

What Are They and How Do I Use Them?

Strategies and Tools to Increase and Improve Filing of the Federal Hope and Lifetime Learning Education Tax Credits by Low-Income Filers

A Report by FutureWorks

For the Annie E. Casey Foundation

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Table of Contents

| | <u>Page</u> |
|--|-------------|
| I. Introduction and Background..... | 2 |
| II. Overview of the Federal Hope and Lifetime Learning Education Tax Credits..... | 3 |
| III. Who Benefits from the Education Tax Credits?..... | 5 |
| IV. Strategies and Tools for Marketing and Filing for the Education Tax Credits for Low-Income Filers..... | 9 |
| Addressing Operational Barriers | 9 |
| ▪ <i>Lack of Awareness</i> | |
| ▪ <i>Claiming the Credits</i> | |
| Addressing Policy Restrictions | 16 |
| ▪ <i>Net Tuition and Required Fees Only</i> | |
| ▪ <i>Non-refundability</i> | |
| V. Education Tax Credits as a Workforce Development Tool..... | 17 |
| Bibliography | 18 |
| Appendices | |
| <i>A: CNM Community College Education Tax Credits Postcard</i> | 19 |
| <i>B: CNM Community College and Tax Help New Mexico Flyers</i> | 20 |
| <i>C: Help Your Tax Clients Claim An Education Tax Credit: Information on the Hope and Lifetime Learning Tax Credits</i> | 22 |
| <i>D: Tax Counseling Project, CEP Client Intake Sheet</i> | 24 |
| <i>E: IRS Form 13614 Intake and Interview Sheet</i> | 26 |
| <i>F: IRS Form 8863 – Education Credits</i> | 28 |
| <i>G: Quick Reference Guide: Filing for the Hope and Lifetime Learning Tax Credits</i> | 29 |
| <i>H: 1098-T and Education Benefits</i> | 35 |

I. Introduction and Background

In 2005, the Annie E. Casey Foundation (AECF) commissioned FutureWorks, LLC to engage in an “action research” project around the federal Hope and Lifetime Learning Education Tax Credits. This project stemmed from an earlier research project by FutureWorks (funded by AECF) on the use and value of the education tax credits for working adults, especially those with low-incomes. The report from that project, *Getting Serious About Lifelong Learning: Improving the Use and Value of the Hope and Lifetime Learning Tax Credits for Working Adult Students*, reported that few low-income adult students benefit from the education credits and that the education tax credits were not making a significant contribution to addressing the growing skills gaps in this nation’s workforce.

The action research project initiated in 2005 focused on two questions:

1. What strategies, materials, and tools can improve and increase the filing of education tax credits by tax preparation assistance sites on behalf of low-income filers eligible to claim them?
2. How can the federal education tax credits be used as a workforce development tool for low-income individuals?

FutureWorks conducted primary and secondary research to answer these two questions. We conducted a literature review, interviewed several practitioners and experts in the field, and worked with three sites that provide free or low-cost tax preparation for low-income filers. Two of the three sites – East Harbor Community Development Corporation and Our Money Place at Bon Secours Foundation – were both in Baltimore, Maryland, and ran significant tax preparation programs. Neither community-based organization (CBO) provides a significant amount of workforce education or training. The third site – Instituto del Progreso Latino – was in Chicago, Illinois. This CBO provide significant workforce education and training, but partners with another organization to provide free tax preparation assistance to their clients.

Although related, the two questions for this project encompass vastly different topics. Therefore, we have written two separate reports to address each one. This report provides an overview of the education tax credits and describes strategies, materials, and tools that might be used to improve and increase filing of education tax credits by low-income filers already eligible for the credits. It is aimed at coordinators and volunteers in free or low-cost tax preparation sites serving low-income tax filers. This report includes several appendices with materials and tools that we discovered in the process of our research or that we created specifically for this project.

The companion report, *A Workforce Development Triad: Federal Education Tax Credits, Community-Based Organizations, and Community Colleges*, addresses the second question: how can the education tax credits be used as a workforce development tool? Because the education credits can be used only at accredited postsecondary educational institutions eligible to participate in the federal Title IV student financial aid programs, the focus of that report is how community-based organizations can better connect to postsecondary educational institutions to provide workforce development services for their clients. The report reviews the limited amount

of research on CBO-community college partnerships and provides three case studies of a variety of organizations linking tax preparation, workforce development, and postsecondary education. The hope is that practitioners can use the analysis, lessons, and case studies in the report to make connections with postsecondary institutions in their regions to help clients access higher education and utilize the federal education tax credits.

II. Overview of the Federal Hope and Lifetime Learning Education Tax Credits

The Hope Scholarship (Hope) and Lifetime Learning Tax Credits (Lifetime Learning) were introduced by the *Taxpayer Relief Act of 1997* to increase college affordability and to encourage lifelong learning. The primary target group was middle-class taxpayers. The two credits were designed to complement each other by targeting different groups of students. While the Hope may be used only for a student's first two years of postsecondary education, the Lifetime Learning credit is available for unlimited years to individuals taking classes beyond their first two years of college including college juniors and seniors, graduate students, and working adults pursuing lifelong learning.¹

Eligible expenses for each credit include only tuition and required fees at an educational institution eligible for aid administered by the federal Department of Education. Tax filers may claim tuition and fee amounts after subtracting grants, scholarships, and other tax-free educational assistance including Pell Grants, employer-provided education assistance, and Veteran's educational assistance.²

The Hope provides a credit equal to 100% of the first \$1,100 plus 50% of the next \$1,100 of net tuition and fees paid during the tax year, for a maximum credit of \$1,650. The student must be enrolled at least half-time (at least six credit hours per semester, which typically is two classes) and pursue a degree or other recognized educational credential in order to be eligible.

In contrast, individuals are not required to enroll at least half-time or pursue an educational credential in order to be eligible for the Lifetime Learning credit. This credit is available to adults taking an occasional college course or to those enrolled in any course aimed at acquiring or improving job skills, including adult basic education and English for speakers of Other Languages courses, as long as they are taken at an eligible institution. Currently, the Lifetime Learning credit is equal to 20% of the first \$10,000 of net tuition and fees, for a maximum credit of \$2,000. Both credits reduce the amount of taxes filers owe and are not refundable (i.e., the tax payer does not get any amount of the credit above the amount credited toward his/her tax liability).

The Hope credit can be claimed for multiple eligible students in a family; whereas, the Lifetime Learning credit is capped at \$2,000 per tax return, no matter the number of students in the family or the amount of their combined educational expenses. Families are allowed to claim the

¹ The Hope credit can be claimed for only two tax years, even if it takes a student longer to complete his or her first two academic years (freshman and sophomore years).

² Tuition and fees minus these tax-free and non-loan sources of student aid is considered "net tuition and fees."

Lifetime Learning credit for some members and the Hope credit for others in the same year. However, the same student cannot take both credits.

The benefits of the tax credits phase out for higher-income taxpayers. For “married filing joint” couples, the phase-out begins at \$90,000 in adjusted gross income (AGI) in the 2006 tax year, with no credit available to those with an AGI of \$110,000 or more. Those filing “single” see the phase-out starting at \$45,000, with no credit for an AGI of \$55,000 or more (“married filing jointly” tax filers are not eligible for either credit).³ The table below provides a summary of the credits.

| | Hope Scholarship Tax Credit (Hope) | Lifetime Learning Tax Credit |
|-----------------------|--|---|
| Amount | <ul style="list-style-type: none"> 100% for the first \$1,100 of qualified expenses; 50% on the second \$1,100 (up to \$1,650 credit <i>per eligible student</i>) | <ul style="list-style-type: none"> 20% for the first \$10,000 of qualified expenses (up to \$2,000 credit <i>per return</i>) |
| Targeted Group | <ul style="list-style-type: none"> Students in their first two years of undergraduate postsecondary education | <ul style="list-style-type: none"> College juniors and seniors Graduate and professional degree students Adults upgrading skills or changing careers |
| Recipient Eligibility | <ul style="list-style-type: none"> Available for the first two academic years’ worth of postsecondary education and only for two tax years Must pursue a recognized credential Must be enrolled at least half-time Must not have a felony drug conviction | <ul style="list-style-type: none"> Available for any postsecondary education to acquire or improve job skills (including non-credit) Available for an unlimited number of years Do not need to pursue a recognized credential Available for one or more courses Felony drug conviction rule does not apply |
| Claimant | <ul style="list-style-type: none"> Taxpayers may claim a credit for their own tuition/fee expenses or those of their spouse or dependents. The credit is calculated on a <i>per-eligible student</i> basis, and there is no limit on the number of eligible students. | <ul style="list-style-type: none"> Taxpayers may claim a credit for their own tuition expenses or those of their spouse or dependents. Maximum credit is determined on a <i>per-return</i> (family) basis, regardless of the number of post-secondary students in the family. |
| Expenses Covered | <ul style="list-style-type: none"> “Net tuition and fees” - Tuition and required fees paid to a postsecondary educational institution required for enrollment or attendance <u>minus</u> grants, scholarships, and other tax-free educational assistance (including Pell Grants, employer-provided education assistance, and Veteran’s educational assistance) Note: The expenses covered do not include the cost of books, supplies, equipment, insurance, medical expenses (including student health fees), room and board, transportation, or other living expenses unless they must be paid to the institution as a condition of enrollment or attendance. | |
| Eligible Institutions | <ul style="list-style-type: none"> 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. Includes virtually all accredited, public, non-profit, and proprietary postsecondary institutions. | |
| Income Eligibility | <ul style="list-style-type: none"> Phased out for joint filers with \$90,000 to \$110,000 of modified AGI (tax year 2006) Phased out for single filers with \$45,000 to \$55,000 modified AGI (tax year 2006) Married couples must file a joint return to claim a benefit (married filing separately is not eligible) Individuals must modify their AGI to include income earned abroad | |
| Other Details | <ul style="list-style-type: none"> Families are able to claim the Lifetime Learning tax credit for some members and Hope credit for others in the same year. However, the same student cannot take both credits. Neither credit can be claimed by those who are “married, but filing separately.” | |

Note: Summarized from Internal Revenue Service Publication 970, Tax Benefits for Higher Education (2005 tax year), with updated amounts for tax year 2006

³ AGI is total income minus deductions for items such as alimony, student loans, IRAs, and medical savings accounts. For most taxpayers, AGI is equal to total income.

In addition to the Hope and Lifetime Learning Education Tax Credits, filers have the option of claiming a tuition and fees deduction for qualified educational expenses (but cannot claim both for the same expenses). This deduction can reduce the filer's income by up to \$4,000. In general, the same eligibility rules apply for the deduction as for the credits (see IRS Publication 970 section of Tuition and Fees Deduction). WE recommend that volunteer tax preparers compare the tax benefit a client might receive claiming an education deduction to the tax benefits received by claiming a credit by trying each scenario separately in the tax preparation software and filing for whichever tax benefit yields the highest return.

III. Who Benefits from the Education Tax Credits?

Since the inception of the Hope and Lifetime Learning Education tax credits in 1997, between 4 and 6 percent of tax filers receive a credit each year, and they receive between \$5 billion and \$6 billion in aggregate. Take-up rates of the credits increased in the late 1990s, but have steadied to between 5 and 6 percent since the early part of this decade.

Relatively low take-up rates are caused by several factors. First, few adults know about the credits. A survey in 2001 revealed that just 21 percent of adults in the general population had heard about the credits (Choitz, Dowd, and Long 2004). This rate is even lower among low-income adults (between 9 and 20 percent for adults with household incomes under \$30,000, depending on income level). It also is lower among adults with lower levels of education (12 percent of those with less than high school and 16 percent of those with a high school diploma). While Black adults' awareness of the education tax credits equaled the average (21 percent), Hispanic adults' awareness was just 16 percent. Even adults already enrolled in college lack awareness of the education credits. In 2001, only one-third of adults enrolled in college had used or planned to use the credits (many may not have been eligible).

Despite these low levels of awareness, in 2001, 7.2 million filers received \$5.2 billion in education tax credits. In 2006, filers received \$5.99 in education tax credits. This is not an insignificant number and is worth a closer look. Specifically, it is important to understand this total across two dimensions: (1) for whom the credit was filed; and (2) the income level of the tax filer.

