



LAW ADVOCATE GROUP, LLP

9701 Wilshire Blvd. Suite 1000 Beverly Hills, CA 90212

Phone: 310-651-3065 Fax: 310-601-7110

www.LawAdvocateGroup.com

Doron F. Eghbali Taxation Law

Student Financial Aid V. Taxes: A Dichotomy

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Most students receive financial aid to attend public or private universities. The question then arises if such aid is taxable or not. Let us explore the intricacies involved in treating financial aid taxable or non-taxable.

SOME BASICS

Whether the financial aid your child receives is primarily determined by the type of aid your child receives.

- **NOT TAXABLE:** If your child receives the student aid in exchange for NO WORK, then the aid is usually not taxable. Such student aid could be referred to as "grant", "scholarship", or "fellowship". Remember the key is whether the student aid regardless of its name is given in exchange for work performed or not.
- **TAXABLE:** If your child receives the student aid in exchange for work to be done, no matter what the student aid is called, even if it is called "fellowship" or "scholarship", that student aid is taxable and MUST be reported on the student's tax return.
- **CAVEAT:** It is immaterial for the IRS where the money comes from. This means the money could be from a governmental agency, private institution, non-profit or profit corporations. The bottom line is the latter considerations are used to determine whether such money is taxable or not.

SOME GOOD NEWS: GENERALLY, MOST STUDENT AID IS NON-TAXABLE

Student aid is mostly non-taxable if it is awarded because of *Financial Need OR Academic Merit AND:*

- The recipient is a degree candidate. The degree candidate could be a graduate degree candidate.

- The recipient is OBLIGATED to use the funds for ONLY tuition and related expenses, including books and supplies.
- The recipient HAS NO RESTRICTION to use the funds for any particular purpose.
- Alternatively, the recipient MUST SHOW tuition and related expenses exceeded student aid benefits.

SOME MORE GOOD NEWS

Even if your child has to report student aid as taxable income, this does not necessarily mean, the child or you necessarily has to pay taxes on it, for the following reasons:

- **NON-DEPENDENT CHILD:** If your child is not dependent, then the child can take advantage of personal exemption \$3,650 for 2010 OR \$3,700 for 2011. In addition, your child could take advantage of standard deduction, \$5,700 for 2010 and \$5,800 for 2011, assuming your child is unmarried.
- **DEPENDENT CHILD:** If your child is dependent, then he is not entitled to personal exemption deduction. Nonetheless, the child would be still entitled to standard deduction, \$5,700 for 2010 and \$5,800 for 2011.

DORON EGHBALI is a Partner at the Beverly Hills Offices of [Law Advocate Group, LLP](#). He Primarily Practices [Business](#), [Real Estate](#) and [Entertainment Law](#). [Doron](#) Can Be Reached at: 310-651-3065. For More Information, Please, Visit: [HERE](#).