



History of the Tax Status of Scholarships

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Scholarships are one of the few forms of charitable giving which may subject the recipient to a tax liability, despite the donor deriving no personal, tangible benefit from the donation. For example, scholarships used to pay for room and board result in taxable income to the recipient, while contributions to a food bank or homeless shelter do not. Even tax-free scholarships used for tuition and required fees as well as books and supplies may displace federal funds by reducing the recipient's eligibility for need-based federal student aid. This taxing of the generosity of scholarship providers may provide a disincentive for the expansion of private scholarship programs.

Originally, the Internal Revenue Code of 1954 [ch. 736, 68A Stat. 38, August 16, 1954] provided for an unlimited exclusion from gross income for scholarships and fellowships received by a degree candidate for study at an educational institution, plus incidental amounts spent for travel, research, clerical help or equipment. There also were no restrictions on awards that represented fee for services.

In the case of an individual, gross income does not include ... any amount received ... as a scholarship at an educational institution, ... or ... as a fellowship grant, including the value of contributed services and accommodations, and any amount received to cover certain specified expenses which are incident to a scholarship or to a fellowship grant, but only to the extent that the amount is actually expended for the purposes enumerated therein.

The Internal Revenue Code of 1954 also provided an exclusion from income for non-degree candidates, capped at \$300 multiplied by the number of months of support, with a maximum lifetime exclusion of 36 months of support. To be excluded from income, the support for a non-degree candidate must have been provided by an educational institution, tax exempt 501(c)(3) organization or federal/state/local government agency, as opposed to the student's employer.

These rules were subsequently modified by a variety of amendments, the most significant of which occurred in 1986. Many of the amendments narrowed the exclusion from income for qualified scholarships.

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| 9/21/1961 | <i>The Fulbright-Hays Act</i> (P.L. 87-256) added several funding sources to the list of grantors for which a non-degree candidate could obtain an exclusion from income. These funding sources included foreign governments, international organizations and binational or multinational educational and cultural foundations. The changes were effective 1/1/1962. | Funding sources |
| 10/4/1976 | <i>The Tax Reform Act of 1976</i> (P.L. 94-455) clarified the definition of an educational institution. The changes were effective 1/1/1977. | Eligible institution |
| 12/17/1980 | <i>The Tax Treatment Extension Act of 1980</i> (P.L. 96-541) added a requirement that the portion of a scholarship or fellowship that represented pay for services was not excludable from income. | Fee for services |

However, the law included an exception if all degree candidates were required to provide such services (e.g., all Ph.D. candidates required to perform research and/or teaching duties). The changes were effective 1/1/1981.

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| 7/18/1984 | <p><i>The Deficit Reduction Act of 1984</i> (P.L. 98-369) added an exclusion from income for qualified tuition reduction plans (e.g., full or partial tuition waivers) provided to college employees, their spouses and dependents. Congress refused to specify that restricting benefits to just faculty is not discriminatory, forcing many colleges to provide similar benefits to staff to ensure that the plans would not be considered discriminatory. This change was effective for education furnished on or after 7/1/1985 for taxable years ending after that date.</p> | Tuition waivers |
| 10/22/1986 | <p><i>The Tax Reform Act of 1986</i> (P.L. 99-514) added several restrictions to the exclusion from income for scholarships and fellowships. The exclusion from income is only available to degree candidates. Non-degree candidates are no longer eligible. The exclusion from income no longer applies to any payments for teaching, research, or other services by the individual as a condition for receiving such a scholarship, regardless of whether the services were required of all degree candidates. (Congress also repealed a specific exception for federal employees who were receiving federal grants.) The law also no longer allows the portion of a scholarship or fellowship for living expenses to be excluded from income, even if the living stipend is used to pay for tuition. The scholarship or fellowship does not need to be specifically earmarked for tuition, required fees and course-related expenses (e.g., books, supplies and equipment), but if the terms of the grant preclude it from being used for such expenses (e.g., restricted to just living expenses, such as room and board), it cannot be excluded from income. Congress also dropped the provision for travel/research, assuming that these would be deductible as ordinary and necessary business expenses. The non-excludable portion of a scholarship or fellowship is treated as earned income. The changes were effective 1/1/1987. Prior law continued to apply to any scholarships or fellowships granted before 8/17/1986. The changes were estimated to increase tax revenues by \$8 million in 1987, \$64 million in 1988, \$130 million in 1989, \$160 million in 1990 and \$164 million in 1991.</p> | <p>Exclusion from income limited to degree candidates</p> <p>Fee for services</p> <p>Living expenses</p> <p>Travel & research</p> |
| 11/10/1988 | <p><i>The Technical and Miscellaneous Revenue Act of 1988</i> (P.L. 100-647) added an exclusion from income for qualified tuition reductions received by graduate students (as opposed to spouses and dependents) who work as teaching or research assistants for educational institutions. The relevant legislative</p> | Tuition reductions |

