Department of the Treasury
Internal Revenue Service

Publication 970
Cat. No. 25221V

Tax Benefits for Higher Education

For use in preparing

2000 Returns

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Contents

Important Change

Photographs of missing children. The Internal Revenue Service is a proud partner with the National Center for Missing and Exploited Children. Photographs of missing children selected by the Center may appear in this publication on pages that would otherwise be blank. You can help bring these children home by looking at the photographs and calling **1–800–THE–LOST (1–800–843–5678)** if you recognize a child.

Introduction

This publication explains the tax benefits for persons who are saving for or paying higher education costs for themselves and members of their families. It covers the following topics.

- The Hope credit.
- The lifetime learning credit.
- The deduction of student loan interest.
- Canceled student loans.
- Education individual retirement arrangements (education IRAs).
- Withdrawals from traditional or Roth IRAs for the costs of higher education.
- The exclusion of savings bond interest used to pay the costs of higher education.
- Employer-provided educational assistance benefits.
- Qualified state tuition programs.

CAUTION *You generally cannot claim more than one benefit for the same education expense.*

Appendix B on page 34 gives you a general comparison of some features of the different benefits. You may find it helpful in determining the benefits for which you are eligible.

This publication does not cover the itemized deduction you may be able to claim for work-related educational expenses. Information on that deduction can be found in Publication 508, *Tax Benefits for Work-Related Education.* This publication also does not cover scholarships that you may be able to exclude from your income. Information on scholarships can be found in Publication 520, *Scholarships and Fellowships.*

TIP *You may be able to reduce the amount of your federal income tax withholding throughout the year based on your estimated tax benefits for higher education. After you figure the amount of your estimated 2001 income, exclusions, deductions, and credit(s), see Publication 919,* How Do I Adjust My Tax Withholding?

Caution. *You should check your withholding again during the year if there are changes to your personal or financial situation that would affect your expected 2001 tax liability, including your allowable higher education tax benefits.*

Comments and suggestions. We welcome your comments about this publication and your suggestions for future editions.

You can e-mail us while visiting our web site at **www.irs.gov/help/email2.html**.

You can write to us at the following address:

Internal Revenue Service
Technical Publications Branch
W:CAR:MP:FP:P
1111 Constitution Ave. NW
Washington, DC 20224

We respond to many letters by telephone. Therefore, it would be helpful if you would include your daytime phone number, including the area code, in your correspondence.

Useful Items

You may want to see:

Publication

- ☐ **508** Tax Benefits for Work-Related Education
- ☐ **520** Scholarships and Fellowships
- ☐ **525** Taxable and Nontaxable Income
- ☐ **550** Investment Income and Expenses
- ☐ **590** Individual Retirement Arrangements (IRAs) (Including Roth IRAs and Education IRAs)

Form (and Instructions)

- ☐ **8815** Exclusion of Interest From Series EE and I U.S. Savings Bonds Issued After 1989
- ☐ **8863** Education Credits (Hope and Lifetime Learning Credits)

See *How To Get Tax Help* in chapter 9 for information about getting these publications and forms.

1.

Hope Credit

The Hope credit and the lifetime learning credit are tax credits that may be available to you if you pay higher education costs. This chapter discusses the Hope credit. The lifetime learning credit is discussed in chapter 2 of this publication.

The following table, *Comparison of Education Credits* summarizes the differences between the Hope and lifetime learning credits. If you are eligible to claim both credits based on the higher education expenses of one student, it will generally be to your benefit to claim the Hope credit.

Table 1–1. **Comparison of Education Credits**

Hope Scholarship Credit	Lifetime Learning Credit
Up to $1,500 credit per **eligible student**	Up to $1,000 credit per **return**
Available **ONLY** for the first two years of postsecondary education. . . . . .and **ONLY** for 2 years per eligible student	Available for any postsecondary education. . . . . .and for an unlimited number of years
Student must be pursuing a degree or other recognized educational credential	Student does not need to be pursuing a degree or other recognized educational credential
Student must be enrolled at least half time for at least one academic period beginning during the year	Available for one or more courses
No felony drug conviction on student's record	Felony drug conviction rule does not apply

This chapter explains:

- Who can claim the Hope credit,
- What expenses qualify for the Hope credit, and
- How the Hope credit is computed and claimed.

What is the tax benefit of the Hope credit? You may be able to claim a Hope credit of up to $1,500 for qualified tuition and related expenses paid for ***each*** eligible student.

A tax credit reduces the amount of income tax you may have to pay. Unlike a deduction, which reduces the amount of income subject to tax, a credit directly reduces the tax itself.

Credit more than tax. Your Hope credit cannot be more than the amount of your tax. Therefore, you cannot get a refund for any part of the credit that is more than your tax.

Can you claim both education tax credits this year? For each student, you can elect for any year only ***one*** of the credits. For example, if you elect to take the Hope credit for a child on your 2000 tax return, you cannot, for that same child, also claim the lifetime learning credit for 2000.

Lifetime learning credit after Hope credit. You can claim the Hope credit for the first 2 years of an eligible student's postsecondary education and claim the lifetime learning credit for that same student in later years.

Tax credits for more than one student. If you pay qualified expenses for more than one student in the same year, you can choose to take credits on a per-student, per-year basis. This means that, for example, you can claim the Hope credit for one student and the lifetime learning credit for another student in the same year.

Who Can Claim the Credit?

Generally, you can claim the Hope credit if you pay ***qualified tuition and related expenses*** of higher education for an ***eligible student*** who is either yourself, your spouse, or a ***dependent for whom you claim an exemption*** on your tax return. Qualified tuition and related expenses are defined later under *What Expenses Qualify?* Eligible students are defined later under *Who Is an Eligible Student?*

Dependent for whom you claim an exemption. You claim an exemption for a person if you list his or her name on line 6c, Form 1040 (or Form 1040A).

Expenses of a dependent. If there are higher education costs for your dependent for a year, either you or your dependent, but not both of you, can claim a Hope credit for that dependent's expenses for that year.

IF you. . .	THEN only. . .
Claim an exemption on your tax return for a dependent who is an eligible student	You can claim the Hope credit based on that student's expenses. The student cannot claim the credit.
Do **not** claim an exemption on your tax return for a dependent who is an eligible student	The student can claim the Hope credit. You cannot claim the credit based on this student's expenses.

Expenses paid by dependent. If an eligible student is your dependent, treat any expenses paid by the student as if you had paid them. Include these expenses when figuring the amount of your Hope credit.

TIP *Qualified tuition and related expenses paid directly to an eligible educational institution for your dependent under a court-approved divorce decree are treated as paid by your dependent.*

Expenses paid by others. If someone other than you, your spouse, or your dependent (such as a relative or former spouse) makes a payment directly to an eligible educational institution to pay for an eligible student's qualified tuition and related expenses, the student is treated as receiving the payment from the other person. The student is treated as paying the qualified tuition and related expenses to the institution. If the student is your dependent, you are considered to have paid the expenses.

Example. Ms. Allen makes a payment directly to an eligible educational institution in 2000 for her grandson Todd's qualified tuition and related expenses. For purposes of claiming a Hope credit, Todd is treated as receiving the money as a gift from Ms. Allen and, in turn, paying his qualified tuition and related expenses himself.

If Todd is not listed as a dependent on anyone's return, only Todd can use the payment to claim a Hope credit.

If anyone, such as his parents, lists him as a dependent on their tax return, whoever lists him as a dependent may be able to use the expenses to claim a Hope credit. In this case, Todd cannot claim a Hope credit.

Who Is an Eligible Student?

For purposes of the Hope credit, an eligible student is a student who meets **all** of the following requirements.

1) Did not have expenses that were used to figure a Hope credit in any 2 earlier years.
2) Had not ***completed the first 2 years*** of postsecondary education (generally, the freshman and sophomore years of college) before 2000.
3) Was ***enrolled at least half-time*** in a program that leads to a degree, certificate, or other recognized educational credential for at least one ***academic period*** beginning in 2000.
4) Was free of any federal or state felony conviction for possessing or distributing a controlled substance as of the end of 2000.

Completion of first 2 years. A student who was awarded 2 years of academic credit for postsecondary work completed before 2000 has completed the first 2 years of postsecondary education. This student would not be an eligible student for purposes of the Hope credit.

Any academic credit awarded solely on the basis of the student's performance on proficiency examinations is disregarded in determining whether the student has completed 2 years of postsecondary education.

Enrolled at least half-time. A student was enrolled at least half-time if the student was taking at least half the normal full-time work load for his or her course of study.

The standard for what is half of the normal full-time work load is determined by each eligible educational institution. However, the standard may not be lower than standards for half-time established by the Department of Education under the Higher Education Act of 1965.

Academic period. An academic period includes a semester, trimester, quarter, or other period of study (such as a summer school session) as reasonably determined by an educational institution.

Who Cannot Claim the Credit?

You cannot claim the Hope credit if any of the following apply.

- Your filing status is married filing separate return.
- You are listed as a dependent in the *Exemptions* section on another person's tax return (such as your parents). See *Expenses of a dependent*, earlier.
- Your modified adjusted gross income is $50,000 or more ($100,000 or more in the case of a joint return). Modified adjusted gross income is explained later under *Does Income Affect the Amount of the Credit?*
- You (or your spouse) were a nonresident alien for any part of 2000 and the nonresident alien did not elect to be treated as a resident alien. More information on nonresident aliens can be found in Publication 519, *Tax Guide for U.S. Aliens*.
- The eligible student received a tax-free withdrawal from an education IRA during 2000 and did not waive the tax-free treatment. This waiver is discussed in chapter 4 under *Withdrawal and Deduction or Credit*.
- You claim the lifetime learning credit for the same student in 2000.

What Expenses Qualify?

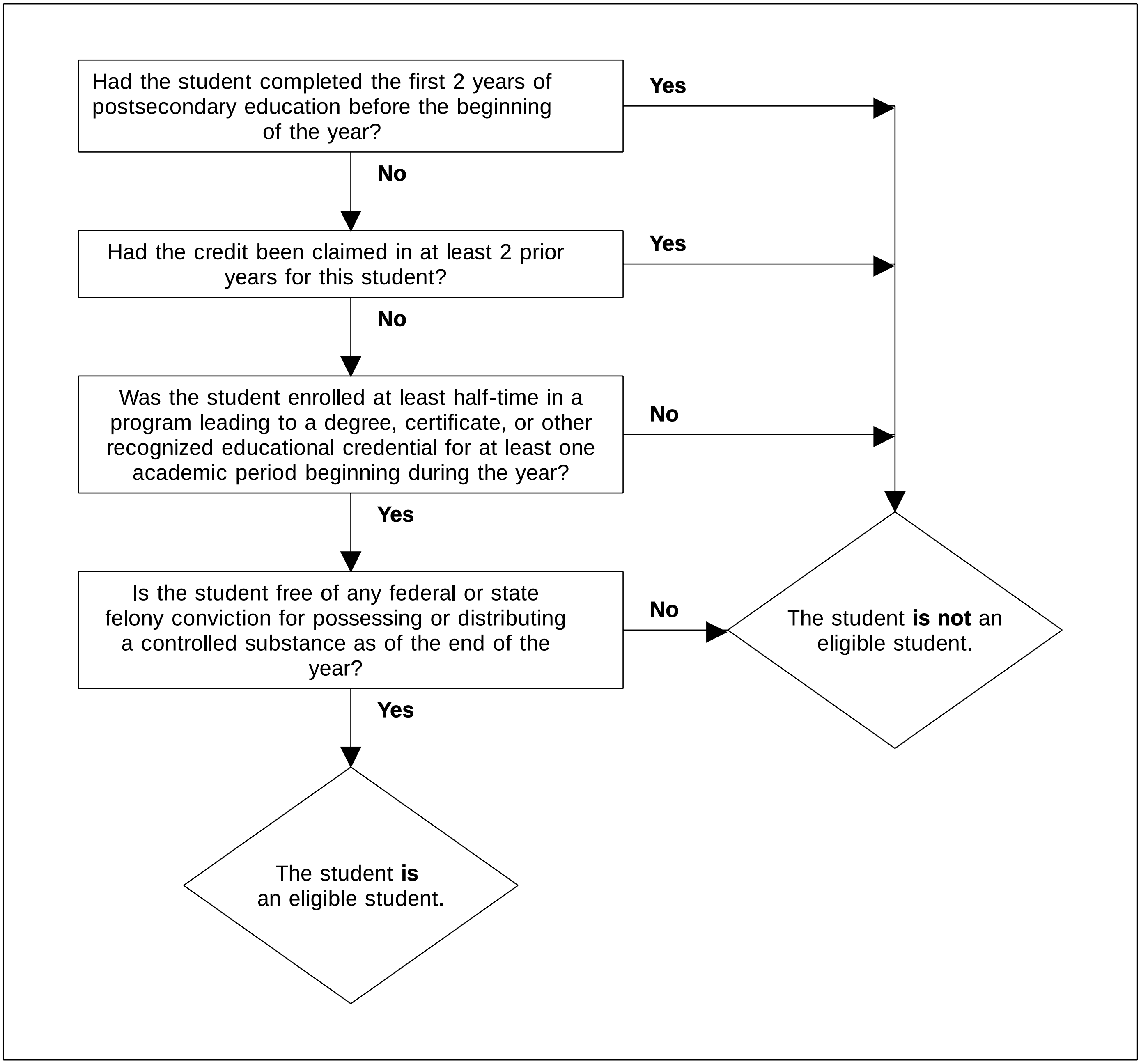
The Hope credit is based on qualified tuition and related expenses you pay for yourself, your spouse, or a dependent for whom you claim an exemption on your tax return. Generally, the credit is allowed for qualified tuition and related expenses paid in 2000 for an ***academic period*** (defined earlier) beginning in 2000 (but see *Prepaid expenses*, later).

