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A lesson in education tax breaks

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With the soaring cost of college, parents are happy to take any break they can get. There are several tax credits and deductions that can help offset education expenses. Here's the lowdown:

HOPE CREDIT AND LIFETIME LEARNING CREDIT

These are two education tax credits, available for taxpayers based on education expenses paid for you, your spouse or your dependents. But don't worry about getting too much of a good thing. You can only claim one credit for each student in any given year.

You can claim a Hope Credit for an eligible student, which means the student must be in his first two years of college (generally a freshman or sophomore) and is taking at least half the normal full-time workload.

The Hope credit is calculated as 100 percent of the first \$1,100 of qualified educational expenses and 50 percent of the next \$1,100. So, if you have expenses of at least \$2,200, you can claim the full \$1,650 Hope Credit per student per year, assuming you meet the income and other eligibility requirements, said Marnie Aznar, a certified financial planner with Aznar Financial Advisors in Morris Plains.

The Hope Credit can only be used for two tax years for each eligible student.

Then you have the Lifetime Learning Credit. This can be used for anyone taking undergraduate, graduate or professional degree classes, as long as the classes will give the student improved job skills. The value: a maximum \$2,000 credit per year, or 20 percent of your eligible expenses.

There is no limit on the number of tax years for which the Lifetime Learning credit can be claimed for each student.

If you have several students attending school at the same time, you can use a combination of the Lifetime Learning credit and the Hope credit, as long as each credit or deduction is taken for a different student.

Both credits may be phased out based on your Modified Adjusted Gross Income. If you file married filing jointly and you earn more than \$110,000, or if you're single and earn more than \$53,000, you can't take the credit. If you file married filing single, you can't take the credit.

There are also double-dipping restrictions if you're paying for college with funds from a 529 plan or a Coverdell Education Savings Account (formerly called Education IRAs).

"If the parent already has enough money already saved in 529 accounts to pay for college in full, they may still want to utilize the credits," said Sheri Iannetta Cupo, a CFP with Sage Advisory Group in Morristown. "Monies leftover in the 529 accounts after the children are through with college can fund parents' education or a grandkid's education and it keeps growing tax-free."

TUITION AND FEES TAX DEDUCTION

If you miss out on taking the Hope or Lifetime credits, you may be able to use the Tuition and Fees Tax Deduction.

This deduction can reduce your taxable income by up to \$4,000 in 2006. If you qualify, you can deduct up to \$4,000 of tuition and fees for eligible postsecondary institutions.

You can't deduct the costs for room and board, medical or transportation expenses.

You may be eligible if you claim as a dependent an eligible student who attends an eligible institution. You and your spouse, if you're back to the halls of learning, can also qualify as the student.

There's a scale for how much of this deduction you can take. Married couples with a Modified Adjusted Gross Income of \$130,000 or less, and singles with MAGI of \$65,000 or less, may be able to claim the full \$4,000 deduction. If your MAGI is more than \$160,000 as a married couple or more than \$80,000 as a single, you're out of luck.

And note that the deduction can't be used if you paid the tuition bills from tax-free scholarships, grants (including Pell grants) or other non-taxable educational funds.

STUDENT LOAN INTEREST DEDUCTIBILITY

You may be able to deduct up to \$2,500 of interest on student loans if your MAGI is less than \$135,000 for marrieds and less than \$65,000 for singles.

Generally, you can claim the deduction if your filing status is anything except married filing separately, no one else is claiming the student on his or her tax return and the taxpayer paid the interest on a qualified student loan.

See the IRS Web site (www.irs.gov) or talk to your tax preparer for more details if you're eligible to take the deduction.

RUN THE NUMBERS

You have to run the numbers to see which tax savings option is best for you, Aznar said.

For example, in the 28 percent tax bracket, the \$4,000 Tuition and Fees Tax Deduction would yield savings of \$1,120. If you are eligible for the Hope Credit in the same year, \$4,000 of eligible expenses would result in a credit of \$1,650. If you are also eligible for the Lifetime Learning Credit in that year, the credit would result in \$800 of savings on \$4,000 of expenses. In this case, Aznar said, the Hope Credit would create the best end result if you qualify based on the multiple requirements involved.

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