

What every counselor needs to know about education benefits

1. There are many different education benefits. See Pub 4012 pages J-2 and J-3 for a summary of each benefit. Note, in particular, the different definitions of “qualifying education expense.”
2. If the student is a dependent, some benefits go on parents’ return, some on the student’s.
3. No double dipping is allowed.
 - A. Each student can claim (or be claimed) for only one of the following:
 - American Opportunity Credit (AOTC)
 - Lifetime Learning Credit (LLC)
 - Tuition and Fees Adjustment (T&F) (if extended by Congress)
 - B. Each expense can be applied to only one benefit. [Exception: expenses used to waive early distribution penalty can be used again.]
 - C. If expenses are paid with tax-free veterans benefits or tax-free employer-provided education benefits, they cannot be used anywhere on the tax return.
4. Dollar amounts on Form 1098-T are often wrong. Use the student’s statement of account from school to get more accurate numbers.
5. Some benefits affect other parts of the tax return; some do not. Frequently, it’s not clear which benefit is best, so we use trial and error method. Show the different results to the taxpayer and let him/her decide which to use.
6. Complete both federal and state returns for all other income, expenses and credits before comparing education benefits.

Step-by-Step Instructions

Simple return: student qualifies for American Opportunity credit, received no unrestricted grants or scholarships, and education is not work-related.

1. Subtract any restricted scholarships from the qualified expenses.
2. Complete Form 8863 page 2, and enter remaining expenses (up to \$4,000) on line 27.
3. If student is a dependent, Form 8863 is part of parents’ return.
4. If student is under age 24 and not a dependent, see Pub 4012 page J-8 and Form 8863 Line 7.

Normal return, one with

- No Social Security income,
- No Shared Responsibility Payment,
- Education not work-related, and
- No or low state income tax rate.

1. Go to the education calculator at <https://cotaxaide.org/tools/Education%20Calculator.html> and complete the following tabs:

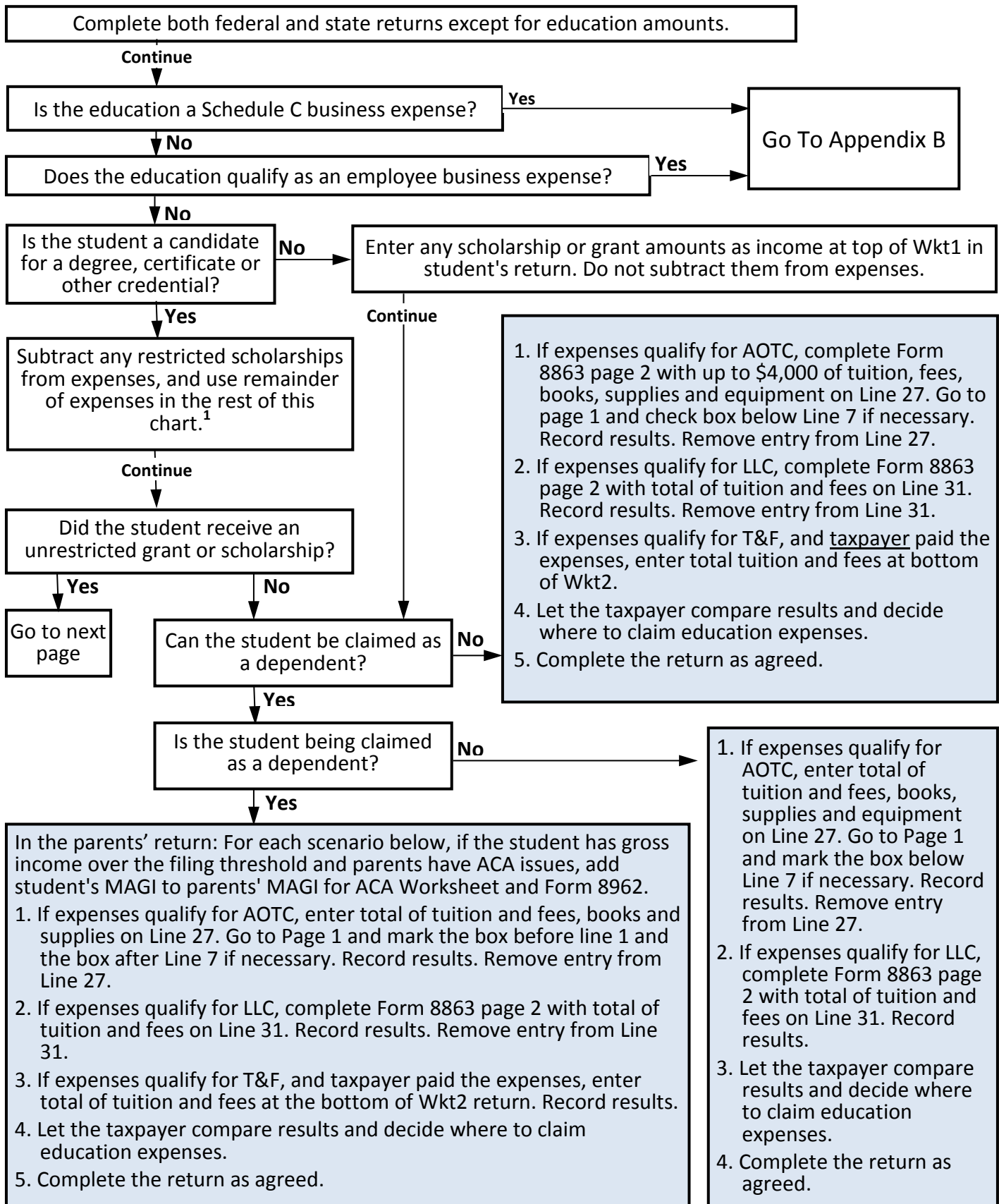
✓ Taxpayer Information	✓ Optimizer (entering information from the tax returns PRIOR to including education income or expenses for this student)
✓ Funding Sources	
✓ Expense Information	

