

# 12 Children, College, and Family

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## Modified AGI for Computing Education Tax Benefits

Modified AGI is the taxpayer's AGI modified by adding back the deductions and exclusions listed below.

AGI plus:	Education Credits	Student Loan Interest Deduction	ESA Contributions	U.S. Bond Interest Exclusion
Student loan interest deduction		X		X
Adoption benefits excluded under an employer's adoption assistance program				X
Foreign earned income exclusion	X	X	X	X
Foreign housing exclusion or deduction	X	X	X	X
American Samoa and Puerto Rico bona fide resident income exclusion	X	X	X	X

## ■ New for 2024 ■

- **QTP to Roth IRA rollover.** Beginning January 1, 2024, a beneficiary may roll over a distribution from a section 529 plan to a Roth IRA. See *QTP rollover to a Roth IRA*, page 12-6.

## Common Elections

- Election to treat nontaxable scholarship as taxable to claim education credit, page 12-3.
- Parents' election to report child's interest and dividends (Form 8814), page 12-10.

## Children Subject to Kiddie Tax (page 12-10)

Under Age 18	Kiddie Tax applies.
Age 18	Kiddie tax applies unless the child's earned income was more than half of his or her support.
Full-Time Students Ages 19–23	

Age is determined on January 1.\*

\* **January 1 birthdays.** Under Kiddie Tax rules, a child born on January 1 reaches that age at the end of the previous year. For example, a child born on January 1, 2007, reaches age 18 on December 31, 2024.

## Kiddie Tax (page 12-10)

<b>Unearned Income</b>	Over \$2,600 taxed at parents' tax rate.
<b>Earned Income</b>	Up to \$14,600 not taxed. Over \$14,600 taxed at child's tax rate.

## Comparison of Education Credits

American Opportunity Credit	Lifetime Learning Credit
Up to \$2,500 credit per eligible student.	Up to \$2,000 credit per return.
Available for the first four years of postsecondary education.	Available for all years of postsecondary education and for courses to acquire or improve job skills.
Student must be pursuing an undergraduate degree or other recognized education credential.	Student does not need to be pursuing a degree or other recognized education credential.
Student must be enrolled at least half time for at least one academic period beginning during the year.	Available for one or more courses.

## Claiming a Student's Education Expenses—Credits

	Taxpayer claims student as a dependent?	Who paid education expenses?*	Who can claim credit or deduction?
<b>American Opportunity Credit and Lifetime Learning Credit</b>	Yes.	Student, taxpayer, or other.	Only the taxpayer.
	No (even if entitled to claim).	Student, taxpayer, or other.	Only the student.

\* Qualified education expenses paid directly to an eligible education institution for a student under a court-approved divorce decree, by a grandparent, or other individual are all treated as paid by the student.

## 2024 Education Benefits Comparison Chart<sup>1</sup>

(See related text for details.)

	American Opportunity Credit	Lifetime Learning Credit	Qualified Tuition Programs (QTP) <sup>2</sup>	Coverdell Education Savings Account (ESA) <sup>2</sup>	Scholarships, Fellowships, and Grants	U.S. Savings Bond Interest Exclusion	Penalty-Free IRA Distributions	Student Loan Interest Deduction
<b>IRC §</b>	IRC §25A(b)	IRC §25A(c)	IRC §529	IRC §530	IRC §117	IRC §135	IRC §72(t)(2)(E)	IRC §221
<b>Benefit</b>	40% of the credit may be refundable (limited to \$1,000 per student).	Tax credit (nonrefundable).	Tax-free earnings.	Tax-free earnings.	Amounts received may be nontaxable.	Tax-free interest.	No 10% penalty on early distribution.	Above-the-line tax deduction.
<b>Annual Limit</b>	\$2,500 credit per student.	\$2,000 credit per tax return.	None	\$2,000 contribution per beneficiary.	None	Amount of qualified education expenses.	Amount of qualified education expenses.	\$2,500 deduction per return.
<b>Qualifying Expenses</b> (In addition to tuition and required enrollment fees)	Course-related books, supplies, and equipment.	Course-related books, supplies, and equipment, only if paid to the institution as a condition of enrollment.	<ul style="list-style-type: none"> <li>Books, supplies, equipment.</li> <li>Room and board for at least half-time students.</li> <li>Expenses for special needs services.</li> <li>K–12 tuition.</li> <li>Qualified education loan repayments.</li> <li>Computer equipment, software, or internet access and related services.</li> </ul>	<ul style="list-style-type: none"> <li>Books, supplies, equipment.</li> <li>Expenses for special needs services.</li> <li>Contributions to QTP.</li> <li>Higher education room and board if at least half-time student.</li> <li>K–12 room and board, uniforms, transportation, computer access.</li> <li>Computer equipment, software, or internet access and related services.</li> </ul>	Course-related books, supplies, and equipment.	<ul style="list-style-type: none"> <li>Payments to Coverdell ESA.</li> <li>Contributions to QTP.</li> </ul>	<ul style="list-style-type: none"> <li>Books, supplies, equipment.</li> <li>Room and board for at least half-time students.</li> <li>Expenses for special needs students.</li> </ul>	<ul style="list-style-type: none"> <li>Books, supplies, equipment.</li> <li>Room and board.</li> <li>Transportation.</li> <li>Other necessary expenses.</li> </ul>
<b>Qualifying Education</b> (In addition to undergraduate and graduate study)	Must be within the first four years of post-secondary study. <sup>4</sup>	Courses to acquire or improve job skills.	<ul style="list-style-type: none"> <li>K–12.</li> <li>Registered apprenticeship program.</li> </ul>	K–12.	K–12.	None	None	Internship or residency program leading to a degree or certificate from an institution offering postgraduate training.
<b>Other Conditions<sup>3</sup></b>	<ul style="list-style-type: none"> <li>Can be claimed for only four years.</li> <li>Must be enrolled at least half-time in a degree program.</li> <li>No felony drug convictions.</li> </ul>	One or more courses.	<ul style="list-style-type: none"> <li>Maximum of \$10,000 per year per student for K–12.<sup>2</sup></li> <li>Certain rollovers to ABLE accounts.</li> </ul>	<ul style="list-style-type: none"> <li>Assets must be distributed at age 30 unless special needs beneficiary.<sup>2</sup></li> <li>Rollover to another ESA for a beneficiary's family member under age 30.</li> </ul>	<ul style="list-style-type: none"> <li>Must be in a degree or vocational program.</li> <li>Payment of tuition and fees must be allowed under the grant.</li> </ul>	Applies only to Series EE bonds issued after 1989 or Series I bonds.	None	Must have been at least half-time student in a degree program.
<b>Modified AGI Phaseout<sup>3</sup></b>	\$80,000–\$90,000 \$160,000–\$180,000 (MFJ)	\$80,000–\$90,000 \$160,000–\$180,000 (MFJ)	None	\$95,000–\$110,000 \$190,000–\$220,000 (MFJ)	None	\$96,800–\$111,800 \$145,200–\$175,200 (MFJ)	None	\$80,000–\$95,000 \$165,000–\$195,000 (MFJ)
<b>Where to Report</b>	Form 8863	Form 8863	Taxable distributions: line 8z, Schedule 1 (Form 1040), and Form 5329	Taxable distributions: line 8z, Schedule 1 (Form 1040), and Form 5329	<ul style="list-style-type: none"> <li>Taxable amounts: line 8r, Schedule 1 (Form 1040).</li> <li>Nontaxable amounts are not reported.</li> </ul>	Form 8815	Form 5329	Line 21, Schedule 1 (Form 1040)
<b>Text page</b>	page 12-3	page 12-4	page 12-5	page 12-5	page 12-7	page 12-7	page 12-8	page 12-8

<sup>1</sup> Any nontaxable distribution is limited to the amount that does not exceed qualified education expenses.<sup>2</sup> See the *QTP and ESA Contributions Chart*, page 12-5, for additional ownership and contributor limitations.<sup>3</sup> MFS filers do not qualify for the American Opportunity Credit, Lifetime Learning Credit, U.S. Savings Bond interest exclusion, or student loan interest deduction.<sup>4</sup> The student must not have completed the first four years of postsecondary education before the end of the preceding tax year as determined by the educational institution.

