

# PAYMENTS TO STUDENT OFFICERS AND DIRECTORS: AN ANALYSIS

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*The Auxiliary Organizations Association (AOA)<sup>1</sup> commissions and publishes monographs for its members on timely governance and management subjects.*

*This paper is an update to a monograph by the same title published in 2007, and includes expanded coverage relating to undocumented student support and qualified scholarship requirements under tax law. It does not constitute legal, tax or accounting advice. Auxiliary organization governance issues follow patterns, but most are quite fact and circumstance sensitive, and should, therefore, be addressed and resolved in consultation with appropriate advisors. AOA will endeavor to keep this monograph up-to-date. The analysis, conclusions and approaches are those of the author, not the AOA or its member organizations.*

## **Background**

Many AS and student union organizations operating within the CSU provide for payments to designated student office-holders (elected or appointed). Such payments pose several related issues. This paper was commissioned by the AOA AS/Union Standing Committee to identify the primary concerns and provide sufficient analysis to aid organizations in formulating sound policy and practices. This analysis is not a substitute for legal advice required in specific situations.

These payments – often described as stipends, grants or scholarships – vary in amounts, payment intervals, and qualification criteria. In some cases, they involve performance conditions. All raise tax liability and reporting issues. A fundamental distinction is needed from the outset: *compensatory payments* made to student officer-holders should not be confused with payments made in respect for the service of the student to the campus community as an elected or appointed student leader. If the student leader is carried on the organization's payroll as a student employee, then the payments are *wages*, not a stipend, grant, scholarship or related financial assistance. Such wages are reportable income and subject to withholding rules.

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<sup>1</sup> The AOA, a California public benefit nonprofit corporation, is organized to develop and foster sound relationships between member-organizations and with their customers and clients; and to provide governance and management development programs, services and publications. AOA members are auxiliary organizations serving campuses within the California State University. The AOA is *not* an auxiliary organization.

Student leader payments have been the subject of auxiliary organization compliance and control reviews by the University Auditor. Typical findings and recommendations have dealt with:

- documenting the authority to use student body funds for such payments; and
- the proper administration of such payments, including verification of eligibility, appropriate tax withholding, and reporting to and review by the campus financial aid office.

## **Analysis**

This analysis is organized around several perspectives. They should not be viewed as mutually exclusive in nature. In fact they are quite interrelated, if not completely consistent or clear in purpose or terminology.

### **A. Legal Framework**

There is a statutory and regulatory basis for the use of student body fee funds for payments to students by AS and union auxiliary organizations.

These organizations are typically incorporated under the California Nonprofit Public Benefit Law, and subject to the provisions on the compensation of officers and directors. Corporations Code Section 5151(c)(3) permits directors to be compensated on a reasonable basis, and to be reimbursed for reasonable expenses. The terms of compensation should be spelled out in the bylaws or (if the bylaws do not prohibit compensation) by board resolution.<sup>2</sup> Section 5151(c)(5) allows for reasonable officer compensation if authorized on a basis parallel to that required for directors.

California Education Code Section 89302 provides, in part, that:

*Student body funds used for scholarships, grants-in-aid, stipends, loans, and similar expenditures shall conform to the regulations of the trustees. The funds shall be approved by the financial aid office before the funds are expended and shall be reflected on the student's record kept in that office. The student's financial aid record shall include all the funds received by the student.*

Note that there is an apparent distinction being made in 89302 between “award” expenditures, and all funds received by the student from the student body organization (such as employment or other compensatory payments). Thus,

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<sup>2</sup> As auxiliary organizations, student body organizations (titled “associated students”) are required under Title 5 [*California Code of Regulations* (CCR) § 42659(k)] to secure the approval of the student body for such compensation. This requirement can be satisfied if the bylaws are subject to student-body voter approval.

while “award” fund expenditures need to be closely coordinated with the financial aid office, there is no apparent requirement that “compensation” payments be reported to the financial aid office. *That function belongs to the student (financial assistance-applicant).*

Similarly, but at a broader frame of reference, the CSU Board of Trustees included *Loans, Scholarships, Grants-in-Aids, Stipends, & Related Financial Assistance*<sup>3</sup> in the list of authorized auxiliary organization functions deemed appropriate to perform in accordance with applicable policies, rules and regulations.

