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## **A SIGNIFICANT NUMBER OF STUDENTS IN EVERY STATE ARE SHUT OUT OF FEDERAL HIGHER EDUCATION TAX CREDITS**

### **Senate Finance Committee Will Soon Consider Whether to Address This Issue**

By Aviva Aron-Dine and Arloc Sherman

As early as next week, the Senate Finance Committee is expected to vote on legislation restructuring the higher education tax credits. The federal tax code includes two tax credits that offset tuition costs for students enrolled in higher education: the Hope Credit, worth up to \$1,650, and the Lifetime Learning Credit, worth up to \$2,000.<sup>1</sup> While a key rationale for these tax benefits is to enable students to attend college who could not otherwise afford to do so, *nearly 4 million* prospective college students — or *more than a fifth* of all high-school-age children nationwide — cannot expect to receive any help from the credits because their families' incomes are *too low*.

The higher education tax credits are “nonrefundable,” which means they can only benefit those with incomes high enough to generate sufficient federal income tax liability. As a result, students from low-income families generally do not qualify for them. This year, a family of four with income of less than \$24,000 (more than twice full-time minimum wage earnings) would receive *no benefit* from the tax credits. And the family would need an income of over \$40,000 to qualify for the full benefits of either of the two credits.

In contrast, if a tax credit is “refundable,” taxpayers can receive a tax refund for the amount by which the credit exceeds their income tax liability. Put another way, only refundable tax credits provide the same benefits to taxpayers at all income levels, rather than shutting out those with low incomes.

Based on Census data for 2003-2005, we estimate that about 3.9 million high-school-age (14-17 year-old) children nationwide live in families that could not expect to benefit at all from the tax credits if the children went on to college, simply because the credits are not refundable.<sup>2</sup> Table 1 provides figures for the number of such students in each state.

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<sup>1</sup> In addition, taxpayers may claim deductions for tuition costs and student loan interest and may save for college in tax-preferred savings accounts. These tax benefits go almost entirely to middle- and upper-income students.

<sup>2</sup> In practice, many more likely would not benefit because of the credits' narrow definition of qualifying expenses. See Aviva Aron-Dine, “Making Higher Education Tax Credits More Available to Low- and Moderate-Income Students: How and Why,” Center on Budget and Policy Priorities, May 10, 2007, <http://www.cbpp.org/5-10-07tax.htm>.

## Impact of Tax Credits Likely Greatest for Low-Income Students

Studies have found that financial assistance can significantly influence college enrollment decisions. A number of studies have estimated that a \$1,000 reduction in the cost of college can increase enrollment by 3 to 4 percentage points. (If the percentage of high school graduates who enrolled in college immediately following graduation increased by 3 to 4 percentage points, this would be an increase of almost 100,000 students annually.)

Yet a major study of the Hope Credit and the Lifetime Learning Credit found no evidence that they had increased college enrollment.<sup>3</sup> One important factor behind these disappointing results is the credits' unavailability to low-income students.

Common sense suggests — and careful academic research corroborates — that subsidies are likely to have the largest impact on the college enrollment decisions of low- and moderate-income students.

- In 2004, only about 50 percent of high-school graduates from families in the bottom fifth of the income scale went directly from high school to college, compared with more than 60 percent of those in the middle three-fifths of the income scale and about 80 percent of those in the top fifth.<sup>4</sup> This suggests that low- and moderate-income students are more likely than middle- or upper-income students to be deterred by the costs of going to college.
- According to the Congressional Research Service, studies consistently find that “lower-income students [are] more sensitive to changes in tuition and aid than students from middle- and upper-income families.”<sup>5</sup>

Nevertheless, for millions of low- and moderate-income high school students, the federal tax credits provide *no incentive* for college enrollment because their families cannot expect to benefit from these credits.

## Low- and Moderate-Income Students Have Substantial Unmet Financial Need

Some mistakenly believe that governmental and school-based aid sufficiently insulates low-income students from high college costs and that these students do not need the assistance provided by the education tax benefits. This, however, is not the case. The National Center for Education Statistics reports that the large majority of low- and moderate-income undergraduates have significant unmet financial need even *after* taking into account governmental and institutional grants, subsidized loans, work study, and other aid.<sup>6</sup>

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<sup>3</sup> Bridget Terry Long, “The Impact of Federal Tax Credits for Higher Education Expenses,” National Bureau of Economic Research Working Paper No. 9553, March 2003.

