

Guide to the Tax Treatment of Scholarships

By Mark Kantrowitz

Some scholarships, fellowships, grants and assistantships are tax-free and some are not. Part of a scholarship, fellowship, grant or assistantship may be tax-free and part may be taxable.

Tax-Free Scholarships, Fellowships, Grants and Assistantships

For a scholarship, fellowship, grant or assistantship to be tax-free, it must satisfy the following requirements:

- The student must be a candidate for a degree at an educational institution. The educational organization does not need to be accredited or eligible for Title IV federal student aid.
- The educational assistance must not be payment for teaching, research or other services.
- Only amounts used for tuition and required fees, books, supplies and equipment are tax-free. It is not just the intended purpose of the scholarship, but also how the money is actually used.
- All other amounts are taxable, including amounts used for housing, meal plans, transportation and other living expenses.

Tuition waivers that are provided as part of a teaching assistantship or research assistantship are tax-free, even though the assistantship may be considered payment for teaching or research services. However, the living stipend portion of an assistantship remains taxable.

There are also exceptions for the [National Health Service Corps Scholarship](#) and the [Armed Forces Health Professions Scholarship](#), which are considered to be tax-free if used for tuition and required fees, books, supplies and equipment.

The following are examples of taxable scholarship amounts:

- A scholarship that is earmarked for room and board is taxable even if the money is used to pay for tuition and textbooks, if the scholarship terms do not allow it to be used for tuition and required fees, books, supplies and equipment.
- The portion of a scholarship that exceeds total tuition and required fees, books, supplies and equipment is taxable even if the scholarship is earmarked for these expenses.
- The portion of a scholarship that is used to pay for room and board or other living expenses.
- A Federal Pell Grant is treated the same as a scholarship. The portion of a Federal Pell Grant that is used to pay for housing, meal plans, transportation and other living expenses is taxable.

Note that coordination restrictions prevent taxpayers from using the same qualified expenses to justify both the tax-free status of scholarships and another education tax benefit, such as the American Opportunity Tax Credit or tax-free distributions from 529 college savings plans. Each tax benefit must correspond to separate qualified expenses.



Scholarships, fellowships, grants and assistantships are exempt from FICA taxes, such as Social Security and Medicare taxes, regardless of whether the student is a degree candidate or not.

How to Report Taxable Scholarships, Fellowships, Grants and Assistantships on a Federal Income Tax Return

Qualified tuition and related expenses are listed on [IRS Form 1098-T](#), *Tuition Statement*. The 1098-T will include the amount of tuition billed and the amount of scholarships, fellowships, grants and assistantships received by the student. The 1098-T does not list amounts spent on textbooks, supplies and equipment. (Students should keep copies of the receipts for these items.) The difference between the scholarships, fellowships, grants and assistantships and the tuition and required fees, books, supplies and equipment is the taxable portion of the scholarships.

The tax-free portion of a scholarship, fellowship, grant or assistantship is not reported on the recipient's federal income tax return. There are no income phase-outs and there is no requirement to file a particular type of federal income tax return.

A student will receive IRS Form W-2 for the taxable portion of the scholarship, fellowship, grant or assistantship if the money is a payment for teaching, research or other services. If the student receives a W-2, the taxable portion of the scholarship, fellowship, grant or assistantship will be reported in the wages/salaries item on the federal income tax return. The wages/salaries field appears on line 7 of IRS Form 1040 or 1040A, line 1 of IRS Form 1040EZ, line 12 of IRS Form 1040NR and line 5 of IRS Form 1040NR-EZ.

Otherwise, if the taxable portion of a scholarship was not reported on a W-2, write "SCH" and the taxable scholarship amount to the left of the wages/salaries field on the federal income tax return and add it to the value reported on this line. Note that scholarship providers are not required to issue 1099s.

Use of 529 College Savings Plans for Scholarships, Fellowships and Grants

Some scholarship providers may contribute the money to the student's 529 college savings plan, instead of paying the scholarship to the student or to the student's college or university. This benefits the student in several ways:

- **Expands tax-free status.** 529 plans have a broader definition of qualified higher education expenses, so the student can use the money tax-free for housing, meal plans and transportation, not just for tuition and textbooks.
- **Minimizes scholarship displacement.** If the 529 plan is owned by a dependent student or a dependent student's custodial parent, it is reported as a *parent* asset on the Free Application for Federal Student Aid (FAFSA), yielding a more favorable impact on eligibility for need-based financial aid. For example, a parent asset reduces eligibility for need-based aid by at most 5.64% of the asset value, while a scholarship not only reduces current aid eligibility on a dollar-for-dollar basis, but it also is reported as income on a subsequent year's FAFSA.

On the other hand, the scholarship provider cannot prevent the scholarship recipient from taking a non-



qualified distribution from the 529 plan to pay for a big-screen TV or a Porsche. Non-qualified distributions are subject to ordinary income taxes and a 10% tax penalty on the earnings portion of the distribution.

Taxable amounts, such as non-qualified distributions, are reported on the beneficiary's federal income tax return.

References

Additional information about the taxability of scholarships may be found in [Chapter 1](#) of [IRS Publication 970, Tax Benefits for Education](#), and in [IRS Tax Topic 421](#).

The statutory language appears in section 117 of the Internal Revenue Code of 1986 [[26 USC 117](#)]. The regulations appear at [26 CFR 1.117-1](#), [26 CFR 1.117-2](#), [26 CFR 1.117-3](#), [26 CFR 1.117-4](#), [26 CFR 1.117-5](#) and [26 CFR 1.6041-3](#).

Last Updated: April 11, 2018