

# TOPS Scholarship Recipients Who Failed to Claim the Education Tax Credits for 1998 Should Consider Filing Amended Returns

Susan Kalinka

---

### Repository Citation

Susan Kalinka, *TOPS Scholarship Recipients Who Failed to Claim the Education Tax Credits for 1998 Should Consider Filing Amended Returns*, 60 La. L. Rev. (1999)  
Available at: <https://digitalcommons.law.lsu.edu/lalrev/vol60/iss1/10>

This Article is brought to you for free and open access by the Law Reviews and Journals at LSU Law Digital Commons. It has been accepted for inclusion in Louisiana Law Review by an authorized editor of LSU Law Digital Commons. For more information, please contact [kreed25@lsu.edu](mailto:kreed25@lsu.edu).

## TOPS Scholarship Recipients Who Failed to Claim the Education Tax Credits for 1998 Should Consider Filing Amended Returns

Susan Kalinka\*

In Notice 99-32,<sup>1</sup> the Internal Revenue Service announced that taxpayers who failed to claim the Hope Scholarship Credit or the Lifetime Learning Credit (collectively referred to as "education tax credits") for the 1998 taxable year and later years may elect to claim the credit by attaching Form 8863 to an amended return. Notice 99-32 relaxes the provisions under the proposed regulations<sup>2</sup> disallowing an education tax credit unless a taxpayer claims the credit on the taxpayer's timely filed federal income tax return for the taxable year in which the credit is claimed. Under Notice 99-32, a taxpayer may claim an education tax credit on a timely filed original federal income tax return, or an original federal income tax return or an amended return filed after the due date of the return and before the expiration of the period of limitation for filing a claim for credit or refund for the taxable year in which the credit is claimed.

It is likely that many students who received scholarship grants under the Louisiana Tuition Opportunity Program for Students ("TOPS") failed to claim education tax credits because the statute authorizing the education tax credits seems to deny the credit to a scholarship recipient. In January 1999, however, the Treasury Department and the IRS issued proposed regulations<sup>3</sup> providing a method whereby scholarship recipients may claim the credit. Because the proposed regulations were issued shortly before the filing season for 1998 income tax returns, tax practitioners may not have received notice that education tax credits are available to scholarship recipients.

During the 1998 income tax filing season, a number of practitioners advised TOPS scholarship recipients and their families that they were not eligible to take advantage of the education tax credits.<sup>4</sup> Under TOPS, the state of Louisiana offers scholarship awards to help Louisiana residents and their children defray the costs of postsecondary education.<sup>5</sup> In 1999, the Louisiana Legislature amended the

---

Copyright 1999, by LOUISIANA LAW REVIEW.

\* Harriet S. Daggett-Frances Leggio Landry Professor, Louisiana State University, Paul M. Hebert Law Center. This article is adapted from Susan Kalinka, *Reconciling the Education Tax Credits and State Scholarship Grants: A Look at Louisiana's TOPS Program*, 77 *Taxes* 31 (Oct. 1999).

1. 1999-23 I.R.B. 6.

2. Education Tax Credits, 64 *Fed. Reg.* 794, 799 (Jan. 6, 1999) (Prop. Reg. § 1.25A-1(d)).

3. *Id.* at 799.

4. See, e.g., Marsha Shuler, *Foster Won't Veto TOPS*, *The Advocate*, July 10, 1999, at A1, A4 (accountants Charles Comeaux and Mary K. Carleton stating that they advised TOPS scholarship recipients and their families that they were not eligible to claim the Hope Scholarship Credit "because of the way TOPS was originally set up").

5. La. R.S. 17:3048.1 (Supp. 1999).

TOPS scholarship legislation to eliminate provisions that were considered to prevent a TOPS scholarship recipient from claiming an education tax credit.<sup>6</sup>

This article discusses the 1999 amendments to the Louisiana legislation granting TOPS scholarship awards for higher education expenses of eligible students that were enacted to enable TOPS scholarship recipients to claim education tax credits. While the 1999 amendments may not have been necessary to ensure eligibility to claim the credits, the legislation illustrates some of the misconceptions concerning the ability of a scholarship recipient to claim an education tax credit in 1998. This article also suggests that TOPS scholarship recipients and/or their families consider filing amended returns if they failed to claim the credits in 1998.

