

Chapter 1: Education

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Please note. Corrections were made to this workbook through January of 2016. No subsequent modifications were made. For clarification about acronyms used throughout this chapter, see the Acronym Glossary at the end of the Index.

For your convenience, in-text website links are also provided as shortURLs. Anywhere you see **uofi.tax/xxx**, the link points to the address immediately following in brackets.

EDUCATION CREDITS

Education credits help offset the cost of higher learning for taxpayers, their spouses, and their dependents. The two credits available in 2015 are the American opportunity credit and the lifetime learning credit.

AMERICAN OPPORTUNITY CREDIT

The American opportunity credit (AOC) expanded and renamed the Hope scholarship credit starting in the 2009 tax year. It is set to expire on December 31, 2017.¹ The important features of the AOC include the following.²

- The maximum amount of the AOC per eligible student is \$2,500 (100% of the first \$2,000 of qualifying expenses and 25% of the next \$2,000).
- The AOC is available for the first **four** years of postsecondary education in a degree or certificate program.
- The AOC is available for **only four tax years** per eligible student (including any years the Hope scholarship credit was claimed).
- Eligible expenses for purposes of the AOC include tuition, fees, and costs of course materials paid during the tax year.
- The phaseout range for the AOC is \$80,000 to \$90,000 for a single taxpayer and \$160,000 to \$180,000 for a married couple filing jointly.
- Forty percent of the AOC is **refundable**, although none of this credit is refundable to those taxpayers subject to the kiddie tax.

¹ IRC §25A(i).

² *American Opportunity Tax Credit: Questions and Answers*. Feb. 6, 2015. [www.irs.gov/uac/American-Opportunity-Tax-Credit:-Questions-and-Answers] Accessed on May 20, 2015.

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Eligible Students

For purposes of the AOC, eligible students must meet all the following requirements.³

- The student did not have expenses that were used to calculate the AOC (or Hope credit) in any **four** earlier tax years.
- The student has not completed the first four years of postsecondary education. **Years** in this context refers to the class standing of the student with the educational institution. The student's class standing at the beginning of the calendar year is used for purposes of this requirement.
- The student is enrolled **at least half time** in a degree, certificate, or other credential program for at least one academic period during the year.
- The student is free of any federal or state felony conviction for possessing or distributing a controlled substance.

Qualified Expenses

Qualified higher education expenses (QHEE) for the AOC are tuition and related expenses required for enrollment or attendance at an **eligible educational institution**.

QHEE must be paid **on behalf of** the taxpayer, the taxpayer's spouse, or the taxpayer's dependent for whom the taxpayer claims an exemption.⁴ If the taxpayer claims an exemption for a dependent who is an eligible student, then the taxpayer can claim the AOC but the dependent cannot. Conversely, if a taxpayer does not claim an exemption for a dependent who is an eligible student (even if entitled to the exemption), then the dependent may claim the nonrefundable portion of the AOC but the taxpayer cannot claim any portion of the AOC.⁵

Note. If the taxpayer claims an exemption for a dependent who is an eligible student, then qualified expenses paid by the dependent or another party are treated as paid by the taxpayer.⁶

Student activity fees are included as QHEE only if they must be paid to the educational institution **as a condition of enrollment or attendance**. Expenses for books, supplies, and equipment needed for a course of study are considered QHEE **even if** they are not purchased from the educational institution.

Room and board, insurance, medical fees, transportation, and personal expenses are **not** considered QHEE. This is true even if these expenses must be paid as a condition of enrollment or attendance at the educational institution. Educational expenses do not include expenses related to sports, games, and hobbies unless such activities are part of the student's degree program.⁷

³. IRS Pub. 970, *Tax Benefits for Education*.

⁴. IRC §25A(f)(1).

⁵. IRS Pub. 970, *Tax Benefits for Education*.

⁶. IRC §25A(g)(3).

⁷. IRC §25A(f)(1)(B).

QHEE must be reduced by all the following tax-free benefits to arrive at **adjusted qualified education expenses (AQEE)**.⁸

- Tax-free scholarships and fellowships
- Pell grants
- Expenses used to compute tax-free withdrawals from a Coverdell education savings account (ESA)
- Expenses used to compute tax-free withdrawals from a §529 plan
- Any other nontaxable payments (other than gifts and inheritances) received for educational expenses such as:
 - ♦ Veterans' educational assistance benefits
 - ♦ Employer-provided educational assistance

Educational expenses qualify in the tax year in which they are paid. Payments must be for education that begins during the tax year or in the first three months of the next tax year.⁹ If the taxpayer receives a **refund** of qualified education expenses for the current year, then the amount refunded reduces the AQEE.

Example 1. On December 1, 2014, Catrina received her tuition bill for the spring semester, which began January 12, 2015. Catrina paid the tuition bill in December. Therefore, she can claim the AOC for the qualified expenses relating to the spring semester on her **2014** return. If she waited until January to pay the tuition bill, then she cannot claim the credit for these expenses until she files her **2015** return.

Educational expenses paid with loan proceeds qualify in the tax year the **expenses are paid**, not in the year the loan is repaid. Loan proceeds disbursed directly to an educational institution are treated as paid on the date the institution credits the proceeds to the student's account.¹⁰

Eligible Educational Institutions

For purposes of the AOC, an eligible educational institution is any college, university, vocational school, or other postsecondary educational institution eligible to participate in a student aid program administered by the U.S. Department of Education.

Note. An online institution may qualify as an eligible educational institution.

Income Limitations

The AOC is phased out for higher-income taxpayers based on modified adjusted gross income (MAGI). MAGI is adjusted gross income (AGI) with the following additions.¹¹

- Foreign-earned income and foreign housing exclusions and deductions
- Exclusion of income by bona fide residents of American Samoa and Puerto Rico¹²

The following phaseout ranges, which are not indexed for inflation, apply.¹³

Filing Status	Phaseout Range
Married filing jointly (MFJ)	\$160,000–\$180,000
Single, head of household (HoH), qualifying widow(er) (QW)	80,000– 90,000
Married filing separately (MFS)	Credit not available

⁸ IRS Pub. 970, *Tax Benefits for Education*.

⁹ IRC §25A(g)(4).

¹⁰ Treas. Reg. §1.25A-5(e)(3).

¹¹ IRS Pub. 970, *Tax Benefits for Education*.

¹² Rev. Proc. 2011-12, 2011-2 IRB 299.

¹³ IRC §25A(i)(4).

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Calculating the Credits

Form 8863, *Education Credits (American Opportunity and Lifetime Learning Credits)*, is used to compute both the AOC and the lifetime learning credit. The refundable portion of the AOC is calculated in part I, and the nonrefundable portion of the AOC is calculated in part II. Student and educational institution information is entered in part III.

Example 2. Barry Bickford is a single father with a MAGI of \$20,000 in 2014. His dependent, Bailey, attends Iowa State University. Bailey's 2014 qualified educational expenses are \$10,000, which is paid with a student loan. Barry's tax liability is zero, so he is not eligible to claim any portion of the nonrefundable credit. However, Barry is eligible to claim a refundable AOC of \$1,000 ($\$2,500 \times 40\%$).

Following is Barry's 2014 Form 8863.

Form 8863 <small>Department of the Treasury Internal Revenue Service (99)</small>	Education Credits (American Opportunity and Lifetime Learning Credits) Attach to Form 1040 or Form 1040A. Information about Form 8863 and its separate instructions is at www.irs.gov/form8863 .	OMB No. 1545-0074 <div style="font-size: 2em; font-weight: bold;">2014</div> Attachment Sequence No. 50
Name(s) shown on return Barry Bickford		Your social security number <div style="display: flex; justify-content: space-around;"> 123 45 6789 </div>



Complete a separate Part III on page 2 for each student for whom you are claiming either credit before you complete Parts I and II.

Part I Refundable American Opportunity Credit		
1 After completing Part III for each student, enter the total of all amounts from all Parts III, line 30	1	2,500
2 Enter: \$180,000 if married filing jointly; \$90,000 if single, head of household, or qualifying widow(er)	2	90,000
3 Enter the amount from Form 1040, line 38, or Form 1040A, line 22. If you are filing Form 2555, 2555-EZ, or 4563, or you are excluding income from Puerto Rico, see Pub. 970 for the amount to enter	3	20,000
4 Subtract line 3 from line 2. If zero or less, stop; you cannot take any education credit	4	70,000
5 Enter: \$20,000 if married filing jointly; \$10,000 if single, head of household, or qualifying widow(er)	5	10,000
6 If line 4 is: • Equal to or more than line 5, enter 1.000 on line 6 • Less than line 5, divide line 4 by line 5. Enter the result as a decimal (rounded to at least three places)	6	1.000
7 Multiply line 1 by line 6. Caution: If you were under age 24 at the end of the year and meet the conditions described in the instructions, you cannot take the refundable American opportunity credit; skip line 8, enter the amount from line 7 on line 9, and check this box <input type="checkbox"/>	7	2,500
8 Refundable American opportunity credit. Multiply line 7 by 40% (.40). Enter the amount here and on Form 1040, line 68, or Form 1040A, line 44. Then go to line 9 below.	8	1,000
Part II Nonrefundable Education Credits		
9 Subtract line 8 from line 7. Enter here and on line 2 of the Credit Limit Worksheet (see instructions)	9	1,500
10 After completing Part III for each student, enter the total of all amounts from all Parts III, line 31. If zero, skip lines 11 through 17, enter -0- on line 18, and go to line 19	10	0
11 Enter the smaller of line 10 or \$10,000	11	
12 Multiply line 11 by 20% (.20)	12	
13 Enter: \$128,000 if married filing jointly; \$64,000 if single, head of household, or qualifying widow(er)	13	
14 Enter the amount from Form 1040, line 38, or Form 1040A, line 22. If you are filing Form 2555, 2555-EZ, or 4563, or you are excluding income from Puerto Rico, see Pub. 970 for the amount to enter	14	
15 Subtract line 14 from line 13. If zero or less, skip lines 16 and 17, enter -0- on line 18, and go to line 19	15	
16 Enter: \$20,000 if married filing jointly; \$10,000 if single, head of household, or qualifying widow(er)	16	
17 If line 15 is: • Equal to or more than line 16, enter 1.000 on line 17 and go to line 18 • Less than line 16, divide line 15 by line 16. Enter the result as a decimal (rounded to at least three places)	17	.
18 Multiply line 12 by line 17. Enter here and on line 1 of the Credit Limit Worksheet (see instructions)	18	0
19 Nonrefundable education credits. Enter the amount from line 7 of the Credit Limit Worksheet (see instructions) here and on Form 1040, line 50, or Form 1040A, line 33	19	0

For Paperwork Reduction Act Notice, see your tax return instructions.

Cat. No. 25379M

Form **8863** (2014)

For Example 2

Form 8863 (2014)

Page 2

Name(s) shown on return

Barry Bickford

Your social security number

123 45 6789



Complete Part III for each student for whom you are claiming either the American opportunity credit or lifetime learning credit. Use additional copies of Page 2 as needed for each student.

Part III Student and Educational Institution Information

See instructions.

20 Student name (as shown on page 1 of your tax return) Bailey Bickford	21 Student social security number (as shown on page 1 of your tax return) 987 65 4321
22 Educational institution information (see instructions)	
a. Name of first educational institution Iowa State University	b. Name of second educational institution (if any)
(1) Address. Number and street (or P.O. box). City, town or post office, state, and ZIP code. If a foreign address, see instructions. 123 Blue St., Ames, IA 50011	(1) Address. Number and street (or P.O. box). City, town or post office, state, and ZIP code. If a foreign address, see instructions.
(2) Did the student receive Form 1098-T from this institution for 2014? <input checked="" type="checkbox"/> Yes <input type="checkbox"/> No	(2) Did the student receive Form 1098-T from this institution for 2014? <input type="checkbox"/> Yes <input type="checkbox"/> No
(3) Did the student receive Form 1098-T from this institution for 2013 with Box 2 filled in and Box 7 checked? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No	(3) Did the student receive Form 1098-T from this institution for 2013 with Box 2 filled in and Box 7 checked? <input type="checkbox"/> Yes <input type="checkbox"/> No
If you checked "No" in both (2) and (3) , skip (4) .	If you checked "No" in both (2) and (3) , skip (4) .
(4) If you checked "Yes" in (2) or (3) , enter the institution's federal identification number (from Form 1098-T). 3 0 - 9 9 9 9 9 9 9	(4) If you checked "Yes" in (2) or (3) , enter the institution's federal identification number (from Form 1098-T). - - - - -
23 Has the Hope Scholarship Credit or American opportunity credit been claimed for this student for any 4 tax years before 2014? <input type="checkbox"/> Yes — Stop! Go to line 31 for this student. <input checked="" type="checkbox"/> No — Go to line 24.	
24 Was the student enrolled at least half-time for at least one academic period that began or is treated as having begun in 2014 at an eligible educational institution in a program leading towards a postsecondary degree, certificate, or other recognized postsecondary educational credential? (see instructions) <input checked="" type="checkbox"/> Yes — Go to line 25. <input type="checkbox"/> No — Stop! Go to line 31 for this student.	
25 Did the student complete the first 4 years of post-secondary education before 2014? <input type="checkbox"/> Yes — Stop! Go to line 31 for this student. <input checked="" type="checkbox"/> No — Go to line 26.	
26 Was the student convicted, before the end of 2014, of a felony for possession or distribution of a controlled substance? <input type="checkbox"/> Yes — Stop! Go to line 31 for this student. <input checked="" type="checkbox"/> No — Complete lines 27 through 30 for this student.	



You cannot take the American opportunity credit and the lifetime learning credit for the same student in the same year. If you complete lines 27 through 30 for this student, do not complete line 31.

American Opportunity Credit

27 Adjusted qualified education expenses (see instructions). Do not enter more than \$4,000	27	4,000
28 Subtract \$2,000 from line 27. If zero or less, enter -0-	28	2,000
29 Multiply line 28 by 25% (.25)	29	500
30 If line 28 is zero, enter the amount from line 27. Otherwise, add \$2,000 to the amount on line 29 and enter the result. Skip line 31. Include the total of all amounts from all Parts III, line 30 on Part I, line 1	30	2,500

Lifetime Learning Credit

31 Adjusted qualified education expenses (see instructions). Include the total of all amounts from all Parts III, line 31, on Part II, line 10	31	
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Form 8863 (2014)

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LIFETIME LEARNING CREDIT

The **lifetime learning** credit is a **nonrefundable credit** calculated as 20% of the first \$10,000 of qualified educational expenses, resulting in a maximum credit of \$2,000 per year.¹⁴ The lifetime learning credit is allowed for **all years** of postsecondary education, including graduate and professional school.

Eligible Students

A student is considered eligible for the lifetime learning credit if the student is enrolled in one or more courses at an eligible educational institution.

The following persons **cannot claim** the lifetime learning credit.

- MFS taxpayers
- Anyone listed as a dependent on another taxpayer's tax return
- Taxpayers who are nonresident aliens and who do not elect to be treated as resident aliens

Note. Taxpayers cannot claim more than one credit or deduction for the same qualified expenses, or for the same student.

Eligible Educational Institutions

An eligible educational institution for purposes of the lifetime learning credit is any college, university, vocational school, or other postsecondary educational institution eligible to participate in student aid programs administered by the U.S. Department of Education.

Qualified Expenses

QHEE for the lifetime learning credit are generally the same as those allowed for the AOC. However, there are some important distinctions.

- Allowable courses for the lifetime learning credit include those taken to **acquire or improve job skills** in addition to those that are part of a postsecondary degree program.
- Student activity fees, as well as expenses for course-related books, supplies, and equipment, are included as QHEE for purposes of the lifetime learning credit only if they must be paid to the educational institution **for enrollment or attendance**.¹⁵

Income Limitations

The lifetime learning credit is phased out for higher-income taxpayers based on MAGI, as shown in the following table.

