After the Diploma: Student Loan Interest Deduction

Definition

The student loan interest deduction allows you to deduct from your gross income a portion of the interest you pay on student loans. The maximum deduction is $2,500.

Eligibility requirements

To take the deduction, you must meet several requirements:

- The interest must be paid on a qualified education loan that was used to pay qualified higher education expenses (for a definition of these terms, see Questions & Answers). Generally, federal student loans, private bank loans, college loans, and state loans are eligible.

- You must have incurred the debt while you were enrolled on at least a half-time basis.

- If married, you must file a joint return.

- In 2019, to take the full deduction, your modified adjusted gross income (MAGI) must be under $70,000 for single filers or under $140,000 for joint filers. A partial deduction is allowed for single filers with a MAGI between $70,000 and $85,000 and joint filers with a MAGI between $140,000 and $170,000. For information on how to calculate your deduction if your MAGI falls within these ranges, see Questions & Answers.

Tip: These income limits differ from those used to determine eligibility for the American Opportunity credit and the Lifetime Learning credit.

Strengths

Provides deduction for student loan interest if certain requirements are met

Assuming you qualify, the student loan interest deduction can help ease the burden of repaying student loans, a financial obligation that lenders now take quite seriously.

Room-and-board expenses are included as qualified higher education expenses

The inclusion of room-and-board expenses as qualified higher education expenses means that a greater portion of your student loan is eligible for purposes of the deduction.

Tradeoffs

Ability to take deduction depends on income

To take the full deduction, your modified adjusted gross income (MAGI) must be below certain levels as noted above.

Less-than-part-time students are ineligible

To take the student loan interest deduction, you must have incurred your loan when you were attending school on at least a half-time basis. This requirement excludes students taking sporadic courses to earn a degree.

You cannot claim the deduction if you are a dependent on someone else's tax return

To claim the deduction, you cannot be listed as a dependent on your parent's (or anyone else's) tax return. For more information, see Questions & Answers.

How to do it

Determine the amount of student loan interest you paid for the year

If you paid over $600 of interest on a qualified student loan to a single lender during the year, you should receive Form 1098-E from your lender showing the amount of interest you have paid for the year. However, it's ultimately your responsibility to keep track of your loan payments, because a lender may forget to send out the form or you may have paid less than $600 of interest to a single lender in a given year.

Assuming you meet the eligibility requirements, take the appropriate deduction for the year

If you meet the income limits and other requirements, you can claim the student loan interest deduction (up to a maximum of $2,500) on your federal tax return.

Questions & Answers

What is a qualified education loan?

A qualified education loan is a loan you take out to pay the qualified higher education expenses of you, your spouse, or any dependent(s) at an eligible educational institution or an institution conducting internship or residency programs leading to a degree from an institution of higher education, a hospital, or a health-care facility conducting postgraduate training. An eligible educational institution is generally a post-secondary institution that offers a degree and is eligible to participate in federal student aid programs.

Such loans include the commonly known student loans (e.g., Stafford, Perkins) but also standard bank loans that are used to pay tuition or room-and-board expenses. But a qualified education loan does not include a loan from a relative or from certain partnerships, trusts, or qualified employer plans.

What are qualified higher education expenses?

For purposes of the student loan interest deduction, qualified higher education expenses are a student's cost of attending school, including tuition, fees, room and board, books, and related expenses.

The IRS requires that qualified higher education expenses be actual out-of-pocket costs. Consequently, qualified higher education expenses must be reduced by items like nontaxable employer-provided educational assistance, any income earned by U.S. savings bonds used to pay college expenses, and any nontaxable qualified scholarships the student obtains.

Example: Joe has $50,000 of qualified higher education expenses during his four years at College X. He borrows $30,000 and receives scholarships totaling $20,000. Of the $50,000 in total expenses, only the interest relating to the $30,000 loan is deductible. The $20,000 scholarship is excluded.

How do you calculate the amount of your deduction if your modified adjusted gross income (MAGI) falls within the phaseout range?

In 2019, the deduction for student loan interest is phased out for single people with a MAGI between $70,000 and $85,000 and joint filers with incomes between $140,000 and $170,000. If your income falls within these ranges, you are allowed to take only a portion of the full deduction, depending on how far into the phaseout range you are.

Example: Hal pays $1,000 worth of interest on a qualified student loan during the year. Hal and his wife file a joint tax return, and their total MAGI for the year is $146,000. This means they are $6,000 into the $30,000 phaseout range ($146,000 minus $140,000). To calculate the available deduction, multiply the amount of interest paid during the year ($1,000) by the fraction of the phaseout range remaining ($24,000/$30,000 = 0.8). The result is that the couple can claim a student loan interest deduction of $800 ($1,000 x 0.8).

Example: Assume the same facts, but instead Hal pays $3,000 worth of student loan interest. The maximum student loan interest deduction for the year is $2,500, but this figure must be reduced because Hal's joint income is in the phaseout range. To calculate the available deduction, multiply the maximum student loan interest deduction ($2,500) by the same fraction in the example above, which represents the phaseout range remaining ($2,500 x 0.8). The result is that the couple can claim a student loan interest deduction of $2,000.

You took out a loan to pay for two computer courses offered at the local community college. The courses met one weekend per month and cost $5,000. Your MAGI is $35,000. Are you eligible for the deduction?

No. Although you meet the income requirements, you are not enrolled on at least a half-time basis at the college. Thus, you are not considered an eligible student at the time you incurred the debt. However, if your tuition costs are $5,000 or more for the year, you would be able to claim the Lifetime Learning credit, which is a tax credit that covers college-level courses.

Are there circumstances where you must exclude the amount of your student loan interest deduction in figuring your MAGI?

Yes. The IRS requires you to exclude your allowed student loan interest deduction when you are calculating your income level to see if you can:

- Contribute to an IRA, or
- Exclude from income the interest earned on U.S. savings bonds used to pay higher education expenses

In other words, you must add the amount of your student loan interest deduction back into your total income.

Example: Assume your MAGI for the year is $35,000, but you took a $1,000 student loan deduction. The result is that for purposes of determining whether you are eligible to contribute to a regular IRA, Uncle Sam considers your MAGI to be $36,000.

Can you take the student loan interest deduction in the same year as the American Opportunity credit or the Lifetime Learning credit?

Yes, you can take the student loan interest deduction in the same year as the American Opportunity credit or the Lifetime Learning credit, provided that you qualify for each independently.

If you are in the process of repaying your student loans and your parents are claiming you as a dependent on their tax return this year, are you eligible for the deduction this year?

No. To take the student loan interest deduction, you cannot be claimed as a dependent on someone else's tax return. However, if your parents had borrowed the money and then repaid the loan in a year they claimed you as a dependent, they would be eligible for the deduction. However, if you repaid the loan, your parents would not be eligible.