

[COMMITTEE PRINT]

DESCRIPTION OF TAX BENEFITS
AND
OTHER PROPOSALS

RELATING TO

ASSISTANCE FOR EDUCATIONAL EXPENSES

PREPARED FOR THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

BY THE STAFF OF THE

JOINT COMMITTEE ON TAXATION



FEBRUARY 13, 1978

U.S. GOVERNMENT PRINTING OFFICE

22-870

WASHINGTON : 1978

JCS-6-78

CONTENTS

	Page
I. Introduction.....	1
II. Background.....	3
A. Educational Expenses.....	3
B. Present Law.....	4
C. Prior Congressional Action.....	7
III. Proposals for Tax Benefits for Educational Expenses.....	9
IV. Alternative Proposals.....	11
V. Issues.....	13
A. Constitutionality.....	13
B. Goals of Education Tax Benefits.....	14
C. Eligible Expenses.....	15
VI. Departmental Position.....	16

I. INTRODUCTION

This pamphlet describes proposals relating to tax credits, tax deductions, tax deferrals, and other methods of providing assistance for educational expenses on which hearings have been scheduled by the Committee on Ways and Means beginning on February 14, 1978.

In connection with these hearings, the staff of the Joint Committee on Taxation has prepared a description of educational assistance proposals and has provided background information on educational expenses, the treatment of these expenses under the present provisions of the Internal Revenue Code, and the issues involved in providing various forms of assistance.

II. BACKGROUND

A. Educational Expenses

Post-secondary education

The increasing costs of education, particularly at institutions of higher education, have become a major public concern. According to the College Entrance Examination Board, the average annual cost of attending a public university has increased 56.6 percent in the past 5 years, from \$1,782 to \$2,790. For a private university, the cost has increased 63.6 percent from \$2,793 to \$4,568. According to a New York Times survey, the total annual costs at many colleges and universities are as high as \$7,000. Supporting one child through undergraduate school can cost \$10,000 to \$25,000.

Tuition costs are expected to continue to increase. It has been estimated that, if costs continue to increase at a compounded rate of 6 percent per year, it will cost \$47,000 to complete an undergraduate program at a public university and \$82,000 at a private university in the 1990's.

While the costs of education have increased greatly, the median family income also has risen at a rate comparable to the rate of increase in student charges at institutions of higher education between 1967 and 1976.

Between 1969 and 1974, the U.S. Census Bureau reports that the percentage of 18 to 24 year olds attending college full time decreased 22 percent while enrollment of students from lower- and higher-income families remained fairly stable. The decline in enrollment apparently reflected a decrease in the percentage of students from middle-income families. Increasing costs are the primary reason. In addition, Census Bureau data shows that many families have more than one child of college age at the same time. Middle- and lower-income families who do not qualify for financial aid, but who cannot keep up with the increases in college expenses, have voiced particular concern about the increased cost of higher education.

Nonpublic education

Many low- and middle-income parents whose children attend nonpublic schools bear a very heavy financial burden. The cost of nonpublic elementary and secondary education has increased substantially in recent years, and it is expected that this increase will continue. At the same time, the cost of public schools also is rising substantially, and taxes keep increasing to meet these costs. As a result, nonpublic school parents must pay for the increased costs of both public and nonpublic schools, even though they relieve the public schools of the cost of educating their children. This financial burden is an important factor in accounting for the declining enrollment and the closing of many nonpublic schools.

Nonpublic schools represent an integral part of our society providing diversity of choice and healthy competition for public education. Many Americans express themselves socially, ethnically, and culturally through nonpublic educational institutions. These institutions often provide stability to urban neighborhoods by motivating parents to stay in the cities. Nonpublic schools relieve the public school system, and thus all taxpayers supporting public schools, of very substantial costs. The closing of many nonpublic schools would increase taxes significantly.¹

B. Present Law

Tax benefits

Present law provides no tax credit, deduction, nor other tax benefit for personal educational expenses.

