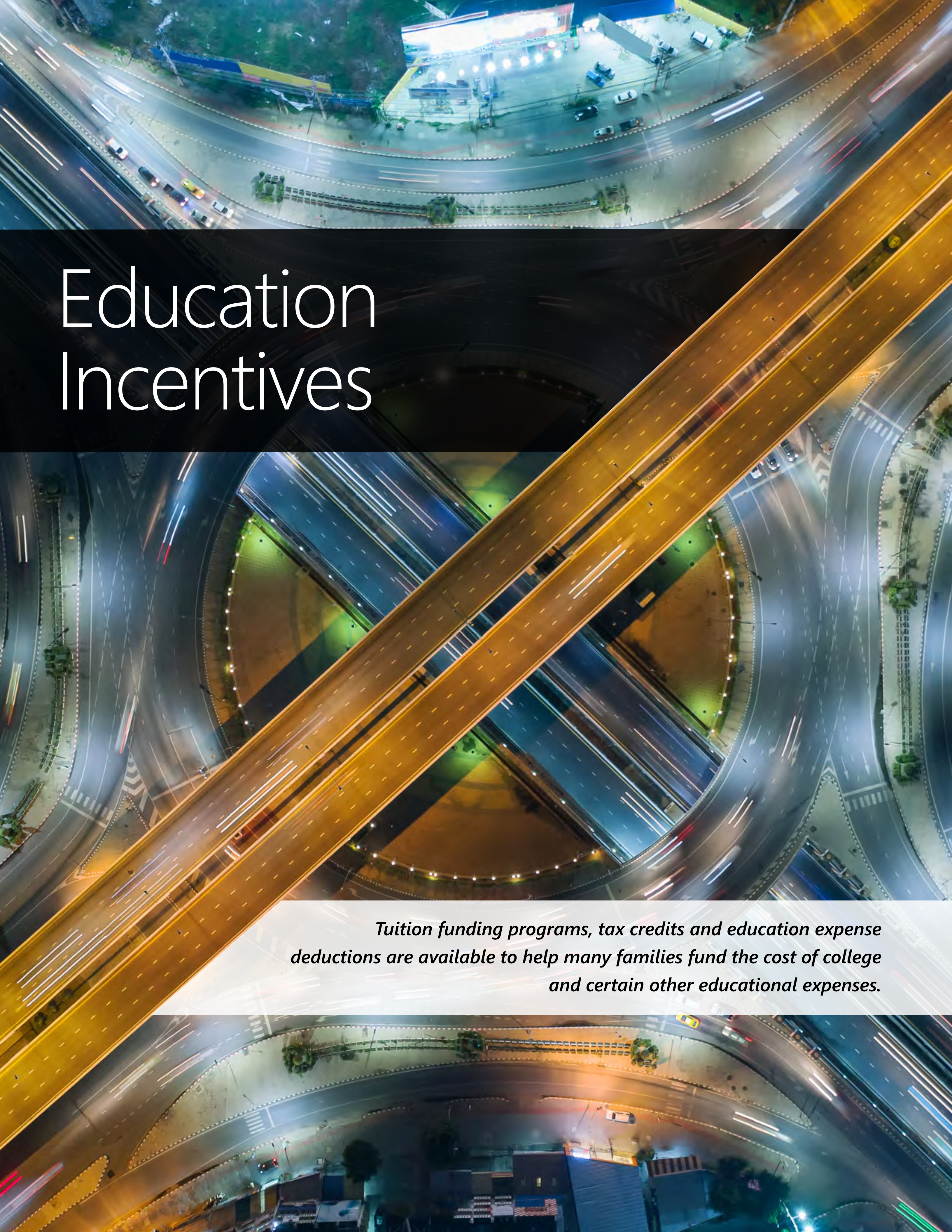
Education Incentives



Tuition funding programs, tax credits and education expense deductions are available to help many families fund the cost of college and certain other educational expenses.

Education Incentives Available

There are education incentives that provide tax benefits to assist you in funding the cost of a college education for your family members, but some of them are subject to phase outs based on AGI, thereby limiting the incentives that may be available to you. See the state tax issues chapter for additional incentives.

The tax incentives available to help pay college costs include:

- IRC Sec. 529 plans.
- American Opportunity Credit and Lifetime Learning Credit.
- Education deductions, including student loan interest.

IRC Sec. 529 Plan

Probably the most popular tax incentive college funding method is an IRC Sec. 529 plan (qualified tuition program), since it is available to all taxpayers regardless of their income. These plans offer the following benefits:

- Although the contributions to the IRC Sec. 529 plans are not currently tax deductible on the federal level, the earnings from the plan are tax-deferred for federal and state taxes.
- Distributions are tax-free if used to pay qualified education expenses at any accredited college, university, or graduate school and most community colleges and certified technical training schools in the United States as well as many schools abroad.
- Distributions can be used to pay for tuition, certain room and board expenses, books, supplies, a computer, computer software and even internet expenses, so long as the computer is used primarily by the beneficiary and the beneficiary's family during any years the beneficiary is enrolled at an eligible educational institution. Allowable computer software must be predominantly educational in nature, so software designed for games, sports or hobbies is excluded. Distributions of up to $10,000 per designated beneficiary may be used for "qualified expenses" (tuition) for elementary or secondary public, private, or religious school.
- Control of the funds remains in the hands of the account owner (not the beneficiary), even after the beneficiary reaches legal age, permitting the account owner to change beneficiaries at any time and for any reason. You may change the beneficiary to another child if the original beneficiary does not go to college, or excess funds remain in one child's account after college. You can also change the beneficiary to yourself if a financial emergency requires you to have access to the funds. However, any distributions representing income earned within the plan will be taxable if not used for qualified education purposes.
- Age and income restrictions do not apply to the account owner or beneficiary, unlike other tax incentive education plans.
- You are not limited to just the plans offered by the state you live in. In addition, you can change your choice of plan every 12 months and roll over plan funds to a new plan. This gives you more investment options and possibly higher contribution ceilings.

