

COMPARISON OF CERTAIN PROPOSED TAX INCENTIVES FOR HIGHER EDUCATION

Scheduled for a Hearing

Before the

HOUSE COMMITTEE ON WAYS AND MEANS

on March 5, 1997

Prepared by the Staff

of the

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INTRODUCTION

The House Committee on Ways and Means has scheduled a public hearing on March 5, 1997, on the education and training tax provisions of the President's fiscal year 1998 budget proposal. This document,¹ prepared by the staff of the Joint Committee on Taxation, summarizes present law and certain tax proposals for education and training contained in (1) the President's fiscal year 1998 budget, (2) Title III ("Affordable College Act") of S. 1 ("Safe and Affordable Schools Act of 1997"), introduced on January 21, 1997, and (3) the Balanced Budget Act of 1995 ("BBA of 1995") (H.R. 2491) (which was vetoed by President Clinton). A more detailed description of present law and the education and training proposals contained in the President's fiscal 1998 budget and in Title III of S. 1 is included in a separate staff pamphlet.²

¹ This document may be cited as follows: Joint Committee on Taxation, *Comparison of Certain Proposed Tax Incentives for Higher Education* (JCX-9-97), March 4, 1997.

² See Joint Committee on Taxation, *Analysis of Proposed Tax Incentives for Higher Education* (JCS-3-97), March 4, 1997.

COMPARISON OF CERTAIN PROPOSED TAX INCENTIVES FOR HIGHER EDUCATION

<i>Present Law</i>	<i>President's FY 1998 Budget</i>	<i>Senate Bill (Title III of S. 1)</i>	<i>BBA of 1995</i>
<p>1. Tuition tax credit</p> <p>There is no tax credit under present law for tuition expenses. Special rules provide an exclusion from gross income for certain student loan discharges (sec. 108(f)), qualified scholarships (sec. 117), and certain employer-provided educational assistance (sec. 127); and an exclusion from gross income also is provided to low- and middle-income taxpayers for interest earned on U.S. savings bonds used to pay post-secondary tuition and required fees (sec. 135).</p>	<p>HOPE scholarship tuition tax credit</p> <p><u>Maximum credit per student--</u> Individual taxpayers would be allowed to claim a nonrefundable tax credit up to \$1,500 per student per year for tuition and required fees (but not room and board) for the first two years of the student's post-secondary education in a degree or certificate program. The maximum credit amount would be reduced by any Federal educational grants, such as Pell grants, awarded to the student for the year. Beginning in 1998, the \$1,500 maximum credit amount would be indexed for inflation. The credit would be available in the taxable year the expenses are paid, provided that the education commences or continues during that year or during the first three months of the next year.</p> <p><u>Eligible students--</u>The education expenses must be incurred on behalf of the taxpayer, the</p>	<p>No provision.</p>	<p>No provision.</p>

<i>Present Law</i>	<i>President's FY 1998 Budget</i>	<i>Senate Bill (Title III of S. 1)</i>	<i>BBA of 1995</i>
	<p>taxpayer's spouse, or a dependent. The student must pursue a course of study on at least a half-time basis. The student must not have been convicted of a Federal or State felony drug offense. To be eligible for the credit for a second taxable year, the student must obtain a GPA of 2.75 on a 4-point scale (or similar measure) for all previous post-secondary education.</p> <p><u>Phase-out of credit</u>--The maximum credit amount would be phased out for taxpayers with modified AGI between \$50,000 and \$70,000 (\$80,000 and \$100,000 for joint returns). Beginning in 2001, the income phase-out ranges would be indexed for inflation.</p> <p><u>No double dipping with respect to any one student</u>--If a taxpayer claims a credit with respect to a particular student, then the proposed above-the-line deduction (described below) would not be available with</p>		

<i>Present Law</i>	<i>President's FY 1998 Budget</i>	<i>Senate Bill (Title III of S. 1)</i>	<i>BBA of 1995</i>
	<p>respect to that student for that taxable year, although the proposed deduction may be available with respect to other students for that same year. Qualified expenses would include only out-of-pocket expenses and not expenses covered by educational assistance that is not required to be included in the gross income of either the student or the taxpayer claiming the credit (such as amounts excluded under present-law secs. 117 or 135). Qualified expenses would include education expenses paid with amounts that constitute a gift under section 102(a).</p> <p>Effective date.--Payments made on or after January 1, 1997, for education commencing on or after July 1, 1997.</p>		

