

HOPE credit and Lifetime Learning credit for qualified tuition and related expenses of higher education

The HOPE credit and the Lifetime Learning credit for "qualified tuition and related expenses" (see below) may allow you to turn part of the higher education expenses you incur for yourself, your spouse, or your dependents into tax savings.

The maximum HOPE credit a taxpayer may claim is \$1,650 *per student* (for both 2006 and 2007) for the first two years of undergraduate education at an eligible educational institution. The maximum HOPE credit amount is adjusted for inflation annually. The maximum Lifetime Learning credit that may be claimed is \$2,000 *per year per taxpayer*, for any post-high school education (including graduate-level courses and courses to acquire or improve job skills) at an eligible educational institution. The maximum Lifetime Learning credit will not be adjusted for inflation. The maximum credit amounts are doubled for 2006 for students in the Gulf Opportunity Zone, which is a designated portion of the Hurricane Katrina disaster area.

Generally, eligible educational institutions are accredited schools offering credit toward a bachelor's or associate's degree or other recognized post-high school credential, and certain vocational schools.

The HOPE credit is available only for the qualified tuition and related expenses of an eligible student, i.e., a student who's enrolled in a degree or certificate program at an eligible educational institution on at least a half-time basis, and who has never been convicted of a federal or state felony drug offense. The Lifetime Learning credit is not subject to the eligible student/felony drug offense restrictions, and may be available for a student taking only one course.

The HOPE credit and the Lifetime Learning credit aren't allowed for an expense that's otherwise deductible. An above-the line deduction for college tuition and related is allowed through 2007. An otherwise eligible taxpayer may choose to claim the appropriate credit *or* the deduction for higher education expenses. Most taxpayers will be better off taking the credit, but in certain cases taxpayers should elect out of the credit and claim the deduction instead. I can advise you about whether the credit or deduction is more beneficial in your case.

A taxpayer may claim a HOPE credit or a Lifetime Learning credit for a tax year *and* exclude from gross income amounts distributed (both the principal and the earnings portions) from a Coverdell education savings account (formerly called an education IRA) for the same student, as long as the distribution isn't used for the same educational expenses for which a credit was claimed. Similarly, a taxpayer may claim a HOPE credit or Lifetime Learning credit for a tax year and also exclude from gross income amounts distributed (both the principal and the earnings portions) from a qualified tuition program (also known as a 529 plan) on behalf of the same student, as long as the distribution isn't used for the same expenses for which a credit was claimed.

The HOPE/Lifetime Learning credits may not be claimed in the same tax year for the same expenses, but each may be claimed for different expenses. For example, in the same tax year, a taxpayer may claim the HOPE credit for the qualified tuition and related expenses of one or more qualifying dependents, and may claim the Lifetime Learning credit for the qualified tuition and related expenses incurred for himself.

In order to be eligible for the HOPE credit or the Lifetime Learning credit for a tax year, qualified tuition and related expenses must be paid during that tax year for education furnished during an academic period (e.g., semester) that starts within that tax year or within the first three months of the following year. Under this rule, taxpayers have a timing option. For example, for a semester beginning in Jan. of Year 2, a taxpayer may pay the expenses in Year 1 or Year 2. The credit will be available in whichever year the payment is made.

The HOPE/Lifetime Learning credits are nonrefundable—i.e., they can reduce regular income taxes to zero but cannot result in the receipt of a refund. And the credits are allowed only to the extent that the taxpayer's regular income tax liability exceeds his or her tentative minimum tax.

If the expenses on which the HOPE/Lifetime Learning credits are based are later refunded, the credits may have to be recaptured—i.e., the tax for the refund year may be increased to account for a recomputed credit for the earlier year.

As noted above, the HOPE/Lifetime Learning credits are based on the payment of qualified tuition and related expenses. These are the expenses for tuition, books and academic fees that are required for enrollment or attendance at an eligible educational institution. Qualified tuition and related expenses do *not* include student activity fees, athletic fees, insurance expenses, room and board, transportation costs and other personal living expenses. They also don't include the cost of any course or education involving sports, games, or hobbies unless the course or education is part of the student's degree program. However, for students in the Gulf Opportunity Zone during 2006, qualified expenses include books, supplies, equipment, and, for at least half-time students, room and board expenses.

The amount of qualified tuition and related expenses taken into account in computing the HOPE/Lifetime Learning credits must be reduced by tax-exempt scholarships and fellowships, certain military benefits, and any other tax-exempt payments of those expenses other than gifts or bequests.

For 2007, both the HOPE credit and the Lifetime Learning credit are phased out ratably for married taxpayers filing jointly with adjusted gross income (AGI), with certain modifications, between \$94,000 and \$110,000 (between \$90,000 and \$110,000 for 2006). That is, the credit is reduced if the modified AGI is above \$94,000 (\$90,000 for 2006) and is unavailable if it's \$110,000 or more for 2007 or 2006. For taxpayers who aren't married filing jointly, the phase-out range is \$47,000 to \$55,000 (\$45,000 to \$55,000 for 2006). These phase-out amounts are adjusted for inflation annually.

Neither the HOPE credit nor the Lifetime Learning credit is available for taxpayers who are married filing separately.

In addition, neither the HOPE credit nor the Lifetime Learning credit is allowed to an individual who is claimed as a dependent on another's return. In this situation, the HOPE/Lifetime Learning credits are allowed instead to the taxpayer claiming that individual as a dependent, and the credits are based on the total qualified tuition and related expenses paid both by the taxpayer and the student. But if no one claims the student as a dependent on a tax return for the year, the HOPE/Lifetime Learning credits are allowed to the student on his or her own return, based on the expenses paid by the student. In either case, the student's credit takes into account the expenses that a third party (e.g., the student's grandparent) pays to the eligible educational institutional directly.

Eligibility for the HOPE and Lifetime Learning credits are subject to a number of technical requirements not discussed above.