

# TAX BULLETIN

## What are the options?

- Credits (page 1)
- Deductions (2)
- Exclusions (2)
- Investment Accounts (2)

-Education Savings Bonds (3)

-Coverdell Education Savings Accounts (3)

-Qualified Tuition Programs (3)

## EDUCATION PLANNING

The cost of college continues to soar in 2004/2005 with a 9-10% increase in the average cost of a four-year public university. The government has responded with numerous tax advantaged programs in the form of deductions and credits. Additionally, the academic institutions have a myriad of financial aid opportunities.

The average annual cost of a 4 year private college including tuition and fees is \$19,710. While annual cost for a 4 year public college tuition and fees averages only \$4,694, a survey by USA Today showed 56% of parents saved nothing for college and only 4% put away more than \$5,000. Surveys show that only 29% of students pay less than \$4,000 per year out of pocket while 8% pay \$24,000 or more per year.

Do not assume that your child or grand-



### Rising Education Costs

child is going to get a full ride academic or athletic scholarship. There are many avenues available including Credits, Deductions, Exclusions and Investment opportunities. Now is the time to take action!

## CREDITS

### Hope Credit

The hope credit covers tuition and fees related to enrollment for post secondary education (college) expenses for the first two years of undergraduate education. The eligible student must be enrolled at least half time in a degree, certificate or other credential program. The maximum credit is \$1,500 per student per year calculated as 100% of the first \$1,000 and 50% of the next \$1,000 of qualified tuition.

### Lifetime Learning Credit

The Lifetime Learning Credit covers tuition and fees required for enrollment or attendance at an eligible education institution and can be claimed once per year for ALL eligible students (including taxpayer, spouse, and dependents). The maximum credit is \$2,000 calculated as 20% of qualifying tuition and fees up to \$10,000.

*“Surveys show that only 29% of students pay less than \$4,000 per year out of pocket while 8% pay \$24,000 or more per year.”*

## DEDUCTIONS

### Student Loan Interest Deduction

An individual may deduct interest paid on any qualified education loan. The maximum amount a taxpayer is permitted to deduct, regardless of the number of students in the family is \$2,500. The deduction is phased out based on adjusted gross income (AGI) as follows:

Married Filing Jointly-\$100,000-130,000  
Single-\$50,000-65,000

### Higher Education Expense

For the years 2002 through 2005, a deduction is available for qualified higher education expenses. For single taxpayers with AGI less than \$65,000, \$4,000 can be deducted in 2004 and 2005. With AGI

between \$65,000 and \$80,000, the deduction is reduced to \$2,000. Married taxpayers filing jointly are eligible for a \$4,000 deduction with AGI up to \$130,000 and a \$2,000 deduction with AGI between \$130,000 and \$160,000. NOTE: the deduction can not be claimed in the same year as either the Hope or Lifetime Learning Credits.

### Ordinary and Necessary Business Expense

Education expenses are deductible if incurred to maintain or improve employment skills, or are required to maintain salary, status or employment. Taxpayer must be currently employed or engaged in business to deduct education expenses.

## EXCLUSIONS

### Working Condition Fringe Benefit

Any employer-provided education expense that an employer pays on behalf of an employee is excluded from the income of the employee as a working condition fringe benefit if paid under an accountable plan.

Education is defined as any form of instruction or training that improves or develops an individual's capabilities regardless of whether or not the education is job related or part of a degree program.

### Employer-Provided Education Assistance Program

Employees can exclude up to \$5,250 per year of qualified educational assistance paid or incurred by the employer. However, no Hope or Lifetime Learning Credit is available on the excluded amounts. Edu-

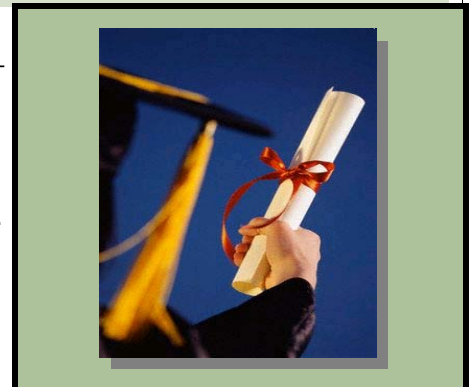
### Scholarships, Fellowships, Grants & Tuition Reductions

Gross income generally does not include any amount received as a qualified scholarship, fellowship, grant or tuition reduction by a degree candidate at an educational institution for tuition, fees, books, supplies and equipment.

## INVESTMENT ACCOUNTS

Like many areas of financial planning, if you have time on your side, there are some better options available to you. The government has established several incentives for taxpayers to save for future education expenses. Education savings bonds,

Coverdell Education Savings Accounts, Traditional or Roth IRA and Qualified Tuition Programs are investment programs which have favorable tax treatment. Each option is explained in more detail on page 3-4 of this newsletter.



## EDUCATION SAVINGS BONDS

An individual who redeems qualified U.S. Savings bonds may exclude the interest from the redemption proceeds from income up to the amount of qualified higher education expenses. This is a very safe

investment with low to moderate return. Qualified U.S. Savings Bonds must be issued at a dis-



count after December 31, 1989 to a taxpayer who must be at least 24 years old before the bond issue date. The bonds must be registered in the name of the taxpayer or in the names of the taxpayer and spouse (not the name of a dependant child). Qualified education expenses include tuition, fees, and contributions to Coverdell Education Savings Accounts or Qualified Tuition Programs. Room, board, books, supplies, etc. are not included in qualified higher education expenses for this type of savings account. The exclusion for interest on the bonds phases out with AGI. For 2004 the phase out ranges are \$89,750-\$119,750 for married taxpayers filing jointly and \$59,850-\$74,850 for single taxpayers.

