



Education Credits



Introduction

This lesson covers tax credits available to help the taxpayer offset the costs of higher education by reducing the amount of income tax. This lesson suggests probing questions you can ask based on the intake and interview sheet, the Volunteer Resource Guide, Tab J, Education Benefits, and on the rules for claiming education credits.

During the interview, ask taxpayers if they are aware of the education credits, and give a brief description. Next, gather information to determine if any credits can be claimed.

Objectives

At the end of this lesson, using your resource materials, you will be able to:

- Determine who qualifies for an education credit
- Determine which credit the taxpayer can claim

What do I need?

- Form 13614-C
- Publication 4012
- Publication 970
- Form 1098-T
- Form 8863 and Instructions

Optional:

- Form 1040 Instructions

What are education credits?

Education credits are amounts that will reduce the amount of tax due. The amount is based on qualified education expenses that the taxpayer paid during the tax year.

There are two different education credits: the American opportunity credit and the lifetime learning credit. The American opportunity credit allows 40% of the credit to be refundable. There are general rules that apply to these credits, as well as specific rules for each credit.

For an overview of the various education tax benefits, review the Volunteer Resource Guide, Tab J, Education Benefits, Highlights of Education Tax Benefits.

Who can take an education credit?

Taxpayers can take education credits for themselves, their spouse, and/or dependents (claimed on the tax return) who were enrolled at or attended an eligible postsecondary educational institution during the tax year. The law requires that the student must generally receive a Form 1098-T, Tuition Statement, in order for the taxpayers to claim the education credit. However, if the student's educational institution is not required to furnish a Form 1098-T, the taxpayer may claim a credit if the student does not receive a Form 1098-T. The student is required to provide the information that would otherwise be included on the Form 1098-T.



Review the dependent section of the intake and interview sheet for children who are shown as full-time students. Ask the taxpayer if there are education expenses.

What basic requirements must the taxpayer meet?

To claim an education credit, verify that the following are true for the taxpayers:

- They cannot be claimed as a dependent on someone else's tax return
- 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



CAUTION Taxpayers claiming the American opportunity credit must have a valid identification number (SSN or ITIN) by the due date of the tax return (including extensions). Further, the student claimed for the credit must also have a valid identification number (SSN, ATIN, or ITIN) by the due date (including extensions). Taxpayers cannot file an amended return to claim the credit for a year that the taxpayer and/or student did not originally have a required identification number by the return due date.

How do I handle dependents?

The taxpayer must claim the student as a dependent to receive the credit for the student's qualified expenses. If the taxpayer claims the student as a dependent, all qualified education expenses of the student are treated as being paid by the taxpayer.

example

Carol Marshall has a grandson named Gary. He is claimed as a dependent on his parent's joint return. Carol paid Gary's tuition directly to the university. For purposes of claiming an education credit, Gary is treated as receiving the money as a gift and paying for the qualified tuition and related expenses. Since his parents are claiming him on their return, they may be able to use the expenses to claim an education credit. Alternatively, if he is claiming himself on his return, he might be able to claim the expenses as if he paid them to the school.

What is an 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 a student aid program administered by the U.S. Department of Education. The school should be able to tell the student if it is an eligible education institution. A searchable database of all accredited postsecondary institutions and programs are available at: <https://ope.ed.gov/accreditation/>.



CAUTION Taxpayers claiming the American opportunity credit are required to report the EIN of the educational institution the student attended on Form 8863, Education Credits (American Opportunity and Lifetime Learning Credits).

What are qualifying expenses?

Qualified education expenses are tuition and certain related expenses required for enrollment or attendance at an eligible educational institution. Qualified education expenses include nonacademic fees, such as student activity fees, athletic fees, or other expenses unrelated to the academic course of institution that must be paid to the institution as a condition of enrollment or attendance. However, for the American opportunity credit, the definition for "certain related expenses" is different from the lifetime learning credit. This will be discussed later in the lesson.

Ask to see documentation, such as Form 1098-T, issued by the school. The taxpayer can add other expenses that qualify for education credits, such as books or supplies not purchased through the school account.

example

When Janice enrolled for her freshman year of college, she had to pay a separate student activity fee in addition to her tuition. This activity fee is required of all students and is used solely to fund on-campus organizations and activities run by students, such as the student newspaper and the student government. No portion of the fee covers personal expenses. Although labeled as a student activity fee, the fee is required for Janice's college enrollment and attendance; therefore, it is a qualified expense.

