



Module 8: TAX BENEFITS FOR EDUCATION OVERVIEW

Special thanks to: Steve Balsam and Tamara Kreigh for their contributions to this module.

By the end of this module you will...

- Determine who qualifies for an education credit
- Determine which credit the taxpayer can claim
- Determine if the taxpayer has scholarship/grant income or eligible expenses



Introduction to Tax Benefits for Education

Introduction to Tax Benefits for Education

- This lesson covers tax credits available to help the taxpayer offset the costs of higher education by reducing the amount of income tax.
- Education credits reduce the amount of tax due and are based on qualified education expenses that the taxpayer paid during the tax year.
- There are two different education credits:
 - American Opportunity Credit (AOC)
 - Lifetime Learning Credit (LLC)
- Only one of these two credits may be taken for a given student. Although, both maybe taken on a single return, if the return contains more than one student.
- There are general rules that apply to these credits, as well as specific rules for each credit.
- There are other benefits to look out for as well:
 - Qualified Tuition Plan 529
 - Veteran Benefits
 - Employer Benefit
- Additional Resource: [Publication 4012](#)

Introduction to Tax Benefits for Education

- **There are 2 ways education expenses can affect a tax return.**
 - Taxable scholarship/grant income
 - Scholarship/Grant/Fellowship is reported as income.

Note: Scholarship/grant income is reported on the student's return, regardless of who claims the **student**. It **must** be reported as income if it is not used for Qualified Education Expenses or the student is not a degree candidate.

- Tax credit
 - American Opportunity Credit
 - Lifetime Learning Credit

Note: These credits are calculated on the return of the taxpayer who is qualified to claim the student as a dependent. Full-time Students under the age of 24 claiming themselves as a dependent and claiming the American Opportunity Credit are only entitled to the nonrefundable portion of the American Opportunity Credit (unless the parents are dead.)

Introduction to Tax Benefits for Education

- During the client intake interview, encountering any one of the following items will require further investigation:
 - Form 1098-T, Tuition Statement
 - Account statement from school
 - Question about scholarship income in Part III of the Form 13614-C, Intake/Interview & Quality Review Sheet, answered, “Yes.”
 - Question about education expenses in Part IV of the Form 13614-C, Intake/Interview & Quality Review Sheet, answered, “Yes.”



Definition of Key Terms

Eligible Institution

An eligible institution is **generally any accredited public, nonprofit, or private college, university, vocational school, or other postsecondary institution** eligible to participate in the Department of Education FAFSA student loan program.

The school should be able to tell the student if it is an eligible education institution.

A searchable database of all accredited schools is available at:

<http://ope.ed.gov/accreditation/>

Eligible student

An eligible student is the **taxpayer, spouse or a dependent** who is enrolled in one or more courses as an undergraduate or graduate student.

varies by the Education Credit. Generally the AOC is most restrictive and highest value.

Qualified Education Expenses

Qualified education expenses include **tuition, fees that are required for enrollment, and course materials the student was required to buy from the school.**

- The following are qualified education expenses **for the purposes of determining the tax-free portion of scholarships and fellowships:**
 - Tuition and fees required to enroll at or attend an eligible educational institution.
 - Course-related expenses, such as fees, books, supplies, and equipment (can include computers) that are required for the courses at the eligible educational institution. These items must be required of all students for the course. For example, if a computer is required for a computer programming course, it would be an eligible expense.

- Qualified education expenses may also include:
 - **Non-academic fees**, such as student activity fees or other expenses unrelated to the academic course **that must be paid to the institution as a condition of enrollment or attendance.**

- Qualified Education Expenses do not include Room & Board, sporting event tickets, health insurance, transportation and parking fees.

- *Note: Qualified Educational Expenses differ for the AOC and LLC.*

Grants and scholarships

A scholarship, grant or fellowship is tax free (excludable from gross income) **only if:**

- The student is a candidate for a degree at an eligible educational institution.

A student is considered a candidate for a degree if the student is pursuing a degree at a college or university or attends an educational institution that offers a program of training to prepare students for gainful employment in a recognized occupation and is authorized under federal or state law to provide such a program and is accredited by a nationally recognized accreditation agency.