Qualified tuition and related expenses. In general, qualified tuition and related expenses are tuition and fees required for enrollment or attendance at an ***eligible educational institution***.

Student-activity fees and fees for course-related books, supplies, and equipment are included in qualified tuition and related expenses ***only*** if the fees must

Figure 1–1. **Who Is An Eligible Student?**

This chart is provided to assist you to quickly decide whether you are an eligible student for the Hope credit. See the text for greater details.



be paid ***to the institution*** as a condition of enrollment or attendance.

Eligible educational institution. 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 Department of Education. It includes virtually all accredited, public, nonprofit, and proprietary (privately owned profit-making) postsecondary institutions. The educational institution should be able to tell you if it is an eligible educational institution.

Prepaid expenses. If you paid qualified tuition and related expenses in 2000 for an academic period that begins in the first three months of 2001, you can use the prepaid amount in figuring your 2000 Hope credit.

For example, if you paid $1,500 in December 2000 for qualified tuition for the winter 2001 semester beginning in January 2001, you can use that $1,500 in figuring your 2000 credit.

Payments with borrowed funds. You can claim a Hope credit for qualified tuition and related expenses paid with the proceeds of a loan. You use the expenses to figure the Hope credit for the year in which the expenses are paid, not the year in which the loan is repaid.

Adjustments To Qualified Expenses

If you pay higher education expenses with certain ***tax-free*** funds, you cannot claim a credit for those amounts. You must reduce the qualified expenses by the amount of any tax-free educational assistance you received. Tax-free educational assistance could include:

- Scholarships,
- Pell grants,
- Employer-provided educational assistance,
- Veterans' educational assistance, and
- Any other nontaxable payments (other than gifts, bequests, or inheritances) received for educational expenses.

Do not reduce the qualified expenses by amounts paid with the student's:

- Earnings,
- Loans,
- Gifts,
- Inheritances, and
- Personal savings.

Also, do not reduce the qualified expenses by any scholarship reported as income on the student's return or any scholarship which, by its terms, cannot be applied to qualified tuition and related expenses.

What Expenses Do Not Qualify?

Qualified tuition and related expenses do not include the cost of:

- Insurance,
- Medical expenses (including student health fees),
- Room and board,
- Transportation, or
- Similar personal, living, or family expenses.

This is true even if the fee must be paid to the institution as a condition of enrollment or attendance.

Qualified tuition and related expenses generally do not include expenses that relate to any course of instruction or other education that involves sports, games or hobbies, or any noncredit course. However, if the course of instruction or other education is part of the student's degree program, these expenses can qualify.

No double benefit allowed. You cannot:

- Deduct higher education expenses on your income tax return and also claim a Hope credit based on those same expenses,
- Claim a Hope credit and a lifetime learning credit based on the same qualified education expenses, or
- Claim a credit based on expenses paid with tax-free scholarship, grant, or employer-provided educational assistance. See *Adjustments to Qualified Expenses*, earlier.

Refunds. Qualified tuition and related expenses do not include expenses for which you receive a refund. If you paid expenses in 2000, and you received a refund of those expenses in 2000 or 2001, but before you file your tax return for 2000, simply reduce the amount of the expenses paid by the amount of the refund received. If you receive the refund after you file your 2000 tax return, see *When Must Credit Be Repaid*, later.

How Is the Credit Figured?

The amount of the Hope credit is the sum of:

1) 100% of the first $1,000 of qualified tuition and related expenses you paid for each eligible student, ***and***

2) 50% of the next $1,000 of qualified tuition and related expenses you paid for each eligible student.

The maximum amount of Hope credit you can claim in 2000 is $1,500 times the number of eligible students. You can claim the full $1,500 for each eligible student for whom you paid at least $2,000 of qualified expenses. However, the credit may be reduced based on your modified adjusted gross income. See *Does Income Affect the Amount of the Credit*, later.

Example. Jon and Karen are married and file a joint tax return. For 2000, they claim an exemption for their dependent daughter on their tax return. Their modified adjusted gross income is $70,000. Their daughter is in her sophomore (second) year of studies at the local university. Jon and Karen pay qualified tuition and related expenses of $4,300 in 2000.

Jon and Karen, their daughter, and the local university meet all of the requirements for the Hope credit. Jon and Karen can claim a $1,500 Hope credit in 2000. This is 100% of the first $1,000 of qualified tuition and related expenses, plus 50% of the next $1,000.

Does Income Affect the Amount of the Credit?

The amount of your Hope credit is phased out (gradually reduced) if your modified adjusted gross income is between $40,000 and $50,000 ($80,000 and $100,000 if you file a joint return). You cannot claim a Hope credit if your modified adjusted gross income is $50,000 or more ($100,000 or more if you file a joint return).

Modified adjusted gross income. For most taxpayers, modified adjusted gross income will be their adjusted gross income (AGI) as figured on their federal income tax return. On Form 1040, AGI is line 33. On Form 1040A, AGI is line 19. However, you must modify your AGI if you excluded income earned abroad or from certain U.S. territories or possessions. If this applies to you, increase your AGI by the following amounts you excluded from your income.

1) Foreign earned income of U.S. citizens or residents living abroad.

2) Housing costs of U.S. citizens or residents living abroad.

3) Income from sources within Puerto Rico, Guam, American Samoa, or the Northern Mariana Islands.

How the phaseout works. The phaseout (reduction) works on a sliding scale. The higher your modified adjusted gross income, the more your credit is reduced. The phaseout, if any, is figured when you complete Part III of Form 8863.

How Is the Credit Claimed?

You elect to claim the Hope credit and you figure the amount to claim by completing **Form 8863**. In Part I, you enter the student's name and taxpayer identification number (usually a social security number) and the amount of qualified expenses paid in 2000. You then complete Part III to compute your total education credits (Hope credit and lifetime learning credit). The amount on line 18 is the total of your Hope credit and lifetime learning credit. This is the amount to enter on line 46 of Form 1040 or line 29 of Form 1040A. Attach the completed Form 8863 to your return.

An eligible educational institution (such as a college or university) that received payment of qualified tuition and related expenses in 2000 generally must issue **Form 1098–T**, *Tuition Payments Statement,* to each student by February 1, 2001. The information on Form 1098–T will help you determine whether you can claim an education tax credit for 2000. The following information should be included on the 2000 Form 1098–T.

1) The name, address, and taxpayer identification number of the educational institution.
2) The name, address, and taxpayer identification number of the student.
3) Whether the student was enrolled for at least half of the full-time academic workload.
4) Whether the student was enrolled exclusively in a graduate-level program.

The eligible educational institution may ask for a completed **Form W–9S**, *Request for Student's or Borrower's Social Security Number and Certification,* or similar statement to obtain the information needed to complete (2) above.

When Must Credit Be Repaid?

If, after you file your 2000 tax return, you receive tax-free educational assistance for, or a refund of, an expense you used to figure a Hope credit on that return, you may have to recapture all or part of the credit. You must refigure your Hope credit for 2000 as if the assistance or refund was received in 2000. Subtract the amount of the refigured credit from the amount of the credit you claimed. See the instructions for your 2001 tax return for information about how and where to report the recapture.

Illustrated Example

Jim Grant, a single taxpayer, enrolled full-time at a local college to earn a degree in computer science. This is the first year of his postsecondary education. During 2000, he paid $1,600 for his qualified 2000 tuition, and he and the college meet all of the requirements for the Hope credit. Jim's modified adjusted gross income is $32,000. His income tax liability is $3,746. He figures his credit of $1,300 as shown on the Form 8863 on the next page.

Note. In *Appendix A* at the end of this publication there is an example illustrating the use of Form 8863 when the Hope credit and the lifetime learning credit are both claimed on the same tax return.

Form **8863**

Department of the Treasury
Internal Revenue Service

Education Credits (Hope and Lifetime Learning Credits)

► **See instructions on pages 2 and 3.** ► **Attach to Form 1040 or Form 1040A.**

OMB No. 1545-1618

2000

Attachment Sequence No. **51**

Name(s) shown on return	Your social security number
Jim Grant	000 00 1111

Part I **Hope Credit. Caution:** *The Hope credit may be claimed for no more than **2** tax years for the **same** student.*

1	**(a)** Student's name (as shown on page 1 of your tax return) First, Last	**(b)** Student's social security number (as shown on page 1 of your tax return)	**(c)** Qualified expenses (but **do not** enter more than $2,000 for each student). See instructions	**(d)** Enter the **smaller** of the amount in column (c) or $1,000	**(e)** Subtract column (d) from column (c)	**(f)** Enter one-half of the amount in column (e)
	Jim Grant	000 00 1111	1,600	1,000	600	300
2	Add the amounts in columns (d) and (f)		2	1,000		300

3	Tentative Hope credit. Add the amounts on line 2, columns (d) and (f) . . . . ►	3	1,300

Part II **Lifetime Learning Credit**

4	**(a)** Student's name (as shown on page 1 of your tax return) First / Last	**(b)** Student's social security number (as shown on page 1 of your tax return)	**(c)** Qualified expenses. See instructions
Caution: *You cannot take the Hope credit and the lifetime learning credit for the same student.*			

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

Part III **Allowable Education Credits**

8	Tentative education credits. Add lines 3 and 7.			8	1,300
9	Enter: $100,000 if married filing jointly; $50,000 if single, head of household, or qualifying widow(er)	9	50,000		
10	Enter the amount from Form 1040, line 34 (or Form 1040A, line 20)*	10	32,000		
11	Subtract line 10 from line 9. If line 10 is equal to or more than line 9, **stop;** you cannot take any education credits.	11	18,000		
12	Enter: $20,000 if married filing jointly; $10,000 if single, head of household, or qualifying widow(er)	12	10,000		
13	If line 11 is equal to or more than line 12, enter the amount from line 8 on line 14 and go to line 15. If line 11 is less than line 12, divide line 11 by line 12. Enter the result as a decimal (rounded to at least three places)			13	× .
14	Multiply line 8 by line 13. . . . . ►			14	1,300
15	Enter the amount from Form 1040, line 42 (or Form 1040A, line 26)			15	3,746
16	Enter the total, if any, of your credits from Form 1040, lines 43 through 45 (or from Form 1040A, lines 27 and 28).			16	0
17	Subtract line 16 from line 15. If line 16 is equal to or more than line 15, **stop;** you cannot take any education credits			17	3,746
18	**Education credits.** Enter the **smaller** of line 14 or line 17 here and on Form 1040, line 46 (or Form 1040A, line 29) . . . . ►			18	1,300

*See Pub. 970 for the amount to enter if you are filing Form 2555, 2555-EZ, or 4563 or you are excluding income from Puerto Rico.

