

TAX REFORM AND HIGHER EDUCATION

WHAT STUDENTS, FAMILIES, AND INSTITUTIONS NEED TO KNOW

Talking Points: Higher Education Tax Credits

The American Opportunity Tax Credit (AOTC) and the Lifetime Learning Credit (LLC), the two primary higher education tax credits, help millions of students, particularly from low- and middle-income families, access postsecondary education.

- In 2023, almost 9.5 million taxpayers, the majority of whom had incomes below \$80,000, received \$14 billion through higher education tax credits.¹
- In addition to increasing access, higher education tax credits empower students to pursue the best postsecondary fit for them, improving educational outcomes.
 - The AOTC offers relief for students and families by reducing the need to rely on student loans, thus lowering overall student debt.
 - The LLC encourages students and professionals alike to invest in ongoing skill development, fostering a well-trained and competitive workforce.²

By helping increase access to higher education and encouraging people to pursue advanced skills, these credits help bolster the American workforce and strengthen American competitiveness.

- Individuals with college degrees are twice as likely to earn higher incomes, maintain healthier lives, and make positive contributions to society.³
 - A study of economic and noneconomic outcomes—such as income, job satisfaction, voting rates, and volunteerism—found that educational attainment has a meaningful, positive statistical relationship with 50 out of 52 variables analyzed.⁴
 - Each additional year of schooling increases earnings by about 10 percent, often more than other investments.⁵
- Increased access to postsecondary education—and the talented workforce developed and nurtured through education—bolsters our economy⁶ and strengthens our national security.⁷

¹ Estimates of Federal Tax Expenditures for Fiscal Years 2023-2027, Joint Committee on Taxation, <https://www.jct.gov/getattachment/4bb6796c-df84-4179-9226-8cce61c7c4b5/x-59-23.pdf>

² The Lifetime Learning Credit Guide, Fidelity, <https://www.fidelity.com/learning-center/personal-finance/lifetime-learning-credit>.

³ Chan, Roy Y. “1 Understanding the Purpose of Higher Education.” *Understanding The Purpose of Higher Education: An Analysis of the Economic and Social Benefits for Completing a College Degree*, Indiana University, Bloomington, 2016, scholar.harvard.edu/files/roychan/files/chan_r._y._2016._understanding_the_purpose_aim_function_of_higher_education._jeppa_65_1-40.pdf.

⁴ Education for What, Lumina, <https://www.gallup.com/file/analytics/510092/Gallup-Lumina%20Education%20for%20What%20Report.pdf>

⁵ Patrinos, Harry A. “Why Education Matters for Economic Development.” *World Bank Blogs*, May 2017, blogs.worldbank.org/en/education/why-education-matters-economic-development.

⁶ The Effect of Postsecondary Educational Institutions on Local Economies: A Bird’s-Eye View, National Bureau of Economic Research, <https://www.nber.org/papers/w32679>.

⁷ Why Higher Education Is Still Our Country’s Greatest Defense, Higher Education Today, <https://www.higheredtoday.org/2024/06/11/higher-ed-greatest-defense/>.

Because the credits are overly complicated and difficult for taxpayers to use, many students do not access or receive their full benefits, particularly the lowest-income students attending the lowest-cost schools. Congress should reform and simplify higher education tax credits to improve their efficiency and increase access to postsecondary education.

- The take up rate for the AOTC among 18- to 21-year-old eligible students is about 60 percent, with rates significantly lower for low-income students.⁸
 - For example, the take-up rate for lowest-income students eligible for the AOTC attending public 2-year schools is only 35 percent.
- Fixing the AOTC-Pell interaction issue will help ensure that students with the lowest incomes at the lowest-cost institutions are not excluded from this important benefit. This can be achieved by repealing the taxability of Pell Grants and addressing the AOTC-Pell offset interaction, which would simplify the tax code and make it easier for these students to navigate their tax obligations.⁹
 - Data from the Department of Education show that an estimated 550,000 Pell-eligible students are adversely affected by this issue each academic year.
 - Pell students, over 90 percent of whom come from families with incomes of \$60,000 or less, often receive little or no benefit of the AOTC, which contains a grant/scholarship offset provision that has the unintended effect of sharply limiting or eliminating the benefit for these students, especially those that attend lower-cost institutions such as community colleges.
- The current structure of the credits does not adequately support post-traditional students, who are often older, working, parenting, or serving in the military, even though they make up the majority of undergraduate students.
- A consolidated tax credit would simplify existing benefits and better serve low- and middle-income students pursuing associate or bachelor's degrees, graduate education, or lifelong learning. A consolidated credit would:
 1. Maintain the current AOTC, offering up to \$2,500 (partially refundable) for students enrolled at least half-time in undergraduate programs.
 2. Add a non-refundable \$2,000 credit, like the LLC, covering 100 percent of the first \$2,000 of eligible expenses for post-traditional students, graduate students, and lifetime learners beyond their first four years.
 3. Expand eligible expenses to include computer equipment and child or dependent care, and replace the AOTC's annual limit with a \$15,000 lifetime cap.

⁸ Barriers to Claiming Education Tax Credits for Low-Income Students, Department of the Treasury, <https://home.treasury.gov/system/files/131/WP-125.pdf>.

⁹ For more on this issue, read our letter supporting bipartisan legislation that would fix the Pell-AOTC interaction: <https://www.acenet.edu/Documents/Letter-Doggett-Kelly-Tax-Free-Pell-050523.pdf>