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The Honorable Orrin Hatch
Chairman, Senate Finance Committee
United States Senate
Washington, DC 20510

Dear Senator Hatch:

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 for more than 10 years has analyzed trends in student loan borrowing and worked to identify and advance practical, solutions to promote college affordability and success, and to reduce the burden of student debt. As part of our work to identify and recommend improvements for each major component of federal financial aid policy, we developed recommendations to simplify and to increase the impact of higher education related tax benefits. These recommendations are described below and in the attached one-page fact sheet.

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 efficiently and 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 complete college. And for those lower and moderate-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 (IRS) over 90 pages to explain them all and how they do and do not interact.

Overall, we recommend almost entirely eliminating higher-education tax benefits and redirecting the savings 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).** There is bipartisan agreement that higher education tax benefits are overly complex, and too poorly timed and targeted to efficiently increase college access or success. The AOTC is currently the most likely benefit to increase college access and success because, through its partial refundability, it provides assistance to low-income students who are more likely to be on the margin of attending and completing college. We worked with stakeholders across the ideological spectrum to help develop and support the "Student and Family Tax Simplification Act", bipartisan legislation introduced in 2013 by Representatives Diane Black (R-TN) and Danny Davis (D-IL). That bill reflected many of our recommendations to dramatically streamline tax benefits by improving the American Opportunity Tax Credit (AOTC) and eliminating less targeted and less effective benefits such as the Tuition and Fees Deduction and Lifetime Learning Credit. Our ongoing, specific 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.** To simplify the tax code, ensure equity, and reduce the burden of student debt, we recommend eliminating the taxation of forgiven or discharged federal student loan debt. Currently, loan balances discharged after 10 years of payments under the Public Service Loan Forgiveness program (PSLF) is not treated as taxable income. But balances discharged after 20 or 25 years of responsible payments in an income-driven repayment (IDR) plan are treated as taxable income. This potential tax liability may discourage some of the borrowers IDR was designed to help most from enrolling. Similarly, loans discharged due to death or permanent disability are currently treated as taxable income, which can lead to significant tax charges for permanently disabled veterans as well as parents grieving the loss of a child whose education they had supported by borrowing. Lastly, statute specifically exempts from taxation closed school and false certification discharges but does not explicitly exempt borrower defense discharges. We support the "Stop Taxing Death and Disability Act" introduced in 2017 by Senators Rob Portman (R-OH), Chris Coons (D-DE), and Angus King (I-ME), and strongly encourage that the bill be expanded to eliminate taxation for all forgiven or discharged student debt amounts.

- **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. We helped develop and support the "Pell Grant Flexibility Act", bipartisan legislation introduced in 2016 by Representatives Mark DeSaulnier (D-CA), Lee Zeldin (R-NY), Thomas MacArthur (R-NJ), and Peter King (R-NY).

Thank you again for the opportunity to submit these recommendations. Please contact me at any time with questions or feedback at jthompson@ticas.org or (202)854-0231

Sincerely,

Jessica Thompson
Policy and Research Director