

Appendix B. Highlights of Tax Benefits for Education for Tax Year 2007

This chart highlights some differences among the benefits discussed in this publication. See the text for definitions and details. Do not rely on this chart alone.

Caution: You generally cannot claim more than one benefit for the same education expense.

	Scholarships, Fellowships, Grants, and Tuition Reductions	Hope Credit	Lifetime Learning Credit	Student Loan Interest Deduction	Tuition and Fees Deduction
What is your benefit?	Amounts received may not be taxable	Credits can reduce amount of tax you must pay		Can deduct interest paid	Can deduct expenses
What is the annual limit?	None	\$1,650 credit per student	\$2,000 credit per family	\$2,500 deduction	\$4,000 deduction
What expenses qualify besides tuition and required enrollment fees?	Course-related expenses such as fees, books, supplies, and equipment	None	None	Books Supplies Equipment Room & board Transportation Other necessary expenses	None
What education qualifies?	Undergraduate & graduate K-12	1st 2 years of undergraduate (postsecondary)	Undergraduate & graduate Courses to acquire or improve job skills	Undergraduate & graduate	Undergraduate & graduate
What are some of the other conditions that apply?	Must be in degree or vocational program Payment of tuition and required fees must be allowed under the grant	Can be claimed for only 2 tax years Must be enrolled at least half-time in degree program No felony drug conviction(s)		Must have been at least half-time student in degree program	Cannot claim both deduction & education credit for same student in same year
In what income range do benefits phase out?	No phaseout	\$47,000 – \$57,000 \$94,000 – \$114,000 for joint returns		\$55,000 – \$70,000 \$110,000 – \$140,000 for joint returns	\$65,000 – \$80,000 \$130,000 – \$160,000 for joint returns

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	Coverdell ESA*	Qualified Tuition Program (QTP)*	Educational Exception to Additional Tax on Early IRA Distributions*	Education Savings Bond Program*	Employer-Provided Educational Assistance*	Business Deduction for Work-Related Education
What is your benefit?	Earnings not taxed	Earnings not taxed	No 10% additional tax on early distribution	Interest not taxed	Employer benefits not taxed	Can deduct expenses
What is the annual limit?	\$2,000 contribution per beneficiary	None	Amount of qualified education expenses	Amount of qualified education expenses	\$5,250 exclusion	Amount of qualifying work-related education expenses
What expenses qualify besides tuition and required enrollment fees?	Books Supplies Equipment Expenses for special needs services Payments to QTP Higher education: Room & board if at least half-time student Elem/sec (K-12) education: Tutoring Room & board Uniforms Transportation Computer access Supplementary expenses	Books Supplies Equipment Room & board if at least half-time student Expenses for special needs services	Books Supplies Equipment Room & board if at least half-time student Expenses for special needs services	Payments to Coverdell ESA Payments to QTP	Books Supplies Equipment	Transportation Travel Other necessary expenses
What education qualifies?	Undergraduate & graduate K-12	Undergraduate & graduate	Undergraduate & graduate	Undergraduate & graduate	Undergraduate & graduate	Required by employer or law to keep present job, salary, status Maintain or improve job skills
What are some of the other conditions that apply?	Assets must be distributed at age 30 unless special needs beneficiary			Applies only to qualified series EE bonds issued after 1989 or series I bonds		Cannot be to meet minimum educational requirements of present trade/business Cannot qualify you for new trade/business
In what income range do benefits phase out?	\$95,000 – \$110,000 \$190,000 – \$220,000 for joint returns	No phaseout	No phaseout	\$65,600 – \$80,600 \$98,400 – \$128,400 for joint returns	No phaseout	May be subject to limit on itemized deductions

* Any nontaxable distribution is limited to the amount that does not exceed qualified education expenses.

EDUCATION TAX INCENTIVES

In 1997, the Taxpayer Relief Act of 1997 (the "Act") was signed into law. The Act provides taxpayers with several tax benefits in the area of higher education. Three such benefits are discussed below.

(1) HOPE SCHOLARSHIP CREDIT

Individuals may elect (on Form 8863, attached to an original or amended return filed by the limitations period for filing a claim for the year the credit is claimed) a personal nonrefundable tax credit equal to 100% of up to \$1,100 for 2007 (\$1,100 for 2006) of qualified higher education tuition and related expenses plus 50% of the next \$1,100 for 2007 (\$1,100 for 2006) of expenses paid for education furnished to an eligible student in an academic period. Thus, for 2007, the maximum credit is \$1,650 (\$1,650 for 2006) a year for each eligible student. For 2007, availability of the Hope credit phases out ratably for taxpayers with modified adjusted gross income (AGI) of \$47,000 to \$57,000 for single return filers (\$94,000 to \$114,000 for joint return filers). For 2006, the phase-out ranges were \$45,000 to \$55,000 (\$90,000 to \$110,000 for joint filers). Married taxpayers must file jointly to claim the credit. The student's name and taxpayer identification number must be included on the return of the taxpayer claiming the credit. The Hope and tax-free Coverdell education savings account distributions are allowed for the same student for the same year, as long as a credit isn't claimed for education expenses used to generate the tax-free Coverdell education savings account distribution.

The Hope credit may be elected for a student's expenses only for two years, and only for students who have not completed the first two years of post-secondary education as of the beginning of the tax year. Additionally, for at least one academic period during the year, the student must be enrolled for at least half of the normal full-time workload for his course of study.

