



## COLLEGE OF CHARLESTON POLICY AND PROCEDURE

**Number & Title:** Scholarships,  
Fellowships,  
Stipends, Prizes and  
Awards

**Originated:** 4/21/06

**Effective date:** 5/16/07

**Reviewed:**

**Owner:** Controller's Office

**Revised:**

### **Policy Statement:**

The College of Charleston will apply and follow the taxation rules of the Internal Revenue Service (IRS), the financial aid rules of the U. S. Department of Education, and the immigration laws of the U. S. Department of Homeland Security for all payments of scholarships, fellowships, stipends, prizes and awards.

### **Scope and Background:**

- A. This information will serve as a guide to faculty, staff and students for preparing documents to pay scholarships, fellowships, stipends and other awards to students and individuals. Taxation of these amounts can vary greatly based on the provisions of the grant, the use of the proceeds, the status of the recipient, and whether the recipient is required to perform services in return for the award. These issues become ever more important in light of increased IRS scrutiny of the colleges and universities.
- B. Ordinarily, the amount of a qualified scholarship (refer to Section E. of the Scope and Background for the definition of a qualified scholarship) is not included in the income of the recipient for tax purposes if the recipient is a candidate for a degree at an appropriate educational institution (Internal Revenue Code (IRC) 117(a)). Consideration of a qualified scholarship requires using the amount received for qualified tuition and related expenses, in accordance with the terms of the

scholarship, fellowship or grant IRC 117(b) (1). The IRC provides that the qualified tuition and related expenses include: tuition and fees required for enrollment and attendance at the institution; and fees, books, supplies, and equipment required for courses of instruction at the institution (IRC 117(b) (2).

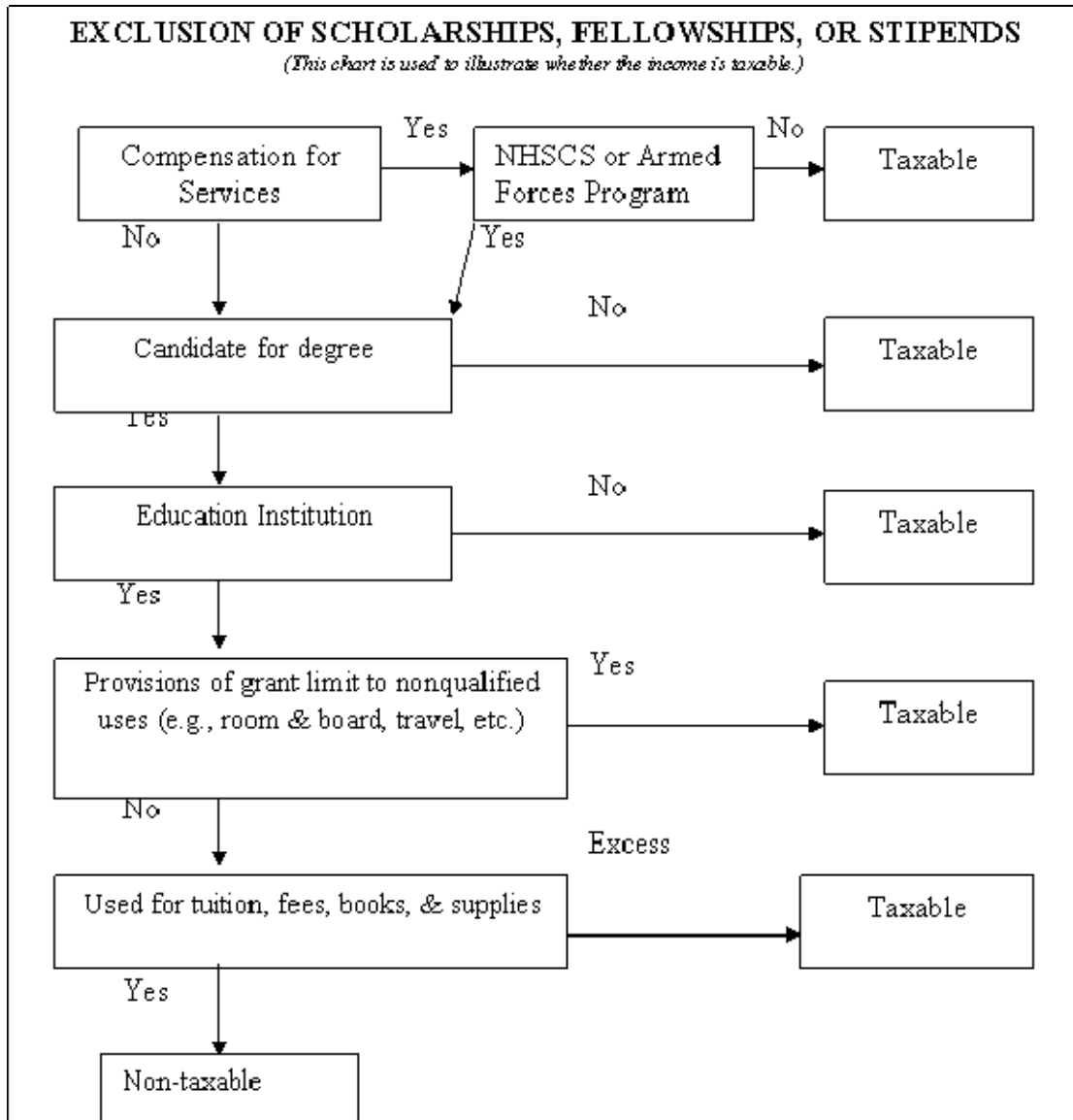
Nonetheless, if the recipient must provide current or future services (e.g., teaching or research) as a condition of the scholarship, the portion that represents payment for such services should not be excluded from the recipient's income (IRC 117(c)). Amounts received under the National Health Service Corps Scholarship (NHSCS) Program and the F. Edward Hebert Armed Forces Health Professions Scholarship and Financial Assistance (Armed Forces) Program are eligible for tax-free treatment without regard to any service obligation imposed on the recipient after December 31, 2001.

