# Smart Education Savings

## *Getting Schooled in Credits & Deductions*

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Sending a child to school is expensive. The costs of tuition, books, extracurricular activities and more can add up quickly. That's especially true for college. According to a 2012 study by Bloomberg, the cost of college has increased 1,120% since 1978. Yes, you read that right – 1,120%. Fortunately, there are a number of tax credits, deductions and savings plans you can take advantage of at any grade level to help offset the rising cost of education.

## Tax Credits and Deductions Grades K-12

There are three Arizona school tax credits available. Taxpayers are allowed to claim all three credits in the same year and they do not need to have a child in school to qualify.

### Credit for Contributions Made or Fees Paid to a Public School

You may claim this credit for making contributions or paying fees to a public school for support of extracurricular activities or character education programs.

**Eligible schools.** Public schools, including charter schools qualify for this credit.

**Maximum credit.** The credit is equal to the amount contributed or the amount of fees paid, but there is a maximum. Single taxpayers and heads of household: $200. Married couples filing jointly: $400. If they file separately, they may each claim half of the credit. It must be claimed in the year the donation is made.

**Can the contribution or fees paid benefit my child?** Yes, but you may not then claim a charitable deduction on Schedule A.

**Nonrefundable.** The credit can only reduce your tax liability to zero. However, you can carry forward any unused amounts for up to five consecutive taxable years.

### Private School Tuition Credits

You may claim these credits for making donations of a certain amount to a qualified school tuition organization for scholarships to private schools.

**Eligible schools.** You must make contributions to a tuition organization that provides scholarships or grants to qualified schools. Non-governmental preschools for disabled students and non-governmental primary or secondary schools in Arizona qualify for the credit.

**Maximum credit.** The credits are equal to the amount contributed; however, each credit has a maximum amount you can claim.

- **Credit for Contributions to Private School Tuition Organizations.** For tax year 2014, single taxpayers or heads of household: $528. Married couples filing jointly: $1,056. If they file separately, they may each claim half of the credit.

- **Credit for Contributions to Certified School Tuition Organization – Individual.** Only taxpayers who first donated the maximum amount allowed under the Credit for Contributions to Private School Tuition Organizations can claim this credit. For tax year 2014, single taxpayers and heads of household: $525. Married couples filing jointly: $1050. If they file separately, they may each claim half of the credit.

You do not have to claim these credits in the year you make a donation. Credit eligible contributions made from January 1 to April 15 in a calendar year can be applied as a tax credit on the prior year taxes.

**Can the contribution benefit my child?** No. You also will not qualify if you and another person agree to designate your donations to benefit each other's children.

**Nonrefundable.** The credits can only be used to the extent that they reduce your tax liability to zero. But, you can carry forward any unused amounts for up to five consecutive taxable years.

### Deductions for Charitable Volunteers

Schools are considered non-profit entities, so if you volunteer at your child's school, you may be able to deduct some out-of-pocket expenses associated with your volunteer work such as buying supplies for the Parent Teacher Organization. There is no charitable deduction allowed for the value of your time. If you use your car while volunteering, you may deduct your actual unreimbursed expenses such as gas and oil costs, or a flat 14 cents per mile. You may also deduct parking fees and tolls.

Be sure to get written acknowledgement for any contribution of $250 or more, or you could lose your deduction. It must include the amount of cash contributed, a description of any property contributed and whether you got anything in return for your contribution.

## College Tax Credits

If you, your spouse, or dependents are currently attending or planning to attend college, you may be able to claim the American Opportunity Tax Credit or the Lifetime Learning Credit. Taxpayers cannot claim both credits for the same student in the same year.

### American Opportunity Tax Credit

The American Opportunity Tax Credit for "qualified tuition and related expenses" is available through 2017 for the first four years of undergraduate education.

**Eligible institutions.** In general, accredited schools offering credit towards a bachelor's or associate's degree (or other recognized post-high school credential), and certain vocational schools are eligible.

**Eligible students.** The student must be enrolled in a degree or certification program on at least a half-time basis. The student also must never have been convicted of a federal or state felony drug offense.

**Qualified tuition and related expenses.** This includes tuition, books, and academic fees required for enrollment or attendance. Student activity fees, athletic fees, insurance, room and board, transportation costs or other personal living expenses do not qualify. The cost of a course or education involving sports, games or hobbies doesn't qualify unless it's part of the student's degree program.

**Maximum credit.** You can claim up to $2,500 per student. Since the limit is per student and not per taxpayer, qualifying expenses for you and two children, for example, may be as high as $7,500.

