

Education Credits – Calculations

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This article presents one method for tabulating qualifying expenses for the education credit and calculating the maximum credit amount. The AOTC worksheet also includes Excel file instructions.

This is one in a series of articles I've written on how to claim education credits. One version of this article was posted on the blog, [Switched Keys](#). The articles and other resources are part of an AOTC toolkit that can be downloaded from www.tylerhosting.com/EdCredit/. Comments, questions, and corrections are welcome and can be submitted through the contact form on the blog.

AOTC Toolkit

- Education Credit Regulations: A discussion of the AOTC and the regulations that permit inclusion of grants and scholarships to increase qualifying expenses and the credit. Coordinating with other education programs is also discussed.
- Education Credit Preparation: Specific instructions for accessing and retrieving expense information from local institutions UT Tyler and TJC.
- Education Credit Calculations: A method for tabulating qualifying expenses and calculating the credit. Includes the spreadsheet version of the AOTC worksheet.
- AOTC Flowcharts: The Student Qualifications Test assists in determining if the taxpayer qualifies for the credit. Same chart as published by the IRS. The Refundable Credit Test helps determine if the taxpayer qualifies for the refundable portion of the AOTC. Instead of the IRS outline of those who **do not qualify**, this flowchart identifies those that **do qualify**.
- AOTC Worksheet: The AOTC worksheet assists in maximizing the AOTC qualifying expenses and calculating the amount of taxable scholarships. Includes examples from IRS publications and regulations. Not the same as related IRS published worksheets.

Organizing Expenses and Payment Records

Although Treasury Regulation 1.117-1 says you should exclude scholarships from income to the degree they are used for qualified expenses, Treasury Regulation 1.25A-5(c) explains how you can manipulate some scholarships to increase the amount of qualified expenses you can use in calculating an education credit. The best way to determine the amounts to include in income requires some organization of expense and payment records.

The Value of a 1098-T

Although the IRS requires some institutions to provide students with a 1098-T showing expenses and aid received, and Form 8863 provides areas to enter the amounts, IRS instructions include the admonition to verify the accuracy of 1098-T amounts. That admonition should be heeded because 1098-T amounts may rarely be accurate. In earlier times the 1098-T was more practical when class registration took place in January of the year of attendance and tuition and fees were recorded on a calendar basis. Now most colleges open registration in

the last month or two of the previous term. The two most commonly reported amounts on a 1098T are in Box 1 and Box 2. Box 1 shows amounts paid for qualified expenses. Because this box shows expenses paid by all sources, including scholarships and grants, it is of limited value in showing what you can claim as amounts paid. Box 2 shows amounts billed for qualified expenses and it is less accurate because often institutions bill students in November or December for the spring semester of the following year.

For qualified expenses on record in December, but for the school term beginning in January of the following year, the payments will be qualified in the year paid. Note, however, that amounts paid in a prior year can only be claimed in that prior year, in line with Regulation 1.25A(e)(2), and if the payment is for expenses in the first three months of the following year.

To make things even more confusing, institutions are not required to prepare and submit 1098-Ts under certain conditions. One condition is if all expenses are paid by scholarships and grants. Many students may be missing out on the AOTC for this reason alone. Failure to receive a 1098-T doesn't disqualify you from receiving the credit. If that is the case, don't waste time waiting for one to come in the mail.

Spreadsheet for Expense Calculations

While you can spend time verifying and adjusting the amounts on a 1098-T, taking a few minutes to get an account statement from the college will insure the taxpayer has an accurate record of amounts received and spent on qualifying expenses. Account records are usually accessible on-line by the student or parent claiming the education credit.

Account Record

Date	Item	Term	Charge	Payment	Refund
12/9/2011	BIOL Course Fee - ANATOMY/PHYSIOLOG...	2012 Spring	61		
12/9/2011	COSC Course Fee - INTERNET & WEB APPL..	2012 Spring	108		
12/9/2011	Designated Tuition - Undergrad	2012 Spring	2,476		
12/9/2011	Lab Fee - ANATOMY/PHYSIOLOGY LAB II	2012 Spring	5		
12/9/2011	Mandatory Fees - Fall/Spring	2012 Spring	915		
12/9/2011	Resident Tuition	2012 Spring	600		
12/9/2011	Student Services Fee	2012 Spring	132		
12/9/2012	Parking Permit Fall	2012 Spring	30		
12/21/2011	MANA Course Fee - DATABASE INFO SYST...	2012 Spring	49		
1/6/2012	Direct Stafford Loan	2012 Spring		2,737	
1/6/2012	Federal Pell Grant	2012 Spring		2,775	
1/6/2012	M J Harvey Sr Memorial End	2012 Spring		1,000	
1/6/2012	Texas Public Ed. Grant	2012 Spring		1,000	
1/9/2012	Refund - Other	2012 Spring			2,737
1/20/2012	Refund - Other	2012 Spring			399

The creation of a spreadsheet to calculate the amounts can be greatly simplified with the information provided

on-line. If the account information cannot be exported into a file you can download, you may be able to mark, copy, and paste the amount from a web page and into a spreadsheet.

