ECMC

# Federal tax benefits for higher education

Tax year 2010

You know that higher education is an investment—in time, energy and money. Thankfully, there are ways to offset your education expenses through tax credits, deductions and savings plans.

This guide zeroes in on the basic qualifications for higher education-related tax benefits. This guide is intended for educational use and is not legal or tax advice. You should always consult a professional tax advisor or the Internal Revenue Service (IRS) at 1-800-829-1040 with any questions you may have. Visit the IRS website at www.irs.gov for relevant publications, forms, instructions and tax tips.

ECMC is a nonprofit corporation that provides services to students, schools, lenders and the U.S. Department of Education in support of higher education finance. We are a national guaranty agency, as well as the designated guarantor in Virginia, Oregon, Connecticut, and as of November 1, 2010, California. We sponsor programs to help students and families plan and pay for college. We provide resources to help student loan borrowers successfully repay their loans.

This summary of tax benefits is intended to assist parents and students considering or currently paying for higher education.

## American Opportunity Credit

This credit allows you to claim: 100 percent of the first $2,000 + 25 percent of the next $2,000 of qualified education expenses[1] for each eligible student.

So, your family can claim a tax credit of up to $2,500 for each eligible student.

### HIGHLIGHTS

- This credit is subtracted from the amount of your federal tax rather than reducing taxable income like a tax deduction.
- Can be claimed for up to four years—including years for which the Hope credit was claimed
- You can receive a refund of up to 40 percent of the amount of the credit you are eligible to receive, up to $1,000, if the amount of your federal tax is less than the amount of the American Opportunity credit for which your family is eligible.

### AMOUNT OF THE AMERICAN OPPORTUNITY CREDIT DEPENDS ON

- Your modified adjusted gross income.
- The amount of qualified education expenses[1] paid.
- The amount of certain scholarships and allowances subtracted from tuition.
- How many eligible students are in your family (unlike the Lifetime Learning credit, which has a maximum credit per family).

### QUALIFYING

An eligible taxpayer must:

- File a federal tax return.
- Claim an eligible student as a dependent on his or her tax return, unless the credit is for the taxpayer or taxpayer's spouse.

The student must not have completed the first four years of postsecondary education and was enrolled at least half time in a program leading to a degree or certificate at an eligible school during the tax year. (Your school can tell you whether it meets this requirement.)

You cannot claim the American Opportunity credit if:

- Your filing status is married, filing separately.
- Your modified adjusted gross income is $90,000 or more (single taxpayer) or $180,000 or more (married filing jointly). The credit amount is phased out (gradually reduced) for families with incomes between $80,000 – $90,000 if single, or $160,000 – $180,000 if married.
- The eligible student was convicted of a federal or state felony drug offense during the tax year in which he/she was enrolled.
- You (or your spouse) were a nonresident alien for any part of 2010 and did not elect to be treated as a resident alien.
- Other exclusions may apply—refer to IRS Publication 970 or consult a tax advisor for more details.

[1] *Qualified education expenses include tuition and certain related expenses required for enrollment in a course at an eligible educational institution. Related expenses generally include course-related books, supplies and equipment needed for a course of study, and do not need to be purchased directly from the institution. An expenditure for a computer would qualify if the computer is required as a condition for enrollment or attendance at the educational institution.*

## Lifetime Learning Credit

This credit allows you to claim: 20 percent of the first $10,000 of qualified education expenses[2] paid for the taxpayer and all eligible dependents combined.

So, the maximum credit is $2,000 per tax year for the taxpayer, taxpayer's spouse or any eligible dependents.

### HIGHLIGHTS

- This credit is subtracted from the amount of your federal tax rather than reducing taxable income like a tax deduction.
- Family-based (up to $2,000 per tax return) rather than based on the number of students in your family
- Available for postsecondary education and courses to acquire or improve job skills.
- Unlike the American Opportunity credit, the Lifetime Learning credit is available for an unlimited number of years.

### AMOUNT OF THE LIFETIME LEARNING CREDIT DEPENDS ON

- Your modified adjusted gross income
- The amount of qualified education expenses paid.
- The amount of certain scholarships and allowances subtracted from tuition.

You cannot claim a Lifetime Learning credit that exceeds the amount of your federal tax liability.

