Financial Management Office

Webinar # 2
Tax Treatment for Scholarships and Fellowships

March 3, 2015
Webinar Instructions

- Web conference login:
  - URL: [http://www.hawaii.edu/halawai/login.htm](http://www.hawaii.edu/halawai/login.htm)
  - Use your regular user name and password
- Questions can be submitted via Halawai function and will be addressed at the end of the presentation
- Presentation will be posted to UH FMO website:
  - [http://www.fmo.hawaii.edu/fmo/](http://www.fmo.hawaii.edu/fmo/)
Disclaimer

• The information provided in this power point presentation is not authoritative material for anyone’s tax return preparation.
• Please consult with your tax advisor if further assistance is needed.
Since May 1, 2014, 1st Webinar, what did we accomplish?

- **May 1, 2014:** Webinar on tax treatment of scholarship and fellowship
- **June 2014:** Posted FAQs on the old website
- **July 2014:** Discussion with various departments (i.e. TRIO, P-20, Upward Bound) on topic
- **August September 2014:** Seek external opinion, worked on easy to read brochure, discussed with Accuity.
- **October 2014:** Discussion with CSO (chartered Student Organization), presented brochure at FA meeting and provided further explanation on scholarship and fellowship
- **November 2014:** Further discussion with TRIO, P-20, Upward Bound, FSO created 3 questions in DV tab, number of subcodes decreased.
Since May 1, 2014, 1\textsuperscript{st} Webinar, what did we accomplish? (continued)

- **December 2014**: Worked with RCUH drafting administrative procedures on such topic.
- **January 2015**: Discussion with Howard Todo, subsequent discussion with executive management and President Lassner, met with Disbursing office to ensure overall understanding.
- **February 2015**: Drafted Administrative Procedure, Approved by Kalbert Young on February 24 and posted on website on February 25. Also, RCUH organized a tax compliance and treatment of payments seminar by Arctic International on Feb. 23 and 24. And RCUH sponsored a 2 hour videoconference/polycom session on Feb. 25 for all campuses of this topic.
Since May 1, 2014, 1st Webinar, what did we accomplish? (continued)

- February 2015 (cont’d): object codes will be limited to 8 different object codes for this kind of payments, subject to final review. Mapping will be used to coordinate old object codes with vendor profiles (either “resident” or “nonresident”) so that no adjustments are needed to comply internally with year end reporting for Form 1042-S, or Form 1099.
Purpose of AP 8.561 Tax Treatment of Non-Service Financial Assistance for Individuals

- To address tax treatment of financial assistance provided to/for individuals who are not required to perform services in exchange for the financial assistance they receive, and who are not regular employees.
- Non-service Financial Assistance (NSFA) is generally considered income by the Internal Revenue Service (IRS), unless an Internal Revenue Code or tax treaty exemption can be applied. Scholarships and fellowships are the most common form of NSFA at educational institutions, and may consist of tuition waivers, as well as payments for fees, room, board, and many other types of expenses, including travel costs.
“The End Result”

- AP 8.561 Tax Treatment of Non-Service Financial Assistance for Individuals
- Website:  
  http://www.hawaii.edu/policy/ap8.561
Quick summary of “The End Result”

<table>
<thead>
<tr>
<th></th>
<th>Qualified Scholarship and Fellowship</th>
<th>Non-Qualified Scholarship and Fellowship</th>
<th>General Program Expense</th>
</tr>
</thead>
<tbody>
<tr>
<td>U.S. Citizen</td>
<td>No Reporting</td>
<td>No Reporting</td>
<td>No Reporting</td>
</tr>
<tr>
<td>Permanent Resident &amp; Resident Alien</td>
<td>No Reporting</td>
<td>No Reporting</td>
<td>No Reporting</td>
</tr>
<tr>
<td>Nonresident Alien</td>
<td>No Reporting</td>
<td>Form 1042-S reporting and possible federal tax withholding</td>
<td>No Reporting</td>
</tr>
</tbody>
</table>
What is “STIPEND”? 

