Tax Benefits

When you are paying for law school, it is sometimes difficult to see the light at the end of the tunnel. Law school can be insanely expensive. However, did you know that some of your higher education expenses may help you reduce your federal income tax? The Internal Revenue Service allows tax savings for individuals and families who pay higher education costs. The benefits vary depending on your eligibility, but both deductions, which reduce the amount of income subject to tax before the tax is calculated, and tax credits, which reduce the amount of income tax dollar-for-dollar after the tax is calculated, are offered by the IRS.

Hope Scholarship Tax Credit: One type of benefit offered by the IRS is the Hope Scholarship Tax Credit. This tax credit may be worth up to $1,500 per eligible student for a taxpayer who paid qualified tuition and related expenses. The catch is that the Hope Scholarship Tax Credit only applies to students in their first two years of college. The eligible student must be enrolled at least half time and be working toward a degree or educational credential. This tax credit applies to students who paid for qualified expenses, including tuition and fees, but excluding room and board, books, and transportation.

The Hope Scholarship Tax Credit is designed to be reduced or phased out as the taxpayer's income increases. For a single filer, the reduction begins with income of $40,000 and the credit is eliminated at $50,000. For joint filers, the reduction begins with income of $80,000 and the credit is eliminated at $100,000. Also, the credit may only be claimed by either the student or their parent. It is a "per student" credit intended to be used by parents for dependent students or by independent students.

Lifetime Learning Tax Credit: After completing your first two years of education, you become eligible for a Lifetime Learning Tax Credit to help defray the costs of tuition and related expenses. You may claim a Lifetime Learning Tax Credit of up to $1,000 if the eligible student is enrolled in at least one course. For this type of tax credit, you do not need to be pursuing a degree. Even if you are just taking classes to improve your job skills, you may be eligible for this credit.

The Lifetime Learning Tax Credit equals 20 percent of the first $5,000 of tuition and related fees paid by the taxpayer. The reduction for this tax credit, based on income, is the same as with the Hope credit. This credit is designed as a "per return" credit. Regardless of the number of dependent students a parent claims on his or her tax return, he or she may only take one Lifetime Learning Tax Credit.

A taxpayer may take only one of the credits for each dependent student each year. For example, if a family has two children in college—one in the second year and one in the fourth year—the taxpayer may claim the Hope credit for one and the Lifetime Learning credit for the other. A taxpayer may also claim the Hope credit during the first two years of college and the Lifetime Learning credit for the remaining years. There is no limit to the number of years you may take the Lifetime Learning credit; so it does apply to graduate-level students as well.

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Student Loan Interest Deduction: Students who paid interest on student loans may deduct up to $2,000 of the interest paid. This adjustment reduces the amount of taxable income, and a taxpayer may take this deduction even if he or she does not itemize deductions. Eligible loans include those taken out to pay tuition, fees, living expenses, books, supplies, transportation, and equipment expenses. Most federal and private education loans would be eligible for this type of deduction. However, the student must be the taxpayer, the taxpayer's spouse, or his or her dependent.

This deduction applies to interest paid during the first five years of repayment. Similar to education tax credits, the deduction is reduced as income increases, beginning at $40,000 for single filers and $60,000 for joint filers. If you are a single tax-return filer with an income of $55,000 or a joint tax-return filer with income greater than $75,000, you will not be eligible for this interest deduction.

Employer-Provided Student Aid: The tax code allows employees to exclude up to $5,250 of employer-provided education benefits from their taxable income. This means that employers can provide educational benefits such as tuition, fees, books, supplies, and equipment tax-free. However, this only applies to undergraduate-level courses.

Education IRAs: Education IRAs (Individual Retirement Accounts) are trusts or custodial accounts designed to help families save for a child's education. The money in these accounts grows tax-free until withdrawn. The student benefiting from an education IRA is permitted to withdraw the funds at any time. If the amount does not exceed the student's higher education expenses in a tax year—including tuition, fees, books, supplies, and room and board—the withdrawal will be tax-free.

If a student withdraws more than his or her qualified expenses for the year, a portion of the education IRA withdrawal will be taxable. The taxable amount will be considered the same as income and must be reported as earnings. The student's taxable withdrawal may also be subject to an additional 10 percent tax.

Taxpayers benefiting from a tax-free education-IRA distribution cannot take advantage of the Hope Scholarship or Lifetime Learning credit in the same year.

Taxpayers may choose to withdraw funds from a Roth IRA or traditional IRA without penalty if the funds will be used for the higher education expenses of the taxpayer, spouse, child, or even grandchild. A portion of the amount withdrawn will be taxable, but there will not be an additional 10 percent tax for an early withdrawal as long as the funds are being used for tuition, fees, books, equipment, and room and board for the year.

Student Loan Cancellation: If a borrower takes a community service job with a nonprofit, tax-exempt, charitable, or education institution that provides loan forgiveness, he or she may not need to include

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the cancelled amount in his or her gross income for the year. To qualify, the loan must have included a provision for this type of program; and it must have been issued by a qualified lender (such as the government, a tax-exempt public benefit corporation, or an educational institution) with the intention of helping borrowers attend educational institutions.

For more information on saving money on your taxes, contact a tax professional or visit the IRS' website at www.irs.gov. Taking advantage of these programs is one way to begin saving money immediately on your education.