

Parent and Student Guide to Federal Tax Benefits For Tuition and Fees (for Tax Year 2006)

Understanding the Hope Scholarship Tax Credit

What Is It?

The Hope Scholarship is a tax credit, not a scholarship. Tax credits are subtracted directly from the tax a family owes, instead of being subtracted from taxable income like a tax deduction. A family must file a federal tax return and owe taxes to get this tax credit. A family cannot get a refund for the Hope credit if it does not pay taxes. A family that owes less tax than the maximum amount of the Hope tax credit for which it is eligible can only take a credit up to the amount of taxes owed.

For the 2006 tax year, a family may claim a tax credit up to \$1,650 for each eligible dependent for up to two tax years (100% of the first \$1,100 and 50% of the second \$1,100 paid for qualified expenses). The Hope credit is available only until each student's first two years of postsecondary education are complete. Gulf Opportunity Zone students may claim up to \$3,300 (100% of the first \$2,200 and 50% of the second \$2,200) for the 2006 tax year.

The exact amount of the Hope credit also depends on a family's income, the amount of qualified tuition and fees paid, and the amount of certain scholarships and allowances subtracted from tuition. The total credit is also based on how many eligible dependents are in the family, rather than a maximum dollar amount for the family as with the Lifetime Learning tax credit.

Who Qualifies?

The Taxpayer: An eligible taxpayer must file a federal tax return and owe taxes to claim the Hope credit. In addition, the taxpayer must claim an eligible student as a dependent on the tax return, unless the credit is for the taxpayer or the taxpayer's spouse. (This means the eligible taxpayer may also be the eligible student.) In 2006, taxpayers cannot claim a Hope credit if their Modified Adjusted Gross Income (MAGI) is \$55,000 or more for a single taxpayer, or \$110,000 or more for married taxpayers filing a joint return.

The Student: An eligible student must be enrolled at least half-time for at least one academic period beginning in 2006 at an eligible program leading to a degree or certificate at an eligible school AND can not have completed the first two years of undergraduate study. You may claim the credit yourself if you are not claimed as a dependent by another taxpayer. (Once again, this means that

the eligible student may also be the eligible taxpayer.) Students convicted of a federal or state drug felony before the end of 2006 are not eligible for the Hope credit.

How Do You Get It?

To apply for the credit, taxpayers must report the amount of tuition and fees paid as well as the amount of certain scholarships, grants, and untaxed income used to pay the tuition and fees. Schools are required to send this information by Jan. 31, 2007 in the form of a 1098-T statement to each taxpayer and to the IRS. Taxpayers use this information and their own records about tuition and fees paid when they fill out IRS form 8863 to claim the tax credit. The statement sent by the school will also include contact information for someone at the school who can answer questions about the information on the form. A taxpayer may wish to talk to a tax advisor for help in calculating the amount of the credit.

When Is It Available?

Generally, the credit is allowed for qualified education expenses paid in 2006 for an academic period that begins in 2006 or during the first three months of 2007, (e.g., paying in December 2006 for an academic period beginning in January 2007).

Can A Family Claim Multiple Benefits?

Taxpayers may claim a Lifetime Learning credit, a Hope credit, and an exclusion from gross income for certain distributions from qualified state tuition programs or education IRAs, if a different student is used for each credit or exclusion and a family does not exceed the Lifetime Learning maximum per family (\$2,000 or \$4,000 for Gulf Opportunity Zone students).

National Association of Student Financial Aid Administrators

Understanding the Lifetime Learning Tax Credit

What Is It?

The Lifetime Learning credit is a tax credit available to individuals who file a tax return and owe taxes. The amount of the credit is subtracted from the taxes owed, rather than reducing taxable income as with a tax deduction. Individuals who do not pay taxes are not eligible for a Lifetime Learning credit. Taxpayers

who owe less tax than the maximum amount of the Lifetime Learning tax credit for which they are eligible can only take a credit up to the amount of taxes owed.

