

34th Annual Tax Symposium

HELP! MY (CLIENT'S) CHILD IS STARTING COLLEGE

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I. INTRODUCTION

- A. The fall is when many parents and their children think of college – football games, parties (and maybe attending classes).
- B. However, for many families, the fall is a time of stress. How will they pay for college for their child(ren)?
- C. The cost of college has substantially outpaced the annual inflation rate.
- D. This presentation will cover various topics to assist you and your clients with college funding.

II. PRACTICAL STEPS THAT CAN SAVE MONEY

- A. Advanced Placement Programs. Many students may be able to get college credit while in high school by doing well on Advanced Placement exams administered by the College Board.
 - 1. There are 36 available AP exams for 2025.
 - 2. The College Board has a search tool that lists information on colleges that offer credit for AP courses. See <https://apstudents.collegeboard.org/getting-credit-placement/search-policies>
- B. Dual Enrollment Programs. Some high schools have dual enrollment programs, which allow a high school student to attend college-level classes. Not all schools offer this, but if this is available, this can result in a substantial savings in college tuition. Information can be found at <https://www.transferology.com/index.htm>

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- C. Choose a low-cost college. This can be a community college or a full 4-year college. In Michigan, we are very lucky to have a wide range of state universities which have reasonable (?) rates for college tuition.

Completing an associate's degree at a community college and then transferring to a 4-year college can greatly reduce the overall tuition expense.

III. SCHOLARSHIPS & FINANCIAL AID

- A. For financial aid, colleges use the Student Aid Index (SAI). This determines the family's expected contribution for college education. The SAI uses a higher contribution percentage for assets owned by the student (generally 20%), but a lower rate of 5.64% for assets owned by the parents.
- B. Some colleges offer a package of aid that will meet 100% of the student's need for funding. They will determine the amount that needs to be provided above the SAI. A list of institutions providing 100% of the student's need can be found at <https://blog.collegevine.com/schools-that-meet-100-percent-financial-need>
- C. Scholarships - Scholarships can be awarded for athletics, music, drama, etc, plus scholarships for academic achievement. A website listing scholarships available is www.scholarships.com
 - 1. Taxation – IRC § 117 provides that scholarship funds for tuition, fees, books and required supplies are not taxable to the student. However, scholarship funds used for room and board are taxable to the student.
 - 2. There are many scholarships that are not awarded each year because nobody applied for them. These typically would be scholarships aimed at a small class of students – such as students with blue eyes! Investigate all scholarships.

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D. Federal Student Aid

1. Available to students enrolled in a school participating in the federal student aid program (most, but not all, colleges participate).
2. Aid is based on need and can include work-study, grants, subsidized or unsubsidized loans.
3. Students must complete the Free Application for Federal Student Aid (FAFSA) form. This determines the SAI.
4. The FAFSA form was recently simplified.

E. Federal Student Loans – There are a number of different types of federal student loans. These include direct subsidized loans, direct unsubsidized loans, and PLUS loans. Each type has different requirements and different benefits.

1. The One Big Beautiful Bill Act made some changes to student loans.
 - a. Beginning July 1, 2026, new loans will be subject to new rules.
 - b. For graduate students, borrowing will be capped at \$20,500 per year with a lifetime graduate school loan limit of \$100,000 (reduced from the prior limit of \$138,500).
 - c. Borrowers working on a professional graduate degree, such as medicine or law, will have an annual limit of \$50,000 and a lifetime maximum of \$200,000 (increased from \$138,500).
 - d. Parent PLUS loans will now have an annual limit of \$20,000 and total of \$65,000 per child.
 - e. There is also a lifetime limit of undergraduate and graduate loans combined of \$257,500/person.

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2. Repayment programs have been reduced from seven plans to two new plans.
 - a. Standard plan. Borrowers will have between 10-25 years to repay their loan, based upon the size of their debt.
 - b. For example, someone owing less than \$25,000 can repay that over 10 years, while someone with over \$100,000 of debt can repay that amount over 25 years.
 - c. The second plan is the Repayment Assistance Plan (RAP). This repayment is generally based upon the borrower's adjusted gross income, based on a sliding scale.
 - d. The payments would range from a low of \$10/month to 10% of AGI for borrowers with AGI of \$100,000 or more.
 - e. RAP waives any interest shortfall. For example, if the borrower is obligated to pay \$50/month, but the interest is accruing at \$75/month, the \$25 is waived. This will prevent loan balances from growing.