language appears in 26 USC 117(d)(5). This change was effective retroactively to 1/1/1988.

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| 11/8/1989 | <i>Increasing the Statutory Limit on the Public Debt</i> (P.L. 101-140) repealed sections 1151(b), (c), (d)(1) and (g) and sections 1011B(a)(22), (27) and (31) of the Tax Reform Act of 1986. The effect was as though the amendments appearing in 26 USC 117(d)(4) had never been made by P.L. 100-647. The repealed provisions allowed the exclusion of employees excluded from consideration under 26 USC 89(h), which was also repealed. | Eligible employees |
| 8/20/1996 | <i>The Small Business Job Protection Act of 1996</i> (P.L. 104-188) implemented a technical correction, replacing a reference to “section 132(f)” with a reference to “section 132(h)” in 26 USC 117(d)(2). | |
| 6/7/2001 | <i>The Economic Growth and Tax Relief Reconciliation Act of 2001</i> (P.L. 107-16) added an exception in 26 USC 117(c)(2) to the ban on fee for services for the National Health Service Corps Scholarship Program and the Armed Forces Health Professions Scholarships and Financial Assistance Program. This change was effective 1/1/2002 and sunsets on 12/31/2010. However, the expiration of the change was extended by Congress from 12/31/2010 to 12/31/2012 by the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 (P.L. 111-312). | Fee for services |

The current tax status of scholarships is specified in section 117 of the Internal Revenue Code of 1986 [26 USC 117].

Internal Revenue Code (26 USC 117): Qualified Scholarships

(a) General rule

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).

(b) Qualified scholarship

For purposes of this section—

(1) In general

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.

(2) Qualified tuition and related expenses

For purposes of paragraph (1), the term “qualified tuition and related expenses” means—

- (A) tuition and fees required for the enrollment or attendance of a student at an educational organization described in section 170 (b)(1)(A)(ii), and
- (B) fees, books, supplies, and equipment required for courses of instruction at such an educational organization.

(c) Limitation

(1) In general

Except as provided in paragraph (2), subsections (a) and (d) 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 qualified tuition reduction.

(2) Exceptions

Paragraph (1) shall not apply to any amount received by an individual under—

- (A) the National Health Service Corps Scholarship Program under section 338A(g)(1)(A) of the Public Health Service Act, or
- (B) the Armed Forces Health Professions Scholarship and Financial Assistance program under subchapter I of chapter 105 of title 10, United States Code.

(d) Qualified tuition reduction

(1) In general

Gross income shall not include any qualified tuition reduction.

(2) Qualified tuition reduction

For purposes of this subsection, the term “qualified tuition reduction” means the amount of any reduction in tuition provided to an employee of an organization described in section 170 (b)(1)(A)(ii) for the education (below the graduate level)

at such organization (or another organization described in section 170(b)(1)(A)(ii)) of —

(A) such employee, or

(B) any person treated as an employee (or whose use is treated as an employee use) under the rules of section 132 (h).

