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A Note from Paul - Education Issue

It's back-to-school time across Oklahoma. At this time of year, educational issues move to the forefront of our lives. In order to help your family make a smooth transition into the school year, I have dedicated this issue to an in-depth discussion of education as impacted by the tax laws. In this issue, I will cover the new federal taxation credit for teachers; the Hope Credit; Lifetime Learning Credit; Coverdell IRAs; State College Savings Plans (otherwise known as "529 plans") concentrating on Oklahoma's plan; community service loan forgiveness, the tax implications of grants, scholarships, and "work study;" and the student loan interest deduction. Don't forget I am offering 20% off of your next tax return or service for every new client that you refer me. As always, if you have questions, please feel free to call me.

Good News for Teachers

Congress has acted to give teachers a larger deduction in relation to expenses spent on classroom supplies. Since teachers are employees, their expenses for books, supplies, computer equipment and software, and other supplementary materials used in a classroom, were only allowed if they itemized. Even then, only as a miscellaneous itemized expense, subject to reduction by 2% of their adjusted gross income.

If you're a teacher with \$250 in classroom expenses, even if you do itemize, an income of as little as \$12,500 wiped out your deduction. ($\$12,500 \times .02 = \250) Under the Job Creation and Worker Assistance Act of 2002, as much as \$250 of your classroom expenses can be deducted without itemization or reduction. This only applies if you're a teacher, instructor, counselor, principal, or aide and work in a classroom of kindergarten through grade 12.

What are Education Credits?

Education credits were introduced with the passing of the Tax Reform Act of 1997. There are two credits available; Hope Credit and Lifetime Learning Credit. The Hope Credit allows a maximum credit of \$1,500 and the Lifetime Learning Credit allows a maximum credit of \$1,000. It should be noted that if a student receives a scholarship, grant or is reimbursed by an employer for the tuition, then not all of the credit may be available.

Hope Credit

The Hope credit is reserved for students in their freshman and sophomore years of college. It works by allowing a credit of 100% of the first \$1,000 and 50% of the next \$1,000 spent on tuition. The maximum credit allowed is \$1,500. For this credit, students need to be taking at least 6 hours in college AND actively seeking a degree. Also, the student must be free of any drug and/

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Education Credits, Continued

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or felony charges to qualify for this credit. To choose the best credit see "Which Credit Should I Use?" section below.

Lifetime Learning Credit

The Lifetime Learning Credit may be used for ALL students, regardless of the year of schooling. It works by allowing a credit of 20% of the first \$5,000 spent on tuition. The maximum credit allowed is \$1,000.

This credit may be taken regardless of the number of hours are being taken. Also, a student does not have to be in a program that will lead to a degree. To choose the best credit see "Which Credit Should I Use?" section below.

What Expenses Qualify for this Credit?

This credit is only intended for use on tuition and required fees associated with taking college courses. These courses MUST be taken at an accredited college, university or vocational school. Qualifying expenses will be those that are paid out of pocket. So, if you have a scholarship that pays for all of the required tuition and fees, you will not be able to claim this credit. The total expenses paid for college will be reported to the student on Form 1098-T.

Expenses that DO NOT qualify:

- Books, supplies, and equipment

purchased for classes

- Room & board
- Medical Insurance

Are there any Annual Gross Income limitations?

Yes; This credit is subject to phase-out at \$80,000 and no credit is allowed for AGI's over \$100,000 for married filing joint (\$40,000 and \$50,000, respectively for other taxpayers).

Who can claim this deduction?

If this tuition is for a dependent, whom ever claims the dependent qualifies for the credit. If the AGI exceeds the numbers from above, the person(s) claiming the dependent can give up the exemption and allow the dependent to claim the credit. In doing this however, the exemption is lost entirely because the dependent will not be able to claim the exemption but they will still be able to claim the credit. NOTE: Those filing married filing separate will not qualify for this credit.

Can I deduct the costs for more than one dependent?

Yes; As long as you meet the requirements for the credit you are wanting to use, you may take a credit for the tuition costs for each student. It should be noted though, that if you use the Lifetime Learning Credit, the total credit available will be limited to \$1,000 regardless of the number of students.

Maximizing you're your education credits will lower your education burden.

Student Loans Interest and Scholarships

Student Loans

Student Loan interest may now be deducted for the entire life of the loan up to \$2,500 in interest per year. The phase out for deductibility now starts at \$50,000 AGI for single taxpayers and \$100,000 for married taxpayers. Previously the phase outs were much lower.

Scholarships

If you're seeking a degree, scholarship funds used to pay tuition, fees,

books, supplies and equipment are tax-exempt. But amounts covering other expenses, such as room and board, are subject to tax. Also taxable are payments for teaching, research or other services required as a condition of receiving the grant.

Work-Study

Payments for work-study are taxable. But since they are earned by the student, it is usually at a lower tax rate than the parents.

Disclosure: The information provided in this newsletter is of a general nature and isn't intended to address the circumstances of any particular individual, business or other entity. Please consult your CPA or Attorney if you have questions or concerns.

