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LESS STUDENT DEBT FROM THE START: WHAT ROLE SHOULD THE TAX SYSTEM PLAY?

HEARING

BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

ONE HUNDRED THIRTEENTH CONGRESS

SECOND SESSION

JUNE 24, 2014



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LESS STUDENT DEBT FROM THE START: WHAT ROLE SHOULD THE TAX SYSTEM PLAY?

TUESDAY, JUNE 24, 2014

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, DC.

The hearing was convened, pursuant to notice, at 10:07 a.m., in room SD–215, Dirksen Senate Office Building, Hon. Ron Wyden (chairman of the committee) presiding.

Present: Senators Schumer, Stabenow, Carper, Brown, Bennet, Casey, Hatch, Grassley, Thune, and Isakson.

Also present: Democratic Staff: Tiffany Smith, Senior Tax Counsel; Adam Carasso, Senior Tax and Economic Advisor; Todd Metcalf, Chief Tax Counsel; and Laura Berntsen, Senior Human Services Advisor. Republican Staff: Chris Hanna, Senior Tax Policy Advisor; Shawn Novak, Senior Accountant and Tax Advisor; Jim Lyons, Tax Counsel; and Chris Campbell, Staff Director.

OPENING STATEMENT OF HON. RON WYDEN, A U.S. SENATOR FROM OREGON, CHAIRMAN, COMMITTEE ON FINANCE

The CHAIRMAN. The committee will come to order.

Today the Finance Committee turns its attention to the U.S. tax code, an anticompetitive, mindlessly complicated tar pit that makes it harder to create good jobs, succeed in global markets, and nurture innovation.

My view is, it is long past time to drain this swamp. Because the tax code is like an ecosystem, changes in one area almost always have big effects on others. That is why tax reform has to be comprehensive. It has to include both individual and business policy.

As the Finance Committee continues to drill down with hearings on tax reform, the committee today focuses on one particularly byzantine part of the tax code that is ripe for improvement. That is, how the tax code incentivizes higher education.

Now, everyone understands that getting a college education is one of the surest ways to climb the economic ladder. But the skyrocketing cost of college leads to smothering loads of student loan debt and, in fact, as we will learn, even has the effect of reinforcing inequality in America.

In its debate over education costs, the Congress has put a good deal of focus on how to make students' enormous debts more manageable. Today the Finance Committee is going to come at this from a different angle, one that is central to any effort to help struggling families and reinvigorate the middle class.

I want to focus today on policies that will mean students have less debt from the start. The crazy quilt of tax benefits and aid programs on the books today does not get that job done. As a result, there are millions of Americans who want to get a college degree, but cannot.

It now takes at least 36 calculations for a family to navigate the overwhelming web of tax incentives for higher education in the tax code today. Each of those tax incentives has its own definition of qualified expenses, student eligibility, and income thresholds. Students and parents should not be expected to wade through a mess like this in America.

The Finance Committee can make the menu simple, get it down to three credits or deductions that are user-friendly, and get our students the help they need. The improved system ought to be based on a handful of key goals: saving, covering costs, and easing the burden of loans.

For one, education tax incentives cannot be allowed to drive inequality the way they do in today's flawed tax code. In 2011, families with incomes under $25,000 got an average of $930 in education tax credits, but families with much higher incomes can get a benefit nearly 3 times that size. For education to be the great equalizer in our society, access to higher education cannot be unequal.

A recent paper from the nonprofit Corporation for Enterprise Development showed that the government's tax spending on higher education is greater than the entire discretionary budget of nine separate Federal agencies. Let us retool, colleagues, that big investment, get more value out of those dollars, and encourage more saving early in a child's life.

Now, with so many families struggling to cover basics like rent and groceries, just repeating "save, save, save" may not be constructive. Families that start saving within a few months of a child's birth could be made eligible for an "Early Savers" break that would compliment a parent's contribution, so as to promote lifelong saving.

Working parents of modest means who manage to save could have their savings matched through the Earned Income Tax Credit. And there are also ways to wring more value out of the tuition savings vehicle that we know as "529 plans." And auto-enrolling employees into saving plans for a youngster's college is another idea that should be examined.

The fact is, there are a variety of ideas on offer to promote lifelong savings. Our colleague, Senator Schumer, has done terrific work putting a number of proposals together. Senator Grassley has had an interest in this, as well as Senator Santorum, Senator Gregg, Senator Dodd, and, of course, President Clinton.

So, colleagues, we have on record a variety of approaches that are bipartisan, to deal with promoting childhood savings. In fact, I think it is fair to say that you do not often see an idea that has this kind of support across the political spectrum. So we ought to come together and get it done.

I also want to make mention of the fact that we ought to clean out the barriers that punish many families when they save. For example, if you are of modest income, one of the things you are going

to do is bump up against these "asset limits," and a struggling family risks losing, for example, anti-hunger assistance when they manage to put aside a little bit of money for their kids' education. Families in America should not face going hungry or foregoing necessary medical care in order to help build that ethic of lifetime saving.

Finally, it is important to do a better job of getting the word out about the education tax incentives. There is not a simple college savings guide for new parents. The Higher Education Act says schools have to provide current and prospective students with a host of information on student aid programs, but nowhere does it talk about private saving or tax credits. Schools do not have to relay this information to students. So it is no wonder that a lot of students—and we are thrilled to have Amber Lee here from Oregon, who is going to tell us a very compelling story—are not aware of what all of the opportunities are for a stellar student like herself.

Colleagues, the incentives are out of whack, and, on a bipartisan basis, we can change that.

Finally, let me make mention of the fact that Senator Warner of this committee, Senator Rubio, and I have introduced the Student Right to Know Before You Go Act, which would also complement reforms in the area of tax incentives, so that students would have a chance—again, students and parents—to be informed investors about what kinds of opportunities are ahead of them.

We understand that some student loan debt may be unavoidable. But leaving students with significantly less debt is something this committee can accomplish. Simplifying the tax code and making education incentives more user-friendly is not just possible, it is essential.

So the steps that I have outlined this morning, in my view, are common-sense ones. They are ones that I believe the committee can pursue on a bipartisan basis to help students avoid taking on paralyzing amounts of debt.

Today's hearing is just one of our committee's challenges in the bipartisan effort to fix America's flawed tax code. But this is an especially important one, and I am determined to work with colleagues on both sides of the aisle on a bipartisan basis to get this right.*

[The prepared statement of Chairman Wyden appears in the appendix.]

The CHAIRMAN. Senator Hatch?

OPENING STATEMENT OF HON. ORRIN G. HATCH, A U.S. SENATOR FROM UTAH

Senator HATCH. Thank you, Mr. Chairman. I appreciate today's hearing. I appreciate the witnesses who are here. We are happy to welcome you back, Dean Zerbe. You have played a very important role on this committee for so many years. I am happy to see you doing well in the private sector.

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*For more information, *see also,* "Background and Present Law Related to Tax Benefits for Education,"Joint Committee on Taxation staff report, June 20, 2014 (JCX–70–14),*https://www.jct.gov/publications.html?func=startdown&id=4621.*

Today's hearing has a narrow, but very important focus: the role of education incentives in our tax code. Traditionally, the Federal Government has supported millions of individuals seeking higher education through grants and loans. Over the last 20 years, however, Federal support for higher education has increasingly relied on incentives in the tax code.

These education tax incentives can generally be classified into one of three categories. The first category includes tax incentives for current expenditures on higher education. These incentives include the Hope, American Opportunity, and Lifetime Learning credits. The second category includes tax incentives for student loans, including the deduction for interest paid on student loans. The third category includes tax incentives for savings for college, which includes qualified tuition plans, usually referred to as 529 plans, as the distinguished chairman has said.

Generally, two reasons have been given for the various education tax incentives. First, college education costs are increasing and are a barrier to entry for those who cannot afford them. Second, college education is a good investment that produces external benefits.

According to the National Center for Educational Statistics, the costs of college education for the 2011–2012 academic year were estimated to be $14,300 at public institutions and $37,800 at private nonprofit institutions. Between 2001 and 2011, the costs for undergraduate tuition, along with room and board, at public institutions rose 40 percent, and the costs of private institutions rose 28 percent. That is after adjusting for inflation.

The high cost of a college education does indeed create a barrier to entry. However, some portion of the barrier is alleviated by the U.S. Department of Education's direct loan program, which includes Stafford loans, Federal Perkins loans, Federal Work Study, Federal Supplemental Educational Opportunity grants, and things like Pell grants, for lower-income students.

In fact, in 2013, the Department of Education disbursed $32.3 billion in Pell grants to more than 9 million students. However, at the same time, approximately 71 percent of college seniors have student loan debt, with an average of $29,400 per borrower. From 2008 to 2012, debt at graduation increased an average of 6 percent per year.

As I mentioned, in addition to the cost barrier, there are external benefits related to higher education, many of which benefit not only the individual student in the form of higher wages and mobility, but also society as a whole. Since these external benefits may not be considered by individual students when considering higher education, individuals may invest less in higher education than is optimal for our society. Providing educational tax incentives may induce potential students to enroll in higher education, increasing investment in education, and thereby creating these important external benefits.

Now, frank conversation about these incentives must also include whether Congress is encouraging a higher-education bubble. There are many questions that need to be answered in this conversation. For example, are these incentives encouraging students to take on more debt and degrees than is warranted by the economic and professional gains they are likely to realize? Are there increasing cases

in which the private and social benefits are outweighed by the costs? Also, we need to determine once and for all whether Federal subsidization of higher education is good policy and whether a tax subsidy would be provided more efficiently by direct spending.

In 1987, then Secretary of Education William Bennett stated that, in the long run, Federal financial aid programs lead to higher tuition as colleges capture some of the Federal aid to students. I do not think anybody can deny that he was right.

Some studies have shown some evidence favorable to Secretary Bennett's hypothesis. I would be interested to hear from witnesses if they believe the Bennett hypothesis applies to Federal student aid that comes in the form of education incentives in the tax code itself. In other words, I would like to know whether colleges and universities capture the financial benefits of education tax incentives at the expense of eligible students and families.

Finally, I believe we need to consider simplicity, something that is far too often missing in our tax discussions. One noted tax scholar has written, "The education tax incentives represent the greatest increase in Federal funding for higher education since the GI bill, but no one can tell you what they are, how they work, or how they interact. Planning to pay for college around these tax breaks is essentially impossible for middle-income families."

I think there is a lot of agreement that the education tax incentives are very complex and, at a minimum, should be consolidated and reformed.

We have a very distinguished panel with us today, and I look forward to hearing what they have to say.

I want to thank you, Mr. Chairman, for setting this up.

The CHAIRMAN. Senator Hatch, thank you. As you could tell, I feel very strongly about making this inquiry in tax reform bipartisan. I look forward to working with you and all our colleagues.

[The prepared statement of Senator Hatch appears in the appendix.]

The CHAIRMAN. We have a terrific panel. I want to tell colleagues we have votes that will start at 11 o'clock. So to our guests, it is going to be a little hectic. You will see Senators look a little bit like trolley cars just going back and forth and back and forth. But we very much appreciate your being here.

I would like to give a brief introduction for each of our witnesses—and, of course, we are just thrilled to have an Oregonian here, Amber Lee, who is really the face, colleagues, of this challenge. She is a stellar student. She wants to be a physician. She has off-the-chart grades and scores, and she is looking at getting a degree and, in effect, being up to her eyeballs in debt.

She is the daughter of a single parent. She is working at Dairy Queen, I guess, 36 hours a week. Basically, all the money is going to go to just trying to figure out how to get an education, and it seems to me her story is really representative of what we are trying to do—to set in place policies so that someone like Amber Lee and her mom, who have always lived paycheck to paycheck, will have a very different set of options in the future. So we are very glad you are here, Amber.

Jayne Fonash is a guidance counselor in Loudoun County, VA, and she is responsible for trying to help these students and the

parents get through the briar patch and try to figure out how to make sense of all of this. Ms. Fonash, we are glad that you are here.

Of course, Dean Zerbe is a welcome face here, an alum of the Finance Committee whom we have worked closely with before, and we welcome him. He has assisted us on a variety of matters already, research and development credits and others, and we appreciate that.

Mark Mazur, Assistant Secretary for Tax Policy at the Department of the Treasury, is also with us, and we appreciate his leadership.

Of course, Scott Hodge has been very helpful to this committee and to me personally in terms of putting together the bipartisan bills over the years with Senator Gregg and Senator Coats. So we welcome Mr. Hodge as well.

So with that, Ms. Lee, welcome. You will be the kickoff. How appropriate it is to have an Oregonian be the launch of what I hope will be a very different approach to this, which is to make sure that, in the future, fewer students are having to unpack thousands and thousands of dollars worth of debt because we figured out a way to get them out of the gate with more savings at the start.

So, if you would, we will make your full statement a part of what we call the full record here. And if you want to just talk to us for a while, you can, and we will each have 5 minutes or so. We just so appreciate your being here, and I very much admire what you are trying to do, given the challenges you and your mom face.

STATEMENT OF AMBER LEE, GRADUATE, WILLAMETTE HIGH SCHOOL, EUGENE, OR

Ms. LEE. Chairman Wyden, Ranking Member Hatch, and members of the committee, thank you so much for allowing me the opportunity to testify today.

I grew up in a very violent, unstable home. My father abused crystal meth on a regular basis, which often resulted in wild outbursts of rage towards my mother or me. During a crucial time of life when children should be learning and developing, I was fending for the well-being of my mother and myself. In my first 9 years of life, my family and I were evicted from 12 different homes due to my father's drug addiction, as well as his love for gambling.

There were many times we were evicted and had no place to stay, and the only solution was to take refuge in our car and pray it would offer us enough shelter until we could get back on our feet. I was a miserable child who had to grow up prematurely due to my circumstances.

Though my home life was complex, school always kept me going. It was a way to escape from the stress I experienced at home. At the age of 7, I decided I wanted to become a doctor due to the fact that I was and still am fascinated with the healing power of medicine.

I can clearly recall the instant I realized that I could be free from the vicious cycle of poverty and violence through education. I found it daunting that through my hard work I could potentially liberate myself by accomplishing what my parents could not.

I do not regret anything from my upbringing, because it has molded me into the strong, motivated woman I am today. My past has kept me focused on my educational and career goals by providing me with the drive to become the best form of myself.

As I got older and advanced to middle school and high school, I was extremely diligent with my school work and extracurricular activities, for I knew that consistent academic success was the key to future opportunities. During my junior and senior years at Willamette High School, I carefully considered various universities to attend in the fall of 2014, including Oregon State University, Portland State University, the University of Oregon, and Oregon Institute of Technology.

Originating from a low-income household of a single mother, I knew that paying for college on my own would be nearly impossible. However, I was extremely optimistic of the opportunities available through grants and scholarships that could potentially aid me in pursuing a higher education.

Due to the overwhelming cost of tuition, books, fees, and room and board associated with 4-year universities, I considered attending community college in order to complete my prerequisites before transferring to a university. After some career counseling, research, and serious thought, I was discouraged from attending community college, mostly because of the negative stigma it has with medical school admission committees.

The prerequisite courses students must complete act as a critical foundation that students must build upon during their preclinical years in medical schools, and I was afraid that the decisions I made could potentially delay or negatively impact my future goals.

I also strongly considered attending the University of Oregon, because it would give me the choice to reside at my mother's house, saving me the cost of room and board. However, the University of Oregon is considered a strong liberal arts college, and I found it important to attend a university with a strong math and science program in order to prepare me for the challenges of medical school.

After many months of consideration, I decided to attend Portland State University, and I was extremely attracted to the job as well as the internship opportunities available through the institution. I was also pleased to learn that Portland State has the lowest public college estimated cost of attendance in the State of Oregon.

I have always considered myself familiar with the overwhelming cost of college, but, unfortunately, it was not until I received my financial aid offering in March of 2014 that I realized exactly how hard it would be to afford a higher education.

I received both the Oregon opportunity grant, as well as the Pell grant, which are providing me with $7,730 worth of aid for the fall of 2014, and act as a blessing. However, combined with scholarships and the government loans I have already accepted, I still need to pay Portland State University $9,822 per year.

It was extremely discouraging to learn that my academic rigor was not enough to help me get to school, but I decided that I could support my dream by becoming the first in my family to continue my education. I work 35 hours a week at a local Dairy Queen in Eugene in order to save funds for college. But a frugal summer spent serving ice cream can hardly put a dent in what I owe to

PSU. In order to attend college, I am relying greatly on many private student loans, as well as the Federal subsidized and unsubsidized loans I have already accepted.

Unfortunately, I am not receiving any sort of family contribution towards my college education. For many years, my mother and I have struggled without any kind of support from my absent father and have not had the means to save for the future. Due to my circumstances, my family has absolutely nothing put aside for me to pursue a higher education. Therefore, it is my responsibility to settle financial matters on my own.

Because of my choice to enroll in rigorous classes and to be active in extracurricular activities, I have not had the time to be employed for very long in order to save substantial funds for myself. It is absolutely appalling to me that students experience so many disheartening financial setbacks just for trying to further their post-high school education.

We are immersed in a culture that supports freedom to challenge ourselves, to search for new knowledge, and to gain meaningful careers, but we are constantly refused the opportunity to do so through the lack of options we have when it comes to paying for education. The idea of a college education has become possible only for the privileged, and that needs to change now.

Senators, I humbly ask that you consider the power you hold over decisions that could potentially aid aspiring students in pursuing their dreams and life opportunities. It is truly troubling that students with different socioeconomic backgrounds such as myself can work their hardest to educate themselves and yet still come up short, despite all of their efforts.

With the amount of total student debt in the United States reaching $1.2 trillion, it is more than apparent that students need more outlets for assistance regarding college funding, including extension and loan forgiveness programs, affordable interest rates, expanded Federal student aid, plus knowledge of tax benefits available for attending college.

Personally, my mother and I were unaware of the potential aid offered through tax benefits regarding post-high school education, and I know if these benefits were made more apparent to the many low-income families in the United States, college could be a more realistic, obtainable goal. I also believe if every family were given the gentle encouragement to open a college savings fund, it could make long-term college savings more convenient for families who struggle to stay afloat.

Thank you, Chairman Wyden and members of the committee, for allowing me the opportunity to share my story today.

The CHAIRMAN. Ms. Lee, thank you for a really inspiring statement, and for doing this. I so enjoyed visiting with you yesterday when you told me what it was like making your first plane flight of your life and seeing the Monument and the Capitol.

[The prepared statement of Ms. Lee appears in the appendix.]

The CHAIRMAN. I want you to know that we are going to do more than provide a little gentle encouragement here on this whole effort. We are going to see if we can put in place a very different set of policies so that young people like yourself who have done everything right—and have done everything right for essentially years

and years and years—would not be looking at this Himalayas of debt, trying to figure out how to get around it and have it shape your life because you have to carry around this virtual boulder on your back.

So, it has been inspiring to have you, and we will have some questions in a moment.

Mr. Mazur, welcome.

STATEMENT OF HON. MARK J. MAZUR, ASSISTANT SECRETARY FOR TAX POLICY, DEPARTMENT OF THE TREASURY, WASHINGTON, DC

Mr. MAZUR. Senator Wyden, Ranking Member Hatch, members of the committee, thanks for having me here today to talk about the role of the tax system in helping students and their families finance higher education.

The Federal Government provides a substantial amount of resources to support post-secondary education, and this support helps individuals acquire the knowledge and skills required to obtain good jobs and achieve a secure economic future.

Higher education has clear financial benefits for individuals. On average, college graduates earn hundreds of thousands of dollars of lifetime income more than high school graduates do, and there are spillover benefits of a highly skilled and educated workforce that enhance the productivity and wages of other workers.

Today what I would like to do is provide some background on tax incentives that support higher education. I want to summarize the existing tax programs that help students and families defray the cost of attending college. Then I want to talk briefly about some proposals from the administration to improve policy in this area. Finally, I want to discuss briefly some of the challenges that the issue of financing post-secondary education poses.

There is an overview of tax benefits that I think each of the Senators has on their table in front of them. It is a list of tables attached to the written testimony. I am going to go through it very, very briefly.

The first tax benefit I want to talk about is the American Opportunity Tax Credit, the largest single tax benefit that is provided through the Federal tax code—a $2,500 maximum per year, partially refundable tax credit. It is available for up to 4 years, so $10,000 in total, and it covers about 80 percent of the cost of attendance at a public 2-year college or about 30 percent of the in-State cost at a 4-year State school.

There is also a Lifetime Learning credit that is up to a $2,000 nonrefundable tax credit, computed as 20 percent times the tuition payments up to $10,000. Taxpayers can only claim one of these credits per year.

There is a tuition deduction that expired at the end of 2013. It is one of the expiring provisions that I know your committee has been looking at. It allowed an above-the-line deduction for up to $4,000 of tuition.

All of these programs have income limits.

There is a dependent exemption and eligibility for a qualifying child for the Earned Income Tax Credit for full-time students up

to age 23, where the typical age for non-full-time students is 18, so, another benefit for attending post-secondary education.

Taxpayers can exclude the value of scholarships, grants, including Pell grants, from taxable income. Taxpayers can also exclude up to $5,250 of employer-provided tuition benefits.

There are section 529 plans to help encourage savings. Here, taxpayers get to exclude earnings on amounts in these accounts if used for post-secondary education expenses. They can cover graduate or undergraduate expenses. States put income limits on them, but, since taxpayers can have multiple accounts in multiple States, there are effectively no Federal limits on how much can be accumulated in a section 529 account.

Coverdell education accounts exist. They allow taxpayers to contribute $2,000 per year for education expenses. The earnings on these accounts are tax-free if used for education expenses, either post-secondary or K-through-12 education.

There is a student loan interest deduction of up to $2,500 a year, subject to income limits, and an exclusion for discharge of indebtedness on certain types of student loans.

Then, in the area of what the tax code provides for educational institutions, there are itemized deductions for charitable contributions to educational institutions; tax-exempt investment income for charitable educational institutions and their endowments; and tax-preferred financing for educational institutions, either the use of tax-exempt bonds or certain types of tax credit bonds. And there are a couple other miscellaneous provisions that are in the tables that you have in front of you.

The administration proposes a few policies to improve education finance. One is to permanently extend the American Opportunity Tax Credit. Right now it is set to expire after 2017. It is more generous than the Hope scholarship that it replaced. It is partially refundable. It is available for 4 years. Really it is a tax benefit that would help millions of families afford college.

The second proposal in the administration's budget is to exclude Pell grants from taxable income, regardless of how these are used; for instance, if they are used for living expenses. Pending enactment of this proposal, Treasury recently put out a fact sheet to help tax preparers, software providers, and taxpayers navigate through the complexity of figuring out how to maximize tax benefits when you are a recipient of a Pell grant and you want to claim theAmerican Opportunity Tax Credit. We expect the results of this fact sheet to begin to show up next filing season.

Then we also, in the budget, propose to improve the reporting of education expenses under the form 1098–T, which education institutions use to report to taxpayers and to the IRS what types of expenditures have been made for tuition and other fees. We propose to make this reporting for tuition paid, not tuition billed or tuition paid, and also to require reporting of scholarships and grants of more than $500. This would allow taxpayers to essentially take the information from the 1098–T and use that information directly to claim their American Opportunity Tax Credit or other tax credits.

These would all help improve compliance.

I see my time is up. I will finish here and await some questions.

The CHAIRMAN. We will have some questions momentarily. Thank you very much, Mr. Mazur.

[The prepared statement of Mr. Mazur appears in the appendix.]

The CHAIRMAN. Ms. Fonash?

STATEMENT OF JAYNE CAFLIN FONASH, DIRECTOR OF SCHOOL COUNSELING, LOUDOUN ACADEMY OF SCIENCE, STERLING, VA

Ms. FONASH. Chairman Wyden, Ranking Member Hatch, members of the committee, thank you for inviting me to testify at this hearing this morning.

I currently serve as the Director of School Counseling at the Loudoun Academy of Science, a public magnet school in Loudoun County, VA. I am also a member of the National Association for College Admission Counseling and the Potomac and Chesapeake Association for College Admission Counseling, which represent more than 13,000 college admission professionals from around the world who work with students and families to navigate the pathway to higher education. My service and leadership roles in these organizations have afforded me the opportunity to collaborate with these professionals and to advocate for students and their families in the transition to higher education.

My objective today is to share my perspective as a school counselor on constraints that, in all likelihood, limit the effectiveness of Federal initiatives such as tax credits for higher education in broadening access to and reducing the price of college.

For many students and families, obtaining the information needed to navigate this complex and potentially confusing process begins with the school counselor. Consider, however, that the average student-to-counselor ratio for public schools in the United States is 471-to-1 and that access to school counselors is often most limited for students who are most likely to be underrepresented in higher education.

Parents and students have become far more cautious with their education dollars. Each year I see students in Virginia choosing to matriculate in-State, some taking advantage of the articulation agreements to begin their college studies at community college. When families are faced with the opportunity to finance their student's education debt-free in-State, they are increasingly opting for the financially cautious path.

Despite these constraints, school counselors can be catalysts for disseminating information about resources that can help students and families. Three recurring challenges limit the school counselor's ability to provide students and their families with information about potentially useful Federal resources for higher education.

First, there is limited awareness of Federal resources for higher education in general. Federal resources for higher education need much more dissemination effort than is presently offered. Easy access to up-to-date information would make the limited time that we have with students more productive.

Students and parents who can rely on a trusted relationship with the school counselor are more likely to consult with that counselor when questions arise about information available in the massive

market for higher education and financial aid advice. A larger government presence in that space could capture the attention of students, families, and professionals and would provide an additional trusted source.

Second, there is little awareness among students and families about tax credits. Many families may be unaware of the tax benefits available to them to help mitigate the cost of post-secondary education. I myself have never engaged in a conversation with a student about the potential impact of future tax credits on the affordability of attendance——

The CHAIRMAN. Can I make sure everybody heard that?

Ms. FONASH. Yes. Do you want me to repeat it?

The CHAIRMAN. You have never talked to a student about any of these tax benefits, the sum of which is greater than a whole host of Federal agencies?

Ms. FONASH. Yes, sir.

The CHAIRMAN. They have never asked.

Ms. FONASH. In addition, parents have never asked.

The CHAIRMAN. Thank you.

Ms. FONASH. I am not alone in that regard as I speak to my colleagues around the country. College financial aid night presentations do not include information on tax benefits. Rather, the presenters shy away from giving any information that could be construed as tax advice.

A concise 1-page document to share with parents and families on the availability of tax benefits and resources to consult for additional information would open the door for counselors to have conversations in that area with families that are often reticent to discuss their personal financial situation.

Third, there is a disconnect between direct student aid and tax benefits. Unlike direct student aid, tax credits are not necessarily well-placed in the sequence of paying for college. Student financial aid award letters include information on direct student aid. However, tax benefits are not part of this process and, as such, may not factor into student decisions.

Families need to be better-informed of the rules that govern tax credits. Under the current system, tax benefits add steps to getting aid, which is counter to the current congressional efforts to simplify the financial aid process. That does not mean that tax benefits are not worthwhile and very helpful for families making that investment, but as it is, it may not make the difference at the time of making a decision to enroll.

Based on what I have observed in my work with students and families, there are three recommendations that I would submit to committee members for their consideration.

First, disseminate educational resources more broadly. Given the current low level of awareness of Federal tax benefits for higher education and the constraints on school counselors, providing resources for professionals, students, and families is essential if these programs are to succeed. Students and families have to navigate a thicket of information, and they may be misled by unscrupulous players in the market. Ensuring that they receive trusted information from the Federal Government, whether directly or by way of a school counselor, is critical.

Number two, utilize regular school communications to convey eligibility. Schools and colleges communicate regularly with their students and families about federally supported programs, such as the annual application for free and reduced lunch at the K–12 level and financial aid award letters at post-secondary level. Incorporating information about Federal tax benefits for higher education into these communications would, at a minimum, ensure that students and families receive this information annually. It may have the added effects of raising awareness of these important benefits and potentially increasing participation over the long term.

Third, address the indirect effect of tax benefits. Since tax benefits accrue on a different schedule than college enrollment and may not affect the amount of money a student must pay to enroll, how much they may have to borrow, and what their loan repayment amount may be, consider ways to ensure that tax benefits for higher education can be brought to bear when the money is most needed.

Thank you again for inviting me to testify before you today, and I will be glad to respond to your questions later.

The CHAIRMAN. Thank you. And I know we will have a number of them.

[The prepared statement of Ms. Fonash appears in the appendix.]

The CHAIRMAN. Mr. Zerbe, welcome, graduate of the Finance Committee.

STATEMENT OF DEAN ZERBE, NATIONAL MANAGING DIRECTOR, ALLIANTGROUP, WASHINGTON, DC

Mr. ZERBE. Thank you very much, Mr. Chairman. It is wonderful to be back. I greatly appreciate it, and I thank you very much for having me at this important hearing on this important topic.

I think your hearing asks exactly the right question. What can we do right from the beginning to keep debt down, to keep tuition down for students? And I think the reality is, there is a great deal that the committee can do in that regard.

What I want the committee to do is focus on two areas: one, looking at the billions of dollars that the committee provides directly through the tax code to colleges and universities and at standards in that area; and second, looking at that bundle of dollars that you provide to see if we can do better. Can we take that money, that is basically $10 billion a year, and target that money better?

So let us first talk about standards for the moneys we provide directly to universities. Assistant Secretary Mazur pointed out, well, there are basically four pots. There are tax-exempt bonds, there are tax re-endowments, there is generous treatment of business activities, and then there are charitable donations. Basically, roughly estimated, it is about $10 billion a year.

Currently, we do not require anything regarding controlling tuition, debt, and loans from universities in return for that $10 billion. So we have no requirements right now. We do, for instance, as an alternative, looking at nonprofit hospitals, have standards there. The committee, in the Affordable Care Act, on a bipartisan basis, put in standards for nonprofit hospitals. Those standards provided good benefits to low-income individuals.

So then you would say, all right, standards, but what could those standards be? Standards you could look at—I would suggest three. One is, you could have a standard that says we are not going to see tuition growing more than the rate of inflation, both real and net. The second standard I suggest you might want to look at is a 6-year graduation rate. You want to make certain that students graduate. We are having a real problem with people dropping out. Therefore, they are left with the problem of having huge debt, but not the benefit of the college education. The third standard I think you want to look at is debt, exactly that. Are they paying off their debt? The reason for that is, it is a good indicator of whether the university is providing value in terms of the education they are giving, preparing young people for the workforce, and helping them come into the workforce.

So I think if you looked at those three standards—you can look at others, obviously, as well—this will start to focus and prioritize for the committee the tax dollars it is giving, the $10 billion a year, to universities, getting their priorities where the committee wants them to be. That is one piece.

The second piece is, look at that $10 billion, and that $10 billion—I would tell you the committee knows very little about those expenditures. Mr. Mazur laid out the main ones, but there are a number of other smaller ones. I think the committee would want to ask Treasury and Joint Tax to give them a detailed understanding of where those dollars go, how much those expenditures are, and what those policies are on those dollars.

But then here is the second key point. In a sense, you want a distribution table. Tell me where those dollars are going. What institutions are getting that $10 billion? Are those the institutions that are helping Amber Lee? Are they helping folks in terms of going forward? Are they helping them in terms of their costs? But you get the idea. Where are these dollars going? Are they going to the right folks? Are they doing what we want as a committee in terms of policies?

I think it will be informative for the committee to understand the dollars and then where the dollars are going, and I think it may cause the committee to revisit their priorities in terms of where they want to be sending dollars so they meet the goals that the committee wants.

Let me touch briefly on two last things. Endowments—there are over $400 billion in endowments right now out there. We have no requirements on payout for endowments. We have a 5-percent required payout for private foundations. We have zero for endowments. Endowments have seen a 7.1-percent growth over the last 10 years. That includes the downturn. Most recently, they had an 11.7-percent growth.

The committee engaged in a very bipartisan review of endowments under Chairman Baucus and Senator Grassley. What we found is that the payouts are usually very much below 5 percent, and it is clear that, Mr. Chairman, you could turn the world upside down if you required a 5-percent payout. The amount of money going out to folks to help students paying for tuition would be enormous. So I encourage you to look at the endowment policy as a possibility of helping students going forward.

The last part is the for-profits. I have talked about the nonprofits and standards. You should have standards for the for-profits as well. I think the same standards should apply. You may want to tie them to the AOTC and to the Lifetime Learning Credit, but the same idea. You have to control tuition. You have to graduate people. We are not going to let you just put people through a churning mill and not graduate them. And you have to see where they are in terms of their jobs and where they are going.

I would consider for both institutions, both private and nonprofit, that you look at them having skin in the game. If their students are not making their debt, have these institutions also have a percentage ownership of that debt they are not paying. Making them feel an ownership for what is going on in terms of their students and their debt would be something the committee could consider.

I think if you step back, set in standards, refocus and reprioritize the $10 billion a year that the committee is moving toward colleges and universities, you could do a world of good. You could have change that will help students, you will have change that will help families, and you will have change that will protect the taxpayers, and that is a key thing, Mr. Chairman.