In the report *Getting Serious About Lifelong Learning* referenced above, the authors made the distinction between three types of students for which an education credit might be claimed:

- **Dependent Student** – The tax filer claims an education credit for a dependent claimed on his/her tax return. Dependent students usually enroll full-time and are supported by their parents.
- **Independent Student** – The tax filer claims the education credit for himself/herself or a spouse and is not supported by his/her parents (thus filing own tax return). In this study, this type of student indicated that the occupation of the person for whom the credit was filed was “student,” which was used as a proxy to being a full-time student.
- **Working adult student** – The tax filer claimed an education credit for himself/herself or spouse and both indicated something other than “student” as

their occupation, which was a proxy for a working adult taking courses on a part-time basis.

Analysis of data from the Internal Revenue Service (IRS) Statistics of Income (SOI) data sample reveals that 46 percent of the Hope credit dollars went to filers for dependent students, 10 percent went to independent student filers; and 42 percent went to working adult students. The Lifetime Learning tax credit dollars were distributed differently, with 27 percent going to filers for dependent students, 19 percent to independent student filers, and 55 percent to working adult student filers. The table below provides a summary of the distribution of Hope and Lifetime Learning credit dollars by income and type of student.

Based on this data, it would appear that working adult students are receiving a not insignificant percentage of the credit dollars. However, when the lens of income is overlaid on this data, it becomes clear that middle and upper-income filers are receiving more of the benefit from the education tax credits than lower income.

According to the IRS SOI data, just over one-third of the Hope credit dollars (34 percent) went to the lowest 1/3 of tax filers (those with adjusted gross incomes below \$30,000). Most of the credit dollars went to middle and upper income filers, per the design of the tax policy. Low-income filers claiming the Hope credit for a dependent student received a very small percentage of the overall Hope dollars (5 percent). Independent students and working adult students fared better.

This was not the case for the Lifetime Learning tax credit, which is the primary credit that working adult students are able to take (in 2001, 3 million filers received the Lifetime Learning tax credit for themselves or a spouse compared to 1.8 million who received a Hope credit). Twenty-three percent of the Lifetime Learning credit dollars went to low-income working adult students, compared to 32 percent that went to middle and upper-income filers. Also, low-income filers who claimed the Lifetime Learning credit for dependents received a significantly lower percentage of the dollars than middle and upper-income filers (2 percent compared to 12 percent and 13 percent).

**Percentage of the Hope and Lifetime Learning Credit Dollar Amounts Received
by Type of Student and Adjusted Gross Income (AGI), 2001**

| Hope Tax Credit | | | | |
|-------------------------------------|--------------------------|--|---|--------------|
| <i>Type of Student</i> | <i>AGI < \$30,000</i> | <i>AGI \$30,000 – under \$60,000</i> | <i>AGI \$60,000 – under \$100,000</i> | <i>TOTAL</i> |
| Dependent | 5% | 19% | 22% | 46% |
| Tax filer-Student | 7% | 3% | 0% | 10% |
| Working Adult Student | 22% | 16% | 4% | 42% |
| TOTAL AVERAGE | 34% | 38% | 26% | 98%* |
| Lifetime Learning Tax Credit | | | | |
| <i>Type of Student</i> | <i>AGI < \$30,000</i> | <i>AGI \$30,000 – under \$60,000</i> | <i>AGI \$60,000 – under \$100,000</i> | <i>TOTAL</i> |
| Dependent | 2% | 12% | 13% | 27% |
| Tax filer-Student | 12% | 6% | 1% | 19% |
| Working Adult Student | 23% | 22% | 10% | 55% |
| TOTAL AVERAGE | 37% | 40% | 24% | 101%* |

Source: Internal Revenue Service, Statistics of Income data sample, 2001

*Totals do not add to 100% due to rounding errors

These findings have been substantiated by other reports on the education tax credits. A 2003 report by Dr. Bridget Terry Long at the Harvard Graduate School of Education found that “primarily middle-income individuals and families claimed the education tax credits. Nearly half of the credits claimed in 2000 were by returns with an AGI between \$30,000 and \$75,000 although this group makes up only 35 percent of the eligible returns” (Long 2003). A report by the Congressional Research Service in 2002 found that the Hope credit - by design – “targets the bulk of its benefits to middle- and upper middle-income students [but] provides assistance to some low-income students.” The report continued, “the Lifetime Learning Credit provides relatively little benefit even to the populations on which it is targeted” (Stoll and Stedman 2002).

This project focused on increasing uptake of the education tax credits by *low-income* filers receiving tax filing assistance at tax assistance sites. Therefore, it is useful to understand more about these filers. A good source for this data is the National Tax Assistance for Working Families Campaign (NTA) sites supported by the Annie E. Casey Foundation. AECF launched this campaign in January 2003 as a way to expand the impact of local Earned Income Tax Credit outreach and free tax preparation projects. In 2005, 41 campaigns filed more than 150,000 tax returns, providing more than \$200 million in federal and state tax refunds to low-income families (Brown 2006).

For the 2005 tax year, 4.5 percent of NTA filers claimed an education tax credit (based on a large sample of the total returns filed). This was slightly below the national average of 5.29 percent of all tax filers that year. The median amount was \$485 per return. Overall, the filers who claimed an education credit had higher incomes than the average NTA filer, were less likely to receive public benefits, were slightly more likely to file single and slightly less likely to file as head of

household, were younger, and were less likely to be Hispanic. Also, most did not claim either of the significant tax credits that benefit low-income filers (the Earned Income Credit and the Child Tax Credit). The table below provides the detailed data.

Comparison of All Filers in the AECF National Tax Assistance For Working Families Campaign and a Subset of Education Credit Claimants, 2005 Tax Year

| | <i>NTA Campaign Average Filer</i> | <i>Education Credit Claimants</i> |
|---|---|---|
| Median adjusted gross income | \$15,132 | \$23,297 |
| Reported having received public benefits | 30% | 13% |
| Filing status | Single: 54% Head of household: 30% Married filing jointly: 15% | Single: 60% Head of household: 22% Married filing jointly: 18% |
| Age | 38 years | 29 years |
| # dependents claimed | 0: 60% 1: 21% 2: 14% 3+: <6% | 0: 65% 1: 20% 2: 11% 3+: 4% |
| Race/ethnicity (significant differences only) | 28% Hispanic 4% Asian/Pacific Islander | 18% Hispanic 6% Asian/Pacific Islander |
| Claimed other benefits | Earned Income Credit: 44% Child Tax Credit: 23% Child & Dependent Care Credit: 3% | Earned Income Credit: 21% Child Tax Credit: 21% Child & Dependent Care Credit: 5% <i>Note: 70% did not claim either the Earned Income Credit or the Child Tax Credit</i> |

For this report, we also worked with East Harbor Community Development Corporation and Our Money Place at Bon Secours (both in Baltimore) to collect tax returns of clients who were initially eligible to claim education tax credits because they had received a 1098-T form from a college. However, we received data on only 15 returns, which resulted in too small a sample size to conduct meaningful analysis. However, it is fair and important to note that, of the 15, just 3 (20 percent) actually claimed a credit. As both of these sites were participating in this project by piloting tools for filing the credits (described below) and had coordinators and volunteers familiar with the education credits, it is unlikely that this small percentage resulted from lack of awareness or inaccurate filing.

More likely, the filers may not have been eligible because they had other forms of free aid that covered any tuition and required fees. Given their low income (all but 4 had incomes below \$15,000), it is quite likely that most potential claimants did receive Pell grants, scholarships, or other grant aid. Alternatively, filers may not have claimed the credit because they knew they had no tax liability against which to claim the credits.

IV. Strategies and Tools for Marketing and Filing for the Education Tax Credits for Low-Income Filers

There are many barriers to low-income filers, specifically, receiving an education tax credit. Some of these barriers are operational and some stem from policy restrictions. Research for this report pointed to two significant “operational barriers,” that is, barriers related to the operation of marketing and filing for the education tax credits:

- Many filers simply do not know about the credits (lack of awareness)
- Filers and, for the purpose of this report, volunteers at free tax sites, may not understand or know how to claim the education tax credits

These barriers are discussed in more detail below along with strategies and tools for overcoming them. Significant barriers to low-income filers benefiting from the Hope and Lifetime Learning Education tax credits also stem from the tax policy itself. They include:

- The education tax credits can only be applied toward net tuition and required fees
- The Lifetime Learning Tax Credit – which holds the greatest promise for low-income working adults due to their likelihood of enrolling less than half-time – covers a very small percentage of tuition and required fees, providing for a paltry credit
- Neither the Hope nor the Lifetime Learning credits are refundable, i.e., filers receive no part of the credit above and beyond their tax liability. For low-income filers with little to no tax liability, this aspect of the policy makes the education credits out of reach.

These policy restrictions are described in more detail after the section on addressing operational barriers. We provide policy recommendations to address these barriers.

Addressing Operational Barriers

Lack of Awareness

As the data presented earlier in this report indicate, lack of awareness is one challenge to increasing the uptake of education tax credits among low-income filers. In 2001, just one in five adults in the general population had heard of the education tax credits, and the rate was even lower among low-income adults and those with limited education. Our work with Our Money Place at Bon Secours of Maryland Foundation and East Harbor Community Development Corporation substantiates this national data. Both of these sites flagged tax clients who indicated that they had paid postsecondary education tuition or fees and asked them to complete consent forms to participate in our research. In total, 14 clients completed consent forms, and we received tax data and attempted to interview each. A tertiary analysis of the tax data from this sample is provided earlier in this report. Here, we focus on the interviews.

Out of the 14 individuals who submitted consent forms, two were no longer at the telephone number provided on the form at the time of the interview (approximately 5 months later), and

another two declined to be interviewed. Of the remaining ten, only two could be reached for an interview. We contacted all ten four times before concluding that they were unreachable.⁴

The findings from the two completed interviews were that free tax clients were not aware of the education tax credits, had no idea what they were based on or how they were calculated (either before or after the tax preparation session), and could not even remember if they received a credit (or how much the credit was). Based on information provided in the interviews on their work and school enrollment intensities, it is likely that only one of the interviewees actually received a credit. She worked full-time and attended school full-time, which means that she may have had enough tax liability and educational costs to qualify for one of the credits. The other interviewee attended school full-time, but did not work full-time (she worked 28 hours per week). It is unlikely that she had a high enough tax liability to be offset by an education tax credit.

Each tax client was flagged as potentially eligible for an education tax credit with different triggers. In one case, the filer simply collected and brought all tax forms into the site. The 1098-T that she received from her postsecondary education institution triggered the tax preparation volunteer to ask more questions about tuition and fees and other important information to complete the forms for the education credits. Our interviews with free tax preparation site managers indicate that this is a common occurrence and is a primary way volunteers know to complete the form to claim an education credit. In the other case, the intake form and volunteer's question about postsecondary education triggered further questions (it is likely that this client also provided a 1098-T from since that form was the main trigger in this small study for a client to receive a study consent form).

It is important for free tax preparation sites to raise the awareness levels of both potentially eligible clients and volunteer tax preparers.

Raising Awareness among Clients

The “bread and butter” of free tax preparation sites is the Earned Income Tax Credit (EITC or EIC). This is a special refundable credit designed to boost the earned income of low- and moderate-income workers.⁵ Sites tend to focus their outreach messages on making potential filers aware of the significant EITC tax credit they may receive. And the EITC is a significant credit. Over \$39 billion in EITC credits was claimed on over 21 million returns in tax year 2004.⁶ In one of the country's largest free tax campaigns – the National Community Tax Coalition - nearly half of the total federal refunds filed in 2004 were EITC refunds (\$175 million out of \$361 million).

⁴ This experience underscored the suspicion this population has about unknown callers. On one call, the interviewer was accused of being a bill collector and was told not to call back before he was hung up on. In another call, the interviewee replied to the interviewers' call, asked what company the interviewer was with, and then hung up on him.

⁵ Refundable means that a filer receives the full amount of the credit even if s/he does not have a tax liability to apply it against.

