Steiman v. Commissioner, 54 T. C. 1214 (1970)

Stipends received by graduate assistants can be excluded from taxable income if the primary purpose is educational rather than compensatory.

Summary

In Steiman v. Commissioner, the Tax Court ruled that stipends received by graduate assistants at Wayne State University were excludable from taxable income under Section 117 as scholarships. The court found that the primary purpose of the stipends was to further the education of the recipients, not to compensate them for services. The graduate assistants were required to perform teaching duties as part of their degree program, which all students had to complete, not just those receiving financial aid. This decision highlights the importance of the primary purpose test in distinguishing between taxable compensation and tax-exempt scholarships.

Facts

Robert Steiman and Helen Lieberman were graduate students at Wayne State University pursuing Ph. D. degrees in the Department of Physiology and Pharmacology (DPP). They received stipends as graduate assistants, which required them to participate in a teacher-training program, a requirement for all DPP Ph. D. candidates. The university awarded these assistantships based on financial need and academic qualifications, not on the students' ability to provide services. The teaching duties were supervised by faculty members and were designed to train students for future teaching roles, with evaluations used for future employment references.

Procedural History

The IRS determined deficiencies in the petitioners' 1967 federal income tax returns, asserting that the graduate assistantship stipends were taxable income. The petitioners contested this in the U. S. Tax Court, arguing that the stipends should be excluded as scholarships under Section 117 of the Internal Revenue Code.

Issue(s)

1. Whether the stipends received by Robert Steiman and Helen Lieberman as graduate assistants at Wayne State University are excludable from income as scholarships or fellowships under Section 117 of the Internal Revenue Code.

Holding

1. Yes, because the primary purpose of the stipends was to further the education and training of the recipients rather than to compensate them for services rendered to the university.

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Court’s Reasoning

The court applied the “primary purpose” test, established in prior cases, to determine whether the stipends were scholarships or taxable compensation. The court found that the stipends had the “normal characteristics associated with the term ‘scholarship'” rather than compensation for services. Key factors included: the selection of assistants was based on financial need and academic merit, not their teaching abilities; the teaching duties were required of all DPP Ph. D. candidates and were part of their educational training; and the university’s administrative handling of the assistantships did not change their educational purpose. The court quoted from prior decisions, such as Elmer L. Reese, Jr. , emphasizing that the primary purpose must be educational, not compensatory. The court also noted that the teaching services provided more burden than benefit to the university, further supporting the educational purpose of the stipends.

Practical Implications

This decision impacts how universities structure graduate assistantship programs and how students receiving such aid should report their income for tax purposes. Universities should ensure that any required services are part of the educational program for all students, not just those receiving aid, to maintain the tax-exempt status of stipends. For legal practitioners, this case serves as a reminder to carefully analyze the primary purpose of financial aid when advising clients on tax implications. The ruling has been cited in subsequent cases involving the tax treatment of graduate assistantships, reinforcing the importance of the primary purpose test in distinguishing between scholarships and taxable compensation.

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