There will usually be two or three columns, Charges, Payments, and possibly Refunds. Once the raw data is pasted into a spreadsheet, rename the existing columns to Qualified Expenses, Elective Scholarships, and Loans/Other. Between the first two amount columns, insert columns for Non-Qualified Expenses (the parking permit isn't qualified) and Exclusive Scholarships.

Add separate columns for Taxable Scholarships if applicable. Then move amounts to their appropriate column. Irrelevant amounts such as refunds can be grouped with student loans. You may only need to move a few amounts as most will probably be qualifying expenses. When complete, add totals to the columns and use those amounts in the following worksheet to maximize education credits. Depending on the education credit you are claiming, be sure to add other qualifying expenses, such as required books and other course materials. This should be done even if you have \$4,000 in educational expenses since they make that amount of remaining scholarships tax-free. If they are not purchased at the institution, you will have to add them manually.

Expense Spreadsheet

Date	Item	Term	Qual Exp	Non Qual Exp	Exclus Schps	Elective Schps	Loans/ Other
12/9/2011	BIOL Course Fee - ANATOMY/PHYS...	2012 Spring	61				
12/9/2011	COSC Course Fee - INTERNET & WEB..	2012 Spring	108				
12/9/2011	Designated Tuition - Undergrad	2012 Spring	2,476				
12/9/2011	Lab Fee - ANATOMY/PHYSIOLOGY L...	2012 Spring	5				
12/9/2011	Mandatory Fees - Fall/Spring	2012 Spring	915				
12/9/2011	Resident Tuition	2012 Spring	600				
12/9/2011	Student Services Fee	2012 Spring	132				
12/9/2012	Parking Permit Fall	2012 Spring		30			
12/21/2012	MANA Course Fee - DATABASE INFO..	2012 Spring	49				
1/6/2012	Direct Stafford Loan	2012 Spring					2,737
1/6/2012	Federal Pell Grant	2012 Spring				2,775	
1/6/2012	M J Harvey Sr Memorial End	2012 Spring				1,000	
1/6/2012	Texas Public Ed. Grant	2012 Spring			1,000		
1/9/2012	Refund - Other	2012 Spring					2,737
1/20/2012	Refund - Other	2012 Spring					399
			4,346	30	1,000	3,775	5,873

Expense amounts should be calculated on a term basis, including only terms in the tax year.

Worksheet to maximize education credits

The IRS does have a worksheet for calculating the education credit included in Pub 970 and other sources, but it is used to calculate what can be excluded from income and lacks the logic included in the regulations for elective taxable scholarships. The following worksheet can be used to aid in calculating the maximum AOTC amount. It can also be expanded or condensed to suit the needs of the practitioner. Excel Formulas are given in the final column appropriate for the listed columns. You may want to include a process in your workflow to link the totals from the calculations to the appropriate cells in the worksheet.

This worksheet assumes the taxpayer does not have any outstanding balances, and does not consider other educational assistance, or the possibility of excluding qualified expenses of other types of financial aid. With more complex arrangements, additional research and manipulation may be necessary.

AOTC Worksheet

A	B	C	D	Formulas
1	Qualified Expenses	Enter the total amount of your qualified educational expenses.	4,346	
2	Total Scholarships	Enter the total amount of all scholarships and grants received for 2013.	4,775	
3	Taxable Scholarships	Enter the amount of scholarships required to be used for other than qualified expenses.	-0-	
4		Subtract line 3 from line 2.	4,775	=D2-D3
5	Excess Scholarships	If line 4 is greater than line 1, subtract line 1 from line 4.	429	=IF(D4>D1,D4-D1,0)
6	Potential Tax-free Scholarships	Subtract line 5 from line 4	4,346	=D4-D5
7	Exclusive Scholarships	Enter the amount of the scholarships that you are required to use for qualified educational expenses.	1,000	
8	Elective Scholarships	If line 6 is greater than line 7, Subtract line 7 from line 6.	3,346	=IF(D6>D7,D6-D7,0)
9	Excess Expenses Paid by Taxpayer	If line 1 is greater than line 6, Subtract line 6 from line 1	-0-	=IF(D1>D6,D1-D6,0)
10	Qualified Expenses for Tax Credit	Add line 8 and line 9 (maximum 4000). Enter this amount on line 27 of Form 8863 .	3,346	=MIN(4000, D9+D8)
11	Elective Scholarships Includable in Income	If line 9 is less than line 10, subtract line 9 from line 10. Otherwise, enter 0.	3,346	=IF(D10>D9,D10-D9,0)
12	Total Scholarships Included in Income	Add line 3, line 5 and line 11. This is the amount of taxable scholarship. Enter SCH and this amount on the dotted line to the left of line 7. Include this amount in the total on line 7 of Form 1040 .	3,775	=D3+D5+D11

Note that scholarship amounts that cover services rendered such as teaching or research are normally considered taxable earned income, not scholarship income, and would not enter into the calculations.

IRS Scenarios

Following are scenarios illustrated in examples from Publication 970 and Regulation Section 1.25A-5.

