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Taxability of Payments to Students

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I. REASON FOR THIS POLICY

The University of South Dakota makes various payments to students for education related activities and care must be taken to classify these payments correctly for tax purposes. The purpose of this policy is to explain how to categorize payments made to students. This policy addresses types of payments made to students including scholarships, compensation for services, reimbursements, prizes and awards, and refunds.

Reporting and taxation of student payments are governed by the Internal Revenue Code and Treasury Regulations and enforced by the Internal Revenue Service (IRS).

II. STATEMENT OF POLICY

The types of payment to students fall into one of five categories: scholarships, compensation, reimbursements, prizes and awards or other. The following helps define each category:

a. Scholarships

- i. Federal Courts have consistently held that “scholarships” are relatively disinterested, “no-strings” educational grants, with no requirement of any substantial services from the recipients. Any amount paid or allowed to, or on behalf of, an individual to enable him/her to pursue studies or research primarily to further the student’s education and training and provided by the University for such purpose does not represent compensation or payment for services. Merely requiring the recipient to provide periodic progress reports to

the University or the fact that the research or study results may provide an incidental benefit to the University is not enough to treat the payment as compensation for services. Such amounts are treated as scholarships, which are not subject to tax withholdings, but are reported as scholarships on IRS Form 1098-T.

- ii. A “qualified scholarship” is excluded from income tax. The IRS defines a qualified scholarship as a scholarship or fellowship grant used for qualified tuition and related expenses. (I.R.C. § 117).
- iii. Amounts excluded from taxable income as Qualified tuition and related expenses are limited to the amount used for tuition and fees, books, supplies, and equipment required for courses. These items must be required of all students in a course of instruction for the scholarship or fellowship grant to be tax-free (Prop. Treas. Reg. § 1.117-6(c)(2)).
- iv. Non-Qualified education expenses include room, board, travel, the cost of optional fees and personal expenses.
- v. A scholarship is excluded from taxable income only if the student is a candidate for a degree at an eligible educational institution.
- vi. Any amounts received by a non-degree candidate are taxable scholarships/fellowships even if the amount pays for otherwise qualified educational expenses. Pursuant to IRS Notice 87-31, the payer of a taxable scholarship/fellowship is not required to withhold income tax and is not required to report the payment either to the student or the IRS.
- vii. Scholarships will be reported by the University to the IRS and to the student on IRS Form 1098-T, Tuition statement.
- viii. Scholarships must be funded with allowable fund sources as noted in the SDBOR policy 3:15.
- ix. Examples of scholarships include:
 - A degree-seeking student is awarded an educational grant to cover the cost of tuition, fees and other typical expenses of enrollment related to the student’s area of study.
 - A group of students travel as part of a student organization to a service learning activity. A select number of students (not all students or not all students uniformly) are eligible for financial assistance to defray some or all of the cost of participation. The financial assistance will be provided in the form of a scholarship and applied to the students’ accounts.
 - A group of students is traveling as part of a Faculty Led Program. A select number of students (not all students or not all students uniformly) are eligible for financial assistance to defray some or all of the cost of participation. The financial assistance will be provided in the form of a scholarship and applied to the students’ accounts.

- A group of students is traveling as part of a Faculty Led Program or service learning opportunity. Rather than providing individual assistance to some students, assistance is used to defray the cost of the entire activity uniformly reducing the cost charged to each student. This programmatic level support is not a Scholarship (or an Award) to the individual students and is not subject to any per student reporting.

b. Compensation

- i. Payment for services performed by students primarily for the benefit of the University is considered taxable compensation. Payment for services is treated as taxable income, which is subject to tax withholding and is reported on IRS Form W-2.
- ii. This includes payments made for teaching, research and/or other activities performed for the benefit of the University.
- iii. This includes student employees, graduate assistants, and work study students.

c. Reimbursement of University Business Expenses

- i. Students who incur costs for approved activities that primarily benefit the University may be entitled to reimbursement of those expenses. As with University employees, this situation arises when student purchases a service or good while acting as an “agent” of the University.
- ii. Reimbursement of University Business Expenses is not reportable as taxable income and is not subject to tax withholding.
- iii. All University policies and procedures apply to these reimbursements.
- iv. Examples of student reimbursements include the following:
 - Student A is approved to travel to Washington, DC to represent USD in a scholastic competition.
 - Student B is approved to travel to a conference held in Memphis, TN to present a paper on behalf of the Department of Social Work.
 - Student C is approved to purchase a toner cartridge for a University-owned printer that is located in his department's lab.
 - Student D travels to Germany to perform research for the University, which happens to be the same topic related to her dissertation. The University would perform research on this topic regardless of the student performing research for her dissertation. The University is the primary beneficiary of this travel.

d. Prizes and Awards

- i. Awards are amounts received primarily in recognition of religious, charitable, scientific, educational, artistic, literary, civic achievement, or as the result of entering a contest. Recipients are selected based on their actions to enter a

contest, competition or proceeding. Drawing gifts or monetary payments are also classified as prizes.