## Coordinating Education Benefits

### Cross References

- Form 5329, *Additional Taxes on Qualified Plans (including IRAs) and Other Tax-Favored Accounts*
- IRS Pub. 590-B, *Distributions from Individual Retirement Arrangements (IRAs)*
- IRS Pub. 970, *Tax Benefits for Education*

### Related Topics

- Educational Assistance (IRC §127), page 22-4

**Double benefit restrictions.** A taxpayer generally cannot claim more than one education benefit for the same qualifying education expense.

**Claiming more than one education benefit.** If expenses are paid for more than one student, a taxpayer can claim more than one education benefit in a tax year provided the same qualified expenses are not used to claim more than one benefit.

#### Exceptions:

- Qualified expenses can be used to claim most education benefits and also be used to eliminate the penalty on IRA distributions. See *Exceptions to the 10% Penalty on Early Distributions*, page 13-3.
- The American Opportunity Credit and the Lifetime Learning Credit cannot be claimed for the same student for the same tax year.

**Elect to treat nontaxable scholarship as taxable.** A taxpayer may maximize the combined value of an education credit and certain educational assistance (including unrestricted scholarships, fellowships, and grants) if the student includes some or all of the assistance in income in the year it is received.

**Example:** Peter is claimed as a dependent on his parents' return. His 2023 educational expense was tuition of \$8,000. He received a scholarship of \$5,000 restricted for tuition only, and a \$2,500 unrestricted scholarship. Both scholarships are tax-free to Peter, but reduce his qualified expenses for purposes of the education credits to \$500. Peter has no other income.

Peter can elect to treat the \$2,500 unrestricted scholarship as earned income, use his standard deduction to offset taxable income, and pay no tax. His parents can then use \$3,000 (\$500 + \$2,500) of qualified expenses to claim either the American Opportunity Credit or Lifetime Learning Credit, whichever provides the best tax outcome.

**Note:** When opting to treat educational assistance as taxable, the income is taxable to the student, regardless of whether the student or his or her parent is claiming the education credit.

**Form 1098-T, Tuition Statement.** Form 1098-T is issued by eligible educational institutions to report tuition payments received during the year. Form 1098-T may also contain other information such as adjustments made for prior years, the amount of scholarships or grants, reimbursements or refunds, and whether the student was enrolled at least half-time or was a graduate student.

**Note:** Generally, to be eligible to claim an education credit, the taxpayer (or dependent) must have Form 1098-T.

**Author's Comment:** The amounts reported on Form 1098-T are not always accurate. It is considered best practice to get a detailed statement from the educational institution's bursar's office.

**Refunds.** If tax-free educational assistance or a refund of expenses used to calculate an education credit is received after filing, a taxpayer must recalculate any education credit claimed as if the funds were actually received in the tax year just filed and may have a recapture amount to report for the next tax year. For

an education credit recapture, add the additional tax to income tax reported on line 16, Form 1040, check box (3), and write "ECR" in the space next to the box.

**Example:** In December 2023, Ginger paid \$9,300 for the Spring 2024 semester. She filed her return on February 15, 2024, claiming a Lifetime Learning Credit of \$1,860. After filing, she dropped two courses and received a \$2,900 refund. Ginger must recalculate her 2023 credit using only \$6,400 of expenses. The recalculated credit is \$1,280. On Ginger's 2024 return, she reports \$580 (\$1,860 - \$1,280) as an education credit recapture.

## American Opportunity Credit

### Cross References

- Form 8863, *Education Credits*
- Form 8867, *Paid Preparer's Due Diligence Checklist*
- IRS Pub. 970, *Tax Benefits for Education*
- IRC §25A(b), *American Opportunity Tax Credit*

### Related Topics

- Dependents, Tab 3
- Due Diligence Requirements, page 11-2

#### Claiming a Student's Education Expenses—Credits

	Taxpayer claims student as a dependent?	Who paid education expenses?*	Who can claim credit or deduction?
American Opportunity Credit and Lifetime Learning Credit	Yes.	Student, taxpayer, or other.	Only the taxpayer.
	No (even if entitled to claim).	Student, taxpayer, or other.	Only the student.

\* Qualified education expenses paid directly to an eligible education institution for a student under a court-approved divorce decree, by a grandparent, or other individual are all treated as paid by the student.

### Due Diligence Requirements

The due diligence requirements for paid preparers include the American Opportunity Credit. File Form 8867, *Paid Preparer's Due Diligence Checklist*, and attach to the return. See *Due Diligence Requirements*, page 11-2.

### American Opportunity Credit Amount

The maximum credit is \$2,500 per student.

- 100% of the first \$2,000 of qualified expenses.
- 25% of the next \$2,000 of qualified expenses.

**Refundable portion.** 40% of the American Opportunity Credit is refundable for most taxpayers.

**Exception:** Taxpayers under age 24 cannot claim any part of the credit as refundable if all three of the following conditions apply.

- 1) The taxpayer is:
  - Under age 18 at the end of the tax year,
  - Age 18 at the end of the tax year with earned income of less than one-half of his or her support, or
  - A full-time student over age 18 and under age 24 at the end of the tax year with earned income of less than one-half of his or her support,
- 2) At least one of the taxpayer's parents was alive at the end of the tax year, and
- 3) The taxpayer is filing as Single, Head of Household, Qualifying Surviving Spouse, or Married Filing Separately for the tax year.

**Support.** A taxpayer's support includes all amounts spent to provide him or her with food, lodging, clothing, education, medical and dental care, recreation, transportation, and similar necessities. A scholarship received by a full-time student is not considered support.

## Restrictions

**Income limit.** Credit is phased out at modified AGI between \$80,000 and \$90,000 (\$160,000 and \$180,000 MFJ). See the *Modified AGI for Computing Education Tax Benefits* chart, page 12-1.

**Who cannot claim the credit.** No credit is allowed if:

- Filing status is Married Filing Separately (MFS).
- The taxpayer is claimed as a dependent on another person's tax return.
- The taxpayer or spouse was a nonresident alien for any part of the year who did not elect to be treated as a resident alien for tax purposes.

**Double benefit restrictions.** A taxpayer generally cannot claim more than one education benefit for the same qualifying education expense. See *Coordinating Education Benefits*, page 12-3.

**Coordinating credits with other benefits.** A taxpayer may be able to increase the value of an education credit if the student includes some or all of certain nontaxable scholarships or grants in income in the year received. See *Coordinating Education Benefits*, page 12-3.

**Ban on claiming American Opportunity Credit.** Ineligible taxpayers that claim the American Opportunity Credit may be banned from claiming the credit for two years (reckless) or 10 years (fraud).

## Eligible Students

The student must be the taxpayer, spouse, or a dependent claimed by the taxpayer. The student must meet all the following requirements to be eligible.

- The American Opportunity Credit has not already been claimed for the student for any four prior tax years.
- As of the beginning of the tax year, the student had not completed the first four years of postsecondary undergraduate education, as determined by the educational institution.
- For at least one academic period beginning during the tax year, the student both:
  - Was enrolled in a program that leads to a degree, certificate, or other recognized educational credential, and
  - Carried at least one-half the normal full-time workload for his or her course of study. Generally, the standard for one-half of the normal full-time workload is determined by each eligible educational institution.
- As of the end of the tax year, the student had no federal or state felony conviction for possessing or distributing a controlled substance.

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**Author's Comment:** Since most academic years begin and end in different tax years, it typically takes a student five tax years to complete four academic years. The American Opportunity Credit can be claimed in any four of these five years.

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**Taxpayer identification number.** The taxpayer and eligible student must have a taxpayer identification number (SSN, ITIN, or ATIN) issued by the due date of the return (including extensions) in order to claim the American Opportunity Credit on either an original or an amended return.

## Qualified Education Expenses

Qualified education expenses are tuition, fees, and course materials required for enrollment or attendance at an eligible educational institution. Credit is allowed for expenses paid in 2024 for an academic period beginning in 2024 or in the first three months of 2025. Qualified expenses can be paid with borrowed funds. If a student withdraws, expenses qualify unless refunded.

