the institute for college access & success

Streamline and Improve the Targeting of Education Tax Benefits

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There is strong evidence and widespread consensus that current higher education tax benefits are too poorly timed and too poorly targeted to efficiently or effectively increase college access or success. This is because they are not made available when college costs are incurred and are not targeted to students who would otherwise be unlikely or unable to enroll in or complete college (such as moderate- and low-income students).

The Institute for College Access & Success' white paper, *Aligning the Means and the Ends: How to Improve Federal Student Aid and Increase College Access and Success*, recommends almost entirely eliminating higher-education tax benefits and redirecting the savings into Pell Grants and incentive funds for states and colleges. However, if such tax benefits are to be retained, we recommend dramatically streamlining and improving their targeting, as well as implementing simpler and more equitable tax treatment of Pell Grants and forgiven loans.

Dramatically streamline higher education tax benefits. Streamline the current tuition deduction, student loan interest deduction, Lifetime Learning Credit, and Coverdell Accounts into an improved American Opportunity Tax Credit (AOTC) that is better designed to increase college access and success. The AOTC is the most likely of the current tax benefits 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. With the savings from eliminating the less effective tax benefits, we recommend improving the AOTC by:

- *Increasing its refundability as much as possible from the current 40%, preferably to 100%.*
- *Replacing the current four-year limit with a lifetime dollar cap to provide the same maximum benefit to all students, including those completing a degree while working and attending school part time.*
- *Indexing the credit amounts and income limits to inflation to prevent the value and eligibility limits from declining over time.*
- *Capping eligibility at the lower, preexisting HOPE Credit income levels. If this is not viable, begin phasing out the benefit earlier—starting at $107,000 for joint filers like the HOPE Credit—while capping eligibility near or at the current maximum AOTC level ($180,000 for joint filers).*
- *Adjusting 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.*
- *Including transportation and child care costs as qualified expenses to align with the definition of eligible expenses for federal student aid.*
- *Studying ways to deliver tax benefits at the time students incur expenses, not months later.*

Stop taxing forgiven or discharged student loans as income. Regardless of the reason, no discharged or forgiven student loan debt should be treated as taxable income. This will correct current inequities that, for instance, exempt from taxation discharges resulting from school closures while taxing discharges for totally and permanently disabled borrowers and for those who have made 20 or 25 years of income-based payments.

Stop taxing Pell Grants as income. To increase fairness, simplify the tax code, and improve coordination with the AOTC, Pell Grants should not be treated as taxable income if they are used for a qualified education expense. Under current law, 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.