In certain cases, taxpayers are entitled to a personal exemption for a dependent, which they otherwise could not claim, because the dependent is a student. Generally, a taxpayer may claim a \$750 personal exemption deduction (and a \$35 credit) for each dependent who has less than \$750 gross income for the taxpayer year. However, the gross income limitation does not apply if the dependent is the taxpayer's child and is under the age of 19 or is a student (sec. 151).

¹ The President's Commission on School Finance estimated that, if many nonpublic schools closed, public school operating costs would increase from \$3.1 billion to \$3.2 billion, and capital costs from \$4.7 to \$10 billion. President's Commission on School Finance, "Schools, People, and Money," p. 55 (1972).

Individuals generally may exclude from income amounts received as scholarships and fellowships (sec. 117).² The exclusion also covers incidental amounts received to cover expenses for travel, research, clerical help, and equipment when they are expended for these purposes. The exclusion for scholarships and fellowship grants is restricted to educational grants by relatively disinterested grantors who do not require any significant consideration (e.g., promises of future services) from the recipient.³

Educational expenses which qualify as trade or business expenses under section 162 may be deducted. Expenditures made by an individual for his own education generally are deductible if they are for education which (1) maintains or improves skills required by the individual's employment or other trade or business, or (2) meets the express requirements of the individual's employer or the requirements of applicable law or regulations imposed as a condition to the retention by the individual of an established employment relationship, status, or rate of compensation. These types of education are commonly called "job-related education."

Direct aid

Under present law, direct Federal assistance to individuals for post-secondary educational expenses is provided through a variety of programs, the majority of which are administered through the Department of Health, Education, and Welfare (HEW). The principal programs administered by HEW are the Basic Educational Opportunity Grant Program (BEOG), the College Work Study Program, the Guaranteed Student Loan Program, the National Direct Student Loan Program, and the State Student Incentive Grant Program. In addition, the Federal Government provides individuals with educational assistance through G.I. Bill education benefits and Social Security student benefits.

The Basic Educational Opportunity Grant Program provides Federal assistance to students on the basis of family income and the cost of college attendance. In fiscal 1978, \$2.1 billion was appropriated for this program. According to HEW, grants presently are provided to 2.2 million students. The maximum grant for low-income students is \$1,600, and the average grant to students in families with incomes between \$8,000 and \$16,000 is \$850. Students from families with incomes in excess of \$16,000 do not qualify for grants.

² To some extent, qualifications differ for individuals who are candidates for degrees and individuals who are not degree candidates. A degree candidate cannot exclude any amount to the extent it represents compensation for teaching, research, or other part-time services which he or she is required to render in order to obtain the grant unless such services are required of all candidates for a particular degree as a condition for receiving the degree.

In the case of a nondegree candidate, the exclusion is available only for up to \$300 per month for no more than 36 months and then only if the grantor of the scholarship is a qualified governmental unit, charity, or international organization.

³ *Bingler v. Johnson*, 394 U.S. 741 (1969).

The College Work Study Program provides 80 percent of the salaries for certain part-time jobs for students. In fiscal 1978, \$435 million was appropriated for this program. More than 700,000 students presently participate in it.

The Guaranteed Student Loan Program subsidizes interest costs and guarantees loan repayments. In fiscal 1978, \$530 million was appropriated for this program. Under present law, students from families with incomes in excess of \$30,000 are not eligible to participate in this program. The Administration has estimated that more than one million students had loans in fiscal 1978 (with about 300,000 loans going to students in families with incomes above \$16,000).

The National Direct Student Loan Program was budgeted at approximately \$310 million for fiscal 1978. Repayments on outstanding loans help fund current benefits. The Administration estimates that in fiscal 1979 approximately 853,000 loans will be made.

The State Student Incentive Grant Program provides scholarships to needy students through matching State and Federal grants. Approximately \$64 million of Federal funds were appropriated and were expended to assist about 250,000 students during the 1978-1979 school year.

A breakdown of the sources of support for the college costs of freshmen entering college in 1975 according to both sources of support and parental income level appears in Table 1 below.