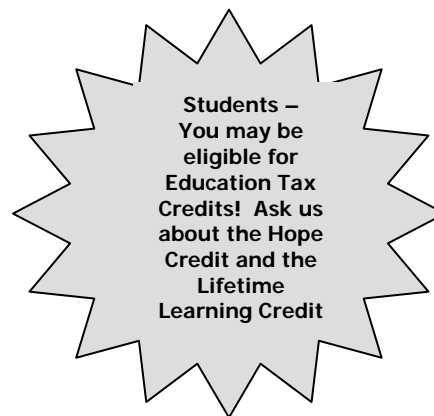
⁶ See this fact sheet by the Center on Budget and Policy Priorities:
http://www.cbpp.org/eic2006/EIC_Participation.pdf

By comparison, education tax credits were claimed by just 4 percent of filers overall and in the Annie E. Casey Foundation’s National Tax Assistance for Working Families Campaign (consistent over tax years 2003, 2004, and 2005). Additionally, the Brookings Institution has found that “just 2.7 percent of EITC earners accessed either the Hope or Lifetime Learner credits to help pay for postsecondary education” (Berube 2006).

The low take-up rate implies that free tax preparation sites should carefully target their outreach messages on education tax credits to populations that are highly likely to be eligible for the credits. As we heard several times in interviews for this project, the resources and staff at free tax sites are already stretched thin, so any new tasks must be high value-added.

Tax sites should assess their targeted population and historic use of the education tax credits to determine how much effort to put toward marketing the education tax credits. For example, the Central New Mexico Community College Foundation (CNM was formally the Albuquerque Technical Vocational Institute or TVI) started Tax Help New Mexico to offer free tax preparation to CNM students. Last year, free tax help was provided at 44 locations throughout the state.⁷ A significant portion of the tax clients are low-income community college students. Because these students are initially eligible to claim an education tax credit, this college sees great value in dedicating resources to outreach materials specifically focused on the education tax credits.⁸

CNM uses two primary outreach tools. It sends the postcard in Appendix A to every student early in the tax season to encourage them to use the free tax sites and to trigger them to ask about the education tax credits. CNM also sends a version of the flyer in Appendix B to all of its students as well as all students at sister community colleges throughout the state (Farmington, Gallup, Santa Fe, Las Cruces, and Clovis). The flyer serves as the base document, but CNM customizes it to college students by adhering an eye-catching, shiny metallic sticker with the words, “Students - You may be eligible for Education Tax Credits! Ask us about the Hope Credit and the Lifetime Learning Credit.” In total, over 60,000 students in New Mexico received this flyer. As shown in the appendix, the flyer also was available in Spanish. For this tax season, CNM is building on this campaign to include students at the University of New Mexico for the 2006 tax year.



Also, in 2007, CNM plans to pair the tax preparation assistance with assisting students in completing the Free Application for Federal Student Aid (FAFSA) to help them access Pell Grants and student loans. This is a smart strategy because much of the information required on the FAFSA is taken from filers’ tax returns. CNM sees tax preparation assistance and assistance in completing the FAFSA as student retention tools. Research shows that many students cannot

⁷ See the profile on Central New Mexico Community College in the companion report described above.

⁸ These students are at least initially eligible for the education tax credits in that they are enrolled in an eligible postsecondary education institution. Other qualifications must also be met, as described in the earlier section of this report.

access or persist in college often because they cannot afford school. By helping students access funding – whether it is grants, loans, or tax credits – CNM is helping them stay in school and persist to graduation.

In Baltimore, Maryland, the representative from the Internal Revenue Service Stakeholder Partnerships, Education and Communications (IRS SPEC) office has worked with the Maryland Higher Education Commission and local colleges to include information on the education credits in college financial aid materials and sent out to students via e-mail and in college student handbooks.

Raising Awareness among Volunteer Tax Preparers

Low-income tax filers are not the only ones with limited awareness of the Hope and Lifetime Learning education tax credits. Interviews with practitioners and our own experience with volunteer tax preparation work indicate that volunteers at free tax preparation sites have little knowledge of the credits. This is partially due to the strong emphasis in most of these sites on the Earned Income Tax and Child Tax credits and also due to the fact that a higher percentage of the tax clients benefit from these credits than from the education tax credits. A related issue is the relatively short amount of training on the education tax credits most volunteers appear to receive. As one interviewee for this research indicated, volunteers – who usually are not familiar with the tax code – have a lot to learn in training; therefore, trainers must focus on the basics and the most used components of the tax code.

Again, we recommend that sites assess how significant the education tax credits are to their work (or could be if all eligible clients were indeed claiming the credits) and train volunteers on the education credits accordingly. However, no matter how significant or insignificant the education credits are in each site's work, all volunteers should receive an overview of the basics on these credits. We have provided a two-page flyer that sites can use to provide this basic information to volunteers in a quick manner (see Appendix C).

Claiming the Education Tax Credits

Related to free tax preparers' lack of awareness about the credits is their confusion over how to file for these credits. There are a variety of reasons for this confusion. First, as described above, volunteers usually received limited training on how to file for the credits. Second, unlike with other credits like the EITC and Child Tax Credit, the TaxWise software that most free tax preparation sites around the country are required to use does not include a prompt in the system that, when triggered, automatically pulls up the education tax credits forms. Volunteers have to go searching for the correct form to complete. Third, with just 4 percent of clients filing for the education tax credits, volunteers do not often complete the steps to file for these credits and are unfamiliar with the process. Finally, the IRS publications provide little guidance to volunteers (and taxpayers, for that matter) on how to correctly claim these credits.

In a study on the quality of EITC campaigns that were part of the National Tax Assistance for Working Families Campaign funded by the Annie E. Casey Foundation in 2006, Amy Brown

found that 31 percent of returns in her sample that had an education credit had a mistake in how the credit was filed (Brown 2006). This percentage was higher than for most other credits, including the Earned Income Tax Credit (3 percent), the Child Tax Credit (4 percent), and the Child and Dependent Care Credit (18 percent). It was slightly lower than the mistake rate for the Retirement Savings Credit (32 percent). The good news is that the 2006 rate was lower than that in 2005 of 43 percent (Brown 2005). A slightly more in-depth analysis of the 2005 data found that half of the mistakes on the education credits had no consequence for the filer. Other mistakes included the tax preparer not including the credit or incorrect determination of which credit applied.

Brown found several reasons for why mistakes were made in filing tax returns overall, not just for the education credits. The reasons she cited that seem most applicable to the education credit mistakes included tax preparers not asking questions, i.e., whether the client paid tuition or fees in the tax year, and volunteers' gaps in tax knowledge. The example Brown provided in her report was directly related to the education credits: "Mistakes resulted when a preparer did not fully understand tax rules, such as the volunteer who thought education credits applied only to four-year colleges..." (Brown 2005).

In both her 2005 and 2006 reports, Brown provides recommendations for improving accuracy in filing tax returns. Among others, she suggests:

- Standard procedures to ensure that key questions are asked of all tax filers
- Introduce tools to assist in making status and credit eligibility determination
- Emphasize the use of decision trees in tax preparer training (Brown 2005 and Brown 2006)

We provide strategies and tools for all three in this report, specifically related to the education tax credits.

Standardize procedures to ensure that key questions are asked of all tax filers

The standard intake form is the most effective point to begin determining if a free tax preparation client might be eligible for an education tax credit. It is our understanding that all sites use some sort of standard intake form. Based on an informal survey conducted for this report of members of the Tax Roundtable listerv sponsored by the National Community Tax Coalition, many campaigns use a form that they have created themselves (78 percent of respondents). Just under a quarter of respondents (22 percent) indicated that they use the official IRS Intake and Interview Sheet (Form 13614).

The wording of questions designed to elicit client eligibility for an education tax credit is important to get accurate information and because sites cannot rely on the 1098-T Tuition Statement for information. Educational institutions must provide the IRS and students with 1098-T Tuition Statements by the end of January of each year that document the student's enrollment status at the institution. They may also, but are not required to, report on the student's qualified tuition and related expenses, scholarships, and grants. A Government Accounting Office study in 2005 found that just 13 percent of all 1098-T statements it reviewed

included such information (United States Government Accounting Office 2005). Given this situation, it is important that sites carefully gather this information on their own.

The Tax Counseling Project of the Center for Economic Progress in Chicago has been successful with this question: “Did you or anyone in your family attend college or vocational school in 20__?” (see this client intake form in Appendix D). The Community Tax Center Program sponsored by the Foundation Communities in Austin, Texas, provides a little helpful prompt to tax preparation volunteers on the intake sheet. Right after the question on educational expenses is the tip: “requires form 8863” in parentheses. This prompts the volunteer to ask more questions and use this form to file for an education tax if the question is answered in the positive.

Some sites use the IRS Intake and Interview Sheet (see Appendix E). This form includes in a check box list at the bottom of page 2 a question on whether the client had “educational expenses for you or your dependents” in the tax year. It is interesting to note that all of the questions on the second page – including the one on educational expenses that might qualify for an education tax credit – are to be asked by a certified volunteer. We do not know how strictly this protocol is followed; however, it would seem to increase the chances that the question would be answered correctly if a volunteer can immediately probe for more information if there is any confusion on whether the tax client might have paid for eligible educational expenses.

Another possibility for improving the process for determining a client’s eligibility for an education credit was raised in the course of this research and centers on the specific software used by most free tax sites. A powerful aspect of the TaxWise software is that it automatically loads necessary forms into a “to be completed” list based on data entered into a “Main Information Sheet.” This software also has its own interview sheet, which includes the question, “Did you pay qualified postsecondary education tuition and related expenses for yourself, your spouse, or your dependents?” If the volunteer marks the “yes” checkbox beside this question, TaxWise will add the appropriate form (Form 8863) to the “to be completed” list.

However, based on our interviews and survey of practitioners for this report, it appears that few sites use this form within the Tax Wise software. Some site managers thought that the interview sheet was “too lengthy and over-extensive” for free tax preparation clients and that it would “slow down the tax preparation process.” One site manager had used the TaxWise interview sheet in her program’s first year. She liked the comprehensiveness of the questions and the fact that the software automatically pulled up the appropriate forms. However, she quit using it after she realized that her volunteers “were too reliant on the sheet and didn’t adequately understand the 1040 [U.S. Individual Income Tax Return].” This manager wanted her volunteers to understand the rules in the tax code and how taxes were filed, not simply how to enter data into a software program. She, too, cited that there were too many irrelevant questions on this sheet for her client population, i.e., questions about farming income. She also indicated that the automatic pull-up of the education tax credits form sometimes caused problems when it was clear that the client would not need to claim the credit (because they had no tax liability, for instance), but the volunteer did not know how to remove the form in order to clear the tax return for filing.

Introduce tools to assist in making status and credit eligibility determination

We have drafted a “Quick Reference Guide” for this project to counter the limited training volunteers may receive on the education tax credits and the limited guidance provided in IRS publications in filing for these credits (see Appendix G). We emphasize “quick” in order to avoid burdening the volunteer with too much information about credits for which they may not often file. Ideally, the volunteer would be somewhat familiar with the basics of the education tax credits after having reviewed the overview handout in Appendix C.

The IRS form that must be completed to claim an education credit is Form 8863 (see Appendix F). The form itself is relatively simple to complete; however, there are three significant issues that arise as a volunteer completes the form that are not adequately dealt with in IRS publications (in the event that a volunteer must rely on these publications to complete an education tax credit claim for the first time). The first is determining if a tax client or his/her dependent is indeed eligible to claim a credit and, if so, which one? The IRS provides flowcharts to help answer both of these questions; however, they are located in two separate publications (IRS Publication 17 and 970). To ease the complexity and burden on the volunteer tax preparer, we have conveniently located both of these flowcharts and directions for their use in a single “Quick Reference Guide” (see Appendix G). One cautionary note is that these charts are for the 2005 tax year. Updated charts for the 2006 tax year were not available as of the release of this report. Anyone using these charts should replace them with updated versions for the current tax year (found in IRS publications 17 and 970).

Another significant issue is determining if the postsecondary education institution the student attended is an “eligible institution.” This is an institution that is accredited and that is eligible to participate in the federal Title IV student financial aid programs, something that is not readily apparent to a student or a volunteer tax preparer. The guide in Appendix G provides a three-step process for determining if the student’s postsecondary education institution is an eligible institution for the education tax credits.