<i>Present Law</i>	<i>President's FY 1998 Budget</i>	<i>Senate Bill (Title III of S. 1)</i>	<i>BBA of 1995</i>
<p>2. Deduction for education expenses</p> <p>In general, education expenses are deductible only as a trade or business expense under section 162, but only if the education (1) maintains or improves a skill required for the taxpayer's current profession, or (2) meets the express requirements of the taxpayer's employer or requirements of law. Education expenses are not deductible if they relate to certain minimum educational requirements or to 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</p>	<p>Education and job training tax deduction</p> <p><u>Maximum deduction per taxpayer return</u>--Individual taxpayers would be allowed an above-the-line deduction for post-secondary tuition and required fees (but not room and board) up to \$5,000 per taxpayer return for 1997 and 1998. After 1998, the maximum deduction would be \$10,000 per taxpayer return. The maximum deduction would not vary with the number of students in a taxpayer's family. There would be no limit on the number of years for which the deduction could be claimed with respect to a particular student. The deduction would be available in the taxable year the expenses are paid, provided that the education commences or continues during that year or during the first three months of the next year.</p> <p><u>Eligible students</u>--The education expenses must be incurred on</p>	<p>Deduction for student loan interest</p> <p><u>Maximum deduction per taxpayer return</u>--Individual taxpayers would be allowed an above-the-line deduction up to \$2,500 per year for interest paid on certain student loans used to pay post-secondary education expenses, including room and board expenses. The deduction would be allowed only with respect to interest paid on a student loan during the first 60 months in which interest payments are required (not counting months during which the loan is in deferral). The maximum deduction would not vary with the number of students in a taxpayer's family. The education expenses must be incurred within a reasonable period before or after the indebtedness is incurred.</p> <p><u>Eligible students</u>--The indebtedness must have been incurred to pay for education expenses of the taxpayer, the</p>	<p>Deduction for student loan interest</p> <p>Same as Senate provision, except that the indebtedness must be incurred to pay for education expenses of the taxpayer or the taxpayer's spouse (and not a dependent).</p> <p><u>Effective date</u>--Payments of student loan interest due after December 31, 1995.</p>

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<p>other miscellaneous deductions, exceed two percent of the taxpayer's AGI.</p> <p>Student loan interest generally is treated as personal interest and thus is not allowed as an itemized deduction from income.</p>	<p>behalf of the taxpayer, the taxpayer's spouse, or a dependent. The student must (1) pursue a course of study on at least a half-time basis, or (2) take a course to improve or acquire job skills. The student may have already completed an unlimited number of years of post-secondary education. There is no minimum GPA requirement, nor is there a requirement that the student be free of felony drug convictions.</p> <p><u>Phase-out of deduction</u>--Same as proposed HOPE scholarship tuition tax credit (described above).</p> <p><u>No double dipping with respect to any one student</u>--Same as proposed HOPE scholarship tuition tax credit (described above).</p> <p><u>Effective date</u>--Same as proposed HOPE scholarship tuition tax credit (described above).</p>	<p>taxpayer's spouse, or a dependent at the time the indebtedness was incurred. The student must be at least a half-time student when the indebtedness was incurred. There is no minimum GPA requirement, nor is there a requirement that the student be free of felony drug convictions.</p> <p><u>Phase-out of deduction</u>--The maximum deduction would be phased out for taxpayers with modified AGI between \$45,000 and \$65,000 (\$65,000 and \$85,000 for joint returns). Beginning in 1998, the income phase-out ranges would be indexed for inflation.</p> <p><u>Reduction of qualified education expenses</u>--Education expenses would include only out-of-pocket expenses and not expenses covered by educational assistance that is not required to be included in the gross income of the student or the taxpayer claiming the deduction (such as amounts</p>	

