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April 15, 2013

## **EXECUTIVE SUMMARY**

We recommend (1) eliminating the Tuition and Fees Deduction and (2) increasing the income thresholds on the Lifetime Learning Credit. This will result in (A) simplified choices for education tax benefits, (B) elimination of an IRS tax form, and (C) removal of an unnecessary line from Form 1040.

### **Simplifying Higher Education Tax Benefits: Why We Should Eliminate the Tuition and Fees Deduction**

Chairwoman Black, Vice Chairman Davis and Members of the Education and Family Benefits Tax Reform Working Group:

Thank you for taking the time to engage with the public toward the goal of simplifying the tax code. We represent the tax compliance arm of the University of Cincinnati and take great interest in making the tax code provisions related to higher education as fair and helpful as possible for our diverse student body and their families.

In particular, we encourage simplifying the current state of higher education tax benefits. At present, there are three mutually exclusive tax provisions directed at reducing tax liability for individuals pursuing higher education: (1) The American Opportunity Tax Credit, (2) the Lifetime Learning Credit, and (3) the Tuition and Fees Deduction. This current scheme is confusing for taxpayers, particularly parents sending children to college for the first time, who struggle with determining which alternative applies and yields the greatest benefit.

After examining the strengths, weaknesses, and purpose of each of these tax benefits, we believe we can simplify the decision facing such taxpayers by eliminating the Tuition and Fees Deduction. The Tuition and Fees Deduction is either inferior or superfluous to the two education credits in most family and income scenarios. In fact, by a small increase to the Lifetime Learning Credit's limits on modified adjusted gross income, we are confident the Tuition and Fees Deduction can be eliminated without any significant impact to taxpayers.

## I. Current Law

### A. Tuition and Fees Deduction

The Tuition and Fees Deduction under Internal Revenue Code section 222 (**the Deduction**) permits a taxpayer to deduct up to \$4,000 per year of qualified education expenses. The size of the Deduction varies by a taxpayer's modified adjusted gross income (**MAGI**). Single filers with up to \$65,000 of MAGI (\$130,000 for joint filers) may claim a deduction of up to \$4,000, single filers with MAGI of \$65,000-\$80,000 (\$130,000-\$160,000 for joint filers) may claim a deduction of up to \$2,000, and the Deduction is not available to single filers with MAGI greater than \$80,000 (\$160,000 for joint filers).

Therefore, because the maximum deduction is only available to single filers with MAGI less than \$65,000, the maximum benefit of the Deduction is \$1,000 in 2012 (\$4,000 deduction x 25% income tax rate for single filers in 2012 on taxable income of \$35,350-\$85,650). The \$1,000 maximum tax benefit of the \$4,000 maximum deduction is the same for married taxpayers filing a joint return because only those with MAGI of \$130,000 or less, a 25% maximum tax bracket, receive the full \$4,000 deduction (\$4,000 deduction x 25% income tax rate for those married filing jointly on taxable income of \$70,701-\$142,700).