TABLE 1.—PERCENTAGE OF TOTAL COLLEGE COSTS OF 1975 FRESHMEN PAID FROM VARIOUS SOURCES, BY INCOME LEVEL

Source	Parental income level			All students
	Low (<\$8,000)	Middle (\$8,000 to 19,999)	High (\$20,000 or more)	
Basic Educational Opportunity Grant (BEOG).....	27.0	7.3	1.5	8.3
Supplemental Educational Opportunity Grant (SEOG)....	3.2	1.1	.2	1.1
State scholarship.....	5.9	4.7	1.4	3.7
Local, private scholarship.....	4.0	4.5	2.6	3.8
Student's GI benefits.....	1.9	1.0	.4	.9
Parents' GI benefits.....	1.0	.6	.3	.5
SS dependents' benefits.....	5.4	1.8	.7	1.9
Total grants.....	48.4	21.0	7.1	20.2
Parents or family.....	18.6	36.8	62.9	43.1
Spouse.....	.7	.4	.3	.4
Total family assistance.....	19.3	37.2	63.2	43.5
Total grants and family assistance.....	67.7	58.2	70.3	63.7
College work study.....	4.3	2.3	.6	2.0
Federal guaranteed student loan.....	2.6	3.6	1.8	2.8
National direct student loan.....	3.0	2.6	.7	2.0
Other loan.....	1.3	2.0	1.3	1.6
Full-time work.....	2.0	2.5	1.8	2.2
Part-time work.....	10.0	15.5	12.2	13.5
Savings.....	7.0	11.2	9.4	9.9
Other financing.....	2.0	1.9	1.8	1.9
Student net cost.....	32.2	41.6	29.6	35.9
Grand total.....	99.9	99.8	99.9	99.6

Note: Totals do not equal 100 percent due to rounding.

Source: Unpublished analyses conducted by the Higher Education Research Institute based on data from the national survey of freshmen entering college in 1975 as reported in Astin, A. W.; King, M. R.; and Richardson, G. T. "The American Freshman," Los Angeles: Laboratory for Research in Higher Education, University of California, Los Angeles, 1975.

C. Prior Congressional Action

In the 1950's, tax deductions against adjusted gross income for some portion of college expenses and an additional personal exemption for each student were the most common legislative proposals for tax relief for educational expenses. In the 1960's, tax credit proposals became popular. From 1967 to 1977, six education tax credit proposals passed the Senate, but none was ever approved by the House of Representatives.

The Social Security Financing Amendments of 1977, as passed by the Senate, contained an amendment to provide a tax credit for certain educational expenses. This amendment was deleted from the bill by the conferees.

The amendment would have allowed a tax credit for educational expenses paid by an individual for himself, his spouse, or his dependents. The credit would have covered 100 percent of the eligible educational expenses at institutions of higher education (but not graduate schools) or vocational schools up to a maximum of \$250 for any one individual.

If more than one taxpayer paid the educational expenses of an individual, the credit with respect to that individual was to be prorated among such taxpayers.

Educational expenses of a taxpayer's spouse could be claimed only if the taxpayer was entitled to an exemption for his or her spouse under section 151(b) or if they filed a joint return. The credit would be allowed only with respect to full-time students. Expenses taken into account in determining a credit were to be reduced by scholarship or fellowship grants excluded from income under section 117 and by educational assistance allowances and educational and training allowances received under chapters 35 and 33 (relating to veterans' benefits), respectively, of title 38 of the United States Code. Eligible expenses were tuition, fees, books, supplies, and equipment, but not meals, lodging, or similar personal, living, or family expenses. Higher education expenses had to be for courses allowed as credit toward a baccalaureate degree. Vocational school expenses had to be for courses allowed as credit for a certificate of required course work. No trade or business expense deduction under section 162 would be allowed for expenses taken into account in determining the credit.

The amendment, which was to be refundable only for the first year in which it was effective, would have applied to educational expenses paid after December 31, 1977, in taxable years beginning after December 31, 1977.

III. PROPOSALS FOR TAX BENEFITS FOR EDUCATIONAL EXPENSES

Credits

A tax credit would reduce a taxpayer's tax liability directly, and would have the same absolute dollar value for all taxpayers. For example, a \$100 tax credit has an after-tax value of \$100 (unless the taxpayer does not have \$100 of tax liability to be offset by the credit),⁴ while a \$100 tax deduction has an after-tax value ranging from \$14 to \$70. Measured in terms of after-tax income, a tax credit provides the same benefit to those in high- and low-income brackets whereas a deduction provides a larger benefit to those in higher income brackets.

