



Is college financial aid taxable? A crash course for families

College can be expensive. According to the College Board, the average sticker price for tuition and fees at private colleges was \$43,350 for the 2024–2025 school year. The average cost for tuition and fees for out-of-state students at public colleges was \$30,780. For in-state students, the cost was \$11,610. Of course, there are additional costs for housing, food, books, supplies, transportation and incidentals that can add thousands to the total.

Fortunately, a surprisingly high percentage of students at many schools receive at least some financial aid, and your child's chances may be better than you think. So, if your child cashes in on some financial aid, what are the tax implications? Here's what you need to know.

The basics

The economic characteristics of what's described as financial aid determine how it's treated for federal income tax purposes.

Gift aid, which is money the student doesn't have to work for, is often tax-free. Gift aid may be called a scholarship, fellowship, grant, tuition discount or tuition reduction.

Most gift aid is tax-free

Free-money scholarships, fellowships and grants are generally awarded based on either financial need or academic merit. Such gift aid is nontaxable as long as:

- The recipient is a degree candidate, including a graduate degree candidate.

- The funds are designated for tuition and related expenses (including books and supplies) or they're unrestricted and aren't specifically designated for some other purpose — like room and board.
- The recipient can show that tuition and related expenses equaled or exceeded the payments. To pass this test, the student must incur enough of those expenses within the time frame for which the aid is awarded.

If gift aid exceeds tuition and related expenses, the excess is taxable income to the student.

Tuition discounts are also tax-free

Gift aid that comes directly from the university is often called a tuition discount, tuition reduction or university grant. These free-money awards fall under the same tax rules that apply to other free-money scholarships, fellowships and grants.

Payments for work-study programs generally are taxable

Arrangements that require the student to work in exchange for money are sometimes called scholarships or fellowships, but those are misnomers. Whatever payments for work are called, they're considered compensation from employment and must be reported as income on the student's federal tax return. As explained below, however, this doesn't necessarily mean the student will actually owe any tax.

Under such arrangements, the student is required to teach, do research, work in the cafeteria or perform other jobs. The college or financial aid payer should determine the taxable payments and report them to the student on Form W-2 (if the student is treated as an employee) or Form 1099-MISC (if the student is treated as an independent contractor).

Taxable income doesn't necessarily trigger taxes

Receiving taxable financial aid doesn't necessarily mean owing much or anything to the federal government. Here's why: A student who isn't a dependent can offset taxable income with the standard deduction, which is \$15,000 for 2025 for an unmarried individual. If the student is a dependent, the standard deduction is the greater of 1) \$1,350 or 2) earned income + \$450, not to exceed \$15,000. The student may have earned income from work at school or work during summer vacation and school breaks. Taxable financial aid in excess of what can be offset by the student's standard deduction will probably be taxed at a federal rate of only 10% or 12%.

Finally, if you don't claim your child as a dependent on your federal income tax return, he or she can probably reduce or eliminate any federal income tax bill by claiming the American

Opportunity Tax Credit (worth up to \$2,500 per year for the first four years of undergraduate study) or the Lifetime Learning Credit (worth up to \$2,000 per year for years when the American Opportunity credit is unavailable).

Avoid surprises at tax time

As you can see, most financial aid is tax-free, though it's possible it could be taxable. To avoid surprises, consult with us to learn what's taxable and what's not.

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