Tax Issues Associated with Reporting Fellowships

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Scope

- This presentation applies to UC graduate students
- This is not intended to provide tax advice; it is informational only and points to published resources such as the IRS and Franchise Tax Board. Please consult your personal tax advisor for more information
The best way to teach your kids about taxes is by eating 30% of their ice cream.
Tax Filing Question

• What is the deadline for filing your 2018 Income Tax Return?
  ➢ April 15, 2019
Fellowship Grants

- How does the IRS treat fellowship grants for income tax purposes?
  - These grants may be classified as either fellowship or compensation, based on the facts and circumstances of the particular program.
Non-compensatory Fellowship Grants

- These are bona fide "fellowships" and not compensation for services rendered.
  - Therefore, these are not wage income subject to OASDI and Medicare.
  - However, these are still taxable income you need to report on your tax return because they are "nonqualified" fellowships, as explained in later slides.
Compensatory Fellowship Grants

- A grant represents compensation for services if either of the following apply:
  - There is a requirement for past, present, or future teaching, research, or other employment services by the recipient; or
  - The grant payment enables the recipient to "pursue studies or research primarily for the benefit of the grantor."

- Therefore, the compensation received by the recipients-
  - are the recipients’ gross income, and
  - must be reported as gross taxable income on the recipients’ income tax returns
  - may be subject to OASDI and Medicare.
Income Calculation: Taxable versus Nontaxable Scholarships and Fellowships

• Scholarships and Fellowships are Nontaxable if they are used for:
  ➢ tuition and fees required for the enrollment or attendance of the University
  ➢ books, supplies, and equipment required for courses of instruction at the University

• These Nontaxable Scholarships and Fellowships are referred to as “qualified” (short for “qualified tuition and related expenses” for scholarship and fellowship purposes only)
Income Calculation: Taxable versus Nontaxable Scholarships

- Taxable if used to pay for expenses other than required tuition, fees, books, supplies, equipment and any fees required as a condition for enrollment.
- These Taxable Scholarships are referred to as “nonqualified”
- Example of Taxable Scholarship Payments:
  - Room and Board
  - Travel
  - Other Living Expenses
Credit to Reduce Income Taxes

- Only applies to U.S. Citizens and Resident Aliens
- Taxpayer may use Lifetime Learning credit ([Form 8863](#))
- Derived from “qualified tuition and related expenses” for tax credit only
  - tuition required for the enrollment or attendance of the University
  - academic fees required for the enrollment or attendance of the University
  - books, supplies, and equipment required for courses of instruction at the University
  - nonacademic fees disallowed, such as health insurance and athletic fees, even though they are required for enrollment
Credit to Reduce Income Taxes

• Tuition Credit
  - Initial income taxes are calculated before the credit is applied
  - Only applies to federal income taxes

• The credit may each be limited to a maximum $2,000 (20% x $10,000 maximum), depending on your tax circumstances.
  • Cannot claim the credit if your modified adjusted gross income (MAGI) is at least $67,000 filing single return ($134,000 filing joint return) for 2018.
  • Credit phases out if MAGI is between $57,000 and $67,000 filing single return ($114,000 and $134,000 if filing a joint return) for 2018.
Difference in the Definition of “Qualified Tuition and Related Expenses”

- **Scholarships and Fellowships (Income Calculation)**
  - Includes the following (I.R.C. § 117(b)(2)):
    - tuition **required** for the enrollment or attendance of the University
    - fees **required** for the enrollment or attendance of the University
    - books, supplies, and equipment **required** for courses of instruction at the University
Difference in the Definition of “Qualified Tuition and Related Expenses”

• **Credit**
  - Includes the following (I.R.C. § 25A(f)(1)(A)):
    - tuition **required** for the enrollment or attendance of the University
    - academic fees **required** for the enrollment or attendance of the University
    - books, supplies, and equipment **required** for courses of instruction at the University
  - Excludes the following (I.R.C. § 25A(f)(1)(C)):
    - nonacademic fees, such as student activity fees, athletic fees, insurance expenses, or other expenses unrelated to an individual's academic course of instruction (even though these fees are **required** for the enrollment or attendance of the University)
Key Difference in the Definition of “Qualified Tuition and Related Expenses”