<sup>4</sup> National Center for Education Statistics, “The Condition of Education 2006,” U.S. Department of Education, June 2006, <http://www.nces.ed.gov/pubs2006/2006071.pdf>.

<sup>5</sup> Pamela J. Jackson, “Higher Education Tax Credits: An Economic Analysis,” Congressional Research Service, updated February 20, 2007, [http://opencrs.cdt.org/rpts/RL32507\\_20070220.pdf](http://opencrs.cdt.org/rpts/RL32507_20070220.pdf).

<sup>6</sup> Data are from the 2003-2004 National Postsecondary Student Aid Study. Figures here are for undergraduate students who are dependents of their parents (and are classified into income groups based on their parents' incomes), but the

Among students from families with incomes under \$20,000 who were attending community colleges in 2003-2004, for instance, 87 percent had unmet financial need, averaging \$4,500 per student. Among students from such families who were attending four-year public institutions, 80 percent had unmet need, averaging \$6,000 per student. Middle- and upper-income students were much less likely to have unmet need.

## **Conclusion**

Making federal tax credits for higher education available to low- and moderate-income students is critical to achieving the credits' fundamental goal of promoting college enrollment. It is also a matter of equity: low- and moderate-income students face significant college expenses even after taking into account governmental and school-based aid, and they should have access to the subsidies for college expenses that Congress has provided through the tax code to students whose families have higher incomes. Making the tax credits available to low-income students would require — at a minimum — making them refundable, so that those with incomes too low to owe federal income taxes could still benefit.

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figures for low-income independent students (generally students who are over age 24, are married, or have dependents, or are enrolled in a graduate or professional program) are similar. See National Center for Education Statistics, "Student Financing of Undergraduate Education: 2003-2004," U.S. Department of Education, August 2006, <http://nces.gov/pubs/2006/2006186.pdf>.

**TABLE 1: Number of High-School Age (14-17 Year Old) Children Whose Families Cannot Expect to Benefit From the Federal Higher Education Tax Credits**

State	Number	Margin of Error
Alabama	61,000	±14,000
Alaska	7,000	±2,000
Arizona	81,000	±17,000
Arkansas	43,000	±9,000
California	575,000	±45,000
Colorado	43,000	±12,000
Connecticut	36,000	±9,000
Delaware	8,000	±2,000
D.C.	10,000	±2,000
Florida	210,000	±26,000
Georgia	128,000	±20,000
Hawaii	11,000	±3,000
Idaho	19,000	±4,000
Illinois	159,000	±23,000
Indiana	79,000	±16,000
Iowa	25,000	±7,000
Kansas	29,000	±8,000
Kentucky	72,000	±15,000
Louisiana	81,000	±16,000
Maine	18,000	±4,000
Maryland	52,000	±13,000
Massachusetts	60,000	±13,000
Michigan	132,000	±20,000
Minnesota	43,000	±11,000
Mississippi	62,000	±11,000
Missouri	74,000	±15,000
Montana	13,000	±3,000
Nebraska	14,000	±4,000
Nevada	32,000	±8,000
New Hampshire	7,000	±3,000
New Jersey	71,000	±15,000
New Mexico	35,000	±8,000
New York	292,000	±31,000
North Carolina	126,000	±20,000
North Dakota	5,000	±2,000
Ohio	120,000	±19,000
Oklahoma	42,000	±10,000
Oregon	43,000	±11,000
Pennsylvania	148,000	±22,000
Rhode Island	17,000	±4,000
South Carolina	62,000	±14,000
South Dakota	8,000	±2,000
Tennessee	88,000	±16,000
Texas	378,000	±37,000
Utah	24,000	±6,000
Vermont	6,000	±2,000
Virginia	71,000	±15,000
Washington	68,000	±15,000
West Virginia	28,000	±6,000
Wisconsin	64,000	±14,000
Wyoming	5,000	±2,000
<b>United States</b>	<b>3,882,000</b>	<b>±101,000</b>

Source: CBPP estimates based on data from the 2004-2006 Annual Social and Economic Supplements to the Census Current Population Survey, which cover years 2003-2005. Figures are averages for 2003-2005, based on 2008 tax law. The estimates likely understate the number of students in families that cannot expect to benefit from the credits because their incomes are too low. They take into account only the child tax credit and Earned Income Tax Credit and not any other tax credits or deductions to which families may be entitled. They thus overestimate families' tax liability, and, as a result, the number of families that have sufficient tax liability to benefit from non-refundable tax credits.