- ii. Prizes and Awards are not Scholarships, Compensation or Reimbursement of University Business Expenses.
- iii. Prizes and Awards are includible in gross income. (I.R.C. § 74 (a))
- iv. Prizes and Awards are reportable to the IRS and the student on IRS Form 1099-MISC, Miscellaneous Income.
- v. Awards are generally funded using Foundation, Institutional Representation or Agency funds.
- vi. Examples of prizes and awards include:
 - Travel abroad assistance for expenses of trip for student traveling independent of a University course, program or sponsored group. Types of expenses contemplated are transportation, lodging, meals and the like where circumstances appear to not be a Scholarship and activity is such that it does not appear to be a University Business Expense.
 - Assistance in emergent situations or situations of particular hardship where the purpose of the funding support student success but the nature of the expenses are personal.
 - Payments to defray costs for an educational experience such as internships or conference attendance where the types of expenses contemplated would not be categorized as a Scholarship and the activity is such that it does not appear to be a University Business Expense.
 - Winning a prize at an art or scholastic competition.
 - Winning a random drawing for a gifts or gift card. (*Note: restrictions relative to University and Foundation policies on gifts and gift cards.*)
 - A student is awarded a travel grant to conduct research or attend a conference where they will present research related to their field of study but not on behalf of USD . As the payment relates to the pursuit of studies or research and furthers the education and training of the recipient, the payment is considered taxable.
 - Funding provided via a stipend payment for a student to go on a summer or other internship, or to go on a job search/interview.

e. Other

- i. Refunds for student account overpayments and/or excess Title IV funds are another form of payments made to student and are not taxable.
- ii. Tuition Reduction related to Graduate Assistants may or may not be taxable to the student depending on the type of assistantship.
 - Graduate Administrative Assistant (GAA) employer paid (waived) tuition – GAA’s do not fall under the guidelines in Internal Revenue Code section

117(d)(5) and therefore would be subject to the \$5,250 maximum exclusion in Section 127(a)(2). At the end of each calendar year, Human Resources reviews the employer waived tuition and if the amount exceeds \$5,250, then the excess is reported on the student's W-2.

- Graduate Research Assistant (GRA) & Graduate Teaching Assistant (GTA) employer paid (waived) tuition – Qualified tuition reduction shall not be included as gross income for graduate students at an educational organization engaged in teaching or research activities. (I.R.C. § 117(d)(5)).

III. DEFINITIONS

Compensation for Services Related to Work: Payments made for teaching, research and/or other activities performed for the benefit of the University, including activities for the University that may be associated with the student's course of study and educational experience. Payments received in connection with the performance of service by a student are taxable income, and may be subject to federal, state and FICA tax withholding.

Non-Qualified Scholarship/Fellowship: A Non-Qualified scholarship or fellowship is a scholarship/fellowship payment used for expenses that are not qualified tuition or related expenses (e.g. amounts used to pay optional fees, room, board, travel and personal expenses). Qualified and Non-Qualified scholarships and fellowships are reported by the University on Form 1098-T or IRS Form 1042-S. Non-Qualified scholarship/fellowship payments are taxable income and are potentially subject to income tax withholding.

Prizes and Awards: Prizes and awards are payments directly to the students in recognition of charitable, scientific, educational, artistic, literary, or civic achievement, or are received as the result of entering a contest. Recipients are selected based on their actions to enter a contest, competition or proceeding. Prizes and awards are taxable income. If certain dollar thresholds are satisfied, the prize or award is reportable to the IRS and the student on IRS Form 1099-MISC, Miscellaneous Income: <http://www.irs.gov/instructions/i1099msc/ar02.html>, or on IRS Form 1042-S, Foreign Person's U.S. Source Income Subject to Withholding: <http://www.irs.gov/pub/irs-pdf/f1042s.pdf>.

Qualified Scholarship/Fellowship: This category includes payments or credits to a degree-seeking student's account to be used only for "qualified tuition and related expenses," which are limited to tuition and required fees, books, supplies, or equipment. Qualified fellowships are not taxable income to the student. Qualified and Non-Qualified scholarships and fellowships are reported by the University on Form 1098-T. Reporting is not required on a 1042-S. Income Code 15, Exemption Code 2 (1042-S) for international students.

Refund: This term is used to describe the processing of a payment to a student resulting from a credit balance on the student account. The term is also applied to the payment to the student for Title IV proceeds (e.g., SEOG, Pell Grants, Federal Direct and Perkins loans) in excess of the amount of tuition and fees, room and board, and other authorized charges.

