Help When It's Needed: Advancing The AOTC

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About the Center for Postsecondary and Economic Success at CLASP

The Center for Postsecondary and Economic Success (C-PES) is a policy and advocacy initiative within CLASP. Its mission is to work for policies and investments that increase the number of low-income adults and disadvantaged youth who earn marketable postsecondary and industry credentials that are essential to opening doors to good jobs, career advancement, and economic mobility.

CLASP develops and advocates for policies at the federal, state, and local levels that improve the lives of low-income people. We work to strengthen families and create pathways to education and work. For more information, visit www.clasp.org.

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1 http://www.clasp.org/admin/site/publications/files/Nov2013RADD_TaxAid.pdf

Executive Summary

You've won a $2,500 college scholarship, but there's a catch: the money won't arrive until several months—or even a year—*after* you start college and have to pay for tuition and books. That's how the federal government delivers more than $20 billion annually in federal student aid through the American Opportunity Tax Credit (AOTC). Because students and families obtain the AOTC through the tax system, the aid can only be received after filing a return at year's end.

There's a better way to do this. Creating a process for more timely delivery of the AOTC would significantly improve college affordability, enabling more low-income students to enroll and stay in school. "Timely delivery" means students could receive the AOTC when college bills are due (in advance of filing a tax return). This issue brief provides policymakers with key design questions and evaluation criteria for timely delivery of the AOTC and proposes a new process for administering higher education tax credits that includes an *Advance AOTC*. This proposal would:

- Create My College Tax Credit Assistant, an IRS tool to help students and families understand the AOTC and claim this source of federal student aid.

- Make estimates available (through the Assistant) at any point in the college planning process to see how much AOTC may be available.

- Enable selection (through the Assistant) of the new *Advance AOTC* option each academic period.

- Require the U.S. Department of Education and higher education institutions to include information on the availability of the AOTC and the *Advance AOTC* in the Free Application for Federal Student Aid (FAFSA) and in financial aid award letters.

- Use the Assistant as a data hub to match enrollment and tuition and fees billing information, as provided by institutions, with tax return and other taxpayer-supplied data to facilitate credit administration and promote tax law compliance.

- Deliver *Advance AOTC* payments early each academic period by electronic funds transfer to participating students, using formulas that protect against paying more credit than is due.

- Facilitate (through the Assistant) year-end AOTC claims on tax returns, reconciling any *Advance AOTC* payments with the total credit due.

- Eliminate the need for problematic IRS Forms 8863 and 1098-T.

Through the new process, students will be better able to use this important source of federal assistance to plan for college, pay for school, and successfully complete their postsecondary education.

Help When It's Needed: Advancing the AOTC

Introduction

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Section I of this brief describes the need for timely delivery. Section II lists questions and options to consider in designing a timely delivery process. Section III specifies criteria for evaluating different approaches to timely delivery. Section IV details our timely delivery proposal for an *Advance AOTC*, and Section V illustrates how the new process would work. Finally, Section VI assesses our *Advance AOTC* proposal using the evaluation criteria.

Section I: The Need for Timely Delivery of Tax-Based Student Aid

Current Process

Higher education tax credits (the AOTC and the Lifetime Learning Credit, or LLC) may be claimed on a tax return to offset a portion of the costs incurred for higher education. The two credits differ in amount, claimant eligibility, and expense qualification, but they use the same process for claiming and disbursing aid.[2]

Taxpayers (students or those claiming students as dependents) may claim the AOTC and the LLC using IRS Form 8863 as an attachment to their annual tax returns. They can use information provided by higher education institutions in the Form 1098-T information return to calculate credits; however, this information does not always directly translate to what can be claimed. Through Form 8863, a taxpayer provides information about each student for whom a credit is being claimed and the institution(s) attended; answers questions to assess eligibility; reports the amount of qualified higher education expenses incurred; and calculates the credit amount to include on the tax return. Taxpayers receive the credit as a reduction in the balance due on the return or as a higher refund.

The Timing Problem

The current process for claiming and receiving higher education tax credits fails to meet the needs of many of the students and families whom the credits are intended to benefit.

Higher education tuition and fees and course materials are expensive. The current tax credit disbursement process effectively assumes that students or their families have the financial means to pay these high costs and wait up to 15 months (depending on the timing of bill payment and tax filing) for partial reimbursement. This delay makes the tax credits much less effective for lower-income students (who typically have limited resources and poor access to financing) and lowers the visibility of the tax credits as a form of assistance for students. In practice, the credits primarily benefit more financially secure households who

2 For a summary of the features and differences of the AOTC and LLC, see the CLASP publication, *Reforming Student Aid: How to Simplify Tax Aid and Use Performance Metrics to Improve College Choices and Completion*. http://www.clasp.org/admin/site/documents/files/Final-RADD-WhitePaper-Feb-2013.pdf.

can afford college *without the tax-based assistance*.

By contrast, most student financial aid, such as grants or loans, is disbursed near the beginning of each semester or other academic period—concurrent with due dates for tuition payments and many other expenses. Higher education tax credits are the anomaly, despite being a major component of federal student aid.[3] Students rarely receive the credits during the semester when various other costs of being in school (such as housing, transportation, and child care) may need to be paid. Students with unmet financial need who could ultimately benefit from tax credit dollars may in the meantime be forced to resort to unsustainable strategies such as working too many hours or taking on high-cost debt. The resulting drain on personal and household resources makes it more difficult to stay and succeed in school.

