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I. Introduction

National Taxpayers Union (NTU) is a 362,000-member citizen group with a 40-year history of participation in the vital debate over restructuring our nation's tax system. While this brief focuses on family and education assistance tax provisions, please know that NTU's members fully support a broad-based overhaul of the Tax Code. NTU has undertaken numerous campaigns to actively support reductions and simplification in federal taxes.

II. Tax Complexity

In "A Taxing Trend: The Rise in Complexity, Forms, and Paperwork Burdens," NTU has conducted annual comprehensive examinations of Tax Code complexity since 1999, highlighting historical trends in the compliance burden the IRS places on Americans.

NTU's 2012 findings include:

- The government's most current version of the Tax Code tops out at 3,939,937 words, an increase of more than 102,000 words from February 1, 2010. That is seven times as long as *War and Peace*.
- Paperwork burdens imposed by the Department of the Treasury, most of them attributable to personal and business income tax forms, cost Americans 6.38 billion hours according to the most recent available data. This gigantic amount of time would add up to a jaw-dropping $228.4 billion, when measured against the Bureau of Labor Statistics' average hourly employer cost for civilian workers and including additional expenses like postage, tax software, and tax preparers.
- The average compliance time for those using any of the Form 1040 series is 18 hours, up from 17.3 hours two years ago. The average out-of-pocket cost for filing these forms is $230. Seventy-five years ago, Form 1040 instructions were just two pages; now they are 189 pages long.
- Beyond the letter of the law, there are 20 volumes of regulations spanning 14,327 pages with 10.1 million words. Meaning the law and regulations now top 14 million words in all.
- Tax preparation costs continue to rise – since 1980, the average H&R Block fee has more than doubled (after inflation) to $179.07. Furthermore, even in the computer age, tests of tax preparers and tax software involving mock returns can still yield surprising and contradictory results.

To read the entire report, please visit: http://www.ntu.org/news-and-issues/taxes/tax-reform/ntupp130.html

III. Family Tax Provisions

A. Child Tax Credit (CTC)

In preparing their tax returns, taxpayers seeking the CTC must tackle IRS Publication 972, which contains a daunting 11 pages of instructions, 5½ pages of which are a complicated worksheet. Beyond issues of complexity, the CTC's distribution effects should be of some concern to policymakers. Nearly one-third of the tax benefits of the CTC go to taxpayers with Adjusted Gross Incomes of $75,000 or more. Meanwhile, less than a quarter of the benefits of the CTC go to taxpayers with AGIs less than $30,000. [i]

B. Earned Income Tax Credit (EITC)

The EITC is a well-intentioned program designed to encourage individuals to transition off of welfare and into the workforce. Although a growing economy and moderate tax burden for all generates the most opportunities to get ahead, the EITC has helped lift many Americans out of poverty, but it remains a program with much room for improvement.

It must be noted that the program is associated with an unacceptably high improper payment rate of approximately 23.5 percent. According to the Treasury Inspector General for Tax Administration, this resulted in $15.2 billion in erroneous payments in Fiscal Year 2011.[ii] It is imperative that the IRS develop better review processes to reduce improper payments.

Additionally, the EITC's "marriage penalty" discourages couples who might otherwise decide to wed. According to Jason Fichtner and Jacob Feldman of the Mercatus Center at George Mason University:

> *"Two non-married workers receiving the EITC could actually see their after-tax income decrease if they married. For example, the phase-out of the EITC for two non-married workers with two children potentially begins at $34,180 while the EITC for the married couple begins decreasing at $22,300. Although the decision to marry shouldn't be based on money, the reality and stress of making ends meet may drive low-income workers to not marry and even drive some marriages into divorce. Whether tax policy should encourage marriage or not is open to debate. But, at the very least, the tax code should not penalize marriage."*[iii]

C. Adoption Credit

The Adoption Tax Credit, which as of 2012 is no longer refundable, has also been plagued by erroneous claims. In 2011, the Treasury Inspector General for Tax Administration testified to the Ways & Means Committee's Oversight Subcommittee that:

> *As of April 28, 2011, the IRS has received 72,656 individual claims for more than $897 million in Adoption Credits. Of these, 42,399 (58 percent) either had no required documentation or the documentation was invalid or insufficient."*[iv]

D. Goals for Family Tax Reform

Policymakers should pursue tax simplification to the maximum extent possible. This should include constantly striving to maintain a uniform definition of a "child" in the Tax Code, eliminating any "marriage penalties," and consolidating numerous overlapping tax provisions. Though far from a panacea, an option worthy of consideration would be moving to a more simplified system with one "Family Tax

Credit" and one "Work Tax Credit," as proposed by the President's Economic Recovery Advisory Board (PERAB) in its 2010 report. PERAB also offered an alternative proposal in which the EITC, CTC and Child Dependent Exemption would be combined. This too, would likely represent a significant improvement over current law.[v]

IV. Education Tax Provisions

A. Duplicative Provisions

There are as many as 18 separate higher education tax provisions in the Tax Code.

These include:

American Opportunity Tax Credit	Lifetime Learning Tax Credit	Tuition and Fees Deduction	Education Loan Interest Deduction	529 College Savings Plans
Coverdell Education Savings Accounts	Tax-Free Employer Educational Assistance	Tax Treatment of Savings Bonds	Tuition Gift Tax Exclusion	Exclusion of Scholarship Income

These provisions have overlapping purposes, differing eligibility standards and confusing coordination rules. Because of their varied nature, the intersection of these provisions is incredibly complex. For example, because the tuition and fees deduction reduces Adjusted Gross Income, utilization of this provision in one tax year could qualify an individual for a different tax provision in a subsequent tax year. The complexity associated with these provisions leads to a great deal of confusion where those eligible for certain benefits often fail to apply and those ineligible sometimes do.

B. Other Federal Education Aid Programs

The numerous education tax provisions also serve a similar function as other education aid programs, namely federal grants and loans.

1. Federal Grants

- Pell Grants
- Federal Supplemental Educational Opportunity Grants (FSEOG)
- Teacher Education Assistance for College and Higher Education (TEACH) Grants
- Iraq and Afghanistan Service Grants

2. Federal Loans

- William D. Ford Federal Direct Loan Program (Direct Subsidized Loans, Direct Unsubsidized Loans, Direct PLUS Loans, Direct Consolidation Loans)
- Federal Perkins Loans

C. Tax Provisions vs. Programmatic Assistance

Are tax provisions the best and most appropriate means of providing financial assistance? Is the IRS well-equipped to perform the necessary review and assessment of eligibility?

In a 2011 review of the American Opportunity Tax Credit (AOTC), "Billions of Dollars in Education Credits Appear to Be Erroneous," the Treasury Inspector General for Tax Administration noted:

"Based on the results of our review, the IRS does not have effective processes to identify taxpayers who claim erroneous education credits. These ineffective processes have resulted in 2.1 million taxpayers receiving a total of $3.2 billion in education credits ($1.6 billion in refundable credits and $1.6 billion in nonrefundable credits) that appear to be erroneous. Over 4 years, erroneous education credits could potentially reach $12.8 billion."[vi]

This suggests the IRS lacks the capability to effectively administer tax credits under the law. If Congress were to simplify those laws, the tax agency's task could be made simpler.

Additionally, the study notes that of these 2.1 million erroneous filings, 51 percent occurred on forms completed by a professional tax preparer, which again speaks to the complexity of the current code.

D. Setting Appropriate and Realistic Policy Goals

Given our government's serious debt and deficit problems, the federal government must prioritize spending and evaluate the merits of all tax provisions. With regard to higher education assistance, any funds expended should be directed toward those most in need. Despite attempts to means-test higher education tax benefits, wealthier Americans benefit the most from these provisions. A 2011 Department of Education study of undergraduate tax benefit recipients found:

"On average, high-middle-income dependent undergraduate tax benefit recipients received the greatest amount in education tax benefits ($1,000), followed closely by their low middle-income counterparts ($900)."[vii]

E. The Higher Education "Bubble"

The relationship between financial aid and increasing tuitions has been a hotly debated topic for decades. But several trends are universally acknowledged to be true: higher education costs are increasing rapidly and students are leaving college with more and more debt.

