Cass v. Commissioner, 86 T. C. 1275 (1986)

Fellowship grants and awards are mutually exclusive for tax purposes, with fellowship grants governed solely by IRC Section 117.

Summary

In Cass v. Commissioner, the U. S. Tax Court ruled that a stipend received by David Cass as a Fairchild Scholar at Cal Tech was a fellowship grant under IRC Section 117, not an award under Section 74(b). The court clarified that Sections 117 and 74(b) are mutually exclusive, with fellowship grants taxed solely under Section 117. Additionally, the court allowed Cass to deduct a portion of his food expenses incurred while in California, applying a reasonable allocation method when precise proof was unavailable.

Facts

David Cass, an economics professor at the University of Pennsylvania, was appointed as a Sherman Fairchild Distinguished Scholar at Cal Tech for the 1978-79 academic year. He received a stipend from Cal Tech equivalent to his Penn salary and fringe benefits. Cass did not apply for the scholarship; he was selected based on his past achievements. While at Cal Tech, Cass worked on research papers, lectured, and established a seminar series, but had no formal duties. He moved his family to California for the year, incurring grocery and restaurant expenses. On his 1979 tax return, Cass excluded the stipend from income, a position challenged by the IRS.

Procedural History

The IRS issued a notice of deficiency to Cass for 1979, asserting the stipend was taxable income. Cass petitioned the U. S. Tax Court for relief. The court heard arguments on whether the stipend was a fellowship grant under Section 117 or an award under Section 74(b), and on the deductibility of Cass's food expenses while in California.

Issue(s)

1. Whether the stipend received by Cass as a Fairchild Scholar is taxable as a fellowship grant under IRC Section 117 or as an award under Section 74(b)?
2. If the stipend is a fellowship grant, whether Cass may deduct the cost of food purchased for his own consumption while in California under IRC Section 162(a)(2)?

Holding

1. No, because the stipend is a fellowship grant under Section 117, which is mutually exclusive from awards under Section 74(b).
2. Yes, because Cass incurred these expenses while away from his tax home in pursuit of his business as an economics professor, and a reasonable allocation of

these expenses is deductible under Section 162(a)(2).

Court's Reasoning

The court distinguished between awards and fellowship grants. Awards under Section 74(b) are retrospective, based on past achievements with no future service requirement. Fellowship grants under Section 117 are prospective, intended to support future study or research. The court found the Fairchild Scholarship was awarded to enable Cass to advance his research, making it a fellowship grant. The court rejected Cass's argument that fellowship grants should be tested first under Section 74(b), holding that Sections 117 and 74(b) are mutually exclusive. This interpretation was supported by legislative history and regulations.

Regarding food expenses, the court applied the business expense deduction rules of Section 162(a)(2). Cass was away from his tax home in Pennsylvania in pursuit of his business as an economics professor. The court rejected the IRS's argument against deduction due to lack of duplicated expenses, citing Congressional intent to allow deductions for expenses incurred while away from home. Cass's method of allocating food expenses based on family weight was deemed flawed, so the court allocated one-fourth of total food expenses to Cass, discounting grocery expenses for dog food, as a reasonable approximation.

Practical Implications

This decision clarifies the tax treatment of fellowship grants, establishing that they are governed exclusively by Section 117, not Section 74(b). Practitioners should advise clients to classify payments based on their prospective or retrospective nature. The ruling also reaffirms the deductibility of food expenses while away from home under Section 162(a)(2), even when precise allocation is challenging. Taxpayers should maintain records to support reasonable expense allocations. Subsequent cases like *United States v. Correll* have upheld the deference given to Treasury regulations in interpreting tax statutes, reinforcing the court's approach in *Cass*.

