deduction under Code Sec. 221; ; and, education IRAs under Code Sec. 530; . Several other '97 law changes to existing IRC sections were also discussed.

Reference(s):

Stat. 788) (TRA '97). Specifically, TRA '97 added section 25A of the Internal Revenue Code providing the Hope Scholarship Credit and Lifetime Learning Credit, section 221 providing a deduction for student loan interest, and section 530 creating Education Individual Retirement Accounts ("Education IRAs"). TRA '97 also amended section 72(t) eliminating the early withdrawal tax on certain IRA withdrawals, section 127 providing an exclusion from income for employer-provided educational assistance, and section 529 setting the requirements for tax-exempt status for qualified state tuition programs (QSTPs).

These provisions create several new tax benefits for families who are saving for, or already paying, higher education costs or are repaying student loans. In addition, TRA '97 extends the exclusion for employer-provided educational assistance and makes the rules for qualified state

The Hope Scholarship Credit may be claimed for payments of qualified tuition and related expenses made on or after January 1, 1998, for academic periods beginning on or after January 1, 1998. Therefore, the first time taxpayers will be able to claim the credit is when they file their 1998 tax returns in 1999. The Hope Scholarship Credit is not available for any amount paid in 1997.

Q1: Who may claim the Hope Scholarship Credit?

A1: An individual paying qualified tuition and related expenses at a postsecondary educational institution may claim the credit, provided the student whose expenses are being paid and the institution meet certain eligibility requirements.

Q2: May an individual claim a Hope Scholarship Credit for paying qualified tuition and related expenses for other family members?

A2: Yes. An individual may claim the credit for his/her own qualified tuition and related expenses and the qualified tuition and related expenses of his/her spouse and other eligible dependents (including children) for whom the dependency exemption is claimed. Generally, a parent may claim the dependency exemption for his/her unmarried child if: (1) the parent supplies more than half the child's support for the taxable year, and (2) the child is under age 19 or is a full-time student under age 24.

Q3: What are the eligibility requirements for the student?

A3: A student is eligible for the Hope Scholarship Credit if: (1) for at least one academic period (e.g., semester, trimester, quarter) beginning during the calendar year, the student is enrolled at least half-time in a program leading to a degree, certificate, or other recognized educational credential and is e [illegible]
[illegible]

Higher Education Act of 1965 (20 U.S.C. 1088) and, therefore, eligible to participate in the student aid programs administered by the Department of Education. This category includes virtually all accredited public, nonprofit, and proprietary postsecondary institutions. (The same eligibility requirements for institutions apply for the Lifetime Learning Credit, described in the next section.)

Q5: The Hope Scholarship Credit may be claimed only for amounts spent on “qualified tuition and related expenses.” Which expenses are included in qualified tuition and related expenses?

A5: The term “qualified tuition and related expenses” means the tuition and fees an individual is required to pay in order to be enrolled at or attend an eligible institution. Amounts paid for any course or other education involving sports, games, or hobbies are not eligible for the credit, unless the course or other education is part of the student's degree program. Charges and fees associated with room, board, student activities, athletics, insurance, books, equipment, transportation, and similar personal, living, or family expenses are not qualified tuition or related expenses. (The same definition of “qualified tuition and related expenses” applies for the Lifetime Learning Credit, described in the next section.)

Q6: The Hope Scholarship Credit is available only if a taxpayer's “modified adjusted gross income” is below a specified amount. How does a taxpayer know what his/her modified adjusted gross income is?

A6: For most taxpayers, modified adjusted gross income is the same as adjusted gross income.

child's parent claims the child as a dependent in that same year. (The same rules apply for the Lifetime Learning Credit, described in the next section.)

Q13: What is the maximum Hope Scholarship Credit a taxpayer may claim for an eligible student?

A13: Until 2002 (when the dollar limitations are indexed for inflation), for each student who meets the eligibility requirements, the credit amount is 100 percent of the first $1,000 of the taxpayer's out-of-pocket expenses for qualified tuition and related expenses, plus 50 percent of the next $1,000 of the taxpayers out-of-pocket expenses for qualified tuition and related expenses. Therefore, the maximum credit amount for the expenses of an eligible student is $1,500. If the taxpayer is claiming a credit for more than one person, the credit amount for each student in the taxpayer's family is added together to determine the maximum total credit the taxpayer may claim.