C. Essentially, the answer to three basic questions determines whether a scholarship award is taxable.

1. Is the payment a qualified scholarship? If the payment is considered a qualified scholarship, then such amount should not be included in the student's income. If not, then the amount could be included in a student's income but the College need not report the amount as wages unless the scholarship constitutes compensation for services.
2. Is the payment compensation for services? ***Even if the payment is considered a qualified scholarship, the College must determine whether any portion of the amount constitutes payment for services.*** To the extent an amount constitutes payment for services, the student should include the amount in his or her income.
3. What reporting and recordkeeping requirements may arise? The College could have a withholding obligation and duty to report amounts constituting payment for services/wages. Additionally, a student may want to retain records to substantiate any scholarship or fellowship amount not included in income. Finally, students may need to report amounts included in income for purposes of filing an individual income tax return.

D. Exclusions of Scholarships, Fellowships and Stipends

1. The College does not report scholarship, fellowship, and stipend amounts included in income for the purposes of filing an income tax return. The student must show such payments as income if the following criteria are true.



2. If considered compensation for services, the payment must be made through payroll.
- E. Qualified Scholarships – To qualify for exclusion under IRC 117, the first inquiry is whether the funds paid or credited to a student’s account constitute a scholarship or fellowship grant.
1. Scholarship or Fellowship Grants

A scholarship or fellowship grant is a cash sum paid to aid an individual in the pursuit of study or research and may come from an educational institution, government agency, charity, or other source. This payment would include any reduction in the amount owed by an individual for tuition, room and board, and other fees. For tax law purposes, the focus is on whether the amounts meet the definition of a scholarship or fellowship as provided in the IRC. Upon determination that a payment meets the

definition of a scholarship or fellowship grant, the payment must be assessed to establish whether it is a qualified scholarship.