Filing Status	2014 Phaseout Range ¹⁶	2015 Phaseout Range ¹⁷
MFJ	\$108,000–\$128,000	\$110,000–\$130,000
Single, HoH, QW	54,000– 64,000	55,000– 65,000
MFS	Credit not available	Credit not available

¹⁴ IRC §25A(c)(1).

¹⁵ IRS Pub. 970, *Tax Benefits for Education*.

¹⁶ Rev. Proc. 2013-35, 2013-47 IRB 537.

¹⁷ Rev. Proc. 2014-61, 2014-47 IRB 860.

Calculating the Credits

Form 8863 is used to compute both the AOC and the lifetime learning credit. Part II of Form 8863 is used to calculate the lifetime learning credit.

Example 3. Kyle and Megan Potter file a joint return and have a 2014 MAGI of \$110,000. They paid \$10,000 of qualified education expenses during the year for their son, Clayton. Clayton is enrolled in graduate school. Kyle and Megan's MAGI is within the range in which the credit must be reduced. Therefore, they do not qualify for the maximum \$2,000 lifetime learning credit.

Kyle and Megan file the following Form 8863 to calculate and claim the lifetime learning credit. Kyle and Megan are entitled to a \$1,800 lifetime learning credit (line 19).

Form 8863 <small>Department of the Treasury Internal Revenue Service (99)</small>	Education Credits (American Opportunity and Lifetime Learning Credits) <small>► Attach to Form 1040 or Form 1040A.</small> <small>► Information about Form 8863 and its separate instructions is at www.irs.gov/form8863.</small>	<small>OMB No. 1545-0074</small> <div style="font-size: 2em; font-weight: bold;">2014</div> <small>Attachment Sequence No. 50</small>
Name(s) shown on return Kyle and Megan Potter		Your social security number <div style="display: flex; justify-content: space-between; width: 100%;"> 444 00 1122 </div>



Complete a separate Part III on page 2 for each student for whom you are claiming either credit before you complete Parts I and II.

Part I Refundable American Opportunity Credit			
1 After completing Part III for each student, enter the total of all amounts from all Parts III, line 30	1		
2 Enter: \$180,000 if married filing jointly; \$90,000 if single, head of household, or qualifying widow(er)	2		
3 Enter the amount from Form 1040, line 38, or Form 1040A, line 22. If you are filing Form 2555, 2555-EZ, or 4563, or you are excluding income from Puerto Rico, see Pub. 970 for the amount to enter	3		
4 Subtract line 3 from line 2. If zero or less, stop ; you cannot take any education credit	4		
5 Enter: \$20,000 if married filing jointly; \$10,000 if single, head of household, or qualifying widow(er)	5		
6 If line 4 is: • Equal to or more than line 5, enter 1.000 on line 6 • Less than line 5, divide line 4 by line 5. Enter the result as a decimal (rounded to at least three places)	6		
7 Multiply line 1 by line 6. Caution: If you were under age 24 at the end of the year and meet the conditions described in the instructions, you cannot take the refundable American opportunity credit; skip line 8, enter the amount from line 7 on line 9, and check this box <input type="checkbox"/>	7		
8 Refundable American opportunity credit. Multiply line 7 by 40% (.40). Enter the amount here and on Form 1040, line 68, or Form 1040A, line 44. Then go to line 9 below.	8		
Part II Nonrefundable Education Credits			
9 Subtract line 8 from line 7. Enter here and on line 2 of the Credit Limit Worksheet (see instructions)	9		
10 After completing Part III for each student, enter the total of all amounts from all Parts III, line 31. If zero, skip lines 11 through 17, enter -0- on line 18, and go to line 19	10	10,000	
11 Enter the smaller of line 10 or \$10,000	11	10,000	
12 Multiply line 11 by 20% (.20)	12	2,000	
13 Enter: \$128,000 if married filing jointly; \$64,000 if single, head of household, or qualifying widow(er)	13	128,000	
14 Enter the amount from Form 1040, line 38, or Form 1040A, line 22. If you are filing Form 2555, 2555-EZ, or 4563, or you are excluding income from Puerto Rico, see Pub. 970 for the amount to enter	14	110,000	
15 Subtract line 14 from line 13. If zero or less, skip lines 16 and 17, enter -0- on line 18, and go to line 19	15	18,000	
16 Enter: \$20,000 if married filing jointly; \$10,000 if single, head of household, or qualifying widow(er)	16	20,000	
17 If line 15 is: • Equal to or more than line 16, enter 1.000 on line 17 and go to line 18 • Less than line 16, divide line 15 by line 16. Enter the result as a decimal (rounded to at least three places)	17	.900	
18 Multiply line 12 by line 17. Enter here and on line 1 of the Credit Limit Worksheet (see instructions) ►	18	1,800	
19 Nonrefundable education credits. Enter the amount from line 7 of the Credit Limit Worksheet (see instructions) here and on Form 1040, line 50, or Form 1040A, line 33	19	1,800	

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For Example 3

Form 8863 (2014)

Page **2**

Name(s) shown on return

Kyle and Megan Potter

Your social security number

444 00 1122



Complete Part III for each student for whom you are claiming either the American opportunity credit or lifetime learning credit. Use additional copies of Page 2 as needed for each student.

Part III Student and Educational Institution Information

See instructions.

20 Student name (as shown on page 1 of your tax return) Clayton Potter	21 Student social security number (as shown on page 1 of your tax return) 555 11 2233
22 Educational institution information (see instructions)	
a. Name of first educational institution University of Illinois	b. Name of second educational institution (if any)
(1) Address. Number and street (or P.O. box). City, town or post office, state, and ZIP code. If a foreign address, see instructions. 999 Green St., Urbana, IL 61801	(1) Address. Number and street (or P.O. box). City, town or post office, state, and ZIP code. If a foreign address, see instructions.
(2) Did the student receive Form 1098-T from this institution for 2014? <input checked="" type="checkbox"/> Yes <input type="checkbox"/> No	(2) Did the student receive Form 1098-T from this institution for 2014? <input type="checkbox"/> Yes <input type="checkbox"/> No
(3) Did the student receive Form 1098-T from this institution for 2013 with Box <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No 2 filled in and Box 7 checked?	(3) Did the student receive Form 1098-T from this institution for 2013 with Box 2 <input type="checkbox"/> Yes <input type="checkbox"/> No filled in and Box 7 checked?
If you checked "No" in both (2) and (3) , skip (4) .	If you checked "No" in both (2) and (3) , skip (4) .
(4) If you checked "Yes" in (2) or (3) , enter the institution's federal identification number (from Form 1098-T). 3 6 - 1 2 3 4 5 6 7	(4) If you checked "Yes" in (2) or (3) , enter the institution's federal identification number (from Form 1098-T). - - - - -
23 Has the Hope Scholarship Credit or American opportunity credit been claimed for this student for any 4 tax years before 2014? <input checked="" type="checkbox"/> Yes — Stop! Go to line 31 for this student. <input type="checkbox"/> No — Go to line 24.	
24 Was the student enrolled at least half-time for at least one academic period that began or is treated as having begun in 2014 at an eligible educational institution in a program leading towards a postsecondary degree, certificate, or other recognized postsecondary educational credential? (see instructions) <input type="checkbox"/> Yes — Go to line 25. <input type="checkbox"/> No — Stop! Go to line 31 for this student.	
25 Did the student complete the first 4 years of post-secondary education before 2014? <input type="checkbox"/> Yes — Stop! Go to line 31 for this student. <input type="checkbox"/> No — Go to line 26.	
26 Was the student convicted, before the end of 2014, of a felony for possession or distribution of a controlled substance? <input type="checkbox"/> Yes — Stop! Go to line 31 for this student. <input type="checkbox"/> No — Complete lines 27 through 30 for this student.	



You cannot take the American opportunity credit and the lifetime learning credit for the same student in the same year. If you complete lines 27 through 30 for this student, do not complete line 31.

American Opportunity Credit

27 Adjusted qualified education expenses (see instructions). Do not enter more than \$4,000	27
28 Subtract \$2,000 from line 27. If zero or less, enter -0-	28
29 Multiply line 28 by 25% (.25)	29
30 If line 28 is zero, enter the amount from line 27. Otherwise, add \$2,000 to the amount on line 29 and enter the result. Skip line 31. Include the total of all amounts from all Parts III, line 30 on Part I, line 1	30

Lifetime Learning Credit

31 Adjusted qualified education expenses (see instructions). Include the total of all amounts from all Parts III, line 31, on Part II, line 10	31	10,000
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Form **8863** (2014)

REPORTING REFUNDS OF CREDITS ALREADY CLAIMED

Occasionally, a taxpayer receives tax-free educational assistance or a refund of tuition and fees after filing a return on which they claimed an educational credit. The taxpayer may have to repay some or all of the credit when this occurs.

COORDINATION OF CREDITS

The AOC and lifetime learning credit cannot be claimed simultaneously for the same student. However, planning when the credits will be claimed can result in increased tax savings over time.

Planning Tip. Usually, the academic school year begins in the fall. Therefore, it is possible to obtain five years of tax credits for only four years of school. Most colleges give students the option of paying for the spring semester in either December or January. When the option to pay in January is available, planning can result in tax savings.

Example 4. Kaitlyn enrolled for her first year at Noname University in August 2013. Her tuition is \$5,000 per semester. Each year, payment is due in August for the fall semester and in December or January for the spring semester. Kaitlyn pays the \$5,000 tuition every August and December. She can claim four years of AOC totaling \$10,000 (\$2,500 maximum credit × 4 years).

Example 5. Use the same facts as **Example 4**, except Kaitlyn meets with her accountant in November 2013 — a month before she plans to pay her spring tuition bill. Her accountant advises her to delay paying her spring tuition until January. With this adjustment, Kaitlyn's total education credits over the next five years will be \$11,000, as shown in the following chart, instead of \$10,000, as calculated in **Example 4**.

	2013	2014	2015	2016	2017	Total
Spring tuition	\$ 0	\$ 5,000	\$ 5,000	\$ 5,000	\$5,000	
Fall tuition	5,000	5,000	5,000	5,000	0	
Total AQEE	\$ 5,000	\$10,000	\$10,000	\$10,000	\$5,000	
AOC	\$ 2,500	\$ 2,500	\$ 2,500	\$ 2,500		\$10,000
Lifetime learning credit					\$ 1,000	1,000
Total credits						\$11,000

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Example 6. Kyle enrolled for his first year at Bigname University in August 2013. Kyle had a table tennis scholarship that paid all but \$500 of his tuition and fees for the 2013 fall semester. When filing his 2013 income tax return, Kyle claimed the AOC, which provided him with a \$500 credit.

In 2014, Kyle developed a case of table tennis elbow and can no longer play the sport. He lost his scholarship and must pay the full \$5,000 tuition each semester. When Kyle met with his accountant to discuss the preparation of his 2014 tax return, he mentioned the loss of his scholarship. Kyle's accountant suggested that he amend his 2013 tax return to claim the lifetime learning credit, which would preserve the AOC for the four years that Kyle must pay full tuition.

The following tables summarize the tuition paid and credit allowed under each alternative.

Prior to Amending

	2013	2014	2015	2016	2017	Total
Spring tuition	\$ 0	\$ 5,000	\$ 5,000	\$ 5,000	\$ 5,000	
Fall tuition	500	5,000	5,000	5,000	0	
Total AQEE	\$500	\$10,000	\$10,000	\$10,000	\$5,000	
AOC	\$500	\$ 2,500	\$ 2,500	\$ 2,500	\$ 0	\$8,000
Lifetime learning credit					1,000	1,000
Total credits						\$9,000

After Amending

	2013	2014	2015	2016	2017	Total
Spring tuition	\$ 0	\$ 5,000	\$ 5,000	\$ 5,000	\$5,000	
Fall tuition	500	5,000	5,000	5,000	0	
Total AQEE	\$500	\$10,000	\$10,000	\$10,000	\$5,000	
AOC		\$ 2,500	\$ 2,500	\$ 2,500	\$2,500	\$10,000
Lifetime learning credit	\$100					100
Total credits						\$10,100

Amending Kyle's 2013 return to claim the lifetime learning credit preserves the AOC for 2017. This allows Kyle to claim tuition credits totaling \$10,100 over five years, rather than the \$9,000 he could claim without amending the 2013 return.

COMPARING THE CREDITS

There are several differences and some similarities between the AOC and the lifetime learning credit, as shown in the following chart.¹⁸ Both credits can be claimed on the same return but not for the same student or the same qualified expenses.

Criteria	AOC	Lifetime Learning Credit
Maximum annual credit or benefit	\$2,500	\$2,000
Refundable or nonrefundable	40% of credit refundable	Not refundable
Limit on MAGI for MFJ taxpayers	\$180,000	\$130,000 for 2015
Limit on MAGI for single, HoH, and QW	\$90,000	\$65,000 for 2015
Number of years of postsecondary education available	Four	All years of postsecondary education and courses to acquire or improve job skills
Type of program required	Degree or other recognized education credential	No degree or education credential requirement
Number of courses	At least half time for at least one academic period in tax year	One or more courses
Felony drug conviction	No felony drug convictions at end of tax year	N/A
Qualified expenses	Tuition, required enrollment fees, and course materials for course of study	Tuition and fees required for enrollment or attendance
Who can the benefit be claimed for	Taxpayer, spouse, or dependent claimed on return	Taxpayer, spouse, or dependent claimed on return

Note. Practitioners should review educational benefits claimed in previous years to ensure they are maximizing educational tax benefits for the student. Amending returns for open years may be advisable.

¹⁸ *Compare Education Credits and Tuition and Fees Deduction*. Apr. 6, 2015. [www.etc.irs.gov/Other-Refundable-Credits/educompchart] Accessed on May 8, 2015. The chart has been modified and updated.

TUITION AND FEES DEDUCTION

The tuition and fees deduction can reduce AGI up to \$4,000. This tax incentive provides an above-the-line deduction for certain QHEE. It is claimed by filing Form 8917, *Tuition and Fees Deduction*. The deduction is **not allowed** if the taxpayer claims either the AOC or the lifetime learning credit for the same student.

Note. The tuition and fees deduction was set to expire at the end of 2013. However, in December 2014, Congress passed the Tax Increase Prevention Act of 2014. It extended the tuition and fees deduction through the end of 2014. At the time this chapter was published, it was uncertain whether this deduction would be extended for years beginning after 2014.

INCOME LIMITATIONS

The amount of the tuition and fees deduction varies based on the taxpayer's MAGI, as shown in the following table.¹⁹

2014 Tuition and Fees Deduction

Filing Status	MAGI Phaseout Range	Maximum Deduction
Single, HoH, QW	\$ 0– 65,000	\$4,000
MFJ	0–130,000	4,000
Single, HoH, QW	65,001– 80,000	2,000
MFJ	130,001–160,000	2,000
MFS	Deduction not available	Deduction not available

QUALIFIED EXPENSES

For the tuition and fees deduction, QHEE includes tuition and related expenses paid on behalf of the taxpayer, the taxpayer's spouse, or the taxpayer's dependent for whom an exemption is claimed.²⁰ Student activity fees and expenses for books, supplies, and equipment qualify only if the fees and expenses must be paid to the educational institution as a **condition of enrollment or attendance**. If the student withdraws from school, then the taxpayer can claim any portion of the tuition and fees that are not refunded.

As with the AOC and the lifetime learning credits, QHEE must be reduced by the following tax-free benefits to arrive at AQEE.

- Tax-free scholarships and fellowships²¹
- Pell grants²²
- Expenses used to compute tax-free withdrawals from Coverdell ESAs²³
- The excludable **income** portion of a distribution from a §529 plan²⁴

¹⁹ IRS Pub. 970, *Tax Benefits for Education*.