Finally, a significant stumbling block to correctly filing for an education tax credit is determining the “qualified expenses” that can be claimed for the education credit. Basically, students can claim only “net” tuition and required fees, which are those left over after all free student aid (grants and scholarships, but not loans) has been applied (note: only tuition and fees count; books, supplies, equipment, room, board, etc. cannot be included in this calculation). The worksheet in the guide in Appendix G can assist volunteers in calculating the “qualified expenses. This worksheet is not included in any IRS publications and was created entirely by the authors of this report. We strongly encourage volunteer preparers to collect information from the client and school documents directly, given the inadequacies of the 1098-T Tuition Statements. The entire guide has been reviewed by IRS SPEC personnel and by free tax preparation practitioners for accuracy and usefulness. Additionally, it was piloted by two free tax sites in the spring of 2005 as part of their free tax services.

Emphasize the use of decision trees in tax preparer training

One of the most useful aspects of the IRS tax publications are the flowcharts and decision trees provided in many publications to aid the taxpayer (and volunteer preparer) in determining eligibility for tax provisions, filing status, and other confusing decisions associated with filing taxes. We have included two of the most useful IRS flowcharts in the Quick Reference Guide described above.

Another useful tool that we discovered in the research for this report was created by the Community Tax Center Program sponsored by the Foundation Communities in Austin, Texas. This tool features a sample 1098-T form that a student should have received from his/her postsecondary educational institution and walks a volunteer preparer through the steps for reading and using this form. This tool is included in Appendix H and is a valuable complement to the Quick Reference Guide in Appendix G.⁹

Addressing the Policy Restrictions

Significant barriers to low-income tax filers benefiting from the education tax credits stem from the tax policy itself. This section reviews these barriers in more depth and provides policy recommendations that can be considered for increasing and use and value of the credits for low-income filers.

Net Tuition and Required Fees Only

The restriction of the credits to include tuition and fees only negatively impacts low-income filers in a few ways. First low-income students tend to attend low-cost institutions, i.e., community college, where tuition and fees are low, which results in low credits, if any. Second low-income students more often combine school and work than their higher income peers. They tend to attend school part-time or even less-than-half-time, which further reduces their tuition and fee costs and, therefore, any education credit they may receive. Third low-income students who attend half-time or more are more likely to get need-based student financial aid, which is the first resource applied toward tuition and fees and may result in no “net tuition and fees” for the student to apply toward an education tax credit.

In both the report, *Getting Serious About Lifelong Learning*, and this report, we recommend that the education tax credits policy be changed in two ways:

- Expand the definition of “qualified expenses” beyond tuition and required fees to include books, supplies, equipment, room, board, transportation, and child care in line with the formulas used in the Title IV student aid programs
- Increase the percentage of qualified educational expenses allowed under the Lifetime Learning Tax Credit from the current 20 percent of the first \$10,000 in tuition and fees to 50 percent and cap the total credit at \$2,000 in order to provide more benefit to

⁹ We would like to thank Elizabeth Colvin, Director of the Community Tax Center Program, for sharing this tool with us for this report.

lower-income students and those attending lower-cost institutions (without negatively impacting other students)

Non-refundability

The non-refundable nature of the credits leaves out many low-income filers who have little to no tax liability against which to apply the credits. We recommend that the education tax credits be refundable similar to the Earned Income Tax Credit and its eligibility guidelines.

The policy barriers present the most significant barriers to low-income filers claiming education tax credits. We would support a national policy advocacy effort to address these barriers and expand the education tax credits to low-income students. In fact, over the last few years, there has been growing interest in the education tax credits. A variety of policy alternatives have been introduced in this conversation, including variations on the recommendations provided above; merging and simplifying the credits; and doing away with the credits altogether. Now is the time for advocates and supporters of low-income workers and their families to enter this policy discussion and advocate for changes that improve the credits for these filers.

V. Education Tax Credits as a Workforce Development Tool

This report has taken a detailed look at the processes around filing for the education tax credits. However, the bigger question remains – how can community-based organizations (CBOs) seeking to help improve low-income clients’ economic situations leverage the Hope and Lifetime Learning Education Tax Credits? Because these credits can be used only at eligible postsecondary education institutions, these CBOs must form some sort of connection to eligible institutions and facilitate their clients’ enrollment in college. This broader issue is covered in the companion report, *A Workforce Development Triad: Federal Education Tax Credits, Community-Based Organizations, and Community Colleges*, and includes analysis and lessons learned from CBO-community college partnerships as well as case studies of three organizations that link tax preparation, workforce development, and postsecondary education.

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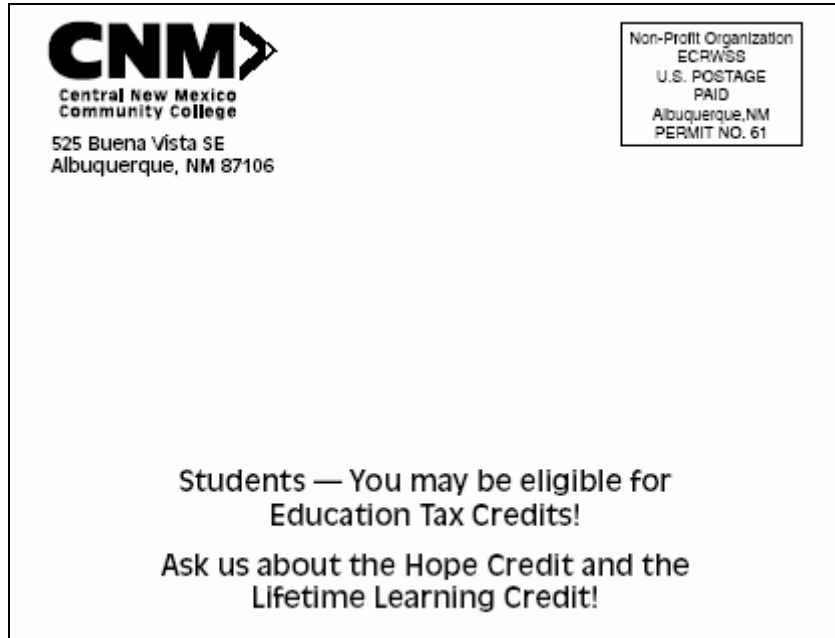
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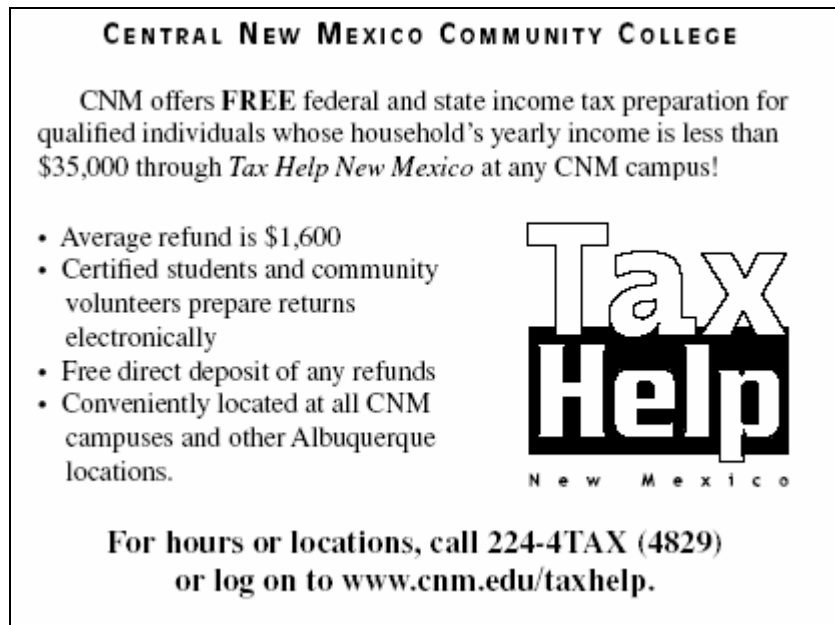
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APPENDIX A
Central New Mexico Community College Education Tax Credits Postcard

Front:



Back:



APPENDIX B
Central New Mexico Community College and
Tax Help New Mexico Education Tax Credits Flyers (Base)

Welcome to

Tax Help New Mexico

Free tax preparation help for low-income and working families

Get your refund faster!

Did you know? If you file electronically and choose to have your refund sent via Direct Deposit, you can receive your money in **7-10** days vs. **more than 14** days when you file a paper return and wait for a mailed check!

In order for us to complete your income tax return you need the following items:

- Social Security cards for yourself, your spouse, and all dependents.
- Birth dates for yourself, spouse and all dependents.
- Form W-2 Wage and Tax Statements from your employer and from your spouse's employer, if filing jointly. You need a W-2 form from every employer you (and your spouse if applicable) worked for in 2004, if the income was taxable.
- Form W-2G Certain Gambling Winnings, if applicable.
- SSA-1099 Social Security Benefits Statement, if applicable.
- Records of all other income received.
- If you would like to use direct deposit to receive your refund, you must have a check or bank document showing the bank routing number and account number for your account.
- If you are claiming child and dependent care expenses, you need the amount you paid for child care, and the care provider name, address, and tax number.

- If you are itemizing your deductions (instead of taking the standard deduction), you will need a list of all deductible expenses. If you are deducting your mortgage interest, you will need the interest statement your mortgage company sent you.

It may be helpful to have the following materials as well:

- A copy of last year's Federal and State return.
- Current year tax package, if received.
- Records to confirm any other item you may want to include on the tax return.

Your spouse must be present

Important: If you are married and filing jointly, your spouse must accompany you so that he or she can also sign the tax form before it is submitted to the IRS. You cannot take the form home to obtain a signature and bring it back later.

WHAT TAX CREDITS DO YOU QUALIFY FOR?

Most New Mexicans qualify for some type of tax credit – see which ones apply to you!

| Tax credit | Maximum benefit | Qualifying factors | Additional information |
|---|---|--|---|
| Earned income tax credit | Up to \$4,300 (for families with qualifying children) | Income less than \$34,458 with 2 or more qualifying children, \$30,338 with one child. | People with no qualifying children may qualify if their income is less than \$11,490. |
| Child tax credit | Up to \$1,000 per qualifying child | Most parents, single or married, qualify for this tax credit. | Ask your tax preparer whether your children "qualify" under IRS rules. This credit may be refundable. |
| Dependent care tax credit | \$2,100 for 2 or more dependents, \$1,050 for 1 dependent | If your adjusted gross income is under \$43,000, you may be eligible to receive credit for between 35 and 21 percent of qualifying expenses. | Besides children, the cost of care for parents who live with you may be eligible. |
| NM Child Day Care credit | Between \$480 and \$1,200, depending on the number of qualifying children | Income must be less than \$21,424. | |
| NM Low Income Comprehensive Tax Rebate | Up to \$450 depending on family size | Income must be less than \$22,000. | Social Security Income and Temporary Assistance for Needy Families recipients usually qualify. |

For locations and hours...

- In Albuquerque call 224-4TAX.
- Outside Albuquerque call 888-453-1304.

Sponsored by



Bienvenidos a

Tax Help New Mexico

Ayuda gratis para preparar la declaración de impuestos para familias trabajadoras con ingresos bajos.

¡Consiga su reembolso más rápido!

¿Ya lo sabía? Si se registra electrónicamente y elige que su reembolso se le envíe como depósito directo, puede recibir su dinero de **7 a 10 días**, ¡nada comparado con los **14 días que hay que esperar** para recibir un cheque por correo con las declaraciones convencionales!

Para completar su devolución de impuestos necesita la siguiente documentación:

- Su tarjeta de seguridad social, de su cónyuge y otros dependientes.
 - Su fecha de nacimiento, la de su cónyuge y otros dependientes.
 - La forma W-2 Wage y los estados de cuenta fiscales de su empleador y del empleador de su cónyuge, si se registran juntos. Es necesaria una forma W-2 por cada empleador que haya tenido usted o su cónyuge durante el año 2004, si los ingresos eran gravables.
 - La forma W-2G Certain Gambling Winnings (ciertas ganancias del juego), si aplica.
 - El SSA-1099, estado de cuenta de los beneficios de la Seguridad Social, si aplica.
 - El registro del resto de ingresos percibidos.
 - Si quiere recibir el reembolso mediante depósito directo, debe proporcionar un cheque o documento bancario con el número de enrutamiento y el número de cuenta.
 - Si esta reclamando gastos de manutención de hijos o dependientes económicos, debe comprobar los gastos realizados, el nombre del proveedor, la dirección y el número de impuesto.
 - Si especifica sus deducciones (en lugar de la deducción estándar), necesitará una lista de todos los gastos deducibles. En caso de que deduzca el interés de su hipoteca, será necesario el estado de cuenta que le envía su compañía hipotecaria.
- Puede ser beneficiario presentar la siguiente documentación:**
- Una copia de la devolución federal y estatal del año pasado.
 - El paquete de impuestos anual actualizado en caso de que ya lo haya recibido.
 - Comprobantes de cualquier otro gasto que quiera incluir en la devolución de impuestos.
- Su cónyuge debe estar presente.**
Importante: si está casado/casada y declaran juntos, su cónyuge debe acompañarle para que también firme la declaración de impuestos antes de que sea enviado al IRS. No puede llevar el documento a su casa para que sea firmado y regresarlo.