2. Enter any resulting taxable scholarship at the top of the student’s TaxWise Worksheet 1.
3. Enter any resulting expenses for credits on Form 8863 page 2 or—for Tuition and Fees adjustment—at the bottom of TaxWise Worksheet 2 (on parents’ return if student is a dependent
4. If student is under age 24, claiming the American Opportunity credit, and not a dependent, see Pub 4012 page J-8.

More complicated return

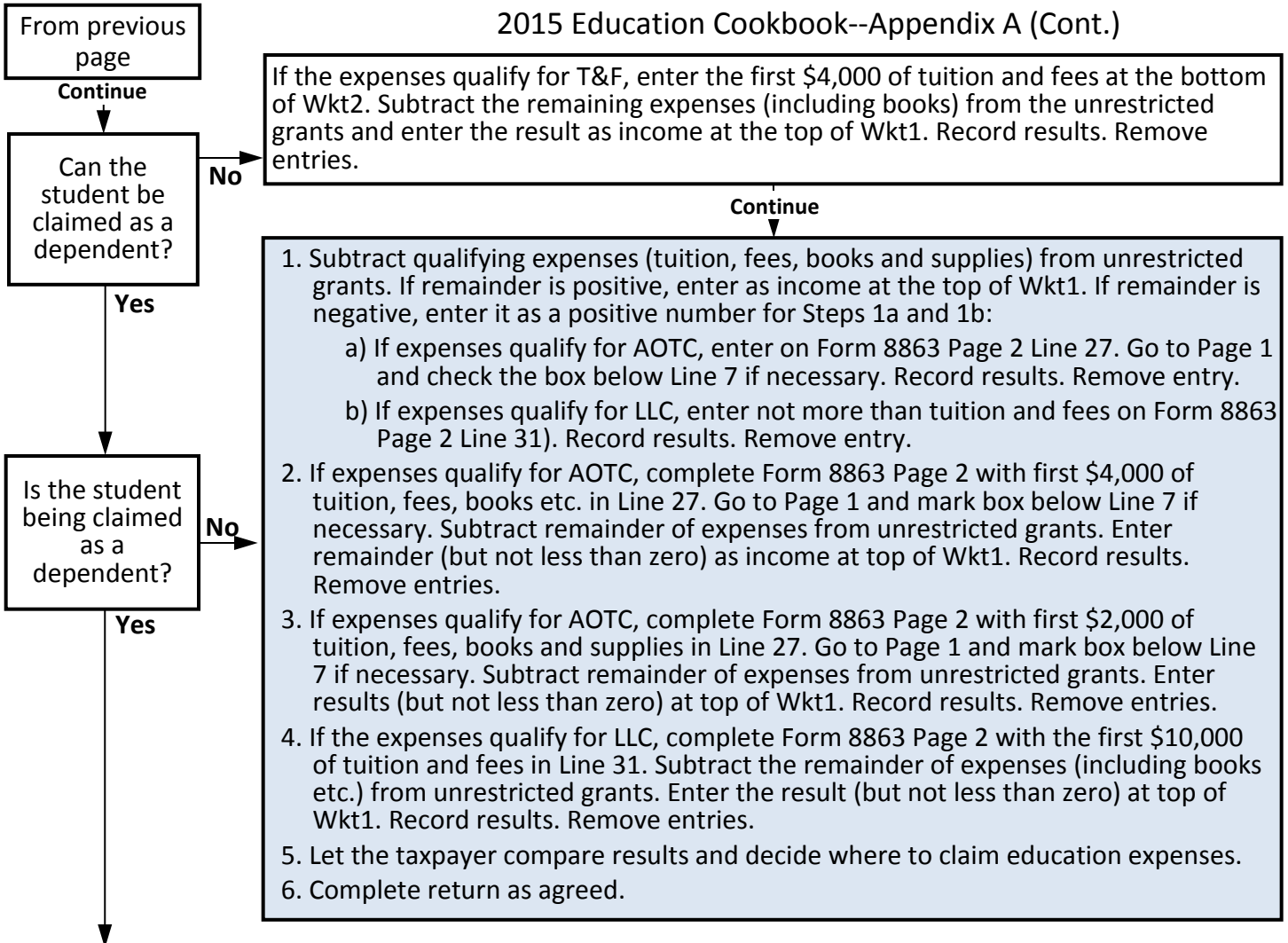
Follow flow chart in Appendix A.

