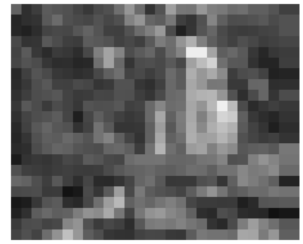

1999 Income Tax School

EDUCATION PROVISIONS

Hope Scholarship Credit. 4
The Hope Scholarship Credit is a nonrefundable tax credit of up to $1,500 per eligible student for qualified tuition and related expenses paid during the year.

Eligible Student 6
Students must be enrolled at least half-time in a degree or certificate program at an eligible educational institution.

Limitations 8
The credit cannot be claimed for the same student if it was claimed in the previous two tax years. A taxpayer with a modified adjusted gross income in excess of $40,000 ($80,000 for a married couple filing a joint return) will see a reduction in the amount of the credit.

Effect on Other Income Tax Provisions 9
The Lifetime Learning Credit cannot be claimed in the same tax year as the Hope Credit.

Effect on Student Financial Assistance. 9
Because student financial aid is based on need, using the Hope Credit to reduce the income taxes of the student's family will result in a decrease in the family's need, which can affect the amount of financial aid the student receives the following year.

Lifetime Learning Credit. 10
The Lifetime Learning Credit is a nonrefundable credit of up to $1,000, and is equal to 20% of qualified tuition and fees. Unlike the Hope Credit, the Lifetime Learning Credit can be claimed for all undergraduate, graduate, and non-degree or certificate educational programs if the program results in the improvement or acquisition of job skills.

Limitations 10
A taxpayer can claim $1,000 per year for the Lifetime Learning Credit, and is not limited to two years as with the Hope Credit. The Lifetime Learning Credit is subject to modified adjusted growth income limits.

Effect on Other Income Tax Provisions 12
Qualified higher education expenses used in determining the amount of the Lifetime Learning Credit cannot be used to calculate the interest exclusion from U.S. savings bonds.

Effect on Student Financial Assistance 12
If students or their families claim the Lifetime Learning Credit to reduce their income taxes, they are likely to see a reduction in the amount of need-based financial aid received the following year.

Reporting the Hope Scholarship and Lifetime Learning Credit 12
The Hope Scholarship Credit and the Lifetime Learning Credit are elected credits and must be claimed by filing Form 8863 with the taxpayer's income tax return.

Education IRAs 14
Education IRAs can be established to defray the future costs of higher education. Contributions are limited to $500 per year per child, and are not deductible expenses. Earnings from Education IRAs are not subject to income taxes if they are used for qualified educational expenses.

Limitations 14
Contributions to Education IRAs are limited to $500 per year per child. Amounts in excess of $500 to Education IRAs are subject to the 6% excess contribution penalty.

Qualified Educational Expenses. 17
If the beneficiary of an Education IRA has qualified educational expenses equal to or greater than the amount of the withdrawal, the withdrawal is not subject to taxation.

10% Penalty for Taxable Withdrawal 19
A 10% withdrawal penalty is assessed on any taxable withdrawals from an Education IRA, but there are exclusions to the penalty assessment.

Rollovers and Changes in Beneficiary 19
Amounts distributed from an Education IRA are not subject to income tax or the 10% penalty if the distribution is contributed to another Education IRA on behalf of the beneficiary or a member of the beneficiary's family under the age of 30.

Members of the Beneficiary's Family 19
Members of the beneficiary's family include spouses, children, siblings, nieces and nephews, parents and grandparents, and in-laws.

Required Distributions 20
Distributions from Education IRAs are required when the beneficiary reaches the age of 30, unless there is a rollover or change in the beneficiary.

Effect on Exclusion of Interest from U.S. Savings Bonds 21
The amount of qualified educational expenses used for calculating the interest exclusion from U.S. savings bonds is reduced by the amount of the expenses used to determine exclusions from Education IRA distributions.

Penalty-Free Withdrawal from IRAs 22
Taxpayers are excluded from the 10% premature distribution penalty from an IRA if the distribution is used to pay for the educational expenses of the taxpayer or the taxpayer's spouse, child, or grandchild.

Limitations 22
Subject to provisions in the Internal Revenue Code, the amount of qualified educational expenses is reduced by any scholarship or other payment that is excluded from gross income.

Effect on Student Financial Aid 22
An IRA distribution used for educational expenses is treated as income when calculating a student's need for financial assistance.

Deduction for Interest on Education Loans. 23
Beginning in 1998, the interest accrued from a qualified education loan can be claimed as an adjustment to gross income. Because the adjustment is not an itemized deduction, it can be claimed in addition to the standard or itemized deductions.

Limitations 24
The deduction is limited to $1,000 in 1998, and the deduction increases by $500 for each year thereafter. The limit of the deduction is ratably phased out for taxpayers with adjusted gross incomes between $40,000 and $55,000.

Effect on Student Financial Assistance 27
The interest deduction is likely to increase the amount of a student's financial assistance in the following school year under the formula used to calculate need.

Cancellation of a Student Loan 28
Although cancellation of indebtedness from a student loan is generally taxable, the forgiveness of a loan in return for community service is tax-free.

Qualifying Loans 28
A qualifying student loan must contain the provision that the indebtedness will be forgiven if the student works for a specified period of time in certain professions or for any of a broad class of employers.

Refinanced Loan 28
An existing student loan may qualify for tax-free cancellation of debt if the taxpayer refinances the loan from an educational institution or certain tax-exempt organizations. The refinanced loan must assist the student in attending the educational institution, and the new lender must meet certain qualifying conditions.

Exclusion for Qualified State Tuition Programs. 28
Certain states and agencies allow taxpayers to purchase credits or certificates, or make contributions to an account to cover future educational expenses. These contributions are not deductible, and withdrawals from the accounts are subject to taxation.

Qualified State Tuition Program. 29
A qualified state tuition program allows a person to purchase tuition credits or certificates, or make contributions to an account that entitles the beneficiary to a waiver or payment of qualified educational expenses.

Operational Overview 29
The definitions of family members, qualified educational expenses, and eligible educational institutions are the same as those for Education IRAs. Because the tuition program imposes penalties on withdrawals made for nonqualified expenses, there is no tax penalty assessed.

Effect on Other Income Provisions 29
Distributions for state tuition programs do not impact the use of education credits or other benefits because there is no income exclusion. Contributions to Education IRAs and state tuition programs cannot be made in the same year. Tax-free contributions can be made to state tuition programs from Education IRA distributions and proceeds from eligible U.S. savings bonds.

Education Savings Bonds 29
The interest received from the sale of qualified U.S. savings bonds is excludable income if the taxpayer uses the interest to pay for qualified educational expenses during the redemption year.

Qualified U.S. Savings Bonds. 29
Series EE bonds issued after 1989 or Series I bonds are considered as qualified bonds. The bond must be issued in the name of the taxpayer or the taxpayer's spouse, and the taxpayer must be 24 years old before the issue date of the bond.

Qualified Expenses. 30
Qualified educational expenses include required tuition and fees for eligible educational institutions, contributions to qualified state tuition programs, and contributions to Educational IRAs paid for the taxpayer, the taxpayer's spouse, or a dependent.

Amount Excludable 30
If the total proceeds from the redemption of qualified U.S. savings bonds do not exceed the taxpayer's educational expenses for the year, the interest can be excluded. Only part of the proceeds from the savings bond redemption can be excluded if the interest exceeds the cost of the educational expenses.

Exclusion for Employer-Provided Educational Assistance. 32
Up to $5,250 in educational assistance benefits paid by an employer under an educational assistance program are tax-free.

Educational Assistance Program. 32
An educational assistance program is qualified if the program is in writing and certain requirements are met.

Educational Assistance 33
Tax-free educational assistance expenses paid by an employer include tuition and fees, books and supplies, and equipment. The payments must be applied to undergraduate-level courses beginning prior to June 1, 2000.

Benefit over $5,250 33
Educational assistance benefits received by an employee from an employer that exceed the $5,250 are taxable, and should be reported as wages unless the payments qualify as a working condition fringe benefit.

Expenses Paid with Benefits. 33
Deductions and educational credits cannot be claimed if the taxpayer received tax-free benefits from a qualified educational assistance program through his or her employment.

Practitioner Questions and Answers 33

EDUCATION PROVISIONS

The Taxpayer Relief Act of 1997 added and amended several income tax benefits for the costs of higher education. The result is a complex set of rules encompassing credits, income exclusions, and deductions for families that are saving for or currently paying the costs of college. Some provisions are mutually exclusive with respect to a student for a given tax year. In most cases, the same expense dollars cannot be used to compute more than one benefit. Consequently, the taxpayer must often choose which provision will provide the greatest benefit.

Qualifications for the provisions include requirements for the educational institution, requirements for the student, and income and support tests for the family.

Proposed regulations help to explain the new rules. The proposed regulations will be effective on the date they are published in the Federal Register as final regulations. However, in the preambles to proposed regulations on education credits, state tuition savings programs, and student interest loan deductions, the Treasury stated that taxpayers may rely on the proposed regulations for guidance pending the issuance of final regulations. If future guidance is more restrictive than the guidance in the proposed regulations, the future guidance will be applied without retroactive effect.

The rules as set out in the proposed regulations, tax forms, and IRS publications are discussed below and illustrated with examples and filled-in forms. The chapter ends with some frequently asked questions and answers that illustrate the application of the rules.

HOPE SCHOLARSHIP CREDIT [I.R.C. §25A; PROP. REG. §1.25A]

GENERAL PROVISIONS

The Hope Scholarship Credit is a nonrefundable credit of up to $1,500 per eligible student. It is equal to 100% of the first $1,000 and 50% of the next $1,000 of qualified tuition and related expenses paid during the year.

Qualified Tuition and Related Expenses. "Qualified tuition and related expenses" includes tuition and fees required for the enrollment or attendance of an eligible student at an eligible educational institution.

The following expenses are not "qualified tuition and related expenses."

1. Charges and fees associated with meals, lodging, student activities, athletics, insurance, transportation, and similar personal, living, or family expenses are **not** included.
2. The expenses of education involving sports, games, or hobbies are **not** qualified tuition expenses unless this education is part of the student's degree program.
3. Qualified tuition and related expenses do **not** include expenses covered by educational assistance that is not required to be included in the gross income of either the student or the taxpayer claiming the credit. Thus, total qualified tuition and related expenses are reduced by any scholarship

or fellowship grants excludable from gross income under present law §117 and any other tax-free educational benefits received by the student during the taxable year.

Practitioner Note. A student may choose to include an otherwise nontaxable grant as taxable income on the student's tax return. If this option is chosen, the now taxable grant does not reduce expenses qualifying for the Hope Credit [Proposed Reg. §1.25A-5(c)(3)(i)].

Other special provisions regarding qualified tuition and related expenses:

1. No reduction of qualified tuition and related expenses is required for a gift, bequest, devise, or inheritance within the meaning of I.R.C. §102(a). See "Third Party Payments" later.
2. A Hope Credit is **not** allowed with respect to any education expense for which a deduction is claimed under I.R.C. §162 or any other section of the Internal Revenue Code.
3. Generally, prepaid expenses do not qualify for the Hope Credit. However, if tuition and fees are paid during a tax year for an academic term that begins in the first three months of the next tax year, the academic term is treated as if it began in the tax year the expenses are paid. Therefore, the taxpayer can claim a Hope Credit for those expenses only for the tax year they are paid [I.R.C. §25A(g)(4); Prop. Reg. §1.25A-3(e)].

Example 1. Justin Tyme paid $5,000 of tuition and fees on December 15, 1999, for the spring 2000 semester, which begins on January 18, 2000. For purposes of the Hope Credit, the spring 2000 term is treated as if it began in 1999. Therefore, the $5,000 is included in qualified education expenses for the 1999 tax year.

Qualified Taxpayers. A taxpayer can claim the Hope Credit for tuition and fees paid for himself or herself, his or her spouse, or a person who is claimed as a dependent on the taxpayer's tax return. A student who is a dependent on another taxpayer's tax return cannot claim the credit, but any qualifying expense paid by the student is treated as paid by the taxpayer who claims the student as a dependent for purposes of the credit [Prop. Reg. §1.25A-5(b)(1)].

Example 2. Ima Student paid a total of $1,800 in qualified tuition and related expenses for the spring semester of her freshmen year (spring 1999) and the fall semester of her sophomore year (fall 1999). Her parents paid none of her tuition and fees but did provide her room and board. Her parents met the support test for claiming Ima as a dependent and claimed her as a dependent on their 1999 income tax return.

Ima is not allowed to claim the Hope Credit in 1999, but her parents can claim a $1,400 (100% × $1,000 plus 50% × $800) credit in 1999, if all other qualifications are met.