Which expenses do not qualify?

Do **not** include expenses such as:

- Room and board, insurance, medical expenses (including student health fees), transportation costs, or other similar personal, living, or family expenses
- Any course of instruction or other education involving sports, games, or hobbies, unless the course is part of the student's degree program or (for the lifetime learning credit) helps the student to acquire or improve job skills

example

Jackie paid \$3,000 for tuition and \$5,000 for room and board at an eligible university. The \$5,000 paid for room and board is not a qualified expense for the education credits.

Are any amounts excluded from qualified expenses?

Tuition or other education expenses that have been used to make scholarships, grants, 529 distributions or other amounts received tax-free cannot be used to figure the credit. Once you have identified each person claiming a credit and their qualified expenses, ask if the student received any of these untaxed educational benefits during the year:

- Tax-free part of Pell grants
- Tax-free employer-provided educational assistance
- Veterans' educational assistance
- Tax-free parts of scholarships and fellowships
- Any other nontaxable payments received as educational assistance (other than gifts or inheritances). For example, distributions from a 529 plan reported on Form 1099-Q, Payments From Qualified Education Programs (Under Sections 529 and 530)
- Refunds of the year's qualified expenses paid on behalf of a student (e.g., the student dropped a class and received a refund of tuition)



Do not reduce the qualified education expenses by any scholarship or fellowship reported as income on the student's tax return if the scholarship or fellowship grant (or any part of it) **must** be applied (by its terms) to expenses (such as room and board) other than qualified education expenses, or if the scholarship or fellowship grant (or any part of it) **may** be applied (by its terms) to expenses (such as room and board) other than qualified education expenses. Some students may choose to pay non-qualifying expenses with scholarship/Pell grants funds, making the scholarship/Pell grants taxable. This is true even if the scholarship/grant was paid directly to the school.



Higher education emergency financial aid grants are not taxable to the student and do not reduce the student's qualified educational expenses.

Generally, any scholarship or fellowship grant is treated as tax-free educational assistance. However, a scholarship or fellowship grant is not treated as tax-free educational assistance to the extent the student includes it in gross income (the student may or may not be required to file a tax return) for the year the scholarship or fellowship grant is received. If the student includes the educational assistance in income, has a filing requirement and unearned income (including the taxable scholarship) over the ceiling amount, the student must file Form 8615, Tax for Certain Children Who Have Unearned Income (Kiddie Tax) to compute the tax. In this case, Form 8615 is out of scope for the VITA/TCE programs. See the Volunteer Resource Guide, Tab J, Education Benefits for the ceiling amount.

Most students should receive Form 1098-T from the educational institution. The form should show the amounts the student paid for tuition and related expenses, the amounts of scholarships and grants received, and whether the student was at least a half-time student or a graduate student. Verify with the taxpayer that the amount in Form 1098-T, Box 1, is actually the amount paid in the current tax year for qualified expenses. Also ask about qualified education expenses paid outside the school, such as from a bookstore.



CAUTION Form 1098-T may have incomplete information. Question the taxpayer to determine the amount of qualified expenses actually paid and adjust this amount by any non-taxable items, such as tax-free scholarships and tuition program distributions.

example

Joan Smith received Form 1098-T from the college she attends. It shows her tuition was \$9,500 and that she received a \$1,500 scholarship. She had no other scholarships or nontaxable payments. Her maximum qualifying expenses for the education credit would be \$8,000 (\$9,500 - \$1,500).

example

Juan, a student, receives a grant equal to his qualifying education expenses. He otherwise has no filing requirement. He earned \$8,600 from a summer job which is less than the cost of half of his support, had \$4,000 in education expenses and a \$4,000 Pell grant. Juan's parents file a return claiming Juan as a dependent and reported income that is within the allowable range for the American opportunity credit (AOC).

Scenario 1: Juan uses the grant to pay the education expenses. Juan has no filing requirement and files only to get his withholding (from his summer job) back. His parents qualified education expenses would be zero.

Gross income = \$8,600, no filing requirement, tax = 0.

