INTERNAL REVENUE SERVICE
www.irs.gov

IRS Fact Sheet

Media Relations Office | Washington, D.C. | Tel. 202.622.4000
For Release: January 2003 | Release No: FS-2003-03

2002 TAX CHANGES: EDUCATION INCENTIVES

Education-Related Adjustments to Income

Taxpayers do not have to itemize deductions on Schedule A to claim the three deductions described below. Each is an adjustment to income on the first page of either Form 1040 or 1040A. These deductions are not available on Form 1040EZ.

Tuition and Fees Deduction

Most taxpayers with adjusted gross incomes up to $65,000 ($130,000 on a joint return) may deduct up to $3,000 for tuition and fees paid to attend an accredited college, university or vocational school. Persons who may be claimed as dependents, and married persons filing separately, may not take this deduction.

A taxpayer may not claim both this deduction and a tax credit for education expenses for the same student in one year. Qualifying expenses must be reduced by any nontaxable earnings from a Coverdell Education Savings Account, a qualified tuition program, or an education savings bond.

Student Loan Interest Deduction

Interest on student loans for higher education may now be deducted whenever paid and regardless of the age of the loan. Prior to 2002, only payments made during the first 60 months of the required repayment term counted. Voluntary payments – for example, those made before the student graduated – did not qualify for the deduction.

This deduction is now available to most taxpayers with incomes up to $65,000, with the deduction amount phasing out as income increases above $50,000. For married couples filing jointly, the phaseout range is from $100,000 to $130,000.

Deduction for Educator Expenses

Educators who work at least 900 hours during a school year as a teacher, instructor, counselor, principal, or aide, may deduct up to $250 of qualified out-of-pocket expenses for books and classroom supplies. The deduction is available for those in public or private elementary or secondary schools (including kindergarten). Educators must reduce qualifying expenses by any nontaxable earnings received from Coverdell ESAs, qualified tuition programs or educational savings bonds.

(more)

Coverdell Education Savings Accounts (ESAs)

Coverdell ESAs – formerly known as Education IRAs – do not give any immediate tax benefit, but they allow beneficiaries to accrue tax-free earnings for qualifying educational expenses. Several changes relate to the contribution rules:

- The annual contribution limit is now $2,000 per beneficiary, up from $500.

- The income eligibility for most married contributors filing jointly is now $190,000. As their adjusted gross income increases from $190,000 to $220,000 – which is double the range for unmarried persons – their contribution limit phases out.

- Corporations, including tax-exempt organizations, and other entities may now contribute to a Coverdell ESA, regardless of income level.

- The deadline for contributions for a given year is now the due date of the contributor's tax return, without extensions, instead of the end of the tax year. Thus, an individual may make 2002 contributions until April 15, 2003.

- A beneficiary may have contributions made to both a Coverdell ESA and a state tuition program in the same year.

More distributions from Coverdell ESAs will qualify for tax-free treatment, thanks to these changes:

- Qualifying educational expenses now include certain elementary and secondary school costs.

- College students who use Coverdell ESA funds may also claim the Hope or Lifetime Learning Credits, as long as the credits are claimed for different expenses than those paid from the ESA funds.

- While most beneficiaries must use up their ESA accounts before age 30 or transfer them to a qualified relative, there is no longer an age limit for special needs beneficiaries.

Tax-Free Scholarships

Although scholarships are usually taxable if they carry a future service requirement, tuition, books and other equipment paid for by the National Health Service Corps Scholarship Program or the Armed Forces Health Professions Scholarship and Financial Assistance Program are no longer taxed. This benefit does not extend to room and board payments under these programs.

(more)

Employer-Provided Educational Assistance

Employers may provide their workers with up to $5,250 a year in tax-free educational benefits. This tax break now applies to graduate studies also.

Qualified Tuition Programs (QTPs)

Certain states offer programs that allow people to prepay a student's tuition or contribute to a higher education savings account. Now, the tax benefits related to such programs also apply to tuition prepayment programs offered by private educational institutions. As before, payments or contributions to a QTP are not deductible. But several changes increase the tax benefits of distributions from QTPs:

- Earnings from state programs are now tax-free to the extent they are used for certain qualifying higher education expenses. The same tax-free treatment will apply to earnings from the prepaid tuition programs of educational institutions, but not until 2004.

- The previous dollar limits for qualifying room and board expenses for students living off-campus were changed to reflect the educational institution's published "cost of attendance" amounts.

- Students receiving tax-free benefits from QTPs will also be allowed to claim the Hope or Lifetime Learning Credits or receive a tax-free distribution from a Coverdell ESA, as long as the same expenses are not used for more than one of these benefits.

- Benefits may now be rolled over from one QTP to another for the same beneficiary, but only once within a 12-month period.

- For rollover and change of beneficiary purposes, the term "family member" now includes first cousins of the original beneficiary. A designated beneficiary may be changed to a family member, or an amount rolled over to a family member's QTP within 60 days of distribution, without tax consequences.

- Expenses of a special needs beneficiary that are necessary in connection with that person's higher education are now qualifying expenses for a QTP.

- Taxable distributions not used for qualified higher education expenses are generally subject to an additional 10% tax.

IRS Publication 970, "Tax Benefits for Education," has details on these and other education-related provisions.

X X X