

Guidelines For Scholarship Programs

June 1994

Many ISA Sections, Districts, and Divisions institute programs to provide scholarships to students. Because ISA, and its Sections, Districts, and Divisions are classified by the Internal Revenue Service as tax-exempt charitable and educational organizations, all scholarship programs offered by Sections, Districts, or Divisions must meet certain rules to avoid violating the federal tax laws. Failure to meet the rules can result in disqualification of the scholarship program and/or loss of tax-exempt status. The following is intended to help guide Sections, District, and Divisions in establishing a scholarship program.

In order to satisfy the tax laws, scholarship programs must follow three basic rules:

1. The pool of eligible recipients for the scholarship must be sufficiently large so that the scholarship is made available to the "public;"
2. The criteria for awarding the scholarship must be reasonable and objective; and
3. Those persons, and their relations, who will make or may possibly influence the decision on who will receive the scholarship must be ineligible to receive it.

Each of these rules is more fully described below.

Scholarship programs may not restrict eligibility to ISA (or Section, District, or Division) members or their dependents. The "public," or at least a reasonably broad segment of the public, must be eligible for the scholarship. Although membership can be used as an alternative criteria, the scholarship cannot be awarded in practice to only members. However, some eligibility restrictions are permitted, including:

- schools that recipients attend (i.e. specific institutions or accredited four year colleges or universities within a particular region);
- fields of study of recipients (i.e. engineering);
- year of study (i.e. Seniors, Masters candidates); and
- combinations of the above;

as long as these restrictions do not unduly reduce the pool of eligible applicants to the point that the "public" is no longer eligible. Eligibility requirements may not be used to assure that a member or member's dependent receives the scholarship.

The decision of who should receive the scholarship must be based on objective and reasonable criteria. The decision cannot be arbitrary or capricious. Examples of valid criteria include:

- grade point averages;
- class rank (i.e. upper 10%);
- SAT or other test scores;
- teacher recommendation;
- competitive essays or research projects;
- demonstrated financial need; and
- combinations of the above.

As with eligibility restrictions, the decision criteria must be sufficiently broad to avoid undue limitations on "public" eligibility for the scholarship.

The decision criteria must be established in advance of the applications and careful consideration should be given to it to make sure it is practical. For instance, using grade point average as the criteria seems easy, but consider, how do you distinguish between grade point averages at different schools (which may use different scales) or for different majors and how do you handle two or more equally qualified applicants (Do you split the award?) Similar concerns arise when using any numerical criteria, including test scores or class rank. Competitive essays or research projects are sound criteria, but who will evaluate them? Teacher recommendations may rely more on the eloquence of a particular teacher than on actual merit. And, do you really want to know the financial status of the applicants? As a practical matter, consider using multiple criteria and use a competitive essay or project evaluated by impartial judges.

Other practical issues which need to be addressed include the period for the award. For instance, will the recipient continue to receive the scholarship amount annually until graduation without reapplication or is the scholarship a one-time award? In addition, when will the scholarship be paid, in full at the beginning of the school year or in portions at the beginning of each semester or quarter? What happens to the award if the recipient drops out of school?

Further, do not require disclosure of information on the application which is not part of the decision criteria. For example, if financial need is not part of the criteria, then there is no need to ask how much it costs the applicant for tuition, fees, or other expenses. Or, if class rank is not part of the criteria, then don't ask for it. The application should be limited to only that information which will be used to make the decision.

Conflicts of interest must be avoided. Accordingly, procedures must be designed so that those who evaluate the applicants, leaders of the group, and other influential "insiders," and their relatives, are ineligible for the scholarship. One solution is to have disinterested, qualified non-members evaluate the applications and make the award. This is particularly well-suited to the evaluations of essays or research projects.

TAX ASPECTS OF SCHOLARSHIP PROGRAMS

No special federal tax returns are required to be filed with the IRS by the Section, District, or Division. Nor is the Section, District, or Division required to withhold income or other taxes from the award. It is the obligation of the recipient to properly report the receipt of the scholarship for tax purposes. The Section, District, or Division should so inform the recipient. Additionally, Sections should report the amount of the award on line 22 of its annual tax return, Form 990, and also as a "Program Service" in Part III of Form 990 or 990EZ. (Districts and Divisions should report the amounts awarded to Headquarters for inclusion in the Society's consolidated annual tax returns.)

Although not required to do so, the Section, District, or Division may inform the recipient that all or part of the scholarship may constitute taxable income to the recipient. For a scholarship to be excluded from the recipient's taxable income both of the following requirements must be met:

1. The scholarship must be actually spent for one or more of the following expenses during the scholarship period: tuition and fees required by the educational institution or books, supplies, or equipment required for the courses attended at the educational institution; and
2. The recipient must be a candidate for a degree at a primary or secondary school, at an accredited college or university, at an accredited educational institution which offers full credit courses toward a bachelor or higher degree, or at an accredited educational institution which offers a program of training to prepare students for gainful employment in a recognized occupation.

Any amounts from the scholarship used for room and board, travel, entertainment or other expenses not included in item 1 above are taxable income to the recipient. Additionally, any part of the scholarship which represents payment for teaching, research, or other services is also taxable income even if all candidates for degrees are required to perform such services. The recipient should report the taxable amount of the scholarship as wages on the recipient's annual 1040 form with a notation that it is a "scholarship." (The Section does not have to issue a W-2 form.)