Scenario 2: Juan chooses to declare \$2,000 of the grant as income on his return and his parents use the education expenses toward the AOC. Juan's gross income is $\$8,600 + \$2,000 = \$10,600$. As a dependent, Juan has no filing requirement and he has no tax. His parents claim \$2,000 as qualified education expenses.

Scenario 3: Juan chooses to include the entire grant as income on his return. Juan's parents can claim the entire \$4,000 education expenses toward the AOC. Juan's gross income is $\$8,600 + \$4,000 = \$12,600$. Since Juan's income is over the dependent's filing requirement income, the kiddie tax applies and his tax return is out of scope. His parents claim an AOC of \$2,500.

What about payments for the next academic year?

The taxpayers can claim payments prepaid for the academic period that begins in the first three months of the next calendar year. Refer to the Volunteer Resource Guide, Tab J, Education Benefits.

example

Thomas pays \$1,500 in December for qualified tuition for the winter semester that begins in January. He can use the \$1,500 paid in December to compute his credit for the current tax year. He cannot count it again next tax year.

What rules apply to each credit?

American Opportunity Tax Credit

Taxpayers can take the American opportunity credit for a student if they can answer all of these questions as indicated below:

- As of the beginning of the tax year, was the student still in the first four years of postsecondary education (generally, the freshman, sophomore, junior, and senior years)? *Yes*
- As of the beginning of the tax year, has the American opportunity credit been claimed for this student for four years? *No*
- Was the student enrolled in a program that leads to a degree, certificate, or other credential? *Yes*
- Was the student taking at least one-half the normal full-time workload for the course of study, for at least one academic period beginning in the current tax year? *Yes*
- Has the student been convicted of a felony for possessing or distributing a controlled substance as of year end? *No*
- Did the taxpayer and student have a taxpayer identification number (TIN) by the due date of the return (including extensions)? *Yes*



If the student does not meet all of the requirements for the American opportunity credit, the taxpayer may be able to take other education benefits for part or all of the student's qualified expenses.

example

Mindy's brother, Jim, started college in 2017. He was eligible for the American opportunity credit for 2017, 2018, 2019 and 2020. His parents claimed the American opportunity credit on their 2017, 2018 and 2019 returns. Jim claimed the credit on his 2020 tax return. Since the credit has been claimed for four years, the credit can't be claimed on any additional returns based on Jim's expenses.

The American opportunity credit can be up to \$2,500 per eligible student, depending on the amount of eligible expenses and the amount of tax on the return.

- The credit is 100% of the first \$2,000 in eligible expenses and 25% of the second \$2,000 in eligible expenses per student, up to the amount of tax
- 40% of the credit is a refundable credit, which means the taxpayer can receive up to \$1,000 even if no taxes are owed
- Taxpayers under age 24 cannot claim the refundable portion of the credit if certain conditions are met

Refer to Volunteer Resource Guide, Tab J, Education Benefits, Student Under Age 24 Claiming American Opportunity Credit, for details.

example

Toby has receipts for books and supplies for his first year at college. He spent \$1,291 for required books, lab supplies, and rock-hunting equipment he needed for his introductory chemistry and geology courses. The school has no policy requiring that these books and equipment be purchased from the college in order to enroll. These are qualified expenses for the American opportunity credit.

Lifetime Learning Credit

The lifetime learning credit can be taken if the taxpayer and the expenses meet the requirements described under “What basic requirements must the taxpayer meet?” Refer to the Volunteer Resource Guide, Tab J, Education Benefits, for the Education Credits Tips. Additional criteria for the lifetime learning credit include:

- Student doesn't need to be pursuing a program leading to a degree or other recognized education credential
- Felony drug conviction doesn't make the student ineligible
- Up to \$2,000 non-refundable credit per return (20% of up to \$10,000 in eligible expenses)
- Available for an unlimited number of tax years
- Available for all years of postsecondary education and for courses to acquire or improve job skills
- Course-related books, supplies, fees, and equipment are included in qualified education expenses only if they must be paid to the institution as a condition of enrollment or attendance

example

Jill attends Wanda's School of Beauty, an eligible institution. She pays \$4,400 for the course of study, which includes tuition, equipment, and books required for the course. The school requires that students pay for the books and equipment when registering for the course. The entire \$4,400 would be an eligible educational expense.

example

Jack attends a culinary school on Saturdays. He pays \$4,400 for the course of study and qualifies for the lifetime learning credit. The school provides a list of equipment that he needs to bring to class. The \$4,400 is an eligible educational expense, but the cost of the equipment and supplies is not.