A scholarship, grant or fellowship is tax free **only to the extent that:**

- It doesn't exceed qualified education expenses;
- It isn't designated or earmarked for other purposes (such as room and board) and doesn't require (by its terms) that it can't be used for qualified education expenses; and
- It doesn't represent payment for teaching, research, or other services required as a condition for receiving the scholarship. These payments are typically reported as W-2 or Form 1099 earnings.

Form 1098-T, Tuition Statement

Eligible colleges or other post-secondary institutions **generally send [Form 1098-T, Tuition Statement](#)** to any student who paid qualified educational expenses in the preceding tax year.

CORRECTED

FILER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone number		1 Payments received for qualified tuition and related expenses \$ _____	OMB No. 1545-1574 2021 Form 1098-T	Tuition Statement Copy B For Student This is important tax information and is being furnished to the IRS. This form must be used to complete Form 8863 to claim education credits. Give it to the tax preparer or use it to prepare the tax return.
FILER'S employer identification no.	STUDENT'S TIN	2	3	
STUDENT'S name		4 Adjustments made for a prior year \$ _____	5 Scholarships or grants \$ _____	
Street address (including apt. no.)		6 Adjustments to scholarships or grants for a prior year \$ _____	7 Checked if the amount in box 1 includes amounts for an academic period beginning January–March 2022 <input type="checkbox"/>	
City or town, state or province, country, and ZIP or foreign postal code		8 Checked if at least half-time student <input type="checkbox"/>	9 Checked if a graduate student <input type="checkbox"/>	
Service Provider/Acct. No. (see instr.)		10 Ins. contract reimb./refund \$ _____		

Form **1098-T** (keep for your records) www.irs.gov/Form1098T Department of the Treasury - Internal Revenue Service

Note: Universities issue 1098-T to the student. If the student is over age 18, they are considered an adult and the school cannot disclose the student's financial information to the parent without the student's permission. Although the student provides the information, it is used to prepare the parent's tax return.

The 1098-T is often not enough information to accurately calculate AOC and the student will need to provide a financial statement with an accounting of the amount paid in tuition, fees, etc. and the amount and type of scholarship or grant received.

Student Account Statement

Shows tuition, fees and other expense payments to third parties received for the school by that student.

- An account statement will usually show school bookstore purchases, and the American Opportunity Credit often allows books purchased or rented from third parties.
- Available from the eligible institution.
- Can be used to determine which fees paid to the institution qualify as eligible.
- Ask the student if they purchased/rented books or supplies.
 - The school account statement usually only includes the book store but students buy/rent from 3rd parties
 - 3rd parties are not allowed by all Education Credits – check your 4012 for details!



Eligibility to Claim Education Credits

Basic Eligibility

- To claim an education credit, the following must be true for the taxpayer(s):
 - They cannot be claimed as a dependent on someone else's tax return
 - The student must be the taxpayer, spouse or the dependent of the filer – a dependent **cannot** file for the Education Credit
 - They are not filing as Married Filing Separately
 - Their adjusted gross income (AGI) is below the limitations for their filing status*
 - They were not nonresident aliens for any part of the tax year, or if they were, they elected to be treated as resident aliens

*the AGI limits are different for each of the credits

Who can claim an education credit?

Taxpayers who **paid qualified educational expenses** for higher education for an **eligible student** attending an **eligible educational institution** can claim an education credit.

- Qualified education expenses paid by a dependent, or by a third party for that dependent, are considered paid by the taxpayer who can claim that student as a dependent.
- If a student isn't claimed as a dependent (even if eligible to be claimed), only the student can claim the education credit, no matter who paid the expenses.
 - Anyone paying the expenses (even directly to the institution) is considered to have given a gift to the student who in turn is treated as having paid the expenses.



American Opportunity Credit

American Opportunity Credit (AOC)

- Student must attend an eligible institution.
- Covers qualified expenses: tuition, fees, books and supplies.
- 40% of the credit is refundable.
- Maximum credit of \$2,500 per eligible student based on \$4,000 of qualifying expenses (multiple students may qualify on the same return, but qualifying expenses are calculated individually).
- Can be claimed for only 4 tax years.
- Must be enrolled at least half-time – it is defined by the Eligible Education Institution, usually by hours. Only needs to be enrolled for at least *one* term.
- Any felony drug conviction by the student disqualifies them from claiming the credit.
- Married Filing Separately disqualifies you for the credit.
- Available ONLY if the student had not completed the first 4 years of postsecondary education before the tax year.
 - This can be problematic if student took dual college classes while still in high school.

