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Educational Expenses

For use in preparing
1996 Returns

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Important Changes for 1996

Employer-provided educational assistance. The exclusion from income of up to \$5,250 of employer-provided education assistance benefits, which expired for tax years beginning after December 31, 1994, will now expire for tax years beginning after May 31, 1997. However, the exclusion does not apply to graduate-level courses that begin after June 30, 1996. See *Employer-Provided Education*, later. Even though the exclusion will expire for tax years beginning after May 31, 1997, you can still exclude benefits for courses that begin before July 1, 1997. See Publication 553, *Highlights of 1996 Tax Changes* for a possible change to “before July 1, 1997.”



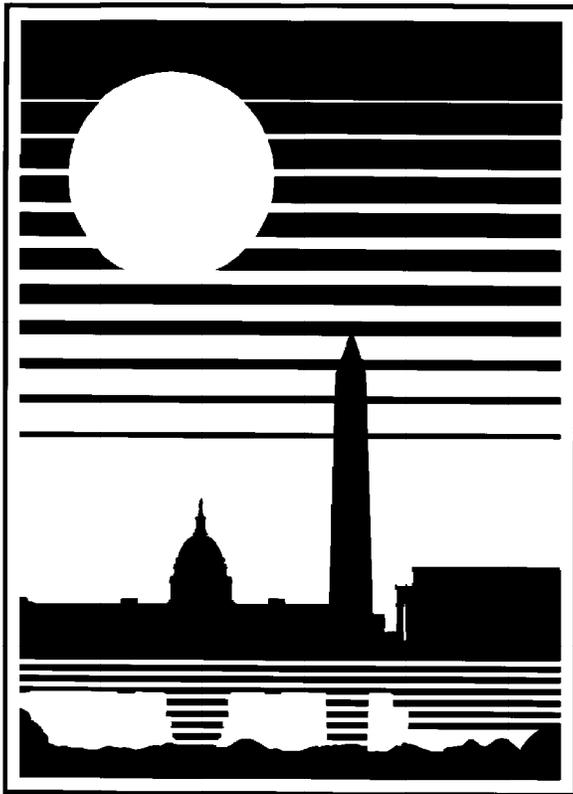
These changes may entitle you to a refund of income, social security, and Medicare taxes. See Refund Procedure for Employees under Employer-Provided Education.

Standard mileage rate. Generally, if you use your car for transportation to school, you can deduct 31 cents per mile. For more information, see *Using Your Car* under *What Educational Expenses Are Deductible*.

Limit on itemized deductions. If your adjusted gross income is more than \$117,950 (\$58,975 if you are married filing separately), your itemized deductions may be limited. See the instructions for Form 1040, Schedule A, line 28.

Introduction

This publication discusses work-related educational expenses. You may be able to deduct these expenses on your tax return as business expenses. In order to deduct these expenses you must:



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- 1) Be working,
- 2) Itemize your deductions on Schedule A (Form 1040) if you are an employee, and
- 3) Meet the requirements discussed under *Qualifying Education*.

You can use *Figure A* as a quick check to see if your educational expenses are deductible.

Other educational expenses, such as costs of sending children to college, are personal expenses that you cannot deduct.

Useful Items

You may want to see:

Publication

- 463** Travel, Entertainment, Gift, and Car Expenses
- 520** Scholarships and Fellowships
- 535** Business Expenses

Form (and Instructions)

- 1040** U.S. Individual Income Tax Return
- 2106** Employee Business Expenses
- 2106-EZ** Unreimbursed Employee Business Expenses
- Schedule A (Form 1040)** Itemized Deductions
- Schedule C (Form 1040)** Profit or Loss From Business (Sole Proprietorship)
- Schedule C-EZ (Form 1040)** Net Profit From Business (Sole Proprietorship)

See *How To Get More Information*, near the end of this publication for information about getting these publications and forms.

Qualifying Education

Education must meet certain requirements before the expenses of that education can be deducted. If these requirements are met, the education is qualifying education. You may be able to deduct the costs of qualifying education even though the education may lead to a degree.

Requirements. The education must:

- 1) Be required by your employer or the law to keep your present salary, status, or job (and serve a business purpose of your employer), or
- 2) Maintain or improve skills needed in your present work.

Exception. Even if your education meets one of the requirements above, it is not qualifying education if it:

- 1) Is needed to meet the minimum educational requirements of your present trade or business, or

- 2) Is part of a program of study that can qualify you for a new trade or business, even if you have no plans to enter that trade or business.

See *Nonqualifying Education*, later.

Present work. Your education must relate to your present work. Education that will relate to work you may enter in the future is not qualifying education. Education that prepares you for a future occupation includes any education that keeps you up-to-date for a return to work or that qualifies you to reenter a job you had in the past.

Temporary absence. If you stop work for a year or less and then go back to the same kind of work, your absence is ordinarily considered temporary. Education during a vacation, temporary leave, or other temporary absence from your job is considered related to your present job. However, after your temporary absence you must return to the same kind of work.

