TaxTips EDUCATION/PARENTS 2013

Before we cover the various tax breaks available to parents, we would like to familiarize you with three important tax law concepts, tax deduction, tax credits, and phase-out.

TAX DEDUCTIONS AND CREDITS: What does it all mean?

Many of the tax reduction provisions we cover in this issue are in the form of tax credits, while others are called tax deductions. Tax credits are direct reductions of taxes. If you have incurred no tax, a tax credit is useless to you – unless it is a refundable tax credit. A tax deduction is a reduction of income, which indirectly reduces taxes (less income = less tax).

THE DREADED PHASE-OUT:
IT ROBS YOU OF YOUR TAX DEDUCTIONS AND CREDITS

Many of the provisions we refer to in this letter “phase out” at certain income levels. These phase-outs can limit, or even eliminate these tax breaks. Thus, if your adjusted gross income (AGI) falls below the phase out range, a full deduction or tax credit is allowed. If your AGI is exactly in the middle of the phase out range, then 50% of the deduction or credit is allowed. You get zero if you are above the phase out range.

TAX CREDITS: MORE CHILDREN, MORE BENEFITS

If you have children under the age of 17, you may be entitled to a Child Tax Credit of up to $1,000 per qualifying child in 2013. In most cases you must have a tax liability to benefit from this credit. The credit is reduced by $50 for every $1,000 of income over $110,000 for married couples filing jointly, $75,000 for singles and heads of household, and $55,000 for married filing separately. If you have three or more children and the tax credit exceeds the amount you owe the government, then you may qualify for a refundable credit, which would come to you in the form of a refund. The credit is completely phased out at AGI above $95,000 for singles and $130,000 for married couples.

ADOPTION CREDIT

The non refundable Adoption Credit of up to $12,970 is allowed for reasonable and necessary expenses (adoption fees, court costs, attorney’s fees and travel expenses) relating to legal adoption of any child age 17 or younger or a child with special needs of any age who is a U.S. citizen or resident alien. This is a non refundable credit.

Taxpayers with Adjusted Gross Income (AGI) above $194,580 and below $234,580 will have their credit gradually phased out. Those with AGI above $234,580 are not eligible for this credit.

Taxpayers claiming this credit must include with their tax returns one or more adoption-related documents. Therefore taxpayers claiming the credit will have to file a paper tax return and not e-filed.

DEPENDENT CARE CREDIT

The Child and Dependent Care Credit of up to $600 for one child and $1,200 for two or more, is available to parents with AGI of $43,000 or higher. For lower AGI, the credit could be as high as $1,050 for one child and $2,100 for two or more children.

EDUCATION TAX CREDITS AND DEDUCTIONS

THE AMERICAN OPPORTUNITY CREDIT

A credit of up to $2,500 per student is available in 2013 to parents (both as a student or the parent of a student) or students (if he/she is not a dependent) who as of January 1, 2013 had not completed their first four years of post-secondary education and had not previously claimed the Hope or American Opportunity Credit four previous times for the student. Qualified expenses for the credit include tuition and fees paid to a post secondary educational institution, as well as books and equipment required for the course.

To be eligible, the student must be in a program leading to a degree or certificate, must be enrolled at least half time for at least one academic period during the calendar year, and must not have been convicted of a drug felony.

The American Opportunity Credit can only be claimed once per student per year and cannot be claimed in conjunction with any other educational deductions or credits. For unmarried individuals, the phase-out is between $80,000 and $90,000 and for married filing joint taxpayers it is between $160,000 and $180,000. The credit is not available for those who are married filing separate.

THE LIFETIME LEARNING CREDIT

A credit of up to $2,000 is available to parents or to students (if he/she is not a dependent) for undergraduate, graduate, or professional courses at an eligible educational institution. It is also available for students studying less than half time for the purpose of acquiring or improving job skills. The credit may be claimed every year and the drug offense restriction does not apply.

You can claim the Lifetime Learning Credit for yourself, your spouse, or your dependent children. However, you may only claim one credit per student per year and, like so many of the tax law's provisions, it has a phase out. For unmarried individuals the phase out income is between $53,000 and $63,000 and for married taxpayers filing jointly $107,000 to $127,000. The credit is not available for married individuals filing separately.

