

# Education Credits – Regulations



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# Introduction



- **Two Credits, many deductions**
  - American Opportunity Tax Credit (focus)
  - Lifetime Learning Credit
- **Assumptions/Misinformation**
  - Loans
  - Not out of pocket
  - Tax-free scholarships, grants
  - No 1098T

# American Opportunity Tax Credit



- **Student Qualifications**
  - Cannot be claimed more than 4 tax years (per student)
  - Half-time at accredited school for degree/cert
  - Not have 4-yr degree at beginning of the year
  - Not have drug felony conviction
- **Taxpayer qualifications**
  - Student, parent, spouse who claims exemption
  - Phase-out

# American Opportunity Tax Credit



- **Qualifying Expenses**
  - Tuition
  - Required fees
  - Books, class material required
  - Computers if required
    - ✦ School or department may require  
(UT Tyler CS department considered this)
  - Does not include parking fees

# American Opportunity Tax Credit



- **Qualifying payments**
  - Student payments
  - Parent payments
  - Payments by relatives (as a gift)
  - Payments by credit, from school loans
  - Payments from taxable income
    - ✦ Pell grants
    - ✦ Some scholarships
- **No double benefits**
  - Can't consider payments tax-free if using to pay expenses for AOTC

# American Opportunity Tax Credit



- **Refundable Qualifications**
- **You do NOT qualify if items 1 (a, b, or c), 2, and 3 apply**
  - You were:
    - ✦ Under age 18 at the end of the tax year, **or**
    - ✦ Age 18 at the end of the tax year **and** your earned income (defined below) was less than one-half of your support (defined below), **or**
    - ✦ Over age 18 and under age 24 at the end of the tax year **and** a full-time student (defined below) **and** your earned income (defined below) was less than one-half of your support (defined below).
  - At least one of your parents was alive at the end of the tax year.
  - You are filing a return as single, head of household, qualifying widow(er), or married filing separately.

# American Opportunity Tax Credit



- **Refundable Qualifications**
- **You DO qualify for a refund if items 1 (a, b, or c), 2, or 3 below apply to you.**
  - You were:
    - ✦ Age 18 at the end of the tax year **and** your earned income (defined below) was at least one-half of your support (defined below), **or**
    - ✦ Over age 18 and under age 24 at the end of the tax year **and** not a full-time student (defined below), or
    - ✦ Over age 18 and under age 24 at the end of the tax year **and** your earned income (defined below) was at least one-half of your support (defined below), or
    - ✦ At least age 24.
  - Neither of your parents was alive at the end of the tax year.
  - You are filing a joint return.

# Lifetime Learning Credit



- **Different qualifications**
  - Does not have to be a half-time student
  - Any education that helps acquire or improve a job skill...
- **Not refundable**
- **Different phase-out**
  - \$54,000 - \$64,000 (\$108,000 - \$128,000 joint)
- **Different qualifying expenses**
  - Required books must be paid to the institution
- **Same qualifying payments**
  - Can re-characterize certain grants and scholarships

# Missing Credits



- **People are missing out on education credits**
  - **Misinformation**
  - **Assumptions**
  - **Tunnel vision**
    - ✦ **Focusing on tax-free nature of scholarships**
  - **Lack of effort**
    - ✦ **Too much work getting information**

# Assumptions and Misinformation



- **Student loans are not expenses paid**
- **Not out-of-pocket**
- **Didn't receive 1098T**
- **Must reduce expenses by amount of tax-free scholarships**
  - **The truth, but not the whole truth**

# Misinformation perpetuated



- **H&R Block** [http://www.hrblock.com/tax-answers/services/jsp/article.jsp?article\\_id=67005](http://www.hrblock.com/tax-answers/services/jsp/article.jsp?article_id=67005)
- **Intuit** <https://ttlc.intuit.com/questions/1901069-are-scholarships-fellowships-and-grants-considered-taxable-income>
- **Tax software Taxslayer support site notes, “You can only receive a deduction or credit for the amount of expenses that you paid out of pocket.”**  
<https://www.taxslayer.com/support/knowledgebasearticle206.aspx>