American Opportunity Credit (AOC)

If a student is under the age of 24 and claiming the American Opportunity Credit:

- None of the credit is refundable if:

- (1) the taxpayer claiming the credit is:

- (a) under age 18, **or**

- (b) age 18 at the end of the year, and their earned income was less than one-half of their own support, **or**

- (c) a full time student over 18 and under 24 and their earned income was less than one-half of their own support; **and**

- (2) the taxpayer has at least one living parent, **and**;

- (3) the taxpayer doesn't file a joint return

students can claim the non-refundable part (\$1,500) if they have that level of tax liability



Lifetime Learning Credit

Lifetime Learning Credit (LLC)

- **Non-refundable tax credit.** Covers undergrad, grad and courses to acquire or improve job skills.
- Maximum credit of \$2,000 per tax return on \$10,000 of qualified expenses.
 - Calculation is 20% of eligible expenses until limit is reached.
- Must attend an eligible institution.
- Qualified expenses include tuition and fees
 - Books only if bought from the educational institution as a condition of enrollment. For example, a nursing program or at a technical school.
 - Rarely do books qualify for LLC.
- Per return – expenses from multiple students can be combined to increase qualified expenses toward the overall \$10,000 maximum.
- Can be less than half-time student.

Decision Process

- Is AGI within Education Credit / Adjustment limits? Limits are highest for AOC and then LLC

- Does American Opportunity Credit apply? AOC is typically the best credit
 - Are there \$4000 of qualified education expenses?
 - Yes, continue.
 - No, consider declaring part of scholarship/grant as taxable to student – caution not to invoke a filing requirement or Kiddie Tax on the student. See Module 8C

- If AOC does not apply, consider Lifetime Learning credit.
 - Is there enough Tax Liability to use the credit?
 - Yes, continue
 - No, you cannot apply the Lifetime Learning Credit



Re-Cap

Re-Cap

- Taxpayer must have a Form 1098-T to claim an education credit. The Taxpayer's Student Account Statement is useful to have to calculate the credit.
- Taxable scholarship/grant income is reported on the student's return when the amount exceeds qualifying education expenses.
- Tax credits are reported on the tax return of the taxpayer who can claim the student as a dependent. The student claims the credit if no taxpayer claims them as a dependent.
 - American Opportunity Credit
 - Lifetime Learning Credit
- In some cases, you can report scholarships as income taxable to the student to maximize education credits.
- See more in [Module 8C!](#)

Re-Cap

Comparison of Education Credits

	American Opportunity Credit	Lifetime Learning Credit
Maximum credit	Up to \$2,500 credit per eligible student	Up to \$2,000 credit per return
Limit on modified adjusted gross income (MAGI)	\$180,000 if married filing jointly; \$90,000 if single, head of household, or qualifying widow(er)	\$180,000 if married filing jointly; \$90,000 if single, head of household, or qualifying widow(er)
Refundable or nonrefundable	40% of credit may be refundable ¹ ; the rest is nonrefundable	Nonrefundable—credit limited to the amount of tax you must pay on your taxable income
Number of years of postsecondary education	Available ONLY if the student had not completed the first 4 years of postsecondary education before 2021	Available for all years of postsecondary education and for courses to acquire or improve job skills
Number of tax years credit available	Available ONLY for 4 tax years per eligible student (including any year(s) Hope credit was claimed)	Available for an unlimited number of tax years
Type of program required	Student must be pursuing a program leading to a degree or other recognized education credential	Student does not need to be pursuing a program leading to a degree or other recognized education credential
Number of courses	Student must be enrolled at least half-time for at least one academic period beginning during 2021 (or the first 3 months of 2022 if the qualified expenses were paid in 2021)	Available for one or more courses
Felony drug conviction	As of the end of 2021, the student had not been convicted of a felony for possessing or distributing a controlled substance	Felony drug convictions do not make the student ineligible
Qualified expenses	Tuition, required enrollment fees, and course materials that the student needs for a course of study whether or not the materials are bought at the educational institution as a condition of enrollment or attendance	Tuition and required enrollment fees (including amounts required to be paid to the institution for course-related books, supplies, and equipment)
Payments for academic periods	Payments made in 2021 for academic periods beginning in 2021 or beginning in the first 3 months of 2022	Payments made in 2021 for academic periods beginning in 2021 or beginning in the first 3 months of 2022
TIN needed by filing due date	Filers and students must have a TIN by the due date of their 2021 return (including extensions)	
Educational institution's EIN	You must provide the educational institution's employer identification number (EIN) on your Form 8863, Education Credits.	

