

# What to Know About Taxation of International Students Receiving Financial Aid

By Ted R. Batson, Jr., Partner

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If your institution has international students who receive financial aid, there are specific income tax requirements you need to be aware of.

Here's what you need to know to help keep your institution in compliance.

Please note that this article does not address wages from student employment.

## General Rule

In general, a scholarship is nontaxable if:

1. The student is a candidate for a degree at an eligible educational institution;
2. The scholarship does not exceed the student's qualified education expenses;
3. The scholarship (or a portion thereof) is not designated or earmarked for other purposes, such as room or board;
4. By its terms, the scholarship doesn't specify that it cannot be used for qualified education expenses; and
5. The scholarship is not received for teaching, research, or any other services required as a condition for receiving the scholarship.<sup>1</sup>

Any portion of a scholarship that can be used for purposes other than qualified education expenses or any amount awarded in excess of qualified education expenses is taxable. Students can use Worksheet 1-1 on page 6 of [IRS Publication 970](#) to compute the taxable portion of their scholarship.

Qualified education expenses include:

- Tuition and fees required to enroll at or attend an eligible educational institution; and
- Course-related expenses, such as fees, books, supplies, and equipment **required** for the courses at the eligible educational institution in which the student is enrolled.<sup>2</sup>

If an international student's scholarship aid only pays for qualified educational expenses, then no portion of the aid is taxable and the student does not need to receive a Form 1042-S, *Foreign Person's U.S. Source Income Subject to Withholding*.

## Effect of Tax Treaties

If the U.S. has entered into an income tax treaty with an international student's country of citizenship, it may affect the taxability of the student's income, but not the reporting requirement.

If a student has otherwise taxable scholarship income that is nontaxable by virtue of a treaty between the U.S. and the student's country of citizenship, he or she must still file an IRS Form 1040NR, *U.S. Nonresident Alien Income Tax Return*, or Form 1040NR-EZ, *U.S. Income Tax Return for Certain Nonresident Aliens With No Dependents*, to report the income and its nontaxable status. This is captured on Schedule OI of the form.

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<sup>1</sup> IRS Publication 970, *Tax Benefits for Education*, pg. 5 (January 18, 2017); available at [irs.gov/pub/irs-pdf/p970.pdf](https://www.irs.gov/pub/irs-pdf/p970.pdf). See also IRS Publication 515, *Withholding of Tax on Nonresident Aliens and Foreign Entities*, pg. 32 (January 12, 2017); available at [irs.gov/pub/irs-pdf/p515.pdf](https://www.irs.gov/pub/irs-pdf/p515.pdf).

<sup>2</sup> *Ibid.*

A list of countries with which the U.S. has tax treaties, and the text of those treaties, is available at [irs.gov/businesses/international-businesses/united-states-income-tax-treaties-a-to-z](https://www.irs.gov/businesses/international-businesses/united-states-income-tax-treaties-a-to-z). In addition, [IRS Publication 901, U.S. Tax Treaties](#), provides summary information regarding many of the tax treaties in force between the United States and foreign countries.

### **Withholding Requirements**

The taxable portion of a scholarship paid to or for the benefit of an international student in the United States on an “F,” “J,” “M,” or “Q” visa who is a degree candidate is subject to federal income tax withholding at a rate of 14%.<sup>3</sup> This includes those amounts allocated to travel and to room and board.

Non-degree candidates are subject to the same 14% withholding rate so long as their financial aid meets the following requirements:

1. Their grant is for study, training, or research in the United States.
2. The grant was made by:
  - a. A tax-exempt organization operated for charitable religious, educational, or other purposes described in Internal Revenue Code section 501(c)(3),
  - b. A foreign government,
  - c. A federal, state, or local government agency, or
  - d. An international organization, or a binational or multinational educational or cultural organization created or continued by the Fulbright-Hays Act.<sup>4</sup>

The standard withholding rate of 30% applies to all other aid recipients.

Alternatively, an educational institution may elect to treat the taxable portion of a scholarship as wages. Where this is the case, the student must complete IRS Form W-4, *Employee’s Withholding Allowance Certificate*.<sup>5</sup> Under this alternative withholding method, a student does not complete IRS Form W-8BEN to claim treaty benefits, but rather must use IRS Form 8233, *Exemption From Withholding on Compensation for Independent (and Certain Dependent) Personal Services of a Nonresident Alien Individual*.<sup>6</sup> Where this withholding method is used, the graduated withholding rates found in IRS Publication 15 are used in lieu of the 14% withholding rate described above.<sup>7</sup>

Regardless of the withholding approach taken, both the taxable amount and the income tax withheld are reported to the student on IRS Form 1042-S.