### I. EDUCATION TAX CREDITS

Section 25A of the Internal Revenue Code generally allows a taxpayer to elect to claim one or both of two nonrefundable education credits, the Hope Scholarship Credit and the Lifetime Learning Credit. The Hope Scholarship Credit is the more generous of the two credits, allowing a credit of up to \$1,500 of qualified tuition and related expenses paid during the taxable year for each eligible student for whom the election is in effect.<sup>7</sup> The amount of the Hope Scholarship Credit is computed as an amount equal to the sum of one hundred percent of the first \$1,000 of qualified tuition and expenses, and fifty percent of the next \$1,000 of qualified tuition and expenses.<sup>8</sup> The Hope Scholarship Credit is allowed only for qualified tuition and related expenses paid during the first two years of a student's undergraduate education.<sup>9</sup>

To be eligible for the Hope Scholarship Credit, the student also must be enrolled for at least one academic period that begins during the taxable year and must carry at least one-half of the normal full-time work load for the course of study the student is pursuing.<sup>10</sup> The Hope Scholarship Credit is not allowed for expenses of a student who has been convicted of a federal or state felony drug offense.<sup>11</sup>

The Lifetime Learning Credit may be available if a student does not qualify for the Hope Scholarship Credit. Section 25A permits a taxpayer to claim a Lifetime Learning Credit in an amount equal to twenty percent of so much of qualified tuition and related expenses as does not exceed \$5,000 (or \$10,000 in the case of taxable years beginning after December 31, 2002).<sup>12</sup> Thus, the maximum amount that a taxpayer may claim as a Lifetime Learning Credit in 1998 or 1999 is \$1,000 (20% x \$5,000). Unlike the Hope Scholarship Credit, the Lifetime Learning Credit

---

6. 1999 La. Acts No. 777; 1999 La. Acts No. 1302.

7. I.R.C. § 25A(a)(1), (b)(1).

8. I.R.C. § 25A(b)(1).

9. I.R.C. § 25A(b)(2)(C).

10. I.R.C. § 25A(b)(2)(B), (b)(3)(B).

11. I.R.C. § 25A(b)(2)(D).

12. I.R.C. § 25A(c)(1).

is available for tuition and related expenses paid by the taxpayer for education of the taxpayer and the taxpayer's spouse and dependents for postsecondary education after the first two years of undergraduate training. There is no requirement that the student carry at least one-half of the normal full-time work load for the course of study the student is pursuing. The Lifetime Learning Credit is not denied if the student has been convicted of a felony drug offense.

While the Hope Scholarship Credit is allowed for each student who meets its requirements,<sup>13</sup> the Lifetime Learning Credit is available only for the aggregate of qualified tuition and related expenses paid by the taxpayer for the taxpayer and for the taxpayer's spouse and dependents.<sup>14</sup> In other respects, the two education tax credits are similar.

Both education tax credits are allowed for "qualified tuition and related expenses," defined as tuition and academic fees for enrollment or attendance at an "eligible educational institution."<sup>15</sup> Eligible educational institutions generally include accredited postsecondary educational institutions that offer credit towards a bachelor's degree, an associates' degree, or other recognized postsecondary credential, as well as some vocational and proprietary institutions.<sup>16</sup>

An education tax credit is not allowed for expenses incurred to purchase books or living expenses such as room and board. Moreover, the credit may not be claimed if a taxpayer's adjusted gross income exceeds certain limits. The full amount of each credit generally is available to single taxpayers with adjusted gross income of \$40,000 or less and married taxpayers filing joint returns with adjusted gross income of \$80,000 or less.<sup>17</sup> The amount of the credit is phased out for single taxpayers with adjusted gross income between \$40,000 and \$50,000 and for married taxpayers filing jointly with adjusted gross income between \$80,000 and \$100,000.<sup>18</sup>

A taxpayer may claim an education tax credit for qualified tuition and related expenses paid by the taxpayer for the benefit of the taxpayer, the taxpayer's spouse, and/or any of the taxpayer's dependents.<sup>19</sup> If a parent does not claim a child as a

---

13. I.R.C. § 25A(b)(1).

14. I.R.C. § 25A(c)(1).

15. I.R.C. § 25A(f)(1)(A), (C).

16. See I.R.C. § 25A(f)(2) (defining the term "eligible educational institution," in part, as an institution which is described in Section 481 of the Higher Education Act of 1965 that is eligible to participate in student aid programs sponsored by the Department of Education).