Source: Table J5 of [Publication 4012](#)



Module 8B: ELIGIBLE EXPENSES

By the end of this module you will...

- Understand which expenses can be claimed for education credits
- Understand how to read Form 1098-T and calculate qualified expenses
- Understand how to interpret Student Account Statements



Determining Eligible Expenses

What does the client need to present?

- Not all eligible education institutions are required to submit the Form 1098-T – please verify that your taxpayers can get it!
 - If not, the student can still file Form 8863 in these cases!
 - They must request the education institution provide the Form 1098-T before the due date of the return
 - They must also qualify for the education benefit
 - They must also be enrolled in an eligible education institution
 - They must also be able to provide substantiation of qualified tuition and related expenses

CORRECTED

FILER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone number \$ _____ 2		1 Payments received for qualified tuition and related expenses \$ _____ 2	OMB No. 1545-1574 <div style="font-size: 2em; font-weight: bold; text-align: center;">2021</div> Form 1098-T	Tuition Statement
FILER'S employer identification no.	STUDENT'S TIN	3		Copy B For Student This is important tax information and is being furnished to the IRS. This form must be used to complete Form 8863 to claim education credits. Give it to the tax preparer or use it to prepare the tax return.
STUDENT'S name		4 Adjustments made for a prior year \$ _____	5 Scholarships or grants \$ _____	
Street address (including apt. no.)		6 Adjustments to scholarships or grants for a prior year \$ _____	7 Checked if the amount in box 1 includes amounts for an academic period beginning January–March 2022 <input type="checkbox"/>	
City or town, state or province, country, and ZIP or foreign postal code		8 Checked if at least half-time student <input type="checkbox"/>	9 Checked if a graduate student <input type="checkbox"/>	
Service Provider/Acct. No. (see instr.)	8 Checked if at least half-time student <input type="checkbox"/>	9 Checked if a graduate student <input type="checkbox"/>	10 Ins. contract reimb./refund \$ _____	

Form 1098-T (keep for your records) www.irs.gov/Form1098T Department of the Treasury - Internal Revenue Service

- A copy of their student account statement from an eligible institution is helpful but not required.

1098-T with entries in boxes 4 or 6, indicating prior year adjustments

In some cases, a 1098-T with an adjustment is out-of-scope for VITA.

If you encounter a taxpayer with a Form 1098-T with an entry in box 4 and/or 6, consult your site coordinator.

CORRECTED

FILER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone number		1 Payments received for qualified tuition and related expenses \$ _____ 2 _____	OMB No. 1545-1574 2021 Form 1098-T	Tuition Statement
FILER'S employer identification no.	STUDENT'S TIN	3 _____		
STUDENT'S name		4 Adjustments made for a prior year \$ _____	Scholarships or grants \$ _____	Copy B For Student This is important tax information and is being furnished to the IRS. This form must be used to complete Form 8863 to claim education credits. Give it to the tax preparer or use it to prepare the tax return.
Street address (including apt. no.)		6 Adjustments to scholarships or grants for a prior year	7 Checked if the amount in box 1 includes amounts for an academic period beginning January–March 2022 <input type="checkbox"/>	
City or town, state or province, country, and ZIP or foreign postal code		8 Checked if at least half-time student <input type="checkbox"/>	9 Checked if a graduate student <input type="checkbox"/>	
Service Provider/Acct. No. (see instr.)		10 Ins. contract reimb./refund \$ _____		

Form **1098-T** (keep for your records) www.irs.gov/Form1098T Department of the Treasury - Internal Revenue Service

