



Education Credits

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➤ **What is an eligible education institution?**

An eligible educational institution is generally any accredited public, nonprofit, or proprietary (privately owned profit-making) college, university, vocational school, or other postsecondary educational institution. Also, the institution must be eligible to participate in a student aid program administered by the U.S. Department of Education. Virtually all accredited postsecondary institutions meet this definition. An eligible educational institution also includes certain educational institutions located outside the



United States that are eligible to participate in a student aid program administered by the U.S. Department of Education.

Look up a school here: <https://www.ed.gov/accreditation?src=rn>

➤ **What counts as tax-free educational assistance?**

You must reduce the qualified educational expenses for each academic period by the amount of tax-free education assistance allocable to that academic period. This assistance includes: tax-free parts of scholarships and fellowship grants, tax-free part of employer-provide education assistance, veterans' educational assistance, and any other nontaxable payments (other than gifts or inheritances) received as educational assistance.

You cannot claim an education credit based on the same expenses used to figure the tax-free portion of a distribution from a Coverdell education savings account (ESA) or qualified tuition program (QTP). Any additional tax-free assistance received from one of these types of accounts not already included on a 1098-T would be added to the sum of tax-free assistance received (alongside scholarships and grants). The full amount of the distribution must have been used toward education expenses or else the return becomes out of scope for VITA. (The Special Tax Services team can prepare this type of return.) The distribution may be reported on a 1099-Q (see later entry).

➤ **Do we have to see the 1098-T?**

We do. Exceptions in which institution not required to send a 1098-T: if the student is a nonresident alien, has qualified education expenses paid entirely with scholarships, has qualified education expenses paid under a formal billing arrangement, or is enrolled in courses for which no credit is awarded. If a student's educational institution is not required to provide a 1098-T to the student, the taxpayer may claim one of the education benefits without it if he/she otherwise qualifies, can demonstrate that the taxpayer (or dependent) was enrolled at an eligible educational institution, and can substantiate the payment of qualified tuition and related expenses.

➤ **Do we need to see the account summary to calculate an education credit?**

Yes, we must see the student's account summary from the educational institution to accurately calculate any education credit and/or taxable scholarship income.

➤ **How do we count years of eligibility for the American Opportunity Credit?**

The American Opportunity Credit (AOC) is available for the first 4 years of post-secondary education. It is available to the student for the first 4 years that they were eligible. (The school defines the parameters for being at least a half-time student.) If you qualify for the credit but do not take it, that counts for 1 of the 4 total years of eligibility. If you were an eligible student for 4 years already, you are no longer eligible to take the credit (even if you did not claim the credit for 4 years yet). However, you can use either semester of your first academic year (fall-spring) toward your first year of eligibility for the credit.



(Example: if your first year of college was fall 2018-spring 2019, you can either claim the first year of AOC in tax year 2018 or 2019.)

➤ **What expenses can we count?**

For 2018, the credits are based on the amount of qualified education expenses paid for the student in 2018 for academic periods beginning in 2018 and in the first 3 months of 2019.

Laptops are not qualified expenses for purposes of the American Opportunity Credit or Lifetime Learning Credit unless the syllabus specifically states a laptop is required for the course.

➤ **What if the qualified education expenses were paid with borrowed funds?**

You can claim an education credit for qualified education expenses to figure the credit for the year in which the expenses are paid, not the year in which the loan is repaid. Treat loan payments sent directly to institution as paid on date institution credits the student's account

➤ **What amounts do not reduce qualified education expenses (unlike tax-free educational assistance)?**

Do not reduce qualified education expenses by amounts paid with funds the student receives as payment for services, such as wages; a loan; a gift; an inheritance; or a withdrawal from the student's personal savings. Additionally, do not reduce qualified education expenses by any scholarship or fellowship grant reported as income on the student's tax return when use of the money is restricted, by the terms of the scholarship, to costs of attendance (such as room and board) other than qualified education expenses.

➤ **What is the definition of a "half-time" student?**

A student is enrolled "at least half-time" if he or she is enrolled for at least half the full-time academic work load (for at least one academic period- e.g. semester- beginning in the tax year) for the course of study the student is pursuing, as determined under the standards of the school where the student is enrolled.

➤ **What if various people helped pay the tuition?**

Qualified education expenses paid on behalf of the student by someone else are treated as paid by the student or by the person claiming the student (if the student is a dependent on someone else's return).

➤ **What if the student withdraws from a class?**

You can claim an education credit for qualified education expenses not refunded when a student withdraws.

➤ **How do we handle PhD students without a detailed account summary?**



For UT PhD students, we may not have access to a detailed account summary. If we do not have definitive information about which grants or scholarships can be used for living expenses, we can use the rule of thumb in this case that typically grants are available to use for living expenses and scholarships are not.

➤ **Can I allocate some of the scholarships and grants to personal expenses in order to increase qualified education expenses for an education credit?**

Yes, in some situations. You may be able to increase an education credit and reduce your total tax or increase your tax refund if the student (you, your spouse, or your dependent) chooses to include all or part of certain scholarships or fellowship grants in income. The scholarship or fellowship grant must be one that may qualify as a tax-free scholarship and must be one that may (by its terms) be used for expenses other than qualified education expenses (such as room and board). That fact that the educational institution applies the scholarship or fellowship grant to qualified education expenses doesn't prevent the student from choosing to apply certain scholarships or grants to other expenses. By choosing to do so, the student will include the part applied to other expenses in gross income and may be required to file a tax return. However, this allows payments made in cash, by check or by credit or debit card, or with borrowed funds such as a student loan, to be applied to qualified education expenses. These payments, unlike certain scholarships or fellowship grants, will not reduce the qualified education expenses available to figure an education credit. The result is generally a larger education credit that reduces your total tax or increases your tax refund.