We have talked about this. Everything I propose will not cost one more dime from the taxpayer, will not cost one more dime for you to accomplish, and it will get you to where you want to be, which is to start talking about keeping tuition low right at the get-go.

Thank you very much, Mr. Chairman.

The CHAIRMAN. Mr. Zerbe, thank you. There is no question it is possible to wring more value out of these existing expenditures, particularly when people like Ms. Fonash and, as we will hear in questions from Ms. Lee, basically, nobody ever even talked about it. There was no discussion about it, and that is what we have to change.

[The prepared statement of Mr. Zerbe appears in the appendix.]

The CHAIRMAN. Mr. Hodge, welcome. Again, our thanks. You all have been very helpful in working with us on tax reform.

STATEMENT OF SCOTT A. HODGE, PRESIDENT, TAX FOUNDATION, WASHINGTON, DC

Mr. HODGE. Thank you, Chairman Wyden and Ranking Member Hatch, members of the committee.

I think it is fair to say that college affordability is really one of the hottest topics in the news these days for families, and, over the past 15 years or so, we have increasingly turned to the tax code to try to help students with affordability of higher education.

Since the first education credit was enacted in 1997, the number of taxpayers taking advantage of these credits has grown by nearly 400 percent, while the cost, after adjusting for inflation, has also increased by about 400 percent during the same period of time.

Now, ironically, as these tax credit programs have grown over the years, so too has the student loan debt load. So now, as lawmakers are looking for ways to relieve that debt, including various programs to relieve the debt or have debt forgiveness, the question is, should we be using the tax code at all to access the cost of higher education, make college more affordable, or address this rising student loan debt? And I think the answer should be "no."

If you want less student loan debt, you have to address the factors that are leading to higher college costs, and I think the fact is that there is strong evidence that education tax credits may actually be one of those causes of higher tuition costs and have simply become a windfall for colleges and not students.

Now, why is that? Well, it is because the market for higher education is unlike any in the private sector. Colleges are what economists call pure price discriminators, because they can maximize the price that each student will pay.

Here is how it works. Because of the Federal student aid form—officially the Free Application for Federal Student Aid or FAFSA—the college has intimate knowledge of each student's or family's income and assets and, therefore, knows to what extent a family can afford college and if they are eligible for tax credits, loans, or other financial aid, and this information allows the college to simply adjust their financial aid package in order to capture the maximum value of that tax credit. So, not only can universities choose which buyer or student they prefer to admit, they can also select a different price or funding mix for each of those particular buyers.

Imagine if, before buying a toaster on Amazon, you had to fill out a FAFSA, and Amazon was allowed to charge you a different price based on your family's income, your assets, or your credit score. Something tells me that the Federal Trade Commission would not look too kindly on that.

Now, let us look at the economics. As we think about tax reform, which generally means broadening the tax base while lowering tax rates, it is reasonable to consider the economic effects of trading the elimination of these tax credits for lower tax rates for all Americans. And with that spirit in mind, Tax Foundation economists used our dynamic macroeconomic tax model to measure the long-term effects of eliminating education credits and exchanging them for lower marginal rates across the board. And our model suggests that such a tradeoff would be quite substantial. It would allow for an across-the-board rate cut of nearly 1 percent for everyone. It would boost GDP by about $19 billion a year. It would boost Federal revenues by about $4.5 billion a year on a dynamic basis, and it would increase employment by the equivalent of roughly 121,000 full-time jobs.

So, in addition to reducing the complexity and simplifying the code, such a tradeoff would actually be good for GDP, jobs, and the Federal Treasury. That is a pretty good tradeoff.

So now, how do we help affordability? Well, I think, in the spirit of tax reform, we need to look at simplifying all the various savings mechanisms that are available to taxpayers and families. Through the years, we have created all these buckets that taxpayers have to put their savings in, and that, in some ways, loses then the benefit of compound interest and forces them to follow Federal rules rather than their own dictates. We should simplify all of those savings mechanisms to make savings so much easier for families.

But that does not solve the cost question. The mechanisms that can really effectively control costs are the various prepaid 529 plans that are already in place that allow parents, grandparents, or students to lock in those college costs through these prepayment arrangements. And not only do those plans provide families with

certainty, but they require colleges to think 18 years ahead about what those costs ought to be in order to live up to those agreements. And that is the kind of market mechanism that could work very effectively if we require more and more universities and colleges to take part in these prepayment plans.

I think we could also have other options, such as a futures market in which people could go out and buy units of college, whether it is a semester, a quarter, or an entire year, and then be able to trade that on the open market, depending on where their children would like to go.

Well, let me wrap up by saying that it is very clear that, instead of being a helping hand for students, tax credits have turned into a windfall for universities, and, as long as these tax credits continue, colleges will reap the benefits and student loan debt will continue to climb.

It is time we consider other solutions that do not require us to use the IRS as a spending agency, especially as we prepare for a comprehensive overhaul of the Federal tax code.

Thank you very much, Mr. Chairman. I appreciate the opportunity and look forward to any questions.

The CHAIRMAN. Thank you, Mr. Hodge. Thanks to all of you.

[The prepared statement of Mr. Hodge appears in the appendix.]

The CHAIRMAN. Ms. Lee, let me, if I might, start with you, because what I have been struck by is, you are obviously a very intelligent, very enterprising young woman, and, as I listened to your account, it was clear that so much of the fundamental information that you would benefit from in terms of making informed choices, just nobody told you about, and nobody even really told you what to look for.

So I want to ask a couple of questions about that. My understanding is that you went to the library—you did not want to rely just on the Internet—but nobody, not a guidance counselor or anybody else, told you that there would be this big gap between the grants and loans and what you really needed to know to deal with the facts you would be talking about—$10,000 a year in terms of private loans.

Nobody ever told you anything about that as you kind of journeyed as an enterprising person into this area. Nobody told you about that.

Ms. LEE. Well, I relied mostly on my school's guidance counselor, and I was expecting to take out some loans in order to attend school, but I really had no idea the extent of loans I would have to take out. And I was not aware of the tax benefits that were available, and I just feel like my guidance counselor or maybe the career center could have done maybe a better job informing all of the students of their options for paying for college.

The CHAIRMAN. So, as you went through this odyssey of trying to figure out how you were going to put together the resources, nobody told you about something like the American Opportunity Tax Credit or any others, because this was something that was really designed for people like yourself, and nobody ever told you about that?

Ms. LEE. No. No, they did not.

The CHAIRMAN. And you and your mom obviously sat down and tried to figure out how to proceed. What, out of those conversations, did you do? You went to the library. You went to the Internet. But I assume that it really was not clear what to even look for, based on the fact that you were not hearing about some of these resources from guidance counselors and others.

So, when you went to the library and you went to the Internet, you did not find out about things like the American Opportunity Tax Credit?

Ms. LEE. For me and my mom, the whole idea of college, and applying for and attending college, is very new to us, because I am the first to go to college in my family or at least strive to go to college, and we tried to do some research.

It was mostly—we focused on applying for scholarships—and we were kind of left in the dark. We did not know what kind of financial aid I would be getting back or what grants were available. And so we mostly focused on scholarships and relying on what kind of aid we would get back.

The CHAIRMAN. You focused on scholarships, but nobody really told you about the difference between the loans and the grants and what you would be ending up with in the end, and that is why you are staring at the prospect of something like $40,000 worth of debt as you go to college.

Let me ask you about kind of the alternative. Now, you and your mom obviously were walking an economic tightrope every single month, balancing food costs, medical costs, rent and energy, and the like. So I am sure you have listened to me talk about this, and I enjoyed talking with you yesterday.

If somebody had created a saving account in your name when you were a young child, it seems to me you would not be able to put huge sums into it, because your family was just really challenged every month to pay the bills, but do you think you would have been able, with your mom, to put even a little bit into it each month, and particularly if it was matched along the lines of what I have been talking about today, so it might grow over time? Is that something that might have been feasible for you and your mom?

Ms. LEE. Absolutely. Through my whole life, we kind of saved pennies or whatever change or any extra money that we had towards my higher education, but I definitely think if there was an outlet for families to save over a long time period, it could be really beneficial.

Personally, I know my mother and I were not able to have a bank account on our own just because she did not have the best credit. And so it was really difficult for us to even get an account. But after a trial period, we eventually got one. But it is just barriers like that that people do not really think of, and it really limits students.

The CHAIRMAN. I just want to follow up on that, because that is particularly important. Here you are, you are trying to do everything right and plan and save, and your mom, particularly, given the abusive situation that you were faced with when you were 7, there you are, you are starting over, and it was hard for your mom to open up a checking account. And yet you have told us that, if

there was something like a savings account where she was able to put in even a little bit and we had a match from the Federal Government, in effect, it was automatic when you were able to set aside a little bit of money, you and your mom would have tried to do that.

Ms. LEE. Of course. I mean, anything to help pay for this would be really beneficial, and even if it was like $5 a month, I am sure that was something me and my mom would strive to do.

The CHAIRMAN. Great. And let me just tell you, you are an inspiration to me, Amber, and I am so glad, so glad that you made that trek across the country. And I know my colleagues are going to have some questions too.

We will start with, at this point, Senator Grassley, and then Senator Stabenow, and then Senator Isakson.

Senator Grassley?

Senator GRASSLEY. Let me apologize to the panel, because I did not hear your testimony. I have had a chance to read it, but I was down the hall at the Judiciary Committee meeting.

I am going to start with Mr. Zerbe. Your testimony hits on the topic of large college endowments. I have long been concerned that colleges and universities are not doing enough with their endowments to assist students with financial needs.

I believe your testimony embraced sort of a mandatory 5-percent payout rate, similar to what is currently required of private foundations. I happen to be somewhat sympathetic to that idea, but I also have some concerns that it might become a ceiling.

The tax reform draft put out by Chairman Camp takes a different approach that would essentially impose a 1-percent excise tax on certain university endowments. So I have this question for you. In your view, why is an explicit payout rate preferable to taxing endowments?

Mr. ZERBE. Thank you, Senator, very much for that question. I think the way I look at it is, first of all, I have no fear of a ceiling. As we saw with supporting organizations and we see with endowments, where we do not have a requirement of a payout, they are consistently below 5 percent. It would be a happy problem if that was going to create a ceiling.

The problem is, they are way underpaying at 3 percent, 3.5 percent, 4.5 percent is typical, what we are seeing in endowments. So that is not going to be a problem.

I think the right way to maybe think about it—you are right, Chairman Camp has the tax proposal—is to perhaps impose that tax, maybe dedicating the funds to something that Chairman Wyden was just talking about in terms of a scholarship and savings accounts, but using that tax basically to force some giddy-up from them, saying, look, if you do not pay out, we are going to impose the tax. I think that would be a way to do it. But that way, they can escape that tax if, in fact, they are paying at 5 percent or more, say, a higher figure, something like 6 percent as well.

So I think all that would bring billions into the system to help students meet college costs and be a real game changer, Senator.

Senator GRASSLEY. Also, Mr. Zerbe, I think transparency brings accountability. In 2008, at the urging of this Senator and Senator Baucus, who was then chairman of the committee, the IRS re-

formed its form 990 to require greater disclosure of tax-exempt entities, including adding a new section 8 for nonprofit hospitals.

Do you think nonprofit colleges should similarly be required to show that they are going the extra mile to control costs and provide financial support to students as part of their annual 990 disclosures?

Mr. ZERBE. Yes. Senator Grassley, I think the work that you and Chairman Baucus had done on that and getting the schedule H for hospitals has done an extraordinary amount of good, getting better transparency, greater openness in hospitals. It has been terrifically helpful.

I think the same would be true with schools and universities. The IRS just completed a detailed report on Unrelated Business Income Tax issues and other business-related issues. I think now is the time for a review to see whether it makes sense to have a schedule.

I think there is a lot of information out there regarding colleges that would be useful for transparency, bringing better understanding of the workings of the colleges, and would help shed light on this and get to the goals of trying to understand better where taxpayer dollars are and getting tuition down. Yes, sir.

Senator GRASSLEY. My last question would be to Secretary Mazur.

Requesting specific information such as endowment practices and payout rates of colleges and universities on form 990 is something that Treasury and the IRS could do immediately to increase accountability. Is this something that you could support, your agency could support, or the administration could support? Would you be willing to consider it, and why or why not?

Mr. MAZUR. Well, Senator Grassley, it is certainly something that we would be happy to look into to see what could or should be done in this area. I think that you have a situation here where you have some benefits—and you have outlined potential benefits of getting this information. Obviously, there would be some cost involved in collecting and processing that information.

Really what you want to do is compare the costs and benefits and see which are larger.

Senator GRASSLEY. Is it something that the administration would be willing to consider?

Mr. MAZUR. At least take a look at it, yes.

Senator GRASSLEY. Well, I appreciate that, and I think maybe I will write to you and ask you to give me an update on how you are coming on that.

Thank you, Mr. Chairman. I yield back my time.

The CHAIRMAN. Thank you, Senator Grassley.

Senator Brown?

Senator BROWN. Thank you, Mr. Chairman. And thank you very much for doing this hearing.

Ms. Lee, thank you for coming, using us for your first plane flight. Thank you for that. And I appreciate the testimony of all of you.

The goals of tax incentives for higher education, I believe, should be twofold. First, they should be used to mitigate or lessen the need to borrow and thus defer some of the impact of increases in

higher education costs. Second, they should be used as another tool to get more low-income families to attend college.

My wife, who graduated from Kent State, an important State university in my State, was the first in her family to go to college. Her dad carried a union card for 35 years, and that is how she was able to go. But she faced huge challenges—the difficulty of being first-generation and the difficulty of kind of navigating her way—not just the financial challenges. But she graduated 35 years ago with about $1,200 in student debt, and that is the disservice this generation has done to yours, Ms. Lee, in giving people that opportunity.

But let me ask a couple of questions of Dr. Mazur, if I could, and talk about the size of the incentives we have in place. Student loan interest is deductible for the first $2,500 a year, starts to phase out at $60,000, and is phased out completely at $75,000, is my understanding.

Compare that to the mortgage interest deduction, where there is no limit on the amount of interest that can be deducted on the first $1.1 million in mortgage debt. Whether that is too large—and we give tax breaks that way to, obviously, pretty high-income people—that is a whole other debate.

But, obviously, that speaks to this, whether we should expand the deductibility of interest.

The first question: is the size of the AOTC sufficient, in your mind?

Mr. MAZUR. The American Opportunity Tax Credit, as you know, $2,500 a year, is available for 4 years and provides up to $10,000 over a 4-year cycle for a student in college.

For people who are going to a public university, it covers about 30 percent of the costs of a typical 4-year public university. So by itself, it does not cover the entire thing, but it does provide a pretty substantial down payment.

Obviously, you could do more. That is something for Congress to consider. I think really what the administration is looking at first is making it permanent rather than scaling up the size of it, because it is scheduled to expire in 2017.

I think the first thing would be to make it permanent so that people can rely on it when making a multiyear investment in college.

Senator BROWN. Thank you for that. The other goal for higher education should be to get young people to attend college who would not attend otherwise.

One way to do that is to think about the AOTC almost as a tax credit or an advance. Talk to us, if you would, outlining the challenges—and I hate to make up words like this and use words that are not really words, like advanceability, but give me your thoughts on how that would work, what the challenges are, and how feasible that is, in your mind.

Mr. MAZUR. Sure. Treasury came out with a report that focused primarily on the interaction of the American Opportunity Tax Credit and Pell grants in May—so last month—but part of that report talked a little bit about some of the challenges involved in looking at advance payments of something like the American Opportunity Tax Credit.

One of the difficulties you have here is, essentially you have a spending program that you are trying to run to provide benefits to students going to college, running it through the tax system. The tax system is set up to run on a calendar-year basis, and, when you are taking things off-cycle, trying to make them pay earlier in the tax year, that is a difficult administrative challenge for the IRS to go through.

The second point to keep in mind is that, while it is off-cycle, the advanceability issue is mostly a first-year issue, because, in the second year, you are catching up with the credit you got for the first year. So to the extent you think of it as a financing issue, it is really a matter of getting kind of a bridge loan from, say, August or September when you are paying tuition until, say, March or April when you are getting the benefits of the tax credit.

So it is a challenging issue to think through. It is just hard to figure out a structure where the tax code can help with that advanceability.

Senator BROWN. Thank you. Thank you to all the witnesses. I yield.

Senator STABENOW [presiding]. Thank you very much. Our chairman has passed the baton to me. He has gone to vote and will be coming back momentarily, and we will continue with the questioning.

So, welcome to all of you. And thank you, Ms. Lee, particularly. You are doing what we all say we want folks to do. It is just, work hard and follow the rules and just do the best you can to get ahead. Obviously, given the challenges you have gone through, you deserve a tremendous amount of credit for sticking with it, and it is our job to make sure you get a fair shot to make it.

I would just, first, say that, while it is not in the jurisdiction of this committee, the fastest way we could help right now is to lower the student loan interest rate for you so you at least have the benefit, like anybody refinancing a house, to be able to get the lowest interest rate out there. And that is what we are trying to do, and we are going to keep working hard to get through the filibuster that has been happening to actually get to vote on this so we can pass this.

I think it is also important to note that probably the best investment we all can make, whether it is the Federal Government, State government, business, families, individuals, is education. In fact, the Bureau of Labor Statistics has said that the average entry-level worker with a bachelor's degree will earn twice as much as somebody with a high school education. So there are a lot of reasons for us to be talking about this.

Mr. Hodge, I did want to ask you a question, but first, one of the things that has not been mentioned in all of this discussion about how we have seen costs go up—and there are a number of reasons for that—is that the majority of funding, and certainly I can speak from a Michigan standpoint, is State funding for higher education. The Federal Government funds research, we fund student aid, but the basic funding of community colleges and universities in Michigan and across the country really comes from the State government.

Over the last 40 years in Michigan, we have seen a decline from 70 percent of general funds for the public universities coming from the State down to 16 percent, which is a huge, huge cut, in fact, a nearly 30-percent reduction in State aid just in the last few years. So then we see what happens, and they are looking around for funding, even though we are seeing our universities trying to figure out how to cut costs and so on.

The other thing that is different is that the average tuition at a private university is about twice as much, $30,900 a year, versus public, $15,600. So there are big differences there as well, as we look at how we move forward on this.

But I am wondering, Mr. Hodge, as you are talking about doing away with the tax credits, as I understand it—a couple of things. How do you feel about Pell grants and other kinds of support for low-income students? And secondly, how would you suggest, again, that middle-class families afford sending their children to college without some kind of tax support? Is it just all about savings?

So, number one would be, are you also suggesting no Pell grants or other support, or is this just about the tax code? And then could you talk a little bit more about how you address this, particularly with the sharp decline in State support that we have seen that translates into higher tuition costs?

Mr. HODGE. In terms of Pell grants, I would like to see more focus on them and the use of Pell grants to target needy individuals rather than tax credits, which tend to be spread around and available to everybody. And the economic research tends to show that the tax credits are sort of captured by the universities more so than are Pell grants.

Because Pell grants are targeted and because of the restrictions available, it is more difficult for universities to actually capture those costs and increase tuition as a result. So that is a far better way of addressing this issue, especially for the needy and low-income people, than are broadly available tax credits and interest subsidies.

How would I like to see middle-class families address this issue? One is, yes, savings is a good thing, but there are too many options for savings. I would like to see that consolidated through fundamental tax reform.

But I do believe that we ought to make more opportunities available for people to sort of prepay, get ahead of the game, if you will, and lock in those costs, because that is what forces universities to think years and years ahead on what their costs have to be. And right now it is an open-ended sort of situation where people can never feel like they have saved enough because they cannot keep ahead of the escalating costs.

So, by ratcheting back some of the Federal assistance through the tax code, you could start to control those costs, but you can also use different market mechanisms to force universities and colleges to think about costs ahead of time, and right now they are not.

Senator STABENOW. I agree with you about looking forward in terms of prepayment plans and so on. I was involved, in my State legislative days, in putting together something that Michigan has, and I think that there is more that we can do.

But at the same time, given the financial situation and given the economy at this point, an awful lot of folks are in a very tough situation to say they should just be saving more when they are trying to just hold on and make it every day. But I do agree with you that there is more we can do on the front end.

I am out of time. I would just simply—well, I guess I am the only one here, so I will take as much time as I want. [Laughter.] Hopefully, I am not going to be told here I need to run out and vote as well.

Just let me say quickly, nothing beats people having enough information. The chairman was concerned about the fact that the incentives that are out there—we have loan forgiveness programs we put together, targeting underserved rural communities and urban communities, we have the tax code, and so on.

I am shocked to hear that all of that is not being made available. We have gone through a lot of fights to be able to put in place things that will help middle-class families, low-income families, put a priority on education.

So what more would you suggest that we do to be able to make sure that people know what is available right now?

Ms. FONASH. Specifically, in reference to the tax incentives, it would be helpful if the members of the committee could provide school counselors a 1-page document, a simple document, that would inform them each year about the incentives available and the site to go to to figure out what their eligible aid is or what their eligible tax cut would be based on their family income and the number of people in their family. School counselors could be your best ally in this if you will just put the information in their hands.

When I listened to Ms. Lee speaking, I did a quick search through my papers, and, in Oregon, the student-counselor ratio is over 550 students to 1. So, even for someone like Ms. Lee, who worked hard to look for information to find the best possible resources, she was doing that in a State where a counselor probably has 500 other students whom she was trying to balance the best way possible.

But that one sheet—if you have a trusted relationship with a counselor, you go to the counselor, we can be a great support to the Federal Government in helping to provide that information to families and then guide them towards further action about those opportunities.

Senator STABENOW. Thank you very much. I am actually shocked that that is not already being done, and certainly I am going to work with the chairman on that as well.

Ms. Lee, again, I think our job is to make sure that when you work hard, you have a fair shot to get ahead, and that is the reason for this hearing, and we very much appreciate all of you being here.

Mr. Chairman, I am going to turn it back to you.

The CHAIRMAN. Thank you, Senator Stabenow. I think, because I was sprinting and I am out of breath, maybe I could have a capsulized version of what I think you talked with Senator Stabenow about, Ms. Fonash, because I think it is drop-dead astounding that there is not any discussion with guidance counselors about things that would have helped Amber Lee and her mom.

That is not a Democratic thing or a Republican thing. That is just sensible government 101. To have a program where there is a very large expenditure, a focused part of the Recovery Act, and basically everybody is in the dark about it——

So just unpack for me why you think we are in this predicament. I do not think Senator Stabenow got into this. You said that guidance counselors thought that they were giving tax advice. How can that be a reasonable conclusion when you are just talking about explaining a law?

Ms. FONASH. I believe in my comments I mentioned that, in college financial night presentations, which are usually done by representatives at the university level, they provide a great deal of information about student loans, student grants, student scholarships, but they never discuss tax incentives.

There is a bit of a cloud hanging over that. I think that they believe that they are giving tax advice if they step over into the area of tax incentives.

That being said——

The CHAIRMAN. Just giving people information about a public law or even saying, excuse me, sir or ma'am or student, here is a place where you can get information on it—they actually thought that was giving tax advice?

Ms. FONASH. That has been my experience. I do not want to speak for the 4,000 universities around the country, but that has been my experience in their presentations.

At the high school level, counselors could be some of your best allies in disseminating this information to students and families. The student-counselor ratios in this country range from 250 students to 1 all the way up to 1,000 to 1. So the more information that you could put in the hands of counselors that they can share with students and their families, the more informed they will be.

So, for example, it would be helpful to have a 1-page document listing the opportunities in a given year for tax incentives and sites that families can go to to get more detailed information about that and other resources in the local community that they can follow up on.

As I mentioned, there are some Federal documents that students receive every year—the survey for free and reduced lunch at the K–12 level and then the student aid loans at the Federal level—that include each year information on resources in the area of tax incentives so that families can be educated every step along the way about those possibilities.

I sit in my office every spring with seniors and have very detailed heart-to-heart conversations about incurring student loan debt and what it really would mean to have $80,000 worth of debt when they graduate from college. I have sat in rooms with students making tough decisions about attending a private school versus attending a public school based on cost. But, without information about the tax incentives, I have been at a loss to share that information with students, but I would be more than happy to.

In my district, we have actually started putting together a 1-page information sheet about tax incentives that we are going to include in the financial aid handbook that our students receive every winter when they are applying for aid.

So, simple documents to put the information in front of students, if the members of the committee can help to advance——

The CHAIRMAN. I am going to help advance it right now.

Mr. Mazur, can you work with the guidance counselors to put together this 1-page thing she is talking about?

Mr. MAZUR. Just to give a little background——

The CHAIRMAN. That is like a "yes" or "no"——

Mr. MAZUR [continuing]. We are in conversations with the Department of Education to figure out the best ways to get this information out, and this would be one option.

The CHAIRMAN. Because you guys are the Tax Department.

Mr. MAZUR. We can work with you and the committee to develop that one page or two, if you would like.

Mr. ZERBE. Mr. Chairman, if I can just intervene. I apologize. You might want to look at—the IRS has a fairly active program in terms of education and the EITC and getting out there and educating people about the EITC and what is available out there, and that might be something to look at as a model or as a possibility for you to consider in terms of the education issue, just as a thought.

The CHAIRMAN. Good. Well, I am counting on you, Mr. Mazur, to honcho this, to talk to the people at the Department of Education and all these various and sundry people and get this together, get it to the guidance counselors, and make this happen.

Again, I think if you listen to some of this stuff, you just say, this ought to be a wakeup call. It is one thing to talk about passing big, complicated bills and the like. It is quite another to talk about getting a pamphlet, as Ms. Fonash is talking about.

The only other question I have on this education issue, Ms. Fonash, is, how early do you think this kind of information should get out? For example, you have already heard me talk about how I want to be able to say that, if a parent of modest means, say, 90 days after a child is born, if that parent is able to set aside even a little bit of money—and that is what Ms. Lee and I were talking about—and they are of modest means, I would like to see the Earned Income Tax Credit match it.

So the whole idea here is to get there early. At what age level should this kind of pamphlet start getting home? In other words, kids take a lot of stuff home, parents get a lot of stuff online. Not every parent has a computer. But at what age level should all this information, the 1-page pamphlet, start getting out? Should it be 8th grade?

Tell me a little bit more about that.

Ms. FONASH. Students start bringing home papers in their backpack as early as pre-kindergarten, and, as I mentioned in my testimony and in the previous answers, there is a form that goes home every year that inquires about families' eligibility for free and reduced lunch. It is a federally mandated form.

Send this document home as early as kindergarten so that families are aware of the opportunity to put money aside as early as possible.

The CHAIRMAN. Send Mr. Mazur's 1-pager home as early as possible?

Ms. FONASH. Yes.

The CHAIRMAN. Great.

Ms. FONASH. You know, I am a new grandmother. I have an 8-month-old grandson, and my daughter and son-in-law, about 90 days after his birth, spoke to somebody, found out how to open a 529 account and began to do that. But not every American family knows about those opportunities or that that potential savings benefit is available.

So I am not quite sure how to distribute the form to newborns, but certainly at the pre-K level, we can distribute that in the public and private schools.

The CHAIRMAN. We will get you into this, Mr. Hodge, because we have been sort of at the other end of the table.

How about for each one of you, give us what you think is your best idea that we could get bipartisan support for here on the committee, because I think it is pretty clear that the great challenge of our time on these big issues is bringing people together, getting bipartisan support.

What is your best idea for fresh ways to do what Mr. Zerbe and I are both talking about, which is wringing more value out of the existing dollars? I think I would like to talk about this in the context of families at all income levels. For example, this auto-alert, where, in effect, people are told about automatic withdrawals, and you could tie it to a variety of different criteria.

Parents could get a letter from their employer within 90 days of the birth of the child, notifying them of an option to save for college. So this is free time, folks. Everybody gets to put an idea on the board, but the kind of framework for it is something that is common-sense, that is practical, that could get Democrats and Republicans up here to common ground.

Mr. Hodge?

Mr. HODGE. Mr. Chairman, I do not know if this is a legislative fix, but it is certainly a market mechanism that is already in place, and that is these prepaid 529 plans that are a terrific idea. In fact, there is a consortium of private schools that has come together many years ago, I think it is just called the Private 529 Plan, and there are 270 colleges all within this prepaid 529 plan.

When you buy in, you buy sort of a futures contract, locking in the cost of college many years in advance. You can use that credit in any number of these schools, and they all accept it.

Those are the kind of market mechanisms I think work, because what they do is, they enforce discipline on the universities years in advance. The universities have to think long-term what their future costs are going to be.

The CHAIRMAN. So a number of universities have already started this?

Mr. HODGE. The 270 universities are already a part of this.

The CHAIRMAN. We will follow up. Very good.

Mr. Zerbe?

Mr. ZERBE. Mr. Chairman, I will just repeat myself, but I have a new idea for you too. I would say that standards can move mountains. You put in standards for colleges receiving government assistance and benefits, as we talked about, saying you have to control tuition, both real and net, that you are going to have to look at 6-year outcomes in terms of graduation and you are going to

have to look at people being current on their debt repayments, that is going to move mountains.

Setting those standards is going to be really a game changer in terms of where we are.

I have something new, though. Listening to you and your proposal, Mr. Chairman, in terms of the savings accounts, what if you were to just take the EITC—the EITC is a pretty good dollar figure now, as you know, because it is for folks who have children, by its nature, overwhelmingly—and say, we are going to set aside, say $500 or $1,000 of that automatically, to be dedicated to the account, exactly what you are saying. Yes, you are going to get X amount, but we are going to set aside this amount for a savings account, kind of a forced savings account, if you will, that they could elect out of. But, basically, otherwise, you would have it teed up as an idea.

The CHAIRMAN. That is interesting. I think what I envisioned was something that was on top of the current Earned Income Tax Credit. I think what I have been struck by is, I think we want to create opportunities for all Americans and for people of modest means, and this is what Ms. Lee was talking about with her family. She is talking about, we are going to save pennies, and, if we can, save $5 or $10.

There is a fair amount of evidence, research evidence, that indicates that just starting a child savings account really contributes to young people and families getting ahead. So we will work through the mechanics of this, and what I wanted to do was to make sure that the savings ethic was not one that, in effect, reinforced inequality.

What I have been troubled by—and that is why I gave the statistics—is the big disparity between education credits for people who make under $25,000 and people who make many times that amount getting significantly more.

Mr. ZERBE. You bet. The only thing I would worry about is, if you put so much emphasis on savings, Mr. Chairman, without sending the right messages to the universities to control costs, to increase graduation rates, to deal with that, I am afraid we still will never get there. But I applaud what you are trying to accomplish.

The CHAIRMAN. I understand what you are saying, and, as you heard, Senator Grassley has already taken a strong interest in that.

Ms. Fonash, give us your idea, besides the 1-page pamphlet that you are going to get.

Ms. FONASH. Well, I would be glad to make a suggestion. But quickly, to follow up on the less tangible side effect of the savings at a young age, it also sends the message to a child that going to college is something that is within their grasp, and that is equally important.

In terms of a second idea, I would like to see that high school seniors around the country have more solid education on what they are getting themselves into when they incur the student loan debt.

My understanding is that the education right now is limited, and a lot of it depends on where you happen to be in high school and what access you have to your counselor. But at the age of 18, it is difficult for many students to wrap their head around the idea

of, what does it mean to have an $80,000 loan or a $100,000 loan, and I would like to see more education on the front end about what that responsibility entails and whether that is a prudent choice in light of their income expectations 4 to 5 years down the road.

The CHAIRMAN. You have pretty much described what Senator Warner and Senator Rubio and I are trying to do in the Right to Know Before You Go Act. And I think what is striking about that is, students ought to have that kind of information, and it should not just be debt levels and graduation rates and remedial education, but they ought to have some sense of what they would be likely to earn when they got a degree from a particular school, because that can very much affect their career decisions.

I know when we kicked this off at home, President Ed Ray of Oregon State University said, we are happy to talk about what our track record is on those kinds of matters, because Oregon State feels that it can really showcase its record.

So I want you to know I think that is a very important part of the puzzle. Senator Warner is a very influential member of this committee; Senator Rubio, obviously, is a well-respected colleague on the other side of the aisle. So we are going to really bear down and get that done. It might not be until the Higher Education Act, but we are going to make that happen.

Mr. Mazur, you have a chance to make a good pitch for another idea besides the idea that I like very much that you have talked about between the Pell grant and the American Opportunity Tax Credit.

Do you have another one?

Mr. MAZUR. Sure. You are restricting me to ones that could get bipartisan support?

The CHAIRMAN. Why don't we give them a chance to be doable?

Mr. MAZUR. I would think that one of the best things you could do is enact legislation to improve the form 1098–T reporting and basically have institutions report tuition paid, and then have reporting on grants and scholarships that are made to students.

That would allow students and their families to take that information off the form, just like they do for a W–2, put it on their tax form, claim the tax credits that they are entitled to, allow the IRS to monitor compliance better, and it would actually raise a little bit of revenue in the result.

The CHAIRMAN. Thank you. That is a very good one.

