

24 Education Credits - - - Comprehensive

This is a comprehensive exercise. The taxpayer or dependent may have options to declare some scholarship or grants as wages and reduce the offset to qualified education expense to increase an education tax credit.

Learning Objectives

- Learn how to optimize the options available to the taxpayer to maximize the tax benefit with education benefits
- Review NTTC Modified 4491, Chapter 23 for possible education benefits

Getting Started:

Taken from (2017) IRS Publication 970, Chapter 2, American Opportunity Credit

Note. Whether you will benefit from applying a scholarship or fellowship grant to nonqualified expenses will depend on the amount of the student's qualified education expenses, the amount of the scholarship or fellowship grant, and whether the scholarship or fellowship grant may (by its terms) be used for nonqualified expenses. Any benefit will also depend on the student's federal and state marginal tax rates as well as any federal and state tax credits the student claims. Before deciding, look at the total amount of your federal and state tax refunds or taxes owed and, if the student is your dependent, the student's tax refunds or taxes owed. For example, if you are the student and you also claim the EIC, choosing to apply a scholarship or fellowship grant to nonqualified expenses by including the amount in your income may benefit you if the increase to your American opportunity credit is more than the decrease to your EIC.

Example 1. Bill Pass, age 28 and unmarried, enrolled full-time in 2017 as a first-year student at a local college to earn a degree in law enforcement. This was his first year of postsecondary education. During 2017, he paid \$5,600 for his qualified education expenses and \$4,400 for his room and board for the fall 2017 semester. He and the college meet all the requirements for the American opportunity credit. Bill's adjusted gross income (AGI) and his MAGI, for purposes of figuring his credit, are \$30,400. Bill claims the standard deduction of \$6,350 and personal exemption of \$4,050, resulting in taxable income of \$20,000 and an income tax liability before credits of \$2,538. Bill claims no credits other than the American opportunity credit. He figures his American opportunity credit based on qualified education expenses of \$4,000, which results in a credit of \$2,500 and a tax liability after credits of \$38 (\$2,538 - \$2,500).

Example 2—Scholarship excluded from income. The facts are the same as in Example 1—No scholarship, except that Bill was awarded a \$5,600 scholarship. Under the terms of his scholarship, it may be used to pay any educational expenses, including room and board. If Bill excludes the scholarship from income, he will be deemed (for purposes of figuring his education credit) to have applied the scholarship to pay his tuition, required fees, and course materials. His adjusted qualified education expenses would be zero and he wouldn't have an education credit. Therefore, Bill's tax liability after credits would be \$2,538.

Example 3—Scholarship partially included in income. The facts are the same as in Example 2—Scholarship excluded from income. If, unlike Example 2, Bill includes \$4,000 of the scholarship in income, he will be deemed to have applied that amount to pay for room and board. The remaining \$1,600 of the \$5,600 scholarship would reduce his qualified education expenses and his adjusted qualified education expenses would be \$4,000. Bill's AGI and MAGI would increase to \$34,400, his taxable income would increase to \$24,000, and his tax liability before credits would increase to \$3,138. Based on his adjusted qualified education expenses of \$4,000, Bill would be able to claim an American opportunity credit of \$2,500 and his tax liability after credits would be \$638.

Example 4—Scholarship applied by the postsecondary school to tuition. The facts are the same as in Example 3—Scholarship partially included in income, except the \$5,600 scholarship is paid directly to the local college. The fact that the local college applies the scholarship to Bill's tuition and related fees doesn't prevent Bill from including \$4,000 of the scholarship in income. As in Example 3, by doing so, he will be deemed to have applied \$4,000 to pay for room and board. Bill would be able to claim the American opportunity credit of \$2,500 and his tax liability after credits would be \$638.

Example 5—Student with a dependent child. Jane Doe, age 28 and unmarried, enrolled full-time as a first-year student at a local technical college to get a certificate as a computer technician. This was her first year of postsecondary education. During 2017, she paid \$6,000 for qualified education expenses. She and the college meet all the requirements for the American opportunity credit. Jane has a dependent child, age 10, who is a qualifying child for purposes of receiving the earned income credit (EIC) and the child tax credit. Jane's wages are \$20,000. Jane withheld no income taxes on these wages and has no other income or adjustments. Jane was awarded a \$5,500 scholarship. Under the terms of her scholarship, it may be used to pay tuition and any living expense, including rent. Jane paid \$10,000 in living expenses in 2017.

