

# Improving Form 1098-T: How a Revised Form Could Increase Take-Up, Improve Compliance, and Lower Taxpayer Burden

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## I. Introduction

Form 1098-T originated with the Taxpayer Relief Act of 1997 (TRA97). TRA97 created the Hope Scholarship Tax Credit (HTC) and the lifetime learning credit (LLC). These new benefits allowed qualifying students attending eligible institutions to claim a tax credit against qualifying education expenses. TRA97 also required that eligible educational institutions file a return reporting qualified tuition and related expenses and other information for each enrolled student as prescribed by regulations. Among other items, Form 1098-T reports student status (if the student is attending at least half time, and if a graduate student), student expenses, and scholarships. The current design of Form 1098-T helps taxpayers claim certain education tax credits and it also helps the IRS monitor compliance with the education tax credits.<sup>2</sup> Yet, as currently designed and administered, Form 1098-T falls short of providing *all* the information necessary for students to claim the tax credits or for the IRS to effectively monitor compliance with education-related provisions. This paper presents some evidence that some eligible students may not be taking any education-related tax benefit or may not be choosing the optimal benefit. We also present evidence that some students may be taking a tax benefit for which they are not eligible. But underlying this “evidence” is the fact that not all the information required to determine eligibility is observable on the tax return or the Form 1098-T. As a result, it is not possible to know with certainty whether a student is optimizing or compliant. Students who do not appear to be optimizing or who appear to be noncompliant may be responding to information that is not observable. More information is necessary to be able to guide taxpayers to the optimal and compliant benefit.

In recognition of these limitations, both the President and Congress have proposed modifying the reporting of tuition expenses and scholarships on Form 1098-T.<sup>3</sup> These proposals would move the information reported on Form 1098-T closer to the information needed by taxpayers with education expenses when preparing their tax returns. This paper describes these proposed changes, along with additional ways that improved reporting on Form 1098-T could increase take-up of the education benefits, improve compliance, and decrease the compliance burden that families with students must bear in order to claim this credit.

The paper is organized as follows: Section II briefly describes currently available tax benefits related to postsecondary education expenses. Section III describes Form 1098-T. Section IV describes the limitations of Form 1098-T. Section V presents data gathered from Forms 1098-T and 8863, including the number of students claiming education credits by type of credit and type of student and the number of students claiming a credit without a Form 1098-T. Section VI presents a proposed redesign of Form 1098-T and shows how a new worksheet based on the redesigned Form 1098-T could guide students in selecting the optimal tax benefit. Section VII concludes.

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<sup>1</sup> The authors wish to thank Andrew Bershadker for his assistance. Views and opinions expressed are those of the authors and do not necessarily represent official Treasury positions or policy.

<sup>2</sup> Through 2014, taxpayers with education expenses may claim an above-the-line deduction. This paper focuses on the tuition credits, which will remain available. Claims data are presented for all three benefits, since in the absence of the deduction, many of the taxpayers claiming a deduction would have claimed a credit instead.

<sup>3</sup> See the *General Explanation of the Administration's Fiscal Year 2016 Revenue Proposals (Greenbook)*. Fiscal Year 2016 Revenue Proposals (Greenbook), page 128. This proposal was also included in the FY 2014 and FY 2015 Greenbooks. See also *Summary of Staff Discussion Draft: Tax Administration* by Chairman Baucus, U.S. Senate Committee on Finance, November 2013.

## II. Education-Related Tax Benefits

Form 1098-T was first introduced to help administer the Hope Scholarship Tax Credit (HTC) and the lifetime learning credit (LLC). Both credits were created as part of the Tax Reform Act of 1997 to help families pay for postsecondary education expenses. In 2008, over 7.7 million students received \$7.6 billion in HTC and LLC. In 2009, the American Recovery and Reinvestment Act of 2009 (ARRA) created the American Opportunity Tax Credit (AOTC) as a temporary replacement for the HTC. The maximum AOTC is larger than the maximum HTC and unlike the HTC, the AOTC is partially refundable. The AOTC is currently available through 2017. A brief description of the AOTC and LLC are given below, followed by a description of the above-the-line deduction of up to \$4,000 in tuition and fees, which expires after 2014. We also describe how the administration of certain other education-related tax benefits could benefit from a redesigned Form 1098-T. These include the exclusion of certain scholarships and fellowships from income, the extension of the dependent exemption to full-time students age 19 through 23, and the extension of qualifying children for purposes of claiming an earned income credit to full-time students age 19 through 23.

### *The American Opportunity Tax Credit*

For any given student, a taxpayer may take either an AOTC or a LLC but a taxpayer may not claim both credits for one student; a taxpayer may take an AOTC for one student and an LLC for a second student. If a taxpayer is eligible to take an AOTC for a particular student, the AOTC will provide the greater benefit. The AOTC provides a tax credit of up to \$2,500 per student per year for the first four years of postsecondary school if the student is enrolled at least half time. The AOTC is calculated as 100 percent of the first \$2,000 and 25 percent of the next \$2,000 in qualified tuition and related expenses. Forty percent of the otherwise available AOTC is refundable (for a maximum refundable credit of \$1,000). Qualified tuition and related expenses for the AOTC includes tuition, fees, and course materials including books and supplies required for enrollment or attendance. Since only one benefit may be claimed for any given dollar of qualified expenses, scholarship amounts that are excluded from a student's taxable income must be subtracted from expenses that otherwise qualify for the AOTC. Likewise, expenses that are paid by other tax-preferred sources, such as employer-paid expenses under Internal Revenue Code Section 127 or expenses paid by earnings from a Section 529 qualified tuition plan, are not qualifying expenses for the purpose of claiming the AOTC. To qualify for the AOTC, the student must be enrolled in a course of study leading to a degree, certificate or other recognized credential. The AOTC phases out between modified adjusted gross income (MAGI) of \$80,000 and \$90,000 (\$160,000 and \$180,000 if married filing jointly).

Table 1 shows the number of returns, the amounts claimed, and the share of the credit in excess of tax liability, by AGI of the claimants. In total, 12.8 million taxpayers and their families received \$21.8 billion of AOTC in 2011 with an average credit of \$1,699 per return (some taxpayers may receive more than one credit if there was more than one qualifying student on his or her return). Sixty percent of AOTC returns receive an outlay (a credit that exceeds tax liability) and 30 percent of the total AOTC received on returns is an outlay.

**TABLE 1. Number of Returns, Amount of Credits, and Share of Credit That Is an Outlay by AGI for Returns Claiming an American Opportunity Tax Credit, Tax Year 2011**

Adjusted Gross Income (Thousands)	Total AOTC			Portion of AOTC that Is an Outlay				
	Return Count (Thousands)	Total (\$ Millions)	Average (\$)	Number of Returns (Thousands)	Total Amount (\$ Millions)	Average per Return (\$)	Returns With Outlay (%)	Outlay as Percent of Total AOTC (%)
\$0 to \$10	2,029	1,810	892	2,010	1,763	877	99	97
\$10 to \$20	2,580	2,942	1,140	2,475	2,205	891	96	75
\$20 to \$30	1,775	2,903	1,635	1,494	1,200	804	84	41
\$30 to \$40	1,215	2,243	1,846	730	597	817	60	27
\$40 to \$50	893	1,817	2,036	434	370	852	49	20
\$50 to \$75	1,530	3,404	2,225	352	310	881	23	9
\$75 to \$100	1,083	2,544	2,350	64	59	919	6	2
\$100 to \$150	1,262	3,251	2,577	10	7	656	1	0
\$150 to \$200	384	798	2,078	2	1	520	0	0
> \$200	0	0	0	0	0	0	0	0
<b>Total</b>	<b>12,824</b>	<b>21,786</b>	<b>1,699</b>	<b>7,637</b>	<b>6,573</b>	<b>861</b>	<b>60</b>	<b>30</b>

### *The Lifetime Learning Credit*

The LLC provides a nonrefundable tax credit of up to \$2,000 per tax return. The LLC is not limited to a set number of years, to a particular enrollment intensity, or to students pursuing a degree, certificate or other recognized credential. So, a student who is taking a refresher course to acquire, maintain, or improve job skills would qualify for the LLC but not the AOTC. Likewise, students in their 5th year or more of school, including graduate school, or who are enrolled less than half-time (who are otherwise eligible) will qualify for an LLC but not an AOTC. Importantly, neither credit is available to pay for hobby courses even though some schools may file Form 1098-T for students taking classes for fun.<sup>4</sup> The LLC is calculated as 20 percent of up to \$10,000 in qualified tuition and related expenses per tax return. Qualified expenses for the LLC include only tuition and fees required for enrollment or attendance. The definition of required fees is very narrow for the LLC. As stated in the regulations to this section of the Code, qualifying course materials for the LLC are restricted to those purchased directly through the school as a condition of enrollment or attendance.<sup>5</sup> Thus, most course books are not qualifying expenses for the LLC. In 2014, the LLC phases out between modified adjusted gross income (AGI) of \$54,000 and \$64,000 (\$108,000 and \$128,000 if married filing jointly).