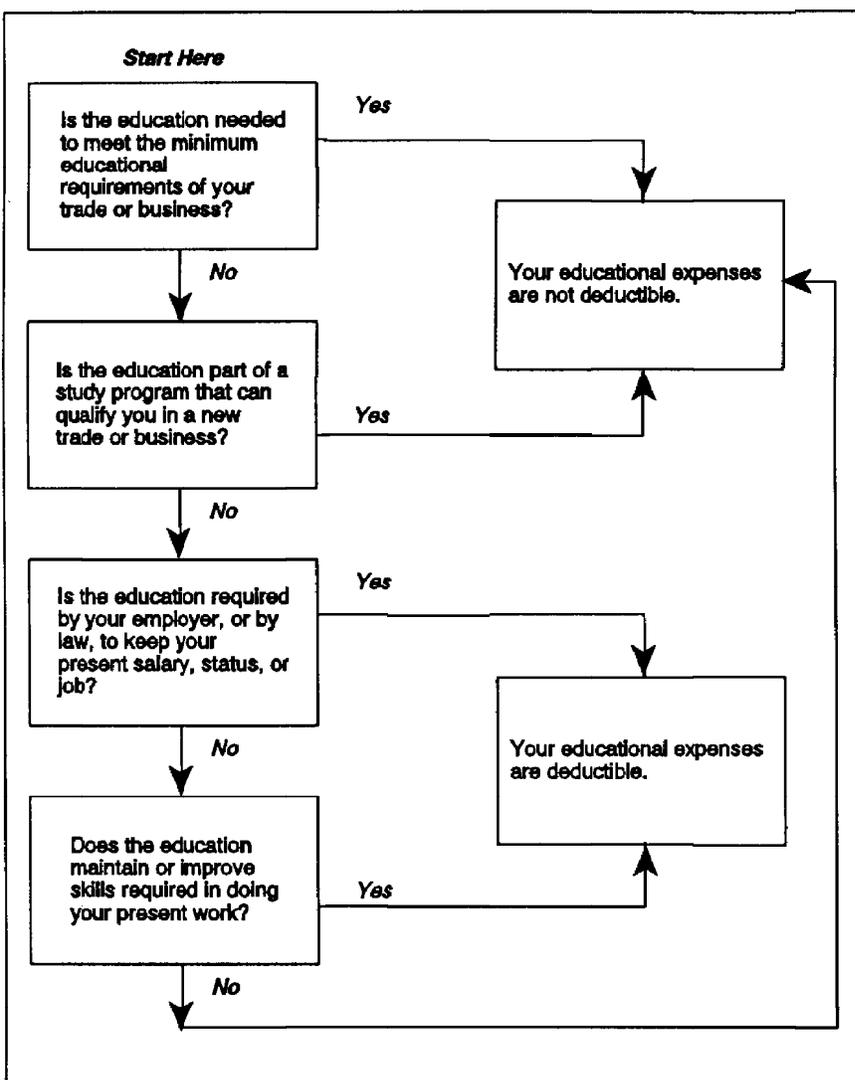
Example. You quit your biology research job to become a full-time biology graduate student for one year. If you return to work in biology research after completing the courses, the education is related to your present work. You may even choose to take a similar job with another employer.

Education Required by Employer or by Law

Once you have met the minimum educational requirements for your job, your employer or the law may require you to get more education. This additional education must be required for you to keep your present salary, status, or job. It must serve a business purpose of your employer and not be part of a program that will qualify you for a new trade or business.

When you take more education than your employer or the law requires, the additional education is qualifying only if it maintains or improves skills required in your present work.

Figure A. Are Your Educational Expenses Deductible?



See *Education To Maintain or Improve Skills*, later.

Example. You are a teacher who has satisfied the minimum requirements for teaching. Your employer requires you to take an additional college course each year to keep your teaching job. You take a course and pay for it yourself. This is qualifying education even if you eventually receive a master's degree and an increase in salary because of this extra education.

Education To Maintain or Improve Skills

If your education is not required by your employer or a law, it must maintain or improve skills needed in your job to be qualifying education. This includes refresher courses, courses on current developments, and academic or vocational courses. However, courses you take that are needed to meet the minimum educational requirements for your job or to qualify you for a new trade or business are not qualifying education. See *Education To Qualify for a New Trade or Business*, later.

Example. You repair televisions, radios, and stereo sets for XYZ Store. To keep up with the latest changes, you take special courses in radio and stereo service. These courses maintain and improve skills required in your work.

Nonqualifying Education

If you need education to meet the minimum requirements for a trade or business or if the education is part of a program of study that will qualify you for a new trade or business, it is nonqualifying education. You cannot deduct the costs of nonqualifying education.

Education To Meet Minimum Requirements

Education needed to meet the minimum educational requirements for your present trade or business is nonqualifying education. The minimum education necessary is determined by:

- 1) Laws and regulations,
- 2) Standards of your profession, trade, or business, and
- 3) Your employer's requirements.

You have not necessarily met the minimum educational requirements of your trade or business simply because you are already doing the work.

Once you have met the minimum educational requirements that were in effect when you were hired, you do not have to satisfy this rule again. This means that if the minimum requirements change, any education you need to meet the new requirements is qualifying education.

Example 1. You are a full-time engineering student. You work part time as an engineer for a firm that will employ you full time as an engineer after you finish college. Although your college engineering courses improve your skills in your present job, you have not met the minimum job requirements for a full-time engineer. The education is nonqualifying education.

Example 2. You are an accountant and you have met the minimum educational requirements of your employer. Your employer later changes the minimum educational requirements and requires you to take college courses to keep your job. These additional courses are not minimum requirements because you already have satisfied the initial minimum requirements. The education is qualifying education.

However, a new accountant coming into the firm would have to satisfy these new minimum requirements. The education the new accountant would need to meet the new minimum requirements would be nonqualifying education.

Example 3. You have your own accounting business. To improve your skills, you take several courses in tax accounting. You already have met the minimum educational requirements to be an accountant. These courses improve skills required in your business and are not part of a program of study that will qualify you for a new trade or business. These courses are qualifying education.

Requirements for Teachers

This discussion applies to teachers and others employed by educational organizations. The minimum educational requirement for teachers is usually set by the state or school district. It is based upon a minimum number of college hours or a college degree usually required of a person hired for that position.