¿QUÉ CRÉDITOS PUEDE OPTAR?

La mayoría de los nuevo mexicanos califican para algún tipo de crédito fiscal- ¡averigüe cuál es el suyo!

| Créditos fiscales | Beneficio máximo | Condiciones para calificar | Información adicional |
|--|---|---|--|
| Creditos fiscales por ingreso | Hasta \$4,300 dólares (para familias con hijos que califiquen) | Ingresos menores a \$34,458 dólares con 2 o más hijos que califiquen, \$30,338 por un hijo que califique. | Las personas con hijos que no califiquen pueden optar a este crédito si sus ingresos son menores a \$11,490 dólares. |
| Crédito fiscales para hijos | Hasta \$1,000 dólares por hijo que califique | La mayor parte de los padres, solteros o casados, califican para este crédito fiscal. | Consulte a su consejero fiscal si sus hijos califican según las reglas IRS. Este crédito puede ser reembolsable. |
| Crédito fiscales para dependientes económicos | \$2,100 dólares para 2 o más dependientes, \$1,050 dólares para 1 dependiente | Si sus ingresos brutos son menores a \$43,000 dólares, puede optar a un crédito que cubra del 35 al 21 por ciento de los gastos que califiquen. | Además de los hijos, el costo de las personas mayores que hay a su cargo también puede optar a crédito. |
| Crédito fiscal para guardería infantil | Entre \$480 y \$1,200 dólares dependiendo de el número de hijos que califique | Los ingresos deben ser menores a \$21,424 dólares. | |
| Descuento fiscal para familias de ingresos bajos | Up to \$450 depending on family size | Los ingresos deben ser menores a \$22,000 dólares. | El costo de la seguridad social y de la asistencia temporal para los integrantes de familias necesitadas también suelen calificar. |

Sucursales y horarios...

- En Albuquerque llame al 224-4TAX.
- Fuera de Albuquerque llame al 888-453-1304.

Patrocinado por



APPENDIX C



Help Your Tax Clients Claim An Education Tax Credit

Information on the Hope and Lifetime Learning Tax Credits



Questions to ask when scheduling an appointment or on intake form:

- Did you or anyone in your family attend college or vocational school in 2006? If so, please write the name of the school(s): _____ (and bring in the forms listed below)
- Did you or anyone in your household receive student financial aid for this education? (bring in the forms listed below)

Forms the client should bring to tax assistance session:

- 1098-T Tuition Statement (filer should have received it from the school, college, or university)
- A bill or receipt from the school, college, or university that shows how much the student paid in tuition and fees or paperwork showing how many credits the student took and the tuition and fees for each credit. ****This information may be on the 1098-T, but often is not and may not be correct.****
- Financial aid statement from the school, college, or university showing the student's estimated cost of attendance for tuition and fees and how much financial aid the student received.

Forms the volunteer tax preparer should complete:

- IRS Form 1040 or 1040A (education tax credits found in the "Tax and Credits" section). *Note: filer cannot use the 1040EZ to claim an education tax credit.*
- IRS Form 8863: Education Credits (Hope and Lifetime Learning Credits)

Publications to find more information:

- Instructions for forms 1040 and 1040A, specifically sections on the education tax credits
- IRS Publication 970: *Tax Benefits for Education*, specifically sections 2 and 3

Tips to keep in mind:

- Claim the Hope Credit if:
 - Student attended college at least half-time (usually 6 credit hours or more, but specifically defined by the school or college) in a program leading to an undergraduate degree, certificate, or other recognized educational credential; and
 - Student was in the first two years of the program (usually freshman or sophomore); and
 - Student has not claimed the Hope credit in any two earlier tax years (or had it claimed on his or her behalf); and
 - Student was free of any federal or state felony conviction for possessing or distributing a controlled substance as of last year.
- Claim the Lifetime Learning Tax Credit if:
 - Student attended college for any number of credit hours; and
 - Student does not qualify for a Hope Credit.
 - Non-credit education counts as long as it is at an eligible institution and is taken to improve job skills; see table below.
- Preparers should compare the tax benefit received by filing an education tax credit to that received by filing for the tuition and fees deduction. This can be done by entering the two scenarios separately in TaxWise and comparing the results. Do this at the end of the session after you have determined the client has a tax liability that can be reduced by a credit or deduction.

- On IRS form 8863, tax preparers and clients must calculate the “qualified expenses.” Remember:
 - The credits can be taken ONLY for tuition and required fees; claimants CANNOT include any other expenses such as room, board, books, supplies, equipment, childcare, transportation, etc., UNLESS these expenses must be paid to the institution as a condition of enrollment or attendance.
 - The credit can be claimed only for tuition and required fees the student paid AFTER all TAX-FREE student aid is subtracted, including Pell Grants, scholarships, employer-provided tuition assistance, and Veterans’ educational assistance. The tuition and fees students paid for with a loan CAN be used to claim the credit.
- To be efficient, volunteers should complete the forms related to these credits toward the end of the tax preparation session. Because these are non-refundable credits, they apply only if a client owes taxes. If a client still has a tax liability after completing all other tax forms, the volunteer should file for the education tax credits.
- See the *Quick Reference Guide: Filing for the Hope and Lifetime Learning Tax Credits*

Summary

| | Hope Scholarship Tax Credit (Hope) | Lifetime Learning Tax Credit (LLTC) |
|-----------------------|--|--|
| Amount | <ul style="list-style-type: none"> • 100% for the first \$1,100 of qualified expenses; 50% on the second \$1,100 (up to \$1,650 credit <i>per eligible student</i>) | <ul style="list-style-type: none"> • 20% for the first \$10,000 of qualified expenses (up to \$2,000 credit <i>per return</i>) |
| Targeted Group | <ul style="list-style-type: none"> • Students in their first two years of undergraduate postsecondary education | <ul style="list-style-type: none"> • College juniors and seniors • Graduate and professional degree students • Adults upgrading skills or changing careers |
| Recipient Eligibility | <ul style="list-style-type: none"> • Available for the first two academic years’ worth of postsecondary education and only for two tax years • Must pursue a recognized credential • Must be enrolled at least half-time • Must not have a felony drug conviction | <ul style="list-style-type: none"> • Available for any postsecondary education to acquire or improve job skills (including non-credit) • Available for an unlimited number of years • Do not need to pursue a recognized credential • Available for one or more courses • Felony drug conviction rule does not apply |
| Claimant | <ul style="list-style-type: none"> • Taxpayers may claim a credit for their own tuition/fee expenses or those of their spouse or dependents. The credit is calculated on a <i>per-eligible student</i> basis, and there is no limit on the number of eligible students. | <ul style="list-style-type: none"> • Taxpayers may claim a credit for their own tuition expenses or those of their spouse or dependents. Maximum credit is determined on a <i>per-return</i> (family) basis, regardless of the number of post-secondary students in the family. |
| Expenses Covered | <ul style="list-style-type: none"> • “Net tuition and fees” - Tuition and required fees paid to a postsecondary educational institution required for enrollment or attendance <u>minus</u> grants, scholarships, and other tax-free educational assistance (including Pell Grants, employer-provided education assistance, and Veteran’s educational assistance) • Note: The expenses covered do not include the cost of books, supplies, equipment, insurance, medical expenses (including student health fees), room and board, transportation, or other living expenses unless they must be paid to the institution as a condition of enrollment or attendance. | |
| Eligible Institutions | <ul style="list-style-type: none"> • 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. Includes virtually all accredited, public, non-profit, and proprietary postsecondary institutions. | |
| Income Eligibility | <ul style="list-style-type: none"> • Phased out for joint filers with \$90,000 to \$110,000 of modified AGI (tax year 2006) • Phased out for single filers with \$45,000 to \$55,000 modified AGI (tax year 2006) • Married couples must file a joint return to claim a benefit (married filing separately is not eligible) • Individuals must modify their AGI to include income earned abroad | |
| Other Details | <ul style="list-style-type: none"> • Families are able to claim the Lifetime Learning tax credit for some members and Hope credit for others in the same year. However, the same student cannot take both credits. • Neither credit can be claimed by those who are “married, but filing separately.” | |

Note: Summarized from Internal Revenue Service Publication 970, Tax Benefits for Higher Education (2005 tax year). Updated amounts for 2006 tax year.

APPENDIX D
Tax Counseling Project, CEP Client Intake Sheet

CLIENT INTAKE SHEET 2006

Tax Counseling Project



YOUR INFORMATION:

First Name M.I. Last Name Social Security Number / ITIN

SPOUSE INFORMATION:

First Name M.I. Last Name (if different) Social Security Number / ITIN

ADDRESS:

Street Apt City State Zip

EMAIL ADDRESS: _____

Telephone Numbers:

YOU

SPOUSE

OCCUPATION

Daytime _____ # Jobs in 2005

Evening _____ Your Occupation # Jobs in 2005

Date of Birth: _____

Age: _____ Spouse Occupation # Jobs in 2005

MARITAL STATUS:

Single Married Divorced Widowed Married, living separate since (when) _____

FAMILY INFORMATION - Do not include yourself or your spouse. Please list everyone who lived in your home during 2005. Also list anyone who did not live with you that you supported. Please circle yes or no to show if the person provided his/her own support.

| Name | Age as of 12/31/05 | Birthday | Social Security Number/ITIN | Relationship | Months lived with you in 2005 | Self Support? |
|------|--------------------|----------|-----------------------------|--------------|-------------------------------|---------------|
| | | | | | | Yes No |
| | | | | | | Yes No |
| | | | | | | Yes No |
| | | | | | | Yes No |
| | | | | | | Yes No |

- Did you live in the Hurricane Katrina disaster area on August 28, 2005? Yes No
- Can your parents or someone else claim you or your spouse as a dependent? Yes No
- Did you or anyone in your family have income in 2005 that was not reported on a W-2? Yes No
- Did you or anyone in your family attend college or vocational school in 2005? Yes No
- Did you pay for child care in 2005? Yes No
- Did you receive Social Security payments in 2005? Yes No
- Did you receive unemployment payments in 2005? Yes No
- Do you own your home? Yes No
- Have you received a letter from the IRS? Yes No

CLIENT INTAKE SHEET 2006

Tax Counseling Project



GENERAL INFORMATION: (Please circle the appropriate answer)

| | | | |
|---|--|--|---|
| (1) What is your ethnicity? | AA-African American | AS-Asian/Pacific Islander | CA-Caucasian |
| | LA-Latino | NA-Native American | OT-Other |
| | | | 99- |
| (2) Do you have a bank account? | CH-Checking | SA-Savings | BO-Both, Checking and Savings |
| | NB-No, but would like one | NO-Not Interested | DQ-No, Don't qualify |
| | | | OS-Opened at Site |
| | | | 99- |
| | Do you want to use Direct Deposit to get a faster refund? | | |
| | | Yes | No |
| (3) What is your native language? | EN-English | SP-Spanish | RS-Russian |
| | | | CH-Chinese |
| | PO-Polish | OT-Other | 99- |
| (4) How did you have your taxes done last year? | 1-Here | 2-Another free place like this | |
| | 3-Did my own | 4-Family or Friend (free) | 5-Paid someone and received an instant refund |
| | 6-Paid someone without instant refund | 7-Did not file | 99- |
| (5) Do you care for a foster or adopted child? | 1-Foster Child | 2-Adopted Child | 3-Both, Foster and Adopted Children |
| | | | 4-None |
| (6) If you think you are getting a refund, how do you plan to use your money? (circle <u>only one</u>) | 1-Food or clothing for my family | 6-Child care or other children's expenses | |
| | 2-Catch up on bills (utilities, etc) | 7-Savings | |
| | 3-Rent, home repair, mortgage | 8-Pay for transportation: buy or repair a car or other vehicle | |
| | 4-Pay doctor or other medical bills | 9-Spend it on something else | |
| | 5-Buy books; pay tuition; or other education expenses | 99-Don't know, not getting refund, or don't want to answer | |

The information contained in this client intake sheet is true and correct. I understand that the Center for Economic Progress will retain this information for tax preparation purposes. I realize that the Center will also use this information to improve tax assistance services to me, speed preparation of tax returns, and offer other services. Personal information is not shared with or sold to any other organization or company. Contact the Center for Economic Progress for a copy of our Privacy Policy or to request the Project not use your information.

