

# Payments to Students and their Taxability

## Background

Western University of Health Sciences (University) makes various payments to students for various reasons. In awarding and processing such payments, care must be taken to classify these payments correctly for tax purposes. These guidelines address types of payments made to students, including scholarships, fellowships, stipends, prizes and awards, compensation for services, refunds and reimbursements. Additionally, this document defines which type of payment is taxable income to the student and which payments the University must report to the Internal Revenue Service (IRS).

Reporting and taxation of student payments are governed by the Internal Revenue Code and Treasury Regulations and enforced by the Internal Revenue Service (IRS).

<http://www.irs.gov/publications/p970/ch01.html>

For example, scholarships/fellowships are not taxable to the extent they do not exceed the cost of tuition, fees, and course-required expenses (*books, supplies, equipment*) and the student is a candidate for a degree. These non-taxable amounts are called qualified education expenses. Amounts in excess of ***qualified education expenses*** are taxable to the student, such as room/board, travel, research, living allowance, etc., and are called ***non-qualified education expenses***.

The purpose of this document is to explain how to categorize payments made to students in support of their education related activities. For example, a stipend can have various meanings, but is typically paid as a living allowance and includes payments other than those defined as non-taxable fellowships.

## Summary Overview: Payments to Students

### Types of Payments to Students and Taxation Implications

There are many different types of payments to students who attend the University and each has its own taxation implications. In summation, the payments fall into two categories:

#### Non-taxable: (Excludable from Income)

- Scholarships/fellowships that are used for qualified tuition and related expenses
- Student reimbursements\* for students purchasing a service or good while acting as an “agent” of the University or club
- Student refunds for student account overpayments and/or excess Title IV funds

#### Taxable: (Includable in Income)

- Prizes and awards
- Funding provided via a stipend payment for a student to attend a conference or conduct research, unless such expenses are for University purposes\*
- Funding provided via a stipend payment for room, board or personal expenses\*

- Compensation for services related to work

\*Student Travel payments and Reimbursements payments are not reportable to the IRS as income to the student if the student can document that the payment:

- a. directly supports a faculty member's project or research program, or
- b. is related to presenting at a conference, or
- c. is an integral part of the student's educational study, or
- d. is official University Business

Any payment which has not meet one of the criteria above will be taxable income to the recipient, and may be reported to IRS on forms W-2 or 1099-MISC\*\*. It is the student's responsibility to maintain records for these payments.

\*\*For payments given to nonresident alien students, there is tax withholding and reporting on Form 1042-S to the IRS.

## Definitions

### Scholarship/Fellowship

The term “scholarship” is used interchangeably with the term “fellowship” by the Internal Revenue Service (IRS) to refer to both taxable and non-taxable payments to students. There are three classifications:

- i. Qualified
- ii. Non-Qualified
- iii. Trainee Fellowships

#### *i. Qualified Scholarship/Fellowship*

This category includes payments to the student (those in a degree program) or credits to a student’s account used only for “qualified tuition and related expenses,” which are limited to tuition and required fees, books, supplies, or equipment. Qualified fellowships are not taxable income to the student as long as qualified payments do not exceed stated tuition and fee amounts. Qualified scholarships and fellowships are reported by the University on Form 1098-T. Reporting is not required on a 1042-S. Income Code 15, Exemption Code 2 (1042-S) for international students.

#### *ii. Non-Qualified Scholarship/Fellowship*

A non-qualified scholarship or fellowship is a scholarship/fellowship payment used for expenses that are not qualified tuition or related expenses (e.g. amounts used to pay optional fees, room, board, travel and personal expenses). All non-qualified scholarship/fellowship payments are potentially subject to income tax withholding and subject to reporting on IRS Form 1098-T or IRS Form 1042-S. The student should always maintain the documentation necessary to support information reported to the Internal Revenue Service (IRS).

#### **a. Prizes and Awards**

Prizes and awards are payments in recognition of charitable, scientific, educational, artistic, literary, or civic achievement, or are received as the result of entering a contest. Recipients are selected based on their actions to enter a contest, competition or proceeding. Drawing gifts or monetary payments are also classified as prizes. Prizes and awards are always taxable. If certain dollar thresholds are satisfied, the University will report the prize or award to the IRS and the student on IRS Form 1099-MISC, Miscellaneous Income: <http://www.irs.gov/instructions/i1099misc/ar02.html> or on IRS Form 1042-S, Foreign Person’s U.S. Source Income Subject to Withholding: <http://www.irs.gov/pub/irs-pdf/f1042s.pdf>.

