



UNIVERSITY
of HAWAII'
SYSTEM

Financial Management Office

Webinar

Tax Treatment for Scholarships and Fellowships

May 1, 2014

Updated as of 5/16/2014

Webinar Instructions

- Web conference login:
 - URL: <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/>

Disclaimer

- The information provided in this power point presentation is not authoritative material for your tax return preparation.
- Please consult with your tax advisor if further assistance is needed.

Three Primary Questions about Federal Income Tax on Scholarships and Fellowships

- Is the payment taxable?
- Is University of Hawaii required to report the payment?
- Is University of Hawaii required to withhold income tax?



What is UH Responsibility

The institution that actually makes the scholarship or fellowship grant will be treated as the "withholding agent".

Type of Payments

- Qualified Scholarships
- Non-Qualified Scholarships/fellowships
- Compensation for Services

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 degree or 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

Stipend Definition

- Stipend is a payment in the form of scholarship and fellowship with no service obligation. It is not wages.

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*."
 - The amount is taxable and reportable. UH is required to withhold income taxes accordingly.
- **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

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).

Payments Covering “Qualified scholarship” (i.e. Tuition, Fees, Books, Supplies & Equipment)

Per Internal Revenue Codes

- Payments of qualified scholarships, fellowships, and grants paid to “candidates for degree” (U.S. citizens, resident aliens, and nonresident aliens) are not includible in the gross income and **NOT reportable** to the IRS.

Payments Covering Non-qualified Scholarships/Fellowships

- **U.S. citizens and resident aliens**
 - The entire grant is includible in the gross income of the recipient.
- **Nonresident aliens**
 - Research grants awarded to post-doctoral research scholars are also entirely includible in the gross income, as such, are subject to withholding.

A recipient of a scholarship/fellowships must include in gross income any amount which represents payment for teaching, research, or other services.

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.

Tax Treatment Matrix for Degree Candidates

Degree Candidate Receiving Qualified Scholarships

Tuition, Fees, Books, Supplies & Equipment

	U.S. Citizen and Resident Alien (Degree Candidate)	Non-Resident Alien Student (Degree Candidate)
Income Taxable	No	No
Reportable	No	No
Federal Income Tax Withholding	No	No

Degree Candidate Receiving Non-Qualified Scholarships/Fellowship Room and board, travel, M&IE, and other items

	U.S. Citizen and Resident Postdoctoral or Visiting Faculty	Non-Resident Alien Postdoctoral or Student
Income Taxable	Yes	Yes
Reportable	No (self-reporting)	Yes on form 1042S
Federal Income Tax Withholding	No	Yes - 30% income tax withholding without Social Security Number (SSN) or 14% with SSN Exceptions: 1) A tax treaty - 0% 2) A foreign source of grant – 0% 3) Visa Type: F-1, J-1, M-1, Q-1, or Q-2 - 14%

Degree Candidate Receiving Compensation

Room and board, travel, M&IE, Work Study and other items

	U.S. Citizen Or Non-Resident Alien Postdoctoral or Visiting Faculty
Income Taxable	Yes
Reportable	Yes on W-2
Federal Income Tax Withholding	Yes based on individual tax status

Compensation is defined by IRS as wages for services provided. The payment is usually paid to UH employees.

Tax Treatment Matrix for Non-Degree Candidates

Non-Degree Candidate Receiving Qualified Scholarships

Tuition, Fees, Books, Supplies & Equipment

	U.S. Citizen and Resident Alien Postdoctoral Fellowship or Student (Non-Degree Candidate)	Non-Resident Alien Postdoctoral Fellowship or Student (Non-Degree Candidate)
Income Taxable	Yes	Yes
Reportable	Yes on form 1099	Yes on form 1042S
Federal Income Tax Withholding	No	Yes - 30% income tax withholding Exceptions: 1) A tax treaty - 0% 2) A foreign source of grant - 0%

Non-Degree Candidate Receiving Non-Qualified Scholarships/Fellowship

Room and board, travel, M&IE, and other items

	U.S. Citizen, Resident Alien	U.S. Citizen, Resident Alien	Non-Resident Alien	Non-Resident Alien
	Business Related	Personal Enrichment (non-business related)	Business Related	Personal Enrichment (non-business related)
Income Taxable	No	Yes	No	Yes
Reportable	No to extend of receipts of FAR	Yes on form 1099	No to extend of receipts of FAR	Yes on form 1042S
Federal Income Tax Withholding	No	No	No	Yes - 30% income tax withholding Exceptions: 1) A tax treaty - 0% 2) A foreign source of grant - 0%

Non-Degree Candidate Receiving Compensation Room and board, travel, M&IE, Work Study and other items

	U.S. Citizen Or Non-Resident Alien Postdoctoral or Visiting Faculty
Income Taxable	Yes
Reportable	Yes on W-2
Federal Income Tax Withholding	Yes based on individual tax status

Compensation is defined by IRS as wages for services provided. The payment is usually paid to UH employees.

