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POINT OF VIEW

Focus Tax Incentives on the Students Who Need Them

By SUSAN M. DYNARSKI

In 1997 Congress crafted an ambitious set of higher-education tax incentives that the House of Representatives and Senate are now revisiting. Millions of students each year receive the Hope tax credit and the Lifetime Learning tax credit. They are now firmly planted in the college-finance landscape.

Whether we consider the education tax incentives a success depends on our aspirations for them. Do we want the Hope and Lifetime Learning credits to ease the pinch of college costs for middle- and upper-income families whose children attend expensive private colleges? If that's their task, they do it well.

But if our goals are to increase the skills of our work force, maintain America's competitive edge in the global economy, and make college a reality for smart but poor kids who believe it is out of reach, then the education tax incentives are a dismal failure.

Ten years after the education tax incentives were introduced, college remains inaccessible to many people. A third of young white people earn a bachelor's degree, but only 13 percent of African-American and 8 percent of Hispanic young people do so. Even among the best students, income is a strong predictor of college attendance. For example, three-quarters of upper-income students with high math scores in eighth grade go on to receive a bachelor's degree, compared with less than a third of those who grew up in a low-income family.

Tax incentives can increase college attendance only if they put money into the hands of people for whom price is a barrier to college. Otherwise, they are not incentives at all but rather windfall gains for those who would have gone to college anyway.

If we want the education tax programs to get more people into college, they have to be offered to students teetering on its threshold who need just a little push to get them through the door. Who are those potential college students? Disproportionally, they are from low-income families. Where do those students usually go to college? The local community college, where tuition and fees average $2,300, or a state university, where costs average $5,800.

That is who we should keep in mind as we design tax incentives for college: a low-income person attending an inexpensive public institution. The student admitted to Denison, Williams, or Yale whose family earns $100,000 is going to college with or without a tax incentive. We should not build our education policy around the prices that student faces. It is not the job of government to make Harvard affordable to the handful who can attend that elite institution each year. It is the job of government to make a solid college education affordable to the millions of people for whom a degree from a public college is a ticket into the middle class.

But the education tax incentives do just about nothing for low-income students at inexpensive public colleges. Instead, they are tailored for upper-income students at the most-expensive private colleges.

A critical flaw of the education tax credits is that they are not refundable. Many low-income families can't take advantage of the incentives because they don't pay enough in taxes. A family of four must have an income above $30,000 to get the maximum credit. In fact, according to a study by Bridget Terry Long, an associate professor of education and economics at the Harvard Graduate School of Education, nearly half of the families who are eligible for the credits cannot claim the maximum amount because their income is too low.

In addition, only students who pay over $10,000 a year in tuition and fees get the full Lifetime Learning tax credit. That is nearly double the cost at a typical public four-year college and four times that at a typical community college. Data from the College Board show that about 80 percent of college students attend institutions with tuition and fees under $10,000.

Further, the credits are delivered to households well past the time when students have to pay their tuition bills. Students who manage to afford tuition can file for a tax credit months later. But those who can't scrape together the payment never make it into the classroom and never file for the tax credit. Such backloading of the tax incentives keeps money out of the hands of students for whom price is truly a barrier.

Several prominent members of Congress are also talking about reviving the tuition tax deduction, which was especially poorly focused. By their nature, tax deductions are most valuable to those in upper tax brackets, because the value of deducting a dollar from taxable income rises linearly with the tax rate. A study by the Urban-Brookings Tax Policy Center showed that more than half of the benefits of the tuition tax deduction flowed to households with incomes over $100,000.

The regressivity and poor timing of the tax incentives are not all that hampers their effectiveness. Families can respond to a price subsidy only if they understand it. The jumble of tax incentives is so complicated and confusing that it is difficult for families to deduce their value. Tellingly, the Internal Revenue Service publication that explains the education tax benefits is 80 pages long.

Families have to choose between the Hope tax credit and the Lifetime Learning tax credit. They must not forget that the Coverdell Education Savings Accounts and the 529 savings plans can't be used for the same expenses as the credits. Oh, and room and board count as expenses for the savings programs, but not the credits.

Again, let's keep our target students firmly in mind. Often the parents of low-income students did not attend college themselves. They may be high-school dropouts. For many such families, English is a second language. Consider the complicated jumble of education tax incentives through their eyes. It is not surprising that the tax incentives have done nothing to increase college attendance, given their burdensome, confusing design.

Effective aid programs are simple and easily communicated. In Georgia a majority of high-school freshmen can correctly explain the rules of the state's aid program, which requires only that students maintain a B average in high school and college. Ninety percent of high-school freshmen can correctly name that program, which has substantially increased college attendance and completion. How many high-school freshmen can correctly explain the rules of the Hope and Lifetime Learning tax credits?

The goals of reform should be to *focus* the incentives on those who are on the margin of attending college and *simplify* the incentives so that families can understand and respond to them. There are many reforms that would move us closer to those ideas of focus and simplicity. Some suggestions are:

- Merge the Hope and Lifetime Learning credits into a *single credit*. That would significantly reduce complexity, enabling families to estimate their likely credit well in advance.
- Make the credit refundable so families in lower tax brackets are eligible for the maximum benefits.
- Count tuition, fees, and room and board as eligible expenses for the purposes of the credit. That would match the definition used for the Coverdell savings accounts and 529 savings accounts. It would also extend the full credit to the vast majority of students who attend public colleges.
- Deliver the credit at the time of college enrollment, when tuition is due, rather than a year or more later when taxes are filed. The Department of Education delivers grants and loans to students and their colleges at the time of enrollment, so this can be done. The IRS can determine eligibility based on the student's or family's income from a previous year.

The simpler and more streamlined the tax benefits, the easier they are to communicate to families and students. Just as the federal government annually sends workers projections of their Social Security benefits to help them plan for retirement, it could send families estimates of their tax benefits to help them plan for college. Such early and clear information would give families the confidence that they can afford college and a reason to encourage their children to work hard in high school.

We could even more radically simplify federal benefits for college by consolidating the tax credits and Pell Grant into a single program. College students and their families now face two parallel, duplicative, and unwieldy bureaucracies that provide aid for college: the tax system and the student-aid system. Congress should consider eliminating the financial-aid application and using tax data to determine aid eligibility for both credits and grants.

An educated work force is key to the economic competitiveness of the United States and the well-being of its families. Although the education tax benefits provide relief for middle- and high-income families that have children in college, they do little to get more people into college. Simplifying and focusing the tax incentives will allow those programs to serve their goal: opening the doors of college to those who have the ability but not the means to further their education.

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