a. Relationship between the Grantor and the Recipient

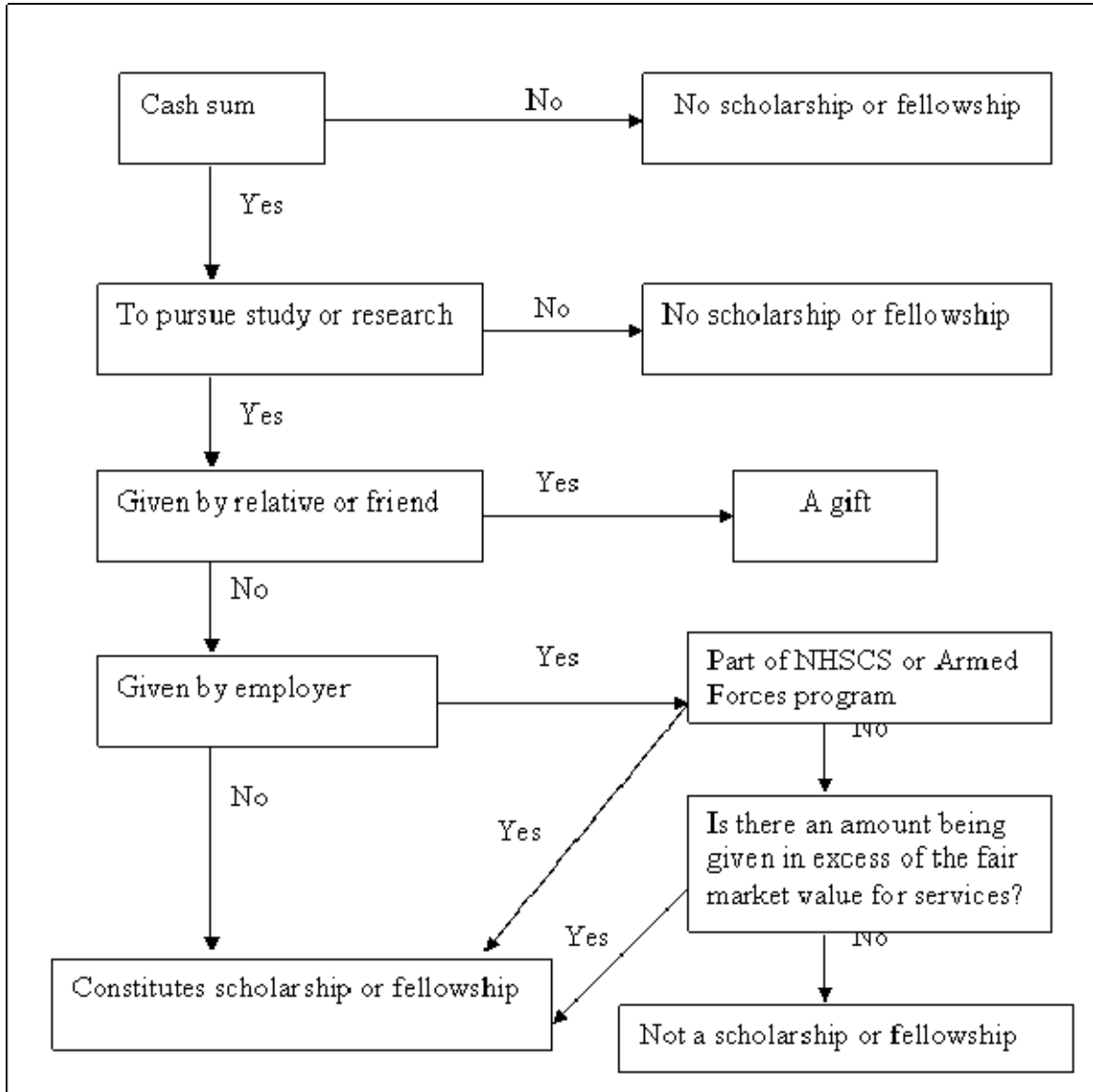
The relationship between the grantor and the recipient may affect whether the amount involved is considered a scholarship or fellowship grant.

b. Employment Relationship

Generally, the courts have developed a “quid pro quo” (an equal exchange or substitution) test to determine whether the amount received is the result of the employer’s “disinterested generosity” or whether the amount is “bargained for consideration” (see *Bingler v. Johnson*, 394 U. S. 741 (1969)).