Calculating expenses available for credit

- The expense must be paid during the calendar year.
 - *Expenses paid in December 2022 for Spring 2023 semester qualify for 2022.*
- Reduce expenses by any scholarships or grants received.
 - *The amount of expenses that exceed scholarships and grants can be used to calculate the credit.*
 - *The amount of scholarships and grants that exceed expenses is reported on the student's return as income.*

Analyzing Student Account Statements

Qualified education expenses **DO NOT INCLUDE** amounts paid for:

- Insurance
- Medical expenses (including student health fees)
- Room and board
- Transportation
- Similar personal, living, or family expenses. This is true even if the amount must be paid to the institution as a condition of enrollment or attendance.
- **Sports, games, hobbies, and noncredit courses.** Qualified education expenses generally don't include expenses that relate to any course of instruction or other education that involves sports, games, or hobbies, or any noncredit course. However, if the course of instruction or other education is part of the student's degree program, these expenses can qualify.
- **Comprehensive or bundled fees.** Some eligible educational institutions combine all of their fees for an academic period into one amount. If you don't receive or don't have access to an allocation showing how much you paid for qualified education expenses and how much you paid for personal expenses, such as those listed earlier, contact the institution. The institution is generally required to make this allocation and provide you with the amount you paid for qualified education expenses on Form 1098-T, Tuition Statement.

Analyzing Student Account Statements

Account Activity		Student: Ann Harvard	
View transaction by term: <input type="text" value="Spring 2021 : 0.00"/> <input type="button" value="Select"/>			
Spring 2022 Account Activity			
To sort, click on the desired column header			
Description	Code	Date	Amount(\$)
Tuition, College Credit	TUI1C	12/15/2020	12624.00
Fee, General Use	FGNFC	12/15/2020	576.00
Fee, Student Accident Ins	FSIFC	12/15/2020	60.00
Fee, Parking Permit	PKPT	12/15/2020	50.00
Tuition, College Credit	TUI1C	01/06/2021	-3156.00
Fee, General Use	FGNFC	01/06/2021	-144.00
Fee, Student Accident Ins	FSIFC	01/06/2021	-15.00
Direct Subsidized Loan	DRSLY	01/12/2021	-1635.00
Federal Pell Grant	FPELL	01/12/2021	-5360.00
Payment	TN	01/12/2021	-3000.00
Term Balance:			0.00

Ineligible Expenses

Analyzing Student Account Statements

Account Activity		Student: Ann Harvard	
View transaction by term: <input type="text" value="Spring 2021 : 0.00"/> <input type="button" value="Select"/>			
Spring 2022 Account Activity			
To sort, click on the desired column header			
Description	Code	Date	Amount(\$)
Tuition, College Credit	TUI1C	12/15/2020	12624.00
Fee, General Use	FGNFC	12/15/2020	576.00
Fee, Student Accident Ins	FSIFC	12/15/2020	60.00
Fee, Parking Permit	PKPT	12/15/2020	50.00
Tuition, College Credit	TUI1C	01/06/2021	-3156.00
Fee, General Use	FGNFC	01/06/2021	-144.00
Fee, Student Accident Ins	FSIFC	01/06/2021	-15.00
Direct Subsidized Loan	DRSLY	01/12/2021	-1635.00
Federal Pell Grant	FPELL	01/12/2021	-5360.00
Payment	TN	01/12/2021	-3000.00
Term Balance:			0.00

Ineligible Expenses

Dropped Class

Student Account Statements Example

- Using the previous two slides as examples, we can calculate how the Account Statement ties to the 1098-T:
 - All payments were received in 2021 and the student has a zero balance on the account.
 - 1098-T Box 1 \$9,900 Tuition paid includes:
 - Spring 2022 Tuition = \$12,624
 - General Use Fees = \$576
 - Dropped Class Tuition = (\$3,156)
 - Dropped Class Fee = (\$144)
 - The 1098-T Box 5 amount is \$5,360 (Pell Grant amount)– noted on the next slide

Determining Eligible Expenses

Reduce expenses by any scholarships or grants received.

The amount of expenses that exceed scholarships and grants can be used to calculate the credit.

