

General Instructions

What's New

Credits expanded for Gulf Opportunity Zone students. For tax years beginning in 2005 and 2006, the education credits have been expanded for students attending an eligible education institution in the Gulf Opportunity Zone (GOZ students). The Hope credit for a GOZ student is increased to 100% of the first \$2,000 in qualified education expenses and 50% of the next \$2,000 of qualified education expenses for a maximum credit of \$3,000 per student. The lifetime learning credit rate for a GOZ student is increased from 20% to 40%. The definition of qualified education expenses for a GOZ student also has been expanded. See *Special Rules for Gulf Opportunity Zone Students* on page 3.

Katrina Emergency Tax Relief Act of 2005. This Act provides tax relief for persons affected by Hurricane Katrina. Under the Act, you may still qualify for an education credit even though you were prevented from completing your normal school term. See Publication 4492, *Information for Taxpayers Affected by Hurricanes Katrina, Rita, and Wilma*.

Change to computation of Hope Credit. To simplify Part I, we have changed the method of figuring the Hope credit. Follow the instructions under *Specific Instructions, Part I*.

Purpose of Form

Use Form 8863 to figure and claim your education credits. The education credits are:

- The Hope credit, and
- The lifetime learning credit.

Who Can Take the Credits

You may be able to take the credits if you, your spouse, or a dependent you claim on your tax return was a student enrolled at or attending an eligible educational institution. The credits are based on the amount of qualified education expenses paid for the student in 2005 for academic periods beginning in 2005 and the first 3 months of 2006.



Qualified education expenses must be reduced by any expenses paid directly or indirectly using tax-free educational assistance. See Tax-Free Educational Assistance and Refunds of Qualified Education Expenses on this page.

Note. If a student is claimed as a dependent on another person's tax return, only the person who claims the student as a dependent can claim the credits for the student's qualified education expenses. If a student is not claimed as a dependent on another person's tax return, only the student can claim the credits.

Generally, qualified education expenses paid on behalf of the student by someone other than the student (such as a relative) are treated as paid by the student. Also, qualified education expenses paid (or treated as paid) by a student who is claimed as a dependent on your tax return are treated as paid by you. Therefore, you are treated as having paid expenses that were paid from your dependent student's earnings, gifts, inheritances, savings, etc.

You cannot take the education credits if any of the following apply.

- You are claimed as a dependent on another person's tax return, such as your parent's return (but see the *Note* above).
- Your filing status is married filing separately.
- Your adjusted gross income on Form 1040, line 38, or Form 1040A, line 22, is (a) \$107,000 or more if married filing jointly, or (b) \$53,000 or more if single, head of household, or qualifying widow(er).
- You are taking a deduction for tuition and fees on Form 1040, line 34, or Form 1040A, line 19, for the same student.

- You (or your spouse) were a nonresident alien for any part of 2005 and the nonresident alien did not elect to be treated as a resident alien.

Additional Information

See Pub. 970, *Tax Benefits for Education*, for more information about these credits.

Rules That Apply to Both Credits

Qualified Education Expenses

Generally, qualified education expenses are amounts paid in 2005 for tuition and fees required for the student's enrollment or attendance at an eligible educational institution. It does not matter whether the expenses were paid in cash, by check, by credit card, or with borrowed funds.

Qualified education expenses do not include amounts paid for:

- Room and board, insurance, medical expenses (including student health fees), transportation, or other similar personal, living, or family expenses.
- Course-related books, supplies, equipment, and nonacademic activities, except for fees required to be paid to the institution as a condition of enrollment or attendance.
- Any course or other education involving sports, games, or hobbies, or any noncredit course, unless such course or other education is part of the student's degree program or (for the lifetime learning credit only) helps the student to acquire or improve job skills.

If you or the student take a deduction for higher education expenses, such as on Schedule A or Schedule C (Form 1040), you cannot use those expenses when figuring your education credits.



Any qualified expenses used to figure the education credits cannot be taken into account in determining the amount of a distribution from a Coverdell ESA or a qualified tuition program that is excluded from gross income.

Tax-Free Educational Assistance and Refunds of Qualified Education Expenses

Tax-free educational assistance includes a tax-free scholarship or Pell grant or tax-free employer-provided educational assistance. See Pub. 970 for specific information.

