

***John E. Adams and Phyllis E. Adams, Petitioners v. Commissioner of Internal Revenue, Respondent, 71 T. C. 477 (1978)***

Stipends paid to medical interns are taxable as compensation for services, not excludable as fellowship grants, when they involve a substantial quid pro quo.

**Summary**

John E. Adams, an intern at a nonprofit osteopathic hospital, sought to exclude his stipend from taxable income as a fellowship grant. The U. S. Tax Court held that the stipend was taxable compensation because it required Adams to perform services beneficial to the hospital, establishing a quid pro quo. This decision was based on the contractual obligation to work, the nature of services performed, and the hospital's treatment of the payments as employee compensation. The ruling underscores that stipends linked to substantial services are taxable, despite any educational benefits to the intern.

**Facts**

John E. Adams, a doctor of osteopathy, began an internship at Rocky Mountain Osteopathic Hospital in 1972 under a contract requiring him to perform assigned duties, maintain professional standards, and refrain from outside activities. He received a monthly stipend of \$875 and a housing allowance of \$150. Adams performed various medical services, including patient care in surgery, obstetrics, and the emergency room. The hospital treated these payments as compensation, withholding taxes and providing employee benefits like insurance and uniforms.

**Procedural History**

Adams filed a joint Federal income tax return with his wife for 1973, excluding \$1,800 of his stipend as a fellowship grant. The Commissioner determined a deficiency, leading Adams to petition the U. S. Tax Court. The court, in a majority decision, ruled in favor of the Commissioner, finding the stipend taxable. Judge Goffe dissented, arguing that part of the stipend should be excluded as a fellowship grant due to the educational nature of Adams' activities.

**Issue(s)**

1. Whether the stipend received by John E. Adams from Rocky Mountain Osteopathic Hospital during his internship is excludable from his gross income as a fellowship grant under section 117(a)(1)(B) of the Internal Revenue Code.

**Holding**

1. No, because the stipend was compensation for services rendered to the hospital, as evidenced by the contractual obligation to work, the substantial services performed, and the hospital's treatment of the payments as employee compensation.

## **Court's Reasoning**

The court applied a “quid pro quo” test, following *Bingler v. Johnson*, to determine that Adams’ stipend was taxable compensation. The court noted the contractual obligation requiring Adams to perform services, the substantial nature of these services (including patient care in multiple departments), and the hospital’s provision of employee benefits and withholding of taxes. The majority rejected Adams’ argument that the primary purpose was educational, emphasizing that the hospital’s purpose in making the payments was to secure Adams’ services. The court also dismissed the relevance of whether patients were charged for Adams’ services, focusing on the hospital’s benefit from his work. Judge Goffe’s dissent argued that the primary purpose was educational, citing the hospital’s waiver of strict manual requirements and the educational focus of Adams’ activities.

## **Practical Implications**

This decision impacts how stipends for medical interns and similar training programs are treated for tax purposes. It clarifies that when interns provide substantial services to the institution, their stipends are taxable compensation, not excludable fellowship grants. Legal practitioners advising interns or institutions must consider the nature of the services performed and the terms of any contracts. Businesses and institutions offering training programs must structure payments carefully to avoid unintended tax liabilities. Subsequent cases have followed this reasoning, reinforcing the principle that a substantial quid pro quo renders payments taxable, even in educational settings.