### QUALIFYING

An eligible taxpayer must:

- File a federal tax return.
- Claim an eligible student as a dependent, unless the eligible student is the taxpayer or taxpayer's spouse

[2] *Qualified education expenses include tuition and certain related expenses required for enrollment in a course at an eligible educational institution. Related expenses generally include course-related books, supplies, fees and equipment only if they must be paid to the institution as a condition of enrollment or attendance.*

The eligible student must be enrolled in at least one course at an eligible postsecondary institution during the calendar year, either as part of a postsecondary degree or to improve or acquire job skills.

You cannot claim the Lifetime Learning credit if:

- Your filing status is married, filing separately.
- Your modified adjusted gross income is $60,000 or more (single taxpayer) or $120,000 or more (married filing jointly). The credit amount is phased out (gradually reduced) for families with incomes between $50,000 – $60,000 if single, or $100,000 – $120,000 if married.
- You (or your spouse) were a nonresident alien for any part of 2010 and did not elect to be treated as a resident alien. Consult a tax advisor for more information.

## FOR BOTH THE AMERICAN OPPORTUNITY AND LIFETIME LEARNING CREDITS

### Receiving the tax credit

To apply, the taxpayer must report the amount of tuition and fees paid, as well as the amount of certain scholarships, grants and untaxed income used to pay tuition and fees. By law, schools must send this information in the form of a 1098-T Tuition Statement to each taxpayer and to the IRS. Your school should mail it to you by January 31, 2011, and it will include contact information for someone at the school who can answer any questions you may have.

You'll use the 1098-T statement and your own records showing tuition and fees you paid to fill out the supplementary IRS Form 8863 to claim the American Opportunity credit or Lifetime Learning credit. You may wish to speak with a tax advisor regarding the exact amount of your credit.

### When you can use it

These credits are allowed for qualified tuition and expenses paid in 2010 in connection with enrollment at an institution of higher education during 2010 or for an academic period beginning in 2010 or in the first three months of 2011. For instance, if you paid $1,500 in December 2010 for qualified tuition for a spring 2011 semester that begins in January 2011, you can use that $1,500 in calculating your 2010 credit.

### Multiple benefits

You cannot claim both the American Opportunity credit and the Lifetime Learning credit for the same student. If there are multiple students in your family, your family can claim more than one benefit as long as they are not both for the same student AND your family does not exceed the maximum Lifetime Learning credit (currently $2,000 per return).

## SIDE-BY-SIDE COMPARISON

| American Opportunity credit | Lifetime Learning credit |
|---|---|
| Up to $2,500 per eligible student | Up to $2,000 per return |
| Available for each eligible student until the first four years of postsecondary education are completed | Available for all years of postsecondary education and for courses to acquire or improve job skills |
| Student must be pursuing an undergraduate degree or other recognized education credential | Student does not need to be pursuing a degree or other recognized education credential |
| Student must be enrolled at least half time for at least one academic period beginning during the year | Available for one or more courses |
| No felony drug conviction on student's record | Felony drug conviction rule does not apply |

*Information courtesy of Internal Revenue Service Publication 970 "Tax Benefits for Education"*

## Student Loan Interest Deduction

This deduction allows you to claim: The interest paid on your student loan in 2010, or $2,500, whichever is smaller.

So, the maximum student loan interest deduction is $2,500 per return.

### HIGHLIGHTS

- This deduction can reduce the amount of your taxable income by up to $2,500 per year.
- Includes required and voluntary interest payments paid during the year on qualified student loans used for higher education.

### AMOUNT OF THE STUDENT LOAN INTEREST DEDUCTION DEPENDS ON

- Your modified adjusted gross income.
- The amount of qualified student loan interest paid.

### QUALIFYING

An eligible taxpayer must:

- Have paid interest on a loan that was used solely to pay qualified education expenses[3] for you, your spouse or an individual who was a dependent at the time you took out the loan; were paid or incurred within a reasonable period of time before or after you took out the loan; and were for higher education provided to an eligible student during an academic period.

You cannot claim the student loan interest deduction if:

- Your filing status is married, filing separately.
- Your modified adjusted gross income (MAGI) is $75,000 or more (single taxpayer) or $150,000 or more (married filing jointly). The amount of your student loan interest deduction is phased out (gradually reduced) if your MAGI is between $60,000 – $75,000 if single, or $120,000 – $150,000 if married.
- You are claimed as a dependent by another taxpayer.

