Education Tax Deductions and Credits

(from IRS web sites and RIA Research)

Tuition and Fees Deduction

You may be able to deduct qualified education expenses paid during the year for yourself, your spouse or your dependent. You cannot claim this deduction if your filing status is married filing separately or if another person can claim an exemption for you as a dependent on his or her tax return. The qualified expenses must be for higher education.

To claim the deduction modified adjusted gross income must be less than $80,000 (filing single) or $160,000 (married filing jointly).

The tuition and fees deduction can reduce the amount of your income subject to tax by up to $4,000. This deduction, reported on Form 8917, Tuition and Fees 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). This deduction may be beneficial to you if, for example, you don't qualify for the American opportunity or lifetime learning credits.

You may be able to take one of the education credits for your education expenses instead of a tuition and fees deduction. You can choose the one that will give you the lower tax. You cannot claim the tuition and fees deduction as well as an education credit for the same expense.

See IRS Publication 970 https://www.irs.gov/pub/irs-pdf/p970.pdf

Lifetime Learning Credit

The Lifetime Learning credit for tuition and related expenses may allow you to save on your taxes for higher education expenses you incur for yourself, your spouse, or your dependents.

The maximum Lifetime Learning credit you can claim is $2,000 per year (20% of up to $10,000 of expenses). The $2,000 maximum isn't adjusted annually for inflation.

The credit is available for any post-high school education (including graduate-level courses and courses to acquire or improve job skills) at an eligible school. In general, eligible schools include: (1) accredited schools offering credit towards a bachelor's or associate's degree or other recognized post-high school credential and (2) certain vocational schools.

The student need not be enrolled in a degree or certificate program. There's no course minimum. The credit may be available even if only one course is taken.

The Lifetime Learning credit isn't allowed for an education expense that is deductible (for example, as a business expense). Taxpayers can elect to claim an above-the-line deduction for qualified tuition and related expenses instead of the Lifetime Learning credit.

If a tax-exempt distribution from a Coverdell education savings account (formerly known as an education individual retirement account or education IRA), or qualified tuition program (also known as a 529 plan) is received for the student in the same year, the Lifetime Learning credit may only be claimed for expenses not covered by the distribution.

To be eligible for the credit for a year, the qualified expenses must be paid during the year for education furnished during an academic period (e.g., semester) starting within the year or within the first three months of the following year. Accordingly, for some expenses you'll have a choice: For a semester beginning in January of Year 2, you can pay the expenses either in Year 1 or 2 and claim the credit for the year of payment.

In addition, to claim the credit, a taxpayer must receive a Form 1098-T payee statement from the educational institution. For purposes of this requirement, if a person the taxpayer claims as a dependent receives the Form 1098-T, the statement is treated as received by the taxpayer.

The credit is nonrefundable, i.e., it can reduce your regular tax bill and your alternative minimum tax (AMT) bill to zero, but it can't result in a refund. Also, if the expenses on which the credit is based are later refunded, you may have to recapture the credit you claimed, i.e., your tax in the year of the refund may be increased due to a recomputation of the credit claimed in the earlier year.

Expenses that qualify for the credit include tuition and academic fees required for enrollment or attendance at an eligible educational institution. They don't include student activity fees, athletic fees, insurance, books, room and board, transportation costs, or other personal living expenses. Courses involving sports, games, or hobbies doesn't qualify unless they're part of the student's degree program. Qualified expenses for purposes of the credit are reduced by tax-exempt scholarships and fellowships, certain military benefits, and any other tax-exempt payments of those expenses (other than gifts or bequests).

For 2017, the credit is “phased out” ratably for married taxpayers filing jointly with adjusted gross income (AGI), with certain modifications, between $112,000 and $132,000 ($111,000 and $131,000 for 2016). That is, for joint filers, the credit is reduced if modified AGI for 2017 is between $112,000 and $132,000, and it is unavailable if AGI is $132,000 or more. For taxpayers filing as single or head of household, the phase-out range for 2017 is $56,000 to $66,000 ($55,000 to $65,000 for 2016). Married taxpayers who file separate returns can't claim the credit.

The Lifetime Learning credit isn't allowed to an individual who is claimed as a dependent on another's tax return. Instead, the credit for that individual is claimed on the return claiming him or her as a dependent. In such a case, the credit is based on the qualified expenses paid by both the student and the person who claims the student as a dependent. A student who is not claimed as a dependent can claim the credit on his or her own return, based on the expenses paid by the student. In either case, amounts paid directly to the school on the student's behalf by a third party, such as a grandparent, are treated as paid by the student.

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Determining which option is best.

Taxpayers who incur education expenses must decide how to take maximum advantage of these complex rules. Taxpayers who take the standard deduction instead of itemizing their deductions will generally want to claim the Lifetime Learning credit or the qualified tuition deduction. Other taxpayers will have to decide whether to take an itemized deduction, the Lifetime Learning credit, or the qualified tuition deduction for their education expenses.

Taxpayers may find an itemized deduction for education expenses more advantageous than the Lifetime Learning credit or the qualified tuition deduction because the itemized deduction is not subject to any amount limit, as are the Lifetime Learning credit and the qualified tuition deduction. And the AGI-based phaseout and AGI-based upper limits for the Lifetime Learning credit and qualified tuition deduction, respectively, will knock out these benefits for some.

