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Date:
April 12, 2013

LEGEND:

Taxpayer =
Program =

Dear :

This is in reply to your request for a ruling of October 2, 2012, on behalf of Taxpayer regarding certain service requirements under Taxpayer's scholarship program. The Program requires participants to perform unpaid services for unrelated community service organizations in order to qualify for scholarships awarded by the Program. Taxpayer has requested a ruling that scholarship funds awarded to participants do not constitute a payment for services within the meaning of section 117(c) of the Internal Revenue Code (the "Code").

FACTS:

Taxpayer is an organization exempt from tax under section 501(c)(3) of the Code. Taxpayer operates the Program, whose purpose is to encourage academic performance, community service, and pursuit of a college education among middle and high school students. Students in grades 8 through 12 are eligible to participate in the Program. Participants are chosen through nomination by unrelated partner agencies. The Program establishes minimum annual academic performance and community service requirements and students who meet these requirements are awarded college scholarship funds on an annual basis. Academic performance and community service requirements as well as scholarship award amounts increase with each grade level after grade nine.

Participants may satisfy 50 percent of the community service required by the program by volunteer work in any capacity of the participant's choosing. Participants satisfy the

remaining 50 percent of the community service requirement by monthly participation in one of several public service projects organized by Taxpayer. Taxpayer partners with various partner organizations in offering these public service projects. The partner organizations are exempt from tax under section 501(c)(3) of the Code and are not related to Taxpayer by common control or otherwise. Participants in these public service projects provide services to the partner organizations and not to Taxpayer. The partner organizations, not Taxpayer, supervise participants in these projects.

The funds used for the Program's scholarship awards are pooled in a single account, with specific amounts electronically credited to each participant as they earn scholarship awards. The Program disburses scholarship award funds only after participants have completed high school and enrolled in a post-secondary educational institution. Participants notify the Program of the institution they will be attending and the Program distributes the funds directly to the institution as payment toward participants' tuition (scholarship funds are modest amounts and are generally absorbed by one year's tuition). The Program never disburses scholarship funds directly to participants. A participant has one year from the date of eligibility (graduation from high school) to use scholarship funds; this time period is increased to four years if the participant joins the military after high school. If the participant does not access the scholarship funds within this time period, he or she forfeits the funds.

ANALYSIS

The federal income tax treatment of qualified scholarships and fellowship grants is addressed in section 117 of the Code. Section 117(a) provides 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) (describing, generally, a school).

Only "qualified scholarships" may be excluded from income. A qualified scholarship is defined as an amount expended for "qualified tuition and related expenses." Section 117(c) of the Code, implementing changes made by the Tax Reform Act of 1986, Pub.L. No. 99-514, provides that the exclusion for qualified scholarships shall not apply to that portion of any amount received which represents payment for teaching, research, or other services by the student required as a condition for receiving the qualified scholarship or fellowship. Regulations governing the includability of compensatory grants in income have been upheld by the Supreme Court of the United States, which has described excludable grants as "relatively disinterested, 'no-strings' educational grants, with no requirement of any substantial *quid pro quo* from the recipient." *Bingler v. Johnson*, 394 U.S. 741 (1969).

A scholarship or fellowship grant represents payment for services when the grantor requires the recipient to perform services in return for the granting of the scholarship or fellowship. A requirement that the recipient pursue studies, research, or other activities

primarily for the benefit of the grantor is treated as a requirement to perform services. A scholarship or fellowship grant conditioned upon either past, present, or future services by the recipient, or upon services that are subject to the direction or supervision of the grantor, represents payment for services under this section.

Although scholarships that represent payment for services are not excludable under current law, not all grants that are subject to conditions or limitations represent payment for services. Determining whether a particular awards program makes compensatory payments within the contemplation of section 117(c) of the Code is an inherently factual matter, requiring a consideration of the nature and extent of the impositions, and of all other relevant facts and circumstances of the program.

Our review of the Program sponsored and funded by Taxpayer indicates that scholarship funds awarded to participants do not constitute a payment for services within the meaning of section 117(c) of the Code. The community service commitment imposed on participants, briefly described above, does not constitute the requirement of a substantial *quid pro quo* from the recipients; on the contrary, we find the grants to be relatively disinterested grants, designed to accomplish public rather than any private or proprietary purposes of Taxpayer. The Program disburses scholarship awards only after participants have completed high school and enrolled in a post-secondary educational institution. Additionally, the Program does not disburse scholarship funds directly to participants and there is no temporal or proximate relationship between the participant's community service and the Program's disbursement of funds.

Participants can fulfill 50 percent of their service commitment through nearly any volunteer position of their choosing. Furthermore, while the Program limits the options for the other 50 percent of the required service commitment, the limited options consist of projects performed for the benefit of and supervised by organizations completely unrelated to Taxpayer. The Program does not require participants to work for, or as directed by, Taxpayer, and the participants' services do not inure in an impermissible manner to the benefit of Taxpayer. The community service commitment is in this case a *de minimis* limitation, designed to assure that grantees perform services to meet social and educational needs, the very charitable purposes for which the Program was established. Any benefit inuring to Taxpayer appears remote, insubstantial, and inconsequential for purposes of section 117(c).

We note that the Program's service commitment is substantially different from that imposed on participants in programs of the type considered in Rev. Rul. 76-183, 1976-1 C.B. 43, where grant recipients are required to perform services in a manner determined by the grantor. Also, we have determined that the Program is distinguishable from the situations considered in Rev. Ruls. 73-256, 1973-1 C.B. 56 and 77-44, 1977-1 C.B. 355 (where grant recipients were expected to perform services in a specific location determined by the grantor), and in Rev. Rul. 76-122, 1976-1 C.B. 42 (where grant recipients were expected to accept employment in offices of the grantor).

In the case of Taxpayer's Program, participants choose the location and manner of services to perform from several options. In addition, for all service options available to participants, unrelated agencies, not Taxpayer, determine what services are performed and direct and supervise participants in performing them. Finally, upon completion of the Program, there is no requirement or expectation that participants will accept employment with Taxpayer or any other employer.

Based on the information presented and representations furnished, and assuming Taxpayer conducts the Program as proposed, we have determined that scholarship funds awarded to participants do not constitute a payment for services within the meaning of section 117(c) of the Code. This ruling applies narrowly to the status of Program's service requirements under section 117(c) and is contingent on the timing and method of disbursing scholarship funds described herein. It does not address whether scholarships awarded under the Program are "qualified scholarships" under section 117(b) or whether recipients of Program's scholarships may exclude awarded scholarship funds from income under section 117(a).

This letter ruling is based on the facts and representations provided, 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.

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

A copy of this letter ruling must be attached to any federal income tax return to which it is relevant.

Sincerely,

Neil D. Shepherd
Senior Counsel, Employment Tax Branch 2
Office of the Division Counsel/Associate Chief
Counsel