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## STUDENT LOAN INTEREST DEDUCTION

By Victor Sy, CPA, MBA

Student loans are very noble means of helping students who do not have the funds to attend college. The federal government backs up student loans. It also encourages families to send their children to school by allowing deductions and credits for funds and loans used to pay school expenses. Let us review some **rules on how to deduct interest payments on student loans**:

1. A qualified student loan is used to pay for **qualified higher education expenses**.
2. Qualified expenses include **tuition, room and board, books, transportation** and related expenses.
3. The **maximum deduction** is \$2,500.
4. Eligible institutions include **colleges, universities and vocational schools**.
5. Expenses are paid on behalf of **dependents, the taxpayer, or spouse**.
6. The deduction is taken “**above the line**,” meaning that it can be taken even if you use standard deduction. It also good for itemizers who benefit from lower adjusted gross income (AGI).
7. Qualified loans include **government-backed loans, home equity loans, credit card debt, and personal loans from unrelated individuals**.
8. Loans that do **not qualify include funds from related parties** such as your parents, trusts, partnerships, or corporations that are more than 50% owned.
9. Only the person who is **legally required to make the payments** may claim the deduction. Let’s say that your dependent son took out a student loan by himself and made payments last year. Your son cannot deduct the student loan interest because he was claimed as a dependent. You cannot deduct the interest either because you are not legally obligated to pay the loan.
10. Benefits are **reduced or phased out** if the modified AGI reaches certain thresholds.
11. If parents' AGI exceeds phase-out limits, consider taking the loan in the **child's name** to ensure deduction.
12. Proposed regulations clarify that the deduction is **not** allowed to an individual who is properly claimed as a **dependent in another's return**.
13. There is **no** more requirement that deductions are allowed only during the first 60 months. The deduction will be limited to interest paid on a qualified loan during only the first 60 months in which the interest payments are required. (EGTRRA changes sunsets after 2010).
14. Banks, schools, and government units that receive \$600 or more in student loan payments must issue **Form 1098-E** for interests received during the year.

**Development** The Supreme Court unanimously ruled that the **government can seize as much as 15% of monthly Social Security checks to pay off old student loans** - courtesy of a certain James Lockhart who became disabled and sued to block seizure of his SS benefits. Mr. Lockhart took out nine federally guaranteed loans to attend four colleges. This ruling gives the government the right to collect more than \$7 billion in delinquent student loans, many of which have been delinquent for more than 10 years.

**Tip:** Pay your student loans early while your tax bracket is low. If you wait until you are in a high tax bracket, you'll be phased out (meaning you cannot deduct your student loan interest anymore).

**Recent Development:** The new Tax Relief Act (Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010) extends this through 2011.