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Internal Revenue Service

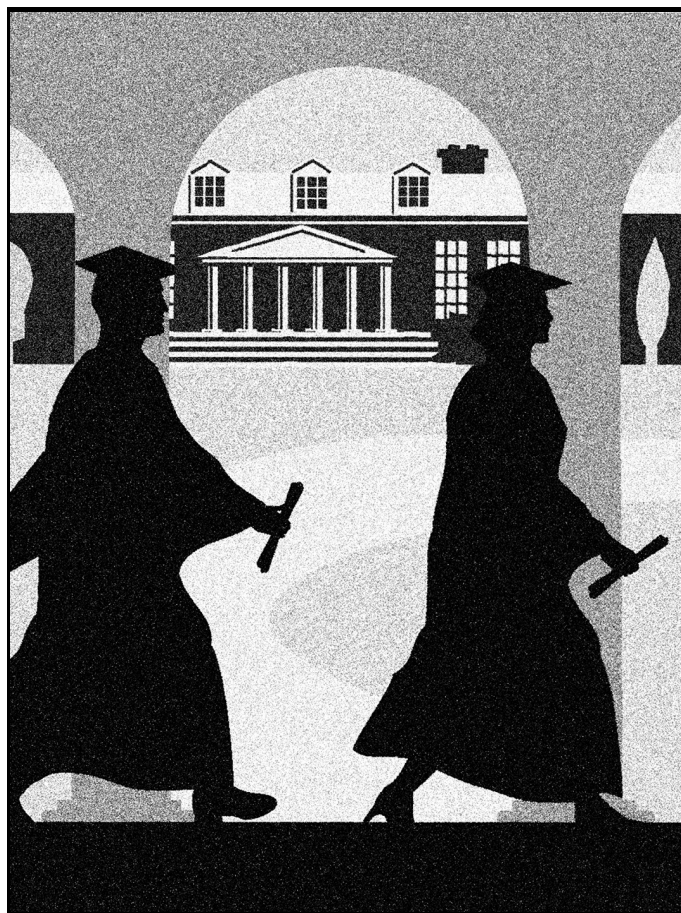
Publication 970

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Tax Benefits for Education

For use in preparing

2011 Returns



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What's New

Lifetime learning credit. For 2011, the amount of your lifetime learning credit is gradually reduced (phased out) if your modified adjusted gross income (MAGI) is between \$51,000 and \$61,000 (\$102,000 and \$122,000 if you file a joint return). You cannot claim a credit if your MAGI is \$61,000 or more (\$122,000 or more if you file a joint return). This is an increase from the 2010 limits of \$50,000 and \$60,000 (\$100,000 and \$120,000 if filing a joint return). For more information, see [chapter 3, Lifetime Learning Credit](#).

Student loan interest deduction. The amount of your student loan interest deduction for 2011 is gradually reduced (phased out) if your modified adjusted gross income (MAGI) is between \$60,000 and \$75,000 (\$120,000 and \$150,000 if you file a joint return). You cannot take a deduction if your MAGI is \$75,000 or more (\$150,000 or more if you file a joint return). This is an increase from the 2010 limits of \$55,000 and \$70,000 (\$115,000 and \$145,000 if filing a joint return). See [chapter 4, Student Loan Interest Deduction](#), for more information.

Business deduction for work-related education. For 2011, if you drive your car to and from school and qualify to deduct transportation expenses, the amount you can deduct for miles driven from January 1, 2011, through June 30, 2011 is 51 cents per mile. The amount you can deduct for miles driven from July 1, 2011, through December 31, 2011 is 55.5 cents per mile. This is up from 50 cents per mile during 2010. See [chapter 12, Business Deduction for Work-Related Education](#), for more information.

Future developments. The IRS has created a page on IRS.gov for more information about Publication 970, at

www.irs.gov/pub970. Information about any future developments affecting Publication 970 (such as legislation enacted after we release it) will be posted on that page.

Reminders

Hope Credit. For 2011, the Hope credit is not available. However, you may be able to claim an American opportunity or lifetime learning credit. See [chapter 2, American Opportunity Credit](#), and [chapter 3, Lifetime Learning Credit](#), for more information.

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. For more information, see Publication 505, Tax Withholding and Estimated Tax.

Photographs of missing children. The Internal Revenue Service is a proud partner with the National Center for Missing and Exploited Children. Photographs of missing children selected by the Center may appear in this publication on pages that would otherwise be blank. You can help bring these children home by looking at the photographs and calling 1-800-THE-LOST (1-800-843-5678) if you recognize a child.

Introduction

This publication explains tax benefits that may be available to you if you are saving for or paying education costs for yourself or, in many cases, another student who is a member of your immediate family. Most benefits apply only to higher education.

What is in this publication. [Chapter 1, Scholarships, Fellowships, Grants, and Tuition Reductions](#), explains the tax treatment of various types of educational assistance, including scholarships, fellowships, and tuition reductions.

Two tax credits for which you may be eligible are explained in [chapter 2, American Opportunity Credit](#), and [chapter 3, Lifetime Learning Credit](#). These benefits, which reduce the amount of income tax you may have to pay, are:

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

Ten other types of benefits are explained in chapters [4](#) through [12](#). 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;
- Deduct tuition and fees for education;
- 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
- Take a business deduction for work-related education.

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

Comparison table. Some of the features of these benefits are highlighted in [Appendix B, Highlights of Education Tax Benefits for Tax Year 2011](#), later, in this publication. This general comparison table may guide you in determining which benefits you may be eligible for and which chapters you may want to read.



When you figure your taxes, you may want to compare these tax benefits so you can choose the method(s) that gives you the lowest tax liability. If you qualify, you may find that a combination of credit(s) and deduction(s) gives you the lowest tax.

Analyzing your tax withholding. After you estimate your education tax benefits for the year, you may be able to reduce the amount of your federal income tax withholding. Also, you may want to recheck your withholding during the year if your personal or financial situation changes. See Publication 919, How Do I Adjust My Tax Withholding, for more information.