Higher education tax credit disbursement is not linked to academic calendars and is not typically mentioned in financial aid award letters (such as the Department of Education's Financial Aid Shopping Sheet). Prospective students may be unaware that they have access to these credits as an additional way to offset some college costs. Because of this disconnect, tax credits can become irrelevant to financial planning for higher education—severely limiting their potential to improve college access through helping students and families see college as more affordable.

Promoting greater college affordability and access requires a viable method for disbursing federal higher education tax credits on a more timely basis, so that students and their families receive tax-based student aid when college bills are due rather than months later.

Timely Delivery Precedents

Timely delivery of federal tax credits is not a new concept. There are three tax credits that have or had a timely delivery option. From 1977 to 2010, a worker expecting to be eligible for the Earned Income Tax Credit (EITC) could annually file an IRS form with her employer requesting that a portion of the credit be disbursed in each paycheck. The employer would consult an IRS table (analogous to the withholding tables) to determine the amount corresponding to the period's gross pay; those dollars would then be added to the worker's paycheck, and the employer would deduct the total payments made from its quarterly tax payment to the IRS. The maximum amount that could be added to a weekly paycheck was about $35, but most of those using the option received much less. The employer would include the year's total Advance EITC (AEITC) payments on the employee's Form W-2, and the employee would subtract this amount from the full EITC claimed on her tax return. The employer role and paycheck-based timing were significant factors in the low participation rate and reporting irregularities that led to the option's repeal.[4]

The Health Coverage Tax Credit (HCTC) was a very small program enacted in 2002 to assist certain workers (in companies experiencing trade-affected job loss or a pension takeover) who had to pay the majority of their health insurance premiums.[5] Those eligible could choose to claim the credit monthly. The claimant paid the HCTC program 27.5 percent of the monthly premium; the credit covered the balance and the HCTC program disbursed the total premium payment to the health insurer. The HCTC could also be claimed on an annual basis by attaching a form to the tax return. With enactment of the Affordable Care Act, the HCTC was discontinued after 2013.

Beginning in 2014, income-eligible enrollees in health plans purchased through the Affordable Care Act insurance exchanges can choose to claim all or a portion of the anticipated health insurance premium tax credit on a monthly basis. The IRS pays the Advance Premium Tax Credit (APTC) directly to the insurer. The final credit for the year is determined through the tax return; after subtracting the total APTC paid on her behalf, the taxpayer may be able to claim a credit balance or need to repay a portion (that varies by income).

3 In Fiscal Year 2014, according to the President's FY15 Budget and the U.S. Department of Education's FY15 Budget Summary and Back ground Information, the federal government is investing $23.3 billion in the AOTC and LLC, as compared to $33.0 billion in Pell Grants.

4 Workers needed to declare their eligibility for income assistance to their employers, the amount of money available per paycheck was typically small, and recipients working for multiple employers were at risk of overpayment. Advances were made independently of the IRS, which depended for reconciliation and enforcement on year-end reporting (via wage statements and tax returns) that was often inaccurate.

5 A 2008 analysis indicated that the HCTC was subsidizing coverage for 16,000 households each month, representing low participation by eligible workers; there were high administrative costs resulting from the numerous monthly transactions associated with each beneficiary. Stan Dorn, "Health Coverage Tax Credits: A Small Program Offering Large Policy Lessons," Urban Institute, 2008.

Section II: Design Options for Timely Delivery

“Timely delivery” means claiming higher education tax credits in advance of filing a tax return. This section summarizes key issues involved in designing a timely delivery process and alternative approaches to consider.

Options for being eligible to claim the credit in advance

AOTC eligibility is tied to a student with qualified educational expenses. The credit is currently claimed on a tax return by the student or by someone claiming the student as a dependent. Eligibility for claiming an advance AOTC payment could be restricted by other considerations, such as the size of the anticipated AOTC, the number of students for whom a credit is being claimed, the refundability status of the credit claimed, the time of year during which qualified expenses are incurred, or the institution attended.

Options for initiating a claim for advance payment

The eligible claimant must signal the choice for an advance AOTC payment. This signal could be given directly to the IRS or communicated through a third-party intermediary, the institution, a state or local government, or some other entity. It could be done as part of another process (such as application for or acceptance of a financial aid award) or through a mechanism specific to the advance AOTC. The choice could be made once annually, once per academic year, once per academic period, or at some other frequency.

Options for calculating the advance payment amount

Currently, the AOTC claimed on the tax return is based on the household configuration (dependent vs. independent students), income, and any qualified higher education expenses declared. An advance payment could be based on information from a prior year’s return or on projections of income and/or expenses. The qualified expenses could be determined from the institution’s cost of attendance, amounts billed, or amounts received. All, or only some, of the expenses qualifying for the AOTC could qualify for the advance. The accelerated payments could be based on the full expected credit or some fraction of it.

Options for timing the advance payment

The advance AOTC payment could be disbursed in full or in part at the beginning of the tax (calendar) year or the academic year. This could be timed similarly to loans and grants to coincide with the beginning of each academic period. It could also be tied to when the IRS receives information about the institution, the household, or the student’s expenses. The advance payments could be made in monthly or other periodic installments.

Options for disbursing the advance payment

Advance AOTC payments could be disbursed to the taxpayer, the student, the institution, a state or local government, or another third-party entity. Disbursement could be by check, through a dedicated prepaid debit card, or by electronic funds transfer to a regular or segregated account.