Reimbursement of University Business Expenses: Students who incur costs for approved activities that primarily benefit the University may be entitled to business expense reimbursement. Business expense reimbursement is not reportable as taxable income to the IRS.

IV. PROCEDURES

Flowchart to Determine How to Process Payments to Students

The flowchart and questions in the link below will help determine the type of payment that should be made to the student, whether the payment to the student is taxable, and in what form it should be reported.

<http://www.usd.edu/~media/Files/Policies/StudentPaymentPolicyFlowchart>

Once the type of payment is determined, the following procedures should be followed for the applicable payment type:

a. Scholarships

- Scholarships are paid to the University and applied to the student's account. The awarding process is completed through scholarship manager and can be found on the USD website at the following address:
https://usd.scholarships.ngwebsolutions.com/ScholarX_AdminPortal.aspx
- Information regarding USD Scholarships can be found on the USD website at the following address: <http://www.usd.edu/admissions/freshmen/scholarships>
- The scholarship policy can be found at the following address:
<http://www.usd.edu/admissions/freshmen/scholarships/scholarship-policy>
- Information related to departmental scholarships can be found on the USD Portal at the following address: <https://portal.usd.edu/financial/financial-aid/departmental-scholarships.cfm>

b. Compensation for Services Related to Work

- Information and forms related to student workers, including workstudy, graduate students and hourly students can be found on the Human Resources site on the USD Portal: <https://portal.usd.edu/administration/human-resources/new-employee-onboarding.cfm>
- In situations where students are paid directly, such as the students working for the Volante, the department would enter a direct pay invoice. Based on the nature of the payment, the University will issue a 1099-misc at the end of the year if payments for services exceed \$600.
- In situations where GAA's exceed the \$5,250 maximum exclusion under Section 127 guidelines, the University will report the amount over \$5,250 as taxable income on the student's W-2.

- Utilization of Foundation funds: Process all payments to the student through USD Human Resources/Payroll and request transfer of funds from the Foundation to the University. Expenses and Foundation funding should both be coded to a 23F account. See USD policy 2.036.
- c. Student Reimbursements
- The Accounting Procedures Manual outlines the procedures for reimbursement related to travel, including lodging, meals, mileage, registration, or airline expenses are available on the USD Portal: <https://portal.usd.edu/financial/financial-affairs/loader.cfm?csModule=security/getfile&PageID=3669>
 - Departments who provide support to students from their funds should develop written internal procedures. Sample internal procedures have been established for the Council on Undergraduate Research & Creative Scholarship (CURCS) mini-grant process and can be obtained from the department.
 - Utilization of Foundation funds can be made either by direct payment from the Foundation to the student or by payment from the University to the student with subsequent request for transfer of funds from the Foundation to the University. If processing through the University, expenses and subsequent reimbursement should utilize the appropriate 23F account.
- d. Prizes and Awards
- Payments from Institutional Funds or Agency Funds should be initiated through Banner.
 - Payments from Foundation funds should be paid directly to the student, following the Foundation Payment Request Guide procedures.
 - Form 1099 reporting is only required if total prizes and awards are \$600 or more in the year: <https://www.irs.gov/instructions/i1099msc/ar02.html> or on IRS Form 1042-S, Foreign Person's U.S. Source Income Subject to Withholding: <http://www.irs.gov/pub/irs-pdf/f1042s.pdf>. See the 1099 training located under the Accounting tab on the portal for additional details.
- e. Student Refunds
- Student refunds are made for student account overpayments and/or excess Title IV funds through the Business Office. Additional information regarding student refunds can be found on the Business Office website: <http://www.usd.edu/financial-affairs/business-office/refunds>

V. RELATED DOCUMENTS, FORMS AND TOOLS

Internal Revenue Service Publication 970 – Tax Benefits for Education - <http://www.irs.gov/pub/irs-pdf/p970.pdf>

South Dakota Board of Regents Policy 3:2 – Resident and Nonresident Classification of Students - <http://www.sdbor.edu/policy/documents/3-2.pdf>

South Dakota Board of Regents Policy 3:15 – Scholarships, Grants, and Loans -
<https://www.sdbor.edu/policy/documents/3-15.pdf>

South Dakota Board of Regents Policy 5:7 – Refunds -
<https://www.sdbor.edu/policy/documents/5-7.pdf>

South Dakota Board of Regents Policy 5:22 – Graduate Assistants and Fellows -
<https://www.sdbor.edu/policy/documents/5-22.pdf>

University of South Dakota Accounting Training regarding 1099's –
<https://portal.usd.edu/financial/financial-affairs/accounting.cfm?casLogin=1>

Foundation Payment Request Guide –
<https://portal.usd.edu/financial/financial-affairs/accounting.cfm?casLogin=1>