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The New Tax Credits: How Much Will They Offset Higher Student Fees in California?

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The American Recovery and Reinvestment Act (ARRA) significantly increases federal tax credits for people who pay for college education. For many families, these tax credits will offset most of the recent fee increases at UC, CSU, and the community colleges. Some students will likely be deterred from enrolling due to the higher fees and it is important to make students and parents aware that the new credits will, for a majority of families, balance out the increase in student fees.

The New Tax Credits

The American Opportunity credit (AO credit) extends the existing Hope credit by increasing income limits at the upper end, increasing the benefit amount, and extending the credit to cover four years of education. The Hope credit offered a maximum annual benefit of $1,800 and was available only for the first two years of undergraduate education.

An important change affecting lower-income families is that the AO credit is partially refundable. If the credit exceeds a taxpayer's overall tax liability, up to $1,000 is paid back to the taxpayer. This is an important benefit for families who have low tax liabilities that may be extinguished by other tax credits.

For example, a married couple with two children, earnings of $40,000, and qualifying for the earned income credit would have a tax liability of $285. Their Hope credit is effectively limited to $285, regardless of the amount paid for fees. Under the AO credit, up to $1,000 is refundable, so the overall benefit can be up to $1,285.

The credit does not cover fees that have already been paid for by waivers, grants, and scholarships. Many low-income students receive aid of this kind that reduces their fees.

Changes in Federal Tax Credits

	Hope Credit *Effective until 2008*	American Opportunity Credit — *Effective 2009*
Credit for	100% of fees up to $1,200, plus 50% of the next $1,200	100% of fees up to $2,000, plus 25% of the next $2,000, plus books
Maximum credit	$1,800 *Nonrefundable*	$2,500 *Refundable up to $1,000*
Available for	First two years of college education	Four years of college education
Phaseout begins at	Income of $100,000 for married couples	Income of $160,000 for married couples

The Lifetime Learning credit is another federal tax credit that can be claimed after eligibility for the American Opportunity credit expires. There is no restriction on the number of years that this credit can be claimed.

The Lifetime Learning credit remains at 20% of fees up to a maximum of $2,000, but the phaseout point has been raised from $96,000 to $100,000 for married couples and from $48,000 to $50,000 for single taxpayers.

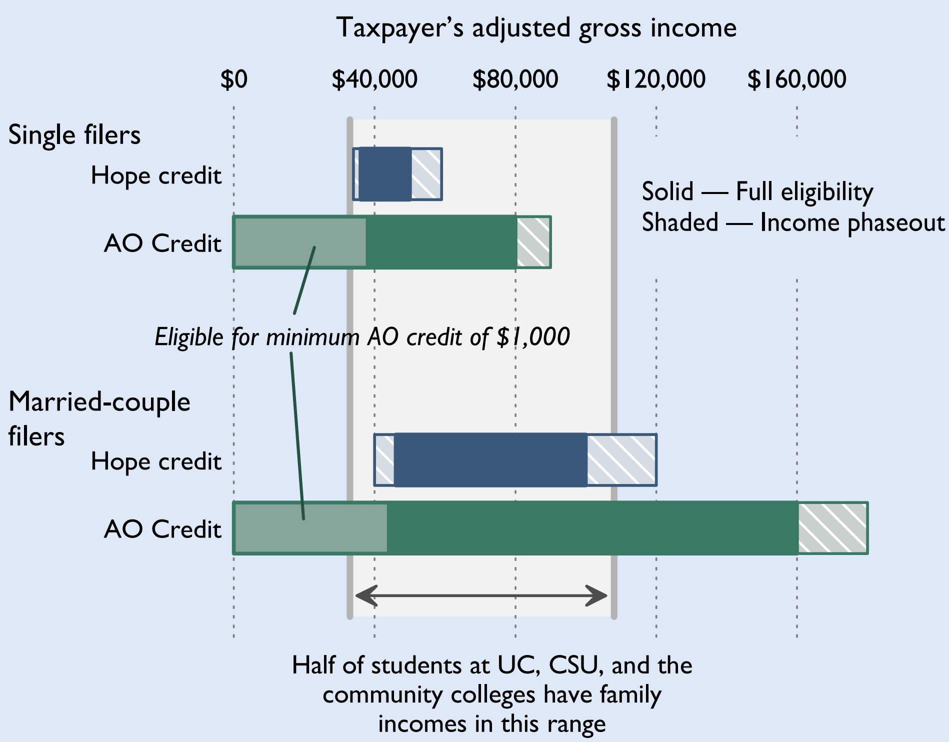
Families Eligible for the American Opportunity Credit

