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EDUCATION TAX AND SAVINGS INCENTIVES

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BEFORE THE

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UNITED STATES SENATE

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WEDNESDAY, FEBRUARY 14, 2001

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, DC.

The hearing was convened, pursuant to notice, at 10:00 a.m., in room 215, Dirksen Senate Office Building, Hon. Charles E. Grassley (chairman of the committee) presiding.

Also present: Senators Murkowski, Snowe, Baucus, Breaux, Conrad, Graham, Bingaman, Kerry, Torricelli, and Lincoln.

OPENING STATEMENT OF HON. CHARLES E. GRASSLEY, A U.S. SENATOR FROM IOWA, CHAIRMAN, COMMITTEE ON FINANCE

The CHAIRMAN. I would like to call our hearing to order.

We have a long list of people from the U.S. Senate that are going to testify who are not members of this committee. To the best of my recollection, and the recollection of senior Finance Committee staff, this is a new record, having eight Senators who are not on the committee testify on legislation.

Since this is our first legislative hearing under my chairmanship, I am pleased to see that there is this much interest off the committee in an important issue for the Finance Committee. This record number of Senator witnesses is a signal of the importance of these education-related tax cuts.

Also, preliminarily, since there are so many of you that want to testify, as a courtesy for your colleagues on the panels, and hopefully staff has alerted your staff about this, I would ask you to limit your testimony to 3 minutes.

Now, if I had a chairman say that to me and I was sitting where you were, I would be darned mad about that. But I do not know whether I have had that many Senators before a committee before, or even been a part of it. So, if you could do that, I'd appreciate it very much.

Now, getting to the issues before us. Whether it is K–12 or college education, our founding fathers—and primarily Thomas Jefferson—made it very clear that an educated populace is the very foundation on which self-governing nations rest.

Education is the ticket to prosperity in America. No matter what an individual's background is, they can achieve a better future. Without education, the door to that better future is closed.

We must ensure that every student who has worked to gain entrance into an institution of higher learning has the wherewithal to fund it. An affordable education must be a priority ahead of the government's needs.

Any other priority for which we intend to tax American citizens, it seems to me, ought to be secondary to educational pursuits because their education is going to enhance the entire economy, which is in turn then going to help government resources.

So the government has a responsibility and an obligation to make education affordable. American families today have a higher tax burden than ever before. To make people beholden to the Federal Tax Code instead of freeing their hard-earned income to fund their own or their children's education is wrong. If not just wrong, it also ought to be immoral.

President Bush has made education a top priority. Three weeks ago, he came out with a blueprint for strengthening elementary and secondary education and making education more affordable for all Americans. The President has included education tax measures as a part of his agenda.

This hearing today is not just about some academic exercise, because we expect the Health, Education, Labor, and Pension Committees to put the bulk of the President's program before the entire Senate. The President's package also included tax provisions such as expanding the education IRA.

When the President's package moves, I hope the Finance Committee—in due course, of course, but in a timely way—will consider education-related tax proposals. It should surprise no one that the Finance Committee is leading off this legislative year with this topic of education.

Last year, the Finance Committee approved the Affordable Education Act. This legislation included several education tax cut proposals. Unfortunately, President Clinton was able to thwart this education tax legislation with vetoes or threats thereof. With a new President and a bipartisan atmosphere in Congress, I am optimistic these tax incentives will become law.

As Chairman of the Finance Committee, I intend to make tax incentives for affordable access to higher education a priority of the committee.

This objective is a bipartisan one. Senator Baucus, to my right, and I have taken the lead on two education bills, one to make permanent the tax-free treatment of employer-provided educational assistance and to apply the benefit to graduate education, the other would expand and simplify the student loan interest deduction.

I have been an advocate of reducing the burden of education debt for many years. For instance, I pushed for, and obtained, reinstatement of the student loan interest deduction, which had been phased out starting in 1986.

Last month, I introduced a bill to expand this deduction beyond the 1997 enactment of mine. This bill would eliminate the 60-month cap when the deduction can be taken. Senator Baucus is also the lead co-sponsor of that bill.

There is obvious bipartisan support for education tax incentives. This is a start of a new Congress and we will have the opportunity to build on this bipartisan support and make education more affordable.*

*For more information on this subject, *see also*, Joint Committee on Taxation staff report, "Overview of Present Law and Economic Analysis Relating to Tax and Savings Incentives for Education," February 12, 2001, JCX–1–01.

We will hear from three panels of witnesses today, but before we do that I would like to now turn the meeting over to Senator Baucus.

OPENING STATEMENT OF HON. MAX BAUCUS, A U.S. SENATOR FROM MONTANA

Senator BAUCUS. Thank you very much, Mr. Chairman. I, first, want to congratulate you on your chairmanship of the first hearing of this Congress. I know I can speak for all of the members of the committee and say we very much look forward to working with you.

I might say, I do believe, for the first time in a good number of years, that we are on the brink of restoring true bipartisanship and cooperation in the Finance Committee that this committee has experienced in so many years past. It is with your chairmanship and our eagerness—certainly mine, and I know others on the Democratic side—to cooperate and work with you.

I think that we are going to see a new day in the Finance Committee, where this committee is going to be working very closely together on a bipartisan basis to develop legislation which is good for this country. I compliment you, Mr. Chairman, on setting that tone.

It is also fitting that our first legislative hearing is about tax incentives for education. We all know across the country how important education is. We are concerned about competitiveness in the world, we are concerned about maintaining America's high standard of living and economic growth, and know that essentially continued growth depends upon education at all levels. I know this is not only true for America, but it is particularly true, Mr. Chairman, in my State of Montana.

I might say, the single most important issue in my State is jobs. It is economic development. Per capita wage income in my State of Montana is the lowest in the Nation; we rank 50th.

It is clear that a key way in the long term to change that and turn that around is to make sure that the Montana education system is a lot better than it now is. It is all right, but it could be a lot better. Certainly the education proposals we are talking about today will benefit my State, as well as every other State, and that is a good thing.

I think the President is on the right track. We clearly do need more resources for education, and we need more accountability for education. Tax incentives, I think, play a very important role. The Code dramatically affects the way families finance higher education.

We know that the vast majority of financial assistance of students in higher education is federal. The HOPE credit and the Lifelong Earning Credit subsidize a significant portion of college tuition costs. Were it not for those programs, many kids just could not go to college today.

I want to particularly thank the leadership of Senator Graham of Florida, and Senator McConnell who is on the panel today, and Senator Sessions. Because of them, an increasing number of families are now saving for college through State-sponsored tuition plans. It is an important piece of the puzzle here.

To state it more constructively, it is a very important part of the foundation, the building blocks of the education foundation. I compliment all of you Senators for helping to make all that happen.

The Code also permits a $500 per year contribution to tax-free education savings accounts for college tuition. Most of these provisions, are we know, were enacted in either 1996 or 1997, and I hope that today's hearing will give us an opportunity to assess those programs.

In addition, I have joined, as the Chairman has mentioned, with the Chairman to introduce two bills. One would permit more graduates to deduct interest on their student loans. Current law limits the deduction to the first 5 years after repayment begins; our bill would eliminate the 5-year cut-off and also expand the income limits so that more taxpayers could benefit.

The other would permanently extend Section 127. That is a provision in the Code which encourages employers to invest in their employees' educational endeavors without increasing taxes on those employees.

Our predecessors, Senators Roth and Moynihan, built a strong base of Senate support for this legislation, and I think this is the year that Congress should make the provision permanent and expand it also to graduate students.

