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April 15, 2013

The Honorable Diane Black
United States House of Representatives
Washington, DC 20515

The Honorable Danny K. Davis
United States House of Representatives
Washington, DC 20515

Dear Representative Black and Representative Davis:

On behalf of The Institute for College Access & Success (TICAS), thank you for the opportunity to provide our recommendations for reforming federal education tax benefits. TICAS is an independent nonprofit organization that conducts research and analysis to make higher education more available and affordable for students of all backgrounds. Please find enclosed our recent white paper, *Aligning the Means and the Ends: How to Improve Federal Student Aid and Increase College Access and Success*. In this paper we explore and make recommendations for improving each major component of federal financial aid policy to better support student access and success, including student and college eligibility for aid, consumer information, federal grant aid, student loans and tax benefits.

It is important to note that when we talk specifically about education tax benefits, it is in the context of a federal aid system where need-based grant aid is insufficient to overcome gaps in access and success by income, where students and families lack adequate information to make fully informed decisions about which colleges to apply to and attend, where the complexity of current aid programs and application processes undermine their effectiveness, and where the neediest students are not consistently prioritized.

Research has shown that to effectively increase college access and success, financial aid must be targeted to students who would otherwise be unlikely or unable to enroll in or complete college (such as moderate- and low-income students), and made available to reduce the cost at the time of enrollment**.** Yet current tax benefits disproportionately accrue to upper-middle- and higher income families, whose children are already the most likely to attend and graduate college. And for those lower income students and families who do qualify, the benefits are received long after they have had to pay for the education. In addition, current higher education tax benefits are complex, confusing, and duplicative. It takes the Internal Revenue Service 87 pages to explain them all and how they do and do not interact.

Based on research, we developed recommendations for reforming education tax benefits, which are detailed on pages 70-79 of our enclosed white paper and summarized below. Overall, we recommend almost entirely eliminating higher-education tax benefits and redirecting the savings (more than $100 billion over the first five years) into Pell Grants and incentive funds for states and colleges to increase access, affordability, and success. However, we recognize that there is strong bipartisan support for higher education tax benefits, and if they are not going to be eliminated and the savings redirected to Pell Grants, we recommend dramatically streamlining and improving the targeting of the benefits.

- **Streamline the tuition deduction, student loan interest deduction, Lifetime Learning Credit and Coverdell Accounts into one improved American Opportunity Tax Credit (AOTC), which is currently the most likely benefit to increase access and success because it provides assistance to low-**

income students who are more likely to be on the margin of attending and completing college. Specifically, our recommendations to improve the AOTC include:

- Increase refundability as much as possible from the current 40%, preferably to 100%.
- Replace the current four-year cap with a lifetime dollar cap to provide the same maximum benefit to all students and provide a benefit to those completing a degree while working full-time and attending school part-time.
- Index the credit amounts and income limits to inflation to prevent the value and eligibility limits from declining over time.
- Phase out eligibility at the lower, preexisting HOPE Credit levels. If this is not viable, begin phasing out earlier—at $107,000 for joint filers like the HOPE Credits—while completely phasing out near or at the current maximum AOTC level ($180,000 for joint filers).
- Adjust the benefit calculation to cover 100 percent of the first $2,000 in expenses and 50 percent of the next $1,000 to lower the total out-of-pocket expenses necessary to receive the maximum credit, providing a greater benefit to students who attend low-cost colleges.
- Include transportation and child care costs as qualified expenses to align with the definition of eligible expenses for federal student aid.
- Study ways to deliver tax benefits at the time student incur expenses, not months later.

- **Stop taxing forgiven or discharged student loans as income.** Current law treats forgiven or discharged student loan balances inconsistently. Tthe discharged amount is not treated as taxable income if the loan is discharged because a school closed before the student could complete or transfer, or if the loan is forgiven as a result of a public service loan forgiveness program. In contrast, the discharged loan is considered taxable income if it is discharged because the borrower died or became totally and permanently disabled, or after 20 or 25 years of income-based payments. Treating discharged loan balances as taxable income creates a tax liability that most recipients will be unable to afford. Bipartisan legislation introduced in the 111^{th} Congress (H.R. 2492) would eliminate the taxation of loans forgiven in income-based repayment programs and was cosponsored by 47 Members of Congress and endorsed by more than 20 organizations and the Administration.

- **Stop taxing Pell Grants as income, whether used to pay for tuition or room and board.** Currently, Pell Grants are not taxed as income if they are used to pay for required tuition, fees, books, supplies, or equipment, but they are taxed as income if they are used to pay for transportation, food, housing, or other eligible costs of attendance. So, if students use their Pell Grants to cover fully their tuition, fees, and books, they will have no out-of-pocket qualified expenses for claiming the AOTC. Meanwhile, if students claim the AOTC for tuition, fees, and books paid for out of pocket, and use their Pell Grants to cover remaining costs of attendance, then they may face a tax liability. By removing the threat of any tax liability associated with Pell Grants, this interaction will no longer occur and more students, particularly at low-tuition institutions such as community colleges, will be able to benefit from both Pell Grants and the AOTC, just as students attending higher cost institutions already do. The Joint Committee on Taxation estimated that eliminating the taxation of Pell Grants would cost less than half a million dollars per year.

Sincerely,

Jessica Thompson, Senior Policy Analyst