

# Tax Treatment of Scholarship and Fellowship Payments

A scholarship or fellowship is tax free (excludable from gross income) **only if**:

- You are a **candidate for a degree** at an eligible educational institution. You are a candidate for a degree if you attend a primary or secondary school or are pursuing a degree at a college or university, or attend an educational institution that offers a program of training to prepare students for gainful employment in a recognized occupation and is authorized under federal or state law to provide such a program and is accredited by a nationally recognized accreditation agency.

A scholarship or fellowship is tax free **only to the extent**:

- It doesn't exceed your qualified education expenses;
- It isn't designated or earmarked for other purposes (such as room and board), and doesn't require (by its terms) that it can't be used for qualified education expenses; and
- It doesn't represent payment for teaching, research, or other services required as a condition for receiving the scholarship. (But for exceptions, see Payment for services in Publication 970, Tax Benefits for Education.)

Use *Worksheet 1-1* below to figure the amount of a scholarship or fellowship you can exclude from gross income.

## Education Expenses

The following are **qualified education expenses** for the purposes of tax-free scholarships and fellowships:

- **Tuition and fees** required to enroll at or attend an eligible educational institution.
- Course-related expenses, such as **fees, books, supplies, and equipment** that are required for the courses at the eligible educational institution. These items must be required of all students in your course of instruction.

Qualified education expenses **don't include** the cost of:

- Room and board
- Research
- Equipment and other expenses not required for enrollment in or attendance at an eligible educational institution
- Travel
- Clerical help

## Worksheet 1-1. Taxable Scholarship and Fellowship Income

1. Enter the total amount of any scholarship or fellowship grant for 2018. See Amount of scholarship or fellowship grant, earlier.	1. _____
<ul style="list-style-type: none"><li>• If you are a degree candidate at an eligible educational institution, go to line 2.</li><li>• If you <b>aren't</b> a degree candidate at an eligible educational institution, <b>stop here</b>. The entire amount is <b>taxable</b>. For information on how to report this amount on your tax return, see Reporting Scholarships and Fellowship Grants, later.</li></ul>	
2. Enter the amount from line 1 that was for teaching, research, or any other services required as a condition for receiving the scholarship. Don't include amounts received for these items under the National Health Service Corps Scholarship Program, the Armed Forces Health Professions Scholarship and Financial Assistance Program, or a comprehensive student work-learning-service program (as defined in Section 448(e) of the Higher Education Act of 1965) operated by a work college (as defined in that section).	2. _____
3. Subtract line 2 from line 1 .....	3. _____
4. Enter the amount from line 3 that your scholarship or fellowship grant required you to use for other than qualified education expenses .....	4. _____
5. Subtract line 4 from line 3 .....	5. _____
6. Enter the amount of your qualified education expenses .....	6. _____
7. Enter the smaller of line 5 or line 6. This amount is the most you can exclude from your gross income <sup>1</sup> (the tax-free part of the scholarship or fellowship grant) .....	7. _____
8. Subtract line 7 from line 5 .....	8. _____
9. <b>Taxable part.</b> Add lines 2, 4, and 8. See Reporting Scholarships and Fellowship Grants, later, for how to report this amount on your tax return .....	9. _____

<sup>1</sup> However, a scholarship or fellowship grant isn't treated as tax free to the extent the student includes it in gross income (the student may or may not be required to file a tax return) for the year the scholarship or fellowship grant is received and either:

- The scholarship or fellowship grant (or any part of it) must be applied (by its terms) to expenses (such as room and board) other than qualified education expenses.
- The scholarship or fellowship grant (or any part of it) may be applied (by its terms) to expenses (such as room and board) other than qualified education expenses.

**You may be able to increase the combined value of an education credit and certain educational assistance if the student includes some or all of the educational assistance in income in the year it is received. See Pub 970 and the Treasury fact sheet on pell grants for more information.**

# Education Credits



**TaxSlayer Navigation:** Federal Section>Deductions>Credits Menu>Education Credits, Keyword “EDUCA” or “886”

Probe/Action: To determine if a taxpayer qualifies for the Education Credit.



**CAUTION** Taxpayers who claim the American Opportunity credit even though they are not eligible can be banned from claiming the credit for up to 10 years.