Client Signature: _____ Date: _____

DISPOSITION AND CHECKLIST: (This section is completed by a Tax Counseling Project volunteer.)

- (7) **Client would be appropriate for an interview, media contact, or photo.** 1-Yes 2-No 3-Don't use info
- Run and Print Diagnostics.
 - Comments entered in client diary on TaxWise.
 - Complete review and assembly using Quality Assurance checklist or send client to Quality Assurance Coordinator

PRINT Volunteer Name: _____ Date: _____

THIS INTAKE SHEET AND TAX RETURN HAS BEEN REVIEWED FOR COMPLETENESS AND ACCURACY:

Site Manager: _____ Date: _____

Make sure this section is complete. Site manager must sign and date the form before the client leaves.

APPENDIX E
IRS Form 13614 Intake and Interview Sheet

| | | |
|---------------------------------------|--|-----------------|
| Form 13614 Rev. August 2006 | Department of the Treasury – Internal Revenue Service Intake and Interview Sheet | OMB # 1545-1964 |
|---------------------------------------|--|-----------------|

You (and Spouse) will need:

- Proof of Identity
- Copies of ALL W-2, 1098, 1099 forms
- Social Security (SSN) or Individual Tax Identification Number (ITIN) for all individuals to be listed on the return
- Child care providers' identification number
- Taxpayers' banking information (voided check and/or savings deposit slip) for refund deposits
- Estimated tax payments made, etc.
- Amounts of other income

Part I: Taxpayer Information

| | | | |
|---|--------------|---|----------------|
| 1. Your First Name | M.I. | Last Name | 2. SSN or ITIN |
| 3. Date of Birth (mm/dd/yyyy) | 4. Job Title | | |
| 5. Spouse's First Name | M.I. | Last Name | 6. SSN or ITIN |
| 7. Date of Birth (mm/dd/yyyy) | 8. Job Title | | |
| 9. Address | Apt # | City | State Zip Code |
| 10. Phone Numbers: Daytime | Evening | Cell | |
| 11. Are you a U.S. Citizen? <input type="checkbox"/> Yes <input type="checkbox"/> No | | 12. Is your Spouse a U.S. Citizen? <input type="checkbox"/> Yes <input type="checkbox"/> No | |
| 13. Can your parents or someone else claim you or your spouse as a dependent on their tax return? <input type="checkbox"/> Yes <input type="checkbox"/> No | | | |
| 14. Did you pay more than half the cost of keeping up the home? <input type="checkbox"/> Yes <input type="checkbox"/> No | | | |
| 15. Check if Legally Blind: <input type="checkbox"/> Taxpayer <input type="checkbox"/> Spouse | | | |
| 16. Check if Permanently and Totally Disabled: <input type="checkbox"/> Taxpayer <input type="checkbox"/> Spouse | | | |
| 17. On December 31st 2006: Were you: <input type="checkbox"/> Single <input type="checkbox"/> Legally Married <input type="checkbox"/> Separated <input type="checkbox"/> Divorced a. If married, were you living apart from your spouse during the last 6 months of the year? <input type="checkbox"/> Yes <input type="checkbox"/> No | | | |
| 18. Was your spouse deceased? If yes, provide the date of death. _____ (mm/dd/yyyy) | | | |

Part II. Family and Dependent Information – Do not include you or your spouse.

Print the name of everyone who lived in your home and outside your home that you supported during the year.

| Name | Date of Birth mm/dd/yyyy | Social Security Number or ITIN | Relationship (son, daughter, etc.) | Months person lived with you in 2006 | US Citizen, Resident of US, Canada or Mexico? (f) | Is the dependent a full time student? (yes or no) (g) |
|------|-----------------------------|-----------------------------------|---------------------------------------|--|---|--|
| (a) | (b) | (c) | (d) | (e) | (f) | (g) |
| | | | | | | |
| | | | | | | |
| | | | | | | |
| | | | | | | |
| | | | | | | |

Paperwork Reduction Act Notice

The Paperwork Reduction Act requires that the IRS display an OMB control number on all public information requests. The OMB Control Number for this study is 1545-1964. Also, if you have any comments regarding the time estimates associated with this study or suggestions on making this process simpler, please write to the: Internal Revenue Service, Tax Products Coordinating Committee, SE:W:CAR:MP:T:T:SP, 1111 Constitution Ave. NW, Washington, DC 20224.

Catalog Number 38836A

Form **13614** (Rev. 8-2006)

STOP Page 2 TO BE COMPLETED BY CERTIFIED VOLUNTEER

Part III. Filing Status & Dependency Determination

Volunteers: In order to conduct a thorough interview, please use the decision trees, interview tips and informational charts in Publications 4012 and/or 17 in addition to this intake sheet. This intake sheet does not constitute a complete interview.

Filing Status Determination – Use Publications 4012 and/or 17 to determine filing status.

1. Based on the interview, the filing status of the taxpayer is: Single MFJ MFS* HH Qualifying Widow(er)

*Spouse Name _____ Social Security Number _____

Dependency Determination – Use Publications 4012 and/or 17 to determine dependency exemptions.

- Yes No 2. Did the taxpayer provide more than 50% of the support for the dependents claimed?
 Yes No 3. Is there a signed Form 8332 or a divorce decree that allows someone else to claim the dependent(s)?
 Yes No 4. Is the dependent permanently and totally disabled?
5. Based on the interview, how many individuals qualify as dependents for this return? _____
-

COMMONLY USED INCOME AND EXPENSES

Volunteers: Please use Publication 17, *Your Federal Income Tax for Individuals* and Publication 4012, *Volunteer Resource Guide* while discussing the questions below with the taxpayer.

Part IV. Income – In 2006, did you receive:

- Yes No 1. Wages or Salary (Include W-2s for all jobs worked during the year)
 Yes No 2. Disability income
 Yes No 3. Interest from: checking or savings account, bonds, dividends, CD, or brokerage account
 Yes No 4. State tax refund (may be taxable if you itemized last year)
 Yes No 5. Alimony income
 Yes No 6. Tip income
 Yes No 7. Pension and/or IRA distribution
 Yes No 8. Unemployment
 Yes No 9. Social Security or Railroad Retirement
 Yes No 10. Self Employment
 Yes No 11. Other Income such as gambling winnings, awards, prizes and Jury duty
-

Part V. Adjustment – Did you have 2006 expenses for:

- Yes No 1. IRA or other retirement account
 Yes No 2. Alimony payments paid (If yes, you must provide the name and SSN of the recipient)
 Yes No 3. Education related expenses
-

Part VI. Itemized Deductions – Did you have 2006 expenses for:

- Yes No 1. Un-reimbursed medical expenses
 Yes No 2. Home mortgage payments (interest and taxes – see Form 1098)
 Yes No 3. Charitable contributions
-

Part VII. Credits – In 2006, did you have:

- Yes No 1. Child/dependent care expenses that allow you (and your spouse-if MFJ) to work
 Yes No 2. Educational expenses for you or your dependents
 Yes No 3. Retirement Savings Contribution
-

Part VIII. Earned Income Tax Credit Determination – EITC Eligibility

- Yes No 1. Was EITC previously disallowed (if yes taxpayer may not be eligible for EITC)
 Yes No 2. Based on the interview, is the taxpayer qualified for EITC?
-

APPENDIX F

IRS Form 8863 – Education Credits

| | | |
|--|--|---|
| Form <b style="font-size: 1.5em;">8863 | Education Credits (Hope and Lifetime Learning Credits) ▶ See instructions. ▶ Attach to Form 1040 or Form 1040A. | OMB No. 1545-0074 <b style="font-size: 1.5em;">2006 Attachment Sequence No. 50 |
| Department of the Treasury Internal Revenue Service (500) | | |
| Name(s) shown on return | | Your social security number |

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

Part I Hope Credit. **Caution:** You cannot take the Hope credit for more than 2 tax years for the same student.

| 1 | (a) Student's name (as shown on page 1 of your tax return) First name Last name | (b) Student's social security number (as shown on page 1 of your tax return) | (c) Qualified expenses (see instructions). Do not enter more than \$2,200* for each student. | (d) Enter the smaller of the amount in column (c) or \$1,100** | (e) Add column (c) and column (d) | (f) Enter one-half of the amount in column (e) |
|---|--|--|---|--|---|--|
| | | | | | | |
| | | | | | | |
| | | | | | | |
| | | | | | | |
| * For each student who attended an eligible educational institution in the Gulf Opportunity Zone, do not enter more than \$4,400. ** For each student who attended an eligible educational institution in the Gulf Opportunity Zone, enter the smaller of the amount in column (c) or \$2,200. | | | | | | |
| 2 | Tentative Hope credit. Add the amounts on line 1, column (f). If you are taking the lifetime learning credit for another student, go to Part II; otherwise, go to Part III | | | | | 2 |

Part II Lifetime Learning Credit

| 3 | (a) Student's name (as shown on page 1 of your tax return) First name Last name | (b) Student's social security number (as shown on page 1 of your tax return) | (c) Qualified expenses (see instructions) | |
|----|--|--|---|----|
| | | | | |
| | | | | |
| | | | | |
| 4 | Add the amounts on line 3, column (c), and enter the total | | | 4 |
| 5a | Enter the smaller of line 4 or \$10,000 | | | 5a |
| | b For students who attended an eligible educational institution in the Gulf Opportunity Zone, enter the smaller of \$10,000 or their qualified expenses included on line 4 (see special rules on page 3) | | | 5b |
| | c Subtract line 5b from line 5a | | | 5c |
| 6a | Multiply line 5b by 40% (.40) | | | 6a |
| | b Multiply line 5c by 20% (.20) | | | 6b |
| | c Tentative lifetime learning credit. Add lines 6a and 6b and go to Part III | | | 6c |

Part III Allowable Education Credits

| | | | | |
|----|--|--|--|----|
| 7 | Tentative education credits. Add lines 2 and 6c | | | 7 |
| 8 | Enter: \$110,000 if married filing jointly; \$55,000 if single, head of household, or qualifying widow(er) | | | 8 |
| 9 | Enter the amount from Form 1040, line 38*, or Form 1040A, line 22 | | | 9 |
| 10 | Subtract line 9 from line 8. If zero or less, stop; you cannot take any education credits | | | 10 |
| 11 | Enter: \$20,000 if married filing jointly; \$10,000 if single, head of household, or qualifying widow(er) | | | 11 |
| 12 | If line 10 is equal to or more than line 11, enter the amount from line 7 on line 13 and go to line 14. If line 10 is less than line 11, divide line 10 by line 11. Enter the result as a decimal (rounded to at least three places) | | | 12 |
| 13 | Multiply line 7 by line 12 | | | 13 |
| 14 | Enter the amount from Form 1040, line 46, or Form 1040A, line 28 | | | 14 |
| 15 | Enter the total, if any, of your credits from Form 1040, lines 47 through 49, or Form 1040A, lines 29 and 30 | | | 15 |
| 16 | Subtract line 15 from line 14. If zero or less, stop; you cannot take any education credits | | | 16 |
| 17 | Education credits. Enter the smaller of line 13 or line 16 here and on Form 1040, line 50, or Form 1040A, line 31 | | | 17 |

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

For Paperwork Reduction Act Notice, see page 4.