Third party payments. If a third party pays qualified educational expenses directly to the educational institution, the payments are treated as if the money has been given to the student and the student paid the expenses.

Third party is defined in the proposed regulations as someone other than the taxpayer, the taxpayer's spouse, or a claimed dependent [Prop. Reg. §1.25A-5(a)(1)].

Practitioner Note. Paying the expense directly to the educational institution results in a gift tax exclusion under I.R.C. §2503(e).

Example 3. Assume Ima's grandparents (from Example 2) paid $1,800 of Ima's qualified expenses directly to Ima's college. The payments are treated as if Ima made them. Therefore, Ima's parents can still claim a $1,400 Hope Credit for 1999.

Not claiming a dependent. If a taxpayer is eligible to claim a student as a dependent but does not, the student (and only the student) may claim the Hope Credit [Prop. Reg. §1.25A-1(g)].

Example 4. Assume that Ima's parents (from Example 2) were not eligible to claim the Hope Credit because they had too much modified adjusted gross income (discussed later in this chapter). Ima's parents could choose to **not** claim Ima as a dependent. This would allow Ima to claim the Hope Credit for 1999.

> **Practitioner Note.** The proposed regulation does **not** allow a student to claim himself or herself as a personal exemption deduction if someone else is eligible to claim the exemption under I.R.C. §151(d)(2). Therefore, if parents are eligible to but do not claim the student as a dependent, no one gets the personal exemption deduction.

Example 5. In Example 4, Ima is not allowed to claim the personal exemption deduction, even though her parents did not claim her as a dependent, because her parents were eligible to claim her as a dependent.

> **Observation.** If Ima's income tax liability for 1999 is less than $1,400, she will not get the full benefit of the Hope Credit since it is not a refundable credit. Ima and her parents should compare the benefit Ima receives from claiming the credit with the benefit her parents receive from claiming Ima as a dependent before deciding that her parents should forgo the dependency exemption.

Example 6. Assume that Ima's parents are in the 31% income tax bracket, are over the threshold for claiming the Hope Credit, but are not over the threshold for phasing out the personal exemption amount. Also assume that Ima owes $1,000 of income taxes before the Hope Credit.

If Ima's parents claim her as a dependent on their 1999 income tax return, their income tax liability will be reduced by $2,750 × 31% = $853. No one will be allowed to claim the Hope Credit. If Ima's parents **do not** claim her as a dependent on their 1999 income tax return, **no one can claim the personal exemption deduction**, but Ima can claim a $1,400 Hope Credit that will reduce her income tax liability by $1,000.

Therefore, forgoing the dependency exemption on the tax return of Ima's parents will save the family $147 ($1,000 – $853) of income taxes.

> **Practitioner Note.** The definition of "third party" includes the student's parents. Therefore, qualified expenses paid by a student's parents are treated as if the student pays them.

Example 7. In the previous examples, Ima paid the qualifying expenses. Now assume Ima's parents paid $1,800 of qualified expenses directly to Ima's college but chose not to claim her as a dependent. Ima treats the $1,800 as if she paid the expenses. Therefore, Ima would be entitled to a $1,400 Hope Credit even though she was eligible to be claimed as a dependent on her parents' income tax return and did not pay the qualified expenses herself.

Residency Requirement. The taxpayer and spouse must **both** be U.S. citizens or treated as permanent resident aliens for the entire year. The student may be a nonresident alien only if he or she is a dependent meeting the qualifications of I.R.C. §152 [Prop. Reg. §1.25A-1(i)].

Eligible Student

Degree Requirement. The Hope Credit can be claimed only for an individual who enrolls at an eligible institution in a program leading toward a post-secondary degree, certificate, or other recognized credential.

Eligible Institution. An eligible institution includes any accredited post-secondary educational institution eligible to participate in a student aid program administered by the federal Department of Education. It includes virtually all accredited public, nonprofit, and proprietary (privately owned and profit-making) institutions. Consequently, vocational and trade schools are included, as well as colleges and universities.

Work Load Requirement. The Hope Credit can be claimed only for an individual who is at least a half-time student for at least one academic term that begins during the tax year. Correspondence study alone cannot qualify.

Academic period is not defined in I.R.C. §25A or the legislative history. The proposed regulations define **academic period** as "a quarter, semester, trimester, or other period of study (such as a summer school session) as reasonably determined by an eligible educational institution [Proposed Reg. §1.25A-2(c)].

The standard for what constitutes "half of the normal full-time workload is determined by each eligible educational institution. However, the standard for half time may not be lower than the standards for half time established by the Department of Education in 34 CFR 674.2(b) for a half-time undergraduate" [Prop. Reg. §1.25A-3(d)(1)(ii)].

Year of Study Requirement. **Before the beginning of the tax year**, the student must have completed **less than two years** of post-secondary education [I.R.C. §25A(b)(2)(C); Prop. Reg. §1.25A-3(d)(1)(iii)]. The test of whether a student has completed two years of post-secondary education is based on the academic credit awarded by the institution for **coursework completed** by the student prior to the beginning of the tax year. Academic credit awarded by the institution solely on the basis of the student's performance on **proficiency examinations** is disregarded.

Example 8. Phil Erup graduated from high school in June 1999. In the fall of 1999, he enrolled in State University. Based on advanced placement exams, Phil was classified as a second semester sophomore when he enrolled. Phil took a full load of courses during the 1999 fall semester and the 2000 spring and fall semesters.

Phil is an eligible student for the Hope Credit for both 1999 and 2000. **The credits he was awarded based on the advanced placement exams are not counted.** Consequently, he is not treated as having completed the first two years of post-secondary education before the beginning of 1999 or before the beginning of 2000 [Prop. Reg. §1.25A-3(d)(2), Example (4)].

Example 9. Cherry Pitt graduated from high school in June 1999. During her junior year (1997–1998) and senior year (1998–1999) of high school, Cherry took courses at Local University but was not enrolled in a degree program. In the fall of 1999, Cherry enrolled at State University. Based on the courses Cherry took at Local University, Cherry was classified as a second semester sophomore when she enrolled. Cherry took a full load of courses during the 1999 fall semester and the 2000 fall and spring semesters.

Cherry is an eligible student for the Hope Credit in 1999 because she had completed less than two years of post-secondary work at the beginning of 1999. Because she was enrolled in a degree program for one semester in 1999, her qualified expenses for the courses she took at Local University in the spring of 1999 as well as the courses she took at State University in the fall of 1999 can be used to calculate the credit.

Cherry is **not** an eligible student for the Hope Credit in 2000 because she has completed **two** years of post-secondary education **prior to the beginning of 2000**. The courses she took at Local University while she was in high school and for which State University awarded credit are counted for purposes of the year of study requirement [Prop. Reg. §1.25A-3(d)(2), Example (6)].

Felony Drug Conviction Requirement. If the student has been convicted of a federal or state felony offense for possession or distribution of a controlled substance as of the end of the taxable year, he or she is not an eligible student.

Limitations

Two Tax Years. The credit **cannot** be claimed if it was claimed in **two prior tax years** with respect to the same student.

> **Practitioner Note.** This is a **different** two-year requirement than the first two years of post-secondary education requirement discussed above. Both requirements must be met.

Example 10. Duane Plug graduated from high school in June 1999. He enrolled in college full time in the 1999 fall semester, the 2000 spring and fall semesters, and the 2001 spring and fall semesters. At the end of the 2000 fall semester, he was classified as a second semester sophomore. Duane has $1,500 of qualified expenses each semester.

Duane is an eligible student in 1999, 2000, and 2001 **because he was not classified as a junior before the beginning of 2001**. If Duane (or his parents) claim the Hope Credit for 1999, the credit for 1999 will be $1,250 ($1,000 × 100% + $500 × 50%). The credit for 2000 will be the $1,500 maximum credit. **There is no Hope Credit for 2001 because the credit has been claimed with respect to Duane in two prior tax years**.

If no one claims the credit for Duane in 1999, the maximum $1,500 credit can be claimed for both 2000 and 2001. Duane is an eligible student at the beginning of 2001, so all of his eligible expenses for that year (including the expenses for his first semester as a junior) qualify for the Hope Credit.

Modified Adjusted Gross Income. The Hope Credit is reduced as the taxpayer's modified adjusted gross income rises above $40,000 ($80,000 for married taxpayers who file a joint return). If the taxpayer's adjusted gross income exceeds $50,000 ($100,000 for married taxpayers who file a joint return), no Hope Credit can be claimed [I.R.C. §25A(d)].

Modified adjusted gross income is defined as adjusted gross income increased by any of the following:

1. The foreign earned income exclusion (I.R.C. §911)
2. The exclusion for income from Guam, American Samoa, or the Northern Mariana Islands (I.R.C. §931)
3. The exclusion for income from Puerto Rico (I.R.C. §933)

Married Taxpayers. Married taxpayers are **not** allowed to claim the Hope Credit **unless** they file a joint income tax return for the year. [I.R.C. §25A(g)(6)] Taxpayers who are considered unmarried under the head of household rules are considered unmarried for this rule [Prop. Reg. §1.25A-1(h) I.R.C. §7703].

Effect of Claiming the Educational IRA Exemption. The Hope Credit **cannot** be claimed in a given year for a student if a distribution from the student's **educational IRA** in that year is excluded from income under I.R.C. §530(d)(2).

Example 11. Patti Cake withdrew $2,000 from her Education IRA in 1999 to pay part of her $5,000 of qualified education expenses. She excluded the $2,000 from income under §530(d)(2). For 1999, **no one** can claim the Hope Credit for any of Patti's qualified expenses.

> **Practitioner Note.** If a taxpayer **waives** the Education IRA exclusion for a given tax year under I.R.C. §530(d)(2)(C), his or her educational expenses for that year qualify for the Hope Credit.

Example 12. If Patti from Example 11 waives the exclusion of the $2,000 Education IRA distribution from income for 1999, she or her parents can use her qualified expenses to calculate a Hope Credit for 1999.

Refund of Qualified Expenses. If a taxpayer receives a refund of tuition or related expenses **before** the tax return is filed for the tax year in which the tuition or related expenses were paid, the qualified tuition and related expenses for the tax year are reduced by the amount of the refund [Prop. Reg. §1.25A-5(f)(1) and (2)].

If a taxpayer receives a refund of tuition or related expenses **after** filing the tax return for the year the tuition or related expenses were paid, the taxpayer must recapture on the next year's return the portion of the credit that was based on the qualifying expense that was refunded [Prop. Reg. §1.25A-5(f)(3)].

Practitioner Note. Credit recaptures are included as additional taxes on the "total tax" line of Form 1040–line 56 of the 1999 Form 1040.

Subsequent-year educational assistance. If a student receives excludable education assistance for qualified tuition or related expenses paid in a previous year, the educational assistance is treated as a refund of the qualified tuition or related expense [Prop. Reg. §1.25A-5(f)(3)].

Effect on Other Income Tax Provisions

The Lifetime Learning Credit **cannot** be claimed for expenses incurred for a student if the Hope Credit is claimed for any expenses of that student for the **same** tax year.

If qualified higher education expenses are used in determining the Hope Credit, the same expenses **cannot** be used to calculate the interest exclusion from U.S. savings bonds on Form 8815.

Example 13. Pete Bogg cashed a $4,000 U.S. savings bond to pay part of his daughter's $5,000 of qualified higher education expenses in 1999. If Pete or his daughter claim the maximum $1,500 Hope Credit for 1999, the qualified expenses must be reduced by the $2,000 of expenses that were used to claim the Hope Credit ($1,000 × 100% plus $1,000 × 50%) when Pete calculates his exclusion of interest income from the savings bond.

Effect on Student Financial Assistance

Student financial assistance based on the student's need uses the **income of the student's family** as part of the base for calculating that need. Since income taxes reduce the income that is used to calculate a family's need, a **reduction of income taxes** resulting from claiming the Hope Credit will **decrease** the family's need for the following year, which can **decrease** the financial assistance.

Under the federal formula, the family's expected contribution for the following school year **is increased by 47% of the Hope Credit** if the parents claim the Hope Credit and their adjusted available income is above $21,201. The expected family contribution is increased by a **lesser** amount if the adjusted available income is **less than $21,201.**

If the **student** claims the Hope Credit and has income above $2,200 (in 1999), the **family's** expected contribution for the following year will be **increased by 50% of the Hope Credit.**

Example 14. If Ima's parents have $30,000 of adjusted available income for 1999 and claim a $1,400 Hope Scholarship Credit on their 1999 income tax return, their expected family contribution for the 2000–2001 school year will be **increased by $658** ($1,400 × 47%). This is likely to **reduce** Ima's need-based student financial aid for 2000–2001 **by $658. Therefore, the net benefit of the Hope Credit is $742 ($1,400 – $658).**

If Ima has $5,000 of adjusted available income in 1999 and claims the Hope Credit on her 1999 income tax return, her need-based student financial aid is likely to **decrease by $700** ($1,400 × 50%) for the 2000–2001 school year. **Therefore, the net benefit of the Hope Credit is $700 ($1,400 – $700).**

LIFETIME LEARNING CREDIT [I.R.C. §25A]

General Provisions

The Lifetime Learning Credit is a **nonrefundable credit** of up to $1,000 ($2,000 adjusted for inflation beginning in 2003). It is equal to 20% of qualified tuition and fees.