If no requirements exist, you will have met the minimum educational requirement when you become a faculty member. You generally will be considered a faculty member when one of the following occurs:

- 1) You have tenure,
- 2) Your years of service count toward obtaining tenure,
- 3) You have a vote in faculty decisions, or
- 4) Your school makes contributions for you to a retirement plan other than social security or a similar program.

Example 1. Your state law requires beginning secondary school teachers to have a bachelor's degree, including ten professional education courses. In addition, to keep the job, a teacher must complete a fifth year of training within 10 years from the date of hire. If the employing school certifies to the State Department of Education that qualified teachers cannot be found, the school may hire persons with only 3 years of college. However, to keep their

job, these teachers must get a bachelor's degree and the required professional education courses within 3 years.

Under these facts, the bachelor's degree, whether it includes the ten professional education courses or not, is considered the minimum educational requirement for qualification as a teacher in your state.

If you have all the required education except the fifth year, you have met the minimum educational requirements. However, if the fifth year will qualify you for a new trade or business, it is nonqualifying education. See *Education To Qualify for a New Trade or Business*, later.

Example 2. Assume the same facts as in Example 1. If you have a bachelor's degree and only six professional education courses, the additional four education courses would be qualifying education. Because a bachelor's degree is the minimum requirement for qualification as a teacher, you have already met the minimum requirements, even though you do not have all of the required courses.

Example 3. Assume the same facts as in Example 1. If you are hired with only 3 years of college, the courses you take that lead to a bachelor's degree (including those in education) are nonqualifying education. They are needed to meet the minimum education for employment as a teacher.

Example 4. You have a bachelor's degree and you work as a temporary instructor at a university. At the same time, you take graduate courses toward an advanced degree. The rules of the university state that you may become a faculty member only if you get a graduate degree. Also, you may keep your job as an instructor only as long as you show satisfactory progress toward getting this degree. You have not met the minimum educational requirements to qualify you as a faculty member. The graduate courses are nonqualifying education.

Certification in a new state. Once you have met the minimum educational requirements for your state, you are considered to have met the minimum educational requirements in a new state, even if you must take additional education to be certified in the new state. Any additional education you need is qualifying education.

Example. You hold a permanent teaching certificate in State A and are employed as a teacher in that state for several years. You move to State B and are promptly hired as a school teacher. You are required, however, to complete certain prescribed courses to get a permanent teaching certificate in State B. These additional courses are qualifying education because the teaching position in State B involves the same general kind of work for which you were qualified in State A. You have already met the minimum requirements for teaching and have not entered a new trade or business.

Education To Qualify for a New Trade or Business

Education that is part of a program of study that can qualify you for a new trade or business is nonqualifying education. This is true even if you are not seeking a new job.

If you are an employee, a change of duties is not a new trade or business if the new duties involve the same general work you did in your old job.

Example 1. You are an accountant. Your employer requires you to get a law degree at your own expense. You register at a law school for the regular curriculum that leads to a law degree. Even if you do not intend to become a lawyer, the education is nonqualifying because the law degree will qualify you for a new trade or business.

Example 2. You are a general practitioner of medicine. You take a 2-week course to review new developments in several specialized fields of medicine. The course does not qualify you for a new profession. It is qualifying education because it maintains or improves skills required in your present profession.

Example 3. While working in the private practice of psychiatry, you enter a program to study and train at an accredited psychoanalytic institute. The program will lead to qualifying you to practice psychoanalysis. The psychoanalytic training does not qualify you for a new profession. It is qualifying education because it maintains or improves skills required in your present profession.

Bar or CPA Review Course

Review courses to prepare for the bar examination or the certified public accountant (CPA) examination are nonqualifying education. These are personal expenses that qualify you for a new profession.

Qualifications for Teachers

All teaching and related duties are considered the same general kind of work. If you change duties in any of the following ways, it is not considered a change to a new business.

- 1) Elementary school teacher to secondary school teacher.
- 2) Teacher of one subject, such as biology, to teacher of another subject, such as art.
- 3) Classroom teacher to guidance counselor.
- 4) Classroom teacher to school administrator.

What Educational Expenses Are Deductible

If your education meets the requirements described earlier under *Qualifying Education*, you can generally deduct your educational expenses if you itemize your deductions or if you are self-employed. However, see *Expenses*

Relating to Tax-Exempt and Excluded Income, later.

Deductible expenses. The following educational expenses can be deducted.

- 1) Tuition, books, supplies, lab fees, and similar items.
- 2) Certain transportation and travel costs.
- 3) Other educational expenses, such as costs of research and typing when writing a paper as part of an educational program.

Nondeductible expenses. Educational expenses do not include personal or capital expenses. For example, you cannot deduct the dollar value of vacation time or annual leave you take to attend classes. This amount is a personal expense.

Unclaimed reimbursement. If you do not claim reimbursement that you are entitled to receive from your employer, you cannot deduct the expenses that apply to the reimbursement. For example, your employer agrees to pay your educational expenses if you file a voucher showing your expenses. You do not file a voucher, and you do not get reimbursed. Because you did not file a voucher, you cannot deduct the expenses on your tax return.

Transportation Expenses

If your education qualifies, you can deduct local transportation costs of going directly from work to school. If you are regularly employed and go to school on a strictly **temporary basis**, you can also deduct the costs of returning from school to home. A temporary basis is irregular or short-term attendance, generally a matter of days or weeks.

If you are regularly employed and go directly from home to school on a temporary basis, you can deduct the round-trip costs of transportation in going from your home to school to home. This is true regardless of the location of the school, the distance traveled, or whether you attend school on non-work days.

Transportation expenses include the actual costs of bus, subway, cab, or other fares, as well as the costs of using your own car. Transportation expenses do not include amounts spent for travel, meals, or lodging while you are away from home overnight.

