

# CPA

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# Client Bulletin

BUSINESS & TAX PLANNING IDEAS *for* OUR CLIENTS *and* FRIENDS

## How the Nontraditional Back-to-School Crowd Pays for Its Education

Did you know that upwards of 43% of college students are deemed "nontraditional"? Loosely interpreted, "nontraditional" refers to those students who are not 18 to 22, who work or have worked, who may be far along in their careers, or who may have served in the military and then attended school.

If you've decided to go back to school to finish your college degree, earn a second or third one, or pursue graduate or professional level education, then it's high time you brush up on your tax savings knowledge as it relates to higher education. Careful planning with our office can yield considerable savings on the ever-inflating cost of higher education.

### The Hope Tax Credit

The Hope Tax Credit is a credit against your federal income tax liability. You may claim a tax credit up to \$1,500 for only two tax years, and it only applies to the first two years of postsecondary education.

The Hope Tax Credit is available only to single taxpayers with modified adjusted gross income (MAGI) of less than \$52,000 or married taxpayers, filing jointly, with MAGI less than \$105,000. The maximum credit amount of \$1,500 is gradually reduced for incomes between \$42,000 and \$52,000 if single, or

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\$85,000 and \$105,000 if married. The credit is not available to married taxpayers who file separately. To obtain this benefit, you must be enrolled at least half-time in an eligible program leading to a degree or certificate during the calendar year.

Our office will calculate the actual amount of the Hope Credit available based on your household income, your number of dependents, the amount of qualified tuition and fees paid, and the amount of certain scholarships and allowances subtracted from tuition.

### The Lifetime Learning Tax Credit

Closely analogous to the Hope Credit, the Lifetime Learning Tax Credit provides a credit against your federal income tax liability. Key differences between the two include the number of years this credit is available and the maximum amount of the credit.

The Lifetime Learning Tax Credit provides for a credit of 20% of the first \$10,000 of qualified educational expenses, resulting in a maximum credit of \$2,000 for each year you are pursuing postsecondary education or taking courses to acquire or improve your job skills. There is no limit on the number of years you can claim this credit.

Our office will perform a detailed analysis to determine the exact amount of this credit for which you are eligible.

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### Did You Know?

In 2004, an estimated 47.7% (10.6 million) of all privately held businesses in the United States were 50% or more owned by women. These firms generated \$2.46 trillion in sales and employed 19.1 million people across the country.

Source: Center for Women's Business Research at [www.nhwbo.org](http://www.nhwbo.org)

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America Counts on CPAs

# CPA Client Bulletin

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## The deduction for qualified higher education expenses

For 2005, you can take an "above-the-line" deduction of up to \$4,000 for tuition and fees for higher education, provided that the tuition you earmark for this deduction is not comprised of the same tuition dollars you designate to qualify for either of the first two credits mentioned above (Hope and Lifetime Learning)—in other words, you may not claim this deduction plus either of the other two for the same student.

You can take this deduction even if you do not itemize your deductions on your income tax return, but if you are married, you must file jointly to claim this deduction.

This deduction is only available if your income does not exceed certain ceilings. To qualify for the full deduction, your income may not exceed \$65,000 (if you are single) or \$130,000 (if you are married filing jointly). The rules allow for lesser deductions at higher rates of income: Single taxpayers with incomes between \$65,000 and \$80,000, as well as married taxpayers filing jointly with incomes between \$130,000 and \$160,000, may claim up to a \$2,000 deduction.

## Interest deductions

**Student loan interest deduction:** Federal aid is not age-restrictive, so you can always opt to apply for educational loans. The maximum deduction is \$2,500, and you don't need to itemize to claim this deduction.

To qualify, you must meet two requirements:

First, the student loan on which you're paying interest must be one that you incurred to pay college expenses when you were at least a half-time stu-

dent. This requirement excludes part-time adult learners or other nontraditional students.



Second, you must meet income limits. To take the full student loan interest deduction, single filers must have a modified adjusted gross income (MAGI) below \$50,000 (below \$100,000 for married persons filing jointly). A partial deduction is available for single filers with an MAGI between \$50,000 and \$65,000 (between \$100,000 and \$130,000 for married filing jointly). These income limits are adjusted annually for inflation.

Early each year, a lender must send Form 1098-E to any borrowers who paid that lender over \$600 of interest on a qualified student loan the previous year. The form provides

details on the amount of interest you paid—contact your lender in the event the form is not sent to you.