Possible tax planning for nonresident aliens:

1. Gross up of amounts to accommodate payee.
 2. Determine if tax treaty is available for payee to obtain smaller federal tax withholding or even zero tax withholding.
- **Note:** tax treaty is agreement between two countries (i. e. U.S. and “resident country” of the nonresident alien) that if their domestic laws have the effect that a person could be charged to tax in both countries, then either one will waive its taxing rights, or will give credit for the other country’s tax when charging its own tax.

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:** T I N (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: U.H. gave tuition waiver to student for grading lab work for science class for the semester. Is the tuition waiver amount taxable?



Case Study #1

Q: U.H. gave tuition waiver to student for grading lab work for science class for the semester.

A: Yes, it is taxable because such amount of tuition waiver represents compensation for employment services. The amount is reported Form W-2.



Case Study #2

Q: State of Hawaii (government) gave a tuition loan to nonresident alien student to obtain teaching degree. He will not be required to pay back this loan as long as he will work in the Department of Education as a teacher for 5 years after obtaining such degree. Is this loan taxable at the time of the payment?



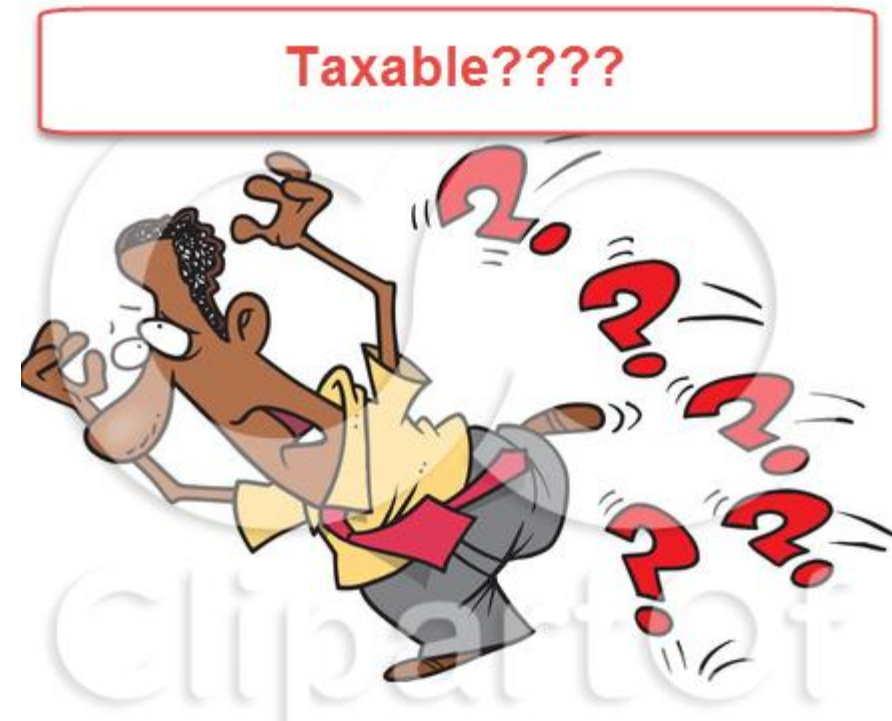
Case Study #2

Q: State of Hawaii (government) gave a tuition loan to nonresident alien student to obtain teaching degree. He will not be required to pay back this loan as long as he will work in the Department of Education as a teacher for 5 years after obtaining such degree. Is this loan taxable at the time of the payment?

A: It is taxable because State of Hawaii will forgive that loan in lieu of future services (teaching for 5 years after obtaining degree) - per IRC section 108 (f)

Case Study #3:

Q: UH reimbursed postdoctoral fellow for airfare. Is the airfare taxable?



Case Study #3:

Q: UH reimbursed postdoctoral fellow for airfare. Is the airfare taxable?