## COVERDELL EDUCATION SAVINGS ACCOUNTS

The Coverdell Education Savings Account is maintained to pay qualified education expenses of the designated beneficiary. Contributions to these accounts are limited to \$2,000 per child per year. Phase-out ranges for these contributions are fairly high (\$190,000-\$220,000 for married filing jointly and \$95,000-\$110,000 for single taxpayers). However, anyone can contribute to the plan so taxpayers who are being phased out could make a cash gift to the beneficiary who could then make the contribution themselves. Contributions are not deductible, however, distributions for

qualified higher education expenses are not taxable to the beneficiary regardless of whether the designated beneficiaries are enrolled full-time, half-time or less than half-time.. Qualified education expenses have a broad definition and may include post secondary education as well as public, private or religious elementary and secondary education schools. If the balance in the account is not used by the time the beneficiary reaches 30, a taxable distribution can be made, OR the balance can be rolled over to the account of a relative (broadly defined).

## TRADITIONAL & ROTH IRA DISTRIBUTIONS

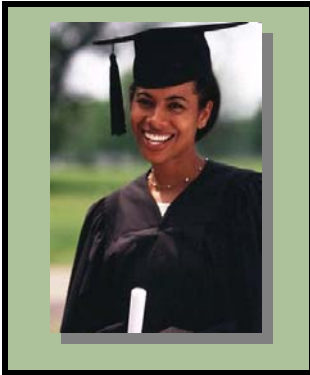
The 10% penalty tax on early IRA distributions does not apply to distributions for qualified higher education expenses. The penalty exclusion applies to traditional and Roth IRA distributions for expenses incurred by the taxpayer, taxpayer's spouse, or any child, or stepchild of the taxpayer or his spouse without regard to income limi-

tations. Qualified higher education expenses are defined broadly to include tuition and fees as well as room and board, books, uniforms, etc. The amount of qualified higher education expenses must be reduced by Hope and Lifetime Learning credits and tax exempt scholarships, such as Pell Grants.

Hercher & Company, PC  
4601 DTC Blvd, Ste 325  
Denver, Colorado 80237  
303-740-6069  
FAX: 303-740-2122  
E-Mail: [jack@herchercpa.com](mailto:jack@herchercpa.com)

## QUALIFIED TUITION PROGRAMS (SEC 529 PLANS)

Prepaid tuition plans allow the taxpayer to pay for future tuition costs in today's dollars on behalf of a designated beneficiary.



Savings plans invest in different ways (typically in money market funds, stock funds, and/or bond funds) to pay all qualified higher education expenses on behalf of the beneficiary. Qualified higher education

expenses include tuition, fees, books, supplies and equipment required for the enrollment or attendance of a designated beneficiary. In addition, if the beneficiary is enrolled at least half time, reasonable room and board also qualifies.

Qualified Tuition Programs have significant advantages. First of all, there are no AGI limitations imposed on the contributor or the beneficiary. Anyone can participate. Also, the contributor retains control of the assets until distributions are made to beneficiaries including when and how much is distributed. The contributor can change the beneficiary. Contributions are eligible for the \$11,000 annual gift tax exclusion. Contributions can be made for any beneficiary, even if the beneficiary is

unrelated to the taxpayer. Distributions from 529 Plans are excluded from the income of the beneficiary and the contributor if used for qualified education expenses and any distributions not used for education are excluded from income if rolled over to the 529 Plan of any family member (broadly defined) within 60 days.

Qualified Tuition Programs began in Michigan as the Michigan Education Trust. Today all 50 states have adopted legislation providing for the implementation of their own 529 Plan. Because Qualified Tuition Programs are state, rather than Federal, plans, there is quite a bit of variety in the plans nationwide. Colorado has a particularly appealing plan because all contributions (between \$25 and \$280,000) are 100% tax deductible on the contributor's Colorado income tax return. So, not only are qualified distributions excluded from both Federal and Colorado income, the contributor also receives a dollar-for-dollar deduction on their Colorado return in the year of contribution to a Qualified Tuition Program.

The account balance in the savings plan is an asset of the account owner for financial aid purposes so funds contributed by Grandparents who are account owners on a 529 Plan do not show up as an asset for financial aid purposes.

This plan is definitely worth considering!

*“Prepaid tuition programs allow the taxpayer to pay for future tuition costs in today's dollars on behalf of a designated beneficiary.”*

## FINANCIAL AID

**Gift Aid**-consists of scholarships or grants such as Pell grants. Available in both need based financial aid and merit based such as academic, athletic or artistic.

**Self-help Aid**-consists of various education loan programs and work-study. All must be repaid.

**-Perkins Loan**-low interest loans ranging up to \$4,000. The loans are available to students with the lowest expected family contribution (EFC)

**-Federal Subsidized Stafford Loans**-need

based loans for which the government pays interest until six months after the student leaves college.

**-Federal Unsubsidized Stafford Loans**-available to most students who fill out a financial aid application. Interest accrues immediately and repayment begins six months after the student leaves college

**-Federal Parents' Loans for Undergraduate Students**-Loans to the parents of college students. Not need based.

**-Work Study**-Jobs in which students earn at least minimum wage toward expenses.

Hercher & Company, PC  
4601 DTC Blvd, Ste 325  
Denver, Colorado 80237  
303-740-6069  
FAX: 303-740-2122  
E-Mail: jack@herchercpa.com