There are some other good ideas on the table from the President, and from others. I am particularly interested in Senator Graham's proposal to give school districts more flexibility to use tax-exempt financing. That is something that Senator Graham has championed in other areas.

Given all these ideas, it is my hope that, as the President's education package moves forward, we can write a tax package which helps American students prepare to meet the educational and occupational challenges of the 21st century.

So, Mr. Chairman, it is going to be a great year, a great 2 years, and I look forward to working with you.

The CHAIRMAN. Thank you, Senator Baucus, for your cooperation.

We have Senator Biden, a senior member at the panel, from Delaware. Then we will hear from Senator Mitch McConnell, the next senior member. He is from Kentucky. Then we will hear from Senator Jeff Sessions from Alabama, then Senator Chuck Schumer from New York, and then a new Senator.

Welcome to the Senate. This may be your first testimony, I do not know, but welcome to Hon. George Allen, the new Senator from the State of Virginia.

Senator Biden?

STATEMENT OF HON. JOSEPH BIDEN, A U.S. SENATOR FROM DELAWARE

Senator BIDEN. Thank you, Mr. Chairman. Thank you very much for the opportunity to come before you and your colleagues today to discuss an issue——

The CHAIRMAN. Senator Biden, you did not hear me say, and I hope it does not create a problem for you. I asked people, because we have eight or nine Senators testifying, if we could have you do it in 3 minutes.

Senator BIDEN. Yes, Mr. Chairman. Thank you very much. I am finished. [Laughter.] Well, then I am going to drop all the part where I compliment you and Senator Baucus about all of the good things that you have done. [Laughter.] And go right to the point that, Mr. Chairman, when I ran in 1972——

Senator BAUCUS. You are in a real trap here, Senator. How do you get out of it?

Senator BIDEN. I certainly am. If you guys want any judges, we will be able to talk. [Laughter.]

In my first campaign in 1972, I ran on three issues. This is one of the issues I ran on. Little did I know, it would take almost 30 years to get to the point where the Congress was seriously considering the idea of the deductibility of tuition.

Senator Schumer and I, in the last Congress, and each of us when he was in the House and in the Senate here for the past 20 years, have introduced various iterations of a tax-deductible proposal that we introduced last year for allowing up to $12,000 of tax deductibility for the cost of college per year.

Too many middle class families, as you know, gentlemen and ladies, are caught between a rock and a hard spot, between getting their kids to a good, or any university for that matter, taking care of their parents' prescription drugs, taking care of long-term care for their parents, and getting, literally, squeezed.

We are in a situation where, Mr. Chairman, that the cost of college tuition has gone up way ahead of inflation, way beyond it. If you want your child to go to a private university in this Nation, you are talking about $30,000 to $35,000 per year. If you want them to go to a public university, you are talking about an average of $7,000 per year, and in most cases $13,000 to $14,000 a year.

Now, how do people make it? How can they possibly make it? Middle income people with good salaries, both wage earners making $60,000, $70,000, $80,000 a year? We get paid very well as U.S. Senators. I know, speaking for myself, I am still paying off $120,000 in student loans, and that is after having paid. That is seven years of Georgetown, Penn, Yale, and Syracuse University, undergraduate and law school.

I have a daughter at Tulane University now. Granted, I could send her to my State university where I went, and I am very proud of that, but even that is $12,000 a year. So people have trouble making it, real trouble making it.

I do not think we should do this incrementally. I think we are beyond the point of incremental change. I will ask unanimous consent that my entire statement be placed in the record, but let me conclude by saying to my colleagues that this is time for some big, bold action. We can afford it now. Let us allow people to deduct up to $12,500 per year—per year—with combined incomes up to over $100,000. It is a big deal. This is a big, big deal.

We are ending up with a two-tiered society again, Mr. Chairman. Probably the greatest equalizer in American history was the GI bill. Irish-Catholic kids like me could go to places like Harvard, Yale, Columbia, and those great schools that none of us were able to get to. I did, and I went to my State university. We made a great effort to make sure that people with middle incomes—now low income, middle income—would be able to make it.

Today, we are going back to a two-tiered system. Somebody who is very well educated, able to get into one of the top 50, or 30, great universities in America, and we know that provides opportunities. It is unfair, but it provides opportunities. I have got a kid that graduating from Yale Law School, a kid graduated from Syracuse Law School.

The kid that graduated from the Syracuse Law School did just as well. The kid who went to Yale, he gets his button punched right off the bat. Any door is open, anyplace, anytime. We are not supposed to say things this open and this crass, but that is the story. That is the real story. People cannot make it. They cannot make it.

So I think that the cost of this, the total cost of the bill, along with Senator Snowe who has a provision in this bill, is a total of about $48 million. Well, all right. Fine. I think we can afford that standing on our head. Standing on our head.

So, I just think we have to make full steps here, Mr. Chairman, not incremental steps, to save a two-tiered system from developing and allow middle class people the opportunity to get what is absolutely essential now, a college degree, and be able to afford it.

I thank my colleagues for their indulgence.

The CHAIRMAN. Thank you, Senator Biden.

[The prepared statement of Senator Biden appears in the appendix.]

The CHAIRMAN. For everybody, including this panel, the second panel, and the third panel, any written statements will be included in whole, so you will not have to ask for permission to do it.

Now, Senator McConnell.

STATEMENT OF HON. MITCH McCONNELL, A U.S. SENATOR FROM KENTUCKY

Senator MCCONNELL. Thank you, Mr. Chairman. Every witness, obviously, will repeat the dramatically increasing cost of tuition at both public and private institutions. We are now dealing with the issue of what to do about it.

Kentucky has been at the forefront of those States offering such plans, and in 1994 I introduced the first legislation to make savings from qualified tuition plans tax-free.

At the same time, families in the Kentucky Education Trust brought several problems to my attention. First, uncertainty about the tax treatment, that these State tuition plans threatened their effectiveness.

In 1996, I was proud to push legislation through the 104th Congress clarifying the plan's tax treatment and allowing the savings to be taxed at the lower rate of the child rather than the higher rate of the parent.

But there were still plenty of problems. We were troubled to learn that the IRS prevented families from using State tuition plans to pay room and board costs, which are often as much as one-half of the cost of college. In the 1997 Taxpayer Relief Act, I helped include a change allowing State tuition plans to pay for room and board expenses.

Finally, we are all upset that these hard-earned savings were being taxed at all. I believe the time has come to finish the work begun back in 1994 and make disbursements from these tax plans tax-free.

To meet this goal, on the floor of the Senate today I will be introducing the Setting Aside for Valuable Education, or SAVE Act. Most importantly, the SAVE Act will finish what I hope to start back in 1994, by making savings from qualified tuition plans tax-free.

The SAVE Act builds upon the Senate's work in the 107th Congress by allowing private institutions to establish their own tuition programs, while maintaining important consumer protections.

Finally, the SAVE Act modifies the cap on room and board expenses to more accurately reflect the costs of attending an institution of higher education.

Mr. Chairman, I am pleased that my legislation enjoys the endorsement of the National Association of State Treasurers, as well as the College Savings Plans Network. I look forward to working with them, and obviously with all of you here on this committee, to ensure that our children can obtain higher education without mortgaging their futures.

I would like, Mr. Chairman, for you to note that I actually finished in under three minutes. [Laughter.]

The CHAIRMAN. All right. That will win you the support of the public, but not your colleagues.

[The prepared statement of Senator McConnell appears in the appendix.]

The CHAIRMAN. Senator Sessions?

