)-4(c), requiring that a plan pass an objective test to assure that the reasonable classification is nondiscriminatory. The objective test has a safe harbor, an unsafe harbor, and a "facts and circumstances" element. A plan passes the objective test if it comes within a safe harbor, or satisfies the facts and circumstances considerations. The test applies with respect to the minimum coverage rules of Code section 410(b) and may be incorporated into Code section 117(d), taking into account the differences between a qualified retirement plan and a qualified tuition reduction plan. Although section 117(d)(3) prohibits discrimination in favor of highly compensated employees described in section 414(q), there is no specific language in section 117(d) mandating that the same coverage tests applicable under section 410 are also applicable under section 117(d). Thus, the determination of whether a tuition reduction plan in fact discriminates in favor of highly compensated employees for purposes of section 117(d)(3) is made based upon an analysis of all relevant facts and circumstances.

Section 1.410(b)-4(b) of the Regulations provides that a classification will be reasonable if, based on all of the facts and circumstances, the classification is reasonable and established under objective business criteria that identify the category of employees who benefit under the plan. Reasonable classifications include specified job categories, nature of compensation (i.e., salaried or hourly), geographic location, and other similar bona fide business criteria. The House Ways and Means Committee Report on the Deficit Reduction Act of 1984, H.R. Rep. No. 98-432, Part 2, 98th Cong., 2d Sess. 1606 (1984), provides additional examples of reasonable classifications. The report explains that an employer could establish a classification based on such factors as seniority, full-time versus part-time employment, or job description, provided that the classification is nondiscriminatory.

As of Date 2, College had faculty and administrative staff employees. There are full-time, permanent employees: are faculty members and the other are staff members. All of these full-time, permanent employees are eligible to participate in the Program, as amended. Of the remaining employees, all are either temporary, part-time, or non-permanent employees. These temporary or part-time employees would not be eligible to participate in the amended Program.

We have determined that the Program satisfies the "reasonable classification" of employees test of section 117(d)(3). Additionally, based on all relevant facts and circumstances, including the facts that: (1) the benefit is available to all College faculty and administrative staff (excluding part-time, temporary and non-permanent employees); and (2) that of the College's total faculty and staff population ( ) is eligible to participate in the Program, we conclude that the Program does not discriminate in favor of highly compensated employees. Thus, College's tuition

reduction Program satisfies the prohibition against discrimination in favor of highly compensated employees as described in section 117(d)(3) of the Code.

Based on the information provided and representations furnished, we have determined that the described tuition reduction benefits provided under the Taxpayer's amended tuition reduction Program, to employees (within the meaning of section 117(d)(2) of the Code) of College for the education below the graduate level of dependent children at any educational institution described in section 170(b)(1)(A)(ii), are excludable from the gross incomes of such employees under section 117(d)(1) of the Internal Revenue Code as "qualified tuition reductions."

Accordingly, the value of the described tuition reduction benefits granted under the Program to employees (within the meaning of section 117(d)(2) of the Code) of the College for the education below the graduate level of such individuals does not constitute "wages" for purposes of section 3401(a). Additionally, such amounts are not subject to section 3402 (relating to withholding for income taxes at source), section 3102 (relating to withholding under the Federal Insurance Contribution Act (FICA)), or section 3301 (relating to the Federal Unemployment Tax Act (FUTA)). Taxpayer is not required to file Forms W-2, or any returns of information under section 6041, with respect to such payments or remissions.

This letter ruling is based on the facts and representations provided by the Taxpayer and is limited to the matters specifically addressed. No opinion is expressed as to the tax treatment of the transactions considered herein under the provisions of any other sections of the Code or regulations which may be applicable thereto, or the tax treatment of any conditions existing at the time of, or effects resulting from, such transactions which are not specifically addressed herein.

Temporary or Final regulations pertaining to one or more of the issues addressed in this ruling have not yet been adopted. Therefore, this ruling may be modified or revoked by adoption of final regulations, to the extent the regulations are inconsistent with any conclusions in this ruling. See section 11.04 of Rev. Proc. 2004-1, 2004 -1 I.R.B. 1, at 46. However, when the criteria in section 11.06 of Rev. Proc. 2004-1 are satisfied, a ruling is not revoked or modified retroactively, except in rare or unusual circumstances.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

The rulings contained in this letter are based upon information and representations submitted by the University and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Because it could help resolve federal tax issues, a copy of this letter ruling should be maintained with the University's permanent records.

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

Sincerely,

William A. Jackson
Branch Chief, Branch 5
Office of Associate Chief Counsel
(Income Tax & Accounting)

Enclosures (2)
Copy of this letter
Copy for § 6110 purposes