For Paperwork Reduction Act Notice, see page 4. Cat. No. 25379M Form **8863** (2000)

2.

Lifetime Learning Credit

The Hope credit and the lifetime learning credit are tax credits that may be available to you if you pay higher education costs. This chapter discusses the lifetime learning credit. The Hope credit is discussed in chapter 1 of this publication.

The following table summarizes the differences between the Hope and lifetime learning credits. If you are eligible to claim both credits based on the higher education expenses of one student, it will generally be to your benefit to claim the Hope credit.

Table 2–1. **Comparison of Education Credits**

Hope Scholarship Credit	Lifetime Learning Credit
Up to $1,500 credit per **eligible student**	Up to $1,000 credit per **return**
Available **ONLY** for the first two years of postsecondary education. . . . . .and **ONLY** for 2 years per eligible student	Available for any postsecondary education. . . . . .and for an unlimited number of years
Student must be pursuing a degree or other recognized educational credential	Student does not need to be pursuing a degree or other recognized educational credential
Student must be enrolled at least half time for at least one academic period beginning during the year	Available for one or more courses
No felony drug conviction on student's record	Felony drug conviction rule does not apply

This chapter explains:

- Who can claim the lifetime learning credit,
- What expenses qualify for the lifetime learning credit, and
- How the lifetime learning credit is computed and claimed.

What is the tax benefit of the lifetime learning credit? You may be able to claim a lifetime learning credit of up to $1,000 for qualified tuition and related expenses paid for ***all*** students enrolled in eligible educational institutions. There is no limit on the number of years for which the lifetime learning credit can be claimed for each student.

A tax credit reduces the amount of income tax you may have to pay. Unlike a deduction, which reduces the amount of income subject to tax, a credit directly reduces the tax itself.

Credit more than tax. Your lifetime learning credit cannot be more than the amount of your tax. Therefore, you cannot get a refund for any part of the credit that is more than your tax.

Can you claim both education tax credits this year? For each student, you can elect for any year only ***one*** of the credits. For example, if you elect to take the lifetime learning credit for a child on your 2000 tax return, you cannot, for that same child, also claim the Hope credit for 2000.

Lifetime learning credit after Hope credit. You can claim the Hope credit for the first 2 years of an eligible student's postsecondary education and claim the lifetime learning credit for that same student in later years.

Tax credits for more than one student. If you pay qualified expenses for more than one student in the same year, you can choose to take credits on a per-student, per-year basis. This means that, for example, you can claim the Hope credit for one student and the lifetime learning credit for another student in the same year.

Who Can Claim the Credit?

Generally, you can claim the lifetime learning credit if you pay ***qualified tuition and related expenses*** of higher education for an ***eligible student*** who is either yourself, your spouse, or a ***dependent for whom you claim an exemption*** on your tax return. Qualified tuition and related expenses are defined later under *What Expenses Qualify?* Eligible students are defined later under *Who Is an Eligible Student?*

Dependent for whom you claim an exemption. You claim an exemption for a person if you list his or her name on line 6c, Form 1040 (or Form 1040A).

Expenses of a dependent. If there are higher education costs for your dependent for a year, either you or your dependent, but not both of you, can claim a lifetime learning credit for that dependent's expenses for that year.

IF you. . .	THEN only. . .
Claim an exemption on your tax return for a dependent who is an eligible student	You can claim the lifetime learning credit based on that student's expenses. The student cannot claim the credit.
Do **not** claim an exemption on your tax return for a dependent who is an eligible student	The student can claim the lifetime learning credit. You cannot claim the credit based on this student's expenses.

Expenses paid by dependent. If an eligible student is your dependent, treat any expenses paid by the student as if you had paid them. Include these expenses when figuring the amount of your lifetime learning credit.

TIP *Qualified tuition and related expenses paid directly to an eligible educational institution for your dependent under a court-approved divorce decree are treated as paid by your dependent.*

Expenses paid by others. If someone other than you, your spouse, or your dependent (such as a relative or former spouse) makes a payment directly to an eligible educational institution to pay for an eligible student's qualified tuition and related expenses, the student is treated as receiving the payment from the other person. The student is treated as paying the qualified tuition and related expenses to the institution. If the student is your dependent, you are considered to have paid the expenses.

Example. Ms. Allen makes a payment directly to an eligible educational institution in 2000 for her grandson Todd's qualified tuition and related expenses. For purposes of claiming a lifetime learning credit, Todd is treated as receiving the money as a gift from Ms. Allen and, in turn, paying his qualified tuition and related expenses himself.

If Todd is not listed as a dependent on anyone's return, only Todd can use the payment to claim a lifetime learning credit.

If anyone, such as his parents, list him as a dependent on their tax return, whoever lists him as a dependent may be able to use the expenses to claim a lifetime learning credit. In this case, Todd cannot claim a lifetime learning credit.

Who Is an Eligible Student?

For purposes of the lifetime learning credit, an eligible student is a student who is enrolled in one or more courses at an ***eligible educational institution***.

Eligible educational institution. 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 Department of Education. It includes virtually all accredited, public, nonprofit, and proprietary (privately owned profit-making) postsecondary institutions. The educational institution should be able to tell you if it is an eligible educational institution.

Who Cannot Claim the Credit?

You cannot claim the lifetime learning credit if **any** of the following apply.

- Your filing status is married filing separate return.
- You are listed as a dependent in the *Exemptions* section on another person's tax return (such as your parents). See *Expenses of a dependent*, earlier.
- Your modified adjusted gross income is $50,000 or more ($100,000 or more in the case of a joint return). Modified adjusted gross income is explained later under *Does Income Affect the Amount of the Credit?*
- You (or your spouse) were a nonresident alien for any part of 2000 and the nonresident alien did not elect to be treated as a resident alien. More information on nonresident aliens can be found in Publication 519, *Tax Guide for U.S. Aliens*.
- The eligible student received a tax-free withdrawal from an education IRA during 2000 and did not waive the tax-free treatment. This waiver is discussed in chapter 4 under *Withdrawal and Deduction or Credit*.
- You claim the Hope credit for the same student in 2000.

What Expenses Qualify?

The lifetime learning credit is based on qualified tuition and related expenses you pay for yourself, your spouse, or a dependent for whom you claim an exemption on your tax return. Generally, the credit is allowed for qualified tuition and related expenses paid in 2000 for an ***academic period*** beginning in 2000 (but see *Prepaid expenses*, later).

Qualified tuition and related expenses. In general, qualified tuition and related expenses are tuition and fees required for enrollment or attendance at an ***eligible educational institution*** (defined earlier).

Student-activity fees and fees for course-related books, supplies, and equipment are included in qualified tuition and related expenses ***only*** if the fees must be paid ***to the institution*** as a condition of enrollment or attendance.

Academic period. An academic period includes a semester, trimester, quarter, or other period of study (such as a summer school session) as reasonably determined by an educational institution.

Prepaid expenses. If you paid qualified tuition and related expenses in 2000 for an academic period that begins in the first three months of 2001, you can use the prepaid amount in figuring your 2000 lifetime learning credit.

For example, if you paid $1,500 in December 2000 for qualified tuition for the winter 2001 semester beginning in January 2001, you can use that $1,500 in figuring your 2000 credit.

Payments with borrowed funds. You can claim a lifetime learning credit for qualified tuition and related expenses paid with the proceeds of a loan. You use the expenses to figure the lifetime learning credit for the year in which the expenses are paid, not the year in which the loan is repaid.

Adjustments To Qualified Expenses

If you pay higher education expenses with certain ***tax-free*** funds, you cannot claim a credit for those amounts. You must reduce the qualified expenses by the amount of any tax-free educational assistance you received. Tax-free educational assistance could include:

- Scholarships,
- Pell grants,
- Employer-provided educational assistance,
- Veterans' educational assistance, and
- Any other nontaxable payments (other than gifts, bequests, or inheritances) received for educational expenses.

Do not reduce the qualified expenses by amounts paid with the student's:

- Earnings,
- Loans,
- Gifts,
- Inheritances, and
- Personal savings.

Also, do not reduce the qualified expenses by any scholarship reported as income on the student's return or any scholarship which, by its terms, cannot be applied to qualified tuition and related expenses.

What Expenses Do Not Qualify?

Qualified tuition and related expenses do not include the cost of:

- Insurance,
- Medical expenses (including student health fees),
- Room and board,
- Transportation, or
- Similar personal, living, or family expenses.

This is true even if the fee must be paid to the institution as a condition of enrollment or attendance.

Qualified tuition and related expenses generally do not include expenses that relate to any course of instruction or other education that involves sports, games or hobbies, or any noncredit course. However, if the course of instruction or other education is part of the student's degree program or, in the case of the lifetime learning credit, is taken by the student to acquire or improve job skills, these expenses can qualify.

No double benefit allowed. You cannot:

- Deduct higher education expenses on your income tax return and also claim a lifetime learning credit based on those same expenses,
- Claim a Hope credit and a lifetime learning credit based on the same qualified education expenses, or
- Claim a credit based on expenses paid with tax-free scholarship, grant, or employer-provided educational assistance. See *Adjustments to Qualified Expenses*, earlier.

Refunds. Qualified tuition and related expenses do not include expenses for which you receive a refund. If you paid expenses in 2000, and you received a refund of those expenses in 2000 or 2001, but before you file your tax return for 2000, simply reduce the amount of the expenses paid by the amount of the refund received. If you receive the refund after you file your 2000 tax return, see *When Must Credit Be Repaid*, later.

How Is the Credit Figured?

The amount of the lifetime learning credit is 20% of the first $5,000 of qualified tuition and related expenses you paid for all eligible students. The maximum amount of lifetime learning credit you can claim for 2000 is $1,000 (20% × $5,000). However, that amount may be reduced based on your modified adjusted gross income. See *Does Income Affect the Amount of the Credit*, later.

Example. Bruce and Toni are married and file a joint tax return. For 2000, their modified adjusted gross income is $50,000. Toni is attending the community college (an eligible educational institution) to earn credits toward an associate's degree in nursing; she already has a bachelor's degree in history and wants to become a nurse. In August 2000, Toni paid $2,000 for her fall 2000 semester. Bruce and Toni can claim a $400 (20% × $2,000) lifetime learning credit on their 2000 joint tax return.

Does Income Affect the Amount of the Credit?

The amount of your lifetime learning credit is phased out (gradually reduced) if your modified adjusted gross income is between $40,000 and $50,000 ($80,000 and $100,000 if you file a joint return). You cannot claim a lifetime learning credit if your modified gross income is $50,000 or more ($100,000 or more if you file a joint return).

Modified adjusted gross income. For most taxpayers, modified adjusted gross income will be their adjusted gross income (AGI) as figured on their federal income tax return. On Form 1040, AGI is line 33. On Form 1040A, AGI is line 19. However, you must modify your AGI if you excluded income earned abroad or from certain U.S. territories or possessions. If this applies to you, increase your AGI by the following amounts you excluded from your income.