- Scholarships and Fellowships (Income Calculation) allows nonacademic fees as long as these fees are **required** for the enrollment or attendance of the University.
- Tuition Credit does **not** allow nonacademic fees.
- Best tax strategy to deal with the definition difference: if you have scholarships, apply nonacademic fees to the scholarships first when attempting to determine nonqualified scholarships that need to be taxed.
FORM 1098-T

• The Form 1098-T reports qualified tuition and related expenses, scholarships, fellowships, and grants administered by the University without regard for its possible taxability
• The Form 1098-T is generally only provided to U.S. citizens and resident aliens
Example of Form 1098-T

Adjusted qualified education expenses = (BOX 1) $25,000
– (BOX 5) $10,000
Adjusted qualified education expenses = $15,000

Report the “Adjusted qualified education expenses” to reduce your income taxes
Example: If a scholarship exceeds qualified education expenses

Assume the following:

Scholarship/Fellowship grants = $30,000
Qualified Tuition/Expenses = $26,000
• $25,000 Tuition
• $1,000 Nonacademic Enrollment Fees (Example: Student Health Insurance)
Books/Required Course Materials = $500

Question: How much is taxable nonqualified scholarship/fellowship?
### Additional Example: Nonqualified scholarship and fellowship payment amount

<table>
<thead>
<tr>
<th>Payments received for qualified tuition and related expenses</th>
<th>Box 5 – Scholarships and Grants</th>
</tr>
</thead>
<tbody>
<tr>
<td>$26,000</td>
<td>(1,000) Box 1 – Nonacademic Fees (use this first to determine qualified scholarship)</td>
</tr>
<tr>
<td></td>
<td>(25,000) Box 1 - Qualified tuition</td>
</tr>
<tr>
<td></td>
<td>(500) Required Books</td>
</tr>
<tr>
<td></td>
<td>3,500 Nonqualified scholarship and fellowship payment amount</td>
</tr>
</tbody>
</table>
Example: If scholarship is less than qualified education expenses

Assume the following:

Scholarship/Fellowship grants = $20,000
Qualified Tuition/Expenses = $31,000
• $30,000 Tuition
• $1,000 Nonacademic Enrollment Fees (Example: Student Health Insurance)
Books/Required Course Materials = $500

Question: How much is the credit?
## Additional Example: Qualified education expenses

<table>
<thead>
<tr>
<th>Box 1 – Nonacademic Fees (use this first to determine qualified scholarship)</th>
<th>20,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1,000)</td>
<td>Box 1 - Qualified tuition</td>
</tr>
<tr>
<td>(30,000)</td>
<td>(500)</td>
</tr>
<tr>
<td>(500)</td>
<td>Required Books</td>
</tr>
<tr>
<td><strong>11,500</strong>*</td>
<td>Adjusted Qualified Education Expenses for taxpayer to take credit***</td>
</tr>
</tbody>
</table>

*Please remember the following:
1. You may take the credit
2. The credit has a $2,000 limit, which can be further reduced depending on your income and qualified education expenses.
Reporting of Nonqualified Scholarship and Fellowship Payments

- The University is **not** required to report these payments to the IRS or withhold tax on the payments.
  - Exception: The University does have to report and withhold Nonqualified Scholarship and Fellowship Payments made to **nonresident aliens** on IRS Form 1042-S

- Graduate Students who are **U.S. citizens** or **resident aliens** are **required to self-report** the total annual value of their fellowships, including benefits for themselves and their dependents, when they prepare their U.S. and California income tax returns.
Qualified Tuition Reduction for Teaching Assistants and Research Assistants

- Generally, University employees who receive tuition reductions for graduate-level courses are subject to imputed taxable income on the reduced tuition.

- However, Graduate Students who are employed by the University as teaching assistants or research assistants may receive tuition reduction for graduate level courses. The reduced tuition is not subject to imputed taxable income because such tuition reduction meets the requirements to be “qualified tuition reduction” under I.R.C. Section 117(d)(5).