Amber, because we have so many votes back and forth, back and forth, I may not be able to get back. I am going to try. So that is why I think it is very fitting that you finish up, as a young Oregonian who, in my view, has a spectacular set of opportunities ahead of you for your career, in your life—and I read a bit about your sister and what you want to do—as long as you do not get smothered by all these debts.

I read a very interesting piece the other day. Apparently, these student loan debts are now making it very difficult for people to save for their retirement. So you are going to have a talented career as an orthopedic surgeon, but you are also going to want to think about your retirement. That is why it is so important to try to help people have less debt at the start. So you are in my shoes

for the last question. The role is reversed among Oregonians. You are the chair up here. I am the student.

Give me one last thought in terms of what you think we ought to be working on.

Ms. LEE. Well, I think we need something like a saving mechanism that somehow allows students to save for college and, also, keeps colleges and their tuition costs kind of consistent, like Mr. Hodge had brought up.

The tuition costs are just going to rise. No matter how much you save, if the cost is rising, then you are still going to be in debt. And I feel like, if there was less debt, I mean, obviously, that is more money that is going back into the economy rather than being saved to just learn.

The CHAIRMAN. Amber, you are being too logical for Washington, DC, because the point that Amber is making is, you save, you work hard, or you get a scholarship, and then the costs go up, what a surprise, by the amount you saved, and you are still staring at a huge financial problem for a big chunk of your life.

So that is a really good one to close on. What I would like to do—I think my staff had said Senator Carper is planning to return. Do we have a Carper staffer here?

What we will do, in the lingo of Washington, is sort of call a time-out, like a recess, and I am going to see if I can find Senator Carper, and I will try to get back.

But I want it understood that I think this has been a terrific panel. I think it is a pretty tough act to try to compete with Amber Lee, but you all have really given us a very clear kind of challenge.

When you are spending billions and billions of dollars, and the government is not even telling gifted young people like Amber Lee, an Oregonian who is doing everything right, what the possible tools are in this education toolkit, something is way, way out of whack, and we are going to get this fixed.

So we will stand in recess at least until we hear from Senator Carper, and I am going to try to get back as well. But you all have been a terrific panel, and I am very appreciative.

Here we have Senator Carper, with a big apology from me, because I understand he may have been missed.

Senator Carper, I am going to turn this over to you for any questions you want, and, when appropriate, you can adjourn the hearing, and I thank you.

Senator CARPER [presiding]. Thank you, Mr. Chairman.

Without objection, I would like to call up—just kidding. I am getting ahead of myself.

We are happy to see all of you. Thank you so much for joining us today. As you probably know, we are in the midst of four or five recorded votes in a row, and we are just going to kind of bounce back and forth.

I have a couple of sons who finished their college educations, oh, gosh, 2 years ago, 4 years ago, and I can say with some certainty that my wife and I understand that the cost of higher education has risen quite a bit, although this report is in the media this week that suggests maybe not as much as we had thought.

But at a Finance Committee hearing about 2 or 3 years ago, we had a fellow named Alan Blinder before us. He had been the Vice

Chairman of the Federal Reserve for a number of years. He is now back teaching economics at Princeton.

The hearing was on deficit reduction, what to do about the deficit, and he was one of four or five very smart people before us. And I think his focus in his remarks was that the key for deficit reduction for the Federal Government is health care costs. He said if we do not get our arms around them, they will consume us, Medicare and Medicaid costs, and, frankly, put us at a financial and economic disadvantage against other countries of the world who spend a whole lot less of their GDP for health care than we do.

I asked him in the Q&A that followed, I said, "What would be your advice to us to help rein in the health care costs?" I will never forget what he said. He said to us—he thought for a moment when I asked the question of what to do, and he said, "I am not a health economist; I am not an expert in that stuff. Here is my advice. I would find out what works and do more of that."

That is all he said: find out what works and do more of that. I said, "Do you mean find out what does not work and do less of that?" He said, "Yes."

So here is my question. I would say as an old Governor, a recovering Governor, I know that the 50 States are all laboratories of democracy. Somebody somewhere may have figured this out in this country, in terms of finding out what works and how to rein in the growing price of tuition and fees and finding out what works and maybe doing more of that.

One example of what might work is, we have some high schools in Delaware that are partnering with colleges and universities so that maybe the last couple of years that students spend in high school could count toward the first 2 years of college. I think that is an interesting idea.

Delaware State University in Dover, I think, is in the process of creating sort of—I will call it a STEM charter high school, where the last 2 years, if the student does well, the last couple of years at the STEM high school could take the place of 2 years, the first 2 years at Delaware State.

So there are some ideas out there, and there is all this distance learning stuff we know about, but just hit us with your best shot or your best couple of shots in terms of what is out there, where we need to do more, just some examples we could learn from, please.

Do you want to go first, Mr. Hodge?

Mr. HODGE. Well, thank you, Senator Carper. I think that a couple of things perhaps ought to be experimented with, and one is breaking the mold of our current higher education system, which is all about a fixed place with lots of infrastructure that is very expensive and which universities really compete on—they have the biggest stadiums and the biggest dorms and all these fancy things—break that mold and allow a lot more competition from online educational services and those kind of things that dramatically reduce the cost, because all that infrastructure is very expensive.

So, when you look at the actual cost of educating a student, it is a fraction of the total package that a student will pay in any given year, because so much of what they are paying is going to support that infrastructure.

I think the more we can provide opportunities for competition and for students to have the availability of online and other sorts of new services, I think that will begin to ratchet down costs and I think give people the kind of options that a marketplace can really deliver.

Senator CARPER. Thanks.

Mr. Zerbe?

Mr. ZERBE. Senator Carper, I think basically the status quo is not working. We have been pouring more money, pouring in more spending, more tax benefits, and, as you have experienced firsthand, tuition is going up and up. There is always maybe a blip in there, but basically the trend line has been just terrible.

I would suggest that we do not have any standards right now for colleges and universities in terms of what we want them to accomplish, in terms of saying, we want you to control tuition, we want you to control both net and ticket price, we want you to achieve 6-year graduation rates, we want you to make people job-ready so that they are keeping current with their debts and what have you.

We do not do any of that. So naturally it is just, Katie, bar the door in terms of what is happening. I think what you need to do is look at the billions of dollars that we give directly to colleges and universities, over $10 billion a year, and say, here are our priorities, here are our standards. If you want these moneys, if you want the support, you need to be meeting these benchmarks and goals.

That, I think, will start to channel maybe to the good ideas that Scott is putting forward and really get universities to focus on the priorities that you as policymakers want to see happen.

Senator CARPER. Good. Thanks very much.

Ms. Fonash?

Ms. FONASH. So, as a counselor and as an educator, I would like to see students have access to an affordable college education, and one of the areas where we can make a difference immediately is being sure that we support students who want to begin their college education at the community college level or through a program like you mentioned where there is a collaboration between the high school and the college to have some advance credit.

When Ms. Lee testified earlier, she expressed her concern that beginning her education at the community college might not perhaps meet the standards of a potential medical school if she chose to go that route, and that is simply unforgiveable.

We have hundreds of community colleges around the country that provide a solid education for our students, and for that to be a first step is very affordable and well prepares them to move on to a 4-year university and then graduate studies and medical studies later.

Senator CARPER. Thank you.

Mr. Mazur?

Mr. MAZUR. One of the things that would be most helpful would be better information to prospective students and their families about costs, outcomes, employment prospects, the whole range of outcomes, by institution.

The administration is working on a college scorecard along these lines as a way to get that information out, effectively making pro-

spective students and their families better shoppers for post-secondary education.

Senator CARPER. All right.

Ms. Lee? Ms. Lee, how are you enjoying your time here in Washington testifying?

Ms. LEE. I love it. I have not really had much time to really get to know the city. Hopefully, I will be able to see a few monuments and kind of get a feel for Washington, DC.

Senator CARPER. Great. We are glad you are here.

Ms. LEE. Thank you.

Senator CARPER. We are glad you are all here.

Ms. LEE. I just feel like colleges should be accountable for their graduation rates and how much debt they are putting their students in if they do not finish, and I feel like they act as institutions that just get the money, and they need to be accountable for the progress that their students make while they are with them.

Senator CARPER. All right. Thank you.

Unless I hear some objection from the staff back here, we are going to wrap it up here.

Thank you very much. This is a really important issue, and one we need to grapple with. I would like to say that people in our business here as Senators, Governors, Mayors, Presidents, we do not create jobs. We help create a nurturing environment for job creation and job preservation. That is our job, to create the nurturing environment.

And there are all kinds of things—transportation, public safety, access to capital, affordable health care, common-sense tax policy, common-sense regulations. But a big part of it is the skills that our workforce brings to the workplace every day, and we have some big challenges here, and thank you for helping us to address some of that today.

My guess is that some of our colleagues will have some questions that they will want to submit for the record. We would just ask that, when you receive those, if you can respond promptly, we will be most grateful.

With that, this hearing is adjourned. Thank you all.

[Whereupon, at 11:50 a.m., the hearing was concluded.]

APPENDIX

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

American Council on Education
Leadership and Advocacy

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Washington, DC 20036
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Testimony for the Record
Submitted to the
United States Senate Committee on Finance
Hearing on Higher Education and the Tax Code
June 24, 2014

Introduction

On behalf of the higher education associations listed below, which represent approximately 4,300 two- and four-year public and private non-profit colleges and universities, I am submitting this written testimony for the record of the June 24, 2014, Hearing on Higher Education and the Tax Code. We appreciate the opportunity to submit our views to the committee on several tax provisions that are important to college students and their families as well as on the issue of college costs, which was also discussed during the hearing.

Although originally enacted discretely, the current federal tax code contains a number of provisions that taken together create a framework that functions as a kind of "three-legged stool" intended to advance three important goals: 1) to encourage saving for higher education; 2) to help students and families pay for college; and, 3) to assist with the repayment of student loans. We strongly support this "three-legged stool" framework. In addition, we believe tax reform provides an excellent opportunity to make improvements to certain provisions in order to maximize their effectiveness and enhance access to higher education.

Provisions to Encourage Saving for Higher Education:

The tax code currently contains two provisions intended to encourage families to save for higher education: Section 529 Education Savings Plans and Coverdell Education Savings Accounts.

- **Section 529 Education Savings Plans**—Under Section 529, states are authorized to sponsor "Qualified Tuition Programs" that are tax-advantaged savings vehicles for qualified postsecondary education expenses, such as tuition, fees, books, required supplies, equipment and room and board. There are two types of 529 Plans: savings plans, which allow families to save for expenses, and pre-paid tuition programs, which generally allow families to make advance tuition payments to cover future attendance at a designated in-state public college or university system.

- **Coverdell Education Savings Accounts**—Under Section 530, individuals can contribute up to $2,000 annually tax-free to pay for the qualified education expenses of a designated beneficiary. Individuals remain eligible to contribute with income up to $110,000 ($220,000 for joint filing). Qualified education expenses are broadly defined to include tuition, fees, course materials and room and board. The $2,000 annual maximum contribution cap was recently made permanent as part of the American Taxpayer Relief Act of 2012 (ATRA).

In Texas, the non-profit Texas Guaranteed Student Loan Corporation (TG), has developed an extensive library of reports, training materials and web applications to help consumers make educated decisions about higher education – their course of study, which school to attend, and how to manage debt. I wish to highlight some of TG's efforts to assist students and their families. For example, TG's college cost calculator (http://www.aie.org/paying-for-college/cost-of-attendance/major-choices/index.cfm) allows consumers to evaluate the projected income and average debt associated with various majors at all Texas institutions of higher education, including public and private (non-profit and for-profit) schools. TG also offers an interactive financial literacy program (see http://www.tgslc.org/finlit/index.cfm) that is available at no cost to Texas colleges and certain other colleges outside of Texas.

I thank the Chairman for convening this hearing and will also submit additional questions for the record.

Testimony to the Senate Finance Committee

Jayne Caflin Fonash

Director of School Counseling

Loudoun Academy of Science

June 24, 2014

Chairman Wyden, Ranking Member Hatch, members of the Committee,

Thank you for inviting me to testify at today's hearing on tax benefits for higher education: Less Student Debt from the Start: What Role Should the Tax System Play? I currently serve as director of school counseling at the Loudon Academy of Science, a public magnet school in the Loudon County, Virginia, Public Schools. In my eighteen years with the Loudoun school system I have also worked in two comprehensive high schools and witnessed the district's growth from 15,000 students in 1995 to over 70,000 when school opened in the fall of 2013, as well as a growth in our minority student population from 19.44% in 1998 to 45% in the fall of 2013. Of the members of the Class of 2013 from our 13 high schools, 63 percent of the graduates planned to attend a four-year college, while 27 percent said they would be attending a two-year school.

In relation to my work as director of school counseling, I am also a member of the Potomac and Chesapeake Association for College Admission Counseling (PCACAC), and of the National Association for College Admission Counseling (NACAC). These organizations represent more than 13,000 school counselors and college admission officers across the country who work with students and families to navigate the pathway to higher education. My involvement in these organizations has included service as PCACAC President and Government Relations Chair, and membership on NACAC's Government Relations Committee. This service has afforded me the opportunity to collaborate with college admission professionals from around the country and the world in our mission to serve students and their families in the transition to higher education, to share best practices, and to advocate for the needs of students, parents, and our institutions.

My objective today is to share my perspective as a school counselor on constraints that, in all likelihood, limit the effectiveness of federal initiatives, such as tax credits for higher education, in broadening access to and reducing the price of college.

In my experience, working with students in the college admission process is both challenging and rewarding – in what other job do you have the opportunity to shepherd a group of students each year in the pursuit of their dreams and aspirations? And yet this search must be done with a balance between dreams and reality – how do students find the right school at an affordable price?

My role in helping students and families to piece together information that can help with college access and affordability is an expectation of school counselors in more than 90 percent of schools, both public and private. However, NACAC research reports that nearly three-fourths of my colleagues have expressed a need for more information in order to feel confident about advising students on paying for college. As members of the committee may be aware, the process of applying to and paying for college is complex. There are more than 7,000 institutions of higher education eligible to participate in federal Higher Education Act Title IV programs. The federal government provides a wide range of financial assistance to help students and families pay for college, including need-based grants, federal Direct Loans (both subsidized and unsubsidized), parent loans, work study, and tax credits. In addition to federal programs, students and families can avail themselves of state grants, institutional aid from colleges and universities, private scholarships, and private loans.

As a counselor who is consistently and frequently available and allowed to provide direct services to my students and their parents, I am able to positively impact students' aspirations, achievements and financial aid knowledge. For many students and families, obtaining the information needed to navigate these complex and potentially confusing application processes begins with a school counselor. Research, as well as my experience, suggests that for many students, the difficulty of navigating these processes can serve as a deterrent to reaching a student's best fit college or perhaps any college at all.

School counselors are typically constrained from providing intensive, one-on-one support to students and families on the intricacies of paying for college. Consider that the average student-to-counselor ratio for public schools in the United States is 471 to 1; that school counselors in public schools are able to devote only about one-fourth of their professional time to assisting students with the college search and financial aid processes; and that access to school counselors is often most limited for the students who are most likely to be under-represented in higher education.

I would be remiss if I did not address several issues important on the front end of the college admission process that directly impact student loan debt. During the past five years, parents – and students - have become far more cautious about incurring large amounts of student loan debt. An increasing number of my students have chosen to matriculate at state colleges and universities in Virginia, a state where the articulation agreement between the community

college system and the four-year colleges and universities provides a financial incentive for students to begin their undergraduate education at the community college. When families are faced with the opportunity to finance their student's undergraduate education debt free in-state versus incurring the loans often required to pay for private or out-of-state schools, families are increasingly opting for the financially cautious path.

Despite these constraints, school counselors—and public schools in general—can be catalysts for disseminating information about resources that can help students and families. Three recurring challenges limit school counselors' ability to provide students and families with information about potentially useful federal resources for higher education.

Limited Awareness of Federal Resources for Higher Education in General

Federal resources for higher education, such as Federal Student Aid website, data resources like College Navigator and the Federal Shopping Sheet, and other initiatives like income-based repayment need much more dissemination effort than presently offered. Those of us in this room today are aware of these resources and are likely to share them liberally with our students and our colleagues. My experience, however, is consistent with NACAC data that suggests that for many federal higher education resources, it can take five years or more for a majority of school counselors to have even heard of a specific federal tool or resource for the college search. With a student caseload of 265 - far below the national average of 471 students - I have the time to develop a familiarity with these federal resources for use with my students and their families, which is not necessarily the case for counselors with higher student loads.

Consider that although the states in this region have the benefit of lower student-to-counselor ratios with Virginia at 315 and Maryland at 357, I have colleagues around the country with far greater challenges. Consider the public schools in Philadelphia, PA, where through the first six weeks of this school year, 16 "itinerant" counselors were responsible for 48,000 students in 115 of the district's schools – an average of 3,000 per counselor. Consider California, where the student-to-counselor ratio of 1,016 to 1 means that they might be one counselor in each school. Serious local conversations about budget priorities are needed to resolve these problems on a long-term basis, but in the meantime the federal government can take a leadership role in disseminating financial aid resources more broadly. While counselors would like to have more time to spend with each student, easy access to up-to-date information would make the limited time we have that much more productive. Students and parents who have had the opportunity to develop a trusted relationship with a school counselor are more likely to consult with that counselor when questions arise about information available in the massive market for higher education/financial aid advice. A larger government presence in that space to capture attention of students, families, and professionals would provide an additional trusted source.

Little Awareness Among Students and Families about Tax Benefits

Many families may be unaware of the tax benefits available to help families mitigate the cost of post-secondary education. I know as a taxpayer with two grown children that these tax credits can directly reduce the amount of federal income tax for returns. That being said, I have never had a conversation with a student about the potential impact of future tax credits on affordability of attendance, nor have I been asked a question by a parent about tax credits. Based on my colleagues' reports, I am not alone in that regard. It is common practice for those of us on the high school side to ask our college financial aid officers to do presentations for our parents about the financial aid process, but it has been my experience that it is rare for a question to arise about tax credits. It has been my experience that that financial aid professionals shy away from giving any information that could be construed as tax advice. If questioned, they may mention that tax credits do exist and that families should consult a tax professional for more information about how that might affect their personal situation. A concise, one-page document to share with parents and students on the availability of tax benefits and resources to consult for additional information would open the door for a conversation in an area that families are often reticent to discuss – their financial situation.

Without more information and education about the impact of tax credits, families may not see much financial difference in the decision to enroll. Any refund for which they qualify won't show up until almost a year after the first tuition bill is due. Families for whom two thousand dollars is the difference between a child enrolling in college or not may not be able to wait that long for the additional funds. Families with the means to send their children to college anyway may be more likely to see the benefit of and take advantage of the tax relief at the end of the academic year.

Disconnect Between Direct Student Aid and Tax Benefits

Unlike direct financial assistance like grants and loans, tax credits are not necessarily well-placed in the sequence of paying for college. For instance, student financial aid award letters include information on direct student aid, including Pell Grants, Direct Loans, specific university and state grants, and work-study programs. Tax benefits are not part of this process, which, as I noted earlier, takes them a step further outside of families' consideration in the process of cutting the college tuition check and taking out loans. In addition, families need to be aware that tax credits are governed by ceilings on adjusted gross income levels, that multiple types of credits cannot be used for the same student in a single year nor may these credits be combined with tax-free withdrawals from education IRAs. Under the current system, tax benefits add steps to getting aid, which is counter to the current Congressional efforts to simplify the financial aid process.

That doesn't mean it isn't worthwhile and very helpful for families making that investment, but it may not make a difference between students enrolling in college at all and not.

Recommendations

Based on what I have observed in my work with students and families, there are a few recommendations that I submit to committee members for their consideration.

1. Disseminate Educational Resources More Broadly

Since school counselors and other college advising professionals are spread so thin, and given the current low level of awareness of federal tax benefits for higher education, providing educational resources for professionals, students and families is essential if these programs are to succeed. Students and families have to navigate a thicket of information, and can be misled by unscrupulous players in the market. Ensuring that they receive trusted information from the federal government, whether directly or by way of a school counselor, is critical.

2. Utilize Regular School Communications to Convey Eligibility

Schools and colleges communicate regularly with their students and families about federally-supported programs, such as the annual application for free and reduced-price lunch in K-12 education and financial aid award letters in postsecondary education. Incorporating information about federal tax benefits for higher education into these communications would, at a minimum, ensure that students and families receive the information annually. It may have the added effect of raising awareness of these important benefits, and potentially increase participation over the long-term.

3. Address the Indirect Effect of Tax Benefits

Since tax benefits accrue on a different schedule than college enrollment, and may not affect the amount of money a student must pay to enroll, how much loan money they have to borrow, and what their loan repayment amount will be, consider ways to ensure that tax benefits for higher education can be brought to bear when the money is most needed.

Thank you again for inviting me to testify at today's hearing. I will be glad to respond to questions from the committee.

Questions for the Record
"Less Student Debt from the Start: What Role Should the Tax System Play?"
Questions for Ms. Jayne Fonash
Hearing Date: June 24, 2014

Senator John Cornyn

1. *Given the large caseloads that school guidance counselors must balance, how much time can each student reasonably expect to spend in reviewing options for college and financing higher education?*

Most public high school counselors are tasked with a number of job responsibilities in addition to college counseling, including various aspects of social, emotional, and crisis counseling. In most private schools, these responsibilities are divided, with the college counselors being assigned specific responsibility for college planning while the remaining tasks are assigned to a separate counseling staff.

According to the Counseling Trends Survey conducted by the National Association of College Admission Counseling (NACAC) in 2012:

- High school counseling staff spent an average of 32 percent of their time on postsecondary admission counseling.
- Counselors in public schools reported spending only 23 percent of their time on college counseling.
- Counselors in private schools reported spending 53 percent of their time on college counseling.
- Counselors at higher-income schools and those at schools with smaller enrollments also spent more time on postsecondary counseling compared to their counterparts at lower-income and larger schools.

Counselors engage in a number of activities to assist students with the process of applying to college. For example, according to the 2012 NACAC survey, 84 percent of counselors reported holding individual meetings with students to discuss postsecondary options. The range of services and the extent to which counselors engage in these college planning activities is highlighted in Figure 13 of the Counseling Trends Survey, which I have attached.

In some large public high schools, counselors, faced with time constraints, have become innovative in the delivery of information about options for applying to and financing higher education. Many schools conduct programing for parents in the evening or early in the morning. While the individual college planning conference is a crucial tool, classroom lessons and discussions play a role in creating a college-going culture in a school. School and college counselors work collaboratively with teachers and administrators to provide classroom lessons on topics including, but not limited to, college preparation, college search, applying to college,

paying for college and succeeding in college. With the "basics" covered through programs like this, sometimes called "College 101," the student is prepared to schedule a one-on-one meeting with his/her counselor, and to use that time fruitfully. Other public school districts have established support programs for first-generation college students or those who are under-represented in the admission process.

All this being said, the time public school students spend with their counselor one-on-one to review options for college may be as little as 20-30 minutes or as much as a series of a few 30 minute meetings during junior and senior year. Contrast this with private schools, at which the college counselor will schedule a 60-90 minute preliminary college meeting with the student and his/her parents during the winter of junior year, with several follow-up conferences during the spring of junior year and fall of senior year.

2. *Is NACAC in a position to develop search tools to assist counselors, students and their parents in obtaining useful and relevant information about college programs, cost of attendance, and financial assistance?*

NACAC provides a number of publications and other media resources, professional development programs and practical research efforts designed to give counseling and admission professionals the tools they need to improve the counseling services they provide to students. In addition, there is a section on the NACAC website (http://www.nacacnet.org/studentinfo/Pages/Default.aspx) specifically designed to provide resources for students and their families about the transition from high school to college, including advice on college preparation, college search, applying to college, paying for college and succeeding in college.

In addition to detailed sections on financial aid, student debt, and income-based repayment, NACAC includes brief summary of 529 savings plans and ways to offset education costs through tax credits and deductions (http://www.nacacnet.org/media-center/Pages/Saving-for-College.aspx). While this page is intended to inform students/parents about savings plans and tax credits, both options have nuances about which NACAC and its members are ill-equipped to provide advice (see my response to Senator Bennet for examples of some of the nuances). Furthermore, a document issued by a federal agency, with appropriate explanations and resources, would carry more weight than NACAC's summaries and assembled references. Moreover, families would be more likely to access a document made and hosted by a federal agency than they would a resource from NACAC. While NACAC is well-known among counseling professionals for its professional development support, families conducting independent research on financing higher education will be more inclined to turn to a website hosted by the IRS or the Department of Education. Bearing in mind the limited time counselors spend with students to discuss college, it is essential that this information be easy found, trusted, and distributed among families without relying on a counselor. NACAC will gladly include this

resource on its website, ensuring that our membership has access to it, and will also distribute the document at its annual National College Fairs, held around the country. But depending on a third-party organization like NACAC to serve as the primary conduit through which counselors, students, and parents have access to comprehensible and usable information on federal programs is irresponsible; without question, more people will benefit from this resource if the federal government plays a leading role in developing and disseminating it.

Questions from Senator Michael Bennet

1. *Last week, Sen. Alexander and I released a proposal to simplify financial aid in order to promote increased access for students and to serve students more effectively. We make the system easier, more transparent, and predictable. Four witnesses at a HELP hearing testified that the complexity in the current system is itself a barrier to access. Is complexity a barrier to utilizing tax benefits as well? Is the current system's complexity and obscurity diluting the effect of education tax benefits for middle-class families? How can we apply the principles of simplicity, transparency, and predictability to make tax benefits more effective for low and middle income families?*

When students and families think about how to pay for college, the logical search term would be "financial aid" or "how to pay for college." Neither of these bring up any information related to education tax credits in the top results. Simplification of this process would include the development of a brief document that would be readily available to families to explain eligibility for and access to education tax benefits.

Parents and students find complexity in the process itself as well as in the resources available. Unlike direct financial assistance like grants and loans, tax credits are not necessarily well-placed in the sequence of paying for college. For instance, student financial aid award letters include information on direct student aid, including Pell Grants, Direct Loans, specific university and state grants, and work-study programs. Tax benefits are not part of this process, which takes them a step further outside of families' consideration in the process of cutting the college tuition check and taking out loans. In addition, families need to be aware that tax credits are governed by ceilings on adjusted gross income levels, that multiple types of credits cannot be used for the same student in a single year, nor may these credits be combined with tax-free withdrawals from education IRAs.

While all of this information can be found in IRS Publication 970, it is a complex, ninety-four page document that may be difficult for low-income and first generation families to navigate. Under the current system, tax benefits add steps to getting aid, which is counter to the current Congressional efforts to simplify the financial aid process.

While counselors would like to have more time to spend with each student, easy access to up-to-date, concise information would make the limited time we have that much more productive. Students and parents who have had the opportunity to develop a trusted relationship with a school counselor are more likely to consult with that counselor when questions arise about information available in the massive market for higher education/financial aid advice. A larger government presence in that space to capture the attention of students, families, and professionals would provide an additional trusted source.

Since tax benefits accrue on a different schedule than college enrollment, and may not affect the amount of money a student must pay to enroll, how much loan money they have to borrow, and what their loan repayment amount will be, I urge you to consider ways to ensure that tax benefits for higher education can be brought to bear when the money is most needed.

STATEMENT OF HON. ORRIN G. HATCH, RANKING MEMBER
U.S. SENATE COMMITTEE ON FINANCE HEARING OF JUNE 24, 2014
LESS STUDENT DEBT FROM THE START: WHAT ROLE SHOULD THE TAX SYSTEM PLAY?

WASHINGTON – U.S. Senator Orrin Hatch (R-Utah), Ranking Member of the Senate Finance Committee, today delivered the following opening statement at a committee hearing examining the role of education incentives in the tax code:

Thank you, Mr. Chairman.

Today's hearing has a narrow, but very important, focus – the role of education incentives in our tax code.

Traditionally, the federal government has supported millions of individuals seeking higher education through grants and loans. Over the last 20 years, however, federal support for higher education has increasingly relied on incentives in the tax code.

These education tax incentives can generally be classified into one of three categories. The first category includes tax incentives for current expenditures on higher education. These incentives include the Hope, American Opportunity, and Lifetime Learning Credits.

The second category includes tax incentives for student loans, including the deduction for interest paid on student loans.

The third category includes tax incentives for savings for college, which includes qualified tuition plans, usually referred to as 529 plans.

Generally, two reasons have been given for the various education tax incentives. First, college education costs are increasing and are a barrier to entry for those who cannot afford them.

Second, college education is a good investment that produces external benefits. According to the National Center for Education Statistics, the costs of college education for the 2011-12 academic year were estimated to be $14,300 at public institutions and $37,800 at private nonprofit institutions.

Between 2001 and 2011, the costs for undergraduate tuition along with room and board at public institutions rose 40 percent, and the costs at private institutions rose 28 percent, after adjusting for inflation.

The high cost of a college education does indeed create a barrier to entry.

However, some portion of the barrier is alleviated by the U.S. Department of Education's Direct Loan Program, which includes Stafford Loans, Federal Perkins Loans, Federal Work Study, Federal Supplemental Educational Opportunity Grants and things like Pell Grants for lower income students.

In fact, in 2013, the Department of Education disbursed $32.3 billion in Pell Grants to more than 9 million students.

However, at the same time, approximately 71 percent of college seniors have student loan debt with an average of $29,400 per borrower. From 2008 to 2012, debt at graduation increased an average of six percent per year.

As I mentioned, in addition to the cost barrier, there are external benefits related to higher education, many of which benefit not only the individual student in the form of higher wages and mobility, but also society as a whole.

Since these external benefits may not be considered by individual students when considering higher education, individuals may invest less in higher education than is optimal for society. Providing educational tax incentives may induce potential students to enroll in higher education, increasing investment in education, and thereby creating these important external benefits.

A frank conversation about these incentives must also consider whether Congress is encouraging a higher education bubble.

There are many questions that need to be answered in this conversation. For example: Are these incentives encouraging students to take on more debt and degrees than is warranted by the economic and professional gains they are likely to realize? Are there increasing cases in which the private and social benefits are outweighed by the costs?

Also, we need to determine once and for all whether federal subsidization of higher education is good policy and whether a tax subsidy would be provided more efficiently by direct spending.

In 1987, then Secretary of Education William Bennett stated that, in the long run, federal financial aid programs lead to higher tuition as colleges capture some of the federal aid to students.

Some studies have shown some evidence favorable to Secretary Bennett's hypothesis. I would be interested to hear from our witnesses if they believe the Bennett hypothesis applies to federal student aid that comes in the form of education incentives in the tax code. In other words, I'd like to know whether colleges and universities capture the financial benefits of education tax incentives at the expense of eligible students and families.

Finally, I believe we need to consider simplicity, something that is far too often missing in our tax discussions.

One noted tax scholar has written: "The education tax incentives represent the greatest increase in federal funding for higher education since the GI Bill. But no one can tell you what they are, how they work, or how they interact. Planning to pay for college around these tax breaks is essentially impossible for middle-income families."

I think there is a lot of agreement that the education tax incentives are very complex and, at a minimum, should be consolidated and reformed.

We have a very distinguished panel with us today. I look forward to hearing what they have to say.

Thank you, once again, Mr. Chairman.

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"Is the Tax Code the Proper Tool for Making Higher Education More Affordable?"

Testimony by
Scott A. Hodge
President, Tax Foundation

Hearing before the U.S. Senate Committee on Finance

June 24, 2014

Mr. Chairman and members of the Committee:

I am Scott Hodge, president of the Tax Foundation. Thank you for the opportunity to speak to you today on the issues surrounding tax reform and education credits.

Founded in 1937, the Tax Foundation is the nation's oldest organization dedicated to promoting economically sound tax policy at the federal, state, and local levels of government. We are a non-partisan 501(c)(3) organization.

For 77 years, the Tax Foundation's research has been guided by the immutable principles of economically sound tax policy that were first outlined by Adam Smith – taxes should be neutral to economic decision making, they should be simple, transparent, stable, and they should promote economic growth.

In other words, the ideal tax system should do only one thing – raise a sufficient amount of revenues to fund government activities with the least amount of harm to the economy. By all accounts, the U.S. is far from that ideal. According to the National Taxpayer Advocate, tax complexity is one of the biggest issues facing taxpayers and the IRS today. The main cause of that complexity has been the proliferation of credits, deductions, and preferences built into the tax code.

Introduction

Recently, college affordability has been on the minds of many. Over the past decade, the cost of college tuition has out stripped both inflation and income growth. On top of that, students are grappling with an ever-growing burden of debt.

Considering the financial benefits of getting a college degree, lawmakers have sought to help students afford the cost of higher education. More traditionally, this was done through loan programs and direct subsidies such as Pell Grants. However, higher education policy has shifted in recent years away from traditional loan and direct subsidy programs (such as Pell Grants) toward the use of various tax credits.

The question is, is the tax code the proper tool to increase access to higher education and make college more affordable?

Generally speaking, the answer is no.

First, these tax credits violate the principles of sound tax policy by greatly increasing the complexity and distortions in the tax code.

