

Internal Revenue Service

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Washington, DC 20224

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Person To Contact:

, ID No.

Telephone Number:

In Re:

Refer Reply To:

CC:ITA:BR05 – PLR-159267-03

Date:

December 23, 2003

Att'n:

Legend:

X =

M =

Dear

This is in response to your authorized representative's letter and submissions of July 15, 2003, and other correspondence and submissions, in which you, X, (sometimes referred to herein as the Seminary) requested certain rulings regarding the proper federal income tax treatment (including any reporting and/or withholding obligations) for grants to be awarded under the M scholarship program, as further described herein. We are pleased to address your concerns.

The information submitted indicates that X, an accredited theological seminary conducting activities at a number of campuses, is recognized as exempt from federal income tax under section 501(c)(3) of the Internal Revenue Code, and is an educational organization described in section 170(b)(1)(A)(ii). X provides graduate level education in theology and religion, and instruction and training in pastoral ministry and related areas. Students pursue Masters of Divinity or Masters of Arts and Religion degrees at X.

In furtherance of its mission of preparing students for pastoral ministries and related duties, X conducts various fellowship and training programs to develop the full range of skills and qualifications required for the religious and ministerial life of its graduates, including student's theological and practical understanding of religious stewardship. Included among the responsibilities of such stewardship is an understanding and familiarity with fundraising, maintenance and support activities, the

solicitation of charitable contributions, and other activities necessary to the economic life and viability of church ministry. Training activity in these areas has typically been underemphasized if not neglected at institutions of higher theological education, but in recent years has been identified as a significant component of ministerial stewardship. In order to develop and encourage expertise in these areas, X plans to conduct the M program aimed at developing expertise and skills in this area of stewardship among its graduates, and to award scholarship grants to students participating in the program.

Under the M scholarship program, X intends to make scholarship grants or tuition reductions available to participating students who demonstrate a commitment to the development of practical stewardship skills in the areas of fundraising/"friend-raising" principles and practices, the development of donor contacts and pledges, the solicitation of charitable contributions, and similar activities related to the church's economic life. Participants will work in connection with a supporting or sponsoring church, and will be expected to attend specialized seminars aimed at developing practical skills in this area of ministry. Selection of participants will be based on a consideration of such factors as academic ability, spiritual maturity, motivation, and commitment to the M program's goals. Program participants will be expected to identify and contact potential donors willing to financially support X's M program. Once admitted to the program, scholarship aid would not be dependent upon a student's success in achieving any such goals. All recipients of scholarship awards under X's M scholarship program will be candidates for post-graduate theological degrees from the Seminary.

The federal 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).

To be considered a scholarship or fellowship grant, an amount need not be formally designated as such. Generally, a scholarship or fellowship grant is any amount paid or allowed to, or to for the benefit of, an individual to aid such individual in the pursuit of study or research. A scholarship or fellowship grant may be in the form of a reduction in the amount owed by the recipient to an educational organization for tuition, room and board, or any other fee.

Only "qualified scholarships" may be excluded from income. A qualified scholarship is defined as an amount expended for "qualified tuition and related expenses." Qualified tuition and related expenses are tuition and fees required for the enrollment or attendance of a student at an educational institution, and fees, books, supplies, and equipment required for courses of instruction at such an educational organization. Amounts received for room, board, travel, and incidental living expenses are not related expenses. Thus, scholarship receipts that exceed expenses for tuition,

fees, books, supplies, and certain equipment are not excludable from a recipient's gross income under section 117.

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 M scholarship program indicates that the scholarship grants to be awarded thereunder do not represent compensation for services within the meaning of section 117(c) of the Code. The stewardship training activities and commitments imposed upon participants, briefly described above, do not constitute the requirement of a substantial quid pro quo from the recipients. Scholarship awards made under the M program are not paid for or in connection with the performance of services within the contemplation of section 117(c), and appear to be relatively disinterested grants to participants to enable them to develop important ministerial stewardship skills and abilities, focusing on the experiences and benefits to be gained by the recipient, rather than on any grantor or third-party benefit. Such awards by the Seminary are designed to accomplish its religious and educational training mission, rather than to achieve any private or proprietary purposes. The M program's funds raising commitment is essentially a *de minimis* limitation designed to assure that X's graduates are competent in the field of church financial and economic stewardship, a charitable, religious, and educational purpose consistent with the purposes for which X is organized and

operated, and for which the M scholarship program was established by X. We note that any benefit inuring to the Seminary-grantor, or to a seminarian-recipient in his individual capacity, as a result of participation in the M program, appears coincidental, insubstantial, and inconsequential for purposes of section 117(c).

Thus, based on the information presented and representations furnished, and assuming the M scholarship program is conducted substantially as proposed, we have determined that the scholarships to be awarded thereunder do not represent compensation for services within the meaning of section 117(c) of the Code. Accordingly, such amounts do not constitute "wages" for purposes of section 3401(a). Additionally, such amounts are not subject to section 3402 (relating to withholding for income taxes at source), section 3102 (relating to withholding under the Federal Insurance Contribution Act (FICA)), or section 3301 (relating to the Federal Unemployment Tax Act (FUTA)). Additionally, X is not required to file Forms W-2, or any returns of information under section 6041, with respect to such grants.

The recipient of a scholarship or fellowship grant is responsible for determining whether such grant is, in whole or in part, includible in gross income for federal income tax purposes. Where, as here, participants are degree candidates, such grants will ordinarily be excludable from the recipients' gross incomes to the extent of their qualified tuition and related expenses. Although X does not intend to award scholarship grants under the instant program in amounts in excess of qualified tuition, students may nonetheless receive scholarship grants from other sources; thus, X may wish to advise participants in the M program that the amount of their scholarship awards in excess of the amount of any qualified tuition and related expenses is generally includible in gross income for federal income tax purposes.

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.

Because it could help resolve federal tax issues, a copy of this letter should be maintained with X's permanent records.

Pursuant to a power of attorney on file with this office, copies of this letter ruling are being sent to X's authorized representatives.

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

Associate Chief Counsel
(Income Tax & Accounting)

By _____
William A. Jackson
Chief, Branch 5

Enclosures:

Copy of this letter

Copy for section 6110 purposes