TAX INCENTIVES FOR POST SECONDARY EDUCATION

HEARING

BEFORE THE

SUBCOMMITTEE ON SELECT REVENUE MEASURES

OF THE

COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED TENTH CONGRESS

SECOND SESSION

MAY 1, 2008

Serial No. 110–80

Printed for the use of the Committee on Ways and Means

U.S. GOVERNMENT PRINTING OFFICE

62–697 WASHINGTON : 2011

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2104 Mail: Stop IDCC, Washington, DC 20402–0001

COMMITTEE ON WAYS AND MEANS

CHARLES B. RANGEL, New York, *Chairman*

FORTNEY PETE STARK, California
SANDER M. LEVIN, Michigan
JIM MCDERMOTT, Washington
JOHN LEWIS, Georgia
RICHARD E. NEAL, Massachusetts
MICHAEL R. MCNULTY, New York
JOHN S. TANNER, Tennessee
XAVIER BECERRA, California
LLOYD DOGGETT, Texas
EARL POMEROY, North Dakota
STEPHANIE TUBBS JONES, Ohio
MIKE THOMPSON, California
JOHN B. LARSON, Connecticut
RAHM EMANUEL, Illinois
EARL BLUMENAUER, Oregon
RON KIND, Wisconsin
BILL PASCRELL, JR., New Jersey
SHELLEY BERKLEY, Nevada
JOSEPH CROWLEY, New York
CHRIS VAN HOLLEN, Maryland
KENDRICK MEEK, Florida
ALLYSON Y. SCHWARTZ, Pennsylvania
ARTUR DAVIS, Alabama

JIM MCCRERY, Louisiana
WALLY HERGER, California
DAVE CAMP, Michigan
JIM RAMSTAD, Minnesota
SAM JOHNSON, Texas
PHIL ENGLISH, Pennsylvania
JERRY WELLER, Illinois
KENNY HULSHOF, Missouri
RON LEWIS, Kentucky
KEVIN BRADY, Texas
THOMAS M. REYNOLDS, New York
PAUL RYAN, Wisconsin
ERIC CANTOR, Virginia
JOHN LINDER, Georgia
DEVIN NUNES, California
PAT TIBERI, Ohio
JON PORTER, Nevada

JANICE MAYS, *Chief Counsel and Staff Director*
JON TRAUB, *Minority Staff Director*

SUBCOMMITTEE ON SELECT REVENUE MEASURES

RICHARD E. NEAL, Massachusetts, *Chairman*

LLOYD DOGGETT, Texas
MIKE THOMPSON, California
JOHN B. LARSON, Connecticut
ALLYSON Y. SCHWARTZ, Pennsylvania
JIM MCDERMOTT, Washington
RAHM EMANUEL, Illinois
EARL BLUMENAUER, Oregon

PHIL ENGLISH, Pennsylvania
THOMAS M. REYNOLDS, New York
ERIC CANTOR, Virginia
JOHN LINDER, Georgia
PAUL RYAN, Wisconsin

CONTENTS

Page

Advisory of April 24, 2008 announcing the hearing 2

WITNESSES

Michael Brostek, Director, Tax Issues, Strategic Issues Team, United States Government Accountability Office 7
Karen Gilbreath Sowell, Deputy Assistant Secretary for Tax Policy, United States Treasury Department 55
Debra M. Townsley, President, Nichols College, Dudley, Massachusetts 84
Wayne Watson Ph.D., Chancellor, City Colleges of Chicago, Chicago, Illinois 89
Susan Dynarski, Associate Professor, Harvard Kennedy School, Cambridge, Massachusetts 100
Dan Ebersole, Director, Georgia Office of Treasury and Fiscal Services, Atlanta, Georgia 113

SUBMISSIONS FOR THE RECORD

Paul J. LeBlanc, Statement 133
B. Russell Lockridge, Statement 134
Dr. Shirley Robinson Pippins, Statement 134
Experience Wave and the Council for Adult and Experiential Learning, Statement 135
Joseph B. Moore, Statement 139
Reid Cramer, Statement 139
Robert Shireman, Statement 143

TAX INCENTIVES FOR POST SECONDARY EDUCATION

THURSDAY, MAY 1, 2008

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON SELECT REVENUE MEASURES,
Washington, DC.

The Subcommittee met, pursuant to notice, at 10:00 a.m., in Room 1100, Longworth House Office Building, the Honorable Richard E. Neal [Chairman of the Subcommittee] presiding.

HEARING ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

Neal Announces Hearing on Education Tax Incentives

April 24, 2008

By (202) 225–5522

House Ways and Means Select Revenue Measures Subcommittee Chairman Richard E. Neal (D–MA) announced today that the Subcommittee on Select Revenue Measures will hold a hearing on tax incentives for postsecondary education. **The hearing will take place on Thursday, May 1, 2008, in the main Committee hearing room, 1100 Longworth House Office Building, beginning at 10:00 a.m.**

Oral testimony at this hearing will be limited to invited witnesses only. However, any individual or organization not scheduled for an oral appearance may submit a written statement for consideration by the Committee and for inclusion in the printed record of the hearing.

FOCUS OF THE HEARING:

The hearing will focus on various tax benefits currently provided for postsecondary education. The Internal Revenue Code currently provides several tax benefits designed to encourage the pursuit of, and assist in the payment for, educational studies beyond the secondary level. The hearing will examine the interaction of many of these benefits, the complexity associated with them, and whether these benefits can be simplified to make them more efficient and effective.

BACKGROUND:

The complexity surrounding the Code has grown in recent years. The laws that apply to tax incentives for postsecondary education do not escape these growing concerns. The many education tax benefits come with complex rules that restrict how these products can be used separately and in combination with other similar benefits. Some of these benefits may be more beneficial to taxpayers if saving begins when the child is young. Such benefits include (1) the Coverdell education savings account; (2) a Section 529 college savings or prepaid tuition-and-fee plan; (3) U.S. education savings bonds; and (4) penalty-free withdrawals from an Individual Retirement Account (IRA).

Other tax incentives relate to the tax treatment of current educational expenses. With respect to these benefits, the taxpayer must decide which benefit provides the greatest tax savings and without violating rules preventing “double dipping” between certain tax benefits. The available benefits are (1) the Hope Credit; (2) the Lifetime Learning Credit; (3) the deduction for tuition and fees; and (4) the deduction for interest on student loans. One limitation of each of these provisions is that they do not benefit families who have no income liability. In addition, many of the benefits are phased out for taxpayers with income above certain thresholds. The complexity and interaction of these provisions can result in confusion and less than optimal choices by the taxpayer. Thus, simplification of our current structure may be necessary to produce greater efficiency and increased access for taxpayers who need as much help as possible with rising college costs.

In announcing the hearing, Chairman Neal stated, **“With more than ten million families claiming tax benefits to help finance higher education each year, Congress must ensure that these benefits work as intended. This hearing will explore whether complexity in the current system means that**

families do not fully utilize these benefits, and provide recommendations for improvement."

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Please Note: Any person(s) and/or organization(s) wishing to submit testimony for the hearing record must follow the appropriate link on the hearing page of the Committee website and complete the informational forms. From the Committee homepage, *http://democrats.waysandmeans.house.gov*, select "110th Congress" from the menu entitled, "Committee Hearings" (*http://democrats.waysandmeans.house.gov/Hearings.asp?congress=18*). Select the hearing for which you would like to submit, and click on the link entitled, "Click here to provide a submission for the record." Follow the online instructions, completing all informational forms and clicking "submit" on the final page. ATTACH your submission as a Word or WordPerfect document, in compliance with the formatting requirements listed below, by close of business **Thursday, May 15, 2008**. Finally, please note that due to the change in House mail policy, the U.S. Capitol Police will refuse sealed-package deliveries to all House Office Buildings. For questions, or if you encounter technical problems, please call (202) 225–1721.

FORMATTING REQUIREMENTS:

The Committee relies on electronic submissions for printing the official hearing record. As always, submissions will be included in the record according to the discretion of the Committee. The Committee will not alter the content of your submission, but we reserve the right to format it according to our guidelines. Any submission provided to the Committee by a witness, any supplementary materials submitted for the printed record, and any written comments in response to a request for written comments must conform to the guidelines listed below. Any submission or supplementary item not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All submissions and supplementary materials must be provided in Word or WordPerfect format and MUST NOT exceed a total of 10 pages, including attachments. Witnesses and submitters are advised that the Committee relies on electronic submissions for printing the official hearing record.

2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.

3. All submissions must include a list of all clients, persons, and/or organizations on whose behalf the witness appears. A supplemental sheet must accompany each submission listing the name, company, address, telephone and fax numbers of each witness.

Note: All Committee advisories and news releases are available on the World Wide Web at *http://democrats.waysandmeans.house.gov*.

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202–225–1721 or 202–226–3411 TTD/TTY in advance of the event (four business days notice is requested). Questions with regard to special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

Chairman NEAL. Let me call this meeting of the Select Revenue Measures Subcommittee to order.

Part of the American Dream has always been the hope that our kids will do better than us, and a college education is one way to ensure that. As the parent of four kids, I can tell you that matters. And how you prepare for college often times requires the need for some help.

I thought I had it tough when I went to college. First generation college student from my family, I worked in a bakery for all four years to pay tuition and fees, drove a 1963 Impala back and forth to a commuter college.

And, in the next generation, as a parent, I found myself with three of my four kids in college at the same time. While I felt blessed that they had been admitted to excellent schools—Springfield College, Trinity College, and Boston College—the combined private school tuition was simply overwhelming, even for a Member of Congress.

During the peak tuition year of $90,000, I actually qualified for financial aid, with 3 kids attending private universities. So I did what most American families do: I took out a second mortgage on my home, I got a second job, teaching at the University of Massachusetts, and I borrowed from my retirement account.

Part of the bargain was that each of my kids would commit to pay for one year on their own. All of us will be paying off this debt for years to come. And, in my instance, one example, I will finish the last tuition payment when I am 68 years old.

But I cannot imagine any other decision for my children. It was an investment in our future, and, most importantly, their future. And imagine my relief when my last child, with a spectacular jump shot, received a four-year scholarship to play basketball at the division one level at La Salle University. I thought, at that juncture, there really is justice.

Franklin Roosevelt noted that school is the last expenditure upon which America should be willing to economize. I certainly understand that sentiment. Congress has responded over the years by creating a variety of tax benefits for families with higher education costs. We may have over-responded, though, with conflicting and overlapping incentives.

GAO will tell us today that a quarter of taxpayers with education expenses either don't claim the right tax benefits, or miss those incentives all together. And half of those tax returns were done by professional preparers. We will also hear that these incentives may help keep down the cost of those already attending college, but may not help those for whom college is out of reach.

We have assembled a diverse set of witnesses who will explain these issues and offer suggestions about how to improve these incentives.

And I must say, as I conclude this opening statement, to those who are seeking the Presidency, or those who are seeking Federal office, this is the sort of issue that the American people are talking about every day. This is precisely where Congressional focus ought to be. And you talk about timing.

I now would like to recognize my friend, and the Ranking Member, and the gentleman from Pennsylvania, Mr. English, for his opening statement.

Mr. ENGLISH. Thank you, Mr. Chairman, and I am going to keep this brief. This is an area of great interest to me, and has been since I came to the Committee, as the Chairman well knows.

Access to higher education for every American who strives to achieve a college education has long been a priority, not only for me, but for a whole range of leaders in this institution.

I look forward to an examination of the benefits and shortcomings of the current maze of tax incentives for higher education.

As a long-time advocate of breaking down the barriers to college savings, I have engaged with my colleagues on the Committee to advance many of the programs that we're going to hear about from the witnesses today, including the tuition deduction, the Section 529 plans, like the Pennsylvania tuition account program, and expanding the deductibility of the student loan interest.

In my view, education is an investment in the future. Congress has a fundamental responsibility to encourage the pursuit of higher education, and to allow individuals in a free society to maximize their opportunities. In a good faith effort to achieve these goals, Congress has created a myriad of tax provisions to help save for college, and to make college more affordable. Some of these are coordinated with educational aid programs; some of them, frankly, are not.

With respect to the tax credits, the testimony that we will receive today will reveal something that comes as little surprise to any of us, that the credits are complex, and as a result, many working families who should benefit from them fail to do so. Today's hearing will give us a chance to consider whether simplification of those policies, those credits, making them partially refundable, as proposed by my colleagues, Mr. Emanuel and Mr. Camp, would increase access to affordable higher education. It is my sense that it would.

Simplification, which I know is dear to your heart, Mr. Chairman, as in other areas of the Tax Code, would likely be a good start in the area of education tax policy. In my view, however, we should also ensure that we maintain the broader goal of simplification and realignment, and that these do not disadvantage students and working families in the short run.

To that end, Congress should ensure that the expired tuition deduction and other education incentives that are anticipated to expire in 2010 should be extended or made permanent until any consolidated program is put in place. I have introduced legislation in congress to do that.

If I might, Mr. Chairman, if it is appropriate, I would like to yield to my colleague, Mr. Camp, who is an original sponsor—the number two sponsor—of this legislation, that he might complete my statement.

Mr. CAMP. Well, thank you. I want thank the gentleman for yielding to me, and thank you, Chairman Neal, for holding this hearing on education tax incentives.

Frankly, this is an area of the Tax Code that is long overdue for reform and simplification. I am glad the Subcommittee is taking a closer look at this issue. And hopefully the Committee will use this hearing as a platform in which we can make some real improvements to the current confusing maze of credits and deductions.

I would also like to recognize my colleague on the Committee, Congressman Rahm Emanuel. Together, we introduced the Universal Higher Education and Lifetime Learning Act. Our bill really goes to the heart of reform and simplification.

I know that several of the witnesses here today will discuss our bill in greater detail, but the key point of our legislation is to strengthen and simplify the three existing tax breaks students currently used to help pay for higher education: the Hope Scholarship, the Lifetime Learning Credit, and the deduction for tuition and fees. These three existing tax breaks I mentioned all have different rules for eligibility and differing maximum credit amounts.

Americans shouldn't have to be experts to take advantage of these incentives, and it's no wonder that the Government Accountability Office found that many Americans don't use these incentives. In its 2006 report, GAO found that 77 percent of the 2002 tax returns were eligible to claim 1 or more of these 3 tax preferences. However, GAO found that 27 percent of those returns—about 374,000 Americans and their families—failed to use any of them.

Our bill combines and simplifies these credits into one larger $3,000 tax credit. By eliminating the complexity and duplication, more students will get the financial help Congress intended. It's a common sense proposal that will help more young adults get the college degree and technical skills they will need to excel in life.

Again, thank you for giving me the opportunity to be here today in support of this bill, and I look forward to working with you, Mr. Chairman, and Ranking Member English, and Mr. Emanuel in advancing this bill in the Committee. Thank you, and I yield back.

Chairman NEAL. Thank you, Mr. Camp. Let me welcome our witnesses this morning. On the first panel we will hear from Mike Brostek, the Director of Tax Issues at the GAO, who will be accompanied by George Scott, Director of Education Issues at the GAO. They have studied not only tax incentives, but also how these interact with Federal aid programs.

We also welcome, for the first time before the committee, Ms. Karen Gilbreath Sowell, Deputy Assistant Secretary for Tax Policy, United States Treasury Department.

On our second panel we will hear from Dr. Debra Townsley, the President of Nichols College, in Dudley, Massachusetts. Nichols is a private, four-year college, and a member of the National Association of Independent Colleges and Universities.

We will also welcome Dr. Wayne Watson, the Chancellor of City Colleges of Chicago, in Chicago, Illinois. Dr. Watson will share his perspective as Chancellor, and the views of the American Association of Community Colleges.

Next we will hear from Dr. Susan Dynarski, a professor at Harvard University's Kennedy School of Government, in Cambridge, Massachusetts. Dr. Dynarski has written extensively on the efficiency of tax incentives.

And, finally, we welcome Dr. Dan Ebersole, of the Georgia Office of Treasury and Fiscal Affairs in Atlanta, Georgia. Mr. Ebersole will share his thoughts as the Director of the office administering the Georgia 529 college savings plan. He also serves as the Chair of the College Savings Plan Network, an affiliate of the National Associate of State Treasurers, which represents the interests of state-run 529 plans.

Without objection, any other Members wishing to return statements as part of the record may do so. All written statements written by the witnesses will be inserted into the record, as well.

And with that, let me recognize Mr. Brostek.

STATEMENT OF MICHAEL BROSTEK, DIRECTOR, TAX ISSUES, STRATEGIC ISSUES TEAM, UNITED STATES GOVERNMENT ACCOUNTABILITY OFFICE, ACCOMPANIED BY GEORGE A. SCOTT, DIRECTOR, EDUCATION ISSUES, EDUCATION, WORKFORCE, AND INCOME SECURITY, UNITED STATES GOVERNMENT ACCOUNTABILITY OFFICE

Mr. BROSTEK. Chairman Neal, Mr. English, and Members of the Subcommittee, thank you for the opportunity to testify today on the Federal Government's efforts to financially support attendance at post-secondary education institutions.

American higher education has long been crucial to the development of our nation's cultural, social, and economic capital. This hearing is an opportunity to consider whether any changes should be made in the government's overall strategy for providing such assistance, or to individual assistance programs and tax provisions.

This is important, because we face large and growing future deficits, and we need to consider how the government allocates its resources. In addition, GAO has noted that a fundamental re-examination of government programs, policies, and priorities is necessary to ensure they match 21st century needs.

My statement focuses on four topics: differences between tax preferences and Title IV assistance; apparent ineffective use of tax preferences, possibly due to their complexity; some issues that may arise if simplification is pursued; and the lack of research about post-secondary education assistance outcomes.

Post-secondary student financial assistance provided through programs authorized by Title IV in the Tax Code differ in three key ways.

First, Title IV grant and loan programs traditional provide aid to students while they are in college. Tax preferences help while in college, but also help families save before and pay after college.

Next, while student aid programs and tax preferences serve students and families across a wide range of income groups, some Title IV programs, particularly the Pell Grant program, provide much of their assistance to students in families with lower average incomes.

For Pell Grants to dependent students, 92 percent of the dollars, went to families with incomes of less than $40,000 in school year 2003–2004. In contrast, in 2005, 60 percent of the benefit of the tuition deduction went to families with incomes exceeding $80,000.

Students and families also have more responsibility for appropriately using tax preferences, compared with Title IV aid. For Title IV aid, students and families fill out the free application for Federal student aid form, and submit it to the Department of Education. The education department calculates the student's and family's expected family contribution. The student's educational institutions, then, determine aid eligibility, the amounts, and packaging of awards.

In contrast, users of tax benefits must identify all the applicable preferences, understand the rules, understand how these preferences interact with one another, and with Federal student aid, keep records sufficient to support their tax filing, and correctly claim any credit or deduction on their returns.

These tax preferences can be difficult for families to understand. Perhaps due to their complexity, hundreds of thousands of taxpayers failed to claim tax benefits that they are entitled to, or did not claim tax benefits that would be most advantageous to them.

For example, for tax year 2005, we estimate that about 410,000 taxpayers—for whom we could make an estimate—failed to claim an education credit or the tuition deduction to which they were entitled. About 190,000 additional taxpayers used one provision, when another would have been better for them. About half of those taxpayers making sub-optimal choices used paid preparers.

The complexity of post-secondary education programs might be simplified by consolidating them, perhaps as a single credit or otherwise. Such simplification might well reduce confusion among taxpayers. In considering simplification, some key issues would need to be understood, such as whether the benefits would be provided before costs are incurred, versus afterward, or the budgetary consequences of differing simplification options.

Finally, we found that Congress has received little evidence concerning the effectiveness of assistance provided under either Title IV, or through the tax preferences, in promoting, for example, post-secondary attendance or choice amongst educational institutions.

We found no research on any aspect of effectiveness for several major Title IV programs and tax preferences. For example, no research had examined the effects of education tax preferences on students' persistence in their studies, or the type of institution they chose to attend. Gaps in research on post-secondary education programs may be due in part to data, methodological challenges that have proven difficult to overcome.

The relative newness of most of the preferences also presents challenges, because relevant data are just now becoming available.

That concludes my statement. Mr. Scott and I will be happy to answer questions.

[The prepared statement of Michael Brostek follows:]

United States Government Accountability Office

GAO

Testimony

Before the Subcommittee on Select Revenue Measures, Committee on Ways and Means, House of Representatives

For Release on Delivery
Expected at 10:00 a.m. EDT
Thursday, May 1, 2008

HIGHER EDUCATION

Multiple Higher Education Tax Incentives Create Opportunities for Taxpayers to Make Costly Mistakes

Statement of Michael Brostek
Director, Tax Issues
Strategic Issues

George A. Scott
Director, Higher Education Issues
Education, Workforce, and Income Security

GAO
Accountability * Integrity * Reliability

GAO-08-717T

May 1, 2008

HIGHER EDUCATION

Multiple Higher Education Tax Incentives Create Opportunities for Taxpayers to Make Costly Mistakes

GAO
Accountability·Integrity·Reliability

Highlights

Highlights of GAO-08-717T, a testimony before the Subcommittee on Select Revenue Measures, Committee on Ways and Means, House of Representatives

Why GAO Did This Study

Federal assistance helps students and families pay for postsecondary education through several policy tools—grant and loan programs authorized by Title IV of the Higher Education Act of 1965 and more recently enacted tax preferences. This testimony summarizes our 2005 report and provides updates on (1) how Title IV assistance compares to that provided through the tax code (2) the extent to which tax filers effectively use education tax preferences, (3) potential benefits and costs of simplifying federal student aid, and (4) what is known about the effectiveness of federal assistance.

This hearing is an opportunity to consider whether changes should be made in the government's overall strategy for providing such assistance or to the individual programs and tax provisions that provide the assistance. This statement is based on updates to previously published GAO work and reviews of relevant literature.

What GAO Recommends

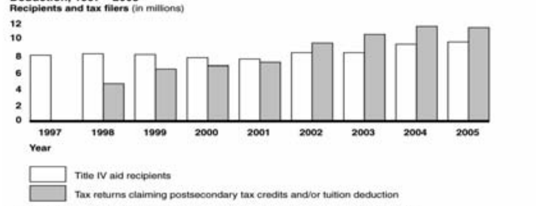
GAO does not make new recommendations in this testimony. In 2002, GAO recommended, among other things, that the Department of Education sponsor research into key aspects of effectiveness of Title IV programs. Education began funding grants in July 2007 to conduct research on topics addressed in this statement; however, no project to date appears to directly evaluate the role and effectiveness of federal assistance in improving access to postsecondary education.

To view the full product, including the scope and methodology, click on GAO-08-717T. For more information, contact Michael Brostek at (202) 512-9110 or George Scott at (202) 512-7215.

What GAO Found

Title IV student aid and tax preferences provide assistance to a wide range of students and families in different ways. While both help students meet current expenses, tax preferences also assist students and families with saving for and repaying postsecondary costs. Both serve students and families with a range of incomes, but some forms of Title IV aid—grant aid, in particular—provide assistance to those whose incomes are lower, on average, than is the case with tax preferences. Tax preferences require more responsibility on the part of students and families than Title IV aid because taxpayers must identify applicable tax preferences, understand complex rules concerning their use, and correctly calculate and claim credits or deductions. While the tax preferences are a newer policy tool, the number of tax filers using them has grown quickly, surpassing the number of students aided under Title IV in 2002.

Recipients of Title IV Assistance and Tax Filers Claiming an Education Tax Credit or Tuition Deduction, 1997—2005



Sources: GAO analysis of Budget of the United States Government and Internal Revenue Service data.

Some tax filers do not appear to make optimal education-related tax decisions. For example, our analysis of a limited number of 2005 tax returns indicated that 19 percent of eligible tax filers did not claim either the tuition deduction or a tax credit. In so doing, these tax filers failed to reduce their tax liability by $219, on average, and 10 percent of these filers could have reduced their tax liability by over $500. One explanation for these taxpayers' choices may be the complexity of postsecondary tax provisions, which experts have commonly identified as difficult for tax filers to use.

Simplifying the grants, loans, and tax preferences may reduce complexities in higher education financing, including reducing the number of eligible tax filers that do not claim tax preferences, but more research would be necessary to understand the full benefits and costs of any such changes.

Little is known about the effectiveness of Title IV aid or tax preferences in promoting, for example, postsecondary attendance or school choice, in part because of research data and methodological challenges. As a result, policymakers do not have information that would allow them to make the most efficient use of limited federal resources to help students and families.

Mr. Chairman and Members of the Subcommittee:

We are pleased to be here this morning to discuss the complexity of multiple tax incentives targeted to postsecondary education. American higher education has long been crucial to the development of our nation's cultural, social, and economic capital. At the dawn of the 21st century, changing workforce demographics, a more integrated global economy, and numerous technological advances are placing new demands on our colleges and universities. For the United States to remain competitive in the rising global knowledge economy, its citizens will need both the ways and means to endow themselves with the tools necessary for the task. Nevertheless, the affordability of American higher education remains a topic of considerable attention as evidenced by the work of the current Congress in both passing the College Cost Reduction and Access Act[1] and its ongoing efforts to reauthorize the Higher Education Act of 1965.

This hearing is an opportunity to consider whether any changes should be made in the government's overall strategy and the individual programs and tax provisions that provide financial assistance to students and families saving or paying for postsecondary education or repaying student loans. This opportunity to review the programs and tax provisions is important for several reasons. The fact that we face large and growing structural deficits in the future—primarily driven by demographics and rising health care costs—emphasizes the need to consider how the government allocates resources. In addition, we have noted that fundamental reexamination of government programs, policies, and priorities is necessary to assure that they match the needs of the 21st century. We have identified the coordination of student aid programs[2] and the effectiveness of those programs[3] both as key topics needing congressional oversight.

Our statement today will focus on four issues that emerged in our 2005 report and subsequent 2006 testimony on student grant and loan

[1]Pub. L. No. 110-84, 121 Stat. 784 (Sept. 27, 2007).

[2]GAO, *21st Century Challenges: Reexamining the Base of the Federal Government*, GAO-05-325SP (Washington, D.C.: February 2005).

[3]GAO, *Suggested Areas for Oversight for the 110th Congress*, GAO-07-235R (Washington, D.C.: Nov. 17, 2006).

assistance made available under Title IV of the Higher Education Act and postsecondary education tax preferences.[4]

- Postsecondary student financial assistance provided through programs authorized under Title IV and the tax code differ in three key ways. First, Title IV grant and loan programs traditionally provide aid to students and families while students are in college, whereas tax preferences help both during the college years as well as before and after college by assisting with saving for or repaying college costs. Additionally, while student aid programs and tax preferences serve students and families across a wide range of income groups, some Title IV programs—particularly the Pell Grant program—provide much of their financial assistance to students and families whose incomes are lower, on average, than students and families who receive student loans, tax credits, and deductions, or who make use of tax-exempt saving vehicles. Last, students and families have more responsibility for appropriately using and thereby obtaining the benefits of tax preferences than they do with Title IV aid.

- Second, postsecondary tax preferences are difficult for families to understand and use correctly. Perhaps due to the complexity of the tax provisions, hundreds of thousands of taxpayers fail to claim tax preferences to which they are entitled or do not claim the tax preference that would be most advantageous to them.

- Third, proposals to simplify the federal financial assistance programs for postsecondary education may help to address the complexities in the current system and improve tax filers' use of education tax preferences. However, more research is needed to understand the range of potential benefits and costs associated with any such changes.

- Finally, we found that Congress has received little evidence concerning the effectiveness of assistance provided under Title IV or through tax preferences, including whether such assistance increases attendance or choice.

[4] See GAO, *Student Aid and Postsecondary Tax Preferences: Limited Research Exists on Effectiveness of Tools to Assist Students and Families through Title IV Student Aid and Tax Preferences*, GAO-05-684 (Washington, D.C.: July 29, 2005), and GAO, *Postsecondary Education: Multiple Tax Preferences and Title IV Student Aid Programs Create a Complex Education Financing Environment*, GAO-07-262T (Washington, D.C.: Dec. 5, 2006).

Our statement today is drawn from reviews of relevant literature and updates to previous GAO reports and testimonies covering postsecondary Title IV programs and tax preferences. We conducted our work in April 2008 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

Financial assistance to help students and families pay for postsecondary education has been provided for many years through student grant and loan programs authorized under Title IV of the Higher Education Act of 1965, as amended. Examples of these programs include Pell Grants for low-income students, PLUS loans to parents and graduate students, and Stafford loans.[5] Much of this aid has been provided on the basis of the difference between a student's cost of attendance and an estimate of the ability of the student and the student's family to pay these costs, called the expected family contribution (EFC). The EFC is calculated based on information provided by students and parents on the Free Application for Federal Student Aid (FAFSA). Federal law establishes the criteria that students must meet to be considered independent of their parents for the purpose of financial aid and the share of family and student income and assets that are expected to be available for the student's education.[6] In fiscal year 2007, the Department of Education made available approximately $15 billion in grants and another $65 billion in Title IV loan assistance. Title IV also authorizes programs funded by the federal government and administered by participating higher education institutions, including the Supplemental Educational Opportunity Grant

[5]Consolidation loans are also authorized under Title IV. These loans allow borrowers to combine multiple student loans, possibly from different lenders and from different loan programs, into a single new loan with extended repayment periods. Because consolidation loans do not generally result in an increase in loan principal, they are not addressed in this testimony.

[6]To be classified as an independent student for the purpose of receiving Title IV financial aid, students must meet one of the following criteria: (1) be a veteran of the armed services, (2) be age 24 years or older by December 31st of the award year, (3) be married, (4) be enrolled in a graduate or professional education program, (5) have legal dependents other than a spouse, or (6) be an orphan or ward of the court. Financial aid administrators may also classify students as independent through the exercise of their professional judgment for other unusual circumstances.

(SEOG), Perkins loans, and federal work-study aid, collectively known as campus-based aid. Table 1 provides brief descriptions of the Title IV programs that we reviewed in our 2005 report and includes two programs—Academic Competitiveness Grants and National Science and Mathematics Access to Retain Talent Grants—that were created since that report was issued.[7]

Table 1: Description of Federal Student Aid Programs Authorized under Title IV of the Higher Education Act

Title IV student aid program	Program description
Pell Grant	Grants are made on the basis of the difference between the EFC and the maximum Pell award or the student's cost of attendance, whichever is less. Grants are not available for postgraduate study.
Supplemental Educational Opportunity Grant (SEOG)	Schools administer grant funds, which are awarded to undergraduates with exceptional financial need; priority is given to Pell Grant recipients. Institutions must match a portion (at least 25 percent) of the federal funds allocated.
Academic Competitiveness Grant	Available to first- and second-year students who have completed a rigorous course of study in high school. To be eligible, students must also be eligible to receive a Pell Grant. Second-year students must also maintain at least a 3.0 grade-point average.
National Science and Mathematics Access to Retain Talent (SMART) Grant	Available to third- and fourth-year students pursuing a major in mathematics, science, or a foreign language deemed critical to national security. To be eligible, students must also be eligible to receive a Pell Grant and maintain at least a 3.0 grade-point average.
Federal Work-Study	Schools administer funds, which are used to provide part-time jobs for undergraduate and graduate students with financial need. Participating schools or nonprofit employers generally contribute at least 25 percent of student's earnings (50 percent in the case of for-profit employers).
Federal Perkins Loan	Schools administer funds, comprised of federal capital contributions and school matching funds (at least one-third of federal contributions), to make low-interest (5 percent) loans for both undergraduate and graduate students with exceptional financial need. Borrower repayments are owed to the school.
Subsidized Federal Family Education Loan (FFEL) or Direct Stafford Loan	Loans made on the basis of financial need to undergraduate and graduate students who are enrolled at least half-time. The federal government pays the interest costs on subsidized loans while the student is in school, for the first 6 months after the student leaves school, and during a period of deferment.
Unsubsidized FFEL or Direct Stafford Loan	Loans made to undergraduate and graduate students who are enrolled at least half-time. Unlike subsidized loans, the federal government does not pay the interest costs on unsubsidized loans while the student is in school, for the first 6 months after the student leaves school, and during a period of deferment. Otherwise, the terms and conditions of unsubsidized loans are the same as those for subsidized loans.
FFEL or Direct PLUS Loan	Loans made to parents on behalf of dependent undergraduate students enrolled at least half-time, or to graduate and professional students. Borrowers are subject to a credit check for adverse credit history and may be denied a loan.

Source: GAO analysis of applicable federal laws and regulations.

[7]For greater detail on federal spending through Title IV postsecondary education assistance programs reviewed in our 2005 report and December 2006 testimony, see app. I.

Postsecondary assistance also has been provided through a range of tax preferences,[8] including postsecondary tax credits, tax deductions, and tax-exempt savings programs. For example, the Taxpayer Relief Act of 1997 allows eligible tax filers to reduce their tax liability by receiving, for tax year 2007, up to a $1,650 Hope tax credit or up to a $2,000 Lifetime Learning tax credit for tuition and qualified related expenses paid for a single student.[9] According to the Office of Management and Budget, the fiscal year 2007 federal revenue loss estimate of the postsecondary tax preferences that we reviewed was $8.7 billion. Tax preferences discussed as part of our 2005 report and December 2006 testimony include the following:[10]

- Lifetime Learning Credit—income-based tax credit claimed by tax filers on behalf of students enrolled in one or more postsecondary education courses.
- Hope Credit—income-based tax credit claimed by tax filers on behalf of students enrolled at least half-time in an eligible program of study and who are in their first 2 years of postsecondary education.
- Student Loan Interest Deduction—income-based tax deduction claimed by tax filers on behalf of students who took out qualified student loans while enrolled at least half-time.
- Tuition and Fees Deduction—income-based tax deduction claimed by tax filers on behalf of students who are enrolled in one or more postsecondary education courses and have either a high school diploma or a General Educational Development (GED) credential.[11]
- Section 529 Qualified Tuition Programs—College Savings Programs and Prepaid Tuition Programs—non-income-based programs that provide favorable tax treatment to investments and distributions used to pay the expenses of future or current postsecondary students.

[8] Tax preferences—also known as tax expenditures—are reductions in tax liabilities that result from preferential provisions in the tax code, such as exemptions and exclusions from taxation, deductions, credits, deferrals, and preferential tax rates.

[9] Pub. L. No. 105-34, § 201, 111 Stat. 788, 799 (Aug. 5, 1997).

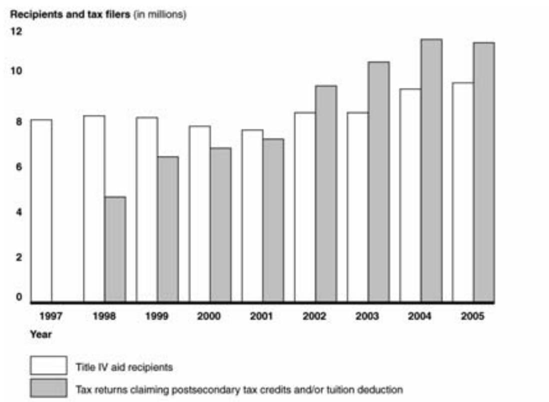
[10] For expanded descriptions of postsecondary education-related tax preferences, see app. I.

