


TR 94/D13 - Income tax: exemption of income from scholarships

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Draft Taxation Ruling

Income tax: exemption of income from scholarships

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What this Ruling is about

1. This Ruling sets out the ATO's views on the interpretation of subparagraph 23(z)(i) of the *Income Tax Assessment Act 1936* (the Act).
2. In certain circumstances income derived by way of a scholarship by a student receiving full-time education is exempt from tax under paragraph 23(z) of the Act. However, subparagraph 23(z)(i) provides that an amount of income is not exempt under paragraph 23(z) if it is received by the student upon condition that the student will (or will if required) render, or continue to render, services to the person or authority from whom the amount is received.
3. In particular this Ruling explains the meaning of the terms:
 - (a) scholarship;
 - (b) person or authority from whom the amount is received; and
 - (c) render services.

as they are used in paragraph 23(z).

Ruling

Scholarship

4. Regardless of the description of the payment an amount is a scholarship if it is given primarily for the education of a student. It is the purpose of the provider of the payment which is important, not the use to which the amount is put by the student.

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5. It is not sufficient that there is some educational purpose in the grant. Where, for example, the scholarship provider makes the payment to have research on a specific topic carried out for the provider's benefit but incidentally requires the recipient to be enrolled in a full-time course of education, the payment is not a scholarship.
6. We consider that payments received by a student in his or her capacity as an employee rather than as a scholar are not a scholarship.

Person or authority from whom the amount is received

7. The provider of the scholarship is to be determined by examining the terms and conditions of the scholarship, the source and control of the funds, and the manner of payment. A scholarship provider includes any person or authority who directly or indirectly provides the scholarship.
8. Where an educational institution provides scholarships from its general funds, or from funds provided by an external body over which the institution has control for the purpose of allocation, the educational institution is the scholarship provider.
9. Where an educational institution provides scholarships from funds provided by an external body which has control over the allocation of the funds, the external body is the scholarship provider.

Rendering a service

10. A service is rendered if a student is required under the terms of the scholarship to undertake activities which may be considered to be of use, help or benefit to the provider. The expression 'render services' may be construed to cover a wide range of activities.
11. The activities are not restricted to employment or employment-related activities.
12. Where the scholarship holder is required to perform one of the following activities, he or she will be rendering a service; the fact that the possibility exists that a student may be required in the future to do any of these things will also constitute rendering of services. The list of activities, while not being exhaustive, is as follows: -
 - (a) working for the scholarship provider during or after the term of the scholarship;
 - (b) furnishing the scholarship provider with reports or other information beyond the scope of a mere 'progress report';
 - (c) assigning to the scholarship provider property rights in respect of the products of intellectual activity (e.g.,

inventions or other original work) undertaken by the scholar pursuant to the scholarship;

- (d) agreeing to assign to the scholarship provider property rights in respect of the products of intellectual activity undertaken by the scholar pursuant to the scholarship, should such products arise;
- (e) performing work which contributes to the completion of a contract between the scholarship provider and an external body;
- (f) forwarding a final report or a copy of the thesis to the scholarship provider before placement in the university library;
- (g) granting the scholarship provider the right to publish the results of the scholar's research; and
- (h) acknowledging the scholarship provider in a report or publication of results.

13. Notwithstanding the decision in *Case V97*, 88 ATC 637; *Case 4459*, 19 ATR 3625, we consider that a mere requirement to lodge an annual progress report does not constitute a requirement to render services for the scholarship provider.

14. If a university under its statutes claims all the intellectual property rights arising from the student's work at the university, the student cannot grant those rights to the scholarship provider as a condition of a scholarship, and consequently is not rendering a service by agreeing to that condition.

15. If the student retains all rights to his or her intellectual property under the university statutes, and agrees as a condition for receipt of a scholarship to give up some or all of those rights, the student is rendering a service.

16. If the student retains some interest in his or her intellectual property under the university statutes, then entering an agreement to give up some or all of that interest as a condition for receipt of a scholarship is the rendering of a service.

17. When the scholarship conditions deal specifically with the surrender of intellectual property rights, the presumption will be that the student is rendering services in agreeing to that condition. This may be refuted by the student if he or she can produce evidence that under the university statutes he or she did not own the intellectual property rights or any interest in them.