17. I.R.C. § 25A(d). For purposes of the income limitations, the statute refers to "modified adjusted gross income," rather than to "adjusted gross income." I.R.C. § 25A(d)(2). For this purpose, the term "modified adjusted gross income" means the taxpayer's adjusted gross income for the taxable year increased by the amount excluded from gross income under Sections 911 (excluding certain foreign earned income), 931 (excluding certain income that is effectively connected with a trade or business in Guam, American Samoa, or the Northern Mariana Islands), or 933 (excluding certain income from sources within Puerto Rico). I.R.C. § 25A(d)(3).

18. I.R.C. § 25A(d)(1), (2). For purposes of determining the amount of adjusted gross income to use for purposes of the phase-out, the taxpayer's adjusted gross income is increased by amounts that were excluded from gross income under I.R.C. § 911, 931, and 933. I.R.C. § 25A(d)(3). See *supra* note 17.

19. I.R.C. § 25A(f)(1)(A). For this purpose, the term "dependent" is defined in I.R.C. § 151. I.R.C.

dependent on the parent's income tax return, the credit will be available to the child. If a parent's adjusted gross income exceeds the income limitations for claiming an education tax credit, but the child's adjusted gross income falls within the income limitations, the family may reap better tax benefits if the parent forgoes the dependency exemption with respect to the child and the child claims the credit instead.<sup>20</sup>

It does not matter whether the parent or the child pays the tuition and related expenses. If the parent pays the child's expenses but the parent does not claim the child as a dependent, the child may take advantage of the education tax credit. In that case, the tuition payment is treated as a gift of money to the child and a payment by the child of the qualified tuition and related expenses.<sup>21</sup> If the child pays the expenses, but the parent claims the child as a dependent, Section 25A treats the transaction as if the parent paid the expenses, and not the child.<sup>22</sup>

## II. AVAILABILITY OF EDUCATION TAX CREDITS TO TOPS SCHOLARSHIP RECIPIENTS IN 1998

Under TOPS, the state of Louisiana pays an amount equal to tuition for the cost of a student's attendance at a state college or university if the student meets certain residency and scholastic requirements.<sup>23</sup> TOPS scholarships are also available to students who meet the residency and scholastic requirements and attend a private college or university in Louisiana. The amount of the award for a student attending a private educational institution is equal to "the weighted average of tuition paid for students attending public colleges and universities at the baccalaureate level."<sup>24</sup> Students who reach a higher academic level of achievement are also eligible to receive stipends of up to \$400 per semester (\$800 per academic year).<sup>25</sup>

As originally enacted, the TOPS scholarship legislation provided that the state of Louisiana would pay the tuition of an eligible student for attendance at certain postsecondary institutions. The payment of tuition by the state, rather than by the student or a person claiming the student as a dependent, was considered to be an impediment to the allowance of an education tax credit.

The doubt concerning the ability of TOPS scholarship recipients and their families to claim education tax credits is not surprising. Section 25A contains two provisions that would seem to prevent a 1998 TOPS scholarship recipient from claiming either one of the credits: (1) a requirement that the taxpayer pay the

---

§ 25A(f)(1)(A)(iii).

20. Forgoing the dependency exemption may be particularly beneficial if the parent has so much adjusted gross income that the dependency exemption is phased out under I.R.C. section 151(d)(3).

21. I.R.C. § 102(a); Education Tax Credits, 64 Fed. Reg. 794, 803 (Jan. 6, 1999) (Prop. Reg. § 1.25A-5(a)(1), (2) Example).

22. I.R.C. § 25A(g).

23. La. R.S. 17:3048.1 (Supp. 1999).

24. La. R.S. 17:3048.1(A)(2) (Supp. 1999).

25. La. R.S. 17:3048.1(A)(3) (Supp. 1999).

student's qualified tuition and related expenses; and (2) a provision reducing the amount of qualified tuition and related expenses for which a credit may be claimed by the amount of any scholarship grant received by the student that is excludable from the student's gross income.

