

**DESCRIPTION OF
TITLE III ("AFFORDABLE COLLEGE ACT")
OF S. 1 ("SAFE AND AFFORDABLE SCHOOLS ACT OF 1997")**

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of the

JOINT COMMITTEE ON TAXATION

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INTRODUCTION

This document,¹ prepared by the staff of the Joint Committee on Taxation, provides a description of Title III ("Affordable College Act") of S. 1 ("Safe and Affordable Schools Act of 1997"). S. 1 was introduced on January 21, 1997 by Senator Coverdell.

Part I of the document is a summary of Title III of the bill. Part II is a description of the provisions of Title III of the bill: (A) Bob Dole education investment accounts; (B) employer-provided educational assistance programs; (C) tax-free withdrawals from qualified State tuition programs; (D) deduction for student loan interest; and (E) exclusion for Federal work study payments.

The document (Part III) also provides estimated revenue effects of Title III of the bill for fiscal years 1997-2007.

¹ This document may be cited as follows: Joint Committee on Taxation, *Description of Title III ("Affordable College Act") of S. 1 ("Safe and Affordable Schools Act of 1997")* (JCX-1-97), January 21, 1997.

I. SUMMARY OF TITLE III OF S. 1 ("Affordable College Act")

Bob Dole Education Investment Accounts

Individual taxpayers would be allowed to make nondeductible annual cash contributions up to \$1,000 into an "education investment account" on behalf of a child under the age of 18. Generally, no more than one such account could be maintained to benefit any one child.

Distributions from an education investment account would be excluded from gross income, except that if the earnings portion of a distribution exceeds qualified higher education expenses, then the excess amount would be includible in gross income. Distributions (of both contributions and earnings) made other than to cover qualified higher education expenses would be subject to a 10-percent penalty tax (except in cases of distributions made on account of the death or disability of, or scholarship received by, the beneficiary). Any amounts remaining in an education investment account would be deemed to be distributed at the time the beneficiary of the account becomes 30 years old.

Qualified higher education expenses would be defined as the student's cost of attendance as defined in section 472 of the Higher Education Act of 1965 (generally, tuition, fees, room and board, and related expenses).

As with present-law IRAs, contributions made to an education investment account made prior to April 15th would be treated as having been made during the previous taxable year.

The provision would be effective for taxable years beginning after December 31, 1996.

Employer-Provided Educational Assistance Programs

The exclusion for employer-provided educational assistance would be made permanent, and the provision limiting the exclusion to undergraduate courses would be repealed.

The repeal of the limitation on the exclusion to undergraduate education would be effective for expenses incurred in taxable years beginning after June 30, 1996. The permanent extension of the exclusion would be effective for taxable years beginning after December 31, 1996.

Allow Tax-Free Withdrawals from Qualified State Tuition Programs

Distributions made by a qualified State tuition program to (or on behalf of) a designated beneficiary to cover qualified higher education expenses would not be included in the gross income of the beneficiary (or any contributor to the qualified State tuition program). Amounts distributed to a beneficiary that exceed qualified higher education expenses incurred by the beneficiary during the taxable year would be included in the gross income of the beneficiary (even if the distribution is made on account of a scholarship received by, or disability of, the beneficiary) to the extent that such amounts exceed contributions made on behalf of the

beneficiary. Any amounts returned to a contributor (e.g., when a parent receives a refund) would be included in the gross income of the contributor to the extent that such amounts exceed contributions made by that person.

In addition, the definition of the term "qualified higher education expenses" would be expanded to include costs of attendance as defined in section 472 of the Higher Education Act of 1965 (thus including room and board expenses).

The provision would be effective for distributions made in taxable years beginning after December 31, 1996.

Deduction for Student Loan Interest

The bill would provide that certain individuals who have paid interest on qualified education loans may claim an above-the-line deduction for such interest expenses, up to a maximum deduction of \$2,500 per year. The deduction would be allowed only with respect to interest paid on a qualified education loan during the first 60 months in which interest payments are required.

A qualified education loan generally would be defined as any indebtedness incurred to pay for the qualified higher education expenses of the taxpayer, the taxpayer's spouse, or any dependent of the taxpayer as of the time the indebtedness was incurred in attending (1) higher education institutions and certain area vocational education schools, or (2) institutions conducting internship or residency programs leading to a degree or certificate from an institution of higher education, a hospital, or a health care facility conducting postgraduate training. Qualified higher education expenses would be defined as the student's cost of attendance as defined in section 472 of the Higher Education Act of 1965 (generally, tuition, fees, room and board, and related expenses).