- Monthly allowance?
- Extra money?
- Payments to students?
- Travel reimbursements?
- Part for work/part for living expenses?
Stipends
Tasks needed **to determine for “The End Result”**

1. Gather enough information to adequately determine payments are for scholarship or fellowship
2. Understand what is “the end result”, which is “only nonresident alien for tax purposes will need have nonqualified scholarship or fellowship reported on Form 1042-S by U.H. and possibly have federal tax withholding on such payments. All other scholarship and fellowship payments for others will not be reported by U.H.
3. Revisit the definitions to ensure correct classification
   a. Scholarship/fellowship (qualified or nonqualified)
   b. General program expenses
   c. Types of individuals being paid and correctly identify such.
Qualified Scholarships

- Scholarships received by a degree candidate who attends an educational institution for tuition, fees, books, supplies, and equipment required for courses. These items must be required of all students in your course of instruction to be tax free.
Non-Qualified Scholarships/Fellowships

- Scholarships or fellowships received for incidental expenses or by a non-degree candidate (e.g. postdoctoral fellow)
  - Room, board, living expenses
  - Travel including airfare, lodging, transportation, M&IE, and conference registration fee
  - Any excess amounts in qualified scholarships
General program expense

- Defined in AP 8.561 as any costs supporting activities of educating or instructing students for imparting knowledge or skill that fulfills the purpose of the academic program

**Example 1**: ASUH paying for airfares to send student officers to regional conference at another college in the mainland.

**Example 2**: Computer department at HCC sending students in that major to compete in a national computer programming collegiate competition in the mainland.
General program expense (cont’d):

Section III A 1c of AP 8.561

- General program expenses incurred by a scholarship or fellowship program that do not benefit a specific individual (such as beverages provided at an informational community meeting or a bus/transportation service that is open to any participant) are not considered part of an individual scholarship/fellowship. However, if the expense is to support a specific recipient (such as payments for an airline ticket or lodging), the expense is likely a scholarship/fellowship (provided all other scholarship/fellowship requirements are met) unless the activity resulting in the expense is part of an official UH course curriculum, the activity is specifically described in the class catalog, or UH Chartered Student Organization.
Compensation for Services

- Per IRS Treasury Regulation 1.117-4
  - The amount represents compensation for past, present, or future employment services;
  - The activity the grant payments fund is "subject to the direction or supervision of the grantor"; or
  - The grant payment enables the recipient to "pursue studies or research primarily for the benefit of the grantor."

- Key Question: Was the taxpayer paid to work or paid to study?
  
  Conclusion:
  - If paid to work, it is compensation
  - If paid to study, it is scholarship/fellowship
  - Must be NSFA (non service financial assistance)
Compensation for Services – Nonresident Aliens

Travel/Expense Reimbursements

• Nonresident aliens who are invited to the U.S. for a short period of time (e.g., to participate in a weekend lecture series) often receive reimbursement of travel expenses.
  ▫ The IRS takes the position that such payments constitute compensation and that withholding is required unless a tax treaty provides for an exemption.

• Exceptions
  • Travel expenses will not be considered compensation if the expenses are properly substantiated under the section 274 accountable plan rules.
  • If the nonresident alien is acting in their capacities as employees of another entity (e.g., employees of foreign universities), the foreign employer must have a reimbursement plan that meets the section 274 requirements. This payment to a nonresident alien requires an identification number (either a SSN or an ITIN) - IRS Treasury Regulation 1.274-5T(h).
**Accountable Plan:**

Definition: An arrangement or method for reimbursing employees or independent contractors for business travel expenses that complies with IRS regulations.

To consider an “accountable plan” by the IRS, such arrangement must have:

1. Expenses must have business connection. They must have been paid or incurred while performing services as an employee or independent contractor.
2. Adequate accounting to payor within a reasonable time.
3. Payee must return excess reimbursement within a reasonable period of time.
## Summary of Income at a University:

<table>
<thead>
<tr>
<th>Income Type</th>
<th>Income Name</th>
<th>Effect</th>
</tr>
</thead>
<tbody>
<tr>
<td>Compensation (dependent personal service)</td>
<td>Wages, Salary, (stipend for svc)</td>
<td>Taxable or tax treaty exempt</td>
</tr>
<tr>
<td>Compensation (dependent personal service)</td>
<td>Travel Reimbursements</td>
<td>Accountable Plan</td>
</tr>
<tr>
<td>Compensation (independent)</td>
<td>Ind Personal Svc/Consulting fees</td>
<td>Taxable/Treaty exempt</td>
</tr>
<tr>
<td>Compensation (independent)</td>
<td>Honoraria/guest speaker fee</td>
<td>Taxable/Treaty exempt</td>
</tr>
<tr>
<td>Compensation (independent)</td>
<td>Travel Reimbursements</td>
<td>Accountable Plan</td>
</tr>
<tr>
<td>Scholarships/Fellowships</td>
<td>Tuition/Fees/Books/supplies etc.</td>
<td>Excluded under IRC section 117</td>
</tr>
<tr>
<td>Room/Board</td>
<td></td>
<td>Taxable/Treaty Exempt</td>
</tr>
<tr>
<td>Travel Reimbursements</td>
<td></td>
<td>Taxable/Treaty Exempt</td>
</tr>
<tr>
<td>Stipends (no service by payee)</td>
<td></td>
<td>Taxable/Treaty Exempt</td>
</tr>
<tr>
<td>Royalties</td>
<td>Royalties</td>
<td>Taxable/Lower Treaty Rate</td>
</tr>
<tr>
<td>Prizes or awards</td>
<td>Prizes or awards</td>
<td>Taxable</td>
</tr>
</tbody>
</table>
Step 1 (getting to “END RESULT”):