Glossary. In this publication, wherever appropriate, we have tried to use the same or similar terminology when referring to the basic components of each education benefit. Some of the terms used are:

- Qualified education expenses,
- Eligible educational institution, and
- Modified adjusted gross income.

Even though the same term, such as qualified education expenses, is used to label a basic component of many of the education benefits, the same expenses are not necessarily allowed for each benefit. For example, the cost of room and board is a qualified education expense for the qualified tuition program, but not for the education savings bond program.

Many of the terms used in the publication are defined in the glossary near the end of the publication. The glossary is not intended to be a substitute for reading the chapter on a particular education benefit, but it will give you an overview of how certain terms are used in discussing the different benefits.

Comments and suggestions. We welcome your comments about this publication and your suggestions for future editions.

You can write to us at the following address:

Internal Revenue Service
Individual and Speciality Forms and
Publications Branch
SE:W:CAR:MP:T:I
1111 Constitution Ave. NW, IR-6526
Washington, DC 20224

We respond to many letters by telephone. Therefore, it would be helpful if you would include your daytime phone number, including the area code, in your correspondence.

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Bloomington, IL 61705-6613

Tax questions. If you have a tax question, check the information available on IRS.gov or call 1-800-829-1040. We cannot answer tax questions sent to either of the above addresses.

Useful Items

You may want to see:

Publication

- 463** Travel, Entertainment, Gift, and Car Expenses
- 525** Taxable and Nontaxable Income
- 550** Investment Income and Expenses
- 590** Individual Retirement Arrangements (IRAs)

Form (and Instructions)

- 1040** U.S. Individual Income Tax Return
- 1040A** U.S. Individual Income Tax Return
- 1040EZ** Income Tax Return for Single and Joint Filers With No Dependents
- 1040NR** U.S. Nonresident Alien Income Tax Return
- 1040NR-EZ** U.S. Income Tax Return for Certain Nonresident Aliens With No Dependents
- 2106** Employee Business Expenses
- 2106-EZ** Unreimbursed Employee Business Expenses
- 5329** Additional Taxes on Qualified Plans and Other Tax-Favored Accounts
- 8815** Exclusion of Interest From Series EE and I U.S. Savings Bonds Issued After 1989
- 8863** Education Credits
- 8917** Tuition and Fees Deduction
- Schedule A (Form 1040)** Itemized Deductions

See [chapter 13, How To Get Tax Help](#), for information about getting these publications and forms.

1.

Scholarships, Fellowships, Grants, and Tuition Reductions

Reminder

Individual retirement arrangements (IRAs). You can set up and make contributions to an IRA if you receive taxable compensation. Under this rule, a taxable scholarship or fellowship is compensation only if it is shown in box 1 of your Form W-2, Wage and Tax Statement. For more information about IRAs, see Publication 590.

Introduction

This chapter discusses the 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 are discussions of:

- Scholarships,
- Fellowships,
- 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 fellowships for studying, teaching, or researching abroad. For information about these rules, see Publication 54, Tax Guide for U.S. Citizens and Resident Aliens Abroad.

Scholarships and Fellowships

A scholarship is generally an amount paid or allowed to, or for the benefit of, a student at an educational institution to aid in the pursuit of studies. The student may be either an undergraduate or a graduate.

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

[Table 1-1, Tax Treatment of Scholarship and Fellowship Payments](#), provides an overview of the tax treatment of amounts received as a scholarship or fellowship (other than amounts received as payment for services). Generally, whether the amount is tax free or taxable depends on the expense paid with the amount and whether you are a degree candidate.

Table 1-1. **Tax Treatment of Scholarship and Fellowship Payments¹**

Do not rely on this table alone. Refer to the text for complete details.

IF you use the payment for...	AND you are...		THEN the payment is...	
	A degree candidate	Not a degree candidate	Tax free ²	Taxable
Tuition	X		X	
		X		X
Fees	X		X ³	
		X		X
Books	X		X ³	
		X		X
Supplies	X		X ³	
		X		X
Equipment	X		X ³	
		X		X
Room	X			X
		X		X
Board	X			X
		X		X
Travel	X			X
		X		X

¹ Does not include payments received for past, present, or future services.

² Payments used for any expenses indicated in this column are tax free only if the terms of the scholarship or fellowship do not prohibit the expense.

³ If required of all students in the course.

Tax-Free Scholarships and Fellowships

A scholarship or fellowship is tax free only if:

- You are a candidate for a degree at an eligible educational institution,
- You use the scholarship or fellowship to pay qualified education expense, and
- It does not represent payment for teaching, research, or other services required as a condition for receiving the scholarship. (But for exceptions, see [Taxable Scholarships and Fellowships](#), later.)

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 and normally has a regularly enrolled body of students in attendance at the place where it carries on its educational activities.

Qualified education expenses. For purposes of tax-free scholarships and fellowships, these are expenses for:

- Tuition and fees required to enroll at or attend an eligible educational institution, and
- Course-related expenses, such as fees, books, supplies, and equipment that are required for the courses at the eligible educational institution. These items must be required of all students in your course of instruction.

However, in order for these to be qualified education expenses, the terms of the scholarship or fellowship cannot require that it be used for other purposes, such as room and board, or specify that it cannot be used for tuition or course-related expenses.

Expenses that do not qualify. Qualified education expenses do not include the cost of:

- Room and board,
- Travel,
- Research,
- Clerical help, or
- Equipment and other expenses that are not required for enrollment in or attendance at an eligible educational institution.

Athletic Scholarships

An athletic scholarship is tax free if it meets the requirements discussed earlier.

Worksheet 1-1. You can use [Worksheet 1-1, Taxable Scholarship and Fellowship Income](#), later, to figure the tax-free and taxable parts of your scholarship or fellowship.

Taxable Scholarships and Fellowships

If your scholarship or fellowship does not meet the requirements described earlier, it is taxable. The following amounts received may be taxable.

- Amounts used to pay expenses that do not qualify.
- Payments for services.
- Scholarship prizes.

Each type is discussed below.

Amounts used to pay expenses that do not qualify. A scholarship amount you use to pay any expense that does not qualify is taxable, even if the expense is a fee that you must pay to the institution as a condition of enrollment or attendance.

