

## 7 College-Funding Tax Breaks

The tax breaks available for paying college tuition continue to grow — the only bad news is it's hard to keep them all straight. Here's a quick list of seven benefits currently offered.

1. **The Hope credit.** It applies to the first two years of college education and can reach \$1,500 each year. To qualify for the maximum amount, your expenses must total \$2,000 and your income must fall below certain limitations. For 2003, the credit is phased out between \$41,000 and \$51,000 of adjusted gross income (AGI) based on a single return and between \$83,000 and \$103,000 for married couples filing jointly. If you don't qualify, consider making a gift to your child (the student) if he or she has enough income to qualify for the credit.
2. **The Lifetime Learning credit.** It applies after the first two years (when the Hope credit is no longer available). In 2003, the credit amount is 20% of the first \$10,000 (with a \$2,000 maximum) and is subject to the same income limitations as the Hope credit. It can also apply to postgraduate education.
3. **A new deduction (even for nonitemizers).** You can currently deduct up to \$3,000 (which will increase to \$4,000 in 2004) of college tuition and fees in computing your AGI. But your AGI must be below \$65,000 — or \$130,000 if you and your spouse are filing a joint return.
4. **The student loan interest deduction.** A 60-month limit on deductibility no longer applies, and you may now take up to \$2,500 as a deduction in computing your AGI. The deduction is phased out when the modified AGI is between \$50,000 and \$65,000 (for single and head-of-household filers) or between \$100,000 and \$130,000 (married couples filing jointly). So, again, you won't need to itemize to reap the advantage.
5. **Section 529 plans.\*** You can contribute up to five years' worth of annual gift tax exclusions (\$55,000 each) into a plan for a family member and take tax-free distributions later to pay for college. Two drawbacks: You don't get a tax deduction and you must invest through a state-authorized plan. The upside: The plan need not be your own state's plan, though some states have special tax breaks for their own plans.
6. **Coverdell Education Savings Accounts (formerly Education IRAs).** These are similar to 529 plans but contributions are limited to \$2,000 per year, and funds can also pay for primary and secondary expenses. Also, you must be below certain income thresholds to contribute, but you're free to choose your own investment vehicles for these accounts.
7. **Employer-provided education assistance.** An employer can create a plan to provide all employees with up to \$5,250 of education assistance as a tax-free benefit that covers tuition, fees, books and supplies. Most courses — including those not related to job responsibilities, but excluding those related to hobbies, sports or games — generally qualify.

Keep in mind: IRA withdrawals you use for qualified education expenses are still subject to income tax. However, you will avoid the 10% penalty tax that normally applies for withdrawals, including those from Roth IRAs, if you are under age 59-1/2. Plus, you can make an unlimited amount of gifts above the

annual gift tax exclusion by giving them directly to an educational organization as tuition payments. Call us for further details and to discuss which strategies would work best for you.

\*As with other investments, there are generally fees and expenses associated with participation in a 529 savings plan. In addition, there are no guarantees regarding the performance of the underlying investments. The tax implications of a 529 plan should be discussed with your legal and/or tax advisors because they can vary significantly from state to state. The tax-free qualified withdrawal provision of these plans is scheduled to expire after Dec. 31, 2010, unless new legislation is enacted by Congress. For withdrawals not used for qualified higher education expenses, earnings are subject to income taxes plus a 10% federal tax penalty.