

Taking Credits for Higher Education

In 2009, Congress replaced the Hope Scholarship tax credit with the more valuable American Opportunity tax credit. The latter credit was scheduled to expire after 2010 but was extended at year-end, along with many other tax benefits. Therefore, the American Opportunity credit remains the primary tax credit available for higher education in 2011 and 2012.

The maximum American Opportunity tax credit is \$2,500 per student. To qualify for the maximum credit, you must spend at least \$4,000 per student in 2012. You must spend this money for a student in his or her first four years of post-high school education. The money you pay for tuition and related fees counts for calculating the tax credit, along with outlays for necessary books, supplies, and equipment. Room and board costs do not count.

Example 1: Carl and Diane Hunter have a son who is a sophomore in college this year and a daughter who is a college senior. They spend \$12,000 on each student's qualifying expenses in 2012. Thus, they can claim two American Opportunity credits of \$2,500 each, for a total of \$5,000. For most taxpayers, the American Opportunity credit is 40% refundable.

Credit constraints

High income taxpayers can't use the American Opportunity tax credit. To get the full credit, your MAGI must be no more than \$80,000 if you are a single taxpayer or \$160,000 if you are married and file a joint tax return. The American Opportunity tax credit phases out with MAGI up to \$90,000 (single) or \$180,000 (joint returns).

In addition, any money that you withdraw from a Coverdell Education Savings Account or a 529 plan won't count for calculating the credit.

Example 2: Jennifer Thomas pays \$10,000 for her son Nick's college bills in 2012. Jennifer's MAGI is \$75,000, so she qualifies for a full American Opportunity tax credit. However, Jennifer withdraws \$8,500 from a 529 plan in 2012. If Jennifer counts that as a tax-free withdrawal, she will have only \$1,500 of expenses that can be offset by the American Opportunity tax credit. If Jennifer counts \$4,000 of expenses to be offset by a full American Opportunity tax credit, she will have only \$6,000 of expenses that can count as a qualified 529 withdrawal.

As you can see, the interplay between a 529 plan, Coverdell account withdrawals, and the American Opportunity tax credit might not be simple. Our office can help you calculate the most tax-efficient amounts to withdraw and the most tax-efficient way to claim education-related benefits on your tax return.

Later learning

You may be able to use a Lifetime Learning tax credit instead of the American Opportunity tax credit; however, the Lifetime Learning credit is less valuable. The American Opportunity tax credit can save as much as \$2,500 *per student*, but the Lifetime Learning credit saves no more than \$2,000 *per tax return*. Moreover, the income limits for the Lifetime Learning credit are stricter.

Why bother with the Lifetime Learning credit? It may be the only education-related tax credit that you can use. The American Opportunity tax credit can be used

only during a student's first four years of post-high school education, and only if that student is pursuing an undergraduate degree or a similar credential. The Lifetime Learning credit can be used if you incur other expenses at any time, such as outlays for graduate school or career advancement courses. A taxpayer cannot take an American Opportunity credit for the same child in the same year; however, it's possible to take an American Opportunity credit for one child and a Lifetime Learning credit for another child on the same tax return.

As mentioned, the Lifetime Learning credit also has income requirements. For 2012, the maximum \$2,000 credit phases out with MAGI of \$52,000-\$62,000 (single) or \$104,000-\$124,000(joint returns).