### III. AMOUNTS PAID BY THE TAXPAYER

Under Section 25A, both credits are allowable for amounts "paid by the taxpayer" for qualified tuition and related expenses.<sup>26</sup> While the statute treats a taxpayer as paying the qualified tuition and related expenses of a dependent if the dependent actually makes the payments,<sup>27</sup> there is no provision concerning the payment of such expenses by any other person.

To remedy the perceived problem, 1999 Louisiana Acts No. 777 offers a procedure whereby the student may elect to defer receiving a TOPS scholarship grant until the student or the student's parent or guardian (if the student is claimed as a dependent) files a federal income tax return.<sup>28</sup> If the student delays the acceptance of the TOPS grant, the student is entitled to receive from the state an amount equal to the amount of the TOPS scholarship grant that the student would have received, less the amount of the credit claimed on a federal income tax return, plus an amount equal to twenty-five percent of the credit claimed.<sup>29</sup> If no federal tax credit is claimed, the student is entitled to receive the full amount of the TOPS scholarship grant that otherwise would have been awarded.<sup>30</sup>

While Act No. 777 was enacted with good intent, it should not be necessary to delay accepting a TOPS scholarship in order to be eligible to claim an education tax credit. The proposed regulations provide that if a third party (someone other than the taxpayer, the taxpayer's spouse, or a claimed dependent) makes a payment directly to an eligible educational institution to pay for a student's qualified tuition and related expenses, the student is treated as receiving the payment from the third party, and, in turn, paying the qualified tuition and related expenses to the institution.<sup>31</sup> The examples in the proposed regulations involve tuition payments by family members who do not claim the student for whom the tuition is paid as a dependent.<sup>32</sup> In each example, the student is treated as paying the qualified tuition and related expenses, thereby causing the student or a person who has claimed the student as a dependent to be eligible to claim an education tax credit.

Admittedly, the proposed regulations do not include any examples in which a state makes qualified tuition payments on behalf of a student. Nevertheless, the language of the regulations is broad enough to cover such a transaction. Thus, direct payments by the state of Louisiana to an educational institution under the

---

26. I.R.C. § 25A(b)(1), (c)(1).

27. I.R.C. § 25A(g)(3).

28. 1999 La. Acts No. 777, § 1 (to be codified at La. R.S. 17:3048.1(K)(3)(a)(i)).

29. 1999 La. Acts No. 777, § 1 (to be codified at La. R.S. 17:3048.1(K)(3)(a)(ii)).

30. 1999 La. Acts No. 777, § 1 (to be codified at La. R.S. 12:3048.1(K)(3)(a)(iii)).

31. Education Tax Credits, 64 Fed. Reg. 794, 803 (Jan. 6, 1999) (Prop. Reg. § 1.25A-5(a)(1)).

32. *Id.* at 803 (Prop. Reg. § 1.25A-5(a)(2) Example, (b)(2) Example).

TOPS scholarship legislation as originally enacted should be treated as payments from the state to the student, and in turn, payments by the student to the educational institution.

An election to defer accepting a TOPS scholarship award could be expensive. If the student or a taxpayer claiming the student as a dependent claims an education tax credit, the student who defers accepting a TOPS scholarship generally will receive from the state of Louisiana a refund in an amount less than the amount the student paid for qualified tuition and related expenses. Even if no federal tax credit is claimed and a deferring student receives the full amount that was paid for qualified tuition and related expenses, the time value of money will reduce the value of the state's refund to the student.

#### IV. REDUCTION FOR EXCLUDABLE SCHOLARSHIP GRANTS

1999 Louisiana Acts No. 1302, in part, amended the language of the TOPS scholarship legislation to address another perceived problem. Section 25A provides that the amount of qualified tuition and related expenses taken into account for purposes of claiming an education tax credit must be reduced by amounts paid for the benefit of the student as a "qualified scholarship which is excludable from gross income under section 117."<sup>33</sup>

TOPS scholarships are excludable from gross income under Section 117. Section 117 permits a taxpayer to exclude from gross income any amount received as a qualified scholarship.<sup>34</sup> For this purpose, the term "qualified scholarship" generally means an amount received for tuition and fees required for attendance at an educational institution and for books, supplies, and equipment required for courses of instruction there, that does not represent payment for teaching, research, or other services by the student which are required as a condition for receiving the scholarship.<sup>35</sup> The TOPS scholarship is received for tuition required for attendance at Louisiana colleges and universities and certain regionally accredited independent colleges and universities.<sup>36</sup> Because a student is not required to provide services to the state of Louisiana in order to receive the scholarship, the TOPS scholarship meets the definition of an excludable "qualified scholarship" for federal income tax purposes.