(3) Reduction must not discriminate in favor of highly compensated, etc.

Paragraph (1) shall apply with respect to any qualified tuition reduction provided with respect to any highly compensated employee only if such reduction is available on substantially the same terms to each member of a group of employees which is defined under a reasonable classification set up by the employer which does not discriminate in favor of highly compensated employees (within the meaning of section 414 (q)). For purposes of this paragraph, the term “highly compensated employee” has the meaning given such term by section 414 (q).

(4) [Repealed. Pub. L. 101–140, title II, § 203(a)(1), (2), Nov. 8, 1989, 103 Stat. 830]

(5) Special rules for teaching and research assistants

In the case of the education of an individual who is a graduate student at an educational organization described in section 170 (b)(1)(A)(ii) and who is engaged in teaching or research activities for such organization, paragraph (2) shall be applied as if it did not contain the phrase “(below the graduate level)”.

Regulations (26 CFR 1.117-1 through 1.117-5)

Note: Some of the regulations relate to earlier versions of the statute and have apparently not been updated to reflect current law.

§ 1.117-1 Exclusion of amounts received as a scholarship or fellowship grant.

(a) *In general.* Any amount received by an individual as a scholarship at an educational institution or as a fellowship grant, including the value of contributed services and accommodations, shall be excluded from the gross income of the recipient, subject to the limitations set forth in section 117(b) and § 1.117-2. The exclusion from gross income of an amount which is a scholarship or fellowship grant is controlled solely by section 117. Accordingly, to the extent that a scholarship or a fellowship grant exceeds the limitations of section 117(b) and § 1.117-2, it is includible in the gross income of the recipient notwithstanding the provisions of section 102 relating to exclusion from gross income of gifts, or section 74(b) relating to exclusion from gross income of certain prizes and awards. For definitions, see § 1.117-3.

(b) *Exclusion of amounts received to cover expenses.* (1) Subject to the limitations provided in subparagraph (2) of this paragraph, any amount received by an individual to cover expenses for travel (including meals and lodging while traveling and an allowance for travel of the individual's family), research, clerical help, or equipment is excludable from gross income provided that such expenses are incident to a scholarship or fellowship grant which is excludable from gross income under section 117(a)(1). If, however, only a portion of a scholarship or fellowship grant is excludable from gross income under section 117(a)(1) because of the part-time employment limitation contained in section 117(b)(1) or because of the expiration of the 36-month period described in section 117(b)(2)(B), only the amount received to cover expenses incident to such excludable portion is excludable from gross income. The requirement that these expenses be incident to the scholarship or the fellowship grant means that the expenses of travel, research, clerical help, or equipment must be incurred by the individual in order to effectuate the purpose for which the scholarship or the fellowship grant was awarded.

(2)(i) In the case of a scholarship or fellowship grant which is awarded after July 28, 1956, the exclusion provided under subparagraph (1) of this paragraph is not applicable unless the amount received by the individual is specifically designated to cover expenses for travel, research, clerical help, or equipment.

(ii) In the case of a scholarship or fellowship grant awarded before July 29, 1956, the exclusion provided under subparagraph (1) of this paragraph is not applicable unless the recipient establishes, by competent evidence, that the amount was received to cover expenses for travel, research, clerical help, or equipment, but such amount need not be specifically designated. The fact that the recipient actually incurred expenses for travel, research, clerical help, or equipment is not sufficient to establish that the amount was received to cover such expenses.

(iii) The exclusion provided under subparagraph (1) of this paragraph is applicable only to the extent that the amount received for travel, research, clerical help, or equipment is actually

expended for such expenses by the recipient during the term of the scholarship or fellowship grant and within a reasonable time before and after such term.