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If Jane excludes the entire scholarship from income, she will be deemed to have applied the entire scholarship to pay qualified education expenses. Her AGI and MAGI would be \$20,000. Her tax liability before any credits would be \$256. Her qualified education expenses would be reduced to \$500. She would be able to receive a \$456 American opportunity credit (\$200 refundable and \$256 nonrefundable), a \$1,000 additional child tax credit, and a \$3,131 earned income credit. In total, she would be able to receive a **tax refund of \$4,331**.

If Jane includes the entire scholarship in income, she will be deemed to have applied the entire scholarship to pay living expenses. Her qualified education expenses would be \$6,000, and her AGI and MAGI would be \$25,500. Her tax liability before any credits would be \$808. She would be able to receive a \$1,808 American opportunity credit (\$1,000 refundable and \$808 nonrefundable), a \$1,000 additional child tax credit, and a \$2,252 earned income credit. In total, she would be able to receive a **tax refund of \$4,252**.

If Jane includes \$3,500 of the scholarship in income, she will be deemed to have applied \$3,500 of the scholarship to pay living expenses, and \$2,000 to pay qualified education expenses. Her qualified education expenses would be \$4,000, and her AGI and MAGI would be \$23,500. Her tax liability before any credits would be \$608. She would be able to receive a \$1,608 American opportunity credit (\$1,000 refundable and \$608 nonrefundable), a \$1,000 additional child tax credit, and a \$2,571 earned income credit. In total, she would be able to receive a **tax refund of \$4,571**.

If Jane includes \$1,500 of the scholarship in income, she will be deemed to have applied \$1,500 of the scholarship to pay living expenses, and \$4,000 to pay qualified education expenses. Her qualified education expenses would be \$2,000, and her AGI and MAGI would be \$21,500. Her tax liability before any credits would be \$408. She would be able to receive a \$1,208 American opportunity credit (\$800 refundable and \$408 nonrefundable), a \$1,000 additional child tax credit, and a \$2,891 earned income credit. In total, she would be able to receive a **tax refund of \$4,691**. This is the highest tax refund among these scenarios.

Video: [Colorado - Bogart Education Calculator](https://www.youtube.com/watch?v=9gQJIPBQCPc&feature=youtu.be)
<https://www.youtube.com/watch?v=9gQJIPBQCPc&feature=youtu.be>

Learning Review

In 2017 Jane Doe is a 25 year old taxpayer attending a school half time that qualifies for the American Opportunity Credit. Jane is unmarried and has a dependent child, age 10, DOB 7/1/2008, who is a qualifying child for the earned income credit (EIC) and the child tax credit.

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- Earned income from W-2s of \$20,000
- Received a Pell Grant of \$5,500
- Paid \$5,000 tuition
- Paid \$1,000 for books and equipment including a laptop computer
- Paid \$10,000 in living expenses.
- Input the Jane Doe scenario into the Bogart Education Benefits Calculator
<https://cotaxaide.org/tools/Education%20Calculator.html>

Output from Bogart's **Education Benefits Calculator**:

On taxpayer's return:


- Most advantageous option:	American opportunity credit
- Scholarship as income amount:	1499
- Education expense amount:	1999

Practice Lab

Using the Optimized output, input Jane Doe's return into Practice Lab. Compare your tax refund to the one calculated in Example 5.

Social Security
125-00-8001
THIS NUMBER HAS BEEN ESTABLISHED FOR
JANE DOE
For Tax Training Purposes Only

