

**Internal Revenue Service**

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:  
CC:DOM:IT&A:1/PLR-118235-98  
Date:  
January 28, 1999

In Re:

Legend

Taxpayer =

Corporation =

Trust =

State =

Applicable  
Federal Law =

\$X =

Dear

This responds to a letter dated September 18, 1998, and subsequent correspondence dated January 15, 1999, requesting rulings on whether distributions made by Trust to an educational institution for educational expenses of Taxpayer may be used to compute the Hope Scholarship Credit or the Lifetime Learning Credit under § 25A of the Internal Revenue Code. The

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letter also requests rulings on (1) whether the rules of Subchapter J of the Code would be applied in determining the extent to which a particular distribution by Trust is includable in Taxpayer's gross income, and (2) the effect this ruling will have on a previously issued letter ruling, PLR 9628009 (April 11, 1996).

## **FACTS**

Taxpayer makes the following representations. Pursuant to Applicable Federal Law, Corporation established Trust. Trust is a trust created under the laws of State and is a settlement trust under Applicable Federal Law. Trust is intended to be an entity independent of the Corporation and the Trust's beneficiaries. Trust's purpose is to provide educational benefits on the basis of merit to those beneficiaries who qualify. Corporation has transferred \$X to Trust to provide for educational benefits. It is the policy of Trust to make distributions directly to an educational institution rather than to an individual beneficiary. Taxpayer is a shareholder of Corporation and a beneficiary of Trust. Taxpayer is not claimed as a dependent by another taxpayer.

## **LAW AND ANALYSIS**

Section 25A of the Code provides for the allowance of a Hope Scholarship Credit and a Lifetime Learning Credit. If certain eligibility requirements are met, § 25A(b) provides for a maximum Hope Scholarship Credit of \$1,500 for taxable years beginning before 2002. The Hope Scholarship credit is equal to 100 percent of the first \$1,000 of the qualified tuition and related expenses paid during the taxable year (for education furnished to each eligible student during any academic period beginning in such taxable year), plus 50 percent of the next \$1,000 of such expenses paid with respect to that student.

Provided certain eligibility requirements are met, § 25A(c) provides for a maximum Lifetime Learning Credit equal to 20 percent of so much of the qualified tuition and related expenses paid during the taxable year (for education furnished at an eligible educational institution during any academic period beginning in such taxable year) as does not exceed \$5,000 (\$10,000 in taxable years beginning after December 31, 2002).

The Hope Scholarship Credit is allowable only with respect to expenses paid after December 31, 1997, for education furnished in academic periods beginning after such date. See § 201(f)(1) of the Taxpayer Relief Act of 1997, Pub. L. No.105-34, 111 Stat. 788, 806 (1997)(the Act). The Lifetime Learning

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Credit is allowable with respect to expenses paid after June 30, 1998, for education furnished in academic periods after that date. See § 201(f)(2) of the Act.

Section 25A(d) provides for the phase-out of these credits when the taxpayer's modified adjusted gross income exceeds a certain amount.

Section 25A(e) provides that the Hope Scholarship and Lifetime Learning Credits are elective. However, an individual cannot elect either of these credits in a year in which the individual receives a tax-free distribution from an Education IRA pursuant to § 530(d)(2) of the Code.

Section 25A(f) defines the terms "qualified tuition and related expenses" and "eligible educational institution" as used in § 25A of the Code.

Section 25A(g) provides special rules for determining whether a taxpayer may claim the credits. These rules reflect the legislative intent that qualified tuition and related expenses generally include only out-of-pocket expenses and exclude educational assistance that is not included in gross income. See H.R. Rep. No. 105-220, 105<sup>th</sup> Cong., 1<sup>st</sup> Sess. 343, 347 (1997).

Section 25A(g)(2) provides that the amount of qualified tuition and related expenses otherwise taken into account in computing the Hope Scholarship Credit or the Lifetime Learning Credit under § 25A of the Code is reduced by the amount of:

- (A) a qualified scholarship that is excluded from gross income under § 117;
- (B) an educational assistance allowance under chapter 30, 31, 32, 34 or 35 of title 38, United States Code, or under chapter 1606 of title 10, United States Code; and
- (C) a payment (other than a gift, bequest, devise, or inheritance within the meaning of § 102(a)) for such individual's educational expenses, or attributable to such individual's enrollment at an eligible educational institution, which is excludable from gross income under any law of the United States.

