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The Upshot
COST OF COLLEGE

$20 Billion in Tax Credits Fails to Increase College Attendance

Susan Dynarski APRIL 19, 2016

Taxpayers will file for $20 billion in tax credits for college expenses they paid in 2015, but while those who get them will no doubt be happy, new evidence shows they have no effect on encouraging people to attend college.

The federal government provides over $30 billion annually in tax benefits for college. In addition to the two tax credits — the American Opportunity Tax Credit and the Lifetime Learning Credit — benefits include a deduction for interest paid on student loans, a recently defunct deduction for tuition expenses, and the 529 and Coverdell tax-advantaged savings accounts.

That is a lot of money. It's about half of what the federal government spends on elementary and secondary education and two-thirds of what it spends on Pell Grants, which subsidize costs for low-income college students.

The tax benefits were created to get more people into and through college. But researchers at Stanford and the University of California, Santa Cruz, have now shown that the largest tax benefit, the tax credits, have no effect on increasing education.

The economists George Bulman and Caroline Hoxby scoured hundred of millions of tax returns searching for an effect of the tax credits and tuition deduction. They inspected detailed, individual-level administrative data from the

I.R.S. (The I.R.S. has developed secure mechanisms that allow these data to be analyzed without compromising the privacy of taxpayers.)

These tax data have already generated a series of high-profile studies, including two that exposed enormous variation across the United States in life spans and intergenerational income mobility.

Dozens of data sets, including the I.R.S. data, show that college enrollment rises with income. If the tax credits help to increase college attendance, we should see this positive relationship between income and college attendance weaken where the tax credits phase out.

(The tax credits phase out within certain income ranges, with their value dropping with each additional dollar of income. The American Opportunity Tax Credit is worth up to $2,500 per student, but above an adjusted gross income of $160,000 for a married couple, the credit drops steadily, until it reaches zero at $180,000.)

The intuition is that, in the phaseout region, rising income is offset by the decreasing credit, blunting the positive correlation between income and attendance. Statistical analysts call this method regression-kink design, because it relies on a change in the relationship between two variables.

Mr. Bulman and Ms. Hoxby found the predicted relationship between adjusted gross income and the receipt of tax credits in the phaseout region: Credits drop as income rises. But they found no corresponding relationship between income and college attendance. College attendance rises unabated with adjusted gross income, with no change when the credits phase out.

Why no effect? One explanation is that the credits primarily go to middle- and upper-income families, whose decision on whether to send their children to college is unlikely to be affected by $2,500. Another, compatible explanation is that the credits are delivered too late to affect enrollment. Families get them after tuition is due; a family that pays tuition in September won't get a tax credit until at least the following January. At that point the credit is a nice windfall, but has arrived too late to help pay the bursar.

The complexity of the tax benefits also most likely undermines their effect. I discuss this in greater detail in a recent paper I wrote with Judith Scott-Clayton, which provides a comprehensive overview of the tax benefits for education.

If the billions spent on the tax credits are to have any effect on college attendance, you would want them delivered when tuition bills are due. One proposal suggested by Ms. Hoxby and Mr. Bulman is to compute eligibility for the credits automatically, using income tax information when a dependent approaches college age. Families could then be notified of their eligibility. The authors also suggest that colleges file to receive the benefits directly from the Department of Education, so that a student need only present evidence of eligibility to have an account credited immediately.

An even more comprehensive approach would be to consolidate the tax credits with the Pell Grant, creating a single grant program that pays college costs at the time of enrollment. Eligibility could automatically be calculated using tax data, with money delivered by the Department of Education. Families could apply by checking off a box on their tax forms.

This approach would cut back substantially on paperwork, a relief for the millions of students who complete both the 1040 and the dreaded Free Application for Federal Student Aid in order to get federal grants, loans and tax credits for college. With a simplified application, and dollars delivered at the right time, the $30 billion now spent on tax credits could open college to many more students.

Susan Dynarski is a professor of education, public policy and economics at the University of Michigan. Follow her on Twitter at @dynarski.