

DEFINITIONS OF INCOME

Determining the category of income paid to an individual or entity is essential for ensuring tax compliance. Tax withholding and reporting are based on two factors: **residency status** and **income category**. These two factors are used to determine the following:

- Is the payment taxable income?
- What is the correct rate (if any) of tax withholding?
- Does any exclusion from tax apply?
- How should the payment be reported?

The following factors should be taken into consideration in determining the category of income.

- the relationship between the payer and payee,
- the exchange that takes place concerning the payment

NEVER does the category of income depend on the source of the funds. You should not rely on the wording used in describing the payment. It is imperative that the withholding agent has enough information to be able to make the appropriate classification.

Listed below are the IRS definitions of categories of income. These may not necessarily reflect how Auburn University uses these terms for internal purposes.

Scholarship/Fellowship

As defined by the IRS, "A scholarship is generally an amount paid or allowed to, or for the benefit of, a student (whether an undergraduate or a graduate) at an educational institution to aid in the pursuit of his or her studies.

A fellowship grant is generally an amount paid for the benefit of an individual to aid in the pursuit of study or research. "

Recipients of scholarships/fellowships are NOT expected to render services to the institution as a consideration for their scholarship, nor are they expected to repay their scholarships.

****Fellowships received via an extramurally sponsored program may include repayment requirements in the award terms and conditions or sponsoring agency regulations. Contact Contracts and Grants Accounting for additional guidance on sponsored fellowships.**

Tax Implication:

US Citizens, Permanent Residents and Resident Aliens for federal tax purposes: Amount of the scholarship that is considered "qualified" scholarship is not taxable or reportable income. There is no tax withholding on scholarships for this group. However, these amounts are reported on a 1098-T.

Non Resident Aliens for federal tax purposes: Amount of the scholarship that is considered "qualified" scholarship is not taxable or reportable income. However, tax withholding may apply to "non-qualified" amounts and are reported to the student and IRS on form 1042-S.

This form of payment **IS** considered as additional financial aid and is calculated toward meeting total cost of attendance.

Award/Prize

Awards and prizes fall under IRS income category, “**Other Income**” Generally, a prize or award is an amount received in recognition of charitable, scientific, educational, artistic, literary or civic achievement, or is received as the result of entering a contest.

Prizes and awards are generally taxable income to the recipient.

Examples: Departments honor individuals at award ceremonies held at the end of an academic year. A competition where there are prizes for 1st, 2nd and 3rd place.

****Per PPS Spending Policy and Procedures-** Awards processed through PPS will only include those awards given through a competitive process. Award payment requests that are routed through PPS should include:

1. Proof that this is a documented awards program, including documentation on the competitive procedures and the qualification and selection criteria.
2. The Vendor Voucher should include the date on which the checks will be awarded, the monetary amount of the award, and the signature of the department head or dean, as required.

Non-competitive awards not paid through PPS:

TAX IMPLICATION

Non-employee US Citizens, Permanent Residents and Resident Aliens for federal tax purposes: 1099 issued for amounts greater than \$600.

Non Resident Aliens for federal tax purposes: 30% tax withholding, reported to individual and IRS on form 1042-S. No De Minimis.

Note: All prize/award payments made to **employees** will be reported to payroll so that all applicable taxes are withheld and reported on a W-2 or 1042-S as appropriate.

This form of payment **IS** considered as additional financial aid and is calculated toward meeting total cost of attendance.

Is the payment a scholarship/fellowship or prize/award?

There are some prizes and awards which could have the characteristics of both categories, depending on the expressed intent of the grantor. The withholding agent must decide which category best describes the grantor's intent.

Prizes and awards generally fall into two income categories:

1. **Prizes/awards in the nature of a scholarship/fellowship.**
Amounts paid in this category are payments in which the **grantor specifically intends to be spent to defray the expenses of their study, training or research.**
2. **Prizes/awards not in the nature of a scholarship and considered other income.**
Amounts paid in this category usually represent an award or recognition for an achievement, skill special knowledge or an award won in a contest. The grantor does **NOT** specifically state the

money be spent to defray the expenses of their study, training or research and can be spent how the recipient wishes.

Compensation

Generally, compensation is defined as a payment made in exchange for services. This can be for a past, present or future activity. Compensation is either **dependent** (wages/salary) or **independent** (consulting fees, speaker fee, etc.)

TAX IMPLICATION

US Citizens, Permanent Residents and Resident Aliens for federal tax purposes:

Dependent compensation reported on W-2.

Independent compensation reported on 1099 for amounts greater than \$600.

Non Resident Aliens for federal tax purposes:

Dependent compensation reported on W-2 and/or 1042-S.

Independent compensation 30% tax withholding, reported to individual and IRS on form 1042-S. No De Minimis.

Stipend

Under U.S tax law, stipends **ARE NOT** considered a category of income. Generally, when the term stipend is used, it refers to a sum of money being paid to an individual to help defray living expenses; however, the term used to describe the payment does not determine the category of income. Therefore, the payer of the income must determine how to properly classify the payment based on the facts surrounding the payment. For example, if services are required to receive the payment, it is compensation, either dependent or independent. If the payment is specifically intended to be used by a student to aid the individual in their studies or research, it would be a scholarship or fellowship. Use the categories of income defined above to determine what category of income you are paying.

Note: For Auburn University payment processing, PPS defines stipend payments as amounts paid to individuals who are **NOT** University students or employees. Stipends are used to defray expenses for participants of a University program.