Payment for services. Generally, you must include in income the part of any scholarship or fellowship that represents payment for teaching, research, or other services required as a condition for receiving the scholarship. This applies even if all candidates for a degree must perform the services to receive the degree. (See below for exceptions.)

Worksheet 1-1. Taxable Scholarship and Fellowship Income

Keep for Your Records 

1. Enter your scholarship or fellowship income for 2011	1. _____
<ul style="list-style-type: none"> • If you are a degree candidate at an eligible educational institution, go to line 2. • If you are not a degree candidate at an eligible educational institution, stop here. The entire amount is taxable. For information on how to report this amount on your tax return, see Reporting Scholarships and Fellowships, later, in this chapter. 	
2. Enter the amount from line 1 that was for teaching, research, or any other services required as a condition for receiving the scholarship. (Do not include amounts received for these items under the National Health Service Corps Scholarship Program or the Armed Forces Health Professions Scholarship and Financial Assistance Program.)	2. _____
3. Subtract line 2 from line 1	3. _____
4. Enter the amount from line 3 that your scholarship or fellowship required you to use for other than qualified education expenses	4. _____
5. Subtract line 4 from line 3	5. _____
6. Enter the amount from line 5 that was used for qualified education expenses required for study at an eligible educational institution. This amount is the tax-free part of your scholarship or fellowship income*	6. _____
7. Subtract line 6 from line 5	7. _____
8. Taxable part. Add lines 2, 4, and 7. See Reporting Scholarships and Fellowships , later, for how to report this amount on your tax return	8. _____

* If you qualify for other education benefits (see chapters 2 through 12), you may have to reduce the amount of education expenses qualifying for a specific benefit by the tax-free amount on this line.

Exceptions. You do not have to include in income the part of any scholarship or fellowship that represents payment for teaching, research, or other services if you receive the amount under:

- The National Health Service Corps Scholarship Program, or
- The Armed Forces Health Professions Scholarship and Financial Assistance Program,

and you:

- Are a candidate for a degree at an eligible educational institution, and
- Use that part of the scholarship or fellowship to pay qualified education expenses.

Example 1. You received a scholarship of \$2,500. The scholarship was not received under either of the exceptions mentioned above. As a condition for receiving the scholarship, you must serve as a part-time teaching assistant. Of the \$2,500 scholarship, \$1,000 represents payment for teaching. The provider of your scholarship gives you a Form W-2 showing \$1,000 as income. You used all the money for qualified education expenses. Assuming that all other conditions are met, \$1,500 of your scholarship is tax free. The \$1,000 you received for teaching is taxable.

Example 2. You are a candidate for a degree at a medical school. You receive a scholarship (not under either of the exceptions mentioned above) for your medical education and training. The terms of your scholarship require you to perform future services. A substantial penalty applies if you do not comply. The entire amount of your grant is taxable as payment for services in the year it is received.

Scholarship prizes. If you win a scholarship as a prize in a contest, the scholarship is fully taxable unless you meet the requirements discussed earlier under [Tax-Free Scholarships and Fellowships](#).

Reporting Scholarships and Fellowships

Whether you must report your scholarship or fellowship depends on whether you must file a return and whether any part of your scholarship or fellowship is taxable.

If your only income is a completely tax-free scholarship or fellowship, you do not have to file a tax return and no reporting is necessary. If all or part of your scholarship or fellowship is taxable and you are required to file a tax return, report the taxable amount as explained below. You must report the taxable amount whether or not you received a Form W-2. If you receive an incorrect Form W-2, ask the payer for a corrected one.

For information on whether you must file a return, see Publication 501, Exemptions, Standard Deduction, and Filing Information, or your income tax form instructions.

How To Report

How you report any taxable scholarship or fellowship income depends on which return you file.

Form 1040EZ. If you file Form 1040EZ, include the taxable amount in the total on line 1. If the taxable amount was

not reported on Form W-2, also enter “SCH” and the taxable amount in the space to the left of line 1.

Form 1040A. If you file Form 1040A, include the taxable amount in the total on line 7. If the taxable amount was not reported on Form W-2, also enter “SCH” and the taxable amount in the space to the left of line 7.

Form 1040. If you file Form 1040, include the taxable amount in the total on line 7. If the taxable amount was not reported on Form W-2, also enter “SCH” and the taxable amount on the dotted line next to line 7.

Schedule SE (Form 1040). To determine your net earnings from self-employment, include amounts you receive under a scholarship as pay for your services that are reported to you on Form 1099-MISC, Miscellaneous Income. If your net earnings are \$400 or more, you must pay self-employment tax. Use Schedule SE, Self-Employment Tax, to figure this tax.

Form 1040NR. If you file Form 1040NR, report the taxable amount on line 12. Generally, you must report the amount shown in box 2 of Form(s) 1042-S, Foreign Person’s U.S. Source Income Subject to Withholding. See the Instructions for Form 1040NR for more information.

Form 1040NR-EZ. If you file Form 1040NR-EZ, report the taxable amount on line 5. Generally, you must report the amount shown in box 2 of Form(s) 1042-S. See the Instructions for Form 1040NR-EZ for more information.

Other Types of Educational Assistance

The following discussions deal with common types of educational assistance other than scholarships and fellowships.

Fulbright Grants

A Fulbright grant is generally treated as a scholarship or fellowship in figuring how much of the grant is tax free. Report only the taxable amount on your tax return. See [Reporting Scholarships and Fellowships](#), earlier.

Pell Grants and Other Title IV Need-Based Education Grants

These need-based grants are treated as scholarships for purposes of determining their tax treatment. They are tax free to the extent used for qualified education expenses during the period for which a grant is awarded. Report only the taxable amount on your tax return. See [Reporting Scholarships and Fellowships](#), earlier.

Payment to Service Academy Cadets

An appointment to a United States military academy is not a scholarship or fellowship. Payment you receive as a cadet or midshipman at an armed services academy is pay for personal services and will be reported to you in box 1 of Form W-2. Include this pay in your income in the year you receive it unless one of the exceptions, discussed earlier under [Payment for services](#), applies.

