## Minnesota State Colleges and Universities

### Procedures for Taxation of Graduate Student Tuition Reductions

**Background**

Section 117 (d) paragraphs 1 & 2 of the Internal Revenue code provides that “gross income shall not include any qualified tuition reduction provided to an employee for education below the graduate level”.  Section 117 (d) paragraph 5 extends the provisions of paragraphs 1 & 2 to “graduate assistants engaged in teaching and research”. Section 117 (c) limits the exclusion from income to tuition reductions that do not have a service requirement as a condition of receiving the tuition reduction.

**Objective**

To provide institutions with procedures for identifying and reporting taxable tuition reductions given to graduate assistants.

**Scope**

Applies to State Universities only.

**Determination of Taxable Income**

A tuition reduction is tax free to a graduate student under the following circumstances:

**1) The tuition reduction does not represent compensation for service, and**

**2) The student is engaged in teaching or research**

The tuition reduction is compensation for service if the student must perform some service for which they are not otherwise compensated.  To the extent the tuition reduction represents compensation for services, the fair market value of the portion of the tuition reduction that represents compensation is taxable. To determine fair market value of services, the compensation in question may be compared to any of the following:

* Amounts the university pays for similar services by students with comparable qualifications, who do not receive tuition reductions.
* Amounts the university pays for similar services by full or part-time non-students with similar qualifications
* Amounts other educational organizations pay students for similar services

The following examples illustrate the above:

**Example 1:**

The graduate student is employed by the university as an office assistant and receives an hourly salary plus a tuition reduction of $1,000 per year.  The tuition reduction is taxable because the graduate student is not engaged in teaching or research.  Whether the graduate student is being paid fair market value is irrelevant since the graduate student is not engaged in teaching or research.

*Whether or not a student is engaged in teaching or research should be determinable by title.  The words “teaching” and “research” in the job title should be indicative of the activity.  Examples of equivalent titles include Lab Assistant, Graduate Student Researcher, Nursery School Assistant or Tutor.  The job title should be consistent with the activity in which the student is engaged.*

**Example 2:**

Deb, a graduate student at a MnSCU State University, is engaged as a teaching assistant, for which she receives a salary of $6,000 per year plus a tuition reduction of $1,000 a year.   Adjunct faculty who teach the same number of credits and have comparable qualifications receive a salary of  $6,000 per year. The graduate student’s salary is reasonable compensation when compared to the adjunct salary so the tuition reduction is tax-free.

**Example 3:**

Same scenario as Example 2 except the adjunct faculty receives a salary of  $7,000 per year.  The graduate assistant’s salary is not reasonable compensation when compared to the adjunct salary so the $1,000 of tuition reduction would be treated as taxable compensation.

**Example 4:**

Same scenario as Example 2 except the adjunct faculty receives a salary of $6,500 per year. $500 of the tuition reduction is taxable compensation and the remaining $500 is tax-free.

**Example 5:**

Same scenario as Example 2 except adjunct faculty is considered more qualified and receives a salary of $7,000 a year.   The graduate student’s salary is approximately 85% of the adjunct, and if the university determines 15% to be a reasonable difference for the levels of experience, the tuition reduction would be tax-free.

*Actual comparisons of compensation may be more difficult in a real life situation so the university should be prepared to document and defend its determination to an IRS auditor.*

**Reporting Taxable Tuition Reductions**

Taxable benefits must be reported on Form W-2 and are subject to the usual employment taxes. In general, graduate assistants will be exempt from FICA under the student FICA exemption.

Student Payroll must use the Taxable Benefit Screen, PR0026UG, to distribute the taxable benefits to the graduate students’ wages. Taxable benefits must be distributed during the same semester as awarded.

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