

INTERNAL REVENUE SERVICE

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Attention: September 10, 2001

Legend:

X (Taxpayer) = EIN No. =
Y (Corporation) =
B (Plan) = X's Tuition Reimbursement for Dependents Plan
M (State) =

Dear Sir or Madam:

This is in response to your authorized representative's letter and submissions of November 9, 2000, 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 and reimbursement benefits provided to employees of various educational functions, activities and components of X and Y 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, is a religious corporation exempt from federal income tax as an organization described in section 501(c)(3) of the Internal Revenue Code, and is a "church" as described in section 170(b)(1)(A)(i) of the Code. Among its myriad activities, X operates directly, through its controlled educational subsidiary Y, and through various affiliated parish corporations, an extensive school system providing elementary and secondary education to nearly 11,000 students at approximately fifty schools in numerous counties within its jurisdiction. Because X is not itself primarily a school or "educational organization," Y was created by X to satisfy requirements of State M's education laws; Y is operated and

controlled by X. Y and X's affiliated parish corporations are integral components of X's religious and educational mission.

Taxpayer's tuition reduction plan, B, provides for certain reductions and/or reimbursements of tuition costs for all employees, full or part-time (20 hours or more per week) who work within the school system operated by X, whether employed directly by X, by Y, or by an affiliated parish corporation of X, with one year of service.

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 (describing, generally, a school).

An institution that is operated as an activity or function of an organization described in section 501(c)(3) of the Code may qualify as an "educational organization" described in section 170(b)(1)(A)(ii) for purposes of section 117(d), even though not separately organized or incorporated. For example, an unincorporated school operated by a church or parish, a museum school, or the school system of a synod or diocese, all may constitute "educational organizations" described in section 170(b)(1)(A)(ii) for purposes of section 117(d) of the Code. See section 4221(d)(5) of the Code for rules relating to the treatment of certain organizations as "educational organizations" for purposes of the exemption from certain federal excise taxes. See also Rev. Rul. 81-79, 1981-1 C.B. 605. The employees generally of such an "educational organization" would be eligible to receive excludable "qualified tuition reductions" from their employer; the exclusion is not limited solely to individuals providing teaching services, but would extend to the employees generally within such function, including secretarial, managerial, administrative, and support function employees. However, in these circumstances, an excludable section 117(d) benefit could not be extended to church employees who were not employed within the context of the school function, or "educational organization," so defined. Thus, for example, a diocese operating a school system may not properly exclude from reportable wages as "qualified tuition reductions" under section 117(d), the value of tuition reduction benefits it might provide

to employees of a hospital it also operates.

We have determined, for purposes of section 117(d), that X's diocesan school system constitutes an "educational organization" within the meaning of section 170(b)(1)(A)(ii). Thus, based on the information provided and representations furnished, tuition reductions and reimbursements provided under Taxpayer's B tuition reduction plan to employees working within the school system operated by X, whether employed directly by X, by Y, or by an affiliated parish corporation of X, for the education below the graduate level of such employees at any 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 "qualified tuition reductions." (Note that section 117(d)(2) specifically provides that the "qualified tuition reduction" provided to the employee need not be provided at the employer educational organization, but may occur at any educational organization described in section 170(b)(1)(A)(ii).) Additionally, we have determined that the reductions do 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.

Accordingly, the value of tuition reductions and reimbursement benefits paid under the B plan to the described employees for education below the graduate level 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)). Neither X, Y, nor any affiliated parish corporation of X is 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 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. 2001-1, 2001-1 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, 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,
WILLIAM A. JACKSON
Chief, Branch 5
Assistant Chief Counsel
(Income Tax & Accounting)

Enclosures:

Copy of this letter

Copy for section 6110 purposes