To eliminate this perceived problem, Act No. 1302 amended some of the language of the TOPS scholarship legislation. As originally enacted, the TOPS scholarship legislation provided that the state would "pay the student's tuition."<sup>37</sup> In 1999, the Louisiana Legislature amended the statute to provide that the state will "award an amount . . . equal to . . . tuition."<sup>38</sup> Because the terms of the TOPS scholarship grant do not require the award to be used for tuition, fees, and books,

---

33. I.R.C. § 25A(g)(2)(A).

34. I.R.C. § 117(a).

35. I.R.C. § 117(b), (c).

36. La. R.S. 17:3048.1(A)(1) (Supp. 1999).

37. La. R.S. 17:3048.1(A)(2), (3), (4), (B)(2), (3) (Supp. 1999).

38. 1999 La. Acts No. 1302, § 1 (to be codified at La. R.S. 17:3048.1(A)(2), (3), (4), (B)(2), (3)).

the grant is not necessarily a "qualified scholarship" for purposes of federal income tax purposes.

Nevertheless, it is likely that the amendments to the TOPS scholarship legislation were not necessary to ensure that TOPS scholarship recipients and their families will be eligible to claim an education tax credit. The proposed regulations indicate that a TOPS scholarship awarded under the former statutory language need not be considered a qualified scholarship for purposes of the education tax credits. The proposed regulations provide, in part, that for purposes of Section 25A, "a scholarship or fellowship grant is treated as a qualified scholarship excludable from income under section 117 unless . . . [t]he student reports the grant as income on the student's federal income tax return."<sup>39</sup>

Thus, it seems that to be eligible to claim an education tax credit (or to cause a student's family to be eligible to claim the credit), all a TOPS scholarship recipient needs to do is to include the TOPS scholarship award in income. Nevertheless, some practitioners have expressed concern that the former TOPS legislation did not satisfy an important requirement under the proposed regulations. In their opinion, a student could not report a TOPS scholarship award as income.<sup>40</sup>

Section 117 provides, "Gross income does not include any amount received as a qualified scholarship."<sup>41</sup> The statute does not state that the amount of a qualified scholarship may be excluded from gross income. Because gross income does not include an amount received as a qualified scholarship, it is impossible to report such an amount as income on a tax return.

Notwithstanding the quoted language, however, there does not seem to be any impediment to including the amount of a TOPS scholarship award in income in 1998. If a TOPS scholarship recipient includes in income the amount awarded by the state of Louisiana, the amount is not a "qualified scholarship" for purposes of Section 117. Section 117 defines the term "qualified scholarship" as "any amount received by an individual as a scholarship grant to the extent the individual establishes that, in accordance with the conditions of the grant, such amount was used for qualified tuition and related expenses."<sup>42</sup>

While the language of the TOPS scholarship provision that was in effect in 1998 states that the payment was made for qualified tuition, Section 117 requires an affirmative act by the recipient of the award to establish that the award was used for qualified tuition and related expenses. Section 117 does not authorize the IRS to establish that any amount of a scholarship grant was used for qualified tuition and related expenses. If the student simply avoids establishing that the award was used for such purposes, the student should be entitled to include the amount of the grant in income. In that case, the student will have met the requirements under the proposed regulations for claiming an education tax credit.

---

39. Education Tax Credits, 64 Fed. Reg. 794, 803 (Jan. 6, 1999) (Prop. Reg. § 1.25A-5(c)(3)(i)).

40. Telephone Interview with Wendell Foushee, C.P.A., (July 12, 1999).

41. I.R.C. § 117(a).

42. I.R.C. § 117(b)(1).

## V. IS THE TOPS SCHOLARSHIP AWARD EXCLUDABLE FROM INCOME?

Taxpayers who have too much adjusted gross income to be eligible to claim an education tax credit will not desire to include in income the amount of a TOPS scholarship award. Such high income taxpayers need not include in income the amount of a TOPS scholarship award that is used for qualified tuition and related expenses, regardless of whether the amount was awarded under the former statute or the amended statute.