Options for reconciling the advance payments to the total credit for the tax year

Mechanisms such as the Advance Earned Income Tax Credit or Advance Premium Tax Credit base the amount advanced during the year on an estimate of the credit that will be payable for the tax year. The final amount of the credit is still calculated in the standard manner at tax time. The net amount payable when the tax return is filed is the full credit amount less the sum of the advance payments; advances in excess of the actual credit amount must be repaid in whole or in part. An alternative approach, used for tax credits in some other countries, is for advances to constitute a floor—protecting taxpayers from having to make repayments but allowing them to receive an additional amount if they turn out to qualify for a larger credit. Going further, the credit could be disconnected from the tax return for those claiming it in advance, with the calculations made in association with each disbursement considered final.

Section III: Evaluation Criteria for Timely Delivery Proposals

This Section specifies several criteria for evaluating proposals that seek to address the timely delivery problem for higher education tax credits.

Is the proposed process feasible for implementation?

Several actors could be involved in the implementation of a timely delivery process: taxpayers, students, institutions, the IRS, the U.S. Department of Education, other federal or state governmental agencies, or other third parties. Any proposed process must assure that these involved parties will be able to perform their expected roles.

To be feasible for students and their families, a new process cannot layer on more requirements; instead, it should make things simpler. Currently, credit claimants must negotiate on their own the process of learning about and obtaining the AOTC (although many are assisted by paid tax return preparers or return preparation software). The applicable guidelines are embedded in a 90-page IRS publication on higher education tax benefits. In using these guidelines to complete Form 8863 and claim the credit, taxpayers must rely on information provided by institutions in a format (Form 1098-T) that is not directly translatable to filling out Form 8863.

Proposals should respect the capacities of financial aid, registrar, and business offices at higher education institutions. Institutions already feel overly burdened with the current reporting requirements embodied by Form 1098-T.

The IRS faces tremendous challenges in managing a complicated tax code with limited resources. A process for timely delivery of the AOTC that adds new administrative burdens without providing additional resources or offering compensating benefits is unrealistic.

At present, the U.S. Department of Education and other governmental entities (such as state governments) have no role in administrating the AOTC. A timely delivery design could call upon their involvement. However, any such proposal would need to address the sizeable implementation challenges posed by novel intergovernmental cooperation arrangements.

Does the proposed process create significant risks for the public?

Any proposal should ensure the AOTC is properly targeted and reaches its intended beneficiaries. If not carefully designed, incremental disbursements (such as advance payments) can sometimes assist persons who are not the intended recipients. New avenues for receiving payments can create incentives and opportunities for criminals to commit fraud. Timely delivery proposals must include safeguards that promote program integrity.

Does the proposed process create significant risks for students and their families?

Proposals to implement timely delivery of the AOTC to students and their families should adhere to a "do no harm" principle. One risk to AOTC claimants is that they would see no net benefit from the credit with an alternative delivery model. This could occur if other sources of financial aid were reduced due to receipt of credit dollars during academic periods. Higher education institutions could react to the increased availability of resources by adjusting pricing. A more direct risk to taxpayers utilizing accelerated disbursement is that they could be required to repay AOTC funds based on a later reassessment of eligibility or credit size.

Is the proposed process likely to prove superior in achieving the desired outcomes for the AOTC?

Similar to the "do no harm" principle, any proposal to modify how the AOTC is claimed should be expected to result in outcomes superior to the status quo. There are four areas with particular promise for improving outcomes:

Take-up of assistance

The goal for higher education tax credits or any other form of student aid is participation by all those eligible for help and exclusion of those who do not qualify. This is optimal for achieving program outcomes. While there are no IRS data available on current take-up of the AOTC, it appears to be significantly short of full participation.[6] Proposed alterations should address this gap.

6 The Tax Policy Center calculates that 75 percent of students imputed to be eligible for the AOTC actually receive the credit, and it appears that the rate is lower for low-income students.

Access to higher education

A primary purpose of the AOTC is to reduce financial barriers to enrollment in higher education. The current disconnect between when costs must be paid and when credit assistance is available makes the AOTC less effective than it could be at improving access. Timely delivery proposals need to establish how the timing of payments in the new process would make college more affordable and enrollment more likely.

Student persistence and completion

Without sufficient financial aid, students often cannot stay in school or must work too many hours to make meaningful progress toward and complete a degree. Again, the AOTC is a key part of the federal government's response to the financial challenges students face. Approaches involving advance payment of credit dollars should be able to show how they are likely to improve student persistence and completion.

Tax law compliance

The tax system relies on voluntary taxpayer compliance overlaid with select enforcement activity. Making tax credit eligibility criteria and claiming processes clear and easy to understand facilitates voluntary compliance. Setting clear expectations for taxpayers, institutions, and others who are required to report information to the IRS promotes compliance through reliable information gathering. Improved data quality and availability, in turn, expedites IRS enforcement.

Does the proposed process reduce complexity?

The complexity of a proposed process is an important consideration in whether it can be feasibly implemented and achieve policy objectives. Across a wide range of governmental programs—the tax code especially—complexity has long been a major problem. Both policymakers and the general public are increasingly frustrated with byzantine rules and bureaucratic processes. Proposals to accelerate disbursement of the AOTC must be conscious of this.