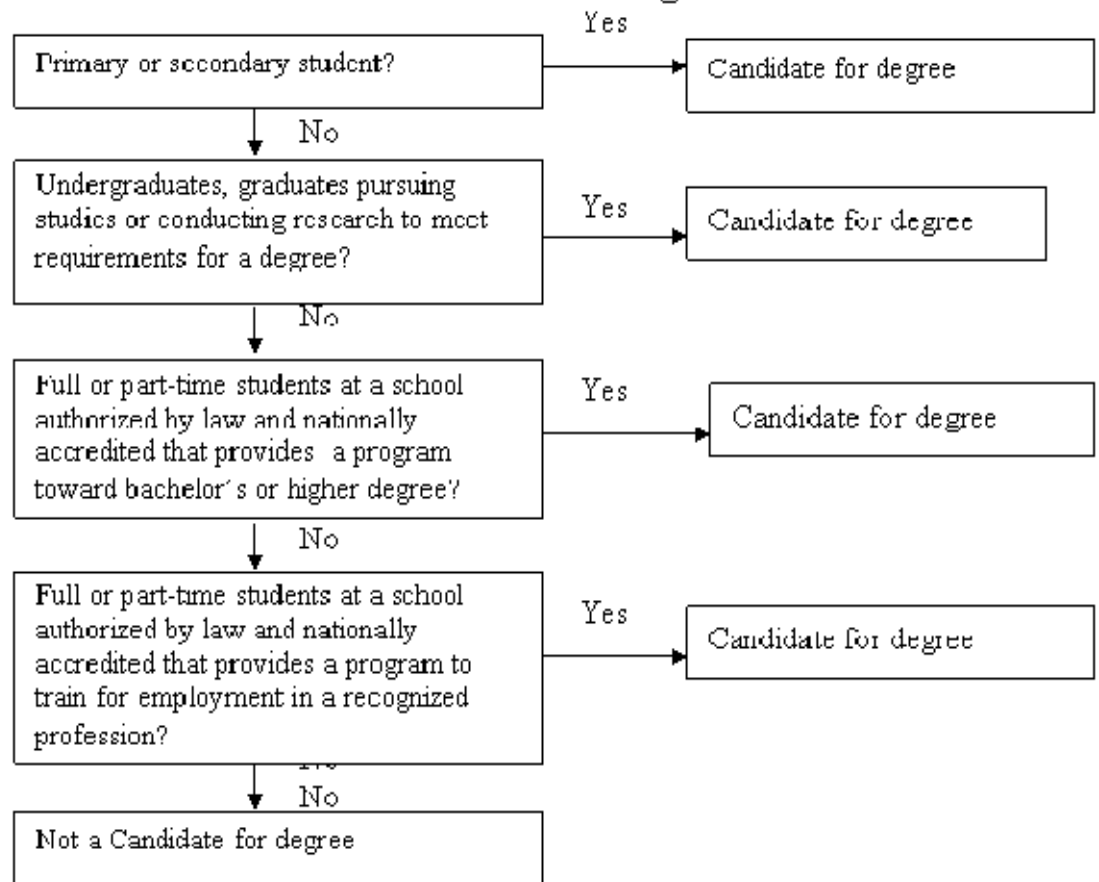
c. Athletic Scholarships – As per the IRS ruling, athletic scholarships are not taxable. Under current law, scholarship amounts used for tuition and required fees, books, supplies and equipment are not considered income, subject to the requirements and limitations outlined in this policy. The exclusion, however, does not apply to incidental expenses such as room and board.

d. Is it a Scholarship or Fellowship Grant?



2. Qualified Tuition and Related Expenses
  - a. A qualified scholarship is excluded from the recipient's taxable income only if the proceeds are used for qualified tuition and related expenses. It is the responsibility of the recipient to establish that the amounts received qualify. To the extent the student is not able to substantiate the appropriate use of funds if asked by the IRS, the student could be required to recognize taxable income. If the grant specifies that funds cannot be used for qualified tuition and related expenses, then the award cannot be considered a qualified scholarship and would be taxable to the recipient.
  - b. With respect to related expenses, to qualify for exclusion from income, the fees, books, supplies and equipment must be required of all students taking this particular course. Incidental expenses are taxable to the recipient.
3. Candidate for a Degree - In order to exclude a qualified scholarship from income, the recipient must be a candidate for a degree. Use the following chart to determine if recipient is considered a Candidate for Degree:

