



Joint Committee on Taxation
March 22, 2000
JCX-31-00

DESCRIPTION OF AN AMENDMENT IN THE NATURE OF A SUBSTITUTE TO THE PROVISIONS OF H.R. 7

The House Committee on Ways and Means has scheduled a markup of the provisions contained in H.R. 7 (the "Education Savings and School Excellence Act of 1999"),¹ on March 22, 1999. This document,² prepared by the staff of the Joint Committee on Taxation, contains a description of an amendment in the nature of a substitute to H.R. 7.

The amendment in the nature of a substitute contains the provisions of the Education Savings and School Excellence Act of 1999, with the following modifications.³

I. MODIFICATIONS TO PROVISIONS

A. Expand Education Savings Accounts

The amendment in the nature of a substitute contains the provisions relating to education savings accounts in the Education Savings and School Excellence Act of 1999, with the following modifications.

Qualified expenses

Under the proposal, the definition of "qualified higher education expenses" would be modified to mean: (1) tuition and fees required for the enrollment or attendance of a designated beneficiary at an eligible education institution; and (2) expenses for books, supplies, and equipment incurred in connection with such enrollment or attendance (but not in excess of the allowance for books and supplies determined by the educational institution for purposes of

¹ A description of the provisions of the Education Savings and Incentive Act of 1999 may be found in Joint Committee on Taxation, *Description of H.R. 7 (the "Education Savings and School Excellence Act of 1999")* (JCX-30-00), March 21, 2000.

² This document may be cited as follows: Joint Committee on Taxation, *Description of an Amendment in the Nature of a Substitute to the Provisions in H.R. 7* (JCX-31-00), March 22, 2000.

³ The amendment in the nature of a substitute would change the short title of the bill to the "Education Savings and School Excellence Act of 1999."

Federal financial assistance programs).⁴ The proposal would provide that “qualified higher education expenses” does not include expenses for education involving sports, games, or hobbies unless this education is part of the student’s degree program or is taken to acquire or improve job skills of the individual. The proposal would not change the definition of “qualified higher education expenses” with respect to expenses for room and board.

Contributions permitted until April 15

Under the proposal, individual contributors to education IRAs would be deemed to have made a contribution on the last day of the preceding taxable year if the contribution is made on account of such taxable year and is made not later than the time prescribed by law for filing the return for such taxable year (not including extensions), generally April 15.⁵ The proposal also would provide that the additional 10-percent tax does not apply to the distribution of any contribution to an education IRA made during the taxable year if such distribution is made on or before the first day of the sixth month of the taxable year (generally June 1) following the taxable year during which the contribution was or was deemed made, provided the distribution is accompanied by the amount of net income attributable to the contribution.

Coordination with HOPE and Lifetime Learning credits

The proposal would allow a taxpayer to claim a HOPE credit or Lifetime Learning credit for a taxable year and to exclude from gross income amounts distributed (both the principal and the earnings portions) from an education IRA on behalf of the same student as long as the distribution is not used for the same educational expenses for which a credit is claimed.

Coordination with qualified tuition programs

The proposal would repeal the excise tax on contributions made by any person to an education IRA on behalf of a beneficiary during any taxable year in which any contributions are made by anyone to a qualified State tuition program on behalf of the same beneficiary (sec. 4973(e)(1)(B)).

⁴ “Qualified higher education expenses” for purposes of education IRAs are defined by reference to the definition of such expenses for purposes of qualified State tuition programs (sec. 530(b)(2)(A)). Because the proposal would modify the definition of “qualified higher education expenses” for purposes of qualified State tuition programs (sec. 529(e)(3)), the definition of “qualified higher education expenses” for education IRAs also would be modified.

⁵ It is expected that trustees of education IRAs would require documentation from a contributor (whether an individual, corporation, or other entity) indicating the taxable year to which the contribution should be allocated.

Change name to “Education Savings Accounts”

The proposal would change the name of education IRAs to “Education Savings Accounts.”

