Comments on "Tax Benefits for College Attendance"
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It is particularly difficult to discuss "Tax Benefits for College Attendance" by Susan Dynarski and Judith Scott-Clayton because I heartily agree with my take on the authors' three principal conclusions: First, the tax system is an extraordinarily inefficient mechanism for subsidizing access to college. Second, the best mechanism for subsidizing access are outside of the tax system; for a more efficient and, arguably, equitable approach, it would be better to put the resources spent on tax incentives into grants paid when tuition is due. And third, the principal benefit of the tax system in this realm involves facilitating the delivery of financial aid. Dynarski and Scott-Clayton make all three points clearly and compellingly in this paper. Moreover, they were extremely responsive to my initial suggestions, leaving very little to critique.

It is, however, still worthwhile to discuss some remaining distributional considerations regarding both the authors' proposals for simplifying college access as well through other ways in which U.S. government implicitly subsidizes higher education.

As the authors point out, at present the Internal Revenue Service and the U.S. Department of Education each maintain a complicated, burdensome, and highly duplicative set of systems to collect information that could be used to determine aid eligibility. The authors wisely propose that the two agencies streamline their processes – with the IRS collecting and verifying income data from households and the Department of Education collaborating with higher education institutions and delivering financial aid to students – with the current tax credits being consolidated within the Pell Grant program. The IRS, under their proposal, would collect and forward applicants' adjusted gross income, dependency status, and number of dependents to the Department of Education, and the Department would determine the degree of aid eligibility and make direct payments to the institutions where the students are enrolled.

This type of system has considerable advantages, as clearly articulated by the authors, but there are potential social costs associated with this approach. Currently, the Department of Education heavily considers aspects of family wealth when determining a family's ability to pay for college. Families are expected to make use of their assets to assist students in affording college. But asset measures are not collected by the IRS, leaving current household income as the method of determining aid eligibility. This is not an issue per se regarding low-income families, as extremely few families with incomes low enough to qualify for Pell Grants would be disqualified due to their assets (Dynarski and Scott-Clayton, 2007). On the other hand, the higher we go up the income distribution, the more likely it is that treatment of wealth will determine the degree of financial aid eligibility. Eliminating the wealth adjustment in aid calculations will surely increase aid recipiency to more

wealthy families. This need not be a first-order cause for concern from an equity perspective if financial aid is treated as a fixed entitlement, in which all eligible students receive their full aid amount regardless of the total bill of the financial aid program. But to the degree to which the government appropriates a limited amount to fund the full financial aid program and either proportionately funds student subsidies or allocates financial aid on a first come-first served basis, the elimination of the wealth factor in determining aid eligibility will likely transfer aid from comparatively needy students to comparatively wealthy students.

Moreover, this transfer, should it exist, would tend to privilege white families at the expense of black and Hispanic families. Thompson and Suarez (2015), investigating the 2013 Survey of Consumer Finances, demonstrate that at all levels of the income distribution, or across the education distribution, white households are dramatically wealthier than are their black and Hispanic counterparts. Therefore, in the event of a policy change in favor of basing aid eligibility solely on IRS-collected data, the decision to guarantee a given amount of financial aid to eligible recipients versus appropriating a fixed amount to be shared among all eligible recipients would likely have welfare implications, with the latter tending to favor higher wealth, and disproportionately white, families at the expense of lower wealth, and disproportionately minority, families. The design of the revised program will determine the degree to which this transfer occurs, should it occur at all.

The authors spend most of the paper discussing the most visible tax system-related benefits to higher education, but there are also potential distributional consequences to the second-largest federal subsidy of higher education in the United States – the tax treatment of charitable contributions to higher education institutions, and of those institutions' endowments. Endowments are either tax-exempt because they are independent 501(c)(3) organizations, operated exclusively for charitable and educational purposes, or because they are part of a higher education institution that is itself a 501(c)(3) organization or public entity. As a consequence, the endowment's investment earnings are tax-free and a contributor's contributions to the endowment are usually tax-exempt as well. Sherlock, Gravelle, Crandall-Hollick, and Stupak (2015) estimate that the value to higher education institutions of the tax-free status of endowment returns was $16 billion in fiscal year 2014, or $11 billion for private colleges and universities alone. In addition, the tax deduction for charitable contributions to higher education institutions, private activity tax exempt bonds for nonprofit institutions, and the share of general obligation tax exempt bonds accruing to public universities and colleges together total around another $11 billion (Sherlock, Gravelle, Crandall-Hollick, and Stupak, 2015). In sum, favorable federal tax treatment of colleges and universities leads to a considerable subsidy to these institutions' activities.