(3) The portion of any amount received to cover the expenses described in subparagraph (1) of this paragraph which is not actually expended for such expenses within the exclusion period described in subparagraph (2) of this paragraph shall, if not returned to the grantor within this period, be included in the gross income of the recipient for the taxable year in which such exclusion period expires.

§ 1.117-2 Limitations.

(a) *Individuals who are candidates for degrees* — (1) *In general.* Under the limitations provided by section 117(b)(1) in the case of an individual who is a candidate for a degree at an educational institution, the exclusion from gross income shall not apply (except as otherwise provided in subparagraph (2) of this paragraph) to that portion of any amount received as payment for teaching, research, or other services in the nature of part-time employment required as a condition to receiving the scholarship or fellowship grant. Payments for such part-time employment shall be included in the gross income of the recipient in an amount determined by reference to the rate of compensation ordinarily paid for similar services performed by an individual who is not the recipient of a scholarship or a fellowship grant. A typical example of employment under this subparagraph is the case of an individual who is required, as a condition to receiving the scholarship or the fellowship grant, to perform part-time teaching services. A requirement that the individual shall furnish periodic reports to the grantor of the scholarship or the fellowship grant for the purpose of keeping the grantor informed as to the general progress of the individual shall not be deemed to constitute the performance of services in the nature of part-time employment.

(2) *Exception.* If teaching, research, or other services are required of all candidates (whether or not recipients of scholarships or fellowship grants) for a particular degree as a condition to receiving the degree, such teaching, research, or other services on the part of the recipient of a scholarship or fellowship grant who is a candidate for such degree shall not be regarded as part-time employment within the meaning of this paragraph. Thus, if all candidates for a particular education degree are required, as part of their regular course of study or curriculum, to perform part-time practice teaching services, such services are not to be regarded as part-time employment within the meaning of this paragraph.

(b) *Individuals who are not candidates for degrees* — (1) *Conditions for exclusion.* In the case of an individual who is not a candidate for a degree at an educational institution, the exclusion from gross income of an amount received as a scholarship or a fellowship grant shall apply (to the extent provided in subparagraph (2) of this paragraph) only if the grantor of the scholarship or fellowship grant is—

(i) An organization described in section 501(c)(3) which is exempt from tax under section 501(a),

(ii) The United States or an instrumentality or agency thereof, or a State, a territory, or a possession of the United States, or any political subdivision thereof, or the District of Columbia, or

(iii) For taxable years beginning after December 31, 1961, a foreign government, an international organization, or a binational or multinational educational and cultural foundation or commission created or continued pursuant to section 103 of the Mutual Educational and Cultural Exchange Act of 1961 (22 U.S.C. 2453).

(2) *Extent of exclusion.* (i) In the case of an individual who is not a candidate for a degree, the amount received as a scholarship or a fellowship grant which is excludable from gross income under section 117(a)(1) shall not exceed an amount equal to \$300 times the number of months for which the recipient received amounts under the scholarship or fellowship grant during the taxable year. In determining the number of months during the period for which the recipient received amounts under a scholarship or fellowship grant, computation shall be made on the basis of whole calendar months. A whole calendar month means a period of time terminating with the day of the succeeding month numerically corresponding to the day of the month of its beginning, less one, except that if there be no corresponding day of the succeeding month the period terminates with the last day of the succeeding month. For purposes of this computation a fractional part of a calendar month consisting of a period of time including 15 days or more shall be considered to be a whole calendar month and a fractional part of a calendar month consisting of a period of time including 14 days or less shall be disregarded. For example, if an individual receives a fellowship grant on September 13 which is to expire on June 12 of the following year, the grant shall be considered to have extended for a period of 9 months. If in the preceding example the grant expired on June 27, instead of June 12, the grant shall be considered to have extended for a period of 10 months.