Title 5 regulations also set some additional criteria for the authority to make award payments from “student body organization funds.” Awardees must be “currently admitted students” in accordance with provisions of Section 42500, subdivision (d).<sup>4</sup> And, before the provision for such payments is established, “the principle of establishing such payments shall be approved by a student referendum.”<sup>5</sup> There appear to be no system-wide policies or directives that attempt to further refine or restrict student office-holder payments – with the following narrow exception:

Title 5, Section 42500(d), implements Education Code Section 89302 by restating the statutory requirement relating to campus financial aid office reporting and approval, and setting a qualified limit on award amounts.<sup>6</sup> The Chancellor’s Office has issued a coded memorandum that requires such payments to be reported on a timely basis to the campus student financial aid office.<sup>7</sup>

Thus, while State law permits *student body organization* use of student fees for such awards, that authority is qualified by the CSU – and possibly campus requirements – that:

1. the organization secure student referendum approval<sup>8</sup> “in principle;”
2. awardees be currently admitted<sup>9</sup> students;

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<sup>3</sup> CCR Title 5, § 42500(a)(6).

<sup>4</sup> CCR at § 42659(d).

<sup>5</sup> CCR at § 42659(k).

<sup>6</sup> Award amounts ... “shall not exceed amounts to be provided under regulations of federal and state financial aid programs, except as provided under Section 42403(b) [trust funds with specific conditions].”

<sup>7</sup> AA-2004-15, *Student Financial Aid Administration – Coordination of Information & Resources*, May 3, 2004, and AA-2009-12, *Reporting New and Continuing Students Receiving the Benefits of AB 540*, June 5, 2009.

<sup>8</sup> This requirement would appear to be satisfied by a bylaws provision in cases where the organization’s bylaws and any amendments need student-vote approval.

<sup>9</sup> While the “admitted” student qualification is certainly intended to apply generally to student awardees, it is certain that as to student leader awardees, the requirement would be that they be currently “enrolled.”

3. the awards be reported to and approved in advance by campus financial aid office; and
4. the awards are within amounts that do not exceed federal or state limitations.

*There does not appear to be any parallel published system-wide limitations applicable specifically to student union organization student officers or directors. However, a number of student body organizations are also authorized to operate the campus student union (or center) under combined or delegated governance structures. There may also be campus policy addressing student leader payments.*

## B. Sorting Out Terms

There are some generally accepted terms for payments made to student office-holders -- yet subtle differences among the types of payments in respect for their campus community leadership roles.

To begin, the term “stipend” appears to have, in practice, a somewhat disparate reputation: very different kinds of payments by the same name. Avoid labeling a payment a “stipend” (when in fact it is obviously something quite different) to skirt a perceived disadvantage or adverse consequence for either the payor or the recipient.

The dictionary definition for a stipend is “a fixed or regular payment, such as a salary for services rendered or an allowance.” Hardly definitive for this analysis, but, within the higher education sector, stipends are often viewed either as *compensatory* or *non-compensatory*. Sometimes the term stipend is preferred to describe a more liberal use to which the payment may be applied (general support), as distinguished from a scholarship that commonly restricts use of the payment to tuition, books, fees, and the like.

The *compensatory stipend* is typically paid to an individual conditioned on the completion of a specified activity (so-called, performance-based award). The awarding organization’s withdrawal or cancellation of stipend payments can occur if the student discontinues participation in the activity. The passage of time as a participant or the satisfactory completion of a service task can trigger the payment. *Compensatory stipends* are normally considered taxable income. Such payments are often called salary stipends and are associated with performing additional assignments under a pre-existing employee-employer relationship. With regard the student office-holders, further analysis of the *award conditions* is crucial to the judgment of whether or not the stipend payments are *compensatory* or *non-compensatory*. See below. In the private sector (for-profit entities), a common practice akin to *compensatory stipends* is the *director fee* – usually paid quarterly or annually based most often on some criteria, like attending committee

and board meetings. Director fees are compensation based upon a non-employment relationship between the individual and the corporation.

*Non-compensatory stipends* are payments made that are not contingent on the completion of a specified activity or role. These payments are usually known as scholarships or grant stipends, and are associated with enrollment in an educational or training program and/or participation in certain institutional activities, such as student government, musical groups or athletic teams and not defined as employment. If the student office-holder must satisfy certain tasks as a *condition precedent* to receiving such stipend payments, then that practice would strongly suggest that the policy objective is to compensate them for completing those tasks while in office.

*However, if the conditions of performance are requirements to retain the office held, rather than to satisfy the payment conditions while in office, then there is an argument that such payments are non-compensatory: that is, as long as the student remains in office, the stipend is paid.*

Other “labels” find themselves attached to such payments, but because they all have vague and often overlapping definitions and usage, the above analysis on stipends applies to these terms as well.

