

The American Opportunity tax credit (the Hope credit, as modified for 2009 and 2010) and the Lifetime Learning credit for “qualified tuition and related expenses” (see below) may allow you to turn part of the higher education expenses you incur for yourself, your spouse, or your dependents into tax savings.

The maximum American Opportunity tax credit a taxpayer may claim is \$2,500 *per student* (for both 2009 and 2010) for the first four years of undergraduate education at an eligible educational institution. The maximum Lifetime Learning credit that may be claimed is \$2,000 *per year per taxpayer*, for any post-high school education (including graduate-level courses and courses to acquire or improve job skills) at an eligible educational institution.

Generally, eligible educational institutions are accredited schools offering credit toward a bachelor's or associate's degree or other recognized post-high school credential, and certain vocational schools.

The American Opportunity tax credit is available only for the qualified tuition and related expenses of an eligible student, i.e., a student who's enrolled in a degree or certificate program at an eligible educational institution on at least a half-time basis, and who has never been convicted of a federal or state felony drug offense. The Lifetime Learning credit is not subject to the eligible student/felony drug offense restrictions, and may be available for a student taking only one course.

Neither credit is allowed for an expense that's otherwise deductible (for example, as a business expense). However, taxpayers can elect to claim either a credit or an above-the-line deduction for qualified tuition and related expenses. Most taxpayers will be better off taking the credit, but in certain cases taxpayers should elect out of the credit and claim the deduction instead.

A taxpayer may claim an American Opportunity tax credit or a Lifetime Learning credit for a tax year *and* exclude from gross income amounts distributed (both the principal and the earnings portions) from a Coverdell education savings account (formerly called an education IRA) for the same student, as long as the distribution isn't used for the same educational expenses for which a credit was claimed. Similarly, a taxpayer may claim an American Opportunity tax credit or Lifetime Learning credit for a tax year and also exclude from gross income amounts distributed (both the principal and the earnings portions) from a qualified tuition program (also known as a 529 plan) on behalf of the same student, as long as the distribution isn't used for the same expenses for which a credit was claimed.

The American Opportunity/Lifetime Learning credits may not be claimed in the same tax year for the same expenses, but each may be claimed for different expenses. For example, in the same tax year, a taxpayer may claim the American Opportunity tax credit for the qualified tuition and related expenses of one or more qualifying dependents, and may claim the Lifetime Learning credit for the qualified tuition and related expenses incurred for himself.

In order to be eligible for the American Opportunity tax credit or the Lifetime Learning credit for a tax year, qualified tuition and related expenses must be paid during that tax year for education furnished during an academic period (e.g., semester) that starts within that tax year or within the first three months of the following year. Under this rule, taxpayers have a timing option. For example, for a semester beginning in Jan. of Year 2, a taxpayer may pay the expenses in Year 1 or Year 2. The credit will be available in whichever year the payment is made.

The Lifetime Learning credit is nonrefundable—i.e., it can reduce regular income taxes to zero but cannot result in the receipt of a refund. For 2009, the credit may be claimed against the alternative minimum tax (AMT).

The American Opportunity tax credit, on the other hand, is 40% refundable, which means that you can get a refund if the amount of the credit is greater than your tax liability. For example, someone who has at least \$4,000 in qualified expenses and who would thus qualify for the maximum credit of \$2,500, but who has no tax liability to offset that credit against, would qualify for a \$1,000 (40% of \$2,500) refund from the government. In addition, the American Opportunity tax credit may be claimed against a taxpayer's AMT, in 2009 and 2010.

If the expenses on which the American Opportunity/Lifetime Learning credits are based are later refunded, the credits may have to be recaptured—i.e., the tax for the refund year may be increased to account for a recomputed credit for the earlier year.

As noted above, the American Opportunity/Lifetime Learning credits are based on the payment of qualified tuition and related expenses. These are the expenses for tuition and academic fees that are required for enrollment or attendance at an eligible educational institution. Qualified tuition and related expenses do *not* include student activity fees, athletic fees, insurance expenses, room and board, transportation costs and other personal living expenses. They also don't include the cost of any course or education involving sports, games, or hobbies unless the course or education is part of the student's degree program. Books are qualified expenses under the American Opportunity tax credit, but not the Lifetime Learning credit.

The amount of qualified tuition and related expenses taken into account in computing the American Opportunity/Lifetime Learning credits must be reduced by tax-exempt scholarships and fellowships, certain military benefits, and any other tax-exempt payments of those expenses other than gifts or bequests.

Both credits are phased out for higher income taxpayers. For 2009 and 2010, the American Opportunity tax credit is phased out for couples with income between \$160,000 and \$180,000, or singles with income between \$80,000 and \$90,000. The Lifetime Learning credit is phased out for couples with income between \$100,000 and \$120,000 for 2009 and 2010, or singles with income between \$50,000 and \$60,000. (The phase-out range for the Lifetime Learning credit is adjusted annually for inflation.)

Neither credit is available for taxpayers who are married filing separately.

In addition, neither credit is allowed to an individual who is claimed as a dependent on another's return. In this situation, the credits are allowed instead to the taxpayer claiming that individual as a dependent, and the credits are based on the total qualified tuition and related expenses paid both by the taxpayer and the student. But if no one claims the student as a dependent on a tax return for the year, the credits are allowed to the student on his or her own return, based on the expenses paid by the student. In either case, the student's credit takes into account the expenses that a third party (e.g., the student's grandparent) pays to the eligible educational institutional directly.

Eligibility for the credits is subject to a number of technical requirements not discussed above.