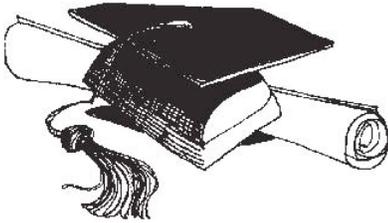

Children and Family Finances – Paying for College

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With college costs rising each year, paying for college can seem like a daunting task. In addition to using exempt income from withdrawals for Coverdell ESAs and Qualified State Tuition Program (QSTP), also known as 529 plans, regular IRAs and cashed saving bonds, this fact sheet covers some of the other ways to cover college costs.

Scholarships and Grants

The advantage of using scholarships and grants to pay for college is that there are no upfront costs and the money does not have to be paid back. The money is not taxable if used for qualified education expenses. The main place to apply is using the Free Application for Federal Student Aid (FAFSA) at <http://www.fafsa.ed.gov/>. Many universities and colleges also require the family to fill out their own student aid form in addition to the FAFSA. They will use the information to provide the student with a financial aid award that may consist of Federal Grants, School related grants and scholarships, work study job, and subsidized and unsubsidized loans based on academics and financial need.

Scholarships are also available for athletes and sometimes for the performing arts. Departments may also have scholarships that are available for their majors. Organizations, on and off campus, offer scholarships based on affiliation, ethnicity, interests, leadership, community service, religion and many other criteria. Check with the high school guidance counselor and college or university to see where to get more information.



Business and Veteran's Tuition Assistance

Some business offer tuition assistance for their employees. This usually requires the employees to pay the tuition which is then reimbursed when the course has been completed satisfactory.

The Department of Veteran Affairs offers assistance to members of the armed forces. The old GI Bill (Montgomery GI Bill) required veterans to pay into a program. When a veteran attended a school or job training program, he/she could access the Montgomery GI Bill savings and receive a monthly deposit based on how

many credits are being taken. This money can be used to pay for tuition costs, books, groceries, rent, etc. However, with recent tuition hikes, this money may not even cover tuition.

The current program (Post-9/11 GI Bill) does not require the vet to pay into the program. It is simply a benefit for military service. Those who serve three years or more receive 100% of the benefits over 36 months while those who serve less and are discharged honorably receive a lower percentage. This program pays up to the highest in-state tuition of the most expensive state school. So, if a student decides to attend a private university, then the veteran would be required to make up the difference. In addition to paying tuition costs, veterans will receive a \$1,000 annual stipend for books as well as the equivalent housing allowance that sergeants (E-5) would receive while living in the zip code where the school is located.

Tax Deductions and Credits for Education Expenses

The following tax deductions and credits below will help you pay for college. See the fact sheet entitled, *Children and Family Finances – Saving for College*, for more information on saving for college.

Remember, you cannot double dip. The same qualifying expense cannot be excluded from income and used to meet the test for a tax deduction or credit. Most tax software packages (including the free e-file software on the IRS website) will assist you in deciding if it would be more advantageous for you to use the deduction or one of the education credits covered below.



Tax Deductions

In 2009, up to \$4,000 can be taken as an adjustment to income on Federal Tax form 1040A or 1040. Since this is an adjustment to gross income, you can take it even if you do not itemize your deductions. You can claim the expenses for yourself, your spouse, and any dependent you can claim on your tax return. The main qualified expense is tuition. Related fees can only be included if they “must be paid to the institution as a condition of enrolment”.

Hope Credit

Up to \$1,800 in federal tax credits may be taken for each eligible first and second year, post-secondary student. The student must be pursuing an undergraduate degree or other recognized education credential and be enrolled at least half-time for one academic period during the year. The student may not have any felony or drug convictions. The credit cannot be claimed if your filing status is married filing separately. You cannot be

claimed as a dependent on another person's tax return. There are also income restrictions. You cannot use this credit if you claim the lifetime learning credit or a tuition and fees deduction for the same student.

What are the Qualified Higher Education Expenses?

Tuition and fees required to enroll in or attend any college, university, vocational school, or other postsecondary educational institution eligible to participate in a student aid program administered by the Department of Education (Qualified expenses do not include expenses for room and board or for courses involving sports, games, or hobbies that are not part of a degree program.)

Expenses must be reduced by the amount of any of the following benefits received by the student.

- Tax-free scholarships
- Tax-free withdrawals from a Coverdell ESA
- Any nontaxable payments (other than gifts, bequests, or inheritances) received for education expenses or for attending an eligible educational institution, such as:
 - Veterans' educational assistance benefits
 - Benefits under a qualified state tuition program
 - Tax-free, employer-provided educational assistance
 - Any expenses used in figuring the Hope Scholarship Credit and Lifetime Learning Credit



Eligible Educational Institution

Eligible educational institutions include any college, university, vocational school, or other postsecondary educational institution that is described in section 481 of the Higher Education Act of 1965 (20 U.S.C. 1088) and, therefore, eligible to participate in the student aid programs administered by the Department of Education. This category includes virtually all accredited public, nonprofit, and proprietary postsecondary institutions.

Lifetime Learning Credit

Once you cannot claim the Hope Credit you may be able to claim the Lifetime Learning Credit. You cannot claim both credits for the same student. If the expenses are more than \$9,000 per year, you are usually better off taking the Lifetime credit. You cannot claim a tax deduction and a lifetime credit for the same expenses or any expenses that were paid with income that is received tax-free. This credit allows you a credit of up to \$2,000. The student does not need to be pursuing a degree or other credential. It is available as long as the student takes one or more classes and the felony drug conviction rule does not apply. The lifetime learning credit is

based on qualified education expenses for yourself, your spouse, or a dependent that you claim on your tax return. If the student cannot be claimed as dependent (for example, they are over 24) then they are considered to have paid the expenses and may take the credit. Qualified expenses and educational institutions are similar to the hope credit

Student Loans

Because you must repay your student loans, they are not considered income. Expenses paid with student loan funds are not considered paid with tax-free money when figuring the tuitions deductions or educational credits described earlier in this fact sheet. The following section is a brief explain of the deduction of student loan interest payments for more detailed information see IRS publication 970, Chapter 4.



Interest Deduction

You can deduct qualified student loan interest on loans for yourself, your spouse, or a student who was a dependent when the loan was taken out. See chapter 4 of IRS publication 970 to see who qualifies as your dependent. To qualify student loan must have been used for tuition, fees, room and board, books, supplies, and equipment, or other necessary expenses such as transportation. Room and board cannot be more than the allowance for room and board determined by the institution or the actual amount of student housing. In addition to the simple interest on the loan you can deduct the loan origination fee and capitalized interest (interest that is add to the outstanding principal) interest on revolving lines of credit if the line of credit (credit card) is used solely for qualified education expenses, interest of voluntary interest payments, and interested on consolidated or collapsed student loans. You can claim the deduction if your filing status is any status other than married filing separately and noe one else is claiming the deduction.

You can deduct the smaller of \$2,500 or the actual amount of interest paid. The amount you can deduct is further limited by your income. You should receive a form 1098-E with the amount of interest that qualifies from your lender. See chapter 4 of IRS publication 970 for a worksheet to help you figure the amount of interest you can claim.

This one is of a set of fact sheets entitled *Children and Family Finances*. You may also want to see the series *Planning for Baby*.

This fact sheet was revised from *Planning for Baby – Family Finances* by Hayhoe, C., Jamison, S. Dillard, A. F., and Chase, M.
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