Using Your Car

If you use your car for transportation to school, you can deduct your actual expenses or use the standard mileage rate to figure the amount you can deduct. The standard mileage rate for 1996 is 31 cents per mile. If you use either method, you may also deduct parking fees and tolls. See Publication 463 for information on deducting your actual expenses of using a car.

Example 1. You regularly work in Camden, New Jersey, and go directly from work to your home. You also attend school every night for 3 weeks to take a course that improves your job skills. Since you are attending school on a **temporary** basis, you can deduct your daily

round-trip transportation expenses in going between home and school. This is true regardless of the distance traveled.

Example 2. Assume the same facts as in Example 1 except that on certain nights you go directly from work to school and then home. You can deduct your transportation expenses from your regular work site to school and then home.

Example 3. Assume the same facts as in Example 1 except that you attend the school for 6 consecutive Saturdays, non-work days. Since you are attending school on a **temporary** basis, you can deduct your round-trip transportation expenses in going between home and school.

Example 4. Assume the same facts as in Example 1 except that you attend classes twice a week for one year. Since your attendance in school is **not considered temporary**, you cannot deduct your transportation expenses in going between home and school. If you go directly from work to school, you can deduct the one-way transportation expenses of going from work to school. If you go from work to home to school and return home, your transportation expenses cannot be more than if you had gone directly from work to school.

Travel Expenses

You can deduct expenses for travel, meals (subject to the 50% limit), and lodging if you travel overnight to obtain qualified education and the main purpose of the trip is to attend a work-related course or seminar. However, you cannot deduct expenses for personal activities, such as sightseeing, visiting, or entertaining.

If your travel away from home is mainly personal, you cannot deduct all of your expenses for travel, meals, and lodging. However, during the time you attend the qualified educational activities, you can deduct your expenses for lodging and 50% of your expenses for meals.

Whether a trip's purpose is mainly personal or educational depends upon the facts and circumstances. An important factor is the comparison of the amount of time spent on personal activities and educational activities. If you spend more time on personal activities, the trip is considered mainly educational only if you can show a substantial nonpersonal reason for traveling to a particular location.

Example 1. John works in Newark, New Jersey. He traveled to Chicago to take a deductible one-week course at the request of his employer. While there, he took a sightseeing trip, entertained some personal friends, and took a side trip to Pleasantville for a day. Since the trip was mainly for business, he can deduct his round-trip airfare to Chicago, but he cannot deduct his transportation expenses of going to Pleasantville. Only the meals and lodging connected with his educational activities can be claimed as educational expenses.

Example 2. Sue works in Boston. She went to a university in Michigan to take a qualifying course for work. She took one course, which is one-fourth of a full course load of

study. She spent the rest of the time on personal activities. Her trip is mainly personal because three-fourths of her time is considered personal time and her reasons for taking the course in Michigan were all personal. She cannot deduct the cost of the train ticket, but she can deduct one-fourth of the meals (subject to the 50% limit) and lodging costs for the time she attended the university.

Example 3. Dave works in Nashville and recently traveled to California to take a deductible 2-week seminar. While there, he spent an extra 8 weeks on personal activities. The facts, including the extra 8-week stay, indicate that his main purpose was to take a vacation. He cannot deduct his round-trip airfare or his meals and lodging for the 8 weeks. He can deduct only his expenses for meals and lodging for the 2 weeks he attended the seminar.

Cruises and conventions. Certain cruises and conventions offer seminars or courses as part of their itinerary. Even if these are work-related, your deduction for travel may be limited. This applies to:

- 1) Travel by ocean liner, cruise ship, or other form of luxury water transportation, and
- 2) Conventions outside the North American area.

TIP *The limits for educational purposes are the same that apply to cruises and conventions for other business purposes. These are discussed under *Luxury Water Travel and Conventions* in Publication 463.*

Meal Expenses

If your educational expenses qualify for deduction, you can deduct the cost of meals that qualify as travel expenses.

50% limit. You can deduct only 50% of your qualifying business-related meals if you were not reimbursed by your employer. This includes meals while traveling away from home to obtain your education.

Employees must use Form 2106-EZ or 2106 to apply the 50% limit. See the instructions for Form 2106-EZ or 2106 to figure the 50% limit.

TIP *For more information on expenses for travel, meals, and lodging, see Publication 463. Travel expenses for qualifying education are treated the same as travel expenses for other employee business purposes.*

Travel as Education

You cannot deduct the cost of travel that in itself is a form of education even though the travel may be directly related to your duties in your work or business.

Example. You are a French language teacher. While on sabbatical leave granted for travel, you traveled through France to improve your knowledge of the French language. You

chose your itinerary and most of your activities to improve your French language skills. You cannot deduct your travel expenses as educational expenses, even though you spent most of your time visiting French schools and families, attending movies or plays, and learning French in similar activities.

Expenses Relating to Tax-Exempt and Excluded Income

Some educational assistance you receive may be tax-exempt or excluded from income. This is income you receive that you are not required to report on your tax return. The rules for determining whether any item is taxable or not taxable are not discussed here. See Publication 525, *Taxable and Nontaxable Income*, for information on the rules on tax-exempt income.

The following discussions illustrate how to treat qualified educational expenses that are related to several tax-exempt or excluded sources: scholarships, veterans' educational assistance, and the education savings bond program.

Scholarships

If you receive a tax-exempt scholarship, you must subtract the amount of the scholarship from your qualified educational expenses.

Example 1. Your tuition for qualifying education is \$8,000. You receive a tax-exempt scholarship of \$6,000 to help pay the tuition. You can include only \$2,000 (\$8,000 – \$6,000) as qualified educational expenses.

Part of scholarship is tax exempt. If only part of your scholarship is tax exempt, you subtract only the expenses related to the tax-exempt part from your qualified educational expenses.