[3] *Qualified education expenses generally include tuition, fees, room and board, books, supplies, equipment and other necessary expenses such as transportation.*

### Receiving the tax deduction

Generally you can claim the student loan interest deduction if all five requirements are met:

1. You paid interest on a qualified student loan.
2. No one else is claiming an exemption for you on his or her tax return.
3. Your filing status is not “married, filing separately.”
4. You meet the income requirements outlined previously under “Qualifying.”
5. You are legally obligated to pay the interest.

Your student loan interest deduction is generally the smaller of $2,500 or the amount of interest you paid in 2010. In addition to simple interest on the loan, the following can be considered student loan interest:

- Loan origination fee
- Capitalized interest
- Interest on revolving lines of credit used solely to pay qualified education expenses
- Interest on refinanced student loans

### When you can use it

This deduction is available for each tax year in which you paid interest, including voluntary payments, on a qualified student loan.

### Multiple benefits

You cannot deduct as student loan interest any amount that is an allowable deduction under any other provision of the tax law (for example, home mortgage interest). To claim this deduction, you must reduce your qualified education expenses by the amount paid for them with any tax-free items such as employer-provided education assistance, veterans’ education benefits, or tax-free distributions from a Coverdell Education Savings Account or qualified tuition program.

## Tuition and Fees Deduction

This deduction allows you to claim: The amount paid for tuition and fees in 2010, up to $4,000.

So, the tuition and fees deduction can reduce the amount of your taxable income by as much as $4,000 for tax year 2010.

### HIGHLIGHTS

- Reduces your taxable income by as much as $4,000 per year
- Based on the amount you spent on tuition and fees required for enrollment or attendance at an eligible postsecondary institution, but not for personal, living or family expenses like room and board, medical expenses and transportation.
- Can benefit you if you do not qualify for the American Opportunity or Lifetime Learning credits.
- You can claim the deduction yourself if you are not claimed as a dependent by another taxpayer.

### AMOUNT OF THE TUITION AND FEES DEDUCTION DEPENDS ON

- The qualified education expenses[4] that you paid for yourself, your spouse or a dependent for whom you are entitled to claim an exemption on your tax return.
- Your modified adjusted gross income.

### QUALIFYING

An eligible taxpayer must:

- File a federal tax return.
- Claim an eligible student (one who is enrolled in one or more courses at an eligible educational institution) as a dependent on the tax return, unless the deduction is for the taxpayer or the taxpayer's spouse.

An eligible educational institution is any college, university, vocational school or other postsecondary educational institution eligible to participate in a student aid program administered by the U.S. Department of Education. According to the IRS, "it includes virtually all accredited public, nonprofit and proprietary postsecondary institutions." The institution you attend can tell you whether it meets this requirement.

You cannot claim the tuition and fees deduction if:

- Your filing status is married, filing separately.
- Your modified adjusted gross income (MAGI) is more than $80,000 (single taxpayer) or $160,000 (married filing jointly). The amount of your maximum tuition and fees deduction is reduced to $2,000 if your MAGI is between $65,000 – $80,000 if single, or $130,000 – $160,000 if married.
- Another person can claim you as a dependent on his or her tax return, even if they don't actually do so.
- You (or your spouse) were a nonresident alien for any part of 2010 and did not elect to be treated as a resident alien.

[4] *Qualified education expenses include tuition and certain related expenses required for enrollment at an eligible institution. Related expenses include student-activity fees and expenses for course-related books, supplies and equipment only if these must be paid to the institution as a condition of enrollment or attendance.*

### Receiving the tax deduction

The taxpayer must complete Form 8917, Tuition and Fees Deduction, and file it with Form 1040 or Form 1040A. Enter the deduction on Form 1040, line 34, or Form 1040A, line 19. An eligible institution that received payment for tuition and fees in 2010 must send a 1098-T Tuition Statement to each taxpayer and to the IRS. Your school should mail it to you by January 31, 2011. The information on that statement will help you determine whether you can claim a deduction for 2010.