Section IV: A Proposal for an Advance AOTC

Consistent with other recommendations of the Consortium for Higher Education Tax Reform, this brief presumes repeal of the LLC and focuses on a process for timely delivery of the AOTC. The Consortium recommends other improvements to the AOTC, such as full refundability and a lifetime cap in place of the current four-calendar-year limit. ***It is important to note that the proposal here for timely delivery is not dependent on those other program modifications.*** However, full refundability would remove some of the risk from advance payment, because it would ensure that the amount of the credit a student could receive would not change based on a loss of taxable income.

This section highlights key features of a new *Advance AOTC*, including its ability to eliminate some currently problematic IRS forms.

My College Tax Credit Assistant

The IRS will create an online interface for higher education tax credits called My College Tax Credit Assistant. The Assistant will have several functions, including estimating credit amounts, enrolling eligible student households for timely delivery, serving as a data hub, and facilitating year-end tax filing and credit reconciliation. Creation of the My College Tax Credit Assistant could be funded from savings achieved through enactment of the Consortium's Shared Agenda package of higher education tax reforms.

My College Tax Credit Assistant – Estimating the AOTC

The estimation function of My College Tax Credit Assistant will be similar to a current IRS tool—the EITC Assistant[7]—and will assist students and families with college planning. By entering information from the Student Aid Report (a summary the Department of Education provides to students of the information they have entered on the Free Application

7 The EITC Assistant is an online tool maintained in English and Spanish by the IRS that helps taxpayers determine eligibility for the Earned Income Tax Credit and calculate an estimated credit. The IRS states that the tool takes 15 to 20 minutes to complete. The tool is available here: http://apps.irs.gov/app/eitc2012/SetLanguage.do?lang=en.

for Federal Student Aid, or FAFSA[8]) or making their own projections, students will receive estimated AOTC amounts based on their income and household composition. The Assistant will provide multiple examples of total tuition and fees and course materials for different types of institutions (such as two-year public, four-year public, and four-year private).[9]

After receipt of financial aid award letters, students will be able to enter the estimated tuition and fees and obtain a more customized estimate of the AOTC.

Outreach to Students and Parents about the AOTC and Available Tools and Options

AOTC availability, including the *Advance AOTC* and a link to the My College Tax Credit Assistant, will be listed under "Other Options" on the Department of Education's Financial Aid Shopping Sheet form. The Financial Aid Shopping Sheet will also include the institution's Employer Identification Number (EIN) to facilitate signing up for the *Advance AOTC* through the Assistant (see below). Title IV institutions choosing not to use the Department of Education form would still be required to include these items in their award letters.[10]

My College Tax Credit Assistant – Selecting the *Advance AOTC*

My College Tax Credit Assistant will enable taxpayers to choose between claiming the AOTC as incremental payments through the *Advance AOTC* or as one year-end payment on their annual tax return.[11] Taxpayers will provide (and update) the names and Social Security Numbers of all students for whom the *Advance AOTC* is being claimed, the names and EINs of the institutions attended, and the account number and routing information for the depository account that will receive electronic transfer of the advance payments.[12]

Through My College Tax Credit Assistant, taxpayers will set the percentage of the available AOTC to be drawn down in advance. The maximum advance percentage will be 100 percent for taxpayers well below the income phase-out range of the credit and 75 percent for those near or in the phase-out range.[13] (If the Consortium's recommendation for full AOTC refundability were not adopted, a maximum advance percentage of 75 percent or less would be universal.[14]) Taxpayers applying funds from tax-preferred savings accounts to college expenses (such as a state 529 plan) will be reminded to consider this in choosing an advance percentage.[15]

My College Tax Credit Assistant – the Data Hub

The IRS will use My College Tax Credit Assistant as a real-time data hub to match taxpayer-supplied information with the most current institution-supplied enrollment and cost information (see sidebar) and pertinent information from its own files. When a taxpayer enrolls in the *Advance AOTC*, the IRS will populate the account with income and household information from the most recent prior-year tax return and update the account periodically based on later filings.[16]

8 In many cases, the FAFSA is populated with accepted income tax return data accessed electronically through the IRS Data Retrieval Tool, simplifying the process for families and enhancing data accuracy. Student families expecting significant changes in income or household configuration can still use their own projections.

9 For most students, the total qualified expenses examples would not need to be reduced by any anticipated Pell Grants, because the latter can be applied to costs of attendance beyond tuition, fees, and course materials. However, under current law, Pell grants applied to such costs must be treated as taxable income; the Consortium's Shared Agenda calls for eliminating all taxation of Pell Grants.

10 *Building an AOTC Movement: Strengthening Outreach for a Reformed American Opportunity Tax Credit*, a brief prepared for the Consortium's White Paper by the New America Foundation's Education Policy Program, provides more detail on how to increase outreach for the AOTC and any timely delivery option.

11 This brief envisions establishment of the *Advance AOTC* as an opt-in provision, leaving year-end payment in full as the default. This is especially wise during the early years of implementation as systems develop and mature. The enacting legislation could include an automatic (though repealable) trigger to convert to an opt-out (advance payment as default) process after a period of time (perhaps five years).

12 Taxpayers without a traditional financial institution account could use alternatives such as prepaid debit cards (perhaps including the Department of Treasury's Direct Express debit card). It would also be worth pursuing direct deposit with lenders to reduce outstanding principal balances on student loans.

