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April 26, 2000

Legend:

X (Taxpayer) =
EIN No. =

B (Plan) =

M (State) =

Dear Sir or Madam:

This is in response to your authorized representative's letter and submissions of November 3, 1999, and other, previous and subsequent correspondence, in which he requested on your behalf certain rulings regarding the proper federal income tax treatment, including any reporting and/or withholding obligations, for certain tuition reduction (remission) and reimbursement benefits paid by you, X (the Taxpayer), to employees of X and its operated institutions under the B tuition reduction plan, as briefly described below. We are pleased to address your concerns.

The information provided indicates that the Taxpayer, X, was created under the Constitution of State M, and has exclusive authority under state law to manage the public colleges, junior colleges, and universities of the state of M. Taxpayer consists of one member from each congressional district in the state and certain additional members from the state at large, who are appointed by the Governor and confirmed by the State Senate. Taxpayer receives a lump sum appropriation from the M General Assembly, and determines the amounts to be allocated and distributed among the various education facilities operated by the Taxpayer.

Taxpayer's tuition reduction plan, B, allows full-time faculty, staff, and administrators to participate in development activities and studies by remitting or

reimbursing tuition for those activities that have been authorized by the employee's institution and that are related to the employee's job or improve opportunities for career advancement. Courses that are not directly related to a specific job, but are career related, also qualify for the benefit. Full-time employees may register without tuition or fees for up to three academic credit courses per term on a space available basis. The employee may register for courses at his or her own institution or, with appropriate approval, another university system institution or private institution. The Policy is applicable both to employees working directly for the Taxpayer, as well as employees employed at the Taxpayers' member institutions, and may cover undergraduate as well as graduate level studies. Courses are normally expected to be taken outside regularly scheduled working hours.

The B tuition reduction program is governed by certain implementation guidelines and policies, copies of which were provided for our review. The guidelines provide generally that any full-time employee of X or any of its operated institutions who has been employed for at least six months (12 months for certain graduate courses) may be eligible to participate in the tuition reduction program with the approval of the employee's supervisor or other appropriate school official.

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, or the school system of a diocese, may constitute an educational organization described in section 170(b)(1)(A)(ii) of the Code. Additionally, the exclusion provided by section 117(d) is not limited solely to individuals providing teaching services for the educational institution, but extends to the employees generally, including secretarial, managerial,

administrative, and support function employees.

Section 117(d)(2) specifically provides that the "qualified tuition reduction" provided to the employee need not be provided at the employer educational institution, but may occur at any educational institution 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.

The Taxpayer in the present case is not a mere association of educational institutions, but itself meets the functional definition of an "educational organization" described in section 170(b)(1)(A)(ii). The Taxpayer and its member institutions constitute one legal entity, and Taxpayer's sole duty and primary activity is to operate, manage, control, and oversee the public educational institutions of a state, each of which also constitutes an "educational organization."

Based on the information provided and representations furnished, we have determined that the described tuition reductions, waivers, remissions and reimbursements provided under the Taxpayer's B tuition plan, or Policy, to employees of the Taxpayer or any of its controlled member institutions, 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." Additionally, we have determined that the reductions do not discriminate in favor of highly compensated employees; thus the plan/Policy satisfies the prohibition against discrimination in favor of highly compensated employees as described in section 117(d)(3) of the Code.

We note that X's tuition reduction program 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), 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, tuition reimbursement and remission benefits paid under the B plan to employees of X and its member institutions for education below the graduate level 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)). Neither X nor its member institutions are required to file Forms W-2, or any returns of information under section 6041, with respect to such payments or remissions.

Certain other rulings respecting the tax treatment of amounts paid under the B plan were also requested. You requested a ruling relating to the exclusion of such amounts under section 132(d) of the Code, as working condition fringe benefits. However, because of the inherently factual nature of such determinations, we are unable to provide the requested ruling. See section 7.01 of Rev. Proc. 2000-1, 2000-1 I.R.B. 4, at 21, and sections 2.01 and 4.02 (1) of Rev. Proc. 2000-3, 2000-1 I.R.B. 103, at 103 and 111. Although we are not providing a ruling on this issue, please note that in testing whether graduate tuition benefits qualify as a working condition fringe, under section 1.132-5(a)(2) of the Income Tax Regulations it is not sufficient that the tuition, if paid by the employee, would be deductible as a trade or business expense. The tuition benefits must relate to the employee's trade or business as an employee of the employer providing such benefits. You also requested a ruling regarding the exclusion of such amounts under section 127 of the Code, relating to amounts paid under qualified educational assistance programs. However, in a letter dated January 6, 2000, you withdrew that request.

This letter ruling is based on the facts and representations provided by X, 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. 2000-1, 2000-1 I.R.B. 4, at 46. However, when the criteria in section 12.05 of Rev.

Proc. 2000-1 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, a copy of this letter is being sent to X's designated authorized representative.

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,

Assistant Chief Counsel
(Income Tax & Accounting)

/s/ William A. Jackson

By_____
William A. Jackson
Chief, Branch 6

Enclosures:
Copy of this letter
Copy for section 6110 purposes