

Private foundations; taxable expenditures; scholarship grants. Grants awarded by a private foundation under an employer-related program are scholarships under section 117(a) of the Code even though the grants will be awarded without regard to the percentage guidelines of section 4.08 of Rev. Proc. 76-47. Therefore, grants awarded under the program will be described in section 4945(g)(1) and will not be taxable expenditures under section 4945(d)(3).

ISSUE

Are grants awarded under the program described below scholarships under section 117(a) of the Internal Revenue Code and, therefore, not taxable expenditures under section 4945(d)(3), even though the grants are awarded without regard to the percentage guidelines of section 4.08 of Rev. Proc. 76-47, 1976-2 C.B. 670?

FACTS

Foundation X is exempt from federal income tax under section 501(c)(3) of the Code and is a private foundation within the meaning of section 509(a). X has applied under section 4945(g) for approval of its proposed college scholarship program. X proposes to award one grant per year to a student to attend an educational organization described in section 170(b)(1)(A)(ii). The grant is a small, fixed amount and may be used to pursue any course of study leading to a degree. The student will be selected from the children of employees of company M on an objective basis using the criteria of financial need or academic ability. M has 3,000 employees of diverse ages and occupations. No fact about M or the plan, such as seasonal employment, extensive use of independent contractors, or an unusually large number of employees without children of qualifying age, disqualifies a significant number of persons who serve the company.

X's program will be conducted in accordance with the guidelines of sections 4.01 through 4.07 of Rev. Proc. 76-47. However, X will award its one grant per year without regard to the percentage limitation guidelines of section 4.08 of Rev. Proc. 76-47. X cannot guarantee that the program will meet these guidelines each year. X reasonably believes that the program will satisfy the ten percent test of section 4.08 each year, but has not determined whether the program will in fact meet that test, because although it knows the number of employees' children who graduate from high school, it does not know how many of those enter a degree program. Further, X reasonably believes that the expense involved in making the determination of the number of children of employees entering a degree program is not justified in light of the small amount awarded in the grant program. Although X will undertake reasonable efforts to secure sufficient

applications to satisfy the 25 percent test of section 4.08, X also anticipates that in some years the number of eligible applicants will be insufficient to satisfy that test because its program provides only one grant annually of a small, fixed amount. X has demonstrated that its applicants and grantees will not be drawn from a specific group of employees.

LAW

Section 4945 of the Code imposes a tax on each taxable expenditure made by a private foundation.

Section 4945(d)(3) of the Code provides that the term 'taxable expenditure' includes any amount paid or incurred by a private foundation as a grant to an individual for study or other similar purpose, except as provided in section 4945(g).

Section 4945(g)(1) of the Code provides that a grant to an individual for study that is made on an objective and nondiscriminatory basis pursuant to a procedure approved in advance by the Secretary is not a taxable expenditure under section 4945(d)(3) 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).

Section 117(a) of the Code provides, with certain limitations, that an individual's gross income does not include any amount received and expended as a scholarship at an educational organization described in section 170(b)(1)(A)(ii) or as a fellowship grant.

Rev. Proc. 76-47, 1976-2 C.B. 670, provides guidelines for determining whether a grant made by a private foundation under an employer-related grant program to a child of an employee of the particular employer to which the program relates is a scholarship or fellowship grant subject to the provisions of section 117(a) of the Code.

Section 4.08 of Rev. Proc. 76-47 provides a percentage test guidelines (sic). 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 ten 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 private foundation'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 scholarships 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 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 may include: the likelihood that the program may be used for employee recruitment or to retain employees, the independence of the selection committee, standards for scholarship eligibility and selection, limitations on the recipient's choice of course of study, the number of grants available, the number of children of employees who would be eligible for them, the percentage of eligible children of employees applying for grants who normally (i.e., on an average basis) receive grants under the program, and whether and how many grants are awarded to individuals who are not children of employees.

ANALYSIS

In applying Rev. Proc. 76-47, it is assumed that the program is conducted on an objective and nondiscriminatory basis (within the meaning of section 4945(g) of the Code section 53.4945-4(b) of the Foundation and Similar Excise Tax Regulations) (sic) except insofar as that conclusion may be affected by the failure of the education grants to be scholarships or fellowships subject to the provisions of section 117(a) and the reason for such failure. The grant program described above satisfies the conditions of sections 4.01 through 4.07 of Rev. Proc. 76-47, but does not meet the percentage test of section 4.08. As a substitute for the percentage test, all the relevant facts and circumstances must be considered to determine whether the primary purpose of the grant is to educate recipients in their individual capacities or to compensate employees.

In this instance, the relevant facts and circumstances indicate that the primary purpose of X's grant program is to educate recipients in their individual capacities rather than to compensate employees. As required by Rev. Proc. 76-47, the selection committee is independent of X and M and awards the grants using the objective criteria of academic performance and financial need. X has demonstrated that the company's employees and the plan have no unusual characteristics that would bear on the likelihood that a grant will be available to any specific subgroup of eligible applicants or that a significant number of children of persons who serve the company will be disqualified. The grant is a small fixed amount. It does not limit the grantee

significantly in choosing a course of study or school. Only one grant per year will be awarded among the children of 3,000 employees. X's inability to show whether it will meet the ten percent test is reasonable, because the expense of determining whether the test is met is greatly out of proportion to the small grant program. These facts indicate that overall there is no significant degree of probability that a grant will be available to the child of any particular employee or to a child selected from any particular group of employees. (The fact that this situation involves only one grant per year among the children of employees does not preclude the possibility that if several grants were awarded, there still would be no significant degree of probability that a grant would be available to any particular employee's child.)

HOLDING

Under the facts set forth above, grants awarded under this program satisfy the requirements of Rev. Proc. 76-47 and constitute scholarships under section 117(a) of the Code. Therefore, grants awarded under the program will be described in section 4945(g)(1) and will not be taxable expenditures under section 4945(d)(3).