

Education Tax Benefits and Planning for a Lifetime of Learning

- Hope Scholarship Credit
- Lifetime Learning Credit
- Education IRAs
- Qualified Tuition Program
- College Tax Deduction

Education Incentives

A key aspect of the Taxpayer Relief Act of '97 focuses on encouraging education beyond high school. New credits, deductions, and savings incentives form the core of these education related changes. Because there are numerous exceptions, elections, phaseouts, etc. associated with these tax benefits, you may wish to obtain professional advice from an Enrolled Agent.

Credits

Since 1998, two credits have been available for taxpayers who pay qualified tuition and related expenses.

Hope Scholarship Credit.

The Hope Scholarship Credit is allowed for tuition and related expenses for the first two years of post secondary education. A maximum credit of \$1,500 is allowed, determined by taking 100 percent of the qualified expenses paid during the tax year up to \$1,000 plus 50 percent of the next \$1000.

Students must be at least a half-time student pursuing a degree or recognized credential at a qualified educational institution. The credit may be claimed for more than one family member.

The Lifetime Learning Credit (LLC).

A credit is allowed for up to 20 percent of the amount of the qualified tuition and related expenses not to exceed \$10,000. The maximum credit is \$2,000. The LLC is allowed for undergraduate and graduate level courses as well as any course of instruction at an eligible institution to acquire or improve job skills. There is no requirement to be a half-time student. The LLC is calculated on a per family basis rather than a per student basis.

Special Rules Applicable to Both Credits

Eligible Expenses

- Tuition and fees for the taxpayer, taxpayer's spouse, or a dependent of the taxpayer.
- Payments for room, board, student activities, and books are not eligible for the credits.
- Qualified expenses are reduced by any amounts that are excluded from income by any other provision of the law.
- Expenses for which a taxpayer elects the Hope credit would not be eligible for the LLC.
- Expenses must generally be paid during the year for an academic period that begins in that tax year, but there is a prepayment rule that allows a credit for expenses paid in one tax year for academic period that begins in first 3 months of the following year.
- Tuition expenses paid with loan proceeds are eligible for the credit in the year the tuition is paid, not when the loan is repaid.

Phaseouts for Tax Year 2005

Both credits have an AGI phaseout for taxpayers with modified AGI between \$43,000 - \$53,000 for single and head of household and \$87,000 to \$107,000 for joint filers.

Who's Eligible?

Credits may be taken for the taxpayer, spouse, or a dependent. A dependent isn't allowed the credit even if he or she pays the expense. The taxpayer claiming the dependency exemption may claim the credits for expenses paid by the dependent. Neither of the credits are allowed if a taxpayer files married filing separately. Taxpayers who are nonresident aliens for any portion of the tax year aren't allowed the credits.

Deductions

Interest payments on educational loans may be deductible as an adjustment to income for certain qualified taxpayers. The new law phased in the deduction over several years. The maximum allowable amount for each year is \$2500.

An educational loan means any loan incurred to pay qualified higher educational expenses which were incurred by the taxpayer, spouse, or dependent.

Limitations

- Deduction is phased out for taxpayers with modified AGI between \$50,000 and \$65,000 (\$100,000 and \$130,000 for joint filers).
- Married couples must file a joint return to claim the deduction.
- Dependents are not allowed the deduction.

The deduction does not depend on whether or not the loan was federally guaranteed or subsidized. Refinancing won't cause the loan to lose its qualifications.

Educational Savings Accounts

A maximum of \$2000 per child, can be contributed into an account to be set aside for the child's education. Any child is eligible from birth to age 18, as long as the aggregate of all contributions does not exceed the maximum annual contribution. This is a great opportunity for cash gifts to be put away for a child's future. If used for educational purposes, all the withdrawals are tax free upon distribution. Including the earnings!

The contribution is phased out if the contributor's MAGI is between \$95,000 and \$110,000 (\$190,000 and \$220,000 MFJ).

There is no limit as to the number of Education IRAs that may be established for a particular child. However, in any given taxable year the total contributions to all accounts for a particular child may not exceed \$2000.

Contribution due dates have been extended to the due date of your return for that year (not including extensions). In previous years, contributions were required to be made by December 31.

Distributions

Distributions from the Education IRA are not taxable if used to pay qualified educational expenses.

If distributions are not used to pay educational expenses, a portion may be taxable and subject to a 10 percent additional tax. Beneficiaries must withdraw the amounts in the Education IRA before reaching age 30.

Rollovers

Amounts remaining in an account when the beneficiary finishes his or her education or before reaching age 30 can be rolled over to another member of the original beneficiary's family. It is also possible just to change the designated beneficiary of an account.

Qualified Tuition Program

Also referred to as 529 Plans. These plans enable taxpayers to either secure current tuition rates through a prepaid tuition program or make contributions to a "Savings Trust."

Under the Prepaid Plan, the parent, grandparent, or other qualifying taxpayer purchases tuition credits to lock in current rates. The credits are used later when the student starts college.

The second type of Qualified Tuition Program is the Savings Plan Trust which is an account set up to be funded each year and grow tax free until the funds are withdrawn for school. Starting in 2002, distributions used to pay qualified higher education expenses will be excluded from gross income. In addition, for those taxpayers wanting to gift out of their estate to fund the plan an election can be made allowing up to \$55,000 in the current year to avoid a gift tax but must consider the annual limit applies to the next 4 years (gifts are limited to \$11,000 per year).

New College Tax Deduction

A new but temporary tax deduction may be used for taxpayers with incomes too high to benefit from the Lifetime Learning or Hope credit. Beginning in 2002 until 2005 Uncle Sam has created a new "above the line" deduction for qualified educational expenses. This deduction will benefit taxpayers with adjusted gross incomes up to \$65,000 for singles and up to \$130,000 for joint filers.

For more information regarding your personal income tax and how these credits and deductions may benefit you, give AJE Financial Services a call today!