**Fees.** Student-activity fees are included in qualified education expenses only if the fees must be paid to the institution as a condition of enrollment or attendance.

**Course materials.** For the American Opportunity Credit, all expenses for books, supplies, and equipment needed for a course of study are included in qualified education expenses whether or not the materials are purchased from the educational institution.

**Sports and hobbies.** Expenses related to sports, games, hobbies, and noncredit courses are qualified only if they are part of a degree program.

**Adjustments.** Reduce qualified expenses by:

- Tax-free assistance (scholarships, fellowships, grants, employer-provided assistance, veterans benefits, and any other nontaxable payments except gifts or inheritances).
- Refunds of 2024 qualified expenses received before filing. See *Refunds*, page 12-3.

**Eligible educational institution.** An eligible educational institution is 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. Eligible institutions include virtually all accredited postsecondary schools in the U.S. and some schools outside the U.S.

**Expenses paid by parents and others.** Students who qualify to claim an education credit can use payments by their parents or third parties to claim education credits. Payments are considered gifts to the student.

**Expenses paid by a dependent.** Taxpayers can use payments made by their dependent student to claim an education credit, including payments by third parties treated as paid by the student.

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**Example:** Jill's grandmother paid \$5,000 tuition directly to Jill's college. Jill also paid tuition of \$3,000 with proceeds from a student loan. Jill's parents claim her as a dependent and can use the \$8,000 paid by Jill and her grandmother to claim an education credit.

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**Choosing not to claim student as a dependent.** If the taxpayer chooses not to claim the student as a dependent, only the student can claim the American Opportunity Credit. However, the refundable portion is not available to the student. See *Claiming a Student's Education Expenses—Credits* chart, page 12-3.

## Lifetime Learning Credit

### Cross References

- Form 8863, *Education Credits*
- IRS Pub. 970, *Tax Benefits for Education*
- IRC §25A(c), *Lifetime Learning Credit*

### Related Topics

- Dependents, Tab 3

## Lifetime Learning Credit Tax Benefit

The Lifetime Learning Credit is 20% of the first \$10,000 of qualified education expenses paid for all eligible students. The maximum credit is \$2,000 per return regardless of the number of eligible students. There is no limit on the number of years the credit can be claimed for each student.

## Restrictions

**Income limit.** Credit is phased out at modified AGI between \$80,000 and \$90,000 (\$160,000 and \$180,000 MFJ). See the *Modified AGI for Computing Education Tax Benefits* chart, page 12-1.

**Who cannot claim the credit.** No credit is allowed if:

- Filing status is Married Filing Separately (MFS).
- The taxpayer is claimed as a dependent on another person's tax return.

*continued on next page*

- The taxpayer or spouse was a nonresident alien for any part of the year who did not elect to be treated as a resident alien for tax purposes.

**Double benefit restrictions.** A taxpayer generally cannot claim more than one education benefit for the same qualifying education expense. See *Coordinating Education Benefits*, page 12-3.

**Coordinating credits with other benefits.** A taxpayer may be able to increase the value of an education credit if the student includes some or all of certain nontaxable scholarships or grants in income in the year received. See *Coordinating Education Benefits*, page 12-3.

## Eligible Students

The student must be the taxpayer, spouse, or a dependent claimed by the taxpayer. The student must be enrolled in one or more courses at an eligible institution.

## Qualified Education Expenses

Qualified education expenses are tuition and certain related expenses required for enrollment in a course at an eligible educational institution. The course must be either part of a post-secondary degree program or taken by the student to acquire or improve job skills.

**Fees and course materials.** Student activity fees and expenses for course-related books, supplies, and equipment are included in qualified education expenses only if the fees and expenses must be paid to the institution as a condition of enrollment or attendance.

**Adjustments.** See *Adjustments*, page 12-4.

**Eligible educational institution.** See *Eligible educational institution*, page 12-4.

**Refunds of qualified expenses.** See *Refunds*, page 12-3.

**Choosing not to claim student as a dependent.** If the taxpayer chooses not to claim the student as a dependent, only the student can claim a Lifetime Learning Credit. See *Claiming a Student's Education Expenses—Credits* chart, page 12-3.

## Qualified Tuition Programs (QTPs) and Education Savings Accounts (ESAs)

### Cross References

- Form 1099-Q, *Payments From Qualified Education Programs*
- IRS Pub. 970, *Tax Benefits for Education*
- IRC §529, *Qualified tuition programs*
- IRC §530, *Coverdell education savings accounts*
- IRS Notice 2018-58

### Related Topics

- Dependents, Tab 3

### QTP and ESA Tax Benefits

Contributions to a qualified tuition program (QTP) or Coverdell education savings account (ESA) are not deductible. Earnings accumulate tax free. Distributions are not taxable if less than the beneficiary's adjusted qualified education expenses in the year of distribution. Contributors can contribute to both a QTP and an ESA in the same year for the same designated beneficiary.

### QTP and ESA Contributions Chart

	<i>Qualified Tuition Programs (QTP)<sup>1</sup></i>	<i>Coverdell Education Savings Accounts (ESA)</i>
<b>Description</b>	State or educational institution programs that allow prepayments or contributions to an account for paying a student's qualified education expenses at an eligible institution.	Accounts similar to Roth IRAs used to pay qualified education expenses of a designated beneficiary.
<b>Ownership</b>	Any U.S. citizen or resident with a valid SSN, including the beneficiary. Owner and beneficiary do not need to be related. Certain types of entities may also open an account if the plan allows.	Beneficiary or parent.
<b>Age Limit</b>	None.	No contributions once beneficiary is 18, and balance must be distributed at age 30. <sup>2</sup>
<b>Contribution Limits</b>	<ul style="list-style-type: none"> <li>• No annual limit.<sup>3</sup></li> <li>• Cannot exceed the anticipated qualified education expenses of the beneficiary.</li> </ul>	\$2,000 per beneficiary, no matter how many Coverdell ESAs are set up for that beneficiary or how many individuals contribute. <sup>4</sup>
<b>Contributors</b>	<ul style="list-style-type: none"> <li>• Any individual, including the beneficiary or entity.</li> <li>• No income limits.</li> </ul>	Any individual, including the beneficiary, subject to an income phaseout range of \$95,000 to \$110,000 (\$190,000 to \$220,000 for MFJ). <sup>5</sup>
<b>Deadline</b>	<ul style="list-style-type: none"> <li>• Federal – None.</li> <li>• States – May vary.</li> </ul>	April 15, 2025, for 2024 contributions.

<sup>1</sup> QTPs are also called college savings plans and 529 plans.

<sup>2</sup> Age limits do not apply to beneficiaries with special needs.

<sup>3</sup> See *5-year gifts to qualified tuition plans*, page 21-27

<sup>4</sup> The beneficiary is subject to a 6% excise tax on excess contributions similar to an excess IRA contribution. See *Excess IRA Contributions*, page 13-8.

<sup>5</sup> Any entity, such as a corporation or trust, not subject to income limits.

## Qualified Education Expenses for QTPs and ESAs

Qualified education expenses are higher education or elementary and secondary (K-12) education expenses required for enrollment or attendance of the designated beneficiary.

**Higher education expenses.** Higher education expenses are related to enrollment or attendance at an eligible postsecondary school.

- Tuition, fees, books, supplies, and equipment required for enrollment or attendance of the designated beneficiary at an eligible institution. See *Eligible educational institution*, page 12-4.
- Expenses for special needs services of a beneficiary with special needs incurred in connection with enrollment or attendance.
- Room and board for students enrolled at least half time in a degree or certificate program. Expenses are limited to the room and board allowance included in the cost of attendance set by the school for financial aid purposes or the actual cost of campus housing, if greater.
- The purchase of computer or peripheral equipment, computer software, or internet access and related services. These items must be primarily used by the beneficiary during any of the years the beneficiary is enrolled at an eligible educational institution. The computer software must be predominantly educational.
- For QTPs only, expenses paid for fees, books, supplies, and equipment required for participation in a registered apprenticeship program.
- For QTPs only, student loan payments of principal or interest on any qualified education loan of the beneficiary, or beneficiary's

sibling, up to a cumulative maximum of \$10,000 per beneficiary and sibling.