Table 2 shows the number of returns and amounts claimed by AGI of the claimants that claimed the LLC in 2011. In total, 2.9 million returns received \$2.1 billion of LLC in 2011 with an average LLC of \$731.

**TABLE 2. Number of Returns and Amount of Credit by AGI for Returns Claiming a Lifetime Learning Credit, Tax Year 2011**

Adjusted Gross Income (Thousands)	Lifetime Learning Credit		
	Number of Returns (Thousands)	Total Amount (\$ Millions)	Average Per Return (\$)
\$0 to \$10	8	0	27
\$10 to \$20	413	150	364
\$20 to \$30	498	334	671
\$30 to \$40	443	344	778
\$40 to \$50	377	329	872
\$50 to \$75	539	442	820
\$75 to \$100	462	397	861
\$100 to \$150	114	89	782
\$150 to \$200	0	0	0
> \$200	0	0	0
<b>Total</b>	<b>2,853</b>	<b>2,087</b>	<b>731</b>

### *The Above-the-Line Deduction for Tuition and Related Expenses*

The above-the-line deduction for tuition and related expenses allowed taxpayers to reduce their taxable income by up to \$4,000 of tuition and fees per tax return. Taxpayers with incomes up to \$65,000 (\$130,000 for joint filers) may claim the full \$4,000 and taxpayers with incomes greater than that but up to \$80,000 (\$160,000 for joint filers) may claim up to \$2,000. A student for whom a deduction is claimed may not be claimed for an education credit. Expenses are defined in the same way as for the LLC. This benefit expired for tax years after 2014.

### *The Exclusion of Certain Scholarships and Fellowships from Income*

Many scholarships, including the Pell grant, can be spent on a wide range of expenses, including tuition and fees, course related expenses, living expenses, and child care. Some scholarships restrict the terms of their use to a limited set of these expenses. For example, certain Post-9/11 GI Bill benefits may pay only the veteran's tuition and required fees although other GI Bill amounts may be used for additional expenses. Scholarship income that is used to pay tuition,

<sup>4</sup> Only the student will know whether certain classes are hobby classes or classes that are being taken to maintain skills. For example, a Shakespeare course could be taken by someone who tutors or teaches to maintain or expand skills or could be taken just for fun.

<sup>5</sup> See Income Tax Regulations, Section 1.25A-2(d)(ii). The education credits are defined in Section 25A of the Internal Revenue Code.

required fees and course-related expenses (including for books) may be excluded from income for purposes of calculating income tax liability. In order to qualify for the exclusion, the scholarship cannot be designated for some other purpose (e.g., room and board) and generally cannot represent a payment for services (e.g., teaching). Excluded amounts should be subtracted from expenses that would otherwise qualify a student for an education credit. The exclusion does not have an AGI limitation. To qualify for the exclusion, the student must be a degree candidate. Scholarships used to pay other expenses such as living expenses do not qualify for the exclusion from income.

If scholarship income is excluded from gross income for tax purposes, the value of the tax benefit will depend on the taxpayer's marginal tax rate and will therefore depend on the variety of factors that determine a taxpayer's marginal tax rate, such as the taxpayer's income, marital status, and whether or not he or she is eligible for certain tax credits, such as the earned income tax credit. Under certain circumstances, excluding a scholarship from income is not the optimal choice for taxpayers. Under current tax law, if the terms of the scholarship allow it to be used for any education expenses, a student may choose whether to allocate scholarship amounts to tuition and fees or to living expenses. If allocated to tuition and fees, a scholarship reduces the amount of tuition eligible to be used to claim the AOTC or LLC. If a scholarship is used to pay all of the student's tuition and related expenses, the student (or parent in the case of a dependent taxpayer) will not be eligible for any AOTC or LLC. If allocated to living expenses, however, then the scholarship becomes taxable for the student. As a result, maximizing the scholarship and education credits requires calculating the value of the credit (as it affects the tax return of the student and the parent, if applicable) relative to the tax liability resulting from counting the scholarship as income.

The Administration's Fiscal Years 2015 and 2016 revenue proposals included a simplification proposal that would have allowed students with Pell grants to exclude their Pell grant from income without subtracting it from expenses that would otherwise be eligible for the AOTC. This would allow Pell grant recipients, most of whom have very low income, to avoid the complicated calculations that are required to allocate a grant optimally between taxable and nontaxable income.

Form 1098-T reports some, but not all, scholarship income (see further discussion below in Section IV, Limitations of Form 1098-T).

### ***Parental Personal Exemption, Head of Household Status and Earned Income Tax Credit for Students Ages 19 Through 23***

For parents supporting college students, there is also an extension of the benefit provided by the dependency exemption deduction and the earned income tax credit (EITC) for full-time students with ages 19 through 23. In the case of a single parent with only one child, the continued presence of a qualifying child allows the parent to use Head of Household filing status, with a bigger standard deduction and more favorable tax rate brackets than available to single filers. Dependent children over the age of 18 do not qualify as children for the dependency exemption or the EITC unless they remain full-time students (up through age 23).<sup>6</sup> In 2014, the personal exemption amount is \$3,950. In 2014, the maximum EITC is \$3,305 for taxpayers who have one qualifying child. For a single parent with one child earning \$30,000 the combined value of these three tax benefits is \$2,581.<sup>7</sup>

## **III. Description of Form 1098-T**

As described in detail below, all postsecondary institutions whose students are allowed to claim education credits are required to file a Form 1098-T with the IRS each year for most (but not all) enrolled students. Schools are also required to send a copy of Form 1098-T to each student for whom they file a Form 1098-T. The 1098-T is the only third-party information the IRS receives regarding a student's postsecondary education expenses, scholarships, and half-time and graduate student status. As such, it is very valuable to the IRS and to students who receive it. However, in its current form, Form 1098-T falls short of providing students and the IRS what is needed to calculate qualified education expenses. Most schools report the eligible expenses that they billed to the student but most schools do not report whether

<sup>6</sup> For purposes of these benefits, a full-time student must attend full-time for some part of "each of five calendar months during the calendar year" and the five months need not be consecutive. A full-time student is defined in the regulations to Section 151 as one who is enrolled "for the number of hours or courses which is considered to be full-time attendance" by the program in which the student is enrolled, in accordance with Department of Education guidelines. Dependent children who are permanently and totally disabled are not subject to the age limitations.

<sup>7</sup> The EITC for such a taxpayer would be \$1,360. Head of household status increases the taxpayer's standard deduction and widens the 10-percent rate bracket for a combined tax benefit of \$628. The extra personal exemption is worth \$593. In total, the combined value of the three benefits is \$2,581.

those expenses were actually paid. Schools also report some, but not all, scholarships received by students. So although, for taxpayers and the IRS, the receipt of a Form 1098-T serves as a notice that a particular student is enrolled at an eligible institution and therefore *may* be eligible for an education tax credit, it does not provide the information necessary for either the taxpayer or the IRS to confirm that he or she actually *is* eligible for a tax credit. Nor does the absence of a Form 1098-T indicate that a student is not eligible for a tax credit.