A: It depends

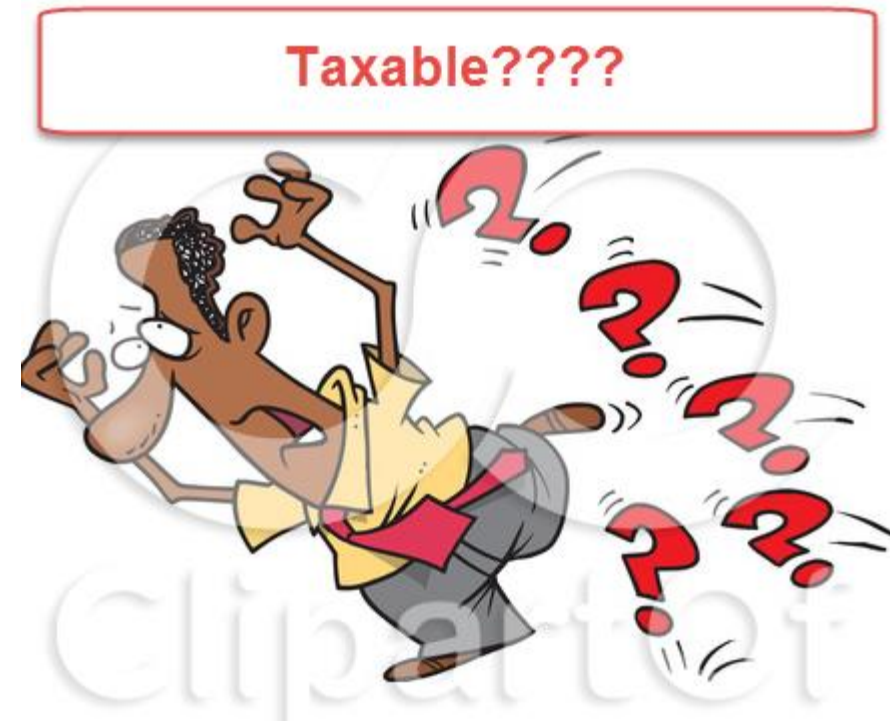
- If the fellow is employed within US, the trip is for business purpose, the airfare is NOT taxable.
- If the fellow is not employed within US but is employed in his/her homeland, and the fellow conducts business on behalf of his/her employer, then the airfare is NOT taxable
- If the fellow is NOT employed by anyone, the airfare is taxable. UH is required to withhold income taxes based on the previous charts.

Note: Any non-UH employees have to fill out UH WH-1 form in order to get paid. The form can be downloaded from below link and will be used to determine if the expense reimbursement is taxable.

http://www.fmo.hawaii.edu/payment_reimb/docs/UH_WH-1.pdf

Case Study #4:

Q: UH paid hotel directly for lodging for the same postdoctoral fellow. Is the lodging taxable?



Case Study 4#:

Q: UH paid hotel directly for lodging for the same postdoctoral fellow. Is the lodging taxable?

A: It depends AGAIN. Same rules from the previous case study apply to this. If the postdoctoral fellow is employed anywhere and on business, the reimbursement is not taxable. Otherwise, it is taxable.



Myths and Facts

Myth: Direct payments to vendors on behalf of participants are never taxable.

Fact: It depends. Direct payments to vendors could be taxable, depending on the type of participants the vendors are paying for.

Myth: All travel reimbursement (direct to vendors or participants) are nontaxable.

Fact: If participant is foreigner, non-employee or student (undergrad or graduate), travel reimbursements will generally be taxable.

Payment Processing

• Stipend Payment to Non-UH Employees

- When payment is made to an individual,
 - Process with Disbursement Voucher (DV) with Form DISB-36 in KFS
- When payment is made to third party (e.g. travel agency),
 - Submit vendor invoice to Disbursing for Payment Request (PREQ) with required documentations (see details in the following slides)

Note: UH Form WH-1 is required for all non-UH employees before payment is made to individual or third party vendor (e.g. travel agency). The answers on the Form are used to determine if the payment is taxable and/or reportable and requires tax withholding.