**K-12 education expenses.** K-12 expenses include enrollment or attendance at any public, private, or religious school providing elementary or secondary education (K-12), as determined under state law.

**QTPs.** For QTPs, tuition expenses up to \$10,000 per beneficiary per year are qualified K-12 education expenses.

**ESAs.** For ESAs, the following K-12 expenses qualify.

- Tuition, fees, books, supplies and equipment, academic tutoring, special needs services.
- Expenses required or provided by an eligible school including room and board, uniforms, transportation, and supplementary items and services including extended day programs.

**ESA contributions to QTP.** Qualified expenses include contributions to a QTP from ESA funds made on behalf of the beneficiary or beneficiary's family member (if beneficiaries changed).

**Adjustments.** Reduce qualified expenses by:

- Tax-free assistance (scholarships, fellowships, grants, employer-provided assistance, veterans benefits, and any other nontaxable payments except gifts or inheritances).
- Amounts used to calculate an education credit or deduction.

**Coordination with education credits.** An education credit can be claimed in the same year the beneficiary takes a tax-free distribution from an ESA or QTP as long as the same expenses are not used for both benefits. Expenses used to claim an education credit reduce qualified education expenses for purposes of computing the taxability of QTP and ESA distributions.

## Tax-Free Distributions

Distributions are not taxable if they are less than the beneficiary's adjusted qualified education expenses (AQEE) for the year. Nontaxable distributions are not reported.

**Example:** Marina withdrew \$10,500 from her QTP in 2024. Her qualified education expenses are listed below. Marina's parents claimed an American Opportunity Credit using expenses of \$4,000.

Tuition and fees .....	\$10,000
Room and board .....	6,000
Less expenses used to claim education credit .....	(4,000)
AQEE .....	\$12,000

Marina's distribution is not taxable because it is less than her AQEE. Although Marina received Form 1099-Q, *Payments From Qualified Education Programs*, she does not report the distribution on her return.

## Taxable Distributions

If distributions are more than the beneficiary's adjusted qualified education expenses, a portion of the earnings is taxable.

The taxable amount is also subject to a 10% additional tax unless an exception applies. See *Exceptions to 10% Additional Tax—Education*, next column.

**Who is taxed?** The taxable part of a distribution is taxed to:

- The designated beneficiary of an ESA.
- The owner of a QTP unless the distribution was paid directly to the designated beneficiary or to an eligible institution for the benefit of the designated beneficiary.

**Taxable earnings.** Form 1099-Q does not list taxable earnings in box 2. Calculate taxable earnings as follows.

$$\text{Tax-free earnings} = \text{Earnings} \times \frac{\text{Adjusted qualified education expenses}}{\text{Total distribution}}$$
$$\text{Taxable earnings} = \text{Earnings} - \text{Tax-free earnings}$$

**Reporting.** The taxable amount is reported as Other Income, line 8z, Schedule 1 (Form 1040). If any taxable amount is reported, Part

II, Form 5329, *Additional Taxes on Qualified Plans (Including IRAs) and Other Tax-Favored Accounts*, is required to calculate additional tax even if an exception applies.

**Multiple accounts.** The amount included in taxable income from a QTP is computed on a distribution-by-distribution basis rather than being aggregated. This will affect the taxable percentage applied to the distribution amount.

**Refunds of education expenses.** A beneficiary who receives a refund of higher education expenses is not taxed on the distribution used to pay for these expenses if:

- The refunded amount is recontributed within 60 days, and
- The recontributed amount does not exceed the refund.

## QTP Rollovers and Transfers

Assets can be rolled over or transferred tax free from one QTP to another QTP or to an ABL account provided the QTP or ABL account is for the benefit of the same beneficiary, or beneficiary's family member. An amount is rolled over if paid to an ABL account or another QTP within 60 days after the date of the distribution. Only one rollover in any 12-month period can be made from one QTP to another QTP for the same beneficiary. In addition, the designated beneficiary can be changed to a beneficiary's family member without transferring accounts. For ABL accounts, rollover amounts count toward the annual contribution limit. See *Achieving a Better Life Experience (ABLE)*, page 12-9.

**New for 2024** **QTP rollover to a Roth IRA.** Effective for distributions made after December 31, 2023, a beneficiary of a QTP may roll over a distribution from the 529 account to a Roth IRA for the beneficiary if certain requirements are met. [IRC §529(c)(3)(E)]

- The rollover is a trustee-to-trustee transfer.
- The rollover amount cannot exceed the Roth IRA annual contribution limit.
- The rollover must be from a section 529 account open for over 15 years.

The lifetime aggregate limit for all QTP to Roth IRA rollover distributions is \$35,000.

## ESA Rollovers and Transfers

Any ESA balance may be transferred tax free to a beneficiary's family member who is under age 30 (or a special needs beneficiary). The transfer can occur by changing the name of the designated beneficiary on the account or by contribution to the family member's ESA within 60 days of the beneficiary receiving a nonqualified distribution (rollover).

Only one rollover in any 12-month period can be made from one ESA to another ESA regardless of how many ESAs are owned by the taxpayer. However, there is no limit on the number of direct trustee-to-trustee transfers because such transfers are not considered to be distributions or rollovers.

**Note:** A transfer or rollover is not limited to the annual contribution limit.

## Exceptions to 10% Additional Tax—Education

Additional tax does not apply to the following distributions.

- Included in income only because qualified education expenses were used to claim an education credit.
- Included in income because the designated beneficiary received tax-free educational assistance.
- Paid at the death of the designated beneficiary.
- Made because the designated beneficiary is disabled.
- Made on account of attendance of the designated beneficiary at a U.S. military academy if distributions do not exceed the costs of advanced education attributable to such attendance.
- Excess contributions and earnings made before June 1 (ESA only).

## Losses on QTPs and ESAs

Under prior law, after all amounts had been distributed, the losses on a QTP or ESA account were deductible as a miscellaneous itemized deduction subject to the 2% AGI limitation. For tax years 2018 through 2025, the deduction for all miscellaneous itemized deductions subject to the 2% AGI limitation is suspended, so these losses are no longer deductible.

## Scholarships, Fellowships, and Grants

### Cross References

- IRS Pub. 525, *Taxable and Nontaxable Income*
- IRS Pub. 970, *Tax Benefits for Education*

### Related Topics

- Nontaxable Income, Tab 3
- Independent Contractor vs. Employee, Tab 5

#### Scholarship and Fellowship Payments for Degree Candidates<sup>1</sup>

Payment Used For:	Tax Free <sup>2</sup>	Taxable
Tuition	X	
Fees/Books/Supplies/Equipment	X <sup>3</sup>	
Room/Board/Travel/Payment for Services		X

- <sup>1</sup> Does not include payments received for past, present, or future services.  
<sup>2</sup> Payments used for any expenses in this column are tax free only if the terms of the scholarship or fellowship do not prohibit the expense.  
<sup>3</sup> If required of all students in the course.

**Note:** If the taxpayer is not a degree candidate, any scholarship is taxable regardless of how the scholarship is used.

### Tax-Free Scholarships

Scholarships, fellowships, and grants are tax free if:

- The taxpayer is a degree candidate at an eligible educational institution, and
- The taxpayer uses the funds to pay qualified education expenses.

This rule applies to scholarships, fellowships, and grants of all types, including athletic scholarships, scholarships won as prizes, Fulbright Grants, Pell Grants, and other Title IV need-based grants. Veterans benefits for education and training are tax free under other rules. Payments for appointments to U.S. military academies are taxable wages.

**Eligible educational institution.** An eligible educational institution is one that maintains a regular faculty and curriculum and normally has a regularly enrolled body of students in attendance at the place where it carries on its educational activities.

#### Qualified education expenses:

- Tuition and fees required to enroll or attend an eligible educational institution.
- Fees, books, supplies, and equipment required of all students in student's course of instruction.

