



## Appeal of Charles B. and Irene L. Larkin

The question presented is whether certain payments received by Charles B. Larkin, hereinafter referred to as appellant, are excludable from gross income as a scholarship or fellowship grant.

Appellant is a physician who specialized in internal medicine for many years prior to 1964. In that year he accepted employment with the State of California, and two years later, in June 1966, he contracted with the California Department of Mental Hygiene to take part in that agency's career resident training program. Under this contract appellant was to receive three years of resident training in psychiatry at Patton State Hospital. In return, he agreed to work for three additional years as a staff psychiatrist at a state hospital.

Appellant entered the program at Patton State Hospital on July 1, 1966. During his first year there about half his time was spent attending lectures. The remainder was spent in on-the-job training, which required appellant to make rounds of wards with a psychiatrist and to assist in treating patients. Also, under supervision, appellant conducted physical and psychiatric examinations, interviewed patients and their relatives, and compiled case histories. He independently performed routine medical and psychiatric work. During the second and third years of the program the formal academic training was reduced and appellant spent more time in the actual treatment of patients.

After completing his residency at Patton State Hospital, appellant was accepted for a "clinical fellowship in neurology" at the University of Southern California - Los Angeles County Medical Center (the Medical Center). This fellowship was administered by the California Department of Mental Hygiene, and was funded through a grant to that agency from the National Institutes of Health. As a prerequisite to receiving the fellowship, appellant agreed to work one year for the State of California for each year of training.

Appellant's training at the Medical Center lasted from July 1, 1969, until June 30, 1971. While there his duties included the direct care and treatment of patients; supervision and teaching of medical students and interns, interpreting electroencephalograms, and carrying out specialized neurological procedures. This work was performed under the direct supervision of the attending staff and clinical professors of the University of Southern California Medical School.

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Throughout his years at Patton State Hospital and at the Medical Center, the State of California considered appellant an employee of the Department of Mental Hygiene. He received monthly payments from that agency, totaling at least \$25,000 per year, which the State Personnel Board characterized as a "salary." Appellant reported the payments received during the years in question on his state personal income tax returns, but he also claimed a \$300 per month exclusion from gross income on the theory that the payments were a "fellowship." Respondent disallowed the exclusion and this appeal followed;

Revenue and Taxation Code section 17150 allows an exclusion from gross income, subject to certain limitations, for amounts received as scholarship or fellowship grants. The terms "scholarship" and "fellowship" are not defined in the statute. The regulations issued thereunder provide, however, that amounts paid as "compensation for past, present, or future employment services" or as "payment for services which are subject to the direction or supervision of the grantor" may not be considered a scholarship or fellowship. (Cal. Admin. Code, tit. 18, reg. 17150(d), subd. (3).) The regulations thus adopt the common understanding of scholarships and fellowships as disinterested grants made primarily to further the education of the recipient, with no requirement of any substantial quid pro quo. (Johnson, 394 U.S. 741, 751 [22 L.Ed. 2d 695]; Robert W. Wilde, 383 F.2d 386, 387. ) Such no-strings payments are distinguished from those made primarily to reward or induce the recipient's performance of services for the benefit of the grantor. (See Elmer L. Reese, Jr., 45 T.C. 407, 411, aff'd per curiam, 373 F. 2d 742.)

In this case, the career resident program at Patton State Hospital and the clinical fellowship in neurology at the Medical Center undeniably benefited the Department of Mental Hygiene. In order to participate in those programs, appellant had to promise to continue working in state hospitals for a number of years. Moreover, while undergoing his training, appellant was required to examine and treat patients, help teach medical students, and perform various other medical tasks. These were valuable services which would otherwise presumably have been left to the regular medical staff of Patton State Hospital or the Medical Center.

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In short, the payments made to appellant did not flow from a disinterested desire to further appellant's education, but rather were conditioned upon the performance of services and a promise to continue working for the state.

It is true that appellant derived significant educational benefits from the career resident program and the clinical fellowship, possibly at the cost of great personal sacrifice. There is nothing in section 17150, however, which requires that payments for services be excluded from gross income merely because the recipient has advanced his education. The crucial factor here is that the payments were made in such a manner and upon such conditions as to ensure that they would provide a staff of trained physicians for California's state hospitals. It thus appears that the primary purpose of the career resident and fellowship programs was to benefit the Department of Mental Hygiene, and that the education which appellant received was incidental to that purpose. (See Robert W. Willie, supra; Joseph D. Woddail, T. C. Memo., Oct. 2, 1962, aff'd, 321 F. 2d 721.)

Appellant points out, however, that the clinical fellowship at the Medical Center was funded by a grant from the National Institutes of Health. He apparently contends that the National Institutes of Health was the grantor of fellowship, not the Department of Mental Hygiene, and that the payments he received were therefore not primarily for the benefit of the grantor. We disagree. The National Institutes of Health grant was awarded to the Department of Mental Hygiene, not directly to appellant. Appellant received the payments in question from the Department of Mental Hygiene. Under these circumstances, we must conclude that that agency was the grantor of the payments. (Frederick Fisher, 56 T. C. 1201, 1214.)

For the above reasons we conclude that the payments which appellant received from the Department of Mental Hygiene were made primarily for the benefit of the grantor, and that they were not a scholarship or fellowship. We therefore sustain respondent's action.

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ORDER

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Charles B. and Irene L. Larkin against proposed assessments of additional personal income tax in the amounts of \$278.00 and \$400.00 for the years 1969 and 1970, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 22nd day of June, 1976, by the State Board of Equalization.

William W. Bennett, Chairman  
George C. Freely, Member  
Robert Stein, Member  
Mrs. Sankey, Member  
\_\_\_\_\_, Member

ATTEST: W. W. Dunlop, Executive Secretary