

INTERNAL REVENUE SERVICE

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December 27, 2000

DO:

Legend:

X = EIN No. =

M =

N =

O =

y =

Dear Sir or Madam:

This is in response to your authorized representative's letter and submissions of June 16, 2000, requesting certain rulings regarding the proper federal income tax treatment, including any reporting and/or withholding obligations, for certain fellowship grants and stipends paid by you, X, to individuals in connection with the fellowship training programs and activities briefly described below.

You, X, are a tax-exempt, non-profit educational organization organized under the laws of State M, and accredited by N, a federally recognized agency responsible for the accreditation of curricula in the area of your expertise. Your mission is to prepare graduates in this area of interest for leadership roles in the field, and to further the training, experience and expertise of outstanding and talented individuals through study, rehearsals, class training, coaching, and performance opportunities. Community education outreach and training activities are also conducted.

In furtherance of your mission, you, X, conduct various fellowship and training programs to develop the full range of skills and qualifications required for such leadership roles. Prospective fellows are invited to join the program on a season-by-season basis, subject to ongoing review, for up to a three-year period. Availability of

fellowship opportunities in your programs is advertised and widely known. To become a fellow, an applicant must have completed his or her undergraduate degree requirements. There are currently approximately y participants in your primary fellowship program, plus a number of additional fellows in two ancillary (audio engineering and orchestra library) programs. X's faculty and staff counsel fellows, provide extensive instrumental coaching (including master classes, lessons and sectionals), help define and develop individual goals, and provide career guidance to participants. Participants in the programs are provided extensive, professional-level performance opportunities through rehearsals, concerts, tours, and public speaking and stage-presence opportunities.

You, X, pay participants in these fellowship training programs certain stipends to help defray general living expenses during their periods of fellowship training; these stipends consist of a weekly living allowance paid during the typical nine-month fellowship session; a certain travel grant to assist fellows in locating to your facility; an amount to cover certain professional fees paid in connection with membership in O; and the value of contributed room or housing at facilities owned and operated by you.

Section 61(a) of the Internal Revenue Code provides that gross income means all income, from whatever source derived.

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.

We have determined that the described amounts paid by X to participants in its various fellowship programs constitute scholarship or fellowship grants within the contemplation of section 117 of the Code.

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 of scholarship or fellowship grants 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.

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 scholarship and fellowship grants that represent payment for services are not excludable under current law, not all grants that are subject to conditions or limitations, or constitute payment for research or training activities, represent payment for services under the statute. 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 and training 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 activities required by the grantor fall 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 fellowship training programs are conducted substantially as described, we have determined that the scholarship and/or fellowship stipends awarded thereunder, including the value of contributed room or housing allowances, 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 development, training, and original study, focusing on the experience to be gained by the recipient rather than on any grantor benefit.

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)). X is not required to file Forms W-2, or any returns of information under section 6041, with respect to such grants. Finally, since X's 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 fellowship 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. 2000-1, 20009-1 I.R.B. 4, at 46. However, when the criteria in section 12.05 of Rev. Proc. 2000-1 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.

A copy of this letter is being furnished to X's district director. Pursuant to a power of attorney currently on file with this office, the original of this letter is being sent to X's authorized representative, and copies are being furnished to X.

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

Sincerely yours,
Associate Chief Counsel
(Income Tax & Accounting)
By: William A. Jackson
Chief, Branch 6

Enclosures:
Copy of this letter
Copy for section 6110 purposes