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# American Opportunity Tax Credit

## Internal Revenue Code Section 25A

### What is It?

- The federal government offers two income tax credits to help offset the costs of higher education. They are the American Opportunity Tax Credit (formerly the Hope Scholarship Tax Credit) and the Lifetime Learning Tax Credit. The American Opportunity Tax Credit is discussed here.
- The American Opportunity Tax Credit (AOTC) was enacted in 2009 for 2009 and 2010. It was extended for two years as part of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010. It was extended again in the American Taxpayer Relief Tax Act of 2012 and expires December 31, 2017.
- The AOTC may be claimed for the qualified tuition, fees, and course materials expenses of each eligible student in a taxpayer's family. The student, or students, must be enrolled: 1) at least half-time in one of the first four years of postsecondary education; 2) for at least one academic period beginning during the relevant tax year; and 3) in a program leading to a degree, certificate, or other recognized educational credential.
- The maximum tax credit is \$2,500 per student. The tax credit is equal to 100 percent of the first \$2,000 of qualifying expenses, and 25 percent of the next \$2,000 of qualifying expenses.
- The AOTC is calculated on qualifying expenses paid during the tax year. The exact amount of the tax credit also depends on a family's adjusted gross income, the amount of qualifying tuition, fees, and course materials expenses paid, and the amount of certain scholarships and allowances awarded to the student. The AOTC is subject to a phase-out for taxpayers with adjusted gross income in excess of \$80,000 (\$160,000 for married couples filing jointly). The credit is allowed against the alternative minimum tax (AMT).
- The AOTC is a partially-refundable tax credit. A refundable tax credit allows a taxpayer to receive a refund, if the amount of the taxpayer's tax credit exceeds the taxpayer's income tax liability. The AOTC is refundable up to a maximum of 40 percent (\$1,000) of the maximum tax credit of \$2,500.
- The AOTC is calculated on qualifying expenses paid during the calendar year. A student may be enrolled in an undergraduate or graduate degree program at an eligible school during the calendar year or may be enrolled in any course of instruction at an eligible school to acquire/improve the student's job skills during the calendar year. The credit is available for up to the first four years of postsecondary education.
- The AOTC is not available to married taxpayers who file separate returns. Students who have been convicted of either a Federal or state felony drug offense are not eligible for the AOTC.

Boston University  
Brandeis University  
Brown University  
California Institute of Technology  
Carnegie Mellon University  
Case Western Reserve University  
Columbia University  
Cornell University  
Duke University  
Emory University  
Georgia Institute of Technology  
Harvard University  
Indiana University  
Iowa State University  
The Johns Hopkins University  
Massachusetts Institute of Technology  
McGill University  
Michigan State University  
New York University  
Northwestern University  
The Ohio State University  
The Pennsylvania State University  
Princeton University  
Purdue University  
Rice University  
Rutgers, The State University of New Jersey  
Stanford University  
Stony Brook University - State University  
of New York  
Texas A&M University  
Tulane University  
The University of Arizona  
University at Buffalo, The State University  
of New York  
University of California, Berkeley  
University of California, Davis  
University of California, Irvine  
University of California, Los Angeles  
University of California, San Diego  
University of California, Santa Barbara  
The University of Chicago  
University of Colorado at Boulder  
University of Florida  
University of Illinois at Urbana-Champaign  
The University of Iowa  
The University of Kansas  
University of Maryland, College Park  
University of Michigan  
University of Minnesota, Twin Cities  
University of Missouri-Columbia  
The University of North Carolina  
at Chapel Hill  
University of Oregon  
University of Pennsylvania  
University of Pittsburgh  
University of Rochester  
University of Southern California  
The University of Texas at Austin  
University of Toronto  
University of Virginia  
University of Washington  
The University of Wisconsin-Madison  
Vanderbilt University  
Washington University in St. Louis  
Yale University

## **Who Benefits and How?**

- The original Hope Scholarship Tax Credit, now the American Opportunity Tax Credit, was enacted to help make college more affordable by reducing the cost of higher education relative to income.
- Federal tax credits for higher education expenses provide subsidies to taxpayers to encourage greater participation in higher education than would otherwise be undertaken. Tax credits are subtracted directly from the amount of income tax a taxpayer owes to the federal government, instead of being subtracted from taxable income like a tax deduction.
- A 2008 study by the Government Accountability Office (GAO) found that U.S. taxpayers are not using higher education tax incentives well. GAO found that “[s]ome tax filers do not appear to make optimal education-related tax decisions” and that a likely explanation of “these taxpayers’ choices may be the complexity of postsecondary tax provisions, which experts have commonly identified as difficult for tax filers to use.”
- To claim the AOTC, taxpayers must report on their income tax returns the amount of tuition, fees, and course materials paid, as well as the amount of certain scholarships, grants, and untaxed income used to pay the tuition and fees. Colleges are required to send information on tuition and fees payments to each taxpayer and to the IRS in the form of a 1098-T statement. Taxpayers use this information and their own records about tuition and fees paid when they claim the AOTC. Taxpayers can claim more than one AOTC on a tax return, provided that more than one individual (the taxpayer, the spouse, or a dependent) meets the qualifications.
- A family may claim both an AOTC and a Lifetime Learning Tax Credit, as long as the same student isn't used as the basis for both credits and the family doesn't exceed the Lifetime Learning credit maximum per family. If a taxpayer is claiming an AOTC for a particular student, none of that student's expenses may be applied to the Lifetime Learning credit for that tax year.

## **Potential Reforms**

- Congress may consider legislative proposals that have been introduced in recent years that would consolidate federal higher education tax credits (the Lifetime Learning Tax Credit and the Hope Scholarship Tax Credit or AOTC) and the qualified tuition and related expenses deduction to make it simpler for students to utilize federal tax benefits in financing their education.

## **Additional Information**

- Joint Committee on Taxation Report, JCX-62-12, "Present Law and Background Relating to Tax Exemptions and Incentives for Higher Education" – <https://www.jct.gov/publications.html?func=startdown&id=4474>.
- IRS Publication 970, Tax Benefits for Education – <http://www.irs.gov/pub/irs-pdf/p970.pdf>.
- GAO Study “Multiple Higher Education Tax Incentives Create Opportunities for Taxpayers to Make Costly Mistakes” – <http://waysandmeans.house.gov/media/pdf/110/GAO5108.pdf>.