13 The 75 percent maximum for taxpayers near or in the AOTC phase-out range provides a cushion in case annual income turns out to be higher than expected and a smaller total credit can be claimed. With a fully refundable AOTC, this risk of overpayment from increased income would be minimal for taxpayers well below the income phase-out, justifying the option to receive a 100 percent advance.

14 In the absence of full refundability, the estimated and actual AOTC amounts could vary due not only to shifts in income but also in household configuration, deductions and credits claimed, and other factors that affect the positive tax liability against which the non-refundable portion of the credit could be applied.

15 Expenses for which another tax benefit is being claimed are not qualified education expenses for the AOTC.

16 Retention of regularly updated data by the My College Tax Credit Assistant data hub could also enable longitudinal tracking of AOTC amounts received by taxpayers to facilitate administration of the dollar-based AOTC lifetime cap included in the Consortium's reform package (which calls for replacing the current four-year limit for AOTC receipt with an equivalent value, or maximum $10,000, lifetime cap).

Data Reporting

Timely delivery of the AOTC requires timely availability of pertinent data. At present, the only data reporting to the IRS is: 1) what higher education institutions provide about individual students after the end of each calendar year through the Form 1098-T information return; and 2) taxpayers' self-reporting through tax returns using Form 8863.

Timely delivery consists of IRS payments during the tax year based on expectations of taxpayer qualification. There is understandable concern that if those expectations prove inaccurate, there could be limited options for recovering potentially improper payments. Of course, this is already a concern with various aspects of the tax code under our system of voluntary compliance (including claims of the AOTC via tax returns). Nonetheless, there is heightened concern with advance payments; consequently, taxpayer self-reporting is not feasible as the basis for timely delivery.

Equally untenable is basing advances solely on institutional reporting of final non-refundable tuition and fees payments. Although this would most closely match the definition of AOTC qualified expenses, it would seldom be timely. Students at some institutions can pay over an extended period through payment plans, and the dates for course withdrawal with partial tuition refundability are typically relatively late in the academic period.

A balanced approach would permit advance payments of the AOTC on the basis of institutionally reported enrollment and net billings. These data are available at or near the start of the academic period. This would achieve the accelerated disbursement that is the essence of timely delivery.

One option may be augmenting the institutional reporting currently done through the National Student Clearinghouse. Most higher education institutions use the Clearinghouse[17] to meet Department of Education reporting requirements regarding student enrollment. If institutions are required to report to the IRS the net amount of tuition and fees billed[18] to the student each academic period (as well as enrollment status[19]), the Clearinghouse could help them fulfill this requirement. The IRS could periodically populate the data hub with enrollment and tuition and fees data from the Clearinghouse. Institutions not utilizing the Clearinghouse or choosing not to share their Clearinghouse data with the IRS would be able to report the required information directly to the IRS near the beginning of each academic period.

Institutional data reporting should be one-way, meaning that institutions will not be able to access IRS data from the data hub to determine taxpayer use of the AOTC.

Advance AOTC Payments

Taxpayers selecting the *Advance AOTC* through My College Tax Credit Assistant will receive a payment whenever new data on student enrollment and billed tuition and fees is matched through the data hub. The amount of the *Advance AOTC* payment will be the advance payment percentage rate selected by the taxpayer times the lesser of:

1) The billed tuition and fees amount for the current academic period;
2) (Until April 15) 50 percent of the earned[20] AOTC for the tax year, or (after April 15) the earned AOTC for the tax year;
3) The earned AOTC for the tax year less the sum of prior *Advance AOTC* payments for the tax year; or

17 The National Student Clearinghouse was founded in 1993 to support the student loan infrastructure. As of fall 2011, 93 percent of post secondary enrollment was included in Clearinghouse data. The coverage rate is very high for public institutions (over 99 percent for public four-year institutions) and private nonprofit schools and much lower for for-profit institutions (48 percent). There are also missing data—estimated at 3 percent to 7 percent—from records blocked (principally by students) under the Family Educational Rights and Privacy Act. Susan M. Dynarski, Steven W. Hemelt, and Joshua M. Hyman, *The Missing Manual: Using National Student Clearinghouse Data to Track Postsecondary Outcomes*, National Bureau of Economic Research, 2013.

18 To offer additional protection against overpayment, the reporting guidelines would require updating of the billed tuition and fees data to reflect in-period withdrawals and refunds; the revised amounts would be in the data hub and would affect the earned AOTC used to calculate any subsequent *Advance AOTC* payments.

19 Institutions would need to report whether the student is enrolled at least half-time. In addition, reporting at or after the beginning of the academic period that a student is enrolled would often reflect some student payment of tuition and fees, providing additional support for the qualification of billed tuition and fees amounts.

20 "Earned" refers to the total credit that would be payable based on the institution-reported tuition and fees amounts since the beginning of the tax year.

4) (If enacted) the maximum lifetime AOTC ($10,000)[21] less the sum of all prior AOTC payments (including advance payments).

To ensure the *Advance AOTC* is based on the most current information available, no advance payments will be made after April 15 if the taxpayer has not yet filed a prior year tax return.[22] Reports of billed tuition and fees made near the end of the calendar year for academic periods beginning in the next calendar year will be assigned to the latter. This will make it more likely that taxpayer payments and *Advance AOTC* payments occur during the same tax year.

