Federal Income Taxation of Scholarships and Fellowships: A Practical Analysis

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I. INTRODUCTION

The general rule of federal income taxation always has been that all income is taxable unless excluded from gross income by a specific section of the Internal Revenue Code.¹ Prior to 1954, there were no provisions in the revenue laws pertaining directly to scholarships and fellowships. Grants given to enable the recipient to pursue study or research were subject to income taxation as compensation unless they were excluded from gross income as gifts.²

Lack of consideration was the crucial factor in determining whether an educational grant was a gift.³ A grant made to an individual for the purpose of furthering his education, with no services being rendered to the grantor in exchange, was considered a gift and thus was excludable from gross income.⁴ If, however, the recipient provided his personal skills, training, or experience, or any other consideration, the grant was regarded as compensation for services rendered.⁵ The intent of the grantor

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³Ephraim Banks, 17 T.C. 1386 (1952).
⁴This test was set out as follows:
The amount of a grant or fellowship award is included in gross income unless it can be established that such amount is a gift. If a grant or fellowship award is made for the training and education of an individual, no services being rendered as consideration therefore, the amount is a gift which is excludable from gross income. However, when the recipient applies his skill and training to advanced research or some other activity the essential elements of a gift are missing and the amount is includable in gross income.
⁵Ephraim Banks, 17 T.C. 1386, 1392 (1952).
was controlling in making this determination, and a grant was excluded from gross income as a gift only if the grantor had an underlying donative intent to further the recipient’s education rather than to engage the recipient’s services for the promotion of the grantor’s self-interest. Whatever educational motives the recipient may have had in accepting the grant were irrelevant to this analysis.

This situation required a case-by-case determination of whether each particular scholarship was a gift or compensation. This case-by-case method generated inconsistent decisions and substantial confusion as to the tax status of educational grants. Congress attempted to dispel the prevailing confusion by specifically providing, in section 117 of the Internal Revenue Code of 1954, for the exclusion of scholarships and fellowships from gross income. This addition to the tax laws rendered the Code provisions pertaining to gifts inapplicable to scholarships and fellowships. According to the Treasury Regulations, the present tax status of educational grants is governed exclusively by section 117.

By providing specifically for the exclusion of scholarships and fellowships from gross income, Congress intended to establish clear rules for determining excludability. Section 117(a) states that gross income does not include any amount received by an individual as a scholarship at an educational institution or as a fellowship grant. This exclusion applies to the value of services or accommodations received as well as to monetary grants. In addition, amounts received to cover travel, research, clerical, or equipment expenses incidental to such grants are also excluded from gross income to the extent that such amounts actually are expended by the recipient.

Although the general exclusionary provision in section 117 appears to be relatively straightforward, its application is complicated by statutory limitations and exceptions to these limitations. Section 117 was not intended to afford a tax shelter for

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7Ti Li Loo, 22 T.C. 220, 225 (1954).
8Treas. Reg. § 1.117-1(a) (1956); Rev. Rul. 72-168, 1972-1 CUM. BULL. 37 (the gift exclusion, INT. REV. CODE of 1954, § 102, does not apply to scholarship grants); Rev. Rul. 72-163, 1972-1 CUM. BULL. 26 (the exclusion of prizes awarded for educational achievement, INT. REV. CODE of 1954, § 74, does not apply to scholarship grants).
10INT. REV. CODE of 1954, § 117, provides:
(b) Limitations.—
(1) Individuals who are candidates for degrees.—In the case of an individual who is a candidate for a degree at an educational
payments which are in effect compensation for services rendered or which merely represent a continuing salary during a period when the recipient is on leave from his regular job. The limitations expressed in section 117(b) were designed to further this

institution (as defined in section 151 (e) (4)), subsection (a) shall not apply to that portion of any amount received which represents payment for teaching, research, or other services in the nature of part-time employment required as a condition to receiving the scholarship or the fellowship grant. If teaching, research, or other services are required of all candidates (whether or not recipients of scholarships or fellowship grants) for a particular degree as a condition to receiving such degree, such teaching, research, or other services shall not be regarded as part-time employment within the meaning of this paragraph.

(2) Individuals who are not candidates for degrees.—In the case of an individual who is not a candidate for a degree at an educational institution (as defined in section 151 (e) (4)), subsection (a) shall apply only if the condition in subparagraph (A) is satisfied and then only within the limitations provided in subparagraph (B).

(A) Conditions for exclusion.—The grantor of the scholarship or fellowship grant is—

(i) an organization described in section 501(c)(3) which is exempt from tax under section 501(a),

(ii) a foreign government,

(iii) an international organization, or a binational or multinational educational and cultural foundation or commission created or continued pursuant to the Mutual Educational and Cultural Exchange Act of 1961, or

(iv) the United States, or an instrumentality or agency thereof, or a State, a territory, or a possession of the United States, or any political subdivision thereof, or the District of Columbia.

(B) Extent of exclusion.—The amount of the scholarship or fellowship grant excluded under subsection (a) (1) in any taxable year shall be limited to an amount equal to $300 times the number of months for which the recipient received amounts under the scholarship or fellowship grant during such taxable year, except that no exclusion shall be allowed under subsection (a) after the recipient has been entitled to exclude under this section for a period of 36 months (whether or not consecutive) amounts received as a scholarship or fellowship grant while not a candidate for a degree at an educational institution (as defined in section 151 (e) (4)).


The House version of the bill to enact section 117 contained a provision excluding grants to non-degree candidates only if the annual amount received plus any compensation from the recipient's former employer was less than 75% of the recipient's salary in the year preceding the grant. Id.

This provision was replaced by the Senate Finance Committee with the present $300, 36-month limitation because of a fear that the House formula might subject grants which were clearly not a continuing salary to income taxation merely as the result of a lack of substantial earned income in the previous year. S. Rep. No. 1622, 83d Cong., 2d Sess. 18 (1954).
policy by allowing the exclusion of genuine scholarships and fellowships from gross income, while denying an exclusion to any portion of a grant which is compensation for the performance of services.

Congress did not envision that the limitations expressed in section 117(b) would result in the income taxation of grants which involve services performed primarily for the training and education of the recipient, or which merely supplement an individual's own funds and enable him to further his educational development. The Senate Finance Committee added the specific exception that services required as a condition to receiving a particular degree are not to be considered part-time employment. The purpose of this addition was to make it clear that services which constitute part of the regular curriculum or course of study are not within the scope of the limitation on excludability.

Despite the presence of this express exception, grants conditioned upon the performance of services which are also a degree requirement have not been excluded ipso facto from gross income. The courts have sustained the Internal Revenue Service's position that section 117 is not a mechanical test and have required an initial determination that the grant possesses the characteristics of a scholarship or fellowship before the limitations or exceptions can be considered.

Because of this construction, only the terminology used to express the problem has changed since the enactment of section 117. Before 1954, the problem was determining whether an educational grant possessed the characteristics of a gift. Today, the controversy revolves around what constitutes a scholarship or fellowship grant or, more precisely, what does not constitute such a grant.

There is no definition in section 117 of the terms "scholarship" and "fellowship." The Treasury Regulations, however, have adopted the commonly accepted usage that a scholarship is an

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15The dictionary definition of scholarship is a sum of money offered by an educational institution, a public or private organization, or foundation to enable a student to pursue his studies at a college, university, or school. WEBSTER'S NEW INTERNATIONAL DICTIONARY 2031 (3d ed. 1961).

The dictionary definition of fellowship is a sum of money offered
amount paid for the benefit of a student at an educational institution to aid in the pursuit of undergraduate or graduate study, and a fellowship is an amount paid for the benefit of an individual who is not a degree candidate to aid in the pursuit of study or research. Although these terms have distinct definitions in the Regulations and separate sets of limitations are imposed by section 117(b), the excludability of a grant which requires the performance of services is not affected, as a practical matter, by the recipient’s status as a degree candidate. Therefore, the terms scholarship and fellowship may be used interchangeably for the purposes of this discussion.

The major problem in determining whether a grant is a scholarship arises not so much from the definitions themselves as from the restrictions which the Treasury Regulations impose upon these definitions. Under the Regulations, an amount paid to aid an individual in the pursuit of studies or research is, nevertheless, not a scholarship if it represents compensation for past, present, or future employment services, or for services which are subject to the direction or supervision of the grantor. Similarly, a grant is not a scholarship if the recipient engages in study or research which is of primary benefit to the grantor. Only if the primary purpose of study or research is to further the education and training of the recipient in an individual capacity does the grant qualify as an excludable scholarship.

The primary purpose test does not appear in the Internal Revenue Code, and the legislative history to support the adoption of a restriction of this nature is scant. The House Ways and Means Committee report on section 117 mentions services performed primarily for the education and training of the recipient only in the context of an exception to the rule that payments which are, in effect, wages for services are taxable income.

There is no mention in the Congressional reports of any restrictions on or tests for the excludability of scholarships other than those which are found in section 117 as enacted.

Because of the incorporation of the primary purpose test, the Treasury Regulations to section 117 have been subjected to

by an educational institution, a public or private organization, or foundation, for advanced study, research or creative writing. Id. at 886.

16Treas. Reg. § 1.117-3(a) (1956).

17Id. § 1.117-3(c).

18Id. § 1.117-4(c) (1).

19Id. § 1.117-4(c) (2).

20Id. § 1.117-4(c).


22An extensive treatment of the legislative history of section 117 is found in Elmer L. Reese, 45 T.C. 407 (1966).
extensive criticism by commentators. The basis of many of these complaints is that the primary purpose test is merely a continuation of the old gift-or-compensation test which was rejected by Congress.23 Under the primary purpose test, as under the gift test, the controlling factors are the intent of the grantor in making the grant and whether any benefit inures to the grantor.24

It has been proposed that scholarships should be treated differently from gifts and compensation because of the unique elements of motive and party relationship which characterize each.25 By providing that the term scholarship does not include an educational grant by a grantor motivated by family or philanthropic considerations, the Treasury Regulations seem to recognize that scholarships and gifts are distinct types of transfers.26 Further, with the enactment of section 117, it no longer follows, even if the primary purpose test is used, that scholarship grants are included in gross income merely because payment is compensatory in nature: If the primary purpose of the grant is to further the


A bill which would have added a primary purpose test was introduced to clarify the rule but was rejected by Congress. S. REP. No. 2207, 87th Cong., 1st Sess. (1961).

24It has been suggested that the identity and intent of the grantor are irrelevant because section 117(b)(1) provides a mechanical test for determining whether grants that require the performance of services are to be considered as nontaxable scholarships. Tabac, Scholarships and Fellowship Grants: An Administrative Merry-Go-Round, 46 TAXES 485, 490 (1968). The courts, however, have sustained the position that section 117 is not a mechanical test. See cases cited at note 14 supra.

It has also been suggested that the mere presence of a benefit to the grantor may not be a useful standard in the context of research grants provided by charitable and governmental organizations for the purpose of rendering a public service rather than obtaining a direct economic benefit from the services of the recipient. 1 J. MERTENS, LAW OF FEDERAL INCOME TAXATION § 7.42, at 7-149 (rev. ed. 1974).

25Scholarships and fellowships are characterized by motives of encouraging education and benefiting society through grants to unrelated parties where the grantor does not direct the grantee’s activities. Compensation is given for reasons of self-interest to unrelated parties where the grantor directs the grantee’s activities. Gifts, on the other hand, are given to relatives or friends because of affection or appreciation. Gordon, Scholarship and Fellowship Grants as Income: A Search for Treasury Policy, 1960 WASH. U.L.Q. 144, 152-53.

26Treas. Reg. § 1.117-3(a), (c) (1956).
education of the recipient in an individual capacity, the grant is excluded. The distinction is made between amounts paid primarily in return for services rendered and amounts paid primarily to further the education of the individual. Therefore, section 117 affords a reasonable basis for determining the character of educational grants if the opportunity for considering scholarships as a distinct type of transfer is utilized, instead of trying to force such grants into the narrow, polar mold required by the either-gift-or-else-compensation concept.

The Treasury Regulations have been called confusing, inconsistent, and ambiguous, and have been denigrated for failing to remedy the problems of statutory construction and to establish clear tests for determining which payments qualify as scholarships. Despite this lack of support from the legal community, the United States Supreme Court in Bingler v. Johnson sustained the Treasury Regulations' definitions of scholarships and fellowships. The Court's decision was based upon the premise that there can be no scholarship if a quid pro quo is given by the recipient. On a philosophical level, the primary purpose test also has been defended on the ground that the arguments for using a compensation policy approach are more compelling than those favoring a policy of tax relief which could result in economic inequality. It is feared that disregarding the compensation argument would result in abuses, especially in the area of


Another criticism which has been raised is that, although section 117 provides different rules for the treatment of grants to persons who are degree candidates and grants to persons who are not, the Regulations do not distinguish between these two categories. The primary purpose test is applied to each class although the view that the terms scholarship and fellowship connote a purpose of assistance distinct from the self-interest of an employer in compensating an employee is a correct statement of Congressional intent only in the case of a non-degree candidate. S. REP. No. 1622, 83d Cong., 2d Sess. 18 (1954); Tabac, Scholarships and Fellowship Grants: An Administrative Merry-Go-Round, 46 TAXES 485, 489 (1968). Section 117(b)(1) specifically provides for a class of services performed by degree candidates which does not give rise to an employment relationship.
32Id. at 751.
wage continuation plans which are, in effect, merely employee training programs. 33

Thus, even though Congress intended to provide clear-cut rules to alleviate the difficulties of determining the taxability of educational grants, 34 the convoluted limitation on the exclusion of scholarships from gross income, the failure of Congress to define the terms "scholarship" and "fellowship," and the additional requirements imposed by the Regulations have resulted in continuing litigation, and the unpredictability, confusion, and inconsistencies of the pre-1954 determinations have continued unabated. 35 This has led to the designation of section 117 as "something of a fun house with traps for the unwary and prizes for the imaginative." 36 Since there are no indications that the current Regulations will be modified, 37 the problem facing the tax planner is how to avoid the traps and gain the prize of excludable income. The solution to the problem lies in determining what characteristics a grant requiring the services of the recipient must possess before it qualifies as a scholarship or fellowship under the present interpretation of section 117.