Effective date

Under the proposal, the provisions relating to education IRAs would be effective with respect to taxable years beginning after December 31, 2000, except that the provision changing the name of education IRAs to Education Savings Accounts would be effective on the date of enactment.

B. Allow Tax-Free Distributions from State and Private Education Programs

The amendment in the nature of a substitute contains the provisions of the Education Savings and School Excellence Act of 1999, with the following modifications.

Coordination with HOPE and Lifetime Learning credits

The proposal would allow a taxpayer to claim a HOPE credit or Lifetime Learning credit for a taxable year and to exclude from gross income amounts distributed (both the principal and the earnings portions) from a qualified tuition program on behalf of the same student as long as the distribution is not used for the same expenses for which a credit is claimed.

Definition of qualified higher education expenses

Under the proposal, the definition of “qualified higher education expenses” would be modified to mean: (1) tuition and fees required for the enrollment or attendance of a designated beneficiary at an eligible educational institution; and (2) expenses for books, supplies, and equipment incurred in connection with such enrollment or attendance (but not in excess of the allowance for books and supplies determined by the educational institution for purposes of Federal financial assistance programs).⁶ The proposal also would provide that “qualified higher education expenses” would not include expenses for education involving sports, games, or hobbies unless this education is part of the student’s degree program or is taken to acquire or improve job skills of the individual. The proposal would not change the definition of “qualified higher education expenses” with respect to expenses for room and board.

⁶ It is intended that, with respect to a distribution made from a qualified tuition program that does not exceed the allowance for books and supplies determined for purposes of Federal financial assistance by the eligible educational institution where the beneficiary is enrolled, Treasury regulations would provide that beneficiaries need not substantiate actual purchases of books, supplies, and equipment.

Rollovers for benefit of same beneficiary

The proposal would provide that a transfer of credits (or other amounts) from one qualified tuition program for the benefit of a designated beneficiary to another qualified tuition program for the benefit of the same beneficiary would not be considered a distribution for a maximum of one such transfer in each 1-year period.

Member of family

The proposal would provide that, for purposes of tax-free rollovers and changes of designated beneficiaries, a “member of the family” includes first cousins of such beneficiary.

Short title

The proposal would provide that the section of the proposal relating to qualified tuition plans may be cited as the "Collegiate Learning and Student Savings (CLASS) Act."

Effective date

The proposal would generally be effective for taxable years beginning after December 31, 2000. The provision modifying the definition of qualified higher education expenses would be effective for amounts paid for education furnished after December 31, 2000.

C. Eliminate Tax on Awards under National Health Service Corps Scholarship Program, F. Edward Hebert Armed Forces Health Professions Scholarship and Financial Assistance Program, National Institutes of Health Undergraduate Scholarship Program, and Certain State-Sponsored Scholarship Programs

The amendment in the nature of a substitute contains the provisions relating to education savings accounts in the Education Savings and School Excellence Act of 1999, with the following modifications.

The proposal would provide that amounts received under the National Institutes of Health Undergraduate Scholarship Program (the “NIH Scholarship Program”)⁷ and any State-sponsored health scholarship program determined by the Secretary of the Treasury to have substantially

⁷ The NIH Scholarship Program awards scholarships to students from disadvantaged backgrounds interested in pursuing a career in biomedical research. In exchange, the recipients must work for the National Institutes of Health after graduation.

similar objectives to these programs⁸ are eligible for tax-free treatment as qualified scholarships under section 117, without regard to any service obligation by the recipient.⁹ As with other qualified scholarships under section 117, the tax-free treatment would not apply under the proposal to amounts received by students for regular living expenses, including room and board.

The proposal would be effective for education awards received under the NIH Scholarship Program or a State-sponsored health scholarship program designated by the Secretary of the Treasury after December 31, 1999.

D. Liberalize Tax-Exempt Bond Arbitrage Rebate Exceptions for Public School Construction Bonds

The amendment in the nature of a substitute contains the provisions of the Education Savings and School Excellence Act of 1999, with the following two modifications.