The key driver for the timing of *Advance AOTC* payments will be IRS receipt and processing in the data hub of enrollment and cost information for the academic period. If institutions report within 30 days of the start of the academic period, the Department of the Treasury Financial Management Service (the federal government's disbursing agency) should be able to transfer funds into a taxpayer's designated depository account within the first 45 to 60 days of the period.

My College Tax Credit Assistant – Filing for the Year-End Credit

During the tax return preparation process, My College Tax Credit Assistant will serve as an online worksheet for all taxpayers claiming the credit, regardless of whether they received any *Advance AOTC* payments. All credit-claiming taxpayers will report the total tuition and fees actually paid during the tax year, as well as payments for other AOTC-qualified expenses (such as books and other course materials). Taxpayers will enter the AOTC amount determined through the account interface, which will automatically net out any *Advance AOTC* payments paid, on the tax return. The credit will (as it does now) reduce a taxpayer's tax balance due or increase her tax refund.

Protection Against Overpayments

Several program features lessen the chance that the credit will overpaid (occurring when the sum of *Advance AOTC* payments is greater than the total AOTC that can be claimed for the tax year and must be repaid). The calculation base for *Advance AOTC* payments will not include qualified expenses other than tuition and fees, meaning additional amounts will usually factor into the year-end calculation. Taxpayers who are likely to be subject to the credit phase-out will receive smaller *Advance AOTC* payments to reduce the risk of excessive payment. Year-end tuition and fee billings will be deemed to occur in the following tax year, and taxpayers will be further advised to pay for tuition and fees during the calendar year in which the corresponding *Advance AOTC* payment is made. The *Advance AOTC* calculation formula (see above) guards against overpayments. However, *Advance AOTC* overpayment could still occur if: a) the taxpayer received *Advance AOTC* payments for a student who is no longer claimed as the taxpayer's dependent; or b) the taxpayer's net payments for an academic period ended up being significantly less than the billed tuition and fees reported by the institution (for example, a student withdraws from classes early enough in the period to receive a partial refund) and the student did not incur additional tuition and fees expenses later in the tax year.

Elimination of Certain Tax Forms

Periodic institutional reporting of student enrollment and cost information to the IRS data hub will eliminate the need for the Form 1098-T information return. There is currently considerable variation among institutions in how they complete the form and the information they provide. The amounts reported on Form 1098-T are often not the amounts taxpayers should use to claim the AOTC, but the form's identity as an IRS document inevitably creates that impression.[23] The functionality of My College Tax Credit Assistant will also eliminate the need for Form 8863 (and its associated worksheets and lengthy instructions).[24]

21 The Consortium's Shared Agenda package recommends replacing the current four-year limit for AOTC receipt with an equivalent value lifetime cap.

22 The requirement to file a return by April 15 to receive *Advance AOTC* payments would limit the availability of the option for taxpayers choosing filing extensions. Taxpayers who did not file a prior-year return because they were not required to do so would be encouraged to file a return anyway if they wish to receive *Advance AOTC* payments.

23 "Determining Qualifying Expenses for Education Credits," published in 2014 by the National Community Tax Coalition, provides a descrip tion of the challenges faced by taxpayers in utilizing Form 1098-T: http://tax-coalition.org/program-resources/tax-preparation-services/quality-assurance/education-expense.

24 The Consortium's Shared Agenda package recommends elimination of the Lifetime Learning Credit. However, if that credit were to remain in place, it could also be administered through the My College Tax Credit Assistance interface and data hub.

Summary of Proposal's Design Elements

Who is eligible to claim the* Advance AOTC*?

The taxpayer—who may be the student or may be someone for whom the student is a dependent—claims the *Advance AOTC*, based on the student's qualified expenses.

How is a claim for* Advance AOTC *initiated?

The taxpayer signals the choice to receive advance payments by using a new IRS tool called My College Tax Credit Assistant and selecting the percentage of the available credit to be paid in advance.

What is the basis for calculating the* Advance AOTC*?

The *Advance AOTC* is based on the estimated full AOTC for the tax year, drawing income and household information from the most recently filed tax return. For example, an advance in January 2014 will be based on the tax year 2012 return. A subsequent advance in August 2014 will use a revised AOTC estimate based on the tax year 2013 return. Each *Advance AOTC* disbursement will be tied to billed tuition and fees for the current academic period reported by the student's institution.

The IRS applies the taxpayer's chosen advance payment percentage to the advanceable amount, which is based on billed tuition and fees (including updated data from prior academic periods), the currently estimated annual AOTC for the taxpayer, prior *Advance AOTC* payments during the tax year, and (potentially) credits received in prior years.

When is an* Advance AOTC *payment made?

An *Advance AOTC* payment is made as early during the academic period as the IRS receives and processes the enrollment and cost information from the college or university.

How is an* Advance AOTC *payment disbursed?

The Department of Treasury's Financial Management Service makes a single *Advance AOTC* payment for each academic period through electronic transfer to the depository account designated by the taxpayer through My College Tax Credit Assistant.

How are* Advance AOTC *payments reconciled to the final credit due?

All taxpayers claiming the AOTC determine the credit amount using a My College Tax Assistant worksheet and enter that on the tax return. As under current law (and similarly to other tax claims such as charitable contributions), taxpayers are responsible for determining how much they paid during the year for the AOTC-claimed students and reporting the total qualified expenses. For taxpayers receiving one or more *Advance AOTC* payments during the tax year, the Assistant reduces the AOTC to be claimed on the tax return by the total advance payments (in rare cases, this would be the amount to be repaid due to excessive advances).