Cat. No. 25370M

Form **8863** (2006)

APPENDIX G

Quick Reference Guide

Filing for the Hope and Lifetime Learning Tax Credits

About this Guide

This Quick Reference Guide has been prepared to assist community-based organizations providing free or low-cost tax assistance in helping clients claim the Hope and Lifetime Learning Tax Credits. It is meant to aid in the completion of IRS Form 8863 on the education credits. Most of the Form 8863 is form is self-explanatory; however, there are three key aspects that must be completed prior to completing it – these are covered below.¹⁰ Two IRS documents will be helpful in completing Form 8863, and tax preparers should have both available for reference:

- IRS Publication 17 *Your Federal Income Tax For Individuals* for the current tax year
- IRS Publication 970 *Tax Benefits for Education* for the current tax year

Tip: To be efficient, volunteer preparers should complete Form 8863 toward the end of the tax preparation session. Because this is a non-refundable credit, it only applies if a tax filer has an outstanding tax liability (owes taxes after all deductions and other credits are taken). Therefore, we recommend the volunteer complete everything except the education tax credits forms. IF the client still has a tax liability, then complete the Form 8863.

Tip: Filers have the option of claiming an education tax credit or a tuition and fees deduction of up to \$4,000. Volunteer preparers should compare the tax benefits of claiming a credit versus claiming a deduction by trying each scenario separately in TaxWise. See IRS Publication 970 for instruction on claiming the deduction.

1. Determining Who is an “Eligible Student”

A key clue to whether a student is eligible to claim an education tax credit is whether they received a 1098-T form. Whether or not they received it, it is recommended to check student eligibility using an IRS eligibility chart. The IRS has published four flowcharts to determine if someone is an eligible student for the education tax credits. Tax preparers can use just two to determine student eligibility.

First, go through the chart, “Figure 35-A Can You Claim an Education Credit for 2005?” in IRS Publication 17 (see next page). This will determine if the student can claim a credit. Note: tax preparers should use the flowchart for the current tax year. The chart for the 2005 tax year is provided as an example only; the chart for 2006 was not available at the release of this guide.

If the flowchart assessment indicates that a student is eligible to claim a credit, you should determine which credit – the Hope or the Lifetime Learning. To determine if the student is eligible for the Hope Credit, go through the chart, **“Figure 2-1 Who is an Eligible Student for the Hope Credit?”** in IRS Publication 970 (again, this is an example from tax year 2005; please use an updated version for the current tax year). This flowchart is on page 3 of this guide. If the student is eligible for a credit, but not for the Hope Credit, it is likely s/he should claim the Lifetime Learning Tax Credit. Remember that the Hope and Lifetime credits cannot be claimed for the same student. See the overview of these credits in the document, *Help Your Tax Clients Claim An Education Tax Credit: Information on the Hope and Lifetime Learning Tax Credits*.

¹⁰ This IS NOT an official IRS document. However, it has been reviewed by IRS SPEC staff and free tax site practitioners for accuracy. It also was piloted by two free tax sites in spring 2006. It has been prepared by FutureWorks, LLC, for the Annie E. Casey Foundation in October 2006.

Figure 35-A. Can You Claim an Education Credit for 2005?

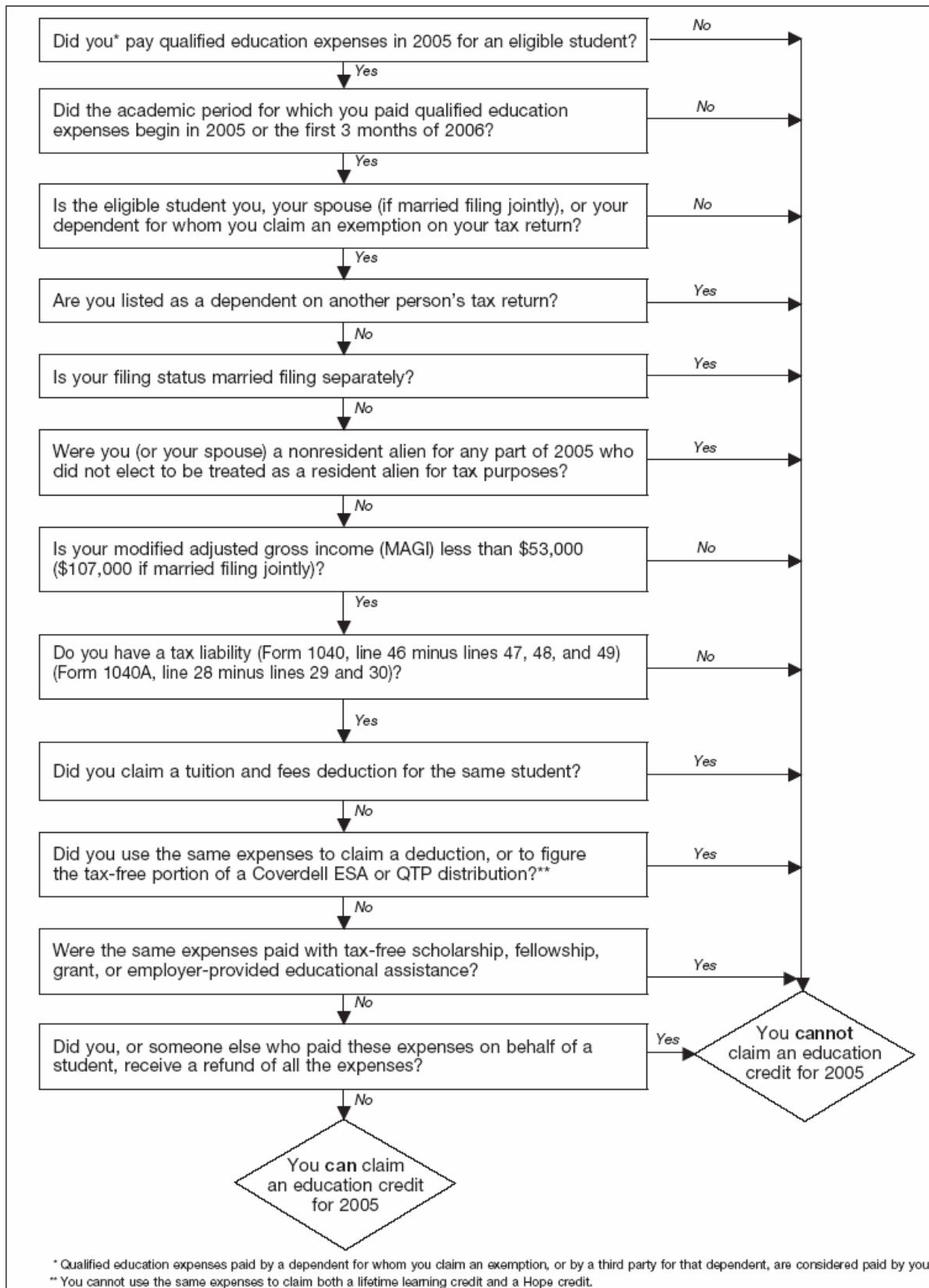
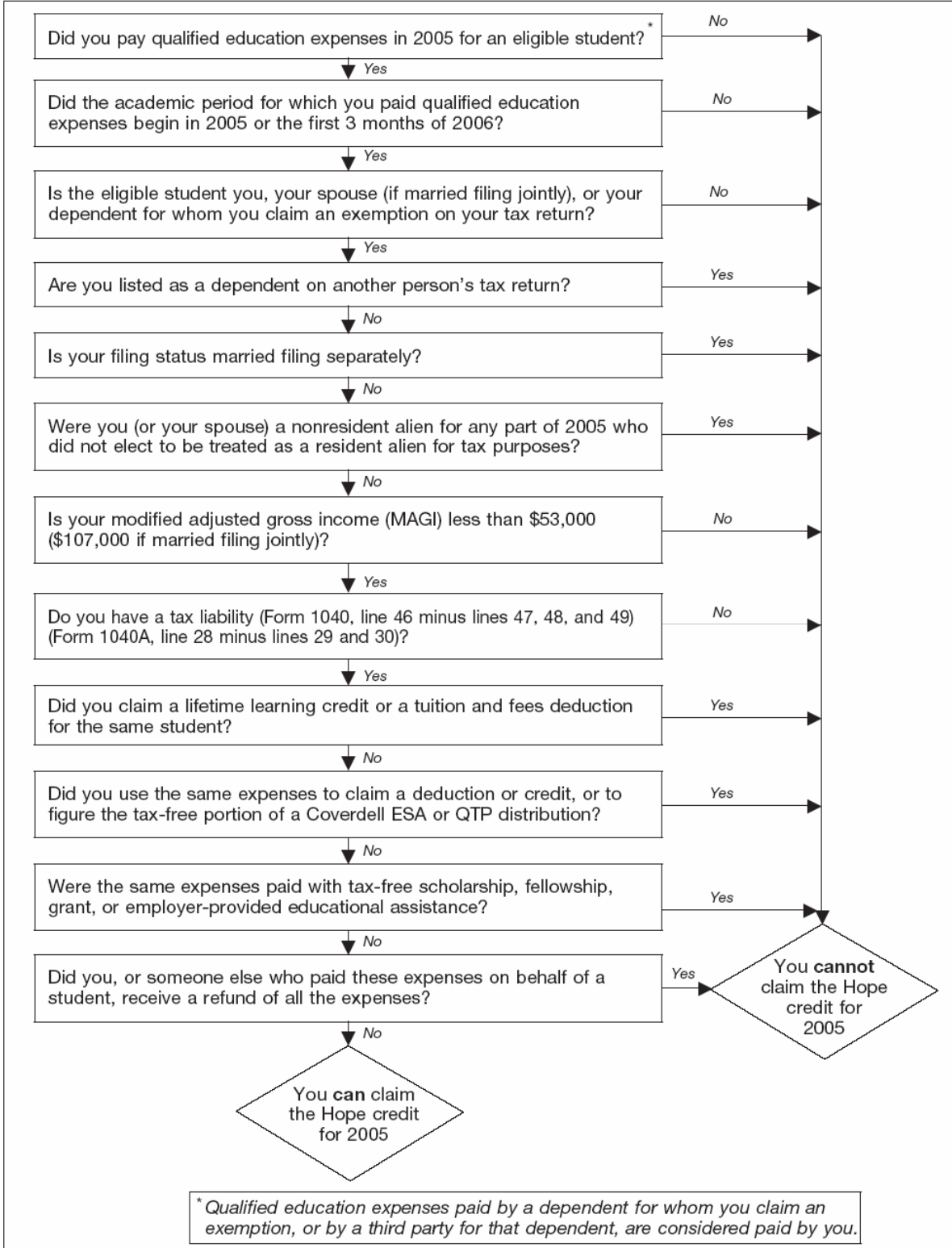


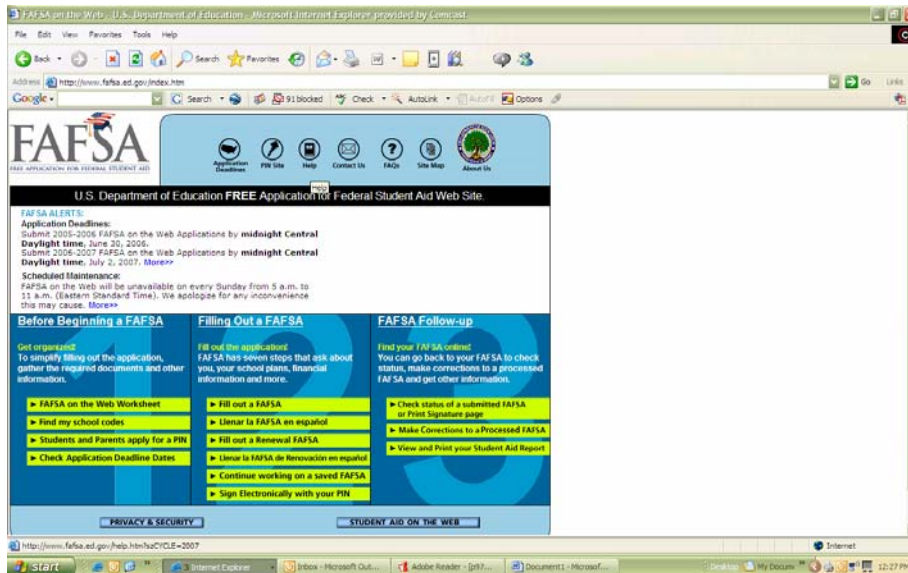
Figure 2-2. Can You Claim the Hope Credit for 2005?