Second, if we are serious about reforming the tax code, there are four sound reasons to eliminate education tax credits within a comprehensive reform package:

1. Since the first education tax credit was enacted in 1997, the government has greatly increased the size and scope of education tax credits. However, there is little evidence that they have accomplished what they intended to do and more evidence that they may be fueling higher costs and simply becoming a windfall for colleges, not students.

2. Education tax credits are not well targeted. Although they reach lower income individuals more than deductions, they still tend to benefit today and tomorrow's high-income taxpayers much more than low-income families.

3. The over-use of tax credits has turned the IRS into an extension of – or substitute for – other government agencies. The IRS is not equipped to be a social welfare agency. As a result, these credits are prone to fraud, improper payments, and placing an excessive burden on the IRS.

4. Trading the elimination of education tax credits for lower marginal tax rates is good for economic growth, which is better for all Americans. Our model suggests that such a exchange would boost GDP by about $19 billion, federal revenues by $4.5 billion, and increase employment by about 121,000 full-time workers.

We know the current system isn't working, so what is the solution? Options consistent with tax reform should include: Simplifying the vehicles for saving within the tax code, perhaps through universal saving accounts; and, encouraging new markets that will incentivize colleges to keep long term costs down, such as pre-paid tuition plans or a "futures market." Finally, a better option to help low-income studies is to shift resources out of "tax programs" and into established programs like Pell Grants.

More Credits, Little Impact

In the scope of federal assistance for higher education expenses, tax credits and deductions are relatively new.[1] Prior to the enactment of the Hope Scholarship Credit and the Lifetime Learning Credit in 1997, the government's primary tools for helping students had been direct assistance

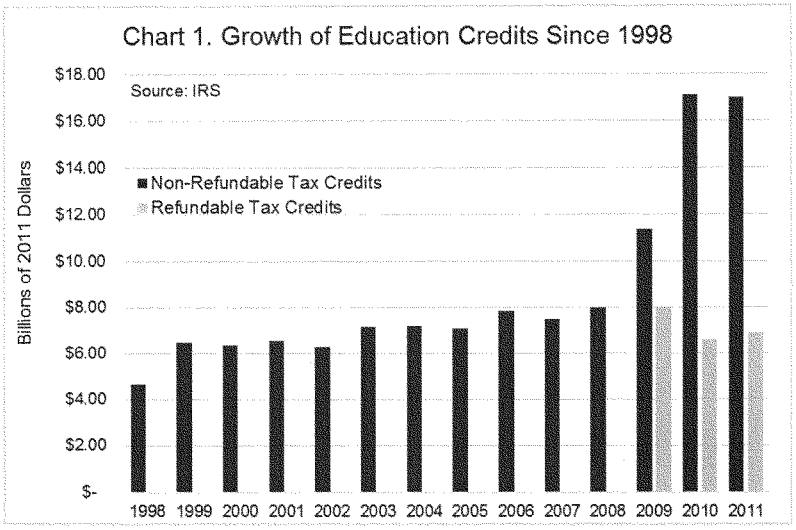
[1] For a short history of federal assistance for higher education costs, see Elaine M. Maag and Katie Fitzpatrick, "Federal Financial Aid for Higher Education: Programs and Prospects," Urban Institute, January, 2004.

(such as the G.I. Bill and Pell Grants) and loan programs. Since 1997, however, lawmakers have increasingly turned to the tax code to help students and families with education costs.

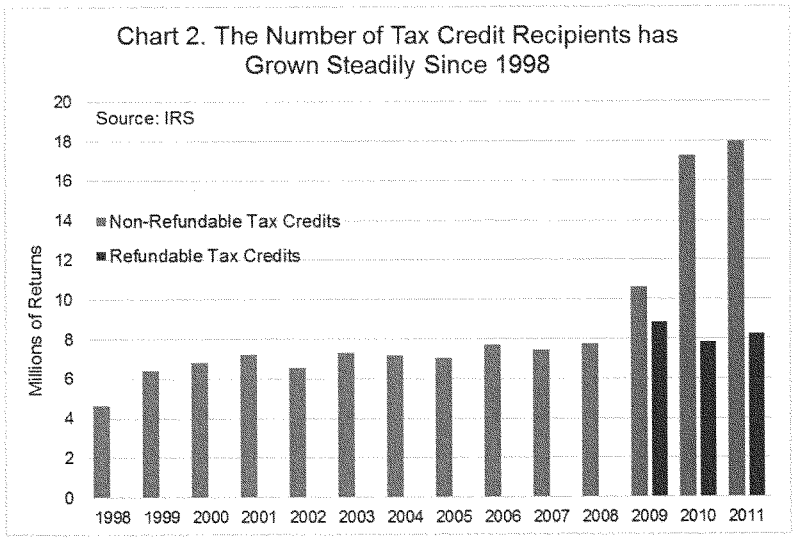
Chart 1 illustrates the gradual growth of the budgetary costs of education tax credits since 1998, while Chart 2 documents the number of tax returns claiming those credits each year since 1998. In 1998, some 4.7 million taxpayers claimed $4.5 billion in credits, after adjusting for inflation. Within five years, the number of taxpayers claiming these credits had climbed to over 7 million, while the inflation-adjusted costs increased to over $7 billion. The average taxpayer claimed roughly $1,000 in education tax credits.

The cost of these programs held steady until 2009 with the enactment of the American Opportunity Tax Credit (AOTC). The AOTC is more generous than the Hope Credit – it covers all of the first $2,000 of education expenses compared to $1,200 for the Hope Credit. It also allows taxpayers with higher incomes to claim the credit – it phases out at $180,000 for joint filers compared to $120,000 for the Hope Credit. Lastly, the AOTC was made refundable for those with no income tax liability.

As can be seen in Chart 1, the inflation-adjusted cost of non-refundable education credits jumped from $8.1 billion in 2008 to $11.4 billion in 2009 and then to $17.4 billion in 2010. Moreover, the IRS distributed $8 billion in refundable American Opportunity credits in 2009 and another $6.7 billion in 2010.



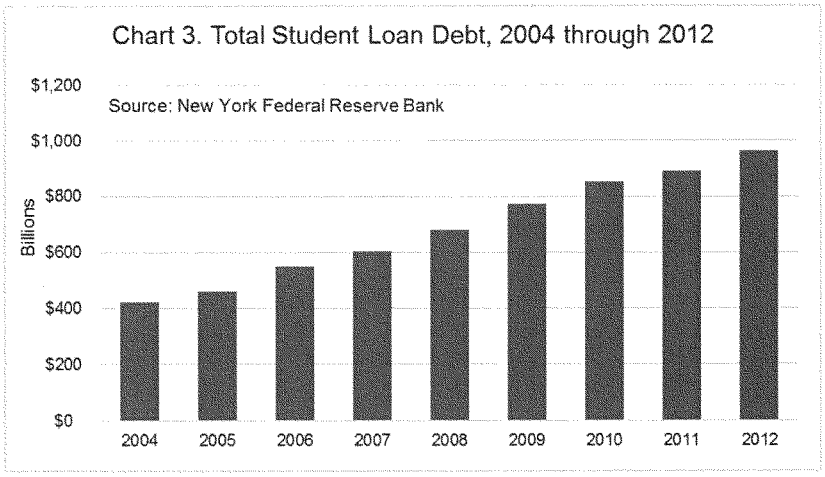
Meanwhile, as is shown in Chart 2 (below), the number of taxpayers claiming various education credits more than doubled between 2008 and 2011, from 7.7 million to over 18 million. In 2011, some 8 million taxpayers received refundable AOTC credits.



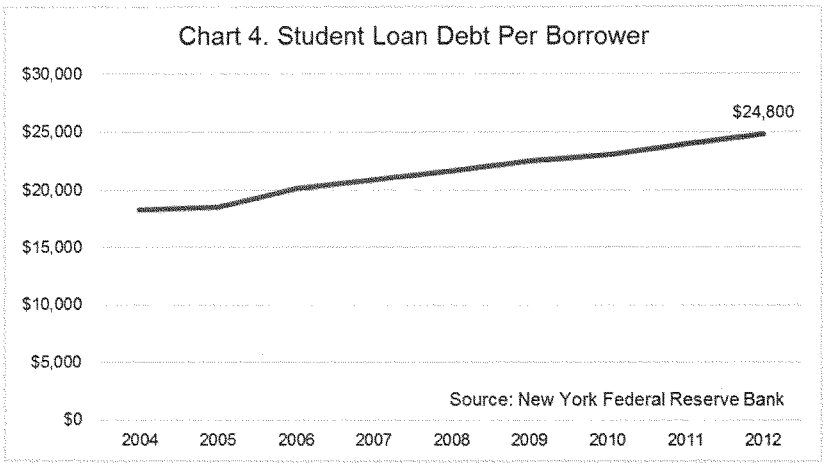
As the size and scope of education tax credits has been expanding, students have still been facing increasing costs. This is indicated by the fact that student loan balances have been greatly increasing in the past decade.

Chart 3 shows the growth in the total student loan debt. From 2004 to 2012, the New York Federal Reserve Bank estimates that total student loan debt has increased by 129 percent. In fact, the New York Fed found that student loan debt was the only type of consumer debt that continued to increase during the recession of 2008. It is now the largest single type of outstanding debt, larger than both credit card debt and auto loan debt.[2]

[2] http://www.newyorkfed.org/newsevents/mediaadvisory/2013/Lee022813.pdf

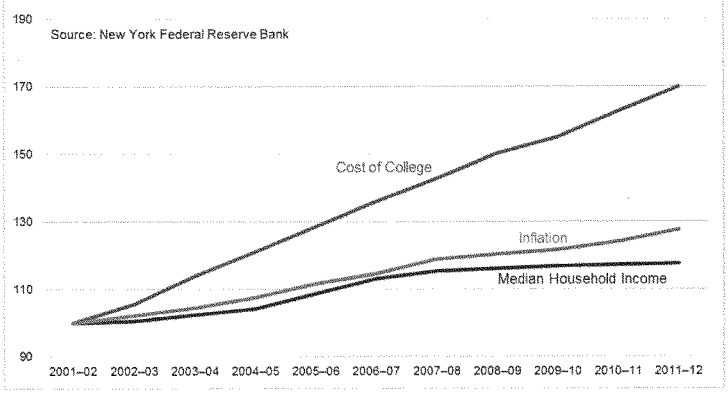


This increase in debt isn't entirely due to an increase in the number of students going to school. The debt load per student has also drastically increased. Chart 4 shows the growth in per student debt from 2004 to 2012. According to data from the New York Federal Reserve Bank, the debt per student has grown by 35 percent to $24,800 per student in 2012.



The growth in cost of a college education has far outstripped inflation in the past decade. Chart 5 compares the growth of the cost of tuition to both median household income and inflation. College tuition plus room and board has grown by approximately 70 percent in the past decade. This has greatly outpaced the growth in household incomes (17 percent) and inflation (27 percent) over the same period.

Chart 5. The Cost of College Tuition has Increased Faster Than Family Income and Inflation over the past Decade



This increase in debt, even in the face of more generous education tax credit, indicates that current policy is not addressing the fundamental issue, which is the wild growth in the cost of college.

Colleges are Price Discriminators

It is likely that instead of helping, Tax Credits may be contributing to the rising cost of college education. The market for higher education like no other in the private sector because colleges are what economists call pure price discriminators because they can maximize the price that each student can pay. In higher education, the seller of the good (the college) has perfect information on the buyer (the student) and, unlike most sellers, they can not only choose which buyer they prefer, but set a different price or funding mix for each buyer.

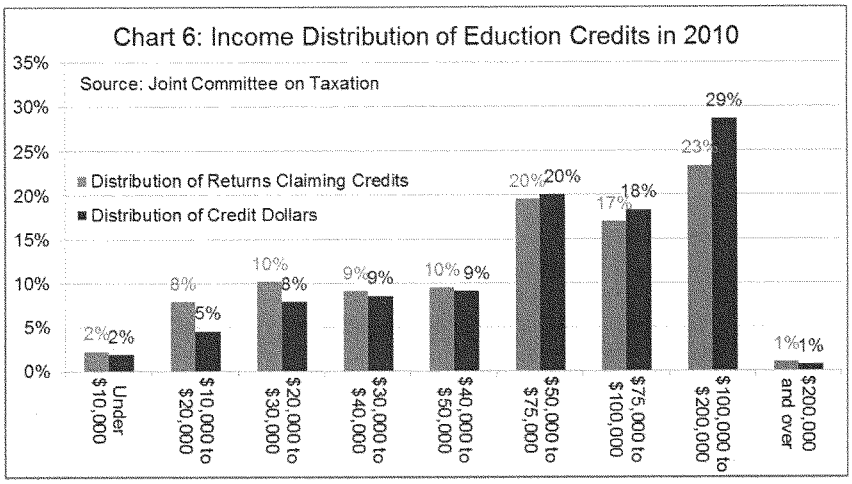
Because of the Federal Student Aid Form (the FAFSA), the college has intimate knowledge of each student's (or family's) income and assets, and therefore knows to what extent a student's family can afford college and if they are eligible for tax credits, loans, or other financial aid. This information allows the college to simply adjust its financial aid package in order to capture the maximum value of the tax credit.

Instead of being a helping hand for students, tax credits have turned into a windfall for universities.

Not a Well-Targeted Program

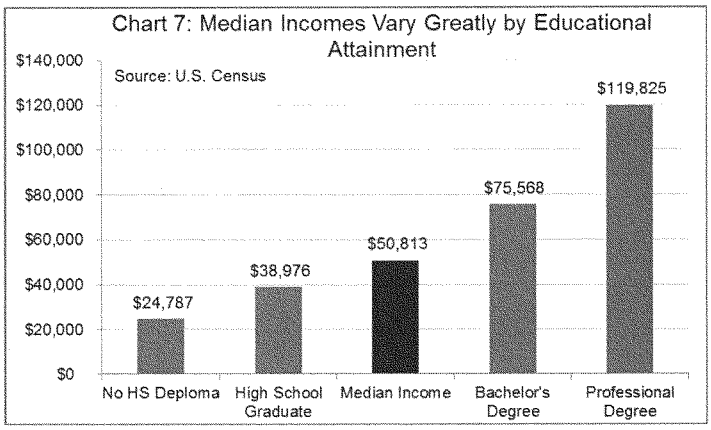
The stated goal of these credits is a help students from low- and moderate- income families pay for the ever increasing cost of college. However, it is not clear that they are accomplishing that goal. In fact, tax credits end up going to students that likely could have afforded college anyway. Even more, these credits direct taxpayer dollars to future high-income individuals.

As Chart 6 illustrates, roughly 30 percent of the current benefits of education tax credits accrue to taxpayers earning over $100,000 and an additional 18 percent accrues to those earning over $75,000. In contrast, only 20 percent of those who claim education tax credits earn under $30,000. By most accounts, these tax preferences are becoming upper-middle class entitlements.



Even more, these tax credits are directing dollars to future high-income individuals. As can be seen in Chart 7, the median income for a worker with a 4-year college degree was $75,568 in 2010. By contrast, the median income for a worker with only a high school diploma was nearly half as much – $38,976. There is even greater income disparity between those with high school diplomas and those with advanced degrees.

In other words, many tax credit dollars are going towards future doctors and lawyers: those who would be more likely than not be able to pay back a loan. To some degree, these benefits accrue to educated professionals at the expense of taxpayers who may never visit a college campus. In many respects this amounts to reverse redistribution up the income ladder.



The Proliferations of Credits Turn the IRS into a Spending Agency

The growth of education tax credits has been part of a larger trend towards using tax credits—especially refundable tax credits—for a number of government priorities. Chart 8 shows the total budgetary costs of refundable tax credits from 2006 to 2013 and the projected costs to 2017.

In 2013, the total cost of refundable tax credits was close to $96 billion. This includes $61 billion for the Earned Income Tax Credit, $30 billion for refundable portion of the Child Tax Credit, and $4.5 billion for the refundable portion of the American Opportunity Credit. In the next five years, the total cost of refundable tax credits will double to nearly $200 billion due entirely to the Affordable Care Act.

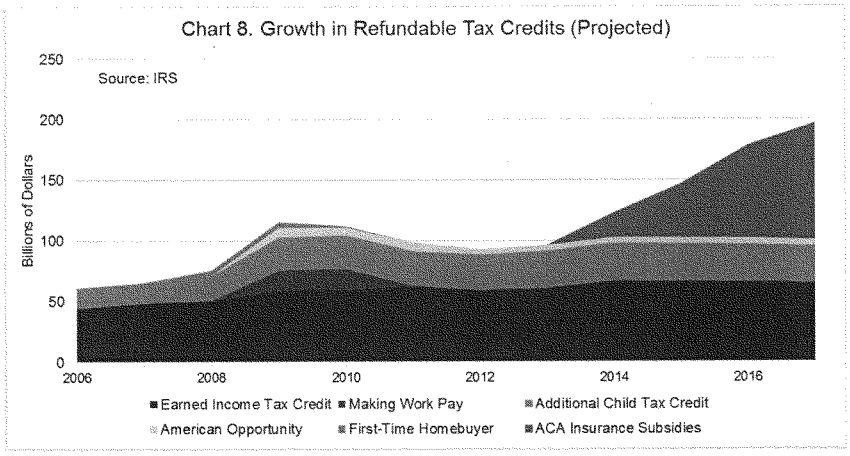
Clearly, the IRS has become an extension of different government spending agencies, a job that it is not equipped to do. The use of tax credits increases the cost of compliance for taxpayers and the IRS, and as a result they are susceptible to error and fraud. This is demonstrated in the high levels of improper payments in these tax credit programs.

As it stands, simply complying with the tax code costs taxpayers an estimate $163 billion each year. About 62 percent of all taxpayers use tax return preparers, but the percentage climbs to about 73 percent for those claiming the EITC, for example.[3] The complexity of EITC eligibility is a contributing factor to the estimated $11 billion to $13 billion in improper overpayments according to the IRS.[4]

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[3] National Taxpayer Advocate, Report to Congress: Fiscal 2010 Objectives, June 30, 2009, p. xxii. http://www.irs.gov/pub/irs-utl/fy2010_objectivesreport.pdf

[4] "Improper Payments in the Administration of Refundable Tax Credits," Testimony of J. Russell George, Treasury Inspector General for Tax Administration, before the Committee on Ways and Means, Subcommittee on Oversight, U.S. House of Representatives, May 25, 2011, p. 3.



Problems with education credits have not reached this level, but there is cause for concern. For instance, the Treasury Inspector General for Tax Administration has found that, "Some taxpayers are claiming the Hope Credit for more years than allowed by law."[5] The limit is two years but some were found to claim the credit for three and even four years. In one investigation, the IG found that "the amounts of credits inappropriately claimed averaged close to $1,400 and totaled just over $232 million."[6]

Furthermore, the IG reported that:

> "Educational institutions are spending millions of dollars and staff hours each year to provide taxpayers and the IRS with copies of Tuition Statements (Form 1098-T). However, the IRS does not use this Form in its compliance programs, or accept the Form as documentation to support claims for education credits."[7]

More recently, the IG has raised red flags about taxpayers improperly claiming the American Opportunity Tax Credit. Again, reports the IG:

> "The IRS requires no documentation to be provided to verify eligibility, including whether an individual claimed as a student even attends a required accredited educational

[5] "Improvements and Needed in the Administration of Education Credits and Reporting Requirements for Educational Institutions," Treasury Inspector General for Tax Administration, September 30, 2009, Reference Number: 2009-30-141, p.2.
[6] Ibid.
[7] Ibid., p. 1.

> institution. Our review is identifying significant improper payments being made to taxpayers claiming the credit and using ineligible students."[8]

I would argue that while we should be appalled by such abuse, we should not be surprised by it. As the IG testified, "Although each of these refundable credits provides benefits to individuals, the unintended consequences of these credits is that they are often the targets of unscrupulous individuals who file erroneous claims for those benefits."[9]

Enforcing these credits is simply asking the IRS to be more than a tax collection agency. It is asking it to manage a social program – a role far beyond what it is designed to perform.

Trading Education Credits for Lower Tax Rates

As we think about tax reform—which generally means broadening the tax base while lowering tax rates—it is reasonable to consider the economic effects of trading the elimination of tax credits for lower tax rates for all taxpayers.

With this spirit in mind, Tax Foundation economists used our Taxes and Growth (TAG) dynamic macroeconomic model to measure the long-term effects of eliminating all education credits and using the revenues to cut marginal tax rates across-the-board. Our findings were quite illuminating[10].

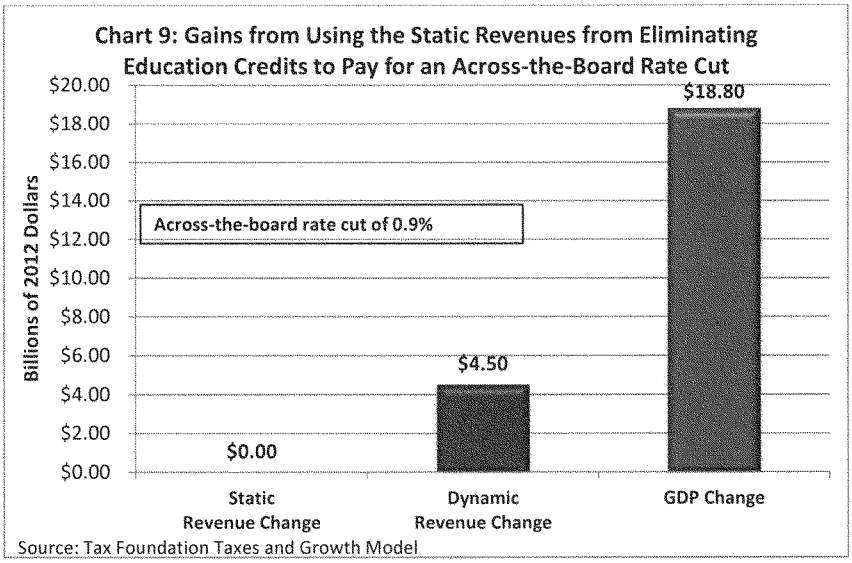
Our model suggests that such a trade-off of tax credits for lower rates would:

- ✓ Allow for an across-the-board rate cut of 0.9%;
- ✓ Boost GDP by $19 per year;
- ✓ Boost federal revenues by $4.5 billion on a dynamic basis; and
- ✓ Increase employment by the equivalent of roughly 121,000 full-time jobs.

So, in addition to reducing complexity and simplifying the tax code, trading education credits for lower tax rates for everyone would not only boost GDP and jobs, it would benefit the federal treasury too. By any objective measure, that would seem like a very good exchange.

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[8] Testimony of J. Russell George, Ibid., p. 7.
[9] Ibid., p. 2.
[10] Michael Schuyler and Stephen J. Entin, "Economics of the Blank Slate, Case Study #8: Education Credits," August 6, 2013. http://taxfoundation.org/article/case-study-8-education-credits



It's Time to Consider Other Solutions

The evidence is clear that current policy has not achieved its goal of making college more affordable. Over the past two decades, the cost of college has risen faster than income and inflation. It would appear that all of tax credits created since 1997 have become more of a windfall for colleges rather than for students. Thus actually fueling higher college costs.

There are two good solutions, one within the spirit of fundamental tax reform, and the second with the goal of encouraging free-market mechanisms that will force colleges to control their costs over the long-term.

As we look to overhaul the tax code, we would do well to simplify and expand the available savings vehicles for families, and avoid micromanaging family savings decisions by increasing the number of targeted savings options.

College savings programs such as 529 plans are excellent, but they are pitted against Health Savings Accounts (HSAs) and Individual Retirement Accounts (IRAs), which forces families to separate their savings into different buckets and, thus, lose some of the growth potential from that savings.

Tax reformers should consider consolidating these different vehicles into a universal family savings plan would allow families to choose where best to direct their savings.

Saving for college is far superior than trying to pay for college with loans financed against uncertain future earnings. However, savings accounts do not act as a market mechanism to force colleges to control future costs.

One mechanism that can effectively do this are the various 529 plans that allow parents, grandparents, or students to lock in college costs through pre-payment arrangements. Not only do these plans provide families certainty, they require colleges to control their costs as much as 18 years in the future—something that tax credits, subsidies, and loan programs not only don't do, but actually discourage colleges from doing.

Currently, 17 states have pre-pay elements to their 529 programs for their public universities, while more than 270 private colleges have collaborated in their own 529 program with a pre-pay option.[11]

Not only should all states and universities be encouraged to participate in such programs, but another option would be to encourage the creation of a type of national futures market, where buyers can purchase hours, semesters, or years of college credit years in advance. These "units of education" would then be tradable, in the same way in which the private "tuition certificates" can be used among the 270 participating schools. These types of programs empower customers of higher education (students and families) and force colleges and universities to be forward thinking about controlling costs.

Finally, if the goal is to help low-income students with college costs, it would make far more sense to shift resources away tax programs like credits and focus the funds on spending programs like Pell Grants would which are more targeted and less susceptible to improper payments and fraud.

Conclusion

While we all understand the value and financial benefit of getting a college degree, using the tax code to "make college more affordable" not only violates the principles of sound tax policy, but it doesn't have the desired effect.

These "tax programs" – for lack of a better word – are failing to address the underlying reasons for the increase in college education and are likely contributing to the rising costs of higher education. These credits, which cost billions, may not even be helping the people that lawmakers intended while transforming the IRS into an extension of the Department of Education and the welfare system.

It's time we consider other solutions that don't require us to use the IRS as a spending agency, especially has we prepare for a comprehensive overhaul of the federal tax code.

Thank you very much for the opportunity to discuss these issues with the Committee today. I look forward to any questions that you may have.

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[11] https://www.privatecollege529.com

Questions for the Record
"Less Student Debt from the Start: What Role Should the Tax System Play?"
Questions for Mr. Scott Hodge
Hearing Date: June 24, 2014

Questions from Senator Orrin Hatch

1. *In a recent paper by an economist who is now at the Treasury Department, the author writes that "Contrary to the intention of policymakers, I find that schools fully counteract the cost reduction of tax-based aid by lowering institutional aid dollar-for-dollar. This finding implies that colleges and universities capture the financial benefits of tax-based aid at the expense of eligible students and families."*

   Would you comment on whether colleges and universities are capturing the financial benefits of tax-based aid, and if they are, what, if anything, should be done in response?

   The market for higher education is like no other in the private sector. Colleges are what economists call price discriminators because they can maximize the price that each student can pay. In higher education, the seller of the good (the college) has perfect information on the buyer (the student) and, unlike most sellers, they can not only choose which buyer they prefer, but set a different price or funding mix for each buyer.

   Because of the Free Application for Federal Student Aid (FAFSA), the college has intimate knowledge of each student's (or family's) income and assets and therefore knows to what extent a student's family can afford college and if they are eligible for tax credits, loans, or other financial aid. This information allows the college to simply adjust its financial aid package in order to capture the maximum value of the tax credit.

   One solution suggested by experts would be to end the requirement that students and parents submit all financial information. This would limit a college's ability to give a student tax-based aid in lieu of institutional aid.

   A second solution would be moving entirely to Pell Grants for low-income students. A paper by the Center for College Affordability and Productivity finds that "aid programs that are restricted to low income students are less likely to allow colleges to raise their tuition." A tax credit program leads to an increase in the demand for higher education which leads to a higher price of tuition. Well-target programs do not increase the demand for education by families with high incomes. Instead, they provide funds to low-income families. This may lead to a slight increase in price, but not nearly as much of an increase that is seen due to general or universal college assistance such as tax credits.

2. *There have been several recent tax articles suggesting that Congress eliminate all education tax incentives and replace them with direct spending programs. In the recent Treasury report on Pell Grants and the AOTC, Treasury writes, "The report concludes that direct grant aid, such as the Pell Grant, is a better mechanism for delivering education subsidies to low-income students [than advance refundability of the education tax credits]."*

   Should the education tax incentives be replaced with direct spending programs?

   Yes, direct spending programs should replace education tax credits. The overuse of tax credits has turned the IRS into an extension of—or substitute for—other government agencies. The IRS is not equipped to be a social welfare agency. As a result, the administration of these credits, along with others, places an excessive burden on the IRS.

   To make matters worse, education tax credits are not well targeted. Roughly 30 percent of the current benefits of education tax credits accrue to taxpayers earning over $100,000 and an additional 18 percent accrues to those earning over $75,000. In contrast, only 20 percent of those who claim education tax credits earn under $30,000.

   Direct spending programs such as Pell Grants are well targeted and—as studies show—their value is less susceptible to being captured by institutions of higher education.

3. *Do you think that certain tax incentives are important in that they create external benefits, sometimes referred to as positive externalities? For example, the research and development credit is usually cited as an important incentive in that social returns to research and development are larger than the private returns.*

   Does a similar argument hold for educational tax incentives – that the social returns associated with higher education outweigh the private returns?

   It's possible that higher education creates positive externalities for society, but, regardless of the social benefit of higher education, the tax code is a tool to raise federal revenue, not to maximize social welfare.

   Tax provisions such as higher education tax credits have the ability to alter the tax code and distort economic growth. Using our Taxes and Growth Model, we find that eliminating education tax credits and trading the revenue for a lower tax rate would increase GDP by $19 billion per year and raise federal revenue by $4.5 billion due to additional hours worked and economic growth.

In order to mitigate the economic distortions caused by using the IRS as a spending agency, policymakers should remove assistance for higher education from the tax code and use the funds to reinvigorate well targeted direct spending programs, such as Pell Grant programs.

4. *I worry about the effect of federal aid and other incentives on middle income families. For example, middle-income families receive less federal aid than lower-income families. But if the Bennett Hypothesis is correct, these middle-income families must still pay the inflated tuition resulting from federal aid.*

   Is this resulting in a financial squeeze for such middle-class families, and would such a situation exist under your vision of reform?

   When it comes to the Bennett Hypothesis, "not all aid is created equally." The level to which aid fuels tuition price inflation depends on the type of aid you provide and to whom you provide it.

   As mentioned before, work by Center for College Affordability and Productivity, shows that well-targeted spending programs, such as the Pell Grant, lead to smaller increases in tuition than near-universal programs, such as tax credits. Well-targeted programs help those who are not able to afford college in the absence of a subsidy pay for tuition. Middle- and upper income families do not receive access to direct spending programs, so colleges would have to set prices knowing that the government is not providing aid to those groups. In fact, research that shows that colleges that receive a high level of Pell Grant scholarship dollars, tend not to have large increases in tuition compared to similar colleges.

   In contrast, near-universal programs, such as our current tax credit programs for high education, generally allow families who could afford college to begin with to afford a higher price for the same product. Colleges know this and set their price accordingly. This drives the price level up for everyone.

Questions from Senator John Cornyn

1. *In your testimony, you suggested that one way to incentivize colleges to contain their costs would be to create a futures market in which individuals could buy, sell and trade prepaid college plans. If the value of a prepaid plan is dependent on the amount by which tuition and fees are raised, how would you ensure that the development of this market would not actually contribute to accelerated tuition increases over time?*

   Current private 529 plans show how a futures market might work to bring down the cost of college tuition. Currently, an individual can "pre-pay" for a semester of college education for their child at today's price. Say the price of one semester of college at the nearby state school is $10,000. This plan would allow a family to purchase shares, or an entire college education at this price. Suppose they purchase one semester's worth for $10,000. This means that this family has locked-in this price and does not have to pay any more for one semester of college. Eighteen years later, when the tuition of the nearby state school has increased to $15,000 a semester, the family will not be liable for any more costs, since they locked-in the lower $10,000 price. They saved $5,000.

   For the college, this creates the incentive to reduce costs in the future. When they are given $10,000 for current tuition prices, the college will likely invest this money in stock and bonds. Eighteen years later, when the student finally enrolls, the college gets no additional cash from the student. They have to cover the cost of future tuition with the return on the originally invested $10,000. If the college earned 5 percent annually on the $10,000, the college would have enough to cover the cost of tuition if tuition increased at the same annual rate. If tuition increased faster than 5 percent per year, the college would experience a loss. On the other hand, if the college was able to keep tuition growth below 5 percent a year, the college would make a profit on this invested money. In other words, a plan like this would introduce market forces to the higher education sector and make it more accountable to students and their families.

Prepared Testimony of Amber Lee
Graduate of Willamette High School

"Less Student Debt from the Start: What Role Should the Tax System Play?"
June 24, 2014

Chairman Wyden, Ranking Member Hatch, and members of the Committee, thank you so much for allowing me the opportunity to testify today.

I grew up in a very violent, unstable home. My father abused crystal meth on a regular basis, which often resulted in wild outbursts of rage towards my mother or me. During a crucial time of life, when children should be learning and developing, I was fending for the wellbeing of my mother and myself. In my first nine years of life my family and I were evicted from twelve different homes due to my father's drug addiction as well as his love for gambling. There were many times we were evicted, and had no place to stay. The only solution was to take refuge in our car, and pray it would offer us enough shelter until we could get back on our feet. I was a miserable child, who had to grow up prematurely due to my circumstances.

