

5.

Student Loan Interest Deduction

What's New

Income limits increased. The amount of your student loan interest deduction for 2009 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 2008 limits of \$55,000 and \$70,000 (\$115,000 and \$145,000 if you file a joint return). See [Effect of the Amount of Your Income on the Amount of Your Deduction](#), later, for more information.

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 2009.

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 5-1](#) 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.

Table 5-1. **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.
Phaseout	The amount of your deduction depends on your income level.

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.

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, Exemptions, Standard Deduction, and Filing Information.

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 (\$3,650 for 2009).

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 12](#).
- Tax-free distribution of earnings from a Coverdell education savings account (ESA). See [chapter 8](#).
- Tax-free distribution of earnings from a qualified tuition program (QTP). See [chapter 9](#).
- U.S. savings bond interest that you exclude from income because it is used to pay qualified education expenses. See [chapter 11](#).
- The tax-free part of scholarships and fellowships. See [chapter 1](#).
- Veterans' educational assistance. See [chapter 1](#).
- 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 2009. Because the loan origination fee was not included in his 2009 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 ($\$480 \div 120 \text{ months} = \4 per month). Bill made 7 payments in 2009, so he paid \$28 ($\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 2008, 6 months after he graduated from college. He began making payments as required. In September 2009, 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 2009. 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 2008, 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 2008 through October 2009) 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 2009.

Peg did not receive a Form 1098-E for 2009 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 2009 payments on her outstanding loan of \$10,625 (\$10,000 principal + \$625 accrued but unpaid interest).

<u>Payment Date</u>	<u>Payment</u>	<u>Stated Interest</u>	<u>Principal</u>
November 2009	\$200.51	\$44.27	\$156.24
December 2009	\$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 2009, Peg starts with the total amount of stated interest she paid, \$87.89. Next, she uses a reasonable method to allocate the loan origination fee over the term of the loan ($\$300 \div 60 \text{ 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 2010, 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 6](#).

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 2009, 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 2009. Assuming all other requirements are met, Josh can deduct the \$600 of interest he paid on his 2009 Form 1040 or 1040A.

Example 2. During 2009, 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 2009 tax return. In this case, neither Jo nor her parents may deduct the student loan interest Jo paid in 2009.

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 2009 is generally the smaller of:

- \$2,500, or
- The interest you paid in 2009.

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 5-1](#) (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 2009 on one or more qualified student loans must send Form 1098-E (or acceptable substitute) to each borrower by February 1, 2010.

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, Request for Student's or Borrower's Taxpayer Identification Number and Certification, 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 5-2 shows how the amount of your MAGI can affect your student loan interest deduction.

Table 5-2. **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), and 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 32 (Student loan interest deduction) and line 33 (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 2009 you paid \$800 interest on a qualified student loan. Your 2009 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 2009 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, 2555-EZ, or 4563, or you are excluding income from sources within Puerto Rico, you must complete [Worksheet 5-1](#) 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 32 (Form 1040NR), or line 9 (Form 1040NR-EZ).



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 2009 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.	_____