Section V: Timely Delivery in Practice

This Section provides two examples illustrating how the *Advance AOTC* will work.

Traditional Student

Amy is graduating from high school in June 2014. She applies to four colleges and universities, is accepted to ABC College and DEF University, and decides to attend DEF. Her parents manage her financial aid process, pay for her unmet financial need, claim her as a dependent on their tax return, and have an adjusted gross income of $60,000.

This table shows a timely delivery process scenario for Amy:

February 2014	Amy's parents enter FAFSA information into My College Tax Credit Assistant to obtain projected credits for 2014 & 2015
May 2014	Amy's parents use My College Tax Credit Assistant to obtain estimated 2014 AOTC amount for consideration in accepting DEF's financial aid award
July 2014	Amy's parents use My College Tax Credit Assistant to select maximum available percentage (100 percent) for advance payment
August 2014	Amy receives bill for 1st semester tuition and fees (net of scholarships and grants) in the amount of $5,000 Amy's parents use loan funds to pay tuition and fees bill
September 2014	DEF reports Amy's 1st semester enrollment and tuition and fees billing to the My College Tax Credit Assistant data hub IRS processes information available in the data hub
October 2014	Amy's parents' bank account receives an *Advance AOTC* payment of $2,500 (applicable amount is the earned AOTC for 2014) Amy's parents use $2,500 to reduce outstanding loan principal
December 2014	Amy receives bill for 2nd semester tuition and fees (net of scholarships and grants) in the amount of $5,000
January 2015	Amy's parents use loan funds to pay tuition and fees bill DEF reports Amy's 2nd semester enrollment and tuition and fees billing to the IRS data hub IRS processes information available in the data hub
February 2015	Amy's parents' bank account receives an *Advance AOTC* payment of $1,250 (applicable amount is 50 percent of earned AOTC for 2015) Amy's parents use $1,250 to reduce outstanding loan principal Amy's parents file 2014 tax return, using My College Tax Credit Assistant to report qualified expenses and calculate full AOTC of $2,500 and net AOTC of $0 for entry on return
August 2015	Amy receives bill for 1st semester tuition and fees (net of scholarships and grants) in the amount of $6,500
September 2015	Amy's parents use loan funds to pay tuition and fees bill DEF reports Amy's 1st semester enrollment and tuition and fees billing to the IRS data hub IRS processes information available in the data hub
October 2015	Amy's parents' bank account receives *Advance AOTC* payment of $1,250 (applicable amount is earned AOTC for 2015 less February *Advance AOTC* payment) Amy's parents use $1,250 to reduce outstanding loan principal

Non-Traditional Student

Alex, age 30, has been taking courses off and on at GHI Community College to obtain a computer-aided design technology certificate, and has decided to finish up the program by taking several courses in the 2014 spring and summer sessions. He uses credit cards to pay for school. Alex files a tax return each year as a single person and has an adjusted gross income of $30,000.

This table shows a timely delivery process scenario for Alex:

January 2014	Alex receives bill for spring semester tuition and fees of $1,500 Alex selects GHI's monthly installment payment plan for tuition and fees and makes 1st payment of $375 using credit card Alex buys books for $250 using credit card Alex uses My College Tax Credit Assistant to select maximum available percentage (100 percent) for advance payment GHI reports Alex's spring semester enrollment and tuition and fees billing to the IRS data hub
February 2014	IRS processes information available in the data hub Alex's prepaid debit card (used by his employer for payroll) receives an *Advance AOTC* payment of $750 (applicable amount is 50 percent of earned AOTC for 2014) Alex uses $625 to pay off credit card and applies $125 to second tuition and fees installment
May 2014	Alex receives bill for summer session tuition and fees of $1,000 Alex selects GHI's monthly installment payment plan for tuition and fees and makes 1st payment of $500 using credit card Alex buys books for $250 using credit card GHI reports Alex's summer session enrollment and tuition and fees billing to the IRS data hub
June 2014	IRS processes information available in the data hub Alex's prepaid debit card receives an *Advance AOTC* payment of $1,000 (applicable amount is summer session tuition and fees) Alex uses $750 to pay off credit card and applies $250 to second tuition and fees installment
February 2015	Alex files 2014 tax return, using My College Tax Credit Assistant to report total qualified expenses of $3,000, calculates full AOTC of $2,250, and claims net AOTC of $500 on return

Section VI: Evaluating the *Advance AOTC* Proposal

This Section uses the evaluative criteria outlined in Section III to assess this brief's *Advance AOTC* proposal.

Feasibility of Implementation

Implementation feasibility requires that those involved in the process—taxpayers, students, higher education institutions, the IRS, and other third parties—are likely able to perform their expected roles.

The proposed process would most affect the IRS. The My College Tax Credit Assistant and its functionality represent a fundamental shift in tax administration, but it is likely that some form of electronic account management and real-time data matching will increasingly become the norm. In fact, the Assistant would be a reasonable test case for converting to a more dynamic process. The inclusion of resources for development of the new data infrastructure would enhance feasibility. As noted below, the new process would offer tremendous benefits to the IRS in improved compliance. Another advantage is that the proposal does not require the involvement of additional governmental entities.