Q14: The amount a taxpayer may claim as a Hope Scholarship Credit is gradually reduced for taxpayers with modified adjusted gross income between $40,000 and $50,000 (between $80,000 and $100,000 for married taxpayers filing jointly). How does this reduction work?

A14: The reduction works on a sliding scale that reflects where the taxpayer's modified adjusted gross income is in the phase-out range. For example, until 2002 (when the dollar limitations on the credit and the income ranges are indexed for inflation), if an eligible student (who is not anyone's dependent for tax purposes) pays $2,000 or more in qualified tuition and related expenses in a particular year, and the student's modified adjusted gross income for the year is $45,000 (half way along the $10,000 phase-out range), the credit amount for the student is limited to $750. By contrast, if the same student's modified adjusted gross income was $35,000, the credit amount for the student would be the maximum $1,500.

Q15: How does a taxpayer claim the Hope Scholarship Credit?

A15: The first year that the credit will be available is 1998. Thus, taxpayers will not be able to claim the credit until they file their 1998 tax returns in 1999. Instructions accompanying the 1998 tax forms (for returns required to be filed in 1999) will explain how to calculate the credit and how to claim it on the tax return.

Q16: Is there a limit to the number of times a taxpayer may claim the Hope Scholarship Credit for each student?

A16: Yes. The credit may be claimed in

expenses in 1998 and again in 1999. After 1999, neither the parents, the student, nor anyone else may claim any additional Hope Scholarship Credits for this student's qualified tuition and related expenses. However, in 2000 and thereafter, the Lifetime Learning Credit may be available for this child's expenses. Furthermore, if the couple has another child who starts as a freshman in the fall of 1999, the couple may claim the Hope Scholarship Credit for that child's expenses in 1999 and one additional year.

Q17: May an individual claim both the Hope Scholarship Credit and the Lifetime Learning Credit for a student's expenses in a single taxable year?

A17: No. For each year in which a student meets the eligibility requirements for the Hope Scholarship Credit, the student's expenses may be used as the basis for a Hope Scholarship Credit or a Lifetime Learning Credit, but not both. If, for example, an eligible student pays more than $2,000 in qualified tuition and related expenses during the calendar year, the student (or the individual claiming the student as a dependent) may not claim the Hope Scholarship Credit for the first $2,000 of expenses and the Lifetime Learning Credit for the rest.

Q18: If a couple has two children, one who is a freshman and one who is a junior, may the couple claim a Hope Scholarship Credit for the freshman's expenses and a Lifetime Learning Credit for the junior's expenses?

A18: Yes. Assuming the applicable eligibility requirements have been met for each credit, a taxpayer may claim the Hope Scholarship Credit for one student's expenses and the Lifetime Learning Credit for another student's expenses in the same year.

Q19: May a parent or student claim a Hope Scholarship Credit for tuition paid in advance of when the academic period begins?

A19: Generally, the credit is available only for payments of qualified tuition and related expenses that cover an academic period beginning in the same calendar year as the payment is made. (An academic period begins on the first day of classes, and does not include periods of orientation, counseling, or vacation.) An exception, however, allows a parent or student to claim a Hope Scholarship Credit for payments of qualified tuition and related expenses made during the calendar year to cover an academic period that begins in January, February, or March of the following taxable year. BECAUSE THE HOPE SCHOLARSHIP CREDIT DOES NOT APPLY TO EXPENSES PAID BEFORE JANUARY 1, 1998, THIS EXCEPTION DOES NOT APPLY TO TUITION PAID IN 1997 TO COVER ACADEMIC PERIODS BEGINNING IN 1998.

Q20: If a student (who is not claimed as a dependent on anyone's Federal income tax return) pays qualified tuition and related expenses using a combination of a Pell Grant, a loan, a gift from a family member, and some personal savings, what expenses may be taken into account in calculating the Hope Scholarship Credit the student may claim?

A20: The student may take into account only “out-of-pocket” expenses in calculating the credit. Qualified tuition and related expenses paid with the student's earnings, a loan, a gift, an inheritance, or personal savings (including savings from a qualified state tuition program) are taken into account in calculating the credit amount. However, qualified tuition and related expenses paid with a Pell Grant or other tax-free scholarship, a tax-free distribution from an Education IRA, or tax-free employer-provided educational assist filing jointly) and $50,000 ($100,000 for married taxpayers filing jointly). Taxpayers with modified adjusted gross income over $50,000 ($100,000 for married taxpayers filing jointly) may not claim a Lifetime Learning Credit. The modified adjusted gross income limitation will be indexed for inflation in 2002 and years thereafter. The definition of modified adjusted gross income is the same as it is for purposes of the Hope Scholarship Credit. (See Sec. 1, Q&A6.)

