

TAX REFORM AND HIGHER EDUCATION

WHAT STUDENTS, FAMILIES, AND INSTITUTIONS NEED TO KNOW

Talking Points: Higher Education Tax Credits

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

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

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

- Individuals with college degrees are twice as likely to earn higher incomes, maintain healthier lives, and make positive contributions to society.³
 - A study of economic and noneconomic outcomes—such as income, job satisfaction, voting rates, and volunteerism—found that educational attainment has a meaningful, positive statistical relationship with 50 out of 52 reports analyzed.⁴
 - Each additional year of schooling increases earnings by about 10 percent, often more than other investments.⁵
- Increased access to postsecondary education—and the talented workforce developed and nurtured through education—bolsters our economy and strengthens our national security.⁶

¹ *Estimates of Federal Tax Expenditures for Fiscal Years 2023–2027*, Joint Committee on Taxation, <https://www.jct.gov/getattachment/4bb6796c-df84-4179-9226-8ccea61c7c4b5/x-59-23.pdf>.

² “The Lifetime Learning Credit Guide,” Fidelity Viewpoints, February 22, 2024, <https://www.fidelity.com/learning-center/personal-finance/lifetime-learning-credit>.

³ Roy Y. Chan, “Understanding The Purpose of Higher Education: An Analysis of the Economic and Social Benefits for Completing a College Degree,” *Journal of Education Policy, Planning, and Administration* 6, no. 5 (2016): 1–40, scholar.harvard.edu/files/roychan/files/chan_r_y_2016_understanding_the_purpose_aim_function_of_higher_education_jeppa_65_1-40.pdf.

⁴ *Education for What* (Gallup, Inc., 2023), <https://www.gallup.com/file/analytics/510092/Gallup-Lumina%20Education%20for%20What%20Report.pdf>.

⁵ Harry A. Patrinos, “Why Education Matters for Economic Development,” *World Bank Blogs*, May 17, 2016, <https://blogs.worldbank.org/en/education/why-education-matters-economic-development>.

⁶ Patrick Lehnert, Madison Dell, Uschi Backes-Gellner, and Eric Bettinger, *The Effect of Postsecondary Educational Institutions on Local Economies: A Bird’s-Eye View*, Working Paper 32679 (National Bureau of Economic Research, 2024), <https://www.nber.org/papers/w32679>; Michele Spires, “Why Higher Education Is Still Our Country’s Greatest Defense,” *Higher Education Today* (American Council on Education blog), June 11, 2024, <https://www.higheredtoday.org/2024/06/11/higher-ed-greatest-defense/>.

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

- Only 60 percent of the students eligible for the AOTC claim the credit.⁷
 - Eligible students with lower incomes are less likely to claim the credit. The take-up rate was 43 percent for students from families with incomes less than \$25,000, compared with 80 percent for students from families with incomes greater than \$100,000.
 - The take-up rate for low-income students attending public two-year institutions with scholarships greater than tuition is only 20 percent.
- Fixing the AOTC-Pell interaction issue will help ensure that students with the lowest incomes at the lowest-cost institutions are not excluded from this important benefit. This can be achieved by repealing the taxability of Pell Grants and addressing the AOTC-Pell offset interaction, which would simplify the tax code and make it easier for these students to navigate their tax obligations.⁸
 - Data from the Department of Education shows that an estimated 550,000 Pell-eligible students are adversely affected by this issue each academic year.
 - Pell students—over 90 percent of whom come from families with incomes of \$60,000 or less—often receive little or no benefit of the AOTC, which contains a grant/scholarship offset provision that has the unintended effect of sharply limiting or eliminating the benefit for these students, especially those that attend lower-cost institutions such as community colleges.
- The current structure of the credits does not adequately support post-traditional students, who are often older, working, parenting, or serving in the military—even though they make up the majority of undergraduate students.
- A consolidated tax credit would simplify existing benefits and better serve low- and middle-income students pursuing associate or bachelor's degrees, graduate education, or lifelong learning. A consolidated credit would:
 1. Maintain the current AOTC, offering up to \$2,500 (partially refundable) for students enrolled at least half-time in undergraduate programs.
 2. Add a nonrefundable \$2,000 credit, such as the LLC, covering 100 percent of the first \$2,000 of eligible expenses for post-traditional students, graduate students, and lifetime learners beyond their first four years.
 3. Expand eligible expenses to include computer equipment and child or dependent care, and replace the AOTC's annual limit with a \$15,000 lifetime cap.

⁷ Julie-Anne Cronin and Joseph Gray-Hancuch, *Barriers to Claiming Education Tax Credits for Low-Income Students*, Working Paper 125 (Office of Tax Analysis, U.S. Department of the Treasury, 2024) <https://home.treasury.gov/system/files/131/WP-125.pdf>.

⁸ For more on this issue, read ACE's letter supporting bipartisan legislation that would fix the AOTC-Pell interaction: <https://www.acenet.edu/Documents/Letter-Doggett-Kelly-Tax-Free-Pell-050523.pdf>.