Gather enough information to adequately determine payments are for scholarship or fellowship:

1. Know the facts of the situation. Payee (U.S. Citizen or Permanent resident? Or nonresident alien)
2. If payee is not U.S. citizen or permanent resident, do SPT. See U.H. Form WH-1 for SPT (substantial presence test).
3. Determine if payments are for scholarship or fellowship.
4. Determine source of income. (U.S. or foreign)
## Source of Income chart:

<table>
<thead>
<tr>
<th>Location of Payor</th>
<th>Location of Activity (U.S.)</th>
<th>Location of Activity (Outside U.S.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>U.S.</td>
<td>U.S. source income</td>
<td>Foreign Source Income</td>
</tr>
<tr>
<td>Outside U.S.</td>
<td>U. S. source income (for svc)</td>
<td>Foreign Source Income</td>
</tr>
</tbody>
</table>
Step 2 think of options when “END RESULT” is probable:

1. Consider tax exceptions such as accountable plan (for employees or independent contractors) or qualifying it as general program expense.
2. Check if tax treaty article is available for such transaction.
3. See if there are other IRS methods to lower the tax withholding.
Step 3 think of options when “END RESULT” is imminent:

- Consider grossing up of amount for nonresident alien
- Inform recipient if needed about the taxability of such payment
- Ensure timeliness and accuracy of information to all parties involved at U.H. (i.e. correct address, U.S. ITIN etc., pay within the calendar year)
Grossing Up of payments scenarios for 3rd Party payments for nonresident aliens:

**Scenario 1 (for missing SSN situations or other income)**
- **Scenario 1 (30%)**: If $100 is due the vendor, divide $100 by 70% (.70) = $142.86 $146.86 is the amount the program must pay.
- $100 is paid to the vendor and
- $42.86 is “withheld tax” paid to the IRS (30% of $142.86)
- This scenario is applicable when a nonresident alien has no social security number or taxpayer i.d. number, or for income other than scholarship or fellowship.

**Scenario 2 (for 14% scholarship or fellowship)**
- **Scenario 2 (14%)**: If $100 is due the vendor, divide $100 by 86% (.86) = $116.28 $116.28 is the amount the program must pay.
- $100 is paid to the vendor and
- $16.28 is “withheld tax” paid to the IRS (14% of $116.28)
- This scenario is applicable for scholarship and fellowship payments to nonresident aliens who have a social security number or taxpayer i.d. number, and no tax treaty benefit.
Exceptions on Nonqualified Scholarship/Fellowship

- Nonresident aliens (IRS Code section 871)
  - If payment is a foreign source grant, it is not reportable to the IRS and is not subject to withholding of Federal income tax.
  - Payments are exempt from tax under a tax treaty.
    - Individual must file Form W-8BEN with the university. Form W-8BEN is valid until December 31st of the third calendar year following the year in which the form was submitted.
  - Payees who are temporarily present in the United States in F-1, J-1, M-1, Q-1, or Q-2 nonimmigrant status are subject to a reduced 14% withholding rate on the taxable portion of the grant.
    - Rationale: Individuals are considered to be engaged in a U.S. trade or business under Internal Revenue Code section 871(c).
  - No withholding of Federal income tax on grants originated from funds provided by the U.S. Agency for International Development (USAID) within Federal Allowable Rate per Diem.
Exceptions on Nonqualified Scholarship/Fellowship (cont.)

- Stipends, tuition waivers, or any other financial aid paid to or on behalf of NONRESIDENT ALIENS which require the recipient to perform services past, present, or future, in exchange for the financial aid are taxable as wages, are reportable to IRS on Form W-2.
Other NSFA:

1. Section J of AP 8.561 (Prizes and Awards): If a payment is based on a past accomplishment or activity or is received as the result of entering a contest, it is generally considered a prize or award, rather than a scholarship/fellowship, which is generally awarded for future or continuing educational activity (such as for future studies or participation in an educational program). A recipient of a prize or award must complete an IRS Form W-9 (U.S. citizens and permanent resident aliens) or a UH Form WH-1 (resident aliens and nonresident aliens).
Other NSFA (cont’d):