The additional work for taxpayers in the AOTC process would be in the context of a financial aid process that already requires significant engagement. The information students and taxpayers would need to provide would be readily available. The experience of My College Tax Credit Assistant would be similar to other online interactions. The biggest challenge would likely be selection of an advance payment percentage, but this is analogous to the decision making required with student loans—and the Assistant can offer generic guidance.

Higher education institutions would have more frequent engagement, but this too would be in the reasonably familiar context of data reporting each academic period. Reporting billed tuition and fees in conjunction with enrollment verification would be new, but the data are readily available. This would replace the cumbersome Form 1098-T process that requires converting information from an academic year to a tax or calendar year.

Limitation of Risk

Risk management in this context refers both to program integrity (assisting intended beneficiaries and discouraging fraud and abuse) and participant experience (maintaining the AOTC's value and avoiding repayment obligations).

The proposed process would provide greater protection for the taxpaying public through pre-disbursement verification of probable credit eligibility, both for in-year advances and year-end tax return claims. Improved reporting and matching of data would enhance program integrity.[25] The accelerated availability of federal financial aid would improve program targeting through greater assistance to students who have inadequate cash flow to finance unmet need.

The proposed process—providing assistance directly to student households without reporting to the higher education institutions—would be unlikely to adversely affect either other sources of financial aid or net pricing. Although institutions could use available financial and household information to estimate independently an individual student's or a student population's possible assistance from the AOTC, the new process would not enhance that ability compared to current practice.

25 In a review of potentially improperly claimed higher education tax credits, the Treasury Inspector General for Tax Administration identified use of Department of Education databases as a mechanism for improving compliance through verification of student enrollment. *Billions of Dollars in Education Credits Appear to Be Erroneous*, 2011, http://www.treasury.gov/tigta/auditreports/2011reports/201141083fr.pdf.

The greatest risk to taxpayers would be receipt of *Advance AOTC* payments in excess of the AOTC determined at year-end via the tax return. With a fully refundable credit, the proposal's combination of the maximum advance percentage applicable to higher-income households and the formula for calculating the amount of each advance would be protective for most claimants. There could be a repayment obligation for a taxpayer who received one or more advances but then was unexpectedly unable to include the qualifying student on her tax return. The other repayment situation could occur if the billed expenses reported by the institution were higher than the net amounts paid. This could arise with a student withdrawal that results in a partial refund of paid tuition or fees in the absence of incurring additional tuition and fees expenses later in the tax year—thus reducing qualifying expenses sufficiently to affect the AOTC calculation. This reflects a necessary balance: it is not possible to reduce the repayment risk to zero and still enable timely delivery.

Superiority in Achieving Program Outcomes

Any modifications for claiming the AOTC should enhance program outcomes, such as increasing credit take-up, improving access to higher education, encouraging student persistence and completion, and tax law compliance.

The proposed timely delivery process should increase AOTC take-up by making the credit more relevant and accessible to eligible households. The estimation and *Advance AOTC* enrollment tools in My College Tax Credit Assistant will better incorporate the credit into the financial aid process, in which most students and their families are already engaged.

The greatest strength of timely delivery would be making higher education more affordable on a real-time basis. The new process would help students and their families understand the role of tax-based federal financial aid as they consider affordability and financing packages. The current reliance on a payment occurring months after tuition bills are due would be replaced by funding that could be drawn down near the beginning of each academic period. This would dramatically reduce the period of time when students are forced to use debt financing to cover basic costs. Overall, improved financing would make college more accessible and improve the likelihood that students stay in school and graduate.

The new process would greatly enhance tax law compliance, because some independent verification of both student enrollment and the accrual of qualified expenses would precede disbursement of AOTC funds. The ambiguity and uncertainty associated with the Form 1098-T process would be eliminated. Taxpayers would have a clearer understanding of the role of the AOTC, eligibility criteria, and reporting requirements, likely resulting in greater voluntary compliance. The IRS would have much more detailed information available when needed for enforcement action.

Reduction of Complexity

When possible, proposed modifications to government programs should strive to reduce complexity.

On balance, the proposed timely delivery process is likely neutral with respect to complexity. The My College Tax Credit Assistant interface could be confusing for some, but it would also offer greater opportunities for clear communication of program goals and expectations. The formula for calculating the amount of each *Advance AOTC* payment is complex to describe, but it will be executed automatically by the Assistant and its structure is necessary for achieving other goals (such as reducing the risk of excessive payments). The use of an online worksheet as part of the tax return preparation process would be novel, but it would replace the daunting challenges posed currently by Forms 1098-T and 8863. For taxpayers facing accessibility challenges that would prevent direct use of My College Tax Credit Assistant, the IRS could provide a process for paper submission of the required data (analogous to paper return filing).

Conclusion

The American Opportunity Tax Credit constitutes one of the principal forms of federal assistance for higher education. As detailed in its Shared Agenda, the Consortium for Higher Education Tax Reform advocates making the AOTC the sole tax credit for higher education and targeting it to the students and families most in need of assistance. To be most effective, however, the AOTC needs to be more than just a line on year-end tax returns. There must be a process for advancing credit payments that better matches when students need the financial assistance to be able to enroll and stay in school.

The *Advance AOTC* will give student households the ability to draw down the AOTC incrementally near the beginning of each academic period. A new tool—My College Tax Credit Assistant—will further enhance the credit's role in the financial aid process by replacing problematic paperwork and enhancing compliance and enforcement. Students will be better able to use this important source of federal assistance to plan for college, pay for school, and successfully complete their postsecondary education.

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