The Honorable Dave Camp
Chairman, House Ways and Means Committee
341 Cannon House Office Building
Washington, DC 20515

The Honorable Diane Black
1531 Longworth House Office Building
Washington, DC 20515

The Honorable Sander Levin
Ranking Member, House Ways and Means Committee
1236 Longworth House Office Building
Washington, DC 20515

The Honorable Danny Davis
2159 Rayburn House Office Building
Washington, DC 20515

April 15th, 2013
Comments: Education and Family Benefits Tax Reform Working Group

Dear Sirs and Madam:

The Institute for Higher Education Policy (IHEP) respectfully submits these public comments for the House Ways and Means Committee's Education and Family Benefits Tax Reform Working Group. Specifically, these comments will address how to improve tax benefits related to higher education. IHEP is a non-profit, non-partisan research organization committed to promoting access to and success in higher education for all students. Based in Washington, D.C., IHEP develops innovative policy- and practice-oriented research to guide policymakers and education leaders, who develop high-impact policies that will address our nation's most pressing education challenges.

Higher Education is More Important, and More Costly, than Ever

Higher education is a steady and powerful predictor of economic success, both for individuals and for the U.S. at large. Median annual earnings are twice as high – and unemployment rates are twice as low – for those with a bachelor's degree than those with a high school diploma.[1] Higher education is also predictor of intergenerational economic mobility: Students born into the bottom quintile of income who obtain a college degree have an 80 percent chance of moving up the economic ladder[2], while nearly half of all adults born in the bottom income quintile remain in the bottom quintile without a postsecondary degree.[3]

As postsecondary education has become increasingly vital to participate and succeed in today's economy, affording it has become cumbersome or impossible for many students, for several reasons. First, state higher education funding per student has receded to its lowest level in 25 years,

[1] Bureau of Labor Statistics (2013). Usual Weekly Earnings of Wage And Salary Workers: Fourth Quarter 2012. Washington, DC: U.S. Department of Labor. Retrieved from: http://www.bls.gov/news.release/pdf/wkyeng.pdf; Bureau of Labor Statistics (2013). Table 7. Employment status of the civilian noninstitutional population 25 years and over by educational attainment, sex, race, and Hispanic or Latino ethnicity. Washington, DC: U.S. Department of Labor. Retrieved from: http://www.bls.gov/cps/cpsaat07.htm
[2] Isaacs, J., Sawhill, I., and Haskins, R. (2011). Getting Ahead or Losing Ground: Economic Mobility in America. Washington, DC: The Pew Charitable Trusts and the Brookings Institution. Retrieved from: http://www.pewtrusts.org/uploadedFiles/wwwpewtrustsorg/Reports/Economic_Mobility/Economic_Mobility_in_America_Full.pdf
[3] Haskins, R., Holzer, H. and Lerman, R. (2009). *Promoting Economic Mobility by Increasing Postsecondary Education.* Washington, DC: Pew Charitable Trusts. Retrieved from: http://www.brookings.edu/~/media/research/files/papers/2009/5/economic%20mobility%20haskins/05_eonomic_mobility_haskins

IHEP
INSTITUTE FOR HIGHER EDUCATION POLICY
1825 K Street, NW, Suite 720
Washington, DC 20006
202 861 8223 TELEPHONE
202 861 9307 FACSIMILE
www.ihep.org WEB

thereby increasing the cost of college for students.[4] Meanwhile, many students need more help than ever in meeting college costs. Currently, over two-thirds (68 percent of elementary and secondary students are eligible for Free and Reduced Price Lunch), up from 42 percent in 1997, meaning students who do access college are less likely to have built up the financial resources to fund it on their own or through support of immediate family members.[5] Unsurprisingly, students – primarily those from low-income and middle-class households – have been required to take on greater levels of debt in order to attend and complete college.[6]

Unfortunately, many students are unable to attend at all. In 2010, 52 percent of low-income students who completed high school enrolled in college in the ensuing fall. Meanwhile, 67 percent of students from middle-income families and 82 percent of students from high-income did so, indicating that college attendance is firmly correlated with socioeconomic status.[7]