(ii) No exclusion shall be allowed under section 117(a)(1) to an individual who is not a candidate for a degree after the recipient has, as an individual who is not a candidate for a degree, been entitled to an exclusion under that section for a period of 36 months. This limitation applies if the individual has received any amount which was either excluded or excludable from his gross income under section 117(a)(1) for any prior 36 months, whether or not consecutive. For example, if the individual received a fellowship grant of \$7,200 for 3 years (which he elected to receive in 36 monthly installments of \$200), his exclusion period would be exhausted even though he did not in any of the 36 months make use of the maximum exclusion. Accordingly, such individual would be entitled to no further exclusion from gross income with respect to any additional grants which he may receive as an individual who is not a candidate for a degree.

(iii) If an individual who is not a candidate for a degree receives amounts from more than one scholarship or fellowship grant during the taxable year, the total amounts received in the taxable year shall be aggregated for the purpose of computing the amount which may be excludable from gross income for such taxable year. If amounts are received from more than one scholarship or fellowship grant during the same month or months within the taxable year, such month or months shall be counted only once for the purpose of determining the number of months for which the individual received such amounts under the scholarships or fellowship grants during the taxable year. For example, if an individual receives a fellowship grant from one source for

the months of January to June of the taxable year and also receives a fellowship grant from another source for the months of March through December of the same taxable year, he shall be considered to have received amounts for 12 months of the taxable year. See example (4) in subparagraph (3) of this paragraph for further illustration.

(3) *Examples.* The application of this paragraph may be further illustrated by the following examples, it being assumed that in each example the grantor is a grantor who is described in section 117(b)(2)(A) and subparagraph (1) of this paragraph:

Example 1. B, an individual who files his return on the calendar year basis, is awarded a post-doctorate fellowship grant in March 1955. The grant is to commence on September 1, 1955, and is to end on May 31, 1956, so that it will extend over a period of 9 months. The amount of the fellowship grant is \$4,500 and B receives this amount in monthly installments of \$500 on the first day of each month commencing September 1, 1955. During the taxable year 1955, B receives a total of \$2,000 with respect to the 4-month period September through December, inclusive. He may exclude \$1,200 from gross income in the taxable year 1955 ($\$300 \times 4$) and must include the remaining \$800 in gross income for that year. For the year 1956, he will exclude \$1,500 ($\300×5) from gross income with respect to the \$2,500 which he receives in that year and must include in gross income \$1,000.

Example 2. Assume the same facts as in example (1) except that B receives the full amount of the grant (\$4,500) on September 1, 1955. Since the amount received in the taxable year 1955 is for the full term of the fellowship grant (9 months), B may exclude \$2,700 ($\300×9) from gross income for the taxable year 1955. The remaining \$1,800 must be included in gross income for that year.

Example 3. C, an individual who files his return on the calendar year basis, is awarded a post-doctorate fellowship grant in March 1955. The amount of the grant is \$4,500 for a period commencing on September 1, 1955, and ending 24 months thereafter. C receives the full amount of the grant on September 1, 1955. C may exclude from gross income for the taxable year 1955, the full amount of the grant (\$4,500) since this amount does not exceed an amount equal to \$300 times the number of months (24) for which he received the amount of the grant during that taxable year.

Example 4. (i) F, an individual who files his return on the calendar year basis, is awarded a post-doctorate fellowship grant (Grant A) for two years commencing June 1, 1955, in the amount of \$4,800. He elects to receive his grant in monthly installments of \$200 commencing June 1, 1955. On March 1, 1956, F is awarded another post-doctorate fellowship grant (Grant B) for two years commencing September 1, 1956, in the amount of \$7,200. He elects to receive this grant in monthly installments of \$300 commencing September 1, 1956.

(ii) For the calendar year 1955, F receives \$1,400 from Grant A which he is entitled to exclude from gross income since it does not exceed an amount equal to \$300 times the number of months (7) for which he received amounts under the grant in the taxable year.