STATEMENT OF HON. JEFF SESSIONS, A U.S. SENATOR FROM ALABAMA

Senator SESSIONS. Thank you, Mr. Chairman.

Briefly, the legislation that I am proposing, along with Senator Bob Graham, the Class Act, is designed to do much the same thing that Mitch's legislation does, and very little differences, frankly, of real significance.

In the last 10 years, college students and their families have incurred more debt than the previous three decades combined. One of the reasons for that, is we are subsidizing students in their borrowing, but we are taxing families who have the wisdom and the frugality to save in advance to pay for their college education.

I think good public policy should encourage the highest, best policies, which would be to save where possible. We are finding that, under the State plans that Mitch mentioned, thousands of Americans are taking advantage of it.

In fact, I will run down some numbers that indicate just how many are using these plans. Forty-eight States now have prepaid college or tuition savings plans. Alabama was one of the first States to establish such a plan; nearly 50,000 Alabamians are currently enrolled in a pre-paid college plan in the State.

Eighteen thousand children are enrolled in the Iowa plan, Mr. Chairman, your State; 2,500 are in Montana, 13,000 Alaska, 100,000 in Texas, 7,000 in Virginia, 38,000 in Maine, and others. The list is growing and more parents are signing up for this.

So I think it is important to note also that these are middle-income families taking advantage of it. For example, 71 percent of the 600,000 participating families in the Florida prepaid college program have annual incomes of less than $50,000. In 1996, families with an annual income of less than $35,000 purchased 62 percent of the prepaid college tuition contracts in Pennsylvania.

In Kentucky, the average contribution in 1995 was $43 a month. This is the kind of thing that I believe goes directly toward helping families, middle income families, afford college education. One of the most important things I believe we need to signal, is that we affirm those programs.

What we ought to also signal to them and to their financial advisors, is by making the interest growth income that accrue to these plans tax-free, we can make the program such that any financial advisor, I think, would be quick to advise a family to take advantage of these prepaid plans.

As you know, many of them allow students to lock in the price of college tuition at today's rate and avoid the increased rates in the future. So Senator Graham and I are very pleased to support this legislation.

I am also pleased that we have co-sponsors, including Senator Breaux and Senator Gramm of Texas, Senators Murkowski, and Bingaman who have supported this legislation.

I think it is the right step. The time has come. We need to do it this year. President Bush did have it in his campaign commitment, Mr. Chairman, last year. It is on his Web site. We would like to see it as part of this tax package.

Thank you very much.

The CHAIRMAN. Thank you, Senator Sessions.

[The prepared statement of Senator Sessions appears in the appendix.]

The CHAIRMAN. Now, Senator Schumer.

STATEMENT OF HON. CHARLES SCHUMER, A U.S. SENATOR FROM NEW YORK

Senator SCHUMER. Thank you, Mr. Chairman. I thank you, Senator Baucus, and the members of this distinguished committee.

I would just like to make a few quick points. First, college has become much more of a necessity than it ever has been before. The old situation where job after job after job was passed down from generation to generation is gone, and every parent knows that the livelihood, the happiness even oftentimes of their children, depends on being able to go to the best college that student deserves to go to.

Second, it is indisputable that tuition costs are rising through the roof. In fact, tuition has risen more than any other cost since 1980, even more than health care. In 1980, the cost of tuition—not including room and board, just tuition—at a typical 4-year private college was $3,600; it is now $16,300. Public education went from $800 a year to $3,500. That is without room and board.

Student debt loads are surging. In my State, student debt loads have gone up 50 percent, and that does not include credit card debt. One million college students have credit card balances exceeding $7,000, and that is mostly from tuition.

So to deal with this problem, it is a family imperative, it is an American imperative. Family, because families cannot afford it. We have to do something, Mr. Chairman.

The poorest of families get all kinds of help. They should, I believe in it. The wealthiest of families can afford tuition. But the people making $40,000, $50,000, $60,000, $70,000 a year cannot, and that is the heart of which the bill that we are talking about today is aimed at. So, I have introduced this bill, along with my colleagues, in alphabetical order: Senators Bayh and Biden, Gordon Smith, and Senator Snowe on this committee.

Our bill is simple. It would make up to $12,000 per year in college tuition tax deductible for anyone in the 28th percent bracket or less; it goes up to people making $105,000.

It would also add the interest tax credit, of which Senator Snowe has been a long-time champion of up to $1,500 to offset the cost of student loan repayments. It gives taxpayers in the 28th percent bracket a maximum benefit of $3,360 per year.

This legislation, Mr. Chairman, was passed by the Senate 53 to 47 in 1999. It did not have the 60 votes it needed. I think its popularity has increased and I think any tax package that includes this kind of proposal would be received even more popularly by the American people.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Schumer.

[The prepared statement of Senator Schumer appears in the appendix.]

The CHAIRMAN. Now, Senator Allen.

STATEMENT OF HON. GEORGE ALLEN, A U.S. SENATOR FROM VIRGINIA

Senator ALLEN. Thank you, Mr. Chairman and members of the committee. Thank you for having this hearing on a very important subject.

I will incorporate by reference your opening remarks, for which I am in complete agreement as to the essential nature of education and knowledge for the future.

The bill that I am going to be introducing we call the Education Opportunity Tax Credit. While the other Senators' bills focused on higher education, this is focused on K–12.

It is essential that, before a child gets to college, that they have learned the academic basics of English, math, science, history, and economics, as well as being technologically proficient.

Now, we know in education the Federal Government's role is to help. It is important to have more teachers so our children get more individualized attention. School construction is important. Teachers, schools, administrators, are all important. Also important, are parents. This is what this measure focuses on, and that is empowering parents.

The Education Opportunity Tax Credit increases education spending. The spending, though, is determined by the parents who know their children's special needs, and their names.

It also reduces the tax burden, most significantly for lower and middle income families. Fourth, it helps reduce the digital divide, enabling more families to purchase computers, educational software, or tutoring for their children. The $1,000 tax credit could not be used for tuition, it would have to be an education expense.

Now, it is capped at $2,000 per year. It is $1,000 per child. They could use it for a variety of things. But if you look at the way families have faced, especially those who, say, have about $39,000 of income, once they pay State, local, Federal taxes, housing, clothing, food, medical care and transportation, for the average family, they have about $2,178 of real disposable income.

That is before you start paying for little league or various school supplies. The average school supplies are about $150 a year, which really leaves very little for someone to buy a Gateway computer, or Canon, or Hewlitt Packard printer, or get Internet access.

So when you look at these costs, which really would be well over $1,000, about $1,500 a year, I think we can make great strides in eliminating the digital divide in providing families so they could have a computer at home. It is important to have computers and connectivity at schools and libraries, of course, but a lot of research, a lot of work goes on at home.

It seems to me that this is just a great idea and a way to make sure there is access to quality technology for economically disadvantaged children that are placed at an early and distinct disadvantage in the classroom, and later in the workforce.

Now, I ran on this issue, Mr. Chairman and members of the committee. This was thoroughly vetted in our campaign, and people liked it, no matter their race, their region, or their political affiliation.

So, I hope that this committee will look at ways of empowering parents to make those spending decisions that are particularly helpful for parents who have children with learning disabilities, where there are software programs that will go at the pace of that child.

I look forward to working with the Chairman and members of this committee to increase education spending, empowering parents while also reducing taxes as we provide them with the opportunities to provide technological advancements for their children so they can compete and succeed and lead fulfilling lives.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Allen.

[The prepared statement of Senator Allen appears in the appendix.]

The CHAIRMAN. I do not know whether members will have questions, but I would ask, in this order: Senator Baucus, Senator Lincoln, Senator Snowe, Senator Murkowski.