**Filing Requirement**

All postsecondary institutions whose students are eligible for Title IV funds<sup>8</sup> (e.g., Pell grants or Federal student loans) are required to file Form 1098-T for all enrolled students with the following exceptions. No reporting is required for: i) nonresident alien individuals; ii) students enrolled exclusively in noncredit courses; and iii) individuals whose qualified tuition and related expenses are waived, paid with scholarships, or covered by a formal billing arrangement.<sup>9</sup> As discussed further below, because of these exceptions some students who may be eligible for an education credit will not receive a Form 1098-T.

**Information Reported**

A copy of Form 1098-T is shown in Figure 1. Summary statistics for this form for Tax Year 2011 are shown immediately after in Table 3.

**FIGURE 1. Form 1098-T, Tax Year 2014**

CORRECTED

FILER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone number		1 Payments received for qualified tuition and related expenses \$	2 Amounts billed for qualified tuition and related expenses \$	OMB No. 1545-1574  <b>2014</b>  Form 1098-T	<b>Tuition Statement</b>
FILER'S federal identification no.	STUDENT'S social security number	3 If this box is checked, your educational institution has changed its reporting method for 2014 <input type="checkbox"/>		<b>Copy B For Student</b>	
STUDENT'S name		4 Adjustments made for a prior year \$	5 Scholarships or grants \$	This is important tax information and is being furnished to the Internal Revenue Service.	
Street address (including apt. no.)		6 Adjustments to scholarships or grants for a prior year \$	7 Checked if the amount in box 1 or 2 includes amounts for an academic period beginning January - March 2015 <input type="checkbox"/>		
City or town, state or province, country, and ZIP or foreign postal code		8 Check if at least half-time student <input type="checkbox"/>	9 Checked if a graduate student . . . . <input type="checkbox"/>	10 Ins. contract reimb./refund \$	

Form **1098-T** (keep for your records) [www.irs.gov/form1098t](http://www.irs.gov/form1098t) Department of the Treasury - Internal Revenue Service

<sup>8</sup> Title IV is the section of the Higher Education Act that describes direct Federal aid programs, including Pell grants, Federal student loans, and work-study. Nearly all domestic institutions participate in the Federal aid programs, along with foreign institutions that want their American students to be able to receive student loans. Although foreign schools participating in Title IV programs are generally required by statute to file this form for many of the American students enrolled in some of their programs, this requirement is not enforced.

<sup>9</sup> A formal billing arrangement is an arrangement in which a) the educational institution bills an employer, a government entity, or certain nonprofits for education provided and b) the educational institution does not maintain a separate account for that individual. An example would include an agreement between an employer and a local community college to provide statistical training to all employees at a fixed rate. If a student receives education through a formal billing arrangement, although the student receives the education, it is the student's employer, a government entity, or the relevant nonprofit that is billed for the education, and not the student. In this case, the school does not maintain a separate financial account for the individual student and under current law would not be required to issue a 1098-T. This term is defined in regulation 1.6050S-1 (26 CFR).



**TABLE 3. Summary Statistics for Form 1098-T, Tax Year 2011**

Box Number and Description	Mean of Nonzero Values (\$)	Percent with Nonzero Values
1. Payments received	5,203	19.1
2. Payments billed	23,650	76.1
3. Change in reporting method	N/A	2.4
4. Prior-year adjustments to Box 1 or Box 2	1,284	7.2
5. Scholarships or grants	5,664	49.2
6. Prior-year adjustments to Box 5	1,349	1.5
7. Includes amounts for next academic year	N/A	31.6
8. At least half-time student	N/A	80.7
9. Graduate student	N/A	13.7
10. Insurance contract refund	3,215	0.1

NOTE: Total number of forms in TY 2011: 27.6 million

*Boxes 1 and 2: Payments received or payments billed for qualified tuition and related expenses.* Under current law, schools may choose to report amounts billed or amounts received for qualified tuition and related expenses. The majority of the students (76 percent of the Form 1098-Ts filed and 80 percent of the Form 1098-Ts reporting positive tuition and related expenses) attend schools that choose to report payments billed for qualified tuition and related expenses. This reduces the usefulness of the Form 1098-T since only amounts paid in a given tax year are eligible expenses for the purpose of claiming a tax credit. Amounts billed during a tax year, even if ultimately equal to the total amounts paid, are unlikely to be the same as payments in a given tax year due to the mismatch between the academic year and the tax year. If the second semester begins in January, tuition amounts are commonly billed during the preceding few months but may not be paid until January.

*Box 3: Change in reporting method.* Occasionally institutions ask and receive permission from the IRS to switch whether they report “tuition billed” or “tuition paid.” Institutions that change their reporting method would check this box in the first year of the change.

*Box 4: Adjustments made for a prior year.* Sometimes the amount that should have been reported in Box 1 or Box 2 changes after the data were collected. This could occur if the student changes the number of credit hours, withdraws, and received a full or partial refund after reporting is complete, or if an error is corrected.

*Box 5: Scholarships or grants.* Schools are required to report scholarships that are “administered and processed” by the school. Different schools may interpret this requirement differently, but it is clear that not all scholarships are being reported on Form 1098-T. For academic year 2011, the College Board reports total grants and scholarships of \$114 billion<sup>10</sup> while the sum of all scholarships reported on all Forms 1098-T for Tax Year 2011 is \$77 billion.

*Box 6: Adjustments to scholarships or grants.* As with the adjustments to Boxes 1 and 2, this box provides an opportunity for corrections due to changed circumstances or error.

*Box 7: Check if tuition reported includes amounts for the next calendar year.* Credits may generally be claimed for payments made in the taxable year for attendance in the taxable year. However, payments made in the taxable year for attendance that begins in the first three months of the following taxable year also qualify for the credit. Checking this box alerts the taxpayer and IRS that reported amounts may reflect amounts billed for attendance in the following year that the taxpayer has not yet paid. Only amounts paid in the current taxable year are eligible for a credit.

*Box 8: At least half-time student check.* Box 8 is checked if the student is enrolled at least half-time for one academic period. Students must be enrolled at least half-time to be eligible for the AOTC. Students who do not have this box checked may still be eligible for the LLC. In 2011, 81 percent of all students with a Form 1098-T were enrolled at least half time.

<sup>10</sup> For the 2011–2012 academic year, the College Board reports a total of \$47.7 billion in Federal grants, \$9.5 billion in State grants, \$42.7 billion in institutional grants and \$14.3 billion in private and employer grants for a total of \$114 billion. Some portion of the institutional grants represents discounted tuition, which is generally excludable and would not be reported in Box 5. <https://trends.collegeboard.org/sites/default/files/student-aid-2013-full-report.pdf>.

*Box 9: Graduate student check.* Box 9 is a check if the student is enrolled as a graduate student. The HTC was limited to the first two years of postsecondary school and therefore excluded graduate students. In contrast, the AOTC is available to students in the first four years of postsecondary school which under unusual circumstances may include graduate students. Students who are in their fifth or later year of postsecondary school may still be eligible for the LLC. In 2011, some 14 percent of all students with a Form 1098-T were enrolled as graduate students.

*Box 10: Contractual reimbursement.* Sometimes students take out insurance against their tuition liability in case illness or other reasons leave them unable to complete the term. Occasionally such insurance would be required by the university for students in an extended payment plan. If there is an insurance payment, it would be reported here. Contractual reimbursements appear on very few forms.

Taxpayers face a complicated problem when they try to match education expenses with grant and tax benefits optimally and compliantly. The next section further describes the limitations of Form 1098-T for guiding taxpayers and as a compliance tool. The suggested changes, described in more detail in the subsequent section, would improve the usefulness to students and to the IRS of the information reported, and thus improve the accuracy of their returns.