(iii) For the calendar year 1956, F receives \$3,600 as the aggregate of amounts received under fellowship grants (\$2,400 from Grant A and \$1,200 from Grant B). F will be entitled to exclude the entire amount of \$3,600 from gross income for the calendar year 1956 since such amount does not exceed an amount equal to \$300 times the number of months (12) for which he received amounts under the grants in the taxable year.

(iv) For the calendar year 1957, F receives \$4,600 as the aggregate of amounts received under fellowship grants (\$1,000 from Grant A and \$3,600 from Grant B). F will be entitled to exclude \$3,600 ($\300×12) from gross income for the calendar year 1957 and he will have to include \$1,000 in gross income.

(v) For the calendar year 1958, F receives \$2,400 from Grant B. F is entitled to exclude \$1,500 ($\300×5) from gross income for the calendar year 1958 and he will have to include \$900 in gross income. While F receives amounts under fellowship Grant B for 8 months during the calendar year 1958, he is limited to an amount equal to \$300 times

5 (months) because of the fact that he has already been entitled to exclude (and has in fact excluded) amounts received as a fellowship grant for a period of 31 months. Accordingly, he can only exclude amounts received under the fellowship grant for 5 months during the calendar year 1958, because of the 36-month limitation period. The fact that he was entitled to exclude only \$1,400 (\$200 a month for 7 months) instead of the maximum amount of \$2,100 (\$300×7) in 1955, is immaterial and the limitation period of 36 months is applicable.

(vi) The following chart illustrates the computation of the number of months for which F received amounts under the fellowship grants during the respective taxable years and the computation of the total amounts received under the fellowship grants during each taxable year:

| Period for which received and source | Number of months | Amounts received |
|--------------------------------------|------------------|------------------|
| 1955: | | |
| June 1 to December 31 | 7 | |
| Grant A | | \$1,400 |
| Grant B | | None |
| Aggregate | 7 | 1,400 |
| 1956: | | |
| January 1 to August 31 | 8 | |
| Grant A | | 1,600 |
| Grant B | | None |
| September 1 to December 31 | 4 | |
| Grant A | | 800 |
| Grant B | | 1,200 |
| Aggregate | 12 | 3,600 |
| 1957: | | |
| January 1 to May 31 | 5 | |
| Grant A | | 1,000 |
| Grant B | | 1,500 |
| June 1 to December 31 | 7 | |
| Grant A | | None |
| Grant B | | 2,100 |
| Aggregate | 12 | 4,600 |
| 1958: | | |
| January 1 to August 31 | 8 | |
| Grant A | | None |
| Grant B | | 2,400 |
| Aggregate | | 2,400 |

[T.D. 6500, 25 FR 11402, Nov. 26, 1960, as amended by T.D. 6782, 29 FR 18355, Dec. 24, 1964]

§ 1.117-3 Definitions.

(a) *Scholarship*. A scholarship generally means an amount paid or allowed to, or for the benefit of, a student, whether an undergraduate or a graduate, to aid such individual in pursuing his

studies. The term includes the value of contributed services and accommodations (see paragraph (d) of this section) and the amount of tuition, matriculation, and other fees which are furnished or remitted to a student to aid him in pursuing his studies. The term also includes any amount received in the nature of a family allowance as a part of a scholarship. However, the term does not include any amount provided by an individual to aid a relative, friend, or other individual in pursuing his studies where the grantor is motivated by family or philanthropic considerations. If an educational institution maintains or participates in a plan whereby the tuition of a child of a faculty member of such institution is remitted by any other participating educational institution attended by such child, the amount of the tuition so remitted shall be considered to be an amount received as a scholarship.

(b) *Educational organization.* For definition of “educational organization” paragraphs (a) and (b) of section 117 adopt the definition of that term which is prescribed in section 151(e)(4). Accordingly, for purposes of section 117 the term “educational organization” means only an educational organization which normally maintains a regular faculty and curriculum and normally has a regularly organized body of students in attendance at the place where its educational activities are carried on. See section 151(e)(4) and regulations thereunder.