Higher Education Tax Benefits Attempt – and Fail – to Alleviate Costs for Many Students

To combat these trends, the federal government has created several mechanisms to help students overcome the costs associated with attending college, including federal grants, loans, and work study. In the last few decades, however, the government has also created several incentives to attend college via the tax code. Some of these, such as the student loan interest deduction, are offered to individuals after they have left school, and are provided to alleviate the burden of student loan debt on students. Others, such as qualified tuition programs (or 529 plans), provide tax advantages for students and families who save for higher education prior to (or during) enrollment. Three in particular, including American Opportunity Tax Credit (AOTC), Lifetime Learning Credit (LLC), and the Tuition and Fees Deduction, are designed to provide aid to students in their current year of study. In particular, these three forms of tax-based aid have the potential to alleviate college costs in real-time to students, thereby in theory increasing their ability to access and persist through school.

Unfortunately, there is little evidence that these incentives through the tax code are reaching the students who stand to benefit the most, namely low-income students, raising questions about whether or not the over $34 billion in lost revenue annually among all education tax incentives[8] is being used wisely, and how it could be put to better use to serve students in pursuit of our national college attainment goals. ***In order to maximize the potential of tax-based aid to students, Congress should examine ways to 1.) reform tax credit eligibility rules so underserved students***

---

[4] State Higher Education Executive Officers Association (2012). State Higher Education Finance Report 2011. Retrieved from: http://www.sheeo.org/sites/default/files/publications/SHEF_FY11.pdf. Figure includes funding per full-time equivalent student.
[5] U.S. Department of Agriculture (2012). The Food Assistance Landscape: FY2012 Annual Report. Retrieved from: http://www.ers.usda.gov/media/1060737/eib-109_single-pages.pdf; U.S. Department of Agriculture (1999). Current Population Survey of NSLP Participation and Income. Retrieved from: http://www.fns.usda.gov/Ora/menu/Published/CNP/FILES/nslpcps.pdf
[6] Houle, J. (2012). Disparities in Debt: Parents' Socioeconomic Resources and Young Adult Student Loan Debt. American Sociological Organization. Retrieved from: http://www.asanet.org/press/middle_income_families_at_risk_for_higher_student_loan_debt.cfm; Federal Reserve Bank of San Francisco (2011). Student Debt and Default in the 12th District. Retrieved from: http://www.frbsf.org/publications/community/research-briefs/student-debt-default-bay-area.pdf
[7] National Center for Education Statistics (2012). NCES Fast Facts: Immediate Transition to College. Washington, DC: U.S. Department of Education. Retrieved from: http://nces.ed.gov/fastfacts/display.asp?id=51
[8] Maag, E. (2013). "Education Tax Credits Rival Pell Grant Program in Size: Reforms Proposed". Tax Vox, the Tax Policy Center blog. Retrieved from: http://taxvox.taxpolicycenter.org/2013/02/25/education-tax-credits-rival-pell-grant-program-in-size-reforms-proposed/

may utilize these benefits, and 2.) restructure tax credit delivery mechanisms so students may take advantage of them when they are most needed – when tuition and other costs come due.

Tax Benefits – By Design or Implementation – Do Not Reach Underserved Students

Over the past fifteen years, the federal government has designed several tax benefits to offset the cost of tuition and college-related expenses. In 1997, Congress created the Hope Credit for individuals earning below $60,000 and households below $120,000. Filers could claim it for two years and receive up to a $1,800 annual benefit, though households without a tax liability were ineligible.

In 2009, as a part of the American Recovery and Reinvestment Act (AOTC), Congress reformed and renamed the Hope Credit (as the AOTC) to expand eligibility for up to four years, increase the maximum benefit to $2,500 (around half of the maximum Pell Grant), expand eligibility upwards to $90,000 for individuals (and $180,000 for households), and include low-income households – to a point.[9] The credit was made partially refundable so that low-income families – those with no tax liability – could receive up to 40 percent (or $1,000) of the credit if they claim it. For reference, over 83 percent of families without a tax liability make under $30,000 annually.[10] Low-income households, therefore, are only eligible for a partial benefit.

