

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:ITA:04 – GENIN-119228-02

Date:

July 31, 2002

Dear [REDACTED]

This letter responds to correspondence you have sent the Internal Revenue Service concerning the proper tax treatment of a graduate fellowship received by your grandson, [REDACTED], in 2001.

Your inquiry, as amplified during a telephone conversation with [REDACTED] of this office, was whether your grandson had received an excludible "qualified scholarship" within the meaning of § 117 of the Internal Revenue Code, or whether instead he had received taxable income. We are providing you with general information on this subject.

Section 117(a) provides generally 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 § 170(b)(1)(A)(ii). Virtually all colleges and universities are included within the broad definition found in § 170(b)(1)(A)(ii).

Section 117(b)(1) provides that the term "qualified scholarship" means any amount received by an individual as a scholarship or fellowship grant to the extent the individual establishes that, in accordance with the conditions of the grant, such amount was used for qualified tuition and related expenses. Qualified tuition and related expenses are defined in § 117(b)(2) to include (A) tuition and fees that are required for the recipient's enrollment or attendance at an institution of higher education, and (B) amounts used to pay for fees, books, supplies, and equipment required for courses of instruction at such an institution.

Amounts received for "incidental expenses" are not "related expenses" and are thus not excludible under § 117. Section 1.117-5(c) of the Income Tax Regulations provides that "incidental expenses" include room and board at an institution of higher education.

Section 1.117-3(c) states that a fellowship grant generally means an amount paid or allowed to, or for the benefit of, an individual to aid him in the pursuit of study or research. If some portion of a grant amount received represents payment for teaching, research, or other services required of the student as a condition of receiving the fellowship, such portion generally must be included in the student's gross income under § 117(c).

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The following example illustrates the above rules. Assume that Student is enrolled in a graduate program at University, for which he receives a \$20,000 fellowship grant. Assume further that \$8,000 of the grant represents compensation for services, that the tuition for the year is \$14,000, that the cost of books, supplies, and equipment required for courses of instruction at University totals \$3,000, and Student's personal living expenses total \$5,000. In this situation, the \$8,000 compensation will be taxable. The remaining \$12,000 (\$20,000 grant minus \$8,000 compensation) will be tax exempt, because it is less than the \$17,000 total (\$14,000 plus \$3,000) spent by Student on "qualified tuition and related expenses."

If we suppose instead that Student is not required to perform services -- and therefore that none of the \$20,000 is compensation -- then Student can exclude \$17,000 of the \$20,000. The remaining \$3,000 (\$20,000 grant minus \$17,000 qualified tuition and related expenses) must be included in income. The \$5,000 of personal living expenses are "incidental expenses" that cannot be used to support the § 117(a) exclusion.

We hope the above general information will be helpful to you. If we may be of further assistance, please call [REDACTED] at the telephone number provided above.

Sincerely,

Robert A. Berkovsky
Branch Chief
Office of Associate Chief Counsel
(Income Tax & Accounting)