Veterans' Benefits

Payments you receive for education, training, or subsistence under any law administered by the Department of Veterans Affairs (VA) are tax free. Do not include these payments as income on your federal tax return.

If you qualify for one or more of the education benefits discussed in chapters 2 through 12, you may have to reduce the amount of education expenses qualifying for a specific benefit by part or all of your VA payments. This applies only to the part of your VA payments that is required to be used for education expenses.

You may want to visit the Veteran's Administration website at www.gibill.va.gov for specific information about the various VA benefits for education.

Example. You have returned to college and are receiving two education benefits under the latest GI Bill: (1) a \$1,534 monthly basic housing allowance (BAH) that is directly deposited to your checking account, and (2) \$3,840 paid directly to your college for tuition. Neither of these benefits is taxable and you do not report them on your tax return. You also want to claim an American opportunity credit on your return. You paid \$5,000 in qualified education expenses (see [chapter 2, American Opportunity Credit](#), later). To figure the amount of credit, you must first subtract the \$3,840 from your qualified education expenses because this payment under the GI Bill was required to be used for education expenses. You do **not** subtract any amount of the BAH because it was paid to you and its use was not restricted.

Qualified Tuition Reduction

If you are allowed to study tuition free or for a reduced rate of tuition, you may not have to pay tax on this benefit. This is called a "tuition reduction." You do not have to include a qualified tuition reduction in your income.

A tuition reduction is qualified only if you receive it from, and use it at, an eligible educational institution. You do not have to use the tuition reduction at the eligible educational institution from which you received it. In other words, if you work for an eligible educational institution and the institution arranges for you to take courses at another eligible educational institution without paying any tuition, you may not have to include the value of the free courses in your income.

The rules for determining if a tuition reduction is qualified, and therefore tax free, are different if the education provided is below the graduate level or is graduate education.

You must include in your income any tuition reduction you receive that is payment for your services.

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.

Officers, owners, and highly compensated employees. Qualified tuition reductions apply to officers, owners, or highly compensated employees only if benefits are available to employees on a nondiscriminatory basis. This means that the tuition reduction benefits must be available on substantially the same basis to each member of a group

of employees. The group must be defined under a reasonable classification set up by the employer. The classification must not discriminate in favor of owners, officers, or highly compensated employees.

Payment for services. Generally, you must include in income the part of any qualified tuition reduction that represents payment for teaching, research, or other services by the student required as a condition of receiving the qualified tuition reduction. This applies even if all candidates for a degree must perform the services to receive the degree. (See below for exceptions.)

Exceptions. You do not have to include in income the part of any scholarship or fellowship that represents payment for teaching, research, or other services if you receive the amount under:

- The National Health Service Corps Scholarship Program, or
- The Armed Forces Health Professions Scholarship and Financial Assistance Program.

Education Below the Graduate Level

If you receive a tuition reduction for education below the graduate level (including primary, secondary, or high school), it is a qualified tuition reduction, and therefore tax free, only if your relationship to the educational institution providing the benefit is described below.

1. You are an employee of the eligible educational institution.
2. You were an employee of the eligible educational institution, but you retired or left on disability.
3. You are a widow or widower of an individual who died while an employee of the eligible educational institution or who retired or left on disability.
4. You are the dependent child or spouse of an individual described in (1) through (3), above.

Child of deceased parents. For purposes of the qualified tuition reduction, a child is a dependent child if the child is under age 25 and both parents have died.

Child of divorced parents. For purposes of the qualified tuition reduction, a dependent child of divorced parents is treated as the dependent of both parents.

Graduate Education

A tuition reduction you receive for graduate education is qualified, and therefore tax free, if both of the following requirements are met.

- It is provided by an eligible educational institution.
- You are a graduate student who performs teaching or research activities for the educational institution.

You must include in income any other tuition reductions for graduate education that you receive.

How To Report

Any tuition reduction that is taxable should be included as wages in box 1 of your Form W-2. Report the amount from Form W-2, box 1, on line 7 (Form 1040 or Form 1040A) or line 1 (Form 1040EZ).

4.

Student Loan Interest Deduction

Introduction

Generally, personal interest you pay, other than certain mortgage interest, is not deductible on your tax return. However, if your modified adjusted gross income (MAGI) is less than \$75,000 (\$150,000 if filing a joint return) there is a special deduction allowed for paying interest on a student loan (also known as an education loan) used for higher education. For most taxpayers, MAGI is the adjusted gross income as figured on their federal income tax return before subtracting any deduction for student loan interest. This deduction can reduce the amount of your income subject to tax by up to \$2,500 in 2011.

The student loan interest deduction is taken as an adjustment to income. This means you can claim this deduction even if you do not itemize deductions on Schedule A (Form 1040).

This chapter explains:

- What type of loan interest you can deduct,
- Whether you can claim the deduction,
- What expenses you must have paid with the student loan,
- Who is an eligible student,
- How to figure the deduction, and
- How to claim the deduction.

[Table 4-1. Student Loan Interest Deduction at a Glance](#) summarizes the features of the student loan interest deduction.

Student Loan Interest Defined

Student loan interest is interest you paid during the year on a qualified student loan. It includes both required and voluntary interest payments.

Qualified Student Loan

This is a loan you took out solely to pay qualified education expenses (defined later) that were:

- For you, your spouse, or a person who was your dependent when you took out the loan,
- Paid or incurred within a reasonable period of time before or after you took out the loan, and
- For education provided during an academic period for an eligible student.

Loans from the following sources are not qualified student loans.

- A related person.
- A qualified employer plan.

Table 4-1. Student Loan Interest Deduction at a Glance

Do not rely on this table alone. Refer to the text for complete details.

Feature	Description
Maximum benefit	You can reduce your income subject to tax by up to \$2,500.
Loan qualifications	Your student loan: <ul style="list-style-type: none">• must have been taken out solely to pay qualified education expenses, and• cannot be from a related person or made under a qualified employer plan.
Student qualifications	The student must be: <ul style="list-style-type: none">• you, your spouse, or your dependent, and• enrolled at least half-time in a degree program.
Time limit on deduction	You can deduct interest paid during the remaining period of your student loan.
Limit on modified adjusted gross income (MAGI)	\$150,000 if married filing a joint return; \$75,000 if single, head of household, or qualifying widow(er).