IV. TAX CREDITS

A. Education Credits –

1. IRC § 25A creates 2 types of credits – the American Opportunity Tax Credit (AOTC) and the Lifetime Learning Credit (LLC).
2. The credits phase out as AGI moves from \$160,000-\$180,000 for married joint filers and \$80,000-\$90,000 for other taxpayers. Neither credit can be carried over.

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B. AOTC

1. Credit of up to \$2,500 per student.
2. Based on 100% of the first \$2,000 of qualified tuition and expenses paid during the tax year and 25% of the next \$2,000 of expenses.
3. The AOTC may be used for the first 4 tax years of postsecondary education.
4. Have student claim the credit to avoid the AGI phase out. Student then cannot be claimed as a dependent by the student's parents.

C. LLC

1. A per taxpayer (tax return) credit rather than a per student credit.
2. Maximum credit is \$2,000 based upon 20% of up to \$10,000 of tuition and related expenses.
3. The LLC can be used for students who are not enrolled at least half-time at a school or for classes that allow the individual to improve job skills. It is not necessary that the classes be related to obtaining a degree.
4. Thus, the LLC will be advantageous for students who are part-time students or taking work-related courses.

D. Coordination of Tax Credits

1. Requires careful planning because some benefits may conflict with other benefits.

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2. Education expenses paid for with tax free scholarship funds or funds from Section 529 plans can't be counted as education expenses for claiming the AOTC or LLC, or for excluding interest on US Savings Bonds.

V. ADDITIONAL TAX ISSUES

A. Interest on Qualified Education Loans

1. IRC Section 221 provides a deduction for up to \$2,500 for interest paid on qualified education loans.
2. The deduction is an above-the-line deduction.
3. The deduction phases out for taxpayers with a modified adjusted gross income of \$170,000-\$200,000 for joint filers and \$85,000-\$100,000 for single filers.
4. No interest deduction can be taken by someone who is a dependent and the deduction can only be claimed by a person legally obligated to make the interest payment.
5. The purpose of this restriction is to prevent parents who are above the phase out amounts from having the child take out the education loan.
6. A qualified education loan is a loan incurred by the taxpayer solely to pay qualified higher education expenses which are incurred on behalf of the taxpayer, his or her spouse or any dependent of the taxpayer. The loan does not qualify if the lender is a person related to the taxpayer (as defined in Section 267(b) or 707(b)(1)) or a loan from a qualified employer plan (as defined in Section 72(p)(4)).

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B. Gift Tax Exclusion for Educational Costs

1. IRC Section 2503(e) provides a special rule that payments made directly to a qualified institution for tuition only are not treated as gifts for gift tax purposes.
2. There is no limit on the amount of the payment as long as it is paid directly to the educational institution.
3. The educational institution must be one which maintains a regular faculty and curriculum and normally has a regular body of students at the place where the educational activities are regularly carried on. IRC § 170(b)(1)(A)(ii).
4. Thus, any school can qualify – not limited to postsecondary schools.
5. Payment of other expenses besides tuition would be treated as taxable gifts.

C. Educational Assistance Programs

1. IRC § 127 provides for amounts paid to an employee under an employer's educational assistance plan to be excluded from income up to \$5,250 per year.
2. The \$5,250 amount will be adjusted for inflation in taxable years beginning after 2026.
3. An Educational Assistance Program must be a written program for the exclusive benefit of the employees.
4. The plan cannot discriminate in favor of highly compensated employees and not more than 5% of the amounts paid by the employer for educational assistance may be provided for the benefit of shareholders or owners who own more than 5% of the company.

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5. See Section 127 for other requirements and restrictions.

D. Interest on US Savings Bonds

1. All or a portion of interest on US Savings Bonds as redeemed can be excluded if bond proceeds are used to pay for college expenses.
2. Bonds must have been issued after 12/31/89, purchased by an individual age 24 or older, and used to pay qualified higher education expenses of the taxpayer, his or her spouse or a dependent.
3. The exclusion phases out between \$99,500 and \$114,500 for single individuals and \$149,250 and \$179,250 for married filing jointly.

