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During the 2014 filing season I discovered that very few people are aware of the full potential of the American Opportunity Tax Credit (AOTC) and specifically the ability to include Pell grants and some scholarships in income to increase the AOTC. With this letter I am attempting to encourage more tax professionals to consider this valuable option provided by Treasury Reg. 1.25A-5(c)(3)<sup>1</sup>. If you understand this option but believe it involves too much work then you may find the tools I created to be helpful this tax season.

Although AOTC is discussed on many websites it isn't discussed in depth. After hours of searching the web, I have found little mention of coordinating AOTC and elective scholarships and grants. As a result, it seems plagued with misinformation and false assumptions. That misinformation has even been perpetuated by companies like H&R Block<sup>2</sup> and Intuit<sup>3</sup>, by tax software companies<sup>4</sup>, and by financial aid departments of colleges and universities.

The AOTC is set to expire in 2017 and it would be unfortunate if people did not learn how to use it before it expires. The IRS cannot be faulted in failing to provide adequate exposure. The inclusion of grants and scholarships to increase AOTC has been in the regulations for years, has been included in Pub 970, and the Treasury Department, in a 2014 report to Congress, discussed the fact that so few take full advantage of the AOTC.

## The Facts

1. By including Pell grants and some scholarships in income, you can maximize the amount of qualifying expenses for the credit. It's estimated that over 50% of students receive Pell grants, and it's possible that most of them would qualify for AOTC.
2. You don't need a 1098T to file for AOTC. Institutions are not required to provide a 1098T if financial aid covers expenses, but taxpayers often still qualify for the credit.
3. The 1098T is often incorrect or incomplete. It will usually be necessary to get school account information from the clients to calculate the credits.
4. The AOTC is not just for the poor. Taxpayer MAGI need only be less than \$90,000 (joint, \$180,000). Even in the phase-out range, the first \$2000 of expenses will be valuable for the credit.

Tax software is great for many aspects of tax preparation, but it may not be so useful for calculating the AOTC. Using only a 1098T, you probably don't have the information necessary to get correct amounts.

## AOTC Toolkit

I've written a set of articles that explain education credits in more detail and provide tools that simplify the calculations. The articles explain how to gather information, tabulate qualifying expenses, and calculate the amounts for the tax return. To make it easier to evaluate the qualifications and calculate the credit, I've also prepared flowcharts and an AOTC worksheet. The toolkit includes:

- Education Credit Regulations: A discussion of the AOTC and the regulations that permit inclusion of

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<sup>1</sup> <http://www.law.cornell.edu/cfr/text/26/1.25A-5>

<sup>2</sup> [http://www.hrblock.com/tax-answers/services/jsp/article.jsp?article\\_id=67005](http://www.hrblock.com/tax-answers/services/jsp/article.jsp?article_id=67005)

<sup>3</sup> <https://tlic.intuit.com/questions/1901069-are-scholarships-fellowships-and-grants-considered-taxable-income>

<sup>4</sup> <https://www.taxlayer.com/support/knowledgebasearticle206.aspx>

grants and scholarships to increase qualifying expenses and the credit, and coordinating with other education benefits.

- Education Credit Preparation: Specific instructions for accessing and retrieving expense information from UT Tyler and TJC.
- Education Credit Calculations: One method for tabulating qualifying expenses and calculating the Credit. Includes the spreadsheet version of the AOTC worksheet.
- AOTC Flowcharts: The *student qualification* flowchart is the same as one published by the IRS. For the *refundable credit test*, instead of the IRS outline of those who **do not qualify**, I prepared a flowchart to identify those that **do qualify**. While the general consensus is that students over 18 and under 24 years of age do not themselves qualify for the refundable portion of the credit, there are exceptions that could easily be overlooked.
- AOTC Worksheet: The AOTC worksheet, unlike related IRS published worksheets, assists in maximizing the AOTC qualifying expenses and the taxable amount of scholarships. This pdf calculates the amounts automatically and includes examples from IRS publications and regulations.

The toolkit can be downloaded from [www.tylerhosting.com/EdCredit/](http://www.tylerhosting.com/EdCredit/)

### **The Mission**

I would like to encourage local tax accountants to gain a working knowledge of the full benefits of the AOTC, and so enable their clients to get this credit. Your clients may not be aware of their AOTC options, so your first step may be to include information in a client letter or with their annual tax organizer informing them that they may qualify for an education credit even if (1) grants and scholarships cover all of the cost or (2) they don't receive a 1098T.

Secondly, I would like to see clients get the credit for any prior years for which they can amend their returns. While information on IRA conversions, Social Security strategies, trust techniques, and year-end strategies abound in trade publications and CPE, advice on education planning and the AOTC is somewhat shallow. I hope the information I've collected will assist you in the upcoming tax season.