If a nonrefundable tax credit were provided for 50 percent of tuition and fees with a maximum credit of \$250 for each full- and part-time student in post-secondary and vocational institutions, the revenue loss would amount to approximately \$2 billion annually when fully effective. A similar nonrefundable credit for elementary and secondary school expenses would cost approximately \$850 million annually.

If a similar tax credit were made refundable, the revenue loss for post-secondary and vocational school expenses would increase to approximately \$2.2 billion annually, and the revenue loss for elementary and secondary school expenses would be closer to \$900 million annually.

Deductions

Tax deductions for educational expenses would reduce taxable income. The usual base for deductions is adjusted gross income. However, a deduction from gross income would extend the benefits to all taxpayers (with sufficient tax liability), even those who do not itemize.⁵ The value of a deduction varies directly with the marginal tax rate of the taxpayer and is worth more to high-income taxpayers than to those with low incomes. For example, a \$100 deduction is worth \$70 to someone with a 70-percent top marginal tax rate but only \$30 to a taxpayer with a 30-percent marginal tax rate.

If an itemized deduction were provided for tuition and fees up to a maximum of \$1,000 for full- and part-time students, the revenue loss from such a deduction for post-secondary and vocational school

⁴ If a tax credit is made "refundable," those whose tax liability is less than the credit would receive a cash payment equal to the difference.

⁵ Adjusted gross income is the income base from which the taxpayer subtracts excess itemized deductions (that is, itemized deductions in excess of the zero bracket amount) to arrive at taxable income. Adjusted gross income is basically an individual's gross income minus moving and certain other expenses incurred by employees in earning that income, payments by the self-employed and employees to retirement plans, alimony, and the 50-percent capital gains deduction. If a tax deduction for educational expenses were enacted as an itemized deduction, it could not be claimed by taxpayers whose itemized deductions were less than the zero bracket amount. However, if it were treated in the same way as moving expenses—a subtraction from gross income made in arriving at adjusted gross income—all taxpayers, even nonitemizers, would benefit from it.

expenses would be about \$1 billion annually. The revenue loss from such a deduction for elementary and secondary school expenses would be about \$500 million annually.

Elective credit or deduction

Taxpayers could be allowed the option of choosing between an income tax credit or an income tax deduction for educational expenses. This type of tax benefit would influence many taxpayers to compute both the credit and the deduction in order to elect the benefit which maximizes the assistance for which they would be eligible. As a result, it would entail greater complexity and higher revenue losses than either a credit or deduction alone.

Deferral

Tax deferrals for educational expenses can be viewed as a form of loan which grants relief by postponing tax payments. The repayment of deferred taxes can be spread over several years. To provide greater relief while the student is attending school, repayment may begin after the student leaves school. Interest charges reduce the cost to the Treasury. However, a low-interest rate or interest-free loan provides a greater subsidy.

A tax deferral plan might be designed to provide deferral of taxes equal to 75 percent of the first \$1,000, 50 percent of the next \$1,000, and 25 percent of the third \$1,000 of post-secondary education expenses. If a 10-year payback period were allowed and interest charged to the taxpayer at the rate of 3 percent, the revenue loss from a proposal effective January 1, 1978, would be about \$1.2 billion in fiscal year 1978, \$8 billion in fiscal years 1979, 1980, and 1981, and would decrease gradually through fiscal 1989 (approximately). Thereafter, a slight revenue increase would begin.

Educational savings plans

Tax credits or deductions could be allowed for a taxpayer's contribution to an educational savings plan account in a financial institution. Such accounts might be established for educational expenses of the taxpayer, a spouse, and his or her dependents. Withdrawals for purposes other than qualified educational expenses could make the taxpayer liable to the Treasury for repayment of the reduction in tax liability which resulted from the credit or deduction. For example, a plan could be designed which allowed a taxpayer a 20-percent tax credit with respect to savings for post-secondary education of up to \$250 a year for each dependent. Such a plan would entail an annual revenue loss of at least \$1.7 to \$2 billion.