1) Foreign earned income of U.S. citizens or residents living abroad.
2) Housing costs of U.S. citizens or residents living abroad.
3) Income from sources within Puerto Rico, Guam, American Samoa, or the Northern Mariana Islands.

How the phaseout works. The phaseout (reduction) works on a sliding scale. The higher your modified adjusted gross income, the more your credit is reduced. The phaseout, if any, is figured when you complete Part III of Form 8863.

How Is the Credit Claimed?

You elect to claim the lifetime learning credit and you figure the amount to claim by completing **Form 8863**. In Part II, you enter the student's name and taxpayer identification number (usually a social security number) and the amount of qualified expenses paid in 2000. You then complete Part III to compute your total education credits (Hope credit and lifetime learning credit). The amount on line 18 is the total of your Hope credit and lifetime learning credit. This is the amount to enter on line 46 of Form 1040 or line 29 of Form 1040A. Attach the completed Form 8863 to your return.

An eligible educational institution (such as a college or university) that received payment of qualified tuition and related expenses in 2000 generally must issue **Form 1098–T**, *Tuition Payments Statement,* to each student by February 1, 2001. The information on Form 1098–T will help you determine whether you can claim an education tax credit for 2000. The following information should be included on the 2000 Form 1098–T.

1) The name, address, and taxpayer identification number of the educational institution.
2) The name, address, and taxpayer identification number of the student.
3) Whether the student was enrolled for at least half of the full-time academic workload.
4) Whether the student was enrolled exclusively in a graduate-level program.

The eligible educational institution may ask for a completed **Form W–9S**, *Request for Student's or Borrower's Social Security Number and Certification,* or similar statement to obtain the information needed to complete (2) above.

When Must Credit Be Repaid?

If, after you file your 2000 tax return, you receive tax-free educational assistance for, or a refund of, an expense you used to figure a lifetime learning credit on that return, you may have to recapture all or part of the credit. You must refigure your lifetime learning credit for 2000 as if the assistance or refund was received in 2000. Subtract the amount of the refigured credit from the amount of the credit you claimed. See the instructions for your 2001 tax return for information about how and where to report the recapture.

Illustrated Example

Judy Green, a single taxpayer, is taking courses at a community college to be recertified to teach in public schools. Her modified adjusted gross income is $22,000. Her tax is $2,246. In July 2000 she pays $700 for the summer 2000 semester; in August 2000 she pays $1,900 for the fall 2000 semester; and in December 2000 she pays another $1,900 for the winter semester. Judy and the college meet all the requirements for the lifetime learning credit. She can use all of the $4,500 tuition she paid in 2000 when figuring her credit for her 2000 tax return. She figures her credit as shown on the filled-in Form 8863 on the next page.

Note. In *Appendix A* at the end of this publication, there is an example illustrating the use of Form 8863 when the Hope credit and the lifetime learning credit are both claimed on the same tax return.

Form **8863**

Department of the Treasury
Internal Revenue Service

Education Credits (Hope and Lifetime Learning Credits)

► See instructions on pages 2 and 3. ► Attach to Form 1040 or Form 1040A.

OMB No. 1545-1618

2000

Attachment Sequence No. 51

Name(s) shown on return	Your social security number
Judy Green	000 00 7777

Part I **Hope Credit. Caution:** *The Hope credit may be claimed for no more than **2** tax years for the **same** student.*

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

3 Tentative Hope credit. Add the amounts on line 2, columns (d) and (f) ► **3**

Part II **Lifetime Learning Credit**

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

(a) Student's name (as shown on page 1 of your tax return) First	Last	(b) Student's social security number (as shown on page 1 of your tax return)	(c) Qualified expenses. See instructions
Judy	Green	000 00 7777	4,500

5 Add the amounts on line 4, column (c), and enter the total	**5**	4,500
6 Enter the **smaller** of line 5 or $5,000	**6**	4,500
7 Tentative lifetime learning credit. Multiply line 6 by 20% (.20) ►	**7**	900

Part III **Allowable Education Credits**

8 Tentative education credits. Add lines 3 and 7			**8**	900
9 Enter: $100,000 if married filing jointly; $50,000 if single, head of household, or qualifying widow(er)	**9**	50,000		
10 Enter the amount from Form 1040, line 34 (or Form 1040A, line 20)*	**10**	22,000		
11 Subtract line 10 from line 9. If line 10 is equal to or more than line 9, **stop;** you cannot take any education credits	**11**	28,000		
12 Enter: $20,000 if married filing jointly; $10,000 if single, head of household, or qualifying widow(er)	**12**	10,000		
13 If line 11 is equal to or more than line 12, enter the amount from line 8 on line 14 and go to line 15. If line 11 is less than line 12, divide line 11 by line 12. Enter the result as a decimal (rounded to at least three places)			**13**	× .
14 Multiply line 8 by line 13 ►			**14**	900
15 Enter the amount from Form 1040, line 42 (or Form 1040A, line 26)			**15**	2,246
16 Enter the total, if any, of your credits from Form 1040, lines 43 through 45 (or from Form 1040A, lines 27 and 28)			**16**	0
17 Subtract line 16 from line 15. If line 16 is equal to or more than line 15, **stop;** you cannot take any education credits			**17**	2,246
18 **Education credits.** Enter the **smaller** of line 14 or line 17 here and on Form 1040, line 46 (or Form 1040A, line 29) ►			**18**	900

*See Pub. 970 for the amount to enter if you are filing Form 2555, 2555-EZ, or 4563 or you are excluding income from Puerto Rico.

For Paperwork Reduction Act Notice, see page 4. Cat. No. 25379M Form **8863** (2000)

3.

Student Loans

This chapter describes the following two tax benefits related to student loans.

1) The student loan interest deduction.

2) Canceled (forgiven) student loans.

Student Loan Interest Deduction

If you paid interest on a student loan in 2000, you may be able to deduct up to $2,000 of the interest you paid. You can deduct interest paid during the ***first 60 months*** that interest payments are required on the loan.

What is the tax benefit of the student loan interest deduction? The benefit of the student loan interest deduction is that you may be able to reduce the amount of your income that is subject to tax by up to $2,000 in the year 2000 (up to $2,500 for 2001 and later years).

TIP *This deduction is taken as an adjustment to income. This means you can claim this deduction even if you do not itemize deductions on Schedule A (Form 1040).*

Include as interest. Loan origination fees (other than fees for services) and capitalized interest are student loan interest if all other requirements are met.

Loan origination fees. These are the costs of getting the loan.

Capitalized interest. This is unpaid interest on a student loan that is added by the lender to the outstanding principal balance of the loan.

TIP *If you pay more than $600 in interest during the year to a single lender, you should receive a statement at the end of the year from the lender showing the amount of interest you paid. That information will help you complete your tax forms.*

Who Can Claim the Deduction?

Generally, you can claim the deduction if **all** of the following requirements are met.

- If you are ***married***, you are filing a joint return.
- No one else is ***claiming an exemption*** for you on their tax return.
- You paid interest on a loan taken out only to pay tuition and other ***qualified higher education expenses*** for yourself, your spouse, or someone who was your dependent when the loan was taken out.
- The education expenses were paid or incurred within a ***reasonable period of time*** before or after the loan was taken out.
- The person for whom the expenses were paid or incurred was an ***eligible student***.
- The ***first 60 months*** in which interest payments were required on the loan did not end before January 2000.

Many of the terms used in the above list are explained later in this chapter.

IF you. . .	THEN you. . .
Are ***married filing separately***	**Cannot** claim the student loan interest deduction.
Are listed as a ***dependent*** on another person's tax return (such as your parent's return)	**Cannot** claim the student loan interest deduction.
Have a ***student loan*** taken solely to pay ***qualified higher education expenses***	May be able to claim the student loan interest deduction.

Married. If you were married on the last day of the year, you are considered married for the entire year. You are not considered married if you are eligible to use the unmarried head of household filing status. More information about your correct filing status can be found in Publication 501, *Exemptions, Standard Deduction, and Filing Information.*

Claiming an exemption. Another taxpayer is claiming an exemption for you on their tax return if they list your name on line 6c, Form 1040 (or Form 1040A).

Dependent. Generally, a dependent is someone who:

- Receives most of his or her support from you,
- Is either related to you or lives with you, and
- Is a citizen or resident of the United States, Canada, or Mexico.

More information about dependents can be found in Publication 501.

What are Qualified Higher Education Expenses?

Generally, these expenses are the total costs of attending an ***eligible educational institution***, including graduate school. They include the costs of:

1) Tuition and fees.

2) Room and board.

3) Books, supplies, and equipment.

4) Other necessary expenses (such as transportation).

However, you must reduce these costs by the **total** amount paid for them with the following tax-free items.

- Employer-provided educational assistance benefits. See chapter 7.
- Tax-free withdrawals from an education IRA. However, the tax-free treatment of the withdrawal can be waived. See chapter 4.
- U.S. savings bond interest used to pay qualified higher education expenses. See chapter 6.
- Certain scholarships. See Publication 520, *Scholarships and Fellowships*.
- Veterans' educational assistance benefits.
- Any other nontaxable payments (other than gifts, bequests, or inheritances) received for educational expenses.

Eligible educational institution. 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 Department of Education. It includes virtually all accredited, public, nonprofit, and proprietary (privately owned profit-making) postsecondary institutions.

For purposes of the student loan interest deduction, the term also includes an institution conducting an internship or residency program leading to a degree or certificate from an institution of higher education, a hospital, or a health care facility that offers postgraduate training.

TIP *The educational institution should be able to tell you if it is an eligible educational institution.*

No double benefit allowed. You cannot deduct as interest on a student loan any amount you can deduct under any other provision of the tax law (for example, home mortgage interest).

What Is A Reasonable Period of Time?

Qualified higher education expenses paid with the proceeds of education loans that are part of a federal post-secondary education loan program meet the requirement of being paid or incurred within a reasonable period of time before or after the loan is taken out.

For other loans, the reasonable period of time usually is determined based on all the relevant facts and circumstances. However, see *Reasonable period safe harbor*, next.

Reasonable period safe harbor. Qualified education expenses are treated as paid or incurred within a reasonable period of time before or after the debt is incurred if:

- The expenses relate to a particular ***academic period***, and
- The loan proceeds are disbursed within a period that begins 60 days before the start of that academic period and ends 60 days after the end of that academic period.

Academic period. An academic period includes a semester, trimester, quarter, or other period of study (such as a summer school session) as reasonably determined by an educational institution.

Who Is An Eligible Student?

An eligible student is a student who was enrolled at least half-time in a program that leads to a degree, certificate, or other recognized educational credential.

Enrolled at least half-time. A student was enrolled at least half-time if the student was taking at least half the normal full-time work load for his or her course of study.

The standard for what is half of the normal full-time work load is determined by each eligible educational institution. However, the standard may not be lower than standards for half-time established by the Department of Education under the Higher Education Act of 1965.

Student Loan Interest Deduction at a Glance

Do not rely on this chart alone. Refer to the text for complete details.

Feature	Description
Maximum benefit	You can decrease your income up to • $2,000 in 2000, and • $2,500 in 2001 and later years.
Loan qualifications	The student loan • must have been taken solely to pay qualified education expenses, and • cannot be from a related person or made under a qualified employer plan.
Student qualifications	The student must be • you, your spouse or your dependent • enrolled at least half-time in a degree program.
Time limit on deduction	The interest deduction can be taken only during the first 60 months of required interest payments.
Phase-out	The amount of the deduction depends on your income level.

First 60 Months

Regardless of when you took out the loan, you can only deduct the interest paid during the first 60 months that interest payments are required.

No deduction is allowed for interest payments due or paid before 1998.

Beginning of 60-month period. The date the 60-month interest deduction period begins is based on:

- The terms of the loan agreement, or
- Applicable federal regulations, if the loan was issued or guaranteed under a Federal post-secondary education program.

