

2022 TAX TRAINING EDUCATION

The following is an overview of education credits and the income implications of scholarships. I will describe the basic rules for the two education credits and the income issues that arise with scholarships. However, to properly handle education credits, you need to understand the ability to optimize education credits. This is a complex topic that is beyond the scope of this series of training sessions. If you are new to education credits and do not understand how to optimize these credits, you need to seek assistance before attempting to complete a return with education credits.

FORM 1098-T

In order to address both the taxable income aspects of scholarships and education credits, you must have a copy of Form 1098-T issued by the post-secondary educational institution to the student. If you are doing the return of the parents (where the education credit is often claimed), you still need this form. In addition, it is often helpful to obtain the student's account statement from the educational institution.

WHAT DO WE DO WITH A 1098-T?

Two issues to address

- Does the student have scholarship income to report on her return?
- Are there Qualified Educational Expenses available to claim an education credit?

STARTING POINT – Determine the amount of Qualified Educational Expenses

- **1098-T Box 1** – This is supposed to report “tuition, fees, and course materials required for a student to be enrolled at or attend an eligible educational institution.”
- **Determine other QEE** – This usually includes books and supplies. The taxpayer must provide this information.
- **Student Account Statement** – If you can get this, review to see if there are any other qualifying expenses.

The following are examples of expenses that do not constitute QEE: room and board, meal plans, parking passes, and fees not required for attendance, such as fees to use athletic facilities.

After determining the total QEE, we need to compare the total amount of QEE to the amount of scholarships and grants reported in Box 5.

- If QEE is GREATER than Box 5, there is no scholarship income to report on the student's return. The difference is QEE for purposes of the education credits.
- If the amount in Box 5 is GREATER than the amount of QEE, the student has scholarship income to report equal to the difference (note the student may or may not have a filing requirement) and there is no QEE for education credits.

ARE WE FINISHED?

MAYBE

We need to determine if we can optimize the education credit to create the best overall tax result. Where possible, we do this by making more of the scholarship amount shown in Box 5 taxable, which leaves a corresponding amount of QEE available for education credits.

WHEN DO WE NOT NEED TO OPTIMIZE?

Examples of situations where we don't need to optimize

- The total QEE amount exceeds the amount shown in Box 5 by \$4,000 or more and the taxpayer qualifies for the AOC. If so, enter \$4,000 as the QEE for the AOC on the return of the taxpayer claiming the credit.
- The scholarship is a restricted scholarship in which case we are not allowed to optimize. A restricted scholarship is one that by its terms can only be used to cover QEE.

Otherwise, we generally want to go through optimizing the education credits.

WHOSE TAX RETURN?

- Scholarship income is always the income of the student!
- The education credits are claimed by the support provider if the support provider is claiming the student as a Dependent. Otherwise, the student would claim the education credit (which often leads to a smaller credit and may make the credit nonrefundable in full).

EDUCATION INCOME ISSUES

Whether the student has to pay tax on the scholarship income depends on whether the student has a filing obligation, the amount of the student's other income, and whether the student is eligible to be claimed as a Dependent.

- See Pub. 4012, pp. A-1 and 2 for the filing obligation thresholds. Scholarship income is earned income for purposes of these thresholds.
- There is a scope issue relating to the Kiddie Tax which we will discuss later.

AOC

A credit of up to \$2,500 (\$1,000 of which is generally refundable). The AOC is always better than the Lifetime Learning Credit if the taxpayer qualifies for both credits.

- The credit is only available for the first 4 years of post-secondary education.
- The student must be enrolled in a degree program on at least a half-time basis. Form 1098-T has a check box for whether the student was at least half-time so use this as a guide.

The credit is a dollar-for-dollar credit for the first \$2,000 of QEE, and then a 25% credit on the next \$2,000 of QEE.

There are also limitations on the refundability of the AOC for taxpayers who are under the age of 24. See Pub. 4012, p. J-12.

LLC

The LLC is a nonrefundable credit of up to \$2,000. The credit is 20% of the QEE (up to a max of \$10,000 of QEE). QEE for this purpose is more restrictive than for the AOC, as books and supplies must be required to be purchased from the educational institution to qualify. The LLC is much less restrictive in its application than the AOC, as it applies to both undergraduate and graduate school, there is no requirement that the student be in a degree program, the courses can be to acquire or improve job skills, and there is no limit to the number of years the credit can be claimed.

SCOPE – KIDDIE TAX

Finally, there is one significant scope issue – the Kiddie Tax. This is very complex, but you have to understand if it is an issue before you can proceed with completing a return for a student. Note

that this issue only applies to the **student's** return and only if there is scholarship income on the student's return.

If the Kiddie Tax applies, the student's unearned income (including any scholarship income) is taxed at the tax rate of the parents. It does not matter whether the student is claiming herself, it can apply in either case.

For the Kiddie Tax to apply, the student must be under the age of 24. There are 5 requirements that must be satisfied. Pub. 4012, p. H-3, has a good job aide for determining whether these 5 requirements are met and thus whether the Kiddie Tax applies, thereby making the return out of scope.

If the student has scholarship income of more than \$2,300 and is required to file a tax return (generally because their income, including the scholarship income, is greater than \$12,950), seek assistance to determine whether there is a Kiddie Tax issue.