Tax Issues Associated with Reporting Fellowships

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March 2020
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
Tax Filing Question

• What is the deadline for filing your 2019 Income Tax Return?
  ➢ April 15, 2020
Fellowship Grants

• How does the IRS treat fellowship grants for income tax purposes?
  • Fellowship payments are taxable, unless they are excluded from taxable income under Section 117(a) of the Internal Revenue Code
  • Non-compensatory fellowship grants need to be reported 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 (both academic and nonacademic) *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 *(both academic and nonacademic)* 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](#)). Generally Individual receives Form 1098-T
• 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 by I.R.C. Section 25A(f)(1)(C), such as student activity fees, athletic fees, insurance expenses, or other expenses unrelated to a student's academic course of instruction, 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
  • **Lifetime Learning Credit**: The credit modified adjusted gross income (MAGI) increases to $68,000 filing single return ($136,000 filing joint return) for 2019.
  • The credit may each be limited to a maximum $2,000 (20% x $10,000 maximum “qualified tuition and related expenses”), depending on your tax circumstances.
Difference in the Definition of “Qualified Tuition and Related Expenses”

• **Step 1: Converting Scholarships Into Nontaxable Qualified Scholarships**
  
  > (I.R.C. § 117(b)(2)): Applies nonacademic fees required for the enrollment or attendance of the University to help determine nontaxable qualified scholarships (subtract from scholarships)

• **Step 2: Determining Credits To Subtract From Income Taxes**
  
  > (I.R.C. § 25A(f)(3)(C)): Specifically disallows nonacademic fees, even those required for the enrollment or attendance of the University

• The best strategy is to subtract nonacademic fees required for enrollment from scholarships in Step 1 before subtracting the other expenses, like tuition and books.
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

Assume: 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>Box 1 - Nonacademic Fees</th>
<th>Box 5 – Scholarships</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1,000) (subtract nonacademic fees first as best tax strategy)</td>
<td>Nonqualified scholarship and fellowship payment amount</td>
</tr>
<tr>
<td>(25,000)</td>
<td></td>
</tr>
<tr>
<td>(500)</td>
<td>Required Books</td>
</tr>
<tr>
<td>3,500 (taxable income because scholarships exceed expenses)</td>
<td></td>
</tr>
</tbody>
</table>
Example: If scholarship is less than qualified education expenses

Assume the following:

Scholarship/Fellowship grants = $20,000
Qualified Tuition/Expenses = $29,000
• $28,000 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

**Box 1 – Nonacademic Fees**

- (1,000) (subtract nonacademic fees first as best tax strategy)
- (28,000)
- (500)

**Box 5 – Scholarships and Grants**

- 20,000

**Adjusted Qualified Education Expenses for taxpayer to take credit**

- 9,500* (expenses exceed scholarship)

*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.
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>Form 1042-S</th>
<th>Foreign Person’s U.S. Source Income Subject to Withholding</th>
<th>2019</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Go to <a href="http://www.irs.gov/Form1042S">www.irs.gov/Form1042S</a> for instructions and the latest information.</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>1</th>
<th>Income code</th>
</tr>
</thead>
<tbody>
<tr>
<td>2</td>
<td>Gross income</td>
</tr>
<tr>
<td>3</td>
<td>Chapter indicator. Enter “F” or “4”</td>
</tr>
<tr>
<td>3a</td>
<td>Exemption code</td>
</tr>
<tr>
<td>4a</td>
<td>Exemption code</td>
</tr>
<tr>
<td>3b</td>
<td>Tax rate</td>
</tr>
<tr>
<td>4b</td>
<td>Tax rate</td>
</tr>
</tbody>
</table>

| 5 | Withholding allowance |
| 6 | Net income |
| 7a | Federal tax withheld |
| 7b | Check if federal tax withheld was not deposited with the IRS because escrow procedures were applied (see instructions) |
| 7c | Check if withholding occurred in subsequent year with respect to a partnership interest |
| 8 | Tax withheld by other agents |
| 9 | Overall tax paid to recipient pursuant to adjustment procedures (see instructions) |
| 10 | Total withholding credit (combine boxes 7a, 8, and 9) |
| 11 | Tax paid by withholding agent (amounts not withheld) (see instructions) |

| 12a | Withholding agent’s EIN |
| 12b | Ch. 3 status code |
| 12c | Ch. 4 status code |
| 13a | Recipient’s U.S. TIN, if any |
| 13f | Ch. 3 status code |
| 13g | Ch. 4 status code |
| 13h | Recipient’s GIIN |
| 13i | Recipient’s foreign tax identification number, if any |
| 13j | LOB code |
| 13k | Recipient’s account number |
| 13l | Recipient’s date of birth (YYYYMMDD) |

| 14a | Primary Withholding Agent’s Name (if applicable) |
| 14b | Primary Withholding Agent’s EIN |
| 15 | Check if pro-rata basis reporting |

| 15a | Intermediary or flow-through entity’s EIN, if any |
| 15b | Ch. 3 status code |
| 15c | Ch. 4 status code |

| 15d | Intermediary or flow-through entity’s name |
| 15e | Intermediary or flow-through entity’s GIIN |

| 16a | Payer’s name |
| 16b | Payer’s TIN |
| 16c | Payer’s GIIN |
| 16d | Ch. 3 status code |
| 16e | Ch. 4 status code |

| 17a | State income tax withheld |
| 17b | Payer’s state tax no. |
| 17c | Name of state |