E. IRA Withdrawals

1. Withdrawals for education from a traditional IRA or a Roth IRA can be made without the 10% early withdrawal penalty.
2. The withdrawn funds must be used to pay qualified higher education expenses for the taxpayer, his or her spouse, or children, stepchildren or grandchildren of the taxpayer or the taxpayer's spouse.
3. The withdrawn funds are still subject to income tax if the withdrawal was a taxable withdrawal.

VI. QUALIFIED TUITION PLANS (QTP)

- A. IRC Section 529 provides for QTPs which can be either prepaid tuition plans or college savings plans.
- B. State law creates these plans.

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- C.
 - 1. A college savings plan is like a 401K plan – money contributed to the plan earns income tax free on an annual basis. There is no guarantee of the amount that will be available, as the plan growth is dependent upon the investment program chosen. The Michigan plan is the Michigan Education Savings Plan (MESP).
 - 2. A prepaid tuition plan, such as the Michigan Education Trust (MET), does guarantee payment of tuition no matter how much the tuition payment increases over the years. The MET has 3 different plans: Full Benefits Plan, Limited Benefits Plan and a Community College Plan. The costs for purchase and the benefits received thus vary.
- D. There is no federal deduction for amounts contributed to the QTP. However, certain states, such as Michigan, do provide a deduction for amounts contributed to the plan. Michigan allows a deduction of up to \$5,000 for single taxpayers and \$10,000 for married filing joint returns.
- E. Withdrawals from the QTP are income tax free, provided that the funds are used to pay qualified education expenses. Any distributions not used for qualified education expenses are subject to income tax and a 10% penalty.
- F. The owner of the QTP can change the beneficiary of the QTP without any tax consequences – even to himself or herself.
- G. The QTP is not limited to college expenses. It can be used for elementary, secondary, trade schools, undergraduate or graduate schools. The annual distribution limit per child for K-12 expenses will double to \$20,000 next year.
- H. Contributions to the QTP are taxable gifts. However, 5 years worth of gifts can be made in 1 year and will use up the annual exclusion (currently \$19,000) for the current year plus the next 4 years.
- I. Amounts above the annual exclusion levels can be made and would be applied against the donor's lifetime gift tax exclusion (currently \$13,990,000).

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- J. Most states have a limit on contributions. In Michigan, contributions cannot be made to the QTP once the account is worth \$500,000.
- K. Taxpayers are not required to use the QTP created in their state and can have QTP accounts in more than one state.
- L. Another benefit is that the beneficiary of the QTP can withdraw up to \$10,000 (lifetime limit) to pay educational loans for themselves or a sibling.
- M. SECURE 2.0 added a provision allowing funds to be withdrawn from a QTP by a beneficiary and contributed to a Roth IRA.
 - 1. The Section 529 account must be at least 15 years old;
 - 2. The rollover amount is limited to a lifetime maximum of \$35,000; and
 - 3. The beneficiary must have earned income at least equal to the rollover amount for the year.

VII. EDUCATION SAVINGS ACCOUNT

- A. An Education Savings Account (also known as a Coverdell Account) is created to pay qualified education expenses of the designated beneficiary of the account.
- B. Anyone can contribute to the ESA provided that the beneficiary is under age 18 (or has special needs).
- C. However, no more than \$2,000 can be contributed to the ESA each year.
- D. The \$2,000 contribution limit phases out for joint filers with modified AGI of \$190,000-\$220,000 and \$95,000-\$110,000 for single filers.
- E. Any funds remaining in the ESA when the beneficiary reaches age 30 must be distributed to the beneficiary within 30 days of reaching age 30.

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- F. Withdrawals from the ESA are tax free if used for qualified education expenses.
- G. Funds can be used for elementary, secondary, undergraduate and graduate levels.

VIII. APPENDIX

See the attached appendix for a chart showing various aspects of the programs presented here.

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APPENDIX

Publication 970 (2024)

Highlights of Education Tax Benefits for Tax Year 2024

This chart highlights some differences among the benefits discussed in this publication. See the text for definitions and details. **Don't rely on this chart alone.**

Caution: You generally can't claim more than one benefit for the same education expense.