A family may claim a tax credit of up to \$2,000 per tax year for the taxpayer, taxpayer's spouse, or any eligible dependents for an unlimited number of tax years (\$4,000 for Gulf Opportunity Zone students). If you are claiming a lifetime learning credit for both Gulf Opportunity Zone students and other students, the qualified education expenses taken into account in Part II of the 8863 form cannot exceed \$10,000 reduced by the qualified education expenses of the Gulf Opportunity Zone students. The amount of the Lifetime Learning tax credit is 20% of the first \$10,000 of qualified educational expenses paid for all eligible students. Therefore, the maximum amount of a Lifetime Learning tax credit is \$2,000. The Lifetime Learning credit is available for all years of postsecondary education and for courses to acquire or improve job skills, unlike the Hope credit which is only available for two years.

The actual amount of the credit depends on a family's income, the amount of qualified tuition and fees paid, and the amount of certain scholarships and allowances subtracted from tuition. This credit is family-based (up to \$2,000 per tax return or \$4,000 for Gulf Opportunity Zone students) rather than based on the number of dependents in a family as with the Hope credit.

Who Qualifies?

The Taxpayer: An eligible taxpayer must file a tax return and owe taxes to claim the credit. The taxpayer must also claim the eligible student as a dependent unless the credit is for the taxpayer or the taxpayer's spouse. (This means the eligible taxpayer may also be the eligible student.) You cannot claim a Lifetime Learning credit if your Modified Adjusted Gross Income (MAGI) is \$55,000 or more (if single), or \$110,000 or more (for married taxpayers filing a joint return). MAGI limits were increased by \$2,000 for single taxpayers and married taxpayers for the 2006 tax year. Taxpayers that claim the Hope credit or tuition and fees deduction for a student are not eligible to claim the Lifelong Learning credit for the same student.

The Student: An eligible student may be enrolled in an eligible program leading to an undergraduate or graduate degree at an eligible school during the calendar year OR may be enrolled in any course of instruction at an eligible school to acquire/improve the student's job skills during the calendar year. Students may claim the credit themselves if they are not claimed as a dependent by another taxpayer. (Once again, this means that the eligible student may also be the eligible taxpayer.)

How Do You Get It?

To apply for the credit, the taxpayer must report the amount of tuition and fees paid as well as the amount of certain scholarships, grants, and untaxed income used to pay the tuition and fees. The law specifies that schools will send this information by January 31, 2006 in the form of a 1098-T statement to individual taxpayers and to the IRS. Taxpayers will use this information and their own records about tuition and fees paid when they fill out the IRS Form 8863 to claim the tax credit. The statement sent by the school will also include contact information for someone at the school who can answer questions about the information on the form. A taxpayer may wish to talk to a tax advisor for help in calculating the amount of its credit.

When Is It Available?

Generally, the credit is allowed for qualified education expenses paid in 2006 for an academic period that begins in 2006 or during the first three months of 2007 (e.g., paying in December 2006 for an academic period beginning in the first three months of 2007).

Can A Family Claim Multiple Benefits?

A family may claim a Lifetime Learning credit, a Hope credit, and an exclusion from gross income for certain distributions from qualified state tuition programs or education IRAs as long as the same student isn't used as the basis for each credit or exclusion AND the family doesn't exceed the Lifetime Learning maximum per family.

National Association of Student Financial Aid Administrators

Understanding the Tuition and Fees Tax Deduction

What Is It?

The Tuition and Fees Tax Deduction can reduce taxable income by as much as \$4,000 in 2006. This deduction is taken as an adjustment to income, which means you can claim this deduction even if they do not itemize deductions on Schedule A of Form 1040. This deduction may benefit taxpayers who do not qualify for either the Hope or Lifetime Learning Education Tax Credits.

Up to \$4,000 may be deducted from tuition and fees required for enrollment or attendance at an eligible postsecondary institution. Personal living and family

expenses, including room and board, insurance, medical and transportation, are not deductible expenses.

The exact amount of the Tuition and Fees Tax Deduction depends on the amount of qualified tuition and related expenses paid for one's self, spouse, or dependent for whom the taxpayer can claim an exemption.

Who Qualifies?

The Taxpayer: An eligible taxpayer must file a federal tax return to claim the Tuition and Fees Tax Deduction. The taxpayer must also claim an eligible student (an individual enrolled in one or more courses at an eligible educational institution) as a dependent on the tax return. The deduction may also be for the taxpayer or the taxpayer's spouse. The amount of qualified education expenses that can be deducted through the Tuition and Fees Deduction remained level for the 2006 tax year at \$4,000 for taxpayers with a Modified Adjusted Gross Income (MAGI) of \$65,000 or less (\$130,000 or less for married couples filing jointly). The maximum Tuition and Fees Deduction is \$2,000 for taxpayers with a MAGI greater than \$65,000 (\$130,000 for married couples filing jointly), but not greater than \$80,000 (\$160,000 for married couples filing jointly). Taxpayers with a MAGI greater than \$80,000 (\$160,000 for married couples filing jointly) are not eligible for this deduction.

