TAX GUIDE

for education planning

Today there are several tax-smart ways both to build a college fund and to pay for education expenses. Each option has its own restrictions and limitations, so deciding which to use requires careful planning. This brochure gives a quick overview of the major education tax breaks available.

SAVING for education

Consider these tax-advantaged ways to save for your child's education. With some options, the earnings are tax-deferred. With others, the earnings are tax-free.

Section 529 plans. Section 529 plans come in two forms – prepaid tuition programs and college savings accounts.

- *Prepaid tuition plans* are designed to hedge against inflation. You can purchase tuition credits, at today's rates, that your child can redeem when he or she attends college. Using tuition credits from these programs is tax-free.
- *College savings plans* are investment accounts that let you build a fund for your child's college expenses. Once in the plan, your money grows tax-free. Provided the funds are used to pay for qualified college expenses, withdrawals are tax-free. Qualified expenses include tuition, fees, books, supplies, and certain room and board costs.

Do your homework before you invest in a Section 529 plan. The same federal tax rules apply to all 529 plans. However, the benefits and restrictions for different state and private plans vary widely.

Coverdell education savings accounts. You can contribute to a Coverdell education savings account for any child under age 18. The total contributions made for a child cannot exceed $2,000 per year. Contributions are nondeductible, and to contribute the full amount, your income must be below certain limits.

Funds can accumulate and be paid out tax-free for qualified college expenses, including tuition, fees, books, supplies, equipment, and certain room and board costs. The funds can also be used to pay for elementary and secondary (K-12) school expenses at public, private, or religious schools.

Individual retirement accounts. Regular and Roth IRAs can provide a way to save for college expenses too. Generally, you'll incur a 10% penalty if you withdraw IRA money before reaching age 59½. However, funds used for qualified education expenses are not subject to the early withdrawal penalty.

Penalty-free does not mean tax-free. You'll still have to pay income tax on traditional IRA distributions and, if you are under age 59½, on Roth IRA earnings. To be treated as a qualified distribution, the Roth IRA must also satisfy a five-year holding period.

Education savings bonds. You can invest in Series EE or Series I savings bonds to save for college expenses. The interest is tax-free on bonds issued after 1989 if purchased by someone at least 24 years old and used to pay qualified higher education expenses.

PAYING for education

Paying education expenses may entitle you to tax deductions and/or tax credits. Tax credits are generally more valuable than tax deductions because they reduce your income tax dollar for dollar. Here are the credits and deductions you should know about.

American opportunity credit. This credit can be claimed for tuition and fees relating to the first four years of post-secondary education. The credit is calculated per student, per year, and the credit amount is adjusted periodically for inflation. The student must be enrolled in an accredited school at least half-time for one academic period during the year.

Lifetime learning credit. The lifetime learning credit can be claimed for tuition and fees relating to any year of post-secondary education and for job-related courses as well. The maximum credit is calculated per taxpayer, rather than on the number of students in the taxpayer's family.

Student loan interest deduction. Interest on certain student loans can be deducted whether or not you itemize your other deductions. The maximum deduction is $2,500 per year and is subject to income limits.

Information presented in this brochure is of a general nature and should not be acted upon without further details and/or professional assistance. For more information, contact our office.

TAX BREAKS at a glance

Tax Break	Description
American Opportunity Credit	A tax credit allowed per student for the first four years of post-secondary education. Subject to income limits.
Lifetime Learning Credit	A tax credit allowed per family for all years of post-secondary education and for certain job-related courses. Subject to income limits.
Coverdell Education Savings Accounts	Annual contribution limit is $2,000. Tax-free withdrawals if funds used to pay elementary, secondary, or higher education expenses. Subject to income limits.
Education Savings Bonds	Interest on Series EE and Series I savings bonds tax-free if used for qualified higher education expenses. Subject to income limits.
Section 529 Plans	Plans allow individuals to set up an account on behalf of someone else (e.g., a child or grandchild) that can be used to pay college expenses. The two types include prepaid tuition plans and college savings plans. Not subject to income limits.
Student Loan Interest Deduction	Up to $2,500 above-the-line deduction. Subject to income limits.

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The Final Piece of the Puzzle...

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