CAUTION *The 60-month period continues to pass whether or not the required interest payments are actually made. However, the 60 months may or may not be consecutive. For more information, see* Suspension of 60-month period*, later.*

Effect of refinancing. Generally, the refinancing of a student loan has no effect on the 60-month period. All refinancings of a student loan are the same loan for the purposes of determining the 60-month period. A refinanced loan has the same 60-month period as the original loan. See *Consolidated loan* and *Collapsed loans*, next.

Consolidated loan. This is a loan that refinances more than one student loan of the same borrower. The 60-month period for a consolidated loan begins on the most recent date on which interest payments became due on any of the refinanced loans.

Collapsed loans. These are two or more loans of the same borrower that are treated by both the lender and the borrower as one loan. The 60-month period for a collapsed loan begins on the most recent date on which interest payments became due on any of the separate loans.

Suspension of 60-month period. The 60-month period is suspended for any period of time during which interest payments are not required by the lender. However, the 60-month period is not suspended if, under the terms of the loan both of the following statements are true.

1) Interest continues to accrue (be charged) even though the payments are not required.
2) You keep making interest payments even though you are not required to do so.

TIP *If you refinance, consolidate, or collapse a student loan, the new loan can also be a student loan. But refinancing, consolidating, or collapsing a loan does not extend the 60-month period described earlier. The 60-month period is based on the original loan.*

Exception. If a student loan was not issued or guaranteed under a federal postsecondary education loan program, the 60-month period is suspended only if the borrower meets certain conditions. Those conditions include:

- Half-time study at a postsecondary educational institution,
- Study in an approved graduate fellowship program,
- Study in an approved rehabilitation program for the disabled,
- Inability to find full-time employment,
- Economic hardship, and
- The performance of services in certain occupations or federal programs.

Example. You took out a student loan in 1993. You made a payment on the loan every month, as required, beginning October 1, 1995. You can deduct the interest on your first nine payments for 2000. You cannot deduct the interest on any later payments because they are after the 60-month period (October 1, 1995 – September 30, 2000).

Who Cannot Claim the Deduction?

You cannot claim a deduction for student loan interest if any of the following apply.

- Your filing status is married filing a separate return.
- You are a ***dependent for whom an exemption is claimed*** on the tax return of another person.
- The interest was paid on a ***loan from a related person***.
- The interest was paid on a ***loan from a qualified employer plan***.

Dependent for whom an exemption is claimed. You are a dependent for whom an exemption is claimed on another person's tax return if another taxpayer lists your name on line 6c of their Form 1040 (or Form 1040A).

Loan from related person. You cannot deduct interest on a loan you get from a related person. Related persons include your brothers and sisters, half brothers and half sisters, spouse, ancestors (parents, grandparents, etc.), and lineal descendants (children, grandchildren, etc.). Related persons also include certain corporations, partnerships, trusts, and exempt organizations.

Loan from a qualified employer plan. You cannot deduct interest on a loan made under a qualified employer plan or under a contract purchased under such a plan.

How Is the Deduction Figured and Reported?

Your student loan interest deduction for 2000 is generally the smaller of:

1) $2,000, or
2) Your interest payments that were both:
   a) Paid in 2000, and
   b) Paid during the first 60 months that interest payments were required.

However, the amount determined above may be phased out (gradually reduced) or eliminated based on your filing status and modified adjusted gross income as explained later under *Does Income Affect the Amount of Your Deduction?*

Maximum Deduction

Your deduction for 2000 cannot be more than $2,000. This limit increases to $2,500 for 2001 and later years.

Does Income Affect the Amount of Your Deduction?

The amount of your student loan interest deduction is phased out (gradually reduced) if your modified adjusted gross income is between $40,000 and $55,000 ($60,000 and $75,000 if you file a joint return). You cannot take a student loan interest deduction if your modified adjusted gross income is $55,000 or more ($75,000 or more if you file a joint return).

The following chart describes the affect the amount of your modified adjusted gross income has on the student loan interest deduction you are allowed to claim.

IF your filing status is. . .	AND your modified AGI is. . .	THEN your student loan interest deduction is. . .
Single, Head of household, Or Qualifying widow(er)	Not more than $40,000	Not affected by the phaseout.
	More than $40,000 but less than $55,000	Reduced because of the phaseout.
	$55,000 or more	Eliminated by the phaseout.
Married filing joint return	Not more than $60,000	Not affected by the phaseout.
	More than $60,000 but less than $75,000	Reduced because of the phaseout.
	$75,000 or more	Eliminated by the phaseout.

Modified adjusted gross income. For most taxpayers, modified adjusted gross income will be their adjusted gross income (AGI) as figured on their federal income tax return but without the deduction for student loan interest. On Form 1040, AGI is line 33. On Form 1040A, AGI is line 19. However, you must make adjustments to your AGI if you excluded income earned abroad or from certain U.S. territories or possessions. If this applies to you, increase your AGI by the following amounts you excluded from your income.

1) Foreign earned income of U.S. citizens or residents living abroad.
2) Housing costs of U.S. citizens or residents living abroad.
3) Income from sources within Puerto Rico, Guam, American Samoa, or the Northern Mariana Islands.

How the phaseout works. To figure the phaseout, multiply your interest deduction (before the phaseout) by a fraction. The numerator is your modified adjusted gross income minus $40,000 ($60,000 in the case of a joint return). The denominator is $15,000. Subtract the result from your deduction (before the phaseout). This result is the amount you can deduct.

Example 1. During 2000 you paid $800 interest on a qualified student loan. Your 2000 modified adjusted gross income is $67,500 and you are filing a joint return. You must reduce your deduction by $400, figured as follows.

$$\$800 \times \frac{\$67,500 - \$60,000}{\$15,000} = \$400$$

You can deduct $400 ($800 – $400).

Example 2. The facts are the same as in *Example 1* except that you paid $2,200 interest. Your maximum deduction for 2000 is $2,000. You must reduce your maximum deduction by $1,000, figured as follows.

$$\$2,000 \times \frac{\$67,500 - \$60,000}{\$15,000} = \$1000$$

You can deduct $1,000 ($2000 – $1,000).

How Do You Report the Deduction?

The student loan interest deduction is an adjustment to income. To claim the deduction, enter the allowable amount on line 24 of Form 1040, or line 17 of Form 1040A.

Canceled Student Loan

Generally, if you are responsible for making loan payments, and the loan is canceled (forgiven), you must include the amount that was forgiven in your gross income for tax purposes. However, if your student loan is canceled, you may not have to include any amount in income. This section describes the requirements for tax-free treatment of canceled student loans.

Which Loans Qualify?

To qualify for tax-free treatment, your loan must contain a provision that all or part of the debt will be canceled if you work:

- For a certain period of time,
- In certain professions, and
- For any of a broad class of employers.

The loan must have been made by a ***qualified lender*** to assist the borrower in attending an ***educational institution***.

Qualified lenders. These include the following.

1) The government — federal, state, or local, or an instrumentality, agency, or subdivision thereof.

2) A tax-exempt public benefit corporation that has assumed control of a state, county, or municipal hospital and whose employees are considered public employees under state law.

3) An educational institution if the loan is made:

   a) As part of an agreement with an entity described in (1) or (2) under which the funds to make the loan were provided to the educational institution, or

   b) Under a program of the educational institution that is designed to encourage students to serve in occupations or areas with unmet needs, and where the services required of the students are for or under the direction of a governmental unit or a tax-exempt ***section 501(c)(3) organization***.

CAUTION *In satisfying the service requirement in (3)(b), the student must not provide services for the lender organization.*

Educational institution. This is an organization with a regular faculty and curriculum and a regularly enrolled body of students in attendance at the place where the educational activities are carried on.

Section 501(c)(3) organization. This is any corporation, community chest, fund, or foundation organized and operated exclusively for one or more of the following purposes.

- Charitable.
- Religious.
- Educational.
- Scientific.
- Literary.
- Testing for public safety.
- Fostering national or international amateur sports competition (but only if none of its activities involve providing athletic facilities or equipment).
- The prevention of cruelty to children or animals.

Refinanced loan. If you refinanced a student loan with another loan from an educational institution or a tax-exempt organization, that loan can also be a student loan.

It is a student loan if it was made under a program of the institution or organization designed to encourage students to serve in occupations or areas with unmet needs, and where the services required of the students are for or are under the direction of a governmental unit or a tax-exempt section 501(c)(3) organization.

4.

Education Individual Retirement Arrangement (IRA)

You may be able to establish an education individual retirement account (education IRA or Ed IRA) to finance a child's qualified higher education expenses.

You may be able to contribute up to $500 cash each year to an education IRA for a child under age 18. Contributions to an education IRA are not deductible, but amounts deposited in the account grow tax free until withdrawn.

Any individual (including the child) can contribute to a child's education IRA if his or her income is below a certain amount. There is no limit on the number of education IRAs that can be established designating a child as the beneficiary. However, total contributions for the child during any year cannot be more than $500. See *Contributions*, later.

If, for a year, withdrawals from an account are not more than a child's qualified higher education expenses at an eligible educational institution, the child will not owe tax on the withdrawals. See *Withdrawals,* later.

Education IRAs At a Glance

Do not rely on this chart alone. It provides only general highlights. See the text for definitions of terms in bold type and for more complete explanations.

Question	Answer
What is an **education IRA?**	An IRA that is set up to pay the **qualified higher education expenses** of a designated beneficiary.
Where can it be established?	It can be opened in the United States at any bank or other IRS-approved entity that offers education IRAs.
Who can an education IRA be set up for?	Any child who is under age 18.
Who can contribute to an education IRA?	Generally, any individual (including the beneficiary) whose **modified adjusted gross income** for the year is less than $110,000 ($160,000 in the case of a joint return).

What Is an Education IRA?

An education IRA is a trust or custodial account created or organized in the United States only for the purpose of paying the ***qualified higher education expenses*** of the ***designated beneficiary*** of the account. When the account is established, the designated beneficiary must be a child under age 18. To be treated as an education IRA, the account must be designated as an education IRA when it is created.

The document creating and governing the account must be in writing and must satisfy the following requirements.

1) The trustee or custodian must be a bank or an entity approved by the IRS.

2) The document must provide that the trustee or custodian can only accept a contribution that meets all of the following conditions.

   a) Is in cash.

   b) Is made before the beneficiary reaches age 18.

   c) Would not result in total contributions for the year (not including rollover contributions) being more than $500.

3) Money in the account cannot be invested in life insurance contracts.

4) Money in the account cannot be combined with other property except in a common trust fund or common investment fund.

5) The balance in the account generally must be withdrawn within 30 days after the earlier of the following events.

   a) The beneficiary reaches age 30.

   b) The beneficiary's death.

Designated beneficiary. The individual named in the document creating the trust or custodial account to receive the benefit of the funds in the account is the designated beneficiary.

Qualified higher education expenses. These are expenses required for the enrollment or attendance of the designated beneficiary at an ***eligible educational institution***. The following items are qualified higher education expenses.

1) Tuition and fees.

2) The cost of books, supplies, and equipment.

3) Amounts contributed to a qualified state tuition program. (See chapter 8, *State Tuition Programs*.)

4) In some situations, the cost of room and board.

The cost of room and board is a qualified higher education expense if the designated beneficiary is at least a ***half-time student*** at an eligible educational institution.

The expense for room and board is limited to one of the following two amounts.

1) The school's posted room and board charge for students living on campus.

2) $2,500 each year for students living off campus and not at home.

Eligible educational institution. 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 Department of Education. It includes virtually all accredited, public, nonprofit, and proprietary (privately owned profit-making) postsecondary institutions. The educational institution should be able to tell you if it is an eligible educational institution.

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 the course of study the student is pursuing as determined under the standards of the school where the student is enrolled.

Contributions

Any individual (including the child for whose benefit the account is established) can contribute to an education IRA if the individual's ***modified adjusted gross income*** for the year is less than $110,000 ($160,000 in the case of a joint return). Contributions must be in cash, and cannot be made after the beneficiary reaches age 18.