18. The condition that the student render services need not be legally enforceable (*FCT v. Ranson* 89 ATC 5322, at 5328-5329; (1989) 20

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ATR 1652, at 1660-1661) (*Ranson's Case*). Further, the rendering of services may take place in the future, i.e., subsequent to payment of the scholarship income (*Ranson's Case* at ATC 5330, ATR 1661).

19. It is sufficient that there is a requirement that services will be rendered if required, even if the service is, in fact, never rendered (6 CTBR(NS) *Case 9*).

20. The requirement to render services (or render services if required) may be an express or implied condition for receipt of the scholarship.

21. Where a student performs a service voluntarily or as a matter of courtesy, the scholarship is not received 'upon condition' that services are rendered.

Date of effect

22. This Ruling applies to years commencing both before and after the date of issue. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of a settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

23. Where an exemption from income tax has been granted in relation to a particular scholarship, that exemption will continue until 30 June 1994.

Definitions

24. The following key terms used in this Ruling are defined as follows:

scholarship

- includes any scholarship, bursary or other educational allowance.

scholarship provider

- person or authority from whom the amount is received.

intellectual property

- includes:

- (a) patents under the *Patents Act 1990*;
- (b) designs registered under the *Designs Act 1906*;
- (c) trade marks registered under the *Trade Marks Act 1955*;

- (d) copyright under the *Copyright Act 1968*;
- (e) new plant varieties under the *Plant Variety Rights Act 1987*;
and
- (f) circuit layouts under the *Circuits Layout Act 1989*.

Explanations

Scholarship

25. Before the issue of exemption can be addressed, the payment must be income under ordinary concepts. If an amount does not have the character of income, its assessability will be considered under other provisions of the Act.

In *Ranson's Case*, Davies and Hill JJ said (at ATC 5327, ATR 1656):

'Section 23(z), it may be noted, is conditional upon the relevant scholarship, bursary or allowance being income. It may be possible to conceive of an educational allowance, paid in a lump sum or even periodically as being in a particular case a mere gift and accordingly as not having the character of income in ordinary concepts. Generally however a scholarship or bursary will be income because it consists of a series of periodical receipts.'

26. The *Macquarie Dictionary* defines scholarship as 'the position of a student who, because of merit, etc, is granted money or other aid to pursue his studies' and 'the sum of money or other aid granted to a scholar'. The *Macquarie Dictionary* defines bursary as 'a scholarship'.

27. In *Ranson's Case*, Davies and Hill JJ said (at ATC 5326, ATR 1657):

'The concept of educational allowance may be wider. While the meaning of the word 'allowance' clearly is dependent upon its context, its basic meaning as Jordan C.J. pointed out in *Scott v. C. of T.* (N.S.W.)(1935) 3 A.T.D. 142 at p. 146; (1935) S.R. (N.S.W.) 215 at p. 221 is of 'a definite portion or amount allotted or granted to meet requirements', those requirements being in the case of an educational allowance the cost of education and perhaps support during education.'

28. The Explanatory Memorandum to the *Income Tax and Social Services Contribution Assessment Act 1951* (Act No. 44 of 1951, inserting paragraph 23 (z)), said the:

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'purpose of [the amendment] is to give effect to a recommendation by the Commonwealth Committee on Taxation that income arising from scholarships and **similar** educational awards should be exempt from income tax... The exemption will apply... to payments under various private scholarships and **similar** educational awards...'. [emphasis added].

29. As discussed in Taxation Ruling TR 93/39 the inclusion of the term 'educational allowance' in paragraph 23(z) does not extend the application of the provision. A scholarship, bursary or other educational allowance is 'a description of rewards for merit attained as a result of competition or selection on the basis of general criteria.' The method of selection of the recipient of a payment is therefore relevant to determining the character of that payment.

30. Describing a payment as a 'scholarship' does not necessarily give it that character. The term 'scholarship' is currently used to cover a variety of payments not contemplated when paragraph 23(z) was enacted. The expanded use of the term 'scholarship' in relation to grants for post-graduate research in commercially applicable fields dictates the need to 'look behind' the title given to a payment to find its true character.

