

# GOODMAN & COMPANY

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## American Opportunity Tax Credit

On February 17, 2009, the American Recovery and Reinvestment Act of 2009 was signed into law. The new law provides a temporarily enhanced Hope scholarship tax credit for 2009 and 2010, called the American Opportunity Tax Credit.

The enhanced tax credit is available for a higher amount of tuition, is available for up to the first four years of post-secondary education and for additional expenses, and is available to taxpayers who may not have been able to claim it for prior years because of the adjusted-gross-income limitation (AGI).

**Comment:** The enhanced tax credit is available only for tuition and related expenses paid in 2009 or 2010 for education furnished to the student in an academic period beginning in 2009 or 2010. Many institutions require payment for a spring semester before the end of December in the prior year. For example, the tuition for a spring semester beginning in January 2009 may be due in December 2008. Under these circumstances, the tuition paid in December 2008 is not eligible for the enhanced credit because it was not paid in 2009.

**Amount of the credit.** The enhanced tax credit is allowed for the first 100 % of qualified tuition and related expenses up to \$2,000, and 25% of the qualified tuition and related expenses for the next \$2,000, for a total of \$2,500 a year. In contrast, under prior law, the Hope Tax Credit was equal to 100% of the first \$1,000 of qualified tuition and related expenses and 50% of the next \$1,000 of such expenses, both adjusted for inflation to \$1,200 for 2009, so that the maximum tax credit per student for 2009 was \$1,800.

**Comment:** In 2009, you can claim a larger Hope Scholarship Tax Credit of up to \$3,600 with respect to students attending educational institutions in the Midwestern disaster area. You can elect to waive the American Opportunity Tax Credit and claim the larger tax credit.

**Additional expenses.** In general, the Hope Scholarship Tax Credit is available for qualified tuition and related expenses, which include the tuition and fees required to be enrolled at or attend a particular institution. The Internal Revenue Service has stated that expenses for room and board are not included in qualified tuition and related expenses. Books and classroom supplies and equipment are not considered qualification tuition and related expenses unless payment for such expenses must be made directly to the educational institution for the student to enroll and attend classes at the institution.

The enhanced tax credit is specifically made available for books and other required course materials.

**Available for four years of post-secondary education.** The Hope Scholarship Tax Credit is available for up to two years for any student, and only for expenses paid for the *first two years* of post-secondary education. The enhanced tax credit applies to the *first four years* of a student's post-secondary education for 2009 and 2010.

**Income phase-out.** You may be able to claim the American Opportunity Tax Credit even if you have been unable to claim the Hope Scholarship Tax Credit because of the adjusted gross income (AGI) phase-out. The American Opportunity Tax Credit is phased out for taxpayers with AGI between \$80,000 and \$90,000 (\$160,000 and \$180,000 in the case of a joint return). In comparison, the Hope Scholarship Tax Credit is phased out starting at \$50,000 (\$100,000 for joint returns).

**Alternative Minimum tax.** The American Opportunity Tax Credit can offset the alternative minimum tax (AMT) even in years in which most personal credits cannot.

**Comment:** Another provision of the new law provides that all personal credits offset the AMT in 2009. Thus, this rule applies only in 2010.

**Credit is refundable.** In addition, 40 percent of the tax credit is refundable. In other words, a taxpayer claiming the tax credit can receive a refund greater than the amount of tax liability. However, this does not apply in the case of a child whose income is subject to tax at his parent's income tax rate. Generally, this means any child under age 18 or any child under age 24 who is a student providing less than one-half of his or her own support, who has at least one living parent, and who does not file a joint income tax return.

## **COBRA Premium Assistance**

The Act enhances COBRA continuation coverage by offering a premium subsidy for eligible individuals who are involuntarily terminated from their employment. An eligible individual is treated as having paid the premium required for coverage if the individual pays 35% of the premium. In effect, the individual is provided with a 65% reduction in premiums for the first nine months for which COBRA coverage is required. The employer is reimbursed for the premium not paid in the form of a credit against payroll taxes.

Generally, the premium reduction amount is excluded from the eligible individual's gross income.

If a premium subsidy is provided to an individual during a tax year in which the individual's modified adjusted gross income exceeds \$125,000 (\$250,000 in the case of a joint return), the individual must repay all or a portion of the subsidy provided in that year. The mechanism for repaying the subsidy is an increase in the individual's tax liability for the year equal to the amount of the subsidy. The amount of the subsidy that must be repaid is phased in for individuals whose modified AGI does not exceed \$145,000 (\$290,000 in the case of a joint return).

If you would like more advice about these benefits, please call Goodman & Company, CPAs, **610-253-2745**.

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