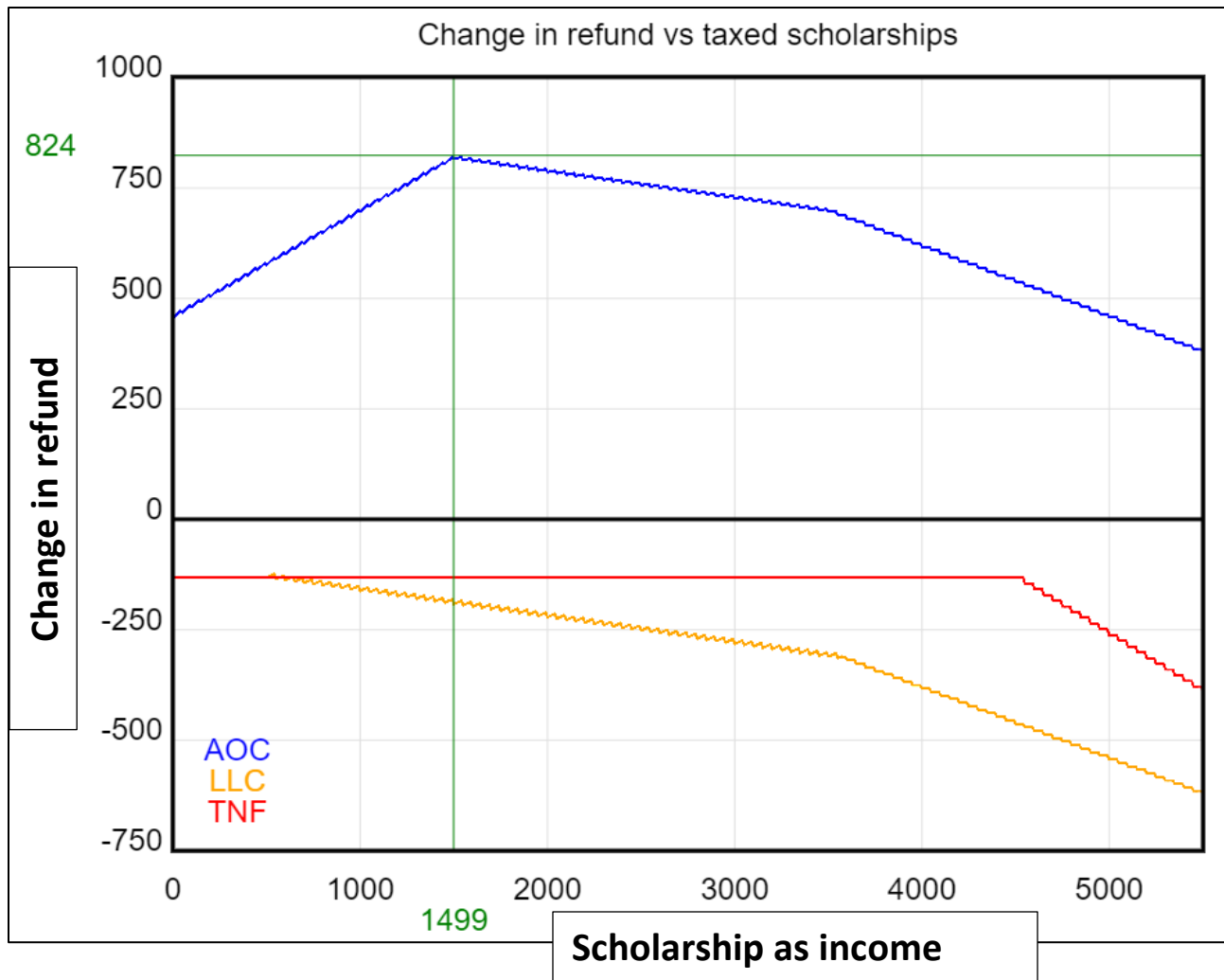
Social Security
125-00-8002
THIS NUMBER HAS BEEN ESTABLISHED FOR
CHILD DOE
For Tax Training Purposes Only

Driver's License (Tax Training Only)
License No. 20181111201822
Name and Address
JANE DOE
123 2ND STREET
YOUR CITY, YSTATE, YZIP
Birth Date 05/01/1993
Issue Date Expiration Date 05/01/2023


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a. Employee's social security number 125-00-8001			
b. Employer identification number (EIN) 12-0123456		1. Wages, tips, other compensation \$20,000.00	2. Federal income tax withheld
c. Employer's name, address, City, State and ZIP Code BOND DENTAL ASSOCIATES 416 CHRISTIAN CT PHILADELPHIA PA 19119		3. Social security wages \$20,000.00	4. Social security tax withheld \$1,240.00
		5. Medicare wages and tips \$20,000.00	6. Medicare tax withheld \$290.00
		7. Social security tips	8. Allocated tips
d. Control number		9. Verification code	10. Dependant care benefits
e. Employee's first name and initial last name f. Employee's address and ZIP code JANE DOE 123 2ND STREET YOUR CITY, YSTATE, YZIP		11. Nonqualified plans	12a. See instructions for box 12
		13. Statutory Retirement Third-party Employee Plan sickpay <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>	12b.
		14. Other	12c.
			12d.
15. State YS	Employer's state ID number 120123456	16. State wages, tips, etc. \$20,000.00	17. State income tax 750.00
Form W-2 Wage and Tax Statement 2018 Copy B - To Be Filed With Employee's FEDERAL Tax Return. This information is being furnished to the Internal Revenue Service.			