Example 2. Your tuition for qualifying education is \$8,000. You receive a \$6,000 scholarship of which \$4,000 is tax exempt and \$2,000 is taxable. You can include only \$4,000 (\$8,000 – \$4,000) as qualified educational expenses.

Part of tuition qualifies. If only part of your tuition is for qualifying education, you subtract only part of the tax-exempt scholarship from the qualifying education.

Example 3. Your total tuition is \$8,000. The tuition for the courses that are qualifying education totals \$3,200. Your tax-exempt scholarship is \$6,000. To determine the part of the scholarship that must be subtracted from the qualified education, multiply the scholarship (\$6,000) by a fraction.

The top number of the fraction is the tuition for qualifying education, \$3,200, and the bottom number is the total tuition, \$8,000. The result, \$2,400, is the amount of the scholarship you must subtract from your qualifying education. You can include \$800 (\$3,200 – \$2,400) as a qualified educational expense.

For more information on scholarships, see Publication 520.

Veterans

Any educational assistance payment you receive from the Department of Veterans Affairs (VA) is tax exempt. You must subtract the part of the VA payment that applies to qualifying education from your qualified educational expenses.

Some VA programs may include payments for subsistence or other personal expenses, and these payments are also tax exempt.

VA programs that pay educational expenses only. If you receive payments under a VA program that pays only for educational expenses, such as tuition, books, and similar expenses, you must subtract the part of the VA payment that applies to qualifying education from your qualified educational expenses.

Example. Your tuition is \$1,000 and all classes are qualifying education. You receive a \$780 educational assistance payment from the VA that is solely for qualifying education. You can only include \$220 (\$1,000 – \$780) as qualified educational expenses.

VA programs that pay living expenses and educational expenses. If you receive payments under a VA program that pays for both living expenses and educational expenses, you must separate payments for educational assistance from those for subsistence. You subtract only the educational part of the VA payment that applies to qualifying education from your qualified educational expenses.

Generally, 50% of the VA payments are for subsistence or living expenses. For married veterans, the percentage will increase.

Example. Your tuition is \$1,000 and all classes are qualifying education. You receive a \$780 educational assistance payment from the VA. Under this program, 50% of the payment is for living expenses. 50% is for educational expenses (\$780 × .50 = \$390). You can include \$610 (\$1,000 – \$390) as qualified educational expenses.

VA payments used for both qualifying and nonqualifying education. If you use a VA payment for both qualifying and nonqualifying education, you must allocate the payment you receive. To find out what part of the VA payment to subtract from the qualified education, multiply the VA payment by a fraction. The numerator (top number) is the cost of the qualifying education. The denominator (bottom number) is the total of your qualifying and nonqualifying educational expenses.

Example. Your tuition and fees for three courses are \$1,500. Only two of the three courses are qualifying education. The two courses cost \$1,000. You receive a \$780 educational assistance payment from the VA under a program that covers tuition and fees only. The payment did not include any amount for living expenses. Since two-thirds (\$1,000/\$1,500) of the total expenses are qualifying, subtract two-thirds of the VA payment ($2/3 \times \$780 = \520) from the \$1,000 cost of the two work-related courses. You can include \$480 (\$1,000 – \$520) as qualified educational expenses.

Education Savings Bond Program

You may be able to exclude from income all or part of the interest you received on the redemption of qualified Series EE U.S. Savings Bonds during the year if you pay qualified higher educational expenses during the same year. This exclusion is known as the *Education Savings Bond Program*. If you excluded interest under the Education Savings Bond Program, you must subtract the excluded interest from your qualified educational expenses. See Chapter 1 in Publication 550, *Investment Income and Expenses* for more information on excluding the savings bond interest.

How To Report Reimbursements and Educational Expenses

This section explains how to treat any reimbursements you received for educational expenses and how to figure your deduction for educational expenses.

If you are an employee, you must take into account any reimbursement you receive. How you treat the reimbursement depends on the type of reimbursement arrangement and the amount of the reimbursement. After you have determined how to treat reimbursements, if any, you will be able to figure your deduction for educational expenses. How you deduct and report these expenses on your tax return is discussed later in this section.

If you are self-employed, you can skip the sections on reimbursements and go to the rules for reporting your deduction. Those rules are explained later under *Where To Deduct Expenses*.

How To Treat Reimbursements

How you treat any reimbursements you receive depends on the arrangement you have with your employer.

No separate reimbursement. If you are paid a salary or commission with the understanding that you will pay your own expenses, then you are not reimbursed or given an allowance for your expenses. All of your salary or commission is included on Form W-2 and must be reported as income.

Types of reimbursement arrangements. There are two basic types of reimbursement arrangements — **accountable plans** and **nonaccountable plans**. You can tell the type of plan you are reimbursed under by the way the reimbursement is reported on your Form W-2.

Accountable plans. If you are reimbursed under an accountable plan, your employer should not include any reimbursement in your income in box 1 of your Form W-2. To be an

accountable plan, your employer's reimbursement arrangement must require you to meet the following rules:

- 1) Your expenses must be business-related,
- 2) You must adequately account to your employer within a reasonable period of time, and
- 3) You must return any excess reimbursement or allowance within a reasonable period of time.

Any part of your reimbursement that does not meet one of these three rules is considered paid under a nonaccountable plan.

Expenses equal reimbursement. If your expenses equal your reimbursement, you do not complete Form 2106 or Form 2106-EZ. You have no deduction since your expenses and reimbursement are equal.

Excess expenses. If your expenses are more than your reimbursement, you can deduct your excess expenses. These rules are discussed later under *Where To Deduct Expenses*.

Nonaccountable plans. Your employer will combine the amount of any reimbursement or other expense allowance paid to you under a nonaccountable plan with your wages, salary, or other compensation and report the total in box 1 of your Form W-2.

