

Appendix B. Highlights of Education Tax Benefits for Tax Year 2008

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	\$1,800 credit (\$3,600 if a student in a <i>Midwestern disaster area</i>) per student	\$2,000 credit (\$4,000 if a student in a <i>Midwestern disaster area</i>) 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 (but see <i>Students in Midwestern disaster areas under Qualified Education Expenses</i> in chapter 2 for an exception)	None (but see <i>Students in Midwestern disaster areas under Qualified Education Expenses</i> in chapter 3 for an exception)	Books Supplies Equipment Room & board Transportation Other necessary expenses	None (but see <i>Students in Midwestern disaster areas under Qualified Education Expenses</i> in chapter 6 for an exception)
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)	No other conditions	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	\$48,000 – \$58,000 \$96,000 – \$116,000 for joint returns		\$55,000 – \$70,000 \$115,000 – \$145,000 for joint returns	\$65,000 – \$80,000 \$130,000 – \$160,000 for joint returns

(Continued)

Appendix B. (Continued)

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.

	Coverdell ESA†	Qualified Tuition Program (QTP)†	Education 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	No other conditions	No other conditions	Applies only to qualified series EE bonds issued after 1989 or series I bonds	No other conditions	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	\$67,100 – \$82,100 \$100,650 – \$130,650 for joint and qualifying widow(er) 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 \$1,200 for 2008 (\$1,100 for 2007) of qualified higher education tuition and related expenses plus 50% of the next \$1,200 for 2008 (\$1,100 for 2007) of expenses paid for education furnished to an eligible student in an academic period. Thus, for 2008, the maximum credit is \$1,800 (\$1,650 for 2007) a year for each eligible student. For 2008, availability of the Hope credit phases out ratably for taxpayers with modified adjusted gross income (AGI) of \$48,000 to \$58,000 for single return filers (\$96,000 to \$116,000 for joint return filers). For 2007, the phase-out ranges were \$47,000 to \$57,000 (\$94,000 to \$114,000 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 2008, 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 2008, the deduction phases out ratably for taxpayers with modified AGI between \$55,000 to \$70,000 (\$115,000 and \$145,000 for joint returns); for 2007, \$55,000 to \$70,000 (\$110,000 to \$140,000 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.)

Paying for College: **Tax Benefits and Savings Options**

An array of tax tools is available to help you meet the cost of higher education, including:

- tax credits—Hope and Lifetime Learning;
- above-the-line deduction for higher education expenses;
- deduction of student loan interest;
- tax-free withdrawals from education savings accounts (ESAs);
- tax-free withdrawals from state-sponsored and private tuition savings plans; and
- tax-free, employer-provided tuition benefits.

Each option is unique, with its own rules and limitations on eligibility and income. This paper provides an overview of the tax benefits that you may be eligible to use to assist you in fulfilling your educational objectives.

Tax Credits and Deductions

You can claim tax credits or, in some cases, deductions, for expenses that you pay for postsecondary education for yourself, your spouse, or your dependent children. The Hope tax credit is available on a per-student basis for the first two years of postsecondary education, whereas the Lifetime Learning credit is available on a tax-return basis and covers a broader time frame and range of educational courses. An “above-the-line” deduction, provides some relief to families whose income is too high to qualify for the Hope and Lifetime Learning tax credits. Education expenses paid for with tax-free grants, scholarships, and employer-provided tuition assistance are not eligible for the credits or for the above-the-line deduction. However, education expenses paid for with loans are eligible for these tax benefits.

Hope Credit

A tax credit equal to all of the first \$1,200 of tuition and fees (less scholarships, grants, and tax-free tuition benefits) and half of the next \$1,200 of tuition and fees, is available to parents of dependent students or to students who are not claimed as dependents on their parents' tax return. For tax year 2008, the maximum amount of the Hope credit is \$1,800 per student. The Hope credit can be claimed only for two tax years and applies only to the first two years of postsecondary education. Students must be enrolled at least half-time in a program that leads to a degree, certificate, or other educational credential during at least one academic period that begins during the tax year. Students cannot have had a drug felony conviction in a year in which the credit applies.

Lifetime Learning Credit

This credit applies to tuition and fees for undergraduate, graduate, and continuing education coursework to acquire or improve job skills. Parents of dependent students or students who are not claimed as dependents on their parents' tax returns may claim a credit equal to 20% of up to \$10,000 of educational expenses; the maximum benefit is \$2,000 each tax year. Eligible education expenses are offset by scholarships, grants, and other tax-free tuition benefits.

Income Limitations on the Education Tax Credits

For 2008, the full value of the education tax credits is available to married taxpayers filing jointly with an adjusted gross income (AGI) of \$96,000 or less and to single taxpayers with an AGI of \$48,000 or less.

Above-the-Line Deduction

If you cannot claim either the Hope or Lifetime Learning tax credit, you may still be able to deduct qualified higher education expenses from your taxable income. Self-supporting students, including those who borrow to pay tuition, are eligible to take this deduction. The deduction also provides relief to families whose AGI is too high to qualify for the Hope or Lifetime Learning tax credits. Single filers with AGI of up to \$65,000 (\$130,000 for joint filers) can deduct up to \$4,000 annually in tuition and related expenses.

