

Education: Scholarships, Grants, and the American Opportunity Credit

Updated for 2025/2026, this course tackles the foundational pieces of education tax benefits — starting with the tax treatment of scholarships, fellowship grants, and tuition reductions, then moving into a detailed look at the American Opportunity Credit. You'll cover eligibility requirements, qualifying expenses, how to handle dependent expense claims, and the steps for calculating and claiming the credit. A solid starting point for tax professionals who prepare returns for students, parents, or clients receiving any form of educational financial assistance.

CREDIT HOURS 2 | FIELD OF STUDY TAXES | EXAM QUESTIONS 5

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LEARNING ASSIGNMENTS AND OBJECTIVES

Assignment

- Study the full course materials included here.
- Complete the review questions after each chapter.
- Answer 5 final exam questions.
- Final exam is scored immediately, 70% or better passes.
- Certificate of completion is available in your account.
- Failed exams can be retaken free of charge.

Course Objectives

- Recognize the taxability of various types of educational assistance.
- Recognize how and when to use the American opportunity credit.

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INTRODUCTION

The goal of this course is to teach you all the different education-related tax benefits that are available to you and your clients. Throughout this course, we use the term “you” which can be substituted with “your client.”

The course starts out with new changes for 2026, and then goes into detail of each different option you have. The course includes an Appendix which shows in graphic form how the different options compare to each other.

This course explains tax benefits that may be available to you if you are saving for or paying higher education costs for yourself or another student who is a member of your immediate family.

Chapter 1 covers the tax treatment of various types of educational assistance, including scholarships, fellowships, grants, and tuition reductions.

Two tax credits for which you may be eligible are explained in Chapter 2, Chapter 1 of course 33852E. These benefits, which reduce the amount of income tax you may have to pay, are:

- The American opportunity credit, and
- The lifetime learning credit.

Additional benefits are explained in Chapter 2 of course 33852E through Chapter 3 of course 33852E of course 33853E. With these benefits, you may be able to:

- Deduct student loan interest,
- Receive tax-free treatment of a canceled student loan,
- Receive tax-free student loan repayment assistance,
- Establish and contribute to a Coverdell education savings account (ESA), which features tax-free earnings,
- Participate in a qualified tuition program (QTP), which features tax-free earnings,
- Take early distributions from any type of individual retirement arrangement (IRA) for education costs without paying the 10% additional tax on early distributions,
- Cash in savings bonds for education costs without having to pay tax on the interest,
- Receive tax-free educational benefits from your employer, and
- Claim a business deduction for work-related education.

Note

You generally cannot claim more than one of the benefits described in the list above for the same qualifying education expense.

I. WHAT'S IMPORTANT FOR 2025/2026

Trump Accounts and new Form 4547. Recent legislation allows parents, guardians, and other authorized individuals to elect to establish a new type of individual retirement account, called a Trump account, for the exclusive benefit of certain children. If the child was born after 2024 and before 2029, is a U.S. citizen, and meets certain other requirements, the authorized individual may also elect to receive a \$1,000 pilot program contribution to the child's Trump account. Both elections can be made on Form 4547, which can be filed at the same time as the authorized individual's 2025/2026 income tax return. For more information on Trump accounts, and to learn how to make these elections, see Form 4547 and its instructions.

Student loan interest deduction. For 2025, the amount of your student loan interest deduction is gradually reduced (phased out) if your MAGI is between \$85,000 and \$100,000 (\$170,000 and \$200,000 if you file a joint return). You cannot claim the deduction if your MAGI is \$100,000 or more (\$200,000 if you file a joint return for 2025). For 2026, the amounts decreased (\$75,000 - \$90,000 for single, and \$155,000 - \$185,000 for married filing a joint return). See Chapter 2 of course 33852E, *Student Loan Interest Deduction*, for more information.

Education savings bond program. For 2025, the amount of your education savings bond interest exclusion is gradually reduced (phased out) if your MAGI is between \$99,500 and \$114,500 (\$149,250 and \$179,250 if you file a joint return). You cannot exclude any of the interest if your MAGI is \$114,500 or more (\$179,250 or more if you file a joint return for 2025). For 2026, the amounts increased (\$101,800 - \$116,800 for single, and \$152,650 - \$182,650 for married filing a joint return). See Chapter 3 of course 33853E for more information.

