

BEFORE THE STATE BOARD OF **EQUALIZATION**  
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of )  
WILLIAM M. AND )  
BARBARA R. CLOVER )

Appearances:

For Appellants: Vinson **Brice**  
Attorney at Law  
  
Charles J. **Perman**  
Certified Public Accountant  
  
For Respondent: James T. **Philbin**  
Supervising Counsel

O P I N I O N

This appeal is made pursuant to section 18594 of the Revenue and Taxation Code on the protest of William M. and Barbara R. Clover against proposed assessments of additional personal income tax in the amounts of **\$179.99** and \$360.00 for the years 1969 and 1970, respectively.

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The sole issue is whether certain payments received by William M. Clover, hereinafter referred to as appellant, are excludable from gross income as a scholarship or fellowship grant.

Appellant is a physician who has been employed in that capacity by the State of California since 1961. In 1969, appellant applied to and was accepted by the California State Department of Mental Hygiene to participate in a two-year clinical fellowship in neurology at the Los Angeles County-University of Southern California 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 entered into a contract agreeing to work an additional two years for the State of California in exchange for the training. Appellant's training at the Medical Center lasted from June 1, 1969, through June 30, 1971. During his training, appellant maintains that his primary responsibility was educational, that he had no responsibility for the direct care and treatment of patients, and that he performed no other services.

Prior to his training at the Medical Center, appellant was classified as a senior psychiatrist by the State of California. During the course of his training, he received a monthly salary exceeding \$2,000 which was the salary of a senior psychiatrist at that time. Upon completion of his clinical fellowship in neurology, appellant was promoted to a medical director at a California state hospital. 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.

With respect to recipients who are not candidates for a degree, section 17150 of the Revenue and Taxation Code allows an exclusion from gross income, subject to certain limitations, for amounts received as scholarship or fellowship grants. The exclusion is limited to \$300 times the number of months for which the recipient

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received a grant during each taxable year with a maximum limitation of 36 months. For recipients who are candidates for a degree there is no monetary limitation. The terms "scholarship" and "fellowship" are not defined in the statute. The applicable regulations 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. 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 generally Appeal of Charles B. and Irene L. Larkin, Cal. St. Bd. Of Equal., June 22, 1976.)

Initially, appellant argues that he was "in substance a candidate for a degree" and that the certificate received from the Medical Center upon completion of his neurology training was "equivalent to a degree." From this appellant concludes that he should be allowed to deduct all of the amounts received from the State **du.ing** the course of his training. The regulations define the term "candidate for a degree" as "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." (Cal. Admin. Code, tit. 18, reg. **17150(c)**, subd. **(5)**.) It is readily apparent from the record that appellant was not "pursuing studies or conducting research to meet the requirements for an academic or professional degree" and, therefore, was not a candidate for a degree. In fact, appellant does not contend otherwise, merely alleging that "in substance" he was a candidate for a degree. We find this argument without merit.

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Next, stressing the fact that he was **required to** perform no services during the course of his training., appellant argues **that** he should be allowed to claim the \$300 monthly exclusion from his gross income. It is not sufficient, however, to predicate the claimed exclusion upon the absence of services performed by appellant during the tenure of his training. **As noted above, the** regulations clearly provide that amounts paid as compensation for past, present, or future employment **services** may not be considered a scholarship or fellowship. In this case, the clinical fellowship in neurology undeniably benefited the Department of Mental Hygiene. In order to participate in the program, appellant had to agree to continue to work in a state hospital for a number of **years** upon completion of his training. In short, the payments made to appellant did not flow from a disinterested desire to further appellant's education, but rather were conditional upon the-agreement to perform future services for the state.

**There is no doubt** that appellant derived substantial educational benefits from the clinical fellowship, perhaps even at the cost of great personal sacrifice. **Nevertheless,** there is nothing in section 17150 which requires **that** payment for services be excluded from gross income merely because the recipient has advanced his education. The critical factor in this appeal is that the payments were **made in such a manner and upon such condition as to ensure that they would provide California's state hospitals with a staff of trained physicians.** Thus, we conclude that the primary purpose of the fellowship program was to benefit the Department of Mental Hygiene, and that the education which appellant received was incidental to that purpose. (See Binqler v. Johnson, 394 U.S. 741 [22 L. Ed. 2d 695] (1969); Ehrhart v. Commissioner, 57 T.C. 872 (1972), aff'd, 470 F.2d 940 (1st Cir. 1973); MacDonald v. Commissioner, 52 T.C. 386 (1969); see also Appeal of Charles B. and Irene L. Larkin, supra.)

In support of his position, appellant relies on three cases. Wrobleski v. Binqler, 161 F. Supp. 901 (W.D. Pa. 1958); Bailey v. Commissioner, 60 T.C. 447 (1973); Bieberdorf v. Commissioner, 60 T.C. 114 (1973).)

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All three of these cases are readily distinguishable from the instant **appeal** by the absence of a contractual obligation or other clear expectation that the recipient would continue in the employment of the grantor.

For the above reasons we conclude that the payments received by appellant were not excludable, in whole or in part, as a scholarship or fellowship. Accordingly, respondent's action must be sustained.

O R D E R

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 William M. and Barbara R. Clover against proposed **assessments** of additional personal income tax in the amounts of \$179.99 and \$360.00 for the years 1969 and 1970, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this **10th day** of May, 1977, by the State Board of Equalization.

*Jim Burgett*, Chairman  
*Paul Dean*, Member  
*Chas. P. Kelly*, Member  
*Mrs. Sankey*, Member  
\_\_\_\_\_, Member

ATTEST: *W. W. Bell*, Executive Secretary