## Candidate for a Degree



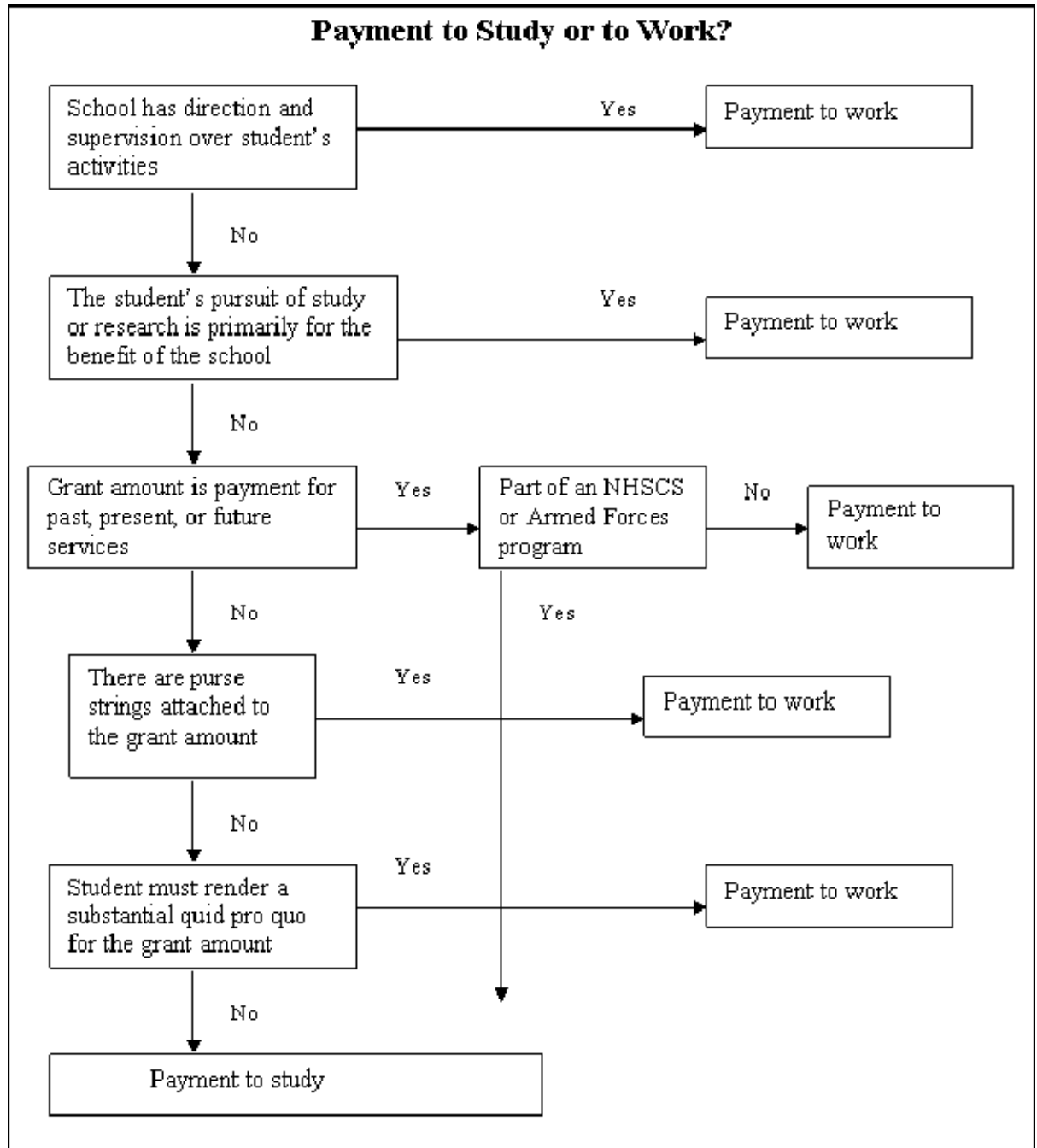
F. When is a Scholarship, Fellowship, or Grant Considered Compensation for Services?

Amounts received by a student for teaching, research, or other services that are a condition of receiving a scholarship are not excluded from the student's income except in the case of NHSCS or Armed Forces program. Two standards developed under prior law help to distinguish payment for services from scholarship, fellowships or grants eligible for exclusion. These two standards include the "primary purpose" test and the "primary benefit" test. A determination must be made as to whether a student's activities are for the "primary benefit" of the College or whether the student's activities have the "primary benefit" of furthering the student's education and training.

Basically, the query is whether the funds were primarily designed to further the education of the recipient or to compensate him for his services. Stated another way, is the money for development of the individual or for the development of a product, i.e., specific research? The following information lists some of major considerations in determining the primary/purpose benefit of a scholarship award.

1. Does the College have direction or supervision over the student's activities?
2. Is the student pursuing studies or research "primarily for the benefit" of the College?
3. Does the scholarship, fellowship, or grant represent payment for services in the past, present, or future?
4. Is the College "relatively disinterested?"
5. Is the student required to render a substantial quid pro quo for the scholarship, fellowship or grant?

6. The fact that the student must submit periodic reports to the College is not determinative. The requirement to submit reports, by itself, does not indicate it represents compensation for services.



## References:

The following excerpts from the Internal Revenue Service Code (IRC) per the Tax Reform Act of 1986 and U. S. Department of Education Title IV Higher Education Act of 1965 (as amended in 1998) are pertinent to the taxation and awarding of scholarship and fellowship grants.

- Section 117(a) of the IRC, as amended by the Act, provides that gross income does not include any amount received as a qualified scholarship by an individual who is a candidate for a degree at an educational organization described in section 170(b)(1)(A)(ii). (See Scope and Background section E.3. Candidate for a Degree Guide.)