### B. Lifetime Learning Credit

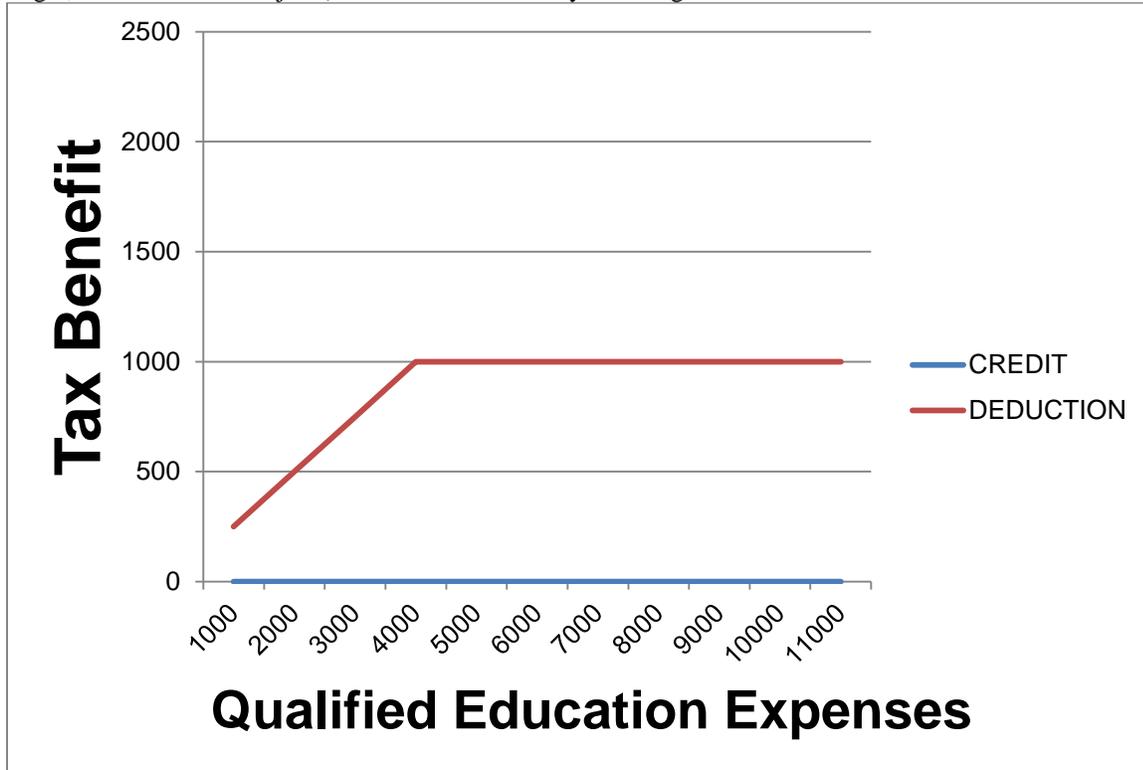
By contrast, the Lifetime Learning Credit under Internal Revenue Code 25A(c) (**the Credit**) grants a taxpayer a credit of up to \$2,000 annually for qualified education expenses. The Credit is calculated as 20% of the first \$10,000 of qualified education expenses. The MAGI thresholds for the Credit are lower than those of the Deduction, with single filers with MAGI less than \$52,000 (\$104,000 for joint filers) eligible for the full benefit of the Credit and a phase-out of the Credit occurring for single filers earning between \$52,000 and \$62,000 (\$104,000-\$124,000 for joint filers). Taxpayers with incomes greater than \$62,000 and \$124,000, respectively, are not entitled to the Credit.

### C. Redundancy of the Tuition and Fees Deduction

Both the Credit and the Deduction are available to the same classes of individuals for the same qualified education expenses. No double benefit is permitted. Taxpayers with qualifying expenses must choose between the Credit or the Deduction. However, given a choice between the two benefits, in most scenarios, the Credit is the superior method for reducing tax liability.

The Deduction yields the greater benefit only for two relatively narrow groups of taxpayers. The first such group is based on MAGI which falls between the lower phase-out range for the Credit and the higher phase-out range for the Deduction. Single filers with MAGI between \$62,000-\$65,000, and joint filers with MAGI between \$124,000-\$130,000 can claim the Deduction and receive a benefit that is up to \$1,000 higher than the Credit. See Figure 1, following. The Deduction also yields a relative, but lesser, benefit for other taxpayers with MAGI in the ranges of \$57,000-\$80,000 (single) or \$114,000-\$160,000 (joint).

