



# *Financial Aid 201*

*Your Guide to Understanding the basics  
of the Federal and Institutional Financial aid System and Available Options.  
Please Seek Professional advice in reference to these options.*

## *College Related Tax Provisions*

Tax legislation over the past 10 years has introduced a number of education related tax provisions. The legislation created the Coverdell Education Savings Accounts (Education IRA), 529 Savings Plans, 529 Prepaid Tuition Plans, Hope Scholarship tax credit, Lifetime Learning tax credit and a deduction for interest on qualified education loans. Each has a large number of different rules and guidelines, many of which conflict and cause problems with receiving the tax benefit from the others. Following is a very brief overview of the highlights of the tax provisions.

### *Coverdell Education Savings Account (Education IRA)*

The Coverdell Education Savings Account (Education IRA) is a new type of "ESA" that parents can use to save money for a child's education. The Coverdell Education Savings Account will reduce the overall cost of sending a student to college. However, up until 2007, the Coverdell Education Savings Account was considered on the financial aid application as an asset of the student thus reducing aid eligibility aid. Any distributions from the Coverdell Education Savings Account (Education IRA) would count as income for the student on the financial aid application and be assessed at 20%. If your modified adjusted gross income is less than \$110,000 (\$220,000 if filing a joint return), you may be able to establish a Coverdell ESA to finance the qualified education expense of a designated beneficiary. The maximum contribution is \$2,000 a year. The only problem here is that most families are past the stage of savings and need immediate assistance with financial aid concerns.

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### *Hope Scholarship Tax Credit*

For the tax year, you may be able to claim a Hope credit of up to \$1,800 for qualified education expenses paid for each eligible student. A tax credit reduces the amount of income tax you may have to pay. Unlike a deduction, which reduces the amount of income subject to tax, a credit directly reduces the tax itself.

The amount of your Hope credit for 2010 is gradually reduced (phased out) if your MAGI is between \$48,000 and \$58,000 (\$96,000 and \$116,000 if you file a joint return) This simply means that if you have income between these numbers and pay qualified education expenses of higher education, you are eligible.

- > The credit is equal to 100% of the first \$1,200 of qualified higher education expenses and 50% of the second \$1,000 of qualified higher education expenses. (or \$1,800)
  - > The credit is allowed for two taxable years per student.
  - > The credit is only allowed for the first two years of post-secondary education.
  - > The student must be enrolled at least half time for at least one semester during the tax year.
  - > The family may claim multiple Hope Scholarships in the same year if the family has multiple students that meet the guidelines. It is on a per-student basis.
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## *Lifetime Learning Tax Credit*

- > The amount of your Lifetime learning credit for 2010 is gradually reduced (phased out) if your AGI is between \$48,000 and \$58,000 (\$96,000 and \$116,000 if you file a joint return).  

The credit is equal to 20% of the first \$10,000 of qualified higher education expenses paid by the tax payer for all eligible students. The maximum credit is \$2,000.
  - > The credit may be claimed for an unlimited number of years.
  - > The credit does not vary according to the number of students. The credit is determined using qualified higher education expenses of all family members. It is on a per-taxpayer basis.
  - > Students do not need to be half time to qualify for credit. Students could be working toward a degree or acquiring or improving job skills at the institution.
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## *529 Savings Plan*

529 Savings plans allow participants to save money in a special college savings account on behalf of a designated beneficiary's qualified higher education expenses. Contributions can vary, depending on the individual savings goals. The plans offer a variable rate of return although some programs guarantee a minimum rate of return. Most states exempt earnings from state income tax and some states allow families to deduct the full or a partial amount of their contribution from their state income taxes. The value of a Section 529 Savings Plan is considered an asset of the parent.

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## *529 Prepaid Tuition Plans*

Several states now allow for an arrangement under which a trust fund may be specifically designated for tuition prepayment. Tuition prepayment plans generally cover tuition and fees and not room, board, books and other expenses included in the cost of attendance. Tuition and fees generally account for about 20% - 50% of costs at any given school. As to the Higher Education Act of 1965 such tuition prepayment plans are not to be reported as assets for federal student aid purposes. But, the annual value of the tuition prepayment will either be used to reduce the student's cost of attendance or be counted as estimated financial assistance. In effect, money in a tuition prepayment plan is assessed at 100%.

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## *Student Loan Interest Deduction*

The Taxpayer Relief Act of 1997 restored a deduction for interest paid on qualified education loans. The deduction is equal to the interest paid during the tax year on any qualified education loan up to an annual maximum. The deduction applies to interest paid after December 31, 1997. The limit on the amount of the deduction is \$2,500. There are income limits and restrictions on which loans qualify for the deduction and limits and restriction on what is a qualified higher education expense.