The new credit will benefit most students at UC, CSU, and the community colleges. The graph below shows how eligibility is expanded compared to the Hope credit. For example, a married-couple family with two dependents and an income of $100,000 would be in the phaseout range for the Hope credit, but will be eligible for the full amount of the AO credit. Income data from the California Student Aid Commission (see page 4) shows that about 20% of students come from families with incomes too high to qualify for the Hope credit.

Families at the lower end of the income scale often saw no benefit from the Hope credit because it was not refundable and they had low tax liability. For a married couple with two dependents, eligible for the earned income credit, the Hope credit is effectively cut off at incomes below $40,000. The cutoff point for a single head of household with two dependents is $34,000. About 30% of students are from families with incomes too low to get the full benefit.

The AO credit is more inclusive. It expands benefits to higher income levels, and includes a refundable benefit to families that have little or no tax liability. Depending on whether the income ceilings are applied for single filers or joint filers, the AO credit excludes only the top 10% to 30%. At incomes below about $40,000, all families will get a minimum benefit amount of up to $1,000.

Comparison of the Hope Credit and the American Opportunity Credit



The Hope credit effectively phased out at low-income levels, because it was nonrefundable and was limited by a family's overall tax liability.

The AO credit offers a benefit of up to $1,000 to families with a low tax liability, less than $1,000.

The AO credit extends the income range to benefit families at lower- and higher-income levels.

Fee Increases

All three public higher education systems increased their fees for the 2009–10 school year. Fees at community colleges increased from $20 per unit to $26 per unit, resulting in annual fees of $780 for full-time students. At CSU, fees increased by 26%, from $3,800 to $4,800 per year, and at UC fees went from $8,000 to $8,700, a 9% increase.

Eligible families will see much of the fee increases covered by the expanded tax credits. The community college fees are still well below the $2,500 limit, so community college students will also be able to claim expenses for course materials, including textbooks.

The amount of the credit depends on the family's income and number of dependents. For example, the credit will cover 70% of the fee increase at CSU and all of the fee increase at UC for a family with an adjusted gross income of $65,000 and two dependents.

Fee Increases and Tax Credits

For many families, fee increases for the 2009–10 school year will be offset by the new tax credit

	Community colleges	CSU	UC
2008			
Annual fees	$600	$3,800	$8,000
Hope credit	$600	$1,800	$1,800
Fees after tax credit	$0	$2,000	$6,200
2009			
Annual fees	$780	$4,800	$8,700
AO credit	$780	$2,500	$2,500
Fees after tax credit	$0	$2,300	$6,200
Net fee increase	$0	$300	$0
Percent covered by increased credit	100%	70%	100%

Tax credits for a married-couple family with two dependents and adjusted gross income of $65,000.

Fees at CSU and UC are approximate and vary between campuses depending on campus fees for services such as counseling, student union activities, student government, and recreation.

Getting the Word Out

Effective communication to students and parents regarding the benefits in the AO credit and the Lifetime Learning credit will be vital to counteract any drop in enrollment that may come from an increase in fees. The financial incentive to remain enrolled is clear, as long as people are aware that significant restrictions under past education tax credits have been changed. Many people will be surprised to learn that they may now benefit from a credit they had not qualified for in the past.

As students head back to school this fall and pay their increased fees, they will not see an in-hand savings but it is, nonetheless, there in the form of a federal tax break that they will get when they or their parents file their federal income tax. Getting this information out to students will not be easy when budgets are being cut and staff are being furloughed. Campus registration, financial aid, and student services offices are starting to communicate the information using new marketing methods such as email, websites, and social networking services.

Student Family Income and Marital Status

The Student Expenses and Resources Survey (SEARS) is a California-specific survey designed by the California Student Aid Commission and administered to students by the higher education systems. Family information collected from the SEARS data for this paper concludes the following averages for parent income quartiles.

The income data used in the survey does not make the distinction between married and single families. However, when asked about the marital status of their parents, 70% responded that their parents were married and 30% responded that their parents were single.

Income Quartiles at Public Colleges