You must reduce the total of your qualified education expenses by any tax-free educational assistance and by any refunds of your expenses. If the refund or tax-free assistance is received in the same year in which the expenses were paid or in the following year before you file your tax return, reduce your qualified education expenses by the amount received and figure your education credits using the reduced amount of qualified expenses. If the refund or tax-free assistance is received after you file your return for the year in which the expenses were paid, you must figure the amount by which your education credits would have been reduced if the refund or tax-free assistance had been received in the year for which you claimed the education credits. Include that amount as an additional tax for the year the refund or tax-free assistance was received on the tax line of your 2005 tax return (Form 1040, line 44, or Form 1040A, line 28). Enter the amount and "ECR" next to that line.

Example. You paid \$8,000 tuition and fees in December 2004, and your child began college in January 2005. You filed your 2004 tax return on February 2, 2005, and claimed a lifetime learning credit of \$1,600. After you filed your return, your child dropped two courses and you received a refund of \$1,400. You must refigure your 2004 lifetime learning credit using \$6,600 of qualified expenses instead of \$8,000. The refigured credit is \$1,320. You must include the difference of \$280 on your 2005 Form 1040, line 44, or Form 1040A, line 28.

Prepaid Expenses

Qualified education expenses paid in 2005 for an academic period that begins in the first 3 months of 2006 can be used in figuring your 2005 education credits. For example, if you pay \$2,000 in December 2005 for qualified tuition for the 2006 winter quarter that begins in January 2006, you can use that \$2,000 in figuring your 2005 education credits (if you meet all the other requirements).



You cannot use any amount paid in 2004 or 2006 to figure your 2005 education credits.

Eligible Educational Institution

An eligible educational institution is generally any accredited public, nonprofit, or proprietary (private) college, university, vocational school, or other postsecondary institution. Also, the institution must be eligible to participate in a student aid program administered by the Department of Education. Virtually all accredited postsecondary institutions meet this definition.

Special Rules for Gulf Opportunity Zone Students

The following rules apply only to students attending an eligible educational institution in the Gulf Opportunity Zone (GOZ), which includes the following areas in three states.

Alabama. The counties of Baldwin, Choctaw, Clarke, Greene, Hale, Marengo, Mobile, Pickens, Sumter, Tuscaloosa, and Washington.

Louisiana. The parishes of Acadia, Ascension, Assumption, Calcasieu, Cameron, East Baton Rouge, East Feliciana, Iberia, Iberville, Jefferson, Jefferson Davis, Lafayette, Lafourche, Livingston, Orleans, Plaquemines, Pointe Coupee, St. Bernard, St. Charles, St. Helena, St. James, St. John the Baptist, St. Martin, St. Mary, St. Tammany, Tangipahoa, Terrebonne, Vermilion, Washington, West Baton Rouge, and West Feliciana.

Mississippi. The counties of Adams, Amite, Attala, Choctaw, Claiborne, Clarke, Copiah, Covington, Forrest, Franklin, George, Greene, Hancock, Harrison, Hinds, Holmes, Humphreys, Jackson, Jasper, Jefferson, Jefferson Davis, Jones, Kemper, Lamar, Lauderdale, Lawrence, Leake, Lincoln, Lowndes, Madison, Marion, Neshoba, Newton, Noxubee, Oktibbeha, Pearl River, Perry, Pike, Rankin, Scott, Simpson, Smith, Stone, Walthall, Warren, Wayne, Wilkinson, Winston, and Yazoo.

All of the other rules discussed on page 2 (as modified by these rules) must still be met. The Hope credit for a GOZ student is 100% of the first \$2,000 in qualified education expenses and 50% of the next \$2,000 of qualified education expenses for a maximum credit of \$3,000 per student. The lifetime learning credit rate for a GOZ student is 40%.

The definition of qualified education expenses is expanded for GOZ students. In addition to tuition and fees required for enrollment or attendance at an eligible educational institution, qualified education expenses for a GOZ student include the following.

1. Books, supplies, and equipment required for enrollment or attendance at an eligible educational institution.
2. For a special needs student, expenses that are necessary for that person's enrollment or attendance at an eligible educational institution.
3. For a student who is at least a half-time student, the reasonable costs of room and board, but only to the extent that the costs are not more than the greater of the following two amounts.

a. 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.

b. The actual amount charged if the student is residing in housing owned or operated by the eligible educational institution.

