

# Employer-Related Scholarships



MAKING EDUCATION MORE  
AFFORDABLE FOR EMPLOYEES  
AND THEIR FAMILIES

Corporate foundations often award scholarships to effect positive change and further their charitable missions. This ability is one of the unique advantages conferred by a corporate foundation, enabling the company to fund potential talent in key areas of interest. Under certain circumstances, a corporate foundation can also be used to award scholarships to the company’s own employees and their children.

**These “employer-related scholarship programs” are distinct from scholarships awarded to the general public in that they:**

- Treat some or all of the employees (and/or their children) of a particular company as a group to which the scholarships may be given;
- Limit the potential recipients for some or all of the foundation’s scholarships to employees (or their children) of a particular employer; or
- Otherwise give such individuals preference or priority over other applicants.



Because employer-related scholarships could be abused as a tax-free perk to recruit employees (or dissuade them from leaving), enrich corporate executives and shareholders, or to reward employee performance, they are subject to regulations that ensure their charitable purpose. When offering employer-related scholarships through a corporate foundation, the benefits to the company should be indirect (e.g., visibility, branding, and community goodwill), and the scholarships cannot be the functional equivalent of extra pay, an employment incentive, or an employee benefit. The use of a scholarship program for any of these purposes could result in a self-dealing violation, which could incur stiff penalties owed by the company. Therefore, before launching an employer-related scholarship program, a corporate foundation needs to apply to the IRS for advance approval, and in so doing, describe the program's structure, selection criteria, and decision-making process.

## Obtaining Approval for Your Employer-Related Scholarship Program /

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To qualify for IRS approval, employer-related scholarship programs must provide evidence that they are awarded to further the recipients' education rather than to compensate employees, and to ensure that recipients are truly deserving by objective standards. Thus, while employment with the company might be a threshold requirement, decisions about who receives aid, and how much, must be made without regard to an individual's employment relationship. The specific evidence that the IRS requires for its analysis consists of two tests: the "facts and circumstances test" and the "percentage test."

THE ABILITY TO AWARD SCHOLARSHIPS IS ONE OF THE UNIQUE ADVANTAGES CONFERRED BY A CORPORATE FOUNDATION. /



### THE FACTS AND CIRCUMSTANCES TEST

This test is used to assess the following:

- **Inducement:** The employer and the foundation may not use the program to recruit employees or to induce employees to continue their employment, or to compel employees to any other course.
- **Selection Committee:** The committee that reviews the applications must be made up of independent individuals, preferably knowledgeable in the field of education. They cannot be connected to the employer, former employees, the foundation, or its funders. The committee has the exclusive right to choose the awardees and vary the amount of the scholarships. The foundation may reduce, but not increase, the number of scholarships. Only the foundation or the committee may publicly announce the awards.
- **Eligibility Requirements:** The foundation must exercise due diligence to ensure that the recipient student is eligible to attend an educational institution and will be expected to attend once the scholarship is awarded. If a minimum period of employment is required for the employee (or employee's child) to become eligible for this program, that period may not exceed three years. No other employment-related metric, such as job performance or rank, may be considered in the eligibility criteria.

- **Standards of Selection:** Scholarship awards must be based solely on objective standards completely unrelated to employment of the recipients, their parents, or the employer's line of business. Such standards include, but are not limited to, prior academic performance, performance on standardized tests, teacher recommendations, and financial need. Personal interviews attesting to motivation and character may also be considered.
- **Employment Status:** The terms of the grant must not require an express or implied commitment of future employment from the recipient or the recipient's parent. And, once awarded, a scholarship may not be terminated because a recipient or recipient's parent leaves the company. In multi-year awards, renewals must be based solely on non-employment criteria, such as maintaining a minimum grade point average and remaining in good standing with the educational institution.
- **Study Objective:** If a scholarship recipient has the opportunity to pursue multiple fields of study, the recipient alone is free to make the choice among them. The foundation cannot limit the student's scholarship award to study programs that benefit the employer or the foundation. Overall, the terms of the grant and course of study must allow recipients to obtain an education solely for their personal benefit.

## THE PERCENTAGE TEST

The Percentage Test, the other important test of employer-related scholarship programs, effectively caps the number of possible awards relative to the size of the eligible applicant pool. This means that an employer-related scholarship program will always be highly competitive and that a majority of the candidates will not receive scholarship support, no matter how outstanding their credentials might be. When the scholarships are made to the employees' children, rather than to employees themselves, the program satisfies the percentage test if the number of scholarships awarded to employees' children under the program in any year does not exceed the greater of either:

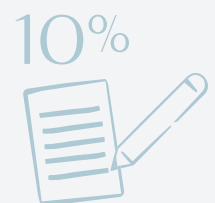
### The 25% Test: Twenty-five percent of eligible applications received and considered for that year.

Foundation Source clients typically opt for the twenty-five percent test because of its clarity and the relative ease of compliance. For example, if there are 800 eligible children of employees, and 400 children actually applied for scholarships, the foundation may award 100 scholarships ( $25\% \times 400$  eligible applicants = 100 awards). However, if only 200 children applied for scholarships, the foundation could award as many as 80 scholarships ( $10\% \times 800$  eligible children = 80, which is greater than  $25\% \times 200$  eligible applicants = 50).



### The 10% Test: Ten percent of the total number of eligible candidates, regardless of whether they submitted applications.

At first glance, the ten-percent test looks simple enough. The program satisfies the percentage test if the number of scholarships awarded annually does not exceed ten percent (10%) of the total number of eligible applications received and considered for that year. In practice, however, this can be a difficult calculation if the company in question is large and without access to detailed records and documentation about their workforce and their children.



Where scholarships are awarded to both employees and to employees' children, the scholarships will be considered as having been awarded under two separate programs: one for the employees and one for their children. Accordingly, scholarships made under each program must meet the appropriate percentage test outlined above.

Finally, a foundation that makes more awards than allowed under the above percentage test may still be compliant if, when seeking advance approval, the foundation lets the IRS know that it might be relying on the facts and circumstances test in lieu of the percentage test.

**SCHOLARSHIP AWARDS MUST  
BE BASED SOLELY ON OBJECTIVE  
STANDARDS COMPLETELY UNRELATED  
TO EMPLOYMENT OF THE RECIPIENTS  
OR THEIR PARENTS.**



## ABOUT FOUNDATION SOURCE

Foundation Source empowers people and companies to create a better world through philanthropy. We make giving easier for more than 2,000 foundations with innovative technology backed by philanthropic expertise.

## HAVE A QUESTION?

Call 800.839.0054 or send us an email at [info@foundationsource.com](mailto:info@foundationsource.com).

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