EXERCISES

Use the Volunteer Resource Guide, Tab J, Education Benefits, and Publication 17, Comparison of Education Credits, to answer the following questions. Answers are at the end of the lesson summary.

Question 1: Bob was a full-time student and a fifth-year senior. He has only claimed the American opportunity credit for three earlier years. Does he qualify for the American opportunity credit?

Yes No

Question 2: Janice works full time and takes one course a month at night school. Some of the courses are not for credit, but they are meant to advance her career. Which credit is appropriate for her?

American opportunity Lifetime Learning

Question 3: Clark is an older student who has gone back to college half time after serving 18 months in prison for felony drug possession. Which credit is appropriate for him?

American opportunity Lifetime Learning

Can a taxpayer take multiple education benefits?

Education expenses can be taken in any of several areas on the tax return. They can be used toward one of these credits, as a business expense on Schedule C, or to reduce the taxable portion of scholarships, fellowships, grants and distributions from education savings accounts. The definition of a qualifying expense varies among these different benefits, but in general, each expense can be used only once. For example, do **not**:

- Figure the education credits based on expenses that have already been taken on Schedule C
- Take both an American opportunity credit and a lifetime learning credit for the same student in the same year



A taxpayer who has taken an early distribution from an IRA may take an exception to the 10% additional tax if the taxable part of the distribution is less than or equal to the adjusted qualified education expenses.



Tax Software Hint: To review information related to software entries, go to the Volunteer Resource Guide, Tab J, Education Benefits.



To determine the most beneficial way to claim education expenses, do not compare them until both federal and state tax returns have been otherwise completed.

How do I determine the amount of the credit?

Here are the general steps in figuring the amount of education credits:

1. Review the list of qualifying students and expenses and decide if the American opportunity credit or lifetime learning credit is more suitable (see the requirements discussed earlier).
2. Form 8863, Part III, page 2, requests information about the student, the student's eligibility for the credit, and the educational institution(s). Taxpayers must complete Part III for each eligible student for whom they are claiming an education credit before completing Parts I and II.
3. Enter each student's qualified expenses. Be sure that these:
 - Include only qualified expenses paid during the tax year
 - Are reduced by untaxed benefits
 - Do not exceed the limit for the credit
4. Find the totals for each section and apply the limits, then transfer the amounts to Parts I and II to determine the refundable and nonrefundable credits. Apply the income test and do the calculations. (Tax software does this step for you.)



To determine the amount of qualified expenses, please review Form 1098-T and have a discussion with the taxpayer to determine the qualified education expenses paid.



Tax Software Hint: When entering qualified expenses, the software allows you to select an education benefit. At this point, you can make changes to determine the most beneficial education benefit to claim for the taxpayer.



If you find taxpayers claimed an education credit in a prior year and they were refunded part or all of the expenses they used to claim the American opportunity or lifetime learning credit, they may have to repay (recapture) all or part of the credit. Information can be found in Publication 970, Tax Benefits for Education, but this is beyond the scope of the VITA/TCE programs. Advise the taxpayer to consult a professional tax preparer.

Taxpayer Interview and Tax Law Application

Here is how our volunteer helped a taxpayer, Barbara Smith, determine which education credits applied to her family.

SAMPLE INTERVIEW

VOLUNTEER SAYS...

Barbara, are you familiar with education credits?

Yes, they apply to certain expenses for postsecondary education. Did anyone in the family attend college or vocational school during the tax year?

There are two kinds of credits – here’s a chart comparing the two education credits. [Explains the differences.]

I think you’re right. You both meet the basic requirements, since you are both on the return and meet the income limits. Do you have your student account information showing the expenses paid?

The books will qualify but her field hockey costs will not. Did she receive any money from an employer, a scholarship, Pell grant, anything like that?

We don’t need to count the gift. The American opportunity credit is available for a student’s first four years of college, so that might be the best for you to claim. Now let’s look at your expenses.