Thank you, Senator Allen.

I will call the second panel, now. We have Senator Tim Hutchinson of Arkansas, my colleague from Iowa, Senator Tom Harkin, and Senator Susan Collins of Maine.

I think we will do it in the order of seniority, so that means Senator Harkin will go first, then I will let you guys flip a coin. [Laughter.]

Senator Harkin?

STATEMENT OF HON. TOM HARKIN, A U.S. SENATOR FROM IOWA

Senator HARKIN. I borrowed a chart from Kent Conrad.

Chairman Grassley, Senator Baucus, and others, thank you for providing this opportunity, for having this hearing on education tax and savings incentives. There is obviously no more important issue than the future of education in our country.

In 1998, Mr. Chairman, the American Society of Civil Engineers, which is decidedly not a political organization, issued a report card on America's infrastructure, the roads, the bridges, the mass transit, drinking water, waste water, all those things.

As you will see by the report card, the only one to get an "F" was our Nation's schools. The only one to receive a failing grade was our Nation's schools. It is a national disgrace that the nicest places our kids see are shopping malls, movie theaters, and sports arenas, and some of the most run-down places they see are our schools. What kind of a signal does that send to them?

Modernizing and repairing the schools is something that I have been advocating for over a decade now. In 1995, I secured $100 million in the appropriations bill as a down payment on this, and then it was rescinded.

Last year we made some progress. We got $1 billion in the appropriations bill to make emergency repairs. That was a bipartisan effort by Congressman Goodling on the House side, Senator Specter and I on the Senate side, and the White House.

Last year, Senator Robb and I offered legislation to provide tax credits for school construction projects, and this was a companion bill to one in the House by Representatives Nancy Johnson and Charles Rangel on the House side.

We are going to reintroduce that again this year. We call it America's Better Classrooms Act. It would leverage $1.7 billion in tax credits over 5 years to pay the interest on $25 billion in school modernization bonds. As I said, we will be introducing that right when we get back from the President's Day recess.

Now, Mr. Chairman, I know and you know that this will work. It mirrors a successful program, I tell members of the committee, that we started in Iowa in 1997. The Iowa demonstration is a two-pronged response: first, we provide grants to local school districts to make urgent repairs to remedy fire code violations; second, grants were made to local school districts to subsidize a portion of the costs for a new construction program.

It has been a big success. During the first two years, Federal funds of $14.7 million supported projects totaling $142 million. Each Federal dollar leveraged $10.33. So, I believe there is a legitimate Federal role in helping fix our Nation's crumbling schools.

Using most of the debate you get on the Federal role in education has to do with local control versus Federal control. That has been an ongoing debate in our society for a long time. That does not rear its head when you talk about just getting help out to schools to rebuild schools and fix fire code violations.

You leave all of that up to local control. They hire the local people. It has nothing to do with content, with what they are teaching, how they are teaching, or anything like that. So, I believe this is really a legitimate place for the Federal Government to be involved.

We should depoliticize it. I see no reason why it should be political. It ought to be bipartisan. If we can do this—as I said, we have done this in Iowa—and I am hopeful that we can work together to craft a bill that includes school modernization tax credit bonds to underwrite $25 billion in new school construction projects.

The GAO, Mr. Chairman, and I will close on this, estimated two or 3 years ago it would take about $112 billion to repair all of the schools; it is now up to $127 billion, if I am not mistaken.

I think this is one way that we could use the Tax Code to get out and really leverage a lot of Federal dollars around the country, because we have done it in Iowa and it has been very successful.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Harkin.

[The prepared statement of Senator Harkin appears in the appendix.]

The CHAIRMAN. Now, Senator Collins.

STATEMENT OF HON. SUSAN COLLINS, A U.S. SENATOR FROM MAINE

Senator COLLINS. Thank you very much, Mr. Chairman. I want to thank you and the members of the committee for focusing this morning on proposals to provide tax relief to assist our Nation's students and teachers.

I am particularly pleased that you have chosen as one of the bills that you are looking at legislation I introduced, along with my good friends Senator Kyl and Senator Landreu, the Teachers Support Act of 2001.

Our bill has two major provisions. First, it would allow teachers and teachers aides to take an above-the-line deduction for their professional development expenses. Second, the bill would grant educators a tax credit of up to $100 for books, supplies, and equipment that they purchase for their students.

According to a study by the National Education Association, the average public school teacher spends more than $400 annually out of their own pockets buying supplies for their classrooms. This sacrifice is typical of the dedication of so many of our teachers to their students.

While our bill provides financial assistance to educators, its ultimate beneficiaries will be their students. Other than involved parents, a well-qualified teacher is the most important prerequisite for student success.

Educational researchers have demonstrated time and again the close relationship between qualified educators and successful students. Moreover, educators themselves understand how important professional development is to maintaining and extending their levels of confidence.

When I meet with teachers from Maine, Mr. Chairman, they repeatedly tell me of their need for more professional development, as well as the scarcity of federal, or any kind of financial support for this worthy pursuit. As President Bush has put it, teachers sometimes lead with their hearts and pay with their wallets.

I greatly admire the many teachers who have voluntarily financed additional educational to improve their skills and to serve their teachers better, as well as those who purchase books, supplies, equipment, and other materials that enhance their teaching.

I hope that these changes in our Tax Code will encourage educators to continue to take formal course work in the subject matter that they teach and to attend conferences to give them new ideas for presenting course work in a challenging manner. This legislation will reimburse educators for a small part of what they invest in our children's future.

I would ask, Mr. Chairman, that in the interest of time that my full statement, as well as the letter of endorsement from the National Education Association, be included in the hearing record.

Thank you very much for the invitation to testify today, and I hope that the committee will look favorably upon this bipartisan legislation. Thank you.

The CHAIRMAN. Thank you.

Let me assure every panelist that your full statement will be included in the record.

[The prepared statement of Senator Collins along with the letter of Ms. Teasley appear in the appendix.]

The CHAIRMAN. Now, Senator Hutchinson.

STATEMENT OF HON. TIM HUTCHINSON, A U.S. SENATOR FROM ARKANSAS

Senator HUTCHINSON. Thank you, Mr. Chairman. I appreciate the opportunity to appear before the committee, and I do have a full statement.

I will just speak briefly about education savings accounts. I am pleased to have introduced an expansion of education savings accounts. We are calling it the Coverdell Education Savings Accounts, after our dear colleague who championed this cause for so many years. I am co-sponsoring it with Senator Torricelli, who has also been a very courageous champion of education savings accounts.

Back in 1997, we created these education IRAs but we limited it to $500 per year on contributions and we limited it to higher education expenses. What this bill would do, is to expand that to $2,000 per year on contributions.

It would make the education uses of it broader for elementary and secondary as well and, most significantly, would allow third party contributions so that an employer, a labor union, or a charitable institution, other third parties, grandparents, could contribute to these education savings accounts, making the argument that it does not benefit poor people really moot, I think.

I could sure envision companies like Wal-Mart or labor unions who negotiate this as part of their benefits, so that you really have an enormous, enormous source of new funding for education.

Now, some would say this is only going to benefit those at the middle and upper income. Studies indicate that 70 percent of these education savings accounts would go to people with incomes of less than $75,000 a year. I want to assure the committee that this is in no way a disguised kind of voucher. The President has advocated a kind of portability, or what some have called vouchers in his education plan. This avoids that whole controversy.

We are going to have a good, healthy debate on that. Senator Collins and I disagree on that issue, but I think this is something that she and I can agree on, and everybody on this committee can agree on, because you are not using any public money.