Business deduction for work-related education. Generally, if you claim a business deduction for work-related education and you drive your car to and from school, the amount you can deduct for miles driven from January 1, 2025, through December 31, 2025, is 70 cents per mile. For January 1, 2026 through June 30, 2026, the mileage rate is 72.5 cents per mile, and from July 1, 2026 thereafter, it is 76 cents per mile.

II. REMINDERS

Form 1098-T, Tuition Statement. When figuring an education credit or tuition and fees deduction, use only the amounts you paid and are deemed to have paid during the tax year for qualified

education expenses. In most cases, the student should receive Form 1098-T from the eligible educational institution by February 2, 2026 (usually this would be by January 31st, however, January 31st is a Saturday, therefore it is pushed to Monday, February 2nd.) However, the amount on Form 1098-T might be different than the amount you actually paid and are deemed to have paid. In addition, the Form 1098-T should give you other information for that institution, 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. The eligible educational institution may ask for a completed Form W-9S, *Request for Student's or Borrower's Taxpayer Identification Number and Certification*, or similar statement to obtain the student's name, address, and taxpayer identification number.

Form 1098-T requirement. To be eligible to claim the American opportunity credit or the lifetime learning credit, the law requires a taxpayer (or a dependent) to have received Form 1098-T, *Tuition Statement*, from an eligible educational institution, whether domestic or foreign.

However, a taxpayer may claim a credit if the student does not receive a Form 1098-T because the student's educational institution isn't required to send a Form 1098-T to the student under existing rules (for example, if the student is a qualified nonresident alien, has qualified education expenses paid entirely with scholarships, has qualified education expenses paid under a formal billing arrangement, or is enrolled in courses for which no academic credit is awarded). If a student's educational institution is not required to provide a Form 1098-T to the student, a taxpayer may claim a credit without a Form 1098-T if the taxpayer otherwise qualifies, can demonstrate that the taxpayer (or a dependent) was enrolled at an eligible educational institution, and can substantiate the payment of qualified tuition and related expenses.

Educational institution's EIN required. To claim the American opportunity credit, you must provide the educational institution's employer identification number (EIN) on your Form 8863. You should be able to obtain this information from Form 1098-T or the educational institution. See Chapter 2.

Form 8862 may be required. If your American opportunity credit was denied or reduced for any reason other than a math or clerical error for any tax year beginning after 2015, you must attach a completed Form 8862, *Information To Claim Certain Refundable Credits After Disallowance*, to your tax return for the next year for which you claim the credit. See Chapter 2.

Ban on claiming the American opportunity credit. If you claim the American opportunity credit even though you're not eligible, you may be banned from claiming the credit for 2 or 10 years depending on your conduct. See Chapter 2.

Taxpayer identification number (TIN) needed by due date of return. If you have not been issued a TIN by the due date of your return (including extensions), you cannot claim the American opportunity credit on either your original or an amended return. Also, the American opportunity

credit is not allowed on either your original or an amended return for a student who has not been issued a TIN by the due date of your return (including extensions). See Chapter 2.

Higher education emergency grants. Emergency financial aid grants under the following are not included in your gross income.

- The CARES Act.
- The Coronavirus Response and Relief Supplemental Appropriations Act, 2021.
- The American Rescue Plan Act of 2021.

Also, for purposes of the American opportunity tax credit (see Chapter 2) and lifetime learning credit (see Chapter 1 of course 33852E), a student does not reduce an amount of qualified tuition and related expenses by the amount of an emergency financial aid grant.

Coordination with Pell grants and other scholarships or fellowship grants. It may benefit you to choose to include otherwise tax-free scholarships or fellowship grants in income. This may increase your education credit and lower your total tax or increase your refund. See *Coordination with Pell grants and other scholarships or fellowship grants* throughout this course.

Student loan interest deduction. You cannot deduct as interest on a student loan any interest paid by your employer after March 27, 2020, under an educational assistance program. See Chapter 2 of course 33852E.

