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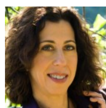

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Tax Overhaul Plan Would Make It Harder To Pay For College

Savvy taxpayers looking to defray the high cost of college education have learned to take advantage of a variety of tax breaks. A Republican proposal for tax reform unveiled yesterday would do away with most of them.

The far-reaching proposal to overhaul the 70,000-page tax code, unveiled yesterday by Dave Camp (R-MI), chairman of the House Ways and Means Committee, would reduce the number of tax brackets and do away with some popular deductions on which Americans have come to depend. Its chance of passage as currently constituted is slim. But it provides some pretty scary early warning signs of what's up for grabs. (A technical explanation by the Joint Committee on Taxation downloads here as a PDF.)

In the area of higher education, the elimination of tax breaks would be especially hard on middle class parents; students who are working to pay their way through school; and recent graduates struggling with student loan debt. Note that some tax breaks already get phased out for higher income taxpayers (the levels vary by item), and others are either/or propositions, so even without "reform," you can't necessarily load up on them.

But don't be distracted by the simplification spin – that in lieu of multiple, nickel-and-dime deductions taxes might be lower. Some valuable benefits that families have been counting on during years of saving for college would go by the wayside. So would tax-advantaged tuition benefits that university employees and even teachers at swank private primary and secondary schools rely on to finance the education of their own kids.

The proposal should be a wake-up call to parents, students and educators to watch the horse-trading carefully as Congress tackles tax reform. Last-minute caucus room compromises can be harmful to your purse. Here are goodies destined for gutting or total extinction if the Republicans have their way and some of the people who each cutback could hurt.

American Opportunity Tax Credit. As under present law, there would be a tax credit rate of 100% on the first $2,000 of qualified tuition and related expenses, and 25% on the next $2,000 of qualified tuition and related expenses, for a maximum credit of $2,500. But under the proposal, far fewer people would qualify for it. That's because the income level at which the benefit would be phased out would go down. The credit, which currently phases out for taxpayers with modified AGI between $80,000 and $90,000

($160,000 and $180,000 for married taxpayers
filing a joint return) would instead phase out for single filers with modified AGI between $43,000 and $63,000 and joint filers with modified AGI between $86,000 and $126,000.

Would hurt: Middle class taxpayers and single parents.

Deduction for interest on education loans. If you took out a loan to pay for higher education for yourself, your spouse or child and your income was below a certain amount, you've been able to deduct the interest on that loan up to $2,500. This would be eliminated.

Would hurt: Low- and moderate-income taxpayers, including recent graduates, struggling with student loan debt – not just now, but potentially for many years to come.

Deduction for tuition. Subject to income limits, until this year you have been able to deduct up to $4,000 for tuition and related expenses for higher education paid each year. (The provision has expired and will not be extended.)

Would hurt: Low- and moderate-income taxpayers.

Tax-free canceled student loan debts. Ordinarily, the forgiveness of student loan debt is considered taxable income. But there's currently an exception for graduates who work for certain period of time in a government-run or nonprofit program in areas with what the tax code calls "unmet needs." This tax break would be repealed for loans discharged after 2014.

Would hurt: Recent graduates committed to public service work – and perhaps the institutions for which they would work.

Tax-free tuition reduction. Some schools offer tuition at a reduced rate for their own employees and their spouses and kids. Right now this benefit isn't taxable. Under the Republican proposal it would be starting next year.

Would hurt: Parents who send their kids to the school where they teach — including not just colleges and universities, but also swank private schools (on the primary and secondary level) — expecting them to get reduced tuition.

Tax-free company education benefits. Subject to certain requirements, which are relatively easy to meet, if your employer pays for your tuition, up to $5,250 of what they spend is considered a tax-free benefit. This tax break would be eliminated.

Would hurt: All those trying to continue their education, including night students pursuing advanced degrees, on the company's dime.

Using savings bonds to pay for education. Right now, subject to certain limitations, if you cash in U.S. Series EE savings bonds issued after 1989 during a year in which you pay higher education expenses for your spouse or child, you don't have to pay tax on the interest you've earned. You can exclude from income an amount up to what you've paid in tuition and fees (but not room and board expenses). This tax break would be eliminated.

Would hurt: Risk-averse savers who have postponed cashing out these currently low-paying bonds figuring it would be most tax efficient to do that when the kids went to college.

Tax-free retirement account withdrawals. Typically there's a 10% penalty if you take withdrawals from an IRA before age 59½, but there are exceptions. One of them is if you take money out to offset education expenses for yourself, your spouse, or child or grandchild. This tax break would be eliminated.

Would hurt: Boomers laid off from their jobs just as their kids are going to college, who want to tap retirement savings as a rainy day fund.

Coverdell education savings accounts. These accounts, sometimes referred to as education IRAs, can pay for any level of schooling. You can set up a separate account for any family member younger than 18, even if you also fund a 529 plan for that person. A beneficiary can have more than one Coverdell account, but total yearly contributions for his or her benefit can't be more than $2,000. Although income limitations may restrict your ability to fund these accounts, parents or grandparents who don't meet the income requirements have been able to give $2,000 to each family member they want to benefit so those relatives can each set up their own Coverdell account. Under the proposal, it won't be possible to make any new contributions to these accounts after Dec. 31, 2014.

Would hurt: Anyone who might be a beneficiary of these accounts in the future, and current beneficiaries whose accounts can no longer grow with additional contributions.

For each of these categories, can you think of other people who might be hurt as a result of these proposals? If so, please join the conversation and comment in the space below.

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Deborah L. Jacobs, a lawyer and journalist, is the author of Estate Planning Smarts: A Practical, User-Friendly, Action-Oriented Guide, *now available in the third edition.*

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