II. UNIVERSITY AS GRANTOR

A. Research Assistantships

It is common for universities to grant stipends to candidates

33 Large corporations have an advantage over small employers in competitive hiring by being able to offer employee educational leaves with continuing tax free payments which approximate the employee's salary. Such "scholarships" are essentially employment arrangements. 21 ALA. L. REV. 375, 386 (1969).


35 In fact, the most recent Revenue Ruling on the subject states that whether a grant is included in gross income depends on the facts and circumstances under which the payments are made. Rev. Rul. 72-263, 1972-1 CUM. BULL. 40.


36 Myers, Tax Status of Scholarships and Fellowships, 22 TAX LAW. 391, 393 (1968).

37 The Internal Revenue Service has indicated that it intends to amend the Regulations to reflect decisions holding that stipends qualify as scholarships. Nothing, however, has come of these indications. Rev. Rul. 65-146, 1965-1 CUM. BULL. 66; Rev. Rul. 65-59, 1965-1 CUM. BULL. 67; Rev. Rul. 63-250, 1963-2 CUM. BULL. 79.
for Master of Science, Master of Arts, and Doctor of Philosophy
degrees. As a condition to receiving a grant, the candidate often
is required to perform research or teaching services at the uni-
versity. The stipend usually is designated as a research or teach-
ing assistantship.

Typically, a graduate student receiving a research assistant-
ship in the physical sciences is expected to perform laboratory
work on various research problems under the direction of a
faculty member. In the social sciences, a research assistant per-
forms library or survey type research which leads to a publish-
able paper on the topic considered. At the beginning of a stu-
dent's graduate schooling, research problems are defined by a
supervising professor and fall within the area of the student's
interest and educational goals. A student may gain research ex-
perience by working on problems under several professors dur-
ing this period. When the student has acquired sufficient course
work and research experience, a thesis problem is selected sub-
ject to faculty approval. Subsequent research is devoted to solv-
ing the thesis problem and writing a dissertation on the subject.
This work generally is carried out independently by a student
with guidance from a single professor.

The amount of time a research assistant must devote to
working varies from university to university and department to
department. Some departments require graduate assistants to
work twenty hours per week, while others fix no time require-
ment. In any case, the major emphasis is placed upon course work

38The description of the research assistantship is a composite picture
of the programs operated by the Biochemistry, Microbiology, and Pharma-
cology Departments of Indiana University-Purdue University at Indianapo-
lis [hereinafter referred to as IUPUI], the Psychology Department of
Purdue University, and the Chemistry and Metallurgy Departments of
Iowa State University. It represents a typical assistantship program. Each
of these departments offers both a Master of Science and a Doctor of
Philosophy degree. The handling of the assistantships is similar regardless
of the degree for which the recipient is a candidate.

39Research assistantships in the social sciences under which the gradu-
ate student works on a thesis problem are rare. To the extent that such
assistantships are offered, the income tax status of the stipend received
by the graduate assistant is governed by the same criteria as payments
to research assistants in the physical sciences. Normally, however, in the
social sciences the term "research assistant" means a student doing source
checking, footnote checking, interviewing, etc., for a professor who is doing
the original work on the project. The student is considered to have a
part-time job for which he receives compensation. Interviews with Prof.
Donald J. Gray, Department of English, Indiana University, in Bloomington,
Indiana, May 14, 1975; and Prof. Sheldon Stryker, Chairman of the Depart-
ment of Sociology, Indiana University, in Bloomington, Indiana, May 14,
1975.
during the first two years of a doctoral program. Afterwards, less time is spent in the classroom, and research consumes an increasing portion of a student's time. In a master's degree program, the time spent in each phase is correspondingly less than in a program leading to a doctoral degree. A research assistantship continues throughout both of these periods. Regardless of the working time required, a student is expected to work at full capacity and to demonstrate an ability to implement successfully an independent research program.

Research work leading to the completion of a thesis project and to the writing and defense of a dissertation is required of all candidates for a doctoral degree regardless of the field of study and regardless of whether a student receives an assistantship stipend. Similar research is also a requirement of most master's degree programs.\(^4\) Thus, in nearly every case the research performed by a research assistant is used to fulfill the degree requirement of writing and defending a dissertation. Additionally, academic credit is given for performing such research and is applied to the number of credits required for the degree.\(^4\) The purpose of these requirements is to expose a student to the type of activity in which he will be engaged upon receiving his degree. The programs are designed to supplement formal course work with a variety of professional activities geared to the individual needs and professional aspirations of each student.

Graduate assistants are selected on the basis of academic qualifications and potential for satisfactorily completing the degree requirements. Thus, the best students receive assistantships. Financial need seldom enters into the selection process. However, the purpose of the assistantship program is to aid the student in completing his education, and it is considered that the vast majority of students experience financial need.

A typical graduate assistantship stipend provides between $250 and $350 per month. Funds for these grants are provided by a variety of foundations and governmental sources. These

\(^4\)Some master's degree programs, for example, the Master of Science programs in the Departments of Pharmacology at IUPUI and Psychology at Purdue University, have an option whereby the student can elect to complete an expanded course requirement and demonstrate a reading knowledge of a foreign language in lieu of a thesis. Thus, it cannot strictly be said that research is a requirement for all candidates for the degree, although such research is a requirement for all candidates electing the thesis option. Interview with Prof. S.R. Wagle, Department of Pharmacology, IUPUI, in Indianapolis, May 8, 1975; Purdue University, 1974-1976 Graduate School Bulletin 295.

\(^4\)Generally the department offers a course entitled "research" and the student enrolls in this course for a specified number of hours.
funds travel two basic paths from an original grantor to a graduate assistant. An individual professor may apply directly to a grantor for funds to support the professor's research project.\textsuperscript{42} The funds from each grant are then held in a separate account and used to cover expenses of the particular projects, including stipends to graduate assistants. Alternatively, funds may be given to a university for the maintenance of a research facility in a particular field.\textsuperscript{43} The university then holds the funds in a general budgetary account to be administered in support of its research goals. In this circumstance, graduate assistantship stipends are paid from the same account as the professors' salaries. Regardless of which funding method is employed, the withholding of taxes from the stipends depends upon the administrative practices of the university or department involved.

Whether a research assistantship is a scholarship excludable from gross income depends upon whether the stipend meets the limitations of section 117(b) (1).\textsuperscript{44} In particular, the scholarship exclusion does not apply to any amount which represents payment for teaching, research, or other services in the nature of part-time employment. If these services are required of all candidates for a particular degree, however, the services are not considered part-time employment. Since a nearly universal condition to receiving a graduate degree is that a candidate perform original research, write a thesis based upon his research project, and defend the thesis, research assistantships seem squarely within the scope of the scholarship exclusion. Significantly, a 1956 Revenue Ruling provides that a grant made by a foundation to enable the recipient to complete the necessary research and dissertation for a doctoral degree is excludable from gross income even though the grantor may derive some benefit from the research.\textsuperscript{45} This ruling, however, is subject to the qualification that the primary

\textsuperscript{42}For example, the graduate assistantship programs in Biochemistry and Microbiology at IUPUI are funded in part by National Institutes of Health grants to the professors. The terms of such grants vary widely. Some such grants specify the particular research project supported, and others merely define the general field to which the funds may be applied. Interviews with Prof. Donald Bowman, Department of Biochemistry, IUPUI, in Indianapolis, May 5, 1975; and Prof. Jack Bauer, Department of Microbiology, IUPUI, in Indianapolis, May 5, 1975.

\textsuperscript{43}For example, the Atomic Energy Commission has established the Ames Laboratory on the campus of Iowa State University. This laboratory is supported by Commission funds administered by the University. The laboratory conducts extensive research in the fields of chemistry, physics, and metallurgy, and supports the University's graduate assistantship programs in these fields.

\textsuperscript{44}INT. REV. CODE of 1954, § 117(b) (1). See note 10 supra.

\textsuperscript{45}Rev. Rul. 56-419, 1956-2 CUM. BULL. 112.
purpose of the grant must be to further the recipient's education and training. Moreover, the recipient must have no commitment to the grantor regarding his course of study or the research subject matter. Thus, insistence upon the primary purpose test makes uncertain the exclusion of even this type of grant.

An argument has been advanced that the limitations of section 117 (b) (1) provide a mechanical test for determining whether a grant is a scholarship. The mechanical test rationale dictates that an amount received for performing services required as a condition to receiving a degree should be excluded without regard to the primary purpose test. This argument is based upon the rule of statutory construction which states that the expression of some limitations prevents additional restrictions from being implied. This interpretation of section 117, however, has been rejected. Thus, before the exclusion comes into play, there must be a threshold determination that the grant has the normal characteristics of a scholarship. Since a dual benefit is often involved in graduate assistantship grants, the determination of the primary purpose necessarily depends upon the facts and circumstances of each particular case.

In Chandler P. Bhalla, a typical research assistantship was found to have the characteristics of an excludable scholarship. In Bhalla, a doctoral degree candidate in physics received from the university a research assistantship financed by a National Science Foundation grant. The court held that the assistantship stipend was an excludable scholarship and stated that services constituting part of the regular curriculum or course of study leading to a degree were not includable within the statutory limitations on the exclusion. Since Bhalla, research assistantships having substantially the same characteristics generally have been excluded from gross income without difficulty.

When a scholarship exclusion is claimed for income tax purposes, it is advantageous to include supporting information with the tax return. This documentation should consist of a letter from the student stating that he was enrolled as a graduate student at the particular university for the period involved and re-

4835 T.C. 13 (1960).
49 Id. at 15.
51 This procedure has been followed by graduate students in chemistry and metallurgy at Iowa State University who have been successfully claiming scholarship exclusions of research assistantship stipends for more than ten years.
ceived a specific monetary stipend for research activity necessary for the degree. The letter should also state that the income is nontaxable under section 117 of the Internal Revenue Code of 1954 as interpreted in Chandler P. Bhalla, 35 T.C. 13 (1960). A separate letter from the department chairman should also be included, stating the above information and further stating that, as part of the training program, the student held an appointment as a graduate assistant for which the student received from the university a specific monetary stipend, that all graduate students are required to perform research as a condition to receiving the degree, that the research performed by the graduate assistant is considered to be a valuable and integral part of his training, and that the research is designed to contribute to the training of the student rather than to benefit the granting entity.

When a grant differs significantly in any respect from those previously described, great difficulty is encountered in convincing the Internal Revenue Service and the courts that the stipend possesses the normal characteristics of a scholarship. Two criteria are essential for a decision in favor of the taxpayer. First, the recipient must receive academic credit for research work performed as a condition to receiving the grant. Secondly, similar research activities must be required of all candidates for the degree whether or not they receive assistantships. Satisfaction of these requirements does not guarantee that a grant will be excluded from gross income, but failure to satisfy them is fatal to a taxpayer's case.

It is not sufficient that the required research merely have a close relationship to the recipient's academic interests or that the payments constitute a form of financial aid that enables the recipient to continue his studies. Reasonable equivalent activities and identity of work patterns for all degree candidates, whether or not they receive stipends, is also required. When the grant recipient performs a different type of research, assumes different responsibilities, or is required to spend more time than degree candidates generally, the stipend is considered compensation for services rendered. It also is helpful if the work performed is directly applicable to the recipient's educational objec-

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52In drafting these letters, the words "employed," "employment," and "salary" should be carefully avoided.
55Alex L. Sweet, 40 T.C. 403 (1963).
tives and interests and thus can be said to be an integral part of the regular curriculum leading to the degree.\(^57\)

Research performed is generally utilized in a student's dissertation. This constitutes evidence that the research is applicable to the student's education and course of study. Mere use of the results of the research in fulfilling the dissertation requirement, however, is not sufficient to demonstrate conclusively that the primary purpose of a grant is to further the recipient's education, particularly when the evidence as a whole suggests that an employment relationship exists. For example, in *Kreis v. Commissioner*;\(^56\) a graduate student who received a stipend while participating in a research project to study the causes of school dropouts, was denied an exclusion. The research project was funded by a United States Office of Education grant to the local school board, which paid stipends to the project staff members. Although the research was supervised by several university professors and the results were used by the student in his thesis, the stipend was found to be compensation since there was no degree requirement that he perform compensated services amounting to a part-time job.\(^59\)

The fine line between grants which qualify as scholarships and those which are construed to be compensation is demonstrated by cases in which a university has a research contract with the original grantor, whose funds the university is administering.


\(^{59}\)Similarly, stipends paid to two graduate students who worked on a highway construction research project for the Alabama Bureau of Roads, and a land rights research project for the Nebraska Soil and Water Conservation Commission, were found to be compensation, although the doctoral degree candidates used the results of the research as a basis for their theses. John B. Karrh, 32 CCH Tax Ct. Mem. 88 (1973); John W. Klein, 32 CCH Tax Ct. Mem. 301 (1973).

The stipend paid a graduate student in business while working on a project in the political science department also was found to be compensation. Here the results of the research were used in a paper required in a psychology course. Charles F. Wall, 31 CCH Tax Ct. Mem. 1069 (1972).