- Section 117(b), as amended by the Act, provides that a “qualified scholarship” is any amount received by an individual as a scholarship or fellowship grant to the extent that the individual establishes that the amounts received are used for qualified tuition and related expenses.
- Section 117(b)(2), as amended by the Act, provides that “qualified tuition and related expenses” are tuition and fees required for enrollment or attendance at the educational organization and fees, books, supplies and equipment required for courses and instruction. Thus, scholarship and fellowship grants that are used for other expenses, such as room and board, are not excludable from gross income. (See Scope and Background, section E.2. Qualified Tuition and Related Expenses.)
- Additionally, section 117(c), as amended by the Act, provides that gross income includes any portion of amounts received as a scholarship or fellowship grant representing payment for teaching, research or other services required as a condition for receiving the qualified scholarship.
- The U. S. Department of Education Title IV – Student Assistance Part A- Grants to Students in Attendance at Institutions of Higher Education Section 454. 20 U.S.C. 1087d Agreements with Institutions reads: “Participation Agreements. --an agreement with any institution of higher education for participation in the direct student loan program under this part shall—(1) provide for the establishment and maintenance of a direct student loan program at the institution under which the institution will— (A) identify eligible students who seek student financial assistance at such institution in accordance with section 484; (B) estimate the need of each such student . . . (C) provide a statement that certifies the eligibility of any student to receive a loan under this part that is not in excess of the annual or aggregate limit applicable to such loan . . .”

## **Procedures:**

### **I. Reporting Obligations of the College of Charleston**

- A. If the student is a U.S. resident for tax purposes, the College has no reporting responsibility with respect to scholarship awards if such amounts are:
  1. Considered a qualified scholarship (as defined in the Scope and Background section of this policy) and
  2. Not considered compensation for services.

- B. The Controller (or designee), the principal investigator, the Payroll Officer and the Director of ORGA (Office of Research and Grants Administration) will determine whether a payment is a qualified scholarship by reviewing the grant documentation to verify the following assertions. To determine if a payment is a qualified scholarship within the externally funded grant document, the award must state to the effect that:
1. The payment must be for tuition and fees required for enrollment and attendance at the institution;
  2. Fees, books, supplies and equipment are required for courses of instruction at the institution; and
  3. The recipient is not required to render current or future services as a condition of the scholarship.
- C. If the externally funded grant document is silent on what use is to be made of the funds, then the College will take the position that it is for qualified purposes.
- D. If the externally funded grant document states that the funds are to be used for something other than tuition and fees, then it is not for a qualified purpose.
- E. Taxation and Method of Payment of Scholarships, Fellowships and Stipends
1. Unless a scholarship or fellowship grant is subject to the provisions of Section 117(c) of the Internal Service Revenue Code and that is “. . . gross income includes any portion of amounts received as a scholarship or fellowship grant representing payment for teaching, research or other services required as a condition for receiving the qualified scholarship,” **the College will not file a return of information with respect to such grant.** Furthermore, unless section 117(c) of the Code applies, the amount of scholarship or fellowship grant is not considered wages. Thus such amount is not subject to section 3402 (relating to withholding for income taxes), section 3102 (relating to withholding under the Federal Insurance Contribution Act (FICA) or section 3301 (relating to the Federal Unemployment Tax Act (FUTA)). **Therefore the payment must be made through the College Financial Aid Office resulting in a Student Information System (SIS) generated check through the accounts payable process.**
  2. A scholarship or fellowship grant that is includible in gross income under section 117(c) of the Code is considered wages for purposes of section 3401(a). The application of FICA and FUTA depends on the nature of the employment and the status of the organization. In addition the College or grantor is subject to the provisions of section 6051 (relating to reporting of wages of employees) and is required to file Form W-2 with respect to amounts provided as a scholarship or fellowship grant that are

subject to provisions of 117(c). For example, if a college reduces a student's tuition solely in return for performing services that are required as a condition to receiving the scholarship, the college must file Form W-2 reflecting the amount of the reduction. **In this case the scholarship or fellowship is taxable, and payment must occur through the College's Career Center.**

3. Where a **portion** of a scholarship is granted in return for services described in section 117(c) of the Code, the Controller (or designee), the principal investigator, Payroll Office, and the Director of ORGA will make a good faith allocation, based on all the facts and circumstances, to determine that portion of the amount that represents compensation for services provided by the recipient.
  - a. The recipient of the income will be required to complete a Student Employment Hire form for payment of the portion that constitutes employment services.
  - b. The portion of income for payment of employment services will be reduced from the amount reported to the Financial Aid Office.
4. *A Form 1099-MISC will not be used to report scholarship or fellowship grants. Scholarships or fellowship grants that are taxable to the recipient because they are paid for teaching, research, or other services as a condition for receiving the grant are considered wages and must be reported on Form W-2. Other taxable scholarship or fellowship payments (to a degree- or non-degree- candidate) are not required to be reported by the employer to the IRS on any form.*
5. As for 1098-T (Tuition Statement) reporting, the College is required by the Internal Revenue Service to report to students the amount of qualified tuition and related expenses that have been billed to the student during the calendar year if those expenses are greater than qualified scholarships received during the same calendar year. The amount paid on the student's behalf is not recorded on the 1098T. Only qualified expenses billed during the fiscal year are recorded on the form.