UH WH-1
(11/22/13)

UNIVERSITY OF HAWAII STATEMENT OF CITIZENSHIP AND FEDERAL TAX STATUS

PURPOSE: This form is for individuals. To comply with applicable tax provisions of the Internal Revenue Service (IRS) regulations, the information requested on this form is **required** to determine the appropriate federal tax withholding and is required for each calendar year. (Business entities should use IRS Form W-9)

Payment Processing – Fellowship/Stipend to Individual

Fellowship/Stipend Payment [DV]

- DISB – 36 Student Fellowship/Traineeship/Stipend Payment Request

DISB-36 (07/19/13)	UNIVERSITY OF HAWAII	Campus: _____
STUDENT FELLOWSHIP/TRAINESHIP/STIPEND INITIAL PAYMENT REQUEST		Date: <u>04 / 07 / 14</u> <small>(mm/dd/yy)</small>
		E DOC NUMBER _____
Complete the following to assist in determining the tax status as recommended by the Internal Revenue Service.		
A. Does this payment require the recipient to perform certain special services outside of his/her study?	<input type="checkbox"/>	Yes <input type="checkbox"/> No
B. If above answer is "yes", are the services required for all students in this field of study?	<input type="checkbox"/>	Yes <input type="checkbox"/> No

Payment Processing – DISB-36

- Ensure Question A & B are answered.
- If any answer is YES, do not use this form.
- E Doc Number on DISB-36 must match the DV eDoc #

Payment Processing – Fellowship/Stipend to Third Party

- If using Commercial Vendor, Use Gross Up Method
- **Gross Up Method**
 - Use alternative funding source
 - Department absorbs the cost of the tax withholding
 - Example (14%): $\$1,000.00 \times 1.16279 = \$1,162.79$
 - Example (30%): $\$1,000.00 \times 1.42857 = \$1,428.57$

Payment Processing – Fellowship/Stipend to Third Party (Con't)

- Payment made for airfare, lodging, and registration fees
 - Use object code 6541 for U.S. Citizens and Permanent Resident Aliens
 - Use object code 6543 for non-Resident Aliens

- Purchase Order to Vendors
 - Payment made on Gross Up PO Amount and 1042 Taxes Withheld
 - Department submits spreadsheet of participants to Disbursing
 - Information Required: Full Name, US TIN (if any), Current Mailing address, Pro Rata amount per person
 - Information manually inputted into IRS Form 1042-S at calendar year end

Future KFS Enhancements - Stipend DVs

- Eliminate DISB-36
- Create a Fellowship/Scholarship tab under Payment Reason Code S
- Answer the questions in KFS

Selected FAQs from the Webinar

Q. When you say degree candidate, does the candidate need to be a UH degree candidate or can they be a candidate elsewhere?

A. They can be a candidate either at UH or elsewhere.

Q. Can I use Pcard to purchase airfare on behalf of stipend recipient.

A. Do not use a Pcard to purchase airfare. This is because there is no mechanism in the bank Pcard system to capture the data that is used to determine resident status and purpose of the trip of the participants for income taxability, reporting, and withholding obligation. One should use a purchase order to purchase airline tickets through a local vendor if possible.

Q. We routinely are asked to pay for foreigner to travel to a conference in a foreign country. They will not enter the U.S. Is there a tax issue?

A. On the surface, there does not appear to be tax issue as foreigner never set foot in the United States. However, more details need to be provided to FMO for a reassuring response.

Selected FAQs from the Webinar (cont.)

Q. Can you elaborate about how the substantial presence test on the WH-1 forms affect tax withholdings for foreigners? My understanding is that if the non-resident alien passes the test, then that person will be treated as a U.S. citizen for tax purposes.

A. Yes, once the nonresident alien passes the substantial presence test, that person will be treated as a U.S. resident for tax purposes. As long as payment is for “scholarship” (regardless qualified or non-qualified), UH will not be required to report such amount on the tax return.

Q. With the changes in Pcard and preference to use Pcard instead of PO, can we continue with small PO process for 3rd party payment on behalf of stipend recipient?

A. Yes. In fact, we ask you to make stipend payments using purchase order process, if possible. This is because there is no mechanism in the bank Pcard system to capture the data that can be used to determine resident status and purpose of the trip of the participants for income taxability, reporting, and withholding obligation.

Selected FAQs from the Webinar (cont.)

Q. If stipend payment to a student (who is on financial aid) is determined to be non-taxable, how does the stipend payment affect the student's financial aid package?

A. Please contact UH financial office to evaluate student's financial aid eligibility.

Q. Can you please explain the difference between reportability vs. taxability from both an institutional and individual view? My understanding was that from an individual standpoint, taxability falls under the umbrella of reportability so all that is reportable may not necessarily be taxable. However, from an institutional standpoint, what may be taxable may not necessarily be reportable (via 1099, etc) is this correct?