2015 Education Cookbook Appendix A—Education Flowchart



Footnote 1: If the terms of the scholarship permit, first subtract books, supplies and equipment from the restricted scholarship amount. Then subtract the remainder of the scholarship from the tuition and fees.

2015 Education Cookbook--Appendix A (Cont.)



In the parents' return: For each scenario below, if parents have ACA issues and student has gross income over the filing threshold, add student's MAGI to parents' MAGI for ACA Worksheet and Form 8962.

1. Subtract qualifying expenses (tuition, fees, books and supplies) from unrestricted grants. If remainder is positive, enter as income on Wkt1 of the student's return. If remainder is negative, enter it as a positive number on the parents' return for Steps 1a, 1b, and 1c. Record results for both returns.
 - a) If expenses qualify for T&F, enter at bottom of parents' Wkt2. Record results. Remove entries.
 - b) If expenses qualify for AOTC, enter on Form 8863 Page 2 Line 27. Go to Page 1 and check the box below Line 7 if necessary. Record results. Remove entry.
 - c) If expenses qualify for LLC, enter not more than tuition and fees on Form 8863 Page 2 Line 31). Record results. Remove entry.
2. If expenses qualify for AOTC, complete Form 8863 Page 2 of the parents' return with first \$4,000 of expenses in Line 27. Subtract remainder of tuition, fees, books etc. from unrestricted grants. Enter remainder (but not less than zero) at top of Wkt1 of the student's return. Record results for both returns. Remove entries.
3. If expenses qualify for AOTC, complete Form 8863 Page 2 of the parents' return with first \$2,000 of tuition, fees, books and supplies in Line 27. Subtract remainder of expenses from unrestricted grants. Enter remainder (but not less than zero) at top of Wkt1 in the student's return. Record results for both returns. Remove entries.
4. If the expenses don't qualify for AOTC but do qualify for LLC, complete Form 8863 Page 2 of the parents' return with the first \$10,000 of tuition and fees in Line 31. Subtract the remainder of expenses from unrestricted grants. Enter the result (but not less than zero) at the top of Wkt1 of the student's return. Record results for both returns. Remove entries.
5. Let the taxpayer and student compare results and decide where to claim education expenses.
6. Complete return as agreed.

Appendix B—Work-related Education Expenses

Does the education apply to employee business or self-employment business?

Employee business: Enter travel and transportation expenses on Form 2106-EZ. Use remaining expenses in the education calculator at <http://tools.cotaxaide.org>. Use any unused expenses on Form 2106-EZ.

Self-employment business: Use travel and transportation expenses as Schedule C deductions. Use remaining expenses with the following three options.