Employee educational expenses

Under present law, educational expenses of employees which are provided for, or reimbursed by, an employer or paid for by the employee out of his or her own funds are excludable or deductible, respectively, if they are job-related. It has been suggested that the "job-related" test for excluding or deducting such expenses be eliminated by allowing employees to receive all educational benefits provided directly or indirectly by their employer without having to include them in their gross income. It has been estimated that a general exclusion for employer-provided educational assistance would reduce revenues by \$30 to \$40 million annually by the early 1980's and by increasing amounts thereafter.

IV. ALTERNATIVE PROPOSALS

Several proposals for assisting individuals with educational expenses would not entail the provision of new tax benefits.

Administration proposal

The Administration proposes to assist individuals with educational expenses by expanding eligibility for, and increasing the benefits provided by, three Federal programs for direct student aid. The Administration estimates that its proposed changes in the Basic Educational Opportunity Grant Program, the College Work Study Program, and the Guaranteed Student Loan Program would increase the number of awards in Federal student assistance programs from approximately 3.2 million in fiscal 1978 to more than 7 million in fiscal 1979. Because some students receive awards under more than one program, the Administration estimates that more than 5 million students would receive financial assistance from the Federal government in fiscal 1979 (an increase of at least 2 million students over those benefited in fiscal 1978).

The total additional appropriation which the Administration is requesting for its package of grants, work study, and loans is \$1.46 billion (an increase from \$3.8 billion in fiscal 1978 to \$5.2 billion in fiscal 1979).

Basic Educational Opportunity Grant Program

This program provides Federal assistance to students on the basis of family income and the cost of college attendance. The Administration will request an additional \$1 billion over the \$2.1 billion appropriated for this program for fiscal 1987. With this additional funding, the Administration intends to (1) provide grants to 3.1 million additional students (raising the total from 2.2 to 5.3 million); (2) guarantee a \$250 grant to 2.8 million students from families with annual incomes of up to \$25,000 (including assistance to at least 2 million students from families in the \$16,000 to \$25,000 range who had not previously participated in this program); (3) increase the maximum grant for low-income students from \$1,600 to \$1,800; (4) increase the amount of the average grant by \$200 (from \$850 to \$1,050) to students in families with incomes between \$8,000 and \$16,000; and (5) eliminate inequities in the treatment of self-supporting students, particularly those with dependents.

According to Administration estimates, approximately \$700 million of the \$1 billion increase in the Basic Educational Opportunity Grant Program will be concentrated on families with annual incomes between \$16,000 and \$25,000.

College Work Study Program

This program provides 80 percent of the salaries for certain part-time jobs for students. The Administration will seek an additional \$165 million over the \$435 million appropriated for this program in fiscal 1978. With this additional appropriation, the Administration intends to provide work opportunities for as many as 280,000 more students (increasing the program total to more than one million students). The Administration estimates that approximately 380,000 of the students eligible for benefits would be from families with incomes above \$16,000.

Guaranteed Student Loan Program

This program subsidizes interest costs and guarantees loan repayments. The Administration will request an additional \$297 million over the \$530 million appropriated for this program in fiscal 1978. Through technical amendments, the Administration intends to address the problem of the availability of capital by making participation in the loan program more attractive to banks. Families with "adjusted family incomes" of up to \$40,000, under these amendments, would be eligible for interest subsidies worth as much as \$250 per year. (The present adjusted family income limit is \$25,000.)

In fiscal 1979, the Administration estimates that its proposed changes in the Guaranteed Student Loan Program would support 260,000 new loans to students in families with adjusted family incomes in excess of \$16,000. (The Administration estimates that, in fiscal 1978, more than one million students had loans and that 300,000 loans went to students in families with adjusted family incomes above \$16,000.)

(According to the Department of Health, Education, and Welfare, an "adjusted family income" of \$40,000 is approximately equal to an adjusted gross income of \$45,000 for a family of four, and an "adjusted family income" of \$25,000 is approximately equal to an adjusted gross income of \$30,000 for a family of four.)

