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# Tax Benefits for Education

For use in preparing

**2005** Returns



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## What's New

**Katrina Emergency Tax Relief Act of 2005.** This Act provides tax relief for persons affected by Hurricane Katrina. Under the Act, you may be able to claim an education credit, a student loan interest deduction, and/or a tuition and fees deduction. See Publication 4492.

**Hope and lifetime learning credits.** Beginning in 2005, the amount of your Hope or lifetime learning credit is gradually reduced (phased out) if your modified adjusted gross income (MAGI) is between \$43,000 and \$53,000 (\$87,000 and \$107,000 if you file a joint return). You cannot claim a credit if your MAGI is \$53,000 or more (\$107,000 or more if you file a joint return). This is an increase from the 2004 limits of \$42,000 and \$52,000 (\$85,000 and \$105,000 if filing a joint return). For more information, see chapters 2 and 3.

**Education savings bond program.** Beginning in 2005, the amount of your interest exclusion will be phased out (gradually reduced) if your filing status is married filing jointly or qualifying widow(er) and your modified adjusted gross income (MAGI) is between \$91,850 and \$121,850. You cannot take the deduction if your MAGI is \$121,850 or more. For 2004, the limits that applied to you were \$89,750 and \$119,750.

For all other filing statuses, your interest exclusion is phased out if your MAGI is between \$61,200 and \$76,200. You cannot take the deduction if your MAGI is \$76,200 or more. For 2004, the limits that applied to you were \$59,850 and \$74,850. For more information, see chapter 10.

**Business deduction for work-related education.** Beginning in 2005:

- If you drive your car to and from school and qualify to deduct transportation expenses, the amount you can deduct for miles driven from January 1, 2005, through August 31, 2005, is 40½ cents per mile. The amount you can deduct for miles driven from September 1, 2005, through December 31, 2005, is 48½ cents per mile. This is up from 37½ cents per mile in 2004. See chapter 12 for more information.
- If your adjusted gross income for 2005 is more than \$145,950 (\$72,975 if you are married filing separately), your itemized deductions may be limited. See chapter 12 and the instructions for line 28 of Schedule A (Form 1040).

## Reminders

**Estimated tax.** If you have taxable income from any of your education benefits and the payer does not withhold enough income tax, you may need to make estimated tax payments. For more information, see Publication 505, Tax Withholding and Estimated Tax.

**Student loan interest deduction.** Beginning with interest due and paid on qualified education loans after December 31, 1997:

- A 90-day safe harbor is allowed for disbursing loan proceeds used to pay qualified education expenses.
- Payment of interest by a third party may be deductible.

See chapter 4 for more information.

**Student loan repayment assistance.** Student loan repayments provided under certain federal and state repayment programs are tax free. See chapter 5 for more information.

**Qualified tuition program (QTP).** A distribution from a QTP established and maintained by an eligible educational institution (generally private colleges and universities) can be excluded from income if the amount distributed is less than or equal to the beneficiary's adjusted qualified education expenses. See chapter 8 for more information.

**Photographs of missing children.** The Internal Revenue Service is a proud partner with the National Center for Missing and Exploited Children. Photographs of missing children selected by the Center may appear in this publication on pages that would otherwise be blank. You can help bring these children home by looking at the photographs and calling 1-800-THE-LOST (1-800-843-5678) if you recognize a child.

## Introduction

This publication explains tax benefits that may be available to you if you are saving for or paying education costs for yourself or, in many cases, another student who is a member of your immediate family. Most benefits apply only to higher education.

**What is in this publication.** Chapter 1 explains the taxability of various types of educational assistance, including scholarships, fellowships, and tuition reductions.

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## Employer-Provided Educational Assistance

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### Introduction

If you receive educational assistance benefits from your employer under an educational assistance program, you can exclude up to \$5,250 of those benefits each year. This means your employer should not include the benefits with your wages, tips, and other compensation shown in box 1 of your Form W-2. This also means that you do not have to include the benefits on your income tax return.



*You cannot use any of the tax-free education expenses paid for by your employer as the basis for any other deduction or credit, including the Hope credit and the lifetime learning credit.*

**Educational assistance program.** To qualify as an educational assistance program, the plan must be written and must meet certain other requirements. Your employer can tell you whether there is a qualified program where you work.

**Educational assistance benefits.** Tax-free educational assistance benefits include payments for tuition, fees and similar expenses, books, supplies, and equipment. For

courses beginning on or after January 1, 2002, the payments may be for either undergraduate- or graduate-level courses. The payments do not have to be for work-related courses.

Educational assistance benefits do not include payments for the following items.

1. Meals, lodging, or transportation.
2. Tools or supplies (other than textbooks) that you can keep after completing the course of instruction.
3. Courses involving sports, games, or hobbies unless they:
  - a. Have a reasonable relationship to the business of your employer, or
  - b. Are required as part of a degree program.

**Benefits over \$5,250.** If your employer pays more than \$5,250 for educational benefits for you during the year, you must generally pay tax on the amount over \$5,250. Your employer should include in your wages (Form W-2, box 1) the amount that you must include in income.

**Working condition fringe benefit.** However, if the benefits over \$5,250 also qualify as a working condition fringe benefit, your employer does not have to include them in your wages. A working condition fringe benefit is a benefit which, had you paid for it, you could deduct as an employee business expense. For more information on working condition fringe benefits, see *Working Condition Benefits* in chapter 2 of Publication 15-B, Employer's Tax Guide to Fringe Benefits.