Qualified tuition and related expenses means tuition and fees required for the enrollment or attendance of the taxpayer, the taxpayer's spouse, or any tax dependent at a post-secondary educational institution eligible to participate in the federal student loan program. Expenses for courses involving sports, games, or hobbies do not qualify unless they are part of the student's degree program. Nonacademic fees, such as student activity fees, athletic fees, insurance expenses, or other expenses unrelated to an individual's academic courses also do not qualify. Book expenses do not qualify. Qualified tuition and related expenses must be reduced by qualified scholarships, certain educational assistance programs (Footnote 1), and other tax-free payments. However, qualified amounts are not reduced by amounts paid by gift, bequest, devise, or inheritance. No credit is allowed for any expense for which an income tax deduction is allowed. Also, a Hope credit is not allowed for a student convicted (as of the end of the tax year for which the credit is claimed) of a felony offense for possessing or distributing a controlled substance. Special rules apply for tuition refunds and excludable tuition assistance received after the tax year in which qualified tuition and related expenses are paid.

If a dependency deduction for an individual is allowed to another taxpayer, the dependent cannot claim the Hope credit, and qualified tuition and expenses paid by the dependent during the tax year are treated as paid by the taxpayer who is allowed the dependency deduction. If a third party (not the taxpayer, spouse, or dependent) pays a student's qualified expenses directly to an educational institution, the student is treated as receiving the payment from the third party and, in turn, paying the expenses. If the student in such a case is claimed as a dependent on another's return, the expenses deemed to be paid by the student would be treated as expenses of the taxpayer claiming the student as a dependent. If a taxpayer is eligible to but does not claim a student as a dependent, only the student can claim the education credit for the student's qualified tuition and related expenses. If qualified tuition and expenses are paid during one tax year for an academic period that begins during the first three months of the next year, the academic period is treated for these credit purposes as beginning in the earlier year. Thus, the credit is allowed only in the tax year in which the expenses are paid. A nonresident alien for any portion of the year may elect a Hope credit only if he elects to be treated as a resident alien.

(Footnote 1 – All-Volunteer Force Educational Assistance, Training and Rehabilitation for Veterans with Service-Connected Disabilities, Post-Vietnam Era Veterans' Educational Assistance, Veterans' Educational Assistance, Survivors' and Dependents' Educational Assistance, and Educational Assistance for Members of the Selected Reserve)

(2) LIFETIME LEARNING CREDIT

Taxpayers may elect (use Form 8863) a Lifetime Learning credit equal to 20% of up to \$10,000 (maximum of \$2,000) of qualified tuition and related expenses paid during the tax year. Unlike the Hope credit, which is available for the qualifying expenses of each qualifying student, the Lifetime Learning credit is available only per taxpayer. So, for example, a joint filing couple with two children could claim no more than a \$2,000 Lifetime Learning credit for 2007, even if each family member is a qualifying student with qualifying expenses.

The same phase-out rules, coordination with Coverdell education savings account, definition of qualified tuition and related expenses, adjustment for tax-free scholarships, etc..., treatment of expenses paid by dependent, treatment of certain prepayments, denial of double benefit, denial of credit to marrieds not filing jointly, nonresident alien bar, and indexing that apply for Hope credit purposes also apply to the Lifetime Learning credit. However, certain additional expenses for any course of instruction at an eligible institution to acquire or improve job skills that would not qualify for the Hope credit (which requires at least half-time enrollment) qualify for the Lifetime Learning credit. Also, in contrast to the Hope credit (which may be elected only with respect to the first two years of undergraduate education), the Lifetime Learning credit may be claimed with respect to tuition and fees incurred with respect to undergraduate or graduate-level (and professional degree) courses.

Expenses for a student for whom a Hope credit is allowed for the tax year do not qualify for the Lifetime Learning credit. However, the two credits can be claimed simultaneously for different qualifying students.

(3) STUDENT LOAN INTEREST DEDUCTION

For student loan interest, individuals may deduct a maximum of \$2,500 annually for interest paid on qualified higher education loans. The deduction is claimed as an adjustment to gross income to arrive at adjusted gross income (thus, not required to itemize deductions). No deduction is allowed under the higher-education loan provision for any amount for which a deduction is allowable under any other provision of the Internal Revenue Code (e.g. home equity loan).

For 2007, the deduction phases out ratably for taxpayers with modified AGI between \$55,000 to \$70,000 (\$110,000 and \$140,000 for joint returns); for 2006, \$50,000 to \$65,000 (\$105,000 to \$135,000 for joint returns). A person who is claimed as a dependent on another's return cannot claim the education interest deduction. The deduction may be claimed only by a person legally obligated to make the interest payments. Married couples must file joint returns to take the deduction.

A qualified higher education loan is any debt incurred by the taxpayer solely to pay qualified higher education expenses that are incurred on behalf of the taxpayer, his spouse or dependent and attributable to education furnished during a period when the recipient was an eligible student (as defined for Hope credit purposes, i.e. at least a half-time student). Also, a qualified education loan includes debt used to refinance debt that qualifies as a qualified education loan, but doesn't include debt owed to a related person. Revolving lines of credit are not qualified education loans unless the borrower agreed to use the line of credit to pay only qualifying higher education expenses.

Qualified higher education expenses are the costs of attendance at an eligible educational institution, which is generally a post-secondary educational institution eligible to participate in the federal student loan program. Qualified higher education expenses include tuition, fees, room and board, and related expenses, but must be reduced by the amount excluded by reason of such expenses under the rules for employer-provided educational assistance benefits; income from U.S. Savings Bonds used to pay higher education expenses; distributions from a Coverdell education savings account; distributions from a qualified tuition plan; and scholarship or fellowship grants.

IRS Publication 970, "Tax Benefits for Education," has further details on these and other education-related provisions. This publication may be found at the IRS's website of <http://www.irs.ustreas.gov/formspubs/>

(The aforementioned information is intended to offer guidance on some of the education tax incentives. It is provided with the understanding that the author is not herein engaged in interpreting the laws or in rendering legal, tax, or other professional services.)