Similar to the AOTC, the federal government also offers the Lifetime Learning Credit, a $2,000 nonrefundable credit for students who take at least one postsecondary education course in a given year. Students cannot claim both the AOTC and the LLC in the same year. Finally, the federal government offers a $4,000 tuition and fees tax deduction that is available to individuals earning up to $80,000 a year and joint filers making as much as $160,000 annually. By definition, tax deductions – as opposed to credits – provide more benefit for middle- and upper-income families, since they reduce taxable income and the value of a deduction rises with a taxpayer's marginal tax rate. Families with no income tax liability, by definition, cannot benefit from a deduction.

Due to the design of these tax benefits, a substantial portion of these three forms of aid – a quarter – goes to families with incomes exceeding $100,000 annually.[11] In particular, a quarter of all the aid provided by the AOTC still goes to households making between $100,000 and $200,000 annually, with these households receiving over 2.5 times the benefit amount of low-income students and families.[12] More than half of the benefit for the tuition and fees deduction goes to families making over $100,000 a year.[13] Even 529 plans, designed to help families prepare for the oncoming cost of

---

[9] Internal Revenue Service (2011). American Opportunity Tax Credit. Retrieved from: http://www.irs.gov/uac/American-Opportunity-Tax-Credit

[10] Tax Policy Center (2013). T11-0183 - Baseline Distribution of Tax Units with No Income Tax Liability by Cash Income Level; Current Law, 2013 http://www.taxpolicycenter.org/numbers/displayatab.cfm?Docid=3064&DocTypeID=1

[11] College Board (2012). Trends in Student Aid 2012. Washington, DC: The College Board. Retrieved from: http://trends.collegeboard.org/sites/default/files/student-aid-2012-full-report.pdf

[12] Tax Policy Center (2012). Baseline Distribution of Students Receiving Pell Grants, AOTC, LLC, and Tuition and Fees Deduction; All Students, by Adjusted Gross Income, 2013 http://www.taxpolicycenter.org/numbers/displayatab.cfm?Docid=3849&DocTypeID=7

[13] White, James R., and Scott, G. (2012). Improved Tax Information Could Help Families Pay For College, Report To The Committee On Finance, U.S. Senate, GAO-12-560. Government Accountability

college, are not utilized by low-income households. Only 9 percent of participants in 529 plans report incomes below $50,000.[14]

As a reference, nearly three-fourths of Pell Grant recipients – the corresponding federal financial aid program designed to help low-income students – are from families whose income is $30,000 or below.[15] Still, Pell Grant recipients are over twice as likely to take out student loans as non-Pell recipients and graduate with around $3,500 more in student loan debt than higher-income students who do borrow.[16] Even after grant aid, low-income students must devote an amount equivalent to nearly three-fourths of their income to pay for college costs.[17] This indicates that there is ample room for grant and other forms of aid, including tax incentives, to reduce unmet need so that low-income students are less likely to take on higher debt.

Clearly, the middle class has also been squeezed by college costs – and corresponding student debt – but it is also abundantly clear that low-income students, who face the largest financial burden for college, receive far less relief than their more advantaged counterparts. Furthermore, research has found little[18] or mixed[19] evidence that the AOTC and other forms of tax-based aid have an impact on college enrollment for low-income households, and primarily go to students who likely already would have attended college.

Timing and Complexity Reduce the Effectiveness of Tax-Based Aid

If the goal is to reach low-income students and increase college affordability, ***Congress should minimally consider making the AOTC fully refundable, as well as finding mechanisms to provide some of the benefit of the tuition and fees deduction to low-income student populations.*** While these steps would likely increase uptake among the broader population, they would still be insufficient in helping students pay for tuition and other college expenses when they are incurred, though.

