OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of: **SKY J. WOLF**	OTA Case No. 18010816 Date Issued: February 20, 2019

OPINION

Representing the Parties:

For Appellant:	Edward I. Kaplan, Greene Radovsky Maloney Share & Hennigh LLP
For Respondent:	Parviz T. Iranpour, Tax Counsel
For Office of Tax Appeals:	Josh Lambert, Tax Counsel

A. ROSAS, Administrative Law Judge: Pursuant to Revenue and Taxation Code section 19045, appellant Sky J. Wolf (Appellant) appeals an action by respondent Franchise Tax Board (FTB) proposing additional tax of $4,232 plus applicable interest for the 2010 tax year. Appellant waived her right to an oral hearing, and therefore we decide this matter based on the written record.

ISSUE

Appellant received a $45,000 grant from the U.S. Air Force Reserve Pay Office. The issue presented is whether Appellant has established that she is entitled to exclude this grant from her gross income, pursuant to Internal Revenue Code (IRC) section 117.[1]

FACTUAL FINDINGS

1. Appellant was a California resident during the 2010 tax year. Following her completion of medical school, in 2010 she and the U.S. Air Force entered into a contract titled "Financial Assistance Program (FAP) for Physicians/Dentists in Specialized Training."

[1] California conforms to IRC section 117 pursuant to Revenue and Taxation Code (R&TC) section 17131. Further statutory references are to the Internal Revenue Code, unless otherwise noted.

2. In 2010, Appellant worked in the medical field and received a total of $107,571.98 in wages: $38,590.98 in medical residency wages from U.C. San Diego, and $68,980 in "Reserve Pay" from the Air Force Reserve Pay Office. Of the "Reserve Pay," $45,000 was an annual grant and $23,980 was a stipend. The Air Force Reserve Pay Office withheld federal and California income taxes from both amounts.
3. The Air Force FAP's specialized training program required Appellant to complete her medical residency at U.C. San Diego Health, a teaching hospital. In 2010, Appellant was concurrently a U.S. Air Force Reservist and a medical resident at U.C. San Diego Health, where she received specialized on-the-job training in preventative medicine directed toward board certification.
4. As a condition of the annual grant, Appellant agreed to serve 2 ½ years on extended active duty and 5 ½ years in the Individual Ready Reserve. The FAP contract states the Air Force would pay Appellant a "taxable annual grant." The contract also states, "[t]he grant, stipend, base pay, and special pay are subject to Federal Income tax."
5. In her timely filed 2010 California income tax return, Appellant eliminated both the $23,980 stipend and the $45,000 annual grant from her California taxable income.[2]
6. There is no evidence that she used the $45,000 grant, in whole or in part, for payment of tuition, fees, books, supplies, or equipment required for courses of instruction.
7. FTB issued a Notice of Proposed Assessment (NPA), which, among other things, added $45,000 to Appellant's taxable income and proposed additional tax of $4,232.[3]
8. Appellant timely protested the NPA. After FTB issued a Notice of Action affirming the NPA, Appellant filed this timely appeal.

DISCUSSION

FTB's determination of tax is presumed to be correct, and a taxpayer has the burden of proving error. (*Todd v. McColgan* (1949) 89 Cal.App.2d 509.) Generally, the applicable burden of proof is by a preponderance of the evidence. (Evid. Code, § 115; *Appeal of Estate of Gillespie*, 2018-OTA-052P, June 13, 2018, at p. *4.) That is, a party must establish by

[2] Only the $45,000 grant (not the $23,980 stipend) is at issue in this appeal. FTB stated that it did not include the $23,980 in the proposed assessment calculation because of an administrative error.

[3] The NPA also adjusted Appellant's federal adjusted gross income (AGI) as reported on her California return ($81,454), making it equal to the amount reported on her federal return ($83,590).

documentation or other evidence that the circumstances it asserts are more likely than not to be correct. (*Concrete Pipe and Products of California, Inc. v. Construction Laborers Pension Trust for Southern California* (1993) 508 U.S. 602, 622.) However, unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (*Appeal of Magidow*, 82-SBE-274, Nov. 17, 1982.)

California generally conforms to the definition of "gross income" contained in IRC section 61. (Rev. & Tax. Code, § 24271(a).) Section 61(a) provides, in part, that "[e]xcept as otherwise provided . . . gross income means all income from whatever source derived." Section 117(a) excludes from the definition of gross income "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)." Thus, to prevail in this appeal, Appellant must establish that she (1) received a "qualified scholarship," and (2) was a "candidate for a degree at an educational organization described in section 170(b)(1)(A)(ii)." Although she must satisfy both requirements, Appellant has not satisfied either of these requirements.