#### **b. Stipend**

Stipends are generally taxable. IRS defines a stipend as a fixed sum of money paid periodically for services or to defray expenses. The fact that remuneration is termed a "fee" or "stipend" rather than salary or wages is immaterial. Wages are generally subject to employment taxes and should be reported on Form W-2, Wage and Tax Statement. Refer to Publication 15, Circular E, Employer's Tax Guide, section 5, Wages and Other Compensation, for rules on accountable and non-accountable plans for employee business expenses.

Income from stipends is reportable to the IRS. Is the stipend or fee paid to an employee or an independent contractor? The answer to this question determines the method that the stipend is reported. See also Payments to Individuals for Services Provided.

## ***ii. Trainee Fellowship***

There are two types of Trainee categories and a distinction between the two is very important.

- a. Research Assistants, Teaching Assistants, and Post-Doctoral Associates: employees who perform a service for the university and for such services is compensated as any other employee. These types of individuals are performing services in order to receive compensation and are subject to the control of and are supervised by an employee of the University making the payment taxable and reportable to the IRS.
- b. Trainee Fellowships, Post-Doctoral Fellowships, and Research Fellowship: an individual who is performing independent research. If the fellow is a student this research would be part of their educational pursuits. It is important to note that the student is performing independently and not under any direct supervision or direction. They may seek advice or assistance from colleagues, or may collaborate with others in their particular discipline; but the final decisions of what to do, how to proceed, and in what direction the research goes is decided by the fellow.

Example 1: The amount of tuition is waived for OMM students which is non-taxable. However, payments in excess of tuition, i.e. 5th year students receiving cash payments would be taxable and is reported on the IRS form 1099-MISC.

Example 2: Summer Research Stipends are taxable and reported to the IRS since the program is conducted while students are not attending classes and are providing a service for the University under the direction of an instructor.

## **Compensation for Services Related to Work**

This category is defined as payments made for teaching, research and/or other activities performed for the benefit of the University, including activities for the University that may be associated with the student's course of study and educational experience. Payments received in connection with the performance of service by a student are taxable income and may be subject to federal, state and FICA tax withholding.

## **Definition of Student Workers**

A student employee is a part-time employee who is duly enrolled at the University, is registered for classes and whose primary purpose for being at the University is the achievement of a degree or certification. (See [Internal Revenue Notice 2004-12 Section 7. Definitions](#) for guidelines and FICA exceptions.)

## **Student Refund**

This term is used to describe the processing of a payment to a student resulting from a credit balance on the student account. The term is also applied to the payment to the student for Title IV proceeds in excess of the amount of tuition and fees, room and board, and other authorized charges.

## **Student Reimbursements**

Students who incur costs for approved activities that primarily benefit the University may be entitled to reimbursement. Student reimbursements for approved expenditures incurred are NOT considered reportable as taxable income to the IRS on forms W-2 or 1099-MISC.

# Scholarships, Fellowships, Prizes and Awards - Taxation

## Qualified/Non-Taxable Scholarships or Fellowships

Scholarship and fellowship reporting and taxation are governed by the Internal Revenue Code and Treasury Regulations and enforced by the Internal Revenue Service (IRS).

IRS regulations indicate that amounts paid to an individual are scholarship or fellowship **grants** if: "the primary purpose of the studies or research is to further the education and training of the recipient in his/her individual capacity," and the payments did not represent compensation for services. (IRS Treasury Regulation 1.117-4). *There is no obligation required of the student to receive the grant, other than to remain enrolled in a degree program and maintain qualifying requirements of the award.* A "qualified scholarship" is the amount of a scholarship or fellowship grant that can be excluded from the recipient's income and is limited to the amount used for tuition and fees, books, supplies, and equipment required for courses. These items must be required of all students in a course of instruction for the scholarship or fellowship grant to be tax-free (Prop. Reg. 1.117-6(c)(2)).

## How to Process

All scholarships and educational assistance grants must be awarded and processed through the school's Financial Aid office. These payments are generally considered a resource when determining a student's financial aid eligibility.

All qualified scholarships and educational assistance grants will be reported by the University to the Internal Revenue Service (IRS) and to the student on IRS Form 1098-T, Tuition Statement.

### *U.S. Citizens*

Process scholarship and grant payments through the University's Financial Aid office using the appropriate fund code for awarding and disbursing the payment.

### *International Students*

The types of payments we can make to non-resident aliens depend upon their visa status. Some may be given compensation while others can only be reimbursed for expenses. Still others may not be given any form of payment. IRS regulations limit the types of payments non-resident aliens receive.