F. Stipends, Prizes, Awards

1. Stipends
  - a. The first consideration for paying a stipend to an individual is to determine why the person is receiving the income. Does the payment represent compensation for past, present or future employment services or represent payment for services which primarily benefits the grantor? Or does it enable the individual to further his education and training in his individual capacity? And, explained another way were the funds designed to further the education of the student or to compensate him for his services?

- b. Upon review of documentation in the grant proposal, the Controller (or designee), the principal investigator, the Payroll Officer and the Director of ORGA will use the IRS criteria to determine whether the income constitutes compensation for services versus an educational or a training experience for the student or individual. In some cases where the proposal demonstrates that the student is engaged in both, the parties (principal investigator, Payroll Office, ORGA and Controller's Office) will determine a percentage of services performed versus educational experience.
- c. The payments of stipends follow the same guidelines as described under I. Procedures, E. Taxation and Method of Payment of Scholarships, Fellowships, and Stipends.

2. Prizes and Awards

- a. Prizes and awards are amounts received primarily in recognition of religious, charitable, scientific, educational, artistic, literary, or civic achievement, or are received as the result of entering a contest. A prize or award is taxable to the recipient unless all of the following conditions are met: *1) the recipient was selected without any action on his or her part to enter the contest or proceeding; 2) the recipient is not required to render substantial future services as a condition to receive the prize or award; and 3) the prize or award is transferred by the payer to a governmental unit or tax-exempt charitable organization as designated by the recipient.*
- b. Prizes or awards paid to students can be processed through the Accounts Payable Unit using the expense authorization (EA) form but must be reported to the appropriate school's Financial Aid Office. It is the responsibility of the requestor of the payment to notify the school.
- c. Payments to non-COFC employees or State employees otherwise that meet the definition of prizes and awards as described above may be processed through the Accounts Payable Unit using the EA. Payments to State including COFC employees require processing through the appropriate payroll offices.

G. Requirement to Flow through the Financial Aid System

- 1. Per Title IV of the Higher Education Act of 1965, the College signs a participation agreement that requires the coordination and communication of all aid awarded to a student. If

the scholarship/fellowship income (stipend) is primarily to educate the student in an individual capacity and the student is enrolled in a course at the College of Charleston, the portion of the payment not deemed employment must flow through the College's Financial Aid Program. When the payment flows through the CofC Financial Aid Program, the activity will post to the Student Information System and any payment of surplus aid will result in a system-generated student refund check. For any surplus aid, the student has the obligation of reporting the tax liability associated with the income, thereby relieving the College of the obligation.

2. If the individual is a CofC student but not enrolled in a course at the College of Charleston -- usually circumstances surrounding summer school, the payment will be made through the accounts payable process using an expense authorization form. The Controller's Office will notify the Financial Aid Office of the payment so that student's financial record is adjusted accordingly.
3. If the payment is to a CofC student for compensation of employment services or research/studies primarily benefiting the grantor, the payment must be handled by the CofC Career Center (the office that handles student employment.)
4. If the individual is a student but not a College of Charleston student and the payment is considered an award to educate in an individual capacity, the College will pay the appropriate Financial Aid Office of the school where the student is enrolled. If the income is for compensation of employment services, the payment requires handling through the CofC Human Resources and Payroll Offices.
5. If the income is for a prize or award as described under Procedures, Section I. F.2. Prizes and Awards above, the payment may be processed through the accounts payable process if it is determined that the prize/award money is not compensation for services.

