Internal Revenue Service

Department of the Treasury

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Person to Contact:

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Dear Sir or Madam:

This is in response to your authorized representative's submission dated April 13, 1998, which requested certain rulings regarding the proper federal income tax treatment, including any reporting and/or withholding obligations, for certain stipends paid by your organization and the other above referenced taxpayers to individuals in connection with the research training programs briefly described below.

The information submitted indicates that A is recognized as exempt from federal income tax under section 501(c)(3) of the Internal Revenue Code, and is a full service acute care and non-acute care teaching, research and healthcare system. A's affiliate hospitals include B, C, D and E (herein after referred to as the "affiliates"), all of which are also recognized as exempt from federal income tax under section 501(c)(3).

The information submitted further indicates that A and affiliates conduct extensive research, training, and educational programs including clinical fellowships and research fellowships. There are more than 5,000 research projects being conducted at A and its affiliates for the 1998 fiscal year.

A and affiliates' research training programs are modeled after the National Institutes of Health's (NIH's) National Research Service Awards (NRSA) program, and are designed to

mirror it. The focus of the programs is research training and the development of research skills, and not the performance of research services. A and affiliates' research fellows do not serve as medical residents or as laboratory technicians as part of the research programs, and are not replacements or substitutes for either. The activities of the research fellows during their training programs does not materially benefit A or its affiliates. Research issues are determined by the research fellows in conjunction with their faculty mentors after selection into the programs. NRSA grants partially fund A and its affiliates' research programs, and the activities of their research fellows and NRSA fellows are the same. Research fellows are not required to have performed past services or to agree to perform future services for A and its affiliates, as a condition to receiving a research training program stipend.

The federal tax treatment of qualified scholarships and fellowship grants is addressed in section 117 of the Code. Section 117(a) provides that gross income does not include any amount received as a qualified scholarship by an individual who is a candidate for a degree at an educational organization described in section 170(b)(1)(A)(ii) (describing, generally, a school).

To be considered a scholarship or fellowship grant, an amount need not be formally designated as such. Generally, a scholarship or fellowship grant is any amount paid or allowed to, or for the benefit of, an individual to aid such individual in the pursuit of study or research. A scholarship or fellowship grant may, for example, be in the form of a reduction in the amount owed by the recipient to an educational organization for tuition, room and board, or any other fee.

Only "qualified scholarships" may be excluded from income. A qualified scholarship is defined as an amount expended for "qualified tuition and related expenses." Qualified tuition and related expenses are tuition and fees required for the enrollment or attendance of a student at an educational institution, and fees, books, supplies, and equipment required for courses of instruction at such an educational organization. Amounts received for room, board, travel, and incidental living expenses are not related expenses. Thus, scholarship receipts that exceed expenses for tuition, fees, books, supplies, and certain equipment are not excludable from a recipient's gross income under section 117. Fellowship stipends made to non-degree candidates for general living expenses are a typical example of includible scholarship amounts.

Section 117(c) of the Code, implementing changes made by the Tax Reform Act of 1986, Pub. L. No. 99-514, provides that the exclusion for qualified scholarships shall not apply to that portion of any amount received which represents payment for

teaching, research, or other services by the student required as a condition for receiving the qualified scholarship or fellowship. Regulations governing the includibility of compensatory grants in income have been upheld by the Supreme Court of the United States, which has described excludable grants as "relatively disinterested, 'no-strings' educational grants, with no requirement of any substantial quid pro quo from the recipient." Bingler v. Johnson, 394 U.S. 741 (1969).

A scholarship or fellowship grant represents payment for services when the grantor requires the recipient to perform services in return for the granting of the scholarship or fellowship. A requirement that the recipient pursue studies, research, or other activities primarily for the benefit of the grantor is treated as a requirement to perform services. A scholarship or fellowship grant conditioned upon either past, present, or future services by the recipient, or upon services that are subject to the direction or supervision of the grantor, represents payment for services.

A scholarship or fellowship grant that is includible in gross income under section 117(c) of the Code is considered "wages" for purposes of section 3401(a). The grantor of such an amount is subject to certain withholding and reporting requirements respecting wages, including withholding for income taxes and the filing of Forms W-2. The application of Federal Insurance Contributions Act (FICA) and Federal Unemployment Tax Act (FUTA) taxes depends on the nature of the employment and the status of the grantor. See Notice 87-31, 1987-1 C.B. 475.