CORRECTED

FILER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone number State University PO Box 123 Your City, YS, XXXXX		1 Payments received for qualified tuition and related expenses \$ 9,900 2	OMB No. 1545-1574 2021 Form 1098-T	<p style="text-align: center; font-weight: bold; font-size: 1.2em;">Tuition Statement</p> <hr/> <p style="text-align: center; font-weight: bold;">Copy B For Student</p> <p style="font-size: 0.8em;">This is important tax information and is being furnished to the IRS. This form must be used to complete Form 8863 to claim education credits. Give it to the tax preparer or use it to prepare the tax return.</p>
FILER'S employer identification no. XX-XXXXXXX	STUDENT'S TIN XXX-XX-1234	3		
STUDENT'S name Ann Harvard		4 Adjustments made for a prior year \$	5 Scholarships or grants \$ 5,360	
Street address (including apt. no.) 100 Main St		6 Adjustments to scholarships or grants for a prior year \$	7 Checked if the amount in box 1 includes amounts for an academic period beginning January–March 2022 <input type="checkbox"/>	
City or town, state or province, country, and ZIP or foreign postal code Anywhere, US		8 Checked if at least half-time student <input checked="" type="checkbox"/>		
Service Provider/Acct. No. (see instr.)	9 Checked if a graduate student <input type="checkbox"/>		10 Ins. contract reimb./refund \$	

Form **1098-T** (keep for your records) www.irs.gov/Form1098T Department of the Treasury - Internal Revenue Service

Based on the Student Account Statement for Ann Harvard
 Eligible Expenses = \$9,900 - \$5,360 = \$4,540

Determining Eligible Expenses

- Take care not to double dip on eligible expenses calculation!
- Typically, an expense can only be offset by one funding source – scholarship/grant, 529 plan distributions via [Form 1099-Q](#), employer benefit, Veteran's benefit.
- Eligible expenses that were not paid by these sources can be used for the Education Credits.
- The only exception is IRA deductions that are used to Qualified Education Expenses. These distributions are taxable (possibly not subject to early withdrawal penalty) and can also be used for Education Credits.

Determining Total Expenses



Qualified education expenses: books, materials, or equipment required for class

Nonqualified expenses: rent, meals, health insurance, parking, student activity fees, or anything not required for class



Module 8C: TREATMENT OF SCHOLARSHIPS AND GRANTS

By the end of this module you will...

- Understand how to determine if the taxpayer has taxable scholarship/grant income
- Understand when to treat scholarships or grants as income
- Understand when Form 8615 (Kiddie Tax) is required

Tax Rules for Scholarships/Grants

Pell grants and many other scholarships can be treated in one of two ways for tax purposes:

- Excluded from student's income if used for tuition and related expenses. In this case, the scholarship must be subtracted from expenses that would qualify for American Opportunity Credit or Lifetime Learning Credit.

OR

- Included in student's income if used for living expenses. In this case, the scholarship does not reduce the amount of tuition and related expenses that can be used to claim the American Opportunity Credit or Lifetime Learning Credit.

Determining Scholarship or Grant Income – Standard Treatment

The amount of scholarships and grants that exceed education expenses is reported on the student's return as income.

CORRECTED

FILER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone number State University PO Box 123 Your City, YS, XXXXX		1 Payments received for qualified tuition and related expenses \$ 9,900 2	OMB No. 1545-1574 2021 Form 1098-T	Tuition Statement Copy B For Student This is important tax information and is being furnished to the IRS. This form must be used to complete Form 8863 to claim education credits. Give it to the tax preparer or use it to prepare the tax return.
FILER'S employer identification no. XX-XXXXXXX	STUDENT'S TIN XXX-XX-1234	3		
STUDENT'S name Ann Harvard		4 Adjustments made for a prior year \$	5 Scholarships or grants \$ 5,360	
Street address (including apt. no.) 100 Main St		6 Adjustments to scholarships or grants for a prior year \$	7 Checked if the amount in box 1 includes amounts for an academic period beginning January–March 2022 <input type="checkbox"/>	
City or town, state or province, country, and ZIP or foreign postal code Anywhere, US				
Service Provider/Acct. No. (see instr.)	8 Checked if at least half-time student <input checked="" type="checkbox"/>	9 Checked if a graduate student <input type="checkbox"/>	10 Ins. contract reimb./refund \$	

Form 1098-T (keep for your records) www.irs.gov/Form1098T Department of the Treasury - Internal Revenue Service