**II. Guide to what portion of the use of the proceeds of a scholarship, stipend, or fellowship grant is to be treated as taxable or nontaxable.**

<b>SCHOLARSHIP, FELLOWSHIP AND STIPEND AWARDS</b>	
<b>Payment For</b>	<b>Taxable/Non-Taxable</b>
Tuition	Non-Taxable
Fees	Non-Taxable*
Books	Non-Taxable*
Supplies	Non-Taxable*
Equipment	Non-Taxable*
Room	Taxable
Board	Taxable

Travel	Taxable
Teaching	Taxable
Research Services	Taxable
Other Services	Taxable
*If required of all students taking the course	

**III. How should payments made to nonresident aliens be treated with respect to tax withholding?**

- A. Once the College has determined the residency status of the payee, the Controller (or designee), the principal investigator, Payroll Officer and the Director of ORGA will determine the type of payment being made. After the payment type has been determined, the College will begin with the premise that all payments from U.S. sources made to or on behalf of a nonresident alien are taxable unless the payment can be excluded or exempted from tax withholding.
- B. The Controller (or designee) and Payroll Officer will determine whether the College has a withholding obligation and duty to report amounts constituting payment for services/wages.
- C. In the event that a scholarship represents payment for services, the College will comply with any applicable withholding and reporting requirements including:
  - 1. Wage reporting on Form W-2, "Wage and Tax Statement," and Form 941, "Employer's Quarterly Federal Tax Return;"
  - 2. Withholding of federal and state income taxes
  - 3. Withholding of FICA, if applicable; and

4. Payment of federal or state unemployment tax, depending upon the circumstances.
- D. FICA rules provide an exception for services performed by a student who is enrolled and regularly attending classes at a college, university, or school.

## **Roles and Responsibilities:**

### **I. College's Responsibility: Inform students of possible tax liability**

- A. Prior to completing the paperwork to give a student any scholarship, stipend or fellowship award through the Office of Research and Grants Administration, the grants accountant will inform the student as to whether taxes will be withheld from the award or if he or she will be responsible for determining the tax status of the payment.
- B. If the College rules that the individual will be responsible for determining the tax status of the payment, the grants accountant will make general notification of the student in writing using the standard letter (See the "Dear Student Recipient of Scholarship, Fellowship, Stipend" letter located on the Controller's website.)

### **II. The Student's Responsibilities**

Since the student is ultimately responsible for establishing that grant amounts are properly excluded from his or her income for the year, the student is responsible for keeping appropriate records to substantiate qualified tuition and expenses. It is important for students to retain copies of bills, receipts, cancelled checks, or other documents that would show the use of the grant amount.

If a student meets the threshold reporting requirement for income tax purposes, that student must report amounts considered to be wages on Form 1040, *U.S. Individual Income Tax Return*. If a student is considered an independent contractor, such amounts should be reported on Schedule SE of Form 1040, to determine earnings from self-employment. If a student has net earnings from self-employment of \$400.00 or more, that student may be liable for self-employment tax. Generally, a student will have earnings from self-employment only if such earnings represent payment services as outlined above. The taxable portion of a scholarship or fellowship is generally not considered subject to self-employment taxes.

## **Definitions and Reference Materials**

A **scholarship** is generally an amount paid for the benefit of a student at an educational institution to aid in the pursuit of studies. The student may be either an undergraduate or graduate.

A **fellowship** is generally an amount paid for the benefit of an individual to aid in the pursuit of study or research.

A **stipend** as defined by the Internal Revenue Service regulations is 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](#). 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.

**REFERENCE MATERIALS:** The source for much of this information comes from the IRS Code, Section 117 and IRS Notice 87-31. The information is summarized in IRS Publication 520 and "A Guide to Federal Tax Issues" published by the National Association of College and University Business Officers.

**Dear Student recipient of Scholarships, Fellowships, or Stipends:**

According to our records, you are the recipient of a scholarship, fellowship, or stipend award through the College of Charleston. We feel it is our responsibility and in your best interest to explain to you the general treatment of these amounts for tax purposes.

Generally, under the tax laws, you should not have to pay taxes on a scholarship, fellowship, or stipend to the extent you use the funds for tuition, fees, books and equipment required for classes or enrollment. In other words, to what extent you use the funds for these types of expenses, the scholarship, fellowship or stipend award will determine how much should be excluded from your income for tax purposes.

However, any portion of a scholarship, fellowship or stipend award you spend on incidental expenses, including room and board, could be included in your taxable income for the year. Therefore, you may have to pay income taxes on the portion of a scholarship, fellowship or stipend award spent on items such as travel, research and medical insurance.

You should make the determination regarding whether a scholarship, fellowship, or stipend award is taxable based upon your individual facts and accounting for all the scholarships, fellowships, or stipends that you may have received. To the extent that you determine that a portion of all of the funds are not subject to tax, you should retain receipts, cancelled checks, and other documents that could show the total amount of your qualifying expenses.

Please note that this letter is intended to introduce you to the possible consequences of scholarship, fellowship, or stipend amounts. Since individual tax liability depends on each individual's circumstances, you should contact your personal tax advisor with any questions or concerns.

Very Truly Yours,