OPTION 1: Use Education Credits

1. Enter unrestricted grants or scholarships on TaxWise Worksheet 1 in student's return.
2. Does the student qualify for AOTC?
 - Yes:** Apply 1st \$2,000 of expenses toward AOTC—either on student's return or on parents' if they are claiming student's exemption. Complete Form 8863 page 2 and enter up to \$2,000 of tuition, fees, books, supplies and equipment on Line 27. Go to Step 2.
 - No:** Go to Step 6.
3. Does student qualify for EITC with at least one qualifying child?
 - Yes:** On the EIC graph, locate the student's earned income and AGI.
 - Upslope:** Go to Step 4.
 - Downslope:** Go to Step 5.
 - Maximum:** Go to Step 6.
 - No:** Continue to Step 6.
4. If possible avoid reducing earned income so EIC is not affected.
 - a. Apply 2nd \$2,000 of expenses to AOTC.
 - b. Subtract any remaining expenses from the taxable scholarship on Worksheet 1 (but don't go below zero).
 - c. If there are remaining education expenses, apply them to make distributions from educational savings accounts tax-free (OOS unless entire distribution can be used), or
 - d. Use remaining education expenses as Schedule C deductions.
5. Reduce earned income and AGI to increase EIC.
 - a. Use expenses as Schedule C deductions until there is no self-employment tax.
 - b. Subtract remaining expenses from the taxable scholarship on Worksheet 1 (but don't go below zero).
 - c. Apply any remaining expenses toward the 2nd \$2,000 of AOTC.
 - d. If there are remaining education expenses, apply them to make distributions from educational savings accounts tax-free (OOS unless entire distribution can be used) or
 - e. Use remaining education expenses as Schedule C deductions.
6. Minimize self-employment tax.
 - a. Use expenses as Schedule C deductions until there is no self-employment tax.
 - b. Apply remaining expenses toward the 2nd \$2,000 of AOTC.
 - c. Subtract remaining expenses from the taxable scholarship on Worksheet 1 (but don't go below zero).
 - d. If there are remaining education expenses, apply them to make distributions from educational savings accounts tax-free (OOS unless entire distribution can be used) or
 - e. Use remaining education expenses as Schedule C deductions.

2015 Education Cookbook--Appendix B (Cont.)

7. Does student qualify for EITC with at least one qualifying child?

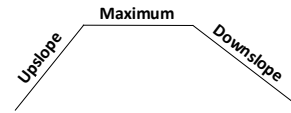
Yes: On the EIC graph, locate the student's earned income and AGI.

Upslope: Go to Step 8

Downslope: Go to Step 9

Maximum: Go to Step 9

No: Continue to Step 9.



8. If possible, avoid reducing earned income.
- Apply up to \$10,000 per return toward LLC. Complete Form 8863—either students or parents' if they are claiming the exemption—and enter up to \$10,000 of tuition and fees on Line 31.
 - Subtract remaining expenses from taxable scholarships on Worksheet 1 (but don't go below zero).
 - If there are remaining education expenses, apply them to make distributions from educational savings accounts tax-free (OOS unless entire distribution can be used) or
 - Use remaining education expenses as Schedule C deductions.
9. Reduce earned income and AGI to increase EIC and/or reduce tax.
- Use expenses as Schedule C deductions until there is no self-employment tax.
 - If marginal tax rate is less than 20%, use remaining expenses toward LLC.
 - Subtract any remaining expenses from taxable scholarships on Worksheet 1 (but don't go below zero).
 - If marginal tax rate is more than 20%, use any remaining expenses (up to \$10,000 per return) toward LLC.
 - If there are remaining education expenses, apply them to make distributions from educational savings accounts tax-free (OOS unless entire distribution can be used).
10. If student has a filing requirement and is claimed as a dependent, enter student's MAGI on parents' ACA Worksheet Form 8862.
11. Record the AGIs and federal and state refunds in the comparison matrix.

OPTION 2: Use Tuition and Fees Adjustment (if extended by Congress)

Tuition and Fees Adjustment can be used ONLY if the taxpayer paid the expenses.

1. Does student qualify for EITC with at least one qualifying child?

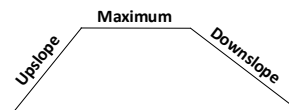
Yes: On the EIC graph, locate the student's earned income and AGI.

Upslope: Go to Step 2.

Downslope: Go to Step 3.

Maximum: Go to Step 3.

No: Continue to Step 3.



2. If possible, avoid reducing earned income.
- Apply up to \$4,000 per return toward T&F. Enter up to \$4,000 of tuition and fees at the bottom of Worksheet 2.
 - Subtract remaining expenses from taxable scholarships on Worksheet 1 (but don't go below zero).
 - If there are remaining education expenses, apply them to make distributions from educational savings accounts tax-free (OOS unless entire distribution can be used) or Use remaining education expenses as Schedule C deductions.