²⁰ IRC §222(d)(1).

²¹ IRS Pub. 970, *Tax Benefits for Education*.

²² Ibid.

²³ IRC §222(c)(2)(B).

²⁴ Ibid.

- Expenses used to compute tax-free interest from U.S. savings bonds²⁵
- Any other nontaxable payments (other than gifts and inheritances) received for educational expenses, such as:²⁶
 - ♦ Veterans' educational assistance
 - ♦ Employer-provided educational assistance

Example 7. DeeDee paid \$1,000 of qualified tuition and related expenses during the year. She also received a \$1,000 tax-free distribution from a Coverdell ESA. The Coverdell distribution includes contributions of \$800 and earnings of \$200.

DeeDee cannot deduct any part of the \$1,000 of the tuition and related expenses she paid. This is because QHEE is reduced by expenses used to compute the **tax-free portion of a Coverdell ESA distribution**. When Coverdell funds are used for education expenses, they are distributed tax free.

Example 8. Use the same facts as **Example 7**, except the distribution was from a §529 plan. The §529 plan distribution includes contributions of \$800 and earnings of \$200.

DeeDee's AQEE for purposes of the tuition and fees deduction is \$800. **This is because qualified expenses only have to be reduced by the income portion of a §529 plan distribution.**

ELIGIBILITY TO CLAIM THE DEDUCTION

Eligible Students

An eligible student is a student who is enrolled in one or more courses at an eligible educational institution. The eligible student **does not** have to be enrolled in school at least half time, in contrast to the AOC requirement. The eligible student must be the taxpayer, the taxpayer's spouse, or the taxpayer's dependent for whom an exemption is claimed.

Eligible Educational Institutions

An eligible educational institution is any college, university, vocational school, or other postsecondary educational institution eligible to participate in a student aid program administered by the U.S. Department of Education.

Other Requirements

The tuition and fees deduction is **not allowed** if any of the following apply.

- The tuition and fees are paid by the taxpayer's dependent.
- The taxpayer's filing status is **married filing separately**.²⁷
- The taxpayer or spouse is a **nonresident alien and did not elect to be treated as a resident alien** for tax purposes.²⁸
- The tuition and fees are being deducted under another Code provision.²⁹
- The taxpayer is **claiming an AOC or lifetime learning credit for the same student**.³⁰

²⁵ Ibid.

²⁶ IRS Pub. 970, *Tax Benefits for Education*.

²⁷ IRC §222(d)(4).

²⁸ IRC §222(d)(5).

²⁹ IRC §222(c)(1).

³⁰ IRC §222(c)(2)(A).

Eligibility for Deduction

To claim the tuition and fees deduction, the taxpayer must have paid qualified education expenses for an eligible student.

When the taxpayer claims an exemption for an eligible student, the tuition and fees deduction is calculated **using only those educational expenses paid by the taxpayer and their spouse**. If the taxpayer claims an exemption for an eligible student but the **student** paid the tuition and fees, then **no one** is allowed to claim the deduction.

Example 9. Michael's qualifying tuition and fees at Exel University were \$5,000 for 2014. Michael was enrolled in two classes for the spring semester and two classes for the fall semester. This is less than half-time enrollment at Exel. Michael paid \$2,000 of his tuition, and his mother, Beth, paid the remaining \$3,000. Beth's 2014 AGI before the tuition and fees deduction is \$64,500. She claims Michael as a dependent.

When Beth calculates her tuition and fees deduction for Michael's education expenses, she can only use the \$3,000 she paid. Michael is not eligible for the tuition and fees deduction for the \$2,000 that he paid because Beth claimed him as a dependent.

Note. Beth is not eligible to claim the AOC because Michael is not enrolled at least half time. She is also not eligible for the lifetime learning credit because her AGI is too high. Michael is not eligible for the lifetime learning credit because he is claimed as a dependent by Beth.

Any educational expenses paid by a **third party** (such as a grandparent, former spouse, or other relative) are **treated as paid by the student**. If the taxpayer **claims an exemption** for the eligible student, then **no one** is allowed to claim the tuition and fees deduction.

Example 10. Use the same facts as **Example 9**, except Michael's grandmother pays all of his qualifying tuition and fees. When Beth files her return and claims Michael as a dependent, she is not eligible to claim the tuition and fees deduction. Additionally, neither Michael nor his grandmother is eligible to claim the tuition and fees deduction.

Note. Michael's grandmother could provide a gift in the amount of the tuition and fees to Beth. Beth could then pay the expense for Michael. In this situation, Beth could claim the tuition and fees deduction.

If the taxpayer does not claim an exemption for the student but is **eligible** to do so, then no one is allowed to claim the tuition and fees deduction. This applies whether the expenses are paid by the taxpayer or the student.

When the taxpayer **does not claim an exemption** for the student and is **not eligible** to claim such an exemption, any educational expenses paid by the taxpayer or another person are treated as a gift to the student. The student can then use those educational expenses to calculate the tuition and fees deduction.

Example 11. Use the same facts as **Example 10**, except Michael cannot be claimed as a dependent on Beth's return. His MAGI for 2014 is \$27,000. Michael's income tax liability before credits is \$2,078. Michael can use his grandmother's \$5,000 payment of tuition and fees to calculate his 2014 tuition and fees deduction of \$4,000. His Form 8917 follows.

Note. Beth and Michael should consider all applicable education credits and deductions to maximize the education benefit.

Form 8917 Department of the Treasury Internal Revenue Service	Tuition and Fees Deduction ▶ Attach to Form 1040 or Form 1040A. ▶ Information about Form 8917 and its instructions is at www.irs.gov/form8917 .	OMB No. 1545-0074 2014 Attachment Sequence No. 60
Name(s) shown on return Michael Jones		Your social security number 444-55-6666

You cannot take both an education credit from Form 8863 and the tuition and fees deduction from this form for the same student for the same tax year.

Before you begin: ✓ To see if you qualify for this deduction, see *Who Can Take the Deduction* in the instructions below.

✓ If you file Form 1040, figure any write-in adjustments to be entered on the dotted line next to Form 1040, line 36. See the 2014 Form 1040 instructions for line 36.

1	(a) Student's name (as shown on page 1 of your tax return)	(b) Student's social security number (as shown on page 1 of your tax return)	(c) Adjusted qualified expenses (see instructions)
First name	Last name		
Michael Jones		444-55-6666	5,000
2 Add the amounts on line 1, column (c), and enter the total		2	5,000
3 Enter the amount from Form 1040, line 22, or Form 1040A, line 15		3	27,000
4 Enter the total from either:			
<ul style="list-style-type: none"> Form 1040, lines 23 through 33, plus any write-in adjustments entered on the dotted line next to Form 1040, line 36, or Form 1040A, lines 16 through 18. 		4	0
5 Subtract line 4 from line 3.* If the result is more than \$80,000 (\$160,000 if married filing jointly), stop ; you cannot take the deduction for tuition and fees		5	27,000
*If you are filing Form 2555, 2555-EZ, or 4563, or you are excluding income from Puerto Rico, see <i>Effect of the Amount of Your Income on the Amount of Your Deduction</i> in Pub. 970, chapter 6, to figure the amount to enter on line 5.			
6 Tuition and fees deduction. Is the amount on line 5 more than \$65,000 (\$130,000 if married filing jointly)?			
<input type="checkbox"/> Yes. Enter the smaller of line 2, or \$2,000.		}	
<input checked="" type="checkbox"/> No. Enter the smaller of line 2, or \$4,000.			
		6	4,000

Also enter this amount on Form 1040, line 34, or Form 1040A, line 19.

For Paperwork Reduction Act Notice, see your tax return instructions.

Cat. No. 37728P

Form **8917** (2014)

Claiming the Deduction

The tuition and fees deduction is claimed on Form 8917, *Tuition and Fees Deduction*, which is attached to the taxpayer's Form 1040, *U.S. Individual Income Tax Return*.

As with the AOC and the lifetime learning credit, **the taxpayer should use the incentive that provides the most advantageous tax treatment.** This choice becomes increasingly complex when the taxpayer has more than one dependent college student. Claiming a tuition and fees deduction for one of the dependent students reduces the taxpayer's AGI. This may result in a larger AOC or lifetime learning credit for the other student(s).

Note. Other considerations for opting to take the tuition and fees deduction instead of an education credit include:

- Reducing the state income tax liability for residents in states that compute taxable income based on the taxpayer's federal AGI,
- Increasing itemized deductions that are based on a percentage of AGI, and
- Lowering AGI to affect other items on the tax return.

Reporting Refunds of Tuition and Fees Already Claimed

Occasionally, a taxpayer receives tax-free educational assistance or a refund of tuition and fees after filing their return. The taxpayer may have to recapture (repay) the deduction when this occurs. Recapture is accomplished by reporting the amount refunded or the tax-free educational assistance received on the line for other income when filing Form 1040 for the year in which the refund or assistance was received. An example of this situation is shown later in this chapter.

QUALIFIED TUITION PROGRAMS

Qualified tuition programs (QTP) are also called **section 529 plans**. IRC §529 grants special tax status to qualified educational savings programs that allow taxpayers to prepay or contribute to an account for paying a student's education expenses at a postsecondary institution. QTPs are established and maintained by either a state government or an eligible educational institution.

A taxpayer cannot deduct payments or contributions to a QTP. **However, no tax is due on QTP distributions unless the amount distributed exceeds the beneficiary's AQEE.**

Note. QTPs were covered extensively in the 2014 *University of Illinois Federal Tax Workbook*, Volume B, Chapter 2: Individual Taxpayer Issues.

U.S. SAVINGS BONDS**INTEREST INCOME EXCLUSION**

Interest income from Series EE and Series I bonds issued after 1989 is excludable from gross income to the extent that the bond proceeds are used to pay for QHEE or are contributed to a QTP or Coverdell ESA for the benefit of the student.³¹ This exclusion is claimed on Form 8815, *Exclusion of Interest From Series EE and I U.S. Savings Bonds Issued after 1989*.

Qualified Expenses

QHEE for purposes of the interest income exclusion includes the following items paid on behalf of the taxpayer, the taxpayer's spouse, or the taxpayer's dependent for whom an exemption is claimed.

- Tuition and fees required to enroll at or attend an eligible educational institution³²
- Contributions to a Coverdell ESA (The earnings portion of the U.S. savings bonds is not included in the taxpayer's basis in the Coverdell ESA.)³³
- Contributions to a §529 plan (The earnings portion of the U.S. savings bonds is not included in the taxpayer's basis in the §529 plan.)³⁴

As with other education tax incentives, QHEE must be reduced by all the following tax-free benefits to arrive at AQEE.³⁵

- Tax-free scholarships and fellowships
- Expenses used to compute tax-free withdrawals from Coverdell ESAs
- Expenses used to compute tax-free withdrawals from §529 plans
- Expenses used to compute the AOC or lifetime learning credit
- Any other nontaxable payments received for educational expenses, including the following
 - ♦ Veterans' educational assistance benefits
 - ♦ Qualified tuition reductions
 - ♦ Employer-provided educational assistance

Income Limitations

The interest exclusion is phased out for higher-income taxpayers based on MAGI. MAGI is AGI with the following additions.³⁶

- Foreign-earned income exclusion
- Foreign housing exclusions and deductions
- Exclusion of income by bona fide residents of American Samoa and Puerto Rico
- Exclusion for adoption benefits received under an employer's adoption assistance program
- Deduction for domestic production activities
- Deduction for student loan interest
- Deduction for tuition and fees

³¹ IRC §135(a); Instructions for Form 8815.

³² IRC §135(c)(2)(A).

³³ IRC §135(c)(2)(C).

³⁴ Ibid.

³⁵ IRS Pub. 970, *Tax Benefits for Education*.

³⁶ Ibid.

2015 Workbook

U.S. Savings Bond Interest Exclusion Income Limitations

Filing Status	2014 ³⁷	2015 ³⁸
MFJ, QW	\$113,950–143,950	\$115,750–145,750
Single, HoH	76,000– 91,000	77,200– 92,200
MFS	N/A	N/A

Example 12. Samuel and Blake have a daughter, Addison. In 1999, when Addison was three years old, Samuel and Blake purchased Series EE and I savings bonds to save for her education.

In 2014, Samuel anticipates that his MAGI will be \$100,000 for the year. This amount is in the range for which the interest income is excluded if it is spent on qualifying educational expenses. Also in 2014, Blake decides she will return to work the following year. She anticipates that she will earn \$50,000.

Samuel and Blake project that their joint 2015 MAGI will be \$150,000. This amount exceeds the top of the phaseout range for joint filers. Thus, all the interest from the redemption of the Series EE and I bonds will be included in their 2015 income. The interest will be included even if they spend it on qualifying educational expenses.

Based on the advice of their CPA, Samuel and Blake cash in all of their Series EE and I savings bonds in 2014 and deposit the proceeds into a §529 plan account for Addison. This contribution includes \$50,000 of principal and \$10,000 of interest. Because their 2014 income is below the phaseout range, Samuel and Blake treat the §529 plan contribution as an allowable educational expense for purposes of the 2014 interest exclusion. If they wait to redeem the savings bonds until 2015, when Blake returns to work, they will not qualify for the interest exclusion.

Following are Samuel and Blake's 2014 Form 8815 and Schedule B, *Interest and Ordinary Dividends*. Note that the name and address of the financial institution that holds the §529 (QTP) account are entered on line 1, column b.

³⁷ Rev. Proc. 2013-35, 2013-47 IRB 537.

³⁸ Rev. Proc. 2014-61, 2014-47 IRB 860.