## IV. Limitations of Form 1098-T

### *Not All Students Receive a Form 1098-T*

Under current regulations, most—but not all—students receive a Form 1098-T. As a result, outreach and enforcement are more challenging. If all students received a Form 1098-T, IRS would be able to determine the full population of students, and by extension, the nonstudents. Universality would enable all students to receive useful information that could guide them toward the benefits; all students would have the opportunity to be reminded of credit eligibility, and IRS' ability to conduct outreach to those who do not claim a benefit could be increased. In addition, extending the requirement to include all students would enable IRS to move toward denying credits claimed on behalf of individuals who are not truly students. In 2011, of the 12.8 million returns that claimed an AOTC, only 69 percent had a Form 1098-T. Some portion of these claims may represent noncompliant behavior, but without universal reporting and reporting of expenses paid (see below), it is not possible for the IRS to know the degree of noncompliance. Finally, in combination with additional information on full-time status, universality could also be used to improve administration of the dependent exemption and EITC.

### *Expenses Cannot Be Determined Using Form 1098-T*

Tuition paid is often not reported on Form 1098-T. Box 1 reports payments received for qualified tuition and related expenses. In 2011, only 19 percent of Form 1098-T recipients received a form with a positive value in this box.<sup>11</sup> Most institutions report only expenses that are billed in the tax year (Box 2), not that were actually paid in the tax year (Box 1). However, only expenses that are paid in the tax year for which the return is filed are eligible for a tax credit. So, for example, if a student is billed \$10,000 for tuition and fees in December of 2013 for a semester that begins in January of 2014, then the student's Form 1098-T for Tax Year 2013 from that school would report \$10,000 for the amount billed in Box 2. If the student (or someone acting on the student's behalf) pays the bill in December of 2013, the student would have \$10,000 of qualifying expenses for the education credits for Tax Year 2013 (all else equal). If instead, the student pays her bill in January of 2014, the Tax Year 2013 Form 1098-T would still report \$10,000 as billed in 2013 but because the bill was not paid in 2013, none of the \$10,000 would qualify for a 2013 education tax credit. Further, the \$10,000 amount (paid in January 2014) would not be reported on a Tax Year 2014 Form 1098-T even though (all else equal) it would be a qualifying expense for a 2014 education tax credit. As a result, most students cannot use the tuition information reported on their Form 1098-T to calculate eligible expenses for purposes of claiming a credit without verifying that they actually paid those expenses in the same year as the report.

### *Book Expenses Are Not Reported on Form 1098-T*

Fees for books and similar course materials that are required to be purchased from the institution before a student is allowed to enroll or attend class are qualifying expenses for both the AOTC and LLC. This narrow class of expenses is generally included in Box 1 or Box 2 on Form 1098-T. In contrast, expenses for course materials that are required for

<sup>11</sup> Five percent of Forms 1098-T report positive amounts for neither tuition paid nor tuition billed in that year.

enrollment or attendance but are not part of fees paid to the institution are qualifying expenses for the AOTC but are not qualifying expenses for the LLC. The amounts spent on this latter type of course materials are most likely unknown to the institution, and therefore cannot be reported by the institution on Form 1098-T. As a result, these AOTC-eligible expenses must be reported by the taxpayer and taxpayers need to keep their own records of these expenses.

### ***Not All Scholarships Are Reported on Form 1098-T***

Scholarships that are “administered and processed” by the institution are reported on Box 5 of Form 1098-T. Different institutions may have different interpretations of what it means to “administer and process” a scholarship.<sup>12</sup> For example, an institution might verify a student’s enrollment status for the purpose of qualifying for a scholarship but never handle the check. Does that qualify as being processed by the school? Differing interpretations of “administered and processed” could lead to inconsistent reporting of scholarships.

However, even if the regulations were clarified so that all schools had the same understanding of their reporting obligations for scholarships, reporting would still be incomplete because institutions are not aware of all scholarships received, since some scholarships are paid directly to the student, and are not handled by the school at all. There is no third-party reporting requirement on these amounts even though some of the scholarship amounts should be included in taxable income. Full reporting of scholarships would improve IRS’s ability to guide taxpayers to the optimal decision regarding whether to exclude scholarship funds from income or not, and if so, how much to exclude. Full reporting of scholarships would also help ensure that amounts that should be included in income actually were included in income.

Table 4 reports the growth of grant dollars by source, as reported by the College Board. These are the best estimates available of the total value of grants distributed each year. As shown in Table 4 and stated above, for academic year 2011-2012, the College Board reported over \$114 billion in scholarships and grants. In contrast, \$77 billion of scholarships were reported in Box 5 of Form 1098-T. Even allowing for differences between academic and tax years and that some share of the institutional grants would not be reported on Form 1098-T, it is clear that some share of scholarship income is not reported.

**TABLE 4. Growth of Federal, Institutional, Private and Employer, and State Educational Grant Dollars, Academic Years 2007–2008 to 2012–2013**

Academic Year	State Grants (\$ Billions)	Private and Employer Grants (\$ Billions)	Institutional Grants (\$ Billions)	Federal Grants (\$ Billions)	Total Grants (\$ Billions)
2007–2008	\$8.8	\$12.7	\$30.9	\$23.3	\$ 75.7
2008–2009	\$8.7	\$13.0	\$32.3	\$26.7	\$ 80.7
2009–2010	\$9.5	\$13.2	\$37.1	\$44.6	\$104.4
2010–2011	\$9.6	\$14.0	\$40.6	\$52.4	\$116.6
2011–2012	\$9.5	\$14.3	\$42.7	\$47.7	\$114.2
2012–2013	\$9.7	\$14.6	\$44.4	\$47.0	\$115.7

NOTE: This table was prepared by College Board in October 2013. All figures are in 2012 dollars. <http://trends.collegeboard.org/student-aid/figures-tables/grants#Types of Grants>.

### ***Full-Time Status is Not Reported on Form 1098-T***

As stated above, taxpayers with a full-time dependent student may qualify for an additional five years of child-related tax benefits. Taxpayers with a dependent under age 24 who attends school full time<sup>13</sup> may claim the student as a qualifying child for the purpose of filing as head of household or receiving the EITC or the dependent exemption. Although Form 1098-T is the only third-party report of student status received by IRS, reporting does not distinguish between half-time students and full-time students and is therefore of limited value toward informing families of their eligibility or identifying noncompliant taxpayers for purposes of administering these benefits.

<sup>12</sup> In a November 2013 Advisory Report, the National Association of College and University Business Officers (NACUBO) reported that since the Form 1098-T regulations were finalized in 2002, “considerable variation has crept into the community’s shared understanding of what needs to be reported on Form 1098-T.”

<sup>13</sup> Full time for purposes of claiming a dependent child is defined in the statute as attending full time during each of five calendar months during the tax year.



## V. Evidence of Problems Created by 1098-T Limitations

Table 5 shows student and family characteristics for i) nondependent returns that claim an education credit or deduction (where the student may be the taxpayer or the taxpayer's dependent) by whether or not they received a Form 1098-T, and ii) nondependent returns that did not claim an education credit or deduction even though either the taxpayer or a dependent claimed by the taxpayer received a Form 1098-T. The student in the table may be either the taxpayer or a claimed dependent of the taxpayer. The results presented are for Tax Years 2010 and 2011 combined, and are restricted to returns with AGI that would not disqualify them for an education credit or deduction.<sup>14</sup>

As indicated earlier, 26 percent of returns claiming an education benefit did not receive a Form 1098-T over the two years in the table. Just as striking, 37 percent of returns that receive a Form 1098-T (and that are below the income limits for an education benefit) did not claim a benefit over the two years in the table.

Table 5 shows that returns claiming an education benefit without the presence of a Form 1098-T are substantially less likely to be claiming the benefit for a dependent student. Only 23 percent of the students on these returns are dependents, compared to about half the students who receive a Form 1098-T. Returns that claim benefits without a Form 1098-T also have relatively lower income (\$33,610) than returns that claim benefits with a Form 1098-T (\$53,136). In part, this may be because these returns are less likely to have two earners; only 24 percent of returns without a Form 1098-T file jointly compared to 50 percent of returns with a Form 1098-T.

