EMPLOYEE SCHOLARSHIP FUNDS

The Internal Revenue Service imposes strict requirements on the awarding of scholarships to employees and children of employees. These requirements must be met for the awards to be treated as scholarship or fellowship grants under section 117(a) of the Internal Revenue Code. If the requirements and the percentage test outlined below are met, then the grants are treated as section 117(a) grants. If the requirements, but not the percentage test are met, then a “facts and circumstances” test is used to determine if the grants will be treated as section 117(a) grants.

Scholarships to employees or children of employees which do not meet the requirements outlined below are treated as taxable fringe benefits to the employees. The following requirements assume that the group of employees/children of employees is sufficiently broad to be a charitable purpose under section 170(c)(2)(B):

I. NOT USED FOR RECRUITMENT OR INDUCEMENT OF EMPLOYMENT

The program cannot be used to recruit employees or induce continuation of employment or other action sought by the employer.

II. SELECTION COMMITTEE

- Must be individuals totally independent and separate from the employer. Former employees may not serve, not totally independent.
- Should be individuals knowledgeable in the education field to have the background and knowledge to properly evaluate the potential recipients.
- Committee selections can be forwarded to the employer, but only for the sole purpose of verifying eligibility.
- Public announcement of awards must be made by the selection committee or the community foundation after approval by the community foundation.
- Grants must be awarded solely in the order recommended by the selection committee.
- The number of grants to be awarded may be reduced, but may not be increased from the number recommended by the selection committee.
- Only the selection committee can vary the dollar amount of the grants.

III. ELIGIBILITY REQUIREMENTS

- Must have identifiable, minimum requirements for grant eligibility.
- In the case of scholarships, must limit consideration to those employees or children of employees who meet the minimum standards for admission to an educational institution for which grants are available.
- If a minimum period of employment is required, it cannot exceed 3 years.
- Eligibility must not be related to other employment-related factors, such as position, service, or duties.
IV. **SELECTION OF RECIPIENTS**

Selection must be based solely on substantial objective standards completely unrelated to the employment of the recipients or their parents or the employer’s line of business.

V. **EMPLOYMENT**

- An award may not be terminated because a recipient or a recipient’s parent terminates employment subsequent to awarding of the grant, regardless of the reasons for termination of employment.
- If a grant is awarded for one academic year and a recipient must reapply for a subsequent year, the potential recipient can not be considered ineligible simply because at the time of re-application, the recipient or the recipient’s parent is no longer employed.
- If a grant is awarded for more than one academic year, subject to renewal, the standards for renewal must be based solely on non-employment related factors. Renewal may not be denied because of employment termination.
- At the time a grant is awarded or renewed, no requirement, condition, or suggestion, either express or implied, of expectation of rendering future employment services can be included.

VI. **COURSE OF STUDY**

The course of study for grant recipients must not be limited to those that would be of particular benefit to the employer. The recipient must have free choice to use the grant in pursuit of any course of study.

VII. **OTHER OBJECTIVES**

The program must meet all the other requirements of section 117 of the Code and must be consistent with the disinterested purpose of education solely for the personal benefit of the recipients and not for the benefit of the employer.
VIII. PERCENTAGE TEST

Specific “percentage tests” must be followed to assure compliance with the rules governing scholarships for employees or children of employees.

Awards for Children of Employees:

Meets the percentage test if the number of grants awarded in any one year does not exceed:

1. 25% of the number of employees’ children who
   - were eligible
   - were applicants for such grants, and
   - were considered by the selection committee in selecting recipients of the grants in that year.

OR

2. 10% of the number of employees’ children who can be shown to be eligible for grants (whether or not they submitted an application).

Clarification of the Alternate 10% Test for Grants to Employee’s Children

In using the “safe harbor” test of 10% of eligible employee’s children, the program administrator may include only those children who

- submit a statement in writing (submitted by the child or his or her authorized representative), or
- for whom information is maintained sufficient to demonstrate, other than by statistical or sampling techniques, that
  - they meet the foundation’s eligibility requirements, and
  - they are enrolled in or have completed a course of study preparing them for admission to an educational institution at the level for which awards are available, have applied or intend to apply and expect, if accepted, to attend in the immediately succeeding academic year, or
  - they currently attend an educational institution for which awards are available but are not in the final year which an award may be made.  (Rev. Proc. 85-51, 1985-2 C.B. 717)
Awards for Employees:

Meets the percentage test if the number of grants awarded in any one year does not exceed 10% of the number of employees who

1. were eligible
2. were applicants for such grants, and
3. were considered by the selection committee in selecting recipients of the grants in that year.

Note:

- An employee or child will be considered eligible only if all the eligibility requirements are met.
- Renewal of grants awarded in prior years will not be considered in determining the number of grants awarded in a current year.


Rounding Convention

If in determining the maximum number of allowable grants, the result is a mixed number with a fraction of ½ or greater, the program administrator may round the number of allowable grants to the nearest whole number, which whole number shall constitute the maximum number of grants that may be awarded that year to employees and/or their children.

The rounding convention may only be used in a year during which the maximum number of allowable grants is at least four (4) without benefit of the rounding convention. (Rev. Proc. 94-78, 1994-2 C.B. 833)

IX. ANNOUNCEMENT OF AVAILABILITY OF SCHOLARSHIPS

A company newsletter, distributed to all employees of a company, may include information regarding the availability of the program, solicitation for applicants, and announcements of the names of the grants, so long as the community foundation is clearly identified as the grantor of the awards. (Rev. Proc. 81-65, 1981-2 C.B. 290)