

# The American Opportunity Tax Credit

Students at Israeli universities including the Hebrew University and Bar-Ilan University should be alerted to the following situation and potential tax trap.

A client called us recently because his daughter was approached on campus by an accountant who told her that she should file a U.S. tax return for a refund based on the tuition that she paid to the university in 2010. She came home with a draft of the tax return already prepared which was to reflect her having earned \$15,000 of wages based on income she earned from babysitting and claiming herself as her own dependent. The accountant was charging 10% of the refund.

This situation can be more costly than anticipated and even more costly than the entire anticipated refund for some or all of the following reasons:

- 1) A tax return which reflects wages that cannot be supported by appropriate documentation may result in the IRS imposing a fine for the filing of inaccurate tax return;
- 2) The student might have other income that he/she is not aware that should be included on such tax return and without that the return would be incomplete;
- 3) The student might already be included (or will be included) as a dependent on his/her parents' tax return. This could result in the parent and/or child having to file an amended tax return;
- 4) The tuition credit might be higher if it is reflected on the parents' tax return;
- 5) The cost to include such credit on the parents' tax return would likely be nominal as opposed to 10% of the refund, and paying the fee based on a return before the refund is received may be thrown out money if the refund is not granted;
- 6) A tax return preparer is not allowed to charge based on a percentage of the refund reflected on the tax return – it is a criminal violation under US tax regulations;
- 7) In the above situation the "baby sitting" income would be considered self-employment income subject to US Social Security Self-employment tax at 15.3%.

## **Following are the main points related to the refundable US tax credit discussed above:**

The American Opportunity Tax Credit, formerly called the Hope Credit, can be claimed for tuition and certain fees paid for higher education in years **2009 - 2012**. It may be claimed for expenses for the first four years of post-secondary education, but not all universities qualify. If you think that you may be entitled to the credit, we suggest getting clarification from the college/university that its tuition and related expenses do in fact qualify for the credit.

A taxpayer who pays qualified tuition and related expenses and whose federal income tax return has a modified adjusted gross income of \$80,000 or less (\$160,000 or less for joint filers) may be eligible for the credit. The credit is reduced ratably if a taxpayer's modified adjusted gross income (adjusted gross income after adding back excluded foreign earned income) exceeds those amounts. A taxpayer whose modified adjusted gross income is greater than \$90,000 (\$180,000 for joint filers) can not benefit from this credit. The American Opportunity Tax Credit can not be claimed if anyone else claims that credit or the lifetime learning credit based on the same expenses for the same year.

It is a tax credit of up to \$2,500 of the cost of qualified tuition and related expenses paid during the taxable year -- 100 percent of the first \$2,000 of qualifying fees paid during the tax year, plus 25 percent of the next \$2,000. The credit will reduce tax liability dollar for dollar. Any excess American Opportunity Tax Credit over and above the regular tax liability is refundable up to a maximum refund of 40 percent of the amount of the qualified credit.

The term "qualified tuition and related expenses" includes expenditures for "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.