

EDUCATION TAX CREDITS AND THE TUITION DEDUCTION

When it comes to reducing your tax liability, the more questions you ask, the more you can learn and save. Here's how the college tuition deduction and education tax credits work.

WHAT DO I NEED TO KNOW ABOUT THE HOPE SCHOLARSHIP CREDIT?

The Hope Scholarship credit amounts to 100 percent of the first \$1,000 of a college student's tuition and fees (not including room and board or books) plus 50 percent of the next \$1,000 at an eligible educational institution. So the maximum credit is \$1,500 for each qualifying student per year. The Hope credit can be claimed for each of the first two years of college studies for each student. Students must be enrolled in a degree or credential program for at least half the normal full-time workload for their courses of study for at least one academic period beginning during the year.

WHAT ARE THE INCOME LIMITATIONS FOR THE HOPE CREDIT?

The Hope credit is gradually reduced if your modified adjusted gross income (MAGI) exceeds \$42,000 for single filers and \$85,000 for joint filers. Once a single filer's income reaches \$52,000, the credit is eliminated; for joint filers, the cap is \$105,000. Regardless of your income, you cannot claim the credit if you are married filing a separate return.

WHO QUALIFIES FOR THE LIFETIME LEARNING CREDIT?

The Lifetime Learning credit is designed to help subsidize college expenses after the first two years. This credit, which is less restrictive than the Hope credit, is equal to 20 percent of qualified expenses. The maximum amount of qualified tuition and expenses that can be used to calculate the Lifetime Learning credit is \$10,000; therefore, the maximum credit is \$2,000 for 2004. The income phase-out rules are the same as for the Hope credit.

The Lifetime Learning credit maximum is calculated per taxpayer and does not vary based on the number of students in a taxpayer's family. Keep in mind that it doesn't matter whether the student attends college full or part time or whether a course leads to a degree. The credit is available in any year the Hope credit is not claimed for the same eligible student and is available for an unlimited number of years.

WHAT IF TWO OR MORE CHILDREN ATTEND COLLEGE FOR THE FIRST TIME?

A Hope credit of up to \$1,500 can be claimed for each qualifying student. For example, if you have twins who are both college freshmen, you can claim a Hope credit for each, for a total of up to \$3,000. However, the Lifetime Learning credit has an annual limit of \$2,000 per family, regardless of how many household members are eligible.

HOW DOES THE DEDUCTION FOR COLLEGE TUITION WORK?

Higher-income taxpayers who expect to receive little, if any, benefit from the Hope or Lifetime Learning credits may be able to get some help from the relatively new tax deduction for college tuition. If your MAGI is less than or equal to \$130,000 if you're married and filing jointly, or \$65,000 if you are a single filer, you can deduct up to \$4,000 of college tuition and fees paid for you, your spouse or dependents for the 2004 and 2005 tax years. This is an above-the-line deduction, which means you don't have to itemize to claim it.

Those with MAGIs between \$130,000 and \$160,000 (joint) and \$65,000 and \$80,000 (single) can claim a deduction of up to \$2,000 for the year. The deduction is not available to those with MAGIs that exceed these ranges.

These amounts are scheduled for repeal after 2005, however.

Keep in mind that you cannot take the tuition deduction and claim a Hope credit or Lifetime Learning credit for the same student. Like the tax credits, you cannot claim the deduction if you're married and filing separately from your spouse.

HOW DO I CHOOSE BETWEEN THE TUITION CREDITS AND THE DEDUCTION?

It's important to remember that the most lucrative education tax breaks are the Hope Scholarship credit and Lifetime Learning credit. Tax credits are always more valuable than deductions. A \$1,000 credit saves you \$1,000 in taxes. In the 28 percent bracket, a \$1,000 deduction would only save you \$280. 