DEPARTMENT OF THE TREASURY 200131031
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

Date: APR 26 2001

Contact Person:

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UIL Nos.
4945.04-04

Dear Sir or Madam:

This is in reply to your letters of January 17 and March 2, 2000, requesting approval of your scholarship grant procedures under section 4945(g)(1) of the Internal Revenue Code.

You, F, are exempt from federal income tax under section 501(c)(3) of the Code and are a private foundation under section 509(a) of the Code. Your scholarship program S provides scholarship grants for children of employees of company C. M, the administrator of your scholarship program, is an organization exempt from federal income tax under section 501(c)(3) of the Code which is not a private foundation under section 509(a) of the Code.

Your scholarship program will not be used as an inducement to serve the employer C or the private foundation F. Your grantees will be selected by persons totally independent (except for participation on this selection committee) of the private foundation, its organizer, and the employer concerned.

Eligible applicants to be considered by the independent selection committee will be persons who meet the standards for such grant and can reasonably be expected to use the grant if selected. Eligibility is conditioned upon at least one year of employment. Grantees will be selected by objective standards that are unrelated to the employer's business. Renewal of a grant will not be denied because any person is no longer employed with the employer. Grantees will not be limited to courses that serve to benefit the employer or the foundation. The grants are for enabling the recipients to obtain an education in their individual capacities solely for their personal benefit, and will not include any understandings suggesting that the studies are for the benefit of any purpose of the employer or foundation.

The annual number of grants to these children of employees will not exceed 25 percent of the number of employees' children who were eligible, were applicants for such grants, and were considered by the selection committee in that year. Alternatively, the annual number of grants will not exceed 10 percent of the number of employees' children who can be shown to be eligible for such grants in that year whether or not they submitted an application. For purposes of these percentage tests, renewals of grants awarded in prior years are not considered in determining the number of grants awarded in a current year.

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You will ensure compliance with the percentage tests under Revenue Procedure 76-47, described below, in the aggregate with respect to your other scholarship programs, if any, available to the same individuals. Your scholarship grant checks will be endorsed by both the grantee and the grantee's educational organization.

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

Section 509(a) of the Code provides that an organization exempt under section 501(c)(3) is further classified as a private foundation under section 509(a) if it is not a financially publicly supported organization as described in section 509(a)(1) or 509(a)(2) and if it is not a supporting organization described in section 509(a)(3).

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

Section 4945(d)(3) of the Code provides that a taxable expenditure includes any grant made by a private foundation to an individual for study, if the private foundation has not obtained from the Service advance approval of its procedures for making such grant under section 4945(g) of the Code.

Section 4945(g)(1) of the Code provides that a taxable expenditure under section 4945(d)(3) of the Code does not include a grant to an individual for study if the grant is made under a procedure approved in advance by the Internal Revenue 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 under section 170(b)(1)(A)(ii) of the Code.

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 170(c)(2)(B) of the Code describes exclusively charitable and educational purposes.

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.

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Section 53.4945-4(c)(4) of the regulations provides that, if grantee reports submitted or other information, including failure to submit reports, indicate 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)(5) of the regulations provides that the annual report under section 53.4945-4(c)(2) and the duty to investigate under section 53.4945-4(c)(4) of the regulations can also be met if the grantor pays the scholarship grant under section 4945(g)(1) of the Code to the grantee's educational institution which agrees to use the grant funds only if the grantee is enrolled at such educational institution and the grantee's standing is consistent with the purposes and conditions of the grant.

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.

Section 53.4945-4(d)(3) of the regulations provides that if, by the 45th day after a request for approval of grant procedures has been properly submitted to the Internal Revenue Service, the private foundation has not been notified that its grant-making procedures are not acceptable, its grant-making procedures shall be considered as approved from the date of submission of its request for approval until receipt of actual notice from the Internal Revenue Service that such procedures do not meet the requirements of section 4945(g) of the Code.

Revenue Procedure 76-47, 1976-2 C.B. 670, provides eight guidelines to assure that a private foundation's "employer-related" scholarship program is operated to meet sections 4945(g)(1) and 117 of the Code:

1. The scholarship program must not be used to serve the employer or the private foundation, for example, as an employment or recruitment inducement.

2. Grant recipients must be selected by persons who are totally independent (except for participation on this selection committee) of the private foundation, its organizer, and the employer concerned. The number of grantees may not be increased from the number recommended by the selection committee. (Under Revenue Procedure 81-65, 1981-2 C.B. 690, any announcement of grantees in an employer newsletter must make it clear that the grants are awarded by the foundation, not the employer.)

3. Eligible applicants to be considered by the independent selection committee must be persons who meet the standards for the grants and who can reasonably be expected to use the grant if selected. Eligibility for a grant cannot be conditioned on any more than three years of employment.

4. Grantees must be selected by objective standards unrelated to the employer's business.

5. Renewal of a grant must not be denied because any person is no longer employed with the employer.

6. Grantees must not be limited to courses that serve to benefit the employer or the foundation.

7. The grants must be consistent with enabling the recipients to obtain an education in their individual capacities solely for their personal benefit, and must not include any understandings suggesting that the studies are for the benefit of any purpose of the employer or foundation.

8. Under the percentage test for grants to children of employees, the annual number of grants must not exceed 25 percent of the number of employees' children who were eligible, were applicants for such grants, and were considered by the selection committee in that year. (Under later Revenue Procedure 94-78, 1994-2 C.B. 833, rounding may be used where this percentage test results in a quotient of 4 or more plus a fraction of 1/2 or more, so that, for example, in the cases of 18 or 19 applicants, divided by the 25 percent test, the resulting quotients of 4.5 and 4.75 can be rounded up to 5 allowable grantees rather than only 4.)

Alternatively, the annual number of grants must not exceed 10 percent of the number of employees' children who can be shown to be eligible for such grants in that year whether or not they submitted an application. (Under Revenue Procedure 85-51, 1985-2 C.B. 717, this test requires an actual questionnaire or survey to determine eligible children, rather than any statistical inference as the number of eligible children of employees.)

For purposes of these percentage tests, renewals of grants awarded in prior years are not considered in determining the number of grants awarded in a current year. Compliance with the percentage tests must be in the aggregate with respect to any other scholarship programs made available by the employer or foundation to the same eligible individuals.

In your case, you have specifically represented that you will meet all of the guidelines of Revenue Procedure 76-47.

Based upon the information you submitted, and assuming your program will be conducted as proposed, with a view to providing objectivity and nondiscrimination in the awarding of grants, we rule that your 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 under 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 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 awarded to your organization's creators, officers, directors, trustees, or members of the selection committee, or for a purpose that is inconsistent with the purposes described in section 170(c)(2)(B) of the Code.

This approval of your grant-making procedures is a one-time approval of your system of standards and procedures for selecting recipients of grants that meet the requirements of section 4945(g)(1) of the Code. Thus, 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.

Because this ruling letter could help to resolve any questions about your status, you should keep it in your permanent records.

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

Sincerely,

/S/

Terrell M. Berkovsky
Manager, Exempt Organizations
Technical Group 2