Table 5 also shows that returns that receive a Form 1098-T but do not claim an education benefit have relatively older students and less income than returns that receive a Form 1098-T and claim an education benefit. The average age of the student (who about half the time is the taxpayer and about half the time is a dependent of the taxpayer) is 38 for taxpayers who do not claim a benefit and 27 for taxpayers who do claim a benefit. This suggests that at least some of the students who do not claim an education benefit may be eligible only for the LLC or tuition deduction, both of which are available to older students but neither of which benefit taxpayers without a tax liability. The AOTC, in contrast, is partially refundable, but since it is available only for four years, generally benefits just younger students.

**TABLE 5. Student and Return Characteristics for Income-Eligible Returns by Presence of Form 1098-T and Presence of an Education Benefit in Tax Years 2010 and 2011**

Student and Return Characteristics	With AOTC, LLC or TD		Without AOTC, LLC or TD
	Without 1098-T	With 1098-T	With 1098-T
Student Characteristics			
Age	34	27	38
Share that are male	48%	41%	52%
Share that are dependent	23%	48%	51%
Return Characteristics			
Average AGI	\$33,610	\$53,136	\$39,625
Share with paid tax preparation	54%	52%	53%
Share with joint filing status	24%	50%	44%
Average balance due (refund)	(\$3,651)	(\$3,172)	(\$2,866)
Number of returns (millions)	8.9	25.5	15.1
Share of all returns with 1098-T	N/A	63%	37%
Share of all returns w/ AOTC, LLC or TD	26%	74%	N/A

NOTE: The first two columns include all returns with credits or deduction, regardless of income. The third column excludes returns with incomes in excess of the income limits for the tuition deduction. All amounts are in 2011 dollars. The table presents averages for Tax Years 2010 and 2011 returns with claims and/or Forms 1098-T.

<sup>14</sup> The tuition deduction had the highest phaseout limits in 2011 so Table 5 is restricted to AGI less than the limits for the tuition deduction by filing status (\$130,000 for joint filers and \$65,000 for other filers).

Table 6 shows the type of tax benefit claimed and the percent of claimants with a Form 1098-T from Tax Years 2009 to 2011. The portion of returns that claim a HTC or AOTC without Form 1098-T ranges from a low of 69 percent in 2011 to a high of 78 percent in 2009.<sup>15</sup> The share of returns claiming a LLC ranges from 81 to 82 percent and the share of returns claiming a tuition and fees deduction without a Form 1098-T ranges from 82 percent to 83 percent. This table suggests that there needs to be further investigation into why the percentage of students claiming benefits without a Form 1098-T has fluctuated and why it varies between the AOTC and LLC. It may simply be that AOTC claimants (who are generally lower income) are more likely to receive scholarships that are in excess of tuition and required fees. Schools are not required to file a Form 1098-T for full-scholarship students even though they may have other expenses (e.g., books) that would still qualify them for an AOTC. Pell grant payments in particular were growing between 2009 and 2011. Alternatively, the lack of a Form 1098-T may be evidence of noncompliance. Better reporting would improve tax administration by allowing the IRS to differentiate between the two groups.

**TABLE 6. Education Tax Benefits and Presence of Form 1098-T, Tax Years 2009–2011**

Tax Benefit and Presence of Form 1098	Tax Year		
	2009	2010	2011
Hope/American Opportunity Tax Credit			
Number of Returns with a Credit (millions)	9.5	12.3	12.8
Share with a Form 1098-T	78%	73%	69%
Lifetime Learning Tax Credit			
Number of Returns with a Credit (millions)	3.3	2.7	2.8
Share with a Form 1098-T	81%	81%	82%
Tuition and Fees Deduction			
Number of Returns with a Deduction (millions)	2.5	1.9	2.0
Share with a Form 1098-T	82%	83%	83%

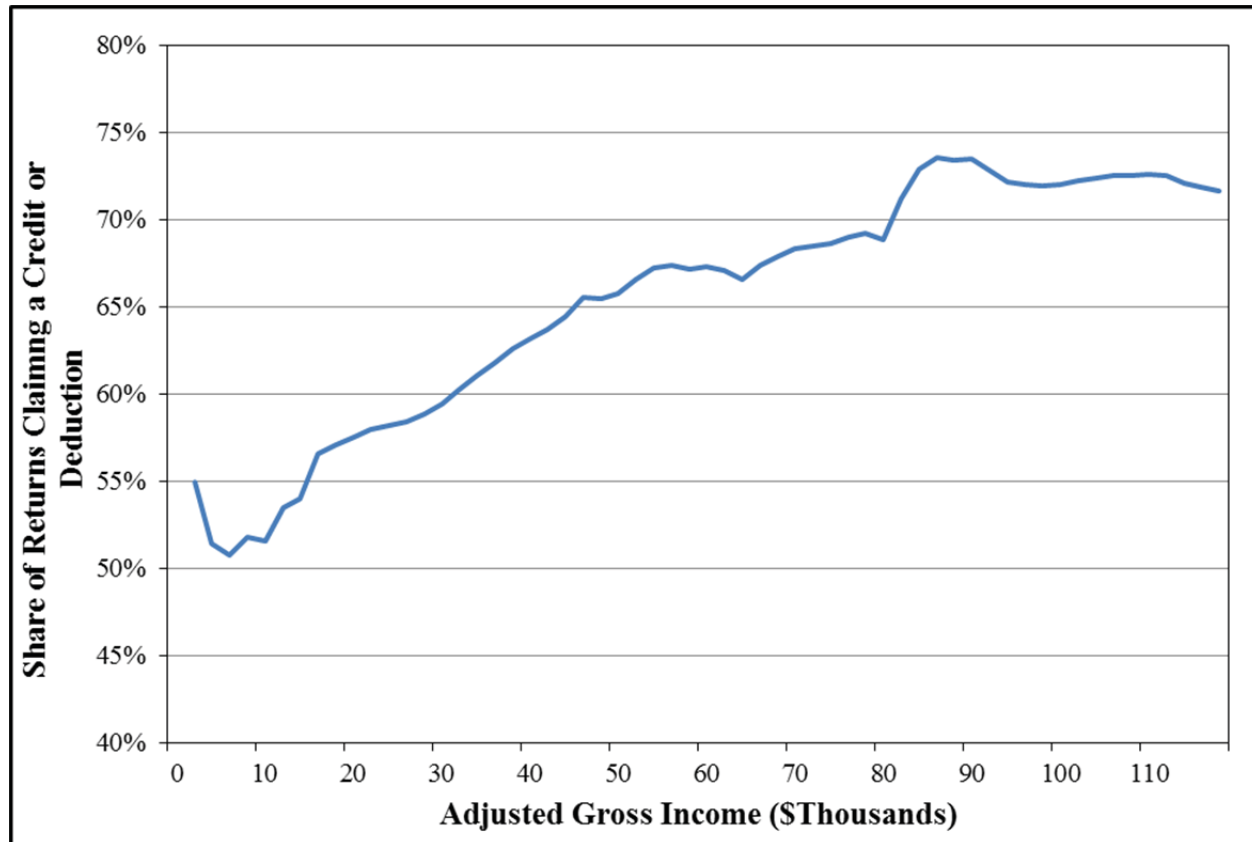
There is also evidence that currently many taxpayers are not aware that they could benefit (could lower their overall tax liability or increase the amount of their tax refund) by including some of their scholarships in income. Figure 2 shows that take-up of education credits and the tuition deduction was lower for low-income students than for middle and higher income students. For all returns with an associated Form 1098-T and income within the claiming range of the tuition deduction by filing status, this figure shows the share of returns by AGI that have an education credit or deduction claimed. After a brief dip between zero and \$5,000, we see a fairly steady increase in take-up rates as income increases. At incomes of \$30,000, the take-up rate is 59 percent. By \$82,000, take-up rates exceed 70 percent. Some of the variation in take-up by income is due to the fact that low-income families generally benefit only from refundable credits like the AOTC, whereas middle and higher income families may benefit from nonrefundable credits, like the LLC or tuition deduction. So students from low-income families who attend school parttime or who are in the 5<sup>th</sup> or more year of schooling may not qualify for any education benefit. The low take-up for low income families may also be the result of low-income families not optimizing the allocation of need-based grants (like Pell grants) between expenses that qualify for the AOTC and those that do not. Some families will be better off including Pell grants in income and claiming an AOTC, but this may not be well understood.<sup>16</sup>

The data presented in this section suggests that there is probably some noncompliance, and some students who are not making the right choices. However, for any given student's data (or tax return) it cannot be known with certainty whether the student is optimizing and compliant, or not. Students may be responding to information that is not available to IRS.