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<p>3. Forgiveness of student loans</p> <p>In the case of an individual, gross income does not include any amount from the forgiveness of certain student loans, provided that the forgiveness is contingent on the student working for a certain period of time in certain professions for any</p>	<p>Expansion of present-law section 108(f)</p> <p>Section 108(f) would be expanded to include forgiveness of loans made by tax-exempt charitable organizations (e.g, colleges or private foundations) if the proceeds of such loans are used to pay costs of attendance (including room and board) at an educational institution or to</p>	<p>excluded under present-law secs. 117 or 135).</p> <p><u>Information reporting</u>--Any person in a trade or business or any governmental agency that receives \$600 or more in education loan interest from an individual during a year would be required to provide an information report on such interest to the IRS and to the payor.</p> <p><u>Effective date</u>--Payments of student loan interest due after December 31, 1996.</p> <p>No provision.</p>	<p>No provision.</p>

<i>Present Law</i>	<i>President's FY 1998 Budget</i>	<i>Senate Bill (Title III of S. 1)</i>	<i>BBA of 1995</i>
<p>of a broad class of employers (sec. 108(f)).</p> <p>Student loans eligible for the section 108(f) exclusion must be made to assist an individual in attending (including room and board expenses) an educational institution that has a regular faculty, student body, and campus. The loan must be made by (1) the United States, (2) a State, (3) certain tax-exempt public benefit corporations that control a State, county, or municipal hospital and whose employees are deemed to be public employees under State law, or (4) an educational organization that originally received the funds from which the loan was made from the United States, a State, or a tax-exempt public benefit corporation. Student loans made with private, nongovernmental funds do not qualify for the section</p>	<p>refinance outstanding student loans and the student is not employed by the lender organization. As under present law, forgiveness of the loan must be contingent on the student working for a certain period of time in certain professions for any of a broad class of employers.</p> <p>The section 108(f) exclusion also would be expanded to cover forgiveness of direct student loans made through the William D. Ford Federal Direct Loan Program where loan repayment and forgiveness are contingent on the borrower's income level.</p> <p><u>Effective date.</u>--Student loan discharges after the date of enactment.</p>		

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<p>108(f) exclusion.</p> <p>4. Education investment accounts</p> <p>Present law generally does not provide special tax treatment for investment accounts established to meet educational expenses.</p> <p>Individuals may make deductible contributions to an 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). If the individual (or spouse) is an active participant, the \$2,000 limit is phased out between \$25,000 and \$35,000 of AGI (\$40,000 and \$50,000 of AGI for joint</p>	<p>No provision.</p>	<p>"Bob Dole education investment accounts"</p> <p>Individual taxpayers would be allowed to make nondeductible annual contributions up to \$1,000 into a "Bob Dole education investment account" on behalf of a child under the age of 18. Distributions from such an account would be excluded from gross income if used to pay for post-secondary education expenses of the beneficiary (including room and board expenses). To the extent that a distribution is not used for such education expenses, the earnings portion of the distribution would be included in gross income (and the distribution also would be subject to a 10-percent penalty tax, unless the distribution was made on account of death or disability of, or a scholarship received by, the beneficiary of the account).</p>	<p>"American Dream Savings Accounts"</p> <p>Individual taxpayers would be permitted to make nondeductible contributions to American Dream Savings Accounts (ADSAs) to the extent that they do not make deductible contributions to a IRA. Tax-free distributions (if a five-year holding period is satisfied) would be allowed for withdrawals from ADSAs to pay for tuition and required fees for the attendance at a post-secondary institution of the individual, a spouse, child, grandchild, or any other ancestor (or any child, grandchild, or other ancestor of the spouse), as well as withdrawals for certain first-time homebuyer expenses and medical expenses. Special purpose withdrawals also would not be subject to the 10-percent early withdrawal penalty tax.</p>

