Tax Issues Associated with Reporting Fellowships

John Barrett
Tax Manager-University of California
Office of the President-CFO Division

Benjamin Tsai
Senior Tax Analyst

Arthur Quilao
Tax Compliance Analyst

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Scope

- This presentation applies to UC postdoctoral fellows and paid directs, and graduate students
- There is tuition associated with graduate students
- Assumption is that there are no services being performed by the Fellows and Paid Directs or 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 Life Lessons of Tax Returns Through the Works of Homer

- Forgetting a Deadline
- Consequences
- What are the life lessons?
Tax Filing Question

• What is the deadline for filing your 2016 Income Tax Return?
  ➢ April 18, 2017 (15th is Saturday and 17th is Emancipation Day in D.C.)
National Research Service Award (NRSA)

- How does the IRS treat NRSA grants and fellowship grants "modeled" on the NRSA program?
  - 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” fellowship, as explained in later slides.
Fellowship Grants Not “Modeled” on the NRSA Program

- But what about fellowship grants not “modeled” on the NRSA program?
  - Non-NRSA grant programs may be classified as either fellowship or compensation, based on the facts and circumstances of the particular program.

* A requirement that a recipient furnish periodic reports to the grantor for the purpose of keeping the grantor informed with respect to the general progress of the individual, however, is not considered the performance of services.
Fellowship Grants Not “Modeled” on the NRSA Program

• 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.
Example

- Fellowship vs. Compensation Determination
  (see checklist)
**EXHIBIT G**  Fellowship vs. Compensation Determination

<table>
<thead>
<tr>
<th>Campus:</th>
<th>Date:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Program or Type of Award:</td>
<td></td>
</tr>
<tr>
<td>PI:</td>
<td>Dept</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>Fellowship</th>
<th>Compensation</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Does the focus of the program relate primarily to (a) the performance of research services for the University, or (b) the development of the research fellow’s training skills?</td>
<td>(b)</td>
<td>(a)</td>
</tr>
<tr>
<td>2. Does the research fellow serve as a replacement or substitute for an employee, such as a medical resident or laboratory technician?</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>3. Do the activities of the research fellow during his/her training program materially benefit the University?</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>4. Are the research fellow’s projects determined by the research fellow in conjunction with his/her training supervisor and/or faculty mentor?</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>5. Is the research fellow required to perform past or future services for the University as a condition to receiving the research fellowship grant?</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>6. Are the research activities conducted by the research fellow substantially the same as those research activities conducted by NIH National Research Service Award grantees?</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>7. Does the research fellow receive substantially the same training and mentoring as a NIH National Research Service Award grantee?</td>
<td>Yes</td>
<td>No</td>
</tr>
</tbody>
</table>

If all of the Fellowship boxes are marked, the individual will be treated as a fellowship recipient for federal tax purposes.
### EXHIBIT G (Cont.)

**Fellowship vs. Compensation Determination**

If all of the Fellowship boxes were *not* marked, then please make the fellowship/compensation determination by responding to the following questions:

<table>
<thead>
<tr>
<th>Question</th>
<th>No</th>
<th>Yes</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Are the research fellow’s projects directly related to the fulfillment of a sponsored research agreement or other University contractual obligation?</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2. Is the research fellow required to perform his/her research activities according to certain planned time schedules, e.g., a specified number of hours a day or week and a specified number of weeks during the year?</td>
<td></td>
<td></td>
</tr>
<tr>
<td>3. Is the research fellow subject to the same level and type of supervision over the conduct of his/her research activities as a University research assistant employee?</td>
<td></td>
<td></td>
</tr>
<tr>
<td>4. Is the research fellow classified as an employee for University payroll tax purposes?</td>
<td></td>
<td></td>
</tr>
<tr>
<td>5. Does the research fellow receive health and other employee benefits that would be provided to career faculty and staff employees?</td>
<td></td>
<td></td>
</tr>
<tr>
<td>6. Does the research fellow receive any faculty privileges?</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

If four or more of the Fellowship boxes are marked, the individual will be treated as a fellowship recipient for federal tax purposes. If fewer than four Fellowship boxes are marked, please submit this checklist to [insert name of applicable office] who will make the fellowship/compensation determination.
Examples of Fellowships

- Fellowship funds paid directly by the University to the Postdoc Fellow
- Fellowship funds provided by a third party on behalf of the Postdoc Fellow (Paid Directs)
  - Example: Award intended to pay recipient’s expenses are paid directly by a third party to UC and credited to a recipient’s University account
  - Payment is treated the same for tax purposes as having been paid to the recipient
Taxable versus Nontaxable Scholarships and Fellowships

- Scholarships and Fellowships are Nontaxable if they are used for required:
  - 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"
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