Contributions can be made to one or several education IRAs for the same child provided that the total contributions are not more than the contribution limit (defined later) for a year.

CAUTION *No contributions can be made to an education IRA on behalf of a child if any amount is contributed during the year to a* **qualified state tuition program** *on behalf of the same child.*

Modified adjusted gross income. For most taxpayers, modified adjusted gross income will be their adjusted gross income (AGI) as figured on their federal income tax return. On Form 1040, AGI is line 33. On Form 1040A, AGI is line 19. However, you must modify your AGI if you excluded income earned abroad or from certain U.S. territories or possessions. If this applies to you, increase your AGI by the following amounts you excluded from your income.

1) Foreign earned income of U.S. citizens or residents living abroad.

2) Housing costs of U.S. citizens or residents living abroad.

3) Income from sources within Puerto Rico, Guam, American Samoa, or the Northern Mariana Islands.

Contribution Limits

There are two yearly limits, one on the total amount that can be contributed for each designated beneficiary (child) in any year and one on the amount that any individual can contribute for any one child for a year.

Limit for each child. The total of all contributions to all education IRAs set up for the benefit of any one designated beneficiary (child) cannot be more than $500 in a year. This includes contributions (other than rollovers) to all the child's education IRAs from all sources. Rollovers are discussed under *Rollovers and Other Tranfers*, later.

Limit for each contributor. You can contribute up to $500 for each child for any year. This is the most you can contribute for the benefit of any one child for any year, regardless of the number of education IRAs set up for the child. However, this limit may be reduced as explained below.

Education IRA Contributions At a Glance

Do not rely on this chart alone. It provides only general highlights. See the text for more complete explanations.

Question	Answer
Are contributions deductible?	No.
Why should someone contribute to an education IRA?	Earnings on the account grow tax free until withdrawn.
What is the **contribution limit** per child?	$500 each year for each child.
What if more than one education IRA has been opened for the same child?	The annual contribution limit is $500 for each child, no matter how many education IRAs are set up for that child.
What if more than one individual makes contributions for the same child?	The contribution limit is $500 per child, no matter how many individuals contribute.
Can contributions other than cash be made to an education IRA?	No.
When must contributions stop?	No contributions can be made to a child’s education IRA after he or she reaches age 18.

If your ***modified adjusted gross income*** (defined earlier) is between $95,000 and $110,000 (between $150,000 and $160,000 if filing a joint return), the $500 limit for each child is gradually reduced (see *Figuring* *the limit*, next). If your modified adjusted gross income is $110,000 or more ($160,000 or more if filing a joint return), you cannot contribute to anyone's education IRA.

Figuring the limit. To figure the limit on the amount you can contribute for each child, multiply $500 by a fraction. The numerator (top number) is your modified adjusted gross income minus $95,000 ($150,000 if filing a joint return). The denominator (bottom number) is $15,000 ($10,000 if filing a joint return). Subtract the result from $500. This is the amount you can contribute for each child.

Example. Paul, who is single, had modified adjusted gross income of $96,500 for the year. Paul can contribute up to $450 for each child, figured as follows.

1) $96,500 – $95,000 = $1,500

2) $1,500 ÷ $15,000 = 10%

3) 10% × $500 = $50

4) $500 – $50 = $450

Additional Tax on Excess Contributions

A 6% excise tax applies each year to excess contributions that are in an education IRA at the end of the year. Excess contributions are the ***total*** of the following three amounts.

1) Contributions to any child's education IRA for the year that are more than $500 (or, if less, the total of each contributor's limit for the year, as discussed earlier).

2) All contributions to a child's education IRA for the year if any amount is also contributed during the year to a qualified state tuition program on behalf of the same child.

3) Excess contributions for the preceding year, reduced by the total of the following two amounts:

   a) Withdrawals (other than those rolled over as discussed later) made during the year, and

   b) The contribution limit for the current year minus the amount contributed for the current year.

Exceptions. The excise tax does not apply if the excess contributions (and any earnings on them) are withdrawn before the due date of the beneficiary's tax return (including extensions). If the beneficiary does not have to file a return, the tax does not apply if the excess contributions (and the earnings) are withdrawn by April 15 of the year following the year the contributions are made. The withdrawn earnings must be included in the beneficiary's income for the year in which the excess contribution is made.

The excise tax also does not apply to any rollover contribution.

Rollovers and Other Transfers

Assets can be rolled over from one education IRA to another. The designated beneficiary can be changed and the beneficiary's interest can be transferred to a spouse or former spouse because of divorce.

Rollovers

Any amount withdrawn from an education IRA and rolled over to another education IRA for the benefit of the same beneficiary or a member of the beneficiary's family who is under age 30 is not taxable. An amount is rolled over if it is paid to another education IRA within 60 days after the date of the withdrawal.

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

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

CAUTION *Only one rollover per education IRA is allowed during the 12-month period ending on the date of the payment or withdrawal.*

Changing the Designated Beneficiary

The designated beneficiary can be changed to a member of the beneficiary's family (defined earlier). There are no tax consequences if, at the time of the change, the new beneficiary is under age 30.

Transfer Because of Divorce

If a spouse or former spouse receives an education IRA under a divorce or separation instrument, it is not a taxable transfer. After the transfer, the spouse or former spouse treats the education IRA as his or her own.

Withdrawals

The designated beneficiary of an education IRA can take withdrawals at any time. Whether the withdrawals are tax free depends, in part, on whether the withdrawals are more than the amount of qualified higher education expenses (defined earlier) that the beneficiary has in the tax year.

Education IRA Withdrawals At a Glance

Do not rely on this chart alone. It provides only general highlights. See the text for definitions of terms in bold type and for more complete explanations.

Question	Answer
Is a withdrawal from an education IRA to pay for a designated beneficiary's qualified higher education expenses tax free?	Generally, yes, to the extent the amount of the withdrawal is not more than the designated beneficiary's qualified higher education expenses.
After the designated beneficiary completes his or her education at an **eligible educational institution,** may amounts remaining in the education IRA be withdrawn?	Yes. Amounts ***must*** be withdrawn when the designated beneficiary reaches age 30. Also, certain transfers to **members of the beneficiary's family** are permitted.
Does the designated beneficiary need to be enrolled for a minimum number of courses to take a tax-free withdrawal?	No.

Withdrawals Not More Than Expenses

Generally, withdrawals are tax free if they are not more than the beneficiary's qualified higher education expenses for the tax year.

Withdrawals More Than Expenses

Generally, a portion of the withdrawals is taxable to the beneficiary if the withdrawals are more than the beneficiary's qualified higher education expenses for the tax year.

The taxable portion is the amount of the withdrawal that represents earnings that have accumulated tax free in the account. Figure the taxable portion as shown in the following steps.

1) Multiply the amount withdrawn by a fraction. The numerator is the total contributions in the account and the denominator is the total balance in the account before the withdrawal(s).
2) Subtract the amount figured in (1) from the total amount withdrawn during the year. This is the amount of earnings included in the withdrawal(s).
3) Multiply the amount of earnings figured in (2) by a fraction. The numerator is the qualified higher education expenses paid during the year and the denominator is the total amount withdrawn during the year.
4) Subtract the amount figured in (3) from the amount figured in (2). This is the amount the beneficiary must include in income.

Example. You receive a $600 withdrawal from an education IRA to which $1,000 has been contributed. The balance in the IRA before the withdrawal was $1,200. You had $450 of qualified higher education expenses for the year. Using the steps above, you figure the taxable portion of your withdrawal as follows.

1) $600 × ($1,000 ÷ $1,200) = $500
2) $600 − $500 = $100
3) $100 × ($450 ÷ $600) = $75
4) $100 − $75 = $25

You must include $25 in income as withdrawn earnings not used for the expenses of higher education.

Additional Tax

Generally, if the beneficiary receives a taxable withdrawal, he or she also must pay a 10% additional tax on the amount included in income.

Exceptions. The 10% additional tax does not apply to withdrawals described in the following list.

1) Paid to a beneficiary (or to the estate of the designated beneficiary) on or after the death of the designated beneficiary.
2) Made because the designated beneficiary is disabled. A person is considered to be disabled if he or she shows proof that he or she cannot do any substantial gainful activity because of his or her physical or mental condition. A physician must determine that his or her condition can be expected to result in death or to be of long-continued and indefinite duration.
3) Made because the designated beneficiary received:
   a) A qualified scholarship excludable from gross income,
   b) An educational assistance allowance, or
   c) Payment for the designated beneficiary's educational expenses that is excludable from gross income under any law of the United States.

   The exception applies only to the extent the withdrawal is not more than the scholarship, allowance, or payment.
4) Included in income only because the beneficiary waived the tax-free treatment of the withdrawal (as explained later under *Waiver of tax-free treatment*).
5) A return of an excess contribution (and any earnings on it) made before the due date of the beneficiary's tax return (including extensions). If the beneficiary does not have to file a return, the excess (and any earnings) must be withdrawn by April 15 of the year following the year of the contribution. The beneficiary must include in gross income for

the year the contribution is made, any income earned on the excess contribution.

Withdrawal and Deduction or Credit

You generally cannot take a deduction or credit for any educational expenses that you use as the basis for a tax-free withdrawal from an education IRA. But see *Waiver of tax-free treatment*, next.

Waiver of tax-free treatment. The designated beneficiary can waive the tax-free treatment of the withdrawal and elect to pay any tax that would otherwise be owed on the withdrawal. The beneficiary or the beneficiary's parents may then be eligible to claim a Hope credit or lifetime learning credit for qualified higher education expenses paid in that tax year. (See chapter 1, *Hope Credit*, and chapter 2, *Lifetime Learning Credit*, to determine if all of the requirements for those credits are met.)

When Assets Must Be Withdrawn

Any assets remaining in an education IRA must be withdrawn when either one of the following two events occurs.

1) The designated beneficiary reaches age 30. In this case, the designated beneficiary must withdraw the remaining assets within 30 days after he or she reaches age 30.
2) The designated beneficiary dies before reaching age 30. In this case, the remaining assets must generally be withdrawn within 30 days after the date of death.

The earnings that accumulated tax free in the account must be included in taxable income. You determine these earnings as shown in the following two steps.

1) Multiply the amount withdrawn by a fraction. The numerator is the total contributions in the account and the denominator is the total balance in the account before the withdrawal(s).
2) Subtract the amount figured in (1) from the total amount withdrawn during the year. The result is the amount of earnings included in the withdrawal. The beneficiary or other person receiving the distribution must include this amount in income.

Exception for transfer to surviving spouse or family member. If an education IRA is transferred to a surviving spouse or other family member as the result of the death of the designated beneficiary, the education IRA retains its status. (For this purpose, family member was defined earlier under *Rollovers.*) This means the spouse or other family member can treat the education IRA as his or her own. There are no tax consequences as a result of the transfer.

5.

Withdrawals From Traditional or Roth IRAs

Generally, if you make withdrawals from your traditional or Roth IRA before you reach age 59½, you must pay a 10% additional tax on the early withdrawal.

However, you can make withdrawals from your traditional or Roth IRA for ***qualified higher education expenses*** without having to pay the 10% additional tax. You will owe income tax on at least part of the amount withdrawn, but you will not have to pay the 10% additional tax on early withdrawals.

A traditional IRA is an IRA that is not a Roth IRA, SIMPLE IRA, or education IRA.

The part not subject to the tax is generally the amount that is not more than the qualified higher education expenses for the year.

Who Can Make Early Withdrawals Free of the 10% Tax?

You can make a withdrawal from your traditional or Roth IRA before you reach age 59½ and not have to pay the 10% additional tax if, for the year, you pay ***qualified higher education expenses*** for yourself, your spouse, or you or your spouse's children or grandchildren.