(c) *Fellowship grant.* 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. The term includes the value of contributed services and accommodations (see paragraph (d) of this section) and the amount of tuition, matriculation, and other fees which are furnished or remitted to an individual to aid him in the pursuit of study or research. The term also includes any amount received in the nature of a family allowance as a part of a fellowship grant. However, the term does not include any amount provided by an individual to aid a relative, friend, or other individual in the pursuit of study or research where the grantor is motivated by family or philanthropic considerations.

(d) *Contributed services and accommodations.* The term “contributed services and accommodations” means such services and accommodations as room, board, laundry service, and similar services or accommodations which are received by an individual as a part of a scholarship or fellowship grant.

(e) *Candidate for a degree.* The term “candidate for a degree” means an individual, whether an undergraduate or a graduate, who is pursuing studies or conducting research to meet the requirements for an academic or professional degree conferred by colleges or universities. It is not essential that such study or research be pursued or conducted at an educational institution which confers such degrees if the purpose thereof is to meet the requirements for a degree of a college or university which does confer such degrees. A student who receives a scholarship for study at a secondary school or other educational institution is considered to be a “candidate for a degree.”

[T.D. 6500, 25 FR 11402, Nov. 26, 1960; 25 FR 14021, Dec. 21, 1960, as amended by T.D. 8032, 50 FR 27232, July 2, 1985]

§ 1.117-4 Items not considered as scholarships or fellowship grants.

The following payments or allowances shall not be considered to be amounts received as a scholarship or a fellowship grant for the purpose of section 117:

(a) *Educational and training allowances to veterans.* Educational and training allowances to a veteran pursuant to section 400 of the Servicemen's Readjustment Act of 1944 (58 Stat. 287) or pursuant to 38 U.S.C. 1631 (formerly section 231 of the Veterans' Readjustment Assistance Act of 1952).

(b) *Allowances to members of the Armed Forces of the United States.* Tuition and subsistence allowances to members of the Armed Forces of the United States who are students at an educational institution operated by the United States or approved by the United States for their education and training, such as the United States Naval Academy and the United States Military Academy.

(c) *Amounts paid as compensation for services or primarily for the benefit of the grantor.* (1) Except as provided in paragraph (a) of §§1.117-2 and 1.117-5, any amount paid or allowed to, or on behalf of, an individual to enable him to pursue studies or research, if such amount represents either compensation for past, present, or future employment services or represents payment for services which are subject to the direction or supervision of the grantor.

(2) Any amount paid or allowed to, or on behalf of, an individual to enable him to pursue studies or research primarily for the benefit of the grantor.

However, amounts paid or allowed to, or on behalf of, an individual to enable him to pursue studies or research are considered to be amounts received as a scholarship or fellowship grant for the purpose of section 117 if the primary purpose of the studies or research is to further the education and training of the recipient in his individual capacity and the amount provided by the grantor for such purpose does not represent compensation or payment for the services described in subparagraph (1) of this paragraph. Neither the fact that the recipient is required to furnish reports of his progress to the grantor, nor the fact that the results of his studies or research may be of some incidental benefits to the grantor shall, of itself, be considered to destroy the essential character of such amount as a scholarship or fellowship grant.

[T.D. 6500, 25 FR 11402, Nov. 26, 1960; 25 FR 14021, Dec. 21, 1960, as amended by T.D. 8032, 50 FR 27232, July 2, 1985]

§ 1.117-5 Federal grants requiring future service as a Federal employee.

(a) *In general.* Under section 117(c), amounts received by an individual under a Federal program as a scholarship or grant for qualified tuition and expenses at an institution of higher education are excluded from the gross income of the recipient even though the recipient is required to perform future service as a Federal employee. See paragraph (c) of this section for the definitions of the terms “qualified tuition and expenses” and “institution of higher education.”