# Tunnel vision and Lack of Effort



- **Lack of effort (too much work)**
  - For taxpayer or preparer
  - Requires getting account information
  - May require researching terms of a scholarship
  - Calculations of expenses, payments,
- **Scholarship taxability**
  - Scholarships in excess of expenses is taxable
  - Taxpayers may assume all scholarships are tax-free
  - Preparers may not probe for fear of finding taxable scholarships

# Coordinating Scholarships and Grants



- **Consider loans first**
  - If loans are more than \$4000, no need to re-characterize
- **Increase qualifying expenses by increasing taxable scholarship income**
- **Based on terms of scholarships**
  - If the scholarship may or must be used for other than qualified expenses
  - Includes Pell grants

# Scholarships and Grants



- **Scholarships are “any amount”**
  - Code section 117
  - any amount received as a qualified scholarship by an individual who is a candidate for a degree at an educational organization described in section 170 (b)(1)(A)(ii).
- **Grants treated the same as scholarships**
- **Note: Scholarships for non-degree candidates are always taxable**
- **Teaching and research scholarships are taxable earned income (W-2)**

# My Three Types of Scholarships



- **Exclusive Scholarships (exclusively tax-free)**
  - Must be used for qualifying expenses
- **Taxable Scholarships**
  - Must be used for non-qualifying expenses
- **Elective Scholarships**
  - May be used for any purpose
- **Scholarships with double requirements must be split between the requirements**
  - Must be used for room and board (taxable) and tuition (elective)
  - Split in any manner between the two requirements

# Exclusive Scholarships



- **Must be used for qualifying expenses**
  - **Tuition**
  - **Required Fees**
  - **Books and materials required**
  - **Computers if required**

# Taxable Scholarships



- **Must be used for other than qualifying expenses**
  - Room and board
- **Any excess scholarship income is also taxable**

# Elective Scholarships



- May or must be used for other than qualifying expenses
- Pell grants
- Other elective scholarships
  - Research required
  - Most federal grants
- Scholarships that refund the excess

# Local Research Examples



- **Pell grants**
  - Based on need
  - Books, supplies, transportation, and misc personal expenses
- **UT Tyler managed scholarships**
  - Tuition, fees, books and supplies
  - Any remaining funds will be disbursed
  - Applies to housing
- **TSBPA Fifth-Year Scholarship**
  - Tuition, fees, books, supplies, and living expenses
- **Elective scholarships are easier to manage**

# Document



- **Keep**
  - **Original receipts**
  - **Original school account information**
  - **Scholarship research**
  - **Calculations**

# Coordinating With Other Benefits



- **Section 529 & Coverdell**
  - Room and board
  - Elementary and High school
  - Computers used by the beneficiary and family (dated)
- **IRAs**
  - Not restricted to educational expenses
- **Contribution limits**
  - IRA contributions for Savers Credit
- **May be taxable (pro rata)**
- **May not be subject to penalties**

# Planning



- **Not needed if every year has \$4000 in expenses**
- **AOTC limited to (any) four years**
- **Coordinate with income**
- **Including part of graduate school**
  - Not earned degree before beginning of the year
- **Saving for Education**
  - (IRA first, then 529, Coverdell)
- **Prepayments**
  - If for first three months of following year
  - Tuition, buying books in advance

# Side Effects and Concerns



- **AGI**
  - AMT phase-out
- **AOTC Phase-out**
  - May limit credit to \$2000
- **Earned Income**
  - Scholarships are not earned income
  - Don't forget to add the SCH note or the IRS may “correct” the return and add earned income credit
- **Educational Assistance**
- **1098-T**
  - If not provided to IRS, may receive request for proof of attendance

# Education Credit Fraud



- **Not common**
- **Related to expenses, payments, not re-characterization of scholarships and grants**
- **IRS hold of 2013 education credit claims**
- **Could be a concern since 1098T not required, inaccurate**
- **May have to prove school status, expenses**

# Amending Prior Year Returns



- **Amend for up to three years**
- **Amend for three years while filing the fourth**
- **Generally to claim for prior year education credits**
- **Changing prior year education credit claims**

# Conclusion

