

In general a grant, either in the form of a scholarship or fellowship, can be excluded from your income if you are a degree candidate, attend a college or university, are not required to perform services in exchange for the money, and expend the funds for acceptable expenses such as tuition and books.

First, at a minimum, you must be a candidate for a degree and attending a college or university. If, however, you are a degree candidate and you are expected or required to perform services (such as teaching or research) in return for the funds, then you do not qualify for the exclusion. This is true regardless of whether the grant is in exchange for services you are currently performing or for services which you performed in the past or are expected to perform in the future. Thus, if your employer is paying your scholarship, you clearly can not exclude the amount from income.

Even if the institution (such as your school) making the scholarship or fellowship grant is not your employer, you may still be required to include the grant amount in income if your study or research primarily benefits that institution. Thus, if you are given a fellowship grant to research a particular scientific area for your college and you are required to publish the results of your research, with the college retaining the copyright on your article, your grant will not be excludable because the research is done primarily for the college's benefit.

It is also possible that the grantor of your scholarship or fellowship grant has clearly indicated that a portion of it is paid for studies only and the rest is paid for your services, such as teaching. In that case you will have to make an allocation of the taxable and non-taxable portions.

Finally, once you have passed the threshold tests described above, it is still necessary for you to be able to show that you have spent the funds on specified items. These acceptable expenditure items include tuition, fees, books, supplies and equipment. Expenditures for any other purpose, such as room and board, are not excludable. The terms of your scholarship or fellowship grant, in fact, have a bearing on this treatment since a grant which designates that funds be used for a nonpermissible purpose or prohibits use of the funds for a permissible purpose will both result in the grant amount not being excludable from your income. The fact that you must show how you expended the grant money does not mean that you have to trace the funds from your scholarship check through your bank account to the actual payment. It is enough that you produce receipts showing that you paid for tuition, books and other qualifying expenses.

As you can see, these rules can be complicated and the excludability of any particular scholarship or fellowship grant depends in large part upon the factual situation in which it arises.