You can deduct your expenses regardless of whether they are more than, less than, or equal to your reimbursement. These rules are discussed later under *Where To Deduct Expenses*. An example of a filled-in Form 2106 illustrating a nonaccountable plan is shown later.

Reimbursement for Nondeductible Expenses

If your employer reimbursed you for expenses of education that you need to meet the minimum requirements for your job or that can qualify you for a new trade or business, you must report the reimbursement in your gross income.

Amount for Meals Included in Reimbursement

If your employer paid you one amount under an accountable plan for both meal expenses and other qualified educational expenses and it is not clear how much of the reimbursement is for each type of expense, you must allocate the reimbursement to figure out what part is for meals and what part is for other expenses. This is necessary to apply the 50% limit to your meal expenses.

Allocate your reimbursement as follows.

- 1) Divide your meal expenses by your total expenses.
- 2) Multiply your total reimbursement by the result from (1). This is reimbursement for your meal expenses.
- 3) Subtract the amount figured in (2) from your total reimbursement. The difference

is reimbursement for your other qualified educational expenses.

Example. Your employer paid you an expense allowance of \$2,000 under an accountable plan. The allowance was to cover all of your expenses of traveling away from home to take a 2-week training course for work. There was no indication of how much of the reimbursement was for each type of expense. You account to your employer for your expenses and they actually equal \$2,500 (\$425 for meals + \$700 lodging + \$150 transportation expenses + \$1,225 for books and tuition).

To allocate the reimbursement between the meal expenses and other expenses of qualified education (including lodging, transportation, books and tuition while traveling away from home), take the following steps. First, divide your meal expenses by your total expenses ($\$425 \div \$2,500$). The result is .17. Then multiply \$2,000 (your reimbursement) by .17. The result is \$340 (the amount of reimbursement allocated for your meals). The remainder of the reimbursement, \$1,660 ($\$2,000 - \340), is the amount of the reimbursement allocated for all other expenses.

Where To Deduct Expenses

Self-employed persons and employees report their educational expenses differently.

The following information explains what forms you must use to deduct your qualified educational expenses discussed earlier under *What Educational Expenses are Deductible*.

Self-employed persons. If you are self-employed, you must report your qualified educational expenses on the appropriate form used to report your business income and expenses.

For example, if you are a sole proprietor or an independent contractor, use Schedule C, Schedule C-EZ, or Schedule F. If you use Schedule C, list and total your educational expenses for tuition, books, laboratory fees, and similar items in Part V and enter the total on line 27. List your car and truck expenses on line 10. Enter your travel expenses on line 24a. Enter your meals and entertainment on line 24b. For more information see the instructions for the form that you file.

Employees. If you are an employee, you generally must report your qualified educational expenses on the forms in the following list of rules for deducting the expenses. To deduct these expenses:

- 1) Your paid expenses must be for qualified education.
- 2) The amount you deduct must be unreimbursed.
- 3) You must file Form 1040.
- 4) You must itemize your deductions on Schedule A (Form 1040). You can deduct only your expenses that are more than 2% of adjusted gross income (Form 1040, line 31). This 2% limit is applied after all other deduction limits have been applied (such as the 50% limit on meal expenses).

- 5) You generally must complete Form 2106 or 2106-EZ first to figure your expenses for education if they include meals and transportation expenses or if you receive reimbursement from your employer.

Qualified performing artist. Even if you were not reimbursed, you must file either Form 2106-EZ or 2106 if you are a qualified performing artist. See Publication 529 for more information about a qualified performing artist.

Impairment-related work expenses. Even if you were not reimbursed, you must file either Form 2106-EZ or 2106 if you are an individual with a disability claiming impairment-related work expenses. See Publication 529 for more information about impairment-related work expenses.

Employee Forms (Form 2106 or Form 2106-EZ)

If you are an employee and item (5) of the preceding list indicates that you must first figure your qualified educational expenses on Form 2106 or Form 2106-EZ, the following information should help you decide which form to use. You may be able to use the simpler Form 2106-EZ, as explained next.

Form 2106-EZ. You can use this form **only** if all the following apply:

- 1) You are an employee deducting job-related business expenses (including qualified educational expenses),
- 2) You **are not** reimbursed by your employer for any expenses (amounts your employer included in box 1 of your Form W-2 are not considered reimbursements), and
- 3) If you are claiming vehicle expense,
 - a) You own your vehicle, and
 - b) You use the 1996 standard mileage rate **and** have used the standard mileage rate since you first used the vehicle in your business.

Form 2106. You use this form if:

- 1) You are an employee deducting job-related business expenses (including qualified educational expenses), and
- 2) You were reimbursed by your employer for your expenses (amounts your employer included in box 1 of your W-2 are not considered reimbursements), or
- 3) You are claiming vehicle expense,
 - a) You used the actual expense method in the first year you used your vehicle for business,
 - b) You used the 1996 standard mileage rate **and** have used the standard mileage rate since you first used the vehicle in your business, or
 - c) You used a depreciation method other than straight line for this vehicle in a prior year.

Reporting amount. If you use Form 2106-EZ or 2106, that form will tell you where to enter on Form 1040 the amount you figured.

Forms not required. You do not have to complete Form 2106 if your reimbursement **not** included in box 1 of Form W-2 is at least as much as your deductible expenses. Do not deduct the expenses or report the reimbursement as income.

If your qualified educational expenses do not include any expenses for travel, transportation, meals or entertainment, and you were not reimbursed for any expenses, you do not have to complete Form 2106-EZ or 2106.

Instead, follow the Form 1040 instruction to enter your unreimbursed expenses for any tuition, books, supplies, or lab fees directly on Form 1040, Schedule A, line 20.