➤ **What does it mean if there is an entry in box 4 and/or 6 on the 1098-T?**

If there is an entry in box 4 or 6 of the 1098-T, the return may be out of scope. We cannot prepare the tax return for the person who claimed the education credit for the student last year.

- If the student was a dependent last year, we can do the student's return this year. If the person who claimed the student last year (e.g. the parent) received the education credit for that student, the return for that person this year is out of scope. (The student will need to share this year's 1098-T with that person.) If that person did not claim the credit last year, we can prepare that person's return this year.
- If the student was not claimed as a dependent last year, we can only do the return if the student did not claim the education credit last year. If the student did claim the education credit last year, the return is out of scope this year.

How we proceed: **For the return that is within scope this year, we disregard the entries in boxes 4 and 6.** These are only relevant to the person whose return is out of scope this year. **Our Special Tax Services program can prepare the return for the person who received the education credit last year.** (It's called a recapture of the education credit. The taxpayer will need to provide a copy of last year's return and the student's 1098-T and account summary for this year.)

➤ **What is Form 1099-Q?**



- **Qualified education programs:** There are two types of qualified education programs: state-sponsored 529 plans and Coverdell ESAs. Both types of accounts allow the account owner to set aside money to cover the qualified education expenses for the person designated as the beneficiary. The tax benefit of both programs is that the IRS allows account contributions to grow tax-free, meaning neither the beneficiary nor the account owner has to pay tax on account earnings. For these Qualified Tuition Programs, *an eligible education institution can be either an eligible postsecondary school or an eligible elementary or secondary school.*
- **Beneficiary receives 1099-Q:** the person or entity who manages the education program has an obligation to report annual distributions on Form 1099-Q to the IRS and to the beneficiary. However, the account owner (such as a parent) will receive a copy of the 1099-Q instead if the distributions from a 529 plan are not made directly to the beneficiary or to an educational institution for the benefit of the beneficiary.

When the beneficiary enrolls in school and starts taking distributions to pay school expenses, he will begin receiving a Form 1099-Q each year. **As long as the distributions are used to pay only qualified education expenses, the beneficiary does not pay income tax on the distributions.**

- **Qualified postsecondary education expenses include:**
 - Tuition and fees (if required for enrollment)
 - Books, supplies, equipment (if required for enrollment)
 - Expenses for special needs services needed by a special needs beneficiary incurred in connection with enrollment
 - Expenses for room and board for students who are at least half time that are not greater of the following two amounts:
 - Allowance for room and board, as determined by the school, included in the cost of attendance (for federal financial aid purposes). (You may need to research the school's qualified room and board costs. Example: see [ACC's 2019-2020 cost of attendance](#) for for in-district, out-of-district, and out-of-state students.)
 - Actual amount charged if student is residing in housing owned or operated by the school
 - Purchase of computer or peripheral equipment, software, or Internet access and related services if it's to be used primarily by the beneficiary during any of the years the beneficiary is enrolled at the an eligible postsecondary school
- **Qualified elementary and secondary education expenses:** For distributions made from qualified tuition programs (QTPs) after 2017, qualified education Q expenses may include no more than \$10,000 paid for elementary or secondary school tuition incurred after 2017.

➤ **How do we handle Form 1099-Q?**



First, determine if the distribution is within scope.

- The return is in scope if 100% of the distribution (reflected in Box 1) was used for qualified education expenses. This means none of the distribution is taxable. If the return is out of scope, refer the client to the Special Tax Services program.

Second, determine whether the return can be prepared onsite.

- If the client is not getting an education credit on the return, you do not need to enter Form 1099-Q anywhere on the return.
- If the client is getting an education credit but not moving any amount of scholarships or grants to taxable income, you can enter the 1099-Q amount on the Education Expenses Worksheet and proceed as usual.
- If the client is getting an education credit and is moving any amount of scholarships or grants to taxable income, the Form 1099-Q distribution can make the calculation more complicated. Please send the return to Drop Off to ensure the return is completed correctly.

Remember! An American Opportunity Credit or Lifetime Learning Credit can be claimed in the same year the beneficiary takes a tax-free distribution from a QRP, as long as the same expenses aren't used for benefits.

➤ **How do we handle 1099-R distributions used to pay for education expenses?**

Qualified education expenses paid with 1099-R distributions are considered paid by the student and can be counted when calculating the education credit.

If this distribution was used to pay for higher education expenses, the taxpayer would be eligible for an exception to paying the early distribution penalty.

➤ **Definitions of payment terms**

- **Scholarship:** an award of financial aid to a student that is not required to be repaid. Can often be used for both tuition and living expenses.
- **Grant:** funds dispersed by one party (often a government, corporation, or foundation) to a recipient and not required to be repaid. Can often be used for both tuition and living expenses.
- **Fellowship:** merit-based award, often restricted to use for tuition and fees.
- **Endowment:** funds given from private individual to the school, use of funds can be restricted.
- **Waiver:** when a charge for tuition or other fees is waived or cancelled. Disregard when calculating education expenses and scholarships and grants.
- **Stipend:** if represents money in exchange for work performed, then is counted as taxable income and disregarded when calculating scholarships and grants. If does not represent payment for work



performed and is paid directly to the student, considered to be available for living expenses and is counted along with scholarships and grants.

- **Refund:** represents money given to student after all school charges are paid (e.g. H1-Fin Aid Refund). This does not factor into the education credit calculation and should be ignored.
- **Loan:** when a loan appears on an account summary, it is considered to be a payment made by the student and is not counted when calculating scholarships and grants.
- **Emergency loan:** also disregarded when calculating scholarships and grants total. Texas 24hour grant is an example of an emergency loan (that must be repaid by the student).