Unlike the Hope Credit, the Lifetime Learning Credit can be claimed for all undergraduate (not just freshmen and sophomores) and graduate students as well as for students who are not in a program leading to a degree, certificate, or other recognized credential, if the education is for the purpose of acquiring or improving job skills.

Example 15. Cherry Pitt (from Example 9 above) is **not** an eligible student for the Hope Credit in 2000 because she has completed two years of post-secondary education prior to the beginning of 2000. However, she or her parents **can claim** the Lifetime Learning Credit in 2000.

Also unlike the Hope Credit, the Lifetime Learning Credit is **not limited to two tax years.**

Example 16. If Cherry Pitt enrolls in a degree program (either undergraduate or graduate) or if she takes a course to acquire or improve skills needed for her employment in 2001 and 2002, she can claim the Lifetime Learning Credit for those years.

Limitations

Per-Taxpayer Credit. Only **one** $1,000 ($2,000 adjusted for inflation beginning in 2003) Lifetime Learning Credit is allowed **for a taxpayer each year**. By contrast, a maximum $1,500 (adjusted for inflation beginning in 2002) Hope Credit can be claimed by a taxpayer for **each eligible student each year**.

Example 17. Charles and Nancy have twin children in college in 1999. They are both seniors and both have $5,000 of qualified higher education expenses. Charles and Nancy can claim only one $1,000 Lifetime Learning Credit for their children's expenses.

However, if Charles and Nancy chose to **not** claim one of their children as a dependent on their 1999 income tax return, that child could claim the $1,000 Lifetime Learning Credit (but not the personal exemption deduction) on his or her 1999 income tax return. Charles and Nancy could then claim a $1,000 Lifetime Learning Credit for the other child.

Modified Adjusted Gross Income. The Lifetime Learning Credit is subject to the same modified adjusted gross income limits as discussed above for the Hope Credit. That is, the credit is phased out for modified adjusted gross income from $40,000 to $50,000 ($80,000 to $100,000 for married filing jointly).

Married Taxpayers. Married taxpayers are not allowed to claim the Lifetime Learning Credit unless they file a joint income tax return for the year [I.R.C. §25A(g)(6)].

Hope Scholarship Credit or Education IRA Distribution Exclusion. The Lifetime Learning Credit cannot be claimed for a tax year in which the Hope Scholarship Credit is claimed for the same student or in a year in which a distribution from the student's Education IRA is excluded from income.

Example 18. Jim and Sandra Scott have one child, Jennifer, who entered college in August 1999. She has $10,000 of qualified higher education expenses in 1999. Jim also attends college and has $2,000 of qualified higher education expenses in 1999. Jim and Sandra have $78,000 of modified adjusted gross income on their joint 1999 income tax return.

Jim and Sandra can claim the maximum $1,500 Hope Credit for Jennifer and a $400 Lifetime Learning Credit for Jim, as shown on Form 8863 below.

Form **8863** — Department of the Treasury, Internal Revenue Service

Education Credits (Hope and Lifetime Learning Credits)

► See instructions on pages 3 and 4. ► Attach to Form 1040 or Form 1040A.

OMB No. 1545-1618 — 1999 — Attachment Sequence No. 51

Name(s) shown on return: *Jim and Sandra Scott (Example 18)* — Your social security number: *777 777 7777*

Part I **Hope Credit**

1 (a) Student's name (First, Last)	(b) Student's social security number	(c) Qualified expenses (but **do not** enter more than $2,000 for each student). See instructions	(d) Enter the **smaller** of the amount in column (c) or $1,000	(e) Subtract column (d) from column (c)	(f) Enter one-half of the amount in column (e)
Jennifer Scott	*100 00 0000*	*2,000*	*1,000*	*1,000*	*500*
2 Add the amounts in columns (d) and (f)		2	*1,000*		*500*

3 Add the amounts on line 2, columns (d) and (f) ► **3** *1,500*

Part II **Lifetime Learning Credit**

Caution: *You cannot take the Hope credit and the lifetime learning credit for the same student.*

4 (a) Student's name — First	Last	(b) Student's social security number	(c) Qualified expenses. See instructions
Jim	*Scott*	*777 77 7777*	*2,000*

5 Add the amounts on line 4, column (c), and enter the total	5	*2,000*
6 Enter the **smaller** of line 5 or $5,000	6	*2,000*
7 Multiply line 6 by 20% (.20) ►	7	*400*

Part III **Allowable Education Credits**

8 Add lines 3 and 7			8	*1,900*
9 Enter: $100,000 if married filing jointly; $50,000 if single, head of household, or qualifying widow(er)	9	*100,000*		
10 Enter the amount from Form 1040, line 34 (or Form 1040A, line 19)*	10	*78,000*		
11 Subtract line 10 from line 9. If line 10 is greater than or equal to line 9, **stop;** you cannot take any education credits	11	*22,000*		
12 Enter: $20,000 if married filing jointly; $10,000 if single, head of household, or qualifying widow(er)	12	*20,000*		
13 If line 11 is greater than or equal to line 12, enter the amount from line 8 on line 14 and go to line 15. If line 11 is less than line 12, divide line 11 by line 12. Enter the result as a decimal (rounded to at least three places)			13	× .
14 Multiply line 8 by line 13 ►			14	*1,900*
15 Enter your tax from Form 1040, line 40 (or Form 1040A, line 25)			15	*11,920*
16 Enter the total, if any, of your credits from Form 1040, lines 41 and 42 (or from Form 1040A, lines 26 and 27)			16	*0*
17 Subtract line 16 from line 15. If line 16 is greater than or equal to line 15, **stop;** you cannot take any education credits			17	*11,920*
18 **Education credits.** Enter the **smaller** of line 14 or line 17 here and on Form 1040, line 44 (or Form 1040A, line 29) ►			18	*1,900*

Effect on Other Income Tax Provisions

As with the Hope Credit, any qualified higher education expenses used in determining the Lifetime Learning Credit cannot be used to calculate the interest exclusion from U.S. savings bonds on Form 8815.

Effect on Student Financial Assistance

As with the Hope Credit, the Lifetime Learning Credit claimed by a student's parents (or by a student) is likely to increase the family's expected contribution for the **following school year by 47%** (or 50%) **of the credit**. See Example 14 above.

REPORTING THE HOPE SCHOLARSHIP CREDIT AND LIFETIME LEARNING CREDIT

The Hope Scholarship Credit and the Lifetime Learning Credit are not automatic credits. No credit is allowed under either provision unless the taxpayer **elects** to have them apply [I.R.C. §25A(e); Prop. Reg. §1.25A-1(d)].

The credits are elected by filing Form 8863 with the taxpayer's individual income tax return that is timely filed (including extensions) or with an amended return filed within the statute of limitations period [Notice 99-32].

Example 19. Ike and Tina Turner are married and file a joint tax return. In 1999 they have two children in college: David was a second semester junior prior to the beginning of 1999, and Jennifer was a second semester sophomore prior to the beginning of 1999. For 1999, Ike and Tina have $85,000 of modified adjusted gross income and claim David and Jennifer as dependents on their joint return. In August 1999 Ike and Tina paid $2,000 of qualified expenses for David and $3,000 of qualified expenses for Jennifer. In December 1999 they paid $2,100 of qualified expenses for David and $3,150 of qualified expenses for Jennifer for their spring 2000 semesters that begin in January 2000.

Ike and Tina, their children, and the colleges they attend meet all of the requirements for the higher education credits. Because Jennifer had **not** completed two years of post-secondary education prior to 1999, her expenses qualify for the Hope Credit. David had completed two years of post-secondary education prior to 1999, so his expenses **do not** qualify for the Hope Credit, but they **do** qualify for the Lifetime Learning Credit.

The expenses Ike and Tina paid in December 1999 for the spring 2000 semester qualify for the 1999 credits **because the term for which they were paid begins in the first three months of the next tax year**. Therefore, Ike and Tina have $4,100 ($2,000 + $2,100) of qualified expenses with respect to David and $6,150 ($3,000 + $3,150) of qualified expenses with respect to Jennifer.

The credit for Jennifer is the maximum $1,500. The credit for David is 20% of $4,100, or $820. Ike and Tina's total credit is $2,320 before the modified adjusted gross income limit is applied, which limits their credit to $1,740.

Ike and Tina claim their education credit by filling out Form 8863 and attaching it to their Form 1040 for 1999. They also report the credit on line 44 of Form 1040.

Form **8863**

Department of the Treasury
Internal Revenue Service

Education Credits
(Hope and Lifetime Learning Credits)

▶ See instructions on pages 3 and 4. ▶ Attach to Form 1040 or Form 1040A.

OMB No. 1545-1618
1999
Attachment Sequence No. 51

Name(s) shown on return: *Ike and Tina Turner (Example 19)*

Your social security number: *001 25 8863*

Part I **Hope Credit**

1	(a) Student's name First, Last	(b) Student's social security number	(c) Qualified expenses (but **do not** enter more than $2,000 for each student). See instructions	(d) Enter the **smaller** of the amount in column (c) or $1,000	(e) Subtract column (d) from column (c)	(f) Enter one-half of the amount in column (e)
	Jennifer Turner	*002 25 8863*	*2,000*	*1,000*	*1,000*	*500*
2	Add the amounts in columns (d) and (f)		2	*1,000*		*500*
3	Add the amounts on line 2, columns (d) and (f) . . . . . . ▶				3	

Part II **Lifetime Learning Credit**

4	(a) Student's name First, Last	(b) Student's social security number	(c) Qualified expenses. See instructions
	David Turner	*003 25 8863*	*4,100*

Caution: *You cannot take the Hope credit and the lifetime learning credit for the same student.*

5	Add the amounts on line 4, column (c), and enter the total	5	*4,100*
6	Enter the **smaller** of line 5 or $5,000	6	*4,100*
7	Multiply line 6 by 20% (.20) . . . . . . ▶	7	*820*

Part III **Allowable Education Credits**

8	Add lines 3 and 7			8	*2,320*
9	Enter: $100,000 if married filing jointly; $50,000 if single, head of household, or qualifying widow(er)	9	*100,000*		
10	Enter the amount from Form 1040, line 34 (or Form 1040A, line 19)*	10	*85,000*		
11	Subtract line 10 from line 9. If line 10 is greater than or equal to line 9, **stop;** you cannot take any education credits	11	*15,000*		
12	Enter: $20,000 if married filing jointly; $10,000 if single, head of household, or qualifying widow(er)	12	*20,000*		
13	If line 11 is greater than or equal to line 12, enter the amount from line 8 on line 14 and go to line 15. If line 11 is less than line 12, divide line 11 by line 12. Enter the result as a decimal (rounded to at least three places)			13	× *. 750*
14	Multiply line 8 by line 13 . . . . . . ▶			14	*1,740*
15	Enter your tax from Form 1040, line 40 (or Form 1040A, line 25)			15	*13,115*
16	Enter the total, if any, of your credits from Form 1040, lines 41 and 42 (or from Form 1040A, lines 26 and 27)			16	*0*
17	Subtract line 16 from line 15. If line 16 is greater than or equal to line 15, **stop;** you cannot take any education credits			17	*13,115*
18	**Education credits.** Enter the **smaller** of line 14 or line 17 here and on Form 1040, line 44 (or Form 1040A, line 29) . . . . . . ▶			18	*1,740*

Due Date of Election. The proposed regulations issued in January 1999 require the Hope Credit and Lifetime Learning Credits to be claimed on a timely filed (including extensions) tax return. Notice 99-32, issued in May 1999, says that the Treasury Department and the Service have determined that taxpayers should be able to make the election under I.R.C. §25A on an original or amended return.

Therefore, a taxpayer may elect to claim an education tax credit by attaching Form 8863 to either of the following:

1. A **timely filed original** Federal income tax return
2. An original Federal income tax return or an amended return filed after the due date of the return and **before the expiration of the period of limitation** for filing a claim for credit or refund for the taxable year in which the credit is claimed

> **Practitioner Note.** Neither the statutes nor the regulations say the election is irrevocable. Therefore, taxpayers apparently can switch between a Hope Credit and a Lifetime Learning Credit until the due date of an amended return.