Employer-Provided Education

If you receive educational assistance benefits from your employer, part or all of the benefits may be tax exempt.

You can exclude up to \$5,250 of the benefits from income if you receive them under a qualified educational assistance program. Your employer can tell you if the program is a qualified program.

Educational assistance. The exclusion of benefits under an educational assistance program, which expired for tax years beginning after 1994, has been extended. It will now expire for tax years beginning after May 31, 1997. The exclusion of benefits under this program applies only to expenses paid for courses that begin before July 1, 1997. However, the exclusion does not apply to graduate level courses (discussed later) that begin after June 30, 1996. The amount you can exclude from income under this program is limited to \$5,250 per year. The education does not have to be work related for the benefits to be excluded.

If you received more than \$5,250 of benefits for the year, the amount over \$5,250 is taxable and must be included in your income, unless it qualifies as a working condition fringe benefit. See *Excludable fringe benefit*, later.

Defined. Educational assistance includes payments by your employer for tuition, fees and similar payments, books, supplies, and equipment. It does not include payments for meals, lodging, transportation, or tools or supplies (other than textbooks) that you can keep after completing the course of instruction. It does not include payments for education involving sports, games, or hobbies unless the education:

- 1) Has a reasonable relationship to the business of your employer, or
- 2) Is required as part of a degree program.

Graduate level course. Educational assistance does not include any payments by your employer for a graduate level course normally taken under a program leading to a law,

business, medical, or other advanced academic or professional degree, if the course begins after June 30, 1996.

Excludable educational benefit program. If you receive tax-exempt benefits under your employer's qualified educational assistance program, you cannot take a deduction or credit for the amount of those benefits.

Excludable fringe benefit. If your employer provided you with education that was not excludable from your gross income under the employer's qualified educational assistance program described earlier, your employer can exclude the value of it from your income if, and only if, it qualifies as a working condition fringe benefit. A working condition fringe benefit is a benefit which if you had paid for it, would have been deductible by you as a trade or business expense incurred as an employee of the employer. For more information on fringe benefits, see Chapter 4 of Publication 535.

Refund Procedure for Employees

The annual exclusion from income of up to \$5,250 of employer-provided educational assistance benefits, which expired for tax years beginning after 1994, was extended. It will now expire for tax years beginning after May 31, 1997. You may be entitled to certain refunds because of this extension. These refunds would be for federal income, social security, and Medicare taxes paid on excludable educational assistance benefits provided in 1995, and for social security and Medicare taxes paid on excludable benefits provided in 1996.

Those not entitled to refunds. If your employer continued to exclude these benefits from your income after December 31, 1994, you have not overpaid taxes on educational benefits and, are not entitled to a refund.

Employee income tax refunds. If you are entitled to an income tax refund for 1995 because your employer did not exclude employer-provided educational assistance from your gross income, you can claim a refund by filing Form 1040X, *Amended U.S. Individual Income Tax Return*. To do this, you need a Form W-2c from your employer showing the corrected wages.

To speed up the processing of these amended returns, print "IRC 127" in the top margin of Form 1040X. Next, enter your name, address, social security number, and tax year on the Form 1040X, sign the form, and attach your Form W-2c. The IRS will figure the refund based on the W-2c information provided and will process these amended returns as quickly as possible.

 *If your employer excluded employer-provided educational assistance from your gross income, you cannot deduct these educational expenses.*

Earned income credit. If your Form W-2c shows corrected wages of less than \$26,673

for 1995, you may qualify for the earned income credit. If you qualify for the credit in 1995 but did not claim it, and you have a qualifying child, attach a completed Schedule EIC to the Form 1040X. If you already received the credit for 1995, do not complete another Schedule EIC. The IRS will automatically refigure the credit for you.

Employee social security and Medicare tax refunds. For 1995 and 1996, if you are entitled to an income tax refund, discussed earlier, you can request reimbursement of social security and Medicare taxes from the employer who provided the educational assistance. Employers may add these reimbursements to your paychecks or make separate payments. If your 1995 wages (not counting educational assistance) exceeded \$61,200, you would not have been subject to social security tax on the educational assistance payments. In that case, you would only be entitled to a Medicare tax refund.

In the unusual case that you are not able to get a refund of these taxes from your employer, file a Form 843, *Claim for Refund and Request for Abatement*, with the IRS. If you use Form 843, attach to the form a statement from your employer listing any amount your employer reimbursed you and any amount your employer claimed (or authorized by you, to be claimed by the employer). If you cannot get this statement from your employer, you must make the same statement (to the best of your knowledge and belief) and also explain why you could not get the statement. As with Form 1040X, write "IRC 127" in the top margin of Form 843 to speed up the processing of your claim.

Effect on retirement programs and IRAs. If you are entitled to a refund for 1995 because of the change in taxation of educational assistance benefits, retirement programs and individual retirement arrangements (IRAs) are permitted to include the educational assistance (that would otherwise be excluded) in your 1995 income. In addition, if you made nondeductible contributions for 1995 to an IRA, the reduction in adjusted gross income that may result from excluding educational assistance benefits, may allow you to treat previously nondeductible 1995 IRA contributions as deductible. To do this, put the correct nondeductible contribution amount on Form 8606 and attach it to Form 1040X.

Recordkeeping

You must keep records as proof of any deduction claimed on your tax return. Generally, you should keep your records for 3 years from the date of filing the income tax return and claiming the deduction. A return filed early is considered as filed on the due date.

If you are an employee who is reimbursed for expenses and you give your records and documentation to your employer, you do not have to keep duplicate copies of this information. However, you should keep your records for a 3-year period if:

- 1) You claim deductions for expenses that are more than your reimbursement,
- 2) Your employer does not use adequate accounting procedures to verify expense accounts,
- 3) You are related to your employer, or
- 4) Your expenses are reimbursed under a nonaccountable plan.

