

Families' Guide to Federal and State Tax Credits and Deductions for Education

Many new tax benefits for parents who are sending or planning to send their children to college and for adults who want to return to school will be available due to the balanced budget signed into law, the Taxpayer Relief Act of 1997 (TRA97, August 1997). These tax cuts effectively make the first two years of college universally available, and they will give many more working Americans the financial means to go back to school if they want to choose a new career or upgrade their skills. When fully phased in, 12.9 million students are expected to benefit -- 5.8 million under the "HOPE Scholarship" tax credit, and 7.1 million under the Lifetime Learning tax credit.

www.ed.gov/inits/hope/

The Hope tax credit

The Hope Scholarship is a tax credit, not a scholarship. Tax credits are subtracted from the tax your family owes, instead of subtracting them from taxable income like a tax deduction. Your family must file a federal tax return and owe taxes to get this tax credit. An individual may claim this income tax credit only for tuition and fees for himself or herself, a spouse, and dependents. The credit cannot be used for expenses incurred for books, room and board or other expenses.

Your family may claim a tax credit up to \$1,500 for each eligible dependent for up to two tax years. Specifically, your family may claim up to 100% of the first \$1,000 of eligible expenses and 50% of the next \$1,000 for a maximum credit of \$1,500.

The credit is available to taxpayers whose income is under \$100,000, who file a joint return, or \$50,000 if filing a single return. The amount of the credit is gradually reduced for those with an income of \$80,000 to \$100,000 on a joint return, and \$40,000 to \$50,000 on a single return. Before calculating the credit, the taxpayer must deduct any scholarships and other tax-free financial assistance, including a Pell Grant and employer-provided educational assistance.

The Lifetime Learning tax credit

The Lifetime Learning credit is a tax credit available to individuals who file a tax return and owe taxes. This means the amount of the credit is subtracted from the taxes your family owes, rather than reducing taxable income like a tax deduction.

Your family may claim a tax credit up to \$1,000 per tax year (until January 1, 2003) and up to \$2,000 (after that date) for the taxpayer, taxpayer's spouse, or any eligible dependents for an unlimited number of tax years. A family may claim annually up to 20% of \$5,000 of eligible expenses for expenses paid after June 30, 1998, and prior to January 1, 2003, and up to 20% of \$10,000 of eligible expenses (for expenses paid after January 1, 2003 and after).

The actual amount of the credit depends on your family's income (refer to income and tax filing status information under Hope tax credit above), the amount of qualified tuition and fees paid, and the amount of certain scholarships and allowances subtracted from tuition. This credit is family-based (e.g., \$1,000 per family) rather than based on the number of dependents in your family like the Hope credit.

Education Loan Interest Deductions

For many college graduates, one of their first financial obligations is to repay their student loans. The student loan interest deduction will reduce the burden of the repayment obligation by allowing students or their families to take a tax deduction for interest paid on student loans. The deduction is available even if an individual does not itemize other deductions. The maximum deduction is \$2,500 per year. It is phased out for joint filers with adjusted gross income between \$60,000 and \$75,000, and single filers with adjusted gross income between \$40,000 and \$55,000.

Qualified Loans

Federal Stafford, PLUS, and Perkins loans, Federal and direct consolidation loans, federal loans for healthcare professionals, and private education loans issued by schools, banks, and not-for-profit associations.

Personal loans, including a loan from a relative or other related party, do not qualify for the tax deduction.

Qualified Expenses

In order to use the deduction:

The loan must be used to pay for the educational expenses of the taxpayer, a spouse, or a dependent. These expenses include tuition, fees, room & board, books, equipment, and other necessary expenses, such as transportation.

A parent may claim the student loan interest deduction if the parent borrows to pay his/her child's costs and incurs the debt in a year in which the parent provides more than half of the student's support.

State of Ohio tax credit for educational expenses

Beginning in tax year 2001, Ohio families can now claim an Ohio income tax deduction for qualified postsecondary tuition and fees paid after January 1, 2001. The state deduction is limited to \$2,500 per year (\$5,000 maximum for the first two years) for an Ohio resident attending an Ohio institution of higher education. This tax benefit is limited to joint filers with a combined federal adjusted gross income not exceeding \$100,000 and to single filers with a federal adjusted gross income not exceeding \$50,000.

OTTA College Savings Programs (www.collegeadvantage.com)

The Ohio Tuition Trust Authority (OTTA) is a state agency created by the Ohio General Assembly in 1989 to promote savings for higher education. Through their **CollegeAdvantage 529 Savings Plan**, OTTA offers four college savings options. The four funds are: 1) the guaranteed savings fund which is guaranteed by the state and guaranteed to keep pace with tuition inflation; 2) an age-based fund with investments weighted more towards equities during a child's younger years and gradually becoming more conservative as the child approaches college age; 3) a balanced fund with investments more equally weighted in both equities and fixed income; and 4) a growth fund with investments primarily in equities. The market-based funds are managed by Putnam investments. Families can choose to participate in all four funds. Investments may be applied at any accredited college or university in Ohio or the country.

Tax Incentives

- Ohio residents can deduct the amount of their contributions to CollegeAdvantage accounts: up to \$2,000 per contributor (or married couple) per beneficiary, with unlimited carryforward in future years. Anyone can contribute to a child's account: parents, grandparents, other relatives, even family friends. Each contributor who is an Ohio resident can take the Ohio state tax deduction.
- Qualified withdrawals made after December 31, 2001 are exempt from federal income tax.

(Part of this information is produced by the Department of Education; for detailed tax information and instruction please consult an accountant and/or IRS tax forms and publications to see if you qualify.)