Higher education institutions have very substantial educational and research purposes that certainly dramatically benefit society. These colleges and universities are engines of economic growth and offer many opportunities for social advancement. Many of these institutions, including Northwestern University, where

I work, use large shares of their endowment income to heavily subsidize access and attendance by low- and moderate-income families. In my mind, there is no question that the vast majority of the American colleges and universities that are tax-exempt organizations fulfill this mission.

That said, the lion's share of the federal tax subsidies that accrue to higher education institutions by virtue of their tax-exempt status are enjoyed by a relatively small share of institutions. Three-quarters (75.8 percent in fiscal year 2014) of all university endowments are concentrated in institutions with the 100 largest endowments, while nearly half (48.5 percent) are shared by the top twenty university endowments (Sherlock, Gravelle, Crandall-Hollick, and Stupak, 2015). One-quarter (24.7 percent) of the total endowments are represented by Harvard University, the University of Texas, Yale University, Stanford University, and Princeton University, and seven percent by Harvard University alone. While the median private, nonprofit doctoral institution has $70,900 in endowment assets per student and the median public doctoral institution has $16,600 in endowment assets per student, the means are $214,300 and $28,000, respectively, driven by the wealth concentration in the hands of a small number of institutions (Sherlock, Gravelle, Crandall-Hollick, and Stupak, 2015) – Princeton, Yale, Harvard, and Stanford, respectively, have per student endowments of $2.6 million, $2.0 million, $1.3 million, and $1.2 million.

The concentration of these tax subsidies at a small number of institutions may be justified, but doing so has some social costs, where the students whose educations are disproportionately subsidizes are drawn from a particular portion of the distribution of students. The 19 extraordinarily selective private institutions among the U.S. News and World Report top 20 national universities account for 39.3 percent of all university endowments and 57.5 percent of all private endowment assets. Of the 27 private colleges and universities with endowments over $2 billion, 26 are classified as "most selective" by U.S. News and World Report, with the other (University of Richmond, classified as "more selective") while among the 53 private colleges and universities with endowments over $1 billion, 41 are classified as "most selective" with the remaining 12 classified as "more selective". Few institutions, public or private, that serve relatively less rarefied sets of students have particularly large endowments.

There are possible tax treatments that could maintain the substantial endowment subsidies for the well-endowed, largely elite universities while transferring a portion of that subsidy to institutions serving a broader sweep of the American student population. For instance, the Tax Reform Act of 2014 (H.R. 1) included a proposal to impose a one percent flat excise tax on private college and university endowments that exceed $100,000 per full-time student, with part-time students measured as full-time student equivalents. The specific features of this proposal, such as the excise tax rate and the threshold for inclusion in the excise tax, are arbitrary, and the presence of a sharp "all-or-nothing" threshold could lead to unintended manipulation of either the numerator or denominator by institutions

near the margin of exposure to the new excise tax. Nonetheless, such a measure (or, alternatively, a tax on endowment earnings), coupled with earmarking revenues to further support financial aid at less competitive colleges and universities, could provide an opportunity to ensure that a portion of the tax subsidies to the mission of higher education institutions that come through the favorable tax treatment of endowment income and charitable contributions are shared with a wider range of higher education institutions and students. Of course, a detailed assessment of the benefits and costs of such a proposal, along with a discussion of the potential distortionary incentive effects that would unquestionably accompany it, is beyond the scope of this commentary.

In summary, the American system of providing tax benefits for college attendance is at present extremely inefficient. Dynarski and Scott-Clayton offer a clear-headed review of the waterfront of the direct subsidies to students, and make thoughtful proposals for reform and improved system efficiency. When carrying out their sensible proposals, it is important to keep in mind potential unintended redistributive consequences, particularly as pertains to the elimination of the wealth criterion for financial aid award determination. Meanwhile, it makes sense to think about the other ways through which the federal government, by virtue of the tax system, subsidizes higher education institutions, and the potential distributional consequences of those actions.

References cited:

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