[11] The Tuition and Fees Deduction expired on December 31, 2007. Legislation has been introduced to reinstate the deduction.

- Coverdell Education Savings Accounts—income-based savings program providing favorable tax treatment to investments and distributions used to pay the expenses of future or current elementary, secondary, or postsecondary students.

As figure 1 demonstrates, the use of tax preferences has increased since 1997, both in absolute terms and relative to the use of Title IV aid.

Figure 1: Recipients of Title IV Assistance and Tax Filers Claiming an Education Tax Credit or Tuition Deduction, 1997—2005



Sources: GAO analysis of Budget of the United States Government and Internal Revenue Service data.

Tax Preferences Differ from Title IV Assistance in Timing, Distribution, and Students' and Families' Responsibility for Obtaining Benefits

Postsecondary student financial assistance provided through programs authorized under Title IV of the Higher Education Act and the tax code differ in timing of assistance, the populations that receive assistance, and the responsibility of students and families to obtain and use the assistance.

Title IV and Tax Programs Differ in Benefit Timing

Title IV programs and education-related tax preferences differ significantly in when eligibility is established and in the timing of the assistance they provide. Title IV programs generally provide benefits to students while they are in school. Education-related tax preferences, on the other hand, (1) encourage saving for college through tax-exempt saving, (2) assist enrolled students and their families in meeting the current costs of postsecondary education through credits and tuition deductions, and (3) assist students and families repaying the costs of past postsecondary education through a tax deduction for student loan interest paid.[12]

Beneficiaries of Title IV Programs and Tax Preferences Differ

While Title IV programs and tax preferences assist many students and families, program and tax rules affect eligibility for such assistance. These rules also affect the distribution of Title IV aid and the assistance provided through tax preferences. As a result, the beneficiaries of Title IV programs and tax preferences differ.

Title IV programs generally have rules for calculating grant and loan assistance that give consideration to family and student income, assets, and college costs in the awarding of financial aid.[13] For example, Pell Grant

[12]Additional details on the differences in timing are available in app. II.

[13]Campus-based aid programs authorized under Title IV differ from these programs in funding and eligibility: institutions provide matching funding for federal spending, and participating institutions distribute aid using institution-specific criteria consistent with federal program requirements. Because they have institution-specific criteria, the relationship between program rules and the distribution of benefits is more complex and was excluded from the analysis of our 2005 report.

awards are calculated by subtracting the student's EFC from the maximum Pell Grant award ($4,310 in academic year 2007—2008) or the student's cost of attendance, whichever is less. Because the EFC is closely linked to family income and circumstances (such as the size of the family and the number of dependents in school), and modest EFCs are required for Pell Grant eligibility, Pell awards are made primarily to families with modest incomes. In contrast, the maximum unsubsidized Stafford loan amount is calculated without direct consideration of financial need: students may borrow up to their cost of attendance, minus the estimated financial assistance they will receive.[14] As table 2 shows, 92 percent of Pell financial support in 2003—2004 was provided to dependent students whose family incomes were $40,000 or below, and the 38 percent of Pell recipients in the lowest income category ($20,000 or below) received a higher share (48 percent) of Pell financial support.

Table 2: Percentage of Aid Recipients and Dollars of Aid by Income Category for Dependent Students Served by Selected Title IV Programs, Academic Year 2003—2004

Program	Dependent students	$0- 20,000	$20,001-40,000	$40,001-60,000	$60,001-80,000	$80,001-100,000	More than $100,000
Pell Grant	Recipients	38	47	14	2	0	0
	Dollars	48	44	8	1	0	0
Stafford Subsidized Loan	Recipients	16	28	23	17	9	7
	Dollars	16	28	24	17	9	6
Stafford Unsubsidized Loan	Recipients	7	14	14	19	18	28
	Dollars	7	12	12	18	19	32

Source: GAO analysis of 2003-2004 National Postsecondary Student Aid Study (NPSAS) data.

Notes: See app. IV for confidence intervals associated with these estimates.

Numbers in rows may not add to 100 percent due to rounding.

Because independent students generally have lower incomes and accumulated savings than dependent students and their families, patterns of program participation and dollar distribution differ. Participation of independent students in Pell, subsidized Stafford, and unsubsidized Stafford loan programs is heavily concentrated among those with incomes of $40,000 or less: from 74 percent (unsubsidized Stafford) to 95 percent

[14] Additionally, loan amounts for both subsidized and unsubsidized Stafford loans are subject to statutory limits on annual and cumulative borrowing.

(Pell) of program participants have incomes below this level. As shown in table 3, the distribution of award dollars follows a nearly identical pattern.

Table 3: Percentage of Aid Recipients and Dollars of Aid by Income Category for Independent Students Served by Selected Title IV Programs, Academic Year 2003—2004

Program	Independent students	$0- 20,000	$20,001-40,000	$40,001-60,000	$60,001-80,000	$80,001-100,000	More than $100,000
Pell Grant	Recipients	67	28	5	0	0	0
	Dollars	73	25	3	0	0	0
Stafford Subsidized Loan	Recipients	51	29	12	5	2	1
	Dollars	52	28	12	5	2	2
Stafford Unsubsidized Loan	Recipients	46	28	14	6	3	3
	Dollars	46	24	13	7	3	5

Source: GAO analysis of 2003-2004 NPSAS data.

Notes: See app. IV for confidence intervals associated with these estimates.

Numbers in rows may not add to 100 percent due to rounding.

Many education-related tax preferences have both de facto lower limits created by the need to have a positive tax liability to obtain their benefit and income ceilings on who may use them. For example, the Hope and Lifetime Learning tax credits require that tax filers have a positive tax liability to use them, and income-related phase-out provisions in 2007 began at $47,000 and $94,000 for single and joint filers, respectively. Furthermore, tax-exempt savings are more advantageous to families with higher incomes and tax liabilities because, among other reasons, these families hold greater assets to invest in these tax preferences and have a higher marginal tax rate, and thus benefit the most from the use of these tax preferences. Table 4 shows the income categories of tax filers claiming the three tax preferences available to current students or their families, along with the reduced tax liabilities from those preferences in 2005.

Table 4: Percentage of Tax Filers Claiming Hope and Lifetime Learning Credits and Tuition Deduction and Tax Preference Dollars by Income Category, Tax Year 2005

Type of aid		$0- 20,000	$20,001-40,000	$40,001-60,000	$60,001-80,000	$80,001-100,000	More than $100,000
Hope Credit	Tax filers	17	32	20	17	13	1
	Dollars	10	32	22	21	14	0
Lifetime Learning Credit	Tax filers	17	32	20	20	11	1
	Dollars	10	31	21	24	15	0
Tuition and Fees Deduction	Tax filers	24	12	16	9	12	28
	Dollars	12	6	14	8	15	45

Source: GAO analysis of 2005 Statistics of Income (SOI) data.

Notes: See app. IV for confidence intervals associated with these estimates.

Numbers in rows may not add to 100 percent due to rounding.

Students and Families Have More Responsibility for Obtaining Benefits of Tax Preferences in Comparison to Title IV Aid

The federal government and postsecondary institutions have significant responsibilities in assisting students and families in obtaining assistance provided under Title IV programs but only minor roles with respect to tax filers' use of education-related tax preferences. To obtain federal student aid, applicants must first complete the FAFSA, a form that requires students to complete up to 99 fields for the 2007—2008 academic year. Submitting a completed FAFSA to the Department of Education largely concludes students' and families' responsibility in obtaining aid. The Department of Education is responsible for calculating students' and families' EFC on the basis of the FAFSA, and students' educational institutions are responsible for determining aid eligibility and the amounts and packaging of awards.

In contrast, higher education tax preferences require students and families to take more responsibility. Although postsecondary institutions provide students and the Internal Revenue Service (IRS) with information about higher education attendance, they have no other responsibilities for higher education tax credits, deductions, or tax-preferred savings. The federal government's primary role with respect to higher education tax preferences is the promulgation of rules; the provision of guidance to tax filers; and the processing of tax returns, including some checks on the accuracy of items reported on those tax returns. The responsibility for selecting among and properly using tax preferences rests with tax filers. Unlike Title IV programs, users must understand the rules, identify applicable tax preferences, understand how these tax preferences interact with one another and with federal student aid, keep records sufficient to support their tax filing, and correctly claim the credit or deduction on their return.

Some Tax Filers May Not Effectively Use Postsecondary Tax Preferences, Possibly Due to Complexity

According to our analysis of 2005 IRS data on the use of Hope and Lifetime Learning Credits and the tuition deduction, some tax filers appear to make less-than-optimal choices among them. The apparent suboptimal use of postsecondary tax preferences may arise, in part, from the complexity of these provisions.

Some Tax Filers Appear to Make Suboptimal Choices

Making poor choices among tax preferences for postsecondary education may be costly to tax filers. For example, families may strand assets in a tax-exempt savings vehicle and incur tax penalties on their distribution if their child chooses not to go to college. They may also fail to minimize their federal income tax liability by claiming a tax credit or deduction that yields less of a reduction in taxes than a different tax preference or by failing to claim any of their available tax preferences. For example, if a married couple filing jointly with one dependent in his/her first 2 years of college had an adjusted gross income of $50,000, qualified expenses of $10,000 in 2007, and tax liability greater than $2,000, their tax liability would be reduced by $2,000 if they claimed the Lifetime Learning Credit but only $1,650 if they claimed the Hope Credit.

In our analysis of 2005 IRS data for returns with information on education expenses incurred, we found that some people who appear to be eligible for tax credits or the tuition deduction did not claim them. We estimate that 2.1 million filers could have claimed a tax credit or tuition deduction and thereby reduced their taxes. However, about 19 percent of those filers, representing about 412,000 returns, failed to claim any of them. The amount by which these tax filers failed to reduce their tax averaged $219; 10 percent of this group could have reduced their tax liability by over $500.[15]

In total, including both those who failed to claim a tax credit or tuition deduction and those who chose a credit or a deduction that did not maximize their benefit, we found that in 2005, 28 percent, or nearly 601,000

[15] Confidence intervals for all estimates in this section are included in app. IV.

tax filers did not maximize their potential tax benefit. Regarding those making a poor choice among the provisions, for example, 27 percent of tax filers that claimed the tuition deduction could have further reduced their tax liability by an average of $220 by instead claiming the Lifetime Learning Credit; 10 percent of this group could have reduced their tax liabilities by over $630. Tax filers that claimed the Hope Credit when the Lifetime Learning Credit was a more optimal choice failed to reduce their tax liabilities by an average of $356.

Suboptimal choices were not limited to tax filers who prepared their own tax returns. A possible indicator of the difficulty people face in understanding education-related tax preferences is how often the suboptimal choices we identified were found on tax returns prepared by paid tax preparers. We estimate that 50 percent of the returns we found that appear to have failed to optimally reduce the tax filer's tax liability were prepared by paid tax preparers. Generalized to the population of tax returns we were able to review, returns prepared by paid tax preparers represent about 301,000 of the approximately 601,000 suboptimal choices we found. Our April 2006 study of paid tax preparers corroborates the problem of confusion over which of the tax preferences to claim.[16] Of the nine undercover investigation visits we made to paid preparers with a taxpayer with a dependent college student, three preparers did not claim the credit most advantageous to the taxpayer and thereby cost these taxpayers hundreds of dollars in refunds. In our investigative scenario, the expenses and the year in school made the Hope education credit far more advantageous to the taxpayer than either the tuition and fees deduction or the Lifetime Learning credit.

The Suboptimal Use of Postsecondary Tax Preferences May Result from Their Complexity

The apparently suboptimal use of postsecondary tax preferences may arise, in part, because of the complexity of using these provisions. Tax policy analysts have frequently identified postsecondary tax preferences as a set of tax provisions that demand a particularly large investment of knowledge and skill on the part of students and families or expert assistance purchased by those with the means to do so. They suggest that this complexity arises from multiple postsecondary tax preferences with similar purposes, from key definitions that vary across these provisions, and from rules that coordinate the use of multiple tax provisions. Twelve

[16]GAO, *Paid Tax Return Preparers: In a Limited Study, Chain Preparers Made Serious Errors*, GAO-06-563T (Washington, D.C.: Apr. 4, 2006).

tax preferences are outlined in IRS Publication 970, *Tax Benefits for Education: For Use in Preparing 2007 Returns.* The publication includes four different tax preferences for educational saving. Three of these preferences—Coverdell Education Savings Accounts, Qualified Tuition Programs, and U.S. education savings bonds—differ across more than a dozen dimensions, including the tax penalty that occurs when account balances are not used for qualified higher education expenses, who may be an eligible beneficiary, annual contribution limits, and other features.

In addition to learning about, comparing, and selecting tax preferences, filers who wish to make optimal use of multiple tax preferences must understand how the use of one tax preference affects the use of others. The use of multiple education-related tax preferences is coordinated through rules that prohibit the application of the same qualified higher education expenses for the same student to more than one education-related tax preference, sometimes referred to as "anti-double-dipping rules." These rules are important because they prevent tax filers from underreporting their tax liability. Nonetheless, anti-double-dipping rules are potentially difficult for tax filers to understand and apply, and misunderstanding them may have consequences for a filer's tax liability.[17]

Benefits to Simplifying Federal Student Aid Have Associated Implementation Challenges and Costs

Many researchers and policy analysts support simplifying the existing federal grant, loans and tax preferences in the belief that doing so would have a net benefit on encouraging access. Indeed, suggestions put forth in recent years to combine the federal grants and tax credits, for example, may help address some of the challenges we identified in recent years regarding tax filers' suboptimal use of postsecondary tax preferences or the confusion created by the interactions between direct student aid programs, such as the Pell Grant, and existing tax preferences. In this case, reducing the number of choices students and their families have to make would likely reduce tax filers' confusion and mistakes.

To date, we have not undertaken any studies of how current Title IV student aid programs or tax preferences could be simplified and, as a result, have not developed any such models or proposals. However, while different aspects of simplification may provide students and their families with various benefits, Congress would likely want to weigh those benefits against a number of potentially related costs.

[17]For an example of this phenomenon, please see app. III.

Simplifying the federal application for student aid—A better understanding is needed about whether or to what extent simplifying the application for federal aid would: (1) alter the administration of other federal, state and institutional student aid programs, (2) be capable of accommodating future federal policies designed to target aid, and (3) affect current programs that are specifically tied to Pell Grant eligibility.[18] The current FAFSA is used to determine students' eligibility for various federal aid programs, including Pell Grants, Academic Competitiveness Grants, SMART Grants, Stafford and PLUS loans, Supplemental Educational Opportunity Grants (SEOG), Perkins Loans, and Federal Work-Study. In addition, many states and schools rely on the FAFSA when awarding state and institutional student aid.[19] To the extent that other programs require FAFSA-like information from applicants to award financial aid, additional research is needed to determine whether simplifying the FAFSA may actually increase the number of applications students and families would be required to submit.

Simplifying eligibility verification requirements—Both grants and tax credits are awarded based, in part, on students' and their families' incomes, which means students and families are required to document their income to receive the benefit. Under the current system, some students and families are eligible to apply for Title IV student aid even though they are not required to file a tax return; in such cases, eligibility is computed based upon information reported on the FAFSA. Any plan to consolidate some or all of the current federal grants and tax preferences would need to consider how to minimize burden on students and families while also controlling federal administrative costs, for example, by minimizing the use of multiple verification procedures that use multiple forms of documentation and that are administered by multiple agencies.

Simplifying program administration while maintaining federal cost controls —Federal grant and loan programs are administered by the Department of Education while federal tax preferences are administered by IRS. Under a system where existing grant aid and tax credits are consolidated, it is unclear without additional research, whether cost

[18]Examples include the recently established Academic Competitiveness and National Science and Mathematics Access to Retain Talent (SMART) Grants.

[19]The first page of the FAFSA lists states' filing deadlines of the form for the purpose of state aid programs, which, for the 2007-2008 award year range from March 1, 2007, to June 30, 2008.

efficiency is better achieved through having the Department of Education or IRS assume federal budgeting and accounting responsibilities. In addition, the grant programs generally are subject to an annual appropriation which enables Congress to control overall federal expenditures by taking into account other federal priorities. In contrast, most tax preferences are like entitlement programs and their revenue losses can only be controlled by changing the statutory qualifications for the tax preference.

Simplifying aid distribution—Policymakers will need to consider costs associated with the federal government recovering funds if students fail to maintain eligibility requirements over the course of an academic year. Families currently claim tax preferences after qualifying higher education expenses have been incurred but receive federal grant benefits to pay current expenses. Program simplifications that consolidate grants and tax preferences into a benefit paid before expenses are incurred likely will require the implementation of new cost recovery mechanisms or other means to allocate payments based on costs actually incurred.

Simplifying eligible expenses—Room and board expenses are considered in the administration of the federal student aid programs authorized under Title IV of the Higher Education Act but not in all tax preferences, particular the Hope and Lifetime Learning Credits. Careful analysis will be needed of how such expenses could be accounted for in a simplified scheme if it is changed to being structured as a tax preference rather than a grant. Room and board expenses vary based on where a school is located or whether a student lives on or off campus, and they can be a significant component of a student's cost of attendance, particularly at community colleges. While certain strategies might be employed to lessen tax filers' recordkeeping requirements and result in fewer tax filer compliance issues, further research is needed on how such an allowance would be optimally set. Establishing too high an allowance, for example, could result in some students receiving a benefit in excess of the costs they incur for room and board, especially for those students who choose to live with their parents. Alternatively, if tax assistance is provided in advance of incurring costs, but the assistance is to be limited to costs actually incurred, a cost recovery or other administrative mechanism would be needed as discussed above.

Research on Effectiveness of Federal Postsecondary Assistance Is Incomplete

Little is known about the effectiveness of federal grant and loan programs and education-related tax preferences in promoting attendance, choice, and the likelihood that students either earn a degree or continue their education (referred to as persistence). Many federal aid programs and tax preferences have not been studied, and for those that have been studied, important aspects of their effectiveness remain unexamined. In our 2005 report, we found no research on any aspect of effectiveness for several major Title IV federal postsecondary programs and tax preferences. For example, no research had examined the effects of federal postsecondary education tax credits on students' persistence in their studies or on the type of postsecondary institution they choose to attend, and there is limited research on the effectiveness of the Pell Grant program on students' persistence.[20] One recently published study suggests that complexity in the federal grant and loan application processes may undermine its efficacy in promoting postsecondary attendance.[21] The relative newness of most of the tax preferences also presents challenges because relevant data are just now becoming available. These factors may contribute to a lack of information concerning the effectiveness of the aid programs and tax preferences.

In 2002, we recommended that the Department of Education sponsor research into key aspects of effectiveness of Title IV programs, that the Department of Education and the Department of the Treasury collaborate on such research into the relative effectiveness of Title IV programs and tax preferences, and that the Secretaries of Education and the Treasury collaborate in studying the combined effects of tax preferences and Title IV aid.[22] In April 2006, the Department of Education's Institute for Education Sciences (IES) issued a Request for Applications to conduct research on, among other things, "evaluating the efficacy of programs, practices, or policies that are intended to improve access to, persistence

[20]Eric Bettinger. "How Financial Aid Affects Persistence," in *College Choices: The Economics of Where to Go, When to Go, and How To Pay for It*, edited by Caroline Hoxby, (Chicago: University of Chicago Press, 2004) 207-238. This study cites numerous data availability and reliability challenges confronting research examining Pell Grant effects on student collegiate outcomes.

[21]Susan M. Dynarski, and Judith E. Scott-Clayton. "The Cost of Complexity in Federal Student Aid: Lessons from Optimal Tax Theory and Behavioral Economics." *National Tax Journal*, June 2006.

[22]GAO, *Student Aid and Tax Benefits: Better Research and Guidance Will Facilitate Comparison of Effectiveness and Student Use*, GAO-02-751 (Washington, D.C.: Sept. 13, 2002).

in, or completion of postsecondary education." Multiyear projects funded under this subtopic began in July 2007. However, none of the grants awarded to date appear to directly evaluate the role and effectiveness of Title IV programs and tax preferences in improving access to, persistence in, or completion of postsecondary education.

As we noted in our 2002 report, more research into the effectiveness of different forms of postsecondary education assistance is important.[23] Without such information federal policymakers cannot make fact-based decisions about how to build on successful programs and make necessary changes to improve less-effective programs. The budget deficit and other major fiscal challenges facing the nation necessitate rethinking the base of existing federal spending and tax programs, policies, and activities by reviewing their results and testing their continued relevance and relative priority for a changing society.[24]

Concluding Observations

In light of the long-term fiscal challenge this nation faces and the need to make hard decisions about how the federal government allocates resources, this hearing provides an opportunity to continue a discussion about how the federal government can best help students and their families pay for postsecondary education. Some questions that Congress should consider during this dialog include the following:

- Should the federal government consolidate postsecondary education tax provisions to make them easier for the public to use and understand?
- Given its limited resources, should the government further target Title IV programs and tax provisions based on need or other factors?
- How can Congress best evaluate the effectiveness and efficiency of postsecondary education aid provided through the tax code?
- Can tax preferences and Title IV programs be better coordinated to maximize their effectiveness?

[23] GAO-02-751.

[24] GAO-05-325SP.

Mr. Chairman and Members of the Subcommittee, this concludes our statement. We welcome any questions you have at this time.

Staff Contacts and Acknowledgments

For further information regarding this testimony, please contact Michael Brostek at (202) 512-9110 or brostekm@gao.gov or George Scott at (202) 512-7215 or scottg@gao.gov. Individuals making contributions to this testimony include David Lewis, Assistant Director; Sarah Farkas, Sheila R. McCoy, John Mingus, Danielle Novak, Daniel Novillo, Carlo Salerno, Andrew J. Stephens, and Jessica Thomsen.

Appendix I: Postsecondary Aid Programs

The federal government helps students and families save, pay for, and repay the costs of postsecondary education through grant and loan programs authorized under Title IV of the Higher Education Act of 1965, as amended, and through tax preferences—reductions in federal tax liabilities that result from preferential provisions in the tax code, such as exemptions and exclusions from taxation, deductions, credits, deferrals, and preferential tax rates.

Federal Grant and Loan Assistance to Postsecondary Students

Assistance provided under Title IV programs include Pell Grants for low-income students, the Academic Competitiveness and National Science and Mathematics Access to Retain Talent Grants, PLUS loans, which parents as well as graduate and professional students may apply for, and Stafford loans.[1] While each of the three grants reduces the price paid by the student, student loans help to finance the remaining costs and are to be repaid according to varying terms. Stafford loans may be either subsidized or unsubsidized. The federal government pays the interest cost on subsidized loans while the student is in school, and during a 6-month period known as the grace period, after the student leaves school. For unsubsidized loans, students are responsible for all interest costs.[2] Stafford and PLUS loans are provided to students through both the Federal Family Education Loan program (FFEL) and the William D. Ford Direct Loan Program (FDLP). The federal government's role in financing and administering these two loan programs differs significantly. Under the FFEL program, private lenders, such as banks, provide loan capital and make loans, and the federal government guarantees FFEL lenders a minimum yield on the loans they make and repayment if borrowers

[1]Consolidation loans are also authorized under Title IV. These loans allow borrowers to combine multiple student loans, possibly from different lenders and from different loan programs, into a single new loan with extended repayment periods. Because consolidation loans do not generally result in an increase in loan principal, consolidation loans are not addressed in this review. However, the federal government can incur significant costs in providing borrowers with these loans. See GAO, *Student Loan Programs: As Federal Costs of Loan Consolidation Rise, Other Options Should Be Examined*, GAO-04-101 (Washington, D.C.: Oct. 31, 2003) and *Student Loan Programs: Lower Interest Rates and Higher Loan Volume Have Increased Federal Consolidation Loan Costs*, GAO-04-568T (Washington, D.C.: Mar. 17, 2004).

[2]While called "unsubsidized," the federal government can still incur costs on such loans, including the costs associated with borrowers who default on their loans and, under the Federal Family Education Loan Program, the costs of making payments to lenders to ensure them a minimum federally guaranteed yield.

default. Under FDLP, the federal government makes loans to students using federal funds.

The Department of Education and its private-sector contractors jointly administer the program. Title IV also authorizes programs funded by the federal government and administered by participating higher education institutions, including the Supplemental Educational Opportunity Grant (SEOG), Perkins loans, and federal work-study aid, collectively known as campus-based aid.

To receive Title IV aid, students (along with parents, in the case of dependent students) must complete a Free Application for Federal Student Aid form. Information from the FAFSA, particularly income and asset information, is used to determine the amount of money—called the expected family contribution—that the student and/or family is expected to contribute to the student's education. Federal law establishes the criteria that students must meet to be considered independent of their parents for the purpose of financial aid and the share of family and student income and assets that are expected to be available for the student's education. Once the EFC is established, it is compared with the cost of attendance at the institution chosen by the student. The cost of attendance comprises tuition and fees; room and board; books and supplies; transportation; certain miscellaneous personal expenses; and, for some students, additional expenses.[3] If the EFC is greater than the cost of attendance, the student is not considered to have financial need, according to the federal aid methodology. If the cost of attendance is greater than the EFC, then the student is considered to have financial need. Title IV assistance that is made on the basis of the calculated need of aid applicants is called need-based aid. Key characteristics of Title IV programs are summarized in table 5 below.

[3]For example, these may include child care expenses for parents of young dependent children or supportive services for disabled students.

Table 5: Description of Federal Student Aid Programs Authorized under Title IV of the Higher Education Act

Title IV student aid program	Program details	Annual award amounts	Number and characteristics of beneficiaries
Pell Grant	Grants are awarded on the basis of difference between the EFC and the maximum Pell award or the student's cost of attendance, whichever is less. Grants are not available for postgraduate study.	$400 to $4,310 for school year 2007—2008.	**Dependent students:** About 2.1 million grants were awarded in school year 2003—2004, totaling $5.3 billion. The average grant award was $2,573; the median income of recipients was $24,576. Independent students: About 3 million grants were awarded in school year 2003—2004, totaling $7.4 billion. The average grant award was $2,436; the median income of recipients was $12,925.
Supplemental Educational Opportunity Grant	Schools administer grant funds, which are awarded to undergraduates with exceptional financial need; priority is given to Pell Grant recipients. Institutions must match a portion (at least 25 percent) of the federal funds allocated.	$100 to $4,000.	**Dependent students:** About 554,000 grants were awarded in school year 2003—2004, totaling $494.2 million. The average grant award was $892; the median income of recipients was $22,827. Independent students: About 715,000 grants were awarded in school year 2003—2004, totaling $391.9 million. The average grant award was $548; the median income of recipients was $11,040.
Academic Competitiveness Grant	Applicable to first- and second-year students who have completed a rigorous course of study in high school. To be eligible, students must also be eligible to receive a Pell Grant. Second-year students must also maintain at least a 3.0 grade-point average.	$750 for first-year students and $1,300 for second-year students.	**Students:** About 310,000 first-year grants and 110,000 second-year grants were expected to be awarded in school year 2006—2007, totaling an estimated $340.0 million. The average grant award is estimated to be $657 and $1,245 respectively.
National Science and Mathematics Access to Retain Talent (SMART) Grant	Applicable to third- and fourth-year students pursuing a major in mathematics, science, or a foreign language deemed critical to national security. To be eligible, students must also be eligible to receive a Pell Grant and maintain at least a 3.0 grade-point average.	$4,000.	**Students:** About 40,000 third-year grants and 40,000 fourth-year grants were expected to be awarded in school year 2006—2007, totaling an estimated $310.0 million. The average grant award is estimated to be $3,718 and $3,875 respectively.
Federal Work-Study	Schools administer funds, which are used to provide part-time jobs for undergraduate and graduate students with financial need. Participating schools or nonprofit employers generally contribute at least 25 percent of student's earnings (50percent in the case of for-profit employers).	Up to $300 more than the student's determined financial need; if employment continues past this point, federal funds may not be used to subsidize the employment.	**Dependent students:** About 1.1 million awards were awarded in school year 2003—2004, totaling $2.0 billion. The average award was $1,901; the median income of recipients was $46,441. **Independent students:** About 438,000 awards were awarded in school year 2003—2004, totaling $1.0 billion. The average award was $2,303; the median income of recipients was $10,561.

Title IV student aid program	Program details	Annual award amounts	Number and characteristics of beneficiaries
Federal Perkins Loan	Schools administer funds, comprised of federal capital contributions and school matching funds (at least 1/3 of federal contributions), to make low-interest (5 percent) loans for both undergraduate and graduate students with exceptional financial need. Borrower repayments are owed to the school.	$4,000 maximum for undergraduate students and $6,000 for graduate students; no minimum award amount. (Aggregate limits: $8,000 for undergraduates who have not completed 2 academic years; $20,000 for undergraduates who have completed 2 years; and, $40,000 for graduate students, including loans borrowed as an undergraduate.)	**Dependent students:** About 495,000 loans were made in school year 2003—2004, totaling $956.0 million. The average loan amount was $1,932; the median income of recipients was $39,175. **Independent students:** About 329,000 loans were made in school year 2003—2004, totaling $905.3 million. The average loan amount was $2,752; the median income of recipients was $10,277.
Subsidized FFEL or Direct Stafford Loan	Loans made on the basis of financial need to undergraduate and graduate students who are enrolled at least half-time. The federal government pays the interest costs on subsidized loans while the student is in school, for the first 6 months after the student leaves school, and during a period of deferment.	$3,500 to $8,500 depending upon year of schooling and dependency status. Aggregate limits are $23,000 for undergraduates and $65,500 for graduate students.	**Dependent students:** About 2.6 million loans were made in school year 2003—2004, totaling $8.1 billion. The average loan amount was $3,188; the median income of recipients was $44,678. **Independent students:** About 3.8 million loans were made in school year 2003—2004, totaling $16.3 billion. The average loan amount was $4,340; the median income of recipients was $19,430.
Unsubsidized FFEL or Direct Stafford Loan	Loans made to undergraduate and graduate students who are enrolled at least half-time. Unlike subsidized loans, the federal government does not pay the interest costs on unsubsidized loans while the student is in school, for the first 6 months after the student leaves school, and during a period of deferment. Otherwise, the terms and conditions of unsubsidized loans are the same as those for subsidized loans.	$3,500 to $20,500 depending on year of schooling (including any subsidized loan amounts received for the same period). Aggregate limits are $23,000 for dependent undergraduates, $46,000 for independent undergraduates, and $138,500 for graduate students.	**Dependent students:** About 1.6 million loans were made in school year 2003—2004, totaling $5.3 billion. The average loan amount was $3,293; the median income of recipients was $75,835. **Independent students:** About 3.3 million loans were made in school year 2003—2004, totaling $18.5 billion. The average loan amount was $5,671; the median income of recipients was $22,108.

Title IV student aid program	Program details	Annual award amounts	Number and characteristics of beneficiaries
FFEL or Direct PLUS Loan	Loans made to parents on behalf of dependent undergraduate students enrolled at least half-time, or to graduate and professional students. Borrowers are subject to a credit check for adverse credit history and may be denied a loan.	Maximum loan amounts are limited to cost of attendance less other estimated financial assistance for the period of enrollment.	About 634,000 loans were made in school year 2003—2004, totaling $5.7 billion. The average loan amount was $9,019; the median income of recipients was $71,397.

Source: GAO analysis of applicable federal laws and regulations and academic year 2003-2004 NPSAS data.

Tax Preferences

Prior to the 1990s, virtually all major federal initiatives to assist students with the costs of postsecondary education were provided through grant and loan programs authorized under Title IV of the Higher Education Act. Since the 1990s, however, new federal initiatives to assist families and students in paying for postsecondary education have largely been implemented through the federal tax code. The federal tax code now contains a range of tax preferences that may be used to assist students and families in saving for, paying, or repaying the costs of postsecondary education. These tax preferences include credits and deductions, both of which allow tax filers to use qualified higher education expenses to reduce their federal income tax liability. The tax credits reduce the tax filers' income tax liability on a dollar-for-dollar basis but are not refundable. Tax deductions permit qualified higher education expenses to be subtracted from income that would otherwise be taxable. To benefit from a higher education tax credit or tuition deduction, a tax filer must use tax form 1040 or 1040A, have an adjusted gross income below the provisions' statutorily specified income limits, and have a positive tax liability after other deductions and credits are calculated, among other requirements.

Tax preferences also include tax-exempt savings vehicles. Section 529 of the tax code makes tax free the investment income from qualified tuition programs. There are two types of qualified tuition programs: savings programs established by states and prepaid tuition programs established either by states or by one or more eligible educational institutions. Another tax-exempt savings vehicle is the Coverdell Education Savings Account. Tax penalties apply to both 529 programs and Coverdell savings accounts if the funds are not used for allowable education expenses. Key features of these and other education-related tax preferences are described below, in table 6.

Table 6: Selected Postsecondary Education Tax Preferences

	Preference details				
Tax preference	**Eligibility**	**Income ranges for phasing out benefits (Tax Year 2007)**[a]	**Eligible expenses**	**Tax benefit (Tax Year 2007)**	**Number and characteristics of beneficiaries**
Hope Credit	Tax filer on behalf of self, spouse, or dependent who is working toward a degree or certificate at least half-time in the first 2 years of postsecondary enrollment.	Single filer: $47,000-$57,000 Joint return: $94,000-$114,000.[b]	Tuition and fees at institutions eligible to participate in Title IV programs.	Maximum credit: $1,650 per student. Credit rate is 100 percent on first $1,100 of qualified higher education expenses, 50 percent on next $1,100.[d] Nonrefundable: if filer has no tax liability due to offsetting deductions, exemptions, or competing tax credits, filer cannot receive credit.	In tax year 2005, 2.9 million tax filers claimed $3.0 billion in Hope credits; the average credit claimed was $1,033, and the median income of filers claiming the credit was $40,252.
Lifetime Learning Credit	Tax filer on behalf of self, spouse, or dependent who is enrolled in undergraduate or graduate courses, or any course that aids in learning new or improving existing job skills, for as many years as the student is enrolled.	Single filer: $47,000-$57,000 Joint return: $94,000-$114,000.[b]	Tuition and fees at institutions eligible to participate in Title IV programs.	Maximum credit: $2,000 per tax filer. (20 percent of qualified higher education expenses up to $10,000).[d] Nonrefundable: if filer has no tax liability due to offsetting deductions, exemptions, or competing tax credits, filer cannot receive credit.	In tax year 2005, 4.4 million tax filers claimed $3.1 billion in Lifetime Learning credits; the average credit claimed was $715, and the median income of filers claiming the credit was $40,527.
Student Loan Interest Deduction	Tax filer, on behalf of self, spouse, or dependent, available even to those who do not itemize interest paid. Student must have been enrolled at least half-time in a degree program.	Single filer: $55,000-$70,000 Joint return: $110,000-$140,000.[c]	Eligible loans are those used to pay for tuition, fees, room and board, and related expenses and include, for example, student loans provided under Title IV.	Maximum deduction: $2,500 Interest paid on eligible education loans is deductible.	In tax year 2005, 8.1 million tax filers deducted $1.1 billion of student loan interest; the average deduction was $135, and the median income of filers deducting student loan interest was $46,243.