Your dependent. Generally, your dependent is someone who is either a:

- Qualifying child, or
- Qualifying relative.

You can find more information about dependents in Publication 501.

Exceptions. For purposes of the student loan interest deduction, there are the following exceptions to the general rules for dependents.

- An individual can be your dependent even if you are the dependent of another taxpayer.
- An individual can be your dependent even if the individual files a joint return with a spouse.
- An individual can be your dependent even if the individual had gross income for the year that was equal to or more than the exemption amount for the year (\$3,700 for 2011).

Reasonable period of time. Qualified education expenses are treated as paid or incurred within a reasonable period of time before or after you take out the loan if they are paid with the proceeds of student loans that are part of a federal postsecondary education loan program.

Even if not paid with the proceeds of that type of loan, the expenses are treated as paid or incurred within a reasonable period of time if both of the following requirements are met.

- The expenses relate to a specific academic period, and
- The loan proceeds are disbursed within a period that begins 90 days before the start of that academic

period and ends 90 days after the end of that academic period.

If neither of the above situations applies, the reasonable period of time usually is determined based on all the relevant facts and circumstances.

Academic period. An academic period includes a semester, trimester, quarter, or other period of study (such as a summer school session) as reasonably determined by an educational institution. In the case of an educational institution that uses credit hours or clock hours and does not have academic terms, each payment period can be treated as an academic period.

Eligible student. This is a student who was enrolled at least half-time in a program leading to a degree, certificate, or other recognized educational credential.

Enrolled at least half-time. A student was enrolled at least half-time if the student was taking at least half the normal full-time work load for his or her course of study.

The standard for what is half of the normal full-time work load is determined by each eligible educational institution. However, the standard may not be lower than any of those established by the U.S. Department of Education under the Higher Education Act of 1965.

Related person. You cannot deduct interest on a loan you get from a related person. Related persons include:

- Your spouse,
- Your brothers and sisters,
- Your half brothers and half sisters,
- Your ancestors (parents, grandparents, etc.),
- Your lineal descendants (children, grandchildren, etc.), and
- Certain corporations, partnerships, trusts, and exempt organizations.

Qualified employer plan. You cannot deduct interest on a loan made under a qualified employer plan or under a contract purchased under such a plan.

Qualified Education Expenses

For purposes of the student loan interest deduction, these expenses are the total costs of attending an eligible educational institution, including graduate school. They include amounts paid for the following items.

- Tuition and fees.
- Room and board.
- Books, supplies, and equipment.
- Other necessary expenses (such as transportation).

The cost of room and board qualifies only to the extent that it is not more than the greater of:

- The allowance for room and board, as determined by the eligible educational institution, that was included in the cost of attendance (for federal financial aid purposes) for a particular academic period and living arrangement of the student, or
- The actual amount charged if the student is residing in housing owned or operated by the eligible educational institution.

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. It includes virtually all accredited public, nonprofit, and proprietary (privately owned profit-making) postsecondary institutions.

Certain educational institutions located outside the United States also participate in the U.S. Department of Education's Federal Student Aid (FSA) programs.

For purposes of the student loan interest deduction, an eligible educational institution also includes an institution conducting an internship or residency program leading to a degree or certificate from an institution of higher education, a hospital, or a health care facility that offers postgraduate training.

An educational institution must meet the above criteria only during the academic period(s) for which the student loan was incurred. The deductibility of interest on the loan is not affected by the institution's subsequent loss of eligibility.



The educational institution should be able to tell you if it is an eligible educational institution.

Adjustments to Qualified Education Expenses

You must reduce your qualified education expenses by the total amount paid for them with the following tax-free items.

- Employer-provided educational assistance. See [chapter 11, Employer-Provided Educational Assistance](#).
- Tax-free distribution of earnings from a Coverdell education savings account (ESA). See [Tax-Free Distributions](#) in [chapter 7, Coverdell Education Savings Account](#).
- Tax-free distribution of earnings from a qualified tuition program (QTP). See [Figuring the Taxable Portion of a Distribution](#) in [chapter 8, Qualified Tuition Program](#).
- U.S. savings bond interest that you exclude from income because it is used to pay qualified education expenses. See [chapter 10, Education Savings Bond Program](#).
- The tax-free part of scholarships and fellowships. See [Tax-Free Scholarships and Fellowships](#) in [chapter 1, Scholarships, Fellowships, Grants, and Tuition Reductions](#).
- Veterans' educational assistance. See [Veterans' Benefits](#) in [chapter 1, Scholarships, Fellowships, Grants, and Tuition Reductions](#).
- Any other nontaxable (tax-free) payments (other than gifts or inheritances) received as educational assistance.

Include As Interest

In addition to simple interest on the loan, if all other requirements are met, the items discussed below can be student loan interest.

Loan origination fee. In general, this is a one-time fee charged by the lender when a loan is made. To be deductible as interest, a loan origination fee must be for the use of money rather than for property or services (such as commitment fees or processing costs) provided by the lender. A loan origination fee treated as interest accrues over the term of the loan.

Loan origination fees were not required to be reported on Form 1098-E, Student Loan Interest Statement, for loans made before September 1, 2004. If loan origination fees are not included in the amount reported on your Form 1098-E, you can use any reasonable method to allocate the loan origination fees over the term of the loan. The method shown in the example below allocates equal portions of the loan origination fee to each payment required under the terms of the loan. A method that results in the double deduction of the same portion of a loan origination fee would not be reasonable.