TUITION AND FEES DEDUCTIONS

If you are "phased out" of the American Opportunity Credit and Lifetime Learning Credit, you may qualify to take the Tuition and Fees deduction of up to $4,000. To qualify, you have to pay tuition for yourself, your spouse, or a dependent and your income (AGI) has to be less than $65,000, if single or head of household and less than $130,000 if you are married. If you surpass $65,000/$130,000 threshold, you may still claim up to $2,000 in Tuition and Fees deductions. To qualify, your AGI has to less than $80,000, if single or head of household, and less than $160,000, if married. So maximize your 401(k), IRA, SEP, Keogh, self-employed health insurance and other deductions in order to reduce your AGI.

NYS COLLEGE TUITION DEDUCTION AND TAX CREDIT

NYS allows it's resident and non-resident filers to claim the college tuition itemized deduction. Additionally, residents are also allowed to claim a tax credit, instead of the itemized deduction. However, only undergraduate tuition is allowed for this deduction / credit.

SECTION 529: PRE PAID TUITION AND COLLEGE SAVINGS PLANS

These plans are run by individual states, with federal and state tax exemptions on the earnings. The plans, which are offered by all 50 states, are not uniform, and are still evolving. In many states, anyone --a parent, a grandparent, a relative, or a friend-- can set up an account for a future college student. You can even set up an account for yourself. The states differ in areas such as contribution limitation, tax deductions, and matching programs. All but three states are fully open to non-residents. Non-Residents may want to invest in other states' section 529 plans if they have taxable income in those states. The deadline to fund section 529 plans is December 31. However, non-residents should be aware that their home state may tax the earnings from Section 529 plans invested in other states. See additional information related to this topic in our Coverdell (Education IRA) section below.

Currently, North Carolina leads all other states, allowing contributions until the beneficiary's account balance reaches $400,000. Connecticut accepts contributions until the beneficiary's account balance reaches $300,000. New York has a contribution limit per beneficiary of $375,000 agragate maximum balance. Most states let you apply the funds to any eligible post secondary educational institution (college, grad school, business or trade school, etc). Furthermore, taxpayers in 35 states (residents and non-residents) can take a tax deduction on their state returns for contributions.

New York and Michigan resident and non-resident filers can take a tax deduction of up to $5,000 for singles and 10,000 if married filing jointly. Mississippi allows twice as much, up to $10,000 for singles and $20,000 for married filing jointly, Oregon taxpayers can deduct up to $2,170 for singles and $4,240 if married filing jointly, Utah taxpayers can deduct up to $1,780 (3,560 joint) per account while New Mexico, Colorado, West Virginia and South Carolina have no limit, subject to the maximum allowance contribution. The following states also allow deductions: Georgia, Idaho, Iowa, Kansas, Louisiana, Maryland, Missouri, Montana, Nebraska, Ohio, Oklahoma, Vermont and Wisconsin. By comparison, California, Massachusetts, and New Jersey do not allow any deductions.

Vermont now also offers an income tax credit of 10% of the first $2,500 contributed to an account, or up to $250 per year per taxpayer. The deduction generally favors taxpayers who can afford sizable contributions and who itemize deductions on their returns. The credit is available to everyone, including those who do not itemize, and does not favor large contributions; but you must have a tax liability to benefit from this credit as it is not refundable. Some states will invest the funds according to published guidelines while others will allow the owner to choose the investments. Most states allow the funds to be used to pay tuition in all states.

Please note that there are 50 different state plans that are constantly evolving and changing. We therefore recommend that you visit www.savingforcollege.com for most up to date information, or the applicable state website

REGULAR AND ROTH IRAs USED FOR EDUCATION

Taking money out of your regular IRA to use for educational purposes is no longer subject to the 10% penalty but is included in your income and taxed accordingly. However, you could withdraw the principal from your Roth IRA, without penalty and taxes, if it is withdrawn five years or more after the initial deposit.