	Preference details				
Tax preference	Eligibility	Income ranges for phasing out benefits (Tax Year 2007)[a]	Eligible expenses	Tax benefit (Tax Year 2007)	Number and characteristics of beneficiaries
Section 529 qualified tuition programs—prepaid tuition programs and state-sponsored college savings programs	Specifics depend on particular program. Normally a prepaid program is open for contributions only on behalf of young children and accounts must be closed within some number of years after the beneficiary reaches college age. Generally, savings programs do not have age restrictions.	No phaseout.	Tuition, fees, books, supplies, and equipment required for attendance. Room and board if enrolled half time or more.	No tax is due on a distribution from an account unless the amount distributed is greater than the beneficiary's adjusted qualified education expenses.	About 7.2 million prepaid tuition and college savings program accounts had been established by December 31, 2004, with a reported balance of $64.7 billion in both types of programs.
Coverdell Education Savings Accounts	Distributions can be used for students enrolled on full-time, half- time, or less than half-time basis. Account must be closed within 30 days after beneficiary reaches age 30.	For contributions, $95,000-$110,000 for single filers and $190,000-$220,000 for joint returns.	Tuition, fees, books, supplies, and equipment required for attendance. Room and board if enrolled half-time or more.	No tax is due on a distribution from an account unless the amount distributed is greater than the beneficiary's adjusted qualified education expenses. Annual contribution limit is $2,000 per year per student (through age 17).	Approximately 1 million contributions were made to accounts in tax year 2002.
Tuition Deduction (expired Dec. 31, 2007)[c]	Same as Lifetime Learning credit.	Single filer: $65,000-80,000 Joint Return: $130,000-160,000.	Tuition and fees at institutions eligible to participate in Title IV programs.	Maximum deduction: $4,000 per return for individual filers whose modified adjusted gross income is less than $65,000 ($130,000 for joint filers); $2,000 per return for individuals whose modified adjusted gross income is more than $65,000 ($130,000) but less than $80,000 ($160,000).	In tax year 2005, 4.7 million tax filers deducted $2.4 billion; the average deduction was $520, and the median income of filers using the deduction was $57,913.

Sources: IRS and College Savings Plan Network; GAO analysis of 2005 IRS Statistics of Income data.

[a]Modified adjusted gross income amounts are provided.

[b]Under section 25A(h) of title 26, United States Code, the income phase-out amounts are indexed to inflation according to a formula specified in law for this purpose, which may or may not result in a yearly increase.

[c]Under section 221(f) of title 26, United States Code, the income phase-out amounts are indexed to inflation according to a formula specified in law for this purpose, which may or may not result in a yearly increase.

[d] or students who attended otherwise eligible educational institutions located within the Gulf Opportunity Zone in tax years 2005 and 2006, the maximum Hope tax credit and maximum Lifetime Learning tax credit were doubled. This increase does not apply to tax years after 2006. Gulf Opportunity Zone Act, Pub. L. No. 109-135, § 102, 119 Stat. 2577, 2594 (Jan. 7, 2005).

[e]Although the tuition deduction has expired, legislation has been introduced that would reinstate the deduction.

Our review of tax preferences did not include exclusions from income, which permit certain types of education-related income to be excluded from the calculation of adjusted gross income on which taxes are based. For example, qualified scholarships covering tuition and fees and qualified tuition reductions from eligible educational institutions are not included in gross income for income tax purposes. Similarly, student loans forgiven when a graduate goes into certain professions for a certain period of time are also not subject to federal income taxes. We did not include special provisions in the tax code that also extend existing tax preferences when tax filers support a postsecondary education student. For example, tax filers may claim postsecondary education students as dependents after age 18, even if the student has his or her own income over the limit that would otherwise apply. Also, gift taxes do not apply to funds used for certain postsecondary educational expenses, even for amounts in excess of the usual $12,000 limit on non-taxable gifts. In addition, funds withdrawn early from an Individual Retirement Account are not subject to the usual 10 percent penalty when used for either a tax filer's or his or her dependent's postsecondary educational expenses.

Appendix II: Comparison of Assistance by Timing of Benefits for Selected Programs and Tax Preferences

Table 7: Comparison of Assistance by Timing of Benefit for Selected Programs and Tax Preferences

Type of assistance	Save for future expenses	Pay current expenses	Repay expenses
Grant programs		Pell Grants Supplemental Educational Opportunity Grants Academic Competitiveness Grants SMART Grants	
Loan programs		Subsidized and Unsubsidized Stafford Loans Federal Perkins Loans Federal PLUS Loans	
Tax preferences	Coverdell Educational Savings Accounts Section 529 Qualified Tuition Programs	Hope Credit Lifetime Learning Credit Tuition Deduction	Student Loan Interest Deduction
Work-Study program		Federal Work-Study	

Source: GAO.

Appendix III: Effects of Tax Rules on Tax Preference Use

For an example of how the use of college savings programs and the tuition deduction is affected by "anti-double-dipping" rules, consider the following: To calculate whether a distribution from a college savings program is taxable, tax filers must determine if the total distributions for the tax year are more or less than the total qualified educational expenses reduced by any tax-free educational assistance, i.e., their adjusted qualified education expenses (AQEE). After subtracting tax-free assistance from qualified educational expenses to arrive at the AQEE, tax filers multiply total distributed earnings by the fraction (AQEE / total amount distributed during the year). If parents of a dependent student paid $6,500 in qualified education expenses from a $3,000 tax-free scholarship and a $3,600 distribution from a tuition savings program, they would have $3,500 in AQEE. If $1,200 of the distribution consisted of earnings, then $1,200 x ($3,500 AQEE / $3,600 distribution) would result in $1,167 of the earnings being tax free, while $33 would be taxable. However, if the same tax filer had also claimed a tuition deduction, anti-double-dipping rules would require the tax filer to subtract the expenses taken into account in figuring the tuition deduction from AQEE. If $2,000 in expenses had been used toward the tuition deduction, then the taxable distribution from the section 529 savings program would rise to $700.[1] For families such as these, anti-double-dipping rules increase the computational complexity they face and may result in unanticipated tax liabilities associated with the use of section 529 savings programs.

[1] The new nontaxable distribution figure is calculated $1,200 x ($1,500/$3,600) = $500. The taxable portion then becomes $1,200 - $500 = $700.

Appendix IV: Point Estimates and Confidence Intervals

We used two data sets for this testimony: Education's 2003-2004 National Postsecondary Student Aid Study and the Internal Revenue Service's 2005 Statistics of Income. Estimates from both data sets are subject to sampling errors and the estimates we report are surrounded by a 95 percent confidence interval. The following tables provide the lower and upper bounds of the 95 percent confidence interval for all estimate figures in the tables in this testimony. For figures and text drawn from these data, we provide both point estimates and confidence intervals.

Table 8: Federal Student Aid Programs Authorized under Title IV of the Higher Education Act, Academic Year 2003-2004: Confidence Intervals

	Number of recipients		Total award		Average award		Median income	
Type of assistance	Lower bound	Upper bound	Lower bound	Upper bound	Lower bound	Upper bound	Lower bound	Upper bound
Dependent students								
Pell Grant	2,026,011	2,115,312	5,201,091,600	5,452,845,564	2,543	2,573	24,165	24,999
Supplemental Educational Opportunity Grant	530,408	577,316	466,079,305	522,325,472	857	892	22,022	23,484
Federal Work- Study	1,023,755	1,089,687	1,927,247,135	2,090,819,033	1,856	1,901	45,000	48,231
Federal Perkins Loan	472,640	517,207	907,800,538	1,004,290,295	1,887	1,932	37,623	40,814
Subsidized FFEL or Direct Stafford Loan	2,505,118	2,604,668	7,962,531,788	8,329,729,995	3,155	3,188	43,834	45,446
Unsubsidized FFEL or Direct Stafford Loan	1,578,160	1,664,757	5,173,481,648	5,505,576,910	3,244	3,293	74,263	77,439
FFEL or Direct PLUS Loan	609,125	659,071	5,458,550,634	5,979,275,038	8,787	9,019	69,547	73,439
Independent students								
Pell Grant	2,967,340	3,087,638	7,212,123,299	7,540,282,035	2,409	2,436	12,614	13,262
Supplemental Educational Opportunity Grant	684,528	745,839	368,492,546	415,343,758	526	548	10,425	11,626
Federal Work- Study	676,216	766,317	933,916,755	1,084,530,206	2,192	2,303	9,808	11,525
Federal Perkins Loan	522,918	595,499	839,749,704	970,851,318	2,648	2,752	9,181	11,628
Subsidized FFEL or Direct Stafford Loan	3,658,692	3,869,237	15,604,880,694	17,068,144,196	4,244	4,340	18,754	20,148
Unsubsidized FFEL or Direct Stafford Loan	3,154,948	3,359,231	17,728,962,613	19,212,909,259	5,531	5,671	21,190	23,095
FFEL or Direct PLUS Loan	0	0	0	0	0	0	0	0

Source: GAO analysis of 2003-2004 National Postsecondary Student Aid Study (NPSAS) data.

Table 9: Selected Postsecondary Education Tax Preferences, Tax Year 2005

	Number of returns	Total benefits ($)	Average benefit ($)	Median income ($)
Type of assistance	Estimate	Estimate	Estimate	Estimate
Hope Credit	2,892,288	2,988,183,691	1,033	40,252
Lifetime Learning Credit	4,382,182	3,131,447,378	715	40,527
Student Loan Interest Deduction	8,072,896	1,069,200,260	135	46,243
Tuition Deduction	4,696,013	2,425,899,689	520	57,913

Source: GAO analysis of 2005 Statistics of Income data.

Table 10: Selected Postsecondary Education Tax Preferences, Tax Year 2005: Confidence Intervals

	Number of returns		Total benefits		Average benefit		Median Income	
Type of assistance	Lower bound	Upper bound	Lower bound	Upper bound	Lower bound	Upper bound	Lower bound	Upper bound
Hope Credit	2,793,098	2,994,041	2,871,011,860	3,105,355,522	1,014	1,053	39,117	41,727
Lifetime Learning Credit	4,260,679	4,506,182	3,013,903,998	3,248,990,757	696	733	39,605	41,700
Student Loan Interest Deduction	7,910,043	8,235,749	1,021,740,137	1,116,660,382	130	141	45,336	47,021
Tuition Deduction	4,573,917	4,820,453	2,331,295,407	2,520,503,972	504	535	56,259	60,249

Source: GAO analysis of 2005 Statistics of Income data.

Table 11: Number of Tax Filers Claiming an Education Tax Credit or Tuition Deduction, Tax Years 1998-2005

Hope Credit, Lifetime Learning Credit, and Tuition Deduction	1998	1999	2000	2001	2002	2003	2004	2005
	4,652,600	6,436,650	6,815,320	7,212,550	9,564,760	10,626,200	11,626,220	11,478,662

Source: GAO analysis of Statistics of Income data.

Table 12: Number of Tax Filers Claiming an Education Tax Credit or Tuition Deduction, Tax Years 1998-2005: Confidence Intervals

Hope Credit, Lifetime Learning Credit, and Tuition Deduction		1998	1999	2000	2001	2002	2003	2004	2005
	Lower bound	4,482,106	6,233,732	6,606,583	6,997,019	9,319,692	10,370,110	11,360,283	11,288,996
	Upper bound	4,827,719	6,639,576	7,024,049	7,428,088	9,809,833	10,882,359	11,892,067	11,668,329

Source: GAO analysis of 2005 Statistics of Income data.

Table 13: Percentage of Aid Recipients and Dollars of Aid by Income Category for Dependent Students Served by Selected Title IV Programs, Academic Year 2003-2004: Confidence Intervals

Program	Dependent students		$0-20,000	$20,001-40,000	$40,001-60,000	$60,001-80,000	$80,001-100,000	More than $100,000
Pell Grant	Recipients	Lower bound	36.66	45.41	13.17	1.41	0	0
		Upper bound	38.89	47.72	14.76	2.02	0	0
	Dollars	Lower bound	46.29	42.41	7.38	0.65	0	0
		Upper bound	48.82	44.89	8.5	1.04	0	0
Stafford Subsidized Loan	Recipients	Lower bound	15.41	26.79	22.45	16.1	8.38	6.23
		Upper bound	16.94	28.73	24.3	17.72	9.61	7.33
	Dollars	Lower bound	15.32	27.14	22.83	15.68	7.92	5.87
		Upper bound	17.07	29.35	24.94	17.51	9.3	7.08
Stafford Unsubsidized Loan	Recipients	Lower bound	6.51	12.83	13.15	17.69	16.68	27
		Upper bound	7.88	14.76	15.21	19.94	18.84	29.5
	Dollars	Lower bound	6.22	11.05	11.31	16.69	17.55	30.3
		Upper bound	7.75	12.99	13.41	19.2	20.15	33.37

Source: GAO analysis of 2003-2004 NPSAS data.

Table 14: Percentage of Aid Recipients and Dollars of Aid by Income Category for Independent Students Served by Selected Title IV Programs, Academic Year 2003-2004: Confidence Intervals

Program			$0-20,000	$20,001-40,000	$40,001-60,000	$60,001-80,000	$80,001-100,000	More than $100,000
Pell Grant	Recipients	Lower bound	66.28	26.59	4.59	0	0	0
		Upper bound	68.35	28.57	5.62	0	0	0
	Dollars	Lower bound	71.68	23.62	2.32	0	0	0
		Upper bound	73.77	25.65	2.96	0	0	0
Stafford Subsidized Loan	Recipients	Lower bound	49.67	27.54	10.78	4.04	1.3	0.86
		Upper bound	52.62	30.38	13.48	5.36	1.98	2.38
	Dollars	Lower bound	49.93	25.26	10.05	3.87	1.2	0.46
		Upper bound	54.61	29.79	14.73	5.4	2.05	2.65
Stafford Unsubsidized Loan	Recipients	Lower bound	44.65	26.59	12.09	5.48	2.31	2.26
		Upper bound	47.82	29.75	15.18	6.87	3.18	4.08
	Dollars	Lower bound	44.28	22.51	11.96	6.22	2.86	3.42
		Upper bound	48.37	26	14.78	8.49	4.12	6.99

Source: GAO analysis of 2003-2004 NPSAS data.

Table 15: Percentage of Tax Filers Claiming Hope and Lifetime Learning Credits and Tuition Deduction and Tax Preference Dollars by Income Category, Tax Year 2005: Confidence Intervals

Type of aid			$0-20,000	$20,001-40,000	$40,001-60,000	$60,001-80,000	$80,001-100,000	More than $100,000
Hope Credit	Tax filers	Lower bound	15.85	30.64	18.36	15.29	11.8	0.92
		Upper bound	18.53	33.92	21.09	17.85	14.12	1.71
	Dollars	Lower bound	8.57	30.44	20.49	19.77	12.86	0.21
		Upper bound	10.46	34.11	23.8	23.18	15.67	0.44
Lifetime Learning Credit	Tax filers	Lower bound	15.66	31.06	18.53	18.43	10.02	0.57
		Upper bound	17.81	33.72	20.74	20.66	11.78	1.09
	Dollars	Lower bound	8.79	28.94	19.18	22.12	13.41	0.17
		Upper bound	10.52	32.4	22.25	25.49	16.25	0.46
Tuition Deduction	Tax filers	Lower bound	22.56	11.2	14.69	8.43	10.68	26.63
		Upper bound	24.83	12.95	16.65	10.01	12.42	28.96
	Dollars	Lower bound	10.93	5.39	13.24	6.58	13.39	43.42
		Upper bound	12.55	6.62	15.69	8.54	16.17	47.48

Source: GAO analysis of 2005 Statistics of Income data.

Table 16: Number and Percentage of Form 1098-Ts with and without Postsecondary Education Expense Information, Tax Year 2005

	Number of returns	Percent of returns
1098-Ts with expense information	4,292,132	24
1098-Ts without expense information	13,399,837	76

Source: GAO analysis of 2005 Statistics of Income data.

Table 17: Number and Percentage of Form 1098-Ts with and without Postsecondary Education Expense Information, Tax Year 2005: Confidence Intervals

	Number of returns: Lower bound	Number of returns: Upper bound	Percent of returns: Lower bound	Percent of returns: Upper bound
1098-Ts with expense information	4,173,915	4,410,349	24	25
1098-Ts without expense information	13,200,126	13,599,548	75	76[a]

Source: GAO analysis of 2005 Statistics of Income data.

[a]Lower and upper bounds were estimated independently and therefore may not add up to 100 percent.

Table 18: Number and Percentage of Taxpayers Apparently Eligible to Claim an Education Tax Credit or Tuition Deduction in Tax Year 2005

	Number of returns	Percent of returns
Total	4,292,132	100
Apparently eligible	2,770,570	65
All other	1,521,562	35

Source: GAO analysis of 2005 Statistics of Income data.

Table 19: Number and Percentage of Taxpayers Apparently Eligible to Claim an Education Tax Credit or Tuition Deduction in Tax Year 2005: Confidence Intervals

	Number of returns: Lower bound	Number of returns: Upper bound	Percent of returns: Lower bound	Percent of returns: Upper bound
Total	4,290,711	4,292,132	100	100
Apparently eligible	2,673,200	2,867,940	63	66
All other	1,453,105	1,590,019	34	37[a]

Source: GAO analysis of 2005 Statistics of Income data.

[a]Lower and upper bounds were estimated independently and therefore may not add up to 100 percent.

Table 20: Number and Percentage of Taxpayers Apparently Eligible to Claim an Education Tax Credit or Tuition Deduction That Failed to Do So in Tax Year 2005

	Number of returns	Percent of returns
Failed to claim	412,058	19

Source: GAO analysis of 2005 Statistics of Income data.

Table 21: Number and Percentage of Taxpayers Apparently Eligible to Claim an Education Tax Credit or Tuition Deduction That Failed to Do So in Tax Year 2005: Confidence Intervals

	Number of returns: Lower bound	Number of returns: Upper bound	Percent of returns: Lower bound	Percent of returns: Upper bound
Failed to claim	374,089	450,027	18	21

Source: GAO analysis of 2005 Statistics of Income data.

Table 22: Amounts by Which Taxpayers Apparently Eligible for an Education Tax Credit or Tuition Deduction Failed to Reduce Their Tax Liability in Tax Year 2005

	Inaction led to increased tax liability
Median	79.16
Mean	219.12
10th percentile	7.64
25th percentile	24.07
75th percentile	268.99
90th percentile	577.38
Maximum value	2,000.00

Source: GAO analysis of 2005 Statistics of Income data.

Table 23: Amounts by Which Taxpayers Apparently Eligible for an Education Tax Credit or Tuition Deduction Failed to Reduce Their Tax Liability in Tax Year 2005: Confidence Intervals

	Inaction led to increased tax liability
Median: Lower bound	66.5
Median: Upper bound	99.58
Mean: Lower bound	189.46
Mean: Upper bound	248.97
10th percentile: Lower bound	5.8
10th percentile: Upper bound	11.71
25th percentile: Lower bound	19.69
25th percentile: Upper bound	31.9
75th percentile: Lower bound	217.46
75th percentile: Upper bound	324.17
90th percentile: Lower bound	492.24
90th percentile: Upper bound	721.48

Source: GAO analysis of 2005 Statistics of Income data.

Table 24: Number and Percentage of Apparently Eligible Taxpayers That Claimed the Tuition Deduction but Would Have Been Better off Claiming the Lifetime Learning Credit in Tax Year 2005

	Number of returns	Percent of returns
Would have been better off claiming Lifetime Learning Credit	131,912	27

Source: GAO analysis of 2005 Statistics of Income data.

Table 25: Number and Percentage of Apparently Eligible Taxpayers That Claimed the Tuition Deduction but Would Have Been Better off Claiming the Lifetime Learning Credit in Tax Year 2005: Confidence Intervals

	Number of returns: Lower bound	Number of returns: Upper bound	Percent of returns: Lower bound	Percent of returns: Upper bound
Would have been better off claiming Lifetime Learning Credit	110,152	153,672	23	30

Source: GAO analysis of 2005 Statistics of Income data.

Table 26: Amounts by Which Apparently Eligible Taxpayers That Claimed the Tuition Deduction Could Have Reduced Their Tax Liability by Claiming the Lifetime Learning Credit in Tax Year 2005

	Lifetime Learning Credit produced larger reduction
Median	73.04
Mean	220.24
10^{th} percentile	[a]
25^{th} percentile	25.16
75^{th} percentile	233.91
90^{th} percentile	631.37
Maximum value	1,697.00

Source: GAO analysis of 2005 Statistics of Income data.

[a]Estimate cannot be calculated due to small sample size.

Table 27: Amounts by Which Apparently Eligible Taxpayers That Claimed the Tuition Deduction Could Have Reduced Their Tax Liability by Claiming the Lifetime Learning Credit in Tax Year 2005: Confidence Intervals

	Lifetime Learning Credit produced larger reduction
Median: Lower bound	53.82
Median: Upper bound	110.64
Mean: Lower bound	161.41
Mean: Upper bound	279.06
10th percentile: Lower bound	[a]
10th percentile: Upper bound	[a]
25th percentile: Lower bound	18.92
25th percentile: Upper bound	42.66
75th percentile: Lower bound	157.16
75th percentile: Upper bound	312.42
90th percentile: Lower bound	345.18
90th percentile: Upper bound	1,025.46

Source: GAO analysis of 2005 Statistics of Income data.

[a]Estimate cannot be calculated due to small sample size.

Table 28: Number and Percentage of Apparently Eligible Taxpayers That Claimed the Lifetime Learning Credit but Would Have Been Better off Claiming the Tuition Deduction in Tax Year 2005

	Number of returns	Percent of returns
Would have been better off claiming the Tuition Deduction	37,580	7

Source: GAO analysis of 2005 Statistics of Income data.

Table 29: Number and Percentage of Apparently Eligible Taxpayers That Claimed the Lifetime Learning Credit but Would Have Been Better off Claiming the Tuition Deduction in Tax Year 2005: Confidence Intervals

	Number of returns: Lower bound	Number of returns: Upper bound	Percent of returns: Lower bound	Percent of returns: Upper bound
Would have been better off claiming the Tuition Deduction	26,897	50,845	5	9

Source: GAO analysis of 2005 Statistics of Income data.

Table 30: Amounts by Which Apparently Eligible Taxpayers That Claimed the Lifetime Learning Credit Could Have Reduced Their Tax Liability by Claiming the Tuition Deduction in Tax Year 2005

	Tuition deduction produced larger reduction
Median	145.17
Mean	204.61
10^{th} percentile	[a]
25^{th} percentile	[a]
75^{th} percentile	274.32
90^{th} percentile	397.45
Maximum value	934

Source: GAO analysis of 2005 Statistics of Income data.

[a]Estimate cannot be calculated due to small sample size.

Table 31: Amounts by Which Apparently Eligible Taxpayers That Claimed the Lifetime Learning Credit Could Have Reduced Their Tax Liability by Claiming the Tuition Deduction in Tax Year 2005: Confidence Intervals

	Tuition deduction produced larger reduction
Median: Lower bound	83.73
Median: Upper bound	194.37
Mean: Lower bound	141.96
Mean: Upper bound	267.26
10th percentile: Lower bound	[a]
10th percentile: Upper bound	[a]
25th percentile: Lower bound	[a]
25th percentile: Upper bound	[a]
75th percentile: Lower bound	177.32
75th percentile: Upper bound	374.41
90th percentile: Lower bound	[a]
90th percentile: Upper bound	[a]

Source: GAO analysis of 2005 Statistics of Income data.

[a]Estimate cannot be calculated due to small sample size.

Table 32: Number and Percentage of Apparently Eligible Taxpayers That Claimed a Hope Credit but Would Have Been Better off Claiming a Lifetime Learning Credit in Tax Year 2005

	Number of returns	Percent of returns
Total	368,605	100
Would have been better off claiming Lifetime Learning Credit	20,727	6
All other	347,878	94

Source: GAO analysis of 2005 Statistics of Income data.

Table 33: Number and Percentage of Apparently Eligible Taxpayers That Claimed a Hope Credit but Would Have Been Better off Claiming a Lifetime Learning Credit in Tax Year 2005: Confidence Intervals

	Number of returns: Lower bound	Number of returns: Upper bound	Percent of returns: Lower bound	Percent of returns: Upper bound
Total	332,477	404,733	99	100
Would have been better off claiming Lifetime Learning Credit	12,950	31,217	4	8
All other	337,388	355,655	92	96[a]

Source: GAO analysis of 2005 Statistics of Income data.

[a]Lower and upper bounds were estimated independently and therefore may not add up to 100 percent.

Table 34: Amounts by Which Apparently Eligible Taxpayers That Claimed the Hope Credit Could Have Reduced Their Tax Liability by Claiming the Lifetime Learning Credit in Tax Year 2005

	Lifetime credit produced larger reduction ($)
Median	296.15
Mean	356.37
10th percentile	86.43
25th percentile	[a]
75th percentile	494.62
90th percentile	[a]
Maximum value	863

Source: GAO analysis of 2005 Statistics of Income data.

[a]Estimate cannot be calculated due to small sample size.

Table 35: Amounts by Which Apparently Eligible Taxpayers That Claimed the Hope Credit Could Have Reduced Their Tax Liability by Claiming the Lifetime Learning Credit in Tax Year 2005: Confidence Intervals

	Lifetime credit produced larger reduction ($)
Median: Lower bound	166.16
Median: Upper bound	491.75
Mean: Lower bound	257.82
Mean: Upper bound	454.93
10th percentile: Lower bound	64.32
10th percentile: Upper bound	156.97
25th percentile: Lower bound	[a]
25th percentile: Upper bound	[a]
75th percentile: Lower bound	303.59
75th percentile: Upper bound	654.08
90th percentile: Lower bound	[a]
90th percentile: Upper bound	[a]

Source: GAO analysis of 2005 Statistics of Income data.

[a]Estimate cannot be calculated due to small sample size.

Table 36: Number and Percentage of Returns where Apparently Eligible Taxpayers Made Suboptimal Choice, Tax Year 2005

	Number of returns	Percent of returns
Total	2,141,870	100
Taxpayers making suboptimal choice	601,267	28
All other	1,540,603	72

Source: GAO analysis of 2005 Statistics of Income data.

Table 37: Number and Percentage of Returns where Apparently Eligible Taxpayers Made Suboptimal Choice, Tax Year 2005: Confidence Intervals

	Number of returns: Lower bound	Number of returns: Upper bound	Percent of returns: Lower bound	Percent of returns: Upper bound
Total	2,056,824	2,229,485	100	100
Taxpayers making suboptimal choice	555,166	647,638	26	30
All other	1,467,713	1,613,493	70	74

Source: GAO analysis of 2005 Statistics of Income data.

Table 38: Amounts by which Apparently Eligible Taxpayers that Made Suboptimal Choice Could Have Further Reduced Their Tax Liability in Tax Year 2005

	Amount ($)
Median	85.74
Mean	222.04
10th percentile	8.32
25th percentile	25.88
75th percentile	284.13
90th percentile	576.86
Maximum value	2,000.00

Source: GAO analysis of 2005 Statistics of Income data.

Table 39: Amounts by which Apparently Eligible Taxpayers that Made Suboptimal Choice Could Have Further Reduced Their Tax Liability in Tax Year 2005: Confidence Intervals

	Amount ($)
Median: Lower bound	75.5
Median: Upper bound	105.94
Mean: Lower bound	197.46
Mean: Upper bound	246.62
10th percentile: Lower bound	6.41
10th percentile: Upper bound	11.79
25th percentile: Lower bound	22.28
25th percentile: Upper bound	34.6
75th percentile: Lower bound	236.65
75th percentile: Upper bound	317.04
90th percentile: Lower bound	499.46
90th percentile: Upper bound	697.14

Source: GAO analysis of 2005 Statistics of Income data.

Table 40: Number and Percentage of Suboptimal Choices Made by Paid Tax Preparers, Tax Year 2005

	Taxpayers making suboptimal choice	
	Number of returns	Percent
Total	601,267	100
No preparer	290,884	48
Paid preparer	301,355	50
IRS prepared/reviewed	[a]	0
VITA/self help/outreach/elderly assistance	[a]	1

Source: GAO analysis of 2005 Statistics of Income data.

[a]Estimate cannot be calculated due to small sample size.

Table 41: Number and Percentage of Suboptimal Choices Made by Paid Tax Preparers, Tax Year 2005: Confidence Intervals

	Taxpayers making suboptimal choice			
	Number of returns: Lower bound	Number of returns: Upper bound	Percent: Lower bound	Percent: Lower bound
Total	555,166	647,368	99.59	100
No preparer	258,439	323,329	44.53	52
Paid preparer	269,038	333,672	46.27	54
IRS prepared/reviewed	[a]	[a]	0	1
VITA/self help/outreach/elderly assistance	[a]	[a]	0.58	3

Source: GAO analysis of 2005 Statistics of Income data.

[a]Estimate cannot be calculated due to small sample size.

Chairman NEAL. Mr. Scott, you can proceed.

Mr. SCOTT. I don't have a statement at this time, Mr. Chairman. I am here to answer questions.

Chairman NEAL. Okay. Ms. Sowell.

STATEMENT OF KAREN GILBREATH SOWELL, DEPUTY ASSISTANT SECRETARY FOR TAX POLICY, UNITED STATES TREASURY DEPARTMENT

Ms. SOWELL. Mr. Chairman, Ranking Member English, and distinguished Members of the Subcommittee, thank you for the opportunity to appear before the Subcommittee today to discuss tax incentives for higher education.

Education is important to the Administration, and we recognize there may be room for improvement in the tax benefits currently provided through the Internal Revenue Code to encourage higher education. We believe, as you do, that it is important, periodically, to assess the provisions within our Tax Code to determine whether modifications are warranted, and we appreciate your leadership in studying this important subject.

From a broad perspective, it is also important that we keep in mind that these tax incentives are just one aspect of an array of governmental and other programs that help individuals and families meet the challenge of financing higher education and that figure into their decisions regarding higher education.

While I am not an expert on the non-tax offerings, we believe the non-tax programs must be taken into account when assessing the efficacy of the higher education tax incentives.

My testimony today highlights the myriad tax incentives enacted over several decades to help families save for college and finance higher education. From available data, we know that certain of these incentives are being utilized by a significant number of America's students and families.

However, our available data does not tell us whether the incentives are being used optimally by taxpayers to maximize their benefits. Further, it does not tell us whether the incentives are effective in influencing higher learning choices, or if, instead, they are simply furthering the goal of making higher education more affordable.

For individuals and families who have the ability and who have the sufficient time to save in advance for higher education, there are significant tax benefits to assist them.

The Administration and Congress have made considerable progress during the past seven years to improve savings-related incentives, notably the 2001 tax legislation expanded Coverdell education savings accounts and Section 529 plans to make distribution from plan accounts for post-secondary education expenses tax-free, and to allow private educational institutions to create Section 529 plans. The Pension Protection Act of 2006 made the changes to Section 529 permanent, which helped eliminate uncertainty with respect to this education savings vehicle.

Further, the Administration's budget for Fiscal Year 2009 includes a proposal to extend the Saver's Credit for contributions to Section 529 plans, in order to encourage and assist low-income families in saving for higher education.

Those students and families who are facing immediate education-related costs without the benefit of savings, however, confront a patchwork of education-related tax incentives, that are complex, often overlapping, and can have varying applications to individuals in different circumstances.

For example, tax credits and deductions to help families pay for higher education include the Hope Credit and the Lifetime Learning Credit. Parents supporting college students may claim a personal exemption, or Earned Income Tax Credit, if applicable, for full-time students aged 19 through 23, where children over the age of 18 otherwise do not qualify as dependents.

To name a few others, a student may exclude from gross income the amount of a qualified scholarship, or a loan that is forgiven if a student works for a required period of time in certain professions or locations. There is also an unlimited gift tax exclusion for tuition paid directly to a school on behalf of a student.

Given the range of available education tax benefits, it is understandable that many find them difficult to parse. The incentives vary, in terms of who may receive benefits, which expenses may be covered, and how large an allowed exclusion, deduction, or credit may be.

For example, part-time students may be eligible for the education credits and savings interest exclusion. Only full-time students may qualify for the dependent deduction. Some provisions, like the Hope Credit, are calculated per student, while others, like the Lifetime Learning Credit and the student loan interest deduction, are calculated per taxpayer. Different expenses qualify under different provisions, and phase-outs with different income thresholds apply to different incentives.

Because of this complexity, it may be difficult for a student or parent to determine the value of the tax incentives. In addition, the value of incentives based on adjusted gross income is necessarily retrospective, unless the student or parents can predict their income with precision. The more difficult it is to predict the value of the tax benefit accurately, the less effective these benefits are as incentives for the pursuit of higher education.

My written testimony includes a number of examples that illustrate the complex nature of the existing tax provisions and the differing outcomes that can occur for students and families in different situations.

In conclusion, while there is clearly a need to address the complexity concerns arising from the current welter of tax incentives, it is important to remain cognizant that revisions to the tax regime may lead to unintended consequences. Recognizing budgetary constraints, legislative reform of existing tax incentives will almost invariably result in winners and losers.

Further, considering that the population of students spans so many circumstances and situations, there may be no one-size-fits-all solution. Legislative reform of tax incentives would also need to address transition issues for those students and families who currently rely on existing provisions, or plan on them in the near term, to minimize the adverse effects of any reform on educational pursuits.

Thank you again, Mr. Chairman, Ranking Member English, and distinguished Members of the Subcommittee, for this opportunity to participate today. I would be pleased to respond to your questions.