### Taxable Scholarships

The taxable portion of scholarships, fellowships, or grants includes the amounts received for:

- Teaching, research, or other services required as a condition of receiving the scholarship, fellowship, or grant. Amounts received for services that are required by the National Health Services Corps Scholarship Program or the Armed Forces Health Professions and Financial Assistance Program are not taxable.
- Incidental expenses such as room and board, travel, and optional equipment.

## Coordination With Other Education Benefits

Tax-free scholarships reduce qualified expenses for education credits and other benefits; taxable scholarships do not.

Depending on the type of scholarship, a student may be able to use scholarship money for nonqualified expenses. Although the scholarship is then taxable to the student, it does not reduce qualified expenses for other benefits.

Most scholarships are unrestricted and they can be used for any type of expense. Restricted scholarships are taxable or tax free depending on the use specified.

- Taxable if limited to nonqualified expenses.
- Tax free if limited to qualified expenses.

See *Elect to treat nontaxable scholarship as taxable*, page 12-3.

### Reporting

- Report taxable scholarship or fellowship income not reported on Form W-2, on line 8r, Schedule 1 (Form 1040).
- Report amounts received as pay for services as an independent contractor on Schedule C (Form 1040), *Profit or Loss From Business*.
- Taxable tuition reductions are included as wages in box 1, Form W-2, *Wage and Tax Statement*.
- Nontaxable amounts are not reported.

### Qualified Tuition Reductions

Tuition reductions provided by eligible educational institutions are tax free if provided for undergraduate education for current employees, retired employees, employees who are disabled, spouses and dependent children of employees. Undergraduate education includes primary and secondary education.

**Graduate education.** Tuition reductions are tax free only if provided to a graduate student who performs teaching or research activities for that institution.

## U.S. Savings Bond Interest Exclusion

### Cross References

- Form 8815, *Exclusion of Interest From Series EE and I U.S. Savings Bonds Issued After 1989*
- IRS Pub. 970, *Tax Benefits for Education*
- IRC §135, *Income from United States savings bonds used to pay higher education tuition and fees*

### Related Topics

- U.S. Savings Bonds, page 6-6

### Exclusion Rules

Interest from qualified U.S. Savings Bonds redeemed by the taxpayer can be excluded from income if:

- The taxpayer paid qualified education expenses during the year for the taxpayer, spouse, or a dependent claimed by the taxpayer.
- Filing status is not Married Filing Separately (MFS).

If proceeds from the redemption (interest and principal) are more than adjusted qualified education expenses, only a percentage of the interest is excludable. Calculate the exclusion on Form 8815, *Exclusion of Interest From Series EE and I U.S. Savings Bonds Issued After 1989*.

**Example:** Marty redeemed qualified bonds for \$10,000, including accrued interest of \$5,500. He paid \$8,000 of qualified education expenses during the year. His excludable interest is:

$$\$5,500 \text{ interest} \times \frac{\$8,000 \text{ qualified expenses}}{\$10,000 \text{ redemption proceeds}} = \$4,400 \text{ tax-free interest}$$

**Income limit.** The exclusion is phased out at modified AGI between \$96,800 and \$111,800 (\$145,200 and \$175,200 MFJ and QSS). See *Modified AGI for Computing Education Tax Benefits* chart, page 12-1.

## Qualified Savings Bonds

- Series EE bonds issued after 1989 and Series I bonds.
- Issued to a person who was age 24 before the bond's issue date printed on the front of the bond. The issue date is the first day of the month in which the bond was purchased (e.g., a bond purchased on May 25 has a May 1 issue date).
- Issued in the name of the taxpayer and/or spouse. There can be no other co-owners, including the taxpayer's child. The bond can have a pay-on-death (POD) beneficiary, including a child.

## Qualified Education Expenses

- Tuition and fees required for enrollment or attendance at an eligible educational institution. Qualified expenses do not include room and board, or courses involving sports, games, or hobbies, unless part of the student's degree program. See *Eligible educational institution*, page 12-4.
- Contributions to a qualified tuition program (QTP).
- Contributions to a Coverdell education savings account (ESA).

**Adjustments.** Reduce qualified education expenses by the following.

- Tax-free educational assistance paid directly to or by the educational institution. See *Eligible educational institution*, page 12-4.
- Amounts used to calculate an education credit.
- Amounts used to calculate the nontaxable amount of a distribution from a Coverdell ESA or QTP.

Qualified expenses are also reduced by the following.

- Tax-free assistance paid to the student (scholarships, fellowships, grants, employer-provided assistance, veterans benefits, and any other nontaxable payments except gifts or inheritances).
- Payments, waivers, and reimbursements under a QTP.

## Dependents

A dependent student can claim this exclusion if the requirements are met. Bonds must have been issued to the student after he or she reached age 24.

A bond bought by a parent and issued in the name of his or her child under age 24 does not qualify for the exclusion by the parent or the child.

## Penalty-Free IRA Distributions

### Cross References

- Form 5329, *Additional Taxes on Qualified Plans (Including IRAs) and Other Tax-Favored Accounts*
- IRS Pub. 970, *Tax Benefits for Education*
- IRC §72(t)(2)(E), *Distributions from individual retirement plans for higher education expenses*

### Related Topics

- Exceptions to the 10% Penalty on Early Distributions, page 13-3

## Penalty Exception

The 10% additional tax on early distributions does not apply to IRA withdrawals used to pay qualified education expenses of the taxpayer, spouse, or any child (including foster child) or grandchild of the taxpayer or spouse. The exclusion applies to IRA distributions, including Roth distributions, but not to distributions from qualified plans. The exclusion only reduces the early withdrawal penalty as distributions are still taxable. The student does not need to be claimed as the taxpayer's dependent. See *IRA Distributions*, page 13-8.

The amount excluded from additional tax is equal to adjusted qualified education expenses paid by the taxpayer during the

tax year. Report the exclusion on Form 5329, *Additional Taxes on Qualified Plans (Including IRAs) and Other Tax-Favored Accounts*.

## Qualified Education Expenses

- Tuition, fees, books, supplies, equipment, and special needs services required for enrollment or attendance at an eligible educational institution.
- Room and board for students enrolled at least half time in a degree or certificate program. Expenses are limited to the room and board allowance included in the cost of attendance set by the school for financial aid purposes or the actual cost of campus housing, if greater.

**Adjustments.** Reduce qualified education expenses by:

- Tax-free assistance (scholarships, fellowships, grants, employer-provided assistance, veterans benefits, and any other nontaxable payments except gifts or inheritances).
- Expenses used to calculate tax-free distributions from a Coverdell ESA but not a QTP.

## Coordination With Other Education Benefits

Other than the adjustments required above, no other coordination rules apply to this exclusion. Qualified expenses used to claim other education benefits can be used again to exclude the 10% additional tax if other requirements are met.

## Student Loan Interest Deduction

### Cross References

- Form 1098-E, *Student Loan Interest Statement*
- IRS Pub. 970, *Tax Benefits for Education*
- IRC §221, *Interest on education loans*

### Related Topics

- Dependents, Tab 3
- Interest Paid, Tab 4

## Student Loan Interest Deduction

**Qualified loans.** Loans that are not part of a student loan program can be qualified student loans under the following circumstances.

- Debt must be incurred solely to pay qualified expenses. Loans used for more than one purpose do not qualify.
- No deduction is allowed for interest that is an allowable deduction under any other provision of the tax law.
- Expenses must be for a specific academic period and paid or incurred within a reasonable time before or after the loan. There is a safe harbor for funds disbursed during the period that begins 90 days before the start and ends 90 days after the academic period.

**Interest paid by parents or other third parties.** Interest is deductible only if the taxpayer has a legal obligation to make interest payments under the terms of the loan. If a person not obligated to pay interest makes the payment, the taxpayer legally obligated to pay is treated as receiving the payment from that person and, in turn, paying the interest. (Reg. §1.221-1)

If a loan is only in the name of the student, the student can deduct interest paid by his or her parents. Because the parents are not legally obligated to pay back the loan, the parents cannot deduct the interest. If the student is claimed as a dependent, neither the parents nor the student can deduct the interest.