(b) *Exception for uniformed services scholarship programs.* The requirements of this section do not apply to amounts received before 1985 by a member of a uniformed service who entered training before 1981 under the Armed Forces Health Professions Scholarship Program, National Public Health Service Corps Scholarship Training Program, or other substantially similar Federal programs requiring the recipient to work for a uniformed Federal service after completion of studies. These awards are governed by section 4 of Pub. L. 93–483 as amended by Pub. L. 95–171, Pub. L. 95–600 and Pub. L. 96–167. See section 101(3) of title 37, United States Code for the definition of the term “uniformed service.”

(c) *Definitions* — (1) *Qualified tuition and related expenses.* For purposes of section 117(c) and this section, qualified tuition and related expenses are those amounts which under the terms of the Federal program are required to be used and in fact are used for payment of:

(i) Tuition and fees that are required for the recipient's enrollment or attendance at an institution of higher education; and

(ii) Those amounts used for payment of fees, books, supplies and equipment required for courses of instruction at such an institution.

Incidental expenses are not considered related expenses and thus are not excludable from gross income under section 117(c). Incidental expenses include room and board at an institution of higher education, expenses for travel (including expenses for meals and lodging incurred during travel and allowances for travel of the recipient's family), research, clerical help, equipment and other expenses which are not required for enrollment at the institution or in a course of instruction at such institution.

(2) *Institution of higher education.* To qualify as an institution of higher education under this section, the institution must be a public or other nonprofit institution in any state which—

(i) Admits as regular students only individuals who have a certificate of graduation from a high school or the recognized equivalent of such a certificate;

(ii) Is legally authorized within the state to provide a program of education beyond high school; and

(iii) Provides an education program for which it awards a bachelor's or higher degree or which is acceptable for full credit towards such a degree, or which trains and prepares students for gainful employment in a recognized health profession. For purposes of this section, recognized health professions are those health professions which are supervised or monitored by appropriate state or Federal agencies or governing professional associations and which require members to be currently licensed or certified in order to practice.

(3) *Service as a Federal employee* — (i) *In general.* Except as otherwise provided in paragraph (c)(3)(ii) of this section, service as a Federal employee refers to employment of the recipient by the Federal government to work directly for the Federal government. Thus, Federal grants or

scholarships which do not require the recipient to work directly for the Federal government are not governed by the rules of this section.

(ii) *Service in a health manpower shortage area.* For purposes of this section an obligation under a grant for the recipient to serve in a health related field in a health manpower shortage area as designated by the Secretary of Health and Human Services according to the criteria of the Public Health Services Act (42 U.S.C. 254(e)) and the regulations promulgated thereunder (42 CFR 5.1–5.4) will be considered an obligation to serve as a Federal employee.

(d) *Records required for exclusion from gross income.* To exclude amounts received under Federal programs requiring future services as a Federal employee, the recipient must maintain records that establish that the amounts received under such programs were used for qualified tuition and related expenses as defined in paragraph (c)(1) of this section. Qualifying uses may be established by providing to the Service, upon request, copies of relevant bills, receipts, cancelled checks or other convenient documentation or records which clearly reflect the use of the money received under the grant. The recipient must also submit, upon request, documentation establishing receipt of the grant and setting out the terms and requirements of the particular grant.

(e) *Applicability of rules of §§117(a) and 117(b).* Except where a different rule has been expressly provided in this section, amounts received under Federal grants requiring future service as a Federal employee, and which meet the requirements for exclusion from gross income under this section, are subject to the rules, limitations and definitions specified in §§117 (a) and (b) of the Code and §§1.117–1 through 1.117–4.

(f) *Effective date.* Except as provided in paragraph (b) of this section, this section will apply to amounts received after December 31, 1980 under Federal programs which meet the requirements of this section.

[T.D. 8032, 50 FR 27232, July 2, 1985]