[The prepared statement of Karen Sowell follows:]

U.S. TREASURY DEPARTMENT OFFICE OF PUBLIC AFFAIRS

EMBARGOED UNTIL 10 A.M. EDT May 1, 2008
CONTACT Andrew DeSouza (202) 622-0470

TESTIMONY OF DEPUTY ASSISTANT SECRETARY FOR TAX POLICY KAREN GILBREATH SOWELL BEFORE THE HOUSE WAYS AND MEANS SUBCOMMITTEE ON SELECT REVENUE MEASURES ON TAX INCENTIVES FOR HIGHER EDUCATION

Washington, DC--Mr. Chairman, Ranking Member English, and distinguished Members of the Subcommittee:

Introduction

Thank you for the opportunity to appear before the Subcommittee today to discuss tax incentives for higher education, which currently include more than a dozen credit, deduction, exclusion, and deferral provisions. While my testimony today focuses on tax incentives, I note that there are numerous non-tax governmental and other programs to help make higher education affordable and that figure into an individual's or family's decisions regarding higher education. The principal Federal student financial assistance programs are authorized under Title IV of the Higher Education Act of 1965, as amended, and this year will provide more than $90 billion in grant, loan and work-study assistance to students and their families. The Title IV programs include Federal Pell Grants, which serve low-income undergraduate students, and Federal student loans, both the bank-based Federal Family Education Loan program and the Department of Education's Direct Loan program, which serve undergraduate students and their parents, as well as graduate professional school students. In addition, colleges, universities, non-profit organizations, and the private sector furnish scholarships, tuition programs, and other assistance to students pursuing higher education, which according to the College Board exceeds $35 billion annually.

Education is important to the Administration, and we recognize that there is room for improvement in the tax benefits currently provided through the Internal Revenue Code to encourage higher education. We believe that the goal of providing incentives to make higher education affordable is best achieved by identifying the most efficient ways to address student needs and effectively utilizing those mechanisms. My testimony will focus first on a brief review of current tax incentives for college and other post-secondary education, and then discuss areas for potential improvement.

Over the last several decades, various provisions have been added to the Internal Revenue Code to facilitate savings for, and to incentivize the pursuit of, post-secondary education. Building on these existing provisions, the Administration and Congress have made significant progress during the past seven years to provide tax benefits related to higher education, particularly in helping families save for post-secondary education. Notably, the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) expanded Qualified Tuition Programs, also known as section 529 plans, to permit tax-free distributions from plan accounts to be used for post-secondary education expenses, and to allow private educational institutions (in addition to states) to create section 529 plans. The Pension Protection Act of 2006 made these changes to section 529 of the Internal Revenue Code permanent, which helped eliminate uncertainty with respect to this education savings vehicle. Further, the Administration's Budget for FY 2009 includes a proposal to extend the Saver's Credit to contributions to section 529 plans in order to encourage and assist lower-income families in saving for higher education.

EGTRRA also expanded Coverdell education savings accounts (formerly known as Education IRAs) by raising the annual contribution limit to Coverdell accounts from $500 to $2,000, and increasing the income phase-outs for joint filers. In addition, EGTRRA eliminated the disallowance of qualified distributions from Coverdell accounts or section 529 plans for those taxpayers who claim an education credit.

Notwithstanding these savings programs for those who have the ability and who have sufficient time to save for higher education, students and families who are facing immediate education-related costs must confront a patchwork of education-related tax incentives. Current law tax incentives may take the form of a credit against tax liability, a deduction from gross income, an exclusion from gross income, or a deferral of (or exemption from) tax. A detailed table of all the major tax incentives related to post-secondary education is attached as Table 1.

Set forth below is a brief overview of certain of the significant provisions under current law. Focusing on but a few of the available incentives reveals the complexity of these tax incentives, all of which are aimed at post-secondary education, but which apply to different people, in different circumstances, and for different educational ends. It is important to keep in mind that consideration of tax incentives is only one piece of the financial puzzle. Students pursuing higher education – be they recent high school graduates, high school graduates returning to higher education after entering the job market or raising a family, or professionals interested in pursuing an advanced degree or a different career – also have available to them the panoply of government grant and loan programs, as well as the many forms of non-governmental assistance available from educational institutions, non-profit organizations and the private sector.

Overview of Major Current Law Tax Incentives for Post-Secondary Education

As noted above, current law tax incentives may take the form of a credit, deduction, exclusion, or deferral. Many of these incentives have unique eligibility requirements, different phase-out limits, and various filing requirements. Generally, if an expense would qualify under more than one provision, current law allows only one tax benefit for the particular educational expense.

Credits

In 1997, Congress enacted a pair of tax credits to help families pay for higher education – the Hope Scholarship Credit (Hope Credit) and the Lifetime Learning Credit. In 2008, a taxpayer may claim a Hope Credit for 100 percent of the first $1,200 and 50 percent of the next $1,200 in qualified tuition and related expenses (for a maximum credit of $1,800 per student) for the first two years of college for a student enrolled at least half-time. A taxpayer may claim a Lifetime Learning Credit for 20 percent of up to $10,000 in qualified tuition and related expenses (for a maximum credit of $2,000) per taxpayer for any post-secondary education. Both credits are subject to an adjusted gross income (AGI) phase-out. In 2008, the credits phase out between $48,000 and $58,000 of AGI ($96,000 and $116,000 if married filing jointly). Only one credit may be claimed by each eligible student.

Dependent Related Deductions and Credits

For parents supporting college students, there is an extension of the benefit provided by the personal exemption for full-time students aged 19 through 23. Dependent children over the age of 18 do not qualify as children for the personal exemption unless they remain full-time students (through age 23). In 2008 the personal exemption amount is $3,500.

This favorable treatment of a full-time student aged 19 through 23 as a qualifying child also applies for purposes of the Earned Income Tax Credit (EITC). The EITC is a refundable tax credit for working families with low incomes. The EITC for families with one eligible child phases in over the first $8,580 of earned income for a maximum credit of $2,917. The credit phases out between $15,740 and $33,995 of earned income ($18,740 and $36,995 for joint filers). For families with modest incomes, allowing dependent students to qualify as children for EITC purposes provides the families supporting the students with a large tax benefit.

Deductions

A deduction may be allowed above-the-line (i.e., without itemization) for up to $2,500 of interest per year on any qualified education loan, subject to an AGI phase-out beginning at $55,000 ($115,000 if married filing jointly). In addition, through 2007, a taxpayer could claim an above-the-line deduction for qualified tuition and related expenses. The maximum amount of the deduction was $4,000 for taxpayers with AGI below $65,000 ($136,000 if married filing jointly), or $2,000 for taxpayers with AGI between $65,000 and $80,000 ($136,000 and $160,000 if married filing jointly) in 2007.

Moreover, deductions may be allowed to taxpayers for work-related education expenses. An employee who itemizes deductions may deduct work-related education expenses as one of a class of miscellaneous itemized deductions subject to a floor of 2 percent of AGI. Similarly, if an employer pays an employee's education expenses and the reimbursement does not take place through an accountable plan, the amount reimbursed is included in the employee's gross income, but the employee may deduct the expenses as a miscellaneous itemized deduction subject to the 2-percent floor.

Exclusions from Income

In addition to any available credits or deductions, any student who receives a qualified scholarship to a degree-granting program (including certain Federal medical training programs) may exclude from gross income amounts used to pay qualified tuition and related expenses, including fees, books, supplies, and required equipment. Under another provision, originally enacted in 1976, a student may exclude from gross income the amount of a loan that is forgiven if the student works for a required period of time in certain professions or locations. For example, after graduating from college, a student might have a loan forgiven if he or she were to become a teacher in an underserved community. Additionally, there is an unlimited exclusion from the gift and generation-skipping transfer tax for tuition paid directly to a school on behalf of a student, resulting in an incentive to make gifts of college tuition

There are also incentives for individuals to continue their education while employed. An employee may exclude employer-provided education expenses (up to $5,250 since 1986) that are part of an Educational Assistance Program (EAP). Under an EAP, there is no requirement that the education be work-related. In addition, like other work-related expense reimbursements, an employee may exclude from gross income employer reimbursements for work-related education made under an accountable plan.

Certain colleges and universities offer tuition-reduction programs to their employees (which can include the employee's spouse or dependent child). Tuition benefits under such programs may be excluded from gross income. Also, certain graduate students employed in teaching or research may exclude tuition reductions from gross income.

Savings Related Deferrals and Exclusions

Traditionally, tax deferral has been afforded to income saved for retirement in an Individual Retirement Arrangement (IRA). Since 1998, an IRA distribution for qualified higher education expenses has been permitted, with penalties waived, although tax attributable to the amounts distributed is still due. The exclusion covers both Traditional and Roth IRAs (effectively without income limits on contributors), encompasses grandchildren as beneficiaries, and extends qualified expenses beyond tuition and required fees to room and board (for students attending college at least half time), books, and supplies.

As noted above, tax deferral on income saved for college expenses has been available since 1996 through Qualified Tuition Programs, also called section 529 plans. Individuals at all income levels may contribute to a section 529 account or prepaid tuition plan. Contributors may use up to five years of annual gift tax exclusion amounts in advance for a gift-tax-free contribution to a student in a single year (for a total of $60,000 in 2008). There is no limit on the number of permissible student donees per year. Some states permit contributors to deduct a limited amount of contributions for state income tax purposes. Not only does income accumulate tax-free in a section 529 account, but distributions from the account, which include a return of contributions and earnings on those contributions, are also excluded from gross income as long as they are used for qualified higher education expenses.

In 1997, an additional deferral vehicle was created in the form of an Education IRA. Subject to an AGI phase-out, contributors were allowed to contribute in the aggregate up to $500 per year to an Education IRA. As noted above, EGTRRA increased contribution limits to Education IRAs, now named Coverdell Education Savings Accounts, to $2,000. Not only does income accumulate tax-free in a Coverdell account, but distributions from the account, which include a return of contributions and earnings on those contributions, are also excluded from gross income as long as they are used for qualified education expenses, including college expenses.

Since 1988, there also has been a college saving incentive in the form of an exclusion of interest on qualified United States Savings Bonds, provided that the proceeds are used to pay for qualified higher education expenses, subject to an AGI phase-out.

Complexity of Tax Incentives

As reflected in the overview above, the education tax incentives under current law are numerous, often overlapping, and complex. The incentives vary in terms of who may receive benefits, which expenses may be covered, and how large an exclusion, deduction, or credit may be allowed. For example, part-time students may be eligible for the education credits (at least half-time in the case of the Hope Credit) and savings bond interest exclusion. Only full-time students may qualify for the dependent deduction or EITC. Some provisions, like the Hope Credit, are calculated per student, but others, like the Lifetime Learning Credit and the student loan interest deduction, are calculated per taxpayer. Different expenses qualify under different provisions. For example, books, supplies and equipment are qualified expenses for many savings provisions but not for purposes of the credits. Finally, phase-outs with different thresholds apply for purposes of the credits, dependent deduction, student loan interest deduction, Coverdell account contribution, and savings bond interest exclusion.

Consider the following examples and their disparate results. The examples show the value of education benefits available under 2007 law to typical families facing a wide range of circumstances regarding their education expenses.[1] In each example, we calculate the tax benefits that typical families would receive from five tax provisions that may help families with education expenses as in effect for 2007: (a) the Hope Credit, (b) the Lifetime Learning Credit, (c) the tuition deduction (expired December 31, 2007), (d) the dependent exemption, and (e) the EITC. Savings incentives, such as Coverdell accounts and section 529 accounts are not considered.

Because the provisions interact, and because only the EITC is refundable, some families may not have sufficient tax liability to benefit fully from all provisions for which they are eligible. The examples show that total tax benefits vary with the family's specific circumstances: family income, filing status, age of the student, dependent status of the student, whether the student attends part-time, year of study, and their expenses. The families in the examples presented are otherwise typical of families with similar incomes. Of course, the results may vary as the facts vary from the typical family model.

Taxpayers may often be eligible for more than one benefit and only some benefits may be used together. Thus, in many instances, the family must choose among the various benefits. The first example shows the optimal choice may not be obvious before computing the family's taxes.

Example 1: A Family May Need to Make Many Calculations to Determine the Best Outcome

A family of three (Family A) has an income of $100,000. Their 19-year-old son is a full-time freshman at the local state university. His tuition and fees for the year are $6,000. The family knows that they are eligible for the Hope Credit, the Lifetime Learning Credit, the tuition deduction, and the dependent exemption that the family would not be eligible for if the son were not a full-time student. The family may use no more than one of the following three benefits: the Hope Credit, the Lifetime Learning Credit, or the tuition deduction. The family is in the phase-out range for the education credits.

---

1 The families in these examples have average levels of deductible expenses and no capital gains income. For families eligible for the EITC, all income is from wages.

- Family A could receive $2,005 – from the Hope Credit ($1,555) and the dependent exemption ($850).
- Family A could receive $1,690 – from the Lifetime Learning Credit ($840) and the dependent exemption ($850).
- Family A could receive $1,850 – from the tuition deduction ($1,000) and the dependent exemption ($850).

Note that if this family had additional children with education expenses, the calculation exercise would be even more complicated. For example, the Lifetime Learning Credit provides a maximum of $2,000 per family and thus, may be limited for families whose total tuition expenses exceed $10,000.

The remaining examples calculate the optimal education benefit for a series of taxpayers with different incomes, filing status, and education needs to demonstrate the potential range of results.

Example 2: Individual in Part-time Training Programs – Income Affects Tax Benefits

A single taxpayer attends a training program that costs $1,000. He attends less than half-time, is not in a degree program, and is not in his first two years of post-secondary study.

- If Taxpayer B earns $25,000, B could receive a Lifetime Learning Credit of $200 (the tuition deduction would be worth $150).
- If Taxpayer B earns $50,000, B could receive a tuition deduction worth $250 (the Lifetime Learning Credit would be worth only $140 due to the phase out).

Example 3: Moderate Income Students Working Toward an Associate's Degree – Family Structure Affects Tax Benefits

A student begins work on an associate's degree at the local community college. The student's family has income of $25,000. The student attends at least half-time. Tuition and required fees are $4,000.

- C, a single student who is not dependent on his or her parents, could receive the maximum Hope Credit of $1,650.
- D, a married student who is not a dependent, could receive a Hope Credit or a Lifetime Learning Credit for $750. (D's family does not have sufficient tax liability to benefit from the education credit fully.)
- E, the married parents of a 19-year old living at home and supported by his or her parents, could receive benefits totaling $2,387 from the Hope Credit ($410), the dependent exemption ($340), and the EITC ($1,637).

Example 4a: Students Attending the Local State University – Income Affects Tax Benefits

A college-age student enrolls full-time at the local state university where tuition and fees are $6,000. The student is in his or her first year of study.

- F, a family earning $25,000, would receive $2,387 – from the Hope Credit ($410), the dependent exemption ($340), and the EITC ($1,637).

- G, a family earning $50,000, would receive $2,160 – from the Hope Credit ($1,650) and the dependent exemption ($510).
- H, a family earning $100,000, would receive $2,005 – from the Hope Credit ($1,155) and the dependent exemption ($850).
- I, a family earning $150,000, would receive $1,350 – from the tuition deduction ($500) and the dependent exemption ($850).
- J, a family earning $200,000, would receive $952 – from the dependent exemption.

Example 4b: This example is the same as Example 4a, except that the student is enrolled in his or her third year of study. As a result, the Hope Credit would no longer be available.

- F, a family earning $25,000, would still receive $2,387 – from the Lifetime Learning Credit ($410), the dependent exemption ($340), and the EITC ($1,637).
- G, a family earning $50,000, would receive $1,710 – from the Lifetime Learning Credit ($1,200) and the dependent exemption ($510).
- H, a family earning $100,000, would receive $1,690 – from the Lifetime Learning Credit ($840) and the dependent exemption ($850).
- I, a family earning $150,000, would still receive $1,350 – from the tuition deduction ($500) and the dependent exemption ($850).
- J, a family earning $200,000, would still receive $952 – from the dependent exemption.

Attached as Table 2 are figures that illustrate graphically the tax value of education benefits under 2007 law, taking into account the same five major tax provisions. The figures show the value of the education benefits for typical families by AGI. As in the examples above, the value of these provisions depends on a student's or family's circumstances: the cost of tuition; family income (including whether the family has any income tax liability); whether the student attends college full-time or part-time; filing status; and for the Hope Credit, whether the student is in the first two years of post-secondary education.

The tax savings for a student or family vary significantly with income and tuition level. At the tuition levels paid by most full-time students whose families are eligible for the credits, the Lifetime Learning Credit offers less assistance than the Hope Credit. The Hope Credit, however, is only available to students in their first two years of college. Thus, the tax value associated with a college freshman or sophomore is larger in many cases than the tax value associated with a college junior or senior.

In general, families with incomes under $100,000 in 2007 owing tuition expenses would have maximized their benefits by claiming an education credit; higher income families would have claimed a tuition deduction. As income rises further, the dependent deduction phases out. Families with no income tax liability receive no benefit from the dependent deduction, the tuition deduction, or education credits. However, a college student may qualify a low-income or moderate-income family for the EITC. Large families may lose the benefit of the dependent deduction because they are more likely to be subject to the alternative minimum tax.

Like the family filing a joint return, higher income individuals who file single returns would have maximized their benefits by claiming the tuition deduction, while individuals with incomes under $50,000 would have claimed a credit. A low-income independent student may be eligible for the EITC, but there is no additional education-related benefit from the EITC and thus, the EITC benefit would be the same as for other low-income individuals. Because independent students receive no benefit from the dependent deduction and no education-related benefit from the EITC, the tax value of the benefits associated with an independent student is smaller than the corresponding tax value for a dependent student.

As illustrated in the examples above and the figures in Table 2, the value of various tax incentives attributable to a student may range from a few hundred to a few thousand dollars depending on filing status and AGI. In addition, a claim of one credit or deduction may adversely affect a taxpayer's eligibility for another credit or deduction. From this variety of incentives, a student or parent must discern the optimal combination of tax benefits, which may require many taxpayers to generate alternative complex computations. As in Example 1 above, taxpayers with dependent students who are eligible for a tuition deduction as well as a Hope or Lifetime Learning Credit must run multiple calculations to determine their maximum benefits. Because a qualified expense may not be eligible for more than one benefit, careful recordkeeping is required to ensure both the optimal distribution of expenses and compliance.

Because of the complexity, it may be difficult for a student or parent to determine the value of the tax incentives. In addition, for incentives based on AGI, their value is necessarily retrospective unless the student or parents can predict their income with precision. The more difficult it is to predict the value of the tax benefit accurately, the less effective these benefits are as incentives for the pursuit of a college education.

In addition to the challenges that students face in navigating the myriad education tax incentives to optimize their use, the complexity of these provisions increases the record-keeping and reporting burden on taxpayers, while making it difficult for the IRS to monitor compliance. For example, to claim an education credit, a taxpayer must file a Form 1040 even if he or she otherwise qualifies to file a Form 1040EZ, and the taxpayer must file an IRS Form 8863, a 17-line form with two pages of instructions.

Observations on Simplification

Despite the complexity, because the tax incentives may provide significant value to a family or individual in pursuit of higher education, it appears the various incentives are widely utilized. Table 3 sets forth statistics on the use of the education credits and the tuition deduction based on the most recent IRS data available (for tax year 2005). In the fall of 2005, more than 17 million students were enrolled in college in the United States. As noted in Table 3, a substantial number of these students claimed some combination of the deduction and credits. Overall, in 2005, more than 11.6 million taxpayers claimed an education credit or tuition deduction. Our data cannot capture whether students and families are utilizing the tax incentives optimally, nor what impact, if any, the tax incentives have on decision-making regarding post-secondary education. However, one would anticipate that the complexity would detrimentally affect the efficient utilization and administration of the benefits.

Because the value of a particular tax incentive may not become apparent until the end of the tax year, which may be months after the tuition or other expense was due, and the tax year does not coincide with the academic year, the tax system is not well suited to provide assistance on the "front end" of funding higher education. Generally, tax benefits become available only after year-end (especially in the case of benefits limited by AGI, which is determined at year-end). As a result, the complexity of the current provisions makes it difficult for even a very sophisticated taxpayer to adjust withholding to "advance" the benefit.

In addition, it is important to remember that recent high school graduates do not constitute the only type of person interested in pursuing a college education. Prospective students also include older persons who entered the job market after high school as well as those who have an interest in pursuing an advanced degree or a career different from the one in which they were originally engaged. The provision of different tax incentives for similar higher education expenses may result in the unequal tax treatment of similarly situated taxpayers.

Suggestions have been offered regarding potential simplifications, primarily along three themes. First, it has been suggested that uniform definitions for operative terms such as "qualified higher education expenses" or "qualified tuition and related expenses" and "eligible education institution" be adopted. For example, currently only tuition may qualify for tuition reduction for college employees and gift tax exclusions; tuition and required fees may qualify for the Hope and Lifetime Learning Credits, tuition deduction, and savings bond interest exclusion; tuition, fees, books, supplies, and equipment may qualify for the scholarship exclusion, employer EAP, and student loan interest deduction; and tuition, fees, books, supplies, equipment (and in the case of a student attending at least half time, room and board) may qualify for penalty-free distributions from IRAs, section 529 accounts, and Coverdell accounts.

A second suggestion has been to conform the phase-out thresholds and ranges and index all amounts for inflation. As noted above, different income thresholds apply to the education credits, dependent deduction, student loan interest deduction, and the different savings provisions.

Third, it has been suggested that the education credits be consolidated along with certain deductions. In particular, the AGI phase-out for the credits could be increased to eliminate the need for the tuition deduction; or a single credit could be designed to cover the same population.

While there is clearly a need to address the complexity concerns arising from the current welter of tax incentives, it is important to remain cognizant that revisions to the tax regime may lead to unintended consequences, and any revision may unsettle taxpayer expectations. Recognizing budgetary constraints, legislative reform of tax incentives will almost invariably result in additional benefits for certain taxpayers and fewer benefits for others. Because of the varying profiles of those who seek the benefits of tax incentives for higher education, it may be challenging to streamline the incentives in a way that would benefit the entire target group. Legislative reform of tax incentives would also need to address transition issues for those students or families who may be planning to rely on relevant provisions under current law.

In contemplating legislative reform of current tax incentives, a good starting point would be to focus on clear, simple ways to help students and their families meet the cost of higher education. While efforts can be made to consolidate and streamline the education tax incentives, to be successful, those efforts should not overlook the non-tax benefits that are available to many students, especially those in low-income and middle-income families, either from Department of Education and other federal and state governmental programs or from private-sector sources. Thank you Mr. Chairman, Ranking Member English, and distinguished Members of the Subcommittee for the opportunity to participate in today's hearing on this important subject. I would be pleased to respond to your questions.

-30-

Table 1. Summary of Tax Provisions Related to Higher Education

	Provision	Tax Benefit	Qualifying Expenses	Eligible Individuals	Maximum Annual Amount	Income Limits	Eligible Institution
1	**Hope Scholarship Credit (§ 25A)**	Per student credit against tax	Tuition and required fees	Taxpayer, spouse or dependent in 1st or 2nd year of higher education enrolled at least half-time	\$1,800: 100% of the first \$1,200 and 50% of the next \$1,200 (indexed for inflation)	Phase-out begins at \$48,000 (\$96,000 if joint return) and is pro rata over \$10,000 (\$20,000 if joint return) (indexed for inflation)	Post-secondary school eligible for Federal student aid
2	**Lifetime Learning Credit (§ 25A)**	Per taxpayer credit against tax	Tuition and required fees	Taxpayer, spouse or dependent in post-secondary or professional education	\$2,000: 20% of the 1st \$10,000 total across all eligible students in household (not indexed for inflation)	Phase-out begins at \$48,000 (\$96,000 if joint return) and is pro rata over \$10,000 (\$20,000 if joint return) (indexed for inflation)	Post-secondary school eligible for Federal student aid
3	**Earned Income Tax Credit for dependent children aged 19 through 23 (§ 32)**	Refundable credit for families with dependent children aged 19 through 23	N/A	Dependent student enrolled full-time for at least 5 months of preceding year	\$2,917 for families with a single dependent child	Phase-in complete at \$8,580 Phase-out begins at \$15,740 (\$18,740 if joint return) Phase-out complete at \$33,995 (\$36,995 if joint return) (indexed for inflation)	Educational organization – any level

	Provision	Tax Benefit	Qualifying Expenses	Eligible Individuals	Maximum Annual Amount	Income Limits	Eligible Institution
4	**Employer-reimbursed educational expenses paid through an accountable plan (§ 62(c))**	Exclusion from gross income	Tuition, required fees, non-academic fees, books, supplies, equipment, room and board, special needs, transportation and travel	Employee	None	None	Educational organization – any level
5	**Traditional and Roth IRAs (§ 72(t)(7))**	Exception from 10% additional tax on early distributions	Tuition, required fees, non-academic fees, books, supplies, equipment, room and board, special needs	Taxpayer, spouse, child or grandchild (enrolled at least half-time for room and board)	None	None	Post-secondary school eligible for Federal student aid
6	**Cancellation of debt (§ 108(f))**	Exclusion from gross income for income from cancellation of certain student loans	N/A	Borrower who works for a certain period of time in certain professions for any of a broad class of employers	None	None	Educational organization – any level
7	**Scholarships and fellowships (§ 117)**	Exclusion from gross income	Tuition, required fees, non-academic fees, books, supplies, equipment	Degree candidate	None	None	Educational organization – any level

	Provision	Tax Benefit	Qualifying Expenses	Eligible Individuals	Maximum Annual Amount	Income Limits	Eligible Institution
8	**Tuition reduction (§ 117(d))**	Exclusion from gross income	Tuition	Employee of college, spouse or dependent; graduate student employed in teaching or research	None	None	Educational organization – college or graduate school
9	**Employer provided education assistance program (EAP) (§ 127)**	Exclusion from gross income	Tuition, required fees, non-academic fees, books, supplies, equipment and special needs	Employee receiving higher education	$5,250 (not indexed for inflation)	Limits on share of benefit that can go to the highly compensated; no individual income limits	Educational organization – any level
10	**Savings bond interest (§ 135)**	Exclusion from gross income for U.S. savings bond interest	Tuition and required fees	Taxpayer, spouse, or dependent	None	Phase-out $50 per $1000, from $67,100-$82,100 ($100,650-$130,650 if joint return) (indexed for inflation)	Post-secondary school eligible for Federal student aid
11	**Dependent children aged 19 through 23 (§ 152(c)(3))**	Personal exemption deduction for dependent children aged 19 through 23	N/A	Student enrolled full-time for at least 5 months of preceding year	3500 (indexed)	Phase-out begins at $159,950 ($239,950 if joint return) (indexed for inflation)	Educational organization – any level

	Provision	Tax Benefit	Qualifying Expenses	Eligible Individuals	Maximum Annual Amount	Income Limits	Eligible Institution
12	**Business expense deduction (§ 162)**	Itemized deduction	Most business or work related education expenses including transportation and childcare	Taxpayer or spouse	None	Overall limitation on itemized deductions may apply to AGI over $159,950 (indexed for inflation)	Educational organization – any level
13	**Student loan interest (§ 221)**	Above-the-line deduction	Tuition, required fees, non-academic fees, books, supplies, equipment, room and board	Taxpayer paying interest on a qualified education loan incurred on behalf of self, spouse, or dependent	$2,500	Phase-out over $55,000-$70,000 ($115,000-$145,000 if joint return) (indexed for inflation)	Post-secondary school eligible for Federal student aid
14	**Education expenses (§ 222) (effective through 2007)**	Above-the-line deduction	Tuition and required fees	Taxpayer, spouse or dependent receiving higher education	$4,000 or $2,000 subject to income limits	Deduction limited to $4,000 if AGI is less than $65,000 ($130,000 if joint return); and to $2,000 if AGI is less than $80,000 ($160,000 if joint return)	Post-secondary school eligible for Federal student aid
15	**Qualified Tuition Plan (QTP) (§ 529)**	Exclusion from gross income for distributions from QTP accounts	Tuition, required fees, non-academic fees, books, supplies, equipment, room and board, and special needs	Any post-secondary student (enrolled at least half-time for room and board)	None	None	Post-secondary school eligible for Federal student aid

	Provision	Tax Benefit	Qualifying Expenses	Eligible Individuals	Maximum Annual Amount	Income Limits	Eligible Institution
16	**Coverdell Education Savings Account (§ 530)**	Exclusion from gross income for distributions	Tuition, required fees, non-academic fees, books, supplies, equipment, room and board, and special needs	Any student, including primary and secondary (enrolled at least half-time for room and board)	Contributions limited to $2,000 per year, per recipient	Phase-out of eligibility for contributions from $95,000-$110,000 ($190,000-$220,000 if joint return)	Post-secondary school eligible for Federal student aid, or secondary or primary school
17	**Gift tax exclusion (§ 2503(e))**	Exclusion for tuition paid directly to educational institution	Tuition	Any student	None	None	Educational organization – any level

Table 2. The Tax Value of a Student under 2007 Law

Figures A through C below illustrate the combined value of five major income tax provisions effective in 2007 – the Hope Credit, the Lifetime Learning Credit, the tuition deduction, the dependent exemption, and the Earned Income Tax Credit (EITC) – to families with different levels of income and different education expenses. Families are otherwise typical of families with similar incomes.[2] The tax value of a student is the difference between the taxpayer's income tax liability and what it would have been if the student had not enrolled in school. The no tuition case corresponds to a full scholarship and reflects the value of the tax benefits of the dependent exemption and the EITC.

Figure A. Tax Value of a Full-Time College Freshman or Sophomore under 2007 Law (Joint Filers)

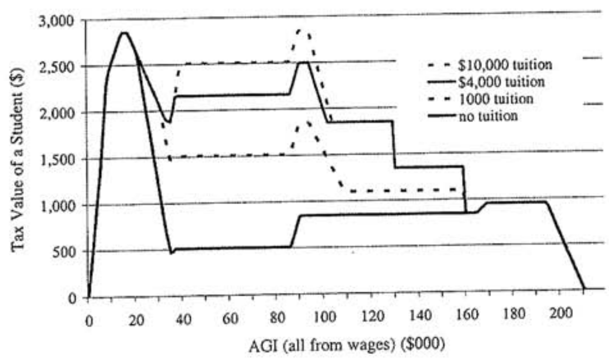
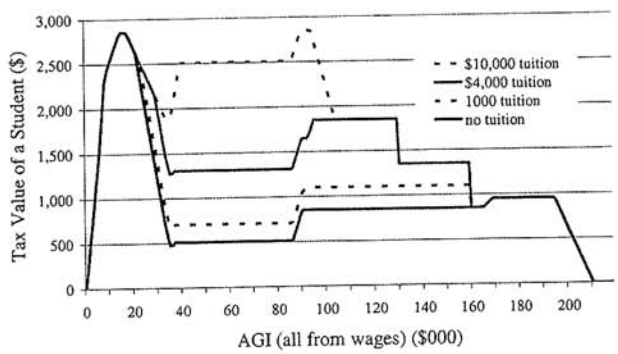


Figure B: Tax Value of a Full-Time College Junior or Senior under 2007 Law (Joint Filers)



[2] The families have average levels of deductible expenses and all income is from wages.

Figure C: Tax Value of an Independent Student Eligible for the Hope Credit under 2007 Law (Single Filers)

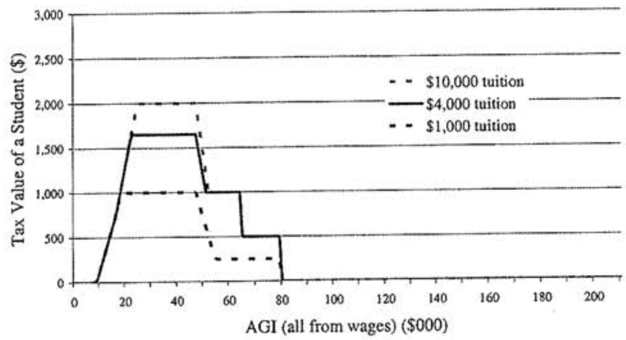


Figure D presents the same information as Figure A, but excludes the benefits of the tuition deduction, which expired on December 31, 20007.

Figure D. Tax Value of a Full-Time College Freshman or Sophomore from Education Credits, Dependent Exemption and EITC (2007 Law, Joint Filers)

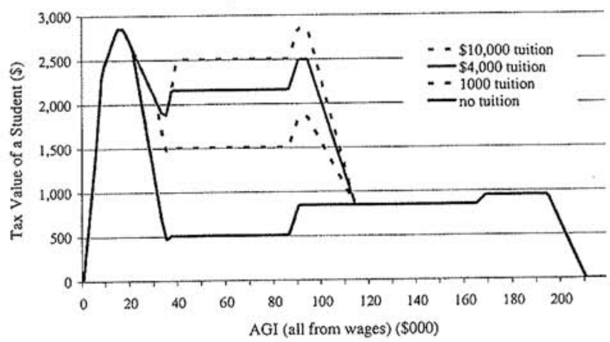


Table 3
Use of Tax Incentives for Higher Education - Tax Year 2005 SOI Data

Education Incentive Claimed		Returns (Thousands)	Dollars (Millions)	Average (Dollars)
Tuition Deduction Only[1]		4,416	10,085	2,284
Hope Credit Only[1]		2,554	2,627	1,029
Lifetime Learning Credit Only[1]		4,011	2,783	694
Any Combination of Above		482	[2]	[2]
	Total	*11,463*		

Department of the Treasury
Office of Tax Analysis

May 1, 2008

Notes:
[1] A Hope or Lifetime Learning Credit amount is used to offset individual income tax liability on a dollar-for-dollar basis. In contrast, the tuition deduction is subtracted from the income upon which tax is calculated. Therefore, the value of the deduction to the taxpayer depends on that taxpayer's effective tax rate.

[2] The 482,000 returns that claim more than one type of incentive claim a total of $762 million in tuition deductions and $707 million in education credits.

Chairman NEAL. Thank you very much, Ms. Gilbreath Sowell. In discussing your testimony with my staff, I concluded that we were pretty impressed with the details that you offered. And considering that this is your inaugural visit to the Committee, you certainly took the task seriously.

In the examples you have included of the confusing choices the typical family might face are extremely instructive for the Committee. On the much tougher question of how we simplify, however, your testimony is more silent. And I don't blame you. Obviously, the choices are not easy. But I know the Administration has proposed some changes to the tax benefits in the past.

Can you tell us whether Treasury is currently looking at an effort to craft a simplified education tax benefit, or are there any proposals that are ruminating through the Department?

Ms. SOWELL. Thank you for your question, Mr. Chairman, and I might add that I am very impressed with the funding that you have provided for your family in these education endeavors.

Chairman NEAL. I will be working until I'm 90.

[Laughter.]

Ms. SOWELL. As I mentioned, over this Administration, this Administration and this Congress have provided significant adjustments to the savings-related incentives for education. And those are permanent adjustments that should serve families well going forward.

There have been significant advancements in the Section 529 accounts and Coverdell savings accounts to allow for tax-free dollars for post-secondary education. And in addition, our current budget proposes to extend the Saver's Credit to the Section 529 savings plans.

As you also are aware, in our Fiscal Year 2005 budget, we recommended simplifying and bringing together some of these tax incentives for simplification purposes.

Chairman NEAL. And, Mr. Brostek, your research is astounding: 28 percent of the filers either missed education tax benefits, or did not claim the right benefit for the maximum credit.