EDUCATION IRAs [I.R.C. §530]

General Provisions

Education IRAs can be set up for future students to help pay the cost of going to college. Contributions to an education IRA are limited to $500 per year per child and are **not** deductible.

The tax benefit of the education IRA is that the earnings are never subject to income tax if they are used to pay qualified educational expenses.

Example 20. Chip is 6 years old, and his sister Dale is 9 years old. In December 1999 Chip and Dale's grandparents put $500 into an education IRA for Chip and $500 into an education IRA for Dale. Chip and Dale's grandparents get no deduction for the contributions. By 2008, each of the education IRAs has grown to $900. Dale withdraws all of the money from her education IRA and uses it for qualified education expenses. Dale does not have to include any of the $900 in her taxable income.

Limitations

$500 per Year. No more than $500 can be put into an education IRA or IRAs for a beneficiary in one calendar year. If amounts in excess of $500 and the earnings on the excess are **not** withdrawn by the due date of the beneficiary's return, the excess is subject to the 6% excess contribution penalty.

Example 21. Chip and Dale's parents (from Example 20) also put $500 into education IRAs for Chip and Dale in 1999. The $500 earned $10 of interest in 1999 and another $6 of interest in 2000 before the due date of Chip and Dale's income tax returns. If Chip and Dale do not withdraw $516 by the due date of their 1999 income tax returns, they must pay a $30 ($500 × 6%) penalty. Dale's penalty is reported on Form 5329, as shown on the next page.

The penalty applies every year the excess contribution remains in the account [I.R.C. §4973(e)(1)(C)].

> **Practitioner Note.** If the excess contribution and earnings are withdrawn by the due date of the beneficiary's return (including extensions), only the earnings are taxable. The distribution is reported on lines 15a and 15b of Form 1040.

Form **5329** Department of the Treasury Internal Revenue Service	**Additional Taxes Attributable to IRAs, Other Qualified Retirement Plans, Annuities, Modified Endowment Contracts, and MSAs** (Under Sections 72, 530, 4973, and 4974 of the Internal Revenue Code) ► Attach to Form 1040. See separate instructions.	OMB No. 1545-0203 **1999** Attachment Sequence No. **29**
Name of individual subject to additional tax. (If married filing jointly, see page 2 of the instructions.) *Dale (Example 21)*		**Your social security number** *530 01 5329*

Part V **Tax on Excess Contributions to Education (Ed) IRAs**
Complete this part if you contributed more to your Ed IRAs for 1999 than is allowable or you had an excess contribution on line 20 of your 1998 Form 5329.

26	Enter your excess contributions from line 20 of your 1998 Form 5329. If zero, go to line 31			26	
27	If your Ed IRA contributions for 1999 are less than your maximum allowable contribution, see page X; otherwise, enter -0-	27			
28	1999 distributions from your Ed IRAs, from Form 8606, line 28	28			
29	Add lines 27 and 28			29	
30	1998 excess contributions. Subtract line 29 from line 26. If zero or less, enter -0-			30	
31	Excess contributions for 1999. See page X			31	*500*
32	Total excess contributions. Add lines 30 and 31			32	
33	**Tax due.** Enter 6% (.06) of the **smaller** of line 32 **or** the value of your Ed IRAs on December 31, 1999. Also include this amount on Form 1040, line 53			33	*30*

Modified Adjusted Gross Income. The $500 limit is reduced if the **contributor's** modified adjusted gross income exceeds $95,000 ($150,000 for married taxpayers who file a joint return) and is zero if the contributor's modified adjusted gross income is $110,000 ($160,000 for married taxpayers who file a joint return).

Modified adjusted gross income is defined as adjusted gross income increased by any of the following:

1. The foreign earned income exclusion (I.R.C. §911)
2. The exclusion for income from Guam, American Samoa, or the Northern Mariana Islands (I.R.C. §931)
3. The exclusion for income from Puerto Rico (I.R.C. §933)

The $500 limit is reduced proportionately over the $15,000 phase-out range ($10,000 for married filing jointly).

Example 22. If Chip and Dale's grandparents from Example 20 have $154,000 of modified adjusted gross income, the **limit** on their contribution is calculated as follows on the worksheet from the Form 8606 instructions:

Ed IRA Contribution Worksheet (keep for your records)

1. Enter your modified AGI for purposes of figuring the contributions limit to an Ed IRA (see definition on page 2)	1 154,000
2. Enter $150,000 if married filing jointly; $0 if married filing separately; or $95,000 in the case of all other filers	2 150,000
3. Subtract line 2 from line 1. If zero or less, enter -0- on line 3, skip lines 4 through 6, and enter $500 on line 7	3 4,000
4. Enter $10,000 if married filing jointly; $15,000 in the case of all other filers. If the amount on line 3 is greater than or equal to the amount on line 4, stop here; you are not allowed to contribute to an Ed IRA for 1999. See Recharacterizations above	4 10,000
5. Divide line 3 by line 4 and enter the result as a decimal (rounded to at least 3 places)	5 .400
6. Multiply line 5 by $500	6 200
7. Subtract line 6 from $500. This is the maximum amount you may contribute to an Ed IRA for 1999	7 300

Note: The total Ed IRA contributions from all sources for the child during the tax year may not exceed $500.

If Chip and Dale do not withdraw the $200 excess contributions from their grandparents' contributions and the earnings on that $200 by the due date of their 1999 income tax return, they must report the $200 on line 20 of Form 5329 and pay a $12 excess contributions penalty. Form 5329 for Chip is shown below.

Form **5329**

Department of the Treasury
Internal Revenue Service

Additional Taxes Attributable to IRAs, Other Qualified Retirement Plans, Annuities, Modified Endowment Contracts, and MSAs
(Under Sections 72, 530, 4973, and 4974 of the Internal Revenue Code)
► Attach to Form 1040. See separate instructions.

OMB No. 1545-0203
1999
Attachment Sequence No. **29**

Name of individual subject to additional tax. (If married filing jointly, see page 2 of the instructions.) *Chip (Example 22)*

Your social security number *530 02 5329*

Part V **Tax on Excess Contributions to Education (Ed) IRAs**
Complete this part if you contributed more to your Ed IRAs for 1999 than is allowable or you had an excess contribution on line 20 of your 1998 Form 5329.

26	Enter your excess contributions from line 20 of your 1998 Form 5329. If zero, go to line 31			**26**	
27	If your Ed IRA contributions for 1999 are less than your maximum allowable contribution, see page X; otherwise, enter -0-	**27**			
28	1999 distributions from your Ed IRAs, from Form 8606, line 28	**28**			
29	Add lines 27 and 28			**29**	
30	1998 excess contributions. Subtract line 29 from line 26. If zero or less, enter -0-			**30**	
31	Excess contributions for 1999. See page X			**31**	*200*
32	Total excess contributions. Add lines 30 and 31			**32**	
33	**Tax due.** Enter 6% (.06) of the **smaller** of line 32 **or** the value of your Ed IRAs on December 31, 1999. Also include this amount on Form 1040, line 53			**33**	*12*

Observation. If excess contributions have been made by more than one taxpayer, the beneficiary should withdraw the contribution by the taxpayer who is subject to the greatest phase-out of the $500 limit.

Example 23. As in Example 21, Chip and Dale's grandparents and parents each contribute $500 to Education IRAs for Chip and for Dale. As in Example 22, their grandparents' modified adjusted gross income is $154,000. Chip and Dale's parents' modified adjusted gross income is $130,000.

Chip and Dale should withdraw their grandparents' $500 contribution. If they withdraw their parents' $500 contribution, they would still have to withdraw $200 of their grandparents' contribution, leaving only $300 in the Education IRA.

Observation. Families can choose among potential donors such as grandparents, parents, or the child to find a donor who is eligible to make the full $500 contribution to the education IRA. The donor is not required to have earned income, and there is no age restriction for the donor.

Example 24. Assume Chip and Dale's parents and grandparents both have more than $160,000 of modified adjusted gross income but that their grandparents want to make $500 contributions to Education IRAs. Their grandparents could give the $500 to Chip and Dale, respectively, and Chip and Dale could then contribute the $500 to Education IRAs.

Age of Beneficiary. Contributions can be made to the education IRA until the date the beneficiary turns 18 years old.

Qualified State Tuition Program Contribution. Contributions made to an education IRA in the same year that a contribution is made to a qualified state tuition program for the same beneficiary are excess contributions [I.R.C. §4973(e)(1)(B)].

Qualified Educational Expenses

Withdrawals from an education IRA are tax-free only if the beneficiary has qualified educational expenses equal to or greater than the withdrawal. Qualified educational expenses are defined more broadly for purposes of Education IRAs than for purposes of the education credits. For Education IRAs qualified higher education expenses are

1. Tuition and fees
2. Books, supplies and equipment
3. Amounts contributed to a qualified state tuition program
4. Room and board if the beneficiary is at least a half-time student at an eligible educational institution

> **Practitioner Note.** If the student lives at home, the amount allocated for room and board cannot exceed $1,500 per academic year. If the student lives off campus, the amount cannot exceed $2,500 [Prop. Reg. §1.529-1(c)].

If the qualified expenses are less than the amount withdrawn, the excess is allocated between the tax-free withdrawal of the original contribution and the taxable distribution of income earned on the original contribution. This computation is made separately for each Education IRA. The taxable amount is reported on Form 8606.

> **Practitioner Note.** A student can waive the income exclusion by checking a box on line 28 of the 1998 Form 8606. The waiver allows the Education IRA beneficiary to regain eligibility for the education credits for that year.

Example 25. In 1999 Linda Hand withdrew $520 from her Education IRA account. At the time she withdrew the money, the account had a balance of $570, which consisted of a $500 contribution in 1998 and $70 of interest income. No contributions were made to an Education IRA for Linda in 1999.

In 1999 Linda had $3,000 of tuition and fees and received $2,600 of scholarships that qualify for the I.R.C. §117 exclusion. Linda was less than a half-time student, so her room and board are not included in her qualified higher education expenses. Therefore, her qualified higher education expenses are $400 ($3,000 – $2,600).

Linda must report $15 of the withdrawal as income on line 29 of Form 8606 and on line 15b of Form 1040. The following Worksheet from the Form 8606 instructions is used to calculate the taxable amount and the basis in the amount remaining in Linda's Education IRA account.

Ed IRA Worksheet—Distributions and Bases (keep for your records)

If line 27 of Form 8606 is more than line 28 of that form, use this worksheet to figure the amount of taxable distributions you received from Ed IRAs in 1999. Also use this worksheet to figure your year-end basis in each of your Ed IRA accounts.

Tip: You may wish to complete this worksheet merely to figure your basis (even if you are not required to complete Part IV). It is to your advantage to keep track of your basis because it is used to figure the nontaxable part of future distributions.

A Enter the total of all amounts contributed in 1998 or 1999 to all Ed IRAs for which you are the beneficiary of the account ______500

Complete lines 1 through 15 separately for each of your Ed IRA accounts.

1. Enter the portion of line A above that was contributed to this account. 1.______500

2. Did you receive any distributions (withdrawals) during 1999 from this account?
   If "Yes," go to line 3.
   If "No," enter the amount from line 1 on line 15 and do not complete the remainder of this worksheet for this account.

3. Enter the total amount of all distributions (withdrawals) you received from this account in 1999. Do not include amounts rolled over within 60 days of receipt. See instructions	3.	520
4. Enter the amount of qualified higher education expenses (see instructions) that were paid for with distributions from this account.	4.	400
5. Subtract line 4 from line 3	5.	120
6. Enter the total value of this account as of 12/31/99 plus any outstanding rollovers. See instructions	6.	50
7. Add lines 3 and 6	7.	570
8. Divide line 1 by line 7 and enter the result as a decimal (rounded to at least 3 places). Do not enter more than "1.000"	8.	.8772
9. Multiply line 3 by line 8. This is the nontaxable portion of your Ed IRA distributions from this account	9.	456
10. Subtract line 9 from line 3	10.	64
11. Did you check the box on line 28 of the form? If "Yes," enter the amount from line 10 on line 14 and go to line 15. If "No," go to line 12.		
12. Divide line 4 by line 3 and enter the result as a decimal (rounded to at least 3 places). Do not enter more than "1.000"	12.	.7692
13. Multiply line 10 by line 12	13.	49
14. Subtract line 13 from line 10. This is the amount of taxable distributions you received from this account in 1999. Enter the result here and include it on line 29 of Form 8606	14.	15
15. Subtract line 9 from line 1. This is the basis in this Ed IRA account as of 12/31/99	15.	44

The $64 on line 10 is the portion of the distribution attributable to earnings. The $15 on line 14 is the portion of the earnings that was not used for qualified education expenses.