### Sources of Additional Information

- <http://www.irs.gov/publications/p970/ch01.html>
- [http://www.nacubo.org/documents/EventsandPrograms/1098T\\_Webcast\\_FAQ.pdf](http://www.nacubo.org/documents/EventsandPrograms/1098T_Webcast_FAQ.pdf)

## Non-Qualified/Taxable Scholarships or Fellowships

Scholarships or fellowships received to offset non-qualified educational expenses are taxable to the student. However, for students who are U.S. citizens or resident aliens, there is no tax withholding or Form 1099 reporting required by the University.

For scholarship or fellowship payments given to nonresident alien students, there is tax withholding and reporting on Form 1042-S to the IRS.

Payment for winning a competition or being a top performer is not a scholarship or fellowship. Instead, the payment is a prize or award. Prizes and awards are taxable to the recipient. A prize or award paid to a U.S. student (including a resident alien) may be reportable to the IRS, depending on the prize amount, on Form 1099-MISC. If the recipient is a nonresident alien for U.S. tax purposes, the amount is reported on Form 1042-S and may be subject to withholding.

### **Non-Qualified Scholarship & Fellowship Payments to Nonresident Aliens (NRAs)**

**Examples:** “Non-qualified” scholarships/fellowships may include payments for room/housing, board/meals, medical, stipends, travel, cash, as well as non-required fees, books, supplies, and equipment.

**Visas:** All NRA student visa information on file is used to determine if the student's visa allows for payment.

For application of tax treaty benefits, use IRS Form 8233. If no treaty benefits are available and the student does not have a F1, J1, M1, or Q Visa, then 30% taxes will be withheld. Also, if the student does not, or will not, complete these forms, then no treaty benefits are available.

**For F1, J1, M1, & Q Visas only: Tax withholding will not exceed 14%. Treaty benefits may also be available.**

**Sourcing Rules:** Tax withholding only applies to U.S. source income. If the University is serving as the paying agent for a foreign grantor located outside of the U.S., then the University is not required to withhold tax.

IRS Form 1042-S: The University will provide each year to NRA students who receive a taxable scholarship or fellowship.

### **Prizes & Awards**

All prizes and awards (with the exception of qualified scholarships) are includible in gross income (Code Sec. 74 (a); Reg. § 1.74-1(a)) unless any of the following conditions are met:

- a. The recipient was selected without any action on his or her part to enter the contest.
- b. The recipient is not required to render substantial future services as a condition to receive the prize or award.
- c. The prize or award is transferred by the payer back to the University or other tax-exempt charitable organization as designated by the recipient.

Any **three** of the above conditions must be met in order to exempt the prize from taxation.

For **U.S. and resident alien students**, all prizes must be reported by the University to the IRS on Form 1099-MISC if total prizes to the student in the relevant year are \$600 or greater. It is the responsibility of all prize recipients, regardless of the amount of the prize, to report the taxable prize received to the IRS on their personal income tax returns.

For **nonresident alien (NRA) students**, the University is required to withhold 30% tax on the full amount of the prize. The prize amount will be reported to the IRS and to the student on Form 1042-S.

Prizes and awards are always taxable and must also be reported to the Financial Aid office. The University will report the prize or award to the IRS and the student on IRS Form 1099-MISC, Miscellaneous Income (Form 1099 reporting is only required if total awards are \$600 or more in the year): <http://www.irs.gov/instructions/i1099misc/ar02.html> or on IRS Form 1042-S, Foreign Person's U.S. Source Income Subject to Withholding: <http://www.irs.gov/pub/irs-pdf/f1042s.pdf>.

**Exception:** If restrictions are placed on the prize or award, it is considered a scholarship; it should be awarded and processed through the University's Financial Aid department.

### *U.S. Citizens*

Submit these payments to University Accounts Payable via University Accounts Payable system. Include a complete description of the prize/award, the term of payment, and a statement indicating there are no restrictions on the use of the funds. Use Natural Accounts listed below for these payments.

If restrictions are placed on the prize or award, and it is therefore considered a scholarship, it should be awarded and processed through the University's financial aid system.

### *International Students*

For additional references regarding taxability of prizes and awards, see IRS publication 515 <http://www.irs.gov/pub/irs-pdf/p515.pdf>.