GAO recommended some time ago that the Department of Education, consulting with Treasury, study the effectiveness of the combined aid and tax programs, but little has really been done. Do you think that a very detailed Federal financial aid form—which, by the way, is pretty challenging—might be one place where families could be tipped off to the potential tax benefits, or is it already so complex that this would simply confuse the matter?

Mr. BROSTEK. Well, that's certainly an option. As you rightfully note, though, that is a long and quite complex form. And it is filled out before assistance is provided, whereas the tax benefits, other than the savings provisions, are generally after the expenses have occurred.

I think it might be better to have a flag like that when it would be contemporaneous with the taxpayer making a decision about which provision to use.

So, for instance, the educational institutions send the taxpayer a Form 1098–T that indicates their child did attend the institution, and also, in some cases, includes the expenses. That form might be a better place to flag to the taxpayer that they can use various tax benefits, and that they need to carefully select among them to choose the one that's best for them.

Chairman NEAL. And, Ms. Gilbreath Sowell, you mentioned the burdens on taxpayers of claiming these benefits, including additional and more complicated tax forms.

After reading your taxpayer examples, where the wrong choice penalizes the taxpayer by hundreds of dollars, it seems we are already forcing these families to seek professional tax assistance, and that certainly lends itself to additional costs. Is that counter-intuitive?

Ms. SOWELL. Mr. Chairman, you are correct, that whenever there are multiple tax provisions that could apply to a single expenditure, that creates complexity.

I will note that the Treasury Department and the IRS have worked very closely with the Department of Education to provide information to the Education Department that could be disseminated to students and families.

In addition, the IRS has a very thoughtful 80-page publication that tries to identify all the tax provisions that are available in a plain-English style, with computational aids that can help families figure this out. I am actually quite impressed with the publication.

If you have had an opportunity to look through it—which I would guess you have, based on your experience—it is a very useful tool.

That said, I have no doubt that, because of the complexity, there are things that are missed, and possibly options that are not taken by students and families that should be taken.

Chairman NEAL. Before I yield to Mr. English, in every January I host two forums on financial aid, where we assemble experts from across the field, and invite constituents to attend.

I must tell you, the crowds are overwhelming. And much of it relates to the whole issue of complexity. And the people that walk through that door of good will and good purpose are genuinely confused by the options that are available to them. Seminars typically last for two hours.

And I must tell you again, nobody gets up to leave. They stay through the whole demonstration process, and they leave maybe with a little bit of relief that they're going to get through it.

But again, the issue of complexity threatens to overwhelm the process. And with that, I would like to yield to Mr. English.

Mr. ENGLISH. Thank you, Mr. Chairman. And I guess my questions will follow very much in the same vein.

Mr. Brostek, in examining this field, I understand many experts believe that taxpayers are often simply not aware of the existence of the Hope or Lifetime Learning tax credits when making a decision about whether to send a child to college, or how much college they can afford.

Instead, for those taxpayers, the credits come as a surprise the following April, when they file their taxes. Did any of your research confirm this?

Mr. BROSTEK. We didn't gather any specific information on that. But, given the number of individuals we found who didn't claim any of the provisions, I can certainly suppose that many people were unaware of them.

Mr. ENGLISH. What are Congress's options, apart from simplification, which I strongly supportive of, to make sure that the credits have their desired effect of helping people who are making a decision about whether they can afford college?

Mr. BROSTEK. There I think it would have to be educational assistance before the expenses are incurred, before a decision is made to go to college. And it is possible that additional assistance with the form—perhaps not on the form, but accompanying it—would be made available to taxpayers, to help them understand that there are tax benefits available, and how much those benefits might be worth.

Perhaps there could be some tools made available, either at the IRS or perhaps in the Department of Education, for people who have computer access, to go in and get some sense, if they had their current financial circumstances, how much aid might they get if they use one of the benefits.

Mr. ENGLISH. In your testimony you note that 19 percent of tax returns that showed eligibility for 1 of the Federal tax benefits for higher education had failed to claim it. You also said that many of these returns were prepared by professional preparers.

The latter fact is especially disturbing. Did you attempt to determine why even professional preparers failed to claim available education tax benefits for their clients?

Mr. BROSTEK. We haven't determined that, but we have at least a little bit of indirect evidence. A couple of years ago we did some mystery shopping during the tax season. We went into some paid preparers, pretending to be taxpayers under a couple of scenarios, one of which was an individual who had a child who was eligible for one of these tax benefits.

And the impression we had was that the paid preparers were not all that knowledgeable themselves, and the software programs—almost all paid preparers use software programs—didn't seem to be giving them the kind of prompts that may have helped the paid preparers determine what would be the best option to make available to their client.

Mr. ENGLISH. Now, on a rather different angle, Mr. Brostek, according to the National Association of College and University Business Officers, in 2006 the 7 universities with the largest endowments were sitting on more than $100 billion of endowment assets. Average endowment asset growth at these schools was 17 percent from the year before.

Some of these endowment dollars are from years of tax-exempt investment income earned by the universities. Some of these endowment dollars are from charitable contributions, for which a deduction was taken decades ago, yet the university has not yet used the money for an educational purpose

Has the GAO examined whether we are getting a good rate of return on our investment, such as through lower tuitions or greater financial aid for students in need? And shouldn't we be asking questions about universities that sharply raise tuition, at the same time balances in their endowment increase even faster?

Mr. BROSTEK. While we haven't directly studied that issue, it certainly is an important one. Some of those endowments are indeed extremely large. There are a number of issues that would need to be considered.

A significant portion of endowments, as I understand it, have strings attached. The donation to the institution requires that money to be used for various identified purposes which may, to some extent, constrict the college's ability to use it for student assistance directly, for instance.

I do think it's a very important topic. As you note, it's a relatively small number of institutions that have the very large endowments, and there are many, many more institutions who don't have those endowments but have needy students.

Mr. ENGLISH. Thank you, Mr. Chairman.

Chairman NEAL. Thank you, Mr. English. Mr. McDermott will inquire.

Mr. MCDERMOTT. Thank you, Mr. Chairman. Having represented the University of Washington in the State Legislature and the United States Congress for almost 40 years, I am somewhat familiar with the complexity of what you're up to.

So, I would like to ask you a question. I would like you to step out of your role here and be a counselor at the University of Washington, or at the Seattle Central Community College, which Newsweek said was the best community college in the United States.

A young woman comes in, single, $30,000 salary as a secretary. She has two kids. She has one year down at the community college. She is trying to go from being a secretary to a legal assistant in the office in which she is working. Which program should she try to access?

Mr. BROSTEK. Well, that's a very good question, and I would——

Mr. MCDERMOTT. Thank you. I appreciate that. That's a vote of confidence.

Mr. BROSTEK. I would have to do some research on the situation.

Mr. MCDERMOTT. Why would you have to do research?

Mr. BROSTEK. Well——

Mr. MCDERMOTT. You guys have been studying this stuff.

Mr. BROSTEK. Well, there is a bit of a difference between doing the research that we have done on—from the tax records, how many people may have made a poor choice, to actually analyzing the specific situation of an individual that is involved.

And I have to admit that a lot of the expertise that went behind our calculations on who made the best choice was not my own personal expertise, but the expertise of people who work with me in my office.

Mr. MCDERMOTT. Do either of the others have any idea what you would tell this young woman who is trying to get ahead?

Mr. SCOTT. I think some of the question you raised, and more generally, the issues that are involved here, get at the heart of why the complexities surrounding the tax preferences, as well as the tile four Higher Education Act programs are important, in terms of looking for ways to enhance the financial literacy of students.

Mr. MCDERMOTT. She can't access Title IV, can she? She has to go half-time, and she is working full-time and raising two kids on $30,000. So the likelihood of her going to school full-time is probably pretty small, isn't it?

Mr. SCOTT. Well, you know, it depends on her financial circumstances, generally. There are a broad range of programs, both under Title IV, as well as institutional-based programs that she might be eligible for.

But, as I mentioned, that's the importance of having sound financial advisors and student financial advisors on campus to help assist her, in terms of making sure that she applies for the broad range of programs that she might be eligible for.

Mr. MCDERMOTT. Did you look at the question of whether any of the colleges had those kinds of advisors in sufficient numbers to actually help them figure out this maze?

Mr. SCOTT. For this study, we did not look at the availability of student financial aid advisors on campus. Generally though, most colleges and universities and community colleges do have a number of staff who are available in the financial aid office to assist students.

The financial aid offices are the ones who, based on the information they receive from the Department of Education, from the FAFSA form, developed a financial aid package for students.

Mr. MCDERMOTT. Where do they get the money to finance the financial aid office?

Mr. SCOTT. My assumption would be that is basically general administrative costs borne by the university.

Mr. MCDERMOTT. So we don't put any money into these programs that could be accessed by schools to finance their financial aid office.

It has to be out of state money or tuition money, or some other place that they might come up with the money to hire the people who are smart enough to help this young woman figure out how to work the way through the maze?

Mr. SCOTT. I am not aware of any direct Federal subsidy to assist schools with the financial aid, administration of financial aid.

Mr. MCDERMOTT. And is there—are the programs that she is going to be offered—I mean can you generally tell me? Would it be better for her to take tax credits or a grant up front? Or can she get a grant? Does anybody know?

Mr. BROSTEK. Well, as I am sure that you do know, there are lots of grants that are available from sources other than the Federal Government. And certainly a financial aid officer, hopefully, would be aware of some of those opportunities that might be available, locally.

I think in the circumstance you're describing, the individual probably could claim the Life—I mean the Hope tax credit. But again, I would have to study the specific situation to be sure.

Mr. MCDERMOTT. I yield back the balance of my time, Mr. Chairman. It is pretty clear that you have to have a Ph.D. to wind your way through the financial aid system. And that is standing in the way of an awful lot of people accessing—she can't—this woman that I am talking about—can't take courses if it is not related to her work and get the tax credit, because it has to be just sort of related—Boeing can give their employees time off, as long as it's supposedly related to what the Boeing Aircraft Company does.

But if they want to get themselves upgraded somewhere else, tax credits don't seem to work very well. I yield back the balance.

Chairman NEAL. I thank the gentleman. The gentleman from Georgia, Mr. Linder.

Mr. LINDER. Thank you, Mr. Chairman. Ms. Sowell, between 1990 and 2005, Federal aid to students increased by 77 percent, and enrollment increased by 26 percent. Why this disconnect? And why should we expect that this change is going to increase enrollment?

Ms. SOWELL. Congressman Linder, that is a very interesting observation that you are making. I must say that I am not really qualified to make any observation on my own, with respect to that.

Mr. LINDER. Mr. Brostek.

Mr. BROSTEK. We haven't studied that, either. George, do you have any——

Mr. LINDER. Thank you. Wasn't able to say.

Chairman NEAL. With that, the gentleman from Connecticut—maybe we could—okay, perhaps we will move to the gentleman from Illinois, Mr. Emanuel, for inquiry.

Mr. EMANUEL. Thank you, Mr. Chairman. Thank you for holding this. I also note that the cosponsor of our legislation on simplification, Congressman Camp, was also here earlier. And I would also like to acknowledge Dr. Watson, who is head of the community colleges in Chicago—he is going to be testifying—and for holding this hearing, both to you and to the Ranking Member.

You know, I mean, what we have here—and I want to follow up on what my colleague, Jim McDermott, was talking about—and I helped in 1997, when we did the balanced budget, creating Hope and Lifetime credits. Our intention here is a good thing. It got messed up.

We just—one of the good things we will do is, if we figure it out and acknowledge when you have 12 different credits and deductions on the books with different instructions, all trying to help people do one thing, go to college, it's time for some reforms, because when 28 percent over a quarter can't get it right, either are missing, are not filling it out right, errors in their judgement, not getting the right type of credit or deduction or missing dollars, we have a problem, Houston. We've got a problem here.

And when the IRS—and the GAO, I think, found this out—even H&R Block, which has professionals, 50 percent of the time got it wrong, that is why Jim's example—there is no way this woman will get it right. And these are well-intentioned programs.

And as somebody who helped pass this, both the Hope and the Lifetime tax credit being the two kind of more significant of the 12, we—I believe it's time for reform to consolidate, which is why Dave Camp and I introduced this legislation, bipartisan legislation, with a lot of sponsors here, on the Ways and Means Committee, because it is imperative that if people are not getting the deductions or the dollars or the resources they need to get the education, they not only suffer, but the country suffers.

And the single largest reason people are not going to college, be that a community college or a four-year institution, is cost. The average graduate today graduates with $19,000 in debt. So before they even get their diploma they get their first Visa bill. And this is crazy.

Now, we have introduced this legislation to make it more uniform, and to bring it in line where you consolidate the top three and have all the standard deductions, so you get—there is 80 pages of recommendations on how to fill it out. Get rid of that, because if it's too complicated and you need a Ph.D. before you fill out the information to get your bachelor's, we got a serious issue here.

One question, though, for the Administration which I—Treasury—which I don't understand, in 2005—in the 2005 budget, the President had proposed a series of reforms to consolidation, et cetera. But the recent budget didn't.

I can't believe that folks in the Treasury thought that we had been making a lot of improvements here, and that some—I mean, either this is an oversight, a mistake, you know, or there is another statement here. What is the reason for that?

Ms. SOWELL. Congressman Emanuel, you raise some very interesting points in your question. The mere fact that our 2005 budget proposal is not included in subsequent years does not indicate that we are not in support of simplification of this complex web of tax incentives.

As your colleague, Congressman McDermott, pointed out, assessing the tax incentive program and where we should go from here inevitably requires a hard look at all the other incentives that are available through the Federal Government, as well as private institutions.

Mr. EMANUEL. Well, I am going to take that as an oversight then, because I guess—I mean, I don't understand what you did in—in 2005 you thought it was good enough. And whatever it is, it is our responsibility here in congress to take this up.

I would like to note one thing on the—if I can, Mr. Chairman—on the legislation, and I know the Ranking Member also spoke about it, and I want to thank him—in favor of it—is that if you consolidate Hope, Lifetime, and the other credits, you would apply both to community colleges, four-year institutions, and graduate schools, and have a standard $3,000. We would go a long way towards simplification.

So, before we get to the debate of other things we got to do, or other resources, simplification would increase participation. That is true also, as we have argued before, on the Earned Income Tax Credit (EITC), where we have great programs that—participation rates are low because of complexity, not because of missed something else that's wrong with the program.

And I happen—in my office we have helped people fill out tax returns in the Earned Income Tax Credit area every year. We do over $1 million in EITC returns, and we need professionals there because of the complexity. And I think that if we did this, we would get participation rates up here.

I would note one other thing. To fill this out is about 80 pages, recommendations from the IRS. If you are Boeing or Microsoft, or any other user of the export/import bank, which has hundreds of lawyers and accountants, the entire form for the loan is 13 questions. And they got lawyers, and all these kids got are their parents—not that the parents aren't good, but the forms for going to college—and, again, the Hope or Lifetime tax credit or the FAFSA should not be the leading cause for divorce in America.

[Laughter.]

Mr. EMANUEL. Okay? It's ridiculous. Now, I have nothing wrong with giving Boeing and—the 13 questions. They figured out how to make it easy. Let's help these kids and their parents figure out how to make it easy to go to college. Thank you, Mr. Chairman.

Chairman NEAL. That was very instructive, Mr. Emanuel.

Mr. EMANUEL. My parents are still married.

[Laughter.]

Chairman NEAL. It occurred to me you might want to start a column called, "Dear Rahm."

All right. With that, the gentlelady from Pennsylvania, Ms. Schwartz, will inquire.

Ms. SCHWARTZ. Thank you, Mr. Chairman, and thank you for this hearing. And I really appreciate the work that is being done by my colleagues to simplify this process.

Certainly, I think many of us have been talking a good deal about the importance of going to college, of getting a higher education in this really competitive world we live in. We understand that access to college is increasingly important. Always was, but even more so in such a competitive marketplace, as we compete not only with each other, but certainly with other countries as well.

The issue that I wanted to raise, in addition to this simplification, is that I—as I went through the different initiatives that are available to students, or potential students, the income limit tends to be at least family income under about $110,000. That's the upper income I could find in all these different programs. And certainly in my district, there are many families that are in that category, but there are many families who are just above it. And I hear from them a good bit.

And you know, particularly in this difficult economic time, two wage earners earning $100,000 seems like a lot of money. They thought they would be doing fine. But by the time they pay their mortgage in—even if they got a better one than—didn't get a really risky one, in the Philadelphia area, Philadelphia or its suburbs, by the time they pay energy costs, obviously health care bills are a major concern, maybe helping to support parents, it's really—the idea of actually finding the hard dollars—these are after-tax dollars, by and large, you know, for college tuition, as well as the costs of room and board, it's really difficult.

And I hear from many parents who are saying how—"I don't know how I'm going to manage to do this," and yet they don't really qualify for any of these programs if you're making $120,000, $150,000 a year. And these are people, again, they thought they would be much more comfortable. They assumed they could send their kids to college, and they can't.

So, if they have more than one child, and they're actually close together in age, and if you compound that—which is the other issue I wanted to ask about, is also about—for non-traditional students who are going back for additional education, they are also saying to themselves, "Well, how could I possibly afford it," maybe at the same time their children are going to college to be able to find those dollars, and they may even be earning—they may be working full-time, earning far more, but know that they need to get other—get a college degree.

So, could you speak to whether you all agree that we might need to look at, as we simplify the access to these loans, look at the income eligibility, as well?

Do you—are you—could you speak to whether, in fact, you think we're at the right place, or whether you would agree that there are families that are making more money than are in any of these programs, but in fact are also finding it very, very difficult to be able to find the hard cold cash that they need to go to college?

Mr. BROSTEK. It's clearly an important policy issue for policy makers, such as yourselves, to decide who should be assisted by the programs.

On your first example, part of what ran through my mind as you were speaking, is that there is the college savings route. And perhaps part of the problem is people not having sufficient financial literacy early in their careers to understand how much they need to set aside to fund their hoped-for college expenses when their children are older.

So, it may not require an adjustment to the assistance that is available while you're in college. It may require more education up front of people early in their careers to set money aside.

Ms. SCHWARTZ. And you determine the 529s, which certainly we try to do in Pennsylvania, really be aggressive about telling parents—and grandparents, potentially—about putting dollars away.

But still, that is a certain amount of outreach to have people know that it applies to them. What we know is that so many families assume that they're not actually eligible for government programs. So that's one that they need to know. But even if they are doing what they thought they should do, in terms of savings, it's still hard to have saved that amount of money for a couple of kids—or maybe three kids, even—to go to college.

Did anyone else want to make a comment about the upper income levels? Ms. Sowell?

Ms. SOWELL. I think you make an excellent point, and I would echo the comments by the GAO.

I think there is also some interesting and important learning when you compare the current benefits as they relate to families versus individuals students who are seeking higher education, and I think that probably needs to go into the determination of where the benefits would ultimately land.

I would also point out that any kind of wholesale rewriting of these rules and trying to synthesize them and bring them together could inevitably result in winners and losers. And those groups of individuals would need to be assessed to determine whether that is the right target group.

Ms. SCHWARTZ. All right. Well, it's something I would actually sort of suggest I might want to have more—further conversation with my colleagues about, how we do this.

Certainly targeting a low income is something we are deeply concerned about, because they have the most difficulty. But again, we are in a position where people who would have thought they, of course, could go to college are finding themselves not able to, or dropping out because their families absolutely can't find the dollars.

So, I think it's something that I think I raise as an issue for my colleagues, as much as for the panel. Thank you very much.

Chairman NEAL. I want to thank the panelists, but I have one last question.

I serve on the Board of Trustees at Mount Holyoke College. And, Mr. Scott or the other panelists, Malcolm Gladwell immortalized the term "tipping point." Is there a tipping point—and I ask this question annually at the Board of Trustees meeting as tuition is raised—if tuition, for example, is at $49,000 and the family says, "We will do that," and all of a sudden tuition goes to $50,000, do they say, "We won't do it at $50,000?" Is there any sort of line that your data would instruct us to pursue?

Mr. BROSTEK. We don't have any analysis that shows us that kind of choice, definitively. But it certainly makes intuitive sense. At some point, something is out of reach.

It does, then, suggest that there are other types of educational institutions that someone might attend that are less expensive, but maybe aren't what someone had kind of dreamed of attending.

Chairman NEAL. Is there also any data that would indicate a trend line as it pertains to ability to pay? Are we beginning to see the really great collages—are they more and more taking into consideration ability to pay, as opposed to a needs-based assessment, in trying to put together a diverse student body?

Mr. SCOTT. Increasingly, we are seeing some schools—primarily large schools; we talked about them previously, those with relatively large endowments—are increasingly looking to provide more grant aid versus loans, in terms of the financial aid package.

Once again, now, that's a real small number of schools who are in a position to do that. Some schools, for example, have said, that for families with incomes less than $100,000, the student won't be charged any tuition or fees, for example. Once again, that's a small number of colleges.

I would like to just add one other thing, that despite the number of challenges we see families facing, in terms of sending children to school, when we looked at the data last fall we did find that the number of folks attending college and universities is continuing to increase, and that the vast majority of students are at—or about 60 percent are at schools charging relatively affordable tuition and fees. Only a small percentage of students are actually attending college and universities where the tuition and fees is over $25,000 a year.

So, despite the number of challenges, overall, the higher education story continues to be a success story——

Mr. EMANUEL. Mr. Chairman, may I address this point when he is done?

Chairman NEAL. Yes.

Mr. EMANUEL. I don't want to interrupt. Are you done?

Mr. BROSTEK. Yes.

Mr. EMANUEL. That is true, except for that's this side of the ledger. Four million kids choose not to go to college because of cost. That's four million people left out of the American dream.

You are right, it's increasing, but that's a demographic fact, not the one we're dealing with here, which is how to make financial access to higher education less intrusive on people's lives.

So, I would—I want to—although you're right on that statistic, we're dealing with something else here, which is the cost of college education, the complexity of the Tax Code, which is our purview, something we have enacted. Can we make it better and easier? And when four million people choose not to go because of cost, we've got a responsibility to see whether we're a contributing factor to that.

Second, when over a quarter of the people who fill out the form either don't get the right credit or deduction that's for them, or B, make errors or mistakes because of the complexity, that doesn't make us immune from our responsibility to simplify. So, I agree with you on the demographics. I don't agree with you on the purview of what this hearing is all about.

And I left off one thing I wanted to add on my statement earlier. When we pass the Higher Education Reauthorization bill in the coming weeks, we will have in there the simplification of the FAFSA form, which will dramatically reduce the 108 questions down in half, and force it to be consumer-friendly English, like we force businesses to do. The government form will actually come down on that.

And that is half the battle. The next half is making the Tax Code as simplified as we are now doing with the FAFSA form, which is for student aid. Thank you, Mr. Chairman.

Chairman NEAL. Thank you, Mr. Emanuel. And I want to thank the panelists for their very informative and instructive testimony today. And let me at this time call up our second panel.

Let me welcome our panelists. And as a customary courtesy, I would like to call on Mr. Emanuel at this time to introduce one of his constituents.

Mr. EMANUEL. This is Dr. Watson, who runs the community colleges in Chicago, who is a dear friend. And I just mentioned the FAFSA form. When—I introduced that legislation when I first ran for congress to simplify this FAFSA form. Dr. Watson, with I at the Harold Washington Community College in Chicago in the loop, was there. And that announcement of six years ago, almost to the day, in about three weeks from now will hopefully become law.

And Dr. Watson has been a great leader in making the community colleges in Chicago—of which I have one, the Wright community College in my district—is a great leader in education and in our country, and has been a dear friend of our family, let alone that we share a similarity, given that I have a background in ballet and Dr. Watson has a background in tap dancing. He is a far better dancer and educator.

Chairman NEAL. We thank you very much.

With that, Dr. Townsley, would you proceed?

STATEMENT OF DEBRA M. TOWNSLEY, PRESIDENT, NICHOLS COLLEGE, DUDLEY, MASSACHUSETTS

Ms. TOWNSLEY. Good morning. Thank you, Mr. Chairman, and Members of the Committee, for the opportunity to testify today. I will keep my comments brief, and will leave written testimony with more details for your review.

My name is Debra Townsley, and I am President of Nichols College, in Dudley, Massachusetts. Nichols is a four-year private institution with a student body of more than 1,500 full and part-time students who are enrolled in Nichols's under-graduate and graduate programs. We have an alumni body of about 11,000.

The mission of Nichols is to develop tomorrow's leaders through a dynamic, career-focused business education. More than 90 percent of Nichols students achieve gainful employment in their field of study within 6 months of graduation. And the average starting salary of last year's class was about $40,000.

Many of our graduates and students are first-generation college students. The vast majority of our students—93 percent—are dependent upon financial aid to help pay their college expenses. Eighty-nine percent receive Nichols College aid, specifically.

At Nichols College, we have an annual budget of about $27 million, and we give financial aid of about $10 million. Our college does extensive outreach programs by providing education and information on access to at-risk populations through programs like Kids to College and Gear Up.

Our admissions and financial aid staff are active in the community, facilitating dozens of financial aid information sessions, both on campus and across the state. And we include parent education on tuition tax benefits. There are several higher education tax incentives, some current and some expired, that are enormously important to the students and families of private colleges, like Nichols.

Two provisions that I would like to mention first are the tuition deduction and the IRA charitable roll-over. Both of these provisions expired at the end of 2007, and have not yet been renewed.

The tuition deduction allowed students or parents who could not claim the Hope or Lifetime tax credits to deduct qualified higher education expenses from their taxable income. This deduction provides relief to self-supporting students and to families whose adjusted gross income is too high to qualify for the Hope and Lifetime learning credits.

The expiration of the deduction in December of 2007 has caused great concern among students and their parents. I urge the Subcommittee and full Committee to extend this important education tax benefit.

The IRA roll-over is a relatively new charitable giving incentive that allowed donors to roll over excess retirement savings to any public charity without tax penalties for non-retirement use of retirement funds. A recent survey by the National Association of Independent Colleges and Universities found that IRA roll-over gifts totaled $144 million.

Just a month ago, I received a call from a trustee, asking if he could use an IRA roll-over to endow a $100,000 scholarship at Nichols. And, sadly, I had to tell him, "Not right now." This is private money that helps colleges and universities with scarce resources and rising costs. As with the tuition deduction, I urge the prompt and retroactive extension of the IRA charitable roll-over.

Other current tax incentives important to colleges and universities, our students and families, would include: the student loan interest deduction; the sections of Internal Revenue Code Section 127, which provide for employer-provided education assistance; tax-favored education savings accounts; and Section 529 college savings plans; and the Hope and Lifetime Learning tax credits.

I applaud the efforts of the Members of this Committee for extending important expiring provisions and simplifying the credits.

Representative English has introduced H.R. 147, which would make permanent those tax benefits set to expire at the end of 2010.

Representatives Emanuel and Camp have taken the lead on simplification by introducing H.R. 2458. The bill would make college more affordable for the middle class, by providing a larger credit than current law allows, and it increases the income caps for individuals eligible to claim the credit.

In conclusion, Mr. Chairman, I ask the Subcommittee and the full Committee to continue their commitments to our students and our institutions by retroactively extending both the tuition deduction and the IRA charitable roll-over.

In addition, I urge Members to make permanent the important provisions that will expire at the end of 2010. In return, I offer the continued commitment of private institutions like Nichols to advance and improve our own efforts to control costs, increase transparency, and educate our students.

Thank you.

[The prepared statement of Debra Townsley follows:]

Statement of Debra M. Townsley, President, Nichols College, Dudley, Massachusetts

Thank you, Mr. Chairman, and Members of the Subcommittee, for the opportunity to testify today.

My name is Debra Townsley, and I am the President of Nichols College in Dudley, Massachusetts. Nichols College is a four-year private institution with a student body of more than 1,500 full-time and part-time students who are enrolled in Nichols' undergraduate, graduate, and certificate programs, and an alumni body of more than 11,000. Nichols College strives to develop tomorrow's leaders through a dynamic, career-focused business education. The College offers quality undergraduate degree programs in business, educator preparation and the liberal arts, graduate degree programs in business and a comprehensive continuing education program. More than 90 percent of Nichols students achieve gainful employment in their field of study within six months of graduation. The average starting salary for last year's class was about $40,000. Many of our students are first-generation college students while many others are second generation and/or children of alumni. Our students come from 43 states and several foreign countries. We have students from all socioeconomic backgrounds, but our typical student is middle income. The vast majority (93%) of our students are dependent upon financial aid, particularly college-funded aid programs, to help pay their college expenses. And, 89% receive Nichols College aid specifically.

The tax-exempt status of colleges and universities recognizes the public good that institutions of higher education contribute to the nation. In 2005, private colleges and universities employed nearly a million people nationwide, and brought more than $355 billion into their local economies.[1] In Massachusetts, private colleges educating the citizens of the Commonwealth save the state public education system $2-$2.5 billion annually.[2] Students attending private colleges and universities today receive five times more grant aid from their own institutions than from the Federal Government.[3] At Nichols College, which has an annual budget of $27 million, we give aid of about $10 million. Nationwide, private colleges enroll as many low-income and minority students as public four-year institutions, but they graduate from our institutions at a higher rate. Surprisingly, nearly 80% of the minority students in Massachusetts attending a four-year college are attending an independent institution.

There are several higher education tax incentives—some current and some expired—that are enormously important to the students and families of private colleges like Nichols. Two provisions I would like to mention first are the tuition deduction and the IRA charitable rollover. Both of these provisions expired at the end of 2007, and have not been renewed.

The tuition deduction allowed students or parents who could not claim the Hope or Lifetime Learning tax credits to deduct qualified higher education expenses from their taxable income. Self-supporting students, including those who borrow to pay tuition, were also eligible to take this deduction without filing a Form 1040. The deduction provides relief to families whose adjusted gross income (AGI) is too high to qualify for the Hope and Lifetime Learning credits. Single filers with an AGI of up to $65,000 ($130,000 for joint filers) could deduct $4,000 per year. While we don't collect specific information on how many of our students have claimed the deduction in the past, I can tell you that the expiration of the deduction in December of 2007 has caused great concern among students and their parents that this important benefit will no longer be available, since it has not yet been renewed. I urge the Subcommittee and Full Committee to extend this important education tax benefit.

The IRA rollover is a relatively new charitable giving incentive that allowed donors to roll over excess retirement savings to any public charity without tax pen-

[1] Data provided by the National Association of Independent Colleges and Universities (NAICU).

[2] Data provided by the Association of Independent Colleges and Universities in Massachusetts (AICUM).

[3] Data provided by NAICU.

alties for non-retirement use of retirement funds. The rollover was only in effect for the last few months of 2006 and all of 2007. It was limited to gifts of $100,000 per person, per year. Individuals age 70½ and older could withdraw funds from either a traditional IRA or a Roth IRA, and gifts could be made to any public charity, including colleges and universities. The National Association of Independent Colleges and Universities conducted a survey among its membership on the effect of the rollover on alumni giving. Responses showed a powerful influence on giving, with over $144 million in gifts to independent colleges and universities. Just a month ago, I received a call from a Trustee asking if he could use an IRA rollover to endow a scholarship at Nichols. I had to tell him not right now, but hopefully Congress will act in time to renew that incentive. This is private money that helps colleges and universities with scarce resources and rising costs. Endowments help colleges like mine fund ongoing scholarships, and most of us do not have large endowments. Sixty percent of Massachusetts independent colleges and universities have endowments less than $50 million, and the median endowment of all privates in Massachusetts is $32 million.[4] As with tuition deduction, I urge the prompt and retroactive extension of the IRA rollover.

Other current tax incentives important to colleges and universities, our students and families, would include the Student Loan Interest Deduction, Internal Revenue Code Section 127—employer-provided education assistance, tax-favored education savings accounts and Section 529 college savings plans, and the Hope and Lifetime Learning tax credits. These tax benefits help students throughout their lifetimes. Section 529 plans encourage families to save for higher education expenses when their children are still young. The Hope and Lifetime Learning credits and the tuition deduction help middle-class families pay tuition while students are still in college. And the Student Loan Interest Deduction gives a much-needed tax break to graduates who are paying back student loans.

I applaud the efforts of members of this Subcommittee for extending important expiring provisions and simplifying the credits. Rep. English has introduced H.R. 1407, the Higher Education Affordability and Equity Act, which would make permanent those tax benefits set to expire at the end of 2010. Rep. Emmanuel and Rep. Camp have taken the lead on simplification by introducing H.R. 2458. Their legislation would consolidate the Hope and Lifetime Learning credits and the tuition deduction into a simple, streamlined credit. The bill would make college more affordable for the middle class by providing a larger credit than current law allows, and increases the income caps for individuals eligible to claim the credit.

According to our Financial Aid Office, and information collected on the FAFSA—the Free Application for Federal Student Aid—approximately half of the students enrolled at Nichols are eligible for the Hope and Lifetime Learning tax credits. I understand that having multiple credits and (hopefully) a tuition deduction can be confusing for students and families, and I support efforts to simplify these benefits. I'm aware that, according to a GAO study, 27% of all eligible filers did not claim either the tuition deduction or the tax credits in past tax years. While this makes a good case for consolidation, I would urge caution that any legislation the Subcommittee or Full Committee considers not eliminate any students or families currently receiving a tax benefit. It would certainly be counterproductive to increase taxes on many in the middle-class in order to bring down the cost of a bill intended to help families access higher education tax benefits.

I recognize that many Members of Congress and the American public have real questions about why college cost so much. Parents are increasingly anxious about how they will pay for their children's education. Private colleges and universities have recently undertaken extensive efforts to increase transparency and to provide access to extensive information for parents and students. In September 2007, the National Association of Independent Colleges and Universities launched U–CAN—the University and College Accountability Network—in response to the call of public policy makers for more user-friendly information about colleges. Though only seven months old, the U–CAN Website, www.ucan-network.org, has already become a busy gathering place for families seeking specific college information. Over 670 private colleges are participating and the list continues to grow. Over 707,000 pages have been viewed so far by more than 236,000 visitors. We hope that if families see how much aid is available, and understand the range of pricing structures even just within the private college sector, some of that anxiety will be alleviated.

Some have argued that Federal assistance—whether it be Pell Grants, other forms of student aid, or tax benefits—has the effect of driving up tuition. The Department of Education has done extensive research over the past 10 years on the

[4] Data provided by the Association of Independent College and Universities in Massachusetts (AICUM).

relationship of assistance to tuition, and each study showed that Federal assistance is unrelated to private college tuition.[5]

At its simplest level, prices have gone up because our annual costs have gone up, and because we are providing more services than ever. The principal cost drivers—health insurance, utilities, and financial aid—remain constant year to year. Institutions are undertaking efforts to counteract the effects of these rising costs, including innovative affordability and cost-cutting initiatives. There is, however, no single approach, because of differences in institutions' missions, student population, and fiscal resources.