Dilatoriness in pursuit of a degree also casts suspicion on whether the actual purpose of the research is to fulfill the degree requirements or to fulfill the duties of an employee. The student took seven years to attain his Doctor of Philosophy degree and did not choose a dissertation topic until five years after he began work, although this work was in fact used in the dissertation. It was determined that since it was uncertain whether this research would ultimately be used in the dissertation, the work did not have the proper purpose. The student's major error, however, appears to have been giving his occupation as "engineer" on his tax return. Stephen L. Zolnay, 49 T.C. 389 (1968).
When the services required of a grant recipient are directly related to the fulfillment of such a contract, they may be considered to play an essential role in meeting the laboratory commitments of the university. This result occurs if a court, on the basis of the evidence as a whole, determines that the payments are essentially compensation paid for the purpose of benefiting the university.\footnote{The student was doing research for a laboratory division of the electrical engineering department which received funds for stipends and other research costs from various contracts and grants. Stephen L. Zolnay, 49 T.C. 389 (1968). This case was followed by Rev. Rul. 69-425, 1969-2 Cum. Bull. 16, which provided that where the taxpayer was hired by a university to conduct research under a contract entered into by the university with a government agency, the taxpayer's activities were conducted primarily for the benefit of the university. Consequently, amounts received by the taxpayer were not excludable as a scholarship.} If a court feels that a grant in these circumstances is a scholarship, however, the contract is classified as an opportunity for research which is not available under the regular university budget and which furthers the university's obligation to contribute to human knowledge and education. The payments are then deemed "aimed to benefit academically qualified students so that they would not need to divert their energies from scholarly activities."\footnote{Lawrence Spruch, 20 CCH Tax Ct. Mem. 324, 326 (1961). The student was working under a professor who had received a Signal Corps contract for a specific proposal.}

The number of working hours required of students and the amount of supervision exercised over them also are factors which have been used to support both sides of this argument. The requirement of a work week of approximately forty hours does not necessarily indicate an employment relationship if academic credit is received by a student for work performed. When such a requirement is coupled with a regular, planned time schedule for performing the work, however, support is given to a finding that the relationship is essentially one of employment.\footnote{Where thirty-five hours of work per week were required and more hours were actually worked, the grant was found to be a scholarship. Lawrence Spruch, 20 CCH Tax Ct. Mem. 324 (1961). Where forty hours of work per week were required and more hours were actually worked, the grant was found to be compensation. The court felt that this was in excess of the research time expected of degree candidates. Stephen L. Zolnay, 49 T.C. 389 (1968).}

The importance of supervision to this determination depends upon who does the supervising. For example, supervision by a

In Zolnay the fact that the work was done on a planned time schedule weighed more heavily than the actual number of hours worked. From the author's experience, the research time expended by graduate students in chemistry, for example, usually is in excess of forty hours per week but is worked in a highly irregular pattern.
grantor is indicative of an employment relationship since the grantor exercises direction and control over the recipient’s activities. The Treasury Regulations accompanying section 117 state that any amount paid to enable the recipient to pursue studies or research is not a scholarship if the amount represents payment for services subject to the direction or supervision of the grantor. Conversely, extensive supervision indicates that the services rendered are primarily a learning experience since the burden of providing supervision offsets the benefits gained from the services. It is unsettled whether work performed under a grant from one organization and filtered through a second agency which supervises the recipient comprises work subject to the supervision of the grantor. The motives of the second agency are important in this situation. If the payments are made by the university in which the recipient is enrolled, from funds derived through other sources, an argument can be advanced that these payments are disbursed by an entity interested in the recipient’s education. Depending upon the circumstances as a whole, this argument may or may not be successful.

The reasoning of many courts in cases involving scholarships is pinned upon the determination of a nebulous item—the policy of the university toward the student-recipient. The argument employed is rather circular. A grant is considered a scholarship if its primary purpose is to further the education and training of the recipient in an individual capacity rather than to benefit the university. The primary purpose is ascertained from the university’s classification of the recipient as a student or an employee. This, in turn, is determined by the purpose of the services—whether they are intended to provide training for the student or benefit the university.

63Treas. Reg. § 1.117-4(c) (1) (1956).
64Robert H. Steiman, 56 T.C. 1350, 1356 (1971).

In some cases lack of extensive supervision by the university has been held to be an indication that the services rendered were not intended to be part of the education and training of the recipient. Edward A. Jamieson, 51 T.C. 635 (1969); Kenneth J. Kopecky, 27 CCH Tax Ct. Mem. 1061 (1968); Elmer L. Reese, 45 T.C. 407 (1966).

65Grants to a university or a professor with the ultimate recipient working under a professor are not considered to be supervised by the grantor. Lawrence Spruch, 20 CCH Tax Ct. Mem. 324 (1961); Chandler P. Bhalla, 35 T.C. 13 (1960).

Grants to a laboratory associated with a university or to a school board with the ultimate recipient working under a professor are considered to be supervised by the grantor. Stephen L. Zohnay, 49 T.C. 389 (1968); Kreis v. Commissioner, 441 F.2d 257 (4th Cir. 1971), aff’g 29 CCH Tax Ct. Mem. 770 (1970).

66See, e.g., Robert H. Steiman, 56 T.C. 1350 (1971) (stipend was held
Several factual criteria indicate the basic policy of the university. These include statements in brochures describing assistantship programs and statements of university officials explaining that the primary function of graduate assistantships is to enable students to pursue their studies and that assistantships are considered a vital part of a student's training. The type of services required must support these statements.

The role of financial need in selecting grant recipients is another important factor. When financial need, rather than research ability or experience, is used as a basis for selection, the grant is characterized as a scholarship. Conversely, when only academic or professional criteria are used to select recipients, a university indicates that its needs, rather than those of the student, are of primary importance. A taxpayer may prevail, however, even though a grant is given without regard to financial need, if the selection is based upon academic ability and the university assumes that students generally are in need of money. If a university gives other scholarships and fellowships and requires no concomitant services, however, the question is raised whether an assistantship is also a scholarship or whether the stipend is merely compensation for services. Using separate qualifications for and administration of grants requiring services also makes them suspect. As with most other elements considered in determining whether a grant has the characteristics of a scholarship, separate administration of assistantships is not conclusive proof that a grant represents compensation.

Numerous practices in the general administration of assistantship grants have been isolated by some courts as evidence that a grant is compensation, but the same practices have been considered to be a scholarship; Stephen L. Zolnay, 49 T.C. 389 (1968) (stipend was held to be compensation).

It has been suggested in all seriousness that a grant which represents compensation can be distinguished on the facts from those cases in which the grants are scholarships because the study and research involved in the scholarship situation serve the primary purpose of furthering education and training and the payments do not represent compensation. Karl Laurence Kirkman, 29 CCH Tax Ct. Mem. 797, 810 (1970).


68Id. at 1355. Where the student is selected to work on a project because of prior experience, rather than for academic performance or financial need, any training received by the student is considered to be incidental to, and for the purpose of, facilitating work on the project. Charles F. Wall, 31 CCH Tax Ct. Mem. 1069 (1972).


erred unimportant in other cases. These factors seem to make no real difference in the outcome of a case and are mentioned by courts only as additional support for decisions against taxpayers. These practices include the paying of assistantships through a university payroll office from general funds, rather than from earmarked funds. Income tax withholding is always mentioned as a factor supporting a decision against the taxpayer. Furthermore, graduate assistants often receive fringe benefits, such as sick leave, paid vacations, medical insurance, or retirement plans, which are similar to those given full-time faculty members. The greater the similarity between the treatment of students and regular employees, the more likely it becomes that assistantship stipends will be considered compensation. A graduate assistant's failure to receive fringe benefits, however, is not in itself sufficient to show that the grant is not compensation.

The size of payments received under graduate assistantship grants is subject to paradoxical judicial analysis. If the amount received is large relative to amounts generally paid as scholarships and if it approximates salaries paid for the same work, the stipend may be considered compensation. On the other hand, if an amount is smaller than that paid regular employees, the stipend also may be compensation on a theory that a benefit flows to the university since it would have had to hire employees at higher salaries if no graduate assistants were available. In one decision, an assistantship stipend greater than the amount ordinarily paid as employee wages was held to be a scholarship since it was apparent that if the objective of the university had been to relieve

73 See, e.g., Stephen L. Zolnay, 49 T.C. 389 (1968). The importance of this factor has been minimized, however, by judicial recognition that a university may withhold tax solely to protect itself from a possible penalty for failure to perform a duty in an area in which the law is not clearly defined. Robert H. Steiman, 56 T.C. 1350, 1357 (1971); Chandler P. Bhalla, 35 T.C. 13, 17 (1960).

The Treasury Regulations indicate that where payment is received for services, only the portion of the grant in excess of the rate of compensation ordinarily paid for similar services is excluded as a scholarship. Treas. Reg. §1.117-2(a) (1956). However, this allocation has not been allowed by the courts, and the entire payment has been considered to be compensation. Elmer L. Reese, 45 T.C. 407 (1966).
the faculty, part-time instructors could have been hired at lower salaries."

In summary, research assistantships paid to graduate students by the university in which the students are enrolled are scholarships and excludable from gross income if the following conditions are satisfied: (1) equivalent research work is required of all degree candidates regardless of whether these students receive assistantships, (2) academic credit is given for the research performed, (3) the type of supervision of the student's activities indicates a learning experience, and the research projects assigned correspond to the student's field of interest and educational objectives, and (4) the research performed is utilized by the students in their theses.

The number of working hours required, the role of financial need in selecting grant recipients, the amount of the stipend, the withholding of income tax from the stipend, and the receipt of fringe benefits by research assistants are factors to be considered in determining whether a grant possesses the normal characteristics of a scholarship or is compensation. However, these factors are not conclusive proof of either result but are evidence of whether a university considers graduate assistants to be students or employees. If grant recipients have many characteristics in common with university employees, the stipend is likely to be compensation. Conversely, if a university treats its research assistants substantially the same as all other graduate students, the stipend probably is a scholarship.

B. Teaching Assistantships

Theoretical differences between research assistantships and teaching assistantships are minimal. Since research assistantship stipends generally are considered scholarships, it would seem logical for courts to treat teaching assistantship stipends in the same manner. This is not the case, however, and teaching assistantship stipends usually are found to be taxable compensation. The income tax treatment of research assistantships is considered an irrelevant analogy to the treatment of teaching assistants. This interpretation is not based upon any intrinsic difference between teaching and research as services but, rather, is predicated upon the factual differences between a university's treatment of research and teaching assistantships and differences in the primary purpose for making the grants.

Typically, a graduate student teaching assistant is expected to perform teaching duties under the supervision of a faculty

member in laboratory or classroom courses or both. Laboratory teaching duties may include preparing necessary equipment and supervising and assisting undergraduate students in learning laboratory techniques. Classroom teaching duties consist of lecturing, conducting classroom discussion and recitation, and constructing, administering, and grading examinations. All of these duties are performed under the supervision of a professor having primary responsibility for a course. A professor oversees and approves the preparation of lecture material and examinations, remains in the laboratory during laboratory instruction, and frequently attends lectures given by the teaching assistant. This close supervision of teaching assistants assures both a valuable educational experience for the graduate assistant and quality instruction for the undergraduate student.

The amount of time a teaching assistant is required to work varies considerably. Some departments require up to twenty hours per week, while others fix no minimum time requirement. The amount of time actually spent depends upon the amount of preparation and consultation necessary for the course being taught. Teaching experience, unlike research experience, generally is not a formal degree requirement. While some departments require teaching as a condition to receiving a degree, other departments merely encourage their students to teach. Nevertheless, nearly all graduate students perform some teaching duties as a part of their training. Some departments require either teaching or research experience for each semester during which the student is enrolled. The mix between research and teaching is then determined by the

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81The description of the teaching assistantship is a composite picture of the programs operated by the Biochemistry, Microbiology, and Pharmacology Departments of Indiana University-Purdue University at Indianapolis [hereinafter cited at IUPUI], the English and Sociology Departments at Indiana University, the Psychology Department at Purdue University, and the Chemistry and Metallurgy Departments at Iowa State University. Each of these departments offers both a Master of Science, or Master of Arts, and a Doctor of Philosophy degree. The handling of the assistantships is similar regardless of the degree for which the recipient is a candidate, except that master’s degree candidates receive fewer assistantships since assistantships frequently are not given to first-year students.

82Teaching experience is required by the Chemistry Department at Iowa State University, and the Microbiology Department at IUPUI. IOWA STATE UNIVERSITY, 1973-1975 GRADUATE COLLEGE BULLETIN 35; Interview with Prof. Jack Bauer, Department of Microbiology, IUPUI, in Indianapolis, May 5, 1975.

Teaching experience is strongly encouraged, although not required, by the Biochemistry and Pharmacology Departments at IUPUI, and the English and Sociology Departments at Indiana University. Interviews with Prof. Donald Bowman, Department of Biochemistry, IUPUI, in Indianapolis, May 5, 1975; Prof. S.R. Wagle, Department of Pharmacology, IUPUI, in Indianapolis,
student's professional aspirations.\textsuperscript{63} Generally, departments which require teaching experience consider it part of the curriculum and provide corresponding academic credit. These teaching programs supplement formal course work with a variety of professional activities in which the student may engage after receiving his degree. Teaching frequently is considered to be an experience necessary for qualifying a student to hold a doctoral degree, since graduate students are an important source of future university faculties. Between thirty and one hundred percent of all graduate students, depending upon the particular field of study, pursue a teaching career after receiving the doctoral degree.\textsuperscript{64}

Graduate assistants are selected on the basis of academic qualifications and potential for satisfactorily completing the degree requirements. Thus, the best students receive assistantships. Financial need seldom enters into the selection process. However, the purpose of an assistantship program is to aid the student in completing his education, and it is considered that the vast majority of students experience financial need.

A typical graduate teaching assistantship stipend provides between $250 to $350 per month and is paid with university funds from a general budgetary account. Teaching grants, therefore, are paid from the same account as university employee salaries. Whether income tax is withheld from the stipend depends upon the administrative practices of the particular university or department involved.