COVERDELL EDUCATIONAL SAVINGS ACCOUNTS (EDUCATION IRA)

The 2013 rules for the Coverdell Educational Savings Accounts (formerly known as "Education IRAs") remain the same. The annual contribution limit is $2,000 per beneficiary and taxpayers are allowed to make contributions to Coverdell accounts in the same year that contributions are made to Section 529 plans. What's more, qualifying expenses include expenses at public, private, or religious elementary and secondary schools, as well as post-secondary schools, and under some circumstances, taxpayers may claim the American Opportunity and Life Time Learning Credits in the same year that "excludable distributions" are made from Coverdell accounts.

Contributions to Coverdell accounts for tax year 2013 can only be made on behalf of an individual under age 18, and must be deposited by April 15th 2014 (just like traditional or Roth IRAs). Withdrawals of principal and earnings are tax-free as long as they are used for education expenses. There are penalties for non-education usage withdrawals; however, the unused portion of the account may be transferred to another beneficiary in the same family. A contribution to an Education IRA is not deductible and is subject to phaseout, which is between $95,000 to $110,000 for singles and head of households, and between $190,000 to $220,000 for married taxpayers. Finally, a contribution to a Coverdell account is considered a gift. If you are considering making additional gifts to the same beneficiary, keep in mind the Coverdell account contribution. Annual gifts exceeding $14,000 to any one person must be reported to the IRS.

THANK YOU FOR READING

If you have any questions about the above material, please call us. Feel free to pass a copy of this letter to friends and colleagues. We appreciate and welcome your referrals.

SELECTED STATE BY STATE 529 PLANS

		MAXIMUM DEDUCTION			
STATE	MAX. CONTRIBUTION	SINGLE + HEAD OF HOUSE.	MARRIED FILING JOINTLY	TELEPHONE	WEBSITE
ALABAMA	$350,000	$5,000	$10,000	888-324-5057	www.collegecounts529.com
CALIFORNIA	$350,000	0	0	877-728-4338	www.scholarshare.com
COLORADO	$280,000	$280,000*	$280,000*	888-572-4652	www.scholars-choice.com
CONNECTICUT	$300,000	$5,000	$10,000	888-799-2438	www.aboutchet.com
DC	$260,000	$4,000	$8,000	800-987-4859	www.dccollegesavings.com
FLORIDA	$394,000	NO STATE INCOME TAX	NO STATE INCOME TAX	800-552-4723	www.myfloridaprepaid.com
GEORGIA	$235,000	$2,000	$2,000	877-424-4377	www.path2college529.com
HAWAII	$305,000	0	0	866-579-3343	www.hi529.com
ILLINOIS	$350,000	$10,000	$20,000	877-432-7444	www.brightstartsavings.com
KANSAS	$325,000	$3,000	$6,000	800-529-2203	www.learningquest.com
LOUISIANA	$289,900	$2400 PER ACCOUNT	$4800 BENEFICIARY	800-259-5626 X1012	www.startsaving.la.gov/savings
MAINE	$360,000	$250 IF FEDERAL GHI < $100,000✦	$250 IF FEDERAL GHI < $200,000✦	877-463-9843	www.nextgenplan.com
MASSACHUSETTS	$300,000	0	0	800-544-2776	www.fidelity.com/ufund
MICHIGAN	$235,000	$5,000	$10,000	877-861-6377	www.misaves.com
MINNESOTA	$235,000	0	0	877-338-4646	www.mnsaves.org
NEW JERSEY	$305,000	0	0	877-465-2378	www.hesaa.org or njbest.com
NEW YORK	$375,000	$5,000	$10,000	877-697-2837	www.nysaves.org
PENNSYLVANIA	$368,600	$13,000 PER CONTRIB/CHILD	$26,000❋	800-440-4000	www.patap.org
RHODE ISLAND	$395,000	$500	$1,000	888-324-5057	www.alliancebernstein.com
TENNESSEE	$235,000	NO STATE INCOME TAX	NO STATE INCOME TAX	888-486-2378	www.tnbest.org
TEXAS	$370,000	NO STATE INCOME TAX	NO STATE INCOME TAX	800-445-4723	www.enterprise529.com
UTAH	$390,000	$1,780 PER ACCOUNT	$3,560 PER ACCOUNT	800-418-2551	www.uesp.org

*Deduction is limited to contribution amount. Contribution amount cannot exceed cumulative lifetime contribution maximum (full amount of contribution).

✦Per beneficiary ❋ Each spouse must have $13,000 income to get maximum deduction.