You will need to contact the eligible educational institution for qualified room and board costs.

Specific Instructions

Part I Hope Credit

You may be able to take a credit of up to \$1,500 (\$3,000 if a GOZ student) for qualified education expenses (defined earlier) paid for each student who qualifies for the Hope credit. The Hope credit equals 100% of the first \$1,000 (\$2,000 if a GOZ student) and 50% of the next \$1,000 (\$2,000 if a GOZ student) of qualified expenses paid for each eligible student. You can take the Hope credit for a student if all of the following apply.

- As of the beginning of 2005, the student had not completed the first 2 years of postsecondary education (generally, the freshman and sophomore years of college), as determined by the eligible educational institution. For this purpose, do not include academic credit awarded solely because of the student's performance on proficiency examinations.
- The student was enrolled in 2005 in a program that leads to a degree, certificate, or other recognized educational credential.
- The student was taking at least one-half the normal full-time workload for his or her course of study for at least one academic period beginning in 2005.
- The Hope credit was not claimed for that student's expenses in more than one prior tax year.
- The student has not been convicted of a felony for possessing or distributing a controlled substance.



If a student does not meet all of the above conditions, you may be able to take the lifetime learning credit for part or all of that student's qualified education expenses instead.

Line 1

Complete columns (a) through (f) on line 1 for each student who qualifies for and for whom you elect to take the Hope credit.

Note. If you have more than three students who qualify for the Hope credit, enter "See attached" next to line 1 and attach a statement with the required information for each additional student. Include the amounts from line 1, column (f), for all students in the total you enter on line 2.

Column (c)

For each student, enter the amount of qualified education expenses remaining after reduction by certain tax-free amounts and refunds, as explained earlier. The expenses must have been paid for the student in 2005 for academic periods beginning after 2004 but before April 1, 2006, as explained under *Prepaid Expenses*. If the student's expenses are more than \$2,000 (\$4,000 if a GOZ student), enter \$2,000 (\$4,000 if a GOZ student). You may use the worksheet on the next page to figure the correct amount to enter in column (c).

Qualified Education Expenses Worksheet

(Do a separate worksheet for each student)

- 1. Total qualified education expenses _____
- 2. Less adjustments:
 - a. Tax-free educational assistance _____
 - b. Refunds of qualified education expenses _____
 - c. Other adjustments (see Pub. 970) _____
- 3. Total adjustments (add lines 2a-2c) _____
- 4. Qualified education expenses
(subtract line 3 from line 1 (enter on Form 8863, Part I or II, column (c)) _____

**Part II
Lifetime Learning Credit**

The maximum lifetime learning credit is \$4,000 for GOZ students and \$2,000 for all other students, regardless of the number of students. If you are claiming a credit for both GOZ students and other students, the qualified education expenses taken into account in Part II for other students cannot exceed \$10,000 reduced by the qualified education expenses of the GOZ students.



You cannot take the lifetime learning credit for any student for whom you are taking the Hope credit.

Line 3

Complete columns (a) through (c) for each student for whom you are taking the lifetime learning credit.

Note. If you are taking the lifetime learning credit for more than three students, enter "See attached" next to line 3 and attach a statement with the required information for each additional student. Include the amounts from line 3, column (c), for all students in the total you enter on line 4.

Column (c)

For each student, enter the amount of qualified education expenses remaining after reduction by certain tax-free amounts and refunds, as explained earlier. The expenses must have been paid for the student in 2005 for academic periods beginning after 2004 but before April 1, 2006, as explained under *Prepaid Expenses*. You may use the worksheet on this page to figure the correct amount to enter in column (c).

Paperwork Reduction Act Notice. We ask for the information on this form to carry out the Internal Revenue laws of the United States. You are required to give us the information. We need it to ensure that you are complying with these laws and to allow us to figure and collect the right amount of tax.

You are not required to provide the information requested on a form that is subject to the Paperwork Reduction Act unless the form displays a valid OMB control number. Books or records relating to a form or its instructions must be retained as long as their contents may become material in the administration of any Internal Revenue law. Generally, tax returns and return information are confidential, as required by Internal Revenue Code section 6103.

The average time and expenses required to complete and file this form will vary depending on individual circumstances. For the estimated averages, see the instructions for your income tax return.

If you have suggestions for making this form simpler, we would be happy to hear from you. See the instructions for your income tax return.