In contrast to the curriculum-oriented training program described above, many universities consider teaching assistants to be associate faculty with full responsibility for the course being taught and treat them as employees rather than strictly as students.\textsuperscript{65} In these circumstances, stipends paid to students are tax-

\textsuperscript{63}This type of program is carried on by the Psychology Department at Purdue University. \textit{Purdue University, 1974-1976 Graduate School Bulletin} 296.

\textsuperscript{64}The departments used as examples in this study gave the following estimates of the percentage of graduate students who pursue a teaching career: Biochemistry 70\%, Chemistry 30\%, English 100\%, Microbiology 40\%, Pharmacology 50\%, Sociology 95\%.

\textsuperscript{65}For example, beginning graduate assistants in the Department of English at Indiana University have responsibilities similar to those outlined above. As these teaching assistants gain experience, however, the responsibilities increase until, in the third year, such graduate assistants have total responsibility for the course being taught. Interview with Prof. Donald J. Gray, Department of English, Indiana University, in Bloomington, Indiana, May 14, 1975.
able compensation for services, rather than scholarships. Because of the propensity of universities to treat teaching assistants as employees, nearly insurmountable obstacles have been encountered in attempts to show that any teaching stipend possesses the normal characteristics of a scholarship. In Robert H. Steiman, however, a case in which a teaching assistantship stipend was found to be a scholarship, these obstacles were circumvented.

In Steiman, a doctoral candidate received a typical curriculum-oriented teaching assistantship. The duties required of him were required of all degree candidates in the department, regardless of whether they received assistantships. The teaching duties required were always within the area of the student's interest and study, and academic credit was given. All of the duties required were performed under the direct supervision of a faculty member in charge of the particular course, who also assigned grades for both the undergraduate students and the teaching assistants. In conformance with the instructional nature of the teaching services provided by the graduate students, the professors also made an overall evaluation of the performance and ability of each student, regardless of whether the student received an assistantship. This evaluation was included in the student's file for use in answering inquiries of potential employers.

Several types of financial assistance, including assistantships, trainingships, and scholarships, were available to graduate students. The university stated that the primary purpose of the graduate assistantship program was to enable students to pursue graduate studies, and that an effort was made to provide the student with the kind of aid which would be most beneficial. Financial need, rather than teaching ability or experience, was the primary factor in determining whether financial aid was appropriate in a given case. The stipends paid to teaching assistants ranged from $2500 to $3000 per year, which exceeded the annual salaries paid to part-time instructors.

The fact that teaching assistants were paid more than part-time instructors, coupled with the extensive faculty supervision of the graduate assistant's work, led the Steiman court to conclude that the potential benefit of the student's services was not a primary consideration for granting the teaching assistantships.

The Department of Sociology at Indiana University has two types of student teaching positions. The teaching assistantship involves work under the direct supervision of the faculty and is similar to the program outlined above. The associate instructorship, however, gives the graduate student the same responsibilities for the course being taught as any other faculty member. Interview with Prof. Sheldon Stryker, Chairman of the Department of Sociology, Indiana University, in Bloomington, Indiana, May 14, 1975.

56 T.C. 1350 (1971).
The court reasoned that if the university's objective had been to aid the faculty, part-time instructors could have been hired at a lesser cost.\textsuperscript{67} The university withheld income taxes from the stipends and provided the teaching assistants with medical benefits maintained for employees and not available to other students, but these indications of an employment relationship were offset by the denial of other employee benefits to graduate assistants. Thus, the \textit{Steiman} court established that teaching assistantship stipends are excludable scholarships when a university requires teaching services as part of its curriculum and treats its teaching assistants as students who are being trained.\textsuperscript{68} This result is also possible, even if teaching is not absolutely required of all candidates for the degree, when an integrated program of teaching and research is required in a proportion determined by the faculty and the student to best fulfill the student's educational goals.\textsuperscript{69}

When a scholarship exclusion is claimed for income tax purposes, it is advantageous to include supporting information with the tax return.\textsuperscript{70} This documentation should consist of a letter from the student stating that he was enrolled as a graduate student at the particular university during the period involved and received a specific monetary stipend for teaching activity necessary for the degree. The letter also should state that this income is nontaxable under section 117 of the Internal Revenue Code of 1954 as interpreted in \textit{Robert H. Steiman}, 56 T.C. 1350 (1971).

A separate letter signed by the chairman of the department should also be included, stating the above information, and further stating that, as part of the training program, the student held an appointment as a graduate assistant for which the student received a specific monetary stipend from the university, that all graduate students are required to perform similar services as a condition to receiving the degree, that the teaching performed by the student as a graduate assistant is considered to be a valuable and integral part of his training, and that the teaching is not

\textsuperscript{67}Id. at 1356.

\textsuperscript{68}The Internal Revenue Service has acquiesced in the \textit{Steiman} decision. 1971-2 \textit{Cum. Bull.} 3.

\textsuperscript{69}The Internal Revenue Service conducted audits of the income tax returns of several recipients of teaching assistantships in the Department of Psychology at Purdue University, which has this type of program. The exclusion of the teaching stipends from gross income was allowed as being substantially similar to \textit{Steiman}.

\textsuperscript{70}This procedure has been followed by graduate students in Psychology at Purdue University in successfully claiming scholarship exclusions of teaching assistantship stipends. This procedure is analogous to that which has been used successfully for more than ten years by students claiming the exclusion from gross income of research assistantships.
done for the benefit of any granting entity but is designed to contribute to the training of the student.

A grant differing substantially from that in Steiman generally is compensation. Failure to require teaching services of all degree candidates, for example, seems to foreclose conclusively the issue of excludability under section 117(b)(1), eliminating the necessity of a prior determination of whether the grant in fact qualifies as a scholarship. In this situation, however, the Tax Court takes great pains to determine on the basis of other facts that the grant represents compensation and then closes its opinion by remarking that even if the record shows that teaching is required of all candidates, the exception is inapplicable absent an initial finding that the grant is a scholarship.

In determining whether a teaching assistantship stipend is a scholarship, equivalency of services required of teaching assistants as a condition to receiving a stipend and services required of all degree candidates is of great significance. A stipend is an excludable scholarship when the only requirement, both for receiving the stipend and for receiving the degree, is to teach one course per quarter. However, when the requirement for receiving the degree is to teach one course for one quarter, and the grant recipient teaches one course for each of three quarters, the stipend is compensation. Thus, a teaching assistantship stipend is taxable compensation when the grant recipient performs different teaching activities, has different responsibilities, or is required to spend more time than degree candidates in general.

Failure to provide academic credit for teaching is also fatal to a showing that services are part of the curriculum or course of study and are not merely employment services. Furthermore, an exclusion is denied when the substantive material taught by a grant recipient is only indirectly useful in the student's studies and any educational benefit gained from the teaching experience itself is merely incidental rather than the primary purpose of the teaching.

91Services required as a condition to receiving a grant are not regarded as part-time employment only if required of all degree candidates. INT. REV. CODE of 1954, § 117(b)(1). See, e.g., Edward A. Jamieson, 51 T.C. 635 (1969); Kenneth J. Kopecky, 27 CCH Tax Ct. Mem. 1061 (1968).
Two other indicia of whether the university considers teaching stipends as compensation rather than scholarships are given great weight. If a teaching assistant has full charge of his class, is responsible for giving course grades, and has the same degree of supervision as other teachers of similar experience, there is a presumption that the relationship between university and student is that of employer-employee.\(^7\) If the number of assistantships granted is geared to the number of undergraduate students enrolled and, therefore, to the number of teachers needed, it is similarly indicative of an employment arrangement entered into for the benefit of the university.\(^8\) Consequently, where teaching assistants replace additional staff who would be hired if no graduate students were available, teaching stipends are compensation, and any benefit to a grant recipient from the performance of these duties is considered incidental.\(^9\) Two recent decisions holding teaching assistantship stipends to be compensation have been distinguished fromSteiman on these grounds.\(^10\)

In summary, teaching assistantship stipends paid to graduate students by the university in which the students are enrolled are scholarships excludable from gross income if the following conditions are satisfied: (1) equivalent teaching services are required of all degree candidates regardless of whether the students receive assistantships, (2) academic credit is given for the teaching performed, (3) the type of supervision of the student's activities indicates a learning experience, and the teaching duties assigned correspond to the student's field of interest and educational objectives, and (4) the teaching assistant does not have complete charge of the class and does not give grades, and the number of assistantships granted does not depend on the university's need for teachers.

The number of working hours required, the role of financial need in the selection of recipients, the amount of the stipend, the withholding of income tax from the stipend, and the receipt of fringe benefits are considered in determining whether the grant has the normal characteristics of a scholarship or is compensation at tax.

\(^7\)Worthington v. Commissioner, 476 F.2d 589 (10th Cir. 1973), \textit{aff'd} 31 CCH Tax Ct. Mem. 447 (1972) (even though teaching was required of all candidates for the degree); Edward A. Jamieson, 51 T.C. 635, 636 (1969); Elmer L. Reese, 45 T.C. 407, 411 (1966); Rev. Rul. 67-443, 1967-2 CUM. BULL. 75.


and are treated much the same as when a research assistantship is involved. These points are not conclusive proof of either scholarship or compensation, but are evidence of whether the university considers the graduate assistant to be a student or an employee. If the grant recipient has many characteristics in common with university employees, the stipend is likely to be compensation. Conversely, if the university treats the teaching assistant substantially the same as any other graduate student, the stipend is likely to be a scholarship.

C. University As Employer

In addition to graduate assistantships, universities traditionally offer programs which provide enrolled students with stipends for performing a variety of services with the university itself or with separate, off-campus organizations. Many of these programs are recognized by universities as part-time student employment, even if recipients are selected on the basis of financial need, duties imposed are related to the student's course of study, and payment is made from a special account. The work-study program sponsored by the Department of Health, Education and Welfare is an example of this part-time employment form of financial aid. Stipends paid under this work-study program represent compensation for services rendered, and no pretense is made that such payments are a scholarship.\(^{101}\)

Stipends paid under other university programs such as the internships which are available in many fields of study, however, frequently are considered scholarships, although the factual circumstances parallel those of the work-study program. Unfortunately, the designation given the stipend by the grantor and the recipient is not as persuasive to the Internal Revenue Service and the courts as is the substance of the transaction. In determining whether internship grants are excludable, the Code provision which states that the exclusion does not apply to amounts received by a degree candidate as payment for services in the nature of part-time employment required as a condition to receiving the scholarship\(^{102}\) is a formidable initial hurdle to surmount. Only three solutions to this problem are apparent: either the services are required of all degree candidates as a condition to receiving the degree, or the services are not in the nature of part-time employment, or the services are not required as a condition to receiving the scholarship. The applicability of these pos-


\(^{102}\)Int. Rev. Code of 1954, § 117(b) (1).
sible solutions is limited by the definitions given in the Treasury Regulations\textsuperscript{103} of grants not considered scholarships, by the primary purpose test, and by the insistence that the grant possess the normal characteristics of a scholarship before the limitations on the exclusion, and the exceptions thereto, may even be considered.

The first proposed solution commonly is inapplicable to internship programs. Participation rarely is a prerequisite to receiving a degree, although many programs of the internship type which provide experience in areas related to the course of study offer academic credit to participants. Even when services are required of all degree candidates, classification of a stipend as a scholarship is not guaranteed when the circumstances as a whole indicate that recipients are paid to work rather than to study.\textsuperscript{104}

The most generally applicable solution to the problem of non-excludability of internship stipends is to show that the services are not in the nature of part-time employment. In making this determination, factors such as the benefit derived by the grantor, the primary purpose of the grant, and administrative practices must be considered. Very few cases, however, have been litigated in this area.\textsuperscript{105} It cannot be determined whether this results from the recipients' having avoided audit of their tax returns or from a lack of confidence in the arguments favoring an exclusion.

Because students engaged in internship programs generally work with organizations outside their universities, these programs are suspected to have the primary purpose of benefiting the re-

\textsuperscript{103}Treas. Reg. § 1.117-4 (1956).

\textsuperscript{104}Thus, where an institute of naval architecture required all students to satisfactorily complete a ten-week practical work term with a private employer, the stipend was considered to be compensation. Karl Laurence Kirkman, 29 CCH Tax Ct. Mem. 797 (1970).

Similarly, where participation in a ten-week work period each year was required by a university as a condition to receiving a Bachelor of Science degree, and the work performed was determined by the needs and activities of the employer, the stipend was compensation. Rev. Rul. 73-218, 1973-1 Cum. Bull. 53.

Also, where a theology school required all students to serve part-time in a parrish assignment which they had no choice in selecting, the stipend was compensation (and since the students were not ordained, they also were denied a rental allowance exclusion). Rev. Rul. 57-522, 1957-2 Cum. Bull. 50.

However, where a college as part of its philosophy of a complete education required all students to work part-time for the college, for which they received a nominal cash payment, the payment was a scholarship. Rev. Rul. 64-54, 1964-1 Cum. Bull. 81.

\textsuperscript{105}Medical interns, of course, are notorious for litigating the character of their stipends. See discussion on pp. 780-88 infra. Such interns are not degree candidates, however, and the problems peculiar to the medical intern situation will be treated separately.
ipients of student services rather than being strictly educational in scope. The fact that these grants may come from yet a third source, that universities administer them, and that grant recipients receive academic credit are not indicia that students derive the primary benefit. Thus, Department of Health, Education and Welfare grants to students working at a center to improve educational services and grants from a nonprofit organization to interns working for state legislators have been found to be compensation for services rendered. Whether the original source of the grant and the beneficiary of the services are the same entity is immaterial. The term "grantor" extends to any entity in the administrative chain of the grant. Therefore, if the services are performed under the direction of, or are in fact beneficial to, the organization receiving them, a stipend given for these services is considered compensation.