The term *scholarship* also has a generic dictionary definition: a grant of financial aid to a student. In practice, this term is used along with qualifying criteria that a recipient must satisfy to obtain (and in some cases, retain) the payment(s).

A *fellowship* payment is generally made to support an individual engaged in specified research, and, therefore, typically involves a student working at a post-graduate level. The dictionary definition is vaguer. Similarly, the term *internship* suggests that the student is engaged in an academic-related program as an adjunct to the leadership role being served. Such an adjunct role typically involves performance-factors, and any payments based upon that role would likely be classified as “non-employment relationship” compensation.

*Grant-in-Aid* can be an even more elusive term, particularly in distinguishing it from other related terms. A *grant-in-aid* payment to an individual usually has specific terms relating to appropriate uses of the granted funds, and may also require some kind of service or the completion of a task.

The term *reimbursement* can crop up to describe payments to student officers or directors. Typically reimbursements are associated with an individual’s actual expenses – such as travel, food and lodging -- incurred while performing official duties. But, a “reimbursement” based, for example, upon documented per-meeting attendance or an authorized time-based factor, without regard to an expense outlay, appear to fall somewhere between a performance-type

*compensatory stipend* and an employee wage. This terminology would likely be characterized for tax purposes as income.

There is a category of compensation to be avoided in making student leadership payments: *the independent contractor*. Do not attempt this route. The “independent contractor-status test” sorts out whether the individual has the right to control the manner or means by which the work is accomplished, regardless of whether the person exercises the right. There are common-law factors considered under federal law and regulations to judge if the individual should be determined an independent contractor.<sup>10</sup> Given the proper role and responsibilities of a student officer or governing board member, and the duty owed the organization, there is no likelihood that a determination of independent contractor status could be established.

*Labeling such payments by one of the above terms will not be as critical as will be the accurate and concise description of the support program in organization policy statements – particularly on the question of whether the student office-holder’s “service” is intended to satisfy the right to retain that office, or to qualify for the support payments.*

C. Tax and Related Implications. There are exacting federal and California Franchise Tax Board (FTB) tax rules on payments that require withholding and/or reporting by a payor-organization, and/or by the recipient. The IRS has well developed guidelines on the proper classification of contractors and employees. Likewise, state law governs how and when wages and salaries must be paid.

Scholarship, fellowship, and grant payments to U.S. citizens and resident aliens are not generally reportable to the IRS by the recipient and are not subject to federal withholding of tax.<sup>11</sup> The university -- as an “eligible educational institution” – does file, with exceptions, an IRS Form 1098-T to report student scholarships and grants. Such payments to nonresident aliens are generally reportable and subject to withholding of federal income tax.<sup>12</sup>

In general, those portions of a scholarship, fellowship, or grant used to pay tuition, fees, books, supplies, or equipment are classified as a “qualified scholarship” and are not includable in gross income of the recipient (for federal tax reporting), if the recipient is a candidate for a degree.<sup>13</sup> U.S. Treasury Regulations informing Section 117 has a broad definition of the term scholarship:

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<sup>10</sup> Rev Ruling 87-14, 1987-1 Cum Bull 276; U.S. Treasury Regulations § 31.3401(c)-1; IRS *Training Manual on Worker Classification*, and IRS Publication 15 and 15-A, (*Circular E*) *Employer’s Tax Guide for use in 2013 and Supplement*.

<sup>11</sup> See IRS overview at: <http://www.irs.gov/Individuals/International-Taxpayers/Withholding-Federal-Income-Tax-on-Scholarships,-Fellowships,-and-Grants-Paid-to-Aliens>

<sup>12</sup> See IRS Notice 87-31. For an overview on withholding federal income tax on scholarships, fellowships, and grants paid to aliens, see: <http://www.irs.gov/publications/p519/ch02.html>. State income tax reporting requirements should also be factored in the “qualified scholarship” analysis.

<sup>13</sup> U.S. *Internal Revenue Code* § 117(a) and (b).

“an amount paid or allowed to, or for the benefit of a student, whether an undergraduate or a graduate, to aid such individual in pursuing his studies.”<sup>14</sup> However, the term “qualified scholarship” has a narrower definition:

A “qualified scholarship” that is excluded from income requires (for federal reporting) that the payment be for either (A) tuition and fees required for the enrollment or attendance of a student at an qualified educational organization<sup>15</sup>, or (B) fees, books, supplies, and equipment required for courses of instruction at such an educational organization.