Although payments for research services are not excludable under current law, not all payments for research activities represent payment for services. The Code and regulations make clear that a scholarship includes any amount paid or allowed to aid an individual in the pursuit of study or research; accordingly, research activities by a student may qualify for exclusion from gross income to no less an extent than formal classroom studies. It is only where the research required by the grantor falls within the ambit of section 117(c), that inclusion in income is required. Determining whether a particular awards program makes compensatory payments within the contemplation of section 117(c) of the Code is an inherently factual matter, requiring a consideration of the nature and extent of the impositions and duties imposed upon the participants, and of all other relevant facts and circumstances of the program.

Based on the information presented and representations furnished, and assuming A, B, C, D and E's research training programs are conducted substantially as described, we have determined that the scholarship and/or fellowship stipends awarded thereunder do not represent compensation for services within the meaning of section 117(c) of the Code. The awards are

not paid for or in connection with the performance of services, and appear to be relatively disinterested grants to participants to enable them to pursue programs of independent research, training, and original study, focusing on the experience to be gained by the recipient rather than on any grantor benefit. We note that the Service does not regard the research and research training activities sponsored by institutional NRSA awards as constituting the performance of services within the contemplation of either current or prior law. See Rev. Rul. 83-93, 1983-1 C.B. 364. Such grants remain eligible for exclusion from federal income tax under section 117 of the Code to the extent of the recipient's qualified tuition and related expenses. X's grants are awarded under programs substantially similar, if not identical, to the NRSA awards program, and are thus entitled to similar tax treatment.

Accordingly, such amounts do not constitute "wages" for purposes of section 3401(a). Additionally, such amounts are not subject to section 3402 (relating to withholding for income taxes at source), section 3102 (relating to withholding under the Federal Insurance Contribution Act (FICA)), or section 3301 (relating to the Federal Unemployment Tax Act (FUTA)). A, B, C, D and E are not required to file Forms W-2, or any returns of information under section 6041, with respect to such grants. Finally, since A, B, C, D and E's research training stipends do not represent payment for services, such amounts are also not subject to Self Employment Contribution Act (SECA) taxes imposed by section 1401 of the Code. See Spiegelman v. Commissioner, 102 T.C. 394 (1994). See, also, Rev. Rul. 60-378, 1960-2 C.B. 38, which states the Service's position that noncompensatory scholarship and fellowship grants do not constitute income from a trade or business, whether or not such amounts are required to be included in gross income.

The recipient of a scholarship or fellowship grant is responsible for determining whether such grant is, in whole or in part, includible in gross income for federal income tax purposes. Where participants are degree candidates, such grants will ordinarily be excludable from the recipients' gross incomes to the extent of their qualified tuition and related expenses. In the case of non-degree candidates, the entire amount of scholarship or fellowship awards is includible in gross income. You may wish to advise participants in your research programs that the amount of their scholarship or fellowship stipends that exceeds their qualified tuition and related expenses, if any, is generally includible in gross income for federal income tax purposes.

This letter ruling is based on the facts and representations provided by the taxpayer, and is limited to the matters specifically addressed. No opinion is expressed as to the tax treatment of the transactions considered herein under the

provisions of any other sections of the Code or regulations which may be applicable thereto, or the tax treatment of any conditions existing at the time of, or effects resulting from, such transactions which are not specifically addressed herein.

Final regulations pertaining to one or more of the issues addressed in this ruling have not yet been adopted. Therefore, this ruling may be modified or revoked by adoption of final regulations, to the extent the regulations are inconsistent with any conclusions in this ruling. See section 12.04 of Rev. Proc. 98-1, 1998-1 I.R.B. 7, 47. However, when the criteria in section 12.05 of Rev. Proc. 98-1 are satisfied, a ruling is not revoked or modified retroactively, except in rare or unusual circumstances.

Because it could help resolve federal tax issues, a copy of this letter should be maintained with A, B, C, D and E's permanent records.

This ruling is directed only to the taxpayer who requested it. Section 6110(j)(3) of the Internal Revenue Code provides that it may not be used or cited as precedent.

Sincerely yours,

Assistant Chief Counsel
(Income Tax & Accounting)

By William A. Jackson
William A. Jackson
Chief, Branch 6

Enclosures:
Copy of this letter
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