<input type="checkbox"/> CORRECTED (if checked)			
FILER'S name, address, city, state, and ZIP code NORTHERN KENTUCKY UNIVERSITY NUNN DRIVE FOUNDERS HALL NEWPORT KY 41076		1 Payments received for qualified tuition and related expenses \$5,000.00	2018 Tuition Statement Form 1098-T
FILER'S federal identification no. 46-9123456	STUDENT'S taxpayer identification no. 125-00-8001	2 Amounts billed for qualified tuition and related expenses	
STUDENT'S name, address, city, state, and ZIP code JANE DOE 123 2ND STREET YOUR CITY, YSTATE, YZIP		3 If this box is checked, your educational institution has changed its reporting method for 2018. <input type="checkbox"/>	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.
		4 Adjustments made for a prior year	
		5 Scholarships or grants \$5,500.00	
		6 Adjustments to scholarships or grants for a prior year	
Service Provider/Acct No. (see instr.)	8. Checked if at least half-time student <input checked="" type="checkbox"/>	9 Checked if a graduate student <input type="checkbox"/>	7 Checked if the amount in box 1 or 2 includes amounts for an academic period beginning January-March 2019. <input type="checkbox"/>
		10 Ins. contract reimb/refund	
Form 1098-T			



- Change in refund – zero represents a \$3,875 refund with \$500 scholarship income and zero qualified education expense as stated on the Form 1098-T
- Optimum represents $3,875 + 824 = 4,699$ refund



Study the associated NTTC Modifications to the IRS Training Guide, Chapter 23

From NTTC Modifications to the IRS Training Guide (page 23-10)

Review of possible education benefits:

Scholarships, grants or fellowships One main benefit is to make scholarships, grants or other education assistance tax-free. Scholarships or grants that are not based on work can be tax-free. If they are tax-free, they are not entered on the tax return. See Worksheet 1-1 in Pub 4012, Tab J.

Coverdell Education Savings Accounts (ESA) and Qualified Tuition Programs (QTP) These are special accounts that have been set up to pay education expenses. The earnings are tax-free if the distributions are used to offset qualifying expenses. Qualifying expenses **include room and board** if the student attended at least half-time.

Coverdell distributions can be used for K-12 expenses as well as post-secondary education. QTP (Sec. 529 plan) distributions can also be used for K-12 expenses, up to an annual limit of \$10,000.

Employer-provided educational assistance Employers may provide up to \$5,250 of tax-free payments or reimbursements for an employee's education expenses. Unreimbursed qualified education expenses that exceed the employer payments can be used toward other benefits.

Veterans Administration education benefit If the student qualifies for one or more VA education benefits, the payments are not included on his or her tax return, but he or she must reduce the amount of education expenses qualifying for an education tax benefit by his or her VA payments. This applies only to the part of his or her VA payments that is required to be used for education expenses.

Business deduction The taxpayer can deduct the costs of qualifying work-related education as a business expense if they are self-employed. Refer to the Business Income lesson.

Educator Expenses Professional development expenses can be claimed as part of the educator expense adjustment to gross income. Refer to the Adjustments to Income lesson.

NTTC Modifications to the IRS Training Guide, Chapter 23

Who can take an education credit?

A Form 1098-T is not required when all the tuition and fees were paid with scholarships or grants. The taxpayer will need to provide the required information to claim an education credit.

Clarify restricted and unrestricted grants

The student can choose whether to apply the education assistance to reduce qualified education expenses or as taxable income **only if** the scholarship or grant is unrestricted. Restricted scholarships or grants must be used for tuition, fees, and other expenses, such as books, as per the terms of the grant. If the student could withdraw unspent assistance amounts from their student account, the assistance is unrestricted.

Clarify in the Juan example (page 23-4) that it may be better to forgo some portion of the AOC when other issues, such as the kiddie tax or premium tax credits, could be adversely affected by Juan having a filing requirement.

Clarify that taxpayers under age 24 (page 23-5) cannot claim the refundable portion of the credit if certain conditions are met – these are the same conditions that would make the kiddie tax apply, other than having unearned income in excess of the kiddie tax ceiling requirement. See Who must file Form 8615 in Lesson 20.

Correct wording in TIP (page 23-7):

A taxpayer who has taken an early distribution from an IRA may take an exception to the 10% additional tax **up to the amount of** the qualified higher education expenses.

Correct last bullet of the Summary (page 23-9):

Students that include tax-free scholarships and grants in income and have a filing requirement **may need to** file Form 8615, Tax for Certain Children Who Have Unearned Income