<table>
<thead>
<tr>
<th>FILER’S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone number</th>
<th>1 Payments received for qualified tuition and related expenses $</th>
</tr>
</thead>
<tbody>
<tr>
<td>STUDENT’S name</td>
<td>2 Amounts billed for qualified tuition and related expenses $</td>
</tr>
<tr>
<td>3 If this box is checked, your educational institution has changed its reporting method for 2016</td>
<td></td>
</tr>
<tr>
<td>4 Adjustments made for a prior year $</td>
<td>5 Scholarships or grants $</td>
</tr>
<tr>
<td>6 Adjustments to scholarships or grants for a prior year $</td>
<td>7 Checked if the amount in box 1 or 2 includes amounts for an academic period beginning January — March 2017</td>
</tr>
<tr>
<td>8 Check if at least half-time student</td>
<td>9 Checked if a graduate student</td>
</tr>
<tr>
<td>10 Ins. contract remb./refund $</td>
<td></td>
</tr>
</tbody>
</table>

Adjusted qualified education expenses = $25,000 - $10,000

Adjusted qualified education expenses = $15,000

Report the “Adjusted qualified education expenses” to reduce your income taxes
Taxable versus Nontaxable Scholarships and Fellowships

- Taxable if used to pay for expenses other than *required* tuition, fees, books, supplies and equipment.
- These Taxable Scholarships and Fellowships are referred to as “*nonqualified*”
- Example of Taxable Scholarship & Fellowship Payments:
  - Room and Board
  - Travel
  - Health Insurance Premiums
  - Other Living Expenses
Health Benefits

The taxability of health benefits provided by the University to a postdoctoral scholar depends on whether the recipient of the benefits is

- a Postdoc Employee, or
- a Postdoc Fellow and/or a Postdoc Paid Direct.
Health Benefits-Postdoc Fellows and Pay Directs

- Health benefits provided by the University to Postdoctoral Fellows (TC 3253) and Paid Directs (TC 3254) {i.e., non-employees} and their dependents are subject to U.S. income tax with respect to the premiums that are paid by the University, less any amounts paid by the recipient. (imputed income)

- Benefits provided to the domestic partner of a Postdoctoral Fellow or Paid Direct also are taxable (for federal purposes) whether or not the domestic partner qualifies as a dependent. State tax treatment may differ.

- These benefits are not subject to FICA taxes.
Health Benefits-Postdoc Employees

- Health benefits provided by the University are **not** taxable (both U.S. and California income taxes) if they are provided to the following:
  - Postdoc Employees {TC 3252} (includes U.S. citizens, U.S. resident aliens, and nonresident aliens)
  - Dependents of Postdoc Employees
- The presence of a 3252 appointment of 50% or more along with a 3253 or 3254 will make the benefit treatment not taxable
- Health benefits provided by the University to the domestic partner of a postdoctoral employee, less any amount paid by the employee, will be taxable income to the postdoctoral employee for federal purposes (unless the domestic partner is a dependent of the postdoc employee)
**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, Postdoctoral Fellows and Paid Directs 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.
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 or fellow 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% 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% 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</td>
</tr>
<tr>
<td>3</td>
<td>Chapter indicator. Enter “3” or “4”</td>
</tr>
<tr>
<td>3a</td>
<td>Exemption code</td>
</tr>
<tr>
<td>3b</td>
<td>Tax rate</td>
</tr>
<tr>
<td>3c</td>
<td>Tax rate</td>
</tr>
<tr>
<td>4</td>
<td>Withholding allowance</td>
</tr>
<tr>
<td>4a</td>
<td>Federal tax withheld</td>
</tr>
<tr>
<td>4b</td>
<td>Tax paid by withholding agent</td>
</tr>
<tr>
<td>4c</td>
<td>Total withholding credit</td>
</tr>
<tr>
<td>5</td>
<td>Amount repaid to recipient</td>
</tr>
<tr>
<td>5a</td>
<td>Withholding agent’s EIN</td>
</tr>
<tr>
<td>5b</td>
<td>Ch. 3 status code</td>
</tr>
<tr>
<td>5c</td>
<td>Ch. 4 status code</td>
</tr>
<tr>
<td>6</td>
<td>Net income</td>
</tr>
<tr>
<td>7</td>
<td>Check if tax not deposited with IRS pursuant toascrow procedure</td>
</tr>
<tr>
<td>7a</td>
<td>Recipient’s U.S. TIN, if any</td>
</tr>
<tr>
<td>7b</td>
<td>Recipient’s GIIN</td>
</tr>
<tr>
<td>7c</td>
<td>Recipient’s foreign tax identification number, if any</td>
</tr>
<tr>
<td>7d</td>
<td>LOB code</td>
</tr>
<tr>
<td>8</td>
<td>Recipient’s account number</td>
</tr>
<tr>
<td>9</td>
<td>Recipient’s date of birth</td>
</tr>
<tr>
<td>10</td>
<td>Intermediary or flow-through entity’s EIN</td>
</tr>
<tr>
<td>11</td>
<td>Intermediary or flow-through entity’s GIIN</td>
</tr>
<tr>
<td>12</td>
<td>Intermediary or flow-through entity’s name</td>
</tr>
<tr>
<td>12a</td>
<td>Withholding agent’s Global Intermediary Identification Number (GIIN)</td>
</tr>
<tr>
<td>12b</td>
<td>Country code</td>
</tr>
<tr>
<td>12c</td>
<td>Foreign taxpayer identification number, if any</td>
</tr>
<tr>
<td>12d</td>
<td>Foreign tax identification number, if any</td>
</tr>
<tr>
<td>12e</td>
<td>Address (number and street)</td>
</tr>
<tr>
<td>12f</td>
<td>City or town, state or province, country, ZIP or foreign postal code</td>
</tr>
<tr>
<td>13a</td>
<td>Recipient’s name</td>
</tr>
<tr>
<td>13b</td>
<td>Recipient’s country code</td>
</tr>
<tr>
<td>13c</td>
<td>Address (number and street)</td>
</tr>
<tr>
<td>13d</td>
<td>State income tax withheld</td>
</tr>
<tr>
<td>14</td>
<td>Payer’s name</td>
</tr>
<tr>
<td>14a</td>
<td>Payer’s TIN</td>
</tr>
<tr>
<td>15</td>
<td>Payer’s GIIN</td>
</tr>
<tr>
<td>15a</td>
<td>Payer’s foreign tax identification number, 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>16</td>
<td>Payer’s state tax no.</td>
</tr>
<tr>
<td>17</td>
<td>Name of state</td>
</tr>
</tbody>
</table>