Though my home life was complex, school always kept me going. It was a way to escape from the stress I experienced at home. At the age of seven I decided that I wanted to become a doctor, due to the fact that I was, and still am fascinated with the healing power of medicine. I can clearly recall the instant I realized that I could be freed from the vicious cycle of poverty and violence through education. I found it daunting that through my hard work I could potentially liberate myself by accomplishing what my parents could not. I do not regret anything from my upbringing because it has molded me into the strong, motivated woman that I am today. My past has kept me focused on my educational and career goals by providing me with the drive to become the best form of myself.

As I got older, and advanced to middle school and high school, I was extremely diligent with my schoolwork and extra-curricular activities, for I knew that consistent academic success was the key to future opportunities. During my junior and senior years at Willamette High School I carefully considered various universities to attend in the fall of 2014 including: Oregon State University, Portland State University, University of Oregon, and Oregon Institute of Technology. Originating from a low-income household of a single mother, I knew that paying for college on my own would be nearly impossible; however I was extremely optimistic of the opportunities available through grants and scholarships that could potentially aid me in pursuing a higher education.

Due to the overwhelming cost of tuition, books, fees, and room and board associated with four-year universities, I also considered attending community college in order to complete my prerequisites before transferring to a university. After some career counseling, research and serious thought, I was discouraged to attend community college mostly because of the negative stigma it has with medical school admission committees.

The prerequisite courses students must complete act as a critical foundation that students must build upon during their pre-clinical years of medical school, and I was afraid that my educational choices now could potentially delay, or negatively impact my future goals. I also strongly considered attending the University of Oregon because it would give me the choice to reside at my mother's house, saving me the cost of room and board; however the University of Oregon is considered a strong liberal arts college, and I found it important to attend a university with a strong math and science program in order to prepare me for the challenges of medical school.

After many months of consideration I decided to attend Portland State University. I was extremely attracted to the job as well as the internship opportunities available through the institution, and I was also pleased to learn that Portland State has the lowest public college estimated cost of attendance in the state of Oregon.

I've always considered myself familiar with the overwhelming cost of college, but unfortunately it wasn't until I received my financial aid offering in March of 2014 that I realized exactly how hard it would be to afford a higher education. I received both the Oregon Opportunity Grant as well as the Pell Grant which are providing me with $7,730 worth in aid for the fall of 2014, and act as a blessing; however combined with scholarships, and government loans I've accepted I still need to pay Portland State University $9,822 per year. It was extremely discouraging to learn that my academic rigor wasn't enough to help me get to college, but I decided to do what I could to support my dream of becoming the first in my family to continue my education. I work 35 hours a week at a local Dairy Queen in order to save funds for college, but a frugal summer spent serving ice cream can hardly put a dent in what I owe to PSU. In order to attend college I am relying greatly on many private student loans as well as the federal subsidized and unsubsidized loans I have already accepted.

Unfortunately, I am not receiving any sort of family contribution towards my college education. For many years my mother and I have struggled without any kind of support from my absent father, and haven't had the means to save for the future. Due to my circumstances, my family has absolutely nothing put aside for me to pursue a higher education; therefore it is my responsibility to settle financial matters on my own. Because of my choice to enroll in rigorous classes, and to be active in extra curricular activities, I have not had the time to be employed for very long in order to save substantial funds myself.

It is absolutely appalling to me that students experience so many disheartening financial set backs just for trying to further their post high school education. We are immersed in a culture that supports the freedom to challenge ourselves, to search for new knowledge, and to gain meaningful careers, but we are constantly refused the opportunity to do so through the lack of options we have when it comes to paying for education. The idea of a college education has become only possible for the privileged, and that needs to change now.

Senators, I humbly ask that you consider the power you hold over decisions that

could potentially aid aspiring students in pursuing their dreams and life opportunities. It is truly troubling that students with difficult socio-economic backgrounds, such as myself, can work their hardest to educate themselves, and yet still come up short despite all of their efforts. With the amount of total student debt in the United States reaching around $1.2 trillion dollars it is more than apparent that students need more outlets for assistance regarding college funding including: extension in loan forgiveness programs, affordable interest rates, expanded federal student aid – plus knowledge of tax benefits available for attending college. Personally my mother and I were unaware of the potential aid offered through tax benefits regarding post high school education, and I know that if these benefits were made apparent to the many low income families in the United States, college could be a more realistic, obtainable goal. I also believe if every family were given the gentle encouragement to open a college savings fund, it could make long-term college saving more convenient for families who are struggling to stay afloat.

Thank you, Chairman Wyden, and the members of the Committee for allowing me the opportunity to share my story today.

Questions for the Record
"Less Student Debt from the Start: What Role Should the Tax System Play?"
Questions for Ms. Amber Lee
Hearing Date: June 24, 2014

Question from Senator Orrin Hatch

1. *Amber, congratulations on your success in high-school and your decision to pursue a college education.*

   The Western Undergraduate Exchange program allows students to attend public universities in other member states without the burden of paying full out of state tuition.

   Both Oregon and Utah participate in the Western Undergraduate Exchange. When looking for universities that met your educational goals, did you consider using the Western Undergraduate Exchange program?

When looking for universities that met my educational goals, I did not consider using the Western Undergraduate Exchange program because not only did I value attending an instate college, but I also found that moving out of state would be financially impractical.

Questions from Senator John Cornyn

1. *You mentioned in your testimony that you were not aware of the federal and state resources available to you for the financing of your education. In your opinion, in addition to speaking with a school guidance counselor, where would you and your mother have been most likely to search for information about higher education benefits/assistance for which you might be eligible? What type of access to online digital resources did you and your mother have?*

Other than speaking to my high school guidance counselor, my mother and I would have been most likely to search for information via the internet; however due to financial circumstances my house hold didn't always have access to internet. We have often had to rely on the Eugene Public Library to provide an hour of free Internet access.

2. *As a working student, what type of tax benefit do you think would most directly support your education goals? For example, how useful would tax credits be to you and your family in helping you to pay for your education?*

Any sort of tax benefit geared towards students would be tremendously helpful. As a working student it's hard enough to support your personal needs as well as pay for education, so I find that any kind of tax benefit that could potentially aid students would be utilized.

Testimony of Mark J. Mazur
Assistant Secretary of the Treasury for Tax Policy
United States Senate Committee on Finance
June 24, 2014

Chairman Wyden, Ranking Member Hatch, and members of the Committee, thank you for having me here today to talk about the role of the tax system in helping students and families finance higher education.

I. Introduction

The Federal government provides substantial resources to support postsecondary (e.g., college level) education. This support helps ensure that individuals acquire the knowledge and skills required to obtain good jobs and achieve secure economic outcomes. Higher education has clear financial benefits for individuals—on average, college graduates earn hundreds of thousands of dollars more over their lifetimes than do high school graduates—and the spillover of benefits a highly skilled and educated workforce also enhance the productivity and wages of other workers, helping the U.S. to prosper in an increasingly global economy.

Tax incentives are among the most important resources the federal government provides to students and families to help pay for postsecondary education. These incentives help defray current expenses, help families save for future expenses (e.g., saving to pay for college), reduce the burden from past expenses (e.g. the costs of paying off education loans), and also support institutions of higher education.

Together these incentives have helped numerous families afford college and reduced its cost. However, the current system of education tax benefits is complex, with numerous programs targeting the same goals. As a result, taxpayers are confronted with difficult decisions about which of several potential tax benefits to claim and how to make the best of their particular situation. Facing this complexity, many taxpayers fail to claim the maximum benefit when they are eligible for more than one program.[1] Interactions between tax benefits and grants, including Pell Grants, exacerbate this complexity. Streamlining education tax benefits and improving coordination between tax benefits and grants could simplify student aid use for millions of students and their families and help ensure that Americans have access to valuable postsecondary education.

Today, I would like to provide some background on the tax incentives that support college attendance. First, I would like to summarize the major existing tax programs that help students and families defray the costs of attending college. Next, I would like to talk briefly about several proposals from President Obama that will make it easier for families to pay for college. Finally, I would like to discuss briefly how financing postsecondary education has changed over time and the challenges this poses for students, their families and the government.

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[1] Turner (2012) finds that roughly one in four taxpayers (including those using paid preparers) fail to claim the maximum tax benefit when they are eligible for multiple tax benefits. (See "Why Don't Taxpayers Maximize their Tax-Based Student Aid? Salience and Inertia in Program Selection." *The B.E. Journal of Economic Analysis & Policy*: 2011, Vol. 11: Issue 1. The U.S. Government Accountability Office (GAO-12-560, *Improved Tax Information Could Help Families Pay for College*, June 2012) also finds evidence that taxpayers fail to maximize their education tax benefits, reporting that 14 percent of filers in 2009 failed to claim an education tax benefit when they appeared eligible.

II. Description of Current Tax Programs

There are 18 major tax benefits that support postsecondary education. They take the form of credits, deductions and income exclusions. In total, they offered more than $41 billion of support last year. This represented more than one-fifth of the total federal support for postsecondary education.[2]

Tax benefits for current postsecondary education expenses (see Table 2A for further details).

In 2009 the President proposed and Congress enacted expanded financial aid for students though the American Opportunity Tax Credit (AOTC). The AOTC is available for up to four tax years for students enrolled at least half-time who pursue a degree or credential. This credit provides up to $2,500 per student for tuition, fees, and course materials for each of the first four years of postsecondary education—a total of up to $10,000 in support for college.[3] In 2013, the maximum available AOTC covered about 80 percent of tuition and fees at the average two-year public institution, or about 30 percent of tuition and fees for an in-state student attending the average four-year public institution. About 11.5 million families benefit and save an average of more than $1,100 per year.

The AOTC replaced the less generous, Hope Tax Credit and is available through 2017. As an alternative to the AOTC, taxpayers may choose the Lifetime Learning Tax Credit (LLTC). The Lifetime Learning Credit is computed at a 20 percent rate on up to $10,000 of qualified expenses (a maximum $2,000 non-refundable tax credit per tax return), is available for an unlimited number of years of education, and does not require qualifying students to pursue a degree or credential for expenses to qualify.[4] Taxpayers may claim at most one education credit (AOTC or LLTC) per student per year. The credits are subject to income limits that are intended to target the tax reductions to lower and middle income families. Only education spending net of other tax-free education assistance, such as grants, scholarships or distributions from education savings accounts, qualifies for these tax credits.

Through the end of 2013, taxpayers could deduct tuition and fees from taxable income, as an alternative to taking the AOTC or the LLTC for a particular student. Like the credits, only spending in excess of other tax-free educational assistance could be deducted. Taxpayers did not need to itemize their deductions to claim this tuition deduction of up to $4,000 of education spending. Like the LLTC, the deduction was available for an unlimited number of years and did not require students to seek a degree or a credential.

Tax credits like the AOTC, especially if they are at least partially refundable, are an effective means to reduce the costs of educational attainment, particularly for lower-income and middle-class families who struggle to finance the costs of college. They can be used to reduce costs of attendance and provide a benefit that does not vary directly with the taxpayer's marginal tax rate.

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[2] The value of tax benefits for education in fiscal year 2013 is from Office of Management and Budget, *Budget of the U.S. Government, Fiscal Year 2015, Analytical Perspectives*, Table 14. Total federal direct spending for the 2012-13 school year includes $48B from federal grants, $103B from federal student loans and $1B from federal work study. See College Board, *Trends in Student Aid 2013*.

[3] The $2,500 maximum amount is not indexed for inflation.

[4] Hobby classes do not qualify for the LLTC.

Other Tax-Related Education Benefits

In addition to these direct credits and deductions associated with tuition expenses, the Tax Code also provides several other benefits for families and students. Child-related tax benefits, including the dependent exemption and being a "qualifying child" for purposes of the Earned Income Tax Credit (EITC), are available for full-time students up to age 23. For non-students, eligibility for the dependent exemption and the EITC ends at age 18.

Taxpayers may exclude the value of scholarships, grants, tuition reductions, and employer-provided educational assistance from income, if the funds are used for qualifying tuition and related expenses. These grants include the federal Pell Grant. In addition, while payments for teaching, research or other services are generally taxable, recipients of National Health Service Corp (NHCS) scholarships and Armed Forces Health Professions Scholarships are excludable from income, even though recipients incur a work requirement. Up to $5,250 of undergraduate and graduate tuition, fees and related expenses provided by an employer may be excluded from income.[5] Tuition reductions provided to employees of institutions of higher education and their spouses are also excludable from income. In addition, gifts in the form of direct payments of tuition are not subject to gift tax.

Tax benefits for education savings (Table 2B provides further details).

The tax code subsidizes education savings in several ways. Earnings in qualified tuition programs (so called "529 plans" allowed by Internal Revenue Code section 529) and Coverdell education savings accounts ("530 plans" allowed by section 530) are not taxed when they are used for qualified education expenses. Generally, 529 plans can be used for undergraduate and graduate expenses,[6] while Coverdell accounts may be used for these expenses as well as certain expenses at the K-12 level. Distributions of earnings that are not used for qualifying expenses are generally subject to income tax and a 10 percent penalty. Contributions are allowed generous gift tax treatment; taxpayers can elect to have contributions in one year treated as if they were made over five years, effectively increasing the annual exclusion amount. Most 529 plans are administered by states and states establish the maximum allowed account balances. In recent years, plan maximums ranged from $225,000 to $370,000. A given beneficiary, moreover, can have plans in multiple states. So, for practical purposes, there are no federal caps on annual contributions to or balances in 529 plans. In contrast, contributions to 530 plans are capped at $2,000 per year per beneficiary across plans and contributions to these plans are subject to income limits.

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[5] Employer spending on education that is primarily for the benefit of the employer is not a tax expenditure and is fully excludable from employee income. Allowing a limited exclusion for employer-provided education for any purpose eliminates the need for employers to distinguish between expenses that are for the benefit of the employer and those that benefit primarily the employee, when the expenses are below $5,250. Thus, it simplifies administration of the tax code as well as potentially encouraging education spending.

[6] There are two types of 529 plans: pre-paid tuition plans and college savings plans. Pre-paid tuition plans allow college savers to purchase units or credits at participating colleges and universities for future tuition and, in some cases, room and board. College savings plans permit a college saver (the "account holder") to establish an account for a student (the "beneficiary") for the purpose of paying the beneficiary's eligible college expenses.

Besides education savings accounts, the tax code provides additional incentives for education savings. Taxpayers may take early distributions from IRA accounts without penalty if the distributions are used for education expenses.[7] Interest on certain savings bonds that are used for education expenses is not taxable.

Tax benefits for prior education expenses (see Table 2C for details).

Beyond providing tax relief for current and future education expenses, the tax code also provides tax benefits for prior education expenses. Taxpayers who meet income limits may deduct up to $2,500 of qualified student loan interest paid. In addition, the discharge of certain forms of student debt is excluded from income subject to tax. For example, students who participate in the National Health Service Corps Repayment program, the Public Service Loan Forgiveness Program, certain state loan repayment programs, and certain profession-based loan programs may exclude discharged debt from gross income.

Tax benefits for education institutions (Table 2D provides further details).

The Tax Code provides important benefits for education institutions. Charitable contributions by individuals may be deducted from income (by taxpayers who itemize their deductions) and charitable contributions received by institutions are not taxable. In addition, the investment income of college and university endowments is not subject to income tax or the excise tax on private foundation net investment income. Education institutions may benefit from tax-preferred financing. Bonds that qualify for tax-free interest include private activity bonds, student loan bonds and school construction bonds. The tax code also provides tax credits for investors who hold zone academy bonds. These bonds are typically used to finance operation of primary and secondary schools in low-income areas.

The Administration's Proposals

Permanently Extend the American Opportunity Tax Credit

The AOTC is scheduled to expire in 2017 when it will be replaced by the Hope tax credit. The Hope credit is less generous and less well targeted than the AOTC in three important ways. First, the Hope credit has a maximum value of $1,800 per year, in contrast to the AOTC's maximum value of $2,500. Second, the Hope credit is only available for two years, while the AOTC is available for four years. Third, the Hope credit is not refundable, while the AOTC is refundable, up to $1,000. Thus, the AOTC substantially increases the benefits available to lower-income families who are most in need of assistance, and because the AOTC is available for four-years, it may better encourage persistence. The Administration proposes to permanently extend the AOTC in order to help make college affordable for millions of families.

Beyond the proposal to permanently extend the AOTC, the Administration provides several other proposals to enhance and improve education-related tax policy.

[7] In general, early distributions from IRA accounts are subject to a 10% penalty.

Improve coordination between Pell Grants and the American Opportunity Tax Credit.

Pell Grants are the largest federal grant program that supports post-secondary education. In 2013-2014, Pell Grants provided $32 billion in grants to nearly 9 million students. Pell Grant recipients generally come from lower-income families. In 2011-2012, 74 percent of Pell Grant families had family income less than $30,000.

The AOTC is the largest tax incentive for higher education and is intended to significantly benefit students from low- and middle-income families. While each program alone increases the likelihood of a low-income student being able to achieve a postsecondary education, the current rules guiding these programs often exclude the neediest students from benefitting fully from both programs. Low-income students are the most likely to be dependent on financial aid in order to enroll in postsecondary schools and yet, under current rules, being eligible for a Pell Grant may reduce eligibility for the AOTC. In addition, current tax rules make it very difficult for students and their families to compute the maximum benefit to which they are legally entitled from the combined effect of both programs. As a result, families fail to claim hundreds of millions of dollars of available tax benefits each year. Better coordination between the two programs would seem to improve the prospects for the success of each.

A recent report by the Department of the Treasury discusses how we might achieve better coordination between the Pell Grant program and the AOTC. As suggested in the report, better coordination could include simplifying the process of applying for federal financial aid so that only information that can be found on a federal income tax form would be used to apply for Pell Grants. Better coordination could also include making more information on a student's eligibility for the AOTC available to students during the time that they apply for financial aid. The report also suggests ways to improve information reporting by schools to ease the compliance burden of students. Finally, the report suggests excluding Pell Grants from taxable income (even when used for living expenses) so that receiving a Pell Grant would no longer make some students ineligible for an AOTC.

Informed by this report, the Administration has moved on several fronts to improve coordination between the AOTC and Pell Grant programs to help make benefits more available to low- and moderate-income families.

On one front, the Administration has begun an outreach program to help inform taxpayers, tax preparers, and other interested advocates about existing rules regarding the interaction of Pell Grants and the AOTC, and about how to properly calculate a student's maximum benefit from the combined effects of these programs. The core of the issue is that the student and her family must allocate the Pell Grant between tuition, on one hand, and room and board, on the other, in a way that minimizes taxes overall, taking account of the AOTC. The problem arises because the amount of a Pell Grant that is used to pay tuition is not included in taxable income, but reduces the AOTC, while the amount of the Pell Grant that is spent on room and board is included in the student's taxable income, but does not reduce the AOTC. This calculation is complicated. Furthermore, even the basic fact that Pell Grants can legally be allocated for tax purposes between tuition and room and board, at the discretion of the student and independently of how the school allocated the Pell Grant, is not widely understood. This issue is discussed at some length in a recent Treasury fact sheet, which I have included as an addendum to my testimony.

Clarifying current law, and helping inform students, parents, taxpayers, colleges and universities, tax preparers, tax software providers, and other stakeholders how to calculate the maximum tax benefits allowed can help ensure that taxpayers get the benefits to which they are entitled. A better solution, however, would be to modify the tax law to remove these complicated interactions. In the President's FY 2015 Budget, there is such a proposal. Under the proposal, Pell Grants would be excludable from gross income without regard to which expenses they are applied, so long as the proceeds are spent in accordance with the Pell Grant program. For purposes of the AOTC and LLTC, taxpayers would be able to treat the entire amount of the Pell Grant as used to pay expenses other than qualified tuition and related expenses, such as room and board. The treatment of other scholarships would not be changed.

We estimate that over a million families would receive an average tax cut of $950 in 2015 if this proposal were enacted, and millions more would benefit from simplification of the rules. In many cases, these families are already entitled to tax benefits under current law but are failing to claim the AOTC or to claim the full amount owed due to the complexity.

Modify Reporting of Tuition Expenses and Scholarships on Form 1098-T

Form 1098-T is used to verify education spending for education-related tax benefits. Eligible institutions of higher education are required to file each year an information return (Form 1098-T) for each enrolled student for whom a reportable transaction is made.[8] Currently, Form 1098-T may not provide all the information that taxpayers need to claim an education tax credit or to properly report taxable scholarship income. Among institutions that file Form 1098-T, many report tuition amounts billed. However only amounts paid in a given tax year qualify for a tax credit in that tax year. (Amounts billed will not qualify for the credits if the amount was paid in a different tax year.) Scholarships that are paid directly to students rather than administered by schools are not reported on Form 1098-T either to students or to the IRS.

In its FY 2015 Budget, the Administration proposes to modify Form1098-T reporting so that institutions of higher education must report amounts of tuition paid. In addition, the proposal would require that any entity issuing a scholarship or grant in excess of $500 that is not processed or administered by an institution of higher education report the scholarship or grant on Form 1098-T. The threshold amount is indexed for inflation after 2015. Institutions of higher education would continue to report the scholarship and grants that they process or administer. Better reporting of tuition and scholarships will assist taxpayers in preparing their returns and allow IRS to monitor and improve compliance.

Provide Exclusion from Income for Student Loan Forgiveness and Certain Scholarships

In general, loan amounts that are forgiven are considered taxable income to the borrower and subject to individual income tax in the year of discharge. Exceptions exist for certain, but not all, student loan repayment programs.

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[8] An eligible educational institution is a college, university, vocational school, or other postsecondary educational institution that is described in section 481 of the Higher Education Act of 1965 as in effect on August 5, 1997, and that is eligible to participate in the Department of Education's student aid programs. This includes most accredited public, nonprofit, and private postsecondary institutions.

While general tax policy principles are clear in stating that forgiven debt is income, taxing student loans forgiven under income-driven repayment plans may create a burden on taxpayers that is perceived as unfair or that undermines other policy goals[9]. In particular, there is concern that students with debt underutilize existing income-driven repayment mechanisms for student loans.[10] These plans can help keep student debt burdens manageable by allowing loan payments to adjust with income changes. Furthermore, because of concerns over the burden of student debt, the Administration has proposed relaxing the eligibility requirements for the more favorable of the income-driven repayment plans.[11]

Under income-driven repayment options, borrowers complete the repayment obligation when the loan is repaid in full (with interest) within the repayment period, or when there is a remaining balance on the loan at the end of the repayment period. For example, in the Pay As You Earn plan, borrowers can qualify for loan forgiveness after making payments for 20 years. For borrowers whose loans are not repaid at the end of the repayment period, the remaining loan balance is forgiven.

Under current law, debt forgiven by these programs is counted as income and subject to the individual income tax. While this treatment conforms to income tax principles, it may reduce the incentive to take advantage of these programs. At the time the loans are forgiven, the individuals who have met the requirements for debt forgiveness in the income-driven repayment plans would have been making payments for many years. For some individuals, paying income tax on the forgiven amounts will be difficult or a surprise, and may be a trap for the unwary. Moreover, because the most recent income-driven repayment plan, the Pay As You Earn Repayment Plan, may provide forgiveness from more borrowers than its predecessors, this problem may be more pronounced in the future.

The Administration's FY 2015 Budget proposes to exclude from gross income any loan amount forgiven for borrowers in the income-driven repayment plans.

The Budget also proposes to provide exclusions from income for debt forgiven under the Indian Health Service (IHS) Loan Forgiveness Program and for IHS Health Professions Scholarships (even though such scholarship recipients incur a work requirement). This will provide the same treatment for IHS Programs as for the National Health Service Corp and Armed Forces Health Professions programs.

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[9] The income-driven repayment plans include the Income-Based Repayment Plan, the Pay As You Earn Repayment Plan, and the Income-Contingent Repayment Plan.

[10] Based on a random sample of borrowers in repayment status as of 2010 matched to tax data, roughly 45 percent of borrowers who are not in default have annual 10-year standard payment amounts in excess of 15 percent of net income, and thus may be eligible for the existing Income-Based Repayment Plan. Among Direct Loan borrowers in repayment status as of 2010 who may be eligible for the Income-Based Repayment Plan, only 41 percent chose a repayment plan that offers lower monthly payment plans than the 10-year standard plan. Moreover, about 70 percent of borrowers in default in 2010 had incomes low enough to qualify for an income-driven repayment plan, which might have kept them out of default.

[11] Under current law, borrowers can enter the Income-Based Repayment Plan, which generally sets payments at 15 percent of discretionary income and have any remaining balance forgiven at the end of a 25-year repayment period. Under regulations issued in 2012, which expanded legislation passed in 2010, newer borrowers can also have their payments set at 10 percent of discretionary income and have any remaining balance forgiven at the end of a 20-year repayment period. This month the President directed the Department of Education to extend this option, called Pay as You Earn, to all borrowers, regardless of how recently they borrowed.

The Challenges of Education Finance

A postsecondary degree or credential confers clear economic benefits on graduates, including higher lifetime earnings, low rates of unemployment, and is even associated with better health and greater civic engagement. Increasingly, however, families are concerned about college affordability, their ability to finance educational investments, and whether the increasingly steep costs of college are a worthwhile investment.

On average, net tuition—the cost of attendance after grants and scholarships—has increased roughly 50 percent since 1994 at public four-year schools; the "sticker price" of college (before grants and scholarships) has increased much more. These trends—posted tuition growing much faster than inflation, declining support for public institutions from state governments, anemic and flat savings rates for middle income families, and limited prospects for earnings during the school year, as well as, on the positive side, increased college enrollment among students from low- and moderate-income families ——have led to student loans becoming an ever-larger part of the education financing mix. Student loan balances recently surpassed $1 trillion in face value, although much of the growth in student loan balances reflects growth in the number of borrowers, rather than in per-borrower balances.

Students and their families are caught in a difficult financial situation, feeling that a college degree or other postsecondary credential is too important to achieving a secure economic future to forgo, but struggling to pay for that investment because of rising costs. Indeed, the resulting difficulties students face in paying off student loan debt has emerged as an important economic challenge itself.

In these conditions it is imperative that government policy facilitate valuable investments in education and skills, both by helping students and families pay for college and to rein in the cost increases we have seen in recent years. Addressing these issues will require better information provision to students, their families, and policymakers. It will also require new and modified financing tools. Tax policies will surely be part of the policy mix in the future, and it is important for these policies to be as efficient and as effective as possible.

I look forward to working with Congress to address these challenges.

Table 1: Cost of Education Tax Benefits (Current Law Tax Expenditure Estimates)								
(millions of dollars)	2013	2014	2015	2016	2017	2018	2019	2015-2019
Programs for Current Education Expenses								
American Opportunity Tax Credit*	16,580	21,700	21,520	21,590	21,460	19,730	2,680	86,980
Hope Tax Credit	0	0	0	0	0	720	7,230	7,950
Lifetime Learning Tax Credit	1,810	1,680	1,720	1,740	1,740	1,880	3,100	10,180
Tuition and Fees Deduction	600	560	0	0	0	0	0	0
Dependent Exemption (does not include EITC)	5,200	5,320	5,400	5,490	5,570	5,660	5,760	27,880
Exclusion of Scholarship Income	2,890	2,980	3,090	3,200	3,310	3,420	3,550	16,570
Exclusion of Employer Provided Educational Assistance	710	750	800	850	900	950	1,000	4,500
Programs for Education Savings								
Qualified Tuition Programs	1,680	1,770	1,900	2,050	2,200	2,350	2,520	11,020
Coverdell Education Savings Accounts	70	80	100	110	120	130	150	610
Exclusion of Interest on Savings Bonds used for Education	10	10	10	20	20	20	20	90
Programs for Prior Education Expenses								
Student Loan Interest Deduction	1,720	1,720	1,780	1,780	1,790	1,790	1,840	8,980
Discharge of Student Loan Debt	90	90	90	90	100	100	100	480
Other Programs								
Exclusion of Interest on Student Loan Bonds	510	560	620	700	760	820	880	3,780
Deductibility of Charitable Contributions	4,550	5,040	5,370	5,810	6,290	6,780	7,290	31,540
Exclusion of Interest on Bonds for Private Non-profit Education Facilities	2,240	2,480	2,760	3,120	3,430	3,660	3,930	16,900
Qualified School Construction Bonds*	1,520	1,590	1,590	1,590	1,590	1,590	1,590	7,950
Credit for Zone Academy Bonds*	220	210	190	160	150	140	130	770

Notes: These estimates assume that all other aspects of the tax code are held fixed.

*These estimates include budget outlay portion.

Source: Office of Management and Budget, Budget of the U.S. Government, Fiscal Year 2015, Analytical Perspectives, Table 14

Table 2A: Tax Benefits for Current Education Expenses

Program	Benefit	Qualifying Expenses	Qualifying Education	Qualifying Income Range	Expiration Date
American Opportunity Tax Credit (AOTC)	Maximum credit of $2,500 per student, equal to 100% of first $2,000 of spending plus 25% of next $2,000 of spending. Up to $1,000 (40 percent) of the credit may be refundable.	Tuition, required fees, course related books, supplies and equipment.	May be claimed for up to four tax years for students enrolled at least half-time who purse a degree or credential.	Benefits phase out for non-joint returns between $80,000-$90,000 and for joint returns between $160,000 - $180,000.	Replaced the Hope Tax Credit beginning in 2009. Set to expire in 2017.
Hope Tax Credit (HTC)	Maximum (nonrefundable) credit of $1,800 per student, equal to 100% of the first $1,200 of spending plus 50% of the next $1,200 of spending.	Tuition and required fees.	May be claimed for up to two tax years for students enrolled at least half-time who purse a degree or credential.	Benefits phase out for non-joint returns between $54,000-$64,000 and for joint returns between $108,000 - $128,000.	Replaced by the AOTC beginning in 2009.
Lifetime Learning Tax Credit (LLTC)	Maximum (nonrefundable) credit of $2,000 per return equal to 20% of the first $10,000 of Education spending.	Tuition and required fees.	May be claimed for any number of years for all postsecondary enrollment.	Benefits phase out for non-joint returns between $54,000-$64,000 and for joint returns between $108,000 - $128,000.	None.
Tuition Deduction	Maximum deduction of $4,000 per return or $2,000 per return depending on income.	Tuition and required fees.	May be claimed for any number of years for all postsecondary enrollment.	Maximum deduction of $4,000 for joint (non-joint) returns with income not more than $130,000 ($65,000). Maximum deduction of $2,000 for joint (non-joint) returns with income more than $130,000 ($65,000) and not more than $160,000 ($80,000).	2013
Dependendent Exemption for Enrolled Students	Youths ages 19-23 may be claimed as dependents and qualify for children for the Earned Income Tax Credit if they are full-time students.	NA	Students must be enrolled fulltime for at least five months, live with the taxpayer claiming the student as a dependent for at least half of the year.	NA	None.
Exclusion of Scholarships, Grants and Tuition Reductions	Amounts received may not be taxable.	Tuition, fees, and course-related expenses including books, supplies and equipment.	K-12, undergraduate and graduate.	NA	None.
Employer Provided Educational Assistance	Up to $5,250 of employer benefit is not taxed.	Tuition, fees, and course-related expenses including books, supplies and equipment.	Undergraduate and graduate. Courses do not have to be work-related.	NA	None.
Gift tax exclusion for Education expenses	Up to $14,000 of gifts for tuition expenses is not taxable.	The gift tax does not apply to amounts paid to education institutions for tuition.	Education at qualifying education institutions.	NA	None.

Table 2B: Tax Benefits for Education Savings

Program	Benefit	Qualifying Expenses	Qualifying Education	Qualifying Income Range	Expiration Date
Qualified Tuition Plans (529s)	Earnings in accounts are not subject to tax. Contributions may be receive benefit at state level. Accounts are not necessarily the property of the designated beneficairy.	Tuition and fees, books, supplies and equipment. Room and board for students enrolled at least half-time. Expenses for special needs.	Undergraduate and graduate.	None.	None.
Coverdell ESA (530s)	Earnings in accounts are not subject to tax. Up to $2,000 may be contributed each year. Accounts become the property of the benficiary (usually the intended student) at age 18 and distributions must be taken by age 30.	Tuition and fees, books, supplies and equipment. Room and board and special needs expenses for students enrolled at least half-time in postsecondary institution. Tutoring, room and board, uniforms, trasnportation and computer access for K-12 students.	K-12, undergraduate and graduate.	Individuals contributing to 530 plans must meet an AGI threshold. Maximum contribution limit phases out for non-joint returns between $95,000-$110,000 and for joint returns between $190,000 - $220,000.	None.
IRA Distributions	Distributions used for qualifying education expenses are not subject to the additional 10% tax.	Tuition and fees, books, supplies and equipment. Room and board for students enrolled at least half-time. Expenses for special needs.	Undergraduate and graduate.	None.	None.
Education Savings Bond Program	Interest on savings bonds is not taxed. Applies to EE bonds issued after 1989 or series I bonds.	Tuition and fees, payments to 529 or 530 savings plan.	Undergraduate and graduate.	Program phases out for non-joint returns between $76,000-$91,000 and for joint returns between $113,950 - $143,950.	None.