- Please note that wages and salaries earned from services provided are still subject to federal and state income taxes.
Income Taxation of Nonqualified Scholarships and Fellowship Grants

- Federal Income Taxes
  - Who are required to pay?
    - U.S. citizens
    - Resident Aliens
    - Nonresident Aliens (it depends)
Federal Income Taxes
U.S. Citizens and Resident Aliens*

- Subject to regular graduated income tax rates on income received from all sources.
  - The income received from all sources include income from both within and outside the United States.
- When reporting on tax return, the student may claim appropriate marital status and exemptions.

* Every non-U.S. citizen who will be receiving a fellowship grant or other type of payment must complete the UC W-8BEN, Certificate of Foreign Status for Federal Tax Withholding form. In most cases, residency status will be determined based on the information provided on this form. The UC W-8BEN is available on the UCOP Financial Accounting web site, located at http://www.ucop.edu/financial-accounting/policies-and-guidance/tax-forms-information/taxation-non-resident-aliens/index.html.
Federal Income Taxes
Nonresident Aliens

- These Nonqualified Scholarships and Fellowships are reported on an IRS Form 1042-S.
- Generally, the University has to withhold 30 percent of Nonqualified Scholarship and Fellowship payments under I.R.C. Section 1441(a).
- For Nonresident Aliens with an F, J, M, or Q visa, the University has to withhold 14 percent of Nonqualified Scholarship and Fellowship payments under I.R.C. Section 1441(a)-(b).
Federal Income Taxes
Nonresident Aliens

- Exceptions to Nonresident Alien Withholding Laws:
  - Foreign Source Fellowship
  - Income Tax Treaties that reduce or eliminate U.S. withholding taxes*
  - Grant that is a qualified scholarship or fellowship and not subject to tax withholding

* For a list of income tax treaties, please visit the IRS website (www.irs.gov) and type in "United States Income Tax Treaties - A to Z"
Example of Form 1042-S

<table>
<thead>
<tr>
<th>Field</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Income code</td>
</tr>
<tr>
<td>2</td>
<td>Gross income code</td>
</tr>
<tr>
<td>3a</td>
<td>Exemption code</td>
</tr>
<tr>
<td>3b</td>
<td>Tax rate</td>
</tr>
<tr>
<td>4a</td>
<td>Exemption code</td>
</tr>
<tr>
<td>4b</td>
<td>Tax rate</td>
</tr>
<tr>
<td>5</td>
<td>Withholding allowance</td>
</tr>
<tr>
<td>6</td>
<td>Net Income</td>
</tr>
<tr>
<td>7a</td>
<td>Federal tax withheld</td>
</tr>
<tr>
<td>7b</td>
<td>Check if federal tax withheld was not deposited with the IRS because escrow procedures were applied (see instructions)</td>
</tr>
<tr>
<td>8</td>
<td>Tax withheld by other agents</td>
</tr>
<tr>
<td>9</td>
<td>Overwithheld tax repaid to recipient pursuant to adjustment procedures (see instructions)</td>
</tr>
<tr>
<td>10</td>
<td>Total withholding credit (combine boxes 7a, 8, and 9)</td>
</tr>
<tr>
<td>11</td>
<td>Tax paid by withholding agent (amounts not withheld) (see instructions)</td>
</tr>
<tr>
<td>12a</td>
<td>Withholding agent’s EIN</td>
</tr>
<tr>
<td>12b</td>
<td>Ch. 3 status code</td>
</tr>
<tr>
<td>12c</td>
<td>Ch. 4 status code</td>
</tr>
<tr>
<td>13a</td>
<td>Recipient’s TIN, if any</td>
</tr>
<tr>
<td>13b</td>
<td>Recipient’s GIIN</td>
</tr>
<tr>
<td>13c</td>
<td>Recipient’s social security number, if any</td>
</tr>
<tr>
<td>13d</td>
<td>Recipient’s account number</td>
</tr>
<tr>
<td>13e</td>
<td>Recipient’s date of birth (YYYY/MM/DD)</td>
</tr>
<tr>
<td>14a</td>
<td>Primary Withholding Agent’s Name (if applicable)</td>
</tr>
<tr>
<td>14b</td>
<td>Primary Withholding Agent’s EIN</td>
</tr>
<tr>
<td>15a</td>
<td>Intermediary or flow-through entity’s EIN, if any</td>
</tr>
<tr>
<td>15b</td>
<td>Ch. 3 status code</td>
</tr>
<tr>
<td>15c</td>
<td>Ch. 4 status code</td>
</tr>
<tr>
<td>16a</td>
<td>Payer’s name</td>
</tr>
<tr>
<td>16b</td>
<td>Payer’s TIN</td>
</tr>
<tr>
<td>16c</td>
<td>Payer’s GIIN</td>
</tr>
<tr>
<td>16d</td>
<td>Ch. 3 status code</td>
</tr>
<tr>
<td>16e</td>
<td>Ch. 4 status code</td>
</tr>
</tbody>
</table>