## Comparison of Education Credits

	American Opportunity Credit	Lifetime Learning Credit
<b>Maximum credit</b>	Up to \$2,500 credit per eligible student	Up to \$2,000 credit per return
<b>Limit on modified adjusted gross income (MAGI)</b>	\$180,000 if married filing jointly; \$90,000 if single, head of household, or qualifying widow(er)	\$134,000 if married filing jointly; \$67,000 if single, head of household, or qualifying widow(er)
<b>Refundable or nonrefundable</b>	40% of credit may be refundable <sup>1</sup> ; the rest is nonrefundable	Nonrefundable—credit limited to the amount of tax you must pay on your taxable income
<b>Number of years of postsecondary education</b>	Available ONLY if the student had not completed the first 4 years of postsecondary education before 2018	Available for all years of postsecondary education and for courses to acquire or improve job skills
<b>Number of tax years credit available</b>	Available ONLY for 4 tax years per eligible student (including any year(s) Hope credit was claimed)	Available for an unlimited number of tax years
<b>Type of program required</b>	Student must be pursuing a program leading to a degree or other recognized education credential	Student does not need to be pursuing a program leading to a degree or other recognized education credential
<b>Number of courses</b>	Student must be enrolled at least half-time for at least one academic period beginning during 2018 (or the first 3 months of 2019 if the qualified expenses were paid in 2018)	Available for one or more courses
<b>Felony drug conviction</b>	As of the end of 2018, the student had not been convicted of a felony for possessing or distributing a controlled substance	Felony drug convictions do not make the student ineligible
<b>Qualified expenses</b>	Tuition, required enrollment fees, and course materials that the student needs for a course of study whether or not the materials are bought at the educational institution as a condition of enrollment or attendance	Tuition and required enrollment fees (including amounts required to be paid to the institution for course-related books, supplies, and equipment)
<b>Payments for academic periods</b>	Payments made in 2018 for academic periods beginning in 2018 or beginning in the first 3 months of 2019	
<b>TIN needed by filing due date</b>	Filers and students must have a TIN by the due date of their 2018 return (including extensions)	
<b>Educational institution's EIN</b>	You must provide the educational institution's employer identification number (EIN) on your Form 8863, Education Credits.	

### Footnote

<sup>1</sup> None of the credit is refundable if (1) the taxpayer claiming the credit is (a) under age 18 or (b) age 18 at the end of the year, and their earned income was less than one-half of their own support or (c) a full time student over 18 and under 24 and their earned income was less than one-half of their own support; and (2) the taxpayer has at least one living parent, and; (3) the taxpayer doesn't file a joint return.

# Education Credits (continued)

Probe/Action: To determine if a taxpayer qualifies for the Education Credit.

## Who Can Claim the Credit?

- Taxpayers who paid qualified educational expenses of higher education for an eligible student.
- Taxpayers who paid the education expenses for a student enrolled at or attending an eligible educational institution. (To determine if eligible, go to the U.S. Department of Education's Office of Post-secondary Education (OPE) website.
- The eligible student is either the taxpayer, taxpayer's spouse or their dependent.

**Note:** Qualified education expenses are considered paid by the taxpayer if paid by their dependent or a third party on behalf of the dependent. If a student isn't claimed as a dependent (even if eligible to be claimed), only the student can claim an education credit no matter who paid the expenses. Anyone paying the expenses (even directly to the institution) are considered to have given a gift to the student who in turn is treated as having paid the expenses.

**Note:** There are two 4-year tests for the American Opportunity Credit. First, the credit can be taken for only 4 tax years. Second, the student must not have completed four years of academic credit before the beginning of this tax year. Follow the examples in the Who is an Eligible Student for the American Opportunity Credit section in Publication 970 for additional information.

## Who Can Claim a Dependent's Expenses?

If the taxpayer...	Then only...
Has a dependent who is an eligible student	The taxpayer can claim the credit based on that dependent's expenses. The dependent can't claim the credit.
Doesn't claim the dependent on the tax return	The dependent can claim the credit. The taxpayer can't claim the credit based on the dependent's expenses.

## Who Can't Claim the Credit?

- Married filing separately filing status
- Anyone listed as a dependent on another person's tax return
- Taxpayers whose modified AGI is more than the allowable income limits
- Taxpayer (or the spouse) was a nonresident alien for any part of the tax year unless one of the exceptions listed in Publication 519, U.S. Tax Guide for Aliens, applies

## What Expenses Qualify?

- Expenses paid for an academic period starting in 2018 or the first 3 months of 2019
- Expenses not refunded when the student withdraws from class
- Expenses paid with the proceeds from a loan

## What are Qualifying Expenses?

- The term "qualified tuition and related expenses" is expanded for the American Opportunity Credit (AOC) to include expenditures for course materials. For this purpose, course-related materials are books, supplies, and equipment needed for a course of study whether or not the materials are purchased from the educational institution as a condition of enrollment or attendance.