By definition, tax benefits are received for behaviors that have already taken place – such as purchasing a home, buying health insurance, working, or, in this case, paying for college. Given that tuition bills are due primarily in September and January of each year, a tax subsidy that is received in April or later of the following year – up to 16 months after tuition is paid – is unlikely to give students much in the way of financial help, much less incentivize college attendance and completion.

Office.

[14] Bearden, Bridget. 2009. Evaluating the College Savings Market Opportunity. Boston, MA: Financial Research Corporation. Retrieved from: http://frcnet.com/college_saving.php.

[15] U.S. Department of Education (2012). FY 2013 Justifications of Appropriations Estimates to Congress: Student Financial Assistance. Washington, DC: U.S. Department of Education. Retrieved from:http://www2.ed.gov/about/overview/budget/budget13/justifications/p-sfa.pdf.

[16] Engle, J., Lynch, M. and Cruz, J. (2011). Lifting the Fog on Inequitable Financial Aid Policies. Washington, DC: The Education Trust. Retrieved from: http://www.edtrust.org/sites/edtrust.org/files/publications/files/Lifting%20the%20Fog%20FINAL.pdf

[17] Author's calculations from the National Postsecondary Student Aid Survey 2007-2008 (NPSAS:08). Calculations are for full-time, full-year dependent students attending one institution.
full-year, one-institution dependent undergraduates

[18] Turner, N. (2011). The Effect Of Tax-Based Federal Student Aid On College Enrollment. National Tax Journal, 64(3). Retrieved from: http://ntj.tax.org/wwtax/ntjrec.nsf/06ACF958A6B9036785257914004B1D3D/$FILE/A04-Turner.pdf

[19] Long, B.T. (2004). The Impact of Federal Tax Credits for Higher Education Expenses, in Hoxby (ed.) College Choices: The Economics of Where to Go, When to Go, and How to Pay For It (ed.) National Bureau of Economic Research. Retrieved from: http://www.nber.org/chapters/c10099.pdf

Also, the AOTC only applies to tuition, fees, books, and computers. College students also incur living expenses, transportation, child care and other costs when attending school. By not allowing these college expenses to qualify for the credit, the AOTC is unavailable to offset a substantial portion of college costs, unduly affecting students with dependent children in particular.[20] ***Congress should consider including these expenses in AOTC eligibility.***

The eligibility for tax credits may also be further reduced for students who receive the Pell Grant and other forms of grant aid, because grant aid almost always applies to tuition and fees before other expenses. If grants cover most or all of the cost of tuition and fees, students will be ineligible for the AOTC, despite incurring other costs due to attending college, such as transportation and child care.[21] Simultaneously, students whose tuition is offset by grant aid must keep track of education-related expenses incurred throughout the year – including books, fees, and computers – in order to prove eligibility for tax credits, which may prove onerous.

Finally, the sheer complexity of eligibility rules between the AOTC, LLC, tuition and fees benefit, and other education benefits increases the likelihood that families who do not engage professional tax help will miss out on benefits for which they are eligible. The Government Accountability Office (GAO) found recently that one-in-four tax filers who were eligible for an education tax credit received less than the maximum to which they were entitled, underscoring the inefficiency of these credits. [22] ***Congress should consider aligning eligibility or streamlining tax credits to ensure that eligible students take advantage of them.***

Improving the AOTC and LLC: Better Targeting, Better Timing

Many have called for tax credits to be eliminated and appropriated toward grant aid[23] – a form of financial aid that has proven more effective for low-income populations.[24] It remains unclear that moving tax-based aid to appropriations, however, would be an uncomplicated step. Furthermore, higher education tax benefits have gained broad bipartisan support – and the AOTC in particular was renewed for five years on January 1st as a part of the American Taxpayer Relief Act of 2012. Given this, Congress should look at ways to improve the AOTC and other credits, by addressing the two main shortcomings inherent in them.