The "qualified scholarship" requirement:

"The term 'qualified scholarship' means any amount received by an individual as a scholarship or fellowship grant *to the extent that the individual establishes that . . . such amount was used for qualified tuition and related expenses*." (§ 117(b)(1), emphasis added.) The term "qualified tuition and related expenses," in turn, is defined as meaning: "(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." (§ 117(b)(2).)

Therefore, whether Appellant's receipt of the FAP's $45,000 annual grant qualified for exclusion from gross income under section 117 requires a facts-and-circumstances determination as to (1) what amount, if any, was used for qualified tuition and related expenses (fees, books, supplies and equipment), and (2) whether those amounts were required in connection with Appellant's being "a student at an educational organization described in section 170(b)(1)(A)(ii)."

Appellant did not attempt to meet her burden of proving that she used this $45,000 grant, in whole or in part, for qualified tuition and related expenses. She did not produce any tuition bills, receipts, bank statements, cancelled checks, credit card records, or similar documentation

or records to substantiate that the she used the grant proceeds for qualified tuition and related expenses. She did not substantiate that she spent any amount on fees, books, supplies, or equipment required for courses of instruction.

Instead, Appellant argued that section 117(c)(2)(B) establishes a per se rule that a medical resident who receives a FAP grant may exclude the full amount of that grant from gross income, regardless of whether the grant proceeds were spent on personal expenses as opposed to qualified tuition and related expenses. Appellant's position contradicts both the plain language of the statute, as well as the intent behind section 117, that the exclusion from gross income for scholarship and fellowship grants should not encompass nondeductible personal expenses.[4]

The "candidate for a degree at an educational organization described in section 170(b)(1)(A)(ii)" requirement:

In order to qualify for the section 117 exclusion, Appellant also must establish that she was "a candidate for a degree at an educational organization described in section 170(b)(1)(A)(ii)." (§ 117(a).)

Appellant has conceded that the FAP's specialized training program for board certification is not the same as pursuing a degree; instead, Appellant argues that her participation in the specialized training program should be viewed as the *equivalent* of pursuing a degree. Appellant has not cited, and we do not find, any authority supporting her argument that becoming board certified is equivalent to obtaining a degree.

However, even if Appellant's board certification training were equivalent to obtaining a degree, Appellant still would not qualify as "a candidate for a degree *at an educational organization described in section 170(b)(1)(A)(ii)*." (§ 117(a), emphasis supplied.) An educational organization described in section 170(b)(1)(A)(ii) has the following requirements: (1) its primary function is the presentation of formal instruction; (2) it normally maintains a regular faculty and curriculum; and (3) it normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on. (Treas. Reg. § 1.170A-9(c)(1).)

[4] In 1986, Congress limited the exclusion to amounts for qualified tuition and related expenses and made all grants for living expenses taxable. (See Tax Reform Act of 1986, Pub. L. No. 99-514, § 123, 100 Stat. 2085, 2112 (1986).) "The Congress concluded that the exclusion for scholarships should be targeted specifically *for the purpose of educational benefits*, and should not encompass other items that would otherwise constitute nondeductible personal expenses." (Joint Comm. on Tax'n, JCS-10-87, Gen. Explanation of Tax Reform Act of 1986, at p. 40 (1987).)

Appellant argues that a medical resident who is the recipient of the FAP and receives specialized training for board certification at a teaching hospital meets the statutory requirements of "an individual who is a candidate for a degree at an educational organization described in section 170(b)(1)(A)(ii)." (§ 117(a).) The cases cited by Appellant—*Spiegelman v. Commissioner* (1994) 102 T.C. 394, 405-406,[5] and *Ruggiero v. Commissioner*, T.C. Memo. 1997-423[6]—do not support her position.

In fact, the case law contradicts Appellant's position; neither board certification nor a teaching hospital satisfy the statutory definition of "an educational organization described in section 170(b)(1)(A)(ii)." In *Streiff v. Commissioner*, T.C. Memo. 1999-84, the tax court held that a taxpayer-doctor could not exclude from income the amount of a fellowship grant received while the taxpayer participated in a medical school program to train postdoctoral fellows. The taxpayer was concurrently fulfilling the requirements to become board-certified, and he argued that although he was not receiving a degree, he was receiving training that would qualify him for board certification.