Are these to improve your job skills?

Are all of these fees required for your courses?

You’ll be eligible for the lifetime learning credit.

[On the intake and interview sheet, indicate that you’ve addressed education benefits.]

BARBARA RESPONDS...

They have something to do with tuition.

My daughter, Carla, is a freshman, going to college full time, and I am taking classes at City College.

Looks like American opportunity for Carla and lifetime learning for me!

Yes, these are for Carla’s tuition, fees, and books for the tax year. These are for extracurricular field hockey.

Only \$5,000 from her grandfather.

All I have are tuition and fees for two classes in accounting, spring and fall semesters.

Yes, but my boss doesn’t reimburse me.

Yes.

I’m so glad you were here to help me!

Which education benefit is better for the taxpayer?

Taxpayers have several options for using education expenses to reduce taxes. They are:

- American opportunity credit or lifetime learning credit
- Business expenses on Schedule C if the expenses qualify
- Make an unrestricted scholarship or grant tax free

Generally, taxpayers will benefit the most from claiming the education credits. The American opportunity credit will always be greater than the lifetime learning credit.

However, you should compute any of the other benefits for which taxpayers are eligible to determine which gives them the lowest tax. Do not claim multiple credits for the same education expense; use the education credit that is most advantageous to the taxpayer.

Refer to the Volunteer Resource Guide, Tab J, Education Benefits for a comparison chart of some of the tax benefits for education.

How can I avoid common errors?

Make sure that you have entered the names, SSNs, and education expense amounts correctly. Check that you have not claimed more than one tax benefit for the same taxpayer or taken a credit or deduction for expenses paid with a tax-free benefit like a scholarship.

On the intake and interview sheet, make sure that the appropriate box is checked to indicate that the taxpayer had education expenses. Note anything unusual that the quality reviewer may need to know when reviewing this part of the tax return. For example, you could note if some expenses were paid with a nontaxable scholarship.

What if American opportunity credit was disallowed in a prior year?

The intake and interview sheet asks if the taxpayer was previously disallowed the American opportunity credit in a prior year. If the taxpayer answers “yes” to this question, refer to the Volunteer Resource Guide, Tab I, Earned Income Credit, Disallowance of Certain Credits.

Summary

You are now ready to help taxpayers determine which education tax benefits are best for them. When you get to this section of the return, always check the intake and interview sheet and ask probing questions based on the taxpayer’s information and on the rules for claiming education credits.

There are two education credits that may reduce a taxpayer’s tax:

- American opportunity credit
- Lifetime learning credit

These are some requirements for the credits:

- Taxpayers and students must have a TIN by the due date of the return, including extensions, to claim the American opportunity credit
- A taxpayer who claims the American opportunity credit and is not eligible can be banned up to 10 years from claiming the credit
- 40% of the American opportunity credit is refundable (up to \$1,000)
- Taxpayers can claim the American opportunity credits for up to four years
- Lifetime learning credit can be claimed for an unlimited number of years
- Lifetime learning credit is a non-refundable credit of up to \$2,000 (20% of up to \$10,000 in expenses)
- Education expenses can be applied to those credits or deducted as business expenses on Schedule C if they qualify
- Students that include tax-free scholarships and grants in income and have a filing requirement may be required to file Form 8615, Tax for Certain Children Who Have Unearned Income, which is out of scope for the VITA/TCE programs

Other education benefits are listed in the Volunteer Resource Guide, Tab J.

One of your roles as a volunteer is to help taxpayers maximize the benefits that they are entitled to under the tax law. Stay alert to ways they can use their education expenses to lower their tax.

What situations are out of scope for the VITA/TCE programs?

The following is out of scope for this lesson. While this list may not be all inclusive, it is provided for your awareness only.

- Taxpayers who must repay (recapture) part or all of an education credit claimed in a prior year.



TAX LAW APPLICATION

To gain a better understanding of the tax law, complete the practice return(s) for your course of study using the Practice Lab on L<.



EXERCISE ANSWERS

Question 1: *Yes. Bob qualifies for the American opportunity credit because he only claimed the credit in three previous tax years.*

Question 2: *Lifetime learning*

Question 3: *Lifetime learning*