DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, DC 20224

OFFICE OF
CHIEF COUNSEL

December 18, 2001

Number: **200236001**
Release Date: 9/6/2002

UILC: 25A.00-00; 151.08-00
CC:ITA:4
TL-N-738-01

MEMORANDUM FOR AREA COUNSEL
(SMALL BUSINESS/SELF-EMPLOYED:AREA 1)
CC:SB:1:BOS

FROM: Heather Maloy
Associate Chief Counsel
(Income Tax & Accounting)

SUBJECT:

This memorandum responds to your request for field service advice, dated August 8, 2001, concerning §§ 25A, 151, and 152 of the Internal Revenue Code. Section 25A pertains to the Hope Scholarship Credit and the Lifetime Learning Credit (collectively, the education tax credit). Sections 151 and 152 relate to deductions for personal and dependency exemptions.

ISSUES:

If a dependency exemption with respect to an individual taxpayer/college student was allowable but not allowed on his parents' federal income tax return for the tax year in issue, then --

1. What is the amount of the taxpayer/student's personal exemption, and

2. Is the student/taxpayer entitled to claim a Hope Scholarship Credit on his own return?

CONCLUSIONS:

1. Because a dependency exemption was allowable to the parents of the taxpayer/student during the year in issue, the taxpayer's personal exemption amount is zero.

2. Because the taxpayer/student was not allowed (claimed) as a dependent by his parents, the taxpayer is entitled to claim a Hope Scholarship Credit on his own return for that year (assuming he meets all other relevant eligibility requirements).

FACTS:

The taxpayer is a college student who filed as a single taxpayer in . His parents, who are married and filed a joint federal income tax return for , were entitled to claim the taxpayer as a dependent on that return. However, the parents reported adjusted gross income (AGI) sufficiently large that they could derive no tax benefit either from claiming the taxpayer as a dependent or from claiming an education tax credit with regard to any education-related expenditures they might have made on his behalf.

On his return, the taxpayer reported an AGI of $, a personal exemption amount of zero, and a Hope Scholarship Credit of $. The Service Center denied the education tax credit, but sent the taxpayer a letter stating that the taxpayer could claim the credit if he filed an amended return claiming himself as a dependent. The taxpayer responded that he could not claim himself as a dependent because his parents could have claimed him as a dependent on their return. However, the taxpayer continued to maintain that he is entitled to an education tax credit for the year and requested assistance from the Taxpayer Advocate in obtaining it.

Your initial understanding of the facts, when this matter was first referred to you, was that the taxpayer's parents had claimed him as a dependent on their federal income tax return. Based on that understanding, your office recommended, and this office informally concurred in, denying an education tax credit to the taxpayer. However, further investigation has revealed that the taxpayer's parents did not in fact claim the taxpayer as a dependent in (although they did claim a dependency exemption with respect to another of their children). Your office then requested our office's written views on whether the taxpayer was correct in claiming the education tax credit on his return.

LAW AND ANALYSIS:

This case involves the relationship between the personal and dependency exemption rules (found in §§ 151 and 152) and the education tax credit rules (found in § 25A). The rules operate in tandem, but a seemingly slight difference in the relevant statutory language -- § 151(d)(2) uses the word "allowable," whereas § 25A(f)(1)(A)(iii) uses the word "allowed" -- is crucial to our determination that the taxpayer was correct both in treating his personal exemption amount as zero and in claiming the education tax credit.

1. Personal and dependency exemptions (§§ 151 and 152) ("allowable" as a deduction)

Sections 151 and 152 pertain to personal and dependency exemptions. Section 151(a) provides that in the case of an individual, the exemptions provided by § 151 "shall be allowed as deductions in computing taxable income." An individual and his or her

spouse may each claim a personal exemption under § 151(b) for the “exemption amount.” Under § 151(c)(1), an individual may also deduct the exemption amount for each of that individual’s dependents if the dependent either has gross income for the relevant year of less than the exemption amount, or is a child of the taxpayer and is either under the age of 19 or, if a student, under the age of 24.

Section 152(a) generally defines a dependent as being an individual who receives (or is treated as receiving) more than half of his or her support for the calendar year from another taxpayer with whom the individual stands in a specified relationship. The first such specified relationship is between a parent and his or her son or daughter. See § 152(a)(1).

The general "exemption amount" for 1999 was $2,750. See § 151(d)(1) and (d)(4) and § 3.08 of Rev. Proc. 98-61, 1998-2 C.B. 811. However, under a special rule found in § 152(d)(2), the exemption amount applicable to an individual is zero if that individual is one “with respect to whom a deduction is **allowable** to another taxpayer” during the taxable year at issue. (Emphasis added.) In general, a deduction is allowable if it is permissible, regardless of whether the deduction is actually used or confers a tax benefit. See Sharp v. U.S., 14 F.3d 583, 588 - 589 (Fed. Cir. 1993).

A dependency exemption was allowable to the taxpayer’s parents for 1999 under § 151(c)(1) because all three conditions of § 152(a) were satisfied: (i) a specified relationship existed; (ii) the parents supplied more than half their son’s support; and (iii) the son was both a student and under the age of 24. As a direct consequence of allowability under § 151(c)(1), however, the taxpayer’s personal exemption amount for 1999 was pegged by § 151(d)(2) at zero: he was not entitled to the tax benefit of a personal exemption for himself because other taxpayers -- his parents -- were permitted to claim him on their return. The effect of § 151(c)(1) and (d)(2), when read together, is both to ensure that only one exemption can properly be claimed per individual and to mandate on which of two possible returns the claim is proper. Once the conditions of § 152(a) are met, an individual will have the status of a dependent -- and the concomitant personal exemption amount of zero -- even if the taxpayer on whose return the dependent can be claimed chooses to forego actually claiming the dependency exemption.