At Nichols College, we offer both merit-based and need-based grants and scholarships to our students. As mentioned, 89% of our students receive Nichols College aid. The average Nichols student receives $11,902 in college aid and most qualify for some federal and/or state grants, work and loan programs for a total average aid package of $17,428 (including Nichols-funded programs). Our College does extensive outreach programs by providing education and information on access to at-risk populations through programs like Kids to College and GEAR UP. Our Admissions and Financial Aid staff are active in the community facilitating dozens of financial aid information sessions, both on campus and across the state, including parent education on tuition tax benefits.

In response to Rep. McKeon's concern about transfer credits and affordability, at Nichols College we have recently begun to work with community colleges to offer an "A to B" program—Associate's to Bachelor's. For example, at Quinsigamond Community College, with whom we signed our first agreement, students may earn an Associate's degree, then take an agreed-upon third year of study at the community college before transferring to Nichols College and earning their Bachelor of Science in Business Administration degree. This program provides access to a Nichols College degree for students who may not otherwise be able to afford it. We also offer our Bachelor of Science in Business Administration (BSBA) and Master of Business Administration (MBA) programs entirely online.

Nichols also belongs to multiple consortia to reduce costs such as purchasing consortia and the Independent College Enterprise (ICE), which is a nonprofit consortium for our shared administrative software. For example, joining ICE saved Nichols College about $800,000 in implementation costs, and we estimate another $100,000 in annual costs. We are trying to reduce energy costs by upgrading to environmentally-friendly systems. As a business school, we understand offering a quality education while running lean and mean!

Efforts such as this at Nichols and colleges across the country, combined with tax benefits, offer much-needed additional assistance for families in saving and paying for a quality higher education experience.

In conclusion, Mr. Chairman, I ask that the Subcommittee and Full Committee continue their commitments to our students and our institutions by retroactively extending both the tuition deduction and the IRA charitable rollover. In addition, I urge members to make permanent the important provisions that will expire at the end of 2010, including Section 127—employer-provided education assistance, the improvements made to the Student Loan Interest Deduction, and the preferential tax treatment of Education Savings Accounts.

In return, I offer the continued commitment of private institutions, like Nichols, to advance and improve our own internal efforts to control costs and increase transparency. This partnership, between Congress and institutions of higher education, will allow us to continue to provide the best college education available in the world, as we prepare today's students to be tomorrow's leaders.

Chairman NEAL. Thank you, Dr. Townsley.

Dr. Watson.

[5] The Impact of Federal Student Financial Assistance on College Tuition Levels (1997).
Study of Costs and Prices (2001).
Issues of Cost and Price in Higher Education (2001).

STATEMENT OF WAYNE WATSON, PH.D., CHANCELLOR, CITY COLLEGES OF CHICAGO, CHICAGO, ILLINOIS

Mr. WATSON. Thank you. Good morning, Chairman Neal, Ranking Member English, and Members of the Subcommittee, including Chicago's own Rahm Emanuel. I am Dr. Watson, Chancellor of the City Colleges of Chicago, which enrolls more than 110,000 students annually. I am here today representing my colleges and the American Association of Community Colleges, which represents the nation's nearly 1,200 community colleges.

Many policy makers are still surprised to learn that our colleges enroll 47 percent of all U.S. undergraduates. Unfortunately, the tax incentives for post-secondary education simply do not work for the financially disadvantaged college students who need this help the most. A 2003 study by Harvard researcher, Bridget Long, found that existing tax credits have had no impact on increasing college enrollment.

A common thread runs between urban and rural America, and that common thread is poverty, unemployment, and lack of access to education. In 2006, rural areas tended to have higher rates of poverty—15.2 percent—than urban areas, 11.8 percent, regardless of race.

For students whose families live on or below the poverty line, their personal resources are dedicated to survival needs like food and shelter. Their decision to place education at the bottom of the priority list is not a choice, but more a lack of a choice.

The bridge that can help solve both urban and rural America poverty is America's community colleges, and we believe that some fairly simple changes to the Tax Code can alter the lack of access to post secondary education by needy students that needs to be a national priority.

As our written testimony outlines, access and success in college remain highly correlated with income. With this by way of context, let me outline three key principles.

First, major items in the Code of higher education finance provision need to be consolidated. Although the Hope, and Lifetime Learning Credits, and the tuition deduction share the common goals of helping students pay for college, these programs differ from—differ in the amount and type of expenses they cover.

Since costs are essentially the same for students as they move through college, the assistance available should remain the same. The current patchwork of tax programs led the GAO to conclude that post-secondary tax incentives are difficult for families to understand and use. In fact, hundreds of thousands of taxpayers fail to claim their tax preferences to which they are entitled, and often do not even claim the preference that would be most advantageous. Chairman Rangel is pursuing overall tax reform, and these provisions cry out to be included.

Second, the higher education provisions must reflect total student expenditures. The Hope, Lifetime Learning credits and tuition deduction only cover tuition. This is profoundly unfair to community college students. For them, tuition is only a small component of their overall college costs. The average tuition cost to a community college student tuition is $2,361 per year, while the total average cost of attendance is more than $13,000. The exclusion of nontuition expenses contradicts long-standing Higher Education Act policies, as well as the Code to college savings provisions.

Third, higher education tax incentives should better assist financially disadvantaged students and be refundable. The current tax incentive provides the bulk of the benefits to students coming from middle-income and more affluent families. While these students can use the help, it rarely makes the difference as to whether they will attend college. According to AACC's estimates, 1.3 million community college students had no tax liability in 2007.

AACC urges enactment of the Universal Higher Education and Lifetime Earning Act, because it efficiently consolidates the Hope and Lifetime Learning credits and tuition deduction. Its $3,000 tax credit would increase benefits for all students, thus increasing college assets and reducing borrowing.

It uses the Higher Education Act student aid budgets for eligible expenses. This provides consistent treatment across the major Federal funding sources for college, and will treat students attending low tuition colleges more fairly. This will also enhance program administration.

Lastly, H.R. 2458 makes the new credit 50 percent refundable. This Tax Code currently denies help to those who need it most, precisely because they are too poor. Please note the AACC supports full refundability, but the legislation provision will represent a substantial advance.

I thank you for the opportunity to testify, and will be happy to answer any of your questions.

[The statement of Wayne Watson follows:]

Statement of the
American Association of Community Colleges

For the Hearing of the
Committee on Ways and Means
Subcommittee on Select Revenue Measures
"Tax Incentives for Postsecondary Education"

Presented by
Dr. Wayne Watson
Chancellor, City Colleges of Chicago
Chicago, Illinois

May 1, 2008
10:00 A.M.

Good morning, Chairman Neal, Ranking Member English, and members of the subcommittee, including Chicago's own Representative Rahm Emanuel. I am Dr. Wayne Watson, and I serve as chancellor of the City Colleges of Chicago.

I am here today representing the City Colleges and the American Association of Community Colleges (AACC), on whose board I sit. AACC represents the nation's nearly 1,200 community colleges.

The seven City Colleges enroll more than 110,000 credit and noncredit students annually. Thirty-four percent of our students are African American and 38 percent are Hispanic. Our colleges provide 31 percent of all the adult education in the state of Illinois and enroll more than 27,000 students each year in workforce development programs.

Many policymakers are still surprised to learn that community colleges enroll 47% of all U.S undergraduates. This includes 57% of all Hispanic students and 50% of all African American students in American higher education. These locally oriented institutions have a tremendous economic and social impact and are a prime means of creating upward mobility and a stable middle class. They do this by providing a broad array of offerings: traditional academic transfer courses and occupational programs in areas of demand, as well as developmental education, English as a Second Language, and post-baccalaureate training and certification courses. Community colleges have evolved from being the "Ellis Island" of American higher education—providing higher education access to those who could not otherwise attain it—to serving as a linchpin of 21st-century prosperity for a broad swath of society.

We commend the committee for convening today's hearing. The issues being discussed are of critical importance to American higher education but have been under-emphasized by many policymakers, who tend to focus on the better-known Higher Education Act (HEA) programs.

As I will explain, the Internal Revenue Code is not working for the financially disadvantaged college students who need its help the most; to give one shocking example, a 2003 study by Harvard researcher Bridget Terry Long for the National Bureau of Economic Research showed that the existing tax credits have had *no* impact on increasing college enrollment. However, fairly straightforward policy changes can alter this situation. A tremendous amount is at stake because access and success in college remain highly correlated with family income, and the tax code can help alter that correlation. Such a change would bring a more prosperous, competitive America.

I would like to first offer some general comments on the existing tax provisions and then address the "Universal Higher Education and Lifetime Learning Act" (H.R. 2458), which AACC strongly supports.

1) Higher Education Student Financing Provisions Need to Be Consolidated and Simplified

Currently, the tax code contains two credits (Hope and Lifetime Learning) and a tuition deduction that are designed to help finance undergraduate education. In 2007, tax expenditures of approximately $6 billion will be allocated to these three incentives. Despite the fact that they all have the common goal of helping students meet current college expenses (as its name implies, the Lifetime Learning tax credit also assists more nontraditional students), these programs are structured differently—including the type, amount, and percentage of expenses eligible for inclusion. This framework needs to be overhauled. It simply does not make sense to change the tax assistance available to students as they move through postsecondary education, since during that time their costs largely remain the same. The needlessly complicated and uncoordinated nature of the existing tax incentives led the GAO to conclude in testimony to the Senate Finance Committee that "postsecondary tax preferences are difficult for families to understand and use correctly. Perhaps due to the complexity of the tax provisions, hundreds of thousands of taxpayers fail to claim tax preferences to which they are entitled or do not claim the tax preference that would be most advantageous." Incredibly, the GAO estimated that about 50 percent of the returns with "suboptimal" use of the higher education tax benefits were prepared by professional tax preparers.

Therefore, we strongly support consolidation of the Hope, Lifetime Learning, and tuition deduction tax provisions. Doing so will provide a number of benefits. It will rationalize assistance for a student's entire time in college. It will make the credit more widely accessible by being easier to understand than the current patchwork of programs. And it will bring greater efficiency to the Code. We note that the chairman of the full Ways and Means Committee is pursuing overall reform of the Internal Revenue Code. The higher education tax credits cry out for reform.

2) Higher Education Tax Provisions Must Reflect Total Student Expenses

Currently, the Hope Scholarship and Lifetime Learning tax credits and tuition deduction do not allow students to claim nontuition expenses. This exclusion is profoundly disadvantageous and unfair to community college students and public college students generally, because for them tuition constitutes only a small component of their overall college costs. According to the College Board, in the fall of 2007 the average tuition for a full-time community college student was $2,361. (The corresponding figures for public and private four-year colleges were $6,185 and $23,712, respectively.) However, the total cost of attending a community college was $13,126. This included $921 for books and $1,270 for transportation. Average living expenses were $6,875. The Hope and Lifetime Learning tax credits and tuition deduction ignore these real costs of college attendance.

This exclusion of nontuition expenses is inconsistent with other long-standing federal student aid policies. As the Committee is aware, Coverdell and Section 529 savings accounts both allow funds to be used to pay for nontuition expenses. Just as significantly, the Federal Title IV student financial aid programs cover the nontuition expenses described above. Students use Pell Grants, Stafford loans, Federal Work-Study, and other program funds to cover room and board, books, transportation, etc. This has always been the case and is a fundamental tenet of federal student financial assistance.

It is ironic that at a time of fevered concern over college costs, public policy would disadvantage students who choose to, or must, attend a lower-priced institution. This committee must act to end this unwarranted and short-sighted policy. Community colleges urge Congress to act swiftly to modify the higher education financing vehicles to incorporate the bulk of the nontuition expenses described above.

3) Higher Education Tax Incentives Should Assist Students Most in Need, and Be Refundable

There is overwhelming evidence that student attendance and persistence in college is strongly correlated with family income. Low-ability, high-income students are more likely to enroll in and graduate from college than their high-ability, low-income contemporaries. As of 2005, 40.2% of all high school graduates between the ages of 18 and 24 from the bottom income quartile had enrolled in college, while 80.5%, or twice as many, from the top quartile had enrolled (*Postsecondary Education Opportunity,* September, 2007). And yet, the current tax incentives provide the bulk of their benefits to students coming from middle-income and more affluent, even wealthy, families. Given college attendance patterns, this is a moral and policy outrage.

For example, in tax year 2004, less than one fifth of all the benefits from the Hope tax credits went to individuals with incomes of less than $20,000. Less than one half went to those with incomes below $40,000. In contrast, more than 87% of all awards in the Pell Grant program, the government's basic college access program, are awarded to students with family incomes below $40,000.

Even more troubling is the fact that, according to the Congressional Research Service, in 2004 as much as 57% of all the benefits of the tuition deduction went to families with incomes above $80,000. The median family income that year was $44,483. This distribution pattern is due in part to the phase-out of the tuition deduction at $160,000 for joint filers. The Hope and Lifetime Learning credits phase out at $110,000 for joint filers, which is equitable, as it provides benefits to those earning close to twice the current annual median family income.

A long-standing flaw in the Hope and Lifetime Learning credits is their being nonrefundable. This means that those who need help the most receive little or none. The low-income backgrounds of many community college students make refundability of any higher education tax benefits of critical importance to AACC's members. According to our estimates, between 900,000 and 1.3 million credit community college students did not have any tax liability in 2007. This is about 15 percent of the community college credit population and includes students who head families with children, or have no dependents, regardless of whether they file jointly or are single.

H.R. 2458, Universal Higher Education and Lifetime Learning Act

AACC strongly supports H.R. 2458 and urges its enactment. We thank Representatives Emanuel and Camp for introducing this ambitious legislation, which forcefully addresses most of the policy objectives outlined above. Some of the bill's more important features include:

- *Consolidating the Hope, Lifetime Learning, and tuition deduction tax provisions*: As noted, the consolidation and rationalization of these three student financing vehicles is highly desirable, both in respect to student financing as well as ease of administration and use by beneficiaries. We believe that a broadly publicized, easy to understand, unified tax credit would send a powerful message to millions of Americans of the availability of increased federal support for college.
- *Providing greater financing assistance*: In creating a $3,000 credit, the legislation would enhance the amount of assistance currently available to filers. Considering the substantial cost of higher education, as well as the uncertainty of increases in federal student aid programs, we strongly support this increased assistance, which we believe would help increase access to college and reduce

borrowing. Students in all sectors of higher education would benefit greatly by this enhanced support.

- *Using Title IV Student Aid Budgets for Eligible "Tuition and Related" Expenses*: We strongly support inclusion in the new credit of all expenses currently covered by the Title IV federal student financial assistance programs. This would provide consistent treatment across the major federal funding sources for college and will ensure that students attending colleges with low tuitions, but who inevitably incur substantial non-tuition costs, receive needed support. Using the statutory definition of "cost of attendance" contained in the Higher Education Act will also ease administration of the new credit, since this definition is used on college campuses across the country. We note that a similar position has been taken in H.R 5269, introduced by Representative Kevin Brady, and we commend this legislation. Also, Representative English has introduced legislation that would expand the eligible expenses covered by the Hope tax credit, and we are grateful for this support. Lastly, the initial leadership on this issue that was provided by Representative Camp in previous Congresses remains appreciated.
- *Making the Credit 50% Refundable*: H.R. 2458 takes an important step toward ensuring that the population most in need of support gets it, through instituting 50% refundability for the tax credit. Again, the tax code currently denies support to those who need it most in order to attend college, precisely because they are too poor. Although AACC supports full, 100%, refundability, the legislation's provision would represent a substantial improvement over current law.

Thank you again for giving me the chance to appear today before the subcommittee. I would be happy to answer any questions that you may have on these critical issues.

Chairman NEAL. Thank you, Dr. Watson.
Dr. Dynarski.

STATEMENT OF DR. SUSAN DYNARSKI, ASSOCIATE PROFESSOR, HARVARD KENNEDY SCHOOL OF GOVERNMENT, CAMBRIDGE MASSACHUSETTS

Ms. DYNARSKI. Thank you. Chairman Neal, Ranking Member English, and Members of the Committee, I am honored to testify before you today.

First thing I want to say is that a college education is a good investment. Over a lifetime, a worker with a bachelor's degree earns, on average, about $1 million more than a worker with just a high school degree. Despite this fact, college remains out of reach for many: 34 percent of young white people earn a BA, but only 19 percent of African-Americans and 10 percent of Hispanics grab that golden ticket.

Now, I give you these statistics to get us thinking about how we can best use tax incentives to encourage college attendance. Tax incentives can increase schooling only if they put money into the hands of kids for whom price is a barrier to college. For tax breaks to truly act as tax incentives, they need to cut the price of college for those students who would not go to college without the subsidy.

Now, who are these potential college students? They are disproportionally non-white or Hispanic. They are from low-income families—just half of low-income youth go to college right after high school, compared to 80 percent of their upper-income classmates. Where might they go to school? The local community college, where tuition and fees average $2,300 or a State university, where costs average $6,200 a year.

Now, this is who we should keep in mind, as we design tax incentives to get people into college: a low-income person attending an inexpensive public college. The fortunate student who is admitted to Yale or Williams or Swarthmore, whose family earns upward of $100,000 is going to go to some college with or without a tax incentive, and I feel that we should not build our education policy around the prices that this student faces.

Now, as currently structured, the education tax incentives do just about nothing for low-income students at inexpensive public colleges. Because the tax incentives, first of all, are not refundable, many low-income families can't get them. A family of four needs to have an income above $40,000 to get the maximum tax credit right now. One-third of all families and half of families with kids have no tax liability and cannot get an education tax credit, currently.

Only students who pay tuition and fees over $10,000 a year can get the full Lifetime Learning credit. That's nearly double the cost of the typical four-year college, and four times that of the typical community college, right? Now, nearly 75 percent of college students attend these inexpensive public colleges.

The tuition deductions are least valuable to those in the lower tax brackets. A $1,000 tuition deduction is worth $330 for somebody in the 33 percent bracket, but it's only worth $150 for somebody in the 15 percent bracket.

The regressivity of the tax incentives is not all that hampers their effectiveness. They're just too complicated and confusing to actually affect schooling decisions. Families simply can't respond to a price subsidy if they don't understand it or know about it.

Again, let's keep our target students firmly in mind, those in the margin of college entry are disproportionately low-income, non-white, Hispanic, parents did not go to college, or perhaps even graduate from high school. For many of these families, English is a second language. And viewed in this context, it's clear that the tax incentives are currently too complicated to do the intended job.

As was noted before, the publication devoted to explaining them is 80 pages long. It may be clearly written, but the fact that you need 80 pages to explain these incentives is prima facie evidence that they're too complicated.

So, here is what I suggest: that we focus the incentives on those who are on the margin of attending college, and we simplify the incentives so that families can understand and respond to them.

So, number one, as has already been proposed, I would suggest creating a single, refundable tax credit for tuition, fees, room, and board. A single credit would significantly reduce complexity and enable families to estimate their credit well in advance.

Make the credit refundable, so families in the lower tax brackets can access it. Count tuition, fees, room, and board as eligible expenses for the purposes of the credit. This matches the definition used by the 529 and the Coverdell accounts, which are available to upper-income families. It also extends the full credit to the vast majority of students who do attend public colleges.

Second, deliver the credit at the time of college enrollment. The student who needs the credit most is the one who drops out because she can't find the money to pay the registrar in September, all right? She is not helped by a credit that arrives a year or 14 months after the bills are due. So we need to put our heads together and find a way to get these credits to students at the time of enrollment. Otherwise, we're excluding the very students whose enrollment depends on the credit, and that's no way to design an incentive program.

There are a number of Federal aid programs that pay college students prospectively, rather than after the fact, as the credits do, but like the Pell Grant, and the Stafford Loan. Veterans education benefits and the now-defunct Social Security student benefit program all paid students at the time of enrollment, rather than after the fact.

One suggestion is to use income from a previous year to determine eligibility for the credit. So eligibility for the credit for the 2008–2009 school year could be based on 2007 income. This is the approach used in determining eligibility for the Pell Grant and the Stafford Loan.

We could even more radically simplify Federal benefits for college by consolidating all of the Federal subsidies for college students into one streamlined system. College students and their families now face two parallel, duplicative, and unwieldy bureaucracies that provide aid for college: the tax system and the aid system. Consolidating this process would substantially simplify life for the families of college students, saving them tens of millions of hours now spent filling out repetitive and mind-numbing forms.

Consolidation would also save billions of tax and tuition dollars that are essentially spent moving pieces of paper back and forth between different agencies of the Federal Government, back and forth between IRS and the Department of Education.

And I have entered into the record a detailed simplification proposal that I have written in coordination with my coauthor, Judith Scott Clayton. It's in the record for your perusal. Thank you, and I am happy to take any questions.

[The prepared statement of Susan Dynarski follows:]

Oral Testimony of Dr. Susan Dynarski

Associate Professor of Public Policy
Kennedy School, Harvard University

Faculty Research Fellow
National Bureau of Economic Research

before the

Subcommittee on Select Revenue Measures
House Committee on Ways and Means

May 1, 2008

Chairman Neal, Members of the Committee, I am honored to testify before you today.

A college education is a good investment. Over a lifetime, a worker with a bachelor's degree earns, on average, a million dollars more than worker with just a high school degree.

But college remains out of reach for many. While 34 percent of young white people earn a BA, only 19 percent of African Americans and ten percent of Hispanics grab that golden ticket.

Even among the smartest kids, income is a strong predictor of college attendance. Three-quarters of upper-income kids who earn top scores on tests in high school go on to college, but less than a third of those who grew up in a low-income family.[1]

Designing Effective Education Tax Incentives

I give you these statistics to get us thinking about how we can best use tax incentives to encourage college attendance.

Tax incentives can *increase schooling* only if they put money into the hands of kids for whom price is a barrier to college. For our tax breaks to truly act as incentives, they need to cut the price of college for those students who would not go to college without the subsidy.

- Who are these potential college students? They are disproportionately nonwhite or Hispanic. They are from low-income families: just half of low-income youth go to college right after high school, compared to 80 percent of their upper-income classmates.[2]

- Where might these potential college students go to school? The local community college, where tuition and fees average $2,300, or a state university, where costs average $6,200.[3]

This is who we should keep in mind as we design tax incentives for college: a low-income person attending an inexpensive, public college.

The fortunate student admitted to Yale, or Williams, or Swarthmore, whose family earns upward of $100,000, is going to college with or without a tax incentive. We should not build our education policy around the prices she 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 for whom a BA or AA from a public college is a ticket into the middle class.

The Education Tax Incentives Don't Reach the Right Students

The education tax incentives do just about nothing for low-income students at inexpensive public colleges. Perversely, the tax incentives are focused on upper-income students at the most expensive private colleges. For the vast majority of these students, going to college was never in question. For their families, the education tax benefits are a windfall, not an incentive.

- Because the education tax credits are not refundable, many low- and middle-income families can't get them. A family of four must have an income above $40,000 to get the maximum credit.[4] One-third of all families, and half of families with kids, have no tax liability and so can get no credit at all.[5]

- Only students who pay tuition and fees over $10,000 a year get the full Lifetime Learning Credit. This is nearly double the cost of the typical, public four-year college and four times that of the typical community college. Nearly 75 percent of college students attend these inexpensive, public colleges.

- Tuition deductions are least valuable to those in lower tax brackets. A $1,000 tuition deduction is worth $330 for someone in the 33 percent bracket but only $150 for someone in the 15 percent bracket.

The Education Tax Incentives Are Complex and Confusing

The regressivity of the tax incentives is not all that hampers their effectiveness. They are too complicated and confusing to affect schooling decisions. Families can't respond to a price subsidy if they do not understand it.

Again, let's keep our target student firmly in mind. Those on the margin of college entry are disproportionately low-income, nonwhite and Hispanic, with parents who did not go to college or graduate from high school. For many of these families, English is the second language.

Viewed in this context, it is clear that the education tax incentives are far too complicated to do their job. The IRS publication devoted to explaining them is 82 pages long! The consequences of this complexity extend beyond mere annoyance and frustration. Evidence shows that simple, easily communicated financial aid programs have a robust impact on college entry and completion, but complicated programs do not.[6]

Simplify and Focus the Education Tax Incentives

The goals of reform should be to *focus* the incentives on those who are on the margin of attending college and s*implify* the incentives so that families can understand and respond to them.

1) Create a single, refundable tax credit for tuition, fees, room, and board.

- Merge the Hope and Lifetime Learning Credits into a *single credit*. A single credit would significantly reduce complexity, enabling families to estimate their credit well in advance.

- Make the credit *refundable* so families in lower tax brackets are eligible for the maximum benefits.

- Count tuition, fees, room and board as eligible expenses for the purposes of the credit. This matches the definition used for the 529 and Coverdell accounts. It also extends the full credit to the vast majority of students who attend public colleges.

2) Deliver the credit at the time of college enrollment.

The student who needs the credit most is the one who drops out because she can't find the money to pay the registrar in September. She is not helped by a credit that arrives a year or more after the bills are due.

We need to put our heads together and find a way to get the credits to students at the time of enrollment. Otherwise, we are excluding the very students whose enrollment depends on the credit. That's no way to design an incentive program!

- The following current or past federal aid programs pay college students prospectively, rather than after the fact:
  - Pell Grant and Stafford Loan
  - Veterans' education benefits
  - Social Security student benefits

- One suggestion is to use income from a previous year to determine eligibility. Eligibility for the credit for the 2008-09 school year would be based on 2007 income. This is the approach used in determining eligibility for the Pell Grant and Stafford loan.

A Simplified Credit Families Can Count On

The simpler and more streamlined the tax benefits, the easier they are to communicate to families and students.[7] Just as workers are annually sent projections of their Social Security benefits to help them plan for retirement, families could be sent estimates of their tax benefits to help them plan for college. This early, clear information would give students and families confidence they can afford college, and encourage them to work hard in elementary school and high school.

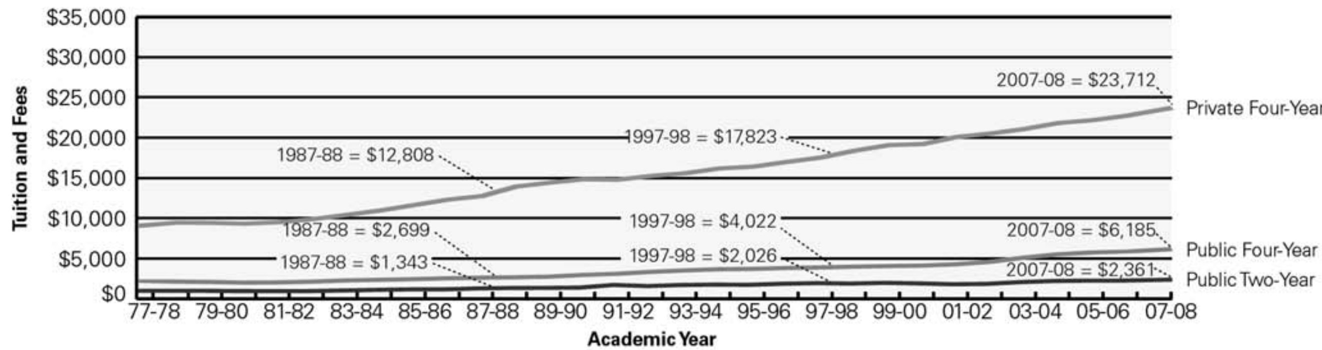
We could even more radically simplify federal benefits for college by consolidating *all* federal subsidies for college students into one streamlined system. College students and their families now face two parallel, duplicative and unwieldy bureaucracies that provide aid for college: the tax system and the aid system.

Consolidating this process would substantially simplify life for the families of college students, saving them tens of millions of hours now spent filling out repetitive, mind-numbing forms. Consolidation would also save billions of tax and tuition dollars that are essentially spent moving pieces of paper back and forth between different agencies of the federal government.[8] Along with my co-author Judith Scott-Clayton, I have developed a detailed simplification proposal, which I have entered into the record.[9]

Conclusion

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

Figure 1: Average Published Tuition and Fees in Constant (2007) Dollars, 1977-78 to 2007-08 (Enrollment-Weighted)



Source: ***Trends in College Pricing 2007*****, College Board**

References and Further Reading

Badchelder, Lily, Fred T. Goldberg, Jr., and Peter R. Orszag, "Reforming Tax Incentives Into Uniform Refundable Credits," Brookings Institution Policy Brief No. 156, August 2006.

Center on Budget and Policy Priorities. 2007. "Making Higher Education Tax Credits Available to Low- and Moderate-Income Students: How and Why."

College Board. 2005. *Education Pays 2005*. New York: College Board Publications.

College Board. 2007. *Trends in College Pricing 2007*. New York: College Board Publications.

Department of the Treasury, Internal Revenue Service. 2005. *Publication 970: Tax Benefits for Education*.

Dynarski, Susan. 2000. "Hope for Whom? Financial Aid for the Middle Class and Its Impact on College Attendance." *National Tax Journal* 53:3, 629-661.

Dynarski, Susan. 2004. "The New Merit Aid," in Caroline M. Hoxby, ed., *College Choices: The Economics of Where to Go, When to Go, and How To Pay for It*. Chicago: University of Chicago Press.

Dynarski, Susan. 2008. "Building the Stock of College-Educated Labor." *Journal of Human Resources* (Summer).

Dynarski, Susan and Judith Scott-Clayton. 2006. "The Cost of Complexity in Higher Education: Lessons from Optimal Tax Theory and Behavioral Economics." *National Tax Journal*.

Dynarski, Susan and Judith Scott-Clayton. 2007. "Pell Grants on a Postcard: A Proposal for Simple and Predictable Federal Student Aid." Hamilton Project Discussion Paper.

Long, Bridget Terry. 2004a. "The Impact of Federal Tax Credits for Higher Education Expenses," in Caroline M. Hoxby, ed., *College Choices: The Economics of Where to Go, When to Go, and How To Pay for It*. Chicago: University of Chicago Press.

Long, Bridget Terry, 2004b. "Using the Tax Code to Provide College Aid: The Higher Education Tax Credits, 1998-2001." Harvard University manuscript.

U.S. Department of Education. 2005. *Youth Indicators, 2005:Trends in the Well-Being of American Youth*.

Endnotes

[1] Tabulations of completed education of 25-29-year-olds from 2007 March Current Population Survey. College attendance statistics by income and test score are from U.S. Department of Education (2005).

[2] College Board, 2005. Figures are for the top quintile of family income (above $78,000) and bottom two quintiles (below $31,000).

[3] College Board, 2007.

[4] Badchelder *et al*, 2006.

[5] Center on Budget and Policy Priorities, 2007.

[6] Dynarski and Scott-Clayton (2006) review the empirical evidence on the types of aid programs that increase education. Long (2004a, 2004b) shows that the current tax credits do not increase college attendance.

[7] In Georgia and Arkansas, simple aid programs have increase college attendance and completion (Dynarski, 2000, 2004, 2008). Ninety percent of high school freshmen can name the Georgia program and a majority know its eligibility rules, because they are easy to explain and remember.

[8] The federal aid application (the FAFSA) makes the IRS tax forms look svelte. The IRS 1040EZ is a single page with 37 questions. Form 1040A is two pages, with 83 questions. Form 1040 is also two pages, with 118 questions. The FAFSA is *five* pages, with 127 questions. A handful of these questions determine most of the variation in aid. Earnings, marital status, family size, and number of family member in college explain 80 percent of the variation in Pell Grants (Dynarski and Scott-Clayton, 2006).

[9] Dynarski and Scott-Clayton, 2007

Chairman NEAL. Thank you, Ms. Dynarski.
Mr. Ebersole.

STATEMENT OF W. DANIEL EBERSOLE, DIRECTOR, GEORGIA OFFICE OF TREASURY AND FISCAL SERVICES, ATLANTA GEORGIA

Mr. EBERSOLE. Thank you, Chairman Neal, Ranking Member English, and Members of the Subcommittee. I am Dan Ebersole. I'm the Director of the Georgia Office of Treasury and Fiscal Services, which is the State Treasury of Georgia. My office also administers the path to college 529 plan, Georgia's 529 college savings plan, which currently has over $600 million in assets.

And I am also the Chair of the College Saving Plan's Network. CSPN is an affiliate of the National Association of State Treasurers, and represents the interest of State-operated 529 college savings and prepaid tuition plans since 1991. The mission of the network is to encourage families to save for college, and to help make higher education an affordable reality for all.

To accomplish this mission, CSPN is the leading national advocate for strengthening and enhancing college savings plans, and we welcome the opportunity to work with Congress as you strive to make higher education and Section 529 programs even more accessible to all American families.

Beginning in the 1990s and through today, the States working with Congress have been instrumental in creating and improving 529 plans. 529 plans are enormously successful, allowing millions of families to pre-pay or save for college. Every state in the nation and the District of Columbia offer these plans. We have seen growth from 2.6 million accounts in 2001 to over 10.5 million accounts by the end of last year. Assets invested by these families and these plans have grown over that same period from $15 billion to $130 billion.

As part of this growth, it is important to ensure that families at all income levels are encouraged to save in 529 accounts. Because states are involved in the establishment and administration of these plans, we ensure that outreach efforts target all segments of the population, including those not typically reached. The states leverage their experience as major institutional investors to establish low-cost, low-fee college savings investment options for families, and ensure, for example, that a low initial investment in the range of, say, $25—like in the Georgia plan—is all it takes to open an account.

I would like to note that the states continue to seek new and innovative ways to attract underserved populations to participate in 529 programs. For example, in Illinois, State Treasurer, Alexi Giannoulias, committed $3.5 million in scholarships to Illinois students, including $2.8 million in need-based grants, awarding up to 400 scholarships each year, and almost 3,000 scholarships to Illinois students through the life of the program.

In Pennsylvania, the State has developed an innovative program that makes use of individual development accounts to encourage college savings through 529 plans.

Finally, Massachusetts emphasizes outreach using grassroots marketing initiatives targeting low to mid-income families through early college savings seminars, financial aid seminars, and educational events, such as literacy events at boys and girls clubs, reading events at public libraries across Massachusetts.

Given all the success of 529 plans, we believe that there is still room for improvement in the Federal tax treatment of these plans, specifically treating computers as an allowable expense for Section 529 plans which would conform and simplify the treatment across different types of education incentives. Now, in a Coverdell plan, a kindergartner can get a computer as an allowed expense, but not in a 529 plan.

We would also like to see 529 plan contributions by lower-income families eligible for a saver's tax credit. And we believe that more can be done in the employer/employee context using 529 plans as a vehicle as either a training program for the employee, or as an employee benefit.

In conclusion, thank you for allowing me to testify today. States have worked hard to make sure Section 529 plans encourage families to save early, providing pre-payment of tuition and low-cost investment options paired with low-investment minimums to ensure that everyone who wants to go to college has a vehicle to save for college.