For Example 12

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) ▶ Information about Form 8815 and its instructions is at www.irs.gov/form8815 . ▶ Attach to Form 1040 or Form 1040A.	OMB No. 1545-0074 2014 Attachment Sequence No. 167																																																								
Name(s) shown on return Samuel and Blake		Your social security number 999-88-1111																																																								
<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <th style="width: 50%; text-align: center;">1</th> <th style="width: 50%; text-align: center;">(a)</th> <th style="width: 50%; text-align: center;">(b)</th> </tr> <tr> <th style="text-align: center;">Name of person (you, your spouse, or your dependent) who was enrolled at or attended an eligible educational institution</th> <th style="text-align: center;">Name and address of eligible educational institution</th> <th></th> </tr> <tr> <td style="text-align: center;">Addison</td> <td>QTP - First Bank of Metropolis</td> <td></td> </tr> <tr> <td></td> <td>Metropolis, IL</td> <td></td> </tr> <tr> <td></td> <td></td> <td></td> </tr> <tr> <td></td> <td></td> <td></td> </tr> </table>			1	(a)	(b)	Name of person (you, your spouse, or your dependent) who was enrolled at or attended an eligible educational institution	Name and address of eligible educational institution		Addison	QTP - First Bank of Metropolis			Metropolis, IL																																													
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If you need more space, attach a statement.																																																										
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You cannot take the exclusion </td> <td style="text-align: center;">4</td> <td style="text-align: right;">60,000</td> <td></td> </tr> <tr> <td> 5 Enter the total proceeds (principal and interest) from all series EE and I U.S. savings bonds issued after 1989 that you cashd during 2014 </td> <td style="text-align: center;">5</td> <td style="text-align: right;">60,000</td> <td></td> </tr> <tr> <td> 6 Enter the interest included on line 5 (see instructions) </td> <td style="text-align: center;">6</td> <td style="text-align: right;">10,000</td> <td></td> </tr> <tr> <td> 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) </td> <td style="text-align: center;">7</td> <td style="text-align: right;">× 1.000</td> <td></td> </tr> <tr> <td> 8 Multiply line 6 by line 7 </td> <td style="text-align: center;">8</td> <td style="text-align: right;">10,000</td> <td></td> </tr> <tr> <td> 9 Enter your modified adjusted gross income (see instructions) </td> <td style="text-align: center;">9</td> <td style="text-align: right;">100,000</td> <td></td> </tr> <tr> <td colspan="4"> Note: If line 9 is \$91,000 or more if single or head of household, or \$143,950 or more if married filing jointly or qualifying widow(er) with dependent child, stop. You cannot take the exclusion. </td> </tr> <tr> <td> 10 Enter: \$76,000 if single or head of household; \$113,950 if married filing jointly or qualifying widow(er) with dependent child </td> <td style="text-align: center;">10</td> <td style="text-align: right;">113,950</td> <td></td> </tr> <tr> <td> 11 Subtract line 10 from line 9. If zero or less, skip line 12, enter -0- on line 13, and go to line 14 </td> <td style="text-align: center;">11</td> <td style="text-align: right;">0</td> <td></td> </tr> <tr> <td> 12 Divide line 11 by: \$15,000 if single or head of household; \$30,000 if married filing jointly or qualifying widow(er) with dependent child. Enter the result as a decimal (rounded to at least three places) </td> <td style="text-align: center;">12</td> <td style="text-align: right;">×</td> <td></td> </tr> <tr> <td> 13 Multiply line 8 by line 12 </td> <td style="text-align: center;">13</td> <td style="text-align: right;">0</td> <td></td> </tr> <tr> <td> 14 Excludable savings bond interest. Subtract line 13 from line 8. Enter the result here and on Schedule B (Form 1040A or 1040), line 3 ▶ </td> <td style="text-align: center;">14</td> <td style="text-align: right;">10,000</td> <td></td> </tr> </table>			2 Enter the total qualified higher education expenses you paid in 2014 for the person(s) listed in column (a) of line 1. See the instructions to find out which expenses qualify	2	60,000		3 Enter the total of any nontaxable educational benefits (such as nontaxable scholarship or fellowship grants) received for 2014 for the person(s) listed in column (a) of line 1 (see instructions)	3			4 Subtract line 3 from line 2. If zero or less, stop . You cannot take the exclusion	4	60,000		5 Enter the total proceeds (principal and interest) from all series EE and I U.S. savings bonds issued after 1989 that you cashd during 2014	5	60,000		6 Enter the interest included on line 5 (see instructions)	6	10,000		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	× 1.000		8 Multiply line 6 by line 7	8	10,000		9 Enter your modified adjusted gross income (see instructions)	9	100,000		Note: If line 9 is \$91,000 or more if single or head of household, or \$143,950 or more if married filing jointly or qualifying widow(er) with dependent child, stop . You cannot take the exclusion.				10 Enter: \$76,000 if single or head of household; \$113,950 if married filing jointly or qualifying widow(er) with dependent child	10	113,950		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	0		12 Divide line 11 by: \$15,000 if single or head of household; \$30,000 if married filing jointly or qualifying widow(er) with dependent child. Enter the result as a decimal (rounded to at least three places)	12	×		13 Multiply line 8 by line 12	13	0		14 Excludable savings bond interest. Subtract line 13 from line 8. Enter the result here and on Schedule B (Form 1040A or 1040), line 3 ▶	14	10,000	
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For Paperwork Reduction Act Notice, see your tax return instructions.

Cat. No. 10822S

Form **8815** (2014)

There is no limit on the number of Coverdell ESAs that can be established for a designated beneficiary. The limit is on the total annual contributions to all Coverdell ESAs for a designated beneficiary.

Note. Custodians of Coverdell ESAs inform the IRS annually on Form 5498-ESA, *Coverdell ESA Contribution Information*, of contributions made for the benefit of each beneficiary in the prior year.

Example 13. When Cheri was born in 2008, family members set up three separate Coverdell ESAs for her. One was set up by her parents, one by her grandparents, and one by her aunt. In 2015, the total contributions to Cheri's three Coverdell ESAs cannot exceed \$2,000.

If Cheri's parents contribute \$2,000 to one of her Coverdell ESAs, then no one else can contribute to any of her three accounts. Alternatively, if her parents contribute \$1,000 and her aunt contributes \$600, then her grandparents or someone else can contribute no more than \$400. These contributions can be made to any of Cheri's Coverdell ESAs.⁴⁵

Example 14. Use the same facts as **Example 13**. Cheri's older brother, Warren, also has a Coverdell ESA. In 2015, their parents can contribute \$2,000 to Cheri's Coverdell ESA and \$2,000 to Warren's Coverdell ESA.

INCOME LIMITATIONS

Contributions to Coverdell ESAs are phased out based on the donor's MAGI.⁴⁶ The following table shows the limits, which **are not** adjusted annually for inflation.⁴⁷

Filing Status	MAGI Phaseout Range
MFJ	\$190,000–220,000
All others	95,000–110,000

MAGI is AGI with the following additions.⁴⁸

- Foreign-earned income and foreign housing exclusions and deductions
- Exclusion of income by bona fide residents of American Samoa and Puerto Rico

Observation. There are no restrictions regarding who can contribute to a Coverdell ESA. Accordingly, a taxpayer whose income is too high can gift the contribution amount to an eligible person who can then make a contribution to the beneficiary's Coverdell.

Corporations and other entities can make contributions to Coverdell ESAs, regardless of the corporation's income during the year of contribution.⁴⁹

⁴⁵ IRS Pub. 970, *Tax Benefits for Education*.

⁴⁶ IRC §530(c)(1).

⁴⁷ IRC §530(c)(1)(A).

⁴⁸ IRS Pub. 970, *Tax Benefits for Education*.

⁴⁹ Ibid.

EXCESS CONTRIBUTIONS

The **beneficiary** is subject to a 6% excise tax on excess contributions that are in a Coverdell ESA at the end of the year. The excise tax does not apply if the excess contributions and earnings are distributed before the beginning of the sixth month following the year of contribution. This means calendar-year taxpayers have until May 31 to withdraw any excess contributions. However, the beneficiary must include the **distributed earnings** in their gross income for the year in which the excess contribution was made.

Excess contributions are defined as the total of the following two amounts.⁵⁰

1. Amounts contributed to a beneficiary's account(s) in excess of the \$2,000 annual contribution limit (or amounts contributed in excess of the maximum contribution limit based on the contributor's income for the year, if less)
2. Excess contributions remaining in the Coverdell ESA from preceding years, reduced by both of the following:
 - a. Distributions during the year (not including rollovers)
 - b. The contribution limit for the current year minus any amount contributed for the current year

The excise tax applies to each year the excess contribution remains in the Coverdell ESA — not just for the year in which the excess contribution was made. The beneficiary reports the excise tax in part V of Form 5329, *Additional Taxes on Qualified Plans (Including IRAs) and Other Tax-Favored Accounts*. If the beneficiary files an individual income tax return for the year, then they should file Form 5329 with the return. If the beneficiary does not have to file an income tax return, then they should complete and file Form 5329 by itself at the time and place they would be required to file Form 1040.⁵¹

Example 15. Pablo's parents and grandparents contributed a total of \$2,300 to his Coverdell ESA in 2013 — an excess contribution of \$300. Because Pablo did not withdraw the excess before June 1, 2014, he had to pay an additional tax of \$18 ($\$300 \times 6\%$). He completed and filed Form 5329 with his 2013 tax return.

In 2014, excess contributions of \$500 were made to Pablo's Coverdell ESA. However, he withdrew \$250 from the account to use for qualified education expenses. Pablo calculates the excess contributions in his account at the end of 2014 as follows.

Excess contributions made in 2014	\$500
Excess contributions in ESA at end of 2013	300
Less: distribution made in 2014	(250)
Excess at end of 2014	\$550
Excise tax rate	$\times 6\%$
Additional tax due	\$ 33

If Pablo limits 2015 contributions to \$1,450 (\$2,000 maximum – \$550 excess contributions from 2014), then he will not owe any additional tax for excess 2015 contributions.⁵²

The excise tax does not apply to any rollover contributions.

⁵⁰ Ibid.

⁵¹ Ibid.

⁵² Adapted from an example in IRS Pub. 970, *Tax Benefits for Education*.

DISTRIBUTIONS

A designated beneficiary of a Coverdell ESA can take a distribution at any time. To be tax free, distributions from Coverdell ESAs must not exceed the amount of the designated beneficiary's AQEE. AQEE is calculated by reducing qualified education expenses by the amount of any tax-free educational assistance. Tax-free educational assistance includes the following.⁵³

- Tax-free scholarships and fellowships
- Veterans' educational assistance benefits
- Pell grants
- Employer-provided educational assistance
- Any other nontaxable payments received as educational assistance

Any amount remaining in a Coverdell ESA must be distributed within 30 days of either of the following events.

- The beneficiary reaches age 30. (This rule does not apply if the individual is a special-needs beneficiary.)
- The beneficiary dies before reaching age 30.

COMPUTATION OF TAXABLE DISTRIBUTIONS

The taxable portion of a distribution is the earnings portion of any distribution not spent on qualified education expenses. This amount is computed as follows.⁵⁴

- Step 1.** Multiply the total distribution by a fraction. The numerator of the fraction is the basis (contributions not previously distributed) at the end of the previous year plus total contributions for the current year. The denominator of the fraction is the total account balance at the end of the current year plus the amount distributed during the year.
- Step 2.** Subtract the amount calculated in Step 1 from the total current-year distribution. The result is the amount of earnings included in the total distribution.
- Step 3.** Multiply the total earnings from Step 2 by a fraction. The numerator of the fraction is the AQEE paid during the year. The denominator of the fraction is the total amount distributed during the year.
- Step 4.** Subtract the amount calculated in Step 3 from the amount of earnings calculated in Step 2. The result is the amount the beneficiary must include in their income.

⁵³ IRS Pub. 970, *Tax Benefits for Education*.

⁵⁴ Ibid.

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Example 16. Brenda received an \$850 distribution from her Coverdell ESA in 2014. No contributions were made to her Coverdell ESA account in 2014. However, \$1,500 had been contributed before 2014. This is her first distribution from the account, so her basis in the account on December 31, 2013, was \$1,500. The balance of her account on December 31, 2014, is \$950. Brenda had \$700 of AQEE for 2014. She calculates the taxable portion of her distribution as follows.

$$\text{Step 1. } \$850 \text{ distribution} \times \frac{\$1,500 \text{ basis} + \$0 \text{ contributions}}{\$950 \text{ value} + \$850 \text{ distribution}} = \$708 \text{ basis portion of distribution}$$

$$\text{Step 2. } \$850 \text{ distribution} - \$708 \text{ basis portion of distribution} = \$142 \text{ earnings}$$

$$\text{Step 3. } \$142 \text{ earnings} \times \frac{\$700 \text{ AQEE}}{\$850 \text{ distribution}} = \$117 \text{ tax-free earnings}$$

$$\text{Step 4. } \$142 \text{ earnings} - \$117 \text{ tax-free earnings} = \$25 \text{ taxable earnings}$$

On her 2014 tax return, Brenda must include \$25 in income as distributed earnings that were not used for qualified education expenses. She reports this amount as “other income” on line 21 of Form 1040, listing the type and amount of income on the dotted line.⁵⁵

The earnings portion of a distribution not spent on qualified educational expenses of the designated beneficiary is subject to a 10% additional tax.⁵⁶ However, the 10% additional tax does not apply in the following circumstances.⁵⁷

- The distribution was made on or after the **death** of the designated beneficiary.
- The distribution was attributable to the **disability** of the designated beneficiary.
- The distribution was included in income because the designated beneficiary received a tax-free scholarship or fellowship, veterans’ educational assistance, or employer-provided educational assistance (if the amount of the distribution does not exceed the amount of the scholarship, fellowship, or assistance).
- The distribution was taxable only because qualified education expenses were taken into account in determining **an education credit**.
- The distribution was made because of the designated beneficiary’s attendance at the **U.S. Military Academy, Naval Academy, Air Force Academy, Coast Guard Academy, or Merchant Marine Academy** (if the amount of the distribution does not exceed the costs of the education attributable to such attendance).

Part II of Form 5329 is used to calculate any additional tax.

⁵⁵ Adapted from an example in IRS Pub. 970, *Tax Benefits for Education*.

⁵⁶ IRC §530(d)(4)(A).

⁵⁷ IRC §530(d)(4)(B).

QUALIFIED EDUCATION EXPENSES

Qualified educational expenses for purposes of the Coverdell ESA can be either qualified higher education expenses or qualified elementary and secondary education expenses.

Qualified higher education expenses are related to enrollment in or attendance at an eligible postsecondary school. They include the following.

1. Tuition, fees, books, supplies, and equipment if required for the enrollment or attendance of a designated beneficiary at an eligible school
2. Expenses for special-needs services for a special-needs beneficiary if incurred in connection with their enrollment or attendance at an eligible school
3. Expenses for room and board for a student enrolled at least half time if the amount does not exceed the greater of the following two amounts:
 - a. The room and board allowance used by the educational institution in calculating the cost of attendance for purposes of federal financial aid
 - b. The actual amount charged if the student resides in housing owned or operated by the school

Qualified higher education expenses also include any amounts contributed to a §529 plan for the benefit of the account beneficiary.⁵⁸ The earnings portion of the Coverdell ESA is not considered part of the basis in the §529 plan.

Qualified elementary and secondary education expenses include the following.⁵⁹

- Expenses for tuition, fees, academic tutoring, special-needs services, books, supplies, and other equipment incurred in connection with the enrollment or attendance of the designated beneficiary at a public, private, or religious school
- Expenses for room and board, uniforms, transportation, and supplementary items and services that are required or provided by a public, private, or religious school in connection with enrollment or attendance
- Expenses for the purchase of computer technology, computer equipment, or Internet access and related services if used by the beneficiary and their family during the years of schooling (not including software designed for sports, games, or hobbies unless it is predominantly educational in nature)

Observation. The definition of qualified elementary and secondary education expenses for Coverdell ESAs is extremely taxpayer friendly. For example, a distribution can be used to fund a home computer used by the beneficiary's entire family.

⁵⁸ IRC §530(b)(2)(B).

⁵⁹ IRC §530(b)(3)(A).

ELIGIBLE EDUCATIONAL INSTITUTIONS

An eligible educational institution can be either an eligible postsecondary school or an eligible elementary or secondary school.

An eligible postsecondary school is an accredited college, university, vocational school, or other postsecondary educational institution eligible to participate in the U.S. Department of Education student aid programs. This includes virtually all accredited public, nonprofit, and proprietary postsecondary institutions.⁶⁰

An eligible elementary or secondary school is any public, private, or religious school that provides elementary or secondary education (kindergarten through grade 12) as determined under state law.⁶¹

ROLLOVERS AND BENEFICIARY CHANGES

Assets can be rolled over from one Coverdell ESA to another for the same designated beneficiary. Also, the designated beneficiary can be changed to another qualifying member of the family.

Assets distributed from a Coverdell ESA are not taxable if they are rolled over to another Coverdell ESA for either the same designated beneficiary or a qualifying member of the family who is under age 30. The age limitation does not apply if the new beneficiary is a special-needs individual.

A distributed amount is rolled over if it is paid to another Coverdell ESA within 60 days after the date of the distribution. Qualifying rollovers are **not** reported on Form 1040.

For rollovers and beneficiary changes, a qualifying member of the family is an individual who has one of the following relationships to the current beneficiary.

- Son, daughter, stepchild, foster child, adopted child, or a descendant of any of them
- Brother, sister, stepbrother, or stepsister
- Father, mother, or ancestor of either
- Stepfather or stepmother
- Niece or nephew
- Aunt or uncle
- Son-in-law, daughter-in-law, father-in-law, mother-in-law, brother-in-law, or sister-in-law
- Spouse of any of the relatives listed above
- Spouse
- First cousin

⁶⁰ IRS Pub. 970, *Tax Benefits for Education*.