### When you can use it

Generally the deduction is allowed for qualified tuition and expenses paid in 2010 in connection with enrollment at an eligible educational institution during 2010 for an academic period beginning in 2010 or in the first three months of 2011. For instance, if you paid $1,500 in December 2010 for qualified tuition for a spring 2011 semester that begins in January 2011, you can use that $1,500 in calculating your 2010 credit.

### Multiple benefits

Your family cannot claim this deduction in the same year you or anyone else claims an American Opportunity credit or a Lifetime Learning credit for the same student—you must choose which benefit to use.

You cannot take the tuition and fees deduction if you deduct tuition and fees expenses under any other provision of the law—for example, as a business expense.

You also cannot claim the deduction if the tuition and fees were paid with a tax-free scholarship, grant or other education assistance (such as Pell Grants, employer-provided education assistance and other non-taxable benefits received to pay for education expenses).

## Coverdell Education Savings Account (ESA)

A Coverdell ESA is a savings account set up to pay the qualified education expenses[5] of a designated beneficiary

### HIGHLIGHTS

- Contributions to a Coverdell ESA are not tax deductible, but earnings in the account are tax-free as long as the funds are used for qualified education expenses.
- No limit on the number of separate Coverdell ESAs that can be established for a beneficiary, but the total of all contributions cannot exceed $2,000 per beneficiary
- Organizations such as corporations and trusts can contribute to Coverdell ESAs if the contributions are in cash and are made before the due date of the contributor's tax return (not including extensions).

### QUALIFYING

The account must be designated as a Coverdell ESA when it's created. The account must be established—and any contributions made—before the designated beneficiary reaches age 18, unless the student is a special-needs beneficiary.

[5] *Qualified education expenses include tuition, fees, books, supplies and equipment if required for enrollment or attendance at an eligible institution, as well as special-needs services for a special-needs beneficiary. Expenses for room and board may be eligible if the student is enrolled at least half time.*

#### Receiving the benefit

The designated beneficiary of a Coverdell ESA can take a distribution at any time. Generally, the distributions are tax free if they do not exceed the beneficiary's adjusted qualified education expenses for the year. At the end of the year, the beneficiary may be subject to a 6 percent excise (gift) tax on excess contributions to a Coverdell ESA.

#### When you can use it

When a student is enrolled at an eligible postsecondary school, funds can be withdrawn tax-free to pay for qualified higher education expenses. These generally include tuition and fees, books, supplies and equipment, special-needs services (for a special-needs beneficiary), and room and board, so long as the beneficiary is enrolled at least half time.

## Qualified Tuition Programs (QTPs) / 529 College Savings Plans

A QTP is a program set up to prepay, or contribute to an account established for paying, a student's qualified education expenses[6] at an eligible educational institution

### HIGHLIGHTS

- Can be established and maintained by states (state programs are called "529 plans") and eligible educational institutions.
- If you prepay tuition, the student (designated beneficiary) will be entitled to a waiver or a payment of qualified education expenses.
- No tax is due on a distribution from a QTP unless the amount distributed is greater than the beneficiary's adjusted qualified education expenses.
- You cannot deduct either payments or contributions to a QTP.

### QUALIFYING

The designated beneficiary is generally the student (or future student) for whom the QTP is intended. The beneficiary can be changed after participation in the QTP begins. If a state or local government or certain tax-exempt organizations purchase an interest in a QTP as part of a scholarship program, the beneficiary is the person who receives the interest as a scholarship.

[6] *Qualified education expenses include tuition, fees, books, supplies and equipment if required for enrollment or attendance at an eligible institution, as well as special-needs services for a special-needs beneficiary. Expenses for room and board may be eligible if the student is enrolled at least half-time. For 2010, computer technology or equipment purchased for educational purposes can be paid for by a QTP plan.*

### Multiple benefits

The American Opportunity credit, Lifetime Learning credit or the tuition and fees deduction can be claimed in the same year the beneficiary takes a tax-free distribution from a Coverdell ESA, as long as the same expenses aren't used for both benefits.

Penalty-free contributions can be made to both a Coverdell ESA and a qualified tuition program (QTP) in the same year for the same beneficiary. However, if the total distribution is more than the beneficiary's adjusted qualified higher education expenses, those expenses must be allocated between the distributions from the Coverdell ESA and the QTP before figuring how much of each distribution is taxable.

