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TAXLOGIC

January 23, 2003 **Vol. 2, No. 5**

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EDUCATION - Part 2

Education is a growing area of tax relief and it is worth taking two parts to review the information available to you.

Tax-Free Employer Education Reimbursements

The tax break for tax-free employer educational cost reimbursements of up to $5,250 annually is now permanent. (It was set to expire at the end of 2001.) So if your employer agrees to reimburse you for a class, you won't owe taxes on any of that income. Also starting in 2002, graduate-level courses now qualify for these tax-free employer reimbursements.

This break is available only for costs incurred by you the employee, so your kids and spouse are ineligible. On the plus side, high income won't be held against you -- there's no AGI-based phase-out rule for this benefit.

If you have your own business, and you have employees with children that are of college age, you should consider this plan as a non-taxable benefit to your employees.

Education IRAs

These are now officially called Coverdell Education Savings Accounts. Starting in 2002, the annual contribution limit increased from a paltry $500 to $2,000, which now makes these a nice tax break. That's especially true if you have several children or grandchildren, since you can contribute $2,000 annually to separate EIRAs for each child. Annual contributions are allowed until the college-bound beneficiary turns 18.

Contributions are non-deductible, but there are no tax penalties on either earnings build-up or withdrawals to pay the beneficiary's college expenses. If the designated child doesn't go to college, or his alma mater doesn't wipe out the account, the balance can be rolled over tax-free into another family member's EIRA.

The best news of all: Starting this year, you can also take tax-free EIRA payouts to cover the account beneficiary's K-12 costs. This is the first time that private schools have had any tax benefits. While the contributions were not deductible the gains or earnings from the account can be used tax-free. Eligible expenses include tuition and fees for private and religious schools, room, board, uniforms and transportation. For public school students, eligible expenses include books and supplies, academic tutoring, computers and software, and even Internet access charges.

Payouts need to be taken by year's end, but another new tax law change allows 2002 contributions to made until April 15, 2003. For joint filers, the AGI phase-out range for EIRAs is now between $190,000 and $220,000, versus $150,000-$160,000 in 2001, allowing more married folk to contribute. Single filers' AGI phase-outs are between $95,000 and $110,000.

Section 529 Plans

For 2002 and beyond, withdrawals from state-sponsored college savings plans, or "Section 529 Plans," to pay the account beneficiary's college costs are now tax-free instead of just tax-deferred. The new treatment also applies to accounts set up before 2002.

Section 529 plans typically offer several investment alternatives, including equity mutual funds, and many welcome out-of-state investors, allowing payouts for attending any accredited college or university nationwide. Shop around to find the plan you like best, but your own state's program may offer the most favorable state tax advantages.

Most college savings plans now permit lump-sum contributions of well over $100,000. For gift-tax purposes, you can spread a large lump-sum contribution over five years.

Gifts made under this year's increased amount of $11,000 won't trigger any federal gift taxes, and five years' worth of contributions can be done upfront, meaning a married couple can make a lump-sum payment of up to $110,000 without any tax consequences. In contrast to the other tax breaks that are phased out for high earners, Section 529 plans' benefits are available to all taxpayers.

A warning: Don't confuse these plans with Section 529 prepaid college tuition plans. (Both were written into existence in the same Tax Code section.) Prepaid tuition plans let you lock in the cost to attend certain colleges, yet you gain nothing if your account earns more than the rate of inflation for costs to attend them. In contrast, savings plans allow you to benefit when your account earns more than the rate of inflation. But if it earns less, you pay the price.