The Lifetime Learning Credit may be claimed for payments of qualified tuition and related expenses made on or after July 1, 1998, for academic periods beginning on or after July 1, 1998. Therefore, the first time taxpayers will be able to claim the credit will be when they file their 1998 tax returns in 1999. The Lifetime Learning Credit is not available for any amount paid in 1997.

Q1: Who may claim the Lifetime Learning Credit?

A1: An individual paying qualified tuition and related expenses at a postsecondary educational institution may claim the credit, provided the institution is an eligible educational institution. Unlike the Hope Scholarship Credit, students are not required to be enrolled at least half-time in one of the first two years of postsecondary education. Nonresident aliens generally are not eligible to claim thc c

Lifetime Learning Credit?

A5: Yes.

Q6: May an individual claim a Lifetime Learning Credit for more than one family member?

A6: Yes. However, unlike the Hope Scholarship Credit, the Lifetime Learning Credit is calculated on a per family, rather than a per student, basis. Therefore, the maximum available credit does not vary with the number of students in the family.

expenses annually through 2002. Thus, the maximum Lifetime Learning Credit a taxpayer may the classes at institutions that meet the eligibility requirements. (See Q&A3 in this section.)

Q14: May a parent or student claim a Lifetime Learning Credit for tuition paid in advance of when the academic period begins?

A14: Generally, the credit is available only for payments of qualified tuition and related expenses that cover an academic period beginning in the same calendar year as the year in which payment is made. (An academic period begins on the first day of classes, and does not include periods of orientation, counseling, or vacation.) An exception, however, allows a parent or student to claim a Lifetime Learning Credit for payments of qualified tuition and related generally subject to income tax and to an additional tax of 10 percent. The Hope Scholarship Credit and Lifetime Learning Credit may not be claimed for a student's expenses in a taxable year in which the student takes a tax-free withdrawal from an Education IRA.

Q1: What is an Education IRA?

A1: An Education IRA is a trust or custodial account that is created or organized in the United States exclusively for the purpose of paying the qualified higher education expenses of the designated beneficiary of the account. The account must be designated as an Education IRA when it is created in order to be treated as an Education IRA for tax purposes

Q2: For whom may an Education IRA be established?

A2: An Education IRA may be established for the benefit of any child under age 18. Contributions to the Education IRA will not be accepted after the designated beneficiary reaches his/her 18th birthday.

Q3: Where may an individual open an Education IRA?

A3: An individual may open an Education IRA with any bank, or other entity that has been approved to serve as a nonbank trustee or custodian of an individual retirement account (IRA), and the bank or entity is offering Education IRAs. Other entities that wish to offer Education IRAs but are not approved to serve as IRA trustees or custodians may seek approval by following the same IRS procedures used for approval of other IRA nonbank trustees. See **Notice** 97-57, 1997-43 I.R.B. (October 27, 1997).

Q4: When may a taxpayer start contributing to an Education IRA for a child?

A4: A taxpayer may start making contributions on January 1, 1998, or at any time thereafter.

Q5: How much may be contributed to a child's Education IRA?

A5: Up to $500 per year in aggregate contributions may be made for the benefit of any child. The contributions may be placed in a single Education IRA or in multiple Education IRAs.

Q6: What happens if more than $500 is contributed to an Education IRA on behalf of a child in a calendar year?

A6: Aggregate contributions for the benefit of a particular child in excess of $500 for a calendar year are treated as excess contributions. If the excess contributions (and any earnings attributable to them) are not withdrawn from the child's account (or accounts) before the tax return for the year is due, the excess contributions are subject to a 6 percent excise tax for each year the excess amount remains in the account.

Q7: May contributions other than cash be made to a child's Education IRA?

A7: No. Education IRAs are permitted to accept contributions made in cash only.

Q8: May contributors take a deduction for contributions made to an Education IRA?