**Employer-provided educational assistance.** No deduction is allowed for any student loan interest paid by an employer under an educational assistance program.

**Qualified education expenses.** The cost of attendance at an eligible educational institution, including graduate school, reduced



by the adjustments listed below. See *Eligible educational institution*, page 12-4.

Cost of attendance is determined by the school using federal financial aid rules. It includes tuition and fees and allowances for room and board, books, supplies, transportation, and miscellaneous expenses. Loans under most student loan programs are capped by the cost of attendance.

**Adjustments.** Reduce qualified expenses by:

- Tax-free assistance (scholarships, fellowships, grants, employer-provided educational assistance, veterans benefits, and any other nontaxable payments except gifts or inheritances).
- The tax-free portion of distributions from an ESA or QTP.
- U.S. savings bond interest excluded from income because it was used to pay qualified education expenses.

### Student Loan Interest Deduction at a Glance

<b>Maximum Deduction Per Return</b>	Up to \$2,500 of interest including early payments not yet required, interest on refinanced and consolidated loans, and capitalized interest.
<b>No Double Benefit [IRC §221(e)(1)]</b>	No deduction allowed for interest paid by: <ul style="list-style-type: none"> <li>• Employer educational assistance programs,</li> <li>• Distribution from a QTP, or</li> <li>• Student loan repayment assistance programs.</li> </ul>
<b>Phaseout</b>	At modified AGI of \$80,000 – \$95,000 (\$165,000 – \$195,000 MFJ). <sup>1</sup>
<b>Loan Qualifications</b>	<ul style="list-style-type: none"> <li>• Incurred by the taxpayer solely to pay qualified education expenses, and</li> <li>• Cannot be from a related person or qualified employer plan.</li> </ul>
<b>Student Qualifications</b>	The student must be: <ul style="list-style-type: none"> <li>• The taxpayer, spouse, or a person who was a dependent<sup>2</sup> when the loan was taken, and</li> <li>• Enrolled at least half-time in a degree or certificate program.</li> </ul>
<b>Time Limit on Deduction</b>	Interest is deductible during the remaining period of the student loan.
<b>Ineligible Taxpayers</b>	<ul style="list-style-type: none"> <li>• A taxpayer filing MFS.</li> <li>• A taxpayer claimed as a dependent.</li> </ul>

<sup>1</sup> See *Modified AGI for Computing Education Tax Benefits*, page 12-1.

<sup>2</sup> A student can be the taxpayer's dependent for purposes of this deduction even if the taxpayer is a dependent, the student files a joint return, or the student has gross income of \$5,050 or more.

**Student loan forgiveness or cancellation.** For tax years 2021 through 2025, certain student loans cancelled, forgiven, or repaid by someone else are excluded from gross income on the taxpayer's federal tax return. Loans cancelled due to services performed for the organization that made the loan or provided the funds do not qualify for tax-free treatment.

**Matching contributions for student loan repayments.** The SECURE 2.0 Act of 2022 permits employers with a 401(k) or similar plan to provide matching contributions based on an employee's qualified student loan payments. See *Matching contributions for student loan repayments*, Tab 29.

## Achieving a Better Life Experience (ABLE)

### Cross References

- Form 5498-QA, *ABLE Account Contribution Information*
- IRS Pub. 907, *Tax Highlights for Persons With Disabilities*

### Related Topics

- Retirement Savings Contributions Credit, page 11-16
- Exceptions to the 10% Penalty on Early Distributions, page 13-3

## Achieving a Better Life Experience (ABLE) Account

An ABLE account is a tax-advantaged savings program for eligible people with disabilities (designated beneficiaries). It is similar to a qualified tuition program (529 plan), as earnings in an ABLE account are exempt from tax. (IRC §529A)

An ABLE account is generally disregarded for purposes of determining eligibility for benefits under Supplemental Security Income (SSI) and certain other means-tested federal programs. The beneficiary can have only one ABLE account at a time.

**Eligible individual.** An individual is eligible for a tax year if the individual is entitled to benefits based on blindness or disability under the Social Security Act, and such blindness or disability occurred before the date on which the individual attained age 26.

**Note:** If an eligible individual ceases to be eligible, then beginning the first day of the next year no contributions may be made and any distributions during an ineligible period are not qualified distributions.

**Contributions.** Contributions to an ABLE account are not tax deductible and must be in cash or cash equivalents. Anyone, including the designated beneficiary, can contribute to an ABLE account. An ABLE account is subject to an annual contribution limit (annual gift tax exclusion amount, \$18,000 for 2024) and a cumulative balance limit (set by the state and the same as the state's 529 plan limit). The ABLE account's designated beneficiary may contribute an additional amount annually up to the lesser of:

- The designated beneficiary's compensation for the year, or
- The poverty line amount for a one-person household applicable in the designated beneficiary's state of residence for the year.

An employed designated beneficiary is not eligible for the increased contribution limit for the tax year if any contribution is made on behalf of the employee to a qualified defined contribution plan.

Excess contributions and earnings are subject to a 6% excise tax if not withdrawn by the tax return due date (including extensions).

**Saver's credit.** Any contribution made by a designated beneficiary of an ABLE account qualifies as a contribution for purposes of claiming the Retirement Savings Contribution Credit. See *Retirement Savings Contributions Credit*, page 11-16.

**Form 5498-QA, ABLE Account Contribution Information.** Form 5498-QA reports contributions (including rollovers), fair market value of the account, program-to-program transfers, and beneficiary's disability code.

**Distributions.** Distributions from an ABLE account may be used to pay for any qualified disability expenses such as expenses for maintaining or improving the beneficiary's health, independence, or quality of life. Qualified disability expenses include those for education, housing, transportation, employment training and support, assistive technology, personal support services, health, prevention and wellness, financial management, administrative services, legal fees, expenses for oversight and monitoring, and funeral and burial expenses.

If distributions from an ABLE account during a year are not more than qualified disability expenses for that year, no amount is taxable for that year. If the total amount distributed during a year is more than qualified disability expenses for that year, the earnings portion of the distribution is included in income for that year. Earnings and taxable distributions are computed in the same manner as QTPs. To compute the taxable portion of a distribution from an ABLE account, see *Taxable Distributions*, page 12-6. Taxable distributions from an ABLE account are subject to an additional 10% tax, reported in Part II, Form 5329, *Additional Taxes on Qualified Plans (Including IRAs) and Other Tax-Favored Accounts*.

**Form 1099-QA, Distributions From ABLE Accounts.** Form 1099-QA reports distributions, earnings, basis, and the termination of an ABLE account.

**Rollovers.** Funds in an ABLÉ account may be rolled over within 60 days into another ABLÉ account of the same beneficiary, or an ABLÉ account of an eligible family member.

**Rollover from a 529 plan.** Rollovers may be made without penalty from a 529 plan to an ABLÉ account if the beneficiary of the ABLÉ account is the designated beneficiary of the 529 plan or is an eligible family member. Rolled over amounts count toward the overall annual contribution limitation.

## Children and Taxes

### Cross References

- Form 8615, *Tax for Certain Children Who Have Unearned Income*
- Form 8814, *Parents' Election to Report Child's Interest and Dividends*
- IRS Pub. 929, *Tax Rules for Children and Dependents*
- IRC §1(g), *Certain unearned income of children taxed as if parent's income*

### Related Topics

- Filing Requirements, Tab 3
- Children in Business, Tab 5
- Family Businesses—Employing Family Members, Tab 5

### Kiddie Tax

The Kiddie Tax rules apply when a child's unearned income (investment income) is over \$2,600. The amount over \$2,600 is taxed at the parents' tax rate if that rate is higher than the child's. [IRC §1(g)]

Children Subject to Kiddie Tax	
Under Age 18	Kiddie Tax applies.
Age 18	Kiddie tax applies unless the child's earned income was more than half of his or her support.
Full-Time Students Ages 19–23	

Age is determined on January 1.\*

\* **January 1 birthdays.** Under Kiddie Tax rules, a child born on January 1 reaches that age at the end of the previous year. For example, a child born on January 1, 2007, reaches age 18 on December 31, 2024.