## **Stipends (Non-Qualified) Taxable and Includable**

A **stipend** is paid to students as a living allowance, and includes payments to the student other than those defined as non-taxable fellowships paid through the Accounts Payable or Payroll (international students). ***In no instance is a stipend a payment involving services related to work.*** Although these payments are usually taxable income to the student, the University is not required to report them to the student or the IRS, nor is the University required to withhold tax on them.

In 1987, the IRS ruled that an institution is not required to either withhold income tax or file any information returns with respect to taxable scholarship/fellowship grants paid to U.S. students (including foreign resident aliens). Therefore, even though the individual may receive taxable scholarship/fellowship income, the institution making the payment is not required to withhold any tax or file any reports with the IRS with respect to the taxable grant.

This "no withholding/no reporting" rule, however, is subject to two important caveats:

1. The scholarship/fellowship recipient must be either a U.S. citizen or a U.S. resident alien for tax purposes.
2. The payment that the institution makes to the individual must be a "scholarship" or "fellowship" and not compensation for services rendered or work.

The most common examples of nonqualified scholarship/fellowship are payments used to pay for room, board, travel, and medical expenses, etc. The following payment types are generally not considered stipends, and that term should not be used to refer to them.

- a. Expense Reimbursement
- b. Bonus
- c. Award or prize to student

## **How to Process**

### ***Domestic Students***

Stipends awarded to students must be processed through University's Financial Aid office with notification to the Bursars office so that payment can be applied to the student's account.

### ***International Students***

All amounts paid to nonresident aliens in the form of scholarships, fellowships, grants, and financial aid, which are not excludible from gross income as a "qualified scholarship" under I.R.C. 117, must be reported to the IRS, regardless of the amount paid, unless the grant is from sources outside the United States.

If the recipient is a nonresident alien, income tax withholding is required at a rate of 14%, unless the grant is exempt under a tax treaty between the U.S. and the recipient's home country and if the scholarship/fellowship payment is made to a nonresident alien, the taxable portion of the grant (generally, amounts paid for room, board, and travel) must be reported to both the IRS and the individual on Forms 1042 and 1042-S. The IRS, however, does not require Form 1042/1042-S reporting with respect to the nontaxable portion of the scholarship/fellowship grant, which generally consists of amounts paid for tuition, fees, and books.

## **Trainee Fellowships (Non-Qualified) Taxable and Includable**

Payments in this category aid in the pursuit of an individual's study or research. There are may be different types of training grants from federal and non-federal agencies.

Trainee Fellowships or grants should be separately tracked in the University's financial accounting system through Sponsored Programs and Contract Management. The primary federal agencies providing training grants are the National Institutes of Health (NIH), Health Resources and Services Administration (HRSA) and the Office of Education (ED). No past, present, or future services are expected in return for the financial support.

According to IRS Notice 87-31, universities are not responsible for withholding or reporting income taxes for tax purposes on Trainee Fellowship payments for: (1) U.S. citizens, (2) permanent residents, and (3) foreign national resident aliens (note that permanent residents and foreign national resident aliens are treated as U.S. citizens for tax purposes).

Fellows do not receive a Form W-2 or 1099-MISC on their fellowship income, as the University does not report the fellowship payment as taxable income to either the state or the federal government. However, the University is required to report fellowships to the IRS for informational purposes only on Form 1098-T, Tuition Statement. Trainee Fellowships may constitute taxable income to the fellow/trainee who is in a degree program to the extent there are no offsetting qualified educational expenses. (Tuition, books, fees and supplies are qualified educational expenses; room, board, living expenses and travel are non-qualified expenses.) Foreign fellows (unless they are U.S. residents for tax purposes) will receive a Form 1042-S reporting their fellowship income and are subject to tax withholding.

## **How to Process**

### ***U.S. Citizens***

All trainee fellowship grants must be awarded and processed through the school's Sponsored Programs and Contract Management department or Accounts Payable. Students should be registered for the term that the funds are being provided, because these payments cannot be applied to a term for which the student is not enrolled in at least one course.



These payments are disbursed through the student's University account and maybe considered a resource when determining a student's financial aid eligibility.

### ***International Students***

Depending on students visa status, payment should be processed the same as above.