*

Scholarship or Grant Income = \$9,950 - \$5,000 = \$4,950

Taxpayer May Choose an Alternate Treatment

- It may seem that minimizing scholarship income would minimize tax liability and increase the taxpayer's refund, but this isn't always true.
- Families may be able to increase their total refund or reduce tax liability by paying some tax on their scholarships/grants and increasing their education credit.
- If a scholarship or grant allows the student to use the money for qualified education expenses or living expense, they have the option to trade-in the tax-free status to take advantage of the sometimes more lucrative education credit.
- When electing this option, you can make an additional amount of qualified expenses useable for education credits, but you must also make the same amount of scholarships taxable to the student.
- Students may allocate scholarships to living expenses (up to the amount of actual living expenses) regardless of how their school treats their Pell grant or other unrestricted scholarships.
- We can help taxpayers choose whether to treat their scholarships and grants as used for education expenses (tax-free, but reduces expenses for education credits) or to be used for living expenses (taxable, but keeps expenses for education credits).

Taxpayer May Not Choose Alternate Treatment

Increasing an education credit by including more scholarship in income is not an option in some cases. For example:

- When the terms of the grant or scholarship dictate that it can only be used to pay tuition, fees, and required books.

OR

- When it is not reasonable that the amount of grant or scholarship included in income could have been spent on the student's general living expenses.
 - For example, if the student/parent has no income/loans to pay the tuition or the amount of living expenses is small and will not cover the grant amount taxed.
- Some common items that are considered general living expenses include the following;
 - Rent
 - Transportation
 - Food

Choice is Clear for Some

- The choice is clear for students with education expenses well in excess of their Pell grant or other scholarships as they won't need to include any of their grants in income in order to claim the maximum education credit
- Specifically, if Qualified Education Expenses – Scholarships \geq \$4,000, the student could exclude scholarship from income and still maximize the American Opportunity Credit education credit
- Example: In this case, the student already has education expenses of \$4000 (\$9000 qualified tuition less \$5000 in grants) so there is no need to tax the scholarships.

CORRECTED

FILER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone number State University PO Box 123 Your City, YS, XXXXX		1 Payments received for qualified tuition and related expenses \$ 9,000 2	OMB No. 1545-1574 2021 Form 1098-T	Tuition Statement Copy B For Student <small>This is important tax information and is being furnished to the IRS. This form must be used to complete Form 8863 to claim education credits. Give it to the tax preparer or use it to prepare the tax return.</small>
FILER'S employer identification no. XX-XXXXXXX	STUDENT'S TIN XXX-XX-1234	3		
STUDENT'S name John Smith		4 Adjustments made for a prior year \$	5 Scholarships or grants \$ 5,000	
Street address (including apt. no.) 100 Main St City or town, state or province, country, and ZIP or foreign postal code Anywhere, US XXXXX		6 Adjustments to scholarships or grants for a prior year \$	7 Checked if the amount in box 1 includes amounts for an academic period beginning January–March 2022 <input type="checkbox"/>	
Service Provider/Acct. No. (see instr.)	8 Checked if at least half-time student <input checked="" type="checkbox"/>	9 Checked if a graduate student <input type="checkbox"/>	10 Ins. contract reimb./refund \$	

Form 1098-T (keep for your records) www.irs.gov/Form1098T Department of the Treasury - Internal Revenue Service

Choice May Be Complicated

- If Qualified Education Expenses – Scholarships < \$4,000, the choice is more complicated
- Many Pell grant recipients will fall into this group
- For them, the tax-minimizing choice depends on the student's tax rate (including EITC phase-out) and other factors
- If the student is a dependent, the tax-minimizing choice for the family also depends on the parent's tax liability before accounting for the AOTC

Choice May Be Complicated: Two Rules of Thumb

- In nearly all cases where Qualified Education Expenses – Scholarships < \$4,000, the student should include enough scholarship in taxable income in order to claim \$2,000 in expenses for the American Opportunity Credit. This is because the first \$2,000 in expenses gets \$100% in credit.
- Beyond that, in many cases, the student should include enough scholarships in taxable income in order to claim \$4,000 in expenses, but only if doing so increases their refund.
- We will focus on taxing the scholarship in order to maximize the American Opportunity Credit as it is unlikely a larger amount of Qualified Education Expenses would result in a higher benefit with the Lifetime Learning Credit.