Form **8606** — Department of the Treasury, Internal Revenue Service (99)

Nondeductible IRAs

▶ **See separate instructions.**

▶ **Attach to Form 1040, Form 1040A, or Form 1040NR.**

OMB No. 1545-1007 — ~~1998~~ 1999 — Attachment Sequence No. **48**

Name. If married, file a separate Form 8606 for each spouse who is required to file Form 8606. See page 4 of the instructions. ***Linda Hand (Example 25)***

Your social security number ***530 03 8606***

Part IV **Distributions from Education (Ed) IRAs**

Before you begin, see page 6 if **(1)** the total Ed IRA contributions made for ~~1998~~ 1999 on behalf of the beneficiary are more than $500, or **(2)** the beneficiary had more than one Ed IRA account for ~~1998~~ 1999.

27	Enter the total Ed IRA distributions (withdrawals) received in ~~1998~~ 1999. Do not include amounts rolled over within 60 days of receipt	**27**	***520***
28	Do you choose to waive any exclusion you may be entitled to for your 1998 qualified higher education expenses (see page 7 before answering)? **Yes.** Check here ▶ ☐ and enter -0-. **No.** Enter your qualified higher education expenses for ~~1998~~ 1999.	**28**	***400***
29	**Taxable amount.** Is line 28 equal to or more than line 27? **Yes.** Enter -0-; none of your Ed IRA distributions are taxable for ~~1998~~ 1999. **No.** Enter the total of the amounts from line 14 of the worksheet on page 7 for each of your Ed IRA accounts. Also include this amount in the total on Form 1040, line 15b; Form 1040A, line 10b; or Form 1040NR, line 16b.	**29**	***15***

Note: *If you have a taxable amount on line 29, you may be subject to an additional 10% tax. See page 7 for details, including exceptions to the additional tax.*

10% Penalty for Taxable Withdrawal

Generally, the beneficiary must pay a 10% penalty tax on any **taxable** withdrawals from an Education IRA. However, there are several exceptions to this rule. The beneficiary **does not** have to pay the 10% penalty tax for the following withdrawals:

1. Withdrawals paid to a beneficiary (or to the estate of the designated beneficiary) on or after the death of the designated beneficiary.
2. Withdrawals made because the beneficiary is disabled. The beneficiary is considered to be disabled if he or she shows proof that he or she cannot do any substantial gainful activity because of his or her physical or mental condition. A physician must determine that the beneficiary's condition can be expected to result in death or to be of long-continued and indefinite duration.
3. Withdrawals made because the beneficiary received a qualified scholarship, an educational assistance allowance, or a payment for the beneficiary's educational expenses that is excludable from gross income to the extent the withdrawal is not more than the scholarship, allowance, or payment.
4. Withdrawals included in income only because the beneficiary waived the tax-free treatment of the withdrawal.
5. A return of an excess contribution (and any earnings on it) before the due date of the beneficiary's tax return (including extensions). If the beneficiary does not have to file a return, the excess (and any earnings) must be withdrawn by April 15 of the year following the year of the contribution.

Practitioner Note. Any income earned on the excess contribution must be included in the beneficiary's gross income for the tax year the contribution was made.

Rollovers and Changes in Beneficiary

Amounts distributed from an Education IRA are not subject to income tax or the 10% penalty tax if they are paid (within 60 days of the distribution) to another Education IRA for the benefit of the same beneficiary or a member of the beneficiary's family who is under age 30. This exclusion can be applied only once in each 12-month period ending on the date of the payment of distribution [I.R.C. §530(d)(5)].

Similarly, no tax is imposed on a change of beneficiary of an Education IRA if the new beneficiary is a member of the previous beneficiary's family and is under age 30 [§530(d)(6)].

Practitioner Note. There is no limit on the number of changes in beneficiary in a 12-month period, and the change in beneficiary does not count as a rollover for purposes of once-in-a-12-month-period limit.

Members of the Beneficiary's Family

The beneficiary's spouse and the following individuals (and their spouses) are members of the beneficiary's family:

1. The beneficiary's child, grandchild, or stepchild
2. A brother, sister, stepbrother, or stepsister of the beneficiary
3. A son or daughter of the beneficiary's brother or sister
4. The father, mother, grandfather, grandmother, stepfather, or stepmother of the beneficiary
5. A brother or sister of the beneficiary's father or mother
6. The beneficiary's son-in-law, daughter-in-law, father-in-law, mother-in-law, brother-in-law, or sister-in-law

Required Distributions

Beneficiary Reaches Age 30. The document that governs the Educational IRA must require the balance in the account to be distributed to the beneficiary within 30 days of the date on which the beneficiary becomes 30 years old. [I.R.C. §530(b)(1)(E)] If the distribution is **not made**, the balance in the account is deemed to be distributed to the beneficiary within 30 days after the date the beneficiary becomes age 30 [I.R.C. §530(d)(8)]. The earnings portion of the distribution is included in the beneficiary's income and is subject to a 10% penalty tax.

Rollover or change in beneficiary. If the balance in the account is rolled over or the beneficiary is changed to another member of the beneficiary's family before the beneficiary turns age 30, there is no deemed distribution when the original beneficiary turns age 30.

Example 26. Chuck Key has a $3,472 balance in his Education IRA on December 20, 2017, when he will turn age 30. The $3,472 consists of $3,000 of contributions and $472 of income. If Chuck does not transfer the account and the balance is not distributed to him, it will be treated as if it were distributed to him on January 19, 2018. Chuck has no qualified higher education expenses in 2018. Therefore he must include the $472 of earnings in his income on his 2018 tax return, as shown on the following Form 8606. He must also pay the 10% penalty tax on the $472, as shown on the following Form 5329.

Form **8606**
Department of the Treasury
Internal Revenue Service (99)

Nondeductible IRAs
► **See separate instructions.**
► **Attach to Form 1040, Form 1040A, or Form 1040NR.**

OMB No. 1545-1007
~~1998~~ 2018
Attachment Sequence No. **48**

Name. If married, file a separate Form 8606 for each spouse who is required to file Form 8606. See page 4 of the instructions.
Chuck Key (Example 26)

Your social security number
530 | 25 | 8606

Part IV **Distributions from Education (Ed) IRAs**

Before you begin, see page 6 if **(1)** the total Ed IRA contributions made for ~~1998~~ 2018 on behalf of the beneficiary are more than $500, or **(2)** the beneficiary had more than one Ed IRA account for ~~1998~~ 2018.

27	Enter the total Ed IRA distributions (withdrawals) received in ~~1998~~ 2018. Do not include amounts rolled over within 60 days of receipt	27	*3,472*
28	Do you choose to waive any exclusion you may be entitled to for your 1998 qualified higher education expenses (see page 7 before answering)? **Yes.** Check here ► ☐ and enter -0-. **No.** Enter your qualified higher education expenses for ~~1998~~ 2018.	28	*0*
29	**Taxable amount.** Is line 28 equal to or more than line 27? **Yes.** Enter -0-; none of your Ed IRA distributions are taxable for ~~1998~~ 2018. **No.** Enter the total of the amounts from line 14 of the worksheet on page 7 for each of your Ed IRA accounts. Also include this amount in the total on Form 1040, line 15b; Form 1040A, line 10b; or Form 1040NR, line 16b.	29	*472*
	Note: *If you have a taxable amount on line 29, you may be subject to an additional 10% tax. See page 7 for details, including exceptions to the additional tax.*		

Form **5329**

Department of the Treasury
Internal Revenue Service

Additional Taxes Attributable to IRAs, Other Qualified Retirement Plans, Annuities, Modified Endowment Contracts, and MSAs

(Under Sections 72, 530, 4973, and 4974 of the Internal Revenue Code)

▶ Attach to Form 1040. See separate instructions.

OMB No. 1545-0203

~~1999~~ 2018

Attachment Sequence No. **29**

Name of individual subject to additional tax. (If married filing jointly, see page 2 of the instructions.) *Chuck Key (Example 26)*

Your social security number *530 25 8606*

Part II **Tax on Certain Taxable Distributions From Education (Ed) IRAs**

Complete this part if you had a taxable amount on Form 8606, line 30.

Note: *You must include the entire taxable amount of the distribution on Form 1040, line 15b.*

5	Taxable distributions from your Ed IRAs, from Form 8606, line 30	5	*472*
6	Taxable distributions not subject to additional tax. See page 4	6	*0*
7	Amount subject to additional tax. Subtract line 6 from line 5	7	*472*
8	**Tax due.** Enter 10% (.10) of line 7. Also include this amount on Form 1040, line 53	8	*47*

Example 27. If Chuck rolls the balance in his Education IRA over to an Education IRA for his sister Mary Lou (age 25 in 2017) before December 20, 2017, he does not have to report any income or pay any penalty tax. However, Mary Lou is then entitled to all of the money in the account.

> **Practitioner Note.** The model trust account agreement (Form 5305-E) and the model custodial account agreement (Form 5305-EA) provided by the IRS both give the grantor the option of allowing the "responsible individual" (parent or guardian of the beneficiary) to change the beneficiary of the account. If the responsible individual for Chuck's account had that power, the responsible individual could change the beneficiary of the account to Mary Lou without Chuck's consent.

Death of Beneficiary. The rules governing an Education IRA must require the balance in the account when the beneficiary dies to be distributed within 30 days of the death of the beneficiary [I.R.C. §530(b)(1)(E)]. If no distribution is made, the account balance is deemed to be distributed 30 days after the date of death [I.R.C. §530(d)(8)].

The earnings portion of the distribution is not subject to the 10% penalty tax [I.R.C. §530(d)(4)(B)(i)]. However, it is subject to income tax unless the distribution goes to the spouse or a family member of the beneficiary who treats the distribution as his or her own Education IRA.

Example 28. Assume Chuck Key from Example 26 died on November 15, 2017, and his estate was named as the successor beneficiary of his Education IRA. Chuck's estate must include the $472 of income on its first income tax return (Form 1041). There is no 10% penalty tax on the $472.

Example 29. If Chuck's Education IRA (from Example 28) names his sister Mary Lou as the successor beneficiary, she can treat the Education IRA as her own. The income is not subject to income tax or the 10% penalty tax as a result of Chuck's death, because Mary Lou is under age 30.

Effect on Exclusion of Interest from U.S. Savings Bonds

The amount of qualified higher education expenses used to calculate the interest exclusion from U.S. savings bonds on Form 8815 is reduced by the amount of the expenses used to determine the exclusion for distributions from an Education IRA [I.R.C. §135(d)(2)].

PENALTY-FREE WITHDRAWAL FROM IRAS [I.R.C. §72(T)(2)(E)]

General Provisions

Beginning in 1998, taxpayers can withdraw money from an IRA (including the new Roth IRAs) without paying the 10% premature distribution penalty if the money is used to pay qualified educational expenses of the taxpayer, the taxpayer's spouse, or any child or grandchild of the taxpayer or the taxpayer's spouse.

Qualified educational expenses include tuition, fees, books, supplies, and equipment required for enrollment or attendance at an educational institution. Certain room and board expenses are also qualified educational expenses if the student is enrolled on at least a half-time basis.

Limitations

Qualified educational expenses must be reduced by any scholarship or other payment (other than a gift or inheritance) that is excluded from gross income by any provision in the Internal Revenue Code. For example, a scholarship that is excluded under I.R.C. §117 or any employer educational assistance that is excluded under I.R.C. §127 reduces qualified educational expenses.

Effect on Student Financial Assistance

A withdrawal from an IRA is treated as income for purposes of calculating a student's need for financial assistance. Under that formula, a withdrawal by a parent is likely to decrease the student's need-based assistance by 47% of the amount withdrawn.

Example 30. If Ben and May withdraw $2,000 from Ben's IRA in 1999 to pay some of their daughter's qualified educational expenses, their daughter's need-based financial assistance is **likely to decrease by $940** ($2,000 × 47%) for the 2000-2001 school year.

Ben reports the distribution on Form 5329, Part I, to show that he meets the exception to the premature distribution penalty.

Form **5329**

Department of the Treasury
Internal Revenue Service

Additional Taxes Attributable to IRAs, Other Qualified Retirement Plans, Annuities, Modified Endowment Contracts, and MSAs

(Under Sections 72, 530, 4973, and 4974 of the Internal Revenue Code)

► Attach to Form 1040. See separate instructions.