The deduction would be phased out ratably over the following modified adjusted gross income (modified AGI) ranges: joint filers (\$65,000-\$85,000) and unmarried individuals (\$45,000-\$65,000). The bill would impose information reporting requirements on any person in a trade or business or any governmental agency who receives \$600 or more in qualified education loan interest from an individual during a calendar year.

The provision would be effective for payments of interest due after December 31, 1996, on any qualified education loan.

Exclusion of Federal Work Study Payments

Amounts received by an individual pursuant to an agreement under the Federal work-study program authorized by section 441 of the Higher Education Act of 1965 (Title 42 U.S. Code, sec. 2751) would be excluded from the gross income of the individual.

The provision would be effective for taxable years beginning after December 31, 1996.

II. DESCRIPTION OF TITLE III OF S. 1

A. Bob Dole Education Investment Accounts (sec. 301 of the bill)

Present Law

An individual may make deductible contributions to an individual retirement arrangement ("IRA") for each taxable year up to the lesser of \$2,000 or the amount of the individual's compensation for the year if the individual is not an active participant in an employer-sponsored qualified retirement plan (and, if married, the individual's spouse also is not an active participant). Contributions may be made to an IRA for a taxable year up to April 15th of the following year. An individual who makes excess contributions to an IRA, i.e., contributions in excess of \$2,000, is subject to an excise tax on such excess contributions unless they are distributed from the IRA before the due date for filing the individual's tax return for the year (including extensions). If the individual (or his or her spouse, if married) is an active participant, the \$2,000 limit is phased out between \$40,000 and \$50,000 of adjusted gross income ("AGI") for married couples and between \$25,000 and \$35,000 of AGI for single individuals.

Present law permits individuals to make nondeductible contributions (up to \$2,000 per year) to an IRA to the extent an individual is not permitted to (or does not) make deductible contributions. Earnings on such contributions are includible in gross income when withdrawn.

An individual generally is not subject to income tax on amounts held in an IRA, including earnings on contributions, until the amounts are withdrawn from the IRA. Amounts withdrawn from an IRA are includible in gross income (except to the extent of nondeductible contributions). In addition, a 10-percent additional tax generally applies to distributions from IRAs made before age 59-1/2, unless the distribution is made on account of death or disability or made in the form of annuity payments.

Description of the Bill

Individual taxpayers would be allowed to make nondeductible annual cash contributions up to \$1,000 into a "Bob Dole education investment account" (referred to as a "education investment account") on behalf of a child under the age of 18. Generally, no more than one such account could be maintained to benefit any one child. An education investment account could be maintained at a bank or as part of a qualified State tuition program.

Distributions from an education investment account would be excluded from gross income, except that to the extent that a distribution is not used for qualified higher education expenses, the earnings portion of the distribution would be included in gross income.²

² If a distribution is not used for qualified higher education expenses, the taxable earnings portion of the distribution would be determined in the manner provided for by present-law section 72.

Distributions (of both contributions and earnings) made other than to cover qualified higher education expenses would be subject to a 10-percent penalty tax. However, the 10-percent penalty tax would not apply in the case of any distribution made on account of death or disability of, or a scholarship received by, the beneficiary of the account. Any amounts remaining in an education investment account would be deemed to be distributed at the time the beneficiary of the account becomes 30 years old.

Qualified higher education expenses would be defined as the student's cost of attendance as defined in section 472 of the Higher Education Act of 1965 (generally, tuition, fees, room and board, and related expenses). Qualified higher education expenses would be reduced by any scholarships received by the beneficiary that are excludable from gross income under section 117, certain other tax free educational benefits, and payments for educational expenses made under a qualified State tuition program.

As with present-law IRAs, contributions made to an education investment account prior to April 15th may be treated as made during the preceding taxable year. An individual who makes excess contributions to an education investment account (i.e., contributions in excess of the \$1,000 limit) would be subject to an excise tax on such excess contributions unless they are distributed from the account before the due date for filing the individual's tax return for the year (including extensions). Rules would be provided governing permissible investments of education investment accounts, similar to present-law rules governing IRAs.

Effective Date

The provision would be effective for taxable years beginning after December 31, 1996.