In Many Cases, but Not All Cases...

Note this statement:

Beyond the first \$2,000 in expenses, *in many cases*, the student should include enough scholarships in taxable income in order to claim \$4,000 in expenses for the American Opportunity Credit

It is “*in many cases.*” It is not *all* cases.

When Student is a Dependent

- Whenever possible, the best option is to have the parent(s) and student come in together to get their returns prepared.
- Education credit, if any, is claimed by the taxpayer who claims the dependent.
- Scholarship/grant income, if any, is reported on the **student's** tax return – it is not income of the person who claims the dependent.
- Many dependents have little or no taxable income.
- Check the student's filing requirement on Page A-2 in Pub 4012. Adding scholarship income to a dependent's return may increase the dependent's income enough to create a filing requirement or the dependent may already be required to file a return.
- If the dependent is required to file a return (see Pub 4012, Tab A) **and** the taxable scholarship income and other unearned income exceeds \$2,200, then the Form 8615 is required which will make the return out-of-scope for 2021.

Kiddie Tax and Form 8615

For TY2021, to determine if [Form 8615](#) is required, ask the following two questions:

1. Does the dependent have over \$2,300 in unearned income (including taxable scholarship income)?
2. Will the dependent file a return?

Single dependents not age 65 or blind must file a return if any of the following apply:

Their unearned income was more than \$1,100 (not including taxable scholarships)

Their earned income was more than \$12,550 (including taxable scholarships)

Their gross income was more than the larger of

- a. \$1,100, or
- b. their earned income (up to \$12,200) plus \$350

Note that taxable scholarship income is considered unearned for Kiddie Tax (Question 1); however, it is considered earned for purposes of determining dependent filing requirement (Question 2).

If you answer Yes to BOTH questions, Form 8615 is required, and the return is out of scope for TY2021.

If you do not answer Yes to BOTH questions, Form 8615 is not required, and the return is in scope.

Example: Does Nick Need to file Form 8615?

Remember...

- Question 1 Form 8615: Taxable scholarship is included as unearned income
Question 2 Filing Requirement: Taxable scholarship is included in earned income
Only if answer YES to BOTH questions, does Nick need to file Form 8615 and is return is out-of-scope

	Scenario A:	Scenario B:	Scenario C:
1. Unearned Income > \$2200?	\$0- No	\$1500-No	\$3500-Yes
2. Filing Requirement?	No	No	No
Unearned income > \$1,100	\$0	\$0	\$0
Earned Income > \$12,400	\$2000	\$3500	\$5500
Gross Income > larger of \$1,100 <u>or</u> earned income (up to \$12,050) plus \$350	\$2000 < \$2350	\$3500 < \$3850	\$5500 < \$5850

Nick is not required to file Form 8615.

Even though he has unearned income in excess of \$2,300 for purposes of Form 8615 in Scenario C, he does not have a filing requirement. Therefore Form 8615 is not required, and the return is in-scope.



Re-Cap

Re-Cap

- Families may be able to increase their total refund or reduce tax liability by paying some tax on their scholarships/grants and increasing their education credit.
- In some cases, you can report scholarships as income taxable to the student to maximize education credits. Check when Education Expenses – Grants < \$4,000.
- For Pell Grants and other scholarships/grants that allow the student to use them for living expenses:
 - Check the case of claiming \$2,000 in education expenses for AOC
 - Check the case of claiming \$4,000 in education expenses for AOC
 - ... up to the amount of actual expenses if actual is less than the above tiers.
 - Apply the allocation that is most beneficial for the client.
- Taxable scholarship/grant income is reported on the student's return when the amount exceeds qualifying education expenses.
- Tax credits are reported on the tax return of the taxpayer who claims the student as a dependent. The student claims the credit if no taxpayer claims him as a dependent.
- Form 8615 is required and out-of-scope when the dependent has more than \$2,300 in unearned income (including taxable scholarship) and has a filing requirement. See Pub 4012, A-2.

Additional Resources

- [Form 8615 Information](#)
- [Education Calculator \(Colorado Tax-Aide\)](#)

Up Next...
Module 9: Finishing the Return