⁶¹ Ibid.

FORM 1098-T

Educational institutions must provide Form 1098-T, *Tuition Statement*, or an acceptable alternative to each student by January 31. This form is often available only online via the student's account. This form is required for most students who are considered enrolled in the school.

Form 1098-T is intended to help taxpayers calculate their deductions or credits. However, using this form can be quite confusing. The first problem is that the school sends the form to the student — not the taxpayer claiming the student as a dependent. When compiling the information needed to prepare their income tax returns, most taxpayers mistakenly include this form with the **student's** tax information. However, the taxpayer **claiming the student as a dependent** needs this information.

The second problem is that not all students receive Forms 1098-T. An educational institution is **not required to furnish a Form 1098-T in the following situations.**

- The student took courses for which no academic credit was offered.
- The student is a nonresident alien.
- The student's entire tuition was waived or paid with scholarships and grants.
- The student's tuition is paid under a formal billing arrangement between the educational institution and the student's employer or a governmental entity.

The third problem is that the financial information reported on Form 1098-T is confusing and often insufficient. The taxpayer's credit or deduction is computed using **the amounts actually paid during the tax year**. The educational institution may choose to report **either the payments it received** for qualified tuition and related expenses in box 1 **or the amount it billed** for qualified tuition and related expenses in box 2. The amount reported in box 1 or 2 may be different from what was actually paid. Consequently, taxpayers should obtain this information from the detailed bills from the educational institution — not from Form 1098-T.

In order to correctly determine the amount, if any, of the education deduction or credit that can be claimed on the tax return, it is critical for the tax preparer to obtain both the Form 1098-T (if issued) and the statement from the school that shows all the charges, payments, scholarships, and/or grants applied to the student's account.

<input type="checkbox"/> CORRECTED		OMB No. 1545-1574 2015 Form 1098-T		Tuition Statement
FILER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone number		1 Payments received for qualified tuition and related expenses \$	2 Amounts billed for qualified tuition and related expenses \$	Copy B For Student This is important tax information and is being furnished to the Internal Revenue Service. This form may be used to complete Form 8863 to claim education credits. Give it to the tax preparer or use it to prepare the tax return.
FILER'S federal identification no.	STUDENT'S social security number	3 If this box is checked, your educational institution has changed its reporting method for 2015 <input type="checkbox"/>		
STUDENT'S name		4 Adjustments made for a prior year \$	5 Scholarships or grants \$	
Street address (including apt. no.)		6 Adjustments to scholarships or grants for a prior year \$	7 Checked if the amount in box 1 or 2 includes amounts for an academic period beginning January - March 2016 <input type="checkbox"/>	
City or town, state or province, country, and ZIP or foreign postal code		9 Checked if a graduate student <input type="checkbox"/>	10 Ins. contract reimb./refund \$	
Service Provider/Acct. No. (see instr.)	8 Check if at least half-time student <input type="checkbox"/>			

Form **1098-T** (keep for your records) www.irs.gov/form1098t Department of the Treasury - Internal Revenue Service

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Following are descriptions of the various boxes on Form 1098-T.

Box 1 — Payments Received. If the educational institution reports payments received (rather than amounts billed), then box 1 shows the total payments the educational institution received **from any source** during the year for the student's qualified tuition and related expenses less any reimbursements or refunds. **The amount reported in box 1 is not reduced by scholarships or grants reported in box 5.**

Box 2 — Amounts Billed. If the educational institution reports amounts billed (rather than payments received), then box 2 shows the net amount billed during the year for the student's qualified tuition and related expenses. The amount reported is the total amount billed less any reductions in charges made during the year. **The amount reported in box 2 is not reduced by scholarships or grants reported in box 5.**

Example 17. Sophia attends Smallville Community College (SCC). Her tuition and fees are \$2,000 per semester. SCC billed Sophia \$2,000 in August 2014 for the fall semester and \$2,000 in December 2014 for the 2015 spring semester. SCC sent the following account statement to Sophia in January 2015.

OFFICIAL ACCOUNT STATEMENT

Smallville Community College

Bursar Office
123 Main Street
Anytown, IL 60101

BILLING DATE	STUDENT ID	DUE DATE	AMOUNT DUE
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1/01/2015	019999999	1/31/2015	\$00.00
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Please make your check payable to "Smallville Community College"
Include your Student ID Number with your payment

Sophia Classtaker
101 Main Street
Yourtown, IL 60101

Bursar Office
Smallville Community College
123 Main Street
Anytown, IL 60101

DATE	DESCRIPTION OF TRANSACTIONS	CHARGES	CREDITS	TOTALS
	Prior Invoice Amount	0	0	0
08/01/2014	Fall Semester 2014	2,000.00	0	2,000.00
08/31/2014	Payment by check—thank you		-2,000.00	0
12/01/2014	Spring Semester 2015	2,000.00	0	2,000.00
12/31/2014	Payment by check—thank you		-2,000.00	0
Net Amount:				\$0

SCC sent Sophia the following Form 1098-T for 2014, which shows \$4,000 in box 2 as amounts billed for qualified tuition and fees.

<input type="checkbox"/> CORRECTED		OMB No. 1545-1574 <div style="font-size: 2em; font-weight: bold;">2014</div> Form 1098-T		Tuition Statement Copy B For Student This is important tax information and is being furnished to the Internal Revenue Service.
FILER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone number Smallville Community College 123 Main Street Anytown, IL 60101				
FILER'S federal identification no. 12-3456789	STUDENT'S social security number 987-65-4321	3 If this box is checked, your educational institution has changed its reporting method for 2014 <input type="checkbox"/>		
STUDENT'S name Sophia Classtaker		4 Adjustments made for a prior year \$	5 Scholarships or grants \$	
Street address (including apt. no.) 101 Main St		6 Adjustments to scholarships or grants for a prior year \$	7 Checked if the amount in box 1 or 2 includes amounts for an academic period beginning January - March 2015 <input checked="" type="checkbox"/>	
City or town, state or province, country, and ZIP or foreign postal code Yourtown, IL 60101		9 Checked if a graduate student <input type="checkbox"/>	10 Ins. contract reimb./refund \$	
Service Provider/Acct. No. (see instr.)	8 Check if at least half-time student <input type="checkbox"/>			

Form **1098-T** (keep for your records) www.irs.gov/form1098t Department of the Treasury - Internal Revenue Service

As reflected on the account statement from SCC, Sophia paid the tuition in the same months she was billed (August and December 2014). Accordingly, she calculated her 2014 education deduction or credit on the entire \$4,000 she paid in 2014.

If Sophia had paid the tuition for the 2015 spring semester in January 2015, then she would calculate her 2014 education deduction or credit on only the \$2,000 she paid in 2014. The \$2,000 billed in December 2014 and paid in January 2015 would then be used to compute her education deduction or credit for 2015.

Box 3 — Change of Reporting Method. This box is checked if the educational institution changed its method of reporting (payments received or amounts billed) from the previous year.

Example 18. Use the same facts as **Example 17**, except Sophia paid her spring 2015 tuition of \$2,000 in January 2015. She paid her fall 2015 tuition of \$2,000 in August 2015 and her spring 2016 tuition of \$2,000 in December 2015.

SCC sends Sophia a completed Form 1098-T for 2015 with **box 3** checked. The \$6,000 of payments **received** in 2015 is reported in **box 1**.

Box 4 — Adjustments Made for a Prior Year. This box shows any adjustments (such as refunds or reductions in charges) made to amounts reported on a prior year's Form 1098-T.

A credit or deduction is not allowed for qualified expenses that are subsequently refunded. Excludable educational assistance received after a student's tuition is paid is treated as a refund. The taxpayer reduces the amount of eligible expenses when a refund is received in the same year expenses are paid or in the following year **prior to the time the return is filed.**⁶²

⁶² Treas. Reg. §1.25A-5(f)(1).

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Example 19. In August 2014, Paul Silver paid \$2,000 tuition and fees to the local community college. He had registered as a full-time student for the fall semester. Paul is single and had 2014 MAGI of \$30,000. Before beginning the semester, he withdrew from some of the classes. This changed his status to three-fourths time. In January 2015, Paul received a refund of \$500 from the college.

To compute his AOC for 2014, Paul must reduce the \$2,000 tuition paid by the \$500 refund received. His net result is \$1,500 of qualified education expenses for 2014, for a maximum AOC of \$1,500. The first page of Paul's Form 8863 follows.

The 2014 Form 1098-T Paul receives from the college should show \$2,000 in box 1 (amount paid) or \$1,500 in box 2 (net amount billed). If the college reports amounts paid in box 1, then Paul will also receive a 2015 Form 1098-T showing \$500 in box 4 (adjustment for prior year).

Form 8863 <small>Department of the Treasury Internal Revenue Service (99)</small>	Education Credits (American Opportunity and Lifetime Learning Credits) Attach to Form 1040 or Form 1040A. Information about Form 8863 and its separate instructions is at www.irs.gov/form8863 .	OMB No. 1545-0074 <div style="font-size: 2em; font-weight: bold;">2014</div> Attachment Sequence No. 50
Name(s) shown on return Paul Silver		Your social security number <div style="display: flex; justify-content: space-between;"> 234 56 7890 </div>



Complete a separate Part III on page 2 for each student for whom you are claiming either credit before you complete Parts I and II.

Part I Refundable American Opportunity Credit		
1 After completing Part III for each student, enter the total of all amounts from all Parts III, line 30	1	1,500
2 Enter: \$180,000 if married filing jointly; \$90,000 if single, head of household, or qualifying widow(er)	2	90,000
3 Enter the amount from Form 1040, line 38, or Form 1040A, line 22. If you are filing Form 2555, 2555-EZ, or 4563, or you are excluding income from Puerto Rico, see Pub. 970 for the amount to enter	3	30,000
4 Subtract line 3 from line 2. If zero or less, stop ; you cannot take any education credit	4	60,000
5 Enter: \$20,000 if married filing jointly; \$10,000 if single, head of household, or qualifying widow(er)	5	10,000
6 If line 4 is: • Equal to or more than line 5, enter 1.000 on line 6 • Less than line 5, divide line 4 by line 5. Enter the result as a decimal (rounded to at least three places)	6	1.000
7 Multiply line 1 by line 6. Caution: If you were under age 24 at the end of the year and meet the conditions described in the instructions, you cannot take the refundable American opportunity credit; skip line 8, enter the amount from line 7 on line 9, and check this box <input type="checkbox"/>	7	1,500
8 Refundable American opportunity credit. Multiply line 7 by 40% (.40). Enter the amount here and on Form 1040, line 68, or Form 1040A, line 44. Then go to line 9 below.	8	600
Part II Nonrefundable Education Credits		
9 Subtract line 8 from line 7. Enter here and on line 2 of the Credit Limit Worksheet (see instructions)	9	900
10 After completing Part III for each student, enter the total of all amounts from all Parts III, line 31. If zero, skip lines 11 through 17, enter -0- on line 18, and go to line 19	10	0
11 Enter the smaller of line 10 or \$10,000	11	
12 Multiply line 11 by 20% (.20)	12	
13 Enter: \$128,000 if married filing jointly; \$64,000 if single, head of household, or qualifying widow(er)	13	
14 Enter the amount from Form 1040, line 38, or Form 1040A, line 22. If you are filing Form 2555, 2555-EZ, or 4563, or you are excluding income from Puerto Rico, see Pub. 970 for the amount to enter	14	
15 Subtract line 14 from line 13. If zero or less, skip lines 16 and 17, enter -0- on line 18, and go to line 19	15	
16 Enter: \$20,000 if married filing jointly; \$10,000 if single, head of household, or qualifying widow(er)	16	
17 If line 15 is: • Equal to or more than line 16, enter 1.000 on line 17 and go to line 18 • Less than line 16, divide line 15 by line 16. Enter the result as a decimal (rounded to at least three places)	17	
18 Multiply line 12 by line 17. Enter here and on line 1 of the Credit Limit Worksheet (see instructions)	18	0
19 Nonrefundable education credits. Enter the amount from line 7 of the Credit Limit Worksheet (see instructions) here and on Form 1040, line 50, or Form 1040A, line 33	19	900

For Paperwork Reduction Act Notice, see your tax return instructions.

Cat. No. 25379M

Form **8863** (2014)

Filing an amended return is **not** required for a taxpayer who receives a refund after filing their return. A taxpayer who claimed one of the **education credits** must recapture any excess credit. This is calculated by reducing AQEE for the prior year by the amount of the refund or tax-free educational assistance. The taxpayer then recalculates the education credit for the prior year. Then they calculate the amount by which the prior year's tax liability would have increased if they had claimed the reduced credit.⁶³ **That amount is included as an additional tax on line 44 (tax) in the year the refund is received. Box c of line 44 should be checked, and "ECR" should be entered in the space next to that box.**⁶⁴

Example 20. Use the same facts as **Example 19**, except Paul did not receive the refund until May 2015. He filed his 2014 return on time and claimed an AOC for the entire \$2,000 tuition payment. When he files his 2015 return, he enters \$500 on line 44 with the notation "ECR."

AOC as reported on Paul's 2014 tax return	\$2,000
Less: AOC as recomputed after refund	(1,500)
Additional tax reported on 2015 Form 1040, line 44	\$ 500

A taxpayer who claims the **tuition and fees deduction** and then receives a refund after their return is filed increases their income in the following year by the refunded amount to the extent that it reduced their tax. To calculate this amount, the qualified expenses on which the original tuition and fees deduction was calculated is reduced by the refund. Then, the deduction is recalculated using the redetermined qualified expenses. That amount is included as additional income on the "other income" line on Form 1040 in the year the refund is received.

Example 21. Use the same facts as **Example 20**, except Paul claimed the tuition and fees deduction in 2014.

Tuition and fees deduction as reported on Paul's 2014 tax return	\$2,000
Less: tuition and fees deduction as recomputed after refund	(1,500)
Additional income reported on Paul's 2015 Form 1040, line 21 (other income)	\$ 500

Box 5 — Scholarships and Grants. This box shows the total amount of scholarships and grants administered and processed by the educational institution for payment of the student's costs of attendance. The amount shown in box 1 or 2 may or may not need to be reduced by the amount shown in box 5. Additionally, the amount shown in box 1 or 2 may need to be reduced by scholarships and grants **not** reported in box 5.

When a scholarship or grant is used to pay tuition and course-related expenses, the taxpayer must reduce the amounts in box 1 or 2 by the portion so used before calculating any education deduction or credit. To the extent that a scholarship or grant is used for expenses other than tuition or course-related expenses, that portion is taxable. Therefore, the amount in box 1 or 2 is not reduced by that portion.

Example 22. Tanisha, a degree candidate, paid \$3,000 tuition and \$5,000 room and board at City University. Tanisha was awarded a \$2,000 scholarship. The terms of her scholarship allow it to be used to pay any of her college expenses.

Tanisha receives a Form 1098-T from City University showing \$3,000 in box 1 and \$2,000 in box 5.

Tanisha uses the scholarship to pay her tuition, which makes her scholarship tax free. She must reduce the \$3,000 tuition by the \$2,000 scholarship, for a net of \$1,000 tuition. She can claim an education deduction or credit for the \$1,000 net amount.

⁶³ Instructions for Form 8863.

⁶⁴ Instructions for Form 1040.

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Example 23. Use the same facts as **Example 22**, except Tanisha uses the scholarship to pay her room and board. Her scholarship is taxable in this situation. The amount is reported as wages on line 7 of her Form 1040 with the notation “SCH.”⁶⁵ Tanisha does not need to reduce the \$3,000 tuition by the scholarship to calculate her education deduction or credit.

Box 6 — Adjustments to Scholarships or Grants for a Prior Year. This box shows the reduction in any scholarship or grant administered and processed by the educational institution that was reported on Form 1098-T in any prior year.

