

## Tax Tips

### Deducting Education Costs

A deduction is available if the education maintains or improves the skills related to your trade or business. Educational costs are also deductible if the education is required (e.g., by law or an employer) to keep your position or job. Conversely, educational costs aren't deductible if the education is required to get into the field (as opposed to staying in the field) or qualifies you for a new trade or business.

For example, a doctor cannot deduct basic medical school costs because they are required to enter the field. Once he becomes a doctor, however, any courses he takes to keep current or learn new techniques are deductible. The expenses of becoming a specialist within a field may or may not be deductible. For example, if the goal all along was to become a psychiatrist and the individual went straight through medical school, internship, and then into a psychiatric residency, all of the costs would be treated as required to enter the field and wouldn't be deductible. However, an internist who has already been practicing medicine for a period of time can deduct the costs of a psychiatric program he enters as improving skills within his profession.

Many taxpayers take law-related courses as helpful to their professions or businesses. Seminars within your profession on law-related issues are deductible since they improve your skills. On the other hand, law school courses (even if taken for the same purpose) are generally not deductible because they lead to qualifying you for a new profession.

If your educational costs are deductible under the above tests, you can include the transportation costs involved in getting from work to the course location or vice versa. Transportation between home and the course location is deductible for education undertaken on a temporary or irregular basis. If the transportation is in the nature of a commute, it's not deductible. If you're away from home for deductible education, you can include the costs of travel, meals (at 50%), and lodging as well. However, travel as the educational vehicle itself (e.g., a French teacher's trip to France) isn't deductible.

In the case of an employee, education expenses that are deductible under the above tests may be claimed as an itemized deduction, but only to the extent the expenses, along with other miscellaneous itemized deductions, exceed 2% of the taxpayer's adjusted gross income (AGI). And, in the case of taxpayers with high AGI, miscellaneous itemized deductions are subject to a further overall limit on itemized deductions.

You must reduce your deductible expenses to the extent you receive a tax-exempt scholarship for the education. Similarly, to the extent an employee has his education costs reimbursed by his employer, the amount qualifying as deductible is reduced. (How the deduction and reimbursement are treated for tax purposes depends on how the employer sets up the reimbursement procedures.) In addition to taking an itemized deduction for education expenses, if you incur debt in obtaining education, interest you pay on student loans taken out may be deductible as an above-the-line deduction, i.e., it's subtracted from gross income to determine AGI. This means that you don't have to itemize to take the deduction, and that the deduction isn't subject to the overall limit on itemized deductions. The maximum deduction is \$2,500 per year, subject to a phaseout for taxpayers with high AGI.

Instead of taking a deduction for education expenses, taxpayers may claim the American Opportunity tax credit (AOTC)/Lifetime Learning credit for qualified tuition and related expenses. The maximum AOTC a taxpayer may claim is \$2,500 per year *per student*, for the first four years of undergraduate education at an eligible education institution. The maximum Lifetime Learning credit that may be claimed is \$2,000 per year *per taxpayer*, for any post-high school education (including courses to acquire or improve job skills) at

an eligible education institution. The AOTC/Lifetime Learning credits are also subject to phaseout for taxpayers with high AGI.

An above-the-line deduction is available for certain higher education expenses—*regardless of whether the education is related to the taxpayer's trade or business or employment*. Generally, the deduction is available for tuition and fees required for enrollment or attendance of an eligible student at a post-secondary educational institution, but not for books, supplies, transportation costs, living expenses, etc. The deduction is allowed for the qualifying expenses of the taxpayer, the taxpayer's spouse, and the taxpayer's dependents for whom a dependency exemption is allowed.

The maximum deduction is \$4,000, available to taxpayers with AGI of up to \$65,000 for singles and \$130,000 for joint filers. A maximum deduction of \$2,000 is allowed for singles with AGI up to \$80,000, or joint filers with AGIs up to \$160,000. The deduction can't be claimed for an individual's expenses if, during the same year, the AOTC/Lifetime Learning credit is claimed for that individual. In addition, the deduction is subject to certain other restrictions.

Taxpayers who incur education expenses must decide how to take maximum advantage of these complex rules. Taxpayers who take the standard deduction instead of itemizing their deductions will want to claim the AOTC/Lifetime Learning credit or the higher education expense deduction. Other taxpayers will have to decide whether to take an itemized deduction, the AOTC/Lifetime Learning credit, or the higher education expense deduction for their education expenses.

Taxpayers may find that an itemized deduction for education expenses is more advantageous than the Lifetime Learning credit because itemized deductions reduce a taxpayer's taxable income, and thus the education expenses save taxes at a taxpayer's top tax rate. Plus, the itemized deduction is not subject to any amount or AGI limits, as are both the Lifetime Learning credit and the higher education expense deduction.

On the other hand, if the education expenses aren't related to a taxpayer's current trade or business, but are incurred to acquire or improve job skills, even for a new trade or business, the expenses aren't deductible as an itemized deduction, but might qualify for the Lifetime Learning credit or the higher education expense deduction.

If you have any questions regarding the above discussed topic or any other tax matter, please feel free to give me a call at (562) 698-9891.

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