For Privacy Act and Paperwork Reduction Act Notice, see instructions.

Ct. No. 11386R

Form 1042-S (2016)
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:
  - PostDoc Employee - Form 8233 (Exemption From Withholding on Compensation for Independent (and Certain Dependent) Personal Services of a Nonresident Alien Individual and a Tax Treaty Statement.
  - 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 7), Form 1040A (Line 7), or Form 1040EZ (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 7 of IRS Form 1040
    - In the space to the left of Line 7 of IRS Form 1040A
    - In the space to the left of Line 1 of IRS Form 1040EZ
  - Nonresident Aliens report their Fellowship Grants on IRS Form 1040NR (Line 12) or Form 1040NR-EZ (Line 5)
Federal Tax Resources

- **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 Notice 96-68: Educational Assistance Programs
Federal Tax Resources

- IRS Form Instructions:
  - 1040
  - 1040A
  - 1040EZ
  - 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 Nonresident

TAXABLE YEAR California Nonresident or Part-Year Resident Income Tax Return Long Form 2016
Resident Income Tax Return

Fiscal year filers only: Enter month of year and end month year 2017.

Your first name Initial last name Suffix Your SSN or ITIN
If joint return, spouse’s/ROPs first name Initial last name Suffix Spouse/ROPs SSN or ITIN

Additional information (See instructions)

Filing status

• Single
• Head of household (with qualifying person). See instructions.

• Married/RDP filing jointly. See inst.
• Qualifying widow(er) with dependent child. Enter year spouse/RDP died.

1 If you filed your 2013 tax return under a different last name, write the last name only from the 2013 tax return.
• Taxpayer
• Spouse/RDP

5 If someone can claim you or (your spouse/RDP) as a dependent, check the box here. See inst. 

6 For line 7, line 8, line 9, and line 10: Multiply the amount you enter in the box by the pre-printed dollar amount for that line.

Personal: If you checked box 1, 2, or 4 above, enter 1 in the box. If you checked box 3 or 5, enter 2. If you checked the box on line 6, see instructions.

Whole dollars only

7 • $1,111 = $7

8 • $1,111 = $8

9 • $1,111 = $9

10 Dependents: Do not include yourself or your spouse/RDP.

Dependent 1 Dependent 2 Dependent 3

First Name
Last Name
SSN
Dependent’s relationship

Total dependent exemptions: Add line 7 through line 10.

11 Exemption amount: Add line 11 through line 10

12 Total California wages from your Form(s) W-2, box 16.

13 Enter federal AGI from Form 1040, line 37, line 40, line 21; 1040EZ, line 4; 1040NR, line 36; or 1040N-R, line 10

14 California adjustments subtraction Enter the amount from Schedule CA (540NR), line 37, column B.

15 Subtract line 14 from line 13. If less than zero, enter the result in parentheses. See instructions.

16 California adjustments additions Enter the amount from Schedule CA (540NR), line 37, column C

17 Adjusted gross income from all sources. Combine line 15 and line 16.

18 Enter the larger of your California itemized deductions from Schedule CA (540NR), line 44; OR your California standard deduction. See instructions.

19 Subtract line 18 from line 17. This is your total taxable income. If less than zero, enter -.

Long Form 540NR or 2016 Side 1

3131163
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=HP_Banner_AllSoftware&WT.svl=HEf1

• 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