These are private monies, after-tax monies that go into savings accounts, the interest of which would be tax-free when pulled out, if used for the appropriate educational expense.

Senator Lincoln, my colleague from Arkansas, we know there are many areas in Arkansas where parents may not have a public school choice or a private school choice, but they sure are going to have the opportunity to use these kinds of accounts for distance learning, computers, tutorial help. So, it is really going to enhance what we all believe in, which is parental control in the area of education.

We passed this in the Senate, we passed it in the House. It was vetoed last time by President Clinton. This has the support of President Bush. He has included it.

In fact, he would like it to go to $5,000 per year on the contributions; that would be fine with me. We have introduced the more modest $2,000 per year education savings account, and I hope the committee will look favorably upon this legislation this year.

We will pass it again as we have in the past. This year we will have a President who will sign it. It will be a great tribute to a great colleague, Senator Paul Coverdell.

[The prepared statement of Senator Hutchinson appears in the appendix.]

The CHAIRMAN. Thank you very much. We have just had three good testimonies. Does anyone want to ask questions, in this order: Senator Baucus, Senator Breaux. Wait. Senator Lincoln, you were here first, then Senator Breaux.

Senator BREAUX. Thank you for your testimony. I support the concept of tax credits for education. We had a couple of meetings with the President, and I asked my Republican colleagues this in particular. He has outlined his tax plan that he is sending to the Congress, and it does not include this.

The campaign did, but the bill that we are going to be getting in the Congress has across-the-board rate reductions, it has a marriage penalty, has estate tax, has charitable contributions, has a child credit, and it has R&D extension, but there is no place in there for an education tax credit. So, I am going to be preparing a letter to him suggesting that we do this. What should my letter say?

Senator HUTCHINSON. Well, Senator Breaux, I think the point is, the cost on this, as was estimated last year, is $3.5 billion per year, with an estimated return of $12 billion in education.

Senator BREAUX. I understand the merits. The problem is, it is not in the bill the President has sent us.

Senator HUTCHINSON. I think what I am going to ask him, and I hope you will ask him also, is that he will put this in the mix. I know there is going to be a lot of competition. After we get beyond the across-the-board rate reduction, there will be a lot of competition on where the rest of those tax cuts come. I think this should be part of it. He supported the idea, and I think we need that commitment from President Bush. I hope he will give it to us.

Senator BREAUX. How does my colleague, Senator Collins, handle this?

Senator COLLINS. I would say to the Senator from Louisiana that I believe that the President is on record in favor of the concept, as you have said, and that he welcomes Congressional input in shaping the tax bill. It is not chiseled in stone.

There are certain principles that he has set forth that he wants to see in any final package, but I think he is very open to suggestions from Congress on how we can shape the package, based on a discussion I had with him just this week.

Senator BREAUX. All right. I really hope the other side of Pennsylvania Avenue hears these two good Republican colleagues with their statements today, because when I have been down to the White House it has been, here is my tax package, it is $1.6 trillion, and it is not going to be a nickel more of that, here is what I want it to cover, this is what it should cover, and do not mess with it.

I have tried to say, look, for the last 2 years we in the Congress have always said my way or no way, and no way always wins. So, there has got to be some compromise and some input in coming up with a tax bill of that magnitude.

Here we have Republican Senators, who I thank them very much, I am right on with what they are recommending, but saying to the President and to the Congress, we have got to work within this framework and come up with some ideas that make sense.

If we are going to spend $1.6 trillion, we are not just going to rubber stamp what they have said, no more than they should rubber stamp what we have said. So, it is a cooperative effort and I appreciate your coming out with this. Thanks.

Senator BAUCUS. Mr. Chairman, if I might just comment.

The CHAIRMAN. Yes.

Senator BAUCUS. I think the Senator has raised an excellent point, and I think everyone in this room knows that it is an excellent point. For example, Secretary O'Neill yesterday said he has $1.6 trillion, and we will get not a penny more or less than $1.6 trillion. Clearly, we have a great need here to stimulate education, savings, et cetera. I do not know how we accommodate both, namely, not a penny more or penny less than $1.6 trillion, yet also the education proposals that we all know are so meritorious.

There will be many others that are very meritorious, health insurance, for example, which I am sure both Senators have a lot of interest in, as well as prescription drug benefits. There is just a whole list of issues that are very, very important and I do not know how we are going to fit those in with the President's proposal.

So, I just urge all of us to follow up on the initial warm words of cooperation on both sides and walk the talk. The rubber is starting to meet the road here, and we all want to work this out together. There is just no doubt about it. I know the Chairman does, and I know many others do.

I just hope that all of us can sit down and reason together how we are going to meet all these various needs. I appreciate the Senator from Louisiana bringing out this point, because it is a fundamental point we are all going to have to grapple with and work with.

Senator COLLINS. I have great confidence in the members of this committee to work with the White House to forge a bill that all of us will find to be exactly what is needed for our Nation.

Senator BAUCUS. That is exactly what I want to hear. Thank you.

The CHAIRMAN. Now, in this order, do Senators Lincoln, Snowe, Murkowski, or Torricelli have questions they want to ask or comments they want to make?

Senator MURKOWSKI. I have a question for Senator Hutchinson. Most of the conversation has been on reducing the cost of higher education, but I think, equally as important, is enabling parents to send children to safe, effective elementary schools and secondary schools. I support the idea of expanding the educational IRA contribution levels, and certainly allowing withdrawals for K–12 expenses.

But I wonder whether early withdrawals for K–12 will really enable parents to send their children to the schools of their choice, and what role, if any, is there for tuition tax credits to help parents pay for K–12 expenses?

Senator HUTCHINSON. First of all, and I am glad Senator Torricelli has arrived so he can assist me if I do not answer correctly, because he has been fighting this fight much longer than I have.

Senator MURKOWSKI. Well, I will ask him.

Senator HUTCHINSON. If a family donated $2,000 every year starting at birth, with a 7.5 percent rate of return, they would have $18,000 in earnings by first grade, and $58,000 by the time they entered high school, and $80,000 by the time they entered college. So if we are talking about whether it is going to be a significant enough amount to give options to parents, I think the answer is yes. Did you ask about vouchers?

Senator MURKOWSKI. What role, if any, do tuition tax credits play?

Senator HUTCHINSON. As I said, what the President has proposed on the portability of Title I funds, I support, but it is going to be very controversial, as we all know, and there are going to be differences of opinion on it. This is something on which pro and anti forces can agree, because you are not taking public money and putting it into private schools.

Senator MURKOWSKI. To follow up just very briefly, it is pretty clear what tuition tax credits are. Has there been any thought to the convertability of vouchers for the same purpose?

Senator HUTCHINSON. Yes, I think there is a great deal of thought. There are a lot of people that think the tax credit is a preferable way to go to the vouchers. This is me, but I am for as many options as we can give parents and finding as many tools to provide them those kinds of choices.

I think the President sets the agenda, to a great extent, and he set the agenda on the Title I funds, which we have clearly got jurisdiction over in providing portability there, and I think that is worth trying. Tax credits may be something we look at further down the road.

Senator MURKOWSKI. A last observation, before Senator Collins leaves. From Maine and Alaska, we are more rural than you are, so the idea of having a choice is fairly unrealistic. In most places, there is not a choice, you have got one school and that is it.

Senator COLLINS. Right.

Senator MURKOWSKI. What do you suggest we do relative to that hard, cold fact that the matter of choice, while it sounds great in urban parts of the country, in rural it just does not work?