The reasons behind this are numerous, but increased federal spending is playing a role. As noted in a study by the Center for College Affordability and Productivity:

"As higher financial aid pushes costs higher, it inevitably puts upward pressure on tuition. Higher tuition, of course, reduces college affordability, leading to calls for more financial aid, setting the vicious cycle in motion all over again."[viii]

That is not to suggest that federal financial aid necessarily causes tuition increases. As the aforementioned study finds:

"For policy makers, the key point is that financial aid that is restricted to low income students is much less likely to be captured by colleges, and will therefore be more likely to succeed in making college more affordable and therefore accessible (for low income students). In contrast, universally available programs are more likely to simply fuel tuition increases and therefore more likely to fail to make college more affordable."[ix]

Once again, this underscores the importance of targeting any federal education assistance to low-income Americans. Broad-based aid programs and excessively refundable tax credits are creating heavy pressure on the federal budget deficit and must be restrained.

F. **Goals for Education Assistance Tax Reform**

Policymakers should pursue a tax code that is as simple and fair as possible. That means eliminating duplicative provisions whenever feasible. To that end, policymakers should consider eliminating all higher education tax provisions. Any higher education assistance deemed appropriate by Congress could be provided through grants and subsidized loans, which should also be improved with private-sector market discipline, instead of wholesale federal takeovers. This is not to say that Congress should increase federal spending or expand the Department of Education. Rather, these changes should be pursued as part of an effort to restore the Tax Code to its intended purpose of raising revenue. Doing so would ease simplification efforts and reduce the potential for waste, fraud and abuse that has led to high improper payment rates for tax provisions like the AOTC.

Notes:

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[i] Tax Policy Center, "Tax Benefit of the Child Tax Credit; Distribution of Federal Tax Change by Cash Income Level, 2013." March 21, 2013. http://www.taxpolicycenter.org/numbers/displayatab.cfm?DocID=3871

[ii] Treasury Inspector General for Tax Administration, "Improper Payments Elimination and Recovery Act Risk Assessments of Revenue Programs Are Unreliable." January 31, 2013. http://www.treasury.gov/tigta/auditreports/2013reports/201340015fr.pdf

[iii] Fichtner, Jason and Feldman, Jacob, "Eliminate the Marriage Tax Penalty," *U.S. News and World Report*, September 18, 2012. http://www.usnews.com/opinion/blogs/economic-intelligence/2012/09/18/eliminate-the-marriage-tax-penalty

[iv] George, J. Russell, "Improper Payments in the Administration of Refundable Tax Credits," Testimony of the Treasury Inspector General for Tax Administration before the House Ways & Means Committee, Subcommittee on Oversight. May 25, 2011. http://www.treasury.gov/tigta/congress/congress_05252011.pdf

[v] The President's Economic Recovery Advisory Board, "The Report on Tax Reform Options: Simplification, Compliance, and Corporate Taxation." August 2010. http://www.whitehouse.gov/sites/default/files/microsites/PERAB_Tax_Reform_Report.pdf

[vi] Treasury Inspector General for Tax Administration, "Billions of Dollars in Education Credits Appear to Be Erroneous." September 16, 2011. http://www.treasury.gov/tigta/auditreports/2011reports/201141083_oa_highlights.pdf

[vii] Radford, Alexandria W. and Berkner, Lutz, "Federal Education Tax Benefits Who Receives Them and to What Extent Do They Shape the Price of College Attendance?" U.S. Department of Education. November 2011. http://nces.ed.gov/pubs2012/2012212.pdf

[viii] Gillen, Andrew, "Introducing Bennett Hypothesis 2.0." Center for College Affordability and Productivity. February 2012. http://centerforcollegeaffordability.org/uploads/Introducing_Bennett_Hypothesis_2.pdf

[ix] *Ibid.*