A scholarship not meeting Section 117 tests should be considered a non-qualified scholarship and, as such, taxable income to the recipient.

There are key factors that can be utilized to help document the basis for “qualified scholarship” program payments for student leaders:

- a. Remitting the scholarship funds directly to the campus financial aid office for award to the student leader;
- b. Making the award at the beginning of the term; and
- c. Restricting the payment specifically for the student leader’s qualified tuition and related expenses, not for services, and irrespective of leadership performance.

Payments either generally for service as a student office-holder as a wage or salary, or as *quid pro quo* for the performance or satisfaction of specified conditions while in office as a stipend, should be considered compensatory in nature. These are income transactions for the student, and depending upon how the organization-student relationship is structured, should generate an IRS Form W-2 (employment) or, in many cases, the Form 1099-MISC (non-employment relationship).<sup>16</sup>

If an organization does not provide a student leader receiving such payments with a W-2 (or the 1099-MISC), that does not necessarily mean the payments are to be considered excluded from reportable gross income for tax purposes. It is the responsibility of the student office-holder to determine whether such payments must be included in gross income and reported to the taxing agencies.

Organizations making payments to student officer-holders as either compensation for performance of their duties (compensatory stipend), or as a

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<sup>14</sup> See Income Tax Regulation § 1.117-3. Assuming the recipient is a student at a CSU campus at the time of payment and, thus, meets the requirement of being a candidate for a degree at an educational organization described in § 170(b)(1)(A)(ii), it is reasonable to assume that the payment is a scholarship.

<sup>15</sup> Ibid.

<sup>16</sup> Additional information is available from IRS Publication 970, *Tax Benefits for Education*, at Section 1.

wage or salary (under an employee-employer relationship), also need to make close judgments to keep such payments in conformity, respectively, with IRS worker-status guidelines, fair labor standards, and California wage-hour rules. There is the risk of penalties for the organization if payments have been made to misclassified individuals.

Federal tax rules classify workers as either independent contractors or common-law employees. The factors involved in determining the correct classification should be considered against the specific circumstances and policy provisions of the organization's student office-holder support program.<sup>17</sup>

The California statutory and Industrial Welfare Commission (IWC) regulatory framework for employee wage, hour and working conditions generally apply to student office-holders classified as employees.<sup>18</sup>

Similarly, *Fair Labor Standards Act* (FLSA) standards relating to exempt versus nonexempt employees present issues on how and when student officers or directors, as employees, should be paid. Nonexempt employees receive overtime pay, while exempt employees do not. With a few exceptions, an exempt employee must be paid at least \$23,600 annually (\$455 per week) on a salary basis, while performing exempt job duties.<sup>19</sup> If student leader payments are paid as wages, these standards apply, or an explicit statutory or rule exclusion or exemption must be claimed.

#### D. Undocumented Students

Education Code Section 68130.5 (AB 540)<sup>20</sup> exempts qualified undocumented (no legal immigration status) students from paying nonresident tuition at California public colleges and universities. The AB 540 exemption does not deal with eligibility for publicly-funded financial support. While AB 540 and other undocumented immigrant students were not initially eligible for federal and state aid, other scholarships were available and permitted that did not require U.S. citizenship and/or state residency.<sup>21</sup>

Is a scholarship payment from student fees to a CSU campus student leader who is AB 540-qualified within the ambit of the *California Dream Act*? Under this Act,

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<sup>17</sup> See IRS overview at: <http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Independent-Contractor-Self-Employed-or-Employee> .

<sup>18</sup> *Cal Labor Code* Section 3351 includes an extensive "employee" definition broad enough to include student organization-paid officers and directors.

<sup>19</sup> FLSA regulations cite specific job duty categories, called "executive," professional," and "administrative" to guide employers in determining the exempt status of certain employees. For further amplification, see: <http://www.dol.gov/whd/regs/compliance/hrg.htm>.

<sup>20</sup> Statutes 2001, Chapter 814, effective January 1, 2002.

<sup>21</sup> *California Dream Act of 2011* (AB 130), Statutes 2011, Chapter 93. Adds *Education Code* § 66021.7 and amends § 68310.7)

the scholarship must be derived from “nonstate funds” received by the student’s institution.<sup>22</sup>

Enter AB 131.<sup>23</sup> This measure “... provides that students, who are exempt from paying nonresident tuition under current state statute, are eligible to apply for, and participate in, any student financial aid program administered by the California State University and the State of California to the full extent permitted by federal law. This requirement becomes effective January 1, 2013.”<sup>24</sup>

#### E. Unemployment Insurance Issues

California Unemployment Code Section 621 also defines the term “employee” in very broad terms. There are, however, potentially relevant, but qualified exceptions for “directors” of a corporation.<sup>25</sup> When structuring a compensation policy for student leaders, take into consideration the statutory withholding and reporting requirement under this statutory framework.