Senator COLLINS. You are right.

Senator MURKOWSKI. You have home schooling, you have other alternatives. Go ahead.

Senator COLLINS. You are right. In the State of Maine, there is just one school in many of the communities in our State. But the reason that I support the approach outlined by Senator Hutchinson, is that that money could be used to buy a computer, it could be used for tutoring, it could be used for an enrichment course that might be offered privately in the community.

So, I do not see it as a means of helping parents to afford a private school K–12, I see it as a way to let them use their own money to enrich the education of their children in a lot of different ways. It might pay for a school trip, for example. So, I think that it is worthy for that reason.

I would ask, since I do have to preside, that I be allowed to leave, Mr. Chairman, as much as I would like to continue this exchange.

The CHAIRMAN. You may leave.

Senator MURKOWSKI. Maybe it would apply for a school trip to Anwar or something.

Senator COLLINS. It always comes back to Anwar.

Senator MURKOWSKI. I did not notice that.

Senator COLLINS. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Lincoln?

Senator LINCOLN. Thank you, Mr. Chairman.

I just have one question. Does this include post-age 18 special needs children?

Senator HUTCHINSON. That would be an eligible education expense.

Senator LINCOLN. But was it not post-18, after they were 18 you could still contribute?

Senator HUTCHINSON. This expands that to elementary and secondary schools, so the uses of this would be expanded to not just higher education, but elementary and secondary, and I tried to emphasize this, would allow third party contributions to those education IRAs, which really opens a whole new opportunity for infusing funds into education.

Senator LINCOLN. But my question was, did it include post-age 18 contributions for special needs children?

Senator HUTCHINSON. Yes. Am I correct, Senator Torricelli?

Senator TORRICELLI. Actually, post-18 is available for all children, because you could roll these into another account after you are 18. For special needs, you could use this for college education, roll it into the accounts that President Clinton established.

The CHAIRMAN. All right. Any further questions? Thank you, Senator Harkin. I am sorry.

Senator Torricelli?

OPENING STATEMENT OF HON. ROBEERT G. TORRICELLI, A U.S. SENATOR FROM NEW JERSEY

Senator TORRICELLI. Having fought this battle for so many years with Senator Coverdell, I am very proud Senator Hutchinson has now taken the leadership role. We have suggested to the Senate that, indeed, if these were to be enacted, that these be Coverdell accounts.

Senator Coverdell worked for so long and believed so strongly in the establishment of these accounts. While this has been discussed at length, I simply wanted to bring before the committee, at some point in this Senate there is going to be a collision of philosophy on the question of vouchers, and it may be inevitable.

But the advantage of educational savings accounts, it allows those of us who oppose vouchers to make clear that we are establishing for families a constitutional vehicle that they can use their own money to support ancillary activities in the public schools, or private schools' tuition.

Those of you who do support vouchers and may not succeed, you can still say to the private school community that we did something that eases this burden. The numbers are overwhelming. For a very modest loss of Federal revenue, we are bringing $12 billion into the educational system of the country, and ironically, overwhelmingly to the public schools.

Seventy-five percent of this money would end up being used for after-school activities in the public schools, for hiring of public school teachers as tutors, and the remainder to help with these tuitions.

I know that it does not appear to be an enormous amount of money in an individual account, but as Senator Hutchinson pointed out, over a period of a lifetime it accumulates to $18,000.

The average kid going to a Catholic school in Newark today—which, by the way, are 75 percent minority students, 70 percent Protestant—is $1,800. It pays their way. It gets them there.

For some working-class family, their kid is going to public school, it may not be an enormous amount of money, but it pays for a science tutor after school to help the kid with their lessons. So, there is a reason why this Congress, both Houses, over 60 Senators, voted for this in the last Senate, and why I think they will do so again.

I am very excited about offering it, very mindful of what Senator Baucus and Senator Breaux have said, that clearly there is a $1.6 trillion limit, appropriately, from the White House. But, indeed, this amounts to a rounding error, and the benefits are so enormous that I hope we find our way to include it in the package.

Now, I know under the rules any statement has to end with a question. So, Senator Hutchinson, is not everything I said correct? [Laughter.]

Senator HUTCHINSON. I endorse it with enthusiasm.

The CHAIRMAN. Thank you, Senator Torricelli, thank you Senator Harkin, thank you Senator Hutchinson.

Now we will have our third, and final, panel. We are going to hear from Kimberly Sheppard. She is from my State of Iowa, attending the dental school at the University of Iowa. She is going to do post-graduate work, specializing in periodontics.

The average graduate student school debt—just the graduate school debt, not the undergraduate—is $100,000 for a dental student. When we consider that it costs between $125,000 and $250,000 to set up a dental practice, you can see how staggering education debt can really be.

Then we are going to hear from Tom Carter, a 23-year veteran of the teaching profession, social studies teacher, West Liberty High School, in the State of Iowa, West Liberty.

Mr. Carter has spent hundreds of dollars on school supplies for his students. Some of these supplies include books, CD-roms, supplies for class projects. His story is not unlike that that we have heard from Senators introducing legislation.

Our goal is to ease this burden by allowing tax credits, like Senators Collins and Senator Kyl proposed. The President has also proposed allowing a $400 tax deduction for out-of-pocket expenses for supplies.

After Mr. Carter will come David Pearlman, vice president and associate general counsel, Fidelity Investments. He will testify to the success of college savings plans being set up in so many States. He helped establish and operate the college savings plan for New Hampshire that was one of the first in the country. He will also discuss the need to expand education IRAs.

The next person will be Janet Parker, senior vice president for Employee and Corporation Relations, Amsouth Bank. Her testimony will focus on employer-provided education assistance, the Section 127 provisions.

Finally, from Steven Maguire, a policy analyst for the Congressional Research Service, Public Finance Division. His testimony will focus on the funding operations and options for construction and maintaining of school facilities.

I think I will do it in the order that I suggested, just from my right to my left. Go ahead.

STATEMENT OF KIMBERLY SHEPPARD, DENTAL STUDENT, UNIVERSITY OF IOWA, KALONA, IA

Ms. SHEPPARD. Good morning, Mr. Chairman and members of the committee. My name is Kimberly Sheppard. I am a fourth-year dental student at the University of Iowa's College of Dentistry, and I plan on graduating on June 8th of this year.

I have been a resident in the State of Iowa almost my entire life, and I am very pleased to be here this morning to express my strong support for significantly enhancing the student loan interest deduction.

To that end, I would like to thank my Senator, Senator Grassley, and the Ranking Member, Senator Baucus, for introducing S. 152. This bill represents a substantial improvement over the current law as it stands.

I received my Bachelor of Science degree from the University of Iowa in 1993. While I was working towards this degree, I held several part-time jobs, most of them being at the University of Iowa's hospitals and clinics, where I became quite exposed to various forms of health care delivery.

It was at this time that I decided I wanted to pursue a career in helping others. Even though I held part-time jobs, by the time I graduated I accumulated a student loan debt of approximately $10,000.

Shortly after graduation, I married and moved to Cincinnati so my husband could work towards his master's degree. After he finished this, we chose to move back to Iowa so that I could be closer to my family and so that I could pursue my education in dentistry.

We chose to settle in Kalona, Iowa, a small town in the southeastern part of the State. While my husband worked, I pursued a second degree in biology. By the time I finished this degree in 1996, I had accumulated an additional debt of $10,000.

While I was waiting for my application to the College of Dentistry to be processed, we moved to Cedar Rapids, Iowa so that we could be closer to my husband's place of employment, and the cost of living there is substantially less compared to Iowa City, where the university is located.