## COVERDELL ESA AT A GLANCE

| Question | Answer |
|---|---|
| Where can a Coverdell ESA be established? | It can be opened in the United States at any bank or other IRS-approved entity that offers Coverdell ESAs |
| Who can have a Coverdell ESA? | Any beneficiary who is under age 18 or is a special-needs beneficiary |
| Who can contribute to a Coverdell ESA? | Generally, any individual (including the beneficiary) whose modified adjusted gross income for the year is less than $110,000 ($220,000 in the case of a joint return) |
| Are distributions tax free? | Yes, if the distributions are not more than the beneficiary's adjusted qualified education expenses for the year |
| Are contributions deductible? | No |
| Why should someone contribute to a Coverdell ESA? | Earnings on the account grow tax free until distributed |
| What is the annual contribution limit per designated beneficiary? | Cash-only contributions of $2,000 for each designated beneficiary, no matter how many Coverdell ESAs are set up for that beneficiary or how many individuals contribute |
| When must contributions stop? | No contributions can be made to a beneficiary's Coverdell ESA after he or she reaches age 18, unless the beneficiary is a special-needs beneficiary |

*Information courtesy of Internal Revenue Service Publication 970 "Tax Benefits for Education"*

### Receiving the benefit

Contributions to a QTP cannot be more than the amount necessary to provide for the qualified education expenses of the designated beneficiary. There may be gift tax implications to the beneficiary if an annual contribution is more than $13,000. There are no income restrictions on the individual contributors. You can contribute to both the QTP and a Coverdell ESA in the same year for the same designated beneficiary.

### When you can use it

The benefit becomes available as soon as the student incurs qualified education expenses.

### Multiple benefits

The American Opportunity credit, Lifetime Learning credit or the tuition and fees deduction can be claimed in the same year the beneficiary takes a tax-free distribution from a QTP, as long as the same expenses aren't used for both benefits.

If a designated beneficiary receives distributions from the QTP and a Coverdell ESA in the same year, and the distributions total more than the beneficiary's adjusted qualified higher education expenses, the expenses must be allocated between the distributions. Any amount distributed from a QTP is not taxable if it is rolled over to another QTP for the benefit of the same beneficiary or for the benefit of a member of the beneficiary's family (including the beneficiary's spouse). An amount is rolled over if it is paid to another QTP within 60 days after the date of the distribution.

*This publication covers a variety of important tax topics related to higher education. It is intended for your educational use and not as legal or tax advice; it does not cover every facet or the full scope of this subject. We recommend that you consult a professional tax advisor or attorney, and encourage you to visit the Internal Revenue Service website, where you will find the complete text of various relevant IRS publications.*

IRS publications

Publication 970: Tax Benefits for Education
www.irs.gov/pub/irs-pdf/p970.pdf

Form 8863 and Instructions: Education Credits
www.irs.gov/pub/irs-pdf/f8863.pdf

Tax Topic 513: Educational Expenses
www.irs.gov/taxtopics/tc513.html

Publication 501: Exemptions, Standard Deduction, and Filing Information
www.irs.gov/pub/irs-pdf/p501.pdf

# Federal tax benefits at a glance

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A GUIDE FOR STUDENTS AND PARENTS (TAX YEAR 2010)

You may be able to take advantage of a number of federal tax benefits, including credits, deductions and savings incentives, to offset your costs for college or career training. This is only a guide to the most common benefits and is not a complete list of all the benefits you may be eligible for. For more information on these and other tax benefits, refer to IRS *Publication 970 (2010), Tax Benefits for Education* available at the Internal Revenue Service website—**www.irs.gov/publications/p970/index.html**—or consult a professional tax advisor.

