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Education Tax Benefits

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CERTIFIED PUBLIC ACCOUNTANTS

Education Tax Benefits

If you pay tuition, fees, and other costs for attendance at an eligible educational institution for yourself, your spouse, or your dependent, you may be able to take advantage of one or more of the education tax benefits.

You can claim more than one education benefit in a tax year as long as you do not use the same expenses for more than one benefit.

Exception: Qualified expenses used to claim education benefits can also be used to eliminate the 10% penalty on premature IRA distributions.

You may claim only one of the following education tax benefits for the same student per year: tuition and fees deduction, American Opportunity Credit, or Lifetime Learning Credit.

Education Deductions.

Deductions reduce the amount of income subject to income tax. Deductions for education expenses include:

- Tuition and fees deduction up to $4,000 from gross income. Income limitations apply.
- The provision for deducting tuition and fees expired for tax years after 2013.
- Student loan interest deduction up to $2,500 from gross income. Income limitations apply.
- Business deduction on Schedule C or F. You can deduct the cost of education related to the business or farm activity.
- Miscellaneous itemized deduction on Schedule A, subject to the 2% AGI limitation. You can deduct the unreimbursed cost of education required to keep your current job or maintain and improve skills needed for your job. You cannot deduct the cost of education that qualifies you for a new trade or business.

Education Tax Credits

Tax credits reduce the amount of income tax you may have to pay. Income limitations apply. The education credits are claimed on Form 8863, *Education Credits* (American Opportunity and Lifetime Learning Credits).

- American Opportunity Credit, $2,500 maximum per student per year.
- Lifetime Learning Credit, $2,000 maximum per tax return per year.

Note: The Hope Credit applied to 2008 and earlier years. It was replaced by the more generous American Opportunity Credit for the 2009 – 2017 tax years.

Penalty-Free IRA Distributions

If you withdraw money from your IRA before you are age 59½, you are generally subject to a penalty of 10% of the distribution, in addition to any tax that may be due on the distribution.

- The 10% penalty does not apply to traditional IRA or Roth IRA withdrawals, if you use the money to pay qualified education expenses for yourself, spouse, or for any child or grandchild of yourself or your spouse.
- Qualified education expenses include tuition, fees, books, supplies, equipment, and special needs services required for enrollment or attendance at an eligible educational institution. Room and board for students enrolled at least half-time in a degree or certificate program may also qualify.
- Reduce qualified expenses by scholarships and other tax-free assistance the student receives, but not by gifts or inheritances.

Comparison of Education Credits	
American Opportunity Credit	*Lifetime Learning Credit*
Up to $2,500 per eligible student.	Up to $2,000 per tax return.
100% of the first $2,000, plus 25% of the next $2,000 of qualifying expenses for each student.	20% of the first $10,000 of total qualifying expenses.
40% of the credit (up to $1,000) may be refundable.	Nonrefundable tax credit.
Eligible years: • Until the first four years of postsecondary education are completed. • Reduced by number of years the American Opportunity Credit and Hope Credit was claimed for the student.	Eligible years: • All years of postsecondary education.
Qualifying expenses: • Tuition, required enrollment fees, and • Course-related books, supplies, and equipment.	Qualifying expenses: • Tuition and required enrollment fees.
The student must be pursuing an undergraduate degree or other recognized education credential.	The student need not be pursuing a degree or credential.
Student must be enrolled at least half-time for at least one academic period beginning during the year.	Student must be enrolled in at least one course.
Additional restrictions: • The student can have no felony convictions. • Taxpayer cannot use MFS status and cannot be claimed as a dependent by another person. • Additional conditions apply for nonresident aliens and for taxpayers under age 24.	Additional restrictions: • None.

Education Savings Plans

Contributions that you make to education savings plans are not deductible, but the earnings accumulate tax free. In addition, no tax will be owed on distributions if they are less than the beneficiary's qualified education expenses. Qualified expenses are reduced by scholarships, other tax-free assistance, and amounts used to figure education credits.

- ***Qualified Tuition Programs (QTPs).*** States sponsor QTPs to allow prepayment of a student's qualified higher education expenses. For information on a specific QTP, you need to contact the state agency or eligible educational institution that established and maintains it. ***Note:*** QTPs are also called 529 Plans because they are authorized under section 529 of the Internal Revenue Code.
- ***Coverdell Education Savings Accounts (ESAs).*** A Coverdell ESA can be used to pay a student's eligible K-12 expenses, as well as higher education expenses. Coverdell ESA contributions are limited to $2,000 total per year for each beneficiary, no matter how many accounts have been established or how many people are contributing. Unless the beneficiary is a person with special needs, contributions to a Coverdell ESA must stop before the beneficiary reaches age 18 and the account balance must be distributed within 30 days after the beneficiary reaches age 30 (or dies, if earlier).

Exclusions From Gross Income.

An exclusion from income means you don't report the benefit you receive as income and you don't pay tax on it, but you also can't use that same tax-free benefit for a deduction or credit.

- You may exclude the part of scholarships, fellowships, and grants that you use for qualifying education expenses while you are a degree candidate.
- You may exclude up to $5,250 paid for you under a qualifying educational assistance plan. Additional amounts are included in your W-2 income, unless they are a working condition fringe benefit. A working condition fringe benefit is an amount that you could have deducted as an employee business expense, had you paid for it instead of your employer.
- If you cash in qualified U.S. Savings Bonds to pay for eligible education expenses for yourself, spouse, or your dependent, you may exclude the bond interest from income. Income limitations apply.

Contact Us

There are many events that occur during the year that can affect your tax situation. Preparation of your tax return involves summarizing transactions and events that occurred during the prior year. In most situations, treatment is firmly established at the time the transaction occurs. However, negative tax effects can be avoided by proper planning. Please contact us in advance if you have questions about the tax effects of a transaction or event, including the following:

- Pension or IRA distributions.
- Significant change in income or deductions.
- Job change.
- Marriage.
- Attainment of age 59½ or 70½.
- Sale or purchase of a business.
- Sale or purchase of a residence or other real estate.
- Retirement.
- Notice from IRS or other revenue department.
- Divorce or separation.
- Self-employment.
- Charitable contributions of property in excess of $5,000.