And finally, I want to touch on one aspect of Section 529 plans which is less concrete, but nonetheless, very important. When families put savings in a Section 529 plan for a newborn, a 5-year-old, or even a 15-year-old, that family is sending a very important message to the child, that the family believes that the child can and will go to college. A college education remains the surest path to success and higher achievement. Saving early in a Section 529 account sends a powerful and positive message to our children, that they can and should go to college. Thank you very much.

[The prepared statement of W. Daniel Ebersole follows:]

CSPN

College Savings Plans Network

Testimony of W. Daniel Ebersole

Director, Office of Treasury and Fiscal Services
State of Georgia
and
Chair, College Savings Plans Network

before the
Subcommittee on Select Revenue Measures
House Committee on Ways and Means
United States House of Representatives
on Education Tax Incentives

May 1, 2008

CSPN

College Savings Plans Network

I. Introduction

Chairman Neal, Ranking Member English, and Members of the Subcommittee, my name is Dan Ebersole and I am the Director of the Georgia Office of Treasury and Fiscal Services, which is responsible for the receipt, investment, accounting and disbursement of state general, trust and custodial funds and certain federal funds. My office also administers the *Path 2 College 529 Plan*, Georgia's 529 college savings plan, which currently has over 600 million dollars in assets under management.

I am also the Chair of the College Savings Plans Network or CSPN. CSPN is an affiliate of the National Association of State Treasurers and has represented the interests of state-operated Section 529 college savings and prepaid tuition plans since 1991. The primary mission of the Network is to encourage families to save for college and help make higher education an affordable reality for all. To accomplish this mission, CSPN is the leading national advocate for strengthening and enhancing college savings plans and we welcome the opportunity to work with Congress as you strive to make higher education and Section 529 programs even more accessible to all American families.

II. Background on Section 529 Plans

In the early 90s, States were concerned about the rising costs of college and the increasing debt burden on families. As a result, Michigan, along with several other States, began creating prepaid tuition and savings trust plans to help families cope with spiraling tuition costs and encourage planning and saving for higher education. These efforts, in conjunction with the support of Congress, have worked -- the plans provide families at all income levels a tax-advantaged, disciplined, effective way to save for college expenses. In 1996, there was uncertainty over the federal tax treatment of these new and innovative programs. The States asked Congress to step in and confirm that, as state instrumentalities, these college savings plans would not be taxed by the federal government. Thus, Section 529 of the Internal Revenue Code was born, and the States' college savings plans became known as Section 529 plans.

Two basic types of Section 529 plans exist—prepaid tuition plans and savings plans. Prepaid tuition plans are similar to a defined benefit pension plan, where the family purchases a defined amount of tuition — either years or credits. Savings trusts are more analogous to defined contribution plans in which families can save in a variety of investment vehicles with many options, including equity and fixed income mutual funds, actively managed accounts, money market and stable value funds. Plans also offer investment options that combine fund types in allocations that are managed on behalf of the participant based on the age of the beneficiary – similar to life-cycle funds. The plans encourage early college savings and promote future access to higher education. Families participating in the programs save specifically for college where otherwise they might not set aside money for this purpose. The programs, through their outreach efforts, draw attention to the need to save for college and help many take that first, all-important step of beginning to save – and to seeing college as an attainable goal.

State college savings programs have achieved tremendous success since their inception. With the enactment of the Economic Growth and Tax Relief Reconciliation Act of 2001, the number of children participating in the programs has skyrocketed. Almost every state in the nation and the District of Columbia now has at least one Section 529 savings plan. In December 2001 there were 2.6 million Section 529 accounts in this country and as of December 2007, there are over 10.5 million Section 529 accounts. In addition, the number of assets under management in these plans has grown significantly. In December 2001 there were 15 billion dollars of assets under management and today there is almost 130 billion dollars of assets under management. The average account size has grown from 5,792 dollars in 2001 to 12,316 dollars today.

CSPN

College Savings Plans Network

III. Section 529 Plans Provide Benefits for Families of all Income Levels

In a survey of parents, ninety-six percent of all parents expected their children to pursue some form of higher education.[1] Yet Americans continue to spend more on take-out meals and vacations than they do on saving for their children's college education[2]. Section 529 plans provide families with a solution to not only begin to save but set families on a path to saving for an expense that dwarfs most other costs that a family will incur. This solution is even more critical today. As our country faces challenging economic times, we need to help families prepare and plan for the increasing costs of a college education.

Because States are involved in the establishment and administration of Section 529 plans, we ensure that plan outreach efforts target all segments of the population – including those not typically reached by private-sector investment firms. In contracting with their private-sector partners, States insist on joint efforts to reach all segments of the population.

In addition, the States leverage their experience as major institutional investors to establish low-cost, low-fee college savings investment options for plan participants. Many investments, such as mutual funds, typically require initial investments and subsequent minimum investments that are too high for most middle- and low-income families to meet. In negotiating agreements with investment managers, States generally insist that these investment minimums for Section 529 plans be reduced so that families of all income levels realistically may participate.

---

[1] In Saving for College: A survey of Parents, 1,109 parents were surveyed by Vanguard and Upromise Research (December 2005)

[2] According to an Internet poll of 1,508 college graduates ages 21 to 35 sponsored by Alliance Bernstein Investments, Inc., and released in February of 2007.

Significantly, the States continue to seek new and innovative ways of attracting under-served populations to participate in Section 529 programs. For example, a private foundation in Maine provides an initial grant of 200 dollars for a new account of at least 50 dollars, and annual matching grants of 50% of contributions up to 200 dollars per beneficiary for qualifying account owners. Families with adjusted gross income below a certain level (2008 grants required that 2007 adjusted gross income be 75,000 dollars or less) qualify for the grants.

In Illinois, State Treasurer Alexi Giannoulias committed 3.5 million dollars in scholarships to Illinois students, including 2.8 million dollars in need-based grants. Through the Illinois State Treasurer's Bright Start Scholarship Program, Giannoulias will distribute 400,000 dollars in scholarships to four-year public and private universities in Illinois each of the next seven years. Schools will select recipients based on need, and the scholarship amounts will range from 1,000 to 2,500 dollars. Up to 400 scholarships will be awarded annually and almost 3,000 scholarships will be awarded to Illinois students through the life of the program.

In Pennsylvania, lower income families are encouraged to save for college through coordination of the state's Individual Development Account or IDA program with its Section 529 program. Families with incomes up to 200% of the poverty level can utilize the IDA program and earn a dollar for dollar match up to 2,000 dollars per saver. The saver's funds and the match can then be placed in Pennsylvania's 529 Guaranteed Savings Plan (GSP), where they grow just as in any other GSP account. Currently, 125 GSP 529 accounts have been opened by Pennsylvania IDA participants. Those lower income families have collectively saved 157,505 dollars and have received government matches of 146,684 dollars. If the saver ever takes a nonqualified withdrawal from the account, a proportionate amount of the match is forfeited.

In Massachusetts, grass roots marketing initiatives specifically target low-to-mid-income families through Early College Savings Seminars, Financial Aid Seminars, and educational events such as literacy events at Boys and Girls Clubs, reading events at public libraries across Massachusetts, and an Annual Art Competition for students across the Commonwealth.

In my own state of Georgia, we also market to low- and middle-income families through numerous initiatives. These include distribution of program information through urban and rural school systems, we work with state and local PTA groups, and we provide outreach to churches and other non-profit civic groups. In addition, we have partnered with other state agencies to insert program information in birth certificate mailings and have worked with parents in day care centers funded by United Way and affiliated with Head Start to encourage participation. We will present program information free of charge to any group, without minimum group size requirements, anywhere in the state.

These unique programs are just a few examples of the vital role the States play in providing opportunities to stimulate saving for higher education by all segments of the population. Without these efforts, it is highly unlikely that the Section 529 market would be so vibrant, and many middle- and low-income families would be underserved.

IV. Room for Improvement

Given all the success of Section 529 plans, there is still room for improvement in the federal tax treatment of these plans.

1. Treat Computer Technology and Equipment as an Eligible Education Expense

Coverdell Education Savings Accounts, which allow families to save for K-12 and higher education expenses, treat computer technology and equipment as an allowable expense. Under current law, however, Section 529 only allows computer technology and equipment to be treated as a qualified higher education expense if the college formally requires a computer for enrollment. CSPN has proposed that Section 529 be amended to provide that computers, Internet access, and educational software are allowable expenses for Section 529 plans.

2. Treat Contributions to Section 529 plans as allowable for the SAVERs credit

The Internal Revenue Code provides a "Saver's tax credit" for lower income taxpayers who voluntarily contribute to IRAs, 401(k) plans, or other similar workplace retirement programs. CSPN has proposed that contributions to a Section 529 qualified tuition program should be treated as contributions that qualify for the Saver's credit.

3. Exclude from Income Employer Contributions to an Employee's Section 529 Account

CSPN has proposed that certain contributions from an employer to an employee's Section 529 account should be excludable from gross income. Congressman Joseph Pitts from Pennsylvania introduced such a proposal this Congress and that legislation is currently pending before this Committee. Under Congressman Pitts' bill, H.R. 5591, employers would be allowed to contribute up to $500 into an employee's Section 529 account without the contribution being treated as income to the employee.

V. Conclusion

In order to ensure that everyone who wants to go to college has a vehicle to save for college -- the States have stepped in to fill a vital role. Section 529 plans provide better access for low and middle class families, better investment options -- including access to low-fee options that consumers can purchase directly from the program, low dollar thresholds for participation, and, of course, state tax incentives – including state income tax deductions or credits.

CSPN

College Savings Plans Network

It is also important to note that the States bring a focus on outreach to all segments of our populations. It is largely because of the State role in Section 529 plans that we see outreach such as I've described – marketing efforts to ensure that our college savings plans are accessible by all income groups. We want to continue to build on these efforts.

Finally, I want to touch on one other aspect of Section 529 plans, which is less concrete but nonetheless very important. When families puts savings in a Section 529 plan for a newborn, a five year old, or even a fifteen year old, that family is sending a very important message to the child – that the family believes the child can and will go to college. A college education remains one of the surest paths to more success and higher achievement. Saving early in a Section 529 account sends a powerful and positive message to our children -- that they can and should go to college.

Chairman NEAL. Thank you, Mr. Ebersole. Dr. Townsley, you have said that one-half of your students may be eligible for the Hope and Lifetime Learning tax credits. Since we have heard so many eligible families miss out, do your financial aid advisors help these families in any way to ensure that they get the maximum credit available?

Ms. TOWNSLEY. Well, we do training. Our financial aid office and admissions staff do training on FAFSA. And when—because that's where we see it reported, whether or not they might have claimed that, is on the FAFSA line.

So, we offer to all of our families, prospective parents and current parents, training on how to fill out the FAFSA. And we mention that when we get to that section there are opportunities to apply for the Hope and Lifetime credit, or tuition benefit deduction. That's how we do it with our families.

Chairman NEAL. Okay. And, Dr. Watson, as you know, many of us are very supportive of extending and expanding these tax benefits. But we are also operating under, now, some very significant budget constraints which certainly don't appear to be improving any time soon.

Which of the tax benefits do you think provides the most benefit to your community college students and their families?

Mr. WATSON. Well, we have to take a look at our students. Our average—you know, one-fifth of our students are below the poverty level. So they do not make enough money to even be eligible for some of the tax credits, because they do not pay taxes. Of course, Pell Grant is out there. But in terms of the tax credits, I guess I would say the Hope.

Chairman NEAL. The Hope? Okay.

Mr. WATSON. But I must also say that it is possible—and I highly commend, you know, what you have done back in 1997, the intent was there—but as Congressman Rahm Emanuel stated, you know, it's now time to enhance it. And we can consolidate it. It's possible to consolidate the Hope Credit, Lifelong Learning Credit, and the tax deduction.

And I feel kind of—not at ease, because you're, like, asking me to choose between three children, you know? And after hearing your——

Chairman NEAL. Two or three Congressman.

Mr. WATSON. Three Congressman? Okay. But after hearing your statement, Sir, when you opened up, I mean, you're like the poster child. I want to take you and put you on a poster for what you're doing.

It is possible to consolidate it. The parents of the poorest kid—and a lot of our kids are just independent, they're 19, 20 years of age, they're living on their own, they don't have parents they are living with, you know?

And then, the parents like yourself, they need all three. Education is expensive. This $13,000 total, when you look at all of the expenses for a community college student, our students are actually making choices between eating and going to college, between shelter and going to college, between taking care of their child and going to college.

And when you have to make those choices, you know? And, on top of it all, they still make the choice to go to college, and to eat a little bit less, or they move in with somebody.

Chairman NEAL. In an earlier conversation this morning with Dr. Townsley, we talked extensively about the role of the community college in America's future. And I think there is one thing that there is almost universal agreement upon, and that is that the community college is going to continue to play a more important role annually in resolving many of the issues that you have raised. I don't think there is any question about it. So, you have great advocacy here, on behalf of the role the community college plays in America.

Mr. WATSON. I mean, community college is—you know, they were the hallmark or milestone set in 1946, when President Truman came up with the Truman Commission. And at that time he put forth that community colleges are really the answer to getting America back on their feet after World War II.

And at that time, it was his goal on the Truman Commission to make college education either free or minimally a cost. And he really struck out hard. And I commend Congress for, over the years—for struggling to do that. But I think that now it is almost 50 years exactly—no, it's not 50. Well, it's almost 60 years where we have an opportunity to take what President Truman tried to put forth in the Truman Commission, and see if we can enhance it again and make education, both community college, four-year colleges affordable.

And I also represent the board of NAFEO. That's the National Association for Equal Education. That's 112 historically black colleges. I also represent that board, making it possible for all of these colleges and universities to put young men and ladies through college, so that we can compete nationally and internationally.

Chairman NEAL. Thank you. I am always very proud of the fact that it was California and Massachusetts that made pioneering commitments long before it was a well known achievement, the role that the community college would play in American life.

Dr. Dynarski, I was very interested in your suggestion that we can deliver these credits in advance, rather than a year later, when the taxpayer files the annual tax return. How would you suggest that the IRS administer an advance credit?

Ms. DYNARSKI. I was speaking—I could punt this to Michael Brostek. He had some ideas. I was speaking to him before the testimony. There are a couple of programs that IRS runs right now that are run through organizations that could provide a template for what we would do here.

So, right now, you know, the Pell, the Stafford, they are advanced, right? And what we do is we use the colleges to confirm that the student has enrolled. And if the student doesn't enroll, the money is withdrawn, all right? So I think what we would need to do is use the institutions themselves to basically administer the funds.

So, eligibility would run through IRS, but funds would flow through the institutions themselves.

Chairman NEAL. Simple enough. And with that, I would yield to Mr. English.

Mr. ENGLISH. Thank you, Mr. Chairman, and I appreciate the opportunity to quiz a panel that has, I think, offered us some very stimulating testimony.

First of all, Dr. Townsley, we have been told by some experts that parents and students are aware of the Pell Grants and financial aid available. However, many don't know about the education tax credits.

When Nichols sends information to prospective students and their parents about possible sources of financial aid, how do you inform them about the Hope and Lifetime Learning credits?

Ms. TOWNSLEY. Well, as I mentioned, we do it through training sessions at all of our open houses. We have training sessions on financial aid. We have orientation, we have students and families there.

We do training sessions, again, for parents and students, and we cover the FAFSA and how to fill it out. When we get to that section, we mention that they should look into those opportunities on their tax form, because they would be able to fill that in on FAFSA, as well.

So, we do it through all of our training sessions, at open houses, at orientations with students and their parents, and also when we do training at high schools across the State. We send our financial aid staff out to do that.

Mr. ENGLISH. Very good. I was curious. Elsewhere in your testimony you urge the prompt and retroactive extension of the charitable IRA provision that expired last year. I am just curious. How does extending the provision retroactively create any incentive for new donations?

Ms. TOWNSLEY. Well, I think if it was within this year, it would help us to be able to offer that currently to our donors. I would actually call my board member right away and say, "Okay, it's time for the scholarship, you can do it."

Mr. ENGLISH. Okay. Mr. Ebersole, under the present law, education tax benefits are received after filing one's tax return in April. But the tuition is usually due in the fall of the prior year. As a result, there is a considerable lag between the time the cost is incurred and the credit is received. We have noted this for a long time.

This lag may prevent the tax credit from fully achieving its goal of making college accessible for more students. I am curious. Would making the tax credit advanceable solve this problem? And would an advanceable credit be easy for the IRS to administer?

Mr. EBERSOLE. I am here representing the 529 college savings plans.

Mr. ENGLISH. I understand.

Mr. EBERSOLE [continuing]. I don't think I am the one who is able to answer your questions.

Mr. ENGLISH. Would anyone like to comment on it?

Ms. TOWNSLEY. I will comment. When you talk about the advance tax credit?

Mr. ENGLISH. Yes.

Ms. TOWNSLEY. The—I think a private school like Nichols and the Association of Private Independent Colleges and Universities, we would take the position that to do it up front would be a very difficult thing to accomplish.

Student aid comes up front. We do have systems in place to manage that. If we had to do the up-front tax, I think we would probably have to hire another staff member to carry that out.

And when we look at the higher education reauthorization, one of the things that we do have concerns about is the additional reporting. And the more and more reporting——

Mr. ENGLISH. Sure.

Ms. TOWNSLEY [continuing]. That we have to do, the more and more costs go up, because we need people to actually fill all those things out, because we do run lean and mean.

Mr. ENGLISH. Thank you, Dr. Townsley.

Ms. DYNARSKI. Could I comment on that?

Mr. ENGLISH. Also for the panel, the Lifetime Learning credit is calculated as a percentage of eligible educational expenses. This gives, I suppose, a greater tax benefit to those who go to more expensive schools.

Dr. Watson, you obviously represent an institution with a mission to reach out to a very broad cross-section. In your view, is this an appropriate way to structure the credit?

Mr. WATSON. Well, our average tuition and fees is $2,260. And a number of our students are not eligible, or fully eligible, for the Hope tax credit. And I think that we do need to take this into consideration, that—and one way to take it into consideration is to expand it beyond just tuition and fees. We need to make books, transportation, supplies, housing eligible under the Hope tax credit.

Mr. ENGLISH. Thank you, Dr. Watson. Now, again, would anyone else like—before my time completely runs out—to take a run at the design of the tax benefit, and specifically the fact that that Lifetime Learning credit right now provides a greater tax benefit to those who go to more expensive schools? Is that the appropriate way to structure the credit?

Ms. DYNARSKI. I would say that the student who is deciding between whether to go to college or not is going to a community college. So we would want to focus our efforts and our funds on that type of student.

So, a structure that gives more money to people who are going to the most expensive schools, no. I don't think that's the right way to structure it.

Okay, I would also like to answer a question that you asked a few minutes ago about the advanceability of the credit.

Mr. ENGLISH. Yes.

Ms. DYNARSKI. I agree. It would be hard to deliver the funds up front. But it is incredibly important. It's the whole point, is to make it possible for students to go to school. They need the money when they register for college. They don't need it a year-and-a-half later.

So, yes, it's the hardest part, but it's the part that would actually make it possible for people to go to school who can't afford it right now. And so, I think, given the brain power that exists in this room and in the colleges and universities of our country, we can find a way to make this work, and we should find a way to make it work.

Mr. ENGLISH. I think both of your answers are thoughtful and well-rounded, and I think we're going to have to wrestle with that. Thank you so much.

Chairman NEAL. Thank you, Mr. English. The gentleman from Washington, Mr. McDermott, will inquire.

Mr. MCDERMOTT. The more I listen, the more confused I think my 30-year-old secretary is about what's available.

The question that I think—I am old enough to remember when University of California was absolutely free, and when we invested millions of dollars in this country in the GI Bill of Rights, when we were pouring investment into education. And it has been a gradual process over the last few years to gradually shift the cost onto the student, and leave the student in debt when they get out of college.

And I—it seems to me that one of the problems here is that we have shifted some of our educational benefits over to the military. "Please join the military. And if you join the military, well then we will give you some tax benefits, or we will give you some money to go to college," as though our only way of having a volunteer army is to somehow make it harder for somebody to simply go to school, but a lot easier if they want to go the military route and pick up the benefits.

And what I am concerned about is the fact that we seem unable to figure out what the people—there are about 26 million families living at poverty or below in this country. Now, their kids cannot—

this IRA business, that's just nonsense, to talk about IRAs with them, or that their parents should have been putting something in the bank on the way while they were growing up. All those programs are designed for middle class and above.

The question is, what's the best program to help—if you were designing—blank sheet of paper. What is the best program to give—to deal with the people who are under $40,000 median income, and who either themselves are trying to go, or trying to help one of their kids go?

I would like to hear what you think the best thing we could do in that regard, to deal with them, because the ones who got money to start when their kid is one year old and putting money in an IRA, you know, I am worried about them, but not very worried in comparison to what I am worried about with this whole, huge bunch of kids who are afraid to go to college because they're going to get in debt, so they say, "Let's go in the military and see how it works out." So, I would like to hear your best proposal. Any one of you.

Ms. DYNARSKI. I will jump in. I think the best system—and I agree, it would not be the one we have right now—is one that is transparent, simple, and certain. You want families to know, when their child is in grammar school, that college is affordable. We have got money spread across dozens of programs at this point in the Tax Code and on the revenue side. And pooling those funds into one, simple certain program I think could make for a very powerful incentive.

So, I would love to see basically pooling the money that we're spending on the tax incentives with the money that we're spending on the Pell Grant and the other campus programs into one super program that we can communicate simply to students and say, up front, "You've got $7,000 a year for college. That's enough to cover, you know, a 4-year university, State university," and you know that when you're in grammar school, and you know that when you're graduating from high school.

Application could be through the tax form itself, just to check off on the tax form, and basically base it on income and on family size, and those would be the criterion. If you look at the financial aid formula, really what drives almost all of it is income and family size. The other 125 questions on the financial aid form don't really have much of an effect on the Pell Grant.

So, put it together with the tax expenditures that we're using right now, and make one, super-effective program.

Mr. WATSON. Sir, I think we have made a major step, or right on the verge of getting ready to make a major step with regards to the Universal Higher Education and Lifetime Learning Act.

That's a major step, if we were to do that, the consolidation, raising it to $3,000, non-tuition being included, and 50 percent refundable. Now, being that you gave me a blank check, though, I would make that 100 percent refundable, all right? And I would think that we would have done the Truman Act a major a complement 60 years later.

In terms of combining the tax credits with the Pell Grant, I would be hesitant to at this point, just because of the fear of the bureaucracy that might follow along with it. I would like to keep them separate at this point. But if we are able to do the Universal Higher Education and Lifetime Learning Act, and change it from 50 percent to 100 percent, this congress would have made a major step in helping the 40 million individuals that you spoke of.

Mr. MCDERMOTT. Do you run your own program of Pell Grants, or do you put it out into the banks? University of Washington runs their own Pell Grant. They don't have a bank intermediary. What do you do, in the community college system in Chicago?

Mr. WATSON. We have the Stafford Loan, and we give out very, very few loans. But in terms of Pell Grants——

Mr. MCDERMOTT. The student loans question is what I'm asking you.

Mr. WATSON. Oh, so you're talking about loans? Oh, okay. Very few loans. We do not encourage our students to take out loans. Let me be very clear on this one.

The City Colleges of Chicago made a list that came out about two weeks ago, saying that there are some colleges that are not encouraging their students to take loans. We are one of those colleges, because we see thousands, tens of thousands of students come to us after having attended schools where they have $19,000, $20,000 in loans, and still have not graduated from college.

We are a community college, and we are there for the purpose of trying to get young men and young ladies through college without a debt. You can attend the City Colleges of Chicago and attend all two years and not have to take out a loan. Our tuition is $2,200 per year. And with Pell Grant, and if we're able to do this with the Universal Higher Education and Lifetime Learning Act, with the change that is being proposed, loans are not necessary for my cohort of students with the AACC—that's 1,200 colleges, that is 46 percent of all students in higher education. It would not be necessary, Sir, except for those very, very select programs.

So, I don't want to mislead you and say, "Well, there are no loans." I do have some programs where students must take loans, because the programs are extremely expensive: dental hygiene, a very, very expensive program. Other than that, I would say 80 percent of my programs we do not encourage it.

Ms. TOWNSLEY. Representative McDermott, I would take the same position as my colleague in the community colleges. I think that that would benefit students greatly.

I would also encourage that we do maintain opportunities for middle income families as well, who are trying to send their children to school. That is the real beauty, I think, of American higher education, is that there is diversity in choice in higher education.

And at Nichols, we work strongly with the community colleges through articulation agreements. And so, students that might not have an opportunity to go all four years certainly can start at a community college and have great savings.

And, in fact, in some community colleges—we have begun in Massachusetts to work on what we're calling an A-to-B program, which is an associate to bachelor's program, and students can take certain courses through the community college that we have agreed to ahead of time for three years. And they earn an associate's plus one year.

And then, the fourth year, they can transfer to Nichols College and they can either do it online—because we have our programs online at a lower cost—they can come for the residential experience in the last year if they would like, which is obviously the most expensive option, or they could take classes in the evening, which, again, is a relatively low cost. And the students then have the opportunity to earn an associate's and a private school bachelor's and business administration degree from Nichols College.

So, we do work closely with community colleges. A lot of my colleagues in private higher education do. So I would encourage that we maintain those benefits across all levels and income groups for opportunity.

Chairman NEAL. Thank you. We can come back if there is time at the end.

Mr. MCDERMOTT. Thank you, Mr. Chairman, for your indulgence.

Chairman NEAL. Thank you, Mr. McDermott, very much. The gentleman from Connecticut, Mr. Larson, is recognized.

Mr. LARSON. Thank you, Mr. Chairman, and thank you for putting together these very thoughtful panels.

Continuing along a similar line of questioning that Mr. McDermott had, what kind of shape are our computer labs in, in our community college systems today? Mr. Watson, would you be——

Mr. WATSON. Yes, Sir. You know, you have heard of unfunded mandates, and that is something that community colleges and universities are pretty much faced with.

There is software upgrades that we must do, in order to respond to the GAO, and all of the different bodies that ask us for reams of data every year. And we must upgrade. Those software upgrades cost tens of millions of dollars to each community college. That is an unfunded mandate.

There are under-funded mandates, which gets to your question, and that is in order for our students to remain competitive internationally and nationally, and just for locally, sometimes, we are being put in a situation where we have to turn over our hardware, like every four to five years. That is expensive, Sir. And there is no—there are very few funding sources that make revenue available to us.

Mr. LARSON. So you have got a serious infrastructure problem that is both under-funded and mandated but not funded at all.

Now, if I could take that a step further, when I was looking at your statistics, Mr. Watson, you were saying how—you were comparing how 80 percent of a particular socio-economic group goes on to higher education, whereas 40 percent of a lower socio-economic group goes.

Well, if you do the math, that means 60 percent or 20 percent. Where are those students, or those individuals going, who don't go to colleges? And where do they get their training to facilitate a lifetime of work in a global economy?

And if our community colleges don't have appropriate labs and are able to provide the transition and don't become what I fear is just a minor league for the college system, where you can't afford to go to college, well, if you spend a few years in the minors you will be okay and then we can matriculate you on up, but it still leaves out a vast majority of people not only who seek to enter college or higher education every year, but those that are in the work force currently, untrained and without skills, in a global economy that is shrinking as fast as technology and innovation can make it.

Would community colleges be open to keeping—if they were funded, keeping their buildings open during the evening for the retraining of individuals within the community? Because, as you noted, the level of technology changes, and skill levels, and whether it's IT or IP, or how people are going to process information, it's changing rapidly all the time. And if our community colleges aren't the facile, flexible means of dealing with this, where are we?

And what do you think that cost would be to, say, on weekends or——

Mr. WATSON. That's right.

Mr. LARSON [continuing]. Three nights a week, to keep the colleges open, and make sure that they had appropriate labs and teachers to do the training? Any idea what——

Mr. WATSON. Yes. Right now, my community college—and I can speak for the other 1,200 community colleges—we are now opening our doors on the weekends and at night. We all have night school, we all have weekend programs. The Borough of Manhattan Community College, they have 8,000 students taking courses on the weekend, all right, 8,000 students.

You know, we, City Colleges of Chicago, have thousands of students taking courses on the weekend, and we are to a point right now where we're open at 8:00 in the morning until 10:00 every night. We are now working out a plan where we are thinking about going up to 12:00 at night, in order to meet the need.

We, Sir, as you have clearly stated, we are that economic engine that can get America back to work. No question about it. We are it. You know, my——

Mr. LARSON. Where do you get the resources from, then?

Mr. WATSON. You know, and we have made a mistake, as community colleges. We are like the "Mikey" at the table, you know. "Feed it to Mikey, he will eat it."

And the reason why I say it's a mistake is because we always make do, to make sure that we try not to ever turn anybody away. And we have taken our dollars over the last decades, and we have not turned students away. And we have raised tuition—and you've seen the creeping tuition of community colleges—we are up to $72.

You know, when my father attended my community college—my father—my grandfather gave my father $10. He said, "You go up there and get enrolled, and bring back the change." And that was a full enrollment, all right? We have gone a long way from that. We have to charge more tuition to our students. We are $72, some of my sister community colleges are $110.

But you also said something else, Sir, I must address. And I really thank you for the opportunity. You said that some community colleges, we don't want them to become second-class schools, well individuals say, "Well, we will just go to a community college because we can't go to a regular college."

I am very proud to share with you that just approximately three weeks ago there was a national competition between universities and community colleges. It was a scholastic competition. And I can't give you more details, because it's going to be on television, and the network will shoot me. But I will just say that the community college beat out eight universities and colleges in a national scholastic competition. And I said more than what I should say. I will talk to you privately and tell you exactly what it was, but I can't say it here.

So, I am only getting to the point of saying that community colleges—the word "junior college" was created in 1901 by William Rainey Harper, the president of the University of Chicago. We have gone from junior college in 1901 to community colleges, which was created by Truman in 1946.

We are legitimate, two-year institutions that, as my college stated, we matriculate students. And research shows that students who come to us for the first two years, they do as well or better than students who start out at a university. And we have an equal or higher rate of success than the junior and senior year.

Mr. LARSON. I would agree with all of that. I see my time is up. I thank the chairman.

Mr. WATSON. Okay, thank you.

Mr. LARSON. But if I could get some numbers—and I will speak with you after the hearing, Mr. Watson, in terms of what you think that that would cost, to upgrade the labs in our schools to make sure the mandates are funded, and then how we can matriculate people into our community colleges, as opposed to having to bring in immigrants to man the jobs that we ought to be training our people for.

Mr. WATSON. You're right. You're right, Sir.

Chairman NEAL. I thank the gentleman from Connecticut. The chair recognizes the gentleman from New York, Mr. Crowley, to inquire.

Mr. CROWLEY. Thank you, Mr. Chairman. Thank you for affording me the opportunity. I would just from the outset, Dr. Watson, it sounds like a movie in the making. So I'm paying attention.

Listening to the witnesses, it appears that there is strong support amongst you all for making the Hope and Lifetime Learning tax credits refundable, which are right now non-refundable, to help those students that Dr. Watson made reference to and highlighted before when he said that one in five of his students are below the poverty line.

Are you all in agreement that the Hope and Lifetime Learning tax credits be refundable?

Ms. TOWNSLEY. Well——

Mr. CROWLEY. You're all nodding your heads, I just want to—if you could, for the record, just say, "Yes."

Ms. TOWNSLEY. Yes, Sir. I—we would be in favor, and private colleges, we have had a discussion around this, and we would be in favor of the refundability, as long as the cost to do the refundable credit is not a burden, and——

Mr. CROWLEY. To the institution.

Ms. TOWNSLEY. To the institution. Because then we have to continue to increase costs, which we're trying to hold the line on.

Mr. WATSON. We are strongly supportive of the refundability, because a number of our students, because of their income, do not have a liability. They do not pay any taxes.

Mr. CROWLEY. Right, okay.

Mr. EBERSOLE. We are here on behalf of the college savings plans to promote college savings, and credits are apart from that. So——

Mr. CROWLEY. Well, Harvard, if I could hear from——

Ms. DYNARSKI. Well, I don't represent Harvard.

Mr. CROWLEY. Okay.

Ms. DYNARSKI. I represent me.

Mr. CROWLEY. Okay.

Ms. DYNARSKI. But I do support the refundability of the credits, and I do—I want to echo that the colleges are understandably apprehensive about bearing the costs of some new program, that they currently bear the vast bulk of the cost in administering the need-based financial aid system and the tax credits.

And so, I understand their fears about any changes to the tax program that would make it even more complicated for them, because they tend to be unfunded complexity. We don't recognize the cost of the complexity in the government programs. They're not on the line, they're not a budget item. They are paid for by billions of dollars by the colleges themselves in running their financial aid offices.

So, I would hope that Congress would be cognizant of this in considering any changes. But I also hope that we would be focused on designing a program that is, first and foremost, centered upon the needs of students and their families and, secondarily, on the needs of the institutions that those students attend.

Mr. CROWLEY. Well, thank you all. I just want to follow up again on a question by Chairman Neal in regards to the outreach that is being done by colleges as it pertains to students taking advantage of the tax credits.

And we have been doing some work, my office along with Chairman Lewis, on the EITC, the Earned Income Tax Credit, and how we can help those who are eligible for those tax credits to access them, as well. And we have been—we've told employers that they have to do more, in terms of outreach.

One, do you—should we require—should there be a requirement that schools—is that something that you think would be helpful, in terms of making that outreach to students?

I know that, Dr. Townsley, you mentioned that you put it on your FAFSA forms when people are applying to your institution. But I would like to ask if there is anything else that we can be doing—that you all can be doing—in terms of communicating and encouraging those who may be eligible for these tax credits to make access to them.

Ms. TOWNSLEY. I think—and the discussion that—it's probably helpful if it is noted on the FAFSA as a note, you know, "You are eligible," so when they're filling it out they will see that, "Oh, I could have maybe done something."

Mr. CROWLEY. Okay.

Ms. TOWNSLEY. So that might be beneficial, because we have to point it out, because they don't really know what should have gone there. So that might be helpful on the new—when the FAFSA does get redesigned.

And then, I think colleges and universities, along with banks, actually, where loans come through, could put it in their literature, as a note. I hate to require more, to be honest. I would say maybe a suggestion. But certainly the FAFSA would bring it right to them.

Mr. CROWLEY. Okay, thank you.

Mr. WATSON. So, one thing that I would—well, one you're getting ready to do, hopefully, and that is you're going to consolidate the Hope Credit, Lifelong Learning Credit, and the tax deduction, and simplify. That will help immensely. You know, Congressman Rahm Emanuel's and Mr. Camp's—their proposal will help immensely, the simplification and consolidation.

And second is my colleagues keep speaking of "our financial aid advisors," you know. Let's be honest. We need to move this one step further. There are high school counselors and advisors. They need to be required to communicate this to every kid that graduates.