The tax court found that the grant was for financial support while he was engaged in research and not for the board certification process. However, the court went on to state that, even if the grant was connected to the board certification process, the board was not an educational organization described in section 170(b)(1)(A)(ii), noting that the American Board of Internal Medicine "does not maintain a curriculum, does not maintain a regular faculty, and does not have a student body." (*Streiff, supra,* T.C. Memo. at p. 2.) Under *Streiff*, if a doctor received a grant connected to the board certification process, the board would not meet the requirements of an educational organization described in section 170(b)(1)(A)(ii) and the grant would not be excludible under section 117.

[5] *Spiegelman* involves an entirely different issue. In that case, the tax court held that a taxpayer was not liable for self-employment taxes on a privately-funded fellowship award if the performance of services was not required as a condition of receiving the award. Here, in contrast, self-employment taxes are not at issue.

[6] *Ruggiero* also is not relevant to this dispute. In *Ruggiero,* an associate professor received a fellowship that provided him the opportunity to conduct research for a new book he was writing. Although the taxpayer took time away from the university to work on his book, he continued to receive salary and benefits from the university. However, in order to maintain his employment at the university while he was in Italy working on his book, he assigned the fellowship proceeds to the university, and deducted the fellowship amount from his income. The tax court concluded that the full amount of the fellowship proceeds was includible in the taxpayer's gross income and that, pursuant to *Spiegelman,* the taxpayer did not owe self-employment taxes on the fellowship income. The tax court also allowed the taxpayer to claim various expenses relating to his fellowship income pursuant to section 212.

Several tax court cases have held that teaching hospitals are not educational organizations for purposes of the section 117 exclusion, focusing on the fact that the primary purpose of teaching hospitals is the care and treatment of its patients, not teaching and research.[7] In *Proskey v. Commissioner* (1969) 51 T.C. 918, the tax court considered the issue of whether amounts received by a resident at a teaching hospital constituted an excludible fellowship grant. In making this determination, the court analyzed whether the hospital's primary purpose was education or patient care. The court concluded that the primary purpose of the hospital was not teaching and research but instead was the care and treatment of its patients.

Therefore, notwithstanding Appellant's argument that her participation in the FAP's specialized training program at U.C. San Diego Health was the equivalent of pursuing a degree, because her specialized training took place at a teaching hospital, she was not a candidate for a degree *at an educational organization* described in section 170(b)(1)(A)(ii).

It is also noted that the FAP contract states the Air Force would pay Appellant a "*taxable* annual grant . . . ." (Emphasis added.) The contract states: "The grant, stipend, base pay, and special pay are subject to Federal Income tax." Appellant signed the contract and acknowledged: "I understand that . . . I will be paid a *taxable* annual grant . . . ." (Emphasis added.) Appellant reported the $45,000 annual grant as taxable income on her 2010 federal income tax return.[8]

In summary, Appellant failed to establish the two statutory requirements: (1) that she received a "qualified scholarship," and (2) that she was a "candidate for a degree at an educational organization described in section 170(b)(1)(A)(ii)." Thus, Appellant's $45,000 annual grant is taxable for California income tax purposes.

[7] See, e.g., *Bharmota v. Commissioner*, T.C. Memo. 1979-28 [The tax court held that compensation received by the taxpayer as a medical resident was not excludible under section 117 because the payor hospitals were "working hospitals whose primary purpose was to heal and care for the sick—not educate students."]; and *Hanson v. Commissioner*, T.C. Memo. 1979-108 [The tax court held that working hospitals and clinics, whose primary purpose was the care of patients, were not "educational institutions" as defined at the time by section 151(e)(4); this was so notwithstanding the fact that the taxpayer-medical resident received didactic instruction and was required to attend certain conferences.]

[8] As stated above, California conforms to section 117 pursuant to R&TC section 17131. However, Appellant took inconsistent positions on her federal and California returns. She reported the $45,000 grant as taxable on her federal return, but she excluded it from taxable income on her California return. Appellant has not explained this inconsistency.

HOLDING

Appellant failed to establish that she is entitled to exclude the $45,000 annual grant from her gross income pursuant to IRC section 117.

DISPOSITION

We sustain FTB's action in full.

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Alberto T. Rosas
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Alberto T. Rosas
Administrative Law Judge

We concur:

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Neil Robinson
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Neil Robinson
Administrative Law Judge

DocuSigned by:
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Andrew J. Kwee
Administrative Law Judge