2. **Section K of AP 8.561** (Miscellaneous NSFA): All other types of financial assistance provided to/for an individual that do not require services and are not considered scholarships or fellowships will be treated in the same manner as a prize or award for tax reporting and/or withholding purposes.
Administrative responsibilities:

AP 8.561 III E 1:

Non-qualified scholarship/fellowship payments are not required to be reported on an IRS Form 1099-Misc. However, programs are responsible for responding to any scholarship/fellowship recipient inquiries regarding the amount of financial assistance provided to the recipient. When welcome/informational letters are first sent to recipients informing them of their financial assistance, it is recommended that the letters include language similar to the following: “If you require financial information regarding the financial assistance and/or benefits you will be receiving, please contact [insert name of appropriate program personnel].” Programs (respective departments) at UH are responsible for responding to any scholarship/fellowship recipient inquiries regarding the amount of financial assistance provided to the recipient.
Required tax forms to claim tax treaty:

1. For nonresident aliens who are paid wages, then use Form 8233.
2. For nonresident aliens who are individuals and getting paid other than wages (i.e. stipends, travel expenses etc.), then use Form W-8BEN.
3. For nonresident aliens who are entities other than individuals (i.e. trusts, corporation, estates, foundations, partnerships etc.), then use Form W-8BEN-E.

**Note:** TIN (taxpayer identification number) is needed on these tax forms to validly claim the tax treaty. Otherwise, the normal 30% federal withholding tax is imposed.
Case Study #1

Q: A community college is planning to provide a culinary school student with an all expenses paid trip to compete in a national culinary competition. If the winner is selected from a local competition, would the all expenses paid trip be reportable to the IRS? Is there a situation where the all expenses paid trip would not be reportable?
Case Study #1

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A: As described, the all-expenses-paid trip is considered a prize that is subject to reporting. However, if participation in the culinary competition was instead a part of the class curriculum as described in the Culinary School’s course catalog, the trip expenses would be a program expense for the class, and would not be considered income to the student selectee. Therefore, it is important to make a link between the payment provided and the academic program, particularly in the event of IRS audit, if the payment is not reportable.
Case Study #2

• Q: The University is planning to pay for the traveling expenses of a student to present his paper at a conference relating to his field of studies in class. The trip is not an annual recurring situation for the department. Explain the tax treatment of the travel expenses.
Case Study #2

Q: The University is planning to pay for the traveling expenses of a student to present his paper at a conference relating to his field of studies in class. The trip is not an annual recurring situation for the department. Explain the tax treatment of the travel expenses.

A: The travel expenses would be treated as a "non-qualified" scholarship for the student, based on the fact that the conference is not a normal, recurring expense of the University, and the student is benefitting from the trip. If the student is a U.S. citizen, permanent resident, or resident alien, the University is not required to report the value of the trip, but the expenses are considered “income” to the student. If student is a nonresident alien, the University is required to report the value of the trip on an IRS Form 1042-S, and tax withholding may also be required. If the student is on an F, J, M or Q visa, the standard withholding rate of 30% is reduced to 14%. The tax withholding amount may also be reduced or eliminated depending on the student’s country’s tax treaty status.
Case Study #3:

Q: A UH program is paying for the overnight lodging costs (i.e., travel costs) for middle school students to visit a UH campus. The event is not a recurring event, and is not a class requirement or part of a course curriculum. Explain the tax treatment of the travel costs for the students.
Case Study #3:

Q: A UH program is paying for the overnight lodging costs (i.e., travel costs) for middle school students to visit a UH campus. The event is not a recurring event, and is not a class requirement or part of a course curriculum. Explain the tax treatment of the travel costs for the students.

A: The travel costs are considered non-qualified S/F expense and constitute a form of financial assistance to the middle school student. However, UH is not required to report on Form 1099-Misc for U.S. Citizen, permanent resident, and resident alien. For nonresident aliens, the amount of the non-S/F expense has to be reported in Form 1042S with proper federal tax withholding.
Case Study #4:

Q: UH Manoa is planning to send student officers of the Associated Students of the University of Hawaii (ASUH) to an annual conference in California for student government officers of various universities. The ASUH is a part of the Chartered Student Organization (CSO), and CSO related events are included in the University’s budget. Explain the tax treatment of the travel costs for the students.
Case Study 4#:

- Q: UH Manoa is planning to send student officers of the Associated Students of the University of Hawaii (ASUH) to an annual conference in California for student government officers of various universities. The ASUH is a part of the Chartered Student Organization (CSO), and CSO related events are included in the University’s budget. Explain the tax treatment of the travel costs for the students.
- A: The costs are considered an operational business expense of the University. To the extent that only actual costs are paid, no IRS reporting is required and the trip is not considered income to the students.
Questions?