31. It is the primary purpose of the scholarship provider that determines whether a grant is a scholarship (*FCT v. Hall* 75 ATC 4156 at 4164;(1975) 5 ATR 450 at 459). To be a scholarship, the grant must be made primarily for the education of the student. Where a scholarship provider gives an amount with the primary purpose of having research conducted into a specific topic, the grant will not be a scholarship. This is so even though the performance of the work may be done in conjunction with a course of study.

32. Where an employer grants a student time off work to undertake studies and continues to pay the student the payment is not a scholarship: *Case E3*, 73 ATC 9; 18 CTBR (NS) *Case 55* .

33. If an employer grants a student leave without pay to undertake studies, and the student is in receipt of study leave payments from the employer, the payment is not a scholarship. This is the case even where there is no agreement to re-employ the student: *Case N28*, 81 ATC 154; 24 CTBR (NS) *Case 100*.

34. In the above instances the payment is considered to be received by the person in his or her capacity as an employee and not as a scholar in receipt of a scholarship.

Person or authority from whom the amount is received

35. In order to determine whether a student is rendering services to the scholarship provider, the scholarship provider must first be identified. The following factors should be examined in determining who is the scholarship provider:

- (a) the terms and conditions of the scholarship;
- (b) the source of the funds;
- (c) who has control over the funds; and
- (d) the manner of payment.

36. A scholarship is provided directly where the body funding the scholarship also makes the payments. The payment is made indirectly where the body funding the scholarship does not make the scholarship payment, for example, where the payment is made by an external body through the educational institution.

37. Where a grant is made from an external body to an educational institution for research into a specific topic, the control exerted by that body in the use of the funds will determine the scholarship provider. Close control of how funds are to be allocated is a primary indicator that the external body is the provider, and the institution its agent in this matter.

38. Where an educational institution and an external body are associated in a joint research project, the provider of the scholarships paid under this arrangement will be able to be determined only from an examination of the documents relating to the project, the provision and control of funds, and the arrangement itself.

Rendering a service

39. Even if conditions for exemption are otherwise satisfied, the scholarship will not be exempt if it is received on the condition that the student will or will if required render services to the provider.

40. The *Macquarie Dictionary* defines 'condition' as 'something demanded as an essential part of an agreement' and in the legal context as 'a stipulation in a contract making some liability contingent on the happening of a future uncertain event'.

41. Any judicial restriction that has been placed on the ordinary general meaning of the expression 'render services' has occurred by virtue of the context in which the expression appears. Thus any restriction imposed on the meaning by courts in other cases is not necessarily relevant to interpretation of the expression in a different

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context. In the context of scholarships it was said in *Case V97*, 88 ATC 637, at 640; *Case 4459*, 19 ATR 3625 at 3629:

'The expression...is capable of covering a very wide range of activities which to a recipient of services might be considered to be to his, her or its benefit. There is no limitation to a particular type of services...In my opinion, the services referred to in section 23(z)(i) cannot be limited to those of the kind referred to by McTiernan J in *Revesby Credit Union*...when considering the expression...in a different context.'

42. A progress report is considered to be an administrative report. If it is necessary for details of the project itself to be included, these would be of a general nature only.

43. The student is prima facie the owner of his or her intellectual property. Most universities have statutes or policy statements covering patent and other intellectual property rights which in some way vary the student's rights. Although the statutes will vary from institution to institution, the possible scenarios for the ownership of intellectual property for these purposes are as follows:

- (i) students own their intellectual property;
- (ii) the university owns the intellectual property rights;
- (iii) students share the intellectual property rights with the university; or
- (iv) students share the intellectual property rights with the university and the external funding body.

44. Generally, students are required to sign a declaration upon enrolment stating they are bound by all university statutes. If an examination of the university statutes shows that the university claims all the intellectual property rights arising from the student's work at the university, the student cannot grant those rights to the scholarship provider as a condition of a scholarship. Even if an 'intellectual property' clause is part of the conditions of the scholarship, the student is not considered to be rendering a service by agreeing to dispose of what he or she does not own.

Examples

Scholarship

45. A drug company advertises a grant to investigate the effects of a new drug on pregnant women. The successful applicant will undertake the research as part of his or her PhD in Medicine. The

grant is not a scholarship. The company's main purpose is to have research conducted. The fact that this is achieved by the applicant in pursuing educational qualifications does not make it a scholarship.

