

Abstract: If your child has been awarded a scholarship for college or another type of school, it's certainly cause for celebration. But parents need to be aware of the potential tax implications. This article explains whether or not scholarships are taxable.

Are scholarships taxable?

Many young adults are heading off or back to college in the fall. It's particularly exciting this year because of high hopes that, thanks to mass vaccinations, students will be able to have something approaching a traditional college experience.

If your child has been awarded a scholarship, that's cause for celebration, too! But be aware that there may be tax implications.

Generally, but not always

Scholarships (and fellowships) are generally tax-free for students at elementary, middle and high schools, as well as those attending college, graduate school or accredited vocational schools. It doesn't matter if the scholarship makes a direct payment to the individual or reduces tuition.

Subject to limited exceptions, however, a scholarship *isn't* tax-free if the payments are linked to services that your child performs as a condition for receiving the award — even if the services are required of all degree candidates. Therefore, a stipend your child receives for required teaching, research or other services is taxable, even if the child uses the money for tuition or related expenses.

What if you, or a family member, is an employee of an education institution that provides reduced or free tuition? A reduction in tuition provided to you, your spouse or your dependents by the school at which you work isn't included in your income or subject to tax.

Returns and recordkeeping

If a scholarship is tax-free and your child has no other income, the award doesn't have to be reported on a tax return. However, any portion of an award that's taxable as payment for services is treated as wages. Estimated tax payments may have to be made if the payor doesn't withhold enough tax.

Your child should receive a Form W-2, "Wage and Tax Statement," showing the amount of these "wages" and the amount of tax withheld. Any portion of the award that's taxable must be reported, even if no Form W-2 is received.

Basic rules

These are just a few of the basic rules. Other rules and limitations may apply. For example, if your child's scholarship is taxable, it may limit other higher education tax benefits to which you or your child are entitled. As we approach the new school year, best wishes for your child's success. Please contact us if you wish to discuss this or any other tax matter.