New and Improved Education Related Tax Benefits:

On the Federal Level:

Students and their parents make out big again this year. If you're single and make less than \$65,000 (\$130,000 on a joint return), you can get a new college tuition deduction of as much as \$3,000 for yourself or a dependent child. If you meet the income qualifications, you can take the Hope or Lifetime Learning tax credits (please see front page), which are even more valuable tax breaks. (A warning: you can't claim the student deduction AND either of the tax credits.)

If you've graduated from college, your employer can now give you as much as \$5,250 per year in tax-free graduate school assistance.

The Educational IRA, now known as the Coverdell Education Account, now allows tax-free withdrawals for use in grades K-12 to pay for tutoring, computer equipment, room, board, uniforms, tuition and extended day programs. Annual contribution limits have been increased to \$2,000. In the past, the limit was \$500 per year per child and the money could only be used for college expenses. Distributions from Section 529 accounts for college ex-

penses are now tax-free. In the past, they were taxed at the child's rate. The Section 529 contribution limits were also raised. Under prior law, there was a special five-year gift tax election, which allowed you to contribute as much as \$50,000 per child. In effect, you were accelerating five \$10,000-per-year exclusions into a single year. Since the annual gift tax exclusion has increased to \$11,000, you can now contribute as much as \$55,000 per child in a single year.

At the Oklahoma State Level:

The new state tax deduction, implemented this year by state lawmakers, makes the Oklahoma College Savings Plan a particularly attractive choice among Section 529 College Savings Plans. Beginning this year, can deduct every penny you've contributed to your child's college savings plan, **up to \$2,500**, from your state income tax that year. All 529 plans will benefit from a law, implemented this year as well, that exempts any earnings used for college-related purposes from federal taxation. The next article discuss 529 plans.

Now would be a good time to add to your investments as the market is at a three year low.

OKLAHOMA 'S COLLEGE SAVINGS PLAN (OK 529 PLAN)

Oklahoma families can now save for college and watch their investment grow tax-free, thanks to the new Oklahoma College Savings Plan. For as little as \$25, Oklahomans can now begin saving for their children's college education and receive significant state and federal tax benefits.

Under the plan, earnings on funds invested for higher education expenses are not taxed during the time the child is growing up. It is only when the child starts attending college and money is withdrawn that the earnings become taxable, but only at the child's tax rate. Usually, children are taxed at much lower rates than their parents. Enabling the investment to grow tax-free means that a family's college savings are able to grow much faster than they could if the earnings and divi-

dends were subject to annual taxation.

Other key advantages of the program include:

- accounts can be established through an initial investment of \$25, or as little as \$15 per pay period through payroll deduction;
- there are no income restrictions;
- funds can be used at nearly all colleges and universities in Oklahoma and elsewhere in the United States;
- funds can be used for tuition, certain room and board expenses, books, and required fees and supplies; and
- up to \$100,000 per child can be invested.

Additionally, the college savings account can be used at an in-state or out-of-state private or public institution. It is

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Shannon Ragsdale, Attorney at Law is offering a Basic Will Packet which includes a Simple Will, Power of Attorney and Advance Directive for Healthcare for only \$299 per couple or \$149 for one. Call today 274-3698.

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*Solid Financial Advice for the
21st Century*

529 Plans, Continued

entirely up to the student and his or her parents to make the choice of which institution is best for them. The plan can also be used for graduate, medical, law or post-secondary vocational-technical school as long as the institution is eligible to participate in federal financial aid programs. Unlike plans in other states, anyone - parents, grandparents, employers or friends - can establish a qualifying account under the Oklahoma plan.

For more information on the Oklahoma College Savings Plan, including an application, call tollfree 877.OK4.SAVING (877-654-7284) or <http://www.ok4saving.org>.

Interested citizens are encouraged to consult the Disclosure Booklet before opening an account to gain more information about the Oklahoma College Savings Plan. Accounts representing interests in the Plan are offered only through the Participation Agreement and the Disclosure Booklet, which describe the program. Neither contributions nor investment returns in an Oklahoma College Savings Plan Account are guaranteed. Investment results will vary based on market performance, and the value of investments can go up or down. Also, there is no guarantee or assurance that specific investment objectives will be met.

In Closing.....

CONSIDER ALL THE NON-TAX RAMIFICATIONS OF YOUR TAX DECISIONS. Earning a tax break won't always leave you better off. An example is the education IRA. These tax-sheltered accounts were created by Congress to help middle-income parents save for their child's college education. But if you have any expectation that your child will be eligible for financial aid in college, think twice before taking advantage of education IRAs for college savings. You could end up losing more in financial aid than you'll save in taxes. The reason:

IRA funds need to be held in a custodial account in your child's name. In determining how much a family can afford to contribute to the cost of college, financial aid formulas count assets held in a child's name much more heavily than assets in the parent's name. If you need help determining what avenue will best meet your family's educational needs, please do not hesitate to contact me.