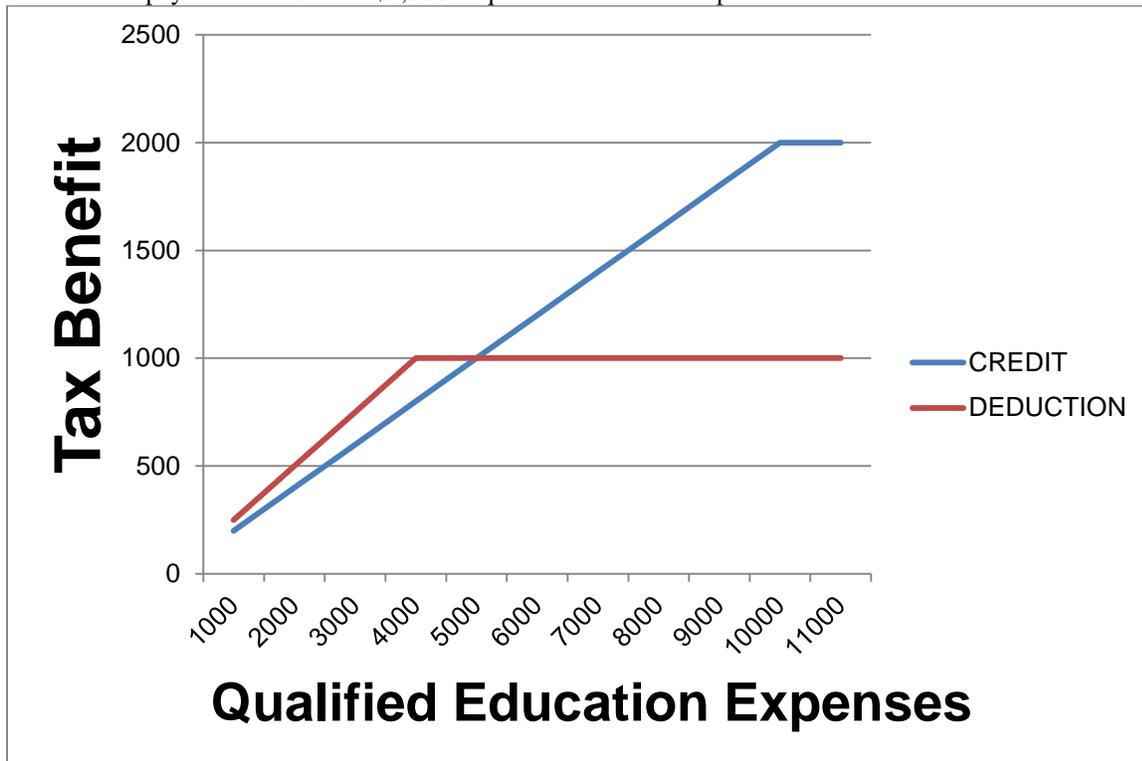
**Figure 1:** Single filer, no dependents, standard deduction, MAGI = \$64,000. Also, joint filers, 2 dependents, standard deduction, MAGI = \$128,000. These taxpayers are within the *very narrow* income ranges (\$62K-\$65K for single; \$124K-\$130K for joint) where the Deduction yields its greatest relative benefit over the Credit.



The second group benefiting more from the Deduction is based on their qualifying education expenses of less than \$5,000. For this group, which applies only to certain income ranges, the Deduction’s relative benefit over the Credit is only \$200 at its greatest. This \$200 advantage occurs only when the taxpayer has exactly \$4,000 of qualified expenses and at least \$4,000 of income taxed at the 25% rate. See Figure 2, following.



**Figure 2:** Single filer, no dependents, standard deduction, MAGI = \$50,000. Also, joint filers, 2 dependents, standard deduction, MAGI = \$110,000. This chart illustrates the Deduction's minimal relative benefit over the Credit for taxpayers with less than \$5,000 in qualified education expenses.



As discussed above, for both single and joint filers, the maximum benefit of the Deduction is \$1,000. The maximum benefit of the Credit is \$2,000. The two alternatives are equal if a taxpayer has exactly \$5,000 of qualified education expenses and has at least \$4,000 of income taxed at 25% rates (taxable income of \$35,350-\$85,650 for single filers or \$70,701-\$142,700 for joint filers). If qualified expenses exceed \$5,000, the Credit is superior by a difference of up to \$1,000.