**Home equity lines of credit:** Some returning students prefer to take advantage of the low interest rates typically associated with home equity lines of credit. If you choose this route to pay your tuition, you can deduct the home equity loan interest. This is a particularly attractive option for nontraditional students with high incomes, as there are fewer income limits to worry about when claiming this deduction, like with deductions for student loan interest. Certain limitations associated with home equity lines of credit exist, even when used for tuition. For example, you can only deduct up to \$100,000 of indebtedness, and there is a separate set of AMT rules that can come into play.

## Employer Tuition Reimbursement Programs

Some of you have the good fortune of working for an employer with a tuition reimbursement program. The law allows working adults to receive up to \$5,250 per year tax-free for tuition and fees associated with graduate and undergraduate level courses. The classes do not need to be job-related. Consult your employee handbook and our office for more information on this benefit. *continued on page 3*

## Planning to Purchase a 2006 Toyota Highlander Hybrid?

The IRS recently certified the model year 2006 Toyota Highlander Hybrid as being eligible for the clean-burning fuel deduction—meaning if you purchase one of these hybrid vehicles new during calendar year 2005, you may claim a tax deduction of up to \$2000 on Form 1040 for 2005. The deduction decreases to only \$500 in 2006 and to \$0 after 2006. Please see the July 2005 edition of *CPA Client Bulletin* for detailed information about this clean-burning fuel deduction.

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### Early withdrawals from IRAs

**Traditional IRA:** The 10% penalty tax imposed on IRA withdrawals before age 59½ does not apply if the distribution is used to pay for “qualified” higher education expenses. You must pay regular income tax, however, on these early withdrawals. Call our office to determine which expenses are deemed to be “qualified.”

**Roth IRAs:** You can avoid the early withdrawal 10% penalty tax if the distribution is used to pay for your qualified higher education expenses, but be advised that you

will owe income tax on any earnings withdrawn from the account. The good news—withdrawals from a Roth are treated as being taken from contributions first, which are not subject to tax. To the extent you have met the Roth withdrawal rules (age 59½ and contributions made at least five years before), your distribution will be completely tax-free.

### Other alternatives

Another tool—if you know that you will go back to school several years in advance of commencing your

studies—is to set up your own 529 plan to save for educational expenses. This attractive option is not limited to saving for the educational needs of your children and grandchildren, contrary to popular belief. Our CPAs can talk to you about the particulars of this tax-free savings vehicle.

Saving what is possibly the best idea for last, free money is always the preferred way to go. If you are over 60 years of age, don't forget to investigate the over-60 programs at schools, many of which offer free or low-cost tuition as incentives to promote lifetime learning and campus diversity.

## Give Win-Win Charitable Donations Every Time

As part of an overall, smart tax-planning strategy, many people get an early start to the holiday gift-giving season by contributing to charities throughout the autumn months. As long as you follow all of the IRS rules, you get the gift of tax savings in return for your contributions, allowing both you and the charity to benefit from your generosity—creating a win-win situation.

### Qualified organizations

Only gifts made to IRS-recognized charities will result in a tax break. These “qualified” organizations include “501(c)(3)s”—named for a section of the Tax Code that defines their status as nonprofits. Other kinds of organizations may also qualify, including educational and religious institutions, federal, state, and local governments, and certain not-for-profit cemetery companies. Our office will be happy to let you know whether your intended beneficiary organization qualifies.

### Over \$250 = proper documentation required

The IRS requires a “contemporaneous written acknowledgment” from the qualified organization that

received your contribution of \$250 or more in cash or non-cash of at least that value. Basically, that means that you want to get proof of your charitable contribution at the same time you make the gift. This written acknowledgment can be provided on paper or electronically, but it *must* include:

- the name of the organization;
- the date that you contributed your gift;
- the specific amount of cash or, if appropriate, a description of the non-cash contribution; and
- an explanation of any benefit you received in return for contributing to the organization, along with an estimated value of that benefit (if no benefit was conferred, then the written statement should indicate that fact).

If you donate less than \$250 or its equivalent to a qualified organization, your cancelled check, credit card, or cash receipt will fulfill the requirement for a “contemporaneous written acknowledgment” and the charity need not supply one.