Example. In August 2004, Bill took out a student loan for \$16,000 to pay the tuition for his senior year of college. The lender charged a 3% loan origination fee (\$480) that was withheld from the funds Bill received. Bill began making payments on his student loan in 2011. Because the loan origination fee was not included in his 2011 Form 1098-E, Bill can use any reasonable method to allocate that fee over the term of the loan. Bill's loan is payable in 120 equal monthly payments. He allocates the \$480 fee equally over the total number of payments ($\$480 \div 120$ months = \$4 per month). Bill made 7 payments in 2011, so he paid \$28 ($\4×7) of interest attributable to the loan origination fee. To determine his student loan interest deduction, he will add the \$28 to the amount of other interest reported to him on Form 1098-E.

Capitalized interest. This is unpaid interest on a student loan that is added by the lender to the outstanding principal balance of the loan. Capitalized interest is treated as interest for tax purposes and is deductible as payments of principal are made on the loan. No deduction for capitalized interest is allowed in a year in which no loan payments were made.

Interest on revolving lines of credit. This interest, which includes interest on credit card debt, is student loan interest if the borrower uses the line of credit (credit card) only to pay qualified education expenses. See [Qualified Education Expenses](#), earlier.

Interest on refinanced student loans. This includes interest on both:

- Consolidated loans—loans used to refinance more than one student loan of the same borrower, and
- Collapsed loans—two or more loans of the same borrower that are treated by both the lender and the borrower as one loan.



If you refinance a qualified student loan for more than your original loan and you use the additional amount for any purpose other than qualified education expenses, you cannot deduct any interest paid on the refinanced loan.

Voluntary interest payments. These are payments made on a qualified student loan during a period when interest payments are not required, such as when the borrower has been granted a deferment or the loan has not yet entered repayment status.

Example. The payments on Roger's student loan were scheduled to begin in June 2010, 6 months after he graduated from college. He began making payments as required. In September 2011, Roger enrolled in graduate school on a full-time basis. He applied for and was granted deferment of his loan payments while in graduate school. Wanting to pay down his student loan as much as possible, he made loan payments in October and November 2011. Even though these were voluntary (not required) payments, Roger can deduct the interest paid in October and November.

Allocating Payments Between Interest and Principal

The allocation of payments between interest and principal for tax purposes might not be the same as the allocation shown on the Form 1098-E or other statement you receive from the lender or loan servicer. To make the allocation for tax purposes, a payment generally applies first to stated interest that remains unpaid as of the date the payment is due, second to any loan origination fees allocable to the payment, third to any capitalized interest that remains unpaid as of the date the payment is due, and fourth to the outstanding principal.

Example. In August 2010, Peg took out a \$10,000 student loan to pay the tuition for her senior year of college. The lender charged a 3% loan origination fee (\$300) that was withheld from the funds Peg received. The interest (5% simple) on this loan accrued while she completed her senior year and for 6 months after she graduated. At the end of that period, the lender determined the amount to be repaid by capitalizing all accrued but unpaid interest (\$625 interest accrued from August 2010 through October 2011) and adding it to the outstanding principal balance of the loan. The loan is payable over 60 months, with a payment of \$200.51 due on the first of each month, beginning November 2011.

Peg did not receive a Form 1098-E for 2011 from her lender because the amount of interest she paid did not require the lender to issue an information return. However, she did receive an account statement from the lender that showed the following 2011 payments on her outstanding loan of \$10,625 (\$10,000 principal + \$625 accrued but unpaid interest).

Payment Date	Payment	Stated Interest	Principal
November 2011	\$200.51	\$44.27	\$156.24
December 2011	\$200.51	\$43.62	\$156.89
Totals	\$401.02	\$87.89	\$313.13

To determine the amount of interest that could be deducted on the loan for 2011, Peg starts with the total amount of stated interest she paid, \$87.89. Next, she allocates the loan origination fee over the term of the loan ($\$300 \div 60$ months = \$5 per month). A total of \$10 (\$5 of each of the two principal payments) should be treated as interest for tax purposes. Peg then applies the unpaid capitalized interest (\$625) to the two principal payments in the order in which they were made, and determines that the remaining amount of principal of both payments is treated as interest for tax purposes. Assuming that Peg qualifies to take the student loan interest deduction, she can deduct \$401.02 ($\$87.89 + \$10 + \303.13).

For 2012, Peg will continue to allocate \$5 of the loan origination fee to the principal portion of each monthly payment she makes and treat that amount as interest for

tax purposes. She also will apply the remaining amount of capitalized interest ($\$625 - \$303.13 = \$321.87$) to the principal payments in the order in which they are made until the balance is zero, and treat those amounts as interest for tax purposes.

Do Not Include As Interest

You cannot claim a student loan interest deduction for any of the following items.

- Interest you paid on a loan if, under the terms of the loan, you are not legally obligated to make interest payments.
- Loan origination fees that are payments for property or services provided by the lender, such as commitment fees or processing costs.
- Interest you paid on a loan to the extent payments were made through your participation in the National Health Service Corps Loan Repayment Program (the “NHSC Loan Repayment Program”) or certain other loan repayment assistance programs. For more information, see [Student Loan Repayment Assistance](#) in chapter 5, *Student Loan Cancellations and Repayment Assistance*.

When Must Interest Be Paid

You can deduct all interest you paid during the year on your student loan, including voluntary payments, until the loan is paid off.

Can You Claim the Deduction

Generally, you can claim the deduction if all of the following requirements are met.

- Your filing status is any filing status except married filing separately.
- No one else is claiming an exemption for you on his or her tax return.
- You are legally obligated to pay interest on a qualified student loan.
- You paid interest on a qualified student loan.

Claiming an exemption for you. Another taxpayer is claiming an exemption for you if he or she lists your name and other required information on his or her Form 1040 (or Form 1040A), line 6c, or Form 1040NR, line 7c.

Example 1. During 2011, Josh paid \$600 interest on his qualified student loan. Only he is legally obligated to make the payments. No one claimed an exemption for Josh for 2011. Assuming all other requirements are met, Josh can deduct the \$600 of interest he paid on his 2011 Form 1040 or 1040A.

Example 2. During 2011, Jo paid \$1,100 interest on her qualified student loan. Only she is legally obligated to make the payments. Jo’s parents claimed an exemption for her on their 2011 tax return. In this case, neither Jo nor her parents may deduct the student loan interest Jo paid in 2011.