#### F. Campus Financial Aid Reporting and Review

The “compliance connection” between payments to student office-holders and the campus student financial aid function<sup>26</sup> should get close attention when the support program is conceived and implemented. There appears to be a variety of methods used by campuses in meeting these requirements.

Keep in mind that the campus financial aid office requires information on such payments to student office-holders from two perspectives -- whether as financial aid support expenditures (requiring organization reporting and prior approval), or as income (requiring student-applicant disclosure) -- to be factored into the level of eligible financial aid support.

The Education Code, Title 5, and coded memoranda require these payments – however characterized – to be consistently reported to the campus financial aid office. Education Code Section 89302 casts a broad *reporting* net over all such payments to students, including scholarships, stipends, loans, and “all funds received by the student” from the organization. If student body funds are used for “scholarships, grants-in-aid, stipends, loans, and similar expenditures,” then, under 89302, the financial aid office must also give *approval* before the funds are expended.

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<sup>22</sup> Ibid at § 66021.7.

<sup>23</sup> Statutes 2012, Chapter 604. Amends *Education Code* § 68130.7, and adds §§ 66021.6, 69508.5, and 76300.5.

<sup>24</sup> CSU Coded Memorandum AA-2011-28, *Updates to California Residency Exception Reporting Process*, dated December 7, 2011.

<sup>25</sup> *California Unemployment Insurance Code* § 622.

<sup>26</sup> See above Section A above at page 2 for the legal framework.

Coded Memorandum AA-2004-15, dated May 3, 2004, is directed to campus financial aid offices to emphasize the need for coordinated and timely student financial support information, federal and CSU system compliance requirements, and specified interdependencies for required data and services to determine support eligibility.<sup>27</sup> Attachment A to AA-2004-15 lists a host of eligibility data sources, including AS organizations for student “stipend and grant” payments. While this directive does not specify a certain practice in gathering and coordinating needed data, it does require that each campus have in place local procedures and administrative systems for the maintenance and exchange of information and the exchange of award and resource data between campus offices and departments.

At least one campus has structured the student office-holder funding support program around a written procedural agreement between the AS organization and the financial aid office.

## **Conclusions**

Student leader payments are either compensatory or non-compensatory. If *compensatory*, then they need to be clearly classified and consistently administered as either: *employee* or *non-employee* (stipend or director fee) [remember, the *independent contractor* classification is not an option]. If paid as wages (*employee*), then applicable payroll tax withholdings/reporting, and wage, hour and working condition standards must be respected. If paid as a *compensatory stipend or director fee*, then the rate of compensation must be reasonable and applicable income tax reports filed.

*Non-compensatory* payments fall more clearly into the realm of financial assistance and should be closely coordinated with (and approved by) the campus financial aid office. As discussed above, there are limitations and processes to be observed.

It is crucial that the provision of payments be clearly characterized in formal, written organizational policy, citing payment authority (for example, the student referendum requirement of Title 5, Section 42659(k) for so-called “award” payments and reimbursements), defining the purpose of the support eligibility, payment levels and frequency, and any conditions of *performance relating to continued payments*. If the payments are to be made while the student holds office, *without performance conditions*, the policy should be made clear on this point. These transactions can be confusing, so the organization should also consider developing written procedures and a flow chart to confirm dealing with such payments. Written practices also aid at audit time. And, of course, the written practices need to be followed on consistent basis, and they should be consistent with the policy statements.

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<sup>27</sup> This coded memorandum was preceded by AA-2004-09, dated March 19, 2004, calling for information on campus financial aid policies and practices.

Giving payments a convenient label is not a sound practice to avoid some perceived disadvantage, or to gain an advantage for either the student or the organization.

While the organization may not be required to withhold from *compensatory* payments for employment taxes, the student may still have an income tax-reporting obligation. Notice to the student from the organization would be prudent.

Wage-paid student officers or directors subject the organization to applicable IRS, FTB, FLSA, UI and IWB rules that include penalties for misclassification of employees. An organization has a distinct and more robust withholding and reporting responsibility if the student officer is a non-resident alien. Student hours worked over prescribed thresholds set for part-time employment may trigger eligibility for retirement and health insurance coverage.