



Education Credits

You may be able to turn part of the higher education expenses you pay for yourself, your spouse, or your dependents into tax savings. You can do this by claiming the **American Opportunity tax credit** and the **Lifetime Learning credit** for tuition and related expenses.

1. The maximum **American Opportunity tax credit** a taxpayer may claim is \$2,500 per student for the first four years of undergraduate education at an eligible educational institution. That's 100% of the first \$2,000 of higher-education tuition and related expenses plus 25% of the next \$2,000 of those expenses.
 - a. It's 40% refundable, so even if your income tax is zero, you'd get 40% of the credit that you otherwise would have received.
 - b. The American Opportunity/Lifetime Learning credits are based on the payment of "qualified tuition and related expenses." These are the expenses for tuition and academic fees that are required for enrollment or attendance at an eligible educational institution. Qualified tuition and related expenses do *not* include student activity fees, athletic fees, insurance, room and board, transportation costs and other personal living expenses. They also don't include courses involving sports, games, or hobbies, unless they are part of the student's degree program. **Books are qualified expenses under the American Opportunity tax credit, but not the Lifetime Learning credit.**
 - c. The credit is phased out for higher-income taxpayers. The American Opportunity tax credit is phased out for couples with income between \$160,000 and \$180,000, or singles with income between \$80,000 and \$90,000.
 - d. The credit is not available for taxpayers who are married filing separately.
2. The **Lifetime Learning credit** still exists as well:
 - a. It is not refundable; you can offset your income tax liability, but if that's zero, you will not get a refund (or higher one) due to this credit.

- b. The maximum Lifetime Learning credit that may be claimed is \$2,000 per year *per taxpayer*, for any post-high school education (including graduate-level courses and courses to acquire or improve job skills) at an eligible educational institution.
- c. Expenses that qualify for the credit include tuition and academic fees required for enrollment or attendance at an eligible educational institution. They don't include student activity fees, athletic fees, insurance, books, room and board, transportation costs, or other personal living expenses. Courses involving sports, games, or hobbies doesn't qualify unless they're part of the student's degree program. Qualified expenses for purposes of the credit are reduced by tax-exempt scholarships and fellowships, certain military benefits, and any other tax-exempt payments of those expenses (other than gifts or bequests).
- d. For 2012, the credit is “phased out” ratably for married taxpayers filing jointly with adjusted gross income (AGI), with certain modifications, between \$104,000 and \$124,000. That is, for joint filers, the credit is reduced if modified AGI for 2012 is between \$104,000 and \$124,000, and it is unavailable if AGI is \$124,000 or more. For taxpayers filing as single or head of household, the phase-out range for 2012 is \$52,000 to \$62,000. Married taxpayers who file separate returns can't claim the credit.
- e. The credit is not available for taxpayers who are married filing separately.

Other things to know about these credits:

1. These credits are taken on the return of the taxpayer claiming the dependency exemption for the student, regardless of who paid the tuition or how it was paid (via loans, for example). The only way these credits can normally be taken on the student's tax return is if no one, including him/herself, claims a dependency deduction for that student.
2. The credit is based on what you paid in a given calendar year, and that can be difficult to determine given all the scholarships and grants that one typically gets. The college does prepare a Form 1098-T that is supposed to show what you paid, but personally, whenever I've been able to compare the form to what someone actually paid – they're not the same. So just be sure you keep good track of what you (or anyone else) actually paid in tuition plus whatever was paid via a student loan.

OTHER THOUGHTS – FINANCING / SAVING

My first advice is to talk to your financial advisor. However, here are some thoughts we have:

1. Know that transferring money to your children, while it might save taxes, will mean they will be expected to pay more of their education by the financial aid folks. Now, if you make a good living you might not get any assistance anyway, and so it would make sense to transfer money and save taxes, but if you make an “average” amount of yearly income I sometimes wonder if

it's worth saving 15 -20% of tax on the interest earned on the money transferred. Suppose you transfer \$20,000 to your child over the years, and the average balance is \$10,000. If interest rates are 2%, that's \$200 of interest; at 20% tax rate that's \$40 of tax "saved". Compare that to how much of that \$20,000 will be expected to be used for college since it belongs to the child instead of you! If you're an investing wizard and can generate tens of thousands of capital gains, that's another story, but for the rest of us...

2. 529 plans and the like. Again – consult your financial advisor. Just realize that there is no tax deduction for these contributions (you will save about \$435 in Michigan taxes on \$10,000 put into a Michigan 529 plan). The interest grows tax-free; will not be taxed if used for education. Can be transferred to other family members, and is a good way for the rich uncle or grandma to fund a child's education!

Please feel free to send me an email if you have any further questions.

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