Examples of records to keep. If any of the above cases apply to you, you must be able to prove that your expenses are deductible. You should keep adequate records or have sufficient evidence that will support your expenses. Estimates or approximations do not qualify as proof of an expense. Some examples of what types of evidence can be used to help prove your expenses are:

- Documents such as transcripts, course descriptions, catalog, etc., showing period of enrollment in educational institutions, principal subjects studied, and description of educational activity.
- Canceled checks and receipts to verify amounts you spent for tuition and books, meals and lodging while away from home overnight for educational purposes, travel and transportation, and other educational expenses.
- Statement(s) from your employer explaining whether the education was necessary for you to keep your job, salary, or status; how the education helped maintain or improve skills needed in your job; how much educational expense reimbursement you received, identified by kind of expense; type of certificate and subjects taught, if a teacher.

- Complete information about any scholarship or fellowship grants, including amounts you received during the year.

Example — Filled-In Form 2106

Victor Jones teaches math at a private high school in North Carolina. He was selected to attend a 3-week math seminar at a university in California. The seminar will improve his skills in his current job and is qualified education. He was reimbursed for his expenses under his employer's nonaccountable plan, so his reimbursement of \$2,100 is shown included in the wages on his Form W-2. Victor will file Form 1040.

His actual expenses for the seminar are as follows:

| | |
|-------------------------|-----------------------|
| Lodging | \$1,050 |
| Meals | 526 |
| Airfare | 550 |
| Taxi fares | 50 |
| Tuition and books | <u>400</u> |
| Total Expenses | <u>\$2,576</u> |

Victor files Form 2106 with his tax return. He enters \$1,650 (\$1,050 + \$550 + \$50) on line 3 to account for his lodging, airfare, and taxi fares. He enters \$400 on line 4 for other work-related educational expenses. On line 5, Victor enters \$526 for meal expenses.

Since his reimbursement was reported as wages on Form W-2 by his employer, he leaves Step 2 blank. He carries down the figures from Step 1 and completes the calculations required for Step 3. The completed filled-in form is shown near the end of this publication.

The amount on line 10 (\$2,313) is the amount that Victor will enter on line 20 of his Schedule A (Form 1040). He will report all of the \$2,100 shown on his Form W-2 as income on line 7 of Form 1040.

Employee Business Expenses

Department of the Treasury
Internal Revenue Service

▶ See separate instructions.

▶ Attach to Form 1040.

Your name Victor Jones Social security number 123 00 4321 Occupation in which expenses were incurred Teaching

Part 1 Employee Business Expenses and Reimbursements

| STEP 1 Enter Your Expenses | Column A Other Than Meals and Entertainment | Column B Meals and Entertainment |
|--|---|--|
| 1 Vehicle expense from line 22 or line 29 | 1 | |
| 2 Parking fees, tolls, and transportation, including train, bus, etc., that did not involve overnight travel or commuting to and from work | 2 | |
| 3 Travel expense while away from home overnight, including lodging, airplane, car rental, etc. Do not include meals and entertainment | 3 <u>1,650</u> | |
| 4 Business expenses not included on lines 1 through 3. Do not include meals and entertainment | 4 <u>400</u> | |
| 5 Meals and entertainment expenses (see instructions) | | 5 <u>526</u> |
| 6 Total expenses. In Column A, add lines 1 through 4 and enter the result. In Column B, enter the amount from line 5 | 6 <u>2,050</u> | 6 <u>526</u> |

Note: If you were not reimbursed for any expenses in Step 1, skip line 7 and enter the amount from line 6 on line 8.

STEP 2 Enter Amounts Your Employer Gave You for Expenses Listed in STEP 1

| | | |
|---|---|--|
| 7 Enter amounts your employer gave you that were not reported to you in box 1 of Form W-2. Include any amount reported under code "L" in box 13 of your Form W-2 (see instructions) | 7 | |
|---|---|--|

STEP 3 Figure Expenses To Deduct on Schedule A (Form 1040)

| | | |
|---|----------------|-----------------|
| 8 Subtract line 7 from line 6 | 8 <u>2,050</u> | 8 <u>526</u> |
| Note: If both columns of line 8 are zero, stop here. If Column A is less than zero, report the amount as income on Form 1040, line 7. | | |
| 9 In Column A, enter the amount from line 8. In Column B, multiply the amount on line 8 by 50% (.50). If either column is zero or less, enter -0- in that column | 9 <u>2,050</u> | 9 <u>263</u> |
| 10 Add the amounts on line 9 of both columns and enter the total here. Also, enter the total on Schedule A (Form 1040). (Qualified performing artists and individuals with disabilities, see the instructions for special rules on where to enter the total.) ▶ | 10 | 10 <u>2,313</u> |

How To Get More Information



You can get help from the IRS in several ways.

Free publications and forms. To order free publications and forms, call 1-800-TAX-FORM (1-800-829-3676). You can also write to the IRS Forms Distribution Center nearest you. Check your income tax package for the address. Your local library or post office also may have the items you need.

For a list of free tax publications, order Publication 910, *Guide to Free Tax Services*. It also contains an index of tax topics and related publications and describes other free tax information services available from IRS, including tax education and assistance programs.

If you have access to a personal computer and modem, you also can get many forms and publications electronically. See *Quick and Easy Access to Tax Help and Forms* in your income tax package for details. If space permitted, this information is at the end of this publication.

Tax questions. You can call the IRS with your tax questions. Check your income tax package or telephone book for the local number, or you can call 1-800-829-1040.

TTY/TDD equipment. If you have access to TTY/TDD equipment, you can call 1-800-829-4059 to ask tax questions or to order forms and publications. See your income tax package for the hours of operation.