When this reduction changes the amount of income reported in the prior year for a taxable scholarship or grant, the taxpayer can claim a current-year deduction for the amount of the reduction.

If the reduction is \$3,000 or less, then the taxpayer can claim the amount on Schedule A, *Itemized Deductions*, as a miscellaneous itemized deduction subject to the 2%-of-AGI limitation. There is no tax benefit if the taxpayer does not itemize or does not meet the 2%-of-AGI limitation.⁶⁶

Example 24. Angel received a \$15,000 taxable grant from Sun State University in 2014. This amount was properly reported as a taxable scholarship on his 2014 return. Angel claimed the standard deduction and paid income tax on the grant. In 2015, the grant was reduced by \$2,000. Because Angel does not itemize, he cannot obtain any tax benefit on his 2015 return.

For reductions greater than \$3,000, the taxpayer has two options.⁶⁷

1. The taxpayer can claim a miscellaneous itemized deduction for the full amount of the repayment.
2. The taxpayer can claim a tax credit on the **current year’s** return. The taxpayer recomputes the tax (under the “claim of right” doctrine) for the prior year as if the income had not been reported. The credit is the difference between the actual tax in the prior year and the recomputed tax. This credit is claimed on the current year’s Form 1040, line 73, with box d checked and the notation “IRC 1341” next to the line.

Note. For more information about the “claim of right” doctrine, see the 2014 *University of Illinois Federal Tax Workbook*, Volume B, Chapter 2: Individual Taxpayer Issues.

Example 25. Use the same facts as **Example 24**, except in **2015**, the grant was reduced by \$4,000. Angel has two options. Because he does not itemize, he chooses the tax credit option.

Angel recomputes his 2014 tax as if the taxable grant were only \$11,000. The tax shown on his original return was \$568. His recomputed tax liability is now \$166. Angel claims a tax credit on his 2015 return for \$402 (\$568 original tax – \$166 recomputed tax).

The taxpayer may file an **amended return** when the reduction increases the amount of the **tuition and fees deduction** or the **education tax credit** claimed in the prior year.

Example 26. In 2014, Cynthia’s tuition and fees were \$5,000. Cynthia received a \$4,000 scholarship, which she treated as nontaxable. She claimed an AOC for the remaining \$1,000.

In 2015, Cynthia’s \$4,000 scholarship for 2014 was retroactively reduced to only \$2,000. She may amend her 2014 return, using \$3,000 to compute her AOC.

⁶⁵ Ibid.

⁶⁶ IRS Pub. 525, *Taxable and Nontaxable Income*.

⁶⁷ Ibid.

Box 7 — Academic Period Beginning in January through March. This box is checked if the amount in box 1 or 2 includes tuition and related expenses for an academic period beginning in January, February, or March of the subsequent tax year.

Box 8 — At Least Half-Time Student. This box is checked if the student is at least half time for at least one academic period during the year. To claim the AOC, the student must meet this requirement.

Box 9 — Graduate Student. This box is checked if the student is considered a graduate student.

Box 10 — Insurance Contract Reimbursements or Refunds. This box shows the amount of refunds or reimbursements of qualified tuition and fees made by an insurer.

If a taxpayer receives a Form 1098-T that they believe contains errors, then they must contact the educational institution and request a corrected Form 1098-T. If the educational institution agrees that the original Form 1098-T was erroneous, it should issue a new Form 1098-T. An “X” should be entered in the “CORRECTED” box at the top of the form.

STUDENT LOANS

Graduating from college without debt is desirable but may not be possible for many students and their families. It is common for part or all of a student’s educational costs to be funded with loans. Fortunately, there are numerous options for college loans. Many of these loans have generous terms, low interest rates, and the possibility of loan forgiveness. Consequently, they can be a valuable part of a family’s college-funding strategy.

IRC §221 governs interest deductions on student loans. Qualified student loans are defined as any indebtedness incurred by the taxpayer solely to pay qualified higher education expenses. This does not include a loan provided by a related person or under a qualified employer plan.⁶⁸

With the exception of interest paid on qualifying educational loans and certain home equity loans, interest paid on loans used for education is considered personal interest and is not deductible. However, if a taxpayer’s 2015 MAGI is less than \$80,000 (\$160,000 for MFJ), a special deduction is allowed for interest paid on a student loan used for higher education.⁶⁹

The deduction is the smaller of the interest actually paid or \$2,500. The deduction is phased out based on the taxpayer’s MAGI. This deduction is taken as an adjustment to AGI; consequently, even taxpayers who do not itemize can benefit from it.

QUALIFIED STUDENT LOAN

A qualified student loan is a loan taken out solely to pay for QHEE. It **does not** have to be a federal student loan to be considered qualified.⁷⁰ A **qualified student loan** must be:

- For the taxpayer, the taxpayer’s spouse, or the taxpayer’s dependent;
- For QHEE paid or incurred within a reasonable period before or after obtaining the loan; and
- For education provided during an academic period for a student enrolled at least half time in a program leading to a degree, certificate, or other recognized educational credential.⁷¹

⁶⁸ IRC §221(d)(1).

⁶⁹ Rev. Proc. 2014-61, 2014-47 IRB 860.

⁷⁰ Treas. Reg. §1.221-1(e)(3)(iv).

⁷¹ IRS Pub. 970, *Tax Benefits for Education*.

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In addition to simple interest on the loan, other items can be considered **student loan interest**.⁷²

- Loan origination fee
- Capitalized interest
- Interest on revolving lines of credit
- Interest on refinanced student loans
- Voluntary interest payments

Example 27. Nathaniel has a qualified student loan. He is a full-time student and is not required to make payments until after he graduates. Nathaniel decides to make voluntary interest payments on the loan. He can deduct them as student loan interest **if he meets the other requirements**.

The taxpayer can deduct interest on student loans on their annual tax returns until the loan is paid in full.

STUDENT LOAN INTEREST DEDUCTION

Generally, a taxpayer can claim the student loan interest deduction if all the following requirements are met.

- The taxpayer's filing status is anything except MFS.
- **No one else claims an exemption for the taxpayer.**
- The taxpayer is legally obligated to pay interest on the qualified student loan.
- The taxpayer paid the interest on the qualified student loan.

No double benefit is allowed for the interest. The taxpayer cannot claim the deduction if the interest on the qualified student loan is an allowable deduction under any other Code provision (e.g., home mortgage interest).

Interest paid by a third party is considered paid by the taxpayer who is legally obligated to make the payments. The taxpayer is treated as receiving the payment from the third party and, in turn, paying the interest.⁷³

INCOME LIMITATIONS

The **student loan interest deduction** is phased out ratably for taxpayers based on MAGI. For purposes of the student loan interest deduction, MAGI is AGI before taking any deduction for student loan interest with the following additions.⁷⁴

- Foreign-earned income and foreign housing exclusions and deductions
- Exclusion of income by residents of American Samoa and Puerto Rico
- The domestic production activities deduction
- The tuition and fees deduction

2014 and 2015 Phaseout of Deductions for Student Loan Interest⁷⁵

Filing Status	MAGI Phaseout Range
MFJ	\$130,000–160,000
Single, HoH, QW	65,000– 80,000
MFS	N/A

⁷² Ibid.

⁷³ Treas. Reg. §1.221-1(b)(4)(i).

⁷⁴ IRS Pub. 970, *Tax Benefits for Education*.

⁷⁵ Rev. Proc. 2013-35, 2013-47 IRB 537; Rev. Proc. 2014-61, 2014-47 IRB 860.

For taxpayers with MAGI that falls within the phaseout range, the deduction is calculated as follows.

- Step 1.** Determine the lesser of \$2,500 or the amount of qualifying interest paid.
- Step 2.** Multiply the amount in Step 1 by a fraction. The numerator of the fraction is the taxpayer's MAGI – \$65,000 (\$130,000 for MFJ). The denominator is \$15,000 (\$30,000 for MFJ).
- Step 3.** Subtract the amount calculated in Step 2 from the amount determined in Step 1.⁷⁶

Example 28. Sharese files her 2014 tax return using the MFJ status. During that year, she paid \$800 interest on a qualified student loan. The MAGI for her and her husband is \$140,000. Sharese's deduction is calculated as follows.

- Step 1.** Qualifying interest paid = \$800
- Step 2.** $\$800 \times \frac{\$140,000 - \$130,000}{\$30,000} = \$267$
- Step 3.** $\$800 - \$267 = \$533$ deduction for student loan interest

Example 29. Use the same facts as **Example 28**, except Sharese paid \$2,750 of interest. Sharese's deduction is calculated as follows.

- Step 1.** Qualifying interest paid = \$2,500 (lesser of qualifying interest paid or \$2,500)
- Step 2.** $\$2,500 \times \frac{\$140,000 - \$130,000}{\$30,000} = \$833$
- Step 3.** $\$2,500 - \$833 = \$1,667$ deduction for student loan interest

FORM 1098-E

Form 1098-E, *Student Loan Interest Statement*, is used to report the amount of interest the taxpayer paid on a student loan for the calendar year. This form is issued by financial institutions, governmental units, educational institutions, or other persons who received student loan interest of \$600 or more from an individual during the year in the course of a trade or business.

☐ CORRECTED (if checked)

RECIPIENT'S/LENDER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone number		OMB No. 1545-1576 2015 Form 1098-E	Student Loan Interest Statement
RECIPIENT'S federal identification no.	BORROWER'S social security number	1 Student loan interest received by lender \$	
BORROWER'S name Street address (including apt. no.) City or town, state or province, country, and ZIP or foreign postal code		Copy B For Borrower This is important tax information and is being furnished to the Internal Revenue Service. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if the IRS determines that an underpayment of tax results because you overstated a deduction for student loan interest.	
Account number (see instructions)		2 If checked, box 1 does not include loan origination fees and/or capitalized interest for loans made before September 1, 2004 <input type="checkbox"/>	

Form **1098-E** (keep for your records) www.irs.gov/form1098e Department of the Treasury - Internal Revenue Service

⁷⁶ IRS Pub. 970, *Tax Benefits for Education*.

Box 1 — Student Loan Interest. This is the amount of interest the lender **received** during the calendar year. For loans made after August 31, 2004, loan origination fees and/or capitalized interest must be included in box 1.

Box 2 — Loan Origination Fee Checkbox. A checkmark in this box indicates that loan origination fees and/or capitalized interest are not reported in box 1 for loans made before September 1, 2004.

FEDERAL STUDENT LOAN PROGRAMS

The U.S. Department of Education administers federal student loan programs. These programs are sources of low-interest loans for both students and parents. There are two types of federal student loan programs.

- The federal Perkins loan program
- The William D. Ford federal direct loan program

Federal Perkins Loans

Federal Perkins loans are awarded to students who show “exceptional financial need.” The determination of need is made by the school the student plans to attend. Perkins loans are a source of low-interest loans for undergraduate and graduate students. They are usually the best student loans available. Perkins loans offer a low fixed-interest rate, no fees, and the best deferment and cancellation provisions.

The current interest rate is 5% for Perkins loans. Repayment expectations and interest accrual do not begin until nine months after the student ceases to be enrolled at least half time.⁷⁷ There are no loan origination fees.

Payments on a Perkins loan **may be deferred** for the following reasons.⁷⁸

- The student is enrolled in a college or career school on at least a half-time basis.
- The student is experiencing economic hardship (includes Peace Corps service).
- The student is in an approved graduate fellowship program or an approved rehabilitation-training program for individuals with disabilities.
- The student is unable to find full-time employment.
- The student is called to active military duty during a war or other military operation.

During deferment, the student is allowed to temporarily postpone payments. Also, interest on the loan stops accruing.

Part or all of Perkins loans **may be partially or fully canceled** for any of the following reasons.⁷⁹

- Student’s total and permanent disability or death
- Service as a full-time teacher in a designated elementary or secondary school serving students from low-income families
- Service as a full-time special education teacher of children with disabilities in a public or other nonprofit elementary or secondary school or educational service agency
- Service as a professional provider of early intervention services
- Service as a full-time teacher of math, science, foreign languages, bilingual education, or other fields determined by a state education agency to have a shortage of qualified teachers

⁷⁷ *Perkins Loans*. U.S. Dept. of Education. [<https://studentaid.ed.gov/types/loans/perkins>] Accessed on Oct. 30, 2014.

⁷⁸ *Deferment and Forbearance*. U.S. Dept. of Education. [<https://studentaid.ed.gov/repay-loans/deferment-forbearance>] Accessed on Oct. 30, 2014.

⁷⁹ *Forgiveness, Cancellation, and Discharge Charts*. U.S. Dept. of Education. [<https://studentaid.ed.gov/repay-loans/forgiveness-cancellation/charts#perkins-loan-cancellation>] Accessed on Oct. 30, 2014.

- Service as a full-time employee of a public or nonprofit child or family services agency providing services to high-risk children and their families from low-income communities
- Service as a full-time nurse or medical technician
- Service as a full-time law enforcement or corrections officer
- Service as a full-time staff member in a Head Start program
- Service as a Peace Corps or VISTA program volunteer
- Service in the U.S. Armed Forces in an area of hostility or imminent danger
- Student's bankruptcy (but only if the bankruptcy court rules that repayment would cause undue hardship)
- Closure of the college before the student can complete their program of study
- Service as a full-time firefighter
- Service as a librarian with a master's degree working in a Title I-eligible elementary or secondary school or public library
- Service as a full-time attorney employed in a federal public or community defender organization
- Service as a full-time speech pathologist with a master's degree working in a Title I-eligible elementary or secondary school
- Service as a full-time teacher in a designated educational service agency serving students from low-income families
- Service as a full-time faculty member at a tribal college or university

A percentage of a student's Perkins loan can be canceled for each completed year of qualifying service or employment.

Generally, when a loan is canceled, the borrower has cancellation-of-indebtedness income. However, certain student loans, such as Perkins loans, qualify for tax-free treatment upon cancellation. If a Perkins loan was made by a qualified lender and the loan is forgiven contingent on the student's working for a certain period of time in a certain profession for any of a broad class of employers, then the student does not have any cancellation-of-indebtedness income to recognize.⁸⁰

Example 30. Ginny graduated from college and got a job as a history teacher. She taught in a school system located in a designated teacher-shortage area. A portion of her Perkins loan was forgiven. Ginny does not have any cancellation-of-indebtedness income to recognize.

Example 31. Humphrey graduated from college and got a job as a history teacher. He taught in a school system in a high-income community, which was not in a designated teacher-shortage area. The school system paid \$10,000 of his Perkins loan. Humphrey has \$10,000 of additional income to recognize.

⁸⁰ IRC §108(f).

William D. Ford Direct Loans

The William D. Ford federal direct loan program (direct loan) is the largest source of low-interest loans administered by the U.S. Department of Education. Four types of direct loans are available.⁸¹

1. Direct subsidized loans
2. Direct unsubsidized loans
3. Direct PLUS loans
4. Direct consolidation loans

Direct Subsidized Loans. Direct subsidized loans are made to eligible **undergraduate** students to help cover the costs of higher education at a college or career school. The student must demonstrate financial need. The school determines the amount that the student can borrow, and the amount cannot exceed the student's financial need.

The U.S. Department of Education pays the interest on the loan during the following periods.