<sup>15</sup> Although for most students AOTC benefits exceeded HTC benefits at all levels of income in 2009, a few students still claimed a Hope credit that year because they were receiving an enhanced Hope credit as part of the Heartland Disaster Tax Relief Act of 2008.

<sup>16</sup> For more information on the interaction between Pell grants and education credits, including examples, see <http://www.treasury.gov/connect/blog/Documents/Pell%20AOTC%204%20pager.pdf>.

**FIGURE 2. Share of Tax Returns with an Associated Form 1098-T Claiming an Education Credit or Deduction, Tax Years 2010 and 2011 Combined**



## VI. Improving Education Reporting on Form 1098-T

This section begins with a discussion of some straightforward changes that would allow Form 1098-T to be aligned more closely with IRS' needs for enforcement and outreach, and taxpayers' needs for clarity and simplicity. It continues by presenting a revised worksheet for Form 8863 and concludes with a suggested set of questions for a revised Form 1098-T. Two of the changes discussed (eliminating the option of reporting tuition billed instead of tuition paid, and extending the Form 1098-T filing requirement to include scholarships not administered by the schools) are included among the Administration's tax proposals for Fiscal Year 2016.<sup>17</sup> Eliminating the option of reporting tuition billed is also included among the reforms to tax administration proposed by the Senate Finance Committee in November 2013.<sup>18</sup>

### *Expand and Clarify Reporting*

*Problem 1: Not all students receive a Form 1098-T.* Changes to existing requirements could make receipt of a Form 1098-T nearly universal. As stated earlier, universal reporting is of benefit to students and the IRS.

The following groups of students should receive a Form 1098-T, but currently do not. Extending the requirements to these students would make the Form 1098-T nearly universal without introducing additional forms of noncompliance.

**Students who begin study in January to March and prepay expenses:** All else equal, institutions are required to report only for students who are enrolled for an academic period beginning during the relevant tax year (or enrolled for an academic period in a prior calendar year who have a reportable transaction—e.g., a refund). So students who begin their studies in January and prepay in December will not receive a Form 1098-T for the December expenses.

<sup>17</sup> Fiscal Year 2016 Greenbook (February 2015).

<sup>18</sup> Tax Administration Reform Staff Discussion Draft Legislative Language (November 2013).

*Students whose tuition is less than or equal to scholarships administered and processed by the school (i.e., Full Scholarship Students):* These students may still have eligible expenses for the education credits. For example, if a student has \$5,000 of tuition, \$6,000 of living expenses and receives a \$5,000 unrestricted scholarship that is paid directly to the school, the school may choose to retain the scholarship to pay tuition.<sup>19</sup> The student, therefore, may not receive a Form 1098-T. Students like this one could interpret the absence of a tuition report as the absence of qualifying expenses or eligibility, and thus fail to claim a credit. However, allocating some scholarship income to taxable expenses allows an education credit to be claimed by this student. Since both tuition and scholarship amounts are reported on Form 1098-T, requiring that Form 1098-T be filed for these students need not induce improper claims, but could encourage more students to claim benefits to which they are entitled.

*Students in formal billing arrangements:* Although these students may have zero tuition due from them to the school, the student may have credit-eligible expenses. Again, the absence of a tuition report may be interpreted as the absence of eligibility. A report of zero tuition along with an added checkbox to identify those who are enrolled but in formal billing arrangements (and thus, have not paid tuition) would allow these students to receive a Form 1098-T without implying that they have tuition available against which to claim an education benefit.

*American students abroad:* Many students studying abroad for U.S. college credit, or who are attending foreign institutions, do not receive a Form 1098-T, even when enrolled at institutions that face a reporting requirement. To ensure that those enrolled abroad receive the form, foreign schools could be asked to comply with existing law as part of continued access to Title IV benefits for their students. To insure that those on exchange receive the Form 1098-T, organizations that provide study abroad opportunities could be required to cooperate with the student's home institutions to insure that the home institutions could calculate qualifying expenses and provide an accurate Form 1098-T.

*Problem 2: Expenses cannot be determined using Form 1098-T.* As stated above, the information on Form 1098-T does not suffice for taxpayers or the IRS to calculate actual expenses. The following changes would improve the reporting of expenses, although they would not achieve the reporting of all expenses.

*Report actual paid tuition (eliminate box 2):* Under current law, institutions have the option of reporting "tuition and related expenses billed" or "tuition and related expenses paid" on Form 1098-T. A redesigned form would remove this choice and require that the schools report "tuition paid." The amount paid would be the gross amount paid to the school from most sources (thus before considering scholarships, gifts paid directly to the school by a relative and other similar amounts, but after considering any amounts not charged to the student) for qualified education expenses. "Tuition and related expenses paid" is much closer to the definition of education expense that is required for claiming a credit, and is therefore the information actually useful to IRS and taxpayers. The FY 2016 Budget includes a proposal to eliminate Box 2 and require all schools to provide total tuition and required fees paid in Box 1 of Form 1098-T.

*Improve reporting of other expenses:* Expenses reported on Form 1098-T will always fail to capture all qualifying expenses for the AOTC, even if reporting were perfectly accurate. That is because some qualifying expenses are not known by the schools and therefore cannot be reported by the schools. A university can never know if a student bought, borrowed, or ignored any text book on a class syllabus, or how much the student spends on other qualifying supplies. These expenses are self-reported on Form 8863 by the student or taxpayer. Two options could improve accountability:

- i) All schools could be asked to provide the student with the Form 1098-T estimates of living expenses and supplies that the school uses as part of creating their "cost of attendance." This is a calculation all Title IV schools compute and provide to the Department of Education as a requirement of program participation. These estimates could guide taxpayers to a proper allocation of expenses across benefits received. Taxpayers would be encouraged to save evidence of actual expenses, and reminded that the information provided are estimates that would vary with intensity of study and other personal characteristics, and that the credits are based on actual expenses.

<sup>19</sup> This strategy makes it easier for the school to recapture funds should the student withdraw or otherwise fail to enroll (the school may be responsible for the repayment) and insure that tuition is paid in a timely fashion.

- ii) Alternatively, expenses for supplies not paid to and reported by the school could be capped at a relatively modest amount. The risk of this option is that some taxpayers may view the cap as a ceiling below which claims would not be challenged, which could lead to improper claims.<sup>20</sup>

*Problem 3: Scholarship reporting is incomplete and rules are not precise:* Two related changes could result in nearly universal reporting of scholarship income. Universal reporting would allow both IRS and taxpayers to determine the right allocation of scholarship income between taxable and nontaxable expenses. First, regulations could define “administered and processed” to mean all scholarships that are paid to the student via the school. All institutions would follow the same rules and report the same way for all students. Well-established rules regarding school processing could ensure that all of this income (even if excluded) is reported on Form 1098-T. Second, Form 1098-T reporting requirements should be extended to include *all organizations* that provide scholarships in excess of \$500 that are provided directly to the student, and thus not administered or processed by the school. Therefore, students might receive more than one Form 1098-T.<sup>21</sup> This requirement increases burden to organizations that currently have no information reporting requirement, but without this reporting, taxpayers may treat at least some of these funds as excluded income, even if it is not to their advantage to do so, and perhaps when they should not treat the funds this way. Evidence from IRS compliance studies shows that compliance is higher when income is subject to information reporting.<sup>22</sup> Clear definitions and increased reporting would mean that a student (or the IRS) could sum all Box 5s across all Forms 1098-T received, add in any small scholarships below the reporting threshold, and know exactly how much scholarship income was received relative to tuition and other expenses. The FY 2016 Budget includes a proposal to increase the requirements for the reporting of scholarships so that nearly all are reported on a Form 1098-T.