OMB No. 1545-0203

1999

Attachment Sequence No. **29**

Name of individual subject to additional tax. (If married filing jointly, see page 2 of the instructions.) ***Ben (Example 30)***

Your social security number ***072 29 5329***

Part I **Tax on Early Distributions**

Complete this part if a taxable distribution was made from your qualified retirement plan (including an IRA other than an education IRA), annuity contract, or modified endowment contract before you reached age 59½. (If a non-taxable distribution was incorrectly indicated as a taxable distribution on your Form 1099-R, see page 3 of the instructions.)
Note: *You must include the entire taxable amount of the distribution on Form 1040, line 15b or 16b.*

1	Early distributions included in gross income. For Roth IRA distributions, see page 3	1	*2,000*
2	Early distributions not subject to additional tax. See page 3 and enter the appropriate exception number from the instructions: *08*	2	*2,000*
3	Amount subject to additional tax. Subtract line 2 from line 1	3	*0*
4	**Tax due.** Enter 10% (.10) of line 3. Also include this amount on Form 1040, line 53	4	*0*
	Caution: *If any part of the amount on line 3 was a distribution from a SIMPLE retirement plan, you may have to include 25% of that amount on line 4 instead of 10%. See page 4.*		

> **Practitioner Note.** Many taxpayers misunderstand this provision. The IRA withdrawal is not excluded from income when it is used for qualifying educational expenses. Therefore, it is of no benefit to taxpayers who have attained age 59½.
>
> The penalty exception is limited to IRAs—it does not apply to employer plans. Taxpayers who take a distribution from a 401(k) plan must pay both the income tax and the premature distribution penalty.

DEDUCTION FOR INTEREST ON EDUCATION LOANS [I.R.C. §221; PROP. REG. §1.221-1]

General Provisions

Qualified education loan interest can be claimed as an adjustment to gross income beginning in 1998. The adjustment is not an itemized deduction, so it can be claimed in addition to the standard deduction or in addition to the itemized deductions.

Example 31. Bill Meelater paid $1,315 of qualified education loan interest in 1999. He reports the $1,315 deduction on line 24 of the 1999 Form 1040, as shown below.

Form **1040** Department of the Treasury– Internal Revenue Service
U.S. Individual Income Tax Return **1999** (99) IRS Use Only– Do not write or staple in this space.

For the year Jan. 1–Dec. 31, 1999, or other tax year beginning , 1999, ending , OMB No. 1545-0074

Label (See instructions on page 18.) Use the IRS	Your first name and initial	Last name	Your social security number
L A B E L	***Bill***	***Meelater (Example 31)***	***221 30 1040***
	If a joint return, spouse's first name and initial	Last name	Spouse's social security number

Adjusted Gross Income			
23	IRA deduction (see page 25)	23	
24	Student loan interest deduction (see page 27)	24	***1,315***
25	Medical savings account deduction. Attach Form 8853	25	
26	Moving expenses. Attach Form 3903	26	
27	One-half of self-employment tax. Attach Schedule SE	27	
28	Self-employed health insurance deduction (see page 28)	28	
29	Keogh and self-employed SEP and SIMPLE plans	29	

Qualified Education Loans. "Qualified education loan" means indebtedness incurred by a taxpayer **solely** to pay qualified higher education expenses that are

1. Incurred on behalf of a student who is the taxpayer, the taxpayer's spouse, or a dependent of the taxpayer at the time the indebtedness is incurred
2. Paid within a reasonable time before or after the indebtedness is incurred (generally, within 60 days before or after the academic term begins or ends)
3. Attributable to an academic period when the student is an eligible student (degree candidate carrying at least a half-time workload)
4. Not paid on a loan from a related party such as a parent or grandparent
5. Not paid on a loan from a qualified employer plan such as a 401(k) plan

Practitioner Note. The Internal Revenue Service Restructuring and Reform Act of 1998 added the provision that the loan must be used solely for qualified education expenses. Consequently, mixed-use loans do not qualify for the interest deduction.

Qualified Expenses. Qualified expenses are defined more broadly for purposes of qualified education loan interest than for other education provisions. The cost of attendance includes transportation, miscellaneous expenses, books, supplies, and room and board. The cost is reduced by nontaxable educational assistance.

Limitations

Dollar Limits. The deduction is limited to $1,000 in 1998, $1,500 in 1999, $2,000 in 2000, and $2,500 in 2001 and thereafter.

Adjusted Gross Income Phase-out. The deduction is phased out ratably for taxpayers with modified adjusted gross income between $40,000 and $55,000 ($60,000 and $75,000 for married individuals who file a joint return). The Internal Revenue Service Restructuring and Reform Act of 1998 conformed the definition of modified adjusted gross income for student loan interest to the definition used for the education credits.

Example 32. Rose Petal paid $1,800 in qualified education loan interest in 1999. She is single, and her total income (line 22 of Form 1040) is $44,500. She made a $2,000 contribution to her IRA in 1999. The maximum interest deduction of $1,500 is reduced to $1,250 because of the modified adjusted gross income limitation, as shown on the following worksheet from the Form 1040 instructions.

Student Loan Interest Deduction Worksheet—Line 24 (keep for your records)

Caution: If you file Form 2555, 2555-EZ, or 4563, or you are excluding income from sources within Puerto Rico, skip lines 3 and 4 below and see Pub. 970 to figure your modified AGI to enter on line 5 below.

1.	Enter the total interest you paid in 1999 on qualified student loans (defined on this page). Do not include interest that was required to be paid after the first 60 months	1. 1,800
2.	Enter the smaller of line 1 or $1,500	2. 1,500
3.	Enter the amount from Form 1040, line 22	3. 44,500
4.	Enter the total of the amounts from Form 1040, line 23, lines 25 through 31a, plus any amount you entered on the dotted line next to line 32	4. 2,000
5.	Modified AGI. Subtract line 4 from line 3 Note: If line 5 is $55,000 or more if single, head of household, or qualifying widow(er) or $75,000 or more if married filing jointly, stop here. You cannot take the deduction.	5. 42,500
6.	Enter: $40,000 if single, head of household, or qualifying widow(er); $60,000 if married filing jointly	6. 40,000
7.	Subtract line 6 from line 5. If zero or less, enter -0- here and on line 9, skip line 8, and go to line 10	7. 2,500
8.	Divide line 7 by $15,000. Enter the result as a decimal (rounded to at least three places)	8. 0.167
9.	Multiply line 2 by line 8	9. 250
10.	Student loan interest deduction. Subtract line 9 from line 2. Enter the result here and on Form 1040, line 24. Do not include this amount in figuring any other deduction on your return (such as on Schedule A, C, E, etc.)	10. 1,250

Rose reports the student loan interest deduction on line 24 of Form 1040, as shown below.

Form **1040** Department of the Treasury–Internal Revenue Service
U.S. Individual Income Tax Return **1999** (99) IRS Use Only–Do not write or staple in this space.

For the year Jan. 1–Dec. 31, 1999, or other tax year beginning , 1999, ending , OMB No. 1545-0074

Label (See instructions on page 18.)	Your first name and initial	Last name	Your social security number
	Rose	Petal (Example 32)	221 32 1040
	If a joint return, spouse's first name and initial	Last name	Spouse's social security number

	22	Add the amounts in the far right column for lines 7 through 21. This is your total income			22	44,500
Adjusted Gross Income	23	IRA deduction (see page 25)	23	2,000		
	24	Student loan interest deduction (see page 27)	24	1,250		
	25	Medical savings account deduction. Attach Form 8853	25			
	26	Moving expenses. Attach Form 3903	26			
	27	One-half of self-employment tax. Attach Schedule SE	27			
	28	Self-employed health insurance deduction (see page 28)	28			
	29	Keogh and self-employed SEP and SIMPLE plans	29			
	30	Penalty on early withdrawal of savings	30			
	31a	Alimony paid b Recipient's SSN	31a			
	32	Add lines 23 through 31a			32	3,250
	33	Subtract line 32 from line 22. This is your adjusted gross income			33	41,250

Observation. If Rose had paid only $1,000 of qualified student loan interest, the AGI phase-out rules would have reduced her deduction to $833. ($1,000 – ($1,000 × .167)).

60-Month Limit. The deduction is also limited to the interest paid during the **first 60 months in which interest payments are required** [I.R.C. §221(d)]. Months during which the qualified education loan is in deferral or forbearance **do not** count against the 60-month period [Prop. Reg. §1.221-1(e)(1)].

Example 33. Ruby Ring has a student loan. Interest accrues on the loan while she earns her undergraduate degree, but Ruby is not required to begin making payments of interest or principal until six months after she graduates. **Ruby's 60-month period begins six months after she graduates.**

If Ruby voluntarily pays interest **before** she is required to make the payments, the interest is **not** deductible, since it is paid before the 60-month period begins [Prop. Reg. §1.221-1(e)(5), Example 1].

Suspension of 60-month period. After the 60-month period begins, it is **suspended** for any period during which interest payments are not required **because the borrower has been granted a deferment or forbearance** [Prop. Reg. §1.221-1(e)(3)]. However, the 60-month period **is not suspended** if under the terms of the loan **all three** of the following occur:

1. Interest continues to accrue while the loan is in deferment or forbearance.
2. The taxpayer has the option of paying the interest as it accrues or allowing it to accumulate.
3. The taxpayer elects to pay the interest as it accrues.

Example 34. Everett Essence graduated from college in May 1998 and was required to begin making monthly payments on his student loan in November 1998. The interest on those payments qualifies for the qualified education loan deduction. In August 2000, Everett enrolled in a graduate program as a full-time student. Under the terms of his undergraduate loan, Everett does not have to make payments on his loan while he is a graduate student, but he can elect to do so.

If Everett makes the payments while he is a graduate student, the interest is deductible as qualified education loan interest and the 60-month period is not suspended. If Everett **does not** make the payments, the 60-month period **is suspended** until he elects or is required to make payments.

> **Practitioner Note.** If the loan is not issued or guaranteed under a federal loan program, the 60-month period will be suspended only if the student meets one of the conditions for forbearance under the federal student loan programs, such as half-time study at a post-secondary educational institution, study in an approved graduate fellowship program, or economic hardship [Prop. Reg. §1.221-1(e)(3)].

Refinanced loans. If a taxpayer refinances a loan, the new and the previous loans are treated as one loan for purposes of calculating the 60-month period [Prop. Reg. §1.221-1(h)(1)(i)].

Example 35. After making the required payments on her student loan for 20 months, Polly Esther took out a new loan from another bank and used the proceeds of the new loan to pay off the original loan. Polly has used up 20 months of the 60-month period and can deduct interest paid on the new loan for **only the next 40 months.**

Consolidated loans. If two or more student loans are consolidated or collapsed into one loan, the 60-month period for the new loan is the same as the 60-month period for the **most recent** loan.

Example 36. Otto Harp was required to make interest payments on a student loan from Last Chance Bank at the time he borrowed the money in December 1997. He was required to make payments on a student loan from his college beginning in November 1999—six months after he graduated. Otto borrowed money from New Start Bank in June 2000 and used the proceeds to pay off both his student loans. **The 60-month period for the new loan begins in November 1999.**

Late payments. A deduction is allowed for interest payments that were required in one month but actually made in a subsequent month within the 60-month period. No deduction is allowed for interest paid after the 60-month period.

Loan origination fees and capitalized interest. Loan origination fees and interest that is accrued and is added to the principal of the loan (capitalized) are treated as interest when they are paid. For purposes of this rule, payments on a loan are allocated as follows:

1. First, to newly accrued interest that is due on the date of the payment
2. Second, to loan origination fees or capitalized interest until such amounts are reduced to zero
3. Third, to principal

Example 37. Sara Bellum took out a $10,000 student loan on which $1,415 of interest accrued while she was in school. That interest was capitalized and added to the principal, resulting in a debt of $11,415 at the time she started making payments. She began making $226.03 monthly payments, as required by the terms of her loan, in August 1999. Her loan amortization for 1999 is as follows:

	Interest	Principal	Balance
August	$ 66.59	$159.44	$11,255.56
September	$ 65.66	$160.37	$11,095.18
October	$ 64.72	$161.31	$10,933.87
November	$ 63.78	$162.25	$10,771.63
December	$ 62.83	$163.20	$10,608.43
Total	$323.58	$806.57	

Sara can deduct the $806.57 of principal payments as well as the $323.58 of interest payments because accrued interest has been capitalized into the loan principal. She can continue to deduct principal payments as qualified education loan interest until the $1,415 of capitalized interest has been deducted.

Pre-1998 loans. If the loan repayment began before 1998, the 60-month period is used up by the months in the repayment before 1998 even though interest for those months cannot be deducted. A deduction is allowed only for that portion of the 60-month period that remains after December 31, 1997 [Prop. Reg. §1.221-1(e)(2)].

