



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

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

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Contact Person:

Identification Number:

Telephone Number:

Employer Identification Number:

Legend:

A =  
B =  
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E =

Dear \_\_\_\_\_ :

We have considered A's ruling request dated August 16, 2005, requesting approval of A's scholarship grant-making procedures under section 4945(g) of the Internal Revenue Code.

A is exempt from federal income tax under section 501(c)(3) of the Code and is a private foundation under section 509(a) of the Code.

The information submitted indicates that A will administer a scholarship program on behalf of B, a boys-only boarding school in C described in section 170(b)(1)(A)(ii) of the Code.

A's board of directors is composed of five members. Three of the members are the current senior officials of B.

A's scholarship grants program is for boys, under the age of 18 on July 1<sup>st</sup> of the intended year of commencement of study, who are advanced students in, or graduates of, U.S. high schools. To be selected for a scholarship, applicants are invited to submit official transcripts of grades from the educational institution they currently attend, results on standardized tests they have taken, written references from educators and others as well as a personal letter explaining

their interest in B. All of these documents are screened initially by A's Vice President-U.S. Operations or by officials of D in E, a U.S. educational institution similar to B. Screened applications are then forwarded to A's other officers for review. Finally, applications are forwarded to B's admissions office in C where a decision is made on the application without regard to race, creed or national origin.

All scholarships are funded according to the financial needs of the individuals as determined by A in consultation with B's admissions office financial needs analysts. To the extent that a student's parents have the financial means to pay tuition, board, travel and related expenses, they will be expected to do so. To the extent that they lack the financial means, A will fill the gap with scholarship grants which are paid directly to B for the benefit of the recipient. A's scholarship grants will be used to cover tuition, fees, books, supplies and equipment.

Persons who select recipients of scholarship grants and their families are ineligible for A's scholarships. Persons who select recipients do not receive any compensation for their activities in the selection process. Furthermore, such persons are not permitted to receive fees or payments of any kind from prospective grant recipients.

Periodic progress reports are made to A's board to determine whether the recipients have performed the activities the scholarships are intended to finance. If such scholarships are not used as intended, because A's board is partially composed of senior officials of B, A will be made aware so that A may investigate and take corrective action.

A maintains all records relating to scholarship applications, grants and follow-up information.

Section 501(c)(3) of the Code provides for the exemption from federal income tax of nonprofit organizations organized and operated exclusively for charitable and/or educational purposes.

Section 509(a) of the Code provides that certain organizations exempt from federal income tax under section 501(c)(3) are private foundations subject to the provisions of Chapter 42 of the Code.

Section 4945 of the Code imposes excise tax on a private foundation's making of any "taxable expenditure" as defined, in pertinent part, by sections 4945(d)(3) and 4945(d)(5).

Section 4945(d)(3) of the Code provides that a taxable expenditure includes an amount paid by a private foundation as a grant to an individual for study or other similar purposes by such individual, unless the grant meets the requirements under section 4945(g) of the Code for approval in advance by the Service.

Section 4945(g)(1) of the Code provides that a taxable expenditure under section 4945(d)(3) does not include any grant to an individual for study if the grant is made on an objective and nondiscriminatory basis under a procedure approved in advance by the Service, constitutes a scholarship under section 117(a) of the Code (as in effect on the day before the

Tax Reform Act of October 22, 1986) and is to be used for study at an educational organization described in section 170(b)(1)(A)(ii).

Section 170(b)(1)(A)(ii) of the Code refers to an educational organization which normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on.

Section 117(a) of the Code indicates, in general, that gross income does not include any amount received as a "qualified scholarship" by an individual who is a candidate for a degree at an educational organization described in section 170(b)(1)(A)(ii).

Section 117(b)(1) indicates that a "qualified scholarship" means any amount received by an individual as a scholarship 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 117(b)(2) indicates, in general, that the term "qualified tuition and related expenses" means: (A) tuition and fees required for the enrollment or attendance of a student at an educational organization described in section 170(b)(1)(A)(ii), and (B) fees, books, supplies, and equipment required for courses of instruction at such an educational organization.

Section 53.4945-4(b) of the Foundation and Similar Excise Taxes Regulations requires that grantees under section 4945(g) of the Code must be selected on an objective and non-discriminatory basis. The group of eligible grantees must be broad enough to enable the giving of the grants to achieve an exempt purpose. The criteria for selection of grantees must be related to the exempt purpose of the grant. The persons selecting the grantees must not be in a position to derive a private benefit, directly or indirectly, if certain potential grantees are selected over others.

Section 53.4945-4(c)(2) of the regulations provides that, at least once per year, the private foundation must obtain a reporting, verified by the educational institution, on the grantee's progress for each academic period.

Section 53.4945-4(c)(4) of the regulations provides that, if grantee reports submitted or other information, including failure to submit reports, indicates that any part of a grant is not being used for purposes of the grant, the grantor foundation is under a duty to investigate and, while conducting its investigation, must withhold further payments. The grantor's reasonable steps to recover misused grant funds must include legal action where appropriate, unless legal action would not, in all probability, result in satisfaction of execution on the judgment.

Section 53.4945-4(c)(6) of the regulations provides that the grantor private foundation must retain adequate records on all of its grants to individuals for study or similar purposes under section 4945(d)(3) of the Code. Such records include: all information which the foundation secures to evaluate the qualifications of potential grantees; identification of all grantees (including any relationship of a grantee to the grantor foundation sufficient to assure that such grantee is not a disqualified person under section 4946 of the Code); specification of the amount and purpose of each grant; and the follow-up information which the grantor obtains from the grantees under sections 53.4945-4(c)(2) and 53.4945-4(c)(4) of the regulations, cited above.

Based upon the information A submitted and assuming that A's program will be conducted as proposed, with a view to providing objectivity and nondiscrimination in the awarding of grants, we rule that A's procedures in the awarding of scholarship grants comply with the requirements of section 4945(g)(1) of the Code. Expenditures made in accordance with these procedures will not constitute "taxable expenditures" within the meaning of section 4945(d)(3) of the Code, and as such are eligible for the exclusion from income provided for in section 117(a) of the Code to the extent that such grants are actually used for qualified tuition and related expenses within the meaning of section 117(b)(2) of the Code.

This ruling letter is conditioned on the understanding that there will be no material change in the facts upon which it is based. It is further conditioned on the premise that no grants will be made to A's creators, officers, directors, trustees or members of the selection committee or for any purpose inconsistent with the purposes described in section 170(c)(2)(B) of the Code.

The approval of A's grant-making procedures is a one-time approval of A's system of standards and procedures for selecting recipients of grants that meet the requirements of section 4945(g)(1) of the Code. Thus, this approval will apply to succeeding grant programs only as long as the standards and procedures under which they are conducted do not differ materially from those described in this request.

We are informing the Ohio TE/GE office of this action. Because this ruling letter could help to resolve any questions about A's status, it should be kept with A's permanent records.

This ruling letter 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.

If there are any questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Robert C. Harper, Jr.  
Manager, Exempt Organizations  
Technical Group 3

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