B. Employer-Provided Educational Assistance Programs (sec. 302 of the bill)

Present Law

Under present law, an employee's gross income and wages do not include amounts paid or incurred by the employer for educational assistance provided to the employee if such amounts were paid or incurred pursuant to an educational assistance program that meets certain requirements. The exclusion is limited to \$5,250 of educational assistance with respect to an individual during a calendar year. The exclusion applies whether or not the education is job related. Under present law, in the absence of this exclusion, educational assistance is excludable from income only if it is related to an employee's current job.

The exclusion for employer-provided educational assistance expires with respect to courses beginning after June 30, 1997. The exclusion does not apply to graduate level courses beginning after June 30, 1996. Graduate courses are defined as any graduate level course of a kind normally taken by an individual pursuing a program leading to a law, business, marketing or other advanced academic or professional degree.

Description of the Bill

Under the bill, the exclusion for employer-provided educational assistance would be made permanent and the provision limiting the exclusion to undergraduate courses would be retroactively repealed.

Effective Date

The repeal of the limitation on the exclusion to undergraduate education would be effective for graduate level courses beginning after June 30, 1996. The permanent extension of the exclusion would be effective for taxable years beginning after December 31, 1996.

**C. Allow Tax-Free Withdrawals from Qualified State Tuition Programs
(sec. 303 of the bill)**

Present Law

Code section 529 (enacted as part of the Small Business Job Protection Act of 1996) provides tax-exempt status to "qualified State tuition programs," meaning programs established and maintained by a State (or agency or instrumentality thereof) under which persons may (1) purchase tuition credits or certificates on behalf of a designated beneficiary that entitle the beneficiary to a waiver or payment of qualified higher education expenses of the beneficiary, or (2) make contributions to an account that is established for the purpose of meeting qualified higher education expenses of the designated beneficiary of the account. "Qualified higher education expenses" are defined as tuition, fees, books, supplies, and equipment required for the enrollment or attendance at a college or university (or certain vocational schools). Qualified higher education expenses do not include room and board expenses.

A qualified State tuition program is required to provide that purchases or contributions may only be made in cash. A qualified State tuition program must provide adequate safeguards to prevent contributions on behalf of a designated beneficiary in excess of those necessary to provide for the qualified higher education expenses of the beneficiary. Contributors and beneficiaries are not allowed to direct any investments made on their behalf by the program. The program is required to maintain a separate accounting for each designated beneficiary. A specified individual must be designated as the beneficiary at the commencement of participation in a qualified State tuition program (i.e., when contributions are first made to purchase an interest in such a program³), unless interests in such a program are purchased by a State or local government or a tax-exempt charity described in section 501(c)(3) as part of a scholarship program operated by such government or charity under which beneficiaries to be named in the future will receive such interests as scholarships. A transfer of credits (or other amounts) from one account benefiting one designated beneficiary to another account benefiting a different beneficiary will be considered a distribution (as will a change in the designated beneficiary of an interest in a qualified State tuition program) unless the new beneficiary is a member of the family of the old beneficiary.⁴ Earnings on an account may be refunded to a contributor or beneficiary, but the State or instrumentality must impose a more than de minimis monetary penalty unless the refund is (1) used for qualified higher education expenses of the beneficiary, (2) made on account of the death or disability of the beneficiary, or (3) made on account of a scholarship (or allowance or payment described in section 135(d)(1)(B) or (C)) received by the designated beneficiary to the extent the amount refunded does not exceed the amount of the scholarship, allowance, or payment. A qualified State tuition program may not allow any interest in the program or any portion thereof to be used as security for a loan.

³ Section 529 permits a change in designated beneficiaries, so long as the new beneficiary is a member of the family of the old beneficiary.

⁴ For this purpose, the term "member of the family" is defined under present-law section 2032A(e)(2).

In addition, section 529 provides that no amount shall be included in the gross income of a contributor to, or beneficiary of, a qualified State tuition program with respect to any distribution from, or earnings under, such program, except that (1) amounts distributed or educational benefits provided to a beneficiary (e.g., when the beneficiary attends college) will be included in the beneficiary's gross income (unless excludable under another Code section) to the extent such amount or the value of the educational benefits exceeds contributions made on behalf of the beneficiary, and (2) amounts distributed to a contributor (e.g., when a parent or other relative receives a refund) will be included in the contributor's gross income to the extent such amounts exceed contributions made by that person.⁵

Contributions made to a qualified State tuition program will be treated as incomplete gifts for Federal gift tax purposes. Thus, any Federal gift tax consequences will be determined at the time that a distribution is made from an account under the program. The waiver (or payment) of qualified higher education expenses of a designated beneficiary by (or to) an educational institution under a qualified State tuition program will be treated as a qualified transfer for purposes of present-law section 2503(e). Amounts contributed to a qualified State tuition program (and earnings thereon) will be included in the contributor's estate for Federal estate tax purposes in the event that the contributor dies before such amounts are distributed under the program.

