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President's Tax Panel Hears Concerns

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12:44 PM PST, March 16, 2005

WASHINGTON — Too many tax incentives do too little to help the neediest families afford college, and they force parents to spend too much time deciphering accounts, credits and deductions, the president's tax panel heard Wednesday.

"People could be doing something else, rather than trying to figure out what the best (account) is for their kids," said Susan Dynarski, a professor at Harvard University's Kennedy School of Government. "They could be reading to their child, for example."

The President's Advisory Panel on Federal Tax Reform, meeting in Chicago, heard about the ways tax laws distort decisions made by individuals and families. In many cases, those tax laws were intended to help families with expensive goals like college and retirement.

Armond Dinverno, co-president of Balasa Dinverno & Foltz financial advisers, said complex tax laws mean people often "let the tax tail wag the dog instead of making good economic decisions."

He dramatized the dilemma by listing the options for a family that wants to save $250 -- apply it to the mortgage, pay off credit card debt, save it in a 401(k) retirement account, deposit it to one of several individual retirement accounts or a college savings account, or stow it in a taxable savings account.

"The easiest solution but maybe not the best -- spend it," he said.

The choices are equally bewildering among tax incentives for education, some designed to help families save for future college costs and others to defray their current college spending.

The sheer complexity creates inequalities because some families figure out the best combination of tax incentives while others don't.

"They're not going to be able to game the system, and they're paying higher taxes than those who do who have equivalent incomes," Dynarski said.

Dynarski said wealthier families benefit most from education savings accounts because the value of the tax incentive increases for those in higher tax brackets. Lower income families often don't use the accounts because penalties imposed when the money isn't used for education can wipe out any tax savings.

"In fact, a high income family who uses a Coverdell (account) for non-educational purposes gets a bigger bang for their buck than a low income family who uses it for educational purposes," she said.

"This is not intentional, I don't think, but this is an example of the kind of perverse incentive you can end up with when you have such a complicated code that the code writers don't quite know what incentives they're creating."

Middle income families, however, reap the biggest benefits from education deductions and credits. But only those families who send their children to the most expensive private schools get the maximum benefit.

"The typical student is attending a school that does not have costs high enough to obtain the highest tax benefits I'm going to show you," Dynarski said. "So the tax incentives, to the degree that they're dependent on tuition, are going to flow disproportionately to the small percentage of students who are at the most expensive schools."

Students from high income families cannot get some benefits because of income cutoffs in the law. Students from lower income families don't benefit if they don't have any tax liability, because they cannot claim the benefits as a refund.

The solution? Simplify the credits, deductions and savings credits into two or three options that can be easily understood.

"You want something that you can describe in a line to an 18-year-old and his family and they can understand it," Dynarski said.

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On the Net:

President's Advisory Panel on Federal Tax Reform: http://www.taxreformpanel.gov

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