Other proposals

One university has proposed a plan to allow students who pay tuition in advance to avoid future tuition increases (projected to be about 9 percent annually over the next few years). If students and their families could not afford to pay the tuition costs in advance, the school would lend the money to them at 9-percent simple interest for up to 8 years. (Such interest apparently would be tax deductible.)

Another recent proposal would establish a Federal trust fund to lend tuition and fees to college students who would repay the money after graduation. According to the sponsor of the proposal, loans would average \$7,500 per student enrolled in a private school and \$1,800 per student enrolled in a State school. Repayment could be carried out over varying periods and would be made either through payroll withholding or estimated tax payments for self-employed persons. Other than a one-time service charge for administration and other costs, the loans would not be interest-bearing.

V. ISSUES

A. Constitutionality

The constitutionality of providing Federal tax benefits to nonpublic school students or their parents has long been a subject of debate because of the sectarian character of most nonpublic schools. No case dealing with tax credits or deductions directly related to the actual cost of nonpublic school tuition has been decided by the Supreme Court. However, in *Committee for Public Education and Religious Liberty v. Nyquist*, 413 U.S. 756 (1973), the Court held that a New York State income tax deduction for each child attending a nonpublic secondary or elementary school in an amount unrelated to the actual cost of tuition violated the establishment clause of the First Amendment of the U.S. Constitution.⁶ Although the *Nyquist* decision did not specifically deal with tax credits or deductions based on the actual cost of tuition, the Court's opinion suggests that these types of benefits also might be unconstitutional. In testing the constitutionality of a statute under the establishment clause of the First Amendment, the Court applied three cumulative tests:⁷

- (1) the statute must have a secular purpose;
- (2) the primary effect of the statute must neither advance nor inhibit religion; and
- (3) the statute must not foster excessive government entanglement with religion.

The Court concluded that the New York State statute met the secular purpose test, but held that the statute failed the primary effect test, and indicated *in dicta* that prospects for passing the excessive entanglement test were not good.

Although tax credits or deductions for nonpublic elementary or secondary schools may entail constitutional difficulties. Federal aid to church-related colleges and universities has generally been regarded with less suspicion by the Supreme Court. In upholding construction grants to church-related colleges and universities for nonsectarian facilities, the Court found in *Tilton v. Richardson*, 403 U.S. 672 (1971), that there was much less likelihood that religion would permeate secular education at that level, and thus the risk that government aid would support religious activities or foster excessive government entanglement with religion was significantly reduced.

⁶ The First Amendment states that: "Congress shall make no law respecting an establishment of religion or prohibiting the free exercise thereof: * * *"

⁷ To be found constitutional under the establishment clause, a statute must pass all three tests. *Lemon v. Kurtzman*, 403 U.S. 602 (1971).

B. Goals of Educational Tax Benefits

Educational tax benefits can be directed at various education and tax policies. In addition to providing financial aid to middle-income and upper middle-income families, these may include maintaining the financial viability of higher-education institutions, improving tax equity, and perfecting the definition of taxable income.

Maintaining the Financial Viability of Higher-Education Institutions

While almost all educational institutions have financial problems, the plight of private or independent institutions is particularly grave. Some proponents of educational tax benefits have argued that such benefits (or other forms of government subsidy) are needed to preserve the United States' plural system of education. Some assert that, without new subsidies, independent educational institutions will no longer be financially viable.

Perfecting the Definition of Taxable Income

Some tax theoreticians believe education tax benefits would improve the calculation of taxable income. The tax law now allows businesses to deduct certain expenses incurred in the production of income, for example, depreciation on capital investments. The expenses of obtaining a college education might be viewed as costs associated with the production of future income—an investment in human capital. If one adopts this view, then the current definition of taxable income should be changed to allow deductions for college expenses as a form of capital investment. However, it may be argued that, under this approach, such costs should be written off over the expected earnings lifetime of the student, and not in the years in which the expenses are paid or incurred.