Stipends given to journalism students working with local newspaper staffs have been found to be compensation for services, although the interns did not replace employees who otherwise would have been hired. The stipends were paid from a university "fellowship fund" to which the newspapers contributed. It was held that the use of a "fellowship fund" as a conduit for payment of the grants did not change the essential nature of the students' standing as employees during the training period, nor did it transform the payment into something other than compensation. From the employer's point of view the students filled the same role as any other part-time employee.

On the other hand, if a fellowship arrangement truly exists, its essential characteristics are not destroyed by treating the recipient as an employee only for payroll and bookkeeping purposes. For example, a grant paid to a postdoctoral research associate in education administration was considered a fellowship even though the recipient received full faculty privileges, the stipend was designated as a salary by the university, and payment was made under a Department of Health, Education and Welfare reimbursement contract which allocated no funds for fellowships. Notably, no benefit was expected or received by

107Rev. Rul. 64-212, 1964-2 CUM. BULL. 39. See Rev. Rul. 71-559, 1971-2 CUM. BULL. 102 (the students worked with state legislative committees and the stipends were paid with a combination of state funds and contributions from a non-profit organization).

However, where the facts do not clearly show that the grantor receives
the university from the recipient’s activities, which included coursework, reading, writing, and participating in a professional seminar. Also, the disbursement of a normal fellowship stipend was impossible under the contract requirements. Thus, use of earmarked salary funds by a university for an unauthorized purpose does not change the substance of a true fellowship arrangement.

In another situation, stipends received by medical technology students participating in a training program which required the performance of analyses in a hospital laboratory were considered excludable scholarships. Students in the program were rotated within the laboratory as they became proficient in various techniques, and all student analyses were checked by registered technicians. This program obviously served only to train the students, and no benefit from the training activities inured to the hospital.

It is apparent from these decisions that the absence of a benefit to the grantor is the key to proving that services performed by student interns are not in the nature of part-time employment. A clear showing that the students’ activities do not result in benefit to the grantor is necessary to remove from these grants the stigma of compensation for services rendered. The designation of compensation as a fellowship does not change the substance of an employment relationship. Conversely, the unauthorized use of salary funds does not work a transformation on a true fellowship arrangement.

Another possible solution to the nonexcludability of internship grants lies in a showing that the services are not required as a condition to receiving the grant. This solution generally is inapplicable to typical internship programs and, strictly speaking, is not a true solution at all. If no services are required, a

no benefit from the recipient’s activities, lack of authority to use the funds for fellowships indicates that the payments were made to further the grantor’s function. Robert W. Carroll, 60 T.C. 96 (1973) (a college professor, who was principal investigator on a research project under a National Science Foundation grant, received a stipend for doing research during the summers). This conclusion is drawn more often in cases where the grantor is not a university. Harvey P. Utech, 55 T.C. 434 (1970) (research associate at the National Bureau of Standards under a National Academy of Science grant).

Rev. Rul. 64-29, 1964-1 Cum. Bull. 79. See Rev. Rul. 72-568, 1972-2 Cum. Bull. 80 (student nurse stipends found to be scholarships). But see Rev. Rul. 73-59, 1973-1 Cum. Bull. 52 (where medical technologist trainees required to work one year in an approved hospital laboratory as a condition to receiving a degree, stipends found to be compensation since the work done was the same as that of any other hospital employee); Dennis Dale Brenneise, 33 CCH Tax Ct. Mem. 1 (1974); Rev. Rul. 74-474, 1974-2 Cum. Bull. 37 (stipends of pharmacy students working as hospital pharmacy residents were held to be compensation).
grant falls within the classical definition of a scholarship—a relatively disinterested payment to further the recipient's education and training in an individual capacity with no requirement of a quid pro quo. Nevertheless, the absence of required services may explain why athletic grants-in-aid are one type of university financial aid program whose character as a scholarship apparently has not been challenged. The lack of litigation in this area is surprising in light of the very strict view taken toward services performed for the grantor in other circumstances.

Typically, a recipient of an athletic grant-in-aid must sign a letter of intent to enroll at the grantor university and must try out for the sport involved. Additionally, athletic departments frequently require athletes to perform odd jobs for the university. Universities admittedly would have to hire personnel to perform these services if students were not available. Arguably, however, none of these requirements prevents a grant from qualifying as a scholarship. A letter of intent does not prohibit a student from enrolling at a different university or from refusing to participate in athletics. Such conduct, of course, terminates a grant. The same result is obtained, however, with respect to most university scholarships. Grants given by a university generally are limited to students enrolled at the university and, in addition, frequently are further restricted to students in a particular curriculum. These qualifications placed upon a recipient do not detract from a grant's characterization as a scholarship.

Students who participate in a sport and perform odd jobs for the university admittedly render services for the grantor.

113Grants-in-aid are distinguished from scholarships by the lack of a high academic grade requirement for eligibility. INDIANA UNIVERSITY, INDIANA UNIVERSITY BULLETIN, FINANCIAL AIDS FOR STUDENTS 8, 13 (1971) [hereinafter cited as FINANCIAL AIDS BULLETIN]. Both grants-in-aid and scholarships are considered to be "gift aid." Id. at 6-7.
114Interview with William Sylvester, Athletic Director, Butler University, in Indianapolis, May 8, 1975.
115Typical jobs are cleaning up the stadium or field house after games, ushering at games, acting as equipment manager or student trainer, or assisting with physical education classes. Id.
116In some instances failure to enroll results in a loss of eligibility for financial aid and athletic competition if the athlete enrolls at another university. This depends on the agreement between the schools. Id.
117Rule 3-1-(f) (2), NATIONAL COLLEGIATE ATHLETIC ASSOCIATION, 1975-1976 NCAA MANUAL 8 [hereinafter cited as NCAA MANUAL].
118FINANCIAL AIDS BULLETIN, supra note 113, at 8-10.
119Scholarships are available to students enrolled in every subject from art to zoology. Indeed, one scholarship is available which gives preference to members of the auditorium usher corps. Id. at 31-82.
Neither of these activities, however, is necessarily required as a condition to receiving the grant. An athletic grant-in-aid may not be terminated or reduced because a recipient lacks athletic ability, fails to contribute to his team's success, cannot participate because of injury, or refuses to perform assigned tasks. Specifically, these grants may be terminated only if a recipient fails to satisfy the university's academic requirements, voluntarily renders himself ineligible for athletic competition, fraudulently misrepresents information on a grant-in-aid application, or subjects himself to substantial disciplinary action by the university. Similar grounds for termination are common to most university academic scholarships.

The maximum permissible financial aid to athletes may not exceed the "commonly accepted educational expenses," which are defined as tuition, fees, room, board, and book expenses. All amounts received by a student during a school term from athletic grants-in-aid, other scholarships, employment, and similar sources must not exceed this limitation and must be administered by the university. Thus, both the amount and the granting entity are restricted, and the grants bear no relation to compensation which would be paid for similar services in an employer-employee relationship. Furthermore, athletic grants are awarded by a university scholarship committee upon recommendation of the ath-

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120 It should be remembered, however, that grants have been determined to be compensation when future services were not actually required, but only expected, of the recipient. See, e.g., Reiffen v. United States, 376 F.2d 883 (Ct. Cl. 1967); John E. MacDonald, Jr., 52 T.C. 386 (1969).

121 The period for which the grant may be given varies among schools from one semester to four years. Renewal is, of course, optional. In practice, however, renewal of a grant is not denied because an athlete is injured and does not play. Interview with William Sylvester, Athletic Director, Butler University, in Indianapolis, May 8, 1975.

122 Rule 3-1- (f), NCAA Manual, supra note 117, at 8.

123 It is specifically provided that any disciplinary action taken toward the recipient of an athletic grant-in-aid must be based on institutional policy applicable to the general student body. Id.

University disciplinary action toward a recipient of a university academic scholarship, particularly if such action involves suspension from classes, is ground for terminating the scholarship. Interview with Dr. Doris Merritt, Dean for Sponsored Programs, Indiana University-Purdue University at Indianapolis, and Associate Dean for Research and Advanced Studies, Indiana University, in Indianapolis, May 5, 1975.

124 Rule 3-1- (f), NCAA Manual, supra note 117, at 8. Fifteen dollars per month for incidental expenses is also allowed, but few schools grant this amount. Interview with William Sylvester, Athletic Director, Butler University, in Indianapolis, May 8, 1975.

125 Rule 3-4, NCAA Manual, supra note 117, at 13. An exception is made for military service benefits and assistance from those upon whom the student is naturally or legally dependent. Id.
letic department. This is the same administrative procedure used in awarding other departmental scholarships.\textsuperscript{126}

In spite of these arguments, athletic grants-in-aid seem closely related to many other grants which are held to be compensation.\textsuperscript{127} The favorable treatment accorded athletic scholarships probably represents a policy decision that such grants should be excluded from gross income and that the national interest in encouraging continued education should prevail, if the grant is limited by and closely related to normal educational expenses.\textsuperscript{128}

In summary, stipends paid by a university to its students under internship and work-study programs which are not required as a condition to receiving the degree generally are compensation for services rendered. These grants fall into the category of excludable scholarships only if (1) no benefit from the student’s activities inures to the grantor, (2) academic credit is given for the services performed, and (3) the type of supervision of students indicates a learning experience, and the duties assigned correspond to the student’s field of interest and educational objectives. The number of working hours required, the role of financial need in selecting the grant recipients, the amount of the stipend, the withholding of income tax from the stipend, and the account from which the grant is paid are considered in determining whether the grant is a scholarship or is compensation, but are not conclusive proof of either result.

III. MEDICAL INTERNS AND RESIDENTS

A. Non-Degree Candidates

The continuing struggle of medical interns and residents\textsuperscript{129} to gain income tax exempt status for stipends paid by hospitals

\textsuperscript{126}See, e.g., \textit{Financial Aids Bulletin}, \textit{supra} note 113, at 31-82.

\textsuperscript{127}A different result was indeed reached when a grant encompassing most of the characteristics of an athletic grant-in-aid, \textit{i.e.}, payment of tuition, fees, room, board, and books, which was not terminated by the unconditional release of the player, but only by his voluntary failure to report for training or to attend an accredited college, was given by a professional ball club to a player under contract to them. Such payments were held to be part of the bargained-for compensation paid under the contract. Rev. Rul. 69-424, 1969-2\textit{Cum. Bull}. 15.

\textsuperscript{128}In several cases involving grants from employers, only the stipend was questioned, and payments of tuition and fees were not at issue. Bingler \textit{v.} Johnson, 394 U.S. 741 (1969); Stewart \textit{v.} United States, 383 F.2d 355 (6th Cir. 1966); Ussery \textit{v.} United States, 296 F.2d 582 (5th Cir. 1961); Jerry S. Turem, 54 T.C. 1494 (1970); John E. MacDonald, Jr., 52 T.C. 386 (1969).

\textsuperscript{129}Because senior medical students receive substantial clinical experience, the American Medical Association has abolished the term “intern” effective
which train physicians presents an interesting example of an exercise in futility. This controversy has been litigated at least fifty-three times since 1958, and the taxpayer has been successful in only five cases.\textsuperscript{131}

July 1, 1975. Henceforth all postgraduate clinical training will be termed a residency. Interview with Dr. A. David McKinley, Assistant Dean of Medicine, Indiana University School of Medicine, in Indianapolis, May 8, 1975.


In addition, one physician twice litigated the tax status of his residency stipend, the amounts at issue being received during different years, and lost both times. Emerson Emory, 32 CCH Tax Ct. Mem. 245 (1973); 30 CCH Tax Ct. Mem. 785 (1971).

In addition to this multitude of cases, several Revenue Rulings also reach the same conclusion. Rev. Rul. 71-346, 1971-2 CUM. BULL. 99; Rev. Rul. 68-520, 1968-2 CUM. BULL. 58; Rev. Rul. 57-386, 1957-2 CUM. BULL. 107.

\textsuperscript{131}Leathers v. United States, 471 F.2d 856 (5th Cir. 1972), aff'd 71-2 U.S. Tax Cas. \$ 9573 (E.D. Ark. 1971); Pappas v. United States, 67-1 U.S.
Medical residencies are the epitome of "learning by doing" educational training. Residents receive training while associated with, and performing services for, one or more hospitals. Many programs involve rotation among several hospitals in order to provide experience in treating a varied patient population and a broad spectrum of medical problems. The resident is considered to be his patients' primary physician and is responsible for taking admitting histories, giving physical examinations, ordering lab work, and providing emergency and continuing care.

A senior resident has direct responsibility for patient care, supervises the activities of junior residents, and participates in teaching courses to medical students. Increasing responsibilities and opportunities are given as a resident's experience increases. The ultimate responsibility for patients' treatment and supervision of the residents, however, rests with the permanent hospital staff. Residency programs place heavy emphasis on clinical work through ward rounds, formal classes and seminars, and informal discussions with the staff physicians. Nonetheless, patient responsibility is considered the only training which will fully develop a resident's medical knowledge, skills, and judgment.

Each medical specialty department determines the number of residencies it will offer. This determination is based upon the facilities and staff available to implement the training, the number of hospital beds, the need for personnel, and the money available for stipends. These stipends, which provide $10,500 to $15,000, are paid by the hospital with which the resident is associated.


The typical program outlined here is based on the program offered by the Indiana University Hospitals, Indianapolis, Indiana. INDIANA UNIVERSITY, SCHOOL OF MEDICINE, INTERNSHIP AND RESIDENCY PROGRAMS. Descriptions of the typical fact situation also are found in the following cases: Woddail v. Commissioner, 321 F.2d 721 (10th Cir. 1963); Aloysius J. Proskey, 51 T.C. 918 (1969); Ethel M. Bonn, 34 T.C. 64 (1960).


