

# Extension of the American Opportunity Credit in the 2010 Tax Relief Act

Dear Client,

The recently enacted “Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010” includes a two-year extension of the American Opportunity tax credit for college costs. Added to the tax code in 2009 as a temporary replacement of the previous Hope tax credit, the American Opportunity credit both increased the tax relief available for students from middle-income families and extended relief for the first time to students from lower-income families.

Now that the American Opportunity credit has been extended for two years, it might be a good time to review the tax benefits available under that credit, with an eye to how it compares with the Hope credit, which would have been in effect over the next two years had the American Opportunity credit not been extended.

- Families with a family member in college can benefit from a tax credit for tuition and fees. From a taxpayer's point of view, a credit is almost always preferable to a deduction, because a credit reduces taxes owed, while a deduction only reduces taxable income. The maximum amount of the American Opportunity credit is \$2,500 (up from a maximum of \$1,800 under the Hope credit). The credit is 100% of the first \$2,000 of qualifying expenses and 25% of the next \$2,000. The maximum credit of \$2,500 is reached when a student has qualifying expenses of \$4,000 or more.
- While the Hope credit was only available for the first two years of undergraduate education, the American Opportunity credit is available for up to four years.
- Under the Hope credit, qualifying expenses included just tuition and fees required for the student's enrollment. Textbooks were excluded, despite their escalating cost. The American Opportunity credit expands the list of qualifying expenses to include textbooks.
- The Hope credit was nonrefundable. It could reduce your regular tax bill to zero but could not result in a refund. This meant that if a family didn't owe any tax it couldn't benefit from the credit, prompting critics to argue that the credit was unavailable to the families who needed it most. The American Opportunity credit addresses this criticism by providing that 40% of the credit is refundable. This means that someone who would qualify for the maximum credit of \$2,500, but has no tax liability to offset that credit, would qualify for a refund of \$1,000 (40% of \$2,500).
- The Hope credit wasn't available to someone with more than moderate income. Under the credit's “phaseout” provision, taxpayers with adjusted gross income (AGI) over \$50,000 (for 2009) saw their credits reduced, and the credit was completely eliminated for AGIs over \$60,000 (twice those amounts for joint filers). Taxpayers with somewhat higher incomes can qualify for the American Opportunity credit, as the phaseout of the credit begins at AGI in excess of \$80,000 (\$160,000 for joint filers).

I hope this information is helpful. If you would like more details about the American Opportunity credit or any other aspect of the new law, please do not hesitate to call.