

Payments to Lehigh University students: summary of relevant tax law and regulations

Taxable Income Defined:

Under the Internal Revenue Code, gross taxable income means all income from whatever source derived unless specifically excluded by the Code.

Qualified Scholarship Exemption:

Section 117 of the Internal Revenue Code exempts “qualified scholarships” from taxable income. In order to meet the definition of a qualified scholarship, the award must be made to candidates for a Lehigh University degree for “qualified tuition and related expenses”.

“Qualified tuition and related expenses” are defined as required tuition and fees for attendance at an educational institution, as well as books, supplies and equipment that are required of all students in that course of instruction at the educational institution. If the equipment or supplies are merely “suggested” for the course, the amounts do not meet the test for qualified scholarships.

There can be no obligation required of the student other than to remain enrolled in the degree plan and maintain the qualifying requirements of the award (i.e. no service requirement). Amounts paid for room, board, travel and incidental expenses do not meet the test of qualified related expenses.

Fellowships:

The primary purpose of a fellowship is to further the education and training of the recipient in his or her individual capacity. This includes amounts received for incidental expenses such as room and board, travel, and equipment expenses that do not meet the qualified scholarship test mentioned above.

To qualify as a fellowship, the payment must be a relatively disinterested “no strings attached” educational grant with no requirement on the part of the recipient to perform services. Payments will qualify as fellowships provided that the grantor will obtain no benefit as a result of the fellowship. If the grantor receives a benefit, the payments are compensation for services and subject to payroll tax withholding.

Under the Internal Revenue Code, fellowships are taxable income but are not subject to income tax withholding or reporting unless the recipient is a nonresident alien. For nonresident aliens, 14% withholding is required and year-end tax reporting is filed with the recipient and the IRS on form 1042-S.

Compensatory Grants:

An amount constitutes 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 grant payment funds an activity that 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”

Whether or not the services are required of all degree candidates is not a factor for federal tax purposes. In summary, whether a payment should be classified as a fellowship or compensation depends upon the fundamental question: “Was the student paid to work or paid to study”?

Faculty versus Student Research/Professional Development Expense:

When faculty members receive reimbursement of expenses to attend a conference, it is excludable from income because it can be classified as a working condition fringe benefit. It is job-related education that maintains or improves skills required by the individual in his or her employment. Other research expenses that are reimbursed for faculty are also nontaxable because of the employment relationship – they are expenses required to support the performance of their duties as an employee providing services to Lehigh. Generally speaking, if a graduate student receives a travel grant for a conference, the expenses are in support of their education, not to provide services to Lehigh.