

Most Advantageous Treatment of Education Expenses

This sheet provides reference information to help Preparers to determine the most advantageous (to the client) place to claim Education Expenses: as an adjustment to income (1040 line 34), as the (new for 2009) American Opportunity Credit (also called extended Hope credit), the Lifetime Learning Credit, or as a Miscellaneous Schedule A line 21 deduction.

1. Complete the “income” section of the return, i.e., 1040 Page 1, above the Adjustments section
2. Enter any deductions on Schedule A or, if not itemizing, insert the Standard Deduction.
3. Determine eligibility of the taxpayer for the four (4) possible places you COULD enter an education expense (not necessarily the SAME expenses!):

For the line 34 Tuition & Fees Adjustment	For the three possible Education tax credits	For Schedule A line 21 Job Education Misc. Deduction
See Pub 17 page 138, Table 19-2 and page 140, Table 19-3.(Page numbers approximate!)	See Pub 17, page 238, “Who Can Claim an Education Credit”, and Figure 35-A, page 240. (Page numbers approximate!)	See Pub 17 page 197, “Qualifying Work-Related Education”. (TIPS: Not applicable if taxpayer is not itemizing. Benefit included in misc. deductions reduced by 2% of AGI.)(Page numbers approximate!)

4. For the eligible entry locations, calculate the allowable expenses. (Room and Board are NOT allowable except as part of travel and living expenses for the Schedule A line 21 deduction.)

For the 1040 line 34 Adjustment	For the AOC	For the Lifetime Learning credit	For the Schedule A line 21 deduction
See Pub 17 page 138, “What Expenses Qualify”. (Limit: \$4,000 or less per tax return, not per student.)(Page numbers approximate!)	See Pub 17, page 239, “Qualified Education Expenses”, figure the total qualified expenses <u>per student</u> .(Page numbers approximate!)	See Pub 17, page 239, “Qualified Education Expenses”, figure the <u>total for all students</u> . (Page numbers approximate!)	See “What Expenses Can Be Deducted” on Pub 17 page 199.(Page numbers approximate!)
Enter using 1040 Worksheet 2.	Enter on Form 8863 Parts I and II	Enter on Form 8863 Part III	Enter on Schedule A line 21

5. In the TaxWise Refund Monitor (near the upper right corner of the TaxWise window), note the refund or underpayment amount: _____.
6. Now you have the numbers you need to determine the most advantageous tax treatment of education expenses. You now try out each benefit. You will enter the allowable expenses in each location, note the change in the Refund Monitor, and then undo that entry and try the next.
7. 1040 Worksheet 2 entry: _____ Refund/underpayment amount: _____ (UNDO ENTRY)
8. 8863 Line 1 total/student: _____, _____, _____ Refund/underpayment amount: _____ (UNDO ENTRY)
9. 8863 Line 3 total/student: _____, _____, _____ Refund/underpayment amount: _____ (UNDO ENTRY)
10. 8863 Line 6 total: _____ Refund/underpayment amount: _____ (UNDO ENTRY)
11. Schedule A line 21 total: _____ Refund/underpayment amount: _____ (UNDO ENTRY)
12. Now choose the entry with the best result: maximum refund or minimum underpayment, re-enter the expenses in that location, and you’re done with this part of the Federal return.
13. Do not forget to review the “NC State Handling of the Education Credits in TaxWise” document in this binder, if applicable.

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Examples

Below are three scenarios as calculated by TaxWise 2009. These are much simplified and somewhat contrived. The best for each scenario is **highlighted**. No scenario is likely to exactly duplicate what Preparers will encounter during the tax year. Your mileage will vary!

For all scenarios:

- AGI=amount, entered as misc. income on 1040 line 21, with no adjustments.
- Deductions entered on Schedule A line 5b as sales tax.
- Tax payments entered on 1040 line 62.

Scenario 1. Filing Status Single, Qualified Expenses: \$5000, Two Students (\$2,500 each)

Adjusted Gross Income	\$30,000	\$60,000	\$90,000
Deductions before Educ.	5,700	11,400	17,100
Tax Payments	2,784	7,531	15,031
Refund/underpayment	100	100	1,525
With AO Credit	4,350	4,350	1,525
With Lifetime Learning Credit	1,100	100	1,525
With 1040 Line 34 Adjustment	700	1,100	2,525
With Schedule A Line 21 Ded.	760	1,050	2,325

Scenario 2. Filing Status MFJ, Qualified Expenses \$5,000, One Student

Adjusted Gross Income	\$30,000	\$60,000	\$90,000
Deductions before Educ.	5,700	11,400	17,100
Tax Payments	2,784	7,531	15,031
Refund/underpayment	1,651	2,167	6,022
With AO Credit	3,784	4,667	8,522
With Lifetime Learning Credit	2,651	3,167	7,022
With 1040 Line 34 Adjustment	2,151	2,767	6,622
With Schedule A Line 21 Ded.	1,651	2,737	6,502

Scenario 3. Filing Status Single, Qualified Expenses \$2,000, One Student

Adjusted Gross Income	\$30,000	\$60,000	\$90,000
Deductions before Educ.	5,700	11,400	17,100
Tax Payments	2,784	7,531	15,031
Refund/underpayment	100	100	1,525
With AO Credit	2,100	2,100	1,525
With Lifetime Learning Credit	500	100	1,525
With 1040 Line 34 Adjustment	400	600	2,025
With Schedule A Line 21 Ded.	310	300	1,575