Table 2C: Tax Benefits for Proir Education Expenses

Program	Benefit	Qualifying Expenses	Qualifying Education	Qualifying Income Range	Expiration Date
Student Loan Interest Deduction	Deduction of up to $2,500 of student loan interest paid.	Loans used to pay for tuition, fees, books, supplies, equipment, room and board, transportation or other necessary expenses.	Undergraduate and graduate. Student must have been enrolled at least half-time.	Program phases out for non-joint returns between $65,000-$80,000 and for joint returns between $130,000 - $160,000.	None.
Discharge of Student Debt	Discharge of certain student loans is excluded from income subject to tax.	Loans used to pay for tuition, fees, books, supplies, equipment, room and board, transportation or other necessary expenses. Only loans made by the federal government, a state government, certain tax-exempt public benefit corporations or an educational institution.	Undergraduate and graduate.	None.	None.

Table 2D: Tax Benefits for Education Institutions

Program	Benefit	Qualifying Expenses	Qualifying Education	Qualifying Income Range	Expiration Date
Deductibility of charitable contributions	Taxpayers may deduct charitable contributions to non-profit education institutions. Qualifying education institutions do not pay tax on the contributions.		Education institutions must meet the definition of charitable education institution defined in IRC 501(c)3. For education institutions, "charitable" includes the advancement of education or science and "educational" relates to the instruction or training of individuals.	None, but taxpayers must itemize in order to deduct the contribution from their income.	None.
Tax-exempt financing for education institutions	Interest on bonds issued by state and local government is excluded from income.	Qualifying bonds include private activity bonds, 501 (c) 3 bonds, student loan bonds and school construction bonds.		NA	None.
Credit for holders of zone academy bonds.	Tax-credit bonds provide tax credits to investors to replace a prescribed portion of the interest cost.	Bonds issued by a state or local government where 100 percent of the proceeds are used at "zone academies" and where at least 10 percent of the bond proceeds are contributed by private entities.	Zone academies include public schools below the college level that operates in a special academic program with businesses and is located in an empowerment zone, or in an area where at least 35 percent of students receive free and reduced price lunch.	NA	None.

Questions for the Record
"Less Student Debt from the Start: What Role Should the Tax System Play?"
Questions for the Honorable Mark J. Mazur
Hearing Date: June 24, 2014

Question from Chairman Ron Wyden

1. There is clearly a problem with our current education tax incentives in that most students don't even realize they could be eligible for thousands of dollars in tax benefits when deciding where to attend and how much to borrow. It is distressing that student financial aid forms determine a student's eligibility for tens of thousands of dollars in debt while never alerting them to the availability of tax credits – as much as $10,000 over four years – that could reduce how much they borrow in the first place.

   What can the Treasury Department and the Department of Education do to alert students about these benefits? Could we require that financial aid award letters that go out to students also include eligibility for tax benefits like the American Opportunity Tax Credit?

   Answer

   The Treasury Department and the Department of Education are engaged in several outreach programs to raise awareness of available education tax benefits. We look forward to continuing these efforts so that all students and their families can claim the benefits to which they are entitled.

   The Internal Revenue Service maintains a Tax Benefits for Education Information Center, which includes an interactive tax assistant tool to help students and their families determine if they are eligible for education tax credits (http://www.irs.gov/uac/Tax-Benefits-for-Education:-Information-Center). IRS Publication 970 *Tax Benefits for Education* (http://www.irs.gov/pub/irs-pdf/p970.pdf) and IRS Form 8863, which is used to claim the education tax credits, have also been recently revised with more examples to help students claim the various education tax credits. In addition, The Department of Education has added tax credit information to their financial aid website (https://studentaid.ed.gov/types/tax-benefits).

   Treasury also recently posted a blog to help students with Pell Grants claim the appropriate amount of education tax credits (http://www.treasury.gov/connect/blog/Pages/Helping-students-and-families-access-college-tax-benefits.aspx). The blog includes a link to a fact sheet that is being shared with higher education institutions and other stakeholders to help students maximize their federal education tax benefits. Finally, IRS and Treasury are developing additional simple communication tools to raise awareness of the education tax credits with guidance counselors, financial aid providers, students, and their families. These tools will include a one-page summary of education credits for use by high-school counselors and improved information on credits to accompany the 1098-T reporting form, which schools currently provide to assist students claiming educational credits.

   Treasury and the Department of Education are also assessing the feasibility of additional communication strategies, including by providing information about eligibility for tax benefits such as the American Opportunity Tax Credit on financial aid award letters.

Questions from Senator Orrin Hatch

1. In a recent paper by an economist who is now at the Treasury Department, the author writes that "Contrary to the intention of policymakers, I find that schools fully counteract the cost reduction of tax-based aid by lowering institutional aid dollar-for-dollar. This finding implies that colleges and universities capture the financial benefits of tax-based aid at the expense of eligible students and families."

   Would you comment on whether colleges and universities are capturing the financial benefits of tax-based aid, and if they are, what, if anything, should be done in response?

   Answer

   The idea that colleges and universities act strategically to capture financial benefits from federal student aid is known as the "Bennett Hypothesis," named after former Education Secretary William Bennett. This hypothesis makes the analogy to a profit-maximizing entity, where institutions attempt to expropriate federal aid intended to lower the cost to students of obtaining higher education. The intuition is that broad-based financial aid may be captured by the education institution, most simply through raising tuition. But the reality is complex and findings on the validity of the Bennett Hypothesis are mixed.

   The study that you mention examined only a subset of four-year schools in a period prior to the American Opportunity Tax Credit. It is not clear that the results from this study hold outside the set of four year schools that were examined, nor is it clear that the findings of this paper apply to the American Opportunity Tax Credit. As you know, the American Opportunity Tax Credit expanded tax-based aid to many lower-income families by making tax-based federal student aid partially refundable. There is some evidence that community colleges and public four-year colleges and universities may be less able than for-profit colleges to capture the financial benefits of federal student aid targeted to a subset of students and families. The simple intuition is that such aid benefits only a segment of the student population, while tuition hikes apply to all, making this strategy less effective for expropriation.

   Still, I understand and share your concern about the effectiveness of tax-based federal student aid programs. We look forward to working with Congress to ensure that all our student aid programs, including tax-based federal student aid, are as effective as possible at increasing college enrollment and graduation.

2. There have been several recent tax articles suggesting that Congress eliminate all education tax incentives and replace them with direct spending programs. In the recent Treasury report on Pell Grants and the AOTC, Treasury writes, "The report concludes that direct grant aid, such as the Pell Grant, is a better mechanism for delivering education subsidies to low-income students [than advance refundability of the education tax credits]."

   Should the education tax incentives be replaced with direct spending programs?

   Answer

   The Treasury report concludes that direct grant aid is a better mechanism than a proposal for an advance refundable credit for delivering education subsidies to low-income students. This result is largely due to the cumbersome nature of that proposal delivering advance payments of tax credits to educational institutions.

3. Do you think that certain tax incentives are important in that they create external benefits, sometimes referred to as positive externalities? For example, the research and development credit is usually cited as an important incentive in that social returns to research and development are larger than the private returns.

   Does a similar argument hold for educational tax incentives – that the social returns associated with higher education outweigh the private returns?

   Answer

   Let me begin with a clarifying point. Tax incentives themselves do not create external benefits. Rather, in some cases tax incentives can encourage activities that produce external benefits (that is, social benefits that exceed the benefits accruing to the individual or entity undertaking the activity).

   When an activity or good creates external benefits, private economic decisions (that is, the market) will under-supply the activity or good. Government intervention can help to correct such a market failure by encouraging more of the activity in question.

   There are undoubtedly some positive externalities or spillovers from education. These include less reliance on public benefits, increased overall economic growth, greater opportunities for less educated workers, lower crime rates, greater civic participation, a more literate electorate, higher rates of volunteerism, and greater parental involvement in child education. All of these may provide support for interventions in the education market.

In addition, there is another type of market failure that can affect the market for education: credit constraints. In the case of education, credit constraints arise because it can be difficult to offer collateral to secure loans used to pay for education. As a result, markets for these loans might not exist. This is especially a problem for lower income families. Credit constraints may prevent low-income students from borrowing to achieve their desired level of education, even if their lifetime benefits from education exceed their costs of schooling, and they could repay the loans. Federal loan programs address the problem of credit constraints. So do other federal aid programs, such as grants and tax-based federal student aid, both of which can alleviate credit constraints by lowering the cost of attending college.

4. Is the increasing accumulation of student loan debt that we see today sowing the seeds for a retirement savings crisis down the road?

Answer

The Obama Administration is concerned about the ability of borrowers to manage student debt obligations and about low levels of retirement saving among some groups of workers. However, I do not foresee today's student debt burdens causing a retirement saving crisis. On average, earnings have kept pace with debt burdens, and one recent study found that monthly student loan payments as a share of income have not grown substantially in recent decades.

5. Does the burden of servicing debt accumulated to finance higher education crowd out saving for retirement?

Answer

Student debt is unlikely to crowd out saving for retirement in the aggregate. The return on investment in education is high – a 15 percent annual return for a bachelor's degree according to one recent estimate. Thus, even if spending for education is financed through borrowing, earnings will generally be higher, increasing the ability to save for retirement or other needs. Furthermore, as mentioned above, on average student debt payments as a share of income have not grown substantially in recent years.

6. The tax system today provides simultaneous incentives to an individual or family unit to both borrow for education and save for retirement. Do you think the education borrowing and retirement savings incentives conflict with each other? If so, what do you recommend?

Answer

I see no serious conflict between incentives that reduce the current cost of higher education through subsidized credit, grants, and tax benefits, and incentives that reduce the cost of saving for retirement through tax preferences.

7. I worry about the effect of federal aid and other incentives on middle income families. For example, middle-income families receive less federal aid than lower-income families. But if the Bennett Hypothesis is correct, these middle-income families must still pay the inflated tuition resulting from federal aid.

Is this resulting in a financial squeeze for such middle-class families, and would such a situation exist under your vision of reform?

Answer

As mentioned above, aid targeted to segments of students is likely to be relatively difficult for schools to appropriate in the form of higher tuition. This casts doubt on the extent to which middle-income families would face higher tuition as a result of federal aid policies. To a larger extent, higher tuition reflects reduced state aid for higher education at public colleges and universities.

Furthermore, middle income families benefit from a variety of federal tax-based aid programs that help them save for college, finance college costs, and repay their federal student loans. Many middle-income families benefit from tax-advantaged savings accounts that allow them to set aside money to save for future college expenses. When students enroll in college, the tax system provides additional benefits, such as from the American Opportunity Tax Credit, which provides up to $2,500 per year of college during each of the first four years of enrollment. This credit provides middle-income families with up to $10,000 of education support per student over four years. After graduation, middle-income borrowers who pay back their loans can deduct up to $2,500 of student loan interest paid from their income subject to tax. These benefits play an important role in maintaining college access and affordability for millions of Americans. I look forward to working with Congress to ensure that our tax-based federal student aid programs are well-designed and as effective as possible at increasing college enrollment and graduation.

Questions from Senator Robert Menendez

Dr. Mazur, as you already know, even if student borrowers do somehow manage to have their loans forgiven, their trial is still not over. Just when they see light at the end of the tunnel, borrowers can get slammed with an unexpected tax bill. I'm preparing legislation titled the Student Loan Tax Relief Act to repeal the tax imposed on student debt forgiven by federal loan forgiveness programs and death or disability. Currently, these forgiven debts are considered part of the borrower's income, often imposing a surprise tax bill for borrowers and their families who were simply trying to do the right thing.

1. Do you believe most student borrowers are aware of this tax burden when they enter into income based repayment programs?

Answer

Student borrowers in Income Driven Repayment (IDR) plans (this category includes Income-Based Repayment (IBR), Income-Contingent Repayment (ICR), and Pay-As-You-Earn (PAYE) programs) have their unpaid loan balances forgiven at the end of 20 or 25 years, depending on the program. Under current law, the unpaid balances are considered income in the year of forgiveness and thus are added to taxable income and subject to income tax. It is reasonable to believe that these borrowers are not focused on possible future income tax liability at the time of enrollment into a payment plan. This is because any tax liability will be due far in the future, and the borrowers are focused on lowering their payments today and probably expect to be able to repay their loans. The President has proposed excluding from income the value of the forgiven debt for students participating in IDR programs in each of the last four Budgets. In the interim, Department of Education websites help student borrowers evaluate whether IDR is right for them and provide some information about the potential future tax liability and the increase in total interest due over the life of the loan when payments are slowed.

Many student borrowers in IDR will also expect that they will pay off their full balance in less than the 20 or 25 years of required payments under IDR programs. Such students benefit from having the lower payments available when needed and will face no additional tax bill at the end of the repayment period.

2. Do you agree that taxing the debt forgiven by the repayment programs runs counter to both the goals of the programs and logic in general?

Answer

Standard tax policy concepts of measuring income would include debt forgiveness as a component of income. However, taxing forgiven debt of student borrowers who participate in IDR programs runs counter to the policy of this Administration. Borrowers in the program who are unable to pay off their debt in the 20 or 25-year repayment period generally will have had low incomes relative to their debt burden for much of their working lives. For many of these individuals, paying income tax on the forgiven amounts would be difficult and much of the debt would be uncollectible. This is why the President has proposed excluding from income the value of the forgiven debt for students participating in IDR programs in each of the last four Budgets.

3. Is the administration willing to work with us to expand their proposal in order to exempt from tax loans forgiven due to death and disability?

Answer

As you are aware, federal student loan debt forgiven is considered ordinary income and therefore subject to tax under current law. The Administration's budget proposal for income exclusion of debt forgiveness for those at the end of their IDR payment period is a first step. For some borrowers and their families whose debt is forgiven due to death or disability, the income tax due can easily exceed their limited ability to pay. We look forward to working with you to address this situation in a way that is administrable for those who need assistance or tax forgiveness.

Questions from Senator Michael Bennet

1. In 2009, the GAO found that 1.5 million students failed to take a credit or deduction for which they were eligible. Assistant Secretary Mazur, as you note, about 1 in 4 taxpayers fail to claim the maximum tax benefit when eligible for multiple benefits. Yet these tax benefits can help middle class families make college more affordable. If we were starting from scratch and wanted to create an educational tax system that was simpler and had a greater impact on middle and low-income families, how would we do it? Would we have 1 tax credit that's larger and more refundable rather than the patchwork of deductions and credits we have now?

   Answer

   Considering ways to simplify the various education tax incentives is a worthy activity. However, one reason why the tax system has multiple benefits for enrolled students is that the programs target different populations.

   For example, the American Opportunity Tax Credit offers a benefit for millions of college students each year – those attending school at least half time and in their first four years of postsecondary education. This credit provides students and their families with up to $2,500 of educational assistance each year during the first four years of college, with up to $1,000 per year as a refundable credit for lower-income families. As a result, students may receive up to $10,000 of educational support from the American Opportunity Tax Credit over four years.

   The tax system also supports millions of part-time and non-degree seeking students with the Lifetime Learning Tax Credit. This non-refundable credit is worth up to $2,000 per year and is available for an unlimited number of years.

   The creation of the AOTC helped to simplify the tax system because it clearly offers the largest education benefit for eligible students during the first four years of study. One could imagine building on the AOTC as a way to create a simpler tax incentive for enrolled students and we look forward to working with Congress in this effort.

2. In Colorado, the average cost of tuition and fees at a 4-year public school is about $9,000. Room and Board can add another $9,000. Is there more we can do to encourage lower and middle income families to save for college? Some data on 529 and Coverdell plans indicate that they tend to benefit upper-middle and upper income families. Is it even possible to create a savings vehicle that attracts lower and middle-income families? Colorado, for instance, provides a dollar-for-dollar match up to $500 for contributions by lower- to moderate-income

families to its 529 plan. Are there ways that the federal government can encourage states to make similar matching investments to middle-income families saving for college?

Answer

For millions of hard-working lower- and middle-income families that struggle to meet their expenses, saving for college is difficult. To help keep college in reach for these families, the federal government provides a number of important federal tax benefits, including the American Opportunity Tax Credit and the Lifetime Learning Credit. For families that are able to save for future college expenses, qualified tuition savings plans and Coverdell accounts allow savings to grow tax-free as long as they are used for qualified education expenses. Many states offer state tax benefits for savings deposited into qualified tuition savings plans. These state-provided benefits can be effective at generating savings and complement the federal exclusion for investment earnings.

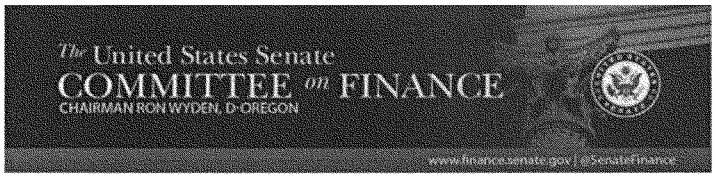
3. Last week, Sen. Alexander and I released a proposal to simplify financial aid in order to promote increased access for students and to serve students more effectively. We make the system easier, more transparent, and predictable. Four witnesses at a HELP hearing testified that the complexity in the current system is itself a barrier to access. Is complexity a barrier to utilizing tax benefits as well? Is the current system's complexity and obscurity diluting the effect of education tax benefits for middle-class families? How can we apply the principles of simplicity, transparency, and predictability to make tax benefits more effective for low and middle income families?

Answer

The tax system, as it applies to education benefits, is complex because, in part, it provides tax benefits for various types of students, from full-time degree-seeking undergraduate students to part-time students to professional graduate students. There is a trade-off between offering programs for these different types of students and offering a simpler system with fewer types of benefits that covers a smaller portion of enrolled students.

The current tax system tries to balance this complexity with the benefits of covering different types of students. And the Administration has taken several steps to simplify education tax incentives. For example, the American Opportunity Tax Credit helps to simplify the existing set of tax benefits for millions of eligible college students. Typically, the American Opportunity Tax Credit offers the largest annual benefit, and, because it provides up to four years of benefits, many students can simply claim the credit for their entire undergraduate course of study. To further simplify tax benefits for higher education, the Administration has

proposed legislation that would allow millions of lower-income students to fully benefit from both the American Opportunity Tax Credit and from Pell Grants to which they are entitled under current law. In addition, the Administration recently published a fact sheet to help students and their families and tax preparers and software providers optimize their tax credit claims when a Pell Grant is part of their financial aid package. All these steps will help ensure that millions of families are able to make the most of their tax benefits for higher education.



Wyden Statement on Improving Education Tax Incentives and Lowering Student Debt from the Start

Today the Finance Committee turns its attention to the U.S. tax code, an anticompetitive, mindlessly-complicated tar pit that makes it harder to create good jobs, succeed in global markets, and nurture innovation. It is long past time to drain this swamp. Because the tax code is like an ecosystem, changes in one area almost always have big effects on others. That's why tax reform must be comprehensive – it has to include both individual and business policies.

As the Finance Committee continues to drill down with hearings on reform, the committee will focus on one byzantine part of the tax code that's ripe for improvement: how the tax code incentivizes higher education. Everybody knows that getting a college education is one of the surest ways to climb the economic ladder. But the skyrocketing cost of college leads to smothering loads of student loan debt, and in fact, it can even have the effect of reinforcing inequality.

In its debate over education costs, Congress has put a great deal of focus on how to make students' huge debt bills more manageable. Today the committee will come at this from another angle – one that I think is central to any effort to help struggling families and reinvigorate the middle class. I want to focus on policies that will mean students have less debt from the start.

The crazy quilt of tax benefits and aid programs on the books today doesn't get that job done. And as a result, there are millions of Americans who want to get a college degree, but can't.

It now takes at least 36 calculations for a family to navigate the overlapping web of tax incentives for higher education in the code today. Each of those tax incentives has its own definition of qualified expenses, student eligibility, and income thresholds. Students and parents shouldn't be expected to wade through this mess.

The Finance Committee can make the menu simple – get it down to three credits or deductions that are user-friendly and get students the help they need. This improved system ought to be based on a few key goals – saving, covering costs, and easing the burden of loans.

For one, education tax incentives cannot be allowed to drive inequality the way they do in today's flawed tax code. In 2011, families with incomes under $25,000 got an average of only $930 in education tax credits. But families with much higher incomes can get a benefit nearly three times that size. If education is the great equalizer in society, then access to higher education cannot be unequal.

A recent paper from the non-profit Corporation for Enterprise Development showed that the government's tax spending on higher education is greater than the entire discretionary budgets of nine separate federal agencies. Let's retool that big investment, get more value out of those dollars, and encourage more saving early in a child's life. With so many families struggling to cover basics like rent and groceries, simply repeating "save, save, save" may not be constructive. Families that start saving within a few months of a child's birth could be made eligible for an "Early Savers" break that would complement a parent's contribution, so as to promote lifelong saving. Working parents of modest means who manage to save could have their savings matched through the Earned Income Tax Credit. There are also ways to wring more value out of the tuition savings vehicles called "529 plans." Auto-enrolling employees into savings plans for college is another idea that deserves strong consideration.

The fact is, there are a variety of ideas of how to promote lifelong savings. Senator Schumer has done terrific work putting proposals together. President Clinton, Senator Grassley, former Senators Kerrey, Santorum, Gregg, and Dodd have all supported various forms of child savings accounts. It's rare to see an idea with that strong level of support from all ends of the political spectrum.

At the same time, it's essential to clear out the barriers known as "asset limits" that punish many families when they save. Too often, a struggling family risks losing food assistance or Medicaid coverage when they manage to put aside some money for their child's education. No family in America should have to face going hungry or forgoing necessary medical care in order to save for their child's education.

It's also important to do a better job of getting the word out about these education incentives. There is no simple college savings guide for new parents. And the Higher Education Act says schools must provide current and prospective students with a host of information on student aid programs, but nowhere does it mention tax credits. Schools aren't required to relay this information to students in any coherent, uniform way. It's no wonder that students and families are leaving money on the table. The incentives are out of whack, leaving families relying too heavily on risky loans.

There are other steps to take that would help students and their families reduce debt from the start. For example, it's important to give students better information about their educational choices. That's why Senator Warner, of this committee, Senator Rubio and I introduced the Student Right to Know Before You Go Act. This legislation would give students a one-stop-shop for information about the net costs, graduation rates, transfer rates, and student debt levels at various schools. And students could get a sense of what they'd earn with various degrees. That way, if students have to take on debt, they'll be doing so as informed investors. It's hard to believe that resource doesn't already exist.

Furthermore, colleges and universities have a responsibility to hold down costs. Higher education cannot become a luxury good, because that would be the death knell of America's middle class.

In Oregon, the average four-year grad with debt owes nearly $27,000. Wait till you hear Amber Lee of Oregon, who's joining the committee here today, describe what's ahead for her. Rather than buying a car or saving up for a down payment on a home, students are making loan payments. More students would walk the halls of college and earn degrees if they had to take on less debt. They'd be pumping more money into their communities and saving for the future.

Some student loan debt may be unavoidable. But leaving students with less debt is possible. Simplifying the tax code and making education incentives more user friendly is not just possible – it's essential. And giving students the information they need to make informed choices about prospective schools and

degrees is another critical piece of the higher ed puzzle. There are common-sense steps I believe this committee can take on a bipartisan basis to help students avoid taking on paralyzing amounts of debt. Today's hearing is just one of our committee's challenges in our bipartisan effort to fix America's tax code. It is an especially important one, and we are determined to get it right.

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Less Student Debt from the Start:

What Role Should the Tax System Play?

U.S. Senate Committee On Finance

Tuesday, June 24, 2014

Testimony

Dean A. Zerbe

National Managing Director, alliantgroup

Chairman Wyden and Ranking Member Hatch, thank you for asking me to testify at today's hearing on college education and tuition.

I personally have had a long road through the higher education system -- leaving high school early with a GED; going to junior college; transferring to a private college for my bachelor's degree. Later, I went to law school at night at a public university while working full time. Finally, I studied for an advanced law degree in taxation from a private university while commuting four hours twice a week from DC to New York while working in the Senate. Between loans, grants, work, savings -- cotton, string and wire – my family and I – like many families -- got through it all. So Senators I've benefited from higher education and I've also seen a great deal of higher education at all levels.

The world is very different now – with skyrocketing tuition and a hard economy. I know you Senators hear every day the stories of families struggling to meet the costs of tuition. Cotton, string and wire aren't enough anymore.

It is for these reasons, that I believe the Committee has asked the exact right question – what can be done in the tax code to encourage colleges to control increases in tuition – and part and parcel – help all families meet the costs of college without risking their future economy security.

The short answer is that the Finance Committee can do a great deal on both these issues. To do so, the Committee needs to recognize two things – first, the enormous amount of taxpayer dollars that are being provided to colleges and universities every year though various provisions of the tax code; and second, that under current law, these billions of dollars are being provided without application of any real requirements, standards or incentives to control the ever increasing cost of tuition.

Also the Committee needs to engage in a thorough review of the billions of dollars dedicated to supporting colleges and universities – understanding what dollars are provided and what institutions are getting those taxpayer monies. Armed with that knowledge, the Committee should consider revisiting the policy choices it has made in the past – particularly looking at areas such as tax-exempt bonds which as I discuss below which are actually in some ways counterproductive to the goals of the Committee of encouraging low tuition costs for students from low and middle income families as well as veterans.

Standards for Taxpayer Dollars

Let's first talk about the taxpayer dollars that go to colleges and universities through the tax code. The value of the charitable status for colleges and universities I estimate (roughly) based on Joint Tax Committee estimates to be approximately $10 billion dollars a year at the federal level.

What are the key parts of these tax benefits? – tax-exempt bonds; donations to the college that are deductible from taxes; tax-free treatment of endowments; and generous tax treatment of university business activities.

Bottom line – colleges and universities receive a massive amount of money in taxpayer-funded subsidies every year. The tax code does not require of these colleges and universities any steps to control net and sticker tuition in return for this taxpayer money.

The question is then – should the Finance Committee consider creating tax code standards for colleges and universities to control net and sticker tuition -- requiring a focus on controlling spiraling costs of our colleges and universities -- in exchange for the billions of dollars they receive from taxpayers?

The tax code and regulations are filled with thousands of pages of examples of where standards are required for taxpayers to get other benefits – or to avoid paying tax.

It is also the case that the Finance Committee has placed detailed standards on charities – such as charitable hospitals and credit counseling centers – when it found that the general exemption rules were inadequate.[1]

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[1] To the Committee's credit, led by then-Chairman Grassley, the Committee on a bipartisan basis placed basic standards for charitable hospitals and credit counseling centers (See Roger Colinvaux, "Charity in the 21st Century: Trending Toward Decay," Florida Tax Review, 2011). The requirements placed on charitable hospitals by this Committee have the potential to provide enormous benefit for the uninsured poor in this country (and in some cases have already helped the poorest significantly). The Committee has also heard thoughtful testimony (Roger Colinvaux, Senate Finance Committee "Tax Reform Options: 'Incentives for Charitable Giving," October 18, 2011) recently that it should revisit the bundling of charitable status – and the tax benefits of being a charity – and arguing that they don't have to go hand-in-hand.

Further, it is clear that the colleges and universities would be responsive to the Committee's actions. Colleges and universities already jump through a score of hoops in response to the US News and World Report ratings – taking dozens of steps to better place themselves in those rankings. Certainly colleges and universities will be responsive to Congressional establishment of standards when there is a great deal of money at stake. [2]

At the core it's simple – the Committee should consider establishing standards for colleges and universities – in short, to act charitably in return for the billions of dollars in subsidies they receive from the taxpayers.

What are the standards that the Committee could require of colleges and universities in return for the billions of dollars in subsidies they receive? The Committee should engage in a broad conversation on this matter – of both what those standards might be (and the timing of those standards) and how they best match with the tax incentives (also see the discussion below about the Committee also reprioritizing these incentives overall).

However, to assist the Committee and encourage discussion, suggestions might include that: colleges and universities are eligible for certain tax benefits only as long as they meet some or all of the following standards:

1) keep growth of both sticker tuition and net tuition at a level of inflation or below (and/or that tuition remains below a certain dollar threshold).[3]

2) meet benchmarks for six-year, full-time freshman graduation rate; and,

3) students of the colleges and universities stay below a default rate on education loans. I would suggest as an added focus on the explosion of loans – that consideration be given to all colleges and universities (including for-profit entities) should assume some of the risk in these loans, that is, that they be required to have skin in the game on student loans – that they are

[2] When Senators Baucus and Grassley raised questions about college endowments – just questions – the giddyup by College Presidents was a wonder to behold – with many institutions swiftly making and announcing changes to their endowment policy, increasing payout and placing greater priority for helping low-income students. That was the response with just a few letters. But this only scratched the surface. Imagine the good that could be accomplished with binding standards on institutions to control tuition prices and prioritize performance outcomes.

[3] While it is outside of the scope of this hearing to discuss the reasons for tuition increases and the possibilities of controlling tuition increases, I note the following articles of interest: Delta Cost Project Issue Brief "Labor Intensive or Labor Expensive?" by Rita Kirchstein (February 2014); Delta Cost Project "Climbing Walls and Climbing Tuitions," by Rita Kirchstein and James Kadamus (December 2012); Goldwater Institute "Administrative Bloat at American Universities: The Real Reason for High Costs in Higher Education," by Jay Greene (August 2010); and, American Council of Trustees and Alumni "Cutting Costs: A Trustee's Guide to Tough Economic Times," by Michael Poliakoff are just a sample of the discussions out there on the topic. The impact of tuition increases at public universities due to reductions in state funding also should be recognized by the Committee.

responsible for a certain percentage of the amount that is loaned to their students and parents.[4]

The Committee may also wish to consider whether to reflect its priorities it makes sense to ensure equal opportunity for low and middle income families as well as veterans at colleges and universities receiving federal tax benefits.

These standards and best practices would place the right emphasis – controlling both net and sticker tuition.[5] Further, these benchmarks would ensure that colleges and universities are focused on helping students get their degrees and in a timely manner (the rising drop-out rate of our college students is a disaster); preparing students to be successful upon graduation; and, reduce the burden of overwhelming debt on students and their families.

The details of the best practices/standards can be debated (and fewer/more), the timing of the benchmarks are all fair points of discussion as the Committee considers what standards to place on colleges and universities in exchange for the billions of dollars they receive for the taxpayers.

I acknowledge that there are a great number of colleges and universities who are doing the right thing, or want to do the right thing regarding providing a good, affordable education.[6]

But the status quo is not working. Introducing standards provides a better path than the path we've been on -- of throwing ever-increasing taxpayer dollars at the problem and just hoping for good things to happen.[7] [8] Putting in place best practices/standards that tie tax

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[4] See "Tough Love: Bottom-Line Quality Standards for Colleges" from the Education Trust – Michael Dannenberg and Mary Nguyen Barry (especially for proposals 2 and 3)(June 2014); and generally Stephen Burd, "Undermining Pell: How Colleges Compete for Wealthy Students and Leave the Low-Income Behind" from New American Foundation (May 2013).

[5] High sticker tuition harms both low and middle income families – with studies finding that higher sticker tuition results in overall higher net tuition for low income families – as well as middle-income -- and essentially serves as a hidden tax on struggling middle income families – See Burd, "Undermining Pell." See also "More Students Subsidize Classmates, by Douglas Belkin, Wall Street Journal, January 10, 2014.

[6] I am taken by the good work of colleges such as Berea, College of the Ozark and Brenau (See Scott Carlson – Chronicle of Higher Education, February 3, 2014, "Brenau U. a woman's college in Georgia is running million-dollar surpluses. Here's how.") as well as a good number of public and private colleges that are showing that it is possible to accomplish the trifecta of low tuition, welcome mat for low-income families and a good education (See Burd, Undermining Pell).

[7] See Andrew Gillen, "Introducing Bennett Hypothesis 2.0," Center for College Affordability and Productivity, 2012 and Dills, Hernandez-Julian, Hale, "Government Policy and Tuition in Higher Education, Mercatus Center, December 2013). Of particular interest to the Committee may also be the excellent work done by Nicholas Turner: "Who Benefits From Student Aid? The Economic Incidence of Tax-Based Federal Student Aid?" October 20, 2010 (Mr. Turner is now in the Office of Tax Analysis at the US Treasury).

[8] The Committee may want to consider these issues immediately – in its extension of the Charitable IRA rollover (which overwhelmingly benefits colleges and universities) the Committee may wish to consider requiring that on a going-forward basis

benefits to reining in tuition costs will put us on the right path to controlling tuition. All this good can be accomplished without a single additional tax dollar.

For-Profit Colleges

A brief point on for-profit colleges. As mentioned above, certainly for-profit colleges should also have skin in the game regarding student loans. I recognize that the for-profit entities don't benefit directly from taxpayer support. However, the for-profit colleges do indirectly benefit from the Hope/American Opportunity Credit and the Lifetime Learning Credit. I would suggest the Committee may wish to consider (and may want to extend to non-profit institutions) denying eligibility for these credits for newly enrolling students in certain instances, for example, if a for-profit college fails to meet the standards and best practices the Committee establishes for 6 year degree completion and low repayment of student loans.