	Scholarships, Fellowship Grants, and Tuition Reductions	American Opportunity Credit	Lifetime Learning Credit	Student Loan Interest Deduction	Coverdell ESA [†]	Qualified Tuition Program (QTP) [†]	Education Exception to Additional Tax on Early IRA Distributions [†]	Education Savings Bond Program [†]	Employer-Provided Educational Assistance [†]	Business Deduction for Work-Related Education
What is your benefit?	Amounts received may not be taxable	Credits can reduce the amount of tax you must pay 40% of the credit may be refundable (limited to \$1,000 per student)	Credits can reduce the amount of tax you must pay	Can deduct interest paid	Earnings not taxed	Earnings not taxed	No 10% additional tax on early distribution	Interest not taxed	Employer benefits not taxed	Individuals who are self-employed, Armed Forces reservists, qualified performing artists, fee-based officials, or disabled can deduct certain expenses
What is the annual limit?	None	\$2,500 credit per student	\$2,000 credit per tax return	\$2,500 deduction	\$2,000 contribution per beneficiary	None	Amount of qualified education expenses	Amount of qualified education expenses	\$5,250 exclusion	Amount of qualifying work-related education expenses
What expenses qualify besides tuition and required enrollment fees?	Course-related expenses such as fees, books, supplies, and equipment	Course-related books, supplies, and equipment	Amounts paid for required books, etc., that must be paid to the educational institution are required fees	Books Supplies Equipment Room & board Transportation Other necessary expenses	Books Supplies Equipment Computer equipment, computer software, or Internet access and related services Expenses for special needs services Payments to QTP Higher education: Room & board if at least half-time student Elem/sec (K-12) education: See chapter 6	Higher education: Books Supplies Equipment Room & board if at least half-time student Computer equipment, computer software, or Internet access and related services Expenses for special needs services Elem/sec (K-12) education: See chapter 7	Books Supplies Equipment Room & board if at least half-time student Computer equipment, computer software, or Internet access and related services Expenses for special needs services	Payments to Coverdell ESA Payments to QTP	Books Supplies Equipment	Transportation Travel Other necessary expenses

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	Scholarships, Fellowship Grants, and Tuition Reductions	American Opportunity Credit	Lifetime Learning Credit	Student Loan Interest Deduction	Coverdell ESA†	Qualified Tuition Program (QTP)†	Education Exception to Additional Tax on Early IRA Distributions†	Education Savings Bond Program†	Employer-Provided Educational Assistance†	Business Deduction for Work-Related Education
What education qualifies?	Undergraduate & graduate K–12	Undergraduate & graduate	Undergraduate & graduate Courses to acquire or improve job skills	Undergraduate & graduate	Undergraduate & graduate K–12	Undergraduate & graduate K–12 for no more than \$10,000 of tuition	Undergraduate & graduate	Undergraduate & graduate	Undergraduate & graduate	Required by employer or law to keep present job, salary, status Maintain or improve job skills
What are some of the other conditions that apply?	Must be in degree or vocational program Payment of tuition and required fees must be allowed under the grant	Can be claimed for only 4 tax years Must be enrolled at least half-time in degree program No felony drug conviction(s) Must not have completed first 4 years of postsecondary education before end of preceding tax year	No other conditions	Must have been at least half-time student in degree program	Assets must be distributed at age 30 unless special needs beneficiary	No other conditions	No other conditions	Applies only to qualified series EE bonds issued after 1989 or series I bonds	No other conditions	Can't be to meet minimum educational requirements of present trade/business Can't qualify you for new trade/business
In what income range do benefits phase out?	No phaseout	\$80,000 – \$90,000 \$160,000 – \$180,000 for joint returns	\$80,000 – \$90,000 \$160,000 – \$180,000 for joint returns	\$80,000 – \$95,000 \$165,000 – \$195,000 for joint returns	\$95,000 – \$110,000 \$190,000 – \$220,000 for joint returns	No phaseout	No phaseout	\$96,800 – \$111,800 \$145,200 – \$175,200 for joint returns	No phaseout	No phaseout

† Any nontaxable distribution is limited to the amount that doesn't exceed qualified education expenses.