

Back-to-School Tax Tips for Students and Parents

Article Highlights:

- Sec. 529 plans
- Coverdell Education Savings Accounts.
- The Lifetime Learning credit
- Qualified Education Loan Interest.

Going to college, and figuring out how to pay for it, can be stressful for students and parents. In recent years, Congress has provided a variety of tax incentives to help defray the cost of education. Some require long-term planning to become beneficial, while others provide current tax deductions or credits. The benefits may even cover vocational schools.

If your child is below college age, there are tax-advantaged plans that allow you to save for the cost of college. Although providing no tax benefit for contributions to the plans, they do provide tax-free accumulation; so the earlier they are established, the more you benefit from them.

- **Section 529 Plans**—Section 529 Plans (named after the section of the IRS Code that created them) are plans established to help families save and pay for college in a tax-advantaged way and are available to everyone, regardless of income. These state-sponsored plans allow you to gift large sums of money for a family member's college education while maintaining control of the funds. The earnings from these accounts grow tax-deferred and are tax-free, if used to pay for qualified higher education expenses. They can be used as an estate-planning tool as well, providing a means to transfer large amounts of money without gift tax. With all these tax benefits, 529 Plans are an excellent vehicle for college funding. Section 529 Plans come in two types, allowing you to either save funds in a tax-free account to be used later for higher education costs, or to prepay tuition for qualified universities. For 2015, you can contribute \$14,000 without gift tax implications (or \$28,000 for married couples who agree to split their gift). The annual amount is subject to inflation-adjustment. There is also a special gift provision allowing the donor to prepay five years of Sec 529 gifts up front without gift tax.
- **Coverdell Education Savings Account**—These accounts are actually education trusts that allow nondeductible contributions to be invested for a child's education. Tax on earnings from these accounts is deferred until the funds are withdrawn, and if used for qualified education purposes, the entire withdrawal can be tax-free. Qualified use of these funds includes elementary and secondary education expenses in addition to post-secondary schools (colleges). This is the only one of the educational tax benefits that allows tax-free use of the funds for below college-level expenses. A total of \$2,000 per year can be contributed for each beneficiary under the age of 18. The ability to contribute to these plans phases out when the modified adjusted gross income is between \$190,000 and \$220,000 for married taxpayers filing jointly, and between \$95,000 and \$110,000 for all others.
- **Education Tax Credits**—Two tax credits, the American Opportunity Credit (partially refundable) and the Lifetime Learning Credit (nonrefundable), are available for qualified post-secondary education expenses for a taxpayer, spouse, and eligible dependents. Both credits will reduce one's tax liability

dollar for dollar until the tax reaches zero. The credit is not allowed for taxpayers who file Married Separate returns.

- *The American Opportunity Credit*—is a credit of up to \$2,500 per student per year, covering the first four years of qualified post-secondary education. The credit is 100% of the first \$2,000 of qualifying expenses plus 25% of the next \$2,000 for a student attending college on at least a half-time basis. Forty percent of the American Opportunity credit is refundable (if the tax liability is reduced to zero). This credit phases out for joint filing taxpayers with modified adjusted gross income between \$160,000 and \$180,000, and between \$80,000 and \$90,000 for others.
- *The Lifetime Learning Credit*—is a credit of up to 20% of the first \$10,000 of qualifying higher education expenses. Unlike the American Opportunity Credit, which is on a per-student basis, this credit is per taxpayer. In addition to post-secondary education, the Lifetime Credit applies to any course of instruction at an eligible institution taken to acquire or improve job skills. For 2015 this credit phases out for joint filing taxpayers with modified adjusted gross income between \$110,000 and \$130,000, and between \$55,000 and \$65,000 for others. The credit is not allowed for taxpayers who file Married Separate returns.

Qualifying expenses for these credits are generally limited to tuition. However, student activity fees and fees for course-related books, supplies, and equipment qualify if they must be paid directly to the educational institution for the enrollment or attendance of the student.

You may qualify for this credit even if you did not pay the tuition. If a third party (someone other than the taxpayer or a claimed dependent) makes a payment directly to an eligible educational institution for a student's qualified tuition and related expenses, the student would be treated as having received the payment from the third party, and, in turn, pay the qualified tuition and related expenses. Furthermore, qualified tuition and related expenses paid by a student would be treated as paid by the taxpayer if the student is a claimed dependent of the taxpayer.

- **Education Loan Interest**—You can deduct qualified interest of \$2,500 per year in computing AGI. This is not limited to government student loans and this could include home equity loans, credit card debt, etc., if the debt was incurred solely to pay for qualified higher education expenses. For 2015, this deduction phases out for married taxpayers with an AGI between \$130,000 and \$160,000 and for unmarried taxpayers between \$65,000 and \$80,000. This deduction is not allowed for taxpayers who file married separate returns.

We all know that a child's success in life has a great deal to do with the education they receive. You cannot start the planning process too early. Please call this office if you would like assistance in planning for your children's future education.