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<p>returns). Individuals are permitted to make nondeductible contributions (up to \$2,000 per year) to an IRA to the extent the individual is not permitted to (or does not) make deductible contributions.</p> <p>5. Qualified State tuition programs</p> <p>Section 529 provides tax-exempt status to certain qualified State tuition programs, under which persons may purchase tuition credits on behalf of a designated beneficiary or make contributions to an account established for the purpose of meeting future tuition and required fees (but not room and board expenses) of a designated beneficiary at a post-secondary educational institution. Amounts contributed to a qualified State tuition program are not</p>	<p>No provision.</p>	<p>Contributions made prior to April 15th may be treated as made during the preceding taxable year.</p> <p>Effective date.--Taxable years beginning after December 31, 1996.</p> <p>Tax-free withdrawals from qualified State tuition programs</p> <p>Distributions made by a qualified State tuition program to (or on behalf of) a designated beneficiary to cover qualified higher education expenses at a post-secondary educational institution would not be included in the gross income of the beneficiary (or any contributor to the program).</p> <p>The term "qualified higher education expenses" would be expanded to include not only tuition and required fees but all costs of attendance as defined in section 472 of the Higher</p>	<p>Contributions made prior to April 15th may be treated as made during the preceding taxable year.</p> <p>Effective date.--Taxable years beginning after December 31, 1995.</p> <p>No provision.</p>

<i>Present Law</i>	<i>Clinton Budget</i>	<i>Senate</i>	<i>BBA</i>
<p>deductible, but contributors obtain the benefit of deferral of tax on earnings until educational benefits are provided to a designated beneficiary (at which time earnings used for educational benefits are includable in the gross income of the student).</p> <p>6. Treatment of Federal work-study payments</p> <p>Gross income generally includes compensation for services. Gross income does not include any amount received as a qualified scholarship, but 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.</p>	<p>No provision.</p>	<p>Education Act of 1965, thus, including room and board expenses.</p> <p>Effective date.--Taxable years beginning after December 31, 1996.</p> <p>Exclusion of Federal work-study payments</p> <p>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.</p> <p>Effective date.--Taxable years beginning after December 31, 1996.</p>	<p>No provision.</p>

<i>Present Law</i>	<i>Clinton Budget</i>	<i>Senate</i>	<i>BBA</i>
<p>7. Employer-provided educational assistance</p> <p>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. This 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 was job related. 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 expires with respect to courses beginning after June 30, 1997 and is not available for graduate level courses beginning after June 30, 1996.</p>	<p>The exclusion for employer-provided educational assistance is extended for taxable years beginning after December 31, 1996, and before January 1, 2001. The provision limiting the exclusion to undergraduate education would be retroactively repealed. The repeal is effective for graduate level courses beginning after June 30, 1996.</p> <p>Effective date.--Taxable years beginning after December 31, 1996, and before January 1, 2001, and the repeal of the restriction of the exclusion to undergraduate education is effective for graduate level courses beginning after June 30, 1996.</p>	<p>The exclusion for employer-provided educational assistance is made permanent, effective for taxable years beginning after December 31, 1996. The provision limiting the exclusion to undergraduate courses would be retroactively repealed. The repeal would be effective for graduate level courses beginning after June 30, 1996.</p> <p>Effective date.--Taxable years beginning after December 31, 1996. The repeal of the restriction of the exclusion to undergraduate education is effective for graduate level courses beginning after June 30, 1996.</p>	<p>The exclusion for employer-provided educational assistance would have been extended for taxable years beginning after December 31, 1994 and before January 1, 1997 and would not have been available for graduate level courses beginning after December 31, 1996.</p> <p>Effective date.--Taxable years beginning after December 31, 1994, and before January 1, 1997. The exclusion for graduate level courses would have expired after December 31, 1996.</p>

<i>Present Law</i>	<i>Clinton Budget</i>	<i>Senate</i>	<i>BBA</i>
<p>8. Small business tax credit for employer-provided educational assistance</p> <p>An employer may deduct certain job-related training and education expenses, as well as amounts paid or incurred for educational assistance provided to employees pursuant to an educational assistance program that meets certain requirements. Employer payments for job-related training and amounts paid under a qualified educational assistance program up to \$5,250 annually are excluded from the gross income and wages of the employee. The exclusion for employer-provided educational assistance expires after June 30, 1997.</p>	<p>The proposal would provide a temporary 10-percent income tax credit for small businesses with respect to expenses incurred for education of employees by third parties under a qualified employer-provided educational assistance program. The credit would be available to employers (including self-employed individuals) where the business has average annual gross receipts of \$10 million or less for the prior three years.</p> <p>Effective date.--The proposal would be effective for payments made in taxable years beginning after December 31, 1997, and before January 1, 2001 with respect to expenses incurred during those years.</p>	<p>No provision.</p>	<p>No provision.</p>