*Problem 4: Cannot identify full-time students:* Under current law, taxpayers are eligible for certain child-related benefits for dependents who are full-time students. Form 1098-T identifies those students who are at least half-time (the definition needed for the credits) but does not identify students who are fulltime. Form 1098-T could be augmented to make the contents of the form match the requirements of the key child-related provisions by requiring that institutions report the number of months that a student is enrolled for at least one day as a full-time student (as defined by the school).<sup>23</sup> Take-up of these benefits by taxpayers who are eligible could be improved since they would have confirmation that their child was a qualifying child. Compliance could be improved because it would allow the IRS to question the dependency exemption (and EITC) for students without the requisite number of months of full-time attendance.

## ***A Redesigned Form***

Figure 3 presents an example of the information that could replace the current content of Form 1098-T. The changes include eliminating the old Box 2, adding check boxes to identify formal billing arrangements and donors of scholarships, and more information about full-time status to assist in identifying those eligible for the AOTC and those meeting the definition of a student for purposes of the child-related benefits. The presentation in Figure 3 is consistent with the expansions and clarifications presented in the first part of this section, and it supports the simplified worksheet in the next section.

<sup>20</sup> Evidence from the literature on noncash charitable contributions suggests this is a valid concern. See Ackerman and Auten (2006) for figures that show spikes in giving at levels just below amounts required to be independently reported by donees.

<sup>21</sup> Form 1098-T is already used for reporting payments by tuition insurance providers.

<sup>22</sup> See U.S. Internal Revenue Service, 2012, *Tax Gap for Tax Year 2006: Overview*.

<sup>23</sup> According to the regulations for Section 151 a full-time student is one who is enrolled “for the number of hours or courses which is considered to be full-time attendance” by the program in which the student is enrolled, in accordance with Department of Education guidelines.



**FIGURE 3. Suggested Questions on a Redesigned 1098-T**

Content Questions on Revised Form 1098-T	
<b>1A</b>	Payments received
	\$
<b>1B</b>	Adjustments to payments received made for a prior year
	\$
<b>1C</b>	Check if student's fees were part of formal billing arrangement (see instructions) <input type="checkbox"/>
<b>1D</b>	Check if the amount in box 1 includes amounts for January-March of following year <input type="checkbox"/>
<b>2A</b>	Scholarships or grants
	\$
<b>2B</b>	Adjustments to scholarships or grants made for a prior year
	\$
<b>2C</b>	Check if issuer is provider of scholarship or grant not processed by the education institution the student attends... <input type="checkbox"/>
<b>3A</b>	Check if student was at least halftime... <input type="checkbox"/>
<b>3B</b>	Number of months of full-time enrollment
<b>4A</b>	Check if enrolled in a degree or certificate program... <input type="checkbox"/>
<b>4B</b>	Check if graduate student for entire period... <input type="checkbox"/>
<b>5</b>	Insurance contract reimbursement/refund
	\$

### ***A Redesigned Worksheet for Form 8863***

Form 8863 is the form taxpayers use to claim education credits. It is attached to Form 1040 or Form 1040A and is filed with the IRS by the taxpayer. (See a copy of the Form in the appendix.) Parts I and II calculate the value of the education credits available to the taxpayer (refundable and nonrefundable portions are computed separately). Part III is filled out for each student the taxpayer may claim; it helps the taxpayer determine eligibility for each of the two credits, and then, subject to expenses, calculates the tentative credit for each eligible student. If a student qualifies for both credits, the AOTC will be the more valuable. It is a complicated form for taxpayers.

Receipt of a Form 1098-T tells taxpayers of their potential eligibility for an education credit. Ideally, the form would be received by all potentially eligible taxpayers and it would contain all the information needed to answer the questions on Form 8863 that confirm eligibility. An improved form would also provide the data needed to calculate "adjusted qualified education expenses" (line 27 or line 31 of Part III of the 8863).

If all students received a Form 1098-T, line 22 of Part III could be reduced from five subparts to a single line requiring students to fill in the EIN of the institution. Likewise, line 24, which asks about eligibility for the AOTC, could be simplified. Currently, it is long and potentially confusing:

Line 24 of the current 8863:

*Was the student enrolled at least half-time for at least one academic period that began in 2013 at an eligible educational institution in a program leading towards a postsecondary degree, certificate, or other recognized postsecondary education credential? (see instructions)*

If all students received a Form 1098-T and schools were asked to report more detail on the characteristics of a student's enrollment, this question could be replaced with:

Improved Line 24

*Is Box 3A checked?*

*Is Box 4A checked?*

If all students received a Form 1098-T and all schools reported payments received for qualified tuition and related fees, then students would have all the information needed to determine the maximum qualifying education expenses for the LLC and almost all the information needed to determine the maximum qualifying education expenses for the AOTC. For the AOTC, students would still need to provide information on books and other class materials not purchased from and reported by the school.

If, in addition, all scholarships received by students were reported on Form 1098-Ts, then the IRS could guide taxpayers to the compliant and optimal tax benefit. Such a worksheet for the AOTC might look like that in Figure 4.

**FIGURE 4. Example of a Worksheet for Expenses Qualifying for AOTC**

Qualifying Expenses Worksheet		
<b>Complete the qualifying expenses worksheet to determine your qualifying education expenses and the amount of qualifying education expenses you should claim.</b>		
<b>Line 1</b>	Payments for qualified tuition and fees	1. <Box 1 of 1098T>
<b>Line 2</b>	Expenses for course related materials	2. <provided by taxpayer>
<b>Line 3</b>	Payments for qualified tuition and related expenses before scholarships	3. <Add lines 1 and 2>
<b>Line 4</b>	Scholarships	4. <Box 2A of 1098T>
<b>Line 6</b>	Payments for qualified tuition and related expenses net of scholarships	6. <Line 3 minus Line 4>
<b>Line 7</b>	Check only one box:	
	a. Line 6 is greater than or equal to \$4,000, STOP Enter \$4,000 on line 27 of Form 8863. Do not include any scholarships in the student's gross income.	<input type="checkbox"/>
	b. Line 6 is less than \$4,000 and line 4 is zero STOP Enter line 6 on line 27 of Form 8863	<input type="checkbox"/>
	c. Line 6 is less than \$4,000 and line 4 is not zero STOP You may benefit from including some of the student's scholarships in the student's gross income. See instructions.	<input type="checkbox"/>

For students whose qualified tuition and related expenses exceeded their scholarships by \$4,000 (Box 7a checked) and for those without scholarships (Box 7b checked), the worksheet would tell them the level of expenses to enter on Form 8863. Just as importantly, the form would also tell certain students (Box 7c checked) that they might benefit from including their scholarships in income in order to qualify for a larger AOTC.<sup>24</sup> The instructions could be used to further guide taxpayers toward choosing the optimal amount of scholarship to include in income but optimizing might require multiple calculations of liability on the part of the taxpayer. Still, the worksheet in Figure 4 would go a long way toward narrowing down the number of taxpayers who would need to make those calculations and helping taxpayers make an optimal choice. Better guidance here could help ensure that low income students with scholarships are receiving the AOTC or LLC to which they are entitled.

## VII. Conclusions

Form 1098-T is an important resource for administering education-related tax provisions. It provides the IRS with the main third-party information about student status, student expenses, and scholarship income, and it helps some students claim education tax credits. However, it could do more. As discussed in the paper, it could be used to improve take-up of the tax credits. It could be used to guide taxpayers to the optimal tax benefit for their situation. And it could be used to ensure program integrity, to make sure that the education tax benefits are limited to those for whom the credits were intended. We proposed three main changes to advance these goals: 1) universal reporting on all students; 2) reporting of tuition and related expense paid, not just those that are billed; and 3) reporting of all scholarships or grants received. These three improvements would enable the IRS to offer the necessary outreach and guidance to students and their families as well as put in place effective compliance capabilities.

<sup>24</sup> See footnote 16.