Student loan forgiveness. The American Rescue Plan Act of 2021 modified the treatment of student loan forgiveness for discharges in 2021 through 2025. See Chapter 3 of course 33852E.

Achieving a Better Life Experience (ABLE) account. This is a savings account for individuals with disabilities and their families. Distributions are tax free if used to pay the beneficiary's qualified disability expenses, which may include education expenses. For more information, see Pub. 907, *Tax Highlights for Persons With Disabilities*.

Estimated tax payments. If you have taxable income from any of your education benefits and the payer does not withhold enough income tax, you may need to make estimated tax payments.

Employer-provided educational assistance benefits. Employer-provided educational assistance benefits include payments made after March 27, 2020, for principal or interest on any qualified education loan you incurred for your education. See Chapter 4 of course 33853E.

Miscellaneous itemized deductions. For tax years beginning after 2017, you no longer deduct work-related education expenses as a miscellaneous itemized deduction subject to a 2%-of-adjusted-gross-income floor. See Chapter 5 of course 33853E.

Chapter 1: SCHOLARSHIPS, FELLOWSHIP GRANTS, GRANTS, AND TUITION REDUCTIONS

Chapter Objective

After completing this chapter, you should be able to:

- Recognize the taxability of various types of educational assistance.

I. INTRODUCTION

This chapter discusses the income tax treatment of various types of educational assistance you may receive if you are studying, teaching, or researching in the United States. The educational assistance can be for a primary or secondary school, a college or university, or a vocational school. Included in the discussion are:

- Scholarships,
- Fellowship grants,
- Need-based education grants, such as a Pell Grant, and
- Qualified tuition reductions.

Many types of educational assistance are tax free if they meet the requirements discussed here.

Special rules apply to U.S. citizens and resident aliens who have received scholarships or fellowship grants for studying, teaching, or researching abroad.

II. SCHOLARSHIPS AND FELLOWSHIP GRANTS

A scholarship is generally an amount paid or allowed to, or for the benefit of, a student (whether an undergraduate or a graduate) at an educational institution to aid in the pursuit of their studies.

A fellowship grant is generally an amount paid for the benefit of an individual to aid in the pursuit of study or research.

Amount of scholarship or fellowship grant. The amount of a scholarship or fellowship grant includes the following:

- The value of contributed services and accommodations. This includes such services and accommodations as room (lodging), board (meals), laundry service, and similar services or accommodations that are received by an individual as a part of a scholarship or fellowship grant.

- The amount of tuition, matriculation, and other fees that are paid or remitted to the student to aid the student in pursuing study or research.
- Any amount received in the nature of a family allowance as a part of a scholarship or fellowship grant.

TAX-FREE SCHOLARSHIPS AND FELLOWSHIP GRANTS

A scholarship or fellowship grant is tax free (excludable from gross income) **only if** you are a candidate for a degree at an eligible educational institution.

Tip

You may be able to increase the combined value of an education credit and certain educational assistance if the student includes some or all of the educational assistance income in the year it is received. See examples under *Coordination with Pell grants and other scholarships*, in Chapter 2 and Chapter 1 of course 33852E, later.

A scholarship or fellowship grant is tax free **only to the extent**:

- It does not exceed your qualified education expenses;
- It is not designated or earmarked for other purposes (such as room and board), and does not require (by its terms) that it cannot be used for qualified education expenses; and
- It does not represent payment for teaching, research, or other services required as a condition for receiving the scholarship. (For exceptions, see *Payment for services*, later.

Use Worksheet 1-1 to figure the amount of a scholarship or fellowship grant you can exclude from gross income.

Candidate for a degree. You are a candidate for a degree if you:

1. Attend a primary or secondary school or are pursuing a degree at a college or university, or
2. Attend an educational institution that:
 - a) Provides a program that is acceptable for full credit toward a bachelor's or higher degree, or offers a program of training to prepare students for gainful employment in a recognized occupation; and
 - b) Is authorized under federal or state law to provide such a program and is accredited by a nationally recognized accreditation agency.

Eligible educational institution. An eligible educational institution is one whose primary function is the presentation of formal instruction and that normally maintains a regular faculty and curriculum