Improving Tax Equity

Fairness among taxpayers is a major tax policy goal. The ability-to-pay principle of taxation underlying the income tax law means that taxpayers who are similarly situated should pay the same taxes (horizontal equity) while those with different taxpaying capacities should pay different amounts of taxes (vertical equity). The tax law recognizes that income alone is not an adequate measure of taxpaying capacity. Various exemptions, exclusions, deductions, and credits have been enacted as refinements of that measure.

Most advocates of educational tax benefits have implicitly claimed that such benefits would improve tax equity. For example, it is often stated that families with more than one child attending college at the same time need tax relief because they are especially burdened. Implicitly, such statements suggest that the taxpaying capacity of these families is reduced. Educational tax benefits would lower the taxes of taxpayers incurring educational expenses compared to the taxes paid by taxpayers without such expenses.

The form of tax benefit, whether it is a credit (refundable or non-refundable), a deduction, or a deferral, will affect the income distribution of the benefits as well as the value of the benefit at various income levels.

C. Eligible Expenses

Types of Costs

Proponents of educational tax benefits generally have restricted eligible expenses to those closely associated with instruction. Other expenses such as room, board, and travel generally have not been covered.

Under these proposals, tax benefits generally would be disallowed for expenses which are not borne by the student or his family. For example, tax credits and deductions generally would be reduced by scholarships, tax-exempt veterans' benefits, and amounts paid by employers.

Limitations

The amount of expenses to be covered by a tax benefit must be considered. Tax credits can be set at a constant or changing rate. For example, a credit could offset 50 percent of all qualified expenses or it could cover a changing proportion of expenses if set at, say, 100 percent of the first \$1,000 for expenses, 50 percent of the next \$1,000, and 25 percent of the third \$1,000. Tax benefits which provide little or no benefit for some base or minimum level of expenditures channel the assistance to students attending relatively more expensive institutions. Benefits set at low, flat-dollar amounts help expensive institutions less.

A benefit ceiling or maximum may be set. Benefits with high ceilings would cover a greater share of expenses and be important for higher-cost schools. However, unless other restrictions are imposed, high ceilings also will reduce the relative cost of attending low-cost institutions and might worsen the competitive position of higher-cost institutions.

Types of Institutions

In providing a tax benefit, it must be decided whether the benefit should be extended to all levels of education or whether some levels of education should be excluded. Qualifications for eligible institutions also may be established. Most bills have required that the eligible institutions be State-accredited and qualify as tax-exempt organizations. (This latter restriction, in effect, requires that the school, in order to be eligible, have a racially nondiscriminatory policy.) In order to prevent abuse, many bills have required that the school, in order to be eligible, offer education on a regular basis; many bills have denied benefits for noncredit and recreational courses.

Types of Students

Many bills have restricted tax benefits to full-time students. However, if aid to educational institutions, tax equity, or definition of taxable income are considered, extending benefits to part-time students might be appropriate. In such an event, a credit or a deduction with a ceiling might provide a greater proportional benefit to part-time students than it would to full-time students.

VI. DEPARTMENTAL POSITION

The Treasury Department opposes the use of tax credits for expenses of higher education. The Treasury Department maintains that such credits reflect unsound tax policy and bad educational policy. According to the Department, such credits are poorly targeted because they grant equal amounts of assistance without regard for the income level or the educational expenses of the recipient. The Treasury Department contends that even if such credits were properly targeted, they would fragment both Congressional and Executive responsibilities for educational policy even further than they currently are. The Treasury Department believes that the President's recently announced proposals to increase direct assistance constitute a superior, more rational, less complex, and better targeted method of providing educational assistance.

In the areas of primary and secondary education, the Treasury Department's primary concern is the potential effect of tax credits on public school systems. The Department predicts that a credit would very likely lead to an increase in the number of students attending private schools and to a decline in public school attendance. The Treasury believes that decisions as to the proper method of providing for educational opportunity should be left with the States and localities.

Finally, as to the other tax alternatives to a tax credit, the Treasury Department believes that they suffer from defects similar to the tax credit. In the Department's view, most tax alternatives which have been suggested would grant greater assistance to higher-income families than to lower-income families, reflecting the fact that the tax system is a poor vehicle by which to provide assistance to families with little or no tax liability.