Also, nonprofits must provide you with a written statement for gifts greater than \$75 if the organization gave you a benefit in return. When this happens, the written statement must include (1) a good faith estimate of the value of the benefit; and (2) an explanation that you

may deduct only the amount of the gift in excess of the benefit.

### Contribute assets if you have them

When choosing between cash and assets, it makes more sense to donate an appreciated capital asset which you held on to for more than a year (long-term) to a qualified charity than to sell it and donate the after-tax proceeds of the sale. Why? First, you will avoid incurring capital gains tax on the sale of your asset. Second, for long-term capital gain property (see below), you will receive a tax deduction equal to its full fair market value.

Examples of capital assets include, but are not limited to, stocks, real property, and works of art—each of which could be classified as “long-term” or “short-term” capital assets depending on how long you have owned the asset. If you hold your asset for under a year, it is short-term property; otherwise, it is generally considered long-term. However, special rules apply to determine the holding period in many situations, including but not limited to, assets acquired through inheritance, divorce, and like-kind property exchanges.

To illustrate your potential tax savings, gain from the sale of long-term assets is taxed at a maximum federal capital gains tax of 15% (5% if your income is under a certain level).

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Gain from the sale of short-term assets is taxed at your marginal federal tax rate, which can be up to 35%.

#### Vehicle donations

New, stringent rules govern how you compute the amount you may deduct for a charitable contribution of a qualified vehicle worth more than \$500. Our office can discuss these rules, information reporting requirements, issues that arise if the charity sells the vehicle, and other issues.

#### Calculating your deduction

Broadly speaking, you are entitled to take charitable deductions of up to

50% of your adjusted gross income (AGI). However, ceilings of 20% and 30% are imposed for certain contributions, which our office can speak to you about. Certain types of donations and contributions to certain types of organizations will trigger these lower limits.

Generally, you can deduct the amount by which your total gift exceeds the value of any benefit you receive in return. Where that benefit is very small, you may completely disregard it and not reduce the amount of your deduction. These "insubstantial" benefits are defined each year by law. Also, you may disclaim a benefit when

it is given, thereby avoiding the impact of a reduced charitable deduction. Of course, you must reject the benefit when it is offered, not after you have received it.

#### Volunteer, but don't try to deduct your time

Although you are not entitled to any deduction for the value of your donated services, you may be able to deduct some expenses you incur when performing volunteer work. For example, you can deduct your travel expenses if the qualified organization does not reimburse you, assuming you did not receive benefit for the travel (such as a pleasure trip, recreation, or vacation).

## Tax Calendar

### SEPTEMBER 2005

#### September 12

**Employees who work for tips.** If you received \$20 or more in tips during August, report them to your employer. You can use Form 4070.

#### September 15

**Individuals.** Make a payment of your 2005 estimated tax if you are not paying your income tax for the year through withholding (or will not pay in enough that way). Use Form 1040-ES. This is the third installment date for estimated tax in 2005.

**Employers.** For Social Security, Medicare, withheld income tax, and nonpayroll withholding, deposit the tax for payments in August if the monthly rule applies.

**Corporations.** File a 2004 calendar year income tax return (Form 1120 or 1120-A) and pay any tax due. This due date applies only if you timely requested an automatic six-month extension.

Deposit the third installment of estimated income tax for 2005. Use the worksheet Form 1120-W to help estimate tax for the year.

**S corporations.** File a 2004 calendar year income tax return (Form 1120S) and pay any tax due. This due date applies only if you timely requested an automatic six-month extension. Provide each shareholder with a copy of Schedule K-1 (Form 1120S).

### OCTOBER 2005

#### October 11

**Employees who work for tips.** If you received \$20 or more in tips during September, report them to your employer. You can use Form 4070.

#### October 17

**Individuals.** File a 2004 income tax return and pay any tax, interest, and penalties due if you were given an additional two-month extension.

**Partnerships.** File a 2004 calendar year return (Form 1065). This due date applies only if you were given an additional three-month extension. Provide each partner with a copy of Schedule K-1 (Form 1065) or a substitute Schedule K-1.

**Electing large partnerships.** File a 2004 calendar year return (Form 1065-B). This due date applies only if you were given an additional three-month extension.

In accordance with IRS Circular 230, this newsletter is not to be considered a "covered opinion" or other written tax advice and should not be relied upon for IRS audit, tax dispute, or any other purposes.

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