## What is Tax-Free Educational Assistance?

- Tax-free parts of scholarships and fellowships
- Pell Grants (see Chapter 1 of Publication 970)
- Employer-provided educational assistance (see Publication 970)
- Veterans' educational assistance
- Any other nontaxable payment (other than gifts or inheritances) received as educational assistance

**Note:** Don't reduce the qualified education expenses by any scholarship or fellowship reported as income on the student's tax return if the use of the scholarship isn't restricted and used to pay education expenses that aren't qualified (such as room and board).

**Note:** Taxpayers must have a Form 1098-T from an eligible educational institution to claim education benefits.

**Note:** If the student includes the tax free educational assistance in income, has a filing requirement and unearned income (including the taxable scholarship) over \$2,100, the student will be subject to filing Form 8615, Tax for Certain Children Who Have Unearned Income (Kiddie Tax), to compute the tax. (See Tab H, Other Taxes, Payments and ACA for additional information).

# Determining Qualified Education Expenses

Box 1 may include non-taxable scholarship and grant amounts. Some students may choose to pay non-qualifying expenses with scholarship/Pell Grant funds, making the scholarship/Pell Grant taxable. This is true even if the scholarship/grant was paid directly to the school. This may increase the amount of qualifying expenses that can be used in calculating an education credit.

<input type="checkbox"/> CORRECTED		OMB No. 1545-1574		<b>2018</b>	<b>Tuition Statement</b>
FILER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone number		1 Payments received for qualified tuition and related expenses			
		\$ _____		Form <b>1098-T</b>	
FILER'S employer identification no.	STUDENT'S TIN	3 If this box is checked, your educational institution changed its reporting method for 2018 <input type="checkbox"/>		<b>Copy B For Student</b>  This is important tax information and is being furnished to the IRS. This form must be used to complete Form 8863 to claim education credits. Give it to the tax preparer or use it to prepare the tax return.	
STUDENT'S name		4 Adjustments made for a prior year			
Street address (including apt. no.)		\$ _____			
City or town, state or province, country, and ZIP or foreign postal code		5 Scholarships or grants			
Service Provider/Acct. No. (see instr.)		6 Adjustments to scholarships or grants for a prior year		7 Checked if the amount in box 1 includes amounts for an academic period beginning January—March 2019 <input type="checkbox"/>	
8 Check if at least half-time student <input type="checkbox"/>		9 Checked if a graduate student <input type="checkbox"/>		10 Ins. contract reimb./refund	
		\$ _____		\$ _____	
Form <b>1098-T</b>		(keep for your records)		www.irs.gov/Form1098T Department of the Treasury - Internal Revenue Service	

**Determine the amount paid by verifying the payment received from the student account statement with the amount shown in Box 1 of Form 1098-T.** Remember to include books, supplies, course related materials and equipment if claiming the American Opportunity Credit. Also remember to include out of pocket payments made by the student or on the student's behalf. This includes student loans, payments, credit cards and **taxable portions of scholarships/grants.**

<b>Adjusted Qualified Education Expenses Worksheet (Form 8863 instructions)</b>	
1. Total qualified education expenses paid for on behalf of the student in 2018 for the academic period . . . . .	5,500
2. Less adjustments:	
a. Tax-free educational assistance received in 2018 allocable to the academic period. . . . .	3,000
b. Tax-free educational assistance received in 2019 (and before you file your 2018 tax return) allocable to the academic period . . . . .	0
c. Refunds of qualified education expenses paid in 2018 if the refund is received in 2018 or in 2019 before you file your 2018 tax return . . . . .	0
3. Total adjustments (add lines 2a, 2b, and 2c) . . . . .	3,000
4. Adjusted qualified education expenses. Subtract line 3 from line 1. If zero or less, enter -0- . . . . .	2,500

Example - Bill and Sue are eligible to claim the American Opportunity Credit for their daughter Sarah, who is in her first year of college. They have a Form 1098-T with \$5,000 in box 1 and a \$3,000 Pell Grant in box 5. During your interview with Bill and Sue, you determine that \$5,000 was paid in September 2018 for the fall semester; \$3,000 was paid by Pell Grant and \$2,000 was paid by loan proceeds. They paid \$500 for books in 2018. To calculate the eligible expenses for their credit, take the \$5,000 (\$3,000 grant + \$2,000 loan) paid in 2018, plus the \$500, for books and enter on line 1 of the worksheet above. The \$3,000 will be entered on line 2a. The line 3 amount would be \$3,000. Subtracting line 3 from line 1, you get qualified education expenses of \$2,500. In this same example, if the taxpayers opted to include all the income as wages, they wouldn't have any adjustments to subtract to determine their expenses.

**Note:** If the student doesn't have a copy of their student account statement, ask them to go online through their college or university to get this information.