Financial Wellness

Uncle Sam's education tax breaks

Once college acceptance letters arrive, members of the incoming freshman class can finally breathe a sigh of relief and prepare for the next stage of their lives. Parents, too, typically make certain adjustments as their children head off to college. On the financial end, they may look at the costs of tuition, room and board, books and other expenses and wonder how their family will be able to afford it all.

There's little argument that attending college is expensive. Public or private, college costs have been rising for a long time. However, the expenses at most colleges and universities are generally less than the quoted prices. Most importantly, there are various ways to lessen the financial burden of attending college, including scholarships, grants and work-study programs. In addition, one key step parents can take is to look into the various federal tax breaks that are available for both saving and paying for college.

Savings opportunities

Section 529 Plans and Coverdell education savings accounts are two education savings opportunities that offer potential tax benefits for parents.

1 Section 529 plans*

Parents can fund a Section 529 plan either in a lump sum or through regular payments spread out over time. Some parents open a 529 account and start contributing to it when their child is first born. You may choose where your contributions will be invested from a menu of investment opportunities offered by the investment company that manages the plan.

Here are some features of Section 529 plans:

- Investment earnings accumulate tax deferred, and no federal income taxes are payable on withdrawals for your child's qualified educational expenses.
- Many states offer additional tax incentives to encourage residents to invest in an in-state plan.
- You retain control of the money in the account even after your child reaches age 18.
- You can change the account beneficiary to another qualifying family member if your child does not attend college or deplete the fund and you will not lose tax benefits.

Consider consulting your financial and tax professional for assistance to better understand all the intricacies and caveats of these plans and if they can benefit your situation.

2 Coverdell education savings accounts

These accounts allow a maximum contribution of $2,000 per child annually. However, this maximum is gradually reduced to zero for taxpayers whose modified adjusted gross income (AGI) is between $95,000 and $110,000 ($190,000 and $220,000 for joint filers).

Amounts you contribute to a Coverdell account will accumulate tax deferred at the federal level, and any earnings can be withdrawn tax free when the money is used for qualified education expenses, such as tuition, room and board, and books.

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However, if you withdraw money from the account for non-education purposes, then you might have to pay federal income taxes and a 10% penalty on the earnings portion of the withdrawal.

Education credits

There are two federal tax credits available to qualifying taxpayers for the payment of tuition and certain other higher education expenses.

1 The American Opportunity Tax Credit (AOTC)

This credit, worth up to $2,500, is available for the payment of tuition, enrollment fees and required course materials for the first four years of post-high school education for each eligible student in your family. The credit equals 100% of the first $2,000 of qualifying expenses plus 25% of the next $2,000. If the credit exceeds the amount of tax you owe, you can receive a refund of 40% of the remaining credit. There are income caps on eligibility for this credit: It is phased out for single taxpayers with modified AGI between $80,000 and $90,000 and for married couples with modified AGI between $160,000 and $180,000.

2 The Lifetime Learning Credit (LLC)

This is another valuable credit that can be worth as much as $2,000 a year. It is available for the payment of tuition and required enrollment fees at an eligible educational institution. It cannot be used for academic supplies, and no part of the credit is refundable. The credit is calculated as 20% of the first $10,000 of expenses.

Like the AOTC, there is an annual income cap on eligibility for the LLC credit. The credit is phased out for single taxpayers with modified AGI between $80,000 and $90,000 and for married couples with AGI between $160,000 and $180,000. If you claim the AOTC for a student for the tax year, you are not allowed to claim the LLC for the same student that year.

> Navigating the complexities of college pricing and investigating the ins and outs of various education-related tax breaks can be complex and time-consuming. Consider reaching out to a financial and tax professional for assistance.

If you have questions about your workplace retirement plan, please contact your Human Resources department or your retirement plan provider's customer service center.

*Certain benefits may not be available unless specific requirements (e.g., residency) are met. There also may be restrictions on the timing of distributions and how they may be used. Before investing, consider the investment objectives, risks, and charges and expenses associated with municipal fund securities. The issuer's official statement contains more information about municipal fund securities, and you should read it carefully before investing.