I started dental school in 1997 and, due to the intensity of the curriculum, I, like most of my colleagues, was unable to hold jobs while in school. I was fortunate, and I received two research grants and some various small scholarships. For a short period of time I tutored pharmacology, which is a required course in the dental school curriculum.

The cost of attending the University of Iowa for the first year for tuition is $23,000 for an in-State resident. The student loans that I received during this time, I used only for those purposes. I was fortunate my husband worked for the first 3 years that I was in dental school, but now is a full-time student at the University of Iowa's College of Law.

When I graduate on June 8th, I will have accumulated a student loan debt of $90,000. I have been accepted into an advanced degree training program in the Department of Periodontics at the University of Iowa.

It is a 3-year program. The tuition, excluding expenses and all, is about $5,000. There is a stipend that they offer, and it is approximately $12,000. However, I feel that I will need to take out additional loans to live.

My husband and I plan on finishing our education in 2004, when we will then seek employment. At that time, our combined debt will be approximately $170,000. All else being equal, I would really like to stay in the State of Iowa. That is where I am from, that is where my family is, and I am very familiar with the State. However, I feel that our debt is going to prohibit us from doing that.

What I wish Congress could do, is help ease the burden of student loan repayment so that professionals like myself and my husband have the opportunity to stay in small parts of America rather than practicing in large cities.

I appreciate you bringing attention to this matter and giving me the opportunity to testify. Thank you.

The CHAIRMAN. Thank you, Kimberly.

[The prepared statement of Ms. Sheppard appears in the appendix.]

The CHAIRMAN. Now, Mr. Carter?

STATEMENT OF TOM CARTER, SOCIAL STUDIES TEACHER, WEST LIBERTY HIGH SCHOOL, WEST LIBERTY, IA

Mr. CARTER. Good morning. My name is Tom Carter, and I have taught and coached in the West Liberty school district in East Central Iowa for 23 years.

My subject areas are Economics and Global Issues. I have coached football, basketball, baseball, and golf. I want to say at the very outset that I love teaching and I love my students. I chose my career because I want to help students the way my teachers and coaches helped me. I hope I have been successful.

I am not here today to complain, nor will I portray the role of a martyr. I am here to educate you about out-of-pocket expenses incurred by educators and why I feel you should help us in this area.

Simply put, teachers are being asked to do more with less in our society. While the world has become far more complex with growing population, increasing economic development, and a huge information technological boom, public schools have cut budgets for teachers for textbooks, supplies, and materials.

In my school, the budget teachers have for supplies is $100 per year. One only needs to examine our catalogue for a few moments to know that this is woefully inadequate.

My subject area is on rotation for new textbooks with other disciplines. Only recently did I get a textbook for my Global Issues class that does not have maps of the Soviet Union and does not address the implications of the Berlin Wall for world peace.

Two weeks ago, our superintendent sent us a memo that we must cut $250,000 from our already decimated budget next year. This will result in a loss of teaching positions and a decrease in supplies. Once again, I will be asked to do more with less.

Most people do not understand the requisition process and why it can result in out-of-pocket expenses for teachers. Teachers requisition items, first, to their building principals, then to superintendents. If a request is denied, teachers can plead their case. If rejected again, we must decide if that resource is important enough to pay for ourselves.

Often, requisitions are denied because administrators do not understand why items are important. This is not an assessment of blame, but rather an explanation of the process. Teachers are trying to serve their students, while superintendents must balance many needs with scarce resources.

A quick story will illustrate the point. Greg Guinn, West Liberty's athletic director of 33 years and a man that I call my mentor, told me the following story Monday night. He had received many new computers in his business classroom. Of course, one of the by-products of computers is heat. His classroom quickly became hot, well over 80, even 90 degrees.

He requisitioned a cooling unit for his classroom, which was rejected. In our building, built in 1916, climate is controlled by opening the windows. Senator Grassley can tell you that this is dangerous in Iowa, as the weather changes every 10 minutes. An unforeseen problem occurred when bees attacked students in the fall; in fact, I was stung three times.

Mr. Guinn decided that, for health and education purposes, he would purchase an air conditioner for his room. He spent $537 on a Whirlpool air conditioner from his own salary. Because of scarce resources and different perspectives on needs, teachers and administrators often struggle with this issue.

Hence, I am often placed in the untenable position on a daily basis of either providing for my students or finding funds elsewhere. Often, elsewhere means out of my own pocket.

In the past year, as Senator Grassley said, I have purchased materials in the amount of $500. On Monday, I e-mailed my colleagues, asking them two questions: what was the largest out-of-pocket expense they had incurred in their career, and what was the average? The largest was $100 to $1,500, and the average, as was stated by a previous Senator, was about $400 per year.

Elementary teachers spend hundreds of dollars every year on construction paper, glue, crayons, markers, and so on, while junior high and high school teachers buy supplementary materials.

In my subject area, social studies, it is necessary to purchases these because the world changes every day. Textbooks are often outdated in a year, or even six months. Maps change every year. The amount of information on the Internet doubles every 6 months.

In order to keep up with the rapid change in the world I must purchase supplementary materials, otherwise my curriculum is quickly made irrelevant.

Science teachers as well must purchase materials, as science discovers new things every day. I am faced, then, with a dilemma. Do I buy supplementary materials out of my own pocket, or provide an inferior education? In most cases, I do the former, I buy them out of my pocket.

I feel that it is important at this juncture to note that nearly one-third of Iowa's teachers will be retiring in the next 10 years. According to the Des Moines Register, 28 percent of Iowa's teachers quit after only 3 years in our profession; 17 percent quit after the first year.

Recently, I asked a group of talented seniors how many were considering teaching as a profession. After a brief bout of snickering, none was affirmative. When I asked why not, the reply was unanimous: why would I want to enter a low-paying career filled with so much frustration?

The bell rang. I have less than a minute left, is that all right?

The CHAIRMAN. Finish out your thoughts.

Mr. CARTER. Sure. The bill you are discussing today is part of a larger question: what is the future of education in America in this millennium? Who is going to teach our children?

Why should a person enter the teaching profession when they must pay out of their own pocket, making $23,000 per year? It is simply not reasonable to expect me to impart a new millennium education with a budget created in the 1980's. This paradigm will not work.

The message I hope that you can send us today from Congress is simple, that you appreciate our efforts, that you will give us the only reward that I feel teachers really want, and that is, a thank-you for our efforts.

It has been an honor and privilege today. I thank you for my remarks. I only ask you to help me to do one thing. Remove the label, America: A Nation at Risk, and replace it with America: Number One in the World.

The CHAIRMAN. We thank you for your testimony, but I also thank you for your service to the people of your district.

[The prepared statement of Mr. Carter appears in the appendix.]

The CHAIRMAN. Ms. Parker?

STATEMENT OF JANET PARKER, SENIOR VICE PRESIDENT FOR EMPLOYEE AND CORPORATE RELATIONS, AMSOUTH BANK, BIRMINGHAM, AL

Ms. PARKER. Good morning, Mr. Chairman and members of the committee. My name is Janet Parker, and I am the senior vice president of Employee Relations for Amsouth Bank.

Amsouth is a regional bank holding company headquartered in Birmingham, Alabama. Amsouth was established approximately 120 years ago and has since grown to operate in Alabama, Tennessee, Florida, Georgia, Mississippi, and Louisiana. We are a leader among regional banks in the southeast, and the 20th largest financial institution in the country.