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Section 25A(g)(5) provides that no credit is allowed under § 25A for any expense for which a deduction is allowed under another section of the Code, thereby denying any double benefit to a taxpayer.

The tax consequences of contributions by Corporation to Trust were addressed in PLR 9628009. Based on the facts presented and representations made in that ruling request, the Service ruled that the shareholders of Corporation receive a currently taxable economic benefit when cash or other assets are transferred by Corporation to Trust. That economic benefit is treated as a distribution by Corporation to the shareholders with respect to its stock within the meaning of § 301(a). The amount of the deemed distribution to each shareholder equals the beneficiary's interest in Trust times the value of the cash and other property transferred to Trust. Based on the facts and circumstances regarding the transfer of cash or other assets by the Corporation to the Trust, the deemed distribution is treated as either a dividend, a reduction of the shareholder's stock basis, or gain from the sale or exchange of property. Corporation's shareholders will receive a basis in their respective beneficial interest or Trust units (representing such beneficial interest) equal to the amount of each respective distribution (cash plus the fair market value of property transferred by Corporation to Trust).

A distribution from the Trust for Taxpayer's educational expenses that is included in Taxpayer's gross income and used to pay qualified tuition and related expenses may be used to compute the Hope Scholarship Credit or the Lifetime Learning Credit under § 25A of the Code, even if the Trust makes the distributions directly to an educational institution rather than to Taxpayer. Whether a distribution from the Trust for Taxpayer's educational expenses that is not included in Taxpayer's gross income and used to pay qualified tuition and related expenses may be used to compute the Hope Scholarship or the Lifetime Learning Credit depends on the particular factual circumstances of the distribution.

Accordingly, based solely on the facts presented and representations made in this ruling request, we conclude as follows:

1. If distributions from the Trust for Taxpayer's educational expenses are included in Taxpayer's gross income and are used to pay qualified tuition and related expenses, these amounts may be used to compute the Hope Scholarship Credit or the Lifetime Learning Credit under § 25A of the Code.

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2. If distributions from the Trust for Taxpayer's educational expenses are not included in Taxpayer's gross income and are used to pay qualified tuition and related expenses, whether these amounts may be used to compute the Hope Scholarship or the Lifetime Learning Credit under § 25A of the Code depends on the particular facts of the distribution, and a separate determination must be made for each distribution based on the particular facts.
3. General principles of federal taxation, including rules under Subchapter J of the Code, will apply to determine the extent to which a particular distribution from Trust is includable in Taxpayer's gross income.
4. Nothing expressed in these rulings affects the prior ruling issued to Corporation and Trust as set forth in PLR 9628009, except to the extent of any conditions stated in that ruling.

Except as set forth above, no opinion is expressed regarding the federal tax treatment of this transaction under any other provision of the Code. In addition, no opinion is expressed and no inference may be drawn from these rulings regarding the federal tax treatment of this transaction to any other taxpayer, including Corporation and Trust.

Temporary or final regulations pertaining to one or more of the issues addressed in this ruling have not yet been adopted. Therefore, this ruling will be modified or revoked if the adopted temporary or final regulations are inconsistent with any conclusion in the ruling. See § 12.04 of Rev. Proc. 99-1, 1999-1 I.R.B. 6, 47. However, when the criteria in § 12.05 of Rev. Proc. 99-1 are satisfied, a ruling is not revoked or modified retroactively except in rare or unusual circumstances.

This ruling is directed only to Taxpayer. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Pursuant to the power of attorney on file in this office, the original of this letter is being sent to your authorized representative.

Sincerely,

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DAVID B. AUCLAIR  
Assistant to the Chief, Branch 1  
Office of Assistant Chief Counsel  
(Income Tax and Accounting)

Enclosures (2):

Copy of this letter

Copy for section 6110 purposes

cc: