

# Scholarships from Organizations

When a professional organization provides financial assistance to help a student attend college, it must determine whether a Form 1099 needs to be issued.

Many professional organizations take great pride in providing some form of financial assistance to students enrolled in degree programs at higher education institutions. The assistance may be called an award, a scholarship, a gift, or simply a prize. Regardless of the name, the fact is the student has earned a financial subsidy that may or may not be taxable, and the organization must decide whether to issue a Form 1099 to the student at year-end.

Giving financial resources in the form of scholarships to assist students in covering the ever-rising costs of tuition, books, and fees is a wonderful thing! But the issue is how best to give the student the scholarship. That is, should it be given directly to the student or provided through the student's educational facility? If the gesture isn't handled properly, student recipients may find themselves with a tax situation that they hadn't expected.

If the students are paid directly by the organization, they will more than likely have a special appreciation for that organization.

But does the organization need to issue a Form 1099 to the student, and does the student need to report the award as income? Treasury Regulation §1.6041-3(n) states that returns of information aren't required for "payments to individuals as scholarships or fellowship grants within the meaning of IRC §117(b)(1), whether or not 'qualified scholarships' as described in IRC §117(b)." The instructions for Form 1099-MISC cite this regulation and specifically state, "Do not use Form 1099-MISC to report scholarship or fellowship grants."

Even though Form 1099 isn't required, many organizations issue it anyway. In so doing, they effectively take a scholarship that wasn't taxable to the student and encourage the Internal Revenue Service (IRS) to issue a notice requesting the tax, penalty, and interest for the money as reported on the Form 1099. It's understandable that an organization wants to be compliant with the tax code with respect to reporting payments made to a student and thereby minimize the need for the IRS to question the payments. But issuing Form 1099 isn't a good answer. Once it's issued, the student, as the taxpayer, is ultimately re-

sponsible for the tax treatment of the scholarship—and then the student must demonstrate that the money received as a scholarship isn't taxable and that, before claiming any educational tax credits, he or she has reduced the amounts paid for educational expenses by the amount of the scholarship.

## Alternative Distribution

One alternative to awarding the scholarship to the student is to pay the university directly for the benefit of the student. The university then becomes the agent responsible for any reporting requirements. This appears to be the IRS's view as evidenced by the "scholarships and grants" box on Form 1098-T (box 5). The educational institution is instructed to "enter the total amount of any scholarships or grants that they *administered and processed* during the calendar year for the payment of the student's costs of attendance" (emphasis added). Moreover, because the educational institution has the reporting requirements of Form 1098-T with the amount of scholarships received, the professional organization is able to rely on that provision to say that the scholarship will be or has been reported.

The university already has the burden of obtaining the student's information, such as whether the student is a candidate for a degree and if he or she is a citizen.

A nonresident alien student may need to be issued Form 1042-S instead of Form 1098-T. In addition, the scholarship could be subject to withholding depending on the tax treaty of the student's home country or the standard rate where no tax treaty exists. One would expect the university to have personal information on all students, putting it in position to handle such tax matters. A professional organization, on the other hand, wouldn't have such personal information and more than likely wouldn't want to invest the time in determining the student's degree and citizenship statuses. That gives further incentive to award the scholarship to the student's university rather than to the student directly.

### **Awarding Students Directly**

Some people feel it's better to give the scholarship to the student directly. One reason may be the potential loss of additional financial support by the educational institution due to eligibility rules. If the student has earned outside assistance and is therefore less "needy," the financial support might be given to another student. In other words, the net effect of the award to the student from the professional organization could be reduced or even eliminated because the student's school could reduce or retract financial aid. This appears to be considered scholarship or aid displacement, where the professional organization may un-

intentionally benefit the educational institution by redirecting the institution's financial aid to other students instead of the intended recipient. The degree of displacement, if any, that an educational institution may practice depends on its scholarship policies and should be investigated if a professional organization is concerned with the possibility of displacement. For example, the Veterans Administration is aware of this possible issue when it pays a student's tuition under the Post-

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9/11 GI Bill and therefore requires the educational institution to refund the government if it won't be used.

If a professional organization elects to give financial support for the cost of the student's room and board, then a Form 1099-MISC will probably be required to be issued to the student. Room and board generally doesn't qualify as an educational expense, so it isn't eligible for education credits or exclusion provisions. The instructions for Form 1099-MISC don't specifically state that payments for room and board need to be reported, but it does require noting prizes and awards in the amount of \$600 or more. IRS Publication 970, *Tax Benefits for Education*, lists room and board among other items that aren't tax-free to the

student. For example, the U.S. Armed Services issues Form 1099-MISC to its Reserve Officer Training Corps (ROTC) cadets who receive room and board. Most ROTC cadets receive only tuition and book benefits, but some receive room and board with their ROTC scholarship because another scholarship, such as a sports scholarship, already paid for tuition. As mentioned, why not rely on the university to assist with reporting requirements by paying them instead of paying the student directly?

Paying the scholarship to the university directly instead of to the student appears to be the better choice. It's better for both the professional organization and the student to let the university be responsible for the reporting requirements. The university will have the student's information for the tax reporting requirements. It may be a nice goal to avoid dealing with the university's rules and regulations for awarding scholarships, but it's far better for the professional organization to negotiate with the university than for the student to deal with the IRS. **SF**

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