### Children and Taxes at a Glance

<b>2024 Filing Requirements<sup>1</sup></b>	<ul style="list-style-type: none"> <li>• Unearned income over \$1,300.</li> <li>• Earned income over \$14,600.</li> <li>• Gross income more than the larger of \$1,300 or earned income (up to \$14,150) plus \$450.</li> <li>• Net earnings from self-employment income of at least \$400.<sup>5</sup></li> </ul>
<b>Standard Deduction</b>	The greater of \$1,300 or earned income plus \$450 but not to exceed \$14,600.
<b>Custodial Accounts</b>	Assets in a custodial account belong to the minor. Income is taxed to the minor. Use the minor's SSN on the accounts. If the custodian receives Forms 1099 in his or her SSN, then nominee income procedures can be used to report the income to the minor. See <i>Nominee interest and dividends</i> , Tab 3.
<b>Tax—Earned Income Only</b>	<ul style="list-style-type: none"> <li>• Up to \$14,600, not taxed.</li> <li>• Over \$14,600, taxed at the child's rate.</li> </ul>
<b>Kiddie Tax<sup>2</sup></b>	<ul style="list-style-type: none"> <li>• Unearned income: <ul style="list-style-type: none"> <li>\$0 to \$1,300 ..... not taxed</li> <li>\$1,301 to \$2,600 ..... taxed at child's tax rate</li> <li>Over \$2,600 ..... taxed at parents' rate<sup>3</sup></li> </ul> </li> <li>• Earned income ..... taxed at child's rate<sup>4</sup></li> </ul>

<sup>1</sup> For unmarried child under age 65. Also, returns may be filed to claim a refund if tax was withheld.

<sup>2</sup> If the child has earned income and investment income, but the Kiddie tax does not apply, then income is taxed at the child's rate. See *Children Subject to Kiddie Tax*, above.

<sup>3</sup> At the child's rate, if higher.

<sup>4</sup> For tax calculation in this situation, see *Example*, next column.

<sup>5</sup> For exceptions to self-employment rules, see *Children in Business*, Tab 5.

**Filing the child's return.** If the child cannot file the return for any reason, such as age, then the parent or guardian is responsible for filing the return and can sign by writing "(child's name) by (parent's signature), parent (or guardian) for minor child."

**Authority.** Only a parent or guardian who signs a return on a child's behalf can deal with the IRS on all matters connected with the return. A parent or guardian who does not sign the child's return may be authorized as a third-party designee, but this designation does not authorize the parent or guardian to receive any refund check, bind the child to any tax liability, or otherwise represent the child before the IRS.

**Form 8615, Tax for Certain Children Who Have Unearned Income.** If a child's unearned income is more than \$2,600, Form 8615 is used to compute the child's tax. If the parents have more than one child required to file Form 8615, income over \$2,600 for all children is included. The increase in tax is divided among the children in proportion to income.

**Filing requirements.** File Form 8615 with the child's return if:

- The child has more than \$2,600 of unearned income,
- The child is required to file a tax return (if the parents qualify and elect to report the child's income on their return, the child is not required to file a return or Form 8615),
- The child meets certain age requirements. See *Children Subject to Kiddie Tax* chart, previous column.
- At least one of the child's parents was alive at the end of the tax year, and
- The child does not file a joint return.

If the filing requirements are met, Form 8615 is required even if the child is not a dependent.

**Itemized deductions.** If the child itemized, the threshold for computing tax is the greater of \$2,600, or \$1,300 plus itemized deductions directly connected with the production of the child's unearned income.

**Net investment income tax.** A child whose tax is calculated on Form 8615 may be subject to the net investment income tax. See *Net Investment Income Tax*, page 6-4.

**Example:** Beth is 17 and earned \$4,000 in wages and \$3,000 in interest for income of \$7,000. Beth claims a standard deduction of \$4,450, leaving \$2,550 of taxable income. Beth pays tax at her parents' rates on \$400 (\$3,000 minus \$2,600). The remaining \$2,150 is taxed at Beth's tax rate.

**Alternative minimum tax (AMT).** The AMT exemption for children subject to Kiddie Tax is the same AMT exemption available to other taxpayers.

**Form 8814, Parents' Election to Report Child's Interest and Dividends.** If a child is required to file a return, the parents may qualify to report the child's income on their return instead.

#### Requirements for parents' election:

- The child was under age 19 (or under age 24 if a full-time student) at the end of the tax year.
- The child's gross income is less than \$13,000.
- The child's only income is from interest, dividends, capital gain distributions, and Alaska Permanent Fund Dividends.
- The child does not file a joint return.
- No federal income tax was withheld from the child's income.
- No estimated tax payments were made for the child.
- Taxpayer is the parent whose return may be used. See *Parents who qualify for election*, below.

The election is made by filing Form 8814 with the parents' return by the due date (including extensions). A separate Form 8814 must be filed for each child with unearned income.

#### Parents who qualify for election:

- Parents file Married Filing Jointly,

*continued on next page*

- The parent with higher taxable income if parents file Married Filing Separately, or unmarried and living together, or
- The custodial parent if parents are unmarried and living apart, separated, divorced, or treated as unmarried. A custodial parent who remarries qualifies for the election if he or she files jointly with a new spouse or files separately and has higher taxable income than the new spouse.

#### Tax Treatment of Child's Income\*

	On Child's Return	On Parent's Return
<b>First \$1,300</b>	Not taxed.	Not taxed.
<b>Second \$1,300</b>	Taxed at 10% (0% for capital gains and qualified dividends).	Taxed at 10%.
<b>Amounts over \$2,600</b>	Taxed at parents' rate for ordinary income and/or capital gains.	Added to parents' income as ordinary income, qualified dividends, or capital gain distributions.

\* For dependents with no earned income.

**Net investment income tax.** A parent who elects to report a child's unearned income on his or her return must include the child's income in calculating MAGI and add the child's income to the parents' net investment income. See *Net Investment Income Tax*, page 6-4.

#### Reasons to file a separate return for the child:

- Parents qualify for the Earned Income Credit. The child's investment income can reduce the credit.
- Income over \$2,600 increases the parents' AGI. All deductions and credits limited or phased out by AGI are affected (Child Tax Credit, Credit for Other Dependents, education credits, medical deductions, etc.).
- Taxable Social Security may increase.
- Some deductions can be taken only on the child's return.
  - Higher standard deduction for a child who is blind.
  - Child's itemized deductions.
  - Penalty on early withdrawal of child's savings.
  - Child's capital loss carryover.
- If the child has qualified dividends or capital gain distributions, tax is up to \$130 lower on the child's return.
- Child's tax-exempt interest from certain private activity bonds is included in the parents' AMT calculation.
- Child's tax increases parents' estimated tax requirements.

#### Reasons to report income on parents' return:

- No return is required for the child.
- No estimated tax payments for the child.
- Child's tax can be paid from the parents' withholding.
- Child's income is treated as parents' income for purpose of the investment interest expense deduction.

## Divorce

### Cross References

- IRS Pub. 504, *Divorced or Separated Individuals*
- IRC §414(p), *Qualified domestic relations order defined*
- IRC §1041, *Transfers of property between spouses or incident to divorce*

### Related Topics

- Filing status, Tab 3
- Joint payments and separate returns, Tab 3
- Child of divorced or separated parents, Tab 4
- Community Property, page 14-4
- Relief From Joint and Several Liability on Joint Returns, page 15-12

## Property Settlements and Transfers

### No gain or loss is recognized on:

- Transfers between spouses.
- Transfers between former spouses if incident to divorce.

This rule applies even if the transfer is in exchange for cash, release of marital rights, assumption of liabilities, or other consideration.

**Incident to divorce.** Transfers are incident to divorce if they are:

- Made within one year after the date the marriage ends, or
- Related to the ending of the marriage—made under an original or modified divorce or separation instrument within six years after the date the marriage ends. Transfers that do not meet these conditions are presumed not to be related to the ending of the marriage, but see Regulation section 1.1041-1T (Q&A-7) and PLR 200442003 for information on rebutting the presumption.

