Miscellaneous Business Office Functions

Appendix E

There are two school reporting requirements that involve FSA that are not Department of Education requirements. Both reporting requirements are Treasury Department/Internal Revenue Service (IRS) requirements.

IRS FORM 1098

There are two variations of IRS form 1098—

- IRS Form 1098-E, and
- IRS Form 1098-T.

IRS 1098 Cites

26 CFR Parts 1, 301, and 602
26 U.S.C. 6050S
Federal Register: April 29, 2002 (Volume 67, Number 82) Preamble to Notice of Proposed Rule Making
Federal Register, December 19, 2002 (Volume 67, Number 244) Preamble to Final Rules

IRS FORM 1098-E

Your school must provide IRS Form 1098-E, Student Interest Statement, to all individuals who paid student loan interest of $600 or more on loans held by your school during a calendar year.

IRS FORM 1098-T

Your school must provide Form 1098-T, Tuition Statement, for each student enrolled for credit unless

1. the student is a nonresident alien (unless requested by the student);
2. the student's qualified tuition and related expenses are entirely waived, or entirely paid with scholarships or grants; or
3. the student's qualified tuition and related expenses are entirely covered by a formal billing arrangement between the school and the student's employer or a government agency such as the Department of Veterans Affairs or the Department of Defense.

The instruction for Form 1098-T do not specify what a school should do if –

- a student's qualified tuition and related expenses are entirely covered by **a combination of** scholarships, grants, and formal billing arrangement between the school and the student's employer or a government agency; or
- only a part of a student's qualified tuition and related expenses are covered by a formal billing arrangement between the school and the student's employer or a government agency.

We note that the preamble to the Final Regulations states that ... *a taxpayer cannot claim the education credit for eduction expenses paid with amounts that are excludable from gross income. Educational expenses paid through a formal billing arrangement between an institution and a government entity such as the Veteran's Administration, often are excludable from the gross income of the individual student* . (Federal Register, December 19, 2002 (Volume 67, Number 244) page 77680).

We encourage schools to seek guidance from their in-house counsel and the IRS on how to complete IRS Form 1098-T when the student falls into one of the aforementioned categories.

IRS FORMS 1042 AND 1042-S

Pell Grants and other Title IV need-based grants are tax free to the extent they are used to pay for qualified tuition and course-related expenses during the grant period. Qualified tuition and course-related expenses are defined as tuition, fees, books, supplies and equipment required for courses attempted by a degree candidate at an educational institution. To qualify, fees, books, supplies, and equipment must be required of all students in the course of instruction.

Amounts paid from Pell Grants and other Title IV need based grants other than for qualifying tuition and fees are taxable. This includes amounts paid for room and board, travel and supplies and equipment not required for the course of instruction at an educational institution. (See IRS Publication 520.)

Institutions are **not** required to withhold or report taxable scholarship amounts for students considered residents by the Internal Revenue Service. Students are considered residents for tax purposes if they are U.S. citizens, permanent residents, or nonresidents that meet the IRS substantial presence test, and are not subject to exemption or treaty benefits.

Institutions are required to meet withholding and reporting requirements for non residents. Non residents eligible for Title IV aid include asylees, refugees, and parolees. Schools must generate a 1042-S for each non resident student receiving taxable income other than wages. This includes Title IV need based aid and other grants or scholarships. Schools must also prepare a 1042 summarizing the data reported on the individual 1042-S forms. See IRS instructions for forms 1042 and 1042-S for filing requirements.

Institutions are required to withhold at the rate of 30% of the taxable portion of the Title IV aid for non residents unless the student passes the substantial presence test for the calendar year. To meet this test, the student must be physically present in the United States for

- at least 31 days during the current year; and
- 183 days during the three-year period that includes the current year, and the two years immediately before that. (Count all the days present in the current year, 1/3 of the days present in the first year before the current year and 1/6 of the days present in the second year before the current year.)

IRS Publications 515, Withholding of Tax on Nonresident Aliens and Foreign Entities and IRS Publication 519, U.S. Tax Guide for Aliens provide guidance on withholding and reporting requirements.

As a withholding agent, your school is liable for any taxes you are required to withhold. This liability is independent of the tax liability of the foreign student to whom the payment is made. If your school fails to withhold the required amount, and the foreign student fails to satisfy the U.S. tax liability, then both you and the foreign student are liable for the taxes, as well as for interest and any applicable penalties. (Note that the applicable tax will be collected only once.) Even if the foreign student satisfies his or her U.S. tax liability, your school may still be held liable for interest and penalties for your failure to withhold.

If an institution withholds amounts from taxable Title IV need based aid (or other- scholarships and grants) the institution must complete an IRS Form 1042-S, Foreign Person's U.S. Source Income Subject to Withholding. The foreign student must complete and file an IRS Form 1042, Annual Withholding Tax Return for U.S. Source Income of Foreign Persons with the Internal Revenue Service by March 15 of the year following the calendar year in which the Title IV need based aid or other grant or scholarship was paid.