



tax facts

from the Tax Policy Center

Subsidizing Higher Education Through the Federal Income Tax Code

By Katie Fitzpatrick and Elaine M. Maag

The Taxpayer Relief Act of 1997 expanded assistance for postsecondary education for low- and middle-income families with the creation of two new credits: the HOPE Scholarship Credit (HOPE Credit) and the Lifetime Learning Credit (LLC). Both are intended to subsidize the cost of attending school by allowing a portion of a student's expenses to be offset by a tax credit. The table below describes the credits.

The HOPE Credit, first available for expenses incurred in 1998, can be claimed for any student in the family for the first two years of postsecondary education. The student must be enrolled at least half-time while pursuing a recognized education credential. The credit for each student is 100 percent of the first \$1,000 of qualified expenses and 50 percent of the next \$1,000 of qualified expenses. Beginning in 2002, the maximum credit is adjusted annually for inflation. The LLC, first available for expenses paid after July 1, 1998, can be claimed for any number of years and for any qualified expenses, including those incurred by graduate and professional students and people upgrading skills or changing careers. Starting in 2003, the LLC equals 20 percent of expenses up to \$10,000 per household. Before that, expenses were capped at \$5,000. A student may take advantage of only one credit in a single year.

Both credits begin to phase out for single taxpayers with a modified adjusted gross income of \$40,000 (\$80,000 for married taxpayers), adjusted for inflation, beginning in 2002. The credit completely phases out once modified adjusted gross income equals \$50,000 (\$100,000 for married taxpayers). Neither the HOPE Credit nor the LLC are refundable, so low-income households cannot benefit from the credits. Taxpayers cannot claim a credit for any portion of educational expenses paid with certain tax-free funds, including scholarships, Pell grants, employer-provided educational assistance, veterans' educational assistance, and withdrawals from a Coverdell Education Savings Account or Section 529 plan. Eligible expenses are limited to tuition and required fees; room and board expenses do not qualify.

The Joint Committee on Taxation first estimated that the credits would cost \$25.8 billion over the first four years. IRS data show that the actual cost of the credit for this same period was only \$18.3 billion, approximately 71 percent of the initial estimate. The low utilization may be due to lack of knowledge. A 2001 survey of students at the University of California (UC) by Hoblitzell and Smith found that 70 percent of main campus students did not claim either credit — 29 percent of them reported they were unaware of the credits and 58 percent reported they were ineligible for the credits. Fewer undergraduates claimed an educational credit (27 percent) than graduate students (32 percent).

The Office of Management and Budget estimates FY 2003 tax expenditures for the HOPE Credit to be \$3.52 billion; \$2.25 billion for the LLC.

Comparison of Education Credits — 2003 Tax Law		
	HOPE Credit	Lifetime Learning Credit
Maximum credit	\$1,500 per student	\$2,000 per return
Maximum eligible expenses	\$2,000 per student	\$10,000 per return
Eligible expenses reduced by other tax-free education assistance?	Yes	Yes
Eligible time period	First two years of at least half-time enrollment in postsecondary education	Available for one or more courses
Must pursue a recognized education credential?	Yes	No
Tax expenditure in FY 2003	\$3.52 billion	\$2.25 billion



The Tax Policy Center, a joint venture of the Urban Institute and the Brookings Institution, provides independent, timely, and accessible analysis of current and emerging tax policy issues for the public, journalists, policymakers, and academic researchers.

For more tax facts, see <http://www.taxpolicycenter.org/taxfacts>.