Internal Revenue Service

Department of the Treasury
Washington, DC 20224

Number: **200430024**
Release Date: 7/23/04
Index Number: 117.00-00, 3102.00-00, 3402.00-00

Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
CC:ITA:B04 – PLR-169527-03
Date:
April 09, 2004

In Re:

LEGEND:

X =

M =

A =

Y =

Z =

Dear :

This letter responds to your letters of September 25, 2003, and November 24, 2003. Your submissions concerned X, a large multinational corporation organized and operating under the laws of the state of A. On November 26, 2002, the Internal Revenue Service issued a private letter ruling regarding the federal income tax treatment to X of the transactions described therein. In your recent submissions, X both reaffirmed the representations made in connection with the prior request for a private letter ruling and represented facts not previously represented. X now asks us to rule that the additional facts now represented will not adversely affect our prior rulings concerning X.

The private letter rulings of November 26, 2002

Related private letter rulings of November 26, 2002, involved common representations relating to X, Y, Z and M. Y is an employee of X, working outside the United States; Z is Y's spouse. Y and Z file a joint income tax return of tax for federal income tax purposes. The children of Y and Z, who attend a school encompassing kindergarten through 12th grade, are eligible applicants and potential recipients of grants to be awarded under the scholarship program described below.

M is a domestic organization 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 considered in our prior rulings, 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. Thus, M will conform with the seven guidelines found in §§ 4.01 through 4.07 of that revenue procedure and with the percentage limitations described in § 4.08.

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). Section 117(b)(1) provides that a qualified scholarship means any amount received by an individual as a scholarship or fellowship grant to the extent the individual establishes that, in accordance with the conditions of the grant, such amount was used for qualified tuition and related expenses. Section 1.170A-9(b)(1) of the Income Tax Regulations provides that the term "educational organization" includes primary, secondary, preparatory, and high schools.

In our private letter rulings of November 26, 2002, we concluded that grants awarded in substantial conformity to the procedures found in Rev. Proc. 76-47 fall outside the pattern of employment and are not compensatory in nature. Accordingly, we concluded that any grants received from M for the education of Y and Z's children would be scholarships under § 117(a) to the extent of the recipients' qualified tuition and related expenses. We also concluded that such grants would not be includible in the gross income of Y (the employee by reason of whose employment the scholarship recipient was eligible for consideration for an award) or of Z (Y's spouse), and would not be

wages under § 3401(a). Y and Z are not parties to or affected by the present ruling request.

In the private letter rulings of November 26, 2002, we also concluded that neither the amounts awarded by X to M to fund the described scholarship program, nor the amounts awarded to recipients under the described program, constitute wages for purposes of § 3401(a). Additionally, we concluded that 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)). We further concluded that neither X nor M are required to file Forms W-2, or any returns of information under § 6041, with respect to such grants.

The current ruling request

In your recent submissions, X additionally represents that: (1) under company policy, X is generally required to pay for the educational expenses of its expatriate employees' children; and (2) accordingly, those children for whom X is obligated to pay tuition and fees will have those educational expenses paid by X in the event the children do not receive scholarships from M or another party. X further represents that all prior factual representations made in connection with the private letter ruling of November 26, 2002, remain in effect.

We conclude that the additional facts do not adversely affect our rulings concerning X in the private letter ruling of November 26, 2002. The question here presented is not whether X realizes income when M relieves X of X's pre-existing legal obligation (although it does not),[1] but rather whether the relief accorded by M to X changes the nature of M's grants from noncompensatory to compensatory. We conclude that no such change occurs.

The guidelines found in Rev. Proc. 76-47 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 revenue procedure states that in order to fall

[1] Old Colony Trust v. Commissioner, 279 U.S. 716, 729 (1929), held that a taxpayer/employee realized income when his employer, pursuant to a reimbursement contract, paid his state and federal income tax. The Court observed that the discharge by a third person of the taxpayer's obligation is equivalent to receipt by the taxpayer. However, application of the Old Colony principle generally requires that the third party's payment is made in response to a command by, or contractual obligation with, the taxpayer. Raybestos-Manhattan, Inc. v. United States, 296 U.S. 60, 64 (1935); Douglas v. Willcuts, 296 U.S. 1, 9 (1935). Although X will benefit if M awards grants to children of X's employees, on the facts represented X cannot control, direct, or command M to award such grants, and M's awards will not result in income to X.

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.

X earlier 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. That representation, which remains in full force, establishes that M's grants will be noncompensatory in nature. Nothing in the additional facts affects that representation, and accordingly the rulings previously made concerning X in the private letter ruling of November 26, 2002, remain unchanged.

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