The Student: An eligible student must be enrolled in one or more courses at an 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 U.S. Department of Education. According to the IRS, "it includes virtually all accredited, public, nonprofit, and proprietary postsecondary institutions." Colleges can provide information on whether they meet this requirement. Students may claim this deduction for themselves if they are not claimed as a dependent by another taxpayer.

How Do You Get It?

Because Congress passed last-minute legislation to extend the Tuition and Fees Tax Deduction, the IRS urges taxpayers to use IRS e-file because software will be updated so taxpayers can easily claim this deduction. The paper form used to claim this deduction was created before the extension was passed so people using a paper 1040 must take several special steps. Taxpayers must use existing lines on the current Form 1040 and other tax documents to claim this deduction. Instructions on the paper forms contain a cautionary note to taxpayers that the legislation was pending at the time of printing. People using a paper 1040 and claiming the Tuition and Fees Tax Deduction should follow these steps:

- Taxpayers must file Form 1040 to take this deduction for up to \$4,000 of tuition and fees paid to a post-secondary institution. It cannot be claimed on Form 1040A.
- The deduction for tuition and fees will be claimed on Form 1040, line 35, "Domestic production activities deduction." Enter "T" on the blank space to the left of that line entry if claiming the tuition and fees deduction, or "B" if claiming both a deduction for domestic production activities and the deduction for tuition and fees. For those entering "B," taxpayers must attach a breakdown showing the amounts claimed for each deduction.

An eligible institution that received payment for tuition and fees in the 2006 tax year generally must issue IRS Form 1098-T (the Tuition Statement) to each student by January 31, 2007. The information on that form will help taxpayers determine whether they can claim a deduction for 2006.

When Is It Available?

Generally, the deduction is allowed for qualified tuition and expenses paid in 2006 in connection with enrollment at an institution of higher education during 2006 or for an academic period beginning in 2006 or in the first three months of 2007. For instance, if you paid \$1,500 in December 2006 for qualified tuition for a spring 2007 semester that begins in January 2007, that \$1,500 can be used to figure the 2006 deduction.

Can A Family Claim Multiple Benefits?

Taxpayers may claim this deduction along with a Hope credit, a Lifetime Learning credit, and an exclusion from gross income for certain distributions from qualified state tuition programs or education IRAs, if a different student is used for each deduction, credit, or exclusion AND the family does not exceed the Lifetime Learning maximum per family.

Taxpayers cannot take the Tuition and Fees Tax Deduction if they deduct tuition and fees expenses under any other provision of the law (for example, as a business expense).

This deduction cannot be claimed if the tuition and fees were paid with tax-free scholarships, grants (including Federal Pell Grants), or other educational assistance including employer-provided education assistance and other non-taxable benefits received to pay for education expenses.

Related IRS Publications

- Publication 970 (PDF), Tax Benefits for Higher Education (<http://www.irs.gov/pub/irs-pdf/p970.pdf>)
- Form 8863 and Instructions (PDF), Education Credits (Hope and Lifetime Learning Credits) (<http://www.irs.gov/pub/irs-pdf/f8863.pdf>)
- Tax Topic 605, Education Credits (<http://www.irs.gov/taxtopics/tc605.html>)
- Frequently Asked Questions and Answers from the IRS, Education Tax Credits (<http://www.irs.gov/faqs/faq-kw52.html>)

The National Association of Student Financial Aid Administrators (NASFAA) created this general guide to federal education-related tax benefits for students and their families. We hope you have found useful the basic information about the Hope Scholarship tax credit, the Lifetime Learning tax credit, and the Tuition and Fees Tax Deduction. More detailed information is available from the IRS (including the links noted above) or from financial advisors. For additional information on the financial aid process, please visit our Web site for students and parents at <http://www.StudentAid.org>.

**Updated February 1, 2007 on www.NASFAA.org, the Web Site of the National Association of Student Financial Aid Administrators (NASFAA).
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