For Privacy Act and Paperwork Reduction Act Notice, see instructions.
Tax Treaty Exemption

- A Nonqualified Scholarship or Fellowship paid to a nonresident alien (NRA) may be treated as tax exempt for federal tax purposes if the NRA is from a country that has a tax treaty with the United States.
- If the Nonqualified Scholarship or Fellowship is deemed to be exempt the NRA would need to complete additional forms:
  - Nonqualified Scholarship or Non-employee Fellowships – Form W-8BEN (Certificate of Foreign Status of Beneficial Owner for United States Tax Withholding)
Tax Treaty Exemption

- IRS Publications 519 and 901 contain information on tax treaties.
- Contact your campus International Office to obtain access to the GLACIER Nonresident Alien Tax Compliance Software which will determine treaty eligibility and assist with completing the necessary forms.
Dual Status Aliens

- If you feel you may be a dual status alien for the tax year, please refer to IRS Publication 519.
- You may also contact the campus International Office for access to the Glacier Nonresident Alien Tax Software system which will help guide you through the residency determination process.
How Does the Fellow Report Taxable Fellowships?

- Federal Income Tax Reporting:
  - U.S. Citizens and U.S. Resident Aliens report their Fellowship Grants and Estimated Tax Payments on IRS Form 1040 (Line 1)
  - Since the Lines for these IRS Forms are only for amounts specified on Form W-2, the instructions indicate to write “SCH” and the fellowship amount on the following:
    - On the dotted line next to Line 1 of IRS Form 1040
  - Nonresident Aliens report their Fellowship Grants on IRS Form 1040NR (Line 12) or Form 1040NR-EZ (Line 5)
**U.S. Citizens and Resident Aliens – 1040 Form – Page 1**

![Image of Form 1040](image.png)

**Fill in the blanks with the text:**

- **First Name:** TEST
- **Last Name:** PERSON
- **Social Security Number:**
- **Dependents:**
  - **First Name:**
  - **Last Name:**
  - **Social Security Number:**
  - **Relationship to You:**
  - **Child Tax Credit:**
  - **Credit for Other Dependents:**
- **Signature:**
- **Date:**
- **Occuption:**
- **Preparer's Name:**
- **Preparer's Signature:**
- **PTIN:**
- **Firm's EIN:**
- **Firm's Address:**

**Declaration:**

Under penalties of perjury, I declare that I have examined this return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.
<table>
<thead>
<tr>
<th>Item</th>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Wages, salaries, tips, etc.</td>
<td>SCH 10,000</td>
</tr>
<tr>
<td>2a</td>
<td>Tax-exempt interest</td>
<td>SCH 10,000</td>
</tr>
<tr>
<td>3a</td>
<td>Qualified dividends</td>
<td>SCH 10,000</td>
</tr>
<tr>
<td>4a</td>
<td>IRAs, pensions, and annuities</td>
<td>SCH 10,000</td>
</tr>
<tr>
<td>5a</td>
<td>Social security benefits</td>
<td>SCH 10,000</td>
</tr>
<tr>
<td>6</td>
<td>Total income</td>
<td>SCH 10,000</td>
</tr>
<tr>
<td>8</td>
<td>Standard deduction or itemized deductions</td>
<td>SCH 10,000</td>
</tr>
<tr>
<td>11a</td>
<td>Tax (see inst.)</td>
<td>SCH 10,000</td>
</tr>
<tr>
<td>12a</td>
<td>Child tax credit/credit for other dependents</td>
<td>SCH 10,000</td>
</tr>
<tr>
<td>16</td>
<td>Federal income tax withheld from Forms W-2 and 1099</td>
<td>SCH 10,000</td>
</tr>
<tr>
<td>19</td>
<td>Refund</td>
<td>SCH 10,000</td>
</tr>
<tr>
<td>20a</td>
<td>Amount of line 19 you want refunded to you</td>
<td>SCH 10,000</td>
</tr>
<tr>
<td>21</td>
<td>Amount of line 19 you want applied to your 2019 estimated tax</td>
<td>SCH 10,000</td>
</tr>
</tbody>
</table>