2015 Education Cookbook--Appendix B (Cont.)

3. Reduce earned income and AGI to increase EIC and/or reduce tax.
 - a. Use expenses as Schedule C deductions until there is no self-employment tax.
 - b. Subtract remaining expenses from taxable scholarships on Worksheet 1 (but don't go below zero).
 - c. Apply up to \$4,000 per return toward T&F. Enter up to \$4,000 of tuition and fees at the bottom of Worksheet 2 of the parents' return.
 - d. If there are remaining education expenses, apply them to make distributions from educational savings accounts tax-free (OOS unless entire distribution can be used) or
 - e. Use remaining education expenses as Schedule C deductions
4. If student has a filing requirement and is claimed as a dependent, enter student's MAGI on parents' ACA Worksheet Form 8862.

Record the AGIs and federal and state refunds in the comparison matrix.

OPTION 3: Eliminate Filing Requirement or Minimize AGI

Based on the best results of Option 1 or Option 2

1. Does the student have a filing requirement (other than for self-employment tax)? See Pub 4012 Tab A.
Yes: Go to Step 2.
No: Done.
2. Is student's taxable scholarship income plus other unearned income greater than \$2,000?
Yes: Go to Step 3.
No: Go to Step 5.
3. Is student a) under age 18? b) age 18 with earned income less than ½ his total support? or c) age 19-23 and a full-time student with earned income less than ½ his total support?
Yes: Go to Step 4.
No: Go to Step 5.
4. If possible, reduce taxable scholarships so that the total of taxable scholarship plus other unearned income is less than \$2,100. This eliminates kiddie tax so return stays in scope.
 - a. Move expenses from credits or adjustments to reduce taxable scholarships.
 - b. Move tuition, fees, books, supplies and equipment expenses from Schedule C to reduce taxable scholarships.
 - c. Go to Step 5.
5. Are there ACA issues (SRP or PTC for student or parents if they are claiming student's exemption)?
Yes: Go to Step 6.
No: Go to Step 7.
6. If possible, reduce taxable scholarships so that student has no filing requirement.
 - a. Move expenses from credits or adjustments to reduce taxable scholarships.
 - b. Move expenses from Schedule C to reduce taxable scholarships.
 - c. Go to Step 7.
7. Did student make significant contributions to a retirement account and have AGI near but above the Retirement Savers credit thresholds of Single: \$18,250, HoH: \$27,375, MFJ: \$39,500?
Yes: Go to Step 8.
No: Go to Step 9.
8. Move education expenses from credits or Schedule C to reduce taxable scholarships so that AGI falls below the appropriate Retirement Savers credit threshold.
9. Include student's MAGI on parents' Form 8862 and ACA worksheet if necessary.
10. Record AGIs and federal and state refunds in the comparison matrix.

After recording results in matrix for all the options you are comparing, let the taxpayer choose which education benefits to use. Prepare the return as requested.

2015 Education Cookbook Comparison Matrix

For each scenario in Appendix A or B, record the TaxWise results in the matrix below:

- If the student is being claimed on someone else's return, you will need all eleven lines. If the parents have any ACA issues and the student's gross income is over the filing threshold, enter the student's MAGI in the parents' return on their ACA worksheet and Form 8962.
- If the student is not a dependent, use only the first six lines.
- Eliminate the dependent student's filing requirement if possible to avoid kiddie tax and ACA complications. Limit taxable grants and scholarships to an amount that keeps student's gross income below the filing threshold (usually \$6,300).

	A Make Scholarship Tax-free, Excess Expense to AOTC	B Make Scholarship Tax-free, Excess Expense to LLC	C Make Scholarship Tax-free, Excess Expense to T&F	D Up to \$2,000 of Expense for AOTC, Excess to Tax-free Scholarship	E Up to \$4,000 of Expenses for AOTC, Excess to Tax-free Scholarship	F Up to \$10,000 of Expenses for LLC, Excess to Tax-free Scholarship	G Up to \$4,000 of Expenses for T&F, Excess to Tax-free Scholarship	H Limit Taxable Scholarship to Eliminate Filing Requirement
Education Expense								
Taxable Scholarship								
Student's Return								
AGI								
Federal refund								
State refund								
Total refund								
Parents' Return								
AGI								
Federal refund								
State refund								
Total refund								
TOTAL refund for both returns								