Endowments

When I served as one of the Tax Counsels on the Committee, at the direction of Chairman Grassley and Ranking Member Baucus we began a bipartisan review of college endowments. The college endowments are subject to extraordinary taxpayer support – with donations to the endowment enjoying significant support from taxpayers (being tax deductible) and all the earnings of the endowment also being tax-free (and also therefore supported by taxpayers).

The review involved sending letters to approximately 100 colleges and universities with the largest endowments, meeting with scores of representatives and talking to a host of other interested parties.

In general, the review told us that most colleges with significant endowments can provide far more tuition support from their endowments. This is similar to a report by the New American Foundation which noted that:

> "79 private colleges with endowments of more than $250 million that charge low-income students an average net price over $10,000; 51 that charge over $15,000 and 26 that charge over $20,000." (Burd – Undermining Pell)

The average payout from the endowments we reviewed was consistently below 5% (the requirement in place for most private foundations) – often way below; the definition of endowment used by the universities was uncertain on the best of days (with sometimes

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Charitable IRA donations will only be allowed only for those colleges that have kept sticker and net tuition below the rate of inflation in the previous year (or other benchmarks could be considered). A small, but important, first step.

multiple pots of money given different labels); and how payout was calculated rarely had consistency and was often designed to provide the best optics possible.

Chairman Camp in his proposals for tax reform proposed a 1% excise tax on certain large private college endowments investment income. This limited tax proposal would alone raise raised $1.7 billion dollars over ten years (and gives a hint to the significant tax benefits provided by the taxpayers to these large tax-free endowments).

Setting aside placing an excise tax[9] – which the colleges and universities can't avoid regardless of payout under the Ways and Means Committee proposal – the Committee may wish to consider (as it has done with private foundations and more recently with supporting organizations) requiring a payout of the largest endowments.[10] While 5% is the payout for private foundations, the Committee should bear in mind that private foundations in most cases have all the money they are going to ever have (they generally don't do fundraising). However, colleges and universities with their large alumni base are constantly seeking and getting more funds (in fact, comments have been made that large endowments actually serve to discourage some alumni donations) – so therefore the Committee may wish to consider a different payout requirement.

While recognizing that there can be good years and down years, the most recent ten years numbers are that all endowments have a growth of 7.1% over that time period – with the larger endowments showing a growth of 8.3%. Growth this year was investment return of 11.7% over FY 2013 (which does not include additions to endowments from donations).

Private foundations, that don't receive additional funds and donations and thus rely on endowment income, have thrived with a 5% payout requirements over good years and bad years – colleges and universities can do the same.[11]

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[9] Also the Finance Committee should consider revisiting the issue of endowments (as well as private foundations) that make extensive use of offshore "blockers" to avoid what little tax (UBIT) they might owe – raised in Committee hearings in 2007.

[10] See generally "Rethinking Endowment Payout in Higher Education" by Paul Jansen, McKinsey & Company

[11] It has been argued that these monies in the endowment are somehow tied up though donor restrictions. In my view, that is far from clear. The simple reality is that these monies are not tied up in any significant manner that would prevent universities from substantively helping address the costs and burdens of tuition. Alumni dollars are commonly donated with little to no strings attached that would bar funds from being used to help students and in our review we found that it was often the case that limitations on the use of monies were put in place by the college itself – not the donor. From first-hand experience I can tell you that most donors are more than happy to be responsive to requests from college officials that there be greater freedom in the use of a donation – especially if it is meant to target aid to students.

The requirement of a payout on our largest endowments could cause a seismic change to the current landscape of tuition costs. When the staff on a bipartisan basis talked to one Ivy League representative – the representative stated that if the college was required to have a payout – (intending for us to view this with horror) – that this would mean undergraduate tuition would be free. I can't imagine a better outcome – that some of our best colleges could offer undergraduate tuition for free (or extremely low amounts) and being able to open their doors wide to the most qualified – not just the qualified who can pay. The signal to the rest of the country (where there is still in the minds of many an embrace of chivas regal effect – price equals value) that the best education can be had for free would turn the world upside down when it comes to tuition. Low-income families would realize that a good education is within their grasp. In addition, "free" would force all universities to more closely justify their cost (how can you tell them an education costs $60,000 when they've seen Yale is free) would have a profoundly positive ripple effect.

The Committee should consider the question of whether it wants to have these large endowments – massively subsidized by all taxpayers – continue to sit and gather dust with a few pennies shaken out every so often. Or does the Committee want to instead dynamically change the landscape of college education. As discussed next – the real question for the Committee is – is there a better use of taxpayer-funded expenditures than subsidizing these large endowments that provide very little benefit to today's families struggling to pay tuition?

Where Should Taxpayer Subsidies to Education Go?

As I discussed at the beginning, I roughly estimate that taxpayer directly subsidize colleges and universities to the tune of $10 billion dollars a year.

These subsidies have basically grown over the years – unchecked and without any Congressional review or consideration.

I would encourage the Committee to ask some basic questions to perform a review of these subsidies/expenditures – ask the Treasury Department as well as the Joint Committee on Taxation to provide the Committee the following two items: First, a detailed analysis of the tax benefits (and the value) for higher education. While some of this work has been done – for example, the JCT's excellent brief, provides no discussion of the tax benefits of UBIT and college endowments. In addition, the estimates provided on tax expenditures often do not break out for just higher education (instead providing a more umbrella "education" – covering K-12 as well). In addition, while I've listed four major tax expenditures – there are others – example, that colleges can provide free tuition to the children of university presidents and professors – and it is tax-free, benefits of arbitrage of tax-exempt bonds, etc. The Committee needs the entire list.

Second, the Committee has always had an interest in understanding who (or what organizations) are getting the benefits of a tax policy and tax expenditures – in short a distributional table. The Committee should consider asking both Treasury and JCT to provide a distributional table of these education tax benefits – what institutions get the tax benefits?

The Committee will then have its eyes open to where the dollars are going – for example, how the dollars flow to institutions that are significantly serving students from low-income and middle-income families; dollar flow to institutions with large endowments; etc. The Committee will then be able to make informed decisions on whether the current policy is appropriate or whether there should be changes to that policy to reflect the goals of the Committee.

For example, the current allowance for tax-exempt bonds has many unintended consequences that the Committee should consider. In the Committee's hearing on colleges a few years back, Senators heard thoughtful testimony from Patricia McGuire, the President of Trinity College in DC (a college that educates many low-income students) discussing at length the problems of ratings agencies such as Moody's – and the detrimental impact of tax-exempt bonds. Just two brief excerpts from President McGuire's testimony:

> "Attaining and sustaining the best possible credit rating is one of the most important fiscal responsibilities of the leadership of any university. But the standards that Moody's and other credit ratings apply to determine the credit raking often work in conflict with other values that institutions might espouse, and that public policymakers might also consider very important. Perhaps the greatest irony in this entire conversation about the financial obligations of higher education is the fact that the most scrupulous discharge of the fiduciary duty of the president and trustees of the university might also offend public policy notions of affordability, access and fiscal restraint.
>
> . . . we learned that our restrained tuition price and large volume of minority students (who are assumed to be very needy) would have a substantial negative impact on our ability to get a good rating.[12]

The Committee may in looking at these tax benefits – for instance in the case of tax-exempt bonds, which may in fact be counterproductive.[13] The Committee may wish to consider

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[12] Patricia McGuire, President, Trinity University, Senate Finance Committee, "Report Card on Tax Exemptions and Incentives for Higher Education: Pass, Fail or Need Improvement?," December 5, 2006. See also Moody's Special Comment: "More US Colleges Face Stagnating Enrollment and Tuition Revenue, According to Moody's Survey," by Emily Schwarz and Karen Kedem(January 2013) and Moody's Rating Methodology: "US Not-for-Profit Private and Public Higher Education," by Karen Kedem, (August 2011).

[13] The Committee may also wish to review the CBO Study: "Tax Arbitrage by Colleges and Universities," April 2010 to determine whether these activities meet their policy goals.

whether more limited and targeted tax credit bonds might potentially do a great deal more to further public policy goals than the current law.

Mr. Chairman, this concludes my testimony – as you can see you and the Committee have great opportunities and possibilities to make changes for the good. Changes that will help families and students get a good education at a fair price; changes that will assist those great number of colleges and university leaders that are trying to do the right thing – and will benefit from better, targeted support and clear standards in the tax code; and, finally changes that will make Washington better stewards of the taxpayers' monies.

Questions for the Record
"Less Student Debt from the Start: What Role Should the Tax System Play?"
Questions for Mr. Dean Zerbe
Hearing Date: June 24, 2014

Questions from Senator Orrin Hatch

1. *In a recent paper by an economist who is now at the Treasury Department, the author writes that "Contrary to the intention of policymakers, I find that schools fully counteract the cost reduction of tax-based aid by lowering institutional aid dollar-for-dollar. This finding implies that colleges and universities capture the financial benefits of tax-based aid at the expense of eligible students and families."*

   Would you comment on whether colleges and universities are capturing the financial benefits of tax-based aid, and if they are, what, if anything, should be done in response?

   I am glad you raise the study (which I cite in my testimony) by Mr. Nicholas Turner, "Who Benefits From Student Aid? The Economic-Incidence of Student Based Aid." Mr. Turner's findings are certainly sobering and should be read closely by all Senators and staff as the Finance Committee considers what steps to take regarding tax benefits for students and their families.

   In reviewing the literature -- and talking to parents and students across the country -- the constant view I hear is that the well-intended federal tax benefits designed to assist in meeting college costs are not helping most families keep their financial heads above water in a material way. The overwhelming concern from these students and families is the rising costs of tuition and related costs.

   To go directly to your question – it seems clear that to a fair extent colleges and universities are capturing the financial benefits of tax-based aid. It is for that reason that I suggested in my testimony that if the goal of the Committee is to lessen the burden of rising tuition costs for families and students – it should lessen the burden of rising tuition costs – directly. The Committee should consider a policy of tying the billions of dollars of taxpayer funds that are provided through the tax code to Universities and Colleges to those institutions controlling tuition costs. As I mentioned in my testimony, the idea of tying federal tax benefits to performance has been championed by the Education Trust in a recent report and was embraced in an editorial by the New York Times "*Tying Federal Aid to College Ratings*" – published the day after the Committee's hearing (June 24, 2014).

   There is no question that much can be done to control tuition costs – as shown by former Governor Daniel's work as President of Purdue University. See "*Purdue's Case Study in*

Higher-Ed Cost Cuts," Douglas Belkin, Wall Street Journal, July 26, 2014. (In addition, see several relevant studies cited in my earlier testimony). What is needed though is a strong signal to College and University Presidents from the Finance Committee – through the tax code – that controlling tuition is a top priority and that taxpayer dollars will be directed to those institutions that are controlling tuition costs.

2. *There have been several recent tax articles suggesting that Congress eliminate all education tax incentives and replace them with direct spending programs. In the recent Treasury report on Pell Grants and the AOTC, Treasury writes, "The report concludes that direct grant aid, such as the Pell Grant, is a better mechanism for delivering education subsidies to low- income students [than advance refundability of the education tax credits]."*

   Should the education tax incentives be replaced with direct spending programs?

   When it comes to helping low-income families and students meet the costs of higher education, my reading of the literature (and also from my time providing pro bono tax-preparation assistance to low-income families) is that the easier and cleaner approach would be to provide that benefit through Pell Grants (one-stop shopping; one set of rules; etc.). Providing such tuition assistance through the tax code (especially on an advanced refundable basis) is a cumbersome and second-best approach rather than expanding Pell Grants.

   However, in considering the overall tax policies for helping families with the costs of tuition – the Committee should bear in mind that there has historically been a division of work: Pell Grants were a way of providing support for the costs of higher education for low-income families (often families without a federal income tax liability) and tax incentives were meant to assist middle-income families with the costs of higher education (families more likely to have a federal income tax liability).

   A proposal in which the Committee eliminates all tax benefits for higher education would be a hard road to get through Congress (although, perhaps as part of tax reform with lower rates, expanded EIC as a tradeoff). Perhaps a more likely scenario (and effective) the Committee may wish to consider would be to freeze current law on higher education tax benefits and concentrate on passing incentives for colleges and universities to control tuition (as outlined in my response to question 1 and in my testimony).

3. *Do you think that certain tax incentives are important in that they create external benefits, sometimes referred to as positive externalities? For example, the research and development credit is usually cited as an important incentive in that social returns to research and development are larger than the private returns.*

Does a similar argument hold for educational tax incentives – that the social returns associated with higher education outweigh the private returns?

There are certainly positive externalities to education – our country needs an educated work force and should encourage and support families and students seeking to further their education. This fact of positive externalities (and Congress' support for higher education) is reflected in the billions of dollars that the federal government provides to support higher education – directly through spending, loans, as well as through the tax code – both in tax incentives for families and students as well as tax benefits for colleges and universities.

However, positive externalities do not translate directly into (or justify) a blank check from the taxpayers. The Committee has a responsibility to ensure the tax incentives provided are effective and are giving a real bang for the buck. This includes tax incentives for families and students as well as those tax incentives provided to colleges and universities. As the hearing showed (and supported by a host of studies) – there is much that can be done to improve these tax incentives for families and students and as important there is much that the Committee can consider in ensuring tax dollars provided to colleges and universities are targeted to reflect the policy goals of Congress of controlling the burden of tuition.

4. *I worry about the effect of federal aid and other incentives on middle income families. For example, middle-income families receive less federal aid than lower-income families. But if the Bennett Hypothesis is correct, these middle-income families must still pay the inflated tuition resulting from federal aid.*

   Is this resulting in a financial squeeze for such middle-class families, and would such a situation exist under your vision of reform?

   Senator – I think you raise a very fair concern. While the Bennett Hypothesis is not as clean and straightforward as originally put forward by Secretary Bennett – for many middle and upper-middle income families it still reflects a good deal of the reality they are facing when it comes to the costs of higher education. I cited in my testimony and recommend to you and your staff Andrew Gillen's study "Introducing Bennett Hypothesis 2.0" for the Center for College Affordability and Productivity, (February 2012).

   Relevant to your question, Mr. Gillen finds:

   "For policy makers, the key point is that financial aid that is restricted to low income students is much less likely to be captured by colleges, and will therefore be more likely to succeed in making college more affordable and therefore accessible (for low income students). In

contrast, universally available programs are more likely to simply fuel tuition increases and therefore more likely to fail to make college more affordable."

To counter the Bennett Hypothesis there are essentially two paths. First, the Committee could seek on a bipartisan basis to eliminate or reduce the tax benefits for higher education for middle income and upper middle income families. This path would be highly difficult politically.

The second path, as suggested in my testimony, the Committee could consider placing requirements on colleges and universities for controlling tuition, student debt and other outcomes in return for receiving the billions of dollars in federal tax benefits (as well as the Committee better targeting those federal tax benefits for colleges and universities serving working families). In addition, Congress would freeze current tax benefits to the middle-class for paying for higher education. This proposal would require no additional tax dollars.

In short, there are three policy choices: 1) eliminating tax benefits to the middle class to assist in paying for higher education is a nonstarter; 2) Do nothing and the middle-class will continue to see rising tuition costs partly in response to increased federal support to the middle-class to pay for tuition – so more taxpayer dollars spent and the middle class no better off; and, 3) Keep in place current support for the middle class and target the billions of dollars in federal tax benefits to colleges and universities that are controlling tuition costs and are most helping working families.

Questions from Senator John Cornyn

1. *In your testimony, you suggested that the Finance Committee should establish tax code standards for institutions of higher education, similar to tax standards for charities, in order to contain the cost of attendance. Is there any empirical evidence to support an argument that such standards would in fact accomplish such outcomes? For example, what research has been published on the effect of the tax standards for charities in improving or expanding benefits for the clients of these charities?*

   Thank you Senator for asking this thoughtful question. As the Committee considers standards for colleges and universities to control costs and achieve other policy goals, it would be useful to consider the Committee's experience regarding nonprofit hospitals.

   Historically, nonprofit hospitals were required to provide certain levels of charity care under Treasury regulations. With the introduction of Medicare and Medicaid it was viewed (incorrectly) at the time that there would no longer be a need to require charity care of nonprofit hospitals. See generally, the GAO report: "Nonprofit Hospitals: Variations in Standards and Guidance Limits Comparison of How Hospitals Meet Community Benefits Requirements" September 2008 (one of a number of excellent reports by GAO on this subject).

   The removal of standards for nonprofit hospitals (no longer requiring them to provide charity care) had a devastating impact on the poor in this country – as they faced high costs for medical treatment (or forego medical treatment). NOTE: For a useful discussion of this issue overall and citation to a number of relevant studies, I bring to your attention the Senate Finance Committee Staff Discussion of Potential Non-Profit Hospital Reforms (http://www.finance.senate.gov/newsroom/ranking/release/?id=4e7e7efc- 806d-4a02-a4bf-d41f9a5dd55f) and would especially draw your attention to the work and studies of Community Catalyst on this matter (See www.communitycatalyst.org) .

   The result of removing standards was nonprofit hospitals receiving billions of dollars in tax benefits from taxpayers and not required to provide any charitable care – causing significant hardship to those most vulnerable in our nation. The removal of these standards, brought hard results -- as the IRS Commissioner noted in a letter to the Finance Committee, finding that there was little difference between a for-profit and nonprofit hospital in the amount of charity care provided (See "Nonprofit Hospitals Face Scrutiny Over Practices" New York Times, Robert Pear, March 19, 2006.

   The Finance Committee – after significant oversight, hearings and public discussion – introduced bipartisan legislation (included as part of the Affordable Care Act) Section 501(r) that required nonprofit hospitals to make a number of reforms -- including a written/published financial and emergency medical care policy; limit amounts charged to

the poor for emergency or other medically necessary care; make reasonable efforts to determine an individual's eligibility for financial assistance before engaging in collection actions; and, conduct a community health needs assessment.

These standards for nonprofit hospitals have already had – and even more so when fully implemented – a positive benefit for the poor in this country. More important, the Committee has shown to be good stewards of the taxpayers' dollars – not continuing to allow billions in tax benefits to be provided without any substantive benefit to those most in need and the community.

Senator – in short, there is nothing novel about setting standards in return for receiving significant government funding (whether that funding is provided directly or through tax expenditures). It is commonplace. For example, in your own state of Texas, Governor Perry has effectively set a standard of performance for colleges calling on the creation of a $10,000 college degree. See "Texas Pushes $10,000 Degree: Gov. Perry Renews Call for Low-Cost Education as Student Debt Loads Rise" by Nathan Koppel and Douglas Belkin, Wall Street Journal, October 7, 2012.

The question is not whether colleges and universities will be responsive to standards established by the Committee. The question for the Committee to consider is what standards could possibly be set, whether effective standards can be found that meet the goals of the Committee (and to be clear, looking at what will be the impact and consequences of setting such standards) and, in addition, how best to target government tax benefits for colleges and universities to achieve the goals of Congress of providing an affordable and substantive education – especially to working families.

The establishment of standards has a long history of being a way to help ensure that taxpayer dollars are being used to meet policy goals established by the Congress.

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Testimony for the Record
Submitted to the
United States Senate Committee on Finance
Hearing on Higher Education and the Tax Code
June 24, 2014

Introduction

On behalf of the higher education associations listed below, which represent approximately 4,300 two- and four-year public and private non-profit colleges and universities, I am submitting this written testimony for the record of the June 24, 2014, Hearing on Higher Education and the Tax Code. We appreciate the opportunity to submit our views to the committee on several tax provisions that are important to college students and their families as well as on the issue of college costs, which was also discussed during the hearing.

Although originally enacted discretely, the current federal tax code contains a number of provisions that taken together create a framework that functions as a kind of "three-legged stool" intended to advance three important goals: 1) to encourage saving for higher education; 2) to help students and families pay for college; and, 3) to assist with the repayment of student loans. We strongly support this "three-legged stool" framework. In addition, we believe tax reform provides an excellent opportunity to make improvements to certain provisions in order to maximize their effectiveness and enhance access to higher education.

Provisions to Encourage Saving for Higher Education:

The tax code currently contains two provisions intended to encourage families to save for higher education: Section 529 Education Savings Plans and Coverdell Education Savings Accounts.

- **Section 529 Education Savings Plans**—Under Section 529, states are authorized to sponsor "Qualified Tuition Programs" that are tax-advantaged savings vehicles for qualified postsecondary education expenses, such as tuition, fees, books, required supplies, equipment and room and board. There are two types of 529 Plans: savings plans, which allow families to save for expenses, and pre-paid tuition programs, which generally allow families to make advance tuition payments to cover future attendance at a designated in-state public college or university system.

- **Coverdell Education Savings Accounts**—Under Section 530, individuals can contribute up to $2,000 annually tax-free to pay for the qualified education expenses of a designated beneficiary. Individuals remain eligible to contribute with income up to $110,000 ($220,000 for joint filing). Qualified education expenses are broadly defined to include tuition, fees, course materials and room and board. The $2,000 annual maximum contribution cap was recently made permanent as part of the American Taxpayer Relief Act of 2012 (ATRA).

According to a recent Treasury Department report, Section 529 Education Savings Plans and Coverdell Education Savings Accounts offer "an attractive and convenient means of saving for college that offer substantial tax benefits."[1] We strongly believe that the tax code should continue to encourage savings for higher education expenses. By doing so, the federal government incentivizes financial responsibility in families with the means to save for college. This long-term planning helps reduce student debt, and allows governments and charities to better target scarce student aid funds to those without the means to save.

Provisions to Help Pay for Higher Education:

The current tax code contains several provisions that help students and families pay for higher education: the American Opportunity Tax Credit, the Lifelong Learning Credit, the above-the-line deduction for qualified tuition and related expenses (tuition deduction), Section 127 Employer-provided Educational Assistance, and Sec. 117(d) Tuition Reduction.

- **American Opportunity Tax Credit (AOTC)** —The AOTC significantly enhances and broadens the permanent Hope Scholarship Credit by increasing it from $1,800 to $2,500, expanding eligible expenses, making it available for four rather than only two years of college, increasing the income phase-out thresholds, and making the credit partially refundable. Since its enactment, there has been a significant increase in the use of the AOTC across income levels, particularly for low and middle-income students and their families. According to a recent U.S. Government Accountability Office (GAO) study, in 2009, more than 9 million tax filers claimed the AOTC, receiving $16 billion in tax benefits. Indeed, approximately 66 percent of these benefits went to low and middle-income families with incomes at or below $80,000, with more than 50 percent going to those with incomes at or below $60,000.[2] The AOTC was extended until the end of 2017 under ATRA.

- **Lifetime Learning Credit (LLC)** —Under this permanent nonrefundable tax credit, a taxpayer can claim up to 20 percent of the taxpayer's first $10,000—for a maximum of $2,000, which is not indexed for inflation—of qualified tuition and related expenses paid during each calendar year. The LLC is available for all years of postsecondary education, and there is no limit on the number of years that it can be claimed for each student in a family. The credit phases out for a taxpayer with an income of $60,000 or more ($120,000 for married taxpayers filing jointly). The LLC serves as incentive for taxpayers to pursue higher education or to acquire new or enhanced job skills, thereby strengthening our nation's workforce. According to the GAO, in 2009, 3.4 million taxpayers claimed the credit for a total of $2.4 billion. Approximately 80 percent of the taxpayers claiming the LLC had incomes of $80,000 or less.[3]

- **Tuition Deduction**—The above-the-line deduction for qualified tuition and related expenses permits students or their parents to deduct up to $4,000 per year in qualified higher education expenses from their taxable income. The deduction phases out for taxpayers with incomes of up to

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[1] See U.S. Department of Treasury report, *Analysis of Section 529 College Savings and Prepaid Tuition Plans* (Sept. 2009), p.3.
[2] See GAO Report to the Committee on Finance, U.S. Senate, *Higher Education – Improved Tax Information Could Help Families Pay for College* (May 2012), pp. 24, 63.
[3] Id.

$80,000 ($160,000 for joint filers). Like the AOTC and LLC, the tuition deduction enhances access to higher education by helping to reduce the cost of attending college. The tuition deduction is particularly beneficial to graduate students who are ineligible for the AOTC. The deduction expired at the end of 2013.

- **Enhancing Effectiveness of Tax Credits and the Tuition Deduction Through Consolidation and Simplification**

  It is broadly acknowledged that the current set of higher education tax credits and the tuition deduction are overly complicated and difficult for taxpayers to correctly use.[4] We have long supported legislative efforts to consolidate and simplify these tax incentives in order to maximize their impact and enhance access to higher education. We have long supported reform of the current American Opportunity Tax Credit (AOTC), the Hope Scholarship Credit, the Lifetime Learning Credit, and the tuition deduction, which are overly complex and difficult for students and their families to correctly use. We believe a consolidated credit can simplify the higher education tax benefits while retaining positive aspects of the present credits and deductions to better serve low- and middle-income traditional and nontraditional students now and in the future, helping them attain an associate or bachelor's degree or pursue post-baccalaureate education or lifelong learning. A permanent AOTC-style credit, for example, available beyond the first four years of college, would negate the need for the Hope Scholarship tax credit, a Lifetime Learning Credit and the tuition deduction.

  Because the opportunity to reform these provisions does not come along very often, it is critically important that any reforms address the needs and circumstances of the broad range of students in higher education. To be sure, many students in college still come from the traditional cohort, age 18-22. However, today nearly 50 percent of undergraduates and three-quarters of all students are adult learners, age 23 or older, with a quarter over age 30, a proportion that will likely continue to grow. These students are not just older than their traditional classmates. They tend to work full-time or have dependents—including multiple roles as parents and caregivers—serve in the military, or some combination of these, and take a longer time to complete their degree. Moreover, 50 percent of all students attend part-time, which inevitably increases time to completion. While the median time to degree for all bachelor's degree recipients is 4.3 years, for adult students (between ages 24-29), the median time to degree is 6.6 years. A reformed, consolidated credit should preserve current benefits for as many students as possible and take into account the demographic profile of all of today's students. The number of these nontraditional students will increase in the future, and any legislation that creates a permanent, consolidated credit should also address their needs.

  For this reason, we strongly supported the "American Opportunity Tax Credit Permanence and Consolidation Act of 2013" (S. 835) introduced by Senator Charles Schumer (D-NY). The bill would make a number of important reforms to the AOTC and Lifetime Learning Credit, benefiting

[4] See GAO Report to the Committee on Finance, U.S. Senate, *Higher Education – Improved Tax Information Could Help Families Pay for College* (May 2012); GAO Testimony before Subcommittee on Select Revenue Measures, Committee on Ways and Means, U.S. House of Representatives, *Multiple Higher Education Tax Incentives Create Opportunities for Taxpayers to Make Costly Mistakes* (May 1, 2008).

families across income categories. The bill significantly improves the current AOTC and Lifetime Learning Credit by consolidating them into one simplified, permanent AOTC that would provide up to $3,000 per year in tax relief. In addition, the bill incorporates the expanded eligible expenses of the current AOTC, increases income phase-out thresholds and replaces current limits on the number of years a student can utilize the AOTC with a $15,000 lifetime cap. Moreover, in steps that will particularly benefit low- and moderate-income students, the bill maintains the 40 percent partial refundability of the current AOTC and better coordinates the interaction of the credit with the Pell Grant, thereby making postsecondary education more affordable. This bill provides a model for reform of these provisions but there are others such as Rep. Lloyd Doggett's (D-TX) "American Opportunity Tax Credit Act of 2013" (H.R.1738), which currently has 112 House co-sponsors. We welcome the opportunity to work with the committee on reforming these important higher education tax incentives.

- **Section 127 Employer-provided Educational Assistance**—Section 127 allows employers to offer employees up to $5,250 annually in tuition assistance, which is excluded from taxable income. It is effectively a matching grant program in which the federal government forgoes a proportionally small amount of revenue to leverage the investment employers make in their employees and the American workforce. According to the most recent available Department of Education data, the more than 1.1 million American workers who used this tuition assistance in the 2011-12 academic year had average annual earnings of $53,880. This provision has been an important means of building and adding to the competencies of the workforce and is a critical tool to help our nation accelerate its economic growth. The top majors among recipients of this benefit include those in the STEM fields. More than 35 percent of degrees pursued by employees using education assistance are master's degrees.

  This provision is a terrific public-private partnership, helping to leverage private dollars for higher education. It supports innovation by employers such as Starbucks, which recently joined with Arizona State University in a partnership which relies on Section 127to provide access to higher education for Starbucks' employees. It is widely supported by the employer community and organized labor, and members from both sides of the aisle.

  Recently made permanent by ATRA, we believe that this very successful tax provision should be enhanced to allow employers to offer higher levels of tax-favored tuition assistance to their employees. We recommend that the $5,250 annual limit, which has not changed since the 1970s, be increased with an automatic adjustment for inflation. This would be an extremely effective reform that would generate more private sector funds for financial aid to low- and middle-income students.

- **Sec. 117(d) Qualified Tuition Reduction**—Section 117(d) permits educational institutions, including colleges and universities, to provide their employees, spouses or dependents with tuition reductions that are excluded from taxable income. This long-standing provision helps employees and members of their families afford a college education, providing an important benefit to many middle and low-income college employees. A broad cross-section of our employees benefit from Section 117(d). Indeed, under the law, if an institution chooses to offer this benefit, then all employees must be able to receive it. As such, the benefit has been used by a range of employees,

including secretaries and other front-line administrative staff and maintenance and janitorial staff. In addition to the help it provides our employees, Section 117(d) also gives colleges and universities an important tool for recruiting and retaining valued employees, helping maintain the quality of education our schools can offer. It has been particularly important for many small, private, denominational schools to compete for top employees. Eliminating this benefit would particularly harm employees who are poised to send their children to college and have premised their career choices and college savings decisions on the existing tuition benefits for their children, hurting the lowest-paid college employees the most.

In addition, many schools combine the Section 117 Qualified Scholarships exemption with Section 117(d)(5) to help mitigate the tax liability of graduate students engaged in teaching and/or research as part of their academic programs, many of whom earn very little and increasingly finance their graduate educations. According to the U.S. Department of Education, in 2011-12, a quarter of all graduate students earned less than $11,000, and half were below $32,000. During that same year, there were 1.3 million master's degree students—nearly three-quarters of all graduate students—and approximately 31 percent received no financial aid. Forty-six percent of all master's students and 25 percent of all doctoral students borrowed for their degree. The median amount of those loans per year was $15,665 for master's students and $17,629 for doctoral students. The repeal of Section 117(d)(5) would likely result in an immediate unforeseen tax burden for these graduate students who would unlikely have the disposable income to satisfy this tax liability and would be forced to finance their education through additional loans. For all of these reasons, we strongly believe that Section 117(d)(5) should be preserved.

Provisions to Assist in Repayment of Student Loans:

The current tax code contains provisions that affect the ability of students to repay their student loan debt. As students increasingly have come to rely on loans to finance their college education, we strongly believe the tax code should continue to assist borrowers as they repay their loans.

- **Student Loan Interest Deduction (SLID)** —SLID currently permits taxpayers with less than $75,000 of income ($155,000 for joint filers) to deduct up to $2,500 in federal student loan interest payments each year. To qualify, a student loan must have been for qualified educational expenses, such as tuition and fees, course materials, and room and board. Over the course of an undergraduate education, many students take out at least one federal student loan. According to the College Board, 34 percent of undergraduates used federal loans to finance their education in the 2012-13 academic year. Managing student loan debt after graduation can be a significant hardship. Recent federal actions have increased borrowing costs by eliminating the six-month interest grace period college graduates previously received and by implementing interest charges for graduate student borrowers while they are in school. With these increased loan costs, SLID has become even more important. The current $2,500 interest limit has been in place since 1997. SLID should be preserved.

- **Exclusion of Discharge of Student Loan Debt**—Currently, the tax code provides an exclusion for student loan debt forgiven for individuals that worked for a specified time period in certain professions or for a class of employers. This tax exclusion applies to several federal and state loan

forgiveness programs, including the Public Service Loan Forgiveness for borrowers working in government and certain nonprofit jobs, the TEACH program to assist future teachers, and the National Health Services Corps Loan Repayment Program, which assists medical health professionals working in underserved areas of the country. Each of these programs permits former students with high student loan debt to more easily manage their debt and avoid default in exchange for working, likely for lower salaries, in ways that serve our society.

Congress created various student loan forgiveness programs, including some of the programs mentioned above, in an effort to increase college access and affordability by lowering the burden of student loan debt. We have long supported these efforts and the tax exclusion of the discharge of remaining student loan debt as part of these programs because we believe in the policy goal and the attendant benefits it provides to the larger society. Indeed, we have long advocated that this tax exclusion be extended to two other federal loan forgiveness programs, the Income-Based Repayment (IBR) and Income Contingent Repayment (ICR), to which it does not currently apply. Repeal of the current tax exclusion of discharge of student loan debt would undermine the purpose of these important loan forgiveness programs. In addition, for those programs that require regular loan repayment over many years, taxing the discharge of remaining student loan debt would amount to punishment of these responsible borrowers.