Go to www.irs.gov/Form1040 for instructions and the latest information.
1040NR Tax Form For Nonresident Aliens
Federal Tax Resources

- **Publication 5307**: Tax Reform Basics for Individuals and Individuals
- **Publication 515**: Withholding of Tax on Nonresident Aliens and Foreign Entities
- **Publication 519**: U.S. Tax Guide for Aliens
- **Publication 901**: U.S. Tax Treaties
- **Publication 970**: Tax Benefits for Education
- IRS Notice 87-31: Taxation of Grants
- IRS Website: United States Income Tax Treaties - A to Z
- National Taxpayer Advocate Service: http://www.irs.gov/uac/Taxpayer-Advocate-Service-6
- www.irs.gov
Tax Resources

1) GLACIER Tax Prep: GTP
2) ASUC Student Legal Clinic VITA Program
4) Franchise Tax Board: “Other Online Filing Options”
   https://www.ftb.ca.gov/individuals/efile/allsoftware.shtml?WT.mc_id=HP_Online_AllFilingOptions&WT.svl=HEf2
5) IRS Form Instructions:
   - 1040
   - 1040NR
   - 1040NR-EZ
   - 1040-ES
California State Income Taxes

- Who are required to pay?
  - U.S. citizens
  - Resident Aliens
  - Nonresident Aliens
    - California does not generally conform to Federal tax treaties.
    - Residents of foreign countries who perform services in California or who receive income from California sources are usually subject to State income tax withholding.
California State Income Taxes

- Residents of California
  - Generally, a “resident of California” for income tax purposes is someone who lives in California for more than 9 months in a tax year, files a resident tax return, registered to vote, etc.
  - Please refer to [FTB Publication 1031](#) for guidelines on California residency status

- Nonresidents of California
  - California does not require reporting or withholding on fellowship grant payments, except for the portion that represents payment for services
  - Fellow should review requirements for self reporting items subject to California income taxes
How Does the Fellow Report Taxable Fellowships?

• California State Income Tax Reporting:
  ➢ California Residents report their Federal Adjusted Gross Income on Line 13 of FTB Form 540
  ➢ California Nonresidents and Part-Year Residents report their Federal Adjusted Gross Income on Line 13 of FTB Form 540NR (Long) or FTB Form 540NR (Short)
  ➢ Caution: If Federal Adjusted Gross Income is more than $100,000, use Form 540NR (Long)
California Residents

Line 13 – Federal Adjusted Gross Income

<table>
<thead>
<tr>
<th>Line 13</th>
<th>Federal Adjusted Gross Income</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>13</td>
<td></td>
</tr>
<tr>
<td></td>
<td>10,000</td>
</tr>
</tbody>
</table>

10,000
California Nonresidents

Line 13 – Federal Adjusted Gross Income

10,000
California Tax Resources

- FTB Publication 1031 Guidelines for Determining Resident Status
- FTB Publication 1017: Resident and Nonresident Withholding Guidelines
- Franchise Tax Board (FTB) Website: “Individuals”:
  https://www.ftb.ca.gov/individuals/index.shtml?WT.mc_id=Global_Individuals Tab
California Tax Resources

- FTB’s Online Filing Options: https://www.ftb.ca.gov/individuals/efile/allsoftware.shtml?WT.mc_id=EfileOptions_Sidebar_All_efile
- FTB Form Instructions:
  - 540
  - 540NR (Long)
  - 540NR (Short)
University Resources

- UC Website: http://www.ucop.edu/financial-accounting/units/payroll-coordination-and-tax-services/
- See Tax forms and information for
  - Employee’s Federal-State Withholding Allowance Certificate (UC W-4/DE 4)
  - Taxation of nonresident aliens
- GLACIER Nonresident Alien Tax Preparation Software
Thank you.

Any Questions?