46. A mining body made up of companies which conducts open-cut uranium mining gives money to a university to conduct research into the effects on the environment of such mining. The topics of specific research to be undertaken as part of their educational program are chosen by the students with the approval of the university. University approval is on the basis that the topic is of an acceptable degree of difficulty in respect of the academic qualification sought. Grants by the university to students as part of an educational program out of such funds would be scholarships.

47. A company grants a scholarship to an employee to undertake studies towards completion of a business degree. The scholarship award provides for full salary and preservation of all leave entitlements. There is no requirement on the employee to return to work at the completion of studies. The grant is not a scholarship. The payment is received by the scholar in his or her capacity as an employee and not as a scholar in receipt of a scholarship.

48. A student receives grants from an education fund to which his or her parents have contributed. The student receives the payments because of the parents' participation in the fund. The amounts do not constitute a scholarship.

49. An organisation which develops new plant strains grants a scholarship to a student which requires the research to be undertaken in the organisation's laboratories. The student may choose from among a number of topics of interest to the organisation, but all plant material developed remains the property of the organisation. The grant is not a scholarship as the student is considered to be receiving the payment as a research assistant.

Person or authority from whom the amount is received

50. A university grants a scholarship out of departmental funds to enable a student to undertake studies towards the completion of a PhD in Science. The university is the scholarship provider.

51. A company grants money to a university for research into cancer. The university creates scholarships with the grant and the scholarship recipients are free to choose their own research topics within this broad field. The university is the scholarship provider.

52. A mining body made up of companies which conducts coal mining operations grants money to a university for research into the effects on the environment of such mining. The university has sole

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control over the funds and decides to grant scholarships with the funds. As the university has the discretion to use the funds as it chooses, the university is the scholarship provider.

53. A mining body made up of companies which conducts coal mining operations grants money for research into the effects on the environment of such mining. The mining body is able to direct the university in how to expend the funds including expenditure relating to the granting of scholarships. The mining body is the scholarship provider.

54. A mining body and a university undertake a research project as joint venturers. A review of the agreement between them indicates that the mining body provides funding for senior staff and research assistants, but the university funds scholarships. The university is the scholarship provider.

55. A mining body and a university agree to set up a separate research body to conduct a research project. Both research assistants and students in receipt of scholarships are involved in the research. The research body is provided with funds which it administers independently of the parent bodies. The research body is the scholarship provider.

Rendering a service

56. A company grants a scholarship to a student to undertake studies towards completion of an Engineering degree. A clause in the scholarship conditions states the student is required to submit six-monthly reports showing the progress of the project during that period. As the reports are in the nature of progress reports, unless other conditions indicate the contrary, there is no requirement to render services.

57. A company grants a scholarship to a student to undertake studies towards completion of an Engineering degree. A clause in the scholarship conditions states the student is required to submit annual reports to the company and the company is free to use the information in its publications and reports. In this case, there is a requirement to render services.

58. A university grants a scholarship out of departmental funds to enable a student to undertake studies towards the completion of a PhD in Engineering. The university statutes state that the university retains rights to students' intellectual property. Unless other conditions of the scholarship indicate the contrary, the student is not rendering a service to the university.

59. A university grants a scholarship out of departmental funds to enable a student to undertake studies towards the completion of a PhD in Engineering. The university statutes allow the student to retain the rights to his or her intellectual property. A clause in the scholarship conditions states the student is required to surrender the intellectual property rights to the university. The student is considered to be rendering a service to the university.

60. A company and a university enter into an agreement whereby the company will grant money to the university for research into cancer. The university creates scholarships with the grant. If the students' research assists the university in meeting its obligations to the company, the students would be rendering services to the university.

Previous Rulings

61. Taxation Ruling IT 2581 is now withdrawn. To the extent to which our views in that Ruling still apply, they have been incorporated in this Ruling.

Commissioner of Taxation

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- FCT v. Hall 75 ATC 4156 (1975) 5 ATR 450
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- Case N28 81 ATC 154 ; 24CTBR(NS) Case 100
- Case V97 88 ATC 637; Case 4459 19ATR 3625