Moreover, § 151(d)(2) and (d)(3)(D) will operate to mandate a personal exemption amount of zero for a dependent even if the phase out rule of § 151(d)(3) results in a zero exemption amount being available with respect to that dependent on another taxpayer’s return. Section151(d)(3) requires a phase out (or reduction) of the exemption amount for those “high income” taxpayers whose AGI exceeds a specified “threshold amount.” In the threshold amount for married taxpayers filing jointly began at an AGI of $189,950 of AGI, with the phaseout being complete once AGI reached $312,450. See § 3.08 of Rev. Proc. 98-21. Because the taxpayer’s parents reported an AGI for that was substantially in excess of $312,450, the parents' exemption amount for both personal and dependency exemptions for that year was reduced to zero. Although a zero exemption amount meant that the parents would

have derived no tax benefit from claiming their son as a dependent, that lack of tax benefit was statutorily irrelevant under § 151(d)(3)(D).

In sum, because a dependency exemption with respect to their son was allowable to the parents, the taxpayer/son's personal exemption amount under § 151(d)(2) was zero. Thus, the taxpayer correctly declined to amend his 1999 return.

2. The § 25A education tax credit ("allowed" as a deduction)

Section 25A provides two credits -- the Hope Scholarship Credit and the Lifetime Learning Credit -- that may be claimed with respect to an individual's qualified tuition and related expenses for post-secondary education. Although the credits differ in some important respects,[1] the statutory rule relevant here -- § 25A(f)(1)(A) -- applies equally to both credits. Accordingly, the Hope Scholarship Credit and the Lifetime Learning Credit are referred to collectively in this memorandum as the education tax credit.

During 1999, the education tax credit began being phased out when a taxpayer's modified AGI reached $40,000, and was completely phased out at a modified AGI of $50,000. Section 25A(d).

Section 25A(f)(1)(A) defines qualified tuition and related expenses, in general, as tuition and fees required for the attendance or enrollment of (i) the taxpayer; (ii) the taxpayer's spouse; or (iii) any dependent of the taxpayer with respect to whom the taxpayer is **allowed** a deduction under section 151. (Emphasis added.) In general, a deduction is "allowed" if it has been claimed on the return, regardless of whether the deduction produced a tax benefit. See Virginian Hotel v. Helvering, 319 U.S. 523 (1943).

As noted earlier, although the taxpayer's parents were entitled to claim the taxpayer as a dependent on their tax return, they elected to forego that deduction. The consequences of the parents' forbearance were twofold: (1) a § 151 deduction was not allowed on their return; and (2) the parents were ineligible, under § 25A(f)(1)(A)(iii), to claim an education tax credit with respect to the taxpayer. By not claiming the taxpayer as a dependent, however, the parents ensured that he -- who was the "taxpayer"

---

[1] The Hope Scholarship Credit is allowed for a total of 2 years for individuals who are at least half-time students, who are enrolled in a degree or certificate program, and who have not completed, at the beginning of the taxable year, the first 2 years of post-secondary education. The maximum Hope Scholarship Credit amount for the expenses of an eligible student in 1999 was $1,500. The Lifetime Learning Credit is allowed to any taxpayer for any taxable year for who pays qualified tuition and related expenses to attend an eligible educational institution for the purpose of acquiring or improving job skills. The maximum amount that could be claimed under the Lifetime Learning Credit in 1999 was $1,000. Additional information about the credits can be found in the proposed regulations under § 25A and in Pub. 970, Tax Benefits for Higher Education.

referred to in § 25A(f)(1)(A)(i) – became the (only) person eligible to claim an education tax credit with respect to his qualified tuition and related expenses in . See Notice 97-60, 1997-2 C.B. 310, 312 (Q & A 10). Moreover, the taxpayer became entitled to the credit not only for any qualified tuition and related expenses he may have paid, but also for any such amounts his parents may have paid on his behalf. See Prop. Reg. § 1.25A-(1)(f)(2), Ex. 2.)

Congress deliberately chose the "allowed" standard for the education tax credit because that standard permits more flexibility to a family than does the "allowable" standard found in § 151. See H. Rep. 105-148, 105 Cong., 1st Sess., 1997-4 C.B. (Vol. 1) 319, 639 - 640. That flexibility is illustrated by the facts of this case. Although neither the taxpayer nor his parents could derive any tax benefit from the operation of the § 151 rules, his modified AGI was low enough that he -- although not his parents -- could derive some tax benefit from the education tax credit. The intra-family allocation of the credit to the taxpayer -- which the parents achieved by not claiming him as a dependent -- conferred a tax advantage upon the family as a whole, in a manner consistent with Congressional intent.

Accordingly, we conclude that the Service Center erred in disallowing the taxpayer's claim for the education tax credit.[2] If we can be of further assistance, please telephone (202) 622-4920.

---

[2] Our conclusion is based on our understanding that the only ground for disallowance was the confusion over the "allowed" versus "allowable" standard. We thus are assuming that the amount of the credit claimed by the taxpayer accurately reflects the taxpayer's (and/or his parents') expenditures on qualified tuition and related expenses and that there are no other grounds upon which the credit should be denied.