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Education Credits

For the past several years taxpayers could reduce their taxes by using the HOPE credit or Lifetime Learning Credit. The HOPE credit was for college years one and two and the Lifetime Learning Credit for any year past that.

For 2009 and 2010 the HOPE credit has been replaced by the American Opportunity credit. The details are:

1. The first $2,000 spent on tuition, fees and books net you a $2,000 tax credit.
2. You get a credit of 25% of whatever you spend above that, limited to an extra $500 credit (in other words, 25% of the next $2,000 spent).
3. It’s 40% refundable, so even if your income tax is zero, you’d get 40% of the credit that you otherwise would have received.
4. However, just like the HOPE credit, this credit is not available if you make too much money. The credit you could get is phased out between $160,000 and $180,000 of income for joint tax returns and $80,000 and $90,000 for someone filing a single return.

The Lifetime Learning credit still exists as well:

1. 20% of the first $10,000 of tuition and fees (not books!).
2. This used to be a significant credit for the junior and senior years of college. Given that the American Opportunity credit covers those years, it’s now applicable to graduate programs.

Other things to know about these credits:

1. These credits are taken on the return of the taxpayer claiming the dependency exemption for the student, regardless of who paid the tuition or how it was paid (via loans, for example). The only way these credits can normally be taken on the student’s tax return is if no one, including him/herself, claims a dependency deduction for that student.
2. The credit is based on what you paid in a given calendar year, and that can be difficult to determine given all the scholarships and grants that one typically gets. The college does prepare

a Form 1098-T that is supposed to show what you paid, but personally, whenever I've been able to compare the form to what someone actually paid – they're not the same. So just be sure you keep good track of what you (or anyone else) actually paid in tuition plus whatever was paid via a student loan.

OTHER THOUGHTS – FINANCING / SAVING

My first advice is to talk to your financial advisor. However, here are some thoughts we have:

1. Know that transferring money to your children, while it might save taxes, will mean they will be expected to pay more of their education by the financial aid folks. Now, if you make a good living you might not get any assistance anyway, and so it would make sense to transfer money and save taxes, but if you make an "average" amount of yearly income I sometimes wonder if it's worth saving 15 -20% of tax on the interest earned on the money transferred. Suppose you transfer $20,000 to your child over the years, and the average balance is $10,000. If interest rates are 2%, that's $200 of interest; at 20% tax rate that's $40 of tax "saved". Compare that to how much of that $20,000 will be expected to be used for college since it belongs to the child instead of you! If you're an investing wizard and can generate tens of thousands of capital gains, that's another story, but for the rest of us…

2. 529 plans and the like. Again – consult your financial advisor. Just realize that there is no tax deduction for these contributions (you will save about $435 in Michigan taxes on $10,000 put into a Michigan 529 plan). The interest grows tax-free; will not be taxed if used for education. Can be transferred to other family members, and is a good way for the rich uncle or grandma to fund a child's education!

Please feel free to send me an email if you have any further questions.

Jeff Mulder, CPA
VanderLugt, Mulder, DeVries & Elders
2900 28th Street SW
Grandville, MI 49418
Jeff@vmde.com