Funds deposited into an IRC Sec. 529 plan for the benefit of another person are considered a gift for gift tax purposes. Although the plan's assets are excluded from your estate, there are gift tax considerations. However, to the extent you used your annual gift exclusion to fund an IRC Sec. 529 plan, you will have to limit other tax-free gifts to stay within the annual exclusion amount of $15,000 per donee for 2019 and 2020. For 2019 and 2020, you may elect to treat up to $75,000 ($150,000 if married) of the contribution for an individual as if you had made it ratably over a five-year period. The election allows you to apply the annual exclusion to a portion of the contribution in each of the five years, beginning with the year of contribution.

Also, if your state of residence allows a deduction for the contributions to the plan, you will generally only be allowed to take the deduction for one year's amount in the initial year that you fund the plan.

Private institutions can offer a prepaid tuition program if they satisfy IRC Sec. 529 requirements. Distributions from these private plans used for qualified education expenses will also be tax-free.

IRC Sec. 529 plans also have their disadvantages. Investment options are limited to the plan's choices of investment vehicles. Also, even though you can withdraw funds for uses other than qualified higher education expenses, you'll have to pay income tax and an additional 10% penalty on the earnings, similar to a premature distribution from a retirement account.

PATH modified IRC Sec. 529 rules to treat any distribution from an IRC Sec. 529 account as coming from that account, rather than aggregating all of the accounts. This is so even if the individual making the distribution is operating more than one account. Additionally, a refund of tuition paid with amounts distributed from an IRC Sec. 529 account is treated as a qualified expense if those amounts are re-contributed to an IRC Sec. 529 account within 60 days.

Observation: *The Tax Increase Prevention Act of 2014 ("TIPA") included the Achieving a Better Life Experience ("ABLE") Act, which allows states to establish and operate an ABLE program. Severely disabled individuals (under age 26) would be able to open an IRC Sec. 529 savings account and make annual contributions up to the gift tax exclusion limit of $15,000 for 2019 and 2020, adjusted annually for inflation. The account may be used to meet qualifying disability expenses of a designated beneficiary. Any distribution that exceeds qualified disability expenses is included in gross income and subject to an additional tax of 10%.*

American Opportunity and Lifetime Learning Credits

The American Opportunity/Hope Scholarship Tax Credit ("AOTC") and Lifetime Learning Credit are available if you pay qualified tuition and related education expenses, which includes course materials such as books, supplies and equipment. Room and board expenses do not qualify for either credit.

However, these credits have income limitations which phase out the available credits. The AOTC is phased out ratably with MAGI between $80,000 and $90,000 if single or head of household and $160,000 and $180,000 if married filing jointly for 2019. The Lifetime Learning Credit is phased out ratably with MAGI between $58,000 and $68,000 for 2019 ($59,000 and $69,000 for 2020) if single or head of household and $116,000 and $136,000 for 2019 ($118,000 and $138,000 for 2020) if married filing jointly.

- **American Opportunity Tax Credit.** A $2,500 annual credit per student is available for the first four years of post-secondary education with enrollment on at least a half-time basis in a program leading to a degree. Generally, you can receive up to $1,000 as a refundable credit even if you owe no taxes. However, the refundable credit will not be allowed to an individual if he or she is subject to the kiddie tax and other limitations.
- **Lifetime Learning Credit.** A $2,000 annual credit per taxpayer is available for an unlimited number of years of post-secondary, graduate, or certain other courses to acquire or improve your job skills. The credit is equal to 20% of the first $10,000 of qualified expenses, up to the maximum amount of $2,000.

Employer-Provided Educational Assistance

Under a qualified educational assistance plan, up to $5,250 of the benefits will not be included in the gross

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income of the employee. There is no requirement that educational assistance be job-related. Educational expenses include tuition, fees and similar payments; books; supplies and equipment. However, employer-provided tools or supplies that the employee may retain after completing a course of instruction are includible in gross income. Further, you cannot use any of the tax-free education expenses paid for by your employer under this plan as the basis for any other deduction or credit, including the American Opportunity Tax Credit and Lifetime Learning Credit.

Interest on Education Loan

Certain education expenses are deductible in computing against your federal AGI, subject to income limitations, including interest on education loans. You can take the above-the-line deduction of up to $2,500 of interest paid on qualified education loans annually, subject to a phase out that eliminates the deduction. For 2019 and 2020, the maximum deduction is reduced when MAGI exceeds $70,000 ($140,000 if married filing jointly) and is completely eliminated when MAGI is $85,000 ($170,000 if married filing jointly).

Tuition Fees and Deductions

Under the Further Consolidated Appropriations Act, individuals with MAGI of up to $80,000 ($160,000 for married filing jointly status) can take a deduction from gross income of up to $2000 for tuition and fees for higher education for 2019 and 2020.

Tax Tip

25. AGI Too High to Claim a Credit? Have Your Child Take it

If you pay qualified expenses for your children but income limitations prevent you from taking the American Opportunity Tax Credit or Lifetime Learning Credit, you may have your children claim the credit on their tax returns instead. If your child can claim the full amount of the lifetime learning credit to reduce his or her own tax liability, you will save a maximum of $2,000.

Please note that a child under age 24 cannot claim the refundable portion of American Opportunity Tax Credit as long as one of the parents is alive.