

Education Credits

The HOPE credit and the Lifetime Learning credit for 'qualified tuition and related expenses' (see below) may allow you to turn part of the higher education expenses you incur for yourself, your spouse, or your dependents into tax savings.

The maximum HOPE credit a taxpayer may claim for 2004 is \$1,500 per year per student, for the first two years of undergraduate education at an eligible educational institution. The maximum HOPE credit amount is adjusted for inflation annually. The maximum Lifetime Learning credit that may be claimed is \$2,000 per year per taxpayer, for any post-high school education (including graduate-level courses and courses to acquire or improve job skills) at an eligible educational institution. The maximum Lifetime Learning credit will not be adjusted for inflation.

Generally, eligible educational institutions are accredited schools offering credit toward a bachelor's or associate's degree or other recognized post-high school credential, and certain vocational schools.

The HOPE credit is available only for the qualified tuition and related expenses of an eligible student, i.e., a student who's enrolled in a degree or certificate program at an eligible educational institution on at least a half-time basis, and who has never been convicted of a federal or state felony drug offense. The Lifetime Learning credit is not subject to the eligible student/felony drug offense restrictions, and may be available for a student taking only one course.

The HOPE credit and the Lifetime Learning credit aren't allowed for an expense that's otherwise deductible. But, for qualified tuition and related expenses paid through 2005 for an individual, an otherwise eligible taxpayer may choose to claim the appropriate credit or the deduction allowed for those years for higher education expenses. In most cases, taxpayers will be better off taking the credit, but there are circumstances in which taxpayers should elect out of the credit and claim the deduction instead.

A taxpayer may claim a HOPE credit or a Lifetime Learning credit for a tax year and exclude from gross income amounts distributed (both the principal and the earnings portions) from a Coverdell education savings account (formerly called an education IRA) for the same student, as long as the distribution isn't used for the same educational expenses for which a credit was claimed. Similarly, a taxpayer may claim a HOPE credit or Lifetime Learning credit for a tax year and also exclude from gross income amounts distributed (both the principal and the earnings portions) from a qualified tuition program (also known as a 529 plan) on behalf of the same student, as long as the distribution isn't used for the same expenses for which a credit was claimed.

The HOPE/Lifetime Learning credits may not be claimed in the same tax year for the same expenses, but each may be claimed for different expenses. For example, in the same tax year, a taxpayer may claim the HOPE credit for the qualified tuition and related expenses of one or

more qualifying dependents, and may claim the Lifetime Learning credit for the qualified tuition and related expenses incurred for himself.

In order to be eligible for the HOPE credit or the Lifetime Learning credit for a tax year, qualified tuition and related expenses must be paid during that tax year for education furnished during an academic period (e.g., semester) that starts within that tax year or within the first three months of the following year. Under this rule, taxpayers have a timing option. For example, for a semester beginning in Jan. of Year 2, a taxpayer may pay the expenses in Year 1 or Year 2. The credit will be available in whichever year the payment is made.

The HOPE/Lifetime Learning credits are nonrefundable -- i.e., they can reduce regular income taxes to zero but cannot result in the receipt of a refund. And the credits are allowed only to the extent that the taxpayer's regular income tax liability exceeds his or her tentative minimum tax. If the expenses on which the HOPE/Lifetime Learning credits are based are later refunded, the credits may have to be recaptured -- i.e., the tax for the refund year may be increased to account for a recomputed credit for the earlier year.

As noted above, the HOPE/Lifetime Learning credits are based on the payment of qualified tuition and related expenses. These are the expenses for tuition, books and academic fees that are required for enrollment or attendance at an eligible educational institution. Qualified tuition and related expenses do not include student activity fees, athletic fees, insurance expenses, room and board, transportation costs and other personal living expenses. They also don't include the cost of any course or education involving sports, games, or hobbies unless the course or education is part of the student's degree program.

The amount of qualified tuition and related expenses taken into account in computing the HOPE/Lifetime Learning credits must be reduced by tax-exempt scholarships and fellowships, certain military benefits, and any other tax-exempt payments of those expenses other than gifts or bequests.

For 2004, both the HOPE credit and the Lifetime Learning credit are phased out ratably for married taxpayers filing jointly with adjusted gross income (AGI), with certain modifications, between \$85,000 and \$105,000. That is, the credit is reduced if the modified AGI is above \$85,000 and is unavailable if it's \$105,000 or more. For taxpayers who aren't married filing jointly, the phase-out range is \$42,000 to \$52,000. These phase-out amounts are adjusted for inflation annually. Neither the HOPE credit nor the Lifetime Learning credit is available for taxpayers who are married filing separately.

Eligibility for the HOPE and Lifetime Learning credits are subject to a number of technical requirements not discussed above. Please give us a call if you would like to discuss your eligibility for these credits and how to claim them.