However, a full-time or part-time student's annual qualified education expenses will often exceed \$5,000. Therefore, in most cases the Credit will be more beneficial than the Deduction. An exception can be found in certain adult learners whom the Credit was also designed to benefit. Such adult learners, who may wish to attend as little as a single class to acquire or improve job skills, could have qualified education expenses of less than \$5,000. In such a scenario, the Deduction would be more beneficial than the Credit but never by more than \$200, and only by that much in rare cases.

## II. Proposed Changes to Tax Code

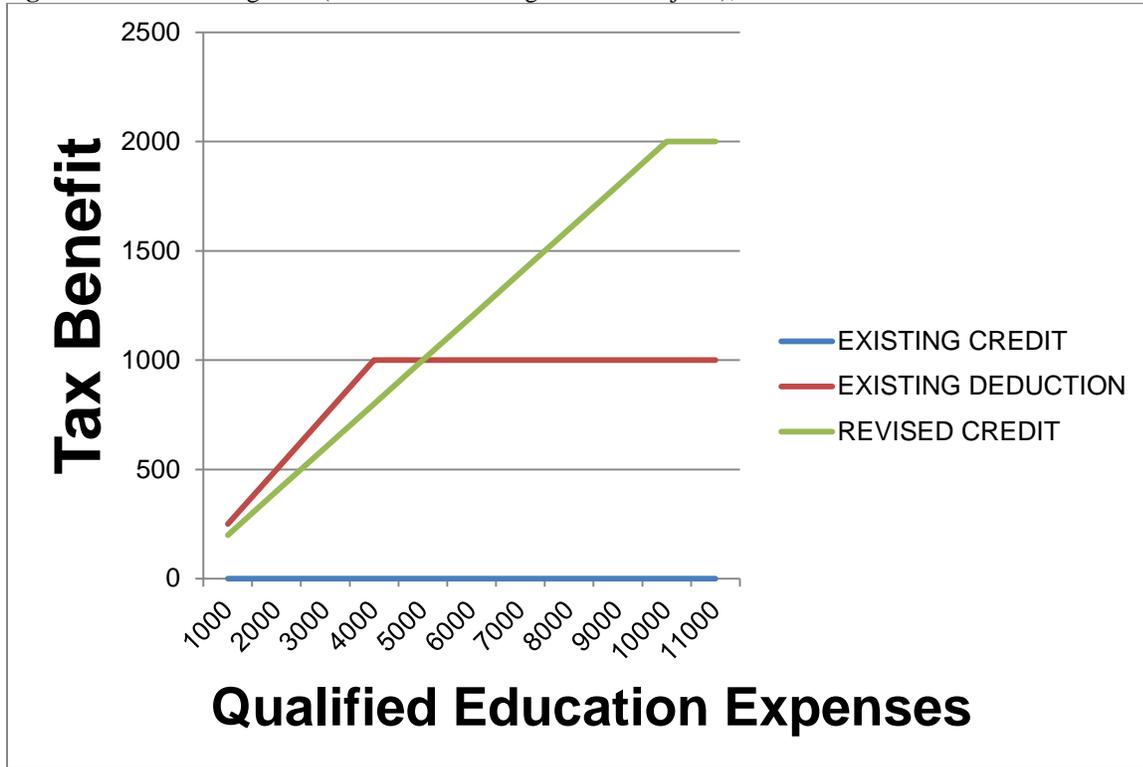
Because claiming the Deduction over the Credit is rarely in a taxpayer's interest, we recommend the Deduction be allowed to expire at the end of 2013 in the interest of simplifying the tax benefit alternatives for those pursuing higher education.