Residents at Indiana University Medical Center rotate among the University Hospitals (established as teaching and referral hospitals), Marion County General Hospital, and the Veterans Administration Hospital. INDIANA UNIVERSITY SCHOOL OF MEDICINE, INTERNSHIP AND RESIDENCY PROGRAM.

The American Medical Association must approve the number of residencies offered by each hospital. The number of residencies is reduced if the hospital does not have sufficient permanent staff and facilities to effectively train the residents. Interview with Dr. A. David McKinley, Assistant Dean of Medicine, Indiana University School of Medicine, in Indianapolis, May 8, 1975.
ciated. If a particular program involves duties at several hospitals in rotation, the resident is paid by each hospital during the period of association. Fringe benefits such as medical care, insurance, vacation, and laundry services normally are received under these programs. A hospital generally considers residents to be employees. It designates stipends as salaries and withholds income tax.  

Stipends received by residents consistently are treated as compensation for services rendered when the principal function of the hospital is to provide patient care and the residents perform duties of necessary personnel who otherwise would be hired. Decisions in this area are based upon the premise that residency programs are designed to facilitate the primary purpose of the hospital—the care and treatment of patients. The services performed by residents are characterized as valuable, essential, professional, and substantial in terms of both time spent and importance to the hospital. The activities are geared to the hospital’s operational needs, and any training provided is incidental to the primary objective of providing treatment for the patients.

While it is true that residents do not have complete responsibility for patients and are supervised by permanent staff, it is also true that most employees are subject to some degree of supervision. Stipends paid to residents, therefore, are not fellowships because the grants are paid to enable the recipients to pursue studies primarily for the benefit of and subject to the direction of the grantor. It is irrelevant whether the initial grantor is a hospital or another organization. If funds are channeled through a hospital that receives a benefit from services, the stipend is regarded as compensation for those services.

A stipend is not transformed into a fellowship because the

135 Id.
136 See, e.g., Woddall v. Commissioner, 321 F.2d 721 (10th Cir. 1963); Aloysius J. Proskey, 51 T.C. 918 (1969).
137 Ethel M. Bonn, 34 T.C. 64, 70 (1960).
140 Treas. Reg. § 1.117-4(c) (1), (2) (1956).

Where the physician is both a resident and a participant in a training program which is the same whether or not the resident receives a stipend, even payment of the training grant and the residency stipend from separate funds does not negate the fact that beneficial services are performed for such payment. Rev. Rul. 71-346, 1971-2 CUM. BULL. 99.
recipient derives substantial benefit from his training.\textsuperscript{142} In applying the primary purpose test, the recipient’s motive in accepting the grant is immaterial; only the grantor’s motive is significant.\textsuperscript{143} Since the recipient’s purpose always is to further his training, this seems to be the proper approach.

[V]irtually all work as an apprentice, whether in medicine or law, or carpentry or masonry, provides valuable training. Nothing in section 117 requires that an amount paid as compensation for services rendered be treated as a nontaxable fellowship grant, merely because the recipient is learning a trade, business, or profession.\textsuperscript{144}

In fact, a more perfect employer-employee relationship than that which exists between hospital and resident would be difficult to imagine.\textsuperscript{145}

Absence of benefit to the hospital from the resident’s activities is the distinguishing feature of the rare residency stipend which qualifies as a fellowship. In Frederick A. Bieberdorf,\textsuperscript{146} a resident spent twenty-five percent of his time in clinical work and seventy-five percent doing research. His clinical activities consisted of examining patients at a hospital in consultation with the hospital staff, attending seminars, and learning techniques. He did not treat patients on his own initiative,\textsuperscript{147} and his major commitment was research, which was performed under the direction and close supervision of a medical school faculty. Initially, he worked on established research projects, and later, as he developed independent interests and ideas, he began an original project. The patients on whom the research was performed were referred to the medical school for study and were not regular patients of the hospital.

The medical school paid the stipend from a National Institutes of Health grant, and income tax was withheld. Furthermore, the medical school paid for insurance, although in a lesser amount than for faculty members. In sum, the resident had no responsibility for patient care, did not replace hospital staff, and had no duty to render services to the hospital. The services that the resident did perform were merely incidental to the training

\textsuperscript{143}Emerson Emory, 30 CCH Tax Ct. Mem. 785, 787 (1971).
\textsuperscript{144}Aloysius J. Proskey, 51 T.C. 918, 925 (1969).
\textsuperscript{145}Woddall v. Commissioner, 321 F.2d 721, 724 (10th Cir. 1963).
\textsuperscript{146}60 T.C. 114 (1973).
\textsuperscript{147}Similarly, where the clinical activities of the resident were limited to transferring the observations and directions of the senior staff onto the patients’ charts, and to making suggestions during rounds, the activities were found to be of minimal value to the hospital and the stipend received by the resident was a fellowship. George L. Bailey, 60 T.C. 447 (1973).
program and of minimal benefit to the hospital. Although the administration of the stipend had some of the characteristics of an employment relationship, the hospital did not benefit from the resident's activities. The stipend, therefore, was a fellowship.

Another situation in which a residency stipend is a scholarship is when a hospital's purpose is to teach residents rather than treat patients. In *Wrobleski v. Bingler*, the court found that a hospital was designed primarily as a center for research and for the education and development of qualified specialists. To provide a cross-section of cases necessary for training, the patients admitted to the hospital were selected from persons hospitalized elsewhere. Since the institute had adequate staff, the services performed by residents were only supplementary. Moreover, the services were not of material benefit since they were performed under continuous, individual supervision. For these reasons, the court concluded that the stipend was a fellowship. Once the primary purpose test is satisfied, therefore, the fact that a grantor derives incidental benefit from activities of the grant recipient does not affect the excludability of the grant from gross income.149

The two other cases in which grants to residents were found to be fellowships were decided by juries. These decisions were based upon determinations that the payments were primarily intended to further the education of the recipient in an individual capacity and did not represent compensation for services. The specific facts and reasoning underlying the decisions, however, were not reported.151

Similar considerations also are applied to non-medical internships. Amounts paid to ministerial interns and residents in a program of training in pastoral care, or to social service interns training with a social service agency, have been deemed compensation when the recipients were primarily performing services but also were acquiring training. On the other hand, the

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147Id. at 904.

In most of the subsequent cases, the court preferred to distinguish *Pappas* on the ground that the stipend paid to Dr. Pappas was primarily to further the recipient's education and training, and the present facts do not support such a determination. See, e.g., Rundell v. Commissioner, 72-1 U.S. Tax Cas. ¶ 9277 (5th Cir. 1972), aff'g 30 CCH Tax Ct. Mem. 177 (1971); Arthur Calick, 31 CCH Tax Ct. Mem. 69 (1972).
stipend of a dietetic intern who did not stay at any one institution long enough to perform significant, beneficial services was found to be a scholarship.\textsuperscript{154} The stipends of pastoral trainees at a teaching hospital which selected patients to meet the needs of the teaching program and had a permanent staff sufficient to serve the patients' needs also were scholarships.\textsuperscript{155}

The credibility of basing a stipend exclusion upon the functional purpose of the grantor hospital recently has been diminished. The district court in \textit{Hembree v. United States}\textsuperscript{156} had held that the stipend received by a resident from a university hospital, which had been established specifically as a teaching hospital, was a scholarship. The court of appeals reversed this decision, however, and concluded that the primary purpose of the hospital was not a proper criterion for determining the character of the resident's stipend. The primary purpose of the payment to the resident, rather than the use of the facility, was controlling.\textsuperscript{157} Thus, the primary purpose test, as applied to residency stipends, has undergone a subtle shift in focus which makes it even more unlikely that the stipends can qualify as fellowships. The primary function of the hospital as an exclusively teaching institution is no longer sufficient to support a claim that a stipend is a relatively disinterested educational grant with no requirement of a substantial quid pro quo.

The exclusion of many stipends apparently goes unchallenged\textsuperscript{158} because of policy differences among local Internal Revenue Service offices.\textsuperscript{159} For this reason, residents whose exclusion is challenged have not been reluctant to litigate the matter. This divergence between the results of litigated cases and the actual

\textsuperscript{154}Thomas P. Phillips, 57 T.C. 420 (1971).
\textsuperscript{156}72-2 U.S. Tax Cas. ¶ 9607 (4th Cir. 1972), rev'd 71-2 U.S. Tax Cas. ¶ 9636 (D.S.C. 1971). The residency program involved rotation among the university hospital, a county hospital, and a Veterans Administration hospital. The district court held that the portion of the stipend received by the resident while working at the university hospital was an excludable scholarship, while the stipends received from the county and Veterans Administration hospitals were compensation for services.
\textsuperscript{157}72-2 U.S. Tax Cas. ¶ 9607, at 85,441.
\textsuperscript{158}The results of a survey taken by a medical journal show that out of 887 residents polled, 29\% claimed the exclusion; and out of 116 physicians on fellowships, 55\% claimed the exclusion. Of the exclusions claimed, 91\% of those by residents and 96\% of those by fellows went unchallenged. On the returns which were audited, some exclusions were disallowed and some were not even questioned. \textit{Another Look at That $3600 Fellowship Exclusion, Hospital Physician} 42 (July 1971).
\textsuperscript{159}Jacobson & deRham, \textit{Lawyer and Accountant Clash on $3600 Exclusion, Resident & Staff Physician} 99 (Nov. 1971).
treatment of a significant percentage of the nonlitigated residency stipends has caused a similar divergence of opinion regarding the proper course for a resident to follow. If a resident can state with confidence that his hospital considers the primary purpose of the residency program to be the furtherance of the resident’s education rather than service to patients, it has been suggested that the exclusion should be claimed.\textsuperscript{160} Emphatic disagreement with this position, however, has been expressed on the ground that one so advising a resident is participating in a plan for improper avoidance of income tax.\textsuperscript{161} The latter position seems untenable, however, since the Internal Revenue Service, in answer to a request for a ruling, has stated that no formal determination can be made.\textsuperscript{162} Each case must be decided upon its own facts and circumstances. Nevertheless, it should be emphasized that a resident claiming an exclusion must believe that his hospital considers the primary purpose of its program, including the payment of the stipend, to be strictly educational. It is a rare hospital that can meet this criterion.

In summary, stipends paid to residents by a hospital in which they are training are taxable compensation. Only in the extremely rare case of a stipend paid solely to enable the recipient to pursue his education and training, with no significant benefit from the recipient’s activities inuring to the grantor, is a residency stipend a fellowship and excludable from gross income.

\textbf{B. Degree Candidates}

Occasionally a physician serving a residency does so in the capacity of a degree candidate.\textsuperscript{163} In this situation, the determination of the character of a stipend is governed by precedent established in cases involving graduate assistantships as well as in cases involving the more common types of medical residencies.\textsuperscript{164} Therefore, if a training program is under the supervision of a graduate school and is part of the regular curriculum required of all degree candidates, a stipend qualifies as a fellowship grant.\textsuperscript{165} Similarly, if a program is not directly controlled by a graduate school, but a resident’s activities are part of the degree requirements and are limited to strictly observational and

\textsuperscript{160}Jacobson, \textit{Tax Tips for Hospital Doctors, Resident & Staff Physician} 91 (Jan. 1971).
\textsuperscript{161}Jacobson & deHamm, \textit{Lawyer and Accountant Clash on $3600 Exclusion, Resident & Staff Physician} 99 (Nov. 1971).
\textsuperscript{162}Id.
\textsuperscript{163}E.g., Master of Science in Internal Medicine, Doctor of Philosophy in Clinical Psychology, or Master of Science in Hospital Administration.
\textsuperscript{164}William Wells, 40 T.C. 40, 47 (1963).
\textsuperscript{165}Anderson v. United States, 61-1 U.S. Tax Cas. ¶9162 (D. Minn. 1960).
educational functions, the grant is a fellowship if the resident does not replace any of the institution's personnel.\footnote{Shuff v. United States, 331 F. Supp. 807 (W.D. Va. 1971).} Even if the resident functions as part of the work force providing patient care at a hospital whose primary purpose is treating patients, if the resident's services are closely supervised and of limited value to the hospital and there is no reduction in the number of regular employees, the stipend still is considered a fellowship.\footnote{Paul H. Chesmore, 33 CCH Tax Ct. Mem. 1226 (1974); William Wells, 40 T.C. 40 (1963).} A residency combined with a degree program is distinguishable from the typical medical residency only on the ground that the grant recipient is a candidate for a degree. This characteristic, of course, also links such a residency to the graduate assistantships given by universities. Thus, the determination of whether a grant to a resident degree candidate has the normal characteristics of a fellowship hinges on criteria drawn from both areas, for example, the granting of academic credit and the degree of supervision of the recipient, coupled with a strict interpretation of the type of services which constitute benefit to the grantor.\footnote{The Internal Revenue Service acquiesced in the decisions in William Wells, 40 T.C. 40 (1963), and Anderson v. United States, 61-1 U.S. Tax Cas. ¶ 9162 (D. Minn. 1960), and this acquiescence has not been removed. Rev. Rul. 65-59, 1965-1 CUM. BULL. 67. However, subsequent cases generally were distinguished on their facts and similar stipends held to be compensation. See, e.g., Quast v. United States, 428 F.2d 750, 754 (8th Cir. 1970) (merely receiving academic credit for residency work does not necessarily make a stipend a fellowship); John M. Gullo, 30 CCH Tax Ct. Mem. 1434 (1971).}

In summary, stipends paid to resident degree candidates by hospitals in which they are training constitute compensation for services rendered. The stipends are classified as fellowships only if (1) the payments meet the requirements for this determination with respect to a normal medical residency, \textit{i.e.}, no benefit inures to the grantor, or (2) the payments meet the requirements for such a determination with respect to a graduate assistantship, \textit{i.e.}, the activities are part of the regular curriculum required of all degree candidates, and academic credit is given.

