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A FEW WORDS FROM JOHN...

Strategies for maximizing the benefits of the education credits.

The American Opportunity tax credit (previously known as the HOPE credit) is available the first four years of postsecondary education. Either the student or the parents may claim the credit. The maximum credit is 100% of the first \$2,000 of qualified expenses plus 25% of the second \$2,000 of qualified expenses. The maximum credit is \$2,500 per student, and the maximum overall credit is \$10,000 over the 4 years.

40% of the American Opportunity tax credit may be refundable. This means that if the nonrefundable part of your credit is more than your tax, you can get the excess back as a refund. However, if you are under age 24, you must determine if you can take advantage of the refundable portion of the credit.

To qualify for the American Opportunity tax credit, the student must be carrying at least one-half of the normal workload for the student's course of study. Individuals convicted of a Federal or state felony offense related to a controlled substance cannot claim the American Opportunity tax credit.

The American Opportunity tax credit only applies to qualified expenses, including tuition and fees necessary for the enrollment or attendance of you, your spouse, or any of your dependents at a higher education institution.

For the American Opportunity tax credit, expenses include books and course materials. However, books and course materials are not included for the Lifetime Learning credit. Expenses do not include sports fees (unless they are part of the degree program), activity fees, insurance expenses, transportation costs, room and board. You must reduce your qualified expenses by scholarships, grants, and other tax-free educational benefits, but you do not need to reduce your qualified expenses by gifts, bequests, or inheritances. Higher education institutions include accredited postsecondary educational institutions that offer degree programs and eligible to participate in student financial aid programs, i.e., colleges, community colleges, and many vocational schools.

Furthermore, you may elect either the American Opportunity tax credit or the Lifetime Learning credit with respect to one student. You cannot use both. Generally, it is better to claim the American Opportunity credit first because the credit is larger (\$2,500 compared to \$2,000 for the Lifetime Credit) and the phase out limits are higher.

Strategy Idea 1: Consider claiming the American Opportunity tax credit or the Lifetime Learning credit for some educational expenses and use tax-free Coverdell Education Savings Account earnings for educational expenses for which no credit is taken. The planning strategies for the American Opportunity tax credit and the Lifetime Learning credit benefit you the most when you can time the tuition payments to receive the \$10,000 maximum American Opportunity credit during your child's first four years of school.

Strategy Idea 2: Because most students start in the fall following graduation from high school, the American Opportunity tax credit is usually available for four of the first five years following graduation. However, if the tuition payment in the first semester is not at least \$4,000, leading to a \$2,500 credit, it may be advisable to claim the Lifetime Learning credit for the first semester and claim the American Opportunity tax credit for the remaining years. For both the American Opportunity tax credit and the Lifetime Learning credit, it may make sense to pay spring semester tuition in the December before the semester begins. For the American Opportunity tax credit, this could bunch two semesters into the high school graduation year.

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