INTERNAL REVENUE SERVICE

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June 20, 2001

Attention:

Legend:
X (Taxpayer) =
EIN No. =
M (State) =
y =

Dear Taxpayer:

This is in response to your authorized representative's letter and submissions of February 20, 2001, in which she requested on your behalf rulings under section 117(d) of the Internal Revenue Code of 1986 regarding the proper federal income tax treatment of certain tuition reduction benefits provided by you, X, (sometimes referred to herein as the Taxpayer or the University) under the University's tuition fee waiver plan (the "Plan"). We are pleased to address your concerns.

The information submitted indicates that X is a political subdivision of the state of M , and operates, manages, controls and oversees the public higher educational system of state M through numerous campuses and academic centers throughout the state. X employees over y employees, most of whom are eligible to participate in the Plan.

Under the Plan X intends to provide tuition fee waivers, or reductions, to eligible employees and their dependents who are enrolled in University degree-granting programs. "Eligible employees" are employees who: (1) have completed 5 or more years of full-time University service, and (2) are active members of a University-sponsored section 401(a) or 403(b) retirement plan. While the 401(a) and 403(b) plans have different eligibility requirements, only students who normally work less than 20 hours per week are not eligible for membership in one of these plans. University authorities have the authority to waive the service requirement in the case of a demonstrated, urgent recruitment or retention need.

"Dependents" include the employee's spouse, same sex domestic partner, children, stepchildren, same sex domestic partner's children, and a dependent for whom the employee provides over half of the support in the calendar year.

Under the Plan, eligible employees can receive fee waivers for a maximum of 12 "person years," in any combination of years or enrollment/number of dependents, to include undergraduate or graduate degree work.

Generally, amounts paid to or for the benefit of employees are presumptively

compensatory in nature, and ordinarily includible in gross income as wages. Section 117(d)(1) of the Internal Revenue Code, however, provides a special rule in the case of a "qualified tuition reduction." Section 117(d)(1) provides that gross income shall not include any "qualified tuition reduction".

Section 117(d)(2) defines a "qualified tuition reduction" as the amount of any reduction in tuition provided to any employee of a section 170(b)(1)(A)(ii) educational organization for the education (below the graduate level) at such an educational organization, of (A) such employee, or (B) any person treated as an employee (or whose use is treated as an employee use) under the rules of section 132(h). Section 132(h) refers, generally, to spouses and dependent children of employees.

Section 170(b)(1)(A)(ii) describes an educational organization as one which normally maintains a regular faculty and curriculum and normally has a regular body of pupils or students in attendance at the place where its education activities are regularly carried on. An entity described in sections 170(c)(1) or (2) of the Code, or an institution that is operated as an activity or function of such an entity, may qualify as an "educational organization" described in section 170(b)(1)(A)(ii) for purposes of section 117(d). For example, an unincorporated school operated by a church, a museum school, a state school system, or the school system of a synod or diocese, may constitute an educational organization described in section 170(b)(1)(A)(ii) of the Code. The Taxpayer in the present case is an "educational organization" described in section 170(b)(1)(A)(ii).

Except for the case or certain graduate teaching and research assistants, the exclusion from income provided by section 117(d) is limited to education "below the graduate level." Section 117(d)(5)[4] provides an exception for individuals who are graduate students at the employing institution and who are engaged in providing teaching or research activities for that educational institution.

"Education below the graduate level" generally refers to any course which is not part of a course of study requiring a bachelor's or equivalent undergraduate degree for admission into the degree program, and which leads to a graduating degree. A course which is part of a course of study leading to a graduate level degree is generally not considered education below the graduate level, even if the course is not taken to fulfill requirements for a graduate level degree, unless such course is taken for credit toward a degree below the graduate level.

Section 117(d)(3) of the Code provides that the exclusion from income of a qualified tuition reduction will apply to highly compensated employees only if such reduction is available on substantially the same terms to each member of a group of employees which is defined under a reasonable classification set up by the employer which does not discriminate in favor of highly compensated employees (within the meaning of section 414(q)).

