Withholding Federal Income Tax on Scholarships, Fellowships, and Grants Paid to Aliens

Payments of scholarships, fellowships, and grants paid to U.S. citizens and resident aliens are not generally reportable to the IRS and are not generally subject to withholding of tax. However, payments of taxable scholarships, fellowships, and grants to nonresident aliens are generally reportable to the IRS and are generally subject to withholding of U.S. Federal income tax.

The items below reflect the regulations under I.R.C. §§ 1441-1464 and related sections of the Internal Revenue Code that went into effect for all payments made on or after January 1, 2001.

- All amounts paid to U.S. CITIZENS and RESIDENT ALIENS in the form of scholarships, fellowships, grants, and financial aid are not required to be reported to the IRS by the payors. (IRS Notice 87-31)

- All amounts paid to NONRESIDENT ALIENS in the form of scholarships, fellowships, grants, and financial aid, which are not excludible from gross income as a "qualified scholarship" under I.R.C. 117 must be reported to IRS on Forms 1042 and 1042-S, regardless of the amount paid, unless the grant is from sources outside the United States, in which case the grant is neither reportable nor subject to withholding. The "source" of a scholarship or fellowship grant is generally the residence of the payer. However, a scholarship or fellowship paid by a resident of the United States to a nonresident alien who conducts his study, training, or research outside of the United States is considered to be a foreign source grant and is not reportable to the IRS and is not subject to withholding of Federal income tax.

- In general, the taxable portion of a scholarship or fellowship paid to a NONRESIDENT ALIEN is subject to Federal income tax withholding at the rate of 30%, unless the payments are exempt from tax under the Internal Revenue Code or a tax treaty. However, payees who are temporarily present in the United States in F-1, J-1, M-1, Q-1, or Q-2 nonimmigrant status are subject to a reduced 14% withholding rate on the taxable portion of the grant because such individuals are considered to be engaged in a U.S. trade or business under I.R.C. § 871(c).

- Students only: In general, those portions of a scholarship, fellowship, or grant used to pay tuition, fees, books, supplies, or equipment are classified as a "Qualified Scholarship" and are not includible in the gross income of the recipient under I.R.C. § 117 if the recipient is a candidate for a degree. Any portion of the scholarship, fellowship, or grant that does not correlate to the five items mentioned above is includible in the gross income of the recipient, which means that it is subject to withholding.

- For non-degree candidates, the entire grant is includible in the gross income of the recipient and is subject to withholding. Research grants awarded to post-doctoral research scholars are entirely includible in the gross income of the nonresident alien recipient and, as such, are
subject to withholding.

- Stipends, tuition waivers, or any other financial aid paid to or on behalf of NONRESIDENT ALIENS which require the recipient to perform services past, present, or future, in exchange for the financial aid are taxable as wages, are reportable to IRS on Forms 941 and W-2, and are subject to the withholding rules discussed under "Wages Paid to Aliens".

- Treasury Regulation 1.1441-4(c)(2) and Revenue Procedure 88-24 provide an alternative withholding procedure for withholding tax on scholarships and fellowships paid to recipients in F-1, J-1, M-1, Q-1, or Q-2 nonimmigrant status. The alternative procedure involves withholding tax at the same graduated rates that apply to wages, instead of using a flat 14%. It also provides for deduction of the personal exemption amount and certain away-from-home expenses (if applicable) when computing which portion of a grant is taxable and subject to withholding. This alternative withholding procedure may be used at the option of the withholding agent and is not mandatory. It is extremely useful in the case of short-term J-1 trainees whose stay in the United States will not exceed one year.

- Any NONRESIDENT ALIEN grantee who claims that part or all of his scholarship or fellowship is exempt from taxation because of a tax treaty must file Form W-8BEN with the university office charged with receiving and processing such forms. Form W-8BEN is valid until December 31st of the third calendar year following the year in which the form was submitted. However, the validity period of Form W-8BEN is indefinite if the form contains the payee's Taxpayer Identification Number (TIN) on it, as long as a reportable payment of income occurs at least once annually. Any Form W-8BEN becomes invalid on the day in which any of the information contained therein ceases to be valid (e.g., on the day the payee's tax treaty benefit expires). The grant recipient is required to notify the university immediately if an event occurs, which renders the information on Form W-8BEN invalid. The university is responsible for monitoring the tax treaty benefit eligibility period for each student or scholar who has filed a Form W-8BEN, and is responsible for withholding Federal income tax at 14%, at 30%, or at the graduated rates on the taxable portion of the scholarship or fellowship after the tax treaty benefit eligibility period has expired. The university should keep all Forms W-8BEN on file for inspection by the IRS in case of an examination, for as long as the document is relevant to a tax return whose examination statute of limitations is still open.

- For all payments made on or after January 1st, 2001, a Form W-8BEN presented for the purpose of claiming a tax treaty benefit which does not contain a valid TIN (Taxpayer Identification Number) cannot be accepted by the withholding agent as a valid withholding certificate for the purpose of claiming a tax treaty benefit. This means that the withholding agent must withhold tax on the taxable portion of the grant. However, a Form W-8BEN without a TIN may still be accepted as a valid withholding certificated only for the purpose of establishing that the grant recipient is a foreign person.

- Section 1441(c)(6) of the Internal Revenue Code provides that no withholding of Federal
income tax is required on grants made to NONRESIDENT ALIEN students and trainees, which originate from funds provided by the U.S. Agency for International Development (USAID) to the extent that such grants consist of "amounts of per Diem for subsistence." Any amount of the grant that exceeds a reasonable amount dedicated to subsistence (food and lodging), or any amount of the grant that is dedicated to something other than subsistence, is subject to withholding of Federal income tax. A reasonable amount dedicated to subsistence is usually measured with reference to the U.S. Government per diem rates in effect with respect to each locality in the United States.

- In general, scholarships, fellowships, and grants which originate from sources outside the United States are not taxable to NONRESIDENT ALIENS who receive such grants; nor are such grants reportable to the Internal Revenue Service. Scholarships and fellowships paid by a U.S. grantor to a NONRESIDENT ALIEN who performs his study, research, or training outside the United States are considered to be foreign-source grants, and are therefore not reportable to the IRS and are not subject to withholding.

- For all payments made on or after January 1st, 2001 the recipient of a taxable scholarship or fellowship on which a treaty exemption is being claimed, and who simultaneously receives taxable wages on which a treaty exemption is also being claimed, may claim both treaty exemptions on Form 8233, and not use Form W-8BEN if he so chooses.