Increase amount of bonds that may be issued by governments qualifying for the “small governmental unit” arbitrage rebate exception

The effective date of the proposal relating to the small governmental unit arbitrage rebate exception would be changed from obligations issued after December 31, 1999, to obligations issued after December 31, 2000.

Liberalize construction bond expenditure rule for governmental bonds for public schools

An additional proposal is included in the amendment in the nature of a substitute. Specifically, the present-law 24-month expenditure exception to the arbitrage rebate requirement would be liberalized for certain public school bonds. Under the proposal, no rebate would be required with respect to earnings on available construction proceeds of public school bonds if the proceeds are spent within 48 months after the bonds were issued and the following intermediate spending levels were satisfied:

⁸ Several States provide a limited number of scholarships to students in health professions who are obligated to work in underserved areas for a period of time after graduation.

⁹ These exclusions are in addition to the exclusions provided under H.R. 7 with respect to amounts received under the National Health Service Corps Scholarship Program and the F. Edward Hebert Armed Forces Health Professions Scholarship and Financial Assistance Program.

12 months	At least 10 percent
24 months	At least 30 percent
36 months	At least 60 percent
48 months	100 percent (less present-law retainage amounts which must be spent within 60 months of issuance)

The liberalized expenditure exception for public school construction bonds would be effective for bonds issued after December 31, 2000.

II. DELETED PROVISIONS

The amendment in the nature of a substitute would delete the provision relating to the extension of the exclusion for employer-provided educational assistance.

III. ADDITIONAL PROVISIONS

The amendment in the nature of a substitute would add the following new provisions to the Education Savings and Excellence Act of 1999.

A. Student Loan Interest Deduction

Present Law

Certain individuals who have paid interest on qualified education loans may claim an above-the-line deduction for such interest expenses, subject to a maximum annual deduction limit (sec. 221). The deduction is allowed only with respect to interest paid on a qualified education loan during the first 60 months in which interest payments are required. Required payments of interest generally do not include nonmandatory payments, such as interest payments made during a period of loan forbearance. Months during which interest payments are not required because the qualified education loan is in deferral or forbearance do not count against the 60-month period. No deduction is allowed to an individual if that individual is claimed as a dependent on another taxpayer's return for the taxable year.

A qualified education loan generally is defined as any indebtedness incurred solely to pay for certain costs of attendance (including room and board) of a student (who may be the taxpayer, the taxpayer's spouse, or any dependent of the taxpayer as of the time the indebtedness was incurred) who is enrolled in a degree program on at least a half-time basis at (1) an accredited post-secondary educational institution defined by reference to section 481 of the Higher

Education Act of 1965, or (2) an institution conducting an internship or residency program leading to a degree or certificate from an institution of higher education, a hospital, or a health care facility conducting postgraduate training.

The maximum allowable deduction per taxpayer return is \$2,000 in 2000, and \$2,500 in 2001 and thereafter.¹⁰ The deduction is phased out ratably for individual taxpayers with modified adjusted gross income (“AGI”) of \$40,000-\$55,000 and \$60,000-\$75,000 for joint returns. The income ranges will be indexed for inflation after 2002.

Description of Proposal

The proposal would increase the beginning point of the income phaseout for the student loan interest deduction for individual taxpayers to \$45,000. The proposal would also increase the beginning point of the income phaseout for taxpayers filing joint returns to twice the beginning point of the income phaseouts applicable to single taxpayers. Thus, the phase-out ranges would be \$45,000 to \$60,000 for individual taxpayers and \$90,000 to \$105,000 for joint filers. The proposal would also repeal both the limit on the number of months during which interest paid on a qualified education loan is deductible and the restriction that nonmandatory payments of interest are not deductible.

Effective Date

The provisions relating to the income phaseout would be effective for taxable years beginning after December 31, 2000. The provisions repealing the 60-month limit on deductible student loan interest and the restriction on nonmandatory payments would be effective for interest paid on qualified education loans after December 31, 2000.