IV. EMPLOYER AS GRANTOR

A. Degree Candidates

Many companies have programs for supporting higher education in which funds are granted to universities or to individual recipients. The most common of these programs are scholarship
and fellowship grants169 and employee tuition-aid plans.170 Fellowship plans generally provide funds to full-time students in a specified field.171 Their broad purpose is encouraging students to prepare for careers in areas related to the company’s business. The company benefits from the additional manpower available for recruitment while fulfilling its sense of social responsibility and enhancing its public image.172

Grants made under many of these plans fit the classical description of scholarships and fellowships. The funds are paid through a university, which selects the recipients on the basis of scholarship and financial need. Companies, however, often retain the right of final approval of the university’s selection.173 The area of study in which the recipient must engage frequently is specified by the company, but no other control over the recipient’s research or course of study is exercised.174 Furthermore, these grants are not conditioned upon acceptance of post-graduate employment with the grantor.175 Under these circumstances, the funds are not compensation for past, present, or future services. Any benefit ultimately derived by the company is merely incidental to furthering the recipient’s education. The amounts received, therefore, are excludable from gross income as a scholarship.

Different considerations predominate when grants are made to employees of the grantor company. The major objective then is to update employees’ technical knowledge and prepare them for positions of higher responsibility.176 Although grant recipients devote full time to studies and the company requires no services

169 A comprehensive study has been made of corporate fellowship plans. This report covers 75 plans sponsored by 60 companies. NATIONAL INDUSTRIAL CONFERENCE BOARD, INC., 209 STUDIES IN PERSONNEL POLICY. COMBATTING KNOWLEDGE OBSOLESCENCE: I. COMPANY FELLOWSHIP PLANS (1968) [hereinafter cited as Fellowship Report].

170 A similar study also has been made of corporate tuition-aid plans. This report covers 200 plans by as many companies. NATIONAL INDUSTRIAL CONFERENCE BOARD, INC., 221 STUDIES IN PERSONNEL POLICY. COMBATTING KNOWLEDGE OBSOLESCENCE: II. EMPLOYEE TUITION-AID PLANS (1970) [hereinafter cited as Tuition-Aid Report].

171 Fellowship Report, supra note 169, at 24.

172 The stated objectives in order of frequency of occurrence are: to enlarge the supply of scientific specialists for recruitment, to support the national scientific effort, to interest universities in the company’s research projects, to fulfill the corporate sense of social responsibility, to enhance the company’s image, to bring employees up to date on new developments, and to prepare employees for more responsible positions. Id. at 23.

173 Id. at 65, 69.

174 Id. at 27.

175 Id. at 61.

176 Id. at 23.
during the grant period, the company generally regards these employees as being on either a special work assignment or an educational leave of absence. In these circumstances, courts do not hesitate to find a continuing employment relationship. Requiring a recipient to work for the grantor for a specified period following the completion of his educational training also supports a determination that a grant is compensation.177 Few grant recipients subject to an obligation of this nature are successful in claiming a scholarship exclusion for income tax purposes.

Aileene Evans178 represents a successful assertion that an educational grant from an employer was a scholarship, even though future employment was required of the recipient. Evans frequently has been relied upon by taxpayers, and just as frequently has been distinguished on the ground that Ms. Evans had not been employed by the grantor prior to receiving the grant.179 After many years of being distinguished into nonexistence, Evans finally was declared an unsound precedent,180 and the Internal Revenue Service removed its acquiescence.181 It is now clear that a stipend given to enable the recipient to pursue further training and in consideration of a promise of future employment is taxable compensation.182

Even when no obligation of future employment exists, circumstances often show that a grant is given with the expectation that the employment relationship will continue. This expectation is a sufficient ground for reaching the conclusion that a grant is

177Id. at 49. Many of the cases involved employees of state welfare agencies who took advantage of educational leave programs funded jointly by the federal government and the states. These programs generally required employment following receipt of the academic degree for a period equal to the leave time. Ulak v. United States, 1972-1 U.S. Tax Cas. ¶9468 (S.D. Cal. 1972); Stewart v. United States, 363 F.2d 355 (6th Cir. 1966); Ussery v. United States, 296 F.2d 582 (5th Cir. 1961); H. Norman Brown, 31 CCH Tax Ct. Mem. 457 (1972); Norman F. Stougaard, 30 CCH Tax Ct. Mem. 1331 (1971); Lowell D. Ward, 55 T.C. 308 (1970); Jerry S. Turem, 54 T.C. 1494 (1970); Marjorie E. Haley, 54 T.C. 642 (1970); Aileene Evans, 34 T.C. 720 (1960).

Most corporate fellowship programs do not require future employment. However, employees are encouraged to continue their employment. Fellowship Report, supra note 169, at 61-62.


given primarily for the benefit of the grantor.\textsuperscript{183} The mere absence of a contract to perform services does not make a stipend a scholarship if the evidence as a whole suggests otherwise.\textsuperscript{184}

Incongruously, payment of tuition, room, board, books, and a small monthly stipend by the Department of the Navy to Naval R.O.T.C. students has been held to be a scholarship despite a requirement of future services to the grantor.\textsuperscript{185} The recipient was found to be acquiring a basic college education and not training specifically for naval duties. To determine the primary purpose of the grant, the court looked to the immediate purpose of furthering the student's education and avoided the ultimate motive of aiding the officer procurement program. It was further suggested that the determinative consideration was not the principal purpose of the grantor in subsidizing the student but the principal purpose of the benefit from the study.\textsuperscript{186} This proposal, however, has not gained acceptance in subsequent cases.\textsuperscript{187}

In cases of employee grants, great weight is given to the view which the grantor takes of the recipient and the grant program. Occasionally this view is explicitly stated, as when the grantor's brochure refers to the recipient as continuing in the capacity of an employee\textsuperscript{188} or as being on special work assignment.\textsuperscript{189} More often, a grantor's outlook is inferred from other details of the relationship. For example, an employee frequently is regarded as taking an educational leave of absence.\textsuperscript{190} Accord-

\textsuperscript{183}See, e.g., Reiffen v. United States, 376 F.2d 883 (Ct. Cl. 1967); John E. MacDonald, Jr., 52 T.C. 386 (1969).

\textsuperscript{184}Ehrhart v. Commissioner, 470 F.2d 940, 944 (1st Cir. 1973), aff'd 57 T.C. 872 (1972); John E. MacDonald, Jr., 52 T.C. 386, 393 (1969).

\textsuperscript{185}Commissioner v. Ide, 335 F.2d 852 (3d Cir. 1964), aff'd 40 T.C. 721 (1963).

\textsuperscript{186}Payments of tuition, fees, book expenses, and relocation expenses to a student who had secured employment at a Navy research laboratory through competitive examination and had subsequently been granted an educational leave with a requirement of continued employment upon graduation, however, were held to be compensation for past, present, or future services. Rev. Rul. 58-403, 1958-2 Cum. Bull. 49.

\textsuperscript{187}Payments to persons attending military academies and to veterans are specifically mentioned as not being scholarships. Commissioner v. Ide, supra, at 854; Treas. Reg. § 1.117-4 (a), (b) (1956).

\textsuperscript{188}Commissioner v. Ide, 335 F.2d 852, 855 (3d Cir. 1964).

\textsuperscript{189}This reasoning was employed in a Third Circuit decision which was overruled by the Supreme Court. Bingler v. Johnson, 394 U.S. 741 (1969), rev'd 396 F.2d 258 (3d Cir. 1968).


\textsuperscript{190}See, e.g., Jerry S. Turem, 54 T.C. 1494 (1970); John E. MacDonald, Jr., 52 T.C. 386 (1969).

\textsuperscript{190}Ehrhart v. Commissioner, 470 F.2d 940 (1st Cir. 1973), aff'd 57 T.C. 872 (1972).
ingly, the employer-employee relationship is not severed, or even suspended, during the leave period, since the employee retains his job seniority and continues to receive employee fringe benefits such as health and life insurance, sick leave, and retirement or profit-sharing benefits. In addition, a stipend often is a continuation or a stated percentage of a recipient's salary and is not based on financial need or educational expenses. Even if the amount of a payment were based upon need, however, there is some authority to the effect that the result would not be altered. Employer administrative practices in making stipend payments from general funds and withholding income taxes also are deemed supportive of a finding that a grant is compensation.

Some grantors require progress reports or even more closely direct a recipient's course of study. Conduct of this nature is considered inconsistent with the normal characteristics of a scholarship. In a majority of cases, however, grantors exercise no control over the course of study other than to designate the general area in which study may be undertaken. Nonetheless, this absence of direction or supervision is not sufficient to overcome other indicia that a grant is intended as compensation.

Employees of city or county welfare agencies frequently argue that they are not employees of the grantor since the funds for educational stipends to these employees are provided by state and federal agencies. The absence of any direct economic benefit to the grantor in this situation, however, does not support the conclusion that the payments are made for a reason other than the grantor's own interest. Any result which is helpful in fulfilling a governmental function, such as increasing the staff of work-

194 Norman F. Stougaard, 30 CCH Tax Ct. Mem. 1331, 1336 (1971). Although the payment in question here was not based on financial need, there is dictum to the effect that meeting such a criterion would not affect the decision in the case.
196 Bingler v. Johnson, 394 U.S. 741 (1969) (thesis topic must be submitted to the employer with approval based on whether the topic bears at least some relationship to the work being done for the employer); John E. MacDonald, Jr., 52 T.C. 386 (1969) (recipient must state why the field in which study is to be undertaken is important to the employer, and approval is based on the relation of the field of study to the areas of primary interest of the employer).
ers trained to provide social services, is a benefit to the grantor. Therefore, if the funds are administered by the city or county agency which receives a direct benefit from the recipient's services, the stipend is compensation for those services.198

Benefit to the grantor remains the key to characterizing an educational grant either as a scholarship or as employee compensation. Factual situations are interpreted with respect to the definition of a scholarship as a relatively disinterested educational grant with no requirement of any substantial quid pro quo flowing from the recipient to the grantor.199 This view of the facts frequently leads to the conclusion that grants to employees from their employer are not intended primarily to further the education of the recipient in an individual capacity, with any benefit to the grantor being merely incidental.200 In effect these grants often support training programs which enable recipients to better perform their duties as employees. This is the stated objective of many corporate scholarship plans.201 From an employer's point of view, the business purpose transcends any desire to further an employee's education per se; the grants are analogous to a bonus designed to induce improved performance or employee relations.202 Since there is a direct benefit to the grantor-employer, the grant is compensation.203

In Laurence E. Broniwitz,204 the only case in the area that still has precedential value, a taxpayer convinced the court that a grant from his employer was a scholarship. Broniwitz indicates that exclusion in the grantor-employer context is possible only in exceptional circumstances. The recipient was an outstanding student who learned of the grant from a notice on a university scholarship bulletin board. He was not employed by the grantor prior

199This problem is not limited solely to industrial employees. A college professor participating in a cooperative educational research training program leading to a Doctor of Philosophy degree at his college received a percentage of his former salary, hospitalization, and insurance. In addition, his thesis covered a problem of interest to the sponsoring college. The grant was determined to be payment for services subject to the direction of, and primarily for the benefit of, the grantor. Rev. Rul. 71-417, 1971-2 CUM. BULL. 96.
201Fellowship Report, supra note 169, at 25.
to receiving the grant and never performed services for the company. He was classified as an employee, however, because this was necessary to his eligibility for educational assistance. The grant paid tuition, book expenses, and a living stipend based on need and academic ability. No control or supervision was exercised by the grantor beyond requiring the submission of progress reports. Even these reports concerned academic activities only and not the substance of the recipient's research project. Furthermore, no obligation of employment following graduation existed, and, in fact, the recipient was not so employed. The recipient was committed to work part-time for the grantor during the summers between school terms. For this he was paid a salary, commensurate with the position held, in addition to and completely separate from his scholarship. Under these circumstances, it was determined that the grant was not compensation for past, present, or future services since the recipient was paid adequately for the part-time employment and the only benefit to the grantor was the incidental possibility of recruiting the recipient for employment after graduation. For these reasons, the primary purpose of the grant was construed as assistance to an outstanding student's education.205

In addition to providing scholarship grants, many companies also have programs which reimburse tuition expenses of employees who are part-time students. These plans have similar objectives to those of employee scholarship plans: to make employees more productive and more able to advance within the company.206 The field of study generally is restricted to those areas related to an employee's present or projected future work assignment.207 While recipients of tuition-aid are encouraged to continue working for the grantor, nearly all such grants have no requirement of future employment.208 Companies granting tuition reimbursement generally consider such a plan to be an employee fringe benefit.209

205Id. at 1093.
206The stated objectives in order of frequency of occurrence are: to enable employees to get ahead in the corporation, to make employees more productive, to enrich the employees' lives, to create a reserve of promotable employees, to attract new employees, and to update the employees' knowledge. Tuition-Aid Report, supra note 170, at 12.
207Id. at 39.
208Id. at 24. Out of 200 plans studied, only 8 require employees to continue their employment after receiving tuition aid. The length of service required by these few companies ranges from six months to five years, with the longer period applying only in the case of personnel who receive a doctoral degree.
209Id. at 12. Only 35 of the 200 participating companies do not consider tuition-aid plans to be an employee fringe benefit.
Most of these companies do not withhold income tax from tuition-aid grants.\(^{210}\)

No cases have arisen dealing directly with tuition grants by employers. This may result from the deduction of educational costs as business expenses rather than the exclusion of them from gross income as scholarships.\(^{211}\) There have been several instances, however, when the exclusion of a stipend or living allowance has been disallowed, but payments for tuition and fees have not been in issue.\(^{212}\) Thus, the income tax status of tuition-aid grants is somewhat speculative. While it is apparent that these payments, at least theoretically, are taxable compensation under the present interpretation of section 117,\(^{213}\) the Internal Revenue Service is not challenging the exclusion of these grants from gross income. This may represent a policy decision that a grant, limited by normal educational expenses and bearing no relation to compensation for services, deserves an exclusion because of the strong national interest in encouraging continued education.