Section 1.410(b)-4 of the Income Tax Regulations generally provides the test for determining whether a classification is reasonable and nondiscriminatory. Section 1.410(b)-4(b) of the Regulations provides that a classification will be reasonable if, based on all of the facts and circumstances, the classification is reasonable and established under objective business criteria that identify the category of employees who benefit under the plan. Reasonable classifications include specified job categories, nature of compensation (i.e., salaried or hourly), geographic location, and other similar bona fide business criteria. The House Ways and Means Committee Report on the Deficit Reduction Act of 1984, H.R. Rep. No. 98-432, Part 2, 98th Cong., 2d Sess. 1606 (1984), provides additional examples of reasonable classifications. The report explains that an employer could establish a classification based on such factors as seniority, full-time vs. part-time employment, or job description, provided that the classification is nondiscriminatory.

Although section 117(d)(3) prohibits discrimination in favor of highly compensated employees described in section 414(q), there is no specific language in section 117(d) that mandates the same coverage tests applicable under section 410. In the instant case, reductions under the Plan are available to essentially all of X's employees, excepting only certain student-employees. The availability of the Plan benefit to such employee population does not discriminate in favor of highly compensated employees; thus the Plan satisfies the prohibition against discrimination in favor of highly compensated employees as described in section 117(d)(3) of the Code.

Based on the information provided and representations furnished, we have determined that the described tuition fee waivers or reductions provided under the Taxpayer's tuition reduction plan, Plan, to employees (within the meaning of section 117(d)(2) of the Code) of the Taxpayer for the education below the graduate level of such employees at any educational institution described in section 170(b)(1)(A)(ii), is excludable from the gross incomes of such employees under section 117(d)(1) of the Internal Revenue Code as "qualified tuition reductions."

We note that X's tuition reduction Plan provides benefits that do not constitute "qualified tuition reductions" as described in section 117(d)(2). The statutory scheme of section 117(d), however, does not contemplate that the providing of nonexcludable benefits by the employing educational institution shall defeat the excludability of benefits satisfying the requirements of the section. The exclusion provided under section 117(d) is available to any individual satisfying the requirements of the section, regardless of whether similar benefits are provided to persons outside the class of individuals for whom the exclusion is available. Thus, the extension of benefits by a qualified educational institution to parties other than those described in sections 117(d)(2) and 132(h), (e.g., to the same sex domestic partners of an employee), or the extension of nonexcludable benefits to described individuals (e.g., the provision of graduate level tuition reductions), simply requires the inclusion of the value of such amounts in the gross incomes of those employees to or for whose benefit such

amounts are paid. The exclusion available to individuals meeting the requirements of section 117(d) is not conditioned upon the employer's denial of benefits to persons not meeting the requirements for exclusion.

Accordingly, the value of the described tuition waivers and reductions granted under X's tuition fee waiver Plan to employees (within the meaning of section 117(d)(2) of the Code) of the Taxpayer for the education below the graduate level of such individuals does 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)). X is not required to file Forms W-2, or any returns of information under section 6041, with respect to such payments or remissions.

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

Temporary or Final regulations pertaining to one or more of the issues addressed in this ruling have not yet been adopted. Therefore, this ruling may be modified or revoked by adoption of final regulations, to the extent the regulations are inconsistent with any conclusions in this ruling. See section 12.04 of Rev. Proc. 2001-1, 2000-1 I.R.B. 1, at 46. However, when the criteria in section 12.05 of Rev. Proc. 2001-1 are satisfied, a ruling is not revoked or modified retroactively, except in rare or unusual circumstances.

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

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

Sincerely yours,
Associate Chief Counsel
(Income Tax & Accounting)
By: William A. Jackson, Chief, Branch 5

Enclosures:
Copy of this letter; Copy for section 6110 purposes