Currently, there are 18.4 million students enrolled in college in the United States, with approximately 50 percent taking out student loans to pay for college. Student loan debt is now in excess of $1 trillion, exceeding debt in consumer credit cards. At a time when more students are borrowing more money for college, this exclusion should be preserved and expanded to cover amounts forgiven under the IBR and ICR programs.

College Costs:

The condition of our economy has elevated the cost of attendance and avenues of access to higher education to sources of genuine anxiety for many American families. While these concerns are understandable, there are also a number of misperceptions about the true cost of attendance that have fueled this dynamic:

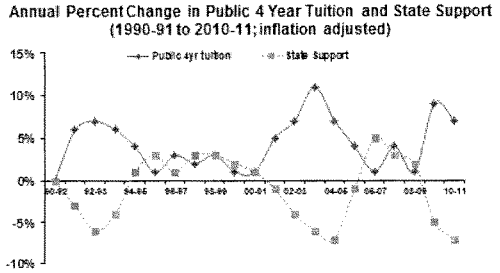
- According to the College Board in 2013-14, nearly two-thirds of full-time students attended four year institutions with a published tuition price of less than $15,000. In addition, 38 percent of all undergraduates attended community colleges, where the average published tuition for a full-time student is $3,264.
- Analysis of data reveals that the net tuition price—the actual cost after incorporating financial aid or tuition discounts, as opposed to the "sticker" price—remains within reach of many students and families, particularly at community colleges. According to the College Board in 2013, students at public four-year schools were paying a net tuition of $3,120 per year on average. Unfortunately, as a direct result of cuts in state appropriations, at public four-year campuses the average net tuition increased by $1,180 after inflation over the past five years.
- Over the five years from 2009–10 to 2013–14, after taking into account grants and education tax benefits, the estimated average net tuition (adjusted for inflation) decreased at community colleges by $300 and at private, nonprofit four-year colleges increased by only $40.

- The total amount of institutionally provided student financial aid has more than doubled over the last 10 years, increasing faster than the rate of increase in tuition. Indeed, the investment by colleges and universities in student aid has increased over the last decade from $19.7 billion to $44.4 billion in 2013.

Among multiple reasons for rising college costs, there are four particularly strong drivers:

- **State Appropriations**

For public institutions, which enroll approximately 72 percent of all students, the single largest factor in driving up college costs is declining state support. In the last 20 years, states have systematically reduced spending on higher education, resulting in increased tuition at public institutions to offset the reduced state revenue. Indeed, there is a direct and inverse relationship between the level of state appropriations and the level of tuition increases, as illustrated in the chart below. For example, at many institutions, a 1 percent decrease in state appropriations may result in a 3-5 percent increase in tuition.



In 2010, state and local support for general higher education operations fell to a 25-year low in inflation-adjusted terms, while full time equivalent enrollment increased by 61 percent. Over the decade, 2002-2003 to 2012-2013, state appropriations as a share of institutional revenues per student dropped from 68 percent to 53 percent at public institutions. As a result of declining state support, the share of the total institutional revenue from tuition rose from 32 percent to 47 percent at public institutions over the same period. Between 2007–08 and 2013–14, state appropriations for higher education per student declined by 19 percent in real terms, the largest three-year decline in 30 years.

Private colleges and universities face a different set of circumstances. Few independent institutions receive significant amounts of state support for their operating budgets. Some states provide financial aid that helps students attend these institutions. When state financial aid is reduced as a result of budget cuts, colleges must use even more of their own funds to fill the gap.

Increasingly, public and private colleges and universities have come to rely on private charitable contributions and endowed funds to help fulfill their teaching, research, and public service missions. Private charitable donations work in concert with federal and state investments in student aid to ensure access to higher education for students irrespective of their socio-economic status. Charitable gifts also support teaching, groundbreaking research and technological innovation, and the public service activities of colleges and universities. In short, the partnership with private donors has delivered enormous economic benefits to our society, but unfortunately, it is a partnership undergoing severe stress.

- **Technology and Knowledge Creation**

With the rapidly changing nature of information technology (IT), the technological expectations and requirements of students, faculty and staff are rising. Beyond initial costs for IT infrastructure, a significant investment of institutional resources goes to the creating and upgrading of technology-enhanced instruction and research media, student services and faculty and staff training. Today's college students expect institutions to provide information and technological services that allow them to access instructional resources and campus services anywhere and anytime. This is evidenced by the rising use of wireless classrooms, lecture capture and podcasting, mobile apps and e-portfolios, for example. No one wants colleges and universities to be equipped with scientific and technological resources from 2000 as they try to meet the needs of students in 2014 and beyond.

Moreover, knowledge in most scientific disciplines doubles every seven to 10 years. Whole new fields of science—such as nanotechnology—have emerged from obscure specialties to essential fields of study that can be found at most institutions. Over the past three decades, the annual volume of paper and electronic subscriptions at academic libraries grew sharply from less than 4,700 to more than 25,000.

- **Government Regulation**

The persistent growth of federal, state and local regulation creates costs for colleges and universities that institutions cannot control but must consider every year in their budgets as they determine tuition. While some of this regulation may be necessary, a substantial share is burdensome, duplicative and contrary to campus mission. Given the range of their activities, colleges and universities are among the most heavily regulated entities in America. In addition to being regulated by state and local governments, higher education is the only industry regulated by every federal agency. According to Sen. Lamar Alexander (R-TN), in 2005, there were more than 7,000 federal regulations governing colleges and universities.

Regulations impose a heavy toll on colleges and universities in the form of additional staff, increased professional development and training, additional paperwork, creation of computer systems and software to support record-keeping requirements, and higher legal fees. These regulations, in turn, increase operating costs.

- **Work Force**

Higher education is among the most labor- and skill-intensive sectors of the economy, with college graduates comprising almost 70 percent of its employees. Higher education institutions typically spend 60 percent or more of their budgets on human resource costs. In recent years, institutions had sharp increases in benefit expenses that now comprise nearly 25 percent of total human resource costs. Colleges and universities compete with the private sector to hire outstanding individuals—such as engineers, biologists, chemists, doctors and lawyers—for faculty positions.

Efforts to increase productivity or reduce academic personnel costs by increasing class sizes or hiring fewer full-time faculty can have a direct, detrimental impact on academic quality and are very unpopular with students and faculty. Further, student demands for increased non-instructional academic support services (e.g. counseling, health services and campus security) also drive up human resource costs.

Federal Financial Aid and Efforts to Control College Costs:

During the hearing, some of the witnesses raised the so-called Bennett hypothesis, which claims that increases in federal student aid drive increases in tuition. A landmark federal study on college costs conducted by the Department of Education in 1998 found that increases in federal financial aid had absolutely no impact on tuition at any type of institution, public or non-profit private.[5] In testimony before the Senate Finance Committee, Professor Bridget Terry Long, found "[c]oncerns about colleges raising tuition prices in response to federal aid appear to be largely unwarranted."[6] More recent extensive analysis of the issue by economists Robert Archibald and David Feldman not only found no relationship between Pell Grants and increases in tuition at public universities but a reverse effect at private institutions: Increases in the Pell Grant generally *reduced* private sector tuitions.[7] The bottom line is there is no empirical data that suggests federal aid significantly drives up college prices.

Colleges and universities have taken a wide range of steps to contain and cut costs as well as help students pay for education. On the cost-containment side, these steps have included: layoffs, pay or hiring freezes; improving administrative efficiency; reducing course offerings, enrollments, or full-time faculty; eliminating academic departments; and imposing budget cutbacks and reallocating resources to pay for other institutional needs. On the affordability side, these steps have included: increasing institutional financial aid, imposing tuition freezes, adopting fixed-tuition guarantees,

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[5] National Center for Education Statistics, U.S. Department of Education, 2001. *Study of College Costs and Prices, 1988-89 to 1997-98*, Executive Summary, p. X, pp. 99-102, 133. *See also,* Wellman, Jane V. 2008. *Cost, Prices, and Affordability: A Background Paper for the Secretary's Commission on the Future of Higher Education.*

[6] *College Tuition Pricing and Federal Financial Aid: Is there a Connection?, Before the U.S. Senate Committee on Finance* 1, 2-3 (2006) (statement of Dr. Bridget Terry Long, Associate Professor of Education and Economics, Harvard University Graduate School of Education).

[7] Archibald, Robert B., and David H. Feldman. 2011. *Why Does College Cost So Much?* New York, NY: Oxford University Press.

initiating accelerated degree completion, instituting curriculum innovation, and reducing textbook costs.

Conclusion:

We strongly support the "three-legged stool" framework in the current tax code that: encourages saving for higher education; helps students and families pay for college; and assists borrowers as they repay student loans. Our nation's long-term economic growth depends upon a larger well-educated and trained workforce. Together these tax provisions help to improve access to and completion of higher education, and advance the important goal of producing enough well-trained workers essential to our economy. We believe that tax reform provides an excellent opportunity to improve some of the individual provisions that will make the framework more effective for students, their families and taxpayers repaying student loans. We thank the committee for the opportunity to submit this statement for the hearing record and for considering our views.

Sincerely,

Terry W. Hartle
Senior Vice President

TWH/ldw

On behalf of:
American Association of Community Colleges
American Association of State Colleges and Universities
American Council on Education
Association of American Universities
Association of Governing Boards
Association of Jesuit Colleges and Universities
Association of Public and Land-grant Universities
Council for Christian Colleges and Universities
National Association of Independent Colleges and Universities

CollegeSavings
FOUNDATION

Statement for the Record
Submitted by the College Savings Foundation
2111 Wilson Blvd. Suite 700
Arlington, VA 22201
For the June 24, 2014, Hearing on
"Less Student Debt from the Start: What Role Should the Tax System Play?"
Before the
Committee on Finance
The United States Senate
June 24, 2014

Chairman Wyden, Ranking Member Hatch, and Members of the Committee:

The College Savings Foundation (CSF) appreciates the opportunity to provide comments for the record regarding the role of the tax system in helping American families meet their higher education costs without assuming crippling debt. CSF is a not-for-profit organization with the mission of helping American families achieve their education savings goals. CSF members include States, program managers, investment managers, and organizations providing services to 529 plans, including legal, accounting, and general consulting firms. The primary focus of CSF is building public awareness of, and providing public policy support for, 529 college savings plans.

Today, in the face of an increasingly competitive world economy, higher education is more essential than ever for the next generations and for the Nation. Yet the cost of college continues to escalate, forcing more families to turn to student loans to help finance their children's education. According to the Federal Reserve Bank of New York (FRBNY), at the end of 2012, there were nearly 40 million student loan borrowers with an average balance per borrower of approximately $24,803.[1] In its 2014 First Quarterly Report on Household Debt and Credit, the FRBNY stated that the outstanding student loan debt balance was $1.1 trillion as of March 31, 2014, a $125 billion increase over the past year.[2]

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[1] Federal Reserve Bank of New York, *Student Loan Debt By Age Group, Data of Fourth Quarter 2012* (2013), *available at* http://http://www.newyorkfed.org/studentloandebt/.

[2] Federal Reserve Bank of New York, *Quarterly Report on Household Debt and Credit*, 2 (May 2014), *available at* http://www.newyorkfed.org/householdcredit/2014-q1/data/pdf/HHDC_2014Q1.pdf.

According to a recent article published by the Federal Reserve Bank of Cleveland, mounting student loan debt not only burdens the borrower, but also has a considerable impact on the economy -- the effects of which are likely to be felt far into the future. Student borrowers may be unable to move out of their parents' homes or purchase a home, plan for retirement, buy a car, start their own businesses, or even pursue their career of choice.[3]

CSF applauds Chairman Wyden's statement during the hearing that he wants to "focus on policies that will mean students have less debt from the start." To that end, Section 529 plans are the single most important initiative allowing working Americans to plan for the cost of their children's college education. Every dollar saved in advance significantly reduces the cost of college, and every dollar saved is one less dollar of debt that the student or the family will face after graduation.

The States have established 529 savings programs to encourage and assist Americans in saving for the escalating costs of higher education. Contributions to 529 plan accounts are made with after-tax dollars and the savings on those accounts grow on a tax-deferred basis. Withdrawals of the earnings are not subject to federal income tax if, and only if, they are used for qualified higher education expenses.

Over 6.6 million U.S. households were saving for college in 529 plans as of December 2013. There were over 11.8 million 529 accounts as of December 31, 2013, with over 2.2 million new accounts opened in just the previous 18 months.[4]

American families are sending a message that 529s are a successful savings vehicle as demonstrated in CSF's most recent quarterly data report. Representing nearly 70 percent of the 529 marketplace, the CSF data was analyzed by the Strategic Insight (SI). The findings are encouraging – families are saving and using 529s. A 2014 survey of high school students conducted by CSF showed that 29 percent of families whose children are college-bound are using a 529 account and 38 percent of these families had started saving when the children were born.[5]

The growing utilization of these plans demonstrates that they are an important means to assist families in addressing the escalating costs of educating their children. During the first quarter of 2014, CSF members reported $4.013 billion in new contributions -- or new money being

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[3] Ann Marie Wiersch, Federal Reserve Bank of Cleveland, *The Cost of College: Student Loan Debt on the Rise* (Jan. 2014), *available at* http://www.clevelandfed.org/forefront/article.cfm?a=13610#.U7XZq0pEuxE.email.

[4] Source: College Savings Foundation.

[5] College Savings Foundation, *2014 Executive Summary*, 1 (2014), *available at* http://www.collegesavingsfoundation.org/pdf/Executive-Summary-Youth-Survey-2014.pdf.

invested in 529 college savings plans -- representing a 4.4 percent increase from $3.845 billion in the first quarter of 2013. Overall, CSF members reported $143.4 billion in 529 college savings plan assets, or approximately 68.1 percent of the total plan assets.[6]

The families that rely on 529 plans are predominantly middle class Americans who work for a living and are caught between limited access to adequate grants or other direct financial aid and the rising costs of college. These families have income that exceeds the levels where they will be eligible for needs-based grants (such as Pell Grants), but they also understand that they will not have the resources to fund their children's education unless they save in advance. For those families, 529 plans provide a roadmap and 529 plan savings become a lifeline.

Over 72 percent of 529 accounts are in households with income below $150,000, and about 95 percent are in households with income below $250,000. The average value of a 529 account has grown in recent years, but remains at a modest $20,020, and the average contribution to accounts that receive regular electronic contributions is approximately $186.67 per month. These figures reflect the modest amounts that families are able to sacrifice for college savings.[7]

A 2009 Treasury Department report to Vice President Biden's White House Task Force on Middle Class Working Families on "Financing the Dream: Securing College Affordability for the Middle Class" stated: "Section 529 plans are an attractive and convenient means of saving for college." The report also noted that it could be argued that "the most effective way to help low income families with college expenses is through direct student aid, and that section 529 plans are therefore naturally targeted to higher income families." The report then makes recommendations to make Section 529 plans even more accessible, effective, and reliable for the middle class, with the majority of those recommendations already implemented.[8]

A post-secondary education is often critical to helping Americans reach their full personal and professional potential, and research shows that higher education produces greater financial success. Simply put, higher education leads to higher earnings. Further, college graduates experience lower levels of unemployment and are less likely to depend on safety-net programs. Research also shows that education increases civic participation, with college-educated adults voting in greater numbers and 25 percent more college graduates performing organized volunteer activities than individuals with a high school diploma. In addition, higher education correlates

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[6] College Savings Foundation, *College Savings Foundation 1Q 2014 Data Shows Strength Across the Board in 529 College Savings Plans* (June 5, 2014), *available at* http://www.collegesavingsfoundation.org/pdf/1Q2014PressRelease6-5-14.pdf.

[7] Source: College Savings Foundation.

[8] U.S. DEPARTMENT OF THE TREASURY, AN ANALYSIS OF SECTION 529 COLLEGE SAVINGS AND PREPAID TUITION PLANS (2009).

with a healthier lifestyle, which is beneficial for college-educated adults and their families, and reduces medical costs within society.[9]

Financing a child's college education can be the chief economic goal of an entire extended family, but the costs of a college education can be daunting. Too often, families take on the entire cost of college through "pay-as-you-go" financing and "pay-after-you-go" loans. Section 529 college savings plans offer a third option -- an opportunity to save in advance. By saving before a child reaches college age, families can help ensure that adequate funds will be there to allow their children to attend college. Moreover, research shows that students with college savings are more likely to attend college than students without any college savings.[10]

With the growing popularity of 529 plans, there must be a continued commitment to encourage savings by all families -- including those of modest income. Section 529 plans in every State have a clear focus or mandate to (1) educate all families on the importance of higher education and ways to finance those goals, (2) encourage and assist low- and moderate-income families to aspire to higher education for all family members, and (3) provide programs that are available to a broad segment of the population, including low- and moderate-income families and individuals, to help them prepare and save for college.

Some of the many ways in which State 529 plans help to make college more accessible and affordable for all families include: (1) low minimum balance requirements for 529 accounts, (2) low monthly contribution minimums, (3) access to mutual fund options that otherwise would require contributions in the thousands of dollars, (4) low fee options through direct-sold programs with no sales commissions or loads, (5) a range of conservative and/or nearly-guaranteed investment and savings options (including FDIC-insured bank accounts, Guaranteed Investment Contracts (GICs), money market funds, and Treasury inflation-protected options), and (6) State benefits, including in many States income tax credits or deductions and creditor protection for 529 accounts.

Several State 529 plans provide scholarship and matching grant programs targeted at various populations, including low- and moderate-income families. A number of 529 plans also are involved in financial aid programs such as providing assistance to State partners in conjunction with the federal GEAR UP ("Gaining Early Awareness and Readiness for Undergraduate Programs"). GEAR UP uses Federal and State funds to create scholarship accounts for low-income children for post-secondary education.

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[9] College Board, *Education Pays, The Benefits of Higher Education for Individuals and Society*, 5-6 (2013), *available at* http://trends.collegeboard.org/sites/default/files/education-pays-2013-full-report.pdf.

[10] William Elliott & Sondra Beverly, *The Role of Savings & Wealth in Reducing "Wilt" Between Expectations and College Attendance*, 17 JOURNAL OF CHILDREN & POVERTY 165 (2011), *available at* http://csd.wustl.edu/Publications/Documents/WP10-01.pdf.

Many of the scholarship and matching grant programs are still relatively new and developing, and while it takes time to truly assess the full effectiveness of these efforts, the commitment of 529 plans to make a difference and help low- and moderate-income families is certain. Everyone involved with 529 plans understands the tremendous potential of these programs to help children, parents, young adults, and others believe that a college education is possible and financially achievable.

Another significant component of all 529 plans is a variety of outreach programs created and administered by the States -- alone or in conjunction with public and private partners. All of these efforts are targeted to that broad segment of the population 529 plans attempt to reach -- including low- and moderate-income families. A small sampling of typical activities of 529 plans include the following: (1) outreach in public schools, K-12, including work with school administrators, parents, and parent-teacher organizations, (2) public service radio and television segments, (3) inserts regarding 529 plans with DMV notices, with birth certificates, with State income tax mailings, and in conjunction with other public-sector communications, (4) collaborations and partnerships with State councils on higher education, colleges and universities, financial aid offices, and educational foundations counseling at-risk students about higher educational opportunities and financing options, (5) partnerships with employers, both public and private, to provide seminars on saving for college, (6) financial literacy outreach and seminars, (7) creative use of websites to provide financial literacy information, college savings calculators, financial aid information, and other pertinent information, and (8) outreach at State and county fairs, children's expos, sporting events, and other kinds of fairs and festivals.

CSF appreciates the interest of the Finance Committee in exploring the use of the tax code to encourage savings for education. While section 529 college savings plans have already helped millions of American families be better prepared for the expense of educating their children and less dependent on crushing debt, CSF continues to examine ways to make 529 plans even more effective. CSF has endorsed several Federal legislative proposals that would enhance the ability of families to better use 529 college savings plans to help meet their education savings goals. These include:

- Clarifying that computers are a qualified higher education expense. Computers are a necessary educational tool, and there should be no question that college students should be able to use 529 funds for their purchase.
- Allowing increased flexibility in making investment changes. Permitting States to modify their 529 plans to allow more than one change in a 529 plan's investments per calendar year would provide 529 plan owners the flexibility to better protect the principal in their plans during times of extreme market volatility. Additionally, the sense that 529 plan investments are "locked in" could even discourage some families from beginning to save for college.
- Allowing the Saver's Credit for contributions to 529 plans. This proposal would provide incentives for low- and moderate-income taxpayers to save for higher education by

making 529 contributions eligible for up to a $1,000 tax credit. The Saver's Credit currently is available only for contributions to retirement savings programs such as IRAs and 401(k)s.

- Eliminating Burdensome Aggregation Requirements. In calculating contributions and earnings attributable to 529 distributions for 1099-Q reporting purposes, each State annually must aggregate all distributions from a plan for the same account owner and beneficiary. This requirement places a costly administrative burden on plan providers with no corresponding tax policy benefit. Aggregation is difficult to demonstrate or explain to 529 account owners. This proposal would eliminate the requirement.
- Permitting Redeposit of Refunds. When student illness or other circumstances result in a withdrawal from classes, refunds may not be redeposited to that student's 529 account without incurring income tax and a 10% penalty on earnings. This proposal corrects that unfair result, provided any redeposit occurs within 60 days of receipt of a refund.
- Providing a Limited Rollover Opportunity. This proposal would allow limited rollovers of 529 balances from accounts open at least ten years to a Roth IRA for the beneficiary or the account owner.
- Encouraging Employers to Match 529 Contributions. This proposal would allow employers to match employee 529 contributions of up to $600 per year, with the employer match excluded from the gross income of the employee.

There is no more important investment this country can make than in educating its citizens. For growing millions of American families, section 529 college savings plans are a critical piece in an overall college financing strategy. The College Savings Foundation looks forward to working with the Finance Committee to help ensure that these important college savings programs remain viable and available to all American families.

Testimony for the Senate Committee on Finance Hearing on
"Less Student Debt from the Start:
What Role should the Tax System Play?"
June 24, 2014
Dr. Debra W. Stewart
President, Council of Graduate Schools
One Dupont Circle, Suite 230
Washington, D.C. 20036

Chairman Wyden, Ranking Member Hatch and distinguished members of the Senate Committee on Finance,

Thank you for the opportunity to submit testimony regarding the education provisions in tax law for the record on behalf of the Council of Graduate Schools (CGS) and for holding this hearing on an important issue that affects all postsecondary students. I am Debra Stewart, President of the Council of Graduate Schools. CGS is dedicated to the advancement of graduate education and research. Its membership includes over 500 universities that enroll approximately 85 percent of all graduate students and annually award more than 92 percent of all U.S. doctorates and over 78 percent of all master's degrees.

Graduate Education, the Economy and the Workforce
Our country's economic past and its continued prosperity rely on individuals with master's and doctoral degrees. Projections from Georgetown University's Center on Education and the Workforce suggest that 65 percent of all jobs will require post-baccalaureate training. Jobs that require a master's degree at entry-level, for example, are expected to grow at a rapid rate into the next decade. Demand for these master's degree holders is expected to grow even faster in certain occupational areas, including healthcare and social services. Graduate students drive the research and innovation at our universities. Their research in science, medicine, health, education and the arts and humanities contributes directly to the groundbreaking discoveries, inventions and innovation which results in sustained economic growth and prosperity.

Every day in the labs, libraries, and classrooms in our institutions of higher education, faculty and graduate students conduct leading-edge research, create and share knowledge, and teach the next generation of scholars and professionals. They are the researchers, entrepreneurs and inventors of the future. Graduate students not only engage in groundbreaking research, they facilitate technology transfer, participate in the development of new products and services that stimulate partnerships between universities and industry, and contribute to methodologies and approaches to solving complex social problems. Graduate degree holders have been instrumental in establishing new start-up companies that create jobs, promoting public health initiatives, creating community reconciliation and reconstruction mechanisms within countries experiencing conflict, and preparing the K-12 teacher workforce. The contributions of

graduate students and graduate degree holders are essential to America's global economic leadership.

These examples illustrate why support for graduate education and graduate students is critical if we are to grow our domestic scientific talent and build the educated and skilled workforce we need to be competitive in a global economy. It is for these reasons that CGS is concerned about changes that may be made to current education tax provisions. A number of the proposals that have been made would seriously affect the ability of master's and doctoral students, especially low-income and underrepresented minority students, to pursue a graduate education.

Graduate Students – Who are they?
CGS's interest is particularly heightened given the policy changes that have been made to federal student financial assistance, in particular to student loans, over the past few years. These changes include eliminating in-school interest subsidies, creating a distinction between undergraduate and graduate student Stafford loans, and increasing the disparity between interest rates for undergraduate and graduate student loans, all of which have eroded federal student loan support for graduate students.

Despite recent news items, graduate students on the whole are not borrowing in excess of six-figures, and the cost of attendance for graduate students is not increasing at a faster rate than the cost for undergraduate students. It is also not true that all graduate students are from affluent families and wind up with high salaried jobs. The reality is that many media reports are focused on a small minority of graduate students. This narrow attention could result in federal policy that overlooks more than 80 percent of this nation's graduate student population.

Issues of Concern
Changes to the education tax provisions in current law may have an adverse impact on graduate students. Any potential changes should not add to the cost of pursuing an advanced degree at a time when some of the fastest growing occupations and the demands of a knowledge economy require education beyond the undergraduate level. For this reason CGS is concerned about proposals that would eliminate the Lifetime Learning Credit by consolidating it into the AOTC, end the deductibility of interest paid on student loans, and consider tuition remissions and waivers as income.

Lifetime Learning Credit
The only tax credit available for low-and middle-income income graduate students and adult learners is the Lifetime Learning Credit (LLC). Over the past few years federal financial support for graduate students has been eroded. Graduate students cannot receive Pell Grants and are no longer eligible for subsidized loans. They pay higher interest rates on their loans and the distinction between undergraduate and graduate students has been heightened through these changes in policy. The elimination of LLC only adds to the difficulty that low- and middle-income and underrepresented minority students already have in financing their continued education.

CGS appreciates the need to simplify education tax credits so that more students can take advantage of them. Advanced education and graduate degrees are becoming the norm for many entry-level positions. Jobs that require a master's degree at entry-level are expected to grow at a rapid rate into the next decade. In order for the U.S. economy to remain competitive, and for state economies to thrive, master's degree holders need to play a critical role in innovation and implementation of new technologies in the marketplace. This is why the policy decisions regarding education tax credits should no longer focus solely on financial support for undergraduate students.

Student Loan Interest Deductibility
Graduate students pay higher interest rates on their federal student loans than undergraduates. In addition, they are not eligible for subsidized loans, which means that interest accrues while they are pursuing their degrees, and they do not have the benefit of a grace period once they graduate. Taking away the ability to deduct interest paid on student loans will only further increase the debt obligation of graduate degree recipients. This means that when graduate students complete their degrees, their repayment obligation is already greater than what they borrowed, unlike undergraduates who benefit from subsidized loans. Additionally, in combination with the higher interest rates that graduate students pay, after the 10 year standard repayment period, graduate students could pay as much as twice as much in interest as students with subsidized loans of the same amount. Taking away deductibility for student loan interest hits graduate students twice as hard.

Tuition Remissions and Waivers
Currently tuition remissions and waivers are excludable from taxable income. One out of four students pursuing doctoral degrees, not including professional degree students, receives institutional tuition and fee waivers, the average amount being $12,646. About six percent of master's degree students receive institutional tuition and fee waivers, the average amount being $6,511. Removing the exclusion of tuition and fee waivers would increase tax liability for graduate students on "income" they never receive.

For example, a doctoral degree student at a public institution had a $14,500 fellowship and was also credited with $9,500 as a tuition/fee waiver. Under the current law in 2012, this student's tax liability would have been $8,550 and the student would have paid $847.50 in federal income tax. If tuition waivers are considered as taxable and LLC is not available, the student's tax liability would increase to $18,050 despite the fact that the student would still take home the same amount of money. The student would wind up paying $2,272.50 in federal income tax, or 16% of the fellowship, increasing the student's federal income tax by $1,425 or 168%.

Conclusion
The 21st century economy demands that our workforce have the education and skills needed to be competitive globally. Public policy should encourage the pursuit of education beyond the undergraduate level. CGS believes that the Lifetime Learning credit, deductibility of student loan interest, and exclusion of institutional tuition and fee waivers are important components of this public policy. In light of recent changes in student federal financial assistance, current education tax benefits are one of a few remaining ways that graduate students can afford to pay for their education.

EFC Education Finance Council

Hearing on "Less Student Debt from the Start: What Role Should the Tax System Play?"

Statement for the Record by the Education Finance Council

Senate Committee on Finance

June 24, 2014

The Education Finance Council (EFC) is the association representing the nation's nonprofit and state agency student finance organizations. These public purpose organizations are dedicated to the single purpose of making college more affordable. Historically, nonprofit student loan organizations have expanded access to higher education by ensuring easier and less expensive methods to pay for college. For decades, nonprofit student loan providers have been leaders in innovation to reduce the cost of a college education.

In connection with the Senate Finance Committee's consideration of ways to reduce the burden of student loans, EFC would like to recommend a modification, described below, to the rules applicable to qualified scholarship funding bonds. The modification we are urging will help reduce student loan costs by updating the qualified scholarship funding bond rules as necessary to take account of changes to federal student loan programs enacted in the 2010 reconciliation legislation.

BACKGROUND: In 1976, as demand for student loans outpaced supply, Congress approved bipartisan legislation to address the growing need for student loans. The legislation authorized the issuance of tax-exempt debt by specialized student loan organizations. Such nonprofit student loan funding providers began to immediately provide the liquidity required to meet the country's growing college financing needs by raising money through the sale of tax exempt bonds to investors, and using that money to finance student loans, typically acquired from banks, savings and loans, and credit unions. States took different approaches to forming nonprofit student loan funding providers, with some being formed as state agencies or public authorities and some as nonprofit corporations under general state nonprofit law but also subject to additional requirements under the Internal Revenue Code ("Code"). These nonprofit corporations are currently referred to as "qualified scholarship funding corporations" and must comply with Code section 150(d), as well as section 501(c)(3) of the Code.

TAX-EXEMPT FINANCING: All nonprofit student loan funding providers are eligible to be designated by their state to issue tax-exempt private activity bonds to finance student loans. Each type (state agency or public authority or section 150(d) organization) has access to tax-exempt financing, subject to the private activity bond cap. The lower cost of tax-exempt financing is passed along to students in the form of lower overall borrowing cost. To a limited extent, it can also be used to help fund college access and financial literacy programs. As is explained in detail below, the only student loans eligible for this use of tax exempt financing were those made under the Federal Family Education Loan Program (FFELP). In 2010, all new student loan originations under the FFELP were terminated.

RECENT CHANGES TO STUDENT LOANS: The Health Care and Education Reconciliation Act of 2010 eliminated the federal guaranteed student loan program and mandated that all federal student loans be provided directly by the Department of Education. Following this legislation, many nonprofit student loan funding providers can continue to fulfill their mission of providing lower-cost funding options and other assistance to students by offering alternative loan programs. Nonprofit student loan funding providers are uniquely situated to make these loans at the best possible terms, particularly with their access to tax-exempt financing. Indeed, this is exactly what many state entities are doing today.

ALTERNATIVE LOAN PROGRAMS: Tuition costs have in recent decades outpaced increases in federal statutory loan limits. This has increased the need for alternative borrowing to bridge the growing gap

between students' cost of attendance and all other available aid. In particular, students attending high cost institutions or pursuing advanced degrees very often require additional borrowing in order to finance their education. Borrowers are in need of alternatives to high interest rate loans and credit cards. However, among nonprofit student loan funding providers, only section 150(d) organizations are currently ineligible to issue tax exempt bonds to finance these alternative loans.

THE ISSUE: The world of student loan financing was dramatically different when section 150(d) of the Code was written. At that time, there was no federal direct lending; only the guaranteed student loan program was in effect. Furthermore, there was little need for alternative loan programs as the cost of tuition was generally in line with federal loan program borrowing limits. This is why section 150(d) allows for qualified scholarship funding corporations to finance only federally guaranteed student loans. Given the dramatic increase in college costs and need for reasonable financing options, we are seeking to make a modest change to the language of section 150(d) to allow these organizations to continue to access tax-exempt financing for alternative private student loans. Simply striking the reference to the Higher Education Act and permitting section 150(d) organizations to be operated for the origination and acquisition of all student loans should accomplish this purpose. We note that a bill effectuating our proposal, H.R. 2573, the "Student Loan Opportunity Act," has been introduced.

TAX LAW ENSURES STUDENTS WILL BENEFIT: Current tax rules relating to tax-exempt bond arbitrage ensure that the reduced borrowing costs for bonds permitted by this change would flow through to students. The arbitrage rules limit the interest rate on bond-funded student loans to no more than two percentage points over the rate on the bonds.

EFC very much appreciates your consideration of this recommendation. If you have any questions, please do not hesitate to contact Elwood G. "Woody" Farber at 202.955.5510.