Section 117 allows an individual to exclude from income an amount received by an individual as a scholarship or fellowship grant if: (1) the individual is a candidate for a degree at an organization described in Section 170(b)(1)(A)(ii), i.e., an educational organization that normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on; (2) and to the extent the individual establishes that, in accordance with the terms of the grant, the amount was used for qualified tuition and related expenses for enrollment or attendance at such an educational organization; and (3) the amount received does not represent payment for teaching, research, or other services by the student required as a condition for receiving the scholarship or fellowship grant.<sup>43</sup> TOPS scholarship awards are paid to students who are candidates for degrees at state postsecondary institutions that are educational organizations described in Section 170(b)(1)(A)(ii). A TOPS scholarship recipient is not required to provide teaching, research, or other services as a condition for receiving the award. Thus, a TOPS Scholarship award is excludable if the recipient can establish that, in accordance with the conditions of the grant, the amount of the award was used for qualified tuition and related expenses.

Under the former language of the TOPS scholarship provision, there was no question that the amount of the award was used for qualified tuition because the statute provided that the state would pay the student's tuition. The TOPS statute, as amended in 1999, does not require that the recipient use the amount of the award for qualified tuition and/or related expenses. It merely states that the recipient is to be awarded an amount equal to tuition. The new language, however, will not cause a TOPS scholarship award to fail to meet the requirements for excluding the award. Proposed regulations issued pursuant to Section 117 provide in part:

To be considered a qualified scholarship, the terms of the scholarship or fellowship grant need not expressly require that amounts received be used for tuition and related expenses. However, to the extent that the terms specify that any portion of the grant cannot be used for tuition and related expenses or designate any portion of the grant for purposes other than tuition and related expenses (such as for room and board or for a meal allowance), such amounts are not amounts received as a qualified scholarship.<sup>44</sup>

---

43. I.R.C. § 117(a), (b), (c).

44. Income Taxes; Exclusion From Gross Income of Qualified Scholarships, 53 Fed. Reg. 21,688,

The new TOPS scholarship provisions do not prohibit a recipient from using the award for tuition and related expenses and do not designate that any portion of the award must be used for purposes other than tuition and related expenses. Thus, a TOPS scholarship recipient need only establish that the amount of the award was used for qualified tuition and related expenses. The proposed regulations provide the following method for establishing that, in accordance with the conditions of the TOPS scholarship award, the amount of the award was used for qualified tuition and related expenses:

In order to be eligible to exclude from gross income any amount received as a qualified scholarship . . . the recipient must maintain records that establish amounts used for qualified tuition and related expenses . . . as well as the total amount of qualified tuition and related expenses. Such amounts may be established by providing to the Service, upon request, copies of relevant bills, receipts, cancelled checks, or other documentation or records that clearly reflect the use of the money. The recipient must also submit, upon request, documentation that establishes receipt of the grant, notification date of the grant, and the conditions and requirements of the particular grant. [Provided the grant does not represent payment for services], qualified scholarship amounts are excludable without the need to trace particular grant dollars to particular expenditures for qualified tuition and related expenses.<sup>45</sup>

Accordingly, TOPS scholarship recipients who desire to exclude the amount of the award should retain receipts and other documentation of their expenses and the conditions and requirements of the TOPS scholarship award. As long as the proper procedures are followed, there should be no trouble in the event of an audit.

#### VI. SHOULD A TAXPAYER CLAIM AN EDUCATION TAX CREDIT OR EXCLUDE THE TOPS SCHOLARSHIP GRANT FROM INCOME?

If a TOPS scholarship recipient or a person claiming the recipient as a dependent has too much adjusted gross income to be eligible to claim an education tax credit, the student will prefer to exclude the amount of the TOPS scholarship award from income. There are others, too, who may prefer to exclude a scholarship grant from income rather than to claim an education tax credit.