First, it would be of great help to low-income students if they could acquire the AOTC in the first place. ***Extending refundability up to 100% of the AOTC amount for low-income tax filers would allow them to receive the full benefit, and applying the credit to non-tuition costs would help students, particularly at low-tuition institutions.*** And much like the popular and successful

---

[20] The Institute for College Access and Success (2012). Aligning the Ends and the Means. Retrieved from: http://www.ticas.org/files/pub/TICAS_RADD_White_Paper.pdf

[21] Reimherr, P. , Harmon, T., Strawn, J. and Choitz, V. (2013). *Reforming Student Aid: How to Simplify Tax Aid and Use Performance Metrics to Improve College Choices and Completion.* Washington, DC: Center for Law and Social Policy. Retrieved from: http://www.clasp.org/admin/site/documents/files/Final-RADD-WhitePaper-Feb-2013.pdf; http://www.ticas.org/files/pub/TICAS_RADD_White_Paper.pdf

[22] Government Accountability Office (2008). Multiple Higher Education Tax Incentives Create Opportunities for Taxpayers to Make Costly Mistakes. Washington, DC: Government Accountability Office. Retrieved from: http://www.gao.gov/assets/120/119907.html

[23] Burd et al (2013). Rebalancing Resources and Incentives in Federal Student Aid. Washington DC: New America Foundation: Retrieved from: http://education.newamerica.net/publications/policy/rebalancing_resources_and_incentives_in_federal_student_aid; TICAS 2013

[24] Heller, D. E. 2012. "Making College a Priority: Promising Practices and Strategies." Testimony before the U.S. Senate Committee on Health, Education, Labor and Pensions. Retrieved from: http://www.help.senate.gov/imo/media/doc/Heller.pdf.

Earned Income Tax Credit, which provides an incentive to work, a refundable AOTC would send a powerful signal that enrolling in higher education is a national priority.

Second, timing and complexity must be addressed. One option could be to ***make the AOTC a formal part of the financial aid package that students receive upon applying for school.*** This could be done in a way that "fronts" the credit to institutions. The institution could then include the AOTC in aid packages along with Pell Grants, Federal Work Study, institutional aid, and loans. This would require coordination between the IRS and the U.S. Department of Education, which are already working on ways to integrate the FAFSA with IRS data.

Another option would still ***provide the credit to students directly, but rather than handing it out well after tuition bills are paid, families could have the option of receiving an advanced credit – deposited into an account that could only be used for educational expenses to which families themselves could also contribute***.[25] The structure of the credit could be maintained; families would only be eligible to receive the credit for four years total, and if a student does not enroll, the money would revert back to the IRS. However, this option may allow students to better understand the ways in which higher education can be financed, and even build meaningful balances over time. Indeed, a growing body of research suggests that early financial preparation can have impacts on academic and other college-going behaviors, even increasing college access for students of all income levels.[26]

We thank this committee for its attention to tax reform, specifically related to higher education. Efforts to improve the tax code to better incentivize all students to attend, and help all students afford college, in a way that maximizes the contributions of the American taxpayers, could have a dramatic impact on the college attainment of all Americans, and perhaps more importantly, our future economic growth as a country.

Sincerely,

Michelle A. Cooper, Ph.D.
President, Institute for Higher Education Policy

[25] Huelsman, M. and Cunningham, A. (2012). Making Sense of the System: Financial Aid for the 21st Century Student. Washington, DC. Institute for Higher Education Policy. Retrieved from: http://www.ihep.org/assets/files/publications/m-r/reimagining-aid-design-and-delivery-final-january-2013.pdf

[26] Elliott, W., and S. Beverly. (2011) "The Role of Savings and Wealth in Reducing 'Wilt' Between Expectations and College Attendance." Journal of Children & Poverty 17(2), 165–185.

IHEP
INSTITUTE FOR HIGHER EDUCATION POLICY
1825 K Street, NW, Suite 720
Washington, DC 20006
202 861 8223 TELEPHONE
202 861 9307 FACSIMILE
www.ihep.org WEB