Dependents. A taxpayer cannot claim the deduction for a taxable year in which he or she is claimed as a dependent on another taxpayer's return [I.R.C. §221(c)]. Therefore, families should plan either to have the parents take out the loan or to have the student be independent of the parents by the time the interest is paid on the loans.

Practitioner Note. Interest can be deducted only if the taxpayer is obligated to make the interest payment.

Example 38. Carrie Okey paid $1,000 of interest on student loans in 1999. Only Carrie is required to make the payments. Carrie's parents properly claim her as a dependent on their 1999 income tax return. **Neither Carrie nor her parents can deduct the $1,000 of interest on their 1999 income tax return.**

Practitioner Note. Parents apparently have the option of forgoing the personal exemption deduction to allow their child to claim the qualified education loan interest deduction. While the proposed regulation for the interest deduction is not as explicit on this issue as the Hope Credit and Lifetime Learning Credit regulations, it does say, "An individual is not allowed a deduction under section 221 for a taxable year if the individual is a dependent (as defined in section 152) for whom a deduction **is claimed** on another taxpayer's federal income tax return" (emphasis added).

Observation. For parents who can claim the full personal exemption deduction, it is rarely good planning to forgo the personal exemption deduction on the parents' income tax return to claim the interest deduction on the student's return, because the personal exemption deduction exceeds the qualified education loan interest deduction. However, high-income parents may lose less than the student gains from this option if the parents' adjusted gross income phases out most or all of the personal exemption deduction.

Married Taxpayers. If the taxpayer is married at the end of the tax year, he or she must file a joint return to claim the interest deduction [I.R.C. §221(f)(2)].

No Double Deductions. Interest cannot be deducted as qualified education loan interest if it is allowable as a deduction under any other federal income tax provision [I.R.C. §221(f)(1)].

Effect on Student Financial Assistance

The interest deduction will **reduce** income that is used to calculate a student's financial need. Under the financial aid formula, the interest deduction is likely to **increase** need-based financial assistance for the next school year by 47% of the deduction if claimed on the parent's return or 50% of the deduction if claimed on the student's return.

Example 39. If Ben and May claim a $500 deduction for interest paid on a PLUS loan in 1999, their daughter's need-based financial assistance for the 2000–2001 school year is **likely to be increased by $235** ($500 × 47%).

CANCELLATION OF A STUDENT LOAN

Cancellation of indebtedness is generally taxable income. However, forgiveness of a student loan in return for certain community service is tax-free.

Qualifying Loans

To qualify for tax-free treatment, the student loan must contain a provision that all or part of the debt will be canceled if the student works for a certain period of time in certain professions for any of a broad class of employers [I.R.C. §108(f)]. The forgiveness is tax-free if the student loan is later canceled because the student agreed to this provision and performed the services required.

Such a loan must be made by one of the following:

1. The government–federal, state, or local, or an instrumentality, agency, or subdivision thereof
2. A tax-exempt public benefit corporation that has assumed control of a state, county, or municipal hospital, and whose employees are considered public employees under state law
3. An educational institution, if the loan is made under either of the following:

   a. An agreement with an entity described in (1) or (2) that provided the funds to the educational institution to make the loan
   b. A program of the educational institution that is designed to encourage students to serve in occupations or areas with unmet needs, and where the services required of the students are for or under the direction of a governmental unit or a tax-exempt section 501(c)(3) organization (In satisfying the community service requirement in (3)(b), the student must **not** provide services for the lender organization.)

Refinanced Loan

If a taxpayer refinances a student loan with another loan from an educational institution or certain tax-exempt organizations, that loan can also qualify for tax-free treatment of canceled debt. This is true if both of the following conditions are met:

1. The loan assists the student in attending the educational institution.
2. The loan is made under a program of the new lender that meets the conditions under paragraph (3)(b) above.

EXCLUSION FOR QUALIFIED STATE TUITION PROGRAMS [I.R.C. §529]

Certain states and agencies maintain programs that allow people to purchase credits or certificates or make contributions to an account to pay for future education. Contributions to a qualified state tuition program are not deductible, and withdrawals are taxable to the beneficiary to the extent they exceed the amount contributed to the program.

Observation. Since distributions are tax-free only to the extent of contributions and are taxable to the beneficiary, this provision provides income deferral and income shifting to the beneficiary but does not provide an income exclusion.

Qualified State Tuition Program

A qualified state tuition program:

1. Allows a person to
   a. Buy tuition credits or certificates for a designated beneficiary who would then be entitled to a waiver or payment of qualified higher educational expenses, **or**
   b. Make contributions to an account that is set up to meet the qualified higher educational expenses of a designated beneficiary of the account.
2. Requires all purchases or contributions to be made only in cash.
3. Prohibits the contributor and the beneficiary from directing the amount invested.
4. Allows a rollover or a change of beneficiary to be made only between members of the same family.
5. Imposes a penalty on any refund of earnings that does not meet at least one of the following conditions:
   a. The amount is used for qualified higher educational expenses of the beneficiary.
   b. The refund is made because of the death or disability of the beneficiary.
   c. The refund is made because the beneficiary received (and the refund is not more than) a scholarship, a veterans' educational assistance allowance, or another nontaxable payment (other than a gift, bequest, or inheritance) received for educational expenses.

Operational Overview

The definition of family member, qualified higher education expenses, and eligible educational institution are the same as those for Educational IRAs.

Distributions are allocated between return of previously taxed contributions and taxable earnings [I.R.C. §72(b)]. The tuition program establishes distribution requirements. There is no tax penalty for distributions that are not used for qualified educational expenses, because the tuition program is required to impose a penalty (item **5** above).

Taxable distributions are reported to the student on Form 1099G and should be included on line 21 of the student's Form 1040.

Effect on Other Income Tax Provisions

Since there is no income exclusion, distributions from state tuition programs do not impact use of the education credits or other benefits. Contributions to Education IRAs cannot be made in the same year for the same child as contributions to state tuition programs. Distributions from Educational IRAs and proceeds from eligible U.S. savings bonds can be contributed to state tuition programs tax-free.

EDUCATION SAVINGS BONDS [I.R.C. §135]

Interest received on the redemption of qualified U.S. savings bonds may be excluded from income if the taxpayer pays qualified higher educational expenses during the redemption year. The exclusion is computed on Form 8815.

Qualified U.S. Savings Bonds

A qualified U.S. savings bond is a series EE bond **issued after 1989** or a series I bond. The bond must be issued either in the name of the taxpayer or in the names of the taxpayer and his or her spouse. The taxpayer must be at least 24 years old before the bond's issue date.

Qualified Expenses

Qualified higher education expenses include the following items paid for the **taxpayer, the taxpayer's spouse, or a dependent for whom the taxpayer claims an exemption**:

1. Tuition and fees required to enroll at or attend an eligible educational institution (Qualified expenses **do not** include expenses for room and board or for courses involving sports, games, or hobbies that are not part of a degree program.)
2. Contributions to a qualified state tuition program
3. Contributions to an education IRA

Expenses Reduced by Certain Benefits. Qualified higher educational expenses must be reduced by the amount of any of the following benefits the student received.

1. Tax-free scholarships
2. Tax-free withdrawals from an education IRA
3. Any nontaxable payments (other than gifts, bequests, or inheritances) received for educational expenses or for attending an eligible educational institution, such as
   a. Veterans' educational assistance benefits
   b. Benefits under a qualified state tuition program
   c. Tax-free employer-provided educational assistance
4. Any expenses used in figuring the Hope and Lifetime Learning credits

Amount Excludable

If the **total proceeds (interest and principal)** from the qualified U.S. savings bonds **redeemed** during the year are **not more than** the taxpayer's qualified higher educational expenses for the year, the interest can be excluded. If the proceeds are **more** than the expenses, the taxpayer can exclude **only part** of the interest.

To determine the excludable amount, multiply the interest part of the proceeds by a fraction. The numerator of the fraction is the qualified higher educational expenses paid during the year, and the denominator of the fraction is the total proceeds received during the year.

Modified Adjusted Gross Income Limit. The interest exclusion is phased out if the taxpayer's modified adjusted gross income is between $53,100 and $68,100 (between $79,650 and $109,650 for joint returns). Modified adjusted gross income, for purposes of this exclusion, is adjusted gross income modified by adding back the following:

1. U.S. savings bond interest that is nontaxable because of qualified higher education expenses
2. Adoption benefits received under an employer's adoption assistance program
3. Foreign earned income of U.S. citizens or residents living abroad
4. Housing costs of U.S. citizens or residents living abroad
5. Income from sources within Puerto Rico, American Samoa, Guam, or the Northern Mariana Islands
6. Student loan interest

Claiming the Exclusion. Form 8815 is used to compute the exclusion. The exclusion is reported on Schedule B (Form 1040) or Schedule 1 (Form 1040A) and reduces taxable interest.

Example 40. Lloyd and Melba Watson are the parents of Laurie, who is a freshman (spring semester) and sophomore (fall semester) at Trinity College during 1999. Laurie's total tuition expense for 1999 is $14,000. Her parents paid $9,000 of that amount. Laurie receives a tax-free $5,000 scholarship from

Trinity College for the balance of the tuition. Her parents claim her as a dependent on their joint 1999 return. The 1999 modified adjusted gross income of Lloyd and Melba is $101,000.

Lloyd purchased Series EE U.S. savings bonds in his name in 1990, when he was 28 years old. He redeemed the bonds in January 1999. The proceeds from the redeemed bonds were $10,000 ($6,000 principal plus $4,000 interest). Lloyd did not report the interest as income as it accrued.

Question 1. *How much of the $4,000 savings bond interest income is excludable on the joint 1999 return of Lloyd and Melba?*

Answer 1. $1,037, as shown on line 14 of Lloyd and Melba's 1999 Form 8815 below.

Question 2. *Where is the $1,037 exclusion entered on Lloyd and Melba's 1999 return?*

Answer 2. Line 3 of Schedule B (Form 1040).

Question 3. *Are Lloyd and Melba eligible to claim the maximum $1,500 Hope Credit for Laurie's 1999 college expense?*

Answer 3. No. Their modified adjusted gross income exceeds the phase-out range for the Hope Credit. They cannot claim any Hope Credit for 1999.

Form **8815** Department of the Treasury Internal Revenue Service (99)	**Exclusion of Interest From Series EE and I U.S. Savings Bonds Issued After 1989** (For Filers With Qualified Higher Education Expenses) Attach to Form 1040 or Form 1040A.	OMB No. 1545-1173 **1999** Attachment Sequence No. 57
Name(s) shown on return	***Lloyd and Melba Watson (Example 40)***	Your social security number ***529 40 1040***

1 (a) Name of person (you, your spouse, or your dependent) who was enrolled at or attended an eligible educational institution	(b) Name and address of eligible educational institution
Laurie Watson	***Trinity College San Antonio, TX 78212***

If you need more space, attach a statement.

2	Enter the total qualified higher education expenses you paid in 1999 for the person(s) listed in column (a) of line 1. See the instructions to find out which expenses qualify			2	***9,000***
3	Enter the total of any nontaxable educational benefits (such as nontaxable scholarship or fellowship grants) received for 1999 for the person(s) listed in column (a) of line 1. See instructions			3	***0***
4	Subtract line 3 from line 2. If zero or less, stop. You cannot take the exclusion			4	***9,000***
5	Enter the total proceeds (principal and interest) from all series EE and I U.S. savings bonds issued after 1989 that you cashed during 1999			5	***10,000***
6	Enter the interest included on line 5. See instructions			6	***4,000***
7	If line 4 is equal to or more than line 5, enter "1.000." If line 4 is less than line 5, divide line 4 by line 5. Enter the result as a decimal (rounded to at least three places)			7	3 ***.900***
8	Multiply line 6 by line 7			8	***3,600***
9	Enter your modified adjusted gross income. See instructions Note: If line 9 is $68,100 or more if single or head of household, or $109,650 or more if married filing jointly or qualifying widow(er), stop. You cannot take the exclusion.	9	***101,000***		
10	Enter: $53,100 if single or head of household; $79,650 if married filing jointly or qualifying widow(er)	10	***79,650***		
11	Subtract line 10 from line 9. If zero or less, skip line 12, enter -0- on line 13, and go to line 14	11	***21,350***		
12	Divide line 11 by: $15,000 if single or head of household; $30,000 if married filing jointly or qualifying widow(er). Enter the result as a decimal (rounded to at least three places)			12	3 ***.712***
13	Multiply line 8 by line 12			13	***2,563***
14	Excludable savings bond interest. Subtract line 13 from line 8. Enter the result here and on Schedule B (Form 1040), line 3, or Schedule 1 (Form 1040A), line 3, whichever applies			14	***1,037***

EXCLUSION FOR EMPLOYER-PROVIDED EDUCATIONAL ASSISTANCE [I.R.C. §127]

Educational assistance benefits provided by an employer under an educational assistance program are tax-free, up to $5,250 each year.