How Do You Figure the Amount Not Subject to the 10% Tax?

When determining the amount of the withdrawal that is not subject to the 10% additional tax, include ***qualified higher education expenses*** paid with any of the following funds.

1) An individual's earnings.
2) A loan.
3) A gift.
4) An inheritance given to either the student or the individual making the withdrawal.
5) Personal savings (including savings from a qualified state tuition program).

Do ***not include*** expenses paid with any of the following funds.

1) Tax-free withdrawals from an education IRA.
2) Tax-free scholarships, such as a Pell grant.
3) Tax-free employer-provided educational assistance.
4) Any tax-free payment (other than a gift, bequest, or devise) due to enrollment at an eligible educational institution.

Qualified higher education expenses. These expenses are tuition, fees, books, supplies, and equipment required for enrollment or attendance at an ***eligible educational institution***. In addition, if the student is at least a ***half-time student***, room and board are qualified higher education expenses.

Eligible educational institution. 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 Department of Education. It includes virtually all accredited, public, nonprofit, and proprietary (privately owned profit-making) postsecondary institutions. The educational institution should be able to tell you if it is an eligible educational institution.

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 the course of study the student is pursuing as determined under the standards of the school where the student is enrolled.

6.

Education Savings Bond Program

Generally, you must pay tax on the interest earned on U.S. savings bonds. If you do not include the interest in income in the years it is earned, you must include it in your income in the year in which you cash in the bonds.

However, you may not have to include the interest in your income in the year in which you cash in the bonds if you pay higher education expenses during that year for you, your spouse, or a dependent for whom you claim an exemption.

Who Can Cash In Bonds Tax Free?

You can cash in ***qualified U.S. savings bonds*** without having to include in your income the interest earned on the bonds if **all** of the following conditions are met.

- You pay ***qualified higher education expenses*** for yourself, your spouse, or a ***dependent for whom you claim an exemption*** on your return.
- Your ***modified adjusted gross income*** is less than $69,100 ($111,100 if filing a joint return).
- Your filing status is not married filing separate return.

Qualified U.S. savings bonds. A qualified U.S. savings bond is a series EE bond ***issued after 1989*** or a series I bond. The bond must be issued either in your name (as the sole owner) or in your and your spouse's names (as co-owners).

The owner must be at least 24 years old before the bond's issue date. The issue date is printed directly on the front of the savings bond.

Qualified higher education expenses. These include the following items you pay for either yourself, your spouse, or a dependent for whom you claim an exemption.

1) Tuition and fees required to enroll at or attend an ***eligible educational institution***. Qualified expenses do ***not*** include expenses for room and board or for courses involving sports, games, or hobbies that are not part of a degree program.
2) Contributions to a qualified state tuition program (see chapter 8).
3) Contributions to an education IRA (see chapter 4).

Expenses reduced by certain benefits. You must reduce your qualified higher educational expenses by the amount of any of the following benefits received by the student.

1) Tax-free scholarships. See Publication 520.
2) Tax-free withdrawals from an education IRA.
3) Any nontaxable payments (other than gifts, bequests, or inheritances) received for educational expenses or for attending an eligible educational institution, such as:
   a) Veterans' educational assistance benefits,
   b) Benefits under a qualified state tuition program, or
   c) Tax-free employer-provided educational assistance.
4) Any expenses used in figuring the Hope and lifetime learning credits.

Dependent for whom you claim an exemption. You claim an exemption for a person if you list his or her name on line 6c, Form 1040 (or Form 1040A).

Eligible educational institution. 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 Department of Education. It includes virtually all accredited, public, nonprofit, and proprietary (privately owned profit-making) postsecondary institutions. The educational institution should be able to tell you if it is an eligible educational institution.

Modified adjusted gross income. Modified adjusted gross income, for purposes of this exclusion, is adjusted gross income (AGI) (line 19 of Form 1040A or line 33 of Form 1040) figured before the interest exclusion, and modified by adding back any:

1) Foreign earned income exclusion,
2) Foreign housing exclusion or deduction,
3) Exclusion of income for bona fide residents of American Samoa,
4) Exclusion for income from Puerto Rico,
5) Exclusion for adoption benefits received under an employer's adoption assistance program, and
6) Deduction for student loan interest.

Use the worksheet in the instructions for line 9, Form 8815, to figure your modified AGI. If you claim any of the exclusion or deduction items (1) – (6) listed above, add the amount of the exclusion or deduction to the amount on line 5 of the worksheet, and enter the total on Form 8815, line 9, as your modified AGI.

CAUTION *Because the deduction for interest expenses attributable to royalties and other investments is limited to your net investment income, you cannot figure the deduction until you have figured this interest exclusion. Therefore, if you had interest expenses attributable to royalties and deductible on Schedule E (Form 1040), you must make a special computation of your deductible interest without regard to this exclusion to figure the net royalty income in-*

cluded in your modified AGI. See Royalties included in modified AGI *under* Education Savings Bond Program *in chapter 1 of Publication 550.*

How Do You Figure the Tax-Free Amount?

If the total you receive when you cash in the bonds is not more than the qualified higher educational expenses for the year, you can exclude all of the interest on the bonds. If the total you receive when you cash in the bonds is more than the expenses, you can exclude only part of the interest.

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

Modified adjusted gross income limit. The interest exclusion is phased out if your modified adjusted gross income is between $54,100 and $69,100 (between $81,100 and $111,100 for joint returns). You do not qualify for the interest exclusion if your modified adjusted gross income is equal to or more than the upper limit.

Claiming the exclusion. Use Form 8815 to figure your exclusion. Attach the form to your Form 1040 or 1040A.

7.

Employer-Provided Educational Assistance

Your employer may be able to provide you, tax free, up to $5,250 of educational benefits each year. This means that you may not have to pay tax on amounts your employer pays for your education. Your employer will be able to tell you whether the benefits are tax free.

CAUTION *You cannot use any of the tax-free educational expenses paid for by your employer as the basis for any other deduction or credit, including the Hope credit and the lifetime learning credit.*

Educational benefits. Educational benefits that your employer can provide tax free include payments for tuition, fees and similar expenses, books, supplies, and equipment. The payments must be for undergraduate-level courses that begin before January 1, 2002. The payments do not have to be for work-related courses.

Educational assistance benefits do not include payments for the following items.

1) Meals, lodging, transportation, or tools or supplies (other than textbooks) that you can keep after completing the course of instruction.
2) Courses involving sports, games, or hobbies unless they:
   a) Have a reasonable relationship to the business of your employer, or
   b) Are required as part of a degree program.
3) Graduate-level courses normally taken under a program leading to a law, business, medical, or other advanced academic or professional degree.

Benefit over $5,250. If your employer pays for more than $5,250 of educational benefits for you during the year, you must generally pay tax on the amount over $5,250. Your employer should include in your wages (box 1 of your Form W–2) the amount which you must include in income.

Working condition fringe benefit. However, if the payments also qualify as a working condition fringe benefit, your employer does not have to include them in your wages. A working condition fringe benefit is a benefit which, had you paid for it, you could deduct as an employee business expense. For more information on working condition fringe benefits, see *Working Condition Benefits* in chapter 2 of Publication 15–B, *Employer's Tax Guide to Fringe Benefits*.

8.

State Tuition Programs

Certain states maintain programs that allow you to either prepay a student's tuition or contribute to an account established for paying a student's qualified higher education expenses (defined later). If you prepay tuition, the student (beneficiary) will be entitled to a waiver or a payment of qualified higher education expenses. You cannot deduct either payments or contributions to a qualified state tuition program.

No tax is due on earnings based on the prepayments or contributions until the earnings are distributed. The student pays tax on the earnings when they are distributed. Because payments and contributions are not deducted, any tax due on them has already been paid. Therefore, when amounts are distributed from the program, tax is due only on the part of the distribution that represents earnings on the payments or contributions. See *Distributions,* later.

NOTE. Even if a qualified state tuition program is used to finance a student's higher education, the student or the student's parents still may be eligible to claim either the Hope credit or the lifetime learning credit.

CAUTION *No contributions can be made to an education IRA on behalf of a beneficiary if any amount is contributed during the same year to a qualified state tuition program on behalf of the same beneficiary. Any amount contributed to the education IRA will be treated as an excess contribution to the education IRA. Education IRAs are discussed in chapter 4.*

More information. For more information on a specific qualified state tuition program, contact the state or agency that established and maintains it.

What Is a Qualified State Tuition Program?

A qualified state tuition program is one established and maintained by a state or an agency or instrumentality of the state. The program must be set up to provide for a student's ***qualified higher educational expenses*** at an ***eligible educational institution***. The program must meet certain requirements. Your state government can tell you whether or not they participate in a qualified state tuition program.

Qualified higher educational expenses. These are the tuition, fees, books, supplies, and equipment required for enrollment or attendance at an eligible educational institution (defined below). They also include the reasonable costs of room and board for a ***beneficiary*** who is at least a half-time student. The cost of room and board is generally considered reasonable if it is not more than either:

1) The school's posted room and board charge, or
2) $2,500 per year for students living off-campus and not at home.

Beneficiary. The beneficiary is generally the student (or future student) for whom the program is intended to provide benefits. The beneficiary can be changed after participation in the program begins. If a state or local government or certain tax-exempt organizations purchase an interest in a program as part of a scholarship program, the beneficiary is the person who receives the interest as a scholarship.

Eligible educational institution. This is any college, university, vocational school, or other postsecondary educational institution eligible to participate in a student aid program administered by the Department of Education. It includes virtually all accredited public, nonprofit, and proprietary (privately owned profit-making) postsecondary institutions. The educational institution should be able to tell you if it is an eligible educational institution.

How Much Can I Contribute?

Contributions on behalf of any beneficiary cannot be more than the amount necessary to provide for the qualified higher education expenses of the beneficiary.

Distributions

The beneficiary is responsible for any tax due on a distribution from the program. A refund of earnings not used to pay qualified higher educational expenses of the beneficiary is subject to a penalty unless it meets one of the conditions listed below under *Allowed uses of distributions.*

Taxation of distributions. Generally, the beneficiary must pay tax on any earnings on amounts paid or contributed to a qualified state tuition program when those earnings are distributed. The beneficiary does not have to pay tax on the earnings if they are not taxable because of some other provision of the law. There is no tax on the part of the distribution representing the amount paid or contributed to the program. The part representing the amount paid or contributed to the program is the part of the distribution which bears the same ratio to the distribution as the payment or contribution bears to the total balance in the program.

Allowed uses of distributions. Generally, distributions must be used to pay the qualified higher education expenses (defined earlier) of the beneficiary.

Penalty. There is a penalty on any refund of earnings that does not meet **at least one** of the following conditions.

1) The refunded earnings are used to pay qualified higher educational expenses of the beneficiary.

2) The refund of earnings is made because of the death or disability of the beneficiary.

3) The refund of earnings is made because the beneficiary received a scholarship, a veterans educational assistance allowance, or another nontaxable payment (other than a gift, bequest, or inheritance) for educational expenses. This only applies to the part of the refund that is not more than the scholarship, allowance, or other payment.

In-kind distributions. Any in-kind distribution (such as a waiver of tuition) furnished to a beneficiary under a qualified state tuition program is considered a distribution to the beneficiary.

Can I Transfer Amounts or Change Beneficiaries?

Amounts can be transferred to other qualified state tuition programs and beneficiaries can be changed.

Amounts in a qualified state tuition program can be transferred tax free to the qualified state tuition program of another beneficiary. The transfer must be completed within 60 days of the distribution and the other beneficiary must be a family member (as defined later) of the beneficiary from whose program the transfer is made.

The beneficiary of a qualified state tuition program can be changed. However, the new beneficiary must be the existing beneficiary's spouse or one of the family members listed below.

Family members. If the beneficiary does not use amounts in the program, they can be transferred tax free to the beneficiary's spouse or any of the following other members of the beneficiary's family.