I run across young men who live in my neighborhood, and I say, "Are you going to college?" "Well, no, no, no, I can't afford to." I say, "Well, are you aware of Pell Grant?" "No." "Are you aware of Hope?" "No."

These young men and young ladies, if you were to take a survey of kids that graduated from the high schools in urban and rural America—and I keep connecting the two, because there is no difference between urban and rural America in this country today, the poverty level is the same. The unemployment level is the same. The crime level is the same. The drug usage level is the same. And if those high school counselors were required to give these students information on Pell Grants, Hope, Lifelong Learning Credit, you will see a significant difference. We are basically getting a horse after it leaves the barn.

Mr. CROWLEY. Right, right. Well, thank you. And I know my time has expired. I want to thank the Chairman for extending the courtesy, and thank you all for what you do.

Ms. DYNARSKI. Thank you.

Mr. EBERSOLE. Thank you.

Mr. WATSON. Thank you.

Ms. TOWNSLEY. Thank you.

Chairman NEAL. Thank you very much, Mr. Crowley. Mr. English and I want to thank all of our witnesses today for their thoughtful testimony. It is most helpful. We may have some written follow-up questions, and we hope you will respond promptly.

If there are no further comments, this hearing is adjourned.

[Whereupon, at 11:59 a.m., the Subcommittee was adjourned.]

[Submissions for the Record follow:]

Statement of Paul J. LeBlanc, Manchester, NH 03106–1045

You probably do not remember me, but when my wife Pat Findlen and I lived in Springfield we worked on your first congressional campaign. We happily see you in the news from time to time and delight in knowing that you still serve and we had some very small part in helping you get to Washington.

I am writing in my role as President of Southern New Hampshire University and as a member of the Board of Trustees for the Council for Adult and Experiential Learning (CAEL), I am pleased to endorse the testimony provided by CAEL and M+R Strategic Services to the Subcommittee on Select Revenue Measures for its hearing on Education Tax Incentives. I would also like to express my strong support of federal tax policy to advance Lifelong Learning Accounts (LiLAs).

In New Hampshire and in New England more generally we see an aging demographic and a struggle by employers to find well trained people to sustain economic growth. Conversely, in our work, we see many adult students who struggle to pay for school with little in the way of financial assistance. CAEL, a national non-profit organization dedicated to advancing lifelong learning, developed LiLAs as a strategy to close this financing gap and put education and training within the reach of working adults. I think LiLAs may be one of those groundbreaking, paradigm sifting pieces of legislation and I hope you will support the proposal around federal tax policy before you.

LiLAs are an innovation that is needed to build the skills of our current and future workforce. I support the introduction of legislation that would help to put LiLAs within the reach of all working Americans.

Statement of B. Russell Lockridge

As Vice President and Chief Human Resource Officer for Brunswick Corporation, and a member of the Board of Trustees for the Council for Adult and Experiential Learning (CAEL), I am pleased to endorse the testimony provided by CAEL and M+R Strategic Services to the Subcommittee on Select Revenue Measures for its hearing on Education Tax Incentives. I would also like to express my strong support of federal tax policy to advance Lifelong Learning Accounts (LiLAs).

Investment in education is one of the best ways for companies to help their employees gain new skills and advance in their careers. CAEL, a national non-profit organization dedicated to advancing lifelong learning, developed LiLAs to encourage workers and businesses to co-invest in education and training activities that would meet the demands of the changing global economy while helping more Americans to achieve their career and education goals.

We know that adult students often face difficulties in affording the education and training they need to succeed in our country's skills-based economy. CAEL, a national non-profit organization dedicated to advancing lifelong learning, developed LiLAs to encourage workers and businesses to co-invest in education and training activities that would meet the demands of the changing global economy while helping more Americans to achieve their career and education goals.

LiLAs are an innovation that is needed to build the skills of our current and future workforce. I support the introduction of legislation that would help to put LiLAs within the reach of all working Americans.

Statement of Dr. Shirley Robinson Pippins

As President of Suffolk County Community College and a member of the Board of Trustees for the Council for Adult and Experiential Learning (CAEL), I am writing to express my support of testimony provided by CAEL and M + R Strategic Services related to the education tax incentives being considered by your subcommittee, particularly with regard to Lifelong Learning Accounts (LiLAs).

With approximately 90% of all new high-wage jobs requiring a college degree or post-secondary training, institutions of higher education serve as vital engines for our economy. As Ben Bernanke, Chairman of the Federal Reserve Board recently stated, "policies that boost our . . . investment in education and training can help reduce inequality while expanding economic opportunity. A substantial body of research demonstrates that investments in education and training pay high rates of return both to individuals and to the society at large."

LiLAs are an effective way to ensure that Americans, particularly older Americans, have the resources they need to achieve their career and education goals, and are encouraged to invest in education and training activities that would meet the demands of the changing global economy. On a state and national level, as operating costs at colleges and universities increase more rapidly than family income, and at steeper rates than increases from government funding sources, the opportunity to provide access to higher education for residents, particularly those from low- and moderate-income families, becomes more and more difficult. LiLAs represent a real opportunity to build the skills of our current and future workforce by establishing a commitment between employees and employers which is endorsed and encouraged with federal incentives.

I strongly urge the Subcommittee to favorably consider legislation creating Lifelong Learning Accounts on a national scale.

Statement of Experience Wave and the Council for Adult and Experiential Learning

Summary

When amending the higher-education tax incentives package, Congress should take into consideration the unique needs of workers at all stages of their careers, including those nearing traditional retirement age, who need to continue their education or retrain for a new career in a different field. Workers of all ages are facing challenges due to a number of factors, including shifting economic conditions, family obligations, and jobs going overseas. The Country's education-related tax policy should be crafted to provide opportunities for workers to overcome these challenges.

Lifelong Learning Accounts ("LiLAs") are one way to address these training and education needs. LiLAs are employer-matched, employee-owned individual educational accounts used to finance workers' education and training. With LiLAs, mature and older workers would have funds available so that they can continue to be productive even though their jobs or personal circumstances have changed. Younger workers would be able to save for education and training to upgrade their knowledge and skills to better position themselves in the labor market. In addition, LiLAs would provide a mechanism for individuals to pursue "encore" careers that will last during retirement.

Learning new skills can open doors to more fulfilling and potentially lucrative career opportunities. But the ability to do so is often limited, especially for workers who may not qualify for assistance that is traditionally available for younger traditional college-age students.

Background

This testimony is being submitted by Experience Wave and the Council for Adult and Experiential Learning ("CAEL"). Experience Wave is a national initiative designed to advance federal and state policies that will facilitate the continued engagement of older adults in work and civic life. Experience Wave, funded by the Atlantic Philanthropies, focuses on the interests of mid-life and older people by promoting policies that

- remove barriers and provide wider opportunities for older people to continue working when they are willing and able, or re-enter the workforce if they have already retired,
- enhance lifelong learning for older people and consider the unique needs of mature and older workers who want to advance in or change careers through accessible high quality and affordable education and training, and
- open doors for older people to engage in meaningful charitable or "pro bono" work.

CAEL is a national, non-profit organization whose mission is to expand education and training opportunities for adults. CAEL works to remove policy and organizational barriers to learning opportunities, identifies and disseminates effective practices, and delivers value-added services. Since its founding in 1974, CAEL has been providing colleges and universities, companies, labor organizations and state and local governments with the tools and strategies they need for creating practical, effective lifelong learning solutions. CAEL's clients include major employers such as Verizon Wireless, Starbucks, CVS Pharmacy, Pennsylvania State University, and Kentucky Community and Technical College System.

Need for Change

A significant portion of the Subcommittee's hearing on education tax incentives (May 1, 2008) was devoted to educational opportunities for traditional aged children and their families. However, it is equally important to expand postsecondary education and workforce development opportunities for working adults.

During the hearing, Congressman McDermott asked the panel what education-related tax incentives would work best for a hypothetical, single mother of two children; whom he described as a 30-year old secretary making $30,000 and having one year completed at the local community college towards her legal assistant degree.

The panelists before the Subcommittee did not have an answer. Congressman McDermott followed up his question by saying that the tax credits and other incentives generally do not work for someone trying to get into a new line of work, just those trying to get ahead within the same industry. The point of Congressman McDermott's hypothetical was to illustrate that tax-related education incentives are too complex. He also highlighted the inadequacy of current education-related tax incentives for working adults: who need training or retraining to increase their future prospects or to adapt to shifting economic conditions. As detailed below, LiLAs would make it possible for that working mother to go back to school and get the credentials she needs to advance in her career and support her family.

Recently, while discussing the Trade Adjustment Assistance Act, Senator Baucus lamented the lack of investment and training opportunities available to today's workforce. He said,

[T]he new global economy conjures images of competition in European, Chinese and Indian markets . . . [W]e can do more to invest in our workforce and make training available to our workers. We can do more to be creative and innovative. We can do more to think about what the competitiveness of our economy and [what our] workers should look like five and 10 years down the road. Challenges posed by globalization and technological change require new workforce strategies.[1]

However, as the American Society for Training & Development stated in their Fall 2006 publication entitled, "Bridging the Skills Gap: How the Skills Shortage Threatens Growth and Competitiveness . . . and What to do About It," U.S. businesses are finding themselves ill-equipped to compete in the 21st-century economy because too many workers lack the necessary skills to help their business grow and succeed. A part of the solution involves individuals taking responsibility for their own skill development and career development and being proactive in acquiring skills, furthering their education, and committing to lifelong learning. In addition, businesses and the government need to provide support and develop programs that encourage individuals to adapt to the changing landscape.

Post-secondary educational attainment is tied to improved employability and higher earning power. Among citizens aged 18–64, for example, those who earn an associate's degree can expect on average an additional $7,000 in annual earnings, and in states like California and Texas, an additional $10,000. Attaining a bachelor's degree adds, on average, $15,000 in annual income, and in some states as much as $18,000. This increase in income level also translates to increased state and federal tax revenues, and a higher skilled workforce that can staff positions of critical importance to the economy, national security, and public health.[2]

Once a global leader, the United States is losing its historic world dominance with respect to higher levels of education attainment for its adult citizens. According to figures released by the Organization for Economic Co-operation and Development, several countries have already surpassed or are close to surpassing the United States in proportion of 25–64 year olds who have attained a tertiary credential. These countries include Canada, Norway, Finland, Sweden, Japan, Korea, the United Kingdom, Spain, Australia, Belgium, the Netherlands, and France. In a world economy that depends more than ever on knowledgeable workers, as well as the possession of advanced literacy and problem-solving skills among line workers, the imperative could not be greater for U.S. leaders and policymakers to recognize and strategically address challenges to expanding adult learning.[3]

But more important that our standing, vis-à-vis other countries, is our ability to staff positions that are of critical importance to the economy, national security, and public health. If our current workforce does not gain new skills and credentials, we may not have enough skilled workers for the growing need. It is estimated that 15 million new U.S. jobs requiring a college education will be created by 2020, but based on current attainment rates, projections show a net gain of only 3 million new workers with college credentials. To meet the skill demands, we cannot only focus on traditional-aged college students—there will not be enough of them. The nation must also place strategic priority on educating the large number of adults in the workforce who have earned high school credentials, but for one reason or another have not previously entered or completed postsecondary study.[4] These individuals are more likely than their peers to live in poverty and to be unemployed or working in a low-wage service sector job. Any while many workers are interested in increasing their skills and knowledge, those that do enroll in postsecondary programs are

[1] Congress Daily, "Baucus, Panel Say National Agenda Is Needed To Compete," May 1, 2008.
[2] Tate, Pamela, "Testimony on Higher Education in the United States and the Needs of Adult Learners: Recommendations for Strategic Directions," January 31, 2006.
[3] See id.
[4] See id.

twice as likely to be enrolled part-time and three times as likely as traditional-age students to be enrolled less than half time.[5]

Another source of workers is older Americans. The United States' workforce demographics are undergoing a tremendous shift. In the next decade, the number of workers over 55 will grow at more than five times the rate of the overall workforce.[6] But most baby boomers are not planning on going the way of traditional retirement. According to an AARP survey, 79% of baby boomers plan to work in some capacity during their retirement years.[7] The shifting economic conditions will force many baby boomers to continue to work because their jobs have been downsized or they have not saved enough for retirement. However, others will want to change to less demanding careers or will just want to give back to their community. With the wisdom and experience older Americans bring to table, investing in their education could be a boon for evolving businesses and distressed labor sectors, such as education and health care.[8]

With those challenges in mind, we urge the Subcommittee to consider passing tax legislation to stimulate the creation of lifelong learning accounts.

Lifelong Learning Accounts

As mentioned above, LiLAs are employer-matched, employee-owned individual educational accounts used to finance workers' education and training. The vision is for all workers to contribute to LiLAs and have those contributions matched by their employers—much like a 401(k), but for education and training. LiLA contributions could also be matched by third parties, including philanthropic, federal, state, and local government resources. LiLA's have the following features:

- Universal Eligibility. All individual workers are eligible for accounts.
- Broad Use of Funds. Eligible expenses include tuition and fees, supplies, materials, and books. Allowable educational activities include, but are not limited to, studies related to a worker's job or industry and training for a new career.
- Portability. LiLAs stay with the employee regardless of the person's current employer or employment status.
- Voluntary Participation. Individuals and employers have the option of participating.
- Matched Funding. LiLAs are funded through individual contributions, employer matches, and potentially third party funds.
- Informed Choice. Individual participants choose the training and education they need to meet their career goals that are grounded in an individual learning plan developed with educational/career advisors.

CAEL and Experience Wave have been working with leaders across the country to advance policy in support of lifelong learning accounts—in particular federal tax incentives for employer and employee LiLA account contributions.

On January 4, 2007, Senator Cantwell introduced a "demonstration project" version of this proposal under which up to 200,000 taxpayers who are residents in 10 designated states could participate. The bill, S. 26, has two co-sponsors, Senator Snowe and Senator Collins. Congressman Allen introduced companion legislation, H.R. 2901, on June 28, 2007, which was co-sponsored by Congressman Michaud.

The bills are very similar. Both bills establish tax incentives for Lifelong Learning Accounts. The accounts are funded through employee and employer contributions. The employee and the employer both are allowed an income tax credit not to exceed $500 for their account contributions. The account funds would be excluded from taxable income if the funds are spent on higher education expenses. Any amounts withdrawn in excess of the individual's higher education expenses would be included in income and assessed an additional 15 percent tax.

In addition, Congressman Emanuel and Congressman Ramstad just introduced a national lifelong learning accounts bill (H.R. 6036). The bill provides tax incentives to participating employees and employers, including a refundable tax credit equal to 50% of the first $500 contributed and 25% of the next $2,000 contributed by the employee. The employee can use the funds in his or her account at any time for education or courses of instruction (including training and apprenticeship programs). These bills are a model of what can be done; the Subcommittee and its Members are free to fashion their own legislative solution.

---

[5] See id.

[6] The Washington Post, "One More Time, With Meaning," January 27, 2008.

[7] The Wall Street Journal, "Second Acts: Career Paths for Worn-Out Executives," April 9, 2008.

[8] See id.

The Success of LiLAs

Since 2001, CAEL has launched several pilot LiLA projects in partnership with LiLA champions across the country. These projects have been located in Chicago, northeastern Indiana, San Francisco, Kansas City, and the states of Illinois and Maine. The pilot programs have transformed many participants' lives Here are some examples:

- Paul Kelvington, a participant in the Chicago demonstration site, set money aside for college while he waited tables. After eighteen years out of school, he is now earning his bachelor's degree with the goal of working in the area of alcohol and drug counseling. "There are a lot of young kids out there that don't have a positive role model in their lives," he says. "I want to be that type of person and in order to impart wisdom I have to education myself. I want to be able to help people and point them in the right direction." The LiLA program helped Paul reach his education goals affordably: "People should never stop learning. The LiLA program helps you financially and it won't break the bank."
- Becky Miller, a married mother of 9-year-old twin boys, found saving for education difficult before the LiLA program. She was promoted from an assembler to an inspector at ITT Aerospace Industries in Fort Wayne, Indiana while participating in the LiLA demonstration. She says, "I never had the money to finish [my degree] until the Lifelong [Learning] Account program came around. When I found out I could finish my degree, I was thrilled!" Becky is now inspired to continue to save—this time for her retirement.
- Fanni Munoz stated taking English as a Second Language courses from City College of San Francisco as soon as she was accepted into the LiLA program. By improving her language skills, Fanni earned a promotion shortly after she began her classes. After observing Fanni's improved work performance and her high motivation level for increasing her skills, Fanni's supervisor nominated her for the Outstanding Employee Award at UCSF Medical Center. She has achieved two promotions in two and half years. Fanni completed her Human Resource Management Certificate at San Francisco State University, Extended Learning. "Thanks for LiLA! Without the program, I would not be where I am right now. I can see many more career opportunities in front of me after I have completed the certificate. [It] is such a fantastic program that helps me advance my career!" [9]
- At age 54, Vicki went back to school with the help of a LiLA to pursue her Teaching Certificate. She completed her program in 2004 and is currently pursuing a full-time elementary school teaching position. She says, "[T]he program is wonderful . . . . [the] LiLA program helped me keep my head above water." [10]
- Christie, at age 57, used a LiLA to enroll in numerous French language classes because she wanted to add to the authenticity of her French restaurant. Now that she is semi-fluent in French, Christie is in the process of taking other classes, including accounting and a computer course in Lotus, that will help her in the future. Christie says, "I haven't been back to school for 30 years and going back to any classroom can be intimidating . . . . [O]nce you put your foot in the door and have success, it motivates you to do more. [A LiLA] made this much easier for me." [11]

With a LiLA, the mother working as a legal secretary in Congressman McDermott's hypothetical could have a similar success story as Paul, Becky, Fanni, Vicki, and Christie. And who knows, maybe after working as a legal assistant she will decide to continue her educational pursuits like Christie. Whatever she decides, a LiLA can help her fulfill her dream.

---

[9] Yahoo! News, "Senators Cantwell and Snowe Introduce Education Account Bill to Make American Workers More Competitive," January 8, 2007.

[10] Due to time constraints, we could not reach the individual for consent to use her story, so a fake name has been substituted.

[11] Due to time constraints, we could not reach the individual for consent to use her story, so a fake name has been substituted.

Conclusion

LiLAs provide employees with the opportunity to increase their future prospects, whether by attaining a higher level of education or by acquiring new skills to meet the demands of a changing economy. We strongly urge the Subcommittee pass legislation to encourage the creation of LiLAs and help adult learners fulfill their dreams.

Statement of Joseph B. Moore, Cambridge, MA 02138–2790

As President of Lesley University in Cambridge, Massachusetts, and Chair of the Board of Trustees for the Council for Adult and Experiential Learning (CAEL), I am pleased to endorse the testimony provided by CAEL and M+R Strategic Services to the Subcommittee on Select Revenue Measures for its hearing on Education Tax Incentives. I would also like to express my strong support of federal tax policy to advance Lifelong Learning Accounts (LiLAs).

In our work, we see many adult students who struggle to pay for school with little in the way of financial assistance. CAEL, a national non-profit organization dedicated to advancing lifelong learning, developed LiLAs as a strategy to close this financing gap and put education and training within the reach of working adults. Our experience with employers also reveals that employees who are enrolled in post-secondary education pursuing a college degree are more reliable and productive employees. The return on the modest financial investment is immediate and substantial.

Statement of Reid Cramer

I work in the Asset Building Program of the New America Foundation, a nonpartisan think tank in Washington, D.C. Our work is committed to identifying programs and policies that expand asset ownership in ways that help more Americans achieve economic security, which today, perhaps more than ever, requires access to both income and assets. Clearly, one of the most significant factors in generating these resources is education, particularly post-secondary education. The problem, also clearly stated, is that for many Americans high and escalating tuition costs make it increasingly difficult to afford and access a post-secondary education.

In 2007, the total cost of attending a four-year public university jumped to $13,589—an increase that far exceeds the rate of inflation at a time when median wages were largely stagnant. As government and institutional aid fails to keep pace with increased costs, few families can expect to afford higher education expenses out of their existing resources. For families wary of taking on costly and onerous levels of debt, savings has become central to accessing education and training. Accordingly, these costs are especially challenging for families with fewer resources. More than half of academically-qualified low-income students are prevented from attending a four-year college because of cost considerations.[1] Given rising tuition costs and the value of a college degree, it is imperative to provide all Americans, and especially lower-income families, the opportunity to save for their futures.

It is hard to argue with anyone claiming to be confused by the array of tax incentives the Federal Government has created with the purpose of promoting education, especially when considered along with the broader set of tax expenditures intended to support savings. In general, there is much to be said for reform efforts that consolidate and simply the tax treatment of savings in general and post-secondary educational savings in particular. This should be as part of a larger tax reform effort.

One of the fundamental problems with our current approach is that by using the Tax Code, including deductions and the promise of tax-free earnings, we fail to assist many families that could benefit from assistance the most. We should be striving to realize more inclusive policies that create opportunities for all aspiring Americans, regardless of their tax liabilities. This critique applies particularly to one of

[1] Christina Milano (2003). Hearing on "Expanding Access to College in America: How the Higher Education Act Can Put College Within Reach" Washington, D.C.: Committee on Education and the Workforce's Subcommittee on 21st Century Competitiveness.

the newest policies, which has quickly developed into the preeminent savings vehicle for post-secondary education, 529 college savings plans.[2]

These 529 savings plans are established and maintained at the state level. Each state plan includes the administration of an account system, the offering of investment options, and the oversight of private-sector investment management. The Federal Government allows for earnings from these personal accounts to be withdrawn tax-free when used to pay for qualified higher education expenses and many states offer additional incentives, such as tax deductions on state income tax calculations.

By the end of 2006, deposits in 529 plans exceeded $91 billion—up from just $20 billion four years ago. More than 7.2 million individual accounts have been established, with an average account size of $12,500. Participation in 529 plans is expected to increase rapidly, with total investments expected to exceed $257 billion by 2011.

The advent of 529 savings plans reflects the general trend to employ an account-based approach to encourage savings. Still many higher-income families would likely send their children to college even without 529 plans and their tax benefits. For lower-income families, the ability to save for post-secondary education is certainly likely to increase access to post-secondary educational opportunities. Unfortunately, they are not expected to greatly benefit from the tax advantages of the 529 plans.

However, there are several promising features of 529 plans which make them a potentially attractive savings platform for families up and down the income scale. I would like to use this testimony to highlight these features and then identify how they could become the basis of a more inclusive savings policy that help provide more Americans, from all income levels, the opportunity to save for their future.

Using 529 Plans as a Savings Platform

Collectively, these state-run 529 plans have characteristics that make them a powerful tool to facilitate saving. While each state is responsible for constructing their own 529 plan, they all have the following beneficial features: (1) public sector oversight that allows incentives and coordination with other policy efforts; (2) centralized accounting functions; (3) a limited number of investment options; and (4) the ability to cross subsidize between large and small accounts.[3]

Public Sector Oversight and Policy Coordination

Because each state controls their savings plan, they have the ability to facilitate coordination with other program efforts and policy objectives. Some states are more active than others in reaching out to lower-income families. These states' actions include broad outreach efforts, small minimum deposit requirements, scholarships for accountholders, and other incentives. A number of states offer a savings match to low- and moderate-income families who are state residents. With these targeted incentives, 529 plans are a preferred route for many families to save for post-secondary education compared to other tax-advantaged vehicles such as Coverdells or IRAs. Also, partnerships with public and non-profit entities allow states to market their 529 savings plans in non-traditional venues, such as in schools, public libraries and other social service systems.

Centralized System of Accounting

As each state is responsible for overseeing plan participation, they create a centralized system of account management. This means that all participants are in the same system, and a single provider carries out all accounting functions. With this centralized system, it becomes easier and less expensive to service the accounts. This is similar to how a 401 (k) plan works. These systems are capable of tracking contributions, investments, and earnings for all plan participants. It also creates the opportunity to match deposits for low- and moderate-income state resident families.

Limited Investment Options

In most 529 plans there is a prevailing simplicity in investment options. Usually only a limited number of funds are offered that capture a range of risk and return characteristics. Professionally-managed mutual funds generate a degree of diversification. Most states generally offer a conservative guaranteed-return fund based on government bonds, balanced funds based on the beneficiary's age, and a small

---

[2] Section 529 of the U.S. Tax Code defines the tax rules that govern qualified tuition programs for post-secondary education. These qualified tuition programs are administered by each state, and include prepaid tuition benefit contracts and savings accounts. Most of my comments focus on the accounts held in state-run 529 savings plans.

[3] Marget Clancey, Reid Cramer, and Leslie Parrish (2005). *Section 529 Savings Plans, Access to Post-Secondary Education, and Universal Asset Building.* Washington, D.C.: New America Foundation.

set of funds that track different aspects of the securities market. The notion is that a limited set of investment options provides account holders adequate investment choice in pursuing their investment strategies and is preferable to the information overload that may be experienced if choosing among an unlimited number of investment options. Recent studies focusing on 401(k) plans have found that too many investment choices can lead to financial inertia, paralysis, and low participation—qualities to avoid in long-term investing.

Small Accounts Viability

Centralizing administrative functions also creates economies of scale that can help lower costs. With such a large asset pool, states are in a strong position to negotiate a more competitive fee structure with their private sector investment managers than would be offered to individual investors. In many states, these advantages have been realized and investment companies have departed from their normal business practices to offer pricing and minimum contribution concessions. As a result, many 529 plans have relatively low initial deposit requirements compared to the mutual fund industry. There is the potential to lower fees further as assets under management rise. Because large- and small-value accounts are held in the same plan, there is a natural cross-subsidy where the smaller accounts (which may be unprofitable) can be supported by the larger accounts (with higher profit margins). As the state negotiates and controls the fee structure, there is an opportunity to support small accounts within the 529 college savings plan structure.

Several potential drawbacks should also be recognized that potentially undermine the appropriateness of using 529 plans as a savings vehicle for lower-income families. These include consideration of how these savings will interact with eligibility for financial aid and public assistance programs, high administrative costs which some state plans charge that erode earnings, and penalties for non-qualified uses if a recipients opts not to choose post-secondary education. Each of these issues should be addressed directly as part of a reform effort to make 529 plans more effective and inclusive savings vehicles.

Options to Make 529 Plans More Effective and Inclusive Savings Vehicles

Over the last thirty years, the number of specialized savings accounts has expanded significantly, extending well beyond 529 savings plans.[4] While this policy trend represents a shift toward asset-based policy, the implementation of these efforts has been considerably more regressive than the proceeding social insurance and means-tested transfer programs developed since the New Deal. Furthermore, the need to save for college is an extension of the underlying importance of savings as the basis for more extensive asset building. As such, there is a case to be made for government to support a more inclusive asset-building policy, which could include a reformed 529 Savings Plan program.

The involvement of state governments in 529 savings plans has provided a laboratory of innovation and led to a series of insights. First, it is clear that the public sector can play a leading role in defining and overseeing policy. Second, private financial firms can build upon their expertise to effectively manage assets and keep administrative costs down with high account volumes, limited transactions, and a small set of investment choices. Third, incentives must be crafted for each target population. Fourth, consumers must have access to timely and transparent information to make informed investment decisions that are right for them.

While the structure of most state-run 529 plans offers an effective savings platform, the federal tax incentives associated with these accounts primarily restrict benefits to middle- and upper-income families. Accordingly, it is unlikely that this federal policy, if left unchanged, will significantly increase access to post-secondary education opportunities.

Building on these insights, there are a series of policy options that would improve the effectiveness and inclusiveness of this policy effort. These proposals built on the guiding principles of transparency, inclusiveness, and offering saving incentives for those who need them most, will enable families to evaluate and make informed choices as to how best to save for college.

Use 529 Plans as a Platform for Lifetime Education Savings

529 plans have qualified uses that include a range of post-secondary educational expenses. These uses should be clarified and expanded to cover more asset-building activities. While commonly associated with saving for a child's higher education ex-

[4] The list includes traditional Individual Retirement Accounts (IRAs) in 1974, Coverdell Education Savings Accounts in 1997, 401(k) plans in 1978, and Health Savings Accounts first created in 1996, and Roth IRAs in 1997.

penses, these accounts can work just as well for working adults looking to save for their own higher education and skills training needs. For workers looking to command a higher wage in their current field, or switch fields altogether, higher education and training is essential. For individuals who cannot pay for tuition, books and fees out of pocket—and are wary of taking on onerous debt—saving is the answer. Instead of creating new workforce training accounts, the Federal Government should use the existing infrastructure available through 529 accounts and work with states to promote and incentivize the use of these accounts by working adults

Add 529 Plans to the List of Products Eligible for the Saver's Credit

The Saver's Credit currently provides a 50 percent match—in the form of a nonrefundable tax credit—to low-and moderate-income people who contribute to a retirement account such as a 401(k) or IRA. To further promote savings in general, a range of savings products, including 529s, could be added to the list of products that trigger this credit; the administration proposed such a change as part of the FY 2008 Budget. Certainly one could argue that pre-retirement assets—especially a post-secondary education—is a critical element of retirement security, and it should be noted that all IRAs already permit tax-and penalty-free withdrawals for post-secondary education.

Matching Grants to Low-Income Savers

Currently 529 plans are largely underutilized by low- and middle-income families. A number of states have dedicated funds to match savings in 529 plans as an additional incentive for low-income families. These incentives appear to be successful in encouraging families to contribute to 529 plans. Seven states—Colorado, Louisiana, Maine, Michigan, Minnesota, Rhode Island, and Utah—already provide matching funds to low-income savers, and Arkansas will begin providing targeted matches in 2008. Additional resources could be devoted to helping states develop matching grant programs.

Create a State Innovation Fund

A variety of state and private sector actors have enacted innovative programs within their 529 plans to primarily help low-income children pay for college. For example, a few non-profit organizations have offered matches to families saving for college through parallel 529 scholarship accounts. In SEED for Oklahoma Kids, 1,000 newborns will receive a 529 plan with a starter deposit of $1,000. Financial information and matching deposits will be provided as incentives for families to continue to save for a post-secondary education. Coalitions are being formed in states such as Kentucky and Michigan to look into the possibilities of universal 529s for every child in the state with progressive savings incentives incorporated to help low-income families. The Federal Government could encourage these types of innovative activities by sponsoring a competitive grant process where states could receive awards to help seed these initiatives.

Facilitate Better Disclosure and Comparison of 529 Plans

Because they are created by state governments, 529 plan investments are not subject to federal security laws such as those covering most mutual funds. In addition, research shows that individuals saving in broker-sold plans were frequently doing so in out-of-state plans, even if they would potentially benefit more from saving in their in-state plans because of state tax incentives. This raises the question of whether brokers recommend plans that benefit themselves rather than seeking the best plan for their client. At a minimum, brokers should be required to inform clients about any benefits that exist from utilizing their own state's 529 plan. In addition, the Federal Government should support efforts to allow the easy comparison of all plans in a particular state and among states. Websites, such as savingforcollege.com, provide a simple comparison of 529 plans which could be promoted or serve as a model. Finally, states should be encouraged to market their direct-sold plans to their residents, which are usually a less expensive alternative to the broker-sold options.

Collect Better Data on Who Saves and Benefits from 529 Plans

Because data is generally not collected about 529 plan accountholders' socioeconomic details, we do not know how plan ownership varies by income and which segments of the population benefit from these tax incentive the most. If this data were collected, it could help shape improvements to 529 plan policies in the future, helping to ensure that tax breaks and other incentives are serving their intended purpose. Useful data about the saving habits of low-income families in 529 plans could be gained from those states offering matching grants, since an application disclosing income must be provided.

Require Employers to Offer Payroll Deduction into 529 Plans

One of the most effective ways to encourage families to save is to make the process automatic. Millions of Americans have already opted to direct a portion of their paycheck into a restricted account such as an IRA or 401(k), allowing them to save for retirement with minimal effort. Payroll deduction has enabled workers to build retirement security by making one, initial decision to divert a portion of their income; the same process should be used to facilitate saving for higher education. Employers should be required to offer payroll deduction into Section 529 higher education savings accounts if requested by their employee. Small- and medium-sized employers that do not already offer payroll deduction can be offered a small tax credit to cover the costs associated with implementing the change.

Statement of Robert Shireman

I am writing to request that as the Members of the Subcommittee consider how best to structure tax incentives for higher education, they also address a tax disincentive that runs counter to the purpose of the federal financial aid system in general, and to the intent of important new loan forgiveness programs in particular.

- As part of the College Cost Reduction and Access Act of 2007 (CCRAA), Congress created three new programs aimed at reducing the burden of student debt and increasing incentives for students to pursue careers in public service. The Income-Based Repayment program (IBR) will keep loan payments fair and manageable for borrowers with low earnings relative to their debt, and forgives any debt that may remain after 25 years of repayment. The new Loan
- Forgiveness for Public Service Employees program will forgive any debt that remains after borrowers have made 10 years of qualifying payments while working in an eligible job. Qualifying payments for public service loan forgiveness include IBR payments made in the Direct Loan Program, as well as payments under the existing, and much smaller, Income-Contingent Repayment program (ICR). Eligible jobs include those in state, local, and Federal Government as well as 501(c)3 nonprofit organizations.
- The new TEACH program provides future teachers with loans that will be treated as grants—forgiven in full—if they meet certain teaching criteria within eight years of graduation, but must be repaid if they do not meet the criteria.

In general, the Code treats canceled or "forgiven" loans as taxable income, although there are specific exceptions for some student loans in certain circumstances. It seems likely—though neither the IRS nor the Education Department has addressed the issue—that loans canceled under the new programs (2) and (3) would already be exempt from taxation under Section 108(f) of the Internal Revenue Code, since they involve loan forgiveness by a third party (the Federal Government) as part of a program to forgive student loan debt of individuals working for a certain time in certain professions.

However, it seems clear that loans forgiven for those in IBR and ICR do not qualify for tax exemption because they are not job-specific. This is a particular concern because borrowers who meet the income-based forgiveness criteria are the most likely to face significant hardships if the forgiveness results in a tax liability.

We are seeking an amendment that would make clear that loans canceled under all three of these new programs, which apply only to federal student loans in these limited circumstances after a number of years of repayment, would not be considered income for federal income tax purposes. Otherwise, the very borrowers whom these programs are supposed to protect from unmanageable repayment burdens will instead be burdened with unmanageable tax obligations.

At the same time that this issue is being addressed, we want to make sure that other loan cancellation provisions that are not currently taxed continue to be treated in that manner. This includes loans canceled due to school closures, falsely-certified loans, and discharges as a result of death or permanent disability.

Thank you for the opportunity to submit this recommendation for the record. The Institute (www.ticas.org), which sponsors the Project on Student Debt, is a nonprofit policy research organization with offices in Washington, D.C., and Berkeley, California.