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)
Fitness Wellness Center – For some reason, the web site says we cannot find this NAICS code – 73194.
<table>
<thead>
<tr>
<th>Form 1040 (2019)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>12a</strong> Tax (see inst.) Check if any from Form(s): 1 [ ] 8314 2 [ ] 4972 3 [ ] 12a</td>
</tr>
<tr>
<td><strong>12b</strong></td>
</tr>
<tr>
<td><strong>12c</strong></td>
</tr>
<tr>
<td><strong>12d</strong></td>
</tr>
<tr>
<td><strong>13a</strong> Child tax credit or credit for other dependents</td>
</tr>
<tr>
<td><strong>13b</strong> Add Schedule 2, line 3, and line 12a and enter the total</td>
</tr>
<tr>
<td><strong>13c</strong></td>
</tr>
<tr>
<td><strong>13d</strong></td>
</tr>
<tr>
<td><strong>14</strong> Subtract line 13b from line 12c. If zero or less, enter -0-</td>
</tr>
<tr>
<td><strong>14</strong></td>
</tr>
<tr>
<td><strong>15</strong> Other taxes, including self-employment tax, from Schedule 2, line 10</td>
</tr>
<tr>
<td><strong>15</strong></td>
</tr>
<tr>
<td><strong>16</strong> Add lines 14 and 15. This is your total tax</td>
</tr>
<tr>
<td><strong>16</strong></td>
</tr>
<tr>
<td><strong>17</strong> Federal income tax withheld from Forms W-2 and 1099</td>
</tr>
<tr>
<td><strong>17</strong></td>
</tr>
<tr>
<td><strong>18a</strong> Other payments and refundable credits:</td>
</tr>
<tr>
<td><strong>18b</strong> Earned income credit (EIC)</td>
</tr>
<tr>
<td><strong>18c</strong> Additional child tax credit. Attach Schedule 8612</td>
</tr>
<tr>
<td><strong>18d</strong> American opportunity credit from Form 8863, line 8</td>
</tr>
<tr>
<td><strong>18e</strong> Schedule 3, line 14</td>
</tr>
<tr>
<td><strong>18f</strong> Add lines 18a through 18d. These are your total other payments and refundable credits</td>
</tr>
<tr>
<td><strong>18g</strong></td>
</tr>
<tr>
<td><strong>19</strong> Add lines 17 and 18e. These are your total payments</td>
</tr>
<tr>
<td><strong>19</strong></td>
</tr>
<tr>
<td><strong>20</strong> If line 19 is more than line 16, subtract line 16 from line 19. This is the amount you overpaid</td>
</tr>
<tr>
<td><strong>20</strong></td>
</tr>
<tr>
<td><strong>21a</strong> Amount of line 20 you want refunded to you. If Form 8612 is attached, check here</td>
</tr>
<tr>
<td><strong>21b</strong> Routing number</td>
</tr>
<tr>
<td><strong>21c</strong> Type: □ Checking □ Savings</td>
</tr>
<tr>
<td><strong>21d</strong> Account number</td>
</tr>
<tr>
<td><strong>22</strong> Amount of line 20 you want applied to your 2020 estimated tax</td>
</tr>
<tr>
<td><strong>23</strong> Amount you owe. Subtract line 19 from line 16. For details on how to pay, see instructions</td>
</tr>
<tr>
<td><strong>23</strong></td>
</tr>
<tr>
<td><strong>24</strong> Estimated tax penalty (see instructions)</td>
</tr>
<tr>
<td><strong>24</strong></td>
</tr>
</tbody>
</table>

**Third Party Designee**

If you want to allow another person (other than your paid preparer) to discuss this return with the IRS? See instructions.

- **Yes.** Complete below.
- **No.** Complete below.

**Sign Here**

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.

- **Your signature**
- **Date**
- **Your occupation**
- **If the IRS sent you an Identity Protection PIN, enter it here (see inst.)**

**Spouse’s signature. If a joint return, both must sign.**

- **Date**
- **Spouse’s occupation**
- **If the IRS sent your spouse an Identity Protection PIN, enter it here (see inst.)**

**Phone no.**

**Email address**

**Paid Preparer Use Only**

- **Preparer’s name**
- **Preparer’s signature**
- **Date**
- **PTIN**
- **Check if:**
  - □ 3rd Party Designee
  - □ Self-employed

**Go to www.irs.gov/Form1040 for instructions and the latest information.**
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](https://www.irs.gov/identity-theft-central)
Tax Resources

1) GLACIER Tax Prep: GTP
2) ASUC Student Legal Clinic
   VITA Program
3) Federal E-Filing Information
   Filing | Internal Revenue Service
4) Franchise Tax Board: “Other Online Filing Options”
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.
### California Residents

**Line 13 – Federal Adjusted Gross Income**

- **income**: 10,000
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”:
California Tax Resources

- FTB’s Online Filing Options:
- FTB Form Instructions:
  - 540
  - 540NR
University Resources

- UC Website: 

- GLACIER Nonresident Alien Tax Preparation Software
Thank you.

Any Questions?