



## American Opportunity Tax Credit (AOTC)

Internal Revenue Code Section 25A

### What Is the American Opportunity Tax Credit?

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 (LLC). The AOTC is discussed here.

***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 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 another recognized educational credential.

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 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.

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.

### Who Benefits and How?

The original Hope Scholarship Tax Credit, now the AOTC, was enacted to help make college more affordable by reducing the cost of higher education relative to income.

The AOTC is a valuable incentive for taxpayers to pursue higher education or to acquire new or enhanced job skills. In this way, the AOTC helps to expand, update, and keep competitive the knowledge and skills of our nation's workforce.

Federal tax credits for higher education expenses provide subsidies to taxpayers to encourage greater participation in higher education. Tax credits are subtracted directly from the amount of income tax a taxpayer owes the federal government.

# American Opportunity Tax Credit

continued

To claim the AOTC, taxpayers must report the qualified expenses, as well as the amount of certain scholarships, grants, and untaxed income used to pay the tuition and fees. Universities 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.

***91 percent of undergraduates or their parents who have out-of-pocket tuition and fee expenses – including tuition and fees financed with student loans – and also file taxes are eligible for a tax credit or deduction.***

*Source: New America Tax Benefits Survey*

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 the AOTC and the LLC, as long as the same student isn't used as the basis for both credits and the family doesn't exceed the LLC maximum per family.

According to a 2016 Congressional Research Service report, “[d]ata confirm that the AOTC primarily benefits middle-income taxpayers, although lower-income taxpayers and upper-middle income taxpayers also receive the credit.”

## Proposals for Strengthening the AOTC

AAU has long supported simplification of higher education tax incentives, given that the multiplicity of credits, complex rules for claiming such credits, and sometimes confusing interaction of these credits, make them difficult for the average taxpayer to use as effectively as Congress intended. In fact, a 2008 study by the Government Accountability Office (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.”

An improved AOTC should work well for both traditional and nontraditional undergraduates, particularly low- and middle-income students. Further, any credit that consolidates the AOTC and the LLC should provide benefits to graduate students and lifelong learners, many of whom are low-income and need assistance in pursuing additional skill development or the advanced degrees that employers and our economy need. We propose the following changes:

### **Consolidate the AOTC and LLC into a two-part AOTC**

1. Consolidation should include the current AOTC, partially refundable, eligible for students enrolled at least half-time, and limited to four years; and
2. A non-refundable credit of \$2,000 (like the LLC) that, like the AOTC, would cover 100 percent of the first \$2,000 of the AOTC’s eligible expenses. A consolidated AOTC should be indexed to inflation.

# American Opportunity Tax Credit

continued

This proposal would simplify the LLC and also create greater parity for students beyond their first four years of college and lifetime learners. In addition, the AOTC part two would provide a benefit for graduate students who have suffered from recent decisions by policymakers to end graduate student eligibility for federal subsidized loans and require them to pay higher interest rates on student loans than undergraduates, a troubling pattern of increasing the cost of education for students pursuing advanced degrees.

## **Fix the AOTC-Pell Grant Interaction**

A consolidated AOTC should better coordinate the interaction of the AOTC with the Pell grant and exclude the Pell grant from taxable income. Currently, the AOTC eligibility formula sharply limits the size of the tax credit received by needy students at the lowest cost schools. As a result, many of the lowest-income students do not receive any benefit from the current AOTC. Ideally, Pell grants also should be excluded from taxable income for purposes of a “reformed” AOTC.

## **Additional Information**

### **Congressional Research Service Report**

“The American Opportunity Tax Credit: Overview, Analysis, and Policy Options”

<https://fas.org/sgp/crs/misc/R41967.pdf>

### **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>

### **New America Tax Benefit Policy Brief**

“A New Look at Tuition Tax Benefits”

<https://www.newamerica.org/education-policy/policy-papers/a-new-look-at-tuition-tax-benefits/>