Description of the Bill

Distributions made by a qualified State tuition program to (or on behalf of) a designated beneficiary to cover qualified higher education expenses would not be included in the gross income of the beneficiary (or any contributor to the qualified State tuition program). Amounts distributed to a beneficiary that are not used for qualified higher education expenses would be included in the gross income of the beneficiary (even if the distribution is made on account of a scholarship received by, or disability of, the beneficiary) to the extent that such amounts exceed contributions made on behalf of the beneficiary. Any amounts returned to a contributor (e.g., when a parent receives a refund) would be included in the gross income of the contributor to the extent that such amounts exceed contributions made by that person.⁶

In addition, the definition of the term "qualified higher education expenses" would be expanded to include costs of attendance as defined in section 472 of the Higher Education Act of 1965 (thus, including room and board expenses).

⁵ Specifically, section 529 provides that any distribution under a qualified State tuition program shall be includible in the gross income of the distributee in the same manner as provided under present-law section 72 to the extent not excluded from gross income under any other provision of the Code.

⁶ Distributions that are not used for qualified higher education expenses would be included in the gross income of the distributee in the same manner as provided under present-law section 72 to the extent not excluded from gross income under any other provision of the Code.

Effective Date

The provision would be effective for distributions made in taxable years beginning after December 31, 1996.

D. Deduction for Student Loan Interest (sec. 304 of the bill)

Present Law

The Tax Reform Act of 1986 repealed the deduction for personal interest. Student loan interest generally is treated as personal interest and thus is not allowable as an itemized deduction from income.

Taxpayers generally may not deduct education and training expenses. However, a deduction for education expenses generally is allowed under section 162 if the education or training (1) maintains or improves a skill required in a trade or business currently engaged in by the taxpayer, or (2) meets the express requirements of the taxpayer's employer, or requirements of applicable law or regulations, imposed as a condition of continued employment (Treas. Reg. sec. 1.162-5). Education expenses are not deductible if they relate to certain minimum educational requirements or to education or training that enables a taxpayer to begin working in a new trade or business. In the case of an employee, education expenses (if not reimbursed by the employer) may be claimed as an itemized deduction only if such expenses relate to the employee's current job and only to the extent that the expenses, along with other miscellaneous deductions, exceed two percent of the taxpayer's adjusted gross income (AGI).

Description of the Bill

Certain individuals who have paid interest on qualified education loans would be allowed to claim an above-the-line deduction for such interest expenses, up to a maximum deduction of \$2,500 per year. The deduction would be allowed only with respect to interest paid on a qualified education loan during the first 60 months in which interest payments are required. Months during which the qualified education loan is in deferral or forbearance would not count against the 60-month period. No deduction would be 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 would be defined as any indebtedness incurred to pay for the qualified higher education expenses of the taxpayer, the taxpayer's spouse, or any dependent of the taxpayer as of the time the indebtedness was incurred in attending (1) higher education institutions and certain area vocational education schools (i.e., eligible educational institutions defined in Code section 135(c)(3)), or (2) institutions conducting internship or residency programs leading to a degree or certificate from an institution of higher education, a hospital, or a health care facility conducting postgraduate training. Qualified higher education expenses would be defined as the student's cost of attendance as defined in section 472 of the Higher Education Act of 1965 (generally, tuition, fees, room and board, and related expenses), reduced by (1) any amount excluded from tax under section 135 (i.e., United States savings bonds used to pay higher education tuition and fees), and (2) the amount of the reduction described in section 135(d)(1) (i.e., scholarships received by the beneficiary that are excludable from gross income under section 117, certain other tax free educational benefits, payments for educational expenses under a qualified State tuition program, and distributions from a Bob Dole education investment account). Such expenses must be paid or incurred within a reasonable period before or after the indebtedness is incurred, and must be attributable to a period when the

student is at least a half-time student.