B. Extension of Deduction for Computer Donations to Schools

Present Law

The maximum charitable contribution deduction that may be claimed by a corporation for any one taxable year is limited to 10 percent of the corporation's taxable income for that year (disregarding charitable contributions and with certain other modifications) (sec. 170(b)(2)). Corporations also are subject to certain limitations based on the type of property contributed. In the case of a charitable contribution of short-term gain property, inventory, or other ordinary income property, the amount of the deduction generally is limited to the taxpayer's basis (generally, cost) in the property. However, special rules in the Code provide an augmented deduction for certain corporate contributions. Under these special rules, the amount of the augmented deduction is equal to the lesser of (1) the basis of the donated property plus one-half of the amount of ordinary income that would have been realized if the property had been sold, or

¹⁰ The maximum allowable deduction was \$1,000 for 1998 and \$1,500 for 1999.

(2) twice basis.

Section 170(e)(6) allows corporate taxpayers an augmented deduction for qualified contributions of computer technology and equipment (i.e., computer software, computer or peripheral equipment, and fiber optic cable related to computer use) to be used within the United States for educational purposes in grades K-12. Eligible donees are: (1) any educational organization that normally maintains a regular faculty and curriculum and has a regularly enrolled body of pupils in attendance at the place where its educational activities are regularly carried on; and (2) tax-exempt charitable organizations that are organized primarily for purposes of supporting elementary and secondary education. A private foundation also is an eligible donee, provided that, within 30 days after receipt of the contribution, the private foundation contributes the property to an eligible donee described above.

Qualified contributions are limited to gifts made no later than two years after the date the taxpayer acquired or substantially completed the construction of the donated property. In addition, the original use of the donated property must commence with the donor or the donee. Accordingly, qualified contributions generally are limited to property that is no more than two years old. Such donated property could be computer technology or equipment that is inventory or depreciable trade or business property in the hands of the donor.

Donee organizations are not permitted to transfer the donated property for money or services (e.g., a donee organization cannot sell the computers). However, a donee organization may transfer the donated property in furtherance of its exempt purposes and be reimbursed for shipping, installation, and transfer costs. For example, if a corporation contributes computers to a charity that subsequently distributes the computers to several elementary schools in a given area, the charity could be reimbursed by the elementary schools for shipping, transfer, and installation costs.

The special treatment applies only to donations made by C corporations; S corporations, personal holding companies, and service organizations are not eligible donors.

The provision is scheduled to expire for contributions made in taxable years beginning after December 31, 2000.

Description of Proposal

The proposal would extend the present-law augmented deduction under section 170(e)(6) for one year, so that it expires for contributions made in taxable years beginning after December 31, 2001.

Effective Date

The provision would be effective on the date of enactment.

C. Two-Percent Floor Not To Apply to Professional Development Expenses of Teachers

Present Law

In general, taxpayers are not permitted to deduct education expenses. However, employees may deduct the cost of certain work-related education. For costs to be deductible, the education must either be required by the taxpayer's employer or by law to retain taxpayer's current job or be necessary to maintain or improve skills required in the taxpayer's current job. Expenses incurred for education that is necessary to meet minimum education requirements of an employee's present trade or business or that can qualify an employee for a new trade or business are not deductible.

An employee is allowed to deduct work-related education and other business expenses only to the extent such expenses (together with other miscellaneous itemized deductions) exceed two percent of the taxpayer's adjusted gross income.

Description of Proposal

The proposal would provide that qualified professional development expenses not in excess of \$1,000 incurred by an elementary or secondary school teacher (including instructors, aides, counselors and principals) with respect to certain courses of instruction would not be subject to the two-percent floor on miscellaneous itemized deductions. Qualified professional development expenses would be expenses for tuition, fees, books, supplies, equipment, and transportation required for enrollment or attendance in a qualified course of instruction, provided that such expenses are otherwise deductible under present law. A qualified course of instruction would mean a professional conference or a course of instruction at an institution of higher education (as defined in sec. 481 of the Higher Education Act of 1965), and which is part of a program of professional development that is approved and certified by the appropriate local educational agency as furthering the individual's teaching skills.

Effective Date

The provision would be effective for taxable years beginning after December 31, 2000.