## **Compensation for Services Involving Work (Includable in Income)**

An amount represents *compensation for services*, and **not** a scholarship or fellowship grant per IRS Treasury Regulation 1.117-4, if:

1. The amount represents compensation for past, present, or future employment services;
2. The activity the grant payments fund is "subject to the direction or supervision of the grantor"; or
3. The grant payment enables the recipient to "pursue studies or research *primarily for the benefit of the grantor.*"

These compensated services are considered wages for employment tax purposes and are subject to employment tax withholding and reporting requirements. Whether a payment is of the nature of a scholarship or is of the nature of compensation depends on the "primary purpose" of the payment: "*Was the taxpayer paid to work or paid to study?*"

More specifically, with respect to research activities, an issue often arises whether the research activities constitute "services" or "independent research." Factors that the IRS and the courts have taken into account in making this determination include:

- The extent of faculty supervision of the student's work, including planned time schedules and required progress reports.
- The student's ability to direct the course and direction of the research activities.
- Whether the student is able to retain any patents or copyrights resulting from his or her efforts.
- Whether the research services are directly related to the fulfillment of a contractual commitment by the university.
- Whether the student is required to work a specified number of hours a week on the research project.
- Whether the payment made to the student was relatively small (generally indicative of a fellowship) or relatively large (generally indicative of compensation), although in the case of large amounts, the amount above an amount typically paid for the services provided may be a non-wage fellowship.
- Whether the university treated the student as a student worker as evidenced by withholding tax on the payments as wages and providing faculty privileges and other employee benefits.

This category is defined as payments made for teaching, research and/or other activities performed for the benefit of the University, including activities for the University that may be associated with the student's course of study and educational experience. Payments received in connection with the performance of service by a student are taxable income, and may be subject to federal, state and FICA tax withholding.

## **Student Workers**

### **Supporting Student Staff: Federal Work-Study Student**

There are two types of on-campus supporting staff workers: federal work-study students and student casual workers. Federal work-study positions are only available to U.S. citizens and eligible non-citizens. The Federal Work-Study Program is designed to promote part-time employment for students who are in need of earnings to help finance their education.

Student employees are considered at-will employees, and their employment is interim or temporary and incidental to the pursuit of a degree or certification.

### **Supporting Student Staff: Student Casual Workers**

Employees who are registered University students who have a “student” status excepting those whose employment is totally independent of, and, unrelated to their student role, FICA (Social Security and Medicare) taxes do not apply to services performed by students employed by a schools, colleges, or university’s where the student is pursuing a course of study. Whether employees are students for this purpose requires examining the individual’s employment relationship with the University to determine if employment or education is predominant in the relationship. If the employee is enrolled and regularly attending classes (the exemption is not applicable to employees who are taking classes at another institution) in pursuit of graduating as their primary purpose, FICA taxes will not apply to compensation.

The University will make student FICA determinations based on [Revenue Procedure 2005-11](#) safe harbor guidelines that is; those students who meet these guidelines will be treated as exempt from FICA taxes, while those student employees who do not meet these guidelines will be subject to FICA taxes on their wages. Additionally, payments to clinical and other fellows, medical residents and postdoctoral research associates are not eligible for the student FICA exemption.

## **How to Process**

### ***U.S. Citizens and International Students***

Payments for services are processed through the University’s Human Resources Department and Payroll Office

### ***Assistants***

Individuals with teaching fellowships or who are research assistants are not classified as employees. Factors used to make this determination are:

- the type of services may be required to be performed in conjunction with a grant;
- the primary purpose of the fellowship is to assist students in developing as scholars and researchers or to teach/perform research primarily for the benefit of the grantor; and
- fellowship recipients do not perform the same work, for the equivalent compensation, as do employees of the institution.

## **Other Payments to Students (Not Taxable)**

### **I. Refunds**

The University's policy is to resolve eligible credit balances in student accounts as promptly as possible in compliance with all applicable regulations by issuing refunds to the student.

At the University the student account is used for the purpose of assessing charges and applying payments against those charges. If a student's account balance is a credit, it is the policy of the University to refund the credit to the student in a timely manner under most circumstances.

### **II. Student Reimbursements**

Students who incur costs for approved activities that primarily benefit the University may be entitled to reimbursement. Student reimbursements for approved expenditures incurred are not considered reportable as taxable income to the IRS.

An example is a student who travels to an approved conference to represent the University as requested by the University. Such expenses are fully reimbursed by the University. All University policies and procedures apply to these reimbursements, including the requirement that reimbursement requests be received by Accounts Payables

#### ***Other Examples:***

- Student A is approved to travel to Washington, D.C. to represent the University in a scholastic competition.
- Student B is approved to travel to a conference held in San Francisco to present a research paper on behalf of the college.
- Student C is approved to purchase a toner cartridge for a University-owned printer that is located in his college's lab.

### **How to Process**

#### ***U.S. Citizens and International Students***

Submit payment requests to University's Accounts Payable Office.