Note: you do not need to itemize to claim the deduction.

Student Loan Interest Deduction

Student borrowers or their families can deduct student loan interest payments from their taxable income. The deduction is available even if you do not itemize other deductions. The loan does not have to be federally guaranteed or subsidized to be eligible for the deduction, but it must be used to pay education expenses such as tuition, fees, books, and room and board. The maximum deduction is \$2,500. The AGI limit for the full interest deduction is \$50,000 for single filers, phasing out at a maximum of \$65,000, and \$105,000 for joint filers, phasing out at \$135,000. Voluntary interest payments may be deducted.

Tax Incentives to Save for College

In recent years, tax-advantaged programs to help families save for college have become more flexible. Prepaid tuition plans allow families to buy units of tuition and guarantee that these units may be redeemed for a portion of tuition in future years. A number of states and a consortium of private colleges offer prepaid tuition plans. Qualified state tuition savings programs provide for market-based investment accounts with tax-deferred earnings. Withdrawals from state college savings and prepaid programs, known as section 529 plans, to pay qualified higher education expenses will be free from federal (and, in many cases, state) income taxes. Withdrawals from Coverdell Education Savings Accounts (ESAs) may be used to cover qualified elementary and secondary expenses at public, private, and religious schools in addition to expenses for higher education.

Prepaid Tuition/Tuition Savings Plans

Distributions from state tuition savings programs and prepaid tuition plans are tax-free for federal income tax purposes, if withdrawals are used for qualified higher education expenses. Similar withdrawals from qualified prepaid tuition plans for private colleges are also tax-free. Accumulations may be rolled over, tax-free, from one 529 plan to another once every 12 months. You may not report payment of the same educational expenses from both 529 plans and ESAs. Likewise, the education expenses covered by Hope or Lifetime Learning credits do not qualify for tax-free distributions from 529 plans or ESAs. Nonqualified withdrawals from 529 plans will be subject to the same 10 percent tax penalty on deferred earnings that applies to ESAs, which is in addition to normal federal income taxes.

Coverdell Education Savings Accounts

You may invest up to \$2,000 annually on an after-tax basis per child in an ESA. Earnings accumulate tax-free, and money withdrawn to pay for qualified education expenses (tuition, fees, books, equipment, room and board) is free from income taxes. Withdrawals may be made for qualified expenses related to education from kindergarten through grade 12 and for undergraduate and graduate education. Contributions must stop when a child reaches age 18. Funds not used for education by the time the child reaches age 30 must be transferred to a younger beneficiary or must be withdrawn, and these funds will be subject to

tax on the earnings and a 10% penalty. Although more than one person may contribute to an ESA for the same child, no more than \$2,000 for that child can be contributed in any year. The AGI limit for married taxpayers is \$220,000 (\$110,000 for single taxpayers); taxpayers claiming an education tax credit can exclude from gross income an ESA distribution used for other qualified expenses; and contributions to both an ESA and a 529 plan are allowed.

Employer-Provided Tuition

You may exclude up to \$5,250 from your annual income when your employer helps you pay for higher education costs. This benefit covers employer-provided tuition assistance for both undergraduate and graduate level courses.

Information Is Important

Remember to save your records of all education-related payments and financial aid for tax purposes. Colleges and universities will need to collect Social Security numbers from all students so they can issue information reports to assist you in preparing your tax returns. Institutions are required to provide Form 1098-T, Tuition Payments Statement, to students from whom or on whose behalf they receive tuition payment (with the exception of continuing education students and nonresident alien students). Banks, institutions, and other lenders that collect student loan interest payments must issue annual information returns—Form 1098-E, Student Loan Interest Payments—to individuals from whom they collect more than \$600 in interest during the tax year. Although

you do not need to have or include a copy of these forms with your tax return to take advantage of the education credits or deductions, these records can assist you in determining your qualified education expenses for the year.

**For more information:
IRS Publication 970, Tax Benefits
for Higher Education, and
Publication 520, Scholarships
and Fellowships, are available
from the IRS Web site at
www.irs.gov or by calling
1-800-TAX-FORM .**

Academic Level for Tax Benefits

Tax Benefit	Types of Classes Eligible
Hope Credit	first two years of undergraduate (status as of January 1)
Lifetime Learning Credit	undergraduate, graduate, and individual job-related courses
Above-the-line Deduction	undergraduate, graduate, and individual courses
Student Loan Interest Deduction	undergraduate, graduate
Withdrawals from Section 529 Plans	undergraduate, graduate
Withdrawals from ESAs	K-12, undergraduate, graduate
Employer-Provider Tuition	undergraduate, graduate

02-05-09

Paying for College: Tax Benefits and Savings Options

Published by the National Association of College and University Business Officers

© 2008. National Association of College and University Business Officers. All Rights Reserved. www.nacubo.org