- While the student is enrolled in school at least half time
- For the first six months after the student leaves school (grace period)

Note. A student who received a direct subsidized loan that was first disbursed between July 1, 2012, and July 1, 2014, is responsible for paying the interest that accrues during the grace period. If the student chooses not to pay the interest that accrues during the grace period, then the interest is added to the loan's principal balance.⁸²

- During any period of deferment

The interest rate for direct subsidized loans that were first disbursed on or after July 1, 2013, and before July 1, 2014, is 3.86%. The interest rate for loans that were first disbursed on or after July 1, 2014, and before July 1, 2015, is 4.66%.⁸³

In addition to interest, a loan fee is charged. This fee is a percentage of the loan amount and is proportionately deducted from each loan disbursement. For loans first disbursed on or after December 1, 2013, and before October 1, 2014, the loan fee is 1.072%. For loans first disbursed on or after October 1, 2014, and before October 1, 2015, the loan fee is 1.073%.⁸⁴

Direct Unsubsidized Loans. Direct unsubsidized loans are made to eligible undergraduate, graduate, and professional students. The student must be enrolled at least half time and does not have to demonstrate financial need to be eligible for the loan. The school determines the amount that the student can borrow based on the cost of attendance and the student's other financial aid.

⁸¹ *Loans.* U.S. Dept. of Education. [<https://studentaid.ed.gov/types/loans>] Accessed on Nov. 1, 2014.

⁸² *Subsidized and Unsubsidized Loans.* U.S. Dept. of Education. [<https://studentaid.ed.gov/types/loans/subsidized-unsubsidized>] Accessed on Nov. 1, 2014.

⁸³ *What are the current interest rates? Subsidized and Unsubsidized Loans.* U.S. Dept. of Education. [<https://studentaid.ed.gov/types/loans/subsidized-unsubsidized#interest-rates>] Accessed on Nov. 1, 2014.

⁸⁴ *Other than interest, is there a charge for this loan? Subsidized and Unsubsidized Loans.* U.S. Dept. of Education. [<https://studentaid.ed.gov/types/loans/subsidized-unsubsidized#additional-charges>] Accessed on Nov. 1, 2014.

The interest rate for direct unsubsidized loans made to **undergraduate students** that were first disbursed on or after July 1, 2013, and before July 1, 2014, is 3.86%. The interest rate for direct unsubsidized loans made to undergraduate students that were first disbursed on or after July 1, 2014, and before July 1, 2015, is 4.66%.⁸⁵

The interest rate for direct unsubsidized loans made to **graduate and professional students** that were first disbursed on or after July 1, 2013, and before July 1, 2014, is 5.41%. The interest rate for direct unsubsidized loans made to graduate and professional students that were first disbursed on or after July 1, 2014, and before July 1, 2015, is 6.21%.⁸⁶

In addition to interest, a loan fee is charged. This fee is a percentage of the loan amount and is proportionately deducted from each loan disbursement. For loans first disbursed on or after December 1, 2013, and before October 1, 2014, the loan fee is 1.072%. For loans first disbursed on or after October 1, 2014, and before October 1, 2015, the loan fee is 1.073%.⁸⁷

The student is responsible for paying the interest on the loan during all periods. If the student chooses not to pay interest while they are in school and during grace periods and any deferment or forbearance periods, the interest accrues and is added to the loan's principal balance.

Direct PLUS Loans. Direct PLUS loans are made to graduate and professional students enrolled at least half time at an eligible school in a program leading to a degree or certificate. Direct PLUS loans are also made to parents of dependent undergraduate students enrolled at least half time to help pay for education expenses that are not covered by other types of financial aid.

The maximum loan amount is the student's cost of attendance (as determined by the school) minus any other financial aid.

The interest rate for direct PLUS loans that were first disbursed on or after July 1, 2013, and before July 1, 2014, is 6.41%, and the interest rate for direct PLUS loans that were first disbursed on or after July 1, 2014, and before July 1, 2015, is 7.21%.⁸⁸ The interest rate is fixed for the life of the loan.

In addition to interest, a loan fee is charged. This fee is a percentage of the loan amount and is proportionately deducted from each loan disbursement. For loans first disbursed on or after December 1, 2013, and before October 1, 2014, the loan fee is 4.288%. For loans first disbursed on or after October 1, 2014, and before October 1, 2015, the loan fee is 4.292%.⁸⁹

The borrower is responsible for paying the interest on the loan during all periods. If the loan is deferred, interest continues to accrue. The borrower can choose to pay the accrued interest or allow the interest to capitalize when the deferment period ends.⁹⁰

Direct Consolidation Loans. A direct consolidation loan allows the student to combine all of their eligible federal student loans into a single loan with one loan servicer. Most federal student loans are eligible for consolidation.

⁸⁵ *What are the current interest rates? Subsidized and Unsubsidized Loans.* U.S. Dept. of Education. [<https://studentaid.ed.gov/types/loans/subsidized-unsubsidized#interest-rates>] Accessed on Nov. 1, 2014.

⁸⁶ Ibid.

⁸⁷ *Other than interest, is there a charge for this loan? Subsidized and Unsubsidized Loans.* U.S. Dept. of Education. [<https://studentaid.ed.gov/types/loans/subsidized-unsubsidized#additional-charges>] Accessed on Nov. 1, 2014.

⁸⁸ *PLUS Loans.* U.S. Dept. of Education. [<https://studentaid.ed.gov/types/loans/plus>] Accessed on Nov. 6, 2014.

⁸⁹ Ibid.

⁹⁰ *What if I have trouble repaying the loan? PLUS Loans.* U.S. Dept. of Education. [<https://studentaid.ed.gov/types/loans/plus#what-if-i-have>] Accessed on Nov. 6, 2014.

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Deferment of Direct Loans. Payments on a direct loan **may be deferred** for the following reasons.⁹¹

- The student is enrolled in a college or career school on at least a half-time basis.
- The student is experiencing economic hardship (includes Peace Corps service).
- The student is in an approved graduate fellowship program or an approved rehabilitation-training program for individuals with disabilities.
- The student is unable to find full-time employment.
- The student is called to active military duty during a war, other military operation, or a national emergency.

Cancellation of Direct Loans. A student's direct loan **may be partially or fully canceled** for any of the following reasons.⁹²

- Student's total and permanent disability or death
- Service as a full-time teacher for five consecutive years in a designated elementary or secondary school or educational service agency serving students from low-income families (A PLUS loan cannot be included in this type of discharge.)
- Service in certain public service jobs after the borrower has made 120 payments on their direct loan
- Student's bankruptcy (but only if the bankruptcy court rules that repayment would cause undue hardship)
- Closure of the college before the student can complete their program of study
- False certification of student eligibility by the school or as a result of identity theft

IRC §61(a)(12) specifies that gross income includes income from the discharge of indebtedness. However, IRC §108(f) specifies that student loan forgiveness is excluded from income "if such discharge was pursuant to a provision of such loan under which all or part of the indebtedness of the individual would be discharged if the individual worked for a certain period of time in certain professions for any of a broad class of employers."

SCHOLARSHIPS, FELLOWSHIPS, AND TUITION REDUCTIONS

A scholarship is an award to a student to help finance their education. A fellowship is an award to an individual to help finance their education or research.

SCHOLARSHIPS AND FELLOWSHIPS

A scholarship or fellowship is exempt from taxation **only** if the following conditions are satisfied.⁹³

- The student is a **candidate for a degree** at an **eligible educational institution**.
- The scholarship or fellowship is used to pay **qualified education expenses**.
- The scholarship or fellowship does not represent payment for teaching, research, or other services required as a condition for receiving the award.

⁹¹ *Deferment and Forbearance*. U.S. Dept. of Education. [<https://studentaid.ed.gov/repay-loans/deferment-forbearance>] Accessed on Nov. 6, 2014.

⁹² *Forgiveness, Cancellation, and Discharge*. U.S. Dept. of Education. [<https://studentaid.ed.gov/repay-loans/forgiveness-cancellation>] Accessed on Nov. 1, 2014.

⁹³ IRS Pub. 970, *Tax Benefits for Education*.

Degree Candidates

A candidate for a degree is a student who:⁹⁴

- Attends a primary or secondary school or pursues a degree at a college or university, or
- Attends an accredited educational institution that is authorized to provide:
 - ♦ A program that is acceptable for full credit toward a bachelor's or higher degree, or
 - ♦ A training program that prepares the student for gainful employment in a recognized occupation.

Eligible Educational Institutions

An **eligible educational institution** is one that has the primary function of presenting formal instruction and that.⁹⁵

- Maintains a regular faculty and curriculum, and
- Has a regularly enrolled body of students in attendance at the place where it carries out its educational activities.

Example 32. Alison received a \$500 scholarship to take a correspondence course. All the students in the course are correspondence students. Alison cannot exclude the \$500 scholarship from income because no students are in attendance at the school's place of business.

Qualified Education Expenses

For purposes of tax-free scholarships and fellowships, qualified education expenses are expenses for the following.⁹⁶

- Tuition and fees required to enroll in or attend an eligible educational institution
- Course-related expenses (e.g., fees, books, supplies, and equipment) that are **required** for all students in the same course of instruction at the eligible educational institution

Example 33. Seth received a scholarship from Epsilon University and enrolled in a writing course. Among the suggested supplies for the course is a laptop computer, but students in the course are not required to obtain a laptop. Seth cannot treat the cost of a laptop computer as a course-related expense in determining the amount excluded from income as qualified education expenses.

The following expenses are specifically **excluded** from qualified education expenses.

- Room and board
- Travel
- Research
- Clerical help
- Equipment and other expenses not required for enrollment in or attendance at an eligible educational institution

Example 34. Starletta is a degree candidate at Hallmark University. She received an \$8,000 scholarship from the school. She used \$5,000 for qualified tuition and the remaining \$3,000 for room and board. Starletta can exclude only \$5,000 from income as a qualified scholarship. **The \$3,000 used for room and board is not excludable and must be included in income.**

⁹⁴ Ibid.

⁹⁵ Ibid.

⁹⁶ Ibid.

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The award is excluded from taxation to the extent it is used for qualifying expenses. This applies even though the terms of the award do not specify it **must be** used for tuition and related expenses. However, if an award specifies it is to be used for purposes other than tuition and related expenses, then it cannot be excluded.

Example 35. Brandon received a \$2,500 scholarship from Premier University, where he is a degree candidate. The scholarship specifies that \$1,000 is for tuition and \$1,500 is for room and board. The \$1,000 designated for tuition is excludable. The \$1,500 designated for room and board is **not excludable** and must be included in income.

Payments for Services

Qualified scholarships and fellowships generally do not include any amounts representing payment for teaching, research, or other services required as a condition for receiving the award. However, any part of a scholarship or fellowship that represents payment for teaching, research, or other services does not have to be included in income if the award was received under one of the following programs.⁹⁷

- The National Health Service Corps Scholarship Program
- The Armed Forces Health Professions Scholarship and Financial Assistance Program

Example 36. Liz, a degree candidate, received a scholarship of \$2,500 from Gala University. As a condition of receiving the scholarship, Liz must serve as a part-time teaching assistant. Of the \$2,500 scholarship, \$1,000 represents payment for teaching. Gala University reports \$1,000 as income on the Form W-2, *Wage and Tax Statement*, it sends to Liz.

Liz's tuition for the year was \$3,000. The entire \$2,500 scholarship was used for tuition, but only \$1,500 is excludable from income. The \$1,000 Liz received for teaching is **not excludable** and must be included in income.

Reporting Scholarships and Fellowships

Whether a scholarship or fellowship must be reported on an individual's tax return depends on:

- Whether the person receiving the award must file a return, and
- Whether any part of the award is taxable.

The individual is not required to file a tax return if their only income is a completely tax-free scholarship or fellowship. If all or part of the award is taxable and the individual is required to file a tax return, the taxable amount should be included on line 7 (wages and salaries) of Form 1040. **If the taxable amount was not reported on Form W-2, the taxable amount and the notation "SCH" should be entered in the space to the left of line 7.**

Any part of the award that is reported on Form 1099-MISC, *Miscellaneous Income*, as pay for teaching or other services is subject to self-employment tax.⁹⁸

QUALIFIED TUITION REDUCTION

A tuition reduction allows an individual the opportunity to study without paying tuition or by paying a reduced rate of tuition. **A qualified tuition reduction does not have to be included in income.**

⁹⁷ IRC §§117(b) and (c).

⁹⁸ IRS Pub. 970, *Tax Benefits for Education*.

A tuition reduction is qualified only if it is received from and used at an eligible educational institution.⁹⁹ However, the individual is not required to use the tuition reduction at the eligible educational institution from which it was received. Instead, they may work for one eligible educational institution and make arrangements to take courses at another eligible educational institution without paying any tuition.

Example 37. Seneca is an academic professional employed at the University of Illinois. Her son, Anders, wants to attend Illinois State University. Seneca applies for a 50% tuition waiver for Anders. If Seneca and Anders meet all the eligibility requirements, the waiver may be used to reduce Anders' tuition costs at Illinois State.

The rules for determining if a tuition reduction is qualified (and thus tax free) vary depending on whether the education provided is below the graduate level or at the graduate level.

Education Below the Graduate Level

If an individual receives a tuition reduction for education below the graduate level (including primary and secondary education), it is a qualified tuition reduction only if the student's relationship to the educational institution providing the benefit is one of the following.

1. The individual is an employee of the eligible educational institution.
2. The individual was an employee of the eligible educational institution but retired or left on disability.
3. The individual is a widow(er) of an individual who died while an employee of the eligible educational institution or who retired or left on disability.
4. The individual is the dependent child or spouse of an individual described in items 1–3.

Graduate Education

A tuition reduction for graduate-level education is qualified if **both** of the following requirements are met.

- The tuition reduction is provided by an eligible educational institution.
- The individual receiving the tuition reduction is a graduate student who performs teaching or research activities for the educational institution.

Reporting a Tuition Reduction

A taxable tuition reduction should be included as wages in box 1 of Form W-2. This amount should then be reported on line 7 of Form 1040.

Example 38. Morgan is a full-time employee at State University. She applies for a tuition reduction for the education of her son, Albert, who has been accepted at State University as an undergraduate student. Albert is not Morgan's dependent. If the tuition reduction is granted by State University, the amount of the reduction is taxable to Morgan and should be included as wages on her Form W-2.¹⁰⁰

⁹⁹ The definition of **eligible educational institution** is the same as that used in the section "Scholarships and Fellowships."

¹⁰⁰ IRS Pub. 970, *Tax Benefits for Education*.

OTHER TYPES OF EDUCATIONAL ASSISTANCE¹⁰¹

Other types of educational assistance are available in addition to scholarships, fellowships, and tuition reductions. Some of the most common types of assistance are discussed in this section.

PELL GRANTS

Pell grants are based on need and are treated as scholarships for federal tax purposes. This type of grant is nontaxable to the extent it is used for qualified educational expenses during the period for which it was awarded. Only the taxable amount, if any, should be reported on the recipient's tax return.

FULBRIGHT GRANTS

A Fulbright grant is generally treated as a scholarship or fellowship in determining how much of the grant is nontaxable. Only the taxable amount should be reported on the recipient's tax return.

VETERANS' BENEFITS

Payments received for education, training, or subsistence under any law administered by the U.S. Department of Veterans Affairs (VA) are nontaxable. These payments should **not** be included as income on the recipient's federal tax return.

If the recipient of VA benefits qualifies for one or more additional educational benefits, they may have to reduce the amount of education expenses qualifying for a specific benefit by part or all of the VA payments. This applies only to the part of the individual's VA payments that is required to be used for education expenses.

Example 39. Herbert returned to college in January 2014 and received benefits under the GI Bill. He received a \$1,600 monthly basic housing allowance (BHA), which was deposited directly into his checking account. Another \$4,000 was paid directly to his college for tuition. Neither of these benefits is taxable to Herbert, and he does not report them on his 2014 tax return.

Herbert wants to claim an AOC on his tax return. During 2014, he paid \$5,000 in qualified education expenses. To calculate the amount of his credit, Herbert must first subtract the \$4,000 from his qualified education expenses because that amount was paid directly to the college under the GI Bill. Herbert does not subtract any part of the BHA because it was paid to him and its use was not restricted.