A. FMO is not a subject matter expert for personal income tax and could not provide much comments. However, from an institutional standpoint, please refer to the following slides for federal income taxability, reporting requirement, and withholding obligation.

Tax Treatment Matrix for Degree Candidates

Degree Candidate Receiving Qualified Scholarships

Tuition, Fees, Books, Supplies & Equipment

	U.S. Citizen and Resident Alien (Degree Candidate)	Non-Resident Alien Student (Degree Candidate)
Income Taxable	No	No
Reportable	No	No
Federal Income Tax Withholding	No	No

Degree Candidate Receiving Non-Qualified Scholarships/Fellowship Room and board, travel, M&IE, and other items

	U.S. Citizen and Resident Postdoctoral or Visiting Faculty	Non-Resident Alien Postdoctoral or Student
Income Taxable	Yes	Yes
Reportable	No (self-reporting)	Yes on form 1042S
Federal Income Tax Withholding	No	Yes - 30% income tax withholding without Social Security Number (SSN) or 14% with SSN Exceptions: 1) A tax treaty - 0% 2) A foreign source of grant – 0% 3) Visa Type: F-1, J-1, M-1, Q-1, or Q-2 - 14%

Degree Candidate Receiving Compensation

Room and board, travel, M&IE, Work Study and other items

	U.S. Citizen Or Non-Resident Alien Postdoctoral or Visiting Faculty
Income Taxable	Yes
Reportable	Yes on W-2
Federal Income Tax Withholding	Yes based on individual tax status

Compensation is defined by IRS as wages for services provided. The payment is usually paid to UH employees.

Tax Treatment Matrix for Non-Degree Candidates

Non-Degree Candidate Receiving Qualified Scholarships

Tuition, Fees, Books, Supplies & Equipment

	U.S. Citizen and Resident Alien Postdoctoral Fellowship or Student (Non-Degree Candidate)	Non-Resident Alien Postdoctoral Fellowship or Student (Non-Degree Candidate)
Income Taxable	Yes	Yes
Reportable	Yes on form 1099	Yes on form 1042S
Federal Income Tax Withholding	No	Yes - 30% income tax withholding Exceptions: 1) A tax treaty - 0% 2) A foreign source of grant - 0%

Non-Degree Candidate Receiving Non-Qualified Scholarships/Fellowship

Room and board, travel, M&IE, and other items

	U.S. Citizen, Resident Alien	U.S. Citizen, Resident Alien	Non-Resident Alien	Non-Resident Alien
	Business Related	Personal Enrichment (non-business related)	Business Related	Personal Enrichment (non-business related)
Income Taxable	No	Yes	No	Yes
Reportable	No to extend of receipts of FAR	Yes on form 1099	No to extend of receipts of FAR	Yes on form 1042S
Federal Income Tax Withholding	No	No	No	Yes - 30% income tax withholding Exceptions: 1) A tax treaty - 0% 2) A foreign source of grant - 0%

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	U.S. Citizen Or Non-Resident Alien Postdoctoral or Visiting Faculty
Income Taxable	Yes
Reportable	Yes on W-2
Federal Income Tax Withholding	Yes based on individual tax status

Compensation is defined by IRS as wages for services provided. The payment is usually paid to UH employees.

Selected FAQs from the Webinar (cont.)

Q. If we receive a WH-1 before making a hotel reservation, could we use our Pcard to pay for the non-employee foreigner's lodging?

A. Do not use a Pcard to purchase non-employee foreigner's lodging. This is because there is no mechanism in the bank Pcard system to capture the data that is used to determine resident status and purpose of the trip of the participants for income taxability, reporting, and withholding obligation. One should use a purchase order to purchase airline tickets through a local vendor if possible.

Q. For research surveys, the PI wants to provide gift cards to participants but the study requires the anonymity, is the WH-1 still required?

A. Yes. WH-1 is still required to determine if the participant is a US Citizen, Resident Alien, Non-Resident Alien (NRA). For NRA, gift card is discouraged because it is difficult to withhold 30% taxation from a gift card.

Q. What object code should we use if we are paying for lodging expenses for non-employees on business?

A. Currently, when paying with a purchase order, you could use either the 4000 or 6500 series object codes.

Questions?