**Transfer to a third party.** Nonrecognition may also apply to a transfer on behalf of a spouse or former spouse. See IRS Pub. 504, *Divorced or Separated Individuals*.

**Sale of residence.** For purposes of the IRC section 121 exclusion of gain, an owner is treated as using property as his or her principal residence during any period that use is granted to a spouse or former spouse under a divorce or separation instrument.

## Qualified Domestic Relations Order (QDRO)

**Retirement plans.** Distributions from qualified retirement plans and tax-sheltered annuities are taxable to the plan participant and subject to early withdrawal penalties unless made to an alternate payee under a QDRO. A QDRO is a judgment, decree, or court order issued under a state's domestic relations law that must state the following provisions.

- Someone other than the participant has a right to receive benefits from a qualified retirement plan or a tax-sheltered annuity,
- Payment of child support, alimony, or marital property rights are to be paid to a spouse, former spouse, child, or other dependent of the participant, and
- The actual amount or a part of the participant's benefits are to be paid to the participant's spouse, former spouse, child, or other dependent.

**Spouse or former spouse.** Distributions under a QDRO are taxable to the recipient spouse but are not subject to early withdrawal penalties. Qualifying distributions can be rolled over. The recipient spouse may elect lump sum treatment if available. The recipient receives a share of the participant's investment in the contract, if any, to compute the taxable amount.

**Other alternate payee.** Benefits paid to a participant's child or other dependent under a QDRO are taxable to the participant but are not subject to early withdrawal penalties.

**Court Case:** According to an addendum to their divorce decree, the taxpayer deposited pension distributions into a joint account with his ex-wife for her exclusive benefit. He did not report the pension distributions on his income tax return. The Tax Court held the addendum failed to be a QDRO because direct payment was not made to the ex-wife as an alternate payee. Distributions were taxable income for the taxpayer even though his ex-wife actually received the money. (*Hackenberg*, T.C. Summary 2010-135)

**IRAs.** Transfer to a spouse under a divorce or separation instrument is not a taxable transfer. Transfers can be made by direct transfer from trustee to trustee or by changing ownership of the IRA account. A QDRO is not required. The IRA is treated as the recipient's as of the date of transfer. IRA distributions are subject to early withdrawal penalties even when the distribution is court ordered. The penalty exception for payments to an alternate payee under a QDRO does not apply to IRAs.

## Deducting Legal Fees

Legal fees paid for a spouse or former spouse may qualify as alimony. See IRS Pub. 504, *Divorced or Separated Individuals*.

**Miscellaneous itemized deductions subject to the 2% AGI limitation.** For tax years 2018 through 2025, this deduction has been suspended. Therefore, fees paid to determine tax or for tax advice and fees paid to get or collect alimony are not deductible.

## Alimony

Alimony is a payment to or for a spouse or former spouse under a divorce or separation instrument. It does not include voluntary payments not made under the instrument.

**Agreements executed after December 31, 2018.** Payments made or received under the following divorce or separation agreements are not deductible by the payer and not included in the gross income of the recipient.

- Divorce or separation agreement executed after December 31, 2018.
- Divorce or separation agreement executed before 2019, but later modified, if the modification expressly states the repeal of the deduction for alimony payment applies to the modification.

**Agreements executed after 1984 and before 2019.** Generally, alimony or separate maintenance payments are tax deductible by the payer, and must be included as taxable income to the recipient.

### Alimony Requirements

**Note:** This chart is for payments made under a divorce or separation instrument executed after 1984. For payments made under instruments executed before 1985, see IRS Pub. 504, *Divorced or Separated Individuals*.

**Alimony—Payments are alimony if all the following are true.**

- Payments are required by a divorce or separation instrument.
- Payer and recipient spouse do not file a joint return.
- Payment is in cash (including checks and money orders). Payments not considered to be in cash include noncash property settlements, spouse's part of community income, upkeep for the payer's property, and use of the payer's property.
- Payment is not designated in the instrument as "not alimony."
- Divorced and legally separated spouses are not members of the same household when payment is made.<sup>1</sup>
- Payments are not required after death of the recipient spouse.<sup>2</sup>
- Payment is not treated as child support.

<sup>1</sup> A house formerly shared by the spouses is considered one household. Spouses are not treated as members of the same household if one spouse is preparing to leave and does in fact leave no later than one month after payment. Until divorce or legal separation is final, spouses can be members of the same household.

<sup>2</sup> If payments can continue after death, the part of the payment that would continue is not alimony whether made before or after death. The divorce or separation instrument does not need to expressly state that payment ceases if liability for payments ends by operation of state law.

**Designating payments as "not alimony."** Spouses can agree not to treat qualifying payments as alimony. A provision clearly instructing that the payment is not to be treated as alimony must be included in a divorce or separation instrument or in a written statement signed by both spouses that refers to a previous written separation agreement. If spouses are subject to temporary support orders, the designation must be in an order. A copy of the written instrument must be attached to the recipient's return.

**Payments to third parties.** Payments to third parties under a divorce or separation instrument can qualify as alimony. Payments are treated as received by the spouse and then paid to the third party. The recipient spouse can claim deductions for items paid with the alimony.

**Home occupied by spouse.** If, under the terms of a divorce or separation instrument, one spouse occupies a home that belongs

to the other, the owner's payments for mortgage, real estate tax, insurance, and repairs are not alimony. Payments for utilities may be alimony. Rent-free use of property is not alimony.

### Expenses of a Jointly-Owned Home—Alimony

<i>If the payer must pay all of the:</i>	<i>And the home is:</i>	<i>The payer can deduct and the recipient must include as alimony:</i>	<i>The payer can claim as an itemized deduction:</i>
Mortgage payments (principal and interest)	Jointly owned	Half of the total payments	Half of the interest if home qualifies*
Real estate taxes and home insurance	Held as tenants in common	Half of the payments	Half of the real estate taxes** and none of the insurance
	Held as tenants by the entirety or in joint tenancy	None of the payments	All of the real estate taxes and none of the insurance

\* The recipient can deduct the other half of the interest if the home qualifies.

\*\* The recipient can deduct the other half of the real estate taxes.

**Payments for home owned by former spouse.** If, under a separation agreement, the payer is making the mortgage, real estate tax, and home insurance payments on a home owned by the former spouse, and the payments otherwise qualify, the payer can deduct the payments as alimony on his or her income tax return, and the spouse must report them as alimony received.

Payments made at the written request of the spouse receiving alimony qualify as alimony if paid in lieu of alimony that would be paid directly to the spouse. The written request must state that both spouses intend the payments as alimony. The payer must receive the written request before filing.

**Recapture—reduction in first three years.** In some cases, if the alimony paid in the second and/or third year decreases from that paid in a prior year, alimony must be recaptured. See Worksheet 1 and the example in IRS Pub. 504, *Divorced or Separated Individuals*.

**Nonresident alien spouse.** A U.S. citizen or resident alien paying alimony to a nonresident alien spouse may be required to withhold tax. See IRS Pub. 515, *Withholding of Tax on Nonresident Aliens and Foreign Entities*.

## Child Support

Child support is not deductible by the payer or taxable to the recipient. Payments specifically designated as child support in a divorce or separation instrument are not alimony.

Payments not specifically designated child support are treated as child support if they are reduced either:

- On the happening of a contingency relating to a child (reaching a specific age or income level, leaving school, marrying, becoming employed, dying, leaving the household, etc.).
- At a time that can be clearly associated with such a contingency. For more information, see IRS Pub. 504, *Divorced or Separated Individuals*, and Regulation section 1.71-1T (Q&A-18).

**Court Case:** The taxpayer received \$24,700 from her ex-husband for the support and maintenance of her and their three minor children. She reported zero alimony income, believing all of the payments to be non-taxable child support. The Tax Court held the divorce decree did not specifically designate any portion of the spousal support payments for the support of the children, so the majority of the total payments were includible in her income as alimony. (*Schilling*, T.C. Memo. 2012-256)

## Underpayment of Alimony or Child Support

If alimony and child support are both required under a divorce or separation instrument, and payments are less than the total required, payments apply first to child support and then to alimony.

~ End ~