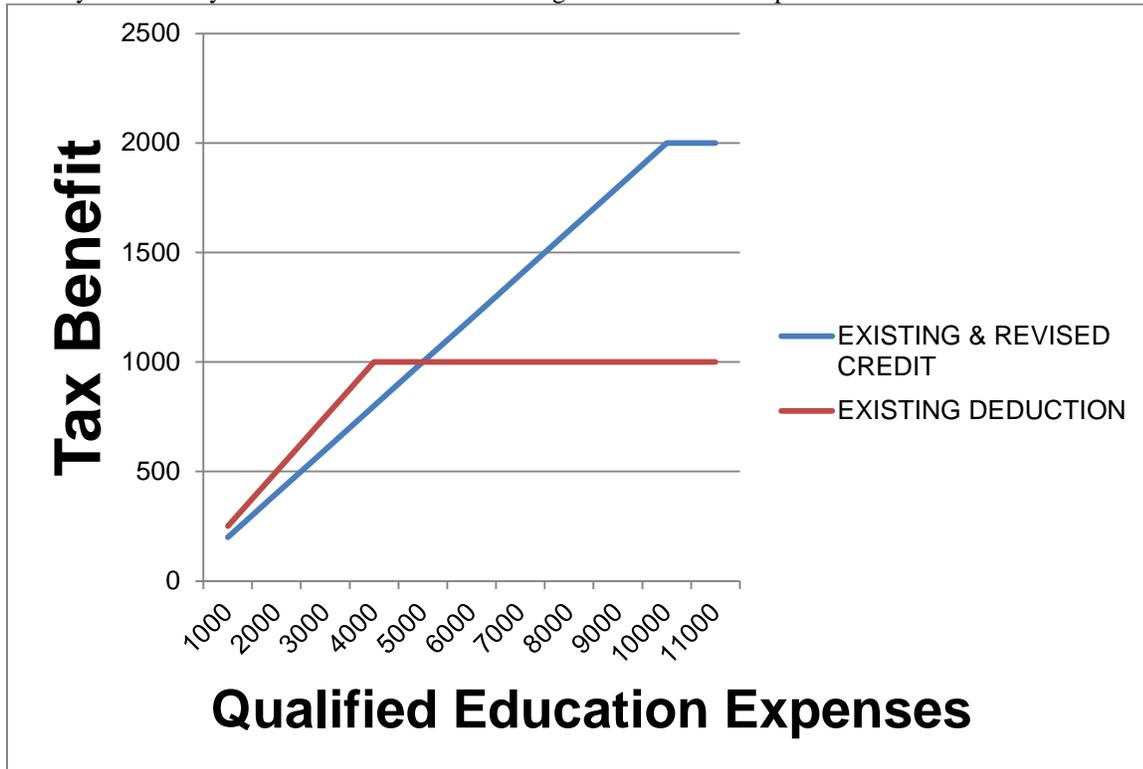
We also recommend an accompanying increase in the Credit's maximum MAGI threshold for single filers from \$62,000 to \$80,000, and for joint filers from \$124,000 to \$160,000, with a reduced credit available beginning at \$65,000 for single filers and \$130,000 for joint filers. These proposed ranges are consistent with the existing Deduction.

After these adjustments, the Credit will yield benefits substantially similar to or greater than what taxpayers currently receive under the existing scheme, and they will no longer have to waste their time trying to analyze which of those two alternatives is better. See Figures 3 and 4.

**Figure 3:** Based on Figure 1 (MAGI = \$64K single or \$128K joint), with addition of Revised Credit.



**Figure 4:** Based on Figure 2 (MAGI = \$50K single or \$110K joint), with addition of Revised Credit. The Revised Credit yields exactly the same benefit as the Existing Credit in this example.



The result would be a clearer analysis for taxpayers pursuing higher education: If the qualified education expenses are for the first four years of undergraduate study, they should use the American Opportunity Credit; If the qualified education expenses are for any other purpose, they should use the Lifetime Learning Credit.

This change will also make tax returns simpler by eliminating IRS Form 8917 (Tuition and Fees Deduction) and by removing line 34 from Form 1040.

These recommendations will reduce confusion and improve efficiency both for taxpayers and the Internal Revenue Service.

You are welcome to contact our Tax Compliance office at (513) 556-5899 or at [tax@uc.edu](mailto:tax@uc.edu) for any further discussion. Thank you for your efforts toward simplifying the Internal Revenue Code.

Sincerely,

Barry L. Holland, CPA  
 Director, Tax Compliance

Gregory Forrest  
 Tax Law Intern