### **Liability for FICA and Medicare**

International students with an F-1 or M-1 visa are exempt from withholding for FICA and Medicare on wages paid to them for services performed within the U.S.<sup>8</sup>

### **Obligations of the Institution**

As the payer of the financial aid and withholding agent, the institution has an obligation to withhold the applicable tax and remit it to the United States Treasury. Withheld amounts are required to be remitted to the Treasury using the Electronic Federal Tax Payment System (EFTPS).<sup>9</sup> If your institution is not already enrolled in EFTPS, you can do so by visiting [eftps.gov](https://www.eftps.gov) or calling 1-800-555-4477.<sup>10</sup>

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<sup>3</sup> IRS Publication 515, *Withholding of Tax on Nonresident Aliens and Foreign Entities*, pg. 32 (January 12, 2017); available at [irs.gov/pub/irs-pdf/p515.pdf](https://www.irs.gov/pub/irs-pdf/p515.pdf).

<sup>4</sup> *Ibid.*

<sup>5</sup> *Ibid.*

<sup>6</sup> Instructions to Form W-8BEN, pg. 6-7; available at: [irs.gov/pub/irs-pdf/iw8ben.pdf](https://www.irs.gov/pub/irs-pdf/iw8ben.pdf).

<sup>7</sup> *Ibid.*

<sup>8</sup> *Social Security/Medicare and Self-Employment Tax Liability of Foreign Students, Scholars, Teachers, Researchers, and Trainees*, [irs.gov/individuals/international-taxpayers/foreign-student-liability-for-social-security-and-medicare-taxes](https://www.irs.gov/individuals/international-taxpayers/foreign-student-liability-for-social-security-and-medicare-taxes), last reviewed or updated August 23, 2016.

<sup>9</sup> IRS Publication 515, *Withholding of Tax on Nonresident Aliens and Foreign Entities*, pg. 32 (January 12, 2017); available at [irs.gov/pub/irs-pdf/p515.pdf](https://www.irs.gov/pub/irs-pdf/p515.pdf).

<sup>10</sup> *Ibid.*

Payments are required to be remitted based on the following schedule:<sup>11</sup>

1. If the amount to be remitted at the end of any quarter-monthly period (i.e., on the 7<sup>th</sup>, 15<sup>th</sup>, 22<sup>nd</sup>, and last day of each month) is \$2,000 or more, the amount must be remitted within three business days of the end of the month;
2. If the amount to be remitted at the end of any month is \$200 or more but less than \$2,000, the amount must be remitted within 15 days after the end of the month; and
3. If the amount to be remitted is less than \$200 at the end of the calendar year, then the tax may be paid either with the annual Form 1042 or by March 15 of the following year.

Do not remit payments belonging to one year in the same deposit as payments belonging to another year.<sup>12</sup>

In addition to the obligation to remit withholdings, the institution must annually file IRS Form 1042, *Annual Withholding Tax Return for U.S. Source Income of Foreign Persons*. This form summarizes the amounts deposited and should agree to the IRS Forms 1042-S provided to the financial aid recipients.

### International Students' Obligations

International students receiving financial aid have the following requirements and considerations:

- **Obtaining U.S. taxpayer identification number** – Students who do not already have a U.S. taxpayer identification number must use [IRS Form W-7, Application for IRS Individual Taxpayer Identification Number](#), to obtain an Individual Taxpayer Identification Number (ITIN).
- **Reporting obligations to the educational institution** – Unless the alternative withholding method using IRS Form W-4 is utilized (see above), an international student must complete Form W-8BEN, *Certificate of Foreign Status of Beneficial Owner for U.S. Tax Reporting*.<sup>13</sup>
- **Tax filing obligations** – If an international student is issued a Form 1042-S reporting U.S. source income and, in some cases, amounts withheld for tax, the student should file IRS Form 1040NR or 1040NR-EZ to report that income and receive a refund, if possible. This is briefly described on page 7 of [IRS Publication 970](#).
- **Effect of visa status on tax filing obligation** – A student with an F-1 visa is treated as a non-resident alien for a period of five years.<sup>14</sup> This is notwithstanding the fact that they are in the U.S. for more than 183 days in any calendar year during this period and would ordinarily be treated as a resident alien for U.S. income tax purposes. To demonstrate eligibility for this treatment, the student should complete [IRS Form 8843, Statement for Exempt Individuals and Individuals With a Medical Condition](#).

As a nonresident alien, the student files IRS Form 1040NR or Form 1040NR-EZ.

### Additional Resources

The IRS maintains an informational resource page on this topic at [irs.gov/individuals/international-taxpayers/foreign-students-and-scholars](https://irs.gov/individuals/international-taxpayers/foreign-students-and-scholars). It will likely be updated from time to time, and we recommend bookmarking it for future reference.

Our team of higher education specialists can help you with this and other issues. You can learn more about our higher education services [here](#) or by [contacting us](#) to discuss your specific needs.

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<sup>11</sup> Ibid.

<sup>12</sup> Ibid.

<sup>13</sup> *Withholding Certificate Forms Under IRC Sections 1441-1464*, [irs.gov/individuals/international-taxpayers/withholding-certificate-forms-under-irc-sections-1441-1464](https://irs.gov/individuals/international-taxpayers/withholding-certificate-forms-under-irc-sections-1441-1464), last reviewed or updated October 20, 2016.

<sup>14</sup> See Example 1 at [irs.gov/individuals/international-taxpayers/alien-residency-examples](https://irs.gov/individuals/international-taxpayers/alien-residency-examples).

## About the Author

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