For purposes of Section 117, excludable "related expenses" include fees, books, supplies and equipment required for courses of instruction at the educational institution.<sup>46</sup> The "related expenses" for which an education tax credit may be claimed include academic fees only.<sup>47</sup> Thus, the amount that may be excludable

---

21,691 (June 9, 1988) (Prop. Reg. § 1.117-6(c)(1)).

45. *Id.* at 21,693 (Prop. Reg. 1.117-6(e)).

46. I.R.C. § 117(b)(2)(B).

47. I.R.C. § 25A(f)(1)(A), (C).

under Section 117 is larger than the amount that may be claimed as a credit under the Section 25A. If the amount of an award is sufficient to pay for both tuition, fees, books, supplies and equipment, excluding the award from income may yield better tax results than claiming an education tax credit, especially if the credit to be claimed is a Lifetime Learning Credit.

On the other hand, a student may prefer to include in income the amount of a scholarship award and claim a credit, especially if the student is eligible to claim a Hope Scholarship Credit. For example, assume that a student in Louisiana receives a TOPS scholarship award of \$2,600 (an amount equal to the cost of tuition at Louisiana State University) and an additional award of \$800 for the year. Assume, too, that the student pays \$800 for fees, books, supplies and equipment required for courses of instruction at Louisiana State University during the taxable year.

If the student is eligible for the Hope Scholarship Credit, the student may include \$3,400 in gross income. Assume that the student has additional taxable income and the student is in the fifteen percent income tax bracket. In that case, the \$3,400 increase in income results in a tax liability of \$510 ( $15\% \times \$3,400$ ). If the student or a taxpayer claiming the student as a dependent claims the Hope Scholarship Credit, the net tax savings is \$990 (\$1,500 Hope Scholarship Credit, less \$510 additional tax liability). If the student is in the twenty-eight percent tax bracket, the tax liability for the TOPS scholarship award is \$952 ( $28\% \times \$3,400$ ), and the net tax savings as a result of claiming the Hope Scholarship Credit is \$548 (\$1,500, less \$952).

On the other hand, if the student is not eligible for the Hope Scholarship Credit, but is eligible for the Lifetime Learning Credit, the amount of the credit is twenty percent of \$2,750 (the annual cost of tuition and educational fees), or \$550. If the student is in the fifteen percent income tax bracket, the credit will yield a net tax savings of \$40 (\$550 Lifetime Learning Credit, less \$510 additional tax liability). In contrast, claiming the Lifetime Learning Credit could be more expensive than excluding the TOPS scholarship grant if the student is in the twenty-eight percent tax bracket. In that case, including the grant in income would result in an additional tax liability of \$952, whereas the tax credit is only worth \$550.

## VII. CONCLUSION

Notice 99-32 provides welcome news to some taxpayers who failed to claim an education tax credit on a 1998 federal income tax return. It is not entirely certain that a TOPS scholarship recipient or a taxpayer claiming a TOPS scholarship recipient as a dependent may claim an education tax credit if the terms of the scholarship grant designate that the amount of the grant is to be used for qualified tuition and related expenses. As explained above, the proposed regulations provide that a scholarship grant is treated as a qualified scholarship excludable from income that will reduce the amount of tuition and related expenses paid by the taxpayer for purposes of claiming an educational tax credit unless the

student reports the grant as income on the student's federal income tax return.<sup>48</sup> The uncertainty concerns whether a student may include in income the amount of a scholarship grant if the terms of the grant, like the 1998 TOPS scholarship provisions, designate that the grant is awarded for tuition and related expenses. The proposed regulations interpreting Section 25A provide no examples in which a student includes in income an otherwise excludable scholarship grant.

Nevertheless, an eligible taxpayer who failed to claim the credit in 1998 because the taxpayer received a scholarship grant in 1998 should consider filing a request for a refund. As this article indicates, requesting the refund should not be considered a frivolous return provision. Because the taxpayer who failed to claim the credit has already paid more tax than would be required if the credit is allowed, the taxpayer who claims an education tax credit on an amended return should not be required to pay interest or penalties. Before filing an amended return, however, the taxpayer should weigh the advantage of claiming the credit against the tax liability to be incurred if the student includes the grant in income.

---

48. Education Tax Credits, 64 Fed. Reg. 794, 803 (Jan. 6, 1999) (Prop. Reg. § 1.25A-5(c)(3)).

