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Person to Contact:

Telephone Number:

Refer Reply To:

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Date:

March 3, 2002

Legend:

X =

Dear :

This ruling is directed only to the taxpayer requesting it. Internal Revenue Code (the Code) section 6110(k)(3) provides that it may not be used or cited as precedent.

This is in response to your authorized representative's letter and submissions of October 19, 2001, requesting certain rulings regarding the proper federal income tax treatment, including any reporting and/or withholding obligations, for certain stipends paid by you, X, to individuals who are either U.S. citizens or resident aliens (as determined under section 7701(b) of the Code) in connection with the research training programs and activities briefly described below.

X is recognized as exempt from federal income tax under section 501(c)(3) of the Internal Revenue Code, and is a medical research organization described in section 170(b)(1)(A)(iii).

In furtherance with its exempt activities, X conducts basic biomedical research, including particularly gene research. In addition, the information submitted indicates that X conducts extensive research, training, and educational programs and activities relating to its area of expertise. In connection with these activities, X conducts an extensive program of biomedical research training designed to foster and develop the research skills and abilities of participants. These research training programs vary in length, depending upon the specialty and discipline. X pays participants in these training programs (predoctoral and postdoctoral fellows) stipends to help defray general living expenses during their periods of training.

X's 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. X's 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 do not materially benefit X. Research issues are determined by the research fellows in conjunction with their training supervisors and faculty mentors after selection into the programs. NRSA grants fund several of X's research fellowships, and the activities of X's research fellows and X's NRSA fellows are the same: all research fellows, NRSA and non-NRSA, receive identical training and mentoring. Research fellows are not required to have performed past services or to agree to perform future services for X, as a condition to receiving a research training stipend. X also provides supplemental stipends to NRSA fellows, so that its NRSA fellows may receive a combined stipend equal to the stipends received by its non-NRSA fellows.

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 of the Code. 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, *Wage and Tax Statement*, pursuant to section 6051. 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.

Unless a scholarship or fellowship grant is subject to the provisions of section 117(c) of the Code, neither the grantor nor the educational organization attended by the recipient (in the case where the educational organization is not the grantor) is required under section 6041 to file a return of information with respect to such grant.

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 X's research training programs are conducted substantially as described, we have determined that the scholarship and/or fellowship stipends awarded thereunder to X's predoctoral and postdoctoral research fellows (including supplemental NRSA stipends) 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, pursuant to your request, the following rulings are made respecting the described scholarship and/or fellowship stipends awarded to X's predoctoral and postdoctoral research fellows (including supplemental NRSA stipends) who are either U.S. citizens or resident aliens (as determined under section 7701(b) of the Code):

- (1) such stipends do not represent compensation for services within the meaning of section 117(c) of the Code;
- (2) the amount of such stipends does not constitute "wages" for purposes of section 3401(a). Additionally, such amounts are not subject to section 3402 (relating to withholding for income taxes at source), section 3102 (relating to withholding under the Federal Insurance Contribution Act (FICA)), or section 3301 (relating to the Federal Unemployment Tax Act (FUTA)); and
- (3) X is not required to file Forms W-2, or any returns of information under sections 6041 or 6051 of the Code with respect to such stipends.

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 X, and is limited to the matters specifically addressed. No opinion is expressed as to the tax treatment of the transactions considered herein under the provisions of any other sections of the Code or regulations which may be applicable thereto, or the tax treatment of any conditions existing at the time of, or effects resulting from, such transactions which are not specifically addressed herein.

Final regulations pertaining to one or more of the issues addressed in this ruling have not yet been adopted. Therefore, this ruling may be modified or revoked by

adoption of final regulations, to the extent the regulations are inconsistent with any conclusions in this ruling. See section 12.04 of Rev. Proc. 2001-1, 2001-1 I.R.B. (or any successor revenue procedure). However, when the criteria in section 12.05 of Rev. Proc. 2001-1 are satisfied, a ruling is not revoked or modified retroactively, except in rare or unusual circumstances.

Because it could help resolve federal tax issues, a copy of this letter should be maintained with X's permanent records.

Pursuant to a power of attorney currently on file with this office, copies are also being furnished to X's authorized representative.

LYNNE CAMILLO
Acting Chief, Employment Tax Branch 2
Office of the Assistant Chief Counsel
(Exempt Organizations/Employment Tax/
Government Entities)