| | AMERICAN OPPORTUNITY CREDIT | LIFETIME LEARNING CREDIT | STUDENT LOAN INTEREST DEDUCTION | TUITION AND FEES DEDUCTION | COVERDELL EDUCATION SAVINGS ACCOUNT | QUALIFIED TUITION PROGRAMS (QTPS) |
|---|---|---|---|---|---|---|
| WHAT IS IT? | Formerly the Hope Credit, this is a tax credit of up to $2,500 per student for qualified education expenses. The American Opportunity Credit can be claimed on your tax returns for up to four years (per student). | A tax credit of up to $2,000 for qualified education expenses. There is no limit to the number of years this credit can be claimed, but the amount is limited to up to $2,000 per return—not per student. | A tax deduction of up to $2,500 per return for interest paid on student loans used to pay for qualified education expenses. May be claimed each year. | A tax deduction of up to $4,000 for paid tuition and fees. A tax deduction is used to reduce the amount of your taxable income and may be claimed each year. | A savings account that is set up to pay qualified education expenses for a designated beneficiary. The beneficiary must be under the age of 18 or a special needs beneficiary at the time contributions are made. | Also called 529 plans, an account that is set up to let you save for or prepay qualified education expenses for you or a designated beneficiary. Each plan has its own annual and total contribution limits. |
| INCOME LIMITS | Modified adjusted gross income of less than $90,000 (less than $180,000 if married and filing jointly). | Modified adjusted gross income of less than $60,000 (less than $120,000 if married and filing jointly). | Modified adjusted gross income of less than $75,000 (less than $150,000 if married and filing jointly). | Modified adjusted gross income of no more than $80,000 (no more than $160,000 if married and filing jointly). | Taxpayers with a modified adjusted gross income of less than $110,000 (less than $220,000 if married and filing jointly) can contribute to a Coverdell ESA. | There are no income restrictions on individual contributors. |
| ENROLLMENT REQUIREMENTS | At least half-time enrollment at an eligible educational institution in a program leading to an undergraduate degree, certificate or other recognized credential. | Enrollment in at least one course at an eligible educational institution, either as part of a postsecondary degree or to improve or acquire job skills. | At least half-time enrollment at an eligible educational institution at the time the loan was incurred. Program must lead to a degree, certificate or another recognized credential. | Enrollment in at least one course at an eligible educational institution. | You can make tax-free withdrawals for qualified education expenses when the beneficiary is enrolled at an eligible educational institution. | You can make tax-free withdrawals for qualified education expenses when the beneficiary is enrolled at an eligible educational institution. |
| DETAILS | You can subtract up to $2,500 for each eligible student (you, your spouse and/or dependents) from the amount of your federal tax. If your tax liability is less than the credit you are eligible to receive, you may receive a refund of up to 40 percent of the credit amount.<br><br>You do not have to itemize deductions on your tax return to claim this credit.<br><br>You cannot claim this credit in the same year you claim a Lifetime Learning Credit or a Tuition and Fees Deduction for the same student. | You can subtract up to $2,000 (per return) from the amount of your federal tax. The credit can be claimed for you, your spouse and/or dependents. If your tax liability is less than the credit you are eligible to receive, the excess amount is not refunded.<br><br>You do not have to itemize deductions on your federal tax return to claim this credit.<br><br>You cannot claim this credit in the same year you claim a American Opportunity Credit or a Tuition and Fees Deduction for the same student. | You can deduct up to $2,500 (per return) from your taxable income for interest paid on loans taken for you, your spouse and/or a person who was your dependent at the time you took the loan(s).<br><br>You do not have to itemize deductions on your federal tax return to claim this deduction. | You can deduct up to $4,000 from your taxable income for tuition and fees paid for you, your spouse and/or dependents.<br><br>You do not have to itemize deductions on your return to claim this deduction.<br><br>You cannot claim this deduction in the same year you or anyone else claims an American Opportunity Credit or a Lifetime Learning Credit for the same student. | Contributions are not deductible, but earnings grow tax-free.<br><br>You can make tax-free withdrawals to pay for qualified education expenses.<br><br>Total contributions cannot exceed $2,000 per year for the same beneficiary, regardless of how many accounts are established for the beneficiary.<br><br>You can contribute to both a Coverdell ESA and a QTP in the same year for the same beneficiary. | Contributions are not deductible, but earnings grow tax-free.<br><br>You can make tax-free withdrawals to pay for qualified education expenses.<br><br>Contributions cannot exceed the amount necessary to pay for the beneficiary's qualified education expenses. There may be gift tax implications to the beneficiary if an annual contribution is more than $13,000.<br><br>You can contribute to both a Coverdell ESA and a QTP in the same year for the same beneficiary. |