Interest paid by others. If you are the person legally obligated to make interest payments and someone else makes a payment of interest on your behalf, you are treated as receiving the payments from the other person and, in turn, paying the interest.

Example 1. Darla obtained a qualified student loan to attend college. After Darla’s graduation from college, she worked as an intern for a nonprofit organization. As part of the internship program, the nonprofit organization made an interest payment on behalf of Darla. This payment was treated as additional compensation and reported in box 1 of her Form W-2. Assuming all other qualifications are met, Darla can deduct this payment of interest on her tax return.

Example 2. Ethan obtained a qualified student loan to attend college. After graduating from college, the first monthly payment on his loan was due in December. As a gift, Ethan’s mother made this payment for him. No one is claiming a dependency exemption for Ethan on his or her tax return. Assuming all other qualifications are met, Ethan can deduct this payment of interest on his tax return.

No Double Benefit Allowed

You cannot deduct as interest on a student loan any amount that is an allowable deduction under any other provision of the tax law (for example, as home mortgage interest).

Figuring the Deduction

Your student loan interest deduction for 2011 is generally the smaller of:

- \$2,500, or
- The interest you paid in 2011.

However, the amount determined above may be gradually reduced (phased out) or eliminated based on your filing status and MAGI as explained below. You can use [Worksheet 4-1. Student Loan Interest Deduction Worksheet](#) (at the end of this chapter) to figure both your MAGI and your deduction.

Form 1098-E. To help you figure your student loan interest deduction, you should receive Form 1098-E. Generally, an institution (such as a bank or governmental agency) that received interest payments of \$600 or more during 2011 on one or more qualified student loans must send Form 1098-E (or acceptable substitute) to each borrower by January 31, 2012.

For qualified student loans taken out before September 1, 2004, the institution is required to include on Form 1098-E only payments of stated interest. Other interest payments, such as certain loan origination fees and capitalized interest, may not appear on the form you receive. However, if you pay qualifying interest that is not included on Form 1098-E, you can also deduct those amounts. See [Allocating Payments Between Interest and Principal](#), earlier.

The lender may ask for a completed Form W-9S, or similar statement to obtain the borrower’s name, address, and taxpayer identification number. The form may also be used by the borrower to certify that the student loan was incurred solely to pay for qualified education expenses.

Effect of the Amount of Your Income on the Amount of Your Deduction

The amount of your student loan interest deduction is phased out (gradually reduced) if your MAGI is between \$60,000 and \$75,000 (\$120,000 and \$150,000 if you file a joint return). You cannot take a student loan interest deduction if your MAGI is \$75,000 or more (\$150,000 or more if you file a joint return).

Modified adjusted gross income (MAGI). For most taxpayers, MAGI is adjusted gross income (AGI) as figured on their federal income tax return before subtracting any deduction for student loan interest. However, as discussed below, there may be other modifications.

Table 4-2 shows how the amount of your MAGI can affect your student loan interest deduction.

Table 4-2. Effect of MAGI on Student Loan Interest Deduction

IF your filing status is...	AND your MAGI is...	THEN your student loan interest deduction is...
single, head of household, or qualifying widow(er)	not more than \$60,000	not affected by the phaseout.
	more than \$60,000 but less than \$75,000	reduced because of the phaseout.
	\$75,000 or more	eliminated by the phaseout.
married filing joint return	not more than \$120,000	not affected by the phaseout.
	more than \$120,000 but less than \$150,000	reduced because of the phaseout.
	\$150,000 or more	eliminated by the phaseout.

MAGI when using Form 1040A. If you file Form 1040A, your MAGI is the AGI on line 22 of that form figured without taking into account any amount on line 18 (Student loan interest deduction) and line 19 (Tuition and fees deduction).

MAGI when using Form 1040. If you file Form 1040, your MAGI is the AGI on line 38 of that form figured without taking into account any amount on line 33 (Student loan interest deduction), line 34 (Tuition and fees deduction), or line 35 (Domestic production activities deduction), and modified by adding back any:

1. Foreign earned income exclusion,
2. Foreign housing exclusion,
3. Foreign housing deduction,
4. Exclusion of income by bona fide residents of American Samoa, and
5. Exclusion of income by bona fide residents of Puerto Rico.

MAGI when using Form 1040NR. If you file Form 1040NR, your MAGI is the AGI on line 36 of that form figured without taking into account any amount on line 33 (Student loan interest deduction) and line 34 (Domestic production activities deduction).

MAGI when using Form 1040NR-EZ. If you file Form 1040NR-EZ, your MAGI is the AGI on line 10 of that form figured without taking into account any amount on line 9 (Student loan interest deduction).

Phaseout. If your MAGI is within the range of incomes where the credit must be reduced, you must figure your reduced deduction. To figure the phaseout, multiply your interest deduction (before the phaseout) by a fraction. The numerator is your MAGI minus \$60,000 (\$120,000 in the case of a joint return). The denominator is \$15,000 (\$30,000 in the case of a joint return). Subtract the result from your deduction (before the phaseout) to give you the amount you can deduct.

Example 1. During 2011 you paid \$800 interest on a qualified student loan. Your 2011 MAGI is \$145,000 and you are filing a joint return. You must reduce your deduction by \$667, figured as follows.

$$\$800 \times \frac{\$145,000 - \$120,000}{\$30,000} = \$667$$

Your reduced student loan interest deduction is \$133 (\$800 – \$667).

Example 2. The facts are the same as in *Example 1* except that you paid \$2,750 interest. Your maximum deduction for 2011 is \$2,500. You must reduce your maximum deduction by \$2,083, figured as follows.

$$\$2,500 \times \frac{\$145,000 - \$120,000}{\$30,000} = \$2,083$$

In this example, your reduced student loan interest deduction is \$417 (\$2,500 – \$2,083).