### Appendix: Form 8863

Form **8863**

### Education Credits (American Opportunity and Lifetime Learning Credits)

OMB No. 1545-0074

Department of the Treasury  
Internal Revenue Service (99)

▶ Attach to Form 1040 or Form 1040A.  
▶ Information about Form 8863 and its separate instructions is at [www.irs.gov/form8863](http://www.irs.gov/form8863).

**2014**  
Attachment  
Sequence No. **50**

Name(s) shown on return

Your social security number



Complete a separate Part III on page 2 for each student for whom you are claiming either credit before you complete Parts I and II.

#### Part I Refundable American Opportunity Credit

1	After completing Part III for each student, enter the total of all amounts from all Parts III, line 30 . . . . .	1	
2	Enter: \$180,000 if married filing jointly; \$90,000 if single, head of household, or qualifying widow(er) . . . . .	2	
3	Enter the amount from Form 1040, line 38, or Form 1040A, line 22. 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 . . . . .	3	
4	Subtract line 3 from line 2. If zero or less, <b>stop</b> ; you cannot take any education credit . . . . .	4	
5	Enter: \$20,000 if married filing jointly; \$10,000 if single, head of household, or qualifying widow(er) . . . . .	5	
6	If line 4 is: • Equal to or more than line 5, enter 1.000 on line 6 . . . . . • Less than line 5, divide line 4 by line 5. Enter the result as a decimal (rounded to at least three places) . . . . .	6	
7	Multiply line 1 by line 6. <b>Caution:</b> If you were under age 24 at the end of the year <b>and</b> meet the conditions described in the instructions, you <b>cannot</b> take the refundable American opportunity credit; skip line 8, enter the amount from line 7 on line 9, and check this box . . . . . ▶ <input type="checkbox"/>	7	
8	<b>Refundable American opportunity credit.</b> Multiply line 7 by 40% (.40). Enter the amount here and on Form 1040, line 68, or Form 1040A, line 44. Then go to line 9 below. . . . .	8	

#### Part II Nonrefundable Education Credits

9	Subtract line 8 from line 7. Enter here and on line 2 of the Credit Limit Worksheet (see instructions)	9	
10	After completing Part III for each student, enter the total of all amounts from all Parts III, line 31. If zero, skip lines 11 through 17, enter -0- on line 18, and go to line 19 . . . . .	10	
11	Enter the smaller of line 10 or \$10,000 . . . . .	11	
12	Multiply line 11 by 20% (.20) . . . . .	12	
13	Enter: \$128,000 if married filing jointly; \$64,000 if single, head of household, or qualifying widow(er) . . . . .	13	
14	Enter the amount from Form 1040, line 38, or Form 1040A, line 22. 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 . . . . .	14	
15	Subtract line 14 from line 13. If zero or less, skip lines 16 and 17, enter -0- on line 18, and go to line 19 . . . . .	15	
16	Enter: \$20,000 if married filing jointly; \$10,000 if single, head of household, or qualifying widow(er) . . . . .	16	
17	If line 15 is: • Equal to or more than line 16, enter 1.000 on line 17 and go to line 18 • Less than line 16, divide line 15 by line 16. Enter the result as a decimal (rounded to at least three places) . . . . .	17	
18	Multiply line 12 by line 17. Enter here and on line 1 of the Credit Limit Worksheet (see instructions) ▶	18	
19	<b>Nonrefundable education credits.</b> Enter the amount from line 7 of the Credit Limit Worksheet (see instructions) here and on Form 1040, line 50, or Form 1040A, line 33 . . . . .	19	

For Paperwork Reduction Act Notice, see your tax return instructions.

Cat. No. 25379M

Form **8863** (2014)

**APPENDIX: Form 8863 Continued**

Form 8863 (2014)

Page **2**

Name(s) shown on return

Your social security number



**Complete Part III for each student for whom you are claiming either the American opportunity credit or lifetime learning credit. Use additional copies of Page 2 as needed for each student.**

**Part III Student and Educational Institution Information**

See instructions.

<p><b>20</b> Student name (as shown on page 1 of your tax return)</p>	<p><b>21</b> Student social security number (as shown on page 1 of your tax return)</p>
<p><b>22</b> Educational institution information (see instructions)</p>	
<p><b>a.</b> Name of first educational institution</p>	<p><b>b.</b> Name of second educational institution (if any)</p>
<p><b>(1)</b> Address. Number and street (or P.O. box). City, town or post office, state, and ZIP code. If a foreign address, see instructions.</p>	<p><b>(1)</b> Address. Number and street (or P.O. box). City, town or post office, state, and ZIP code. If a foreign address, see instructions.</p>
<p><b>(2)</b> Did the student receive Form 1098-T from this institution for 2014? <input type="checkbox"/> Yes <input type="checkbox"/> No</p>	<p><b>(2)</b> Did the student receive Form 1098-T from this institution for 2014? <input type="checkbox"/> Yes <input type="checkbox"/> No</p>
<p><b>(3)</b> Did the student receive Form 1098-T from this institution for 2013 with Box 2 filled in and Box 7 checked? <input type="checkbox"/> Yes <input type="checkbox"/> No</p>	<p><b>(3)</b> Did the student receive Form 1098-T from this institution for 2013 with Box 2 filled in and Box 7 checked? <input type="checkbox"/> Yes <input type="checkbox"/> No</p>
<p>If you checked "No" in <b>both (2) and (3)</b>, skip <b>(4)</b>.</p> <p><b>(4)</b> If you checked "Yes" in <b>(2) or (3)</b>, enter the institution's federal identification number (from Form 1098-T).                  _____</p>	<p>If you checked "No" in <b>both (2) and (3)</b>, skip <b>(4)</b>.</p> <p><b>(4)</b> If you checked "Yes" in <b>(2) or (3)</b>, enter the institution's federal identification number (from Form 1098-T).                  _____</p>
<p><b>23</b> Has the Hope Scholarship Credit or American opportunity credit been claimed for this student for any 4 tax years before 2014? <input type="checkbox"/> Yes — <b>Stop!</b> Go to line 31 for this student. <input type="checkbox"/> No — Go to line 24.</p>	
<p><b>24</b> Was the student enrolled at least half-time for at least one academic period that began or is treated as having begun in 2014 at an eligible educational institution in a program leading towards a postsecondary degree, certificate, or other recognized postsecondary educational credential? (see instructions) <input type="checkbox"/> Yes — Go to line 25. <input type="checkbox"/> No — <b>Stop!</b> Go to line 31 for this student.</p>	
<p><b>25</b> Did the student complete the first 4 years of post-secondary education before 2014? <input type="checkbox"/> Yes — <b>Stop!</b> Go to line 31 for this student. <input type="checkbox"/> No — Go to line 26.</p>	
<p><b>26</b> Was the student convicted, before the end of 2014, of a felony for possession or distribution of a controlled substance? <input type="checkbox"/> Yes — <b>Stop!</b> Go to line 31 for this student. <input type="checkbox"/> No — Complete lines 27 through 30 for this student.</p>	



**You cannot take the American opportunity credit and the lifetime learning credit for the same student in the same year. If you complete lines 27 through 30 for this student, do not complete line 31.**

**American Opportunity Credit**

<b>27</b> Adjusted qualified education expenses (see instructions). <b>Do not enter more than \$4,000</b> . . . . .	<b>27</b>	
<b>28</b> Subtract \$2,000 from line 27. If zero or less, enter -0- . . . . .	<b>28</b>	
<b>29</b> Multiply line 28 by 25% (.25) . . . . .	<b>29</b>	
<b>30</b> If line 28 is zero, enter the amount from line 27. Otherwise, add \$2,000 to the amount on line 29 and enter the result. Skip line 31. Include the total of all amounts from all Parts III, line 30 on Part I, line 1 . . . . .	<b>30</b>	

**Lifetime Learning Credit**

<b>31</b> Adjusted qualified education expenses (see instructions). Include the total of all amounts from all Parts III, line 31, on Part II, line 10 . . . . .	<b>31</b>	
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