1) Son or daughter or descendant of son or daughter.

2) Stepson or stepdaughter.

3) Brother, sister, stepbrother or stepsister.

4) Father or mother or ancestor of either.

5) Stepfather or stepmother.

6) Son or daughter of a brother or sister.

7) Brother or sister of father or mother.

8) The spouse of any individual listed above.

9.

How To Get Tax Help

You can get help with unresolved tax issues, order free publications and forms, ask tax questions, and get more information from the IRS in several ways. By selecting the method that is best for you, you will have quick and easy access to tax help.

Contacting your Taxpayer Advocate. If you have attempted to deal with an IRS problem unsuccessfully, you should contact your Taxpayer Advocate.

The Taxpayer Advocate represents your interests and concerns within the IRS by protecting your rights and resolving problems that have not been fixed through normal channels. While Taxpayer Advocates cannot change the tax law or make a technical tax decision, they can clear up problems that resulted from previous contacts and ensure that your case is given a complete and impartial review.

To contact your Taxpayer Advocate:

- Call the Taxpayer Advocate at **1–877–777–4778.**
- Call the IRS at **1–800–829–1040.**
- Call, write, or fax the Taxpayer Advocate office in your area.
- Call **1–800–829–4059** if you are a TTY/TDD user.

For more information, see Publication 1546, *The Taxpayer Advocate Service of the IRS.*

Free tax services. To find out what services are available, get Publication 910, *Guide to Free Tax Services.* It contains a list of free tax publications and an index of tax topics. It also describes other free tax information services, including tax education and assistance programs and a list of TeleTax topics.

Personal computer. With your personal computer and modem, you can access the IRS on the Internet at **www.irs.gov**. While visiting our web site, you can select:

- *Frequently Asked Tax Questions* (located under *Taxpayer Help & Ed)* to find answers to questions you may have.
- *Forms & Pubs* to download forms and publications or search for forms and publications by topic or keyword.
- *Fill-in Forms* (located under *Forms & Pubs)* to enter information while the form is displayed and then print the completed form.
- *Tax Info For You* to view Internal Revenue Bulletins published in the last few years.
- *Tax Regs in English* to search regulations and the Internal Revenue Code (under *United States Code (USC)).*
- *Digital Dispatch* and *IRS Local News Net* (both located under *Tax Info For Business)* to receive our electronic newsletters on hot tax issues and news.
- *Small Business Corner* (located under *Tax Info For Business)* to get information on starting and operating a small business.

You can also reach us with your computer using File Transfer Protocol at **ftp.irs.gov**.

TaxFax Service. Using the phone attached to your fax machine, you can receive forms and instructions by calling **703–368–9694.** Follow the directions from the prompts. When you order forms, enter the catalog number for the form you need. The items you request will be faxed to you.

Phone. Many services are available by phone.

- *Ordering forms, instructions, and publications.* Call **1–800–829–3676** to order current and prior year forms, instructions, and publications.
- *Asking tax questions.* Call the IRS with your tax questions at **1–800–829–1040.**
- *TTY/TDD equipment.* If you have access to TTY/TDD equipment, call **1–800–829–4059** to ask tax questions or to order forms and publications.
- *TeleTax topics.* Call **1–800–829–4477** to listen to pre-recorded messages covering various tax topics.

Evaluating the quality of our telephone services. To ensure that IRS representatives give accurate, courteous, and professional answers, we evaluate the quality of our telephone services in several ways.

- A second IRS representative sometimes monitors live telephone calls. That person only evaluates the IRS assistor and does not keep a record of any taxpayer's name or tax identification number.
- We sometimes record telephone calls to evaluate IRS assistors objectively. We hold these recordings no longer than one week and use them only to measure the quality of assistance.
- We value our customers' opinions. Throughout this year, we will be surveying our customers for their opinions on our service.

Walk-in. You can walk in to many post offices, libraries, and IRS offices to pick up certain forms, instructions, and publications. Also, some libraries and IRS offices have:

- An extensive collection of products available to print from a CD-ROM or photocopy from reproducible proofs.
- The Internal Revenue Code, regulations, Internal Revenue Bulletins, and Cumulative Bulletins available for research purposes.

Mail. You can send your order for forms, instructions, and publications to the Distribution Center nearest to you and receive a response within 10 workdays after your request is received. Find the address that applies to your part of the country.

- **Western part of U.S.:**
  Western Area Distribution Center
  Rancho Cordova, CA 95743–0001
- **Central part of U.S.:**
  Central Area Distribution Center
  P.O. Box 8903
  Bloomington, IL 61702–8903
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Appendices

The following appendices include an illustrated example of how to use the Form 8863 when claiming both education tax credits at the same time and a chart reflecting some of the major differences between the many tax benefits for higher education that are outlined in this publication.

1) **Appendix A**— An *Illustrated Example of Education Credits* including a filled-in Form 8863 showing how to claim both the Hope credit and lifetime learning credit for 2000.

2) **Appendix B**— A chart summarizing ***some*** of the differences between the different higher education tax benefits discussed in this publication. It is intended only as a guide. Look in the publication for more complete information.

Appendix A. Illustrated Example of Education Credits

Dave and Valerie are married and file a joint tax return. For 2000, they claim exemptions for their two dependent children on their tax return. Their modified adjusted gross income is $82,000. Their tax is $9,475. Their son, Sean, will receive his bachelor's degree in psychology from the state college in May 2001. Their daughter, Corey, enrolled full-time at that same college in August 1999 to begin working on her bachelor's degree in physical education. In July 2000, Dave and Valerie paid $2,200 in tuition costs for each child for the fall 2000 semester.

Dave and Valerie, their children, and the college meet all of the requirements for the higher education credits. Because Sean is beyond the second (sophomore) year of his postsecondary education, his expenses do not qualify for the Hope credit. But, amounts paid for Sean's expenses in 2000 for academic periods beginning in 2000 qualify for the lifetime learning credit. Corey is in her first two (freshman and sophomore) years of postsecondary education and expenses paid for her in 2000 for academic periods beginning in 2000 qualify for the Hope credit.

Dave and Valerie figure their tentative education credits for 2000, $1,940, as shown in the completed Form 8863. They cannot claim the full amount because their modified adjusted gross income is more than $80,000. They carry the amount from line 18 of Form 8863 to line 46 of Form 1040, and they attach the Form 8863 to their return.

Form **8863** | Department of the Treasury Internal Revenue Service

Education Credits (Hope and Lifetime Learning Credits)

► See instructions on pages 2 and 3. ► Attach to Form 1040 or Form 1040A.

OMB No. 1545-1618 | 2000 | Attachment Sequence No. **51**

Name(s) shown on return: Dave and Valerie Jones | Your social security number: 987 00 6543

Part I **Hope Credit. Caution:** *The Hope credit may be claimed for no more than* ***2*** *tax years for the* ***same*** *student.*

1	(a) Student's name (as shown on page 1 of your tax return) First, Last	(b) Student's social security number (as shown on page 1 of your tax return)	(c) Qualified expenses (but **do not** enter more than $2,000 for each student). See instructions	(d) Enter the **smaller** of the amount in column (c) or $1,000	(e) Subtract column (d) from column (c)	(f) Enter one-half of the amount in column (e)
	Corey, Jones	137 00 9642	2,000	1,000	1,000	500
2	Add the amounts in columns (d) and (f)		**2**	1,000		500
3	Tentative Hope credit. Add the amounts on line 2, columns (d) and (f) . . . . ►				**3**	1,500

Part II **Lifetime Learning Credit**

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

4	(a) Student's name (as shown on page 1 of your tax return) First	Last	(b) Student's social security number (as shown on page 1 of your tax return)	(c) Qualified expenses. See instructions
	Sean	Jones	246 00 9731	2,200

5	Add the amounts on line 4, column (c), and enter the total	5	2,200
6	Enter the **smaller** of line 5 or $5,000	6	2,200
7	Tentative lifetime learning credit. Multiply line 6 by 20% (.20) . . . . ►	7	440

Part III **Allowable Education Credits**

8	Tentative education credits. Add lines 3 and 7.			8	1,940
9	Enter: $100,000 if married filing jointly; $50,000 if single, head of household, or qualifying widow(er)	9	100,000		
10	Enter the amount from Form 1040, line 34 (or Form 1040A, line 20)*	10	82,000		
11	Subtract line 10 from line 9. If line 10 is equal to or more than line 9, **stop;** you cannot take any education credits.	11	18,000		
12	Enter: $20,000 if married filing jointly; $10,000 if single, head of household, or qualifying widow(er)	12	20,000		
13	If line 11 is equal to or more than line 12, enter the amount from line 8 on line 14 and go to line 15. If line 11 is less than line 12, divide line 11 by line 12. Enter the result as a decimal (rounded to at least three places)			13	× . 900
14	Multiply line 8 by line 13. . . . . ►			14	1,746
15	Enter the amount from Form 1040, line 42 (or Form 1040A, line 26)			15	9,475
16	Enter the total, if any, of your credits from Form 1040, lines 43 through 45 (or from Form 1040A, lines 27 and 28).			16	0
17	Subtract line 16 from line 15. If line 16 is equal to or more than line 15, **stop;** you cannot take any education credits			17	9,475
18	**Education credits.** Enter the **smaller** of line 14 or line 17 here and on Form 1040, line 46 (or Form 1040A, line 29) . . . . ►			18	1,746

*See Pub. 970 for the amount to enter if you are filing Form 2555, 2555-EZ, or 4563 or you are excluding income from Puerto Rico.

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Appendix B — Highlights of Tax Benefits for Higher Education

This chart highlights some differences among the benefits discussed in this publication. See the text for definitions and details. **Do not rely on this chart alone.**

Caution: *You generally cannot claim more than one benefit for the same education expense.*

	Hope credit	**Lifetime learning credit**	**Education IRA**[1]	**Traditional and Roth IRAs**[1]	**Student Loan Interest**	**State Tuition Programs**	**Education Savings Bond Program**[1]	**Employer's Educational Assistance Program**[1]
What is your benefit?	Credits can reduce the amount of tax you must pay		Earnings are not taxed	No 10% additional tax on early withdrawal	You can deduct the interest	Earnings are not taxed	Interest is not taxed	Employer benefits are not taxed
What is the annual limit?	Up to $1,500 per student	Up to $1,000 per family	$500 contribution per beneficiary	Amount of qualifying expenses	$2,000	None	Amount of qualifying expenses	$5,250
What expenses qualify besides tuition and required enrollment fees?	None		Books Supplies Equipment Room & board if at least a half-time student Payments to state tuition program	Books Supplies Equipment Room & board if at least a half-time student	Books Supplies Equipment Room & board Trans-portation Other necessary expenses	Books Supplies Equipment Room & board if at least a half-time student	Payments to education IRAs Payments to state tuition programs	Books Supplies Equipment
What education qualifies?	1st 2 years of under-graduate	All undergraduate and graduate						Under-graduate
What are some of the other conditions that apply?	Can be claimed only for 2 years Must be enrolled at least half-time in a degree program		Cannot contribute to education IRA and state tuition program in the same year Must withdraw assets at age 30		Applies to 1st 60 months of required interest Must have been at least half-time student in a degree program	Beneficiary must pay tax on withdrawn earnings	Applies only to qualified series EE bonds issued after 1989 or series I bonds	Expires for courses beginning after December 31, 2001
In what income range do benefits phase out?	$40,000 – $50,000; $80,000 – $100,000 for joint returns		$95,000 – $110,000; $150,000 – $160,000 for joint returns	There is no phaseout	$40,000 – $55,000; $60,000 – $75,000 for joint returns	There is no phaseout	$54,100 – $69,100; $81,100 – $111,100 for joint returns	There is no phaseout

[1] Any nontaxable withdrawal is limited to the amount that does not exceed qualifying educational expenses.

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