Internal Revenue Service

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Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
CC:ITA:BR05 – PLR-103676-10

Attention:

Date:
April 15, 2010

LEGEND:

X (Taxpayer) =

EIN =
Y =

Amounts:
m =
n =
o =
p =
q =
r =
s =
t =

Date 1 =

Dear :

This is in response to your authorized representatives' letters and submissions of January 14, 2010, in which they requested on your behalf rulings under section 117(d) of the Internal Revenue Code of 1986 (Code) regarding the proper federal income tax treatment of certain tuition reduction benefits provided by you, X, (sometimes referred to

herein as the Taxpayer) under X's tuition reduction program (the "Program"), more fully described below. We are pleased to address your concerns.

FACTS

The information submitted indicates that X is an educational organization described in section 170(b)(1)(A)(ii) of the Code, providing both undergraduate and graduate-level education.

The purpose of X's tuition reduction Program is to assist faculty and staff with the cost of providing undergraduate college education for their children. The Program, as amended, consists of two component plans: "Plan A," a tuition exemption program for children of employees, and "Plan B," a tuition scholarship program. Plan A is available with respect to the eligible children of all full-time, benefits-eligible employees of X (which includes faculty and staff employees), provided the eligible children are selected through normal admissions processes to attend X, and maintain standards of scholarship and conduct considered satisfactory to X's deans. Plan A provides a benefit of 100% of X's tuition.

Plan B is available to tenured faculty members, associate professors, assistant professors, members of X's administrative council and other administrative officers, certain employees of Y, and certain upper-level management employees. Plan B provides tuition reduction benefits with respect to studies of eligible children *outside of* X, at another section 170(b)(1)(A)(ii) higher-educational institution. The benefit is equal to 50% of the actual tuition and academic fees charged by the other school, not to exceed 50% of X's current tuition. Certain other benefit limitations apply under Plan B.

As of Date 1, X, including affiliates controlled by X, employed approximately m employees (excluding those who have failed to complete a year of service); n of these are highly compensated nonexcludable employees, of which o are eligible to participate in the Program. All o Program-eligible highly compensated employees are eligible to participate in Plan A; p are eligible to participate in Plan B. X employs approximately q non-highly compensated nonexcludable employees (NHCEs); r of these are eligible to participate in the Program: s in Plan A and t in Plan B.

LAW AND ANALYSIS

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 Aqualified tuition reduction@: section 117(d)(1) provides that gross income shall not include any Aqualified tuition reduction@.

Section 117(d)(2) defines a Aqualified 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 organization (or another organization described in section 170(b)(1)(A)(ii)), 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 enrolled 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 Aeducational organization@ described in section 170(b)(1)(A)(ii) for purposes of section 117(d).

Except for the case of certain graduate teaching and research assistants, the exclusion from income provided by section 117(d) is limited to education Abelow 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.

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. That test has two parts: (1) section 1.410(b)-4(b), requiring that a classification established by an employer for its employees be reasonable; and (2) section 1.410(b)-4(c), requiring that a plan pass an objective test to assure that the reasonable classification is nondiscriminatory. The objective test has a safe harbor, an unsafe harbor, and a "facts and circumstances" test for situations falling between the safe and unsafe harbors. The test applies with respect to the minimum coverage rules of Code section 410(b) and may be incorporated into Code section 117(d), taking into account the differences between a qualified retirement plan and a qualified tuition reduction plan. *Nonetheless*, 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) mandating that the same coverage tests applicable under section 410 are also applicable under section 117(d). Thus, the determination of whether a tuition reduction plan in fact discriminates in favor of highly compensated employees *for purposes of section 117(d)(3)*, is made based upon an analysis of all relevant facts and circumstances.

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.

In the instant case, Plan A satisfies the "reasonable classification" of employees test of section 117(d)(3). Pending the adoption of Temporary or Final regulations providing differently, Plan B will also be treated as satisfying the "reasonable classification" of employees test of that section.

Plan A satisfies the "safe harbor" test, and does not discriminate in favor of highly compensated employees. Plan B falls below the unsafe harbor percentages; thus, whether that plan is discriminatory *for purposes of section 117(d)(3)* is determined based on all relevant facts and circumstances. Based on the consideration that X maintains as well, as a part of its overall tuition reduction benefits Program, Plan A, which plan is available to a much larger cross-section of its workforce, including significant number of non-highly compensated employees, and the fact that the different eligibility criteria for Plans A and B appear to be grounded in *bona fide* business and educational considerations not related to compensation, we conclude that Plan B will be treated as not discriminating in favor of highly compensated employees. Thus, X's tuition reduction Program consisting of Plans A and B satisfies the prohibition against discrimination in favor of highly compensated employees as described in section 117(d)(3) of the Code.

CONCLUSION

Based on the information provided and representations furnished, we have determined that the described tuition reduction benefits provided under the Taxpayer=s tuition reduction Program, consisting of both Plan A and Plan B, 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 persons at X or at any other educational institution described in section 170(b)(1)(A)(ii), are excludable from the gross incomes of such employees under section 117(d)(1) of the Internal Revenue Code as Aqualified tuition reductions.@

Accordingly, the value of the described tuition reduction benefits granted under X's tuition reduction Program 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 its authorized representatives, 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 11.04 of Rev. Proc. 2010-1, 2010-1 I.R.B. 1, at 49. However, when the criteria in section 11.06 of Rev. Proc. 2010-1 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,

/s/ William A. Jackson

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William A. Jackson
Chief, Branch 5
Office of Associate Chief Counsel
(Income Tax and Accounting)

Enclosures:
Copy of this letter
Copy for section 6110 purposes