On the other hand, if the education expenses aren't related to a taxpayer's current trade or business, but are incurred to acquire or improve job skills, even for a new trade or business, the expenses aren't deductible as an itemized deduction, but might qualify for the Lifetime Learning credit or the qualified tuition deduction.

Student Loan Interest Deduction

Can you deduct the interest you pay on your dental school loans? The answer is yes, subject to certain limits. The maximum amount of student loan interest you can deduct each year is $2,500. The deduction is phased out if your adjusted gross income (AGI) exceeds certain levels, as explained below.

The interest must be for a “qualified education loan,” which means a debt incurred to pay tuition, room and board, and related expenses to attend a post-high school educational institution, including certain vocational schools. Certain post-graduate programs also qualify. Thus, an internship or residency program leading to a degree or certificate awarded by an institution of higher education, hospital, or health care facility offering post-graduate training can qualify.

It doesn't matter when the loan was taken out or whether interest payments made in earlier years on the loan were deductible or not.

For 2017, the deduction is phased out for taxpayers who are married filing jointly with AGI between $135,000 and $165,000 ($65,000 and $80,000 for single filers). The deduction is unavailable for taxpayers with AGI of $165,000 ($80,000 for single filers) or more.

For 2016, the deduction was phased out for taxpayers who were married filing jointly with AGI between $130,000 and $160,000 ($65,000 and $80,000 for single filers). The deduction was unavailable for taxpayers with AGI of $160,000 ($80,000 for single filers) or more.

Married taxpayers must file jointly to claim this deduction.

No deduction is allowed to a taxpayer who can be claimed as a dependent on another's return. For example, in the typical situation where a parent is paying for the college education of a child whom the parent is claiming as a dependent, the interest deduction is only available for interest the parent pays on a qualifying loan, not for any interest the child/student may pay on a loan the student may have taken out. The child will be able to deduct interest that is paid in a later year when he or she is no longer a dependent.

The deduction is taken “above the line.” In other words, it's subtracted from gross income to determine AGI. Thus, it's available even to taxpayers who don't itemize deductions.

Other requirements. The interest must be on funds borrowed to cover qualified education costs of the taxpayer or his spouse or dependent. The student must be a degree candidate carrying at least half the normal full-time workload. Also, the education expenses must be paid or incurred within a reasonable time before or after the loan is taken out.

Taxpayers must keep records to verify qualifying expenditures. Documenting a tuition expense isn't likely to pose a problem. However, care should be taken to document other qualifying education-related expenditures such as for books, equipment, fees, and transportation.

Documenting room and board expenses should be straightforward for students living and dining on campus. Student who live off campus should maintain records of room and board expenses, especially when there are complicating factors such as roommates.

See IRS Publication 970 https://www.irs.gov/pub/irs-pdf/p970.pdf

Business Deduction for Work-Related Education

If you are an employee and can itemize your deductions, you may be able to claim a deduction for the expenses you pay for your work-related education. Your deduction will be the amount by which your qualifying work-related education expenses plus other job and certain miscellaneous expenses is greater than 2% of your adjusted gross income. An itemized deduction may reduce the amount of your income subject to tax.

If you are self-employed, you deduct your expenses for qualifying work-related education directly from your self-employment income. This reduces the amount of your income subject to both income tax and self-employment tax.

Your work-related education expenses may also qualify you for other tax benefits, such as the the American opportunity credit, tuition and fees deduction and the lifetime learning credit. You may qualify for these other benefits even if you do not meet the requirements listed above. You cannot claim this deduction as well as the tuition and fees deduction for the same expense, nor can you claim this deduction as well as an education credit for the same expense.

To claim a business deduction for work-related education, you must:

- Be working.
- Itemize your deductions on Schedule A (Form 1040 or 1040NR) if you are an employee.
- File Schedule C (Form 1040), Schedule C-EZ (Form 1040), or Schedule F (Form 1040) if you are self-employed.
- Have expenses for education that meet the requirements discussed under Qualifying Work-Related Education, below.

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Qualifying Work-Related Education

You can deduct the costs of qualifying work-related education as business expenses. This is education that meets at least one of the following two tests:

1. The education is required by your employer or the law to keep your present salary, status or job. The required education must serve a bona fide business purpose of your employer.
2. The education maintains or improves skills needed in your present work.

However, even if the education meets one or both of the above tests, it is not qualifying work-related education if it:

- Is needed to meet the minimum educational requirements of your present trade or business or
- Is part of a program of study that will qualify you for a new trade or business.

You can deduct the costs of qualifying work-related education as a business expense even if the education could lead to a degree.

Education Required by Employer or by Law

Education you need to meet the minimum educational requirements for your present trade or business is not qualifying work-related education. Once you have met the minimum educational requirements for your job, your employer or the law may require you to get more education. This additional education is qualifying work-related education if all three of the following requirements are met.

1. It is required for you to keep your present salary, status or job.
2. The requirement serves a business purpose of your employer.
3. The education is not part of a program that will qualify you for a new trade or business.

When you get more education than your employer or the law requires, the additional education can be qualifying work-related education only if it maintains or improves skills required in your present work.

Education to Maintain or Improve Skills

If your education is not required by your employer or the law, it can be qualifying work-related education only if it maintains or improves skills needed in your present work. This could include refresher courses, courses on current developments and academic or vocational courses.