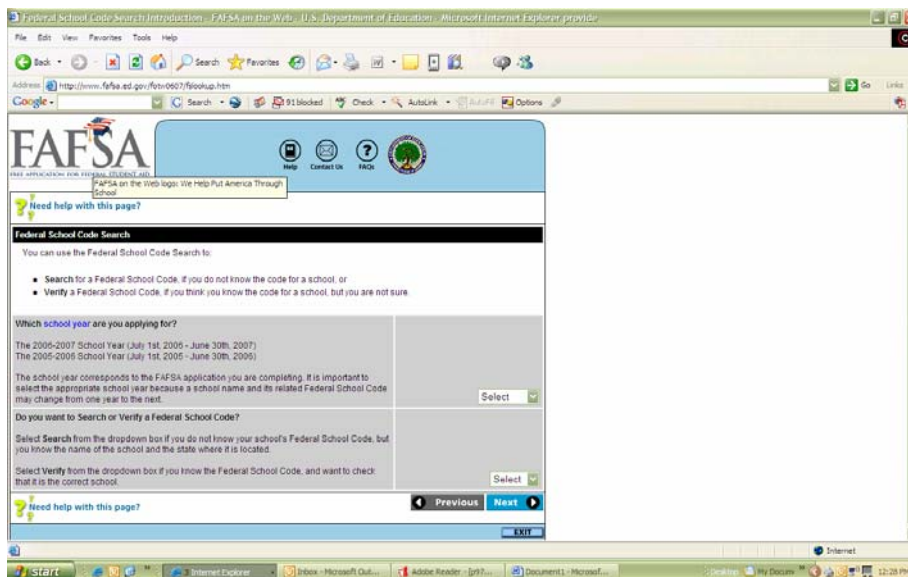
2. Determining an “Eligible Institution”

It is likely that if a student received a Form 1098-T from his/her postsecondary educational institution, that institution is an “eligible institution”; however, a quick on-line check is a good idea. Also, a student may not have a 1098-T but still paid eligible expenses, in which case, this check is useful to determine “eligible institution.” This check can be done through the Free Application for Federal Student Aid (FAFSA) website.

1. Go to www.fafsa.ed.gov and click on “Find my school codes” in the left column



2. In the first drop-down menu, select the current school year. In the second drop-down menu, select “search” (note: it is very important to **not** select “verify”). Click on “Next” at the bottom of the page.



3. In the first drop-down menu, enter the state in which the student attended school. In the second one, enter the city in which the student attended school. In the third one, enter the name of the school or part of the name of the school, i.e., community college. Entering part of the name will bring up a list of schools in that city and state with those words in it. This may help with identifying the school. All of this information should be on the 1098-T. Click on “Next.”

Note: The “state” is the only required information on this page. If you enter just the state, you will get a listing of all of the schools in that state eligible to participate in the federal student financial aid program.



The next page should include the name of the school, the address, and the federal (student aid) school code. If the school is listed on this page with a school code, it is an “eligible institution.” If it is not listed here, it is not an “eligible institution” and the student cannot claim an education tax credit.

3. Calculating “Qualified Expenses”

Use this worksheet to calculate the qualified expenses for *each student* claimed on Form 8863.¹¹

1. Total tuition and fees paid in 2005 and the first three months of 2006 for this student 1. _____

- Sources for information: 1098-T (lines 1 and 2), bill sent to student from school, student aid statement. *Note: Educational institutions are required to send 1098-T forms on each student to the IRS and to the student. They are not required to report on students’ qualified tuition and related expenses, scholarships and grants. Consequently, a U.S. Government Accounting Office study found that just 13% of all 1098-T forms had this information. Do not be surprised if this information is not on the form. Also, some sites have found that the information is incorrect, so volunteers and site coordinators should double check all information with the student (preferably referencing other documentation from the school).*
- Do include any tuition, fees, and expenses that the student **paid to the school as a condition of enrollment or attendance**. Include expenses paid to school for course-related books, supplies, and equipment only if they are required for enrollment or attendance.
- Do **not** include any amounts that have been claimed for any other educational tax benefit, i.e., a deduction.
- Do **not** include tuition and fees for any courses from which the student withdrew (even if s/he was not refunded).

2. Total **tax-free** educational assistance received by student, including scholarships, fellowships, Pell Grants, and other grant aid 2. _____

- Do **not** include any wages, i.e., student work-study; loans (federal student loans, personal loans, or other types of loans); gifts; inheritance; withdrawal from personal savings; or any **taxable** educational assistance.
- For a worksheet to calculate **taxable** educational assistance, see page 5 in IRS Publication 970.

3. Total amount of educational refunds student received or expects to receive from any source, i.e., employer reimbursement 3. _____

4. Add lines 2 and 3 4. _____

5. Subtract line 4 from line 1 5. _____

Enter amount from line 5 in “qualified expenses” for the student under either Part I on the Hope Credit or Part II on the Lifetime Learning Credit. Do not enter more than \$2,000 for each student claiming a Hope Credit. Do not enter more than \$10,000 per return under the Lifetime Learning Credit.

For more information and examples, see IRS Publication 17, Chapter 35 on the Education Credits and IRS Publication 970, *Tax Benefits for Education*, chapters 1 and 2 on the Hope Credit and Lifetime Learning Credit, respectively.

¹¹ Prior to the 2006 tax year, tax filers could deduct tuition and fee expenses from their taxable income in lieu of claiming an education tax credit. However, this provision expired at the end of the 2005 tax year. Volunteers do not need to make a determination as to whether an education tax credit or a tuition deduction is better for their clients,

APPENDIX H

1098-T and Education Benefits

8383 VOID CORRECTED

| | | | | |
|---|----------------------------------|--|--|--|
| FILER'S name, street address, city, state, ZIP code, and telephone number | | 1 Payments received for qualified tuition and related expenses \$ 4,500 | OMB No. 1545-1574 2005 Form 1098-T | Tuition Statement |
| | | 2 Amounts billed for qualified tuition and related expenses \$ | | |
| FILER'S Federal identification no. | STUDENT'S social security number | 3 Adjustments made for a prior year \$ | 4 Scholarships or grants \$ 7,580 | Copy A For Internal Revenue Service Center File with Form 1096. For Privacy Act and Paperwork Reduction Act Notice, see the 2005 General Instructions for Forms 1099, 1098, 5498, and W-2G. |
| STUDENT'S name | | 5 Adjustments to scholarships or grants for a prior year \$ | | |
| Street address (including apt. no.) | | 6 Check this box if the amount in box 1 or 2 includes amounts for an academic period beginning January-March 2006 <input type="checkbox"/> | 7 Reimbursements or refunds of qualified tuition and related expenses from an insurance contract \$ | |
| City, state, and ZIP code | | | | |
| Service Provider/Acct. No. (see instructions) | | 8 Check if at least half-time student <input checked="" type="checkbox"/> | 9 Check if a graduate student <input type="checkbox"/> | |
| | | | | |

Form 1098-T Cat. No. 25087J Department of the Treasury - Internal Revenue Service
Do Not Cut or Separate Forms on This Page Do Not Cut or Separate Forms on This Page

- Issue:** 1) Client received \$7,850 in scholarships/grants.
2) Qualified tuition paid to the institution was \$4,500 and client confirms that amount.

How to handle in Taxwise:

- Since the amount of scholarships/grants is MORE than the qualified tuition amount, client does NOT qualify for an education credit or a tuition deduction on their tax return.
- Subtract the qualified tuition amount from scholarship/grants. That amount (\$7850-\$4500=\$3350) is **taxable income**. Enter that amount (\$3350) on line 7 of the 1040 by "Scholarship income not reported on W-2."

What if the client has the reverse situation?

- \$4,500 in scholarships and grants
- \$7850 in qualified tuition that was paid in 2995

How to handle in Taxwise:

- Since the amount of scholarships/grants is LESS than the qualified tuition amount, the difference between the scholarship/grant amount and the tuition amount can be used for either an education credit or a tuition deduction on their tax return. See the handout in the Volunteer Resource Guide on how to determine which one is best.
- Note that only the tuition amount above the scholarship amount (\$3350) can be applied to an education credit or tuition deduction!**
- Also, only qualified charges that were actually PAID in 2005 can be claimed for the deduction or credit.
- Since all the scholarship and grant money was spent on qualified tuition expenses, there is no taxable income.

Warning: Schools can choose if they report amounts in Box 1 or Box 2. On Form 1098-T, there is no guarantee that the amount in Box 1 or Box 2 was the amount actually paid during the tax year for qualified tuition and fees. Whatever amount the client says he paid for qualified expenses during the tax year should be treated as if it were the amount paid. Explain to client that s/he should have documentation of the amount and date paid.

If the qualified tuition expenses are greater than the scholarship/grant amount, then the difference (\$3,350) can be either an education credit on Form 8863 or an Adjustment to income.

Below is what Form 8863 would look like if client qualified for the **Hope Credit**:

Part I: Hope Credit

The Hope Credit is available for two taxable years only. Those two years must be the first two years of postsecondary education, generally the freshman and sophomore years of college.

* For each student who attended an eligible institution in the Gulf Opportunity Zone, check the box in the GO ZONE column. You can enter up to \$4,000 in column c.

| 1 | (a) Student's name as shown on page 1 of this tax return. First name and last name | (b) Student's social security number | (c) * Qualified expenses but not more than \$2,000, \$4,000 GOZ per student | GO ZONE G O Z O N E | (d) Smaller of column c or \$1,000, \$2,000 GOZ | (e) Add column c and column d | (f) One-half of the amount in column e |
|---|---|---|--|---------------------------------------|--|----------------------------------|---|
| | Student name | 999-99-9999 | 3,350. | <input type="checkbox"/> | 1,000. | 3,000. | 1,500. |
| | | | 0. | <input type="checkbox"/> | 0. | 0. | 0. |
| | | | 0. | <input type="checkbox"/> | 0. | 0. | 0. |
| 2 | Add amounts in column (f) | | | | | | 1,500. |

Hope Credit and Lifetime Learning Credit

The **Hope Credit** is available **only for the first two years** of pursuing a degree at a post-secondary institution. The student must be:

- (1) enrolled at least half-time for at least one semester,
- (2) must be in his/her first two years of school,
- (3) must be pursuing a degree, and
- (4) cannot have been convicted of a felony for possession or distribution of a controlled substance.

The credit is 100% of the first \$1,000 of qualified tuition and fees and 50% of the next \$1,000 of qualified tuition and fees for a maximum credit of \$1,500. The Hope credit may be claimed only **twice** for each student.

The **Lifetime Learning Credit** is available for **any year** of post-secondary education and for non-degree courses, such as classes to acquire or improve job skills. You may NOT claim both credits for the same student for the same year. In order to claim the Lifetime Learning credit,

the student must be enrolled in a course or courses that give or improve job skills including courses taken toward obtaining a degree at a qualified institution. The amount of the credit is 20% of the first \$10,000 of qualified tuition and fees for a maximum credit of \$2,000 per tax return for 2005. This credit is per tax return, not per student.

MORE ON THE 1098-T

ADJUSTMENTS TO PRIOR YEAR: BOXES 3 AND 5

Colleges are required to report adjustments to prior year qualified tuition and fees and scholarships if those adjustments occurred during 2005. Any adjustments that would have increased your prior year qualified tuition and fees or scholarships are included with the current year reporting in boxes 2 and 4 and should be included with your current year tax credit calculation.

However, any adjustments that would have decreased your prior year qualified tuition and fees or scholarships are reported in boxes 3 and 5. *These adjustments require a recalculation of your prior year tax credit with the difference in the tax being included on your current year tax Form 1040, line 44 or Form 1040A, line added to your current year tax liability.* Next to the line, write ECR to alert the IRS that you have a prior year education credit adjustment.

QUALIFIED EXPENSES

Qualified tuition and related expenses are tuition and fees a student **must** pay to be enrolled at or attend an eligible educational institution.

Examples: Resident and Non-resident tuition
 Graduate and Undergraduate Program Fees

NOT qualified tuition and related expenses:

- Amounts paid for any course or other education involving sports, games, or hobbies unless the course or other education is part of the student's degree program or is taken to acquire or improve job skills.
- Charges and fees associated with room and board, parking, student activities, athletics (unless the course is part of the student's degree program), insurance, equipment, transportation and similar personal living or family expenses are not qualified expenses.
- User fees such as for musical instruments and theater arts equipment use.
- The cost of books and equipment are generally NOT qualified expenses because eligible educational institutions usually do not require that fees for such books or equipment be paid to the institution as a condition of the student's enrollment or attendance at the institution.