A21: No. If a student is receiving a tax-free distribution from an Education IRA in a particular taxable year, none of that student's expenses may be claimed as the basis for a Hope Scholarship Credit or Lifetime Learning Credit for that year. However, the student may waive the tax-free treatment of the Education IRA distribution and elect to pay any tax that would otherwise be owed on an Education IRA distribution so that the student or the student's parents may claim a Hope Scholarship Credit or Lifetime Learning Credit for expenses paid in the same year the Education IRA distributions are received.

Q22: May contributions be made to both a qualified state tuition program and an Education IRA on behalf of the same designated beneficiary in the same taxable year?

A22: No. Any amount contributed to an Education IRA on behalf of a designated beneficiary during any taxable year in which an amount is also contributed to a qualified state tuition program on behalf of the same beneficiary will be treated as an excess contribution to the Education IRA. (See Q&A6 in this section for the treatment of excess contributions.)

A4: Yes.

Q5: Are there any limits on who may take the student loan interest deduction?

A5: Yes, there are income restric

A9: No. The student loan interest deduction is available regardless of whether an individual elects to take the standard deduction or to itemize deductions. Instructions accompanying the 1998 tax forms (for returns required to be filed in 1999) will explain how to compute and claim the deduction.

Q10: If a student is claimed as a dependent by his/her parent in a particular taxable year, may the student take the student loan interest deduction for student loan interest that he/she pays in that year?

A10: No. The student may not claim the student loan interest deduction in any taxable year in which he/she is claimed as a dependent on another taxpayer's return. However, if the student continues to pay interest on a student loan and meets the other eligibility requirements, the student may claim the student loan interest deduction for payments made in a later year when the student is no longer a dependent on his/her parent's Federal income tax return.

Q11: Are there any tax benefits available if the student repays his/her loan by performing community service rather than making cash payments?

A11: There may be. Loan forgiveness provided in return for community service is tax-free when it is part of certain lending programs run by the Federal, state, or local government, educational institutions, or charitable organizations. Students should consult a tax advisor to determine whether they qualify.

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required to have a written plan describing the benefit and the terms under which it is available.

Q2: Does the employee have to do anything special to avoid being taxed on employer-provided educational assistance, up to the $5,250 limit?

A2: No. The employer will automatically treat the educational assistance as a tax-free benefit and will not include it as wages on the employee's W-2 form.

Q3: May an employee receive tax-free educational assistance from the employer to attend graduate school?

A3: In general, no. However, employers can provide job-related educational assistance for graduate-level education as a tax-free fringe benefit under certain circumstances. Educational assistance would generally qualify as job-related if it maintains or improves skills required for the employee's current job or satisfies certain express employer-imposed conditions for continued employment. Individuals should consult a tax advisor for help in determining the tax treatment of any assistance the individual may be receiving from an employer for graduate-level education.

Q4: If a student is enrolled in undergraduate courses in a particular year and owes $3,000 in qualified tuition and related expenses, and the student's employer pays all of the student's qualified tuition and related expenses, may a Hope Scholarship Credit or a Lifetime Learning Credit be claimed for that student for that year?

A4: No. Neither the Hope Scholarship Credit nor the Lifetime Learning Credit may be claimed for that student for that year.

Further Information

For further information contact: Donna J. Welch, (202) 622-4910 regarding the Hope Scholarship and Lifetime Learning Credits; Monice L. Rosenbaum, (202) 622-6070 regarding employer-provided educational assistance and qualified state tuition programs; Pamela R. Kinard, (202) 622-6030 regarding Education IRAs and using IRA withdrawals to pay for higher education expenses; and John Moriarty, (202) 622-4950 regarding student loan interest deduction (not toll-free numbers).

The IRS will publish additional guidance on the provisions discussed in this **notice** as well as other provisions included in TRA '97. You may visit the IRS worldwide web site at (http://www.irs.ustreas.gov/hot/tax_law.html) for information on additional guidance as it becomes available.

The Department of Education has a worldwide web site (http://www.ed.gov/prog_info /SFA/StudentGuide) you can visit and telephone numbers (1-800-4FED-AID and 1-800-USA-LEARN) you can call to get more information on affording college and obtaining student aid, such as Pell grants and student loans.

Drafting Information

The principal authors of this notice are Donna J. Welch, Office of Assistant Chief Counsel (Income Tax and Accounting) and Monice L. Rosenbaum and Pamela R. Kinard, Office of Associate Chief Counsel (Employee Benefits and Exempt Organizations). However, other