Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
CC:ITA:B05
PLR-165647-04

Date:
March 07, 2005

In Re:

LEGEND:

Taxpayer:

X Medical School

Dear :

This is in response to your letter and submissions of December 23, 2004, requesting a ruling that certain stipends paid by Taxpayer to individuals in connection with the research training programs and activities briefly described below are fellowship grants not subject to taxation under the Federal Insurance Contributions Act.

Taxpayer is recognized as exempt from federal income tax under section 501(c)(3) of the Internal Revenue Code, and is a full service teaching and research hospital described in section 170(b)(1)(A)(iii). Taxpayer is affiliated with the X Medical School and maintains research training programs in 46 divisions of medicine.

The information submitted indicates that Taxpayer conducts extensive research, training, and educational programs and activities, including research training fellowship programs. In connection with these activities, Taxpayer conducts an extensive program of research training designed to foster and develop the research skills and abilities of participants ("research fellows"). These research training programs vary in length, depending upon the specialty, from three to five years. Taxpayer pays the research fellows stipends to help defray general living expenses during their periods of training;

Taxpayer's research training programs are modeled after the National Institutes of Health's (NIH's) National Research Service Awards (NRSA) training program (in which the taxpayer also participates), 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. Taxpayer's research fellows do not serve as medical residents or as laboratory technicians as part of the research training programs, and are not replacements or substitutes for either. The activities of the research fellows during their research training programs do not materially benefit Taxpayer. Research issues are determined by the research fellows in conjunction with their faculty mentors after selection into the programs. NIH grants substantially fund Taxpayer's research training programs, and the activities required of and conditions imposed upon Taxpayer's NRSA and non-NRSA research fellows are essentially the same: all fellows receive near identical research training and mentoring.

Research fellows are not required to have performed past services or to agree to perform future services for Taxpayer, as a condition to receiving a research training stipend nor are they required to enter into any agreements regarding the future patenting or use of any research findings or inventions attributable to their research activities. Research fellows are encouraged to publish and copyright their research findings to the same extent and subject to the same conditions and practices imposed by NIH upon NRSA grant recipients.

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.

Under section 117(b), only "qualified scholarships" may be excluded from income. A qualified scholarship means any amount received by an individual as a scholarship or fellowship grant to the extent that the amount was used 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 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. 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. Additionally, 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.

Sections 3101 and 3111 impose Federal Insurance Contributions Act (FICA) taxes on “wages,” as that term is defined in section 3121(a). Whether fellowship stipends are wages for employment tax purposes depends upon whether the payments are compensatory based upon the standards of section 117(c) and the regulations thereunder. See Notice 87-31, 1987-1 C.B. 475. Determining whether a particular research training 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 Taxpayer's research training programs are conducted substantially as described, we have determined that the training program stipends awarded thereunder do not represent compensation for services within the meaning of section 117(c) of the Code. The stipends 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 section 117(c). 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. Taxpayer'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 sections 3101, 3111, and 3121(a). Additionally, such amounts are not subject to section 3102 (relating to withholding under FICA).

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

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

Temporary or final regulations pertaining to one or more of the issues addressed in this ruling have not yet been adopted. Therefore, this ruling will be modified or revoked by the adoption of temporary or final regulations, to the extent the regulations are inconsistent with any conclusion in the letter ruling. See section 12.04 of Rev. Proc. 2005-1, 2005-1 I.R.B. 7, 57. However, when the criteria in section 12.05 of Rev. Proc. 2005-1 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 ruling should be maintained in the taxpayer's permanent records.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to the taxpayer.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

/s/ William A. Jackson

William A. Jackson
Branch Chief, Branch 5
(Income Tax & Accounting)

Enclosures:
Copy of this letter
Copy for section 6110 purposes
cc: