

National Society of Tax Professionals

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The Education Menu **Choices, Choices & More Choices** **2003**



ROAD MAP

- THIS PRESENTATION IS INTENDED TO REVIEW MANY OF THE TAX BENEFITS ASSOCIATED WITH THE SUBJECT OF EDUCATION.
- TODAY'S PRESENTATION TAKES INTO ACCOUNT THE MANY ENHANCEMENTS FROM:
 - ***Economic Growth and Tax Relief Reconciliation Act of 2001***
 - ***Job Creation and Worker Assistance Act of 2002***



THE EDUCATION MENU

- COVERDELL EDUCATION SAVINGS ACCOUNTS (formerly Education IRAs)
- DEDUCTION FOR ELEMENTARY & HIGH SCHOOL EDUCATORS
- EMPLOYER-PROVIDED EDUCATIONAL ASSISTANCE
- TUITION & FEES DEDUCTION



THE EDUCATION MENU

Continued

- HOPE CREDIT
- LIFETIME LEARNING CREDIT
- COLLEGE SAVINGS PLANS
- STUDENT LOAN INTEREST DEDUCTION
- WITHDRAWALS FROM IRAs FOR EDUCATION



Vehicles for Education

- **Exclusions:**

- Employer Provided Education Assistance Plans **(\$5,250)**

- **Credits:**

- Hope
- Lifetime Learning



VEHICLES FOR EDUCATION

■ Saving for Education:

- Coverdell Plans
- College Savings Plans (state/529)
- IRA Withdrawals
- Series E & EE Bonds

■ Deductions for Education:

- Educator Expenses
- Student Loan Interest
- Tuition & Fees



IRS PUBLICATION 970

- IRS PUBLICATION **970** OFFERS AN EXCELLENT AND DETAILED REVIEW OF THE ***TAX BENEFITS FOR EDUCATION***.
- VISIT THE IRS WEB SITE AT WWW.IRS.GOV



HISTORICAL NOTE

- MANY OF THE TAX BENEFITS FOR HIGHER EDUCATION CAME OUT OF THE ***TAXPAYER RELIEF ACT OF 1997.***
- THE ***ECONOMIC GROWTH AND TAX RELIEF RECONCILIATION ACT OF 2001*** ADDED SIGNIFICANT ENHANCEMENTS TO THE LAW.



WARNING

- ALL OF THE PROVISIONS OF THE ***ECONOMIC GROWTH AND TAX RELIEF RECONCILIATION ACT OF 2001*** “SUNSET” ON DECEMBER 31, 2010 UNLESS NEW LEGISLATION EXTENDS THEM.



SO, IN 2011

- WE GET TO GO BACK TO THE LAW THAT WAS IN EFFECT PRIOR TO THE PASSAGE OF THE 2001 LEGISLATION.
- AT LEAST WE WILL HAVE THE ***TAXPAYER RELIEF ACT OF 1997*** TO RELY ON.



COVERDELL EDUCATION SAVINGS ACCOUNTS

- EDUCATION IRAs ARE NOW NAMED FOR THE LATE SENATOR PAUL COVERDELL (Georgia).
- BEGINNING IN **2002**, THE *ANNUAL* TAX-DEFERRED CONTRIBUTION LIMITS TO THESE ACCOUNTS INCREASED FROM A MERE \$500 TO **\$2,000** PER BENEFICIARY PER YEAR.



COVERDELL ESAs

Continued

- THE **AGI** ELIGIBILITY TEST:
 - MARRIED COUPLE:
\$190,000-\$220,000
 - SINGLE TAXPAYER:
\$95,000-\$110,000



COVERDELL ESAs

Continued

- THE **FINAL DATE** ON WHICH *CONTRIBUTIONS* CAN BE MADE HAS BEEN EXTENDED TO THE DUE DATE OF THE RETURN (NOT INCLUDING EXTENSIONS).



COVERDELL ESAs

Continued

- QUALIFIED EDUCATION EXPENSES HAVE BEEN EXPANDED TO INCLUDE CERTAIN *ELEMENTARY AND SECONDARY* EDUCATION EXPENSES.
- THE EXPENSES CAN BE PAID TO PRIVATE AND RELIGIOUS SCHOOLS.
 - NOT HOME SCHOOLING



COVERDELL ESAs

Continued

- QUALIFIED EDUCATION EXPENSES INCLUDE:
 - TUITION
 - FEES
 - BOOKS, SUPPLIES
 - EQUIPMENT
 - ROOM AND BOARD (MUST BE IN SCHOOL AT LEAST HALF TIME)*

***THERE ARE LIMITS REGARDING THE
EXPENSE FOR ROOM AND BOARD**



COVERDELL ESAs

Continued

- **CONTRIBUTIONS** TO A COVERDELL ESA ARE PERMITTED UNTIL THE CHILD REACHES AGE **18**.
- AMOUNTS REMAINING IN THE ACCOUNT AT **AGE 30** MUST BE WITHDRAWN OR THE ACCOUNT WILL BE SUBJECT TO TAXES AND A 10% PENALTY UNLESS THE ACCOUNT IS ROLLED OVER FOR THE BENEFIT OF ANOTHER FAMILY MEMBER.



COVERDELL ESAs

Continued

- **CONTRIBUTIONS** FOR A “SPECIAL NEEDS” BENEFICIARY CAN BE MADE AFTER HIS/HER **18TH** BIRTHDAY.
- ASSETS CAN REMAIN IN AN ACCOUNT SET UP FOR A “SPECIAL NEEDS” BENEFICIARY AFTER THE BENEFICIARY REACHES **30**.



COVERDELL ESAs

Tax Planning Tip

TAXPAYERS CAN CLAIM THE **HOPE** OR **LIFETIME LEARNING** CREDIT IN A YEAR THEY TAKE A TAX-FREE WITHDRAWAL FROM A **COVERDELL ESA**.

NOTE:

YOU **CANNOT** TAKE EDUCATION TAX CREDITS FOR EXPENSES PAID WITH COVERDELL FUNDS.



COVERDELL ESAs

Tax Planning Tip

TAXPAYERS CAN CONTRIBUTE TO

COVERDELL ESA and
QUALIFIED TUITION PROGRAM

IN THE SAME YEAR AND FOR THE SAME
BENEFICIARY.



DEDUCTION FOR ELEMENTARY & HIGH SCHOOL EDUCATORS

- THE ***JOB CREATION AND WORKER ASSISTANCE ACT OF 2002*** OFFERS TAX BENEFITS FOR ELEMENTARY AND HIGH SCHOOL TEACHERS, **AIDES**, PRINCIPALS, AND COUNSELORS WHO PURCHASE THEIR OWN TEACHING MATERIALS AND SUPPLIES.



DEDUCTION FOR EDUCATORS

continued

- ONLY DURING **2002** AND **2003**, EDUCATORS ARE ELIGIBLE FOR AN “ABOVE-THE-LINE” DEDUCTION OF UP TO **\$250** A YEAR FOR THE COST OF BOOKS, SUPPLIES, COMPUTER EQUIPMENT, SOFTWARE, ETC.
- **NOT FOR HOME SCHOOLING**



DEDUCTION FOR EDUCATORS

Continued

- IN ORDER TO QUALIFY FOR THE DEDUCTION, THE TAXPAYER MUST WORK AT LEAST **900** HOURS A YEAR.
 - This limitation is targeted at the part-time educator.
 - This deduction is very popular and with any luck will be extended beyond 2003.



EMPLOYER-PROVIDED EDUCATIONAL ASSISTANCE

- UP TO **\$5,250** OF EMPLOYER-PROVIDED EDUCATION ASSISTANCE BENEFITS PER YEAR ARE EXCLUDED FROM INCOME.
- EFFECTIVE 2002, THE FUNDS MAY BE USED FOR BOTH UNDERGRADUATE AND GRADUATE-LEVEL COURSES.



TUITION & FEES DEDUCTION

- FOR TAX YEARS **2002-2005**
TAXPAYERS MAY BE ELIGIBLE TO DEDUCT THE COST OF TUITION AND FEES FOR THEMSELVES, THEIR SPOUSES OR DEPENDENTS.
- THIS DEDUCTION IS "ABOVE-THE-LINE."



TUITION & FEES DEDUCTION

- THE DEDUCTIBLE EXPENSES ARE DEFINED IN THE SAME MANNER AS THEY ARE FOR PURPOSES OF THE **HOPE** CREDIT AND THE **LIFETIME LEARNING** CREDIT.



TUITION & FEES DEDUCTION

- THIS DEDUCTION IS AVAILABLE REGARDLESS OF WHETHER THE INSTRUCTION TAKEN RELATES TO THE TAXPAYER'S TRADE, BUSINESS OR EMPLOYMENT.



TUITION & FEES DEDUCTION

- IN **2002 & 2003**, TAXPAYERS WITH AGI UP TO **\$65,000** (SINGLE) AND **\$130,000** (JOINT) MAY DEDUCT UP TO **\$3,000** IN HIGHER EDUCATION EXPENSES.
- IN **2004 AND 2005**, THE MAXIMUM DEDUCTION GOES UP TO **\$4,000**.
- THE DEDUCTION EXPIRES AFTER **2005**.



TUITION & FEES DEDUCTION

2004 & 2005

- IN **2004 & 2005**, SINGLE TAXPAYERS WITH AGI $>$ \$65,000 BUT \leq \$85,000 ARE ELIGIBLE FOR A **\$2,000** DEDUCTION.
- IN **2004 & 2005**, MARRIED TAXPAYERS FILING JOINTLY WITH AGI $>$ \$130,000 BUT \leq \$160,000 ARE ELIGIBLE FOR A **\$2,000** DEDUCTION.
 - Note: \$160,000 is the phase-out for the married couple filing jointly.



WARNING

Tax Planning Tip

- If you take the NEW above-the-line deduction you cannot take either the HOPE or Lifetime Learning credits using the same expenses.



HOPE & LIFETIME LEARNING CREDITS

- NON-REFUNDABLE CREDITS
- TAXPAYERS USE FORM 8863
- SCHOOLS ISSUE FORM 1098-T



ANNUAL PHASE-OUT RANGES

	<u>2002</u>	<u>2003</u>
Married Filing Jointly	\$82-\$102	\$83-\$103
Single	\$41-\$51	\$41,500- \$51,500
Married Filing Separate	no credit is available	



HOPE & LIFETIME LEARNING CREDITS

Tax Planning Tip

- IF THE STUDENT IS CLAIMED AS A DEPENDENT ON THE PARENT'S TAX RETURN, ONLY THE PARENT IS ELIGIBLE TO CLAIM THE CREDIT.
- WHEN A PARENT CLAIMS THE CREDIT, ANY ELIGIBLE COLLEGE EXPENSES PAID BY THE CHILD DURING THE YEAR ARE TREATED AS IF PAID BY PARENT.



HOPE CREDIT

- BEGINNING IN 2002, TAXPAYERS CAN CLAIM A HOPE CREDIT IN THE SAME YEAR IN WHICH THEY RECEIVE A DISTRIBUTION FROM EITHER A COVERDELL ESA OR A QUALIFIED TUITION PROGRAM (QTP).
- IRS PUBLICATION **553**



HOPE CREDIT

- TAXPAYERS CANNOT USE EXPENSES PAID WITH A DISTRIBUTION FROM EITHER A COVERDELL ESA OR A QTP AS THE BASIS FOR THE HOPE CREDIT.



HOPE CREDIT

- \$1,500 NON-REFUNDABLE CREDIT PER **STUDENT**
- AVAILABLE ONLY FOR THE FIRST TWO YEARS OF POST-SECONDARY EDUCATION
- STUDENT MUST BE ENROLLED AT LEAST HALF-TIME
- STUDENT MUST BE PURSUING A DEGREE OR CREDENTIAL



HOPE CREDIT

- TAXPAYERS CAN CLAIM THE HOPE CREDIT IF THEY PAY QUALIFIED TUITION AND RELATED EXPENSES FOR AN ELIGIBLE STUDENT WHO IS EITHER THE TAXPAYER, THEIR SPOUSE, OR A DEPENDENT FOR WHOM THEY CLAIM AN EXEMPTION.



HOPE CREDIT

- **CALCULATE THE NON-REFUNDABLE CREDIT AS FOLLOWS:**

100% OF THE FIRST \$1,000 PAID

&

50% OF THE NEXT \$1,000 PAID

Note: To qualify for the full \$1,500 HOPE credit, the taxpayer must pay at least \$2,000.



HOPE CREDIT

- THE FOLLOWING EXPENSES WILL QUALIFY FOR THE HOPE CREDIT:
 - TUITION
 - FEES
 - STUDENT ACTIVITY FEES*
 - COSTS FOR BOOKS, SUPPLIES*
 - EQUIPMENT*

***MUST BE PAID TO THE INSTITUTION AS A
CONDITION OF ENROLLMENT**



HOPE CREDIT

- THE FOLLOWING EXPENSES WILL **NOT** QUALIFY FOR THE HOPE CREDIT:
 - **INSURANCE**
 - **STUDENT HEALTH FEES**
 - **ROOM AND BOARD**
 - **TRANSPORTATION**
 - **PERSONAL OR LIVING EXPENSES**



EDUCATION CREDITS

Using Loan Proceeds

- TAXPAYERS CAN CLAIM AN EDUCATION TAX CREDIT FOR QUALIFIED EXPENSES PAID WITH THE PROCEEDS OF A LOAN. USE THE EXPENSES TO FIGURE THE CREDIT FOR THE YEAR IN WHICH THE EXPENSES ARE PAID AND NOT THE YEAR IN WHICH THE LOAN IS REPAYED.



LIFETIME LEARNING CREDIT

- UNLIKE THE HOPE CREDIT, THE LIFETIME LEARNING CREDIT IS **PER TAX RETURN** AND **NOT** PER INDIVIDUAL.
- UNLIKE THE HOPE CREDIT, THE LIFETIME LEARNING CREDIT IS AVAILABLE FOR **ALL** YEARS OF POSTSECONDARY EDUCATION.



LIFETIME LEARNING CREDIT

UNLIKE THE HOPE CREDIT, THE LIFETIME LEARNING CREDIT DOES **NOT** REQUIRE THAT THE STUDENT BE:

PURSUING A DEGREE nor
ENROLLED AT LEAST HALF TIME.



LIFETIME LEARNING CREDIT 2002

- CALCULATE THE NON-REFUNDABLE CREDIT AS FOLLOWS:

20% x QUALIFIED TUITION AND FEES

MAXIMUM CREDIT IN **2002: \$1,000 PER RETURN** (NEED TO PAY **\$5,000** IN QUALIFIED EXPENSES)



LIFETIME LEARNING CREDIT 2003

- BEGINNING IN **2003**, EXPENSES OF UP TO **\$10,000** CAN QUALIFY FOR THE LIFETIME LEARNING CREDIT

20% x \$10,000 = **\$2,000** PER TAX
RETURN



QUALIFIED TUITION PROGRAMS

- IN 2002, QUALIFIED **STATE** TUITION PROGRAMS (QSTPs) WERE RENAMED QUALIFIED TUITION PROGRAMS (QTPs).
- 529 PLANS WERE SUBSTANTIALLY LIBERALIZED BY THE **ECONOMIC GROWTH AND TAX RELIEF RECONCILIATION ACT OF 2001.**



529 PLANS: One of the Most Valuable Tools

- PREPAID TUITION
 - **LOCK IN
TOMORROW'S
TUITION AT
TODAY'S PRICES**

- COLLEGE SAVINGS
 - **POTENTIAL RISK
& REWARD**



QTPs

Continued

- NO AGI TEST ASSOCIATED WITH 529 PLANS.
- BE CAREFUL:
SOME 529 PROMOTERS ARE
SUGGESTING AGGRESSIVE
STRATEGIES (ESTATE PLANNING)
THAT THE IRS HAS NOT RULED ON.



QTPs

Continued

- A TAXPAYER CAN COMBINE 5 YEARS OF ANNUAL GIFTS.
- THERE ARE **NO** GIFT TAX IMPLICATIONS ON GIFTS OF UP TO **\$55,000** PER INDIVIDUAL DONEE IF THE DONOR ELECTS ON FORM 709. FOR A COUPLE, THAT ADDS UP TO **\$110,000** PER DONEE.
- 529 PLANS ALLOW SIGNIFICANT ACCOUNT BALANCES.
- DONOR'S DEATH WITHIN 5 YEARS:REPORT PORTION OF ANNUAL GIFTS ON FORM 706.



QTPs

Continued

- THE **529** PLAN IS CONSIDERED UNDER THE CONTROL OF THE DONOR/OWNER(UNLIKE COVERDELL PLANS)
- DONOR/OWNER CAN TAKE FUNDS OUT OF THE **529** PLAN (TAX IMPLICATIONS) SUBJECT TO THE RULES OF THE PLAN.



QTPs

Continued

- WHILE **529** PLAN CONTRIBUTORS ARE NOT LIMITED TO PARTICIPATING IN A PLAN IN THEIR STATE ... THERE MAY BE STATE TAX BENEFITS FOR INVESTING AT HOME.
- **State-income tax deduction and/or state tax-free treatment on withdrawals.**



QTPs

The Tax Benefit

- A DISTRIBUTION FROM A QTP ESTABLISHED AND MAINTAINED BY A STATE CAN BE EXCLUDED FROM INCOME IF THE AMOUNT IS USED FOR QUALIFIED HIGHER EDUCATION EXPENSES, INCLUDING TUITION AND ROOM & BOARD.



QTPs

Continued

- EFFECTIVE 2002, TAXPAYERS CAN MAKE CONTRIBUTIONS TO A QTP ESTABLISHED AND MAINTAINED BY NON-STATE **EDUCATIONAL INSTITUTIONS.**
- EARNINGS DISTRIBUTED BEFORE **JANUARY 1, 2004** ARE TAXABLE.



QTPs

Continued

- THERE IS PORTABILITY OF 529 FUNDS.
- A DONOR MAY MOVE FROM ONE PLAN TO ANOTHER ONCE EVERY 12 MONTHS.
- PLEASE REVIEW THE RULES OF THE INDIVIDUAL PLAN FOR SPECIFIC DETAILS.



QTPs Continued

- EVEN IF A QTP IS USED TO FINANCE A STUDENT'S HIGHER EDUCATION, THE STUDENT OR THE STUDENT'S PARENTS STILL MAY BE ELIGIBLE TO CLAIM EITHER THE HOPE CREDIT OR LIFETIME LEARNING CREDIT.



STUDENT LOAN INTEREST DEDUCTION

- EFFECTIVE 2002, THE 60 MONTH LIMITATION WAS REPEALED AND THE QUALIFYING INCOME LEVELS WERE INCREASED.
- THE ABOVE-THE-LINE DEDUCTION IS STILL LIMITED TO \$2,500 A YEAR PER TAX RETURN.



STUDENT LOAN INTEREST DEDUCTION

- AGI TEST FOR **2002 & 2003**:

JOINT: \$100,000-\$130,000

SINGLE: \$ 50,000-\$ 65,000

MARRIED/

FILING SEPARATE: No Deduction
Available



WITHDRAWALS FROM IRAs

- WITHDRAWALS MAY BE MADE FROM A *TRADITIONAL* OR *ROTH* IRA FOR QUALIFIED HIGHER EDUCATION EXPENSES WITHOUT HAVING TO PAY THE **10%** EARLY WITHDRAWAL PENALTY.
- TAX WILL BE PAID ON THE AMOUNT WITHDRAWN EARLY.



WITHDRAWALS FROM IRAs

Continued

- QUALIFIED HIGHER EDUCATION EXPENSES INCLUDE:
 - TUITION
 - FEES
 - BOOKS
 - SUPPLIES
 - EQUIPMENT
 - ROOM & BOARD (IF STUDENT IS ENROLLED AT LEAST HALF TIME)



THANK YOU



- THANK YOU FOR YOUR PARTICIPATION IN TODAY'S **TAX EDUCATION BENEFITS MENU** SEMINAR.

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