970-1: Bill Pass, age 28 and unmarried, enrolled full-time in 2013 as a first-year student at a local college to earn a degree in law enforcement. This was his first year of postsecondary education. During 2013, he paid \$5,600 for his qualified education expenses and \$4,400 for his room and board for the fall 2013 semester. He and the college meet all the requirements for the American opportunity credit. He figures his American opportunity credit based on qualified education expenses of \$4,000, which results in a credit of \$2,500.

970-3: The facts are the same as in 970-1, except that Bill was awarded a \$5,600 scholarship. Under the terms of his scholarship, it may be used to pay any educational expenses, including room and board. If Bill includes \$4,000 of the scholarship in income, he will be deemed to have used that amount to pay for room and board. The remaining \$1,600 of the \$5,600 scholarship will reduce his qualified education expenses and his adjusted qualified education expenses will be \$4,000. Based on his adjusted qualified education expenses of \$4,000, Bill would be able to claim an American opportunity tax credit of \$2,500.

25A-2: University X charges Student A, who lives on University X's campus, \$3,000 for tuition and \$5,000 for room and board. University X awards Student A a \$2,000 scholarship. The terms of the scholarship permit it to be used to pay any of a student's costs of attendance at University X, including tuition, room and board, and other incidental expenses. University X applies the \$2,000 scholarship against Student A's \$8,000 total bill, and Student A pays the \$6,000 balance of her bill from University X with a combination of savings and amounts she earns.

Student A reports the entire scholarship as income on the student's federal income tax return. Therefore, for purposes of calculating an education tax credit, Student A is treated as having paid \$3,000 of qualified tuition and related expenses to University X.

25A-4: The facts are the same as in 25A-2, except that the terms of the scholarship require it to be used to pay tuition or room and board charged by University X, and the scholarship amount is \$6,000. Student A may allocate the scholarship between tuition and room and board in any manner. However, because room and board totals \$5,000, that is the maximum amount that can be applied under the terms of the scholarship to expenses other than qualified expenses and at least \$1,000 of the scholarship must be applied to tuition. If Student A reports \$5,000 of the scholarship as income on the student's federal income tax return, then Student A will be treated as having paid \$2,000 (\$3,000 tuition–\$1,000 qualified scholarship excludable under section 117) in qualified tuition and related expenses to University X.

AOTC Worksheet – IRS Examples

			970-1	970-3	25A-2	25A-4
1	Qualified Expenses	Enter the total amount of your qualified educational expenses.	5600	5600	3000	3000
2	Total Scholarships	Enter the total amount of all scholarships and grants received for 2013.	0	5600	2000	6000
3	Taxable Scholarships	Enter the amount of scholarships required to be used for other than qualified expenses.				5000
4		Subtract line 3 from line 2.	0	5600	2000	1000
5	Excess Scholarships	If line 4 is greater than line 1, subtract line 1 from line 4.	0	0	0	0
6	Potential Tax-free Scholarships	Subtract line 5 from line 4	0	5600	2000	1000
7	Exclusive Scholarships	Enter the amount of the scholarships that you are required to use for qualified educational expenses.				1000
8	Elective Scholarships	If line 6 is greater than line 7, Subtract line 7 from line 6.	0	5600	2000	0
9	Excess Expenses Paid by Taxpayer	If line 1 is greater than line 6, Subtract line 6 from line 1	5600	0	1000	2000
10	Qualified Expenses for Tax Credit	Add line 8 and line 9 (maximum 4000). Enter this amount on line 27 of Form 8863 .	4000	4000	3000	2000
11	Elective Scholarships Includable in Income	If line 9 is less than line 10, subtract line 9 from line 10. Otherwise, enter 0.	0	4000	2000	0
12	Total Scholarships Included in Income	Add line 3, line 5 and line 11. This is the amount of taxable scholarship. Enter SCH and this amount on the dotted line to the left of line 7. Include this amount in the total on line 7 of Form 1040 .	0	4000	2000	5000

Phase-out Calculations

The completion of Form 8863 may be more involved if you are in the phase-out range for the AOTC. The phase-out is essentially based on percentage of income between lower and upper phase-out limits. Thus, \$1000 over (based on \$10,000 range) would reduce your credit by 10%.

If you happen to be put into the phase-out range by including scholarships and grants in income, re-calculate the credit omitting some or all of the scholarships to determine the most advantageous treatment. Generally, it will be most advantageous to include the first \$2000 of expenses regardless of including scholarships in income. Above the first \$2000, the net benefit will largely depend on your marginal tax rate and deductions.

Conclusion

When clients mention educational expenses and then dismiss them because everything was covered by scholarships and other financial aid, ask to take a look and explain that they may be able to claim education

credits of up to \$2,500, especially if some of the expenses were paid with student loans. By understanding the regulations and the ability to treat scholarships as income, you can pleasantly surprise your clients. All that is needed is a little pre-season preparation, organization of client educational records, and a worksheet that calculates qualifying expenses used for the credit. Then see if that can be duplicated with prior year returns.