The deduction would be phased out ratably over the following modified adjusted gross income ("modified AGI") ranges: single individuals (\$45,000-\$65,000) and joint filers (\$65,000-\$85,000). The beginning of the phaseout ranges (but not the size of the phaseout range) would be indexed for inflation for taxable years beginning after 1997. Modified AGI would be defined as the taxpayer's AGI (1) increased by the amount otherwise excluded from gross income under Code section 135, 911, or 933, and (2) calculated after the inclusion of Social Security benefits in income, the deduction for contributions to individual retirement arrangements, and the limitations on passive losses.

Any person in a trade or business or any governmental agency that receives \$600 or more in qualified education loan interest from an individual during a calendar year would be required to provide an information report on such interest to the IRS and to the payor.

Effective Date

The provision would be effective for payments of interest due after December 31, 1996, on any qualified education loan. Thus, in the case of already existing qualified education loans, interest payments would qualify for the deduction to the extent that the 60-month period has not expired. For purposes of counting the 60 months, any qualified education loan and all refinancing (that is treated as a qualified education loan) of such loan would be treated as a single loan.

E. Exclusion of Federal Work Study Payments (sec. 305 of the bill)

Present Law

Gross income generally includes compensation for services and all other income from whatever source derived (sec. 61). Gross income does not include, however, any amount received as a qualified scholarship by an individual who is a candidate for a degree at an educational institution meeting certain criteria. Section 117(c) specifically provides that the exclusion for qualified scholarships does not apply to any amount received by a student that represents payment for teaching, research, or other services by the student required as a condition for receiving the scholarship.

Pursuant to the Federal work-study program authorized by section 441 of the Higher Education Act of 1965 (codified at 42 U.S.C. 2751 et seq.), the Secretary of Education is authorized to enter into agreements with certain educational institutions, under which Federal funds are granted to the institution to assist the institution in the operation of a work-study program to provide students who have demonstrated financial need with part-time employment at the institution itself or at nonprofit or governmental organizations. Under such work-study programs, the Federal share of the compensation paid to the student generally may not exceed 75 percent of the total compensation paid to the student under the program.

Description of the Bill

Amounts received by an individual for services performed pursuant to a Federal work-study program operated under section 441 of the Higher Education Act of 1965 would be excluded from the gross income of the individual.

Effective Date

The provision would be effective for taxable years beginning after December 31, 1996.

III. ESTIMATED REVENUE EFFECTS OF TITLE III. (THE "AFFORDABLE COLLEGE ACT") OF S. 1

Fiscal Years 1997 - 2007

[Billions of Dollars]

Provision	Effective	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	1997-02	1997-07
A. Permit \$1,000 per year nondeductible contribution to an education investment account for a child under the age of 18.....	tyba 12/31/96	-0.1	-0.2	-0.3	-0.4	-0.4	-0.4	-0.5	-0.6	-0.8	-0.9	-1.0	-1.8	-5.6
B. Permanent extension of employer-provided educational assistance for graduates (effective 6/30/96) and undergraduates.....	tyba 12/31/96	-0.2	-0.4	-0.7	-0.7	-0.7	-0.8	-0.8	-0.9	-0.9	-0.9	-1.0	-3.5	-8.0
C. Allow tax-free withdrawals from qualified State-sponsored tuition programs.....	tyba 12/31/96	[1]	-0.1	-0.1	-0.1	-0.1	-0.1	-0.2	-0.2	-0.2	-0.2	-0.2	-0.6	-1.6
D. Student loan interest deduction (\$2,500 above-the-line deduction; phaseout \$45,000 - \$65,000 singles/ \$65,000 - \$85,000 joint).....	poida 12/31/96	[1]	-0.1	-0.1	-0.1	-0.1	-0.2	-0.2	-0.2	-0.2	-0.2	-0.3	-0.7	-1.9
E. Exclude Federal work-study payments from Income.....	tyba 12/31/96	[1]	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.4	-1.0
NET TOTALS, TITLE III. OF S. 1		-0.3	-0.9	-1.3	-1.5	-1.5	-1.6	-1.8	-2.0	-2.2	-2.3	-2.6	-7.1	-18.0

Source: Joint Committee on Taxation, January 21, 1997.

NOTE: Details may not add to totals due to rounding.

Legend for "Effective" column: poida = payments of interest due after
tyba = taxable years beginning after

[1] Loss of less than \$50 million.