Which Worksheet To Use

Generally, you figure the deduction using the Student Loan Interest Deduction Worksheet in the instructions for Form 1040, Form 1040A, or Form 1040NR. However, if you are filing Form 2555, Foreign Earned Income, Form 2555-EZ, Foreign Earned Income Exclusion, or Form 4563, Exclusion of Income for Bona Fide Residents of American Samoa, or you are excluding income from sources within Puerto Rico, you must complete [Worksheet 4-1. Student Loan Interest Deduction Worksheet](#) at the end of this chapter.

Claiming the Deduction

The student loan interest deduction is an adjustment to income. To claim the deduction, enter the allowable amount on line 33 (Form 1040), line 18 (Form 1040A), line 33 (Form 1040NR), or line 9 (Form 1040NR-EZ).

Worksheet 4-1. **Student Loan Interest Deduction Worksheet**

Keep for Your Records



Use this worksheet instead of the worksheet in the Form 1040 instructions if you are filing **Form 2555, 2555-EZ, or 4563**, or you are excluding income from sources within Puerto Rico. Before using this worksheet, you must complete **Form 1040**, lines 7 through 32, plus any amount to be entered on the dotted line next to line 36.

1. Enter the total interest you paid in 2011 on qualified student loans. Do not enter more than \$2,500		1.	_____
2. Enter the amount from Form 1040, line 22	2.	_____	
3. Enter the total of the amounts from Form 1040, lines 23 through 32	3.	_____	
4. Enter the total of any amounts entered on the dotted line next to Form 1040, line 36	4.	_____	
5. Add lines 3 and 4	5.	_____	
6. Subtract line 5 from line 2	6.	_____	
7. Enter any foreign earned income exclusion and/or housing exclusion (Form 2555, line 45, or Form 2555-EZ, line 18)	7.	_____	
8. Enter any foreign housing deduction (Form 2555, line 50)	8.	_____	
9. Enter the amount of income from Puerto Rico you are excluding	9.	_____	
10. Enter the amount of income from American Samoa you are excluding (Form 4563, line 15)	10.	_____	
11. Add lines 6 through 10. This is your modified adjusted gross income	11.	_____	
12. Enter the amount shown below for your filing status	12.	_____	
• Single, head of household, or qualifying widow(er)—\$60,000			
• Married filing jointly—\$120,000			
13. Is the amount on line 11 more than the amount on line 12?			
<input type="checkbox"/> No. Skip lines 13 and 14, enter -0- on line 15, and go to line 16.			
<input type="checkbox"/> Yes. Subtract line 12 from line 11	13.	_____	
14. Divide line 13 by \$15,000 (\$30,000 if married filing jointly). Enter the result as a decimal (rounded to at least three places). If the result is 1.000 or more, enter 1.000	14.	_____	
15. Multiply line 1 by line 14	15.	_____	
16. Student loan interest deduction. Subtract line 15 from line 1. Enter the result here and on Form 1040, line 33. Do not include this amount in figuring any other deduction on your return (such as on Schedule A, C, E, etc.)	16.	_____	

5.

Student Loan Cancellations and Repayment Assistance

Introduction

Generally, if you are responsible for making loan payments, and the loan is canceled (forgiven), you must include the amount that was forgiven in your gross income for tax purposes. However, if you fulfill certain requirements, two types of student loan assistance may be tax free. The types of assistance discussed in this chapter are:

- Student loan cancellation, and
- Student loan repayment assistance.

Student Loan Cancellation

If your student loan is canceled, you may not have to include any amount in income. This section describes the requirements for tax-free treatment of canceled student loans.

Qualifying Loans

To qualify for tax-free treatment, for the cancellation of your loan, your loan must have been made by a qualified lender to assist you in attending an eligible educational institution and contain a provision that all or part of the debt will be canceled if you work:

- For a certain period of time,
- In certain professions, and
- For any of a broad class of employers.



The cancellation of your loan will not qualify for tax-free treatment if it is cancelled because of services you performed for the educational institution that made the loan or other organization that provided the funds. See [Exception](#), later.

Eligible educational institution. This is an educational institution 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 lenders. These include the following.

1. The United States, or an instrumentality thereof.
2. A state, territory, or possession of the United States, or the District of Columbia, or any political subdivision thereof.
3. A public benefit corporation that is tax-exempt under section 501(c)(3); and that has assumed control of a state, county, or municipal hospital; and whose employees are considered public employees under state law.

4. An eligible educational institution, if the loan is made:

- a. As part of an agreement with an entity described in (1), (2), (3) under which the funds to make the loan were provided to the educational institution, or
- b. Under a program of the educational institution that is designed to encourage its students to serve in occupations with unmet needs or in areas with unmet needs where the services provided by the students (or former students) are for or under the direction of a governmental unit or a tax-exempt section 501(c)(3) organization.

Occupations with unmet needs include medicine, nursing, teaching and law.

Section 501(c)(3) organization. This is any corporation, community chest, fund, or foundation organized and operated exclusively for one or more of the following purposes.

- Charitable.
- Religious.
- Educational.
- Scientific.
- Literary.
- Testing for public safety.
- Fostering national or international amateur sports competition (but only if none of its activities involve providing athletic facilities or equipment).
- The prevention of cruelty to children or animals.

Exception. The cancellation of your loan does not qualify as tax-free student loan cancellation if your student loan was made by an educational institution and is canceled because of services you performed for the educational institution or other organization that provided the funds.

Refinanced Loan

If you refinanced a student loan with another loan from an eligible educational institution or a tax-exempt organization, that loan may also be considered as made by a qualified lender. The refinanced loan is considered made by a qualified lender if it is made under a program of the refinancing organization that is designed to encourage students to serve in occupations with unmet needs or in areas with unmet needs where the services required of the students are for or under the direction of a governmental unit or a tax-exempt section 501(c)(3) organization.

Student Loan Repayment Assistance

Student loan repayments made to you are tax free if you received them for any of the following:

- The National Health Service Corps (NHSC) Loan Repayment Program (NHSC Loan Repayment Program).
- A state education loan repayment program eligible for funds under the Public Health Service Act.

- Any other state loan repayment or loan forgiveness program that is intended to provide for the increased availability of health services in under served or health professional shortage areas.



You cannot deduct the interest you paid on a student loan to the extent payments were made through your participation in the above programs.