

# Back to School with Education Tax Breaks

*By Cindy Kula, CPA/PFS, CFP*

Tax breaks to help you pay educational expenses are commonly overlooked. Getting the most from the education tax incentives requires careful planning, particularly because of the interrelationship between many of the rules. The following are some of the more utilized and popular education tax breaks:



**American Opportunity Tax Credit.** For 2010, the American Opportunity Tax Credit provides a maximum credit amount of \$2,500 per year for all four years of college. Enacted by the American Recovery and Reinvestment Act of 2009 (2009 Recovery Act), this new credit temporarily replaces and enhances the HOPE credit and applies it to all four years of post-secondary education. The new credit can reach as high as 100 percent of up to \$2,000 qualified higher education expenses, plus 25 percent of the next \$2,000 of eligible expenses. This credit is subject to adjusted gross income phase-out limitations. Forty percent of the credit is refundable for those lower-income taxpayers with a tax liability smaller than the credit amount.

To qualify for the credit, the tuition must be paid on behalf of the taxpayer, the taxpayer's spouse or the taxpayer's dependent. An eligible student (for purposes of the credit) is an individual who is enrolled in a degree, certificate or other program leading to a recognized educational credential at an eligible educational institution. The student must be enrolled at least half-time and must not have been convicted of a federal or state felony for possession or distribution of a controlled substance. Study at many types of post-secondary institutions qualifies for the credit, such as programs for a bachelor's degree, associate's degree or another recognized post-secondary credential.

Qualified expenses must be for tuition and related expenditures. The 2009 Recovery Act expanded the definition of qualifying expenses to include "course materials." For this purpose, the term "course materials" means books, supplies and equipment needed for a course of study, whether or not the materials are purchased from the educational institution, as a condition of enrollment or attendance. Expenses incurred with respect to classes relating to sports or hobbies are not considered qualified expenditures, unless the courses are a part of the degree program. Many nonacademic fees are also not considered for purposes of the credit. Moreover, room and board costs are not included in the definition of qualified tuition and related expenses.

**Lifetime Learning Credit.** Before the 2009 Recovery Act enhanced the HOPE credit, the differences between the HOPE credit and the Lifetime Learning credit were more notable. The Lifetime Learning credit can be claimed for an unlimited number of tax years (and not just for the first two years of college as was the case of the HOPE credit before the 2009 Recovery Act). The Lifetime Learning credit equals 20 percent of up to \$10,000 in eligible education costs during the tax year. The Lifetime Learning credit is subject to phase-out rules.

Qualified expenses for the Lifetime Learning credit are similar to the enhanced HOPE credit. However, the 2009 Recovery Act did not expand the definition of the qualified expenses for the Lifetime Learning credit to include "course materials."

The Lifetime Learning credit may be applied to a non-degree program. For example, an individual who is enrolled in a non-degree program to improve job skills may be eligible for the credit. Additionally, the

Lifetime Learning credit may be claimed if the student is not enrolled at least half-time. An individual who is taking just one class at a community college, for example, may be eligible for the credit.

**Higher Education Deduction.** This deduction has been extended through 2010. The higher education deduction is a temporary above-the-line deduction for qualified tuition and related expenses. Eligible expenses include those spent on behalf of the taxpayer, his or her spouse or dependents at a post-secondary institution. The college or school must be eligible to participate in the federal student loan program. The amount of the deduction depends on your adjusted gross income. You cannot claim the higher education deduction as well as one of the education tax credits; it is an "either/or" situation.

Qualified tuition and related expenses are generally the same as for the Lifetime Learning credit. Most nonacademic fees, such as athletic and student activity fees, are generally excluded. The maximum deductible amount is \$4,000 for individuals subject to adjusted gross income limitations.

**Coordination.** As you have read, there are many federal education tax incentives. All of the incentives must be coordinated; that is, you may not be able to take every one. You generally cannot use education expenses to claim a double benefit. Many taxpayers make genuine and honest mistakes when trying to coordinate the education incentives without help from a tax professional. These mistakes are very costly.

Looking ahead, there is a lot of talk in Congress about simplifying and possibly consolidating all of the educational tax breaks. President Obama has proposed making the American Opportunity credit (the enhanced HOPE credit) permanent. If you would like to explore how the education tax incentives can work for you and have us fully evaluate your situation, please do not hesitate to call.