Educational Assistance Program

To qualify as an educational assistance program, the plan must be written and meet certain other requirements.

Educational Assistance

Tax-free educational assistance benefits include payments by an employer for tuition, fees and similar expenses, books, supplies, and equipment. The payments must be for undergraduate-level courses that begin before June 1, 2000. The payments do not have to be for work-related courses. Educational assistance benefits do not include payments for the following items.

1. Meals, lodging, transportation, or tools or supplies (other than textbooks) that the employee can keep after completing the course of instruction
2. Education involving sports, games, or hobbies unless the education has a reasonable relationship to the business of the employer, or is required as part of a degree program
3. Graduate-level courses that began after June 30, 1996, and are normally taken under a program leading to a law, business, medical, or other advanced academic or professional degree

Benefit over $5,250

If an employer gives an employee more than $5,250 of educational assistance benefits during the year, the amount over $5,250 is generally taxable. The taxable amount should be included in the wages reported in box 1 of Form W-2. However, if the payments also qualify as a working condition fringe benefit, all of the payments can be excluded from the employee's wages. A working condition fringe benefit is a benefit that, had the employee paid for it, the employee could deduct as an employee business expense.

Expenses Paid with Benefits

Neither a deduction nor an education credit can be claimed for qualified educational expenses if the taxpayer received tax-free benefits under an employer's qualified educational assistance program.

Dependents of Employer

Not more than 5% of the amount paid by the employer for educational assistance can be provided to shareholders or owners who own more than 5% of the business or to the spouses or dependents of those shareholders or owners [I.R.C. §127(b)(3)].

PRACTITIONER QUESTIONS AND ANSWERS

Question and Answer 1

Facts. The parents of a college student are divorced. The father is allowed to claim the student as a dependent on his 1999 return, because he has custody. The mother pays the college tuition in 1999, because the father's business has cash flow problems.

Question. *Who is entitled to claim the Hope Credit in 1999?*

Answer. The father is allowed to claim the credit. The mother is a third-party payer, so her payments are treated as if she made a gift to the college student and the student paid the expenses. Expenses paid by a student are treated as paid by the student's parent if the student is claimed as a dependent by the parent [Prop. Reg. §1.25A-5(a)(1)].

> **Practitioner Note.** This answer to the question was changed by the proposed regulations. Question 14 on page 76 of the 1998 Income Tax Workbook gave a different answer for 1998 income tax returns based on information from IRS Publication 970.

Question and Answer 2

Question. *Can I take the Hope Credit for tuition only and use an Education IRA distribution for room and board only and still have the Education IRA distribution be nontaxable?*

Answer. No. A taxpayer can't take the Hope Credit or Lifetime Learning Credit in any year that the taxpayer receives a nontaxable Education IRA distribution.

Question and Answer 3

Facts. A student is finishing his second year at a junior college in the spring of 1999. He will enroll at a four-year college starting his junior year in the fall of 1999. He has a 75% scholarship for tuition at junior college (out-of-pocket tuition is only $200). The Lifetime Learning Credit will be greater for 20% of the 1999 fall semester's tuition at the four-year college.

Question. *Can the student (or his parents) choose which education credit to take?*

Answer. Yes. The student (or his parents) can choose which credit to take, but he does not have to choose under these facts. Since he had not completed his sophomore year before the beginning of 1999, he is eligible to claim the Hope Credit for both his expenses at the junior college in the spring of 1999 and his expenses at the four-year college in the fall of 1999.

Question and Answer 4

Question. *Can you take the Lifetime Learning Credit for college classes being deducted on Schedule C as business expense?*

Answer. No. You can't take both the deduction on Schedule C and the credit on Form 8863 for the same expense [I.R.C. §25A(g)(5)].

Question and Answer 5

Question. *Can parents who will be unable to take the Hope Credit because of their high income allow a child to pay for her own first two years of college—or gift her some money—so that the child will claim her own personal exemption deduction and get the Hope Credit on the child's return?*

Answer. Yes, if the child provides more than half of her support, she can claim her own personal exemption deduction and the Hope Credit.

> **Practitioner Note.** The IRS could possibly argue that the gifts were a sham and deny the claim that the children provided over half of their own support.

Even if the parents pay for more than half of their children's support and are therefore eligible to claim their children as dependents, they can choose not to claim their children as dependents. That would allow their children to claim the Hope Credit based on qualified expenses paid by both the parents and the children. **However, no one would be allowed to claim the personal exemption deduction.**

> **Observation.** Benefits from either the personal exemption deduction or the education credit have value only to the extent the student has taxable income and tax liability. See the Individual and Small Business Problems chapter for more information on this tax planning decision.

Question and Answer 6

Question. *If a child earns college credit while in high school and starts college in the sophomore year, does he or she qualify for two years of Hope Credit or only one?*

Answer. If the college credit was earned by taking college classes while in high school, the classes will count as part of the two-year limit for post-secondary education. However, if the student is still classified as a sophomore after the fall semester, the Hope Credit can be claimed for the first fall semester of college in one tax year and for the spring and fall semesters in the next tax year.

Example 1. A student is awarded college credit for classes she took in high school and is classified as a first-semester sophomore when she begins college in the fall of 1999. At the end of the semester, she is classified as a second-semester sophomore. The Hope Credit can be claimed for her qualified expenses in the fall of 1999 on her (or her parents') 1999 income tax return. The Hope Credit can be claimed for her qualified expenses in the spring and fall of 2000 on her (or her parents') 2000 income tax return, because she had not completed her sophomore year before the beginning of 2000.

If the college credits were earned by taking **proficiency exams,** they **do not count** as part of the two-year limit for post-secondary education.

Example 2. A student is awarded college credit for **advanced placement exams** he took before he entered college and is classified as a first-semester sophomore when he begins college in the fall of 1999. For purposes of the Hope Credit, the credits awarded by exam are not counted. Therefore, assuming the student takes a normal course load in the fall of 1999 and the spring and fall of 2000, he will still be a sophomore at the end of 2000. Consequently, if the Hope Credit is not claimed for his expenses in the fall of 1999, the Hope Credit can be claimed for his expenses in the spring and fall of 2001 (as well as the spring and fall of 2000), because he is treated as not completing his sophomore year prior to the beginning of 2001.

Question and Answer 7

Facts. A student is enrolled in college. His parents pay the tuition and room and board. The student quits before the semester is completed.

Question. *Are the parents entitled to claim either of the education credits in this situation?*

Answer. Apparently yes. The expenses must be paid for **"attendance"** at a qualified institution [I.R.C. §25A(f)(1)(A)]. There is no requirement that the courses be **completed.** Notice 97-60, Answer #3 states that the "student must be **enrolled at least half-time** in a program leading to a degree, certificate, or other recognized educational credential." This eligibility requirement applies to both the Hope Credit and the Lifetime Learning Credit.

Question and Answer 8

Facts. A student paid $8,000 in tuition and fees and $8,000 in other costs. She received $7,000 of nontaxable grants and scholarships.

Question. *How much is eligible for the education credits?*

Answer. The excluded grants and scholarships are applied to the tuition and fees first, leaving $1,000 eligible for the Hope Credit or Lifetime Learning Credit.

Question and Answer 9

Facts. The expenses in the left-hand column were paid with the funds shown in the right-hand column:

Expenses:		Paid with:	
Tuition	$3,000	School grant	$1,000
Fees	500	Pell Grant	2,000
Rm and bd	4,000	Student loan	4,000
Books	500	Out of pocket	1,000
Total	$8,000		$8,000

Question. *How much is eligible for the education credits?*

Answer. The expenses eligible for the credits are calculated as follows:

Eligible expenses		
Tuition	$3,000	
Fees	500	$3,500
Less grants		3,000
Eligible expenses for education credits		$ **500**

Question and Answer 10

Question. *Do Education IRA contributions need to be made before the end of the year?*

Answer. Apparently yes. Contributions "for the taxable year" must not exceed $500 [I.R.C. §530(b)(1)(A)(iii)]. There is no provision that allows contributions for the taxable year to be made by the due date of the return.

Question and Answer 11

Question. *Does a $500 contribution to an Education IRA by a parent reduce that parent's allowable contribution to a traditional IRA or Roth IRA to $1,500 instead of $2,000 for that year?*

Answer. No. Contributions to an Education IRA do not affect the $2,000 contribution limit for traditional or Roth IRAs.

Question and Answer 12

Facts. A retired couple with less than $100,000 in AGI established Education IRAs for their grandchildren in 1998.

Question. *Will the taxable portion of their conversion of their traditional IRA to a Roth IRA disqualify their contribution to Education IRAs in 1998 if the taxable portion causes their AGI to exceed $150,000?*

Answer. Yes. Modified adjusted gross income (AGI) for both the Hope and Lifetime Learning Credits and Education IRAs is adjusted gross income plus foreign income excluded under I.R.C. §911 and income from certain U.S. possessions excluded under I.R.C. §§931 and 933. Therefore, modified AGI includes the taxable portion of a traditional IRA conversion to a Roth IRA.

Question and Answer 13

Question. *If the parents' income is over $150,000, can a child contribute to his or her own Education IRA?*

Answer. Yes. Anyone can contribute to an individual's Education IRA.

Question and Answer 14

Question. *A grandparent who wants to fund a grandchild's college education wants to put money into her own Roth IRA instead of an Education IRA in the child's name, resulting in*

1. Tax-free earnings
2. $2,000 contribution per year (not $500)
3. Grandchild's lack of access to spend for frivolous items at 21 years
4. No effect on student financial aid

Is this a better way to save for a grandchild's education?

Answer. Roth IRAs may be a better way for some taxpayers. Note the following about the four advantages shown above:

1. The earnings that are distributed and used for higher education expenses are included in income unless they are made
   - **a.** On or after the date on which the owner turns age 59½
   - **b.** On or after the death of the owner
   - **c.** Because the owner is disabled
   - **d.** For the purchase of a first home

   Therefore, if none of the above requirements are met, the earnings that are distributed and used for higher education expenses will be subject to income tax even though they are not subject to the 10% penalty tax. Consequently, unless the grandparents are over age 59½ when the distribution is made, the Roth IRA provides tax-deferred rather than tax-free income.
2. The comparison is $500 per grandchild to $2,000 per grandparent. Therefore, depending on the number of grandchildren and the number of grandparents who have enough earned income to qualify for Roth IRA contributions, the Education IRAs may allow a greater amount to be contributed. Furthermore, the Roth IRA can be used **in addition to** the Education IRA, since the Education IRA contributions do not use up any of the $2,000 limit on Roth IRA contributions.

3./4. The question correctly notes that amounts in the grandparent's Roth IRA are not subject to frivolous spending by grandchildren and will not count as assets in the financial aid formula for need-based student financial assistance.

Question and Answer 15

Question. *Will a withdrawal from an IRA to prepay future higher education expenses for a son or daughter be excluded from the 10% early withdrawal penalty? What about using it to make payments on a student loan?*

Answer. No to both questions. The distribution is excluded from the 10% premature distribution penalty only to the extent the taxpayer has qualified higher education expenses for the taxable year [I.R.C. §72(t)(2)(E)].

Question and Answer 16

Question. *If you borrow money to fund a Qualified State Tuition Program, is the interest deductible?*

Answer. No. To be qualified student loan interest, the loan must be attributable to education furnished during a period when the recipient was an eligible student. Qualified education expenses must be attributable for a period when the student is at least a half-time student.

Question and Answer 17

Question. *Can a former student who has paid on a student loan for more than 60 months prior to 1/1/98 take out a new loan in 1998 to pay off the old student loan and then deduct the interest on the new loan for 60 months?*

Answer. No. Refinancing does not start a new 60-month period.

Question and Answer 18

Question. *For unsubsidized Stafford Loans, for which interest must be paid while in school but the repayment period does not begin until 6 months after graduation, is the deduction forgone if you are in school for 5 years (60 months)?*

Answer. No. The 60-month period begins when payments are required to begin.

Question and Answer 19

Question. *When does the 60-month student loan interest begin and end in the case of a married couple filing jointly when both spouses refinance their student loans by lumping them together and one spouse has exhausted fully or partially the 60 months?*

Answer. The deduction is allowed only for the **first 60 months** in which interest payments are required by the **original student loans** of the husband and wife. Interest is not deductible after the expiration of the 60-month period. Refinancing a student loan after the 60-month period **will not** extend the deductible period. However, a deduction is allowed for interest payments made under refinancing within the 60-month limitation period. The consolidated loan provisions apply only to the loans of a **single** borrower; husband and wife are two borrowers.