In summary, educational grants to employees from their employer, while the recipient is on educational leave and performing no services for the employer, are taxable compensation for past, present, or future services. An educational grant to an employee from an employer is a scholarship only in the rare case of a nominal employee who performs no employment services at any time. Similarly, reimbursement of an employee's tuition expenses by the employer constitutes taxable compensation, although the exclusion from gross income of such grants is not being challenged at present.

**B. Non-Degree Candidates**

The quest for a university degree is not a prerequisite to obtaining an educational grant. Many grants are given for the purpose of broadening the recipient's knowledge and expertise.\(^{214}\)

\(^{210}\)Id. at 77. Only 64 of the 200 participating companies withhold income tax from such grants. The plans of the companies which do withhold usually state that reimbursement under the plan is considered to be additional compensation.

\(^{211}\)In Bingler v. Johnson, 394 U.S. 741, 744 n.9 (1969), the Supreme Court, while noting that the tax status of the tuition reimbursement payment was not at issue in the case, stated that "although conceptually includable in the income, such sums presumably would be offset by educational deductions."


\(^{213}\)INT. REV. CODE of 1954, § 117.

\(^{214}\)Examples of such grants are stipends paid to writers by tax-exempt organizations. Such stipends are fellowships and includable from gross income.
In this situation, a typical grantor exercises no control over the subject matter of the work and does not supervise a recipient's activities, although reports outlining the use of the funds and the accomplishments achieved under the grant frequently are required. Rights to any discoveries or work produced under the grant remain with the grant recipient.

In determining whether these grants possess the normal characteristics of a fellowship and are excludable under section 117, the only criterion of any importance is whether the activities of the recipient result in benefit to the grantor. When there is no employment relationship between the grantor and the recipient, either prior to or during the period of the grant, and no obligation of future employment, the grant generally fits the classical description of a fellowship. It is regarded as a relatively disinterested educational grant with no requirement of any substantial quid pro quo. Mandatory progress reports and incidental benefit to the grantor are, in themselves, insufficient to destroy the grant's essential character as a fellowship.

If, however, a stipend is paid to a non-degree candidate employee by his employer, difficulty is encountered in showing that the grant is not encumbered with the obligation of a quid pro quo. This difficulty occurs even though amounts paid for the primary purpose of furthering a recipient's education are excludable despite their compensatory nature. When training obtained by a recipient is job-related, the failure of the training to lead to a degree presents strong evidence that the benefit accrues principally to the employer.

A grant from an employer to a non-degree candidate employee may result in a benefit to the grantor in two distinct situations. The first situation arises when the employer is the grantor and a stipend is paid during a period when no actual services are performed by the recipient for the employer. These

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215 A non-degree candidate is, of course, limited in the source, amount, and period of the fellowship which may be excluded from gross income. Int. Rev. Code of 1954, § 117(b)(2). The problems arise, however, in making the initial determination of whether the grant is a scholarship.

216 Rev. Rul. 58-76, 1958-1 CUM. BULL. 56 (recipient of an American Heart Association Research Fellowship grant to further the training in cardiovascular research was required to devote full time to research).

217 Frank T. Bachmura, 32 T.C. 1117, 1125-26 (1959). The proposition that, in the proper circumstances, a fellowship grant could be compensatory in nature was stated, although the facts of this particular case led to the conclusion that the stipend in question was not a fellowship.
amounts represent continued compensation if the training is part of the recipient's duties as an employee and, therefore, primarily of benefit to the employer.\textsuperscript{219} This conclusion is valid even when an employee is not \textit{required} to return to work upon his completion of training, but it is expected that continued employment will occur.\textsuperscript{219}

In the second situation, services are performed for an organization other than the original grantor. If this organization considers the grant recipient to be an employee and duties are performed for its benefit, the grant is compensation for those services.\textsuperscript{220} The absence of some of the usual employee benefits and the presence of an excellent opportunity for study are not determinative of the character of the grant.\textsuperscript{221} The use of the grant funds often is restricted by the grantor to furthering the organization's function and assigned projects. The organization in this situation has no authority to use the funds to finance individual educational goals, and payment of the grant is made for the organization's own benefit.\textsuperscript{222}

Amounts received by teachers participating in programs and workshops designed to improve the quality of education fall into one or the other of the above categories depending upon the source of the funds. These amounts generally are considered compensation. For example, grants commonly are made either by school boards that regularly employ the teachers\textsuperscript{223} or through federal

\textsuperscript{218}See, \textit{e.g.}, Marjorie Schwartz, 28 CCH Tax Ct. Mem. 762 (1969) (high school language teacher continued to receive her salary while on leave for five months to study at the Sorbonne in preparation for teaching a new course in modern European thinking).

\textsuperscript{219}See, \textit{e.g.}, David E. Mark, 26 CCH Tax Ct. Mem. 1106 (1967) (foreign service officer who received his salary while a fellow of the Harvard Center for International Affairs was considered by the State Department as being on official duty at the time).

\textsuperscript{220}See, \textit{e.g.}, Beulah M. Woodfin, 31 CCH Tax Ct. Mem. 208 (1972) (post-doctoral research assistant at a university under a National Science Foundation grant); Howard Littman, 42 T.C. 503 (1964) (research associate at Argonne Laboratory operated for the Atomic Energy Commission by the University of Chicago); Norman R. Williamson, 32 T.C. 154 (1959) (student at Oak Ridge School of Reactor Technology operated for the Atomic Energy Commission by Union Carbide Corp.); Frank T. Bachmura, 32 T.C. 1117 (1959) (research associate at a university under a Rockefeller Foundation grant).

\textsuperscript{221}Harvey P. Utech, 55 T.C. 434, 440 (1970) (post-doctoral research associate at the National Bureau of Standards under a National Academy of Science grant).

\textsuperscript{222}Id. at 436; Howard Littman, 42 T.C. 503, 509 (1964). If it is exceptionally clear, however, that the grantor gains no benefit from the recipient's activities, use of funds for unauthorized purposes does not change the substance of a true fellowship arrangement. Louis C. Vaccaro, 58 T.C. 721 (1972).

\textsuperscript{223}Marjorie Schwartz, 28 CCH Tax Ct. Mem. 762 (1969); Rev. Rul. 70-518, 1970-2 \textit{CUM. BULL.} 20 (state training program to improve public school
grants administered by a university or state agency which is sponsoring the program. It is deemed unrealistic to conclude that a school would encourage its teachers to participate in these programs if it did not expect to derive the principal benefit of improving the quality of education. It is not considered significant that the grant recipients receive a substantial educational benefit or that the programs contribute to the general education of school children. Participation in these activities appears to be inextricably tied to the recipient’s status as an employee.

An inconsistent ruling was made, however, in the case of a school principal who was allowed administrative leave of absence to attend a leadership development program to advance education in rural, disadvantaged schools. The recipient’s activities included study, research, and observation of innovative programs with a view toward implementation in a rural school environment. The program sponsor paid the funds to the employer school board for disbursement to the recipient. Nonetheless, no employment relationship was found because neither the sponsor, nor the school board, nor the principal considered the disbursing function to be a requirement of the fellowship grant or related to the recipient’s employment. The stipend, therefore, was found to be a fellowship. This holding is contrary to the generally applied principle that any entity in the chain of administration of the grant which receives benefit from the recipient’s increased training is considered to be a grantor.

Although it is difficult to negate the implication of benefit to an employer-grantor, this result is possible under circumstances which clearly show that the educational purpose predominates and that any benefit derived by the grantor from the recipient’s activities during his training is merely incidental. Thus, fellows at an institute designed for extensive individual study and


Robert W. Willie, 57 T.C. 383 (1971) (HEW grant to study education in desegregated schools); Rev. Rul. 68-312, 1968-1 CUM. BULL. 59 (National Teacher Corps grant for teaching underprivileged children was compensation to experienced teachers participating in the program but was a scholarship to student-interns pursuing studies leading to advanced degrees); Rev. Rul. 68-146, 1968-1 CUM. BULL. 58 (National Science Foundation grant to raise the academic quality of colleges); Rev. Rul. 61-174, 1961-2 CUM. BULL. 28 (HEW grant to develop a new teaching approach to algebra).


independent research, who neither performed the duties of nor replaced staff personnel, were not considered to be employees.\textsuperscript{228} Similarly, a university professor who received a grant which, although administered by an employer university, would follow the recipient should he move to another university was not considered to be an employee for the purposes of the grant.\textsuperscript{229} In both cases, the stipends were held to be fellowships.

It is also possible that a grant from an entity other than an employer is compensation. If grants are made to persons of proven originality, experience, and ability, and the legal rights to any discoveries arising from research under the grant are assigned to the grantor, the conclusion may be drawn that the primary purpose of the grant is to benefit the grantor. The grantor has bargained for the services and products of the recipient, and the recipient has received compensation in return.\textsuperscript{230}

In summary, grants to non-degree candidate employees from the employer generally are compensation. Only in the rare instance in which the circumstances show that no significant benefit from the recipient's activities accrues to the grantor is a stipend a fellowship. Grants to non-degree candidates from a grantor who is not the recipient's employer are fellowships unless the legal rights to discoveries or products arising under the grant are assigned to the grantor.

V. Conclusion

Few solid rules can be formulated which will guide one in determining that a grant requiring services is a scholarship or fellowship. It often has been stated that if the primary purpose of a grant is to further the education and training of a recipient in an individual capacity, the grant is a scholarship. This statement, however, is not a rule which may be applied mechanically but is a conclusion drawn from the collection of facts which are variously weighted depending on the circumstances. Nonetheless, a few general guidelines may be postulated. Many can only be stated

\textsuperscript{228}Rev. Rul. 71-538, 1971-2 \textit{Cum. Bull.} 97. The fellow was led through several stages of development as a research scientist: library work, observation of research projects, work on a project under supervision, and finally independent work on a project of the fellow's own choosing. It was not expected that the activities of the fellow would provide a net benefit to the grantor.

\textsuperscript{229}Clarence Peiss, 40 T.C. 78 (1963). The grant was received in addition to the recipient's regular salary and for activities not requires of the recipient as an employee.

as practices to be avoided so as not to disqualify a grant, rather than as practices to be followed to qualify a grant as a scholarship.

Grants to medical residents have been given the most consistent treatment by the courts. These grants are scholarships only in the rare instance when a recipient’s activities are largely observational or highly supervised and when it is obvious that a hospital could continue to function at the same level without the services of the resident. Similarly, educational grants given to employees by their employer nearly always are compensation. However, in this situation, a grant qualifies as a scholarship if the employment relationship is completely severed, which requires a stipend based on financial need rather than previous salary, and an absence of employee benefits and of services performed for the grantor during the period of the grant. No obligation or expectation of continued employment can exist. In addition, the rights to the product of the research or study must not inure to the benefit of the grantor.

Conversely, graduate assistantship research grants usually are scholarships when substantially equivalent activities under the direction of the degree-granting department are required of all degree candidates and academic credit is given. The status of teaching assistantship stipends, however, is not as firmly settled as that of research grants. A more clearly demonstrated absence of benefit to the university is required of teaching assistants before a teaching stipend is excludable. Also, the responsibility given the grant recipient must be severely limited and the number of such grants offered must not be based on the university’s need for teachers.

Between these extremes are other grants offered by universities and charitable and governmental agencies, either directly to the recipient or through the beneficiary of the services. The income tax status of these grants seems to be determined by weighing the facts on each side and then reaching a decision based on the totality of the circumstances.

Definite steps can be taken to enhance the probability of a determination that a given stipend is a scholarship or fellowship. In the case of grants to degree candidates, the activities required of the recipients should be considered part of a particular course of study for which academic credit is given. In addition, the amount of the grant should be based on financial need, education expenses, or academic ability and must bear no relation to the salary which is paid for similar services in an employment relationship. Administratively, such stipends should be treated as any other university scholarship as to the selection of recipients, the account from which it is paid, and income tax
withholding. The university brochures should refer to the grants as “scholarships” and to the recipients as “students.” The words “salary” and “employee” must be avoided.

Whether or not a recipient is a degree candidate, no prior or subsequent employment relationship between the grantor and the recipient should exist. Furthermore, a grantor must not receive any rights in the product of the research or study and the activities of a recipient should not be directly related to the fulfillment of a contract or the general function of the grantor. Lastly, it is imperative that a recipient does not replace regular employees whom it otherwise would be necessary to hire.

To digress briefly into the realm of theoretical policy considerations, if Congress truly believed that continued education so substantially serves the national interest as to merit encouragement through specific, favorable tax treatment, the courts have gone too far in finding that compensation underlies many of these grants. Many payments seem to further this national interest as well as do grants conditioned on the performance of services required of all degree candidates or which have a source other than the recipient’s employer. These include payments supporting activities which are a part of a curriculum and for which academic credit is received, and company tuition-aid payments which are in addition to the salary paid, whether or not the recipient also receives a grant, and which require no additional services performed for the grantor. The purpose of a recipient in performing services as well as the purpose of a grantor in requiring such activities should be considered. Ultimately, a finding that the education and training of a recipient is substantially furthered and the grantor derives only indirect benefit from the services should result in a determination that the grant falls within the exclusionary provisions of section 117.

Whether this position is correct, however, is of only academic interest at present. The only practical course of action, for both the grantor and the recipient, is to tailor their activities so as to make the best of the situation as it now exists.