BUSINESS-RELATED EDUCATION EXPENSE DEDUCTIONS

A taxpayer may be allowed to deduct business-related educational expenses paid during the year. For an expense to be deductible, it must be related to a form of education that meets one of the following tests.¹⁰²

1. The education is required by the taxpayer's employer or the law to keep the taxpayer's present salary, status, or job. The required education must serve the employer's bona fide business purpose.
2. The education maintains or improves skills needed in the taxpayer's present work.

Example 40. Meredith is a general practitioner of medicine. She takes a 2-week course reviewing new developments in several specialized medical fields. The education expenses are deductible because they maintain or improve Meredith's job skills. They do not qualify her for a new trade or business.

^{101.} Ibid.

^{102.} Ibid.

Even if the education meets one of the preceding two tests, IRS regulations specifically prohibit deducting the following expenses for business-related education.¹⁰³

- Expenses qualifying the taxpayer for a new trade or business
- Expenses necessary to meet the minimum requirements for the taxpayer's job

Example 41. Kristin is an accountant. Her employer requires her to get a law degree at her own expense. Kristin registers at a law school for the regular curriculum that leads to a law degree. Even though the education is required by her employer and she does not intend to become a lawyer, Kristin's education expenses are not deductible because the law degree qualifies Kristin for a new trade or business.

Observation. Bar examination or CPA examination review courses are not deductible as business-related education expenses. They are considered expenses that qualify the taxpayer for a new trade or business.

QUALIFYING EXPENSES

If the taxpayer's education meets one of the two tests described earlier, the education expenses can generally be deducted as business-related expenses. The following education expenses can be deducted.¹⁰⁴

- Tuition, books, supplies, lab fees, and similar items
- Certain transportation and travel costs
- Other education expenses, such as the costs of research and typing

Qualified education expenses must be reduced by the following.

- Any tax-free benefits, such as the following:
 - ♦ Tax-free scholarships and fellowships
 - ♦ Pell grants
 - ♦ Veterans' education assistance benefits
 - ♦ Employer-provided educational assistance
- The amount, if any, that is deducted under any other provision of the tax law, such as expenses used to compute the following:
 - ♦ AOC, lifetime learning credits, or tuition and fees deduction
 - ♦ Tax-free withdrawals from Coverdell ESAs
 - ♦ Tax-free withdrawals from §529 plans
 - ♦ Interest exclusion from U.S. savings bonds

Qualifying business-related education expenses are deductible even if the education may lead to a degree.

Example 42. Trina is a teacher who has satisfied the minimum educational requirement for teaching. To keep her job, her employer requires her to take an additional college course each year. This education will not qualify her for a new trade or business. Thus, the course-related expenses qualify even if she eventually receives a master's degree because of this extra education.

¹⁰³. Treas. Reg. §1.162-5(b).

¹⁰⁴. IRS Pub. 970, *Tax Benefits for Education*.

Transportation Expenses

Because commuting costs are not deductible business expenses, expenses incurred in traveling between an individual's home and school are generally nondeductible. However, a taxpayer whose education qualifies as a business-related expense **can deduct the local transportation costs of going directly from work to school**. A taxpayer who is regularly employed and goes to school on a temporary basis **can also deduct the costs of returning to home from school**.¹⁰⁵

Education is considered to be on a **temporary basis** if either of the following situations applies.¹⁰⁶

- The taxpayer's attendance at school is expected to and does last one year or less.
- The taxpayer's attendance at school is initially expected to last one year or less but, at a later date, attendance is reasonably expected to last more than one year. In this situation, the attendance is considered temporary up to the date the taxpayer determines it will last more than one year.

If the taxpayer is in either of these situations, then their attendance is not considered temporary if facts and circumstances indicate otherwise.

A taxpayer who is regularly employed and goes directly from home to school on a temporary basis can deduct the round-trip costs of transportation between home and school. This applies regardless of the location of the school, the distance traveled, and whether the taxpayer attends school on nonwork days.¹⁰⁷

Example 43. Emma attends school two nights a week for three months to take a class that will improve her job skills. Emma's school attendance is temporary, and she is regularly employed. Therefore, she can deduct the transportation expenses incurred in traveling directly between work and school and then between school and home.

Example 44. Montel attends school two nights a week for two years to take classes that will improve his job skills. Because the school attendance is **not** considered temporary, Montel can only deduct his transportation expenses between work and school.

Example 45. Karyn attends school for nine months on Saturdays, which are nonwork days, to take classes that will improve her job skills. Because she is attending school on a temporary basis, Karyn can deduct the round-trip transportation expenses incurred traveling between home and school.

Transportation expenses include the actual costs of bus, subway, cab, and other fares. If the taxpayer uses their own car for transportation to school, they can deduct their actual expenses or use the standard mileage rate. Either way, the taxpayer can also deduct parking fees and tolls.

Transportation expenses do not include amounts spent for travel, meals, and lodging while the taxpayer is away from home overnight.

Travel Expenses

Expenses for travel, meals (subject to the 50% limitation), and lodging are deductible if:¹⁰⁸

- The taxpayer traveled overnight to obtain qualified education, and
- The main purpose of the trip was to attend a work-related course or seminar.

¹⁰⁵. Ibid.

¹⁰⁶. Ibid.

¹⁰⁷. Ibid.

¹⁰⁸. Ibid.

If the main purpose of the trip is personal, then only the lodging and 50% of the expenses for meals incurred during the time the taxpayer attends the qualifying educational activities are deductible. Expenses incurred for personal activities, such as sightseeing and entertainment, are not deductible.¹⁰⁹

Example 46. Peter works in Falls Church, Virginia. He traveled to Chicago to attend a weeklong seminar at the request of his employer. His main reason for going to Chicago was to attend the seminar. While there, Peter took a sightseeing trip and attended a Cubs game.

Peter's trip was mainly for business-related education. This means he can deduct the expenses for his round-trip airfare and for the lodging and meals (subject to the 50% limitation) connected with his educational activities. He cannot deduct the costs of the sightseeing trip and the tickets to the Cubs game.

Whether the main purpose of a trip is personal or educational depends on the facts and circumstances. One important factor is the time spent during the trip on personal activities versus educational activities. If the taxpayer spends more time on personal activities, the trip is considered mainly educational only if the taxpayer can show a substantial nonpersonal reason for traveling to a particular location.¹¹⁰

Example 47. Kelly's employer required her to enroll in a qualifying work-related education course. Although she lives in Boston, she had the option of completing the course in any of several other locations. She decided to take the course at a university in Illinois, and her reasons for doing so were all personal.

Kelly took one course, which was one-fourth of a full course load at the university. She spent the rest of her time engaged in personal activities.

Kelly's trip was mainly personal because three-fourths of her time was considered personal time. She cannot deduct the cost of her round-trip airplane ticket to Illinois. She can deduct one-fourth of her meals (subject to the 50% limit) and lodging costs for the time she attended the university.¹¹¹

Travel as a form of education is not deductible even if it is directly related to the taxpayer's work or business duties.¹¹²

Example 48. Danielle is a French language teacher. While on sabbatical leave granted for travel, Danielle traveled throughout France to improve her knowledge of the French language. She chose her itinerary and most of her activities to improve her French language skills. Danielle **cannot** deduct her travel expenses as education expenses.

EMPLOYEE-PAID EXPENSES

If the taxpayer is an employee, the cost of qualifying work-related education can be deducted only if they meet one of the following conditions.

1. The employee did not receive (and was not entitled to receive) any reimbursement from the employer.
2. The employee was reimbursed under a nonaccountable plan (i.e., the amount was included in box 1 of Form W-2).
3. The employee received reimbursement under an accountable plan (i.e., the employer did not include any reimbursement in box 1 of Form W-2). However, the amount received was less than the expenses the employee submitted for reimbursement.

If item 1 or 2 applies, the taxpayer can deduct the total qualifying cost. If item 3 applies, the taxpayer can deduct only the qualifying costs that exceed the amount of the reimbursement.

¹⁰⁹ Treas. Reg. §1.162-5(e)(1).

¹¹⁰ IRS Pub. 970, *Tax Benefits for Education*.

¹¹¹ Adapted from an example in IRS Pub. 970, *Tax Benefits for Education*.

¹¹² IRC §274(m)(2).

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The cost of the qualifying work-related education should be included on line 21 of Schedule A as a miscellaneous itemized deduction subject to the 2%-of-AGI limitation. Additionally, Form 2106, *Employee Business Expenses*, or Form 2106-EZ, *Unreimbursed Employee Business Expenses*, generally must be completed. Neither Form 2106 nor 2106-EZ is required if:

- Any reimbursements are included in box 1 of the taxpayer's Form W-2, and
- The taxpayer is not claiming travel, transportation, meal, or entertainment expenses.

Example 49. Mistie Raines teaches math at a private high school in Iowa. Over the summer, she attended a 3-week math seminar at a university in California. Completing the seminar improved her skills in her current job and qualified as work-related education. Mistie was reimbursed for \$2,100 of her expenses under her employer's nonaccountable plan, so her reimbursement was included in the wages shown in box 1 of her Form W-2.

Mistie's actual expenses for the seminar are as follows.

Lodging	\$1,050
Meals	526
Airfare	550
Taxi fares	50
Tuition and books	400
Total expenses	<u>\$2,576</u>

Mistie files the following Form 2106-EZ with her tax return. She enters \$1,650 (\$1,050 + \$550 + \$50) on line 3 for her lodging, airfare, and taxi fares. She enters \$400 on line 4 for her tuition and books. On line 5, she enters \$526 for meal expenses and multiplies that amount by 50%. Mistie carries the total of \$2,313 from line 6 to Schedule A, line 21.

For Example 49

Form 2106-EZ Department of the Treasury Internal Revenue Service (99)	Unreimbursed Employee Business Expenses ▶ Attach to Form 1040 or Form 1040NR. ▶ Information about Form 2106 and its separate instructions is available at www.irs.gov/form2106 .	OMB No. 1545-0074 <div style="text-align: center; font-size: 24pt; font-weight: bold;">2014</div> Attachment Sequence No. 129A
Your name Mistie Raines	Occupation in which you incurred expenses Teaching	Social security number 555 99 5555

You Can Use This Form Only if All of the Following Apply.

- You are an employee deducting ordinary and necessary expenses attributable to your job. An ordinary expense is one that is common and accepted in your field of trade, business, or profession. A necessary expense is one that is helpful and appropriate for your business. An expense does not have to be required to be considered necessary.
- You **do not** get reimbursed by your employer for any expenses (amounts your employer included in box 1 of your Form W-2 are not considered reimbursements for this purpose).
- If you are claiming vehicle expense, you are using the standard mileage rate for 2014.

Caution: You can use the standard mileage rate for 2014 **only if:** (a) you owned the vehicle and used the standard mileage rate for the first year you placed the vehicle in service, **or** (b) you leased the vehicle and used the standard mileage rate for the portion of the lease period after 1997.

Part I Figure Your Expenses

1 Complete Part II. Multiply line 8a by 56¢ (.56). Enter the result here	1		
2 Parking fees, tolls, and transportation, including train, bus, etc., that did not involve overnight travel or commuting to and from work	2		
3 Travel expense while away from home overnight, including lodging, airplane, car rental, etc. Do not include meals and entertainment	3	1,650	
4 Business expenses not included on lines 1 through 3. Do not include meals and entertainment	4	400	
5 Meals and entertainment expenses: \$ <u>526</u> × 50% (.50). (Employees subject to Department of Transportation (DOT) hours of service limits: Multiply meal expenses incurred while away from home on business by 80% (.80) instead of 50%. For details, see instructions.)	5	263	
6 Total expenses. Add lines 1 through 5. Enter here and on Schedule A (Form 1040), line 21 (or on Schedule A (Form 1040NR), line 7). (Armed Forces reservists, fee-basis state or local government officials, qualified performing artists, and individuals with disabilities: See the instructions for special rules on where to enter this amount.)	6	2,313	

Part II Information on Your Vehicle. Complete this part **only** if you are claiming vehicle expense on line 1.

7 When did you place your vehicle in service for business use? (month, day, year) ▶ _____ / _____ / _____

8 Of the total number of miles you drove your vehicle during 2014, enter the number of miles you used your vehicle for:

a Business _____ b Commuting (see instructions) _____ c Other _____

9 Was your vehicle available for personal use during off-duty hours? ☐ Yes ☐ No

10 Do you (or your spouse) have another vehicle available for personal use? ☐ Yes ☐ No

11a Do you have evidence to support your deduction? ☐ Yes ☐ No

b If "Yes," is the evidence written? ☐ Yes ☐ No

For Paperwork Reduction Act Notice, see your tax return instructions.

Cat. No. 20604Q

Form **2106-EZ** (2014)

SELF-EMPLOYED TAXPAYER'S EDUCATION EXPENSES

If the taxpayer is self-employed, work-related education must qualify as a trade or business expense under IRC §162 to be deductible. This deduction is claimed on Schedule C, *Profit or Loss From Business*, or Schedule F, *Profit or Loss From Farming*.

INTERACTION WITH OTHER EDUCATION TAX INCENTIVES

Expenses deducted as business-related education cannot be used as the basis for any other tax deduction or tax credit. When an expense is deductible under more than one tax provision, the taxpayer can choose where to claim it. The total expense can be divided between several different provisions.

Observation. When an expense is deductible under more than one tax provision, the practitioner usually needs to calculate the return several different ways in order to obtain the lowest tax liability. Many tax software programs calculate the tax using the options available to ensure optimal results.

Example 50. In 2014, Ryan incurred \$3,000 of business-related education expenses. His other miscellaneous itemized deductions exceed 2% of his AGI. This means Ryan is eligible for a tax benefit for the entire \$3,000 of education expenses.

Ryan's tax professional informs him that \$2,000 of the business-related education expenses also qualify for the tuition and fees deduction. Ryan has a lower tax liability by claiming \$2,000 as a tuition and fees deduction and \$1,000 as an itemized deduction. The tuition and fees deduction reduces his AGI, which increases the deductible amount of his miscellaneous itemized deductions.

EMPLOYER-PROVIDED EDUCATIONAL ASSISTANCE

Employers can offer tax-free education opportunities to their employees in several ways. Two of the most common methods used to provide these benefits are the following.

- Educational assistance programs
- Education offered as a working-condition fringe benefit

EDUCATIONAL ASSISTANCE PROGRAMS¹¹³

An educational assistance program is a written plan that provides educational assistance only to the taxpayer's employees. The program must meet several tests in order to be a **qualified** program. For information about these tests, see IRS Pub. 15-B, *Employer's Tax Guide to Fringe Benefits*.

An employer can exclude up to \$5,250 of educational assistance provided under an educational assistance plan from the employee's wages reported on Form W-2 each year. If the employer does not have an educational assistance plan or provides an employee with assistance that exceeds \$5,250, the value of these benefits must be reported as wages, unless they are working condition fringe benefits.

WORKING-CONDITION FRINGE BENEFITS¹¹⁴

Under IRC §132(d), an employer can offer tax-free education benefits to its employees as a working-condition fringe benefit. This applies to the extent that the employee could deduct the expenses on their individual tax return as a business expense under IRC §162 if they paid it themselves.

¹¹³. IRS Pub. 15-B, *Employer's Tax Guide to Fringe Benefits*.

¹¹⁴. Ibid.

Each course that an employee takes must be evaluated to determine if it qualifies as a working-condition fringe benefit. The education must meet at least one of the following tests.

- The education is required by the employer or by law in order for the employee to keep their present salary, status, or job. The education must serve the employer's bona fide business purpose.
- The education maintains or improves skills needed in the job.

However, even if the education meets one of these two tests, it is **not** qualifying education if it:

- Is needed to meet the minimum educational requirements of the employee's present trade or business, or
- Is part of a study program that will qualify the employee for a new trade or business.

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