**Who can claim the credit?** If the student is claimed as a dependent, only the parent may claim the credit. It would be based on qualified expenses paid by *both* the parent and child. If the parent is eligible to, but does not claim the student as a dependent, only the student can claim the credit. If the student is not claimed as a dependent, then qualifying expenses paid by a parent can be claimed by the child. The child may also claim payments made directly to the school by a third party, such as grandparents.

**Phase-out ranges for modified adjusted gross income (AGI).** In tax year 2014, for married couples filing jointly: $160,000 and $180,000, and it’s unavailable if AGI is $180,000 or more. For individual taxpayers or heads of household: $80,000 to $90,000. No credit is available for married couples filing separately.

**Payments with borrowed funds.** The credit can be claimed for qualified tuition and related expenses paid by a loan.

**The credit is 40% refundable.** Not only can it reduce your regular tax bill to zero, you may also receive a refund. For example, someone who has at least $4,000 in qualified expenses, but no tax liability to offset the credit against, would qualify for a $1,000 (40% of maximum credit of $2,500) refund.

**Lifetime Learning Credit**

There is no limit on the number of years the Lifetime Learning Credit can be claimed for each student.

**Eligible institutions.** The credit is available for any post-high school education (including graduate-level courses and courses to acquire or improve job skills) at an eligible school. That includes accredited schools offering credit towards a bachelor's or associate's degree or other recognized post-high school credential and certain vocational schools. The credit may be available even if only one course is taken.

**Qualified tuition and related expenses.** This includes tuition and academic fees required for enrollment or attendance. Student activity fees, athletic fees, insurance, books, room and board, transportation costs, or other personal living expenses do not qualify. Courses involving sports, games, or hobbies do not qualify unless they're part of the student's degree program.

**Maximum credit.** You can claim $2,000 per year. The credit is per taxpayer, not per student, which means a family's maximum credit is the same regardless of the number of students in the family.

**Nonrefundable.** The credit can reduce your regular tax bill and your alternative minimum tax (AMT) bill to zero, but it can't result in a refund.

**Phase-out ranges for modified AGI.** In tax year 2014, for married couples filing jointly: $108,000 to $128,000, and it is unavailable if AGI is $128,000 or more. For single taxpayers or heads of household: $54,000 to $64,000. Married couples who file separately cannot claim the credit.

## College Savings Plans

*How* you pay for your child's education expenses can result in tax breaks or deductions. Education Savings Accounts (ESA) and Qualified Tuition Programs (529 plans) are the most popular ways.

### Education Savings Accounts

Financial institutions are starting to phase out ESAs because the yearly contribution limit is small at just $2,000 per child.

**Deductions.** You cannot claim a deduction for putting money into an ESA or taking it out.

**Withdrawals.** Earnings in the account are tax free if they are used for qualified education expenses. If the withdrawal is more than the cost of qualified education expenses, a portion of the withdrawal is taxable.

**Eligible Students.** Contributions are not allowed for students over the age of 17.

**Qualified education expenses.** This includes tuition, fees, tutoring, books, room and board, uniforms, transportation, special needs services for special needs beneficiaries and the cost of computer technology, equipment and internet access related to school use.

**Phase-out ranges for modified AGI.** For married couples filing jointly: $190,000 to $220,000. For all others: $95,000 to $110,000.

### 529 Plans

A 529 Plan is an education savings plan operated by a state or educational institution that helps families set aside money to pay for future college costs.

**Deductions.** When you put money into a 529 account, you cannot take a federal deduction. However, you can take an Arizona deduction of up to $2,000 for individuals and $4,000 for married couples.

**Withdrawals.** The annual earnings on 529 plans are not taxable, but instead grow tax-deferred. If you withdraw money, the distribution is split into an "earnings" portion and a "basis" portion based on how much of the account's balance is income (earnings) versus cumulative contributions (basis). The basis portion of your distribution is never taxable. If you pay qualified education expenses with the distribution, the earnings portion of your distribution is also tax-free. If you take a distribution and don't use it for qualified education expenses, the earnings portion is taxable and may be subject to a penalty of 10%.

**Qualified education expenses.** This includes tuition, fees, books, supplies, equipment, and expenses for room. Students must be enrolled at least half-time for room and board expenses to qualify.

**Contribution limit.** Contributions to the account cannot exceed the amount of money necessary to cover qualified education expenses.

Even with a 529 Plan, students or parents may still be eligible to claim the American Opportunity Credit or the Lifetime Learning Credit. To get started saving for education expenses today, or figuring out which tax credits and/or deductions will save you the most money, contact your Henry & Horne, LLP professional tax adviser.

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