I am also on the national board of directors of the Society for Human Resource Management. I am here today on behalf of the Society for Human Resource Management and the Section 127 Coalition.

The Society for Human Resource Management is the leading voice of the human resource profession. With more than 150,000 members throughout the world, the society is the largest human resource management association.

The Section 127 Coalition is a diverse group of more than 100 business, labor, and education organizations that are committed to making the exclusion for employer-provided educational assistance found in Section 127 of the Internal Revenue Code, a permanent part of the Tax Code.

First of all, I would like to start by thanking Ranking Minority Member Baucus and Chairman Grassley for introducing S. 133, legislation to make permanent the Section 127 tax exclusion and to extend Section 127 to cover graduate education. I would also like to thank the committee for its support in the past. I am here today to urge bipartisan Congressional support for this legislation.

As the committee knows, Section 127 allows public or private employers to provide up to $5,250 per year to each of their employees in tax-free reimbursement for tuition, books, and fees for job- or non-job related education.

Section 127 is a purely private sector initiative and the one vehicle that encourages employer investment and assistance in providing educational assistance to workers. Now, why is this important? Well, let me tell you about one of the employees in our staffing department who benefitted from Section 127.

This employee, like many high school students, entered college right after high school, lived on campus for about a year, and found it was way too expensive and had to drop out.

She came to Amsouth, secured a position as a teller, and then went back to school through our tuition reimbursement program. After 6 years of working full-time and going to school, she graduated with a human resources degree.

She was promoted to recruiter, that resulted in a substantial income increase. She is now recruiting for our tellers and can share her own success story. Section 127 allows employers like Amsouth to make tuition reimbursement available for employees who might otherwise not have had the opportunity to go to college or graduate school.

Now, in the absence of 127, the money this employee might have received for educational assistance would be considered income and taxed accordingly. The tax burden on a teller making less than $20,000 a year would be prohibitive, and it is doubtful that she could have actually gone back to secure a degree because of the tax burden.

Congress has certainly recognized the importance of encouraging employers to provide educational assistance to employees in the past by creating Section 127. In fact, it has extended it 10 times since 1978. However, the provision excluding graduate-level educational assistance expired on July 1, 1996 and has yet to be reinstated.

The yearly expiration of 127 causes a great deal of confusion as employers rework payroll systems and change training programs. Employees often find their efforts to further their education put on hold.

Today, the global economy requires individuals in the workforce to maintain a higher level of technical competency skills. This skill level often requires graduate-level education. To stay competitive in that global environment, employers—in fact, our country—must have a direct interest in ensuring the best-educated workforce.

Tuition reimbursement is truly a win-win for both employer and the employee. Employers provide these benefits to their employees because they see value and a return on the investment in their employees' education; employees use Section 127 to improve basic skills and to advance in their careers. Therefore, we would greatly appreciate your leadership and commitment to make Section 127 permanent.

I sincerely appreciate the opportunity today to address the committee and hope that you will continue to turn to the Coalition and the Society for Human Resource Management for assistance concerning Section 127. I will be glad to answer any questions that you might have.

The CHAIRMAN. Thank you.

[The prepared statement of Ms. Parker appears in the appendix.]

The CHAIRMAN. Now, Mr. Pearlman.

STATEMENT OF DAVID PEARLMAN, VICE PRESIDENT AND ASSOCIATE GENERAL COUNSEL, FIDELITY INVESTMENTS, WESTLAKE, TX

Mr. PEARLMAN. Mr. Chairman, Ranking Member Baucus, other distinguished members of the Finance Committee, it is a pleasure and an honor to have the opportunity to testify here today.

I am David Pearlman, vice president and associate general counsel at Fidelity Investments. Fidelity Investments is the Nation's largest mutual fund company. We have over $900 billion in assets under management for over 16 million customers.

Fidelity is also the Nation's largest 401(k) and IRA provider, and a leading online discount brokerage firm from which many IRAs, small business retirement plans, and college savings plans are marketed, sold, and administered.

Today I will outline some of the advantages and drawbacks of Section 529 education savings programs and education IRAs, and make some suggestions designed to increase the attractiveness of both kinds of programs for both parents and grandparents of higher education-bound students.

In 1996, Congress adopted Section 529 of the Internal Revenue Code which governs qualified State tuition programs, and Section 530 which governs education IRAs.

Since then, Fidelity Investments has worked to help develop and implement the qualified State tuition programs of Delaware, Massachusetts, and New Hampshire, for which Fidelity serves as administrator, marketer, and investment manager. I will refer to qualified State tuition programs as Section 529 programs, and I will discuss those first in my testimony.

Also since 1996, Fidelity has followed developments with respect to the education IRA. However, for reasons that I will discuss in a few minutes, Fidelity does not currently offer an education IRA.

First, a little bit of history. Section 529 was the result of a dispute between the State of Michigan and the Internal Revenue Service. Prepaid tuition programs, of which Michigan offered one in the late 1980's, predate Section 529.

Michigan had one of the early ones, Wyoming and Florida also had early ones, and by the mid-1990's, a number of States were offering them. The States and the IRS disagreed on tax treatment of assets held in the programs, and 529 was the result. 529, however, created a number of issues as well as solving them.

There are two kinds of programs that are both covered by Section 529. There are the prepaid tuition programs about which we have heard earlier today. Those essentially are programs in which you can buy tomorrow's education at today's prices. Typically, a program is structured to offer semester credit hours, semesters of education, or 4-year or 2-year programs in one lump-sum package.

The other kind of programs covered under Section 529 are those that have come to be called college savings programs. These are much more like 401(k) programs in that they are purely dollar-based. The big advantage of a prepaid tuition program is that one can lock in tuition, but the big disadvantage is that only participating schools offer you that guarantee.

With a college savings program, the account is entirely portable because it is dollar-based and the dollars can be used anywhere equally, whether it is in the State sponsoring the program or at any institution around the country.

There are a number of technical fixes to Section 529 that would make both kinds of programs more attractive, but before I get to those I would like to just skim over the current tax treatment.

The principal tax advantage, and it applies to both kinds of programs under Section 529, is Federal income tax deferral. No income tax is due on gains until the money is distributed.

The secondary advantage, is the income tax is paid by the student and at the student's rate rather than by the contributor, usually a parent or grandparent. I would like to mention that grandparents have found these programs very attractive; of the programs Fidelity administers, about one dollar out of every seven comes from grandparents.

The first thing that I think would help 529 plans, and help them the most, would be if qualified distributions—those used for qualified higher education expenses—were to be tax-free. This would eliminate also tax bills that come due at the time that the student goes to school.

Students typically do not have income sufficient to cover the bills, and the parents or grandparents who have saved for college all along would now have to come up, at the time of school, with money to pay the student's taxes as well.

Second, accounts should be portable. Consider a family who moves across the Red River from Oklahoma to Texas and brings their child with them. They may have established an account with Oklahoma's Section 529 program and desire to transfer that account to Texas' program. They cannot do it. You have to change beneficiaries when you change programs.

Third, we need bankruptcy protection. That was in a bill vetoed last year by President Clinton. It should be protected like qualified plans.

Fourth, the definition of room and board expenses eligible under 529 should be expanded. Currently, they are limited to the least expensive room and board that the institution offers. Off-campus students and those who live in nicer accommodations are disadvantaged.

Fourth, beneficiaries can be hit with a tax over which they have no control. If I establish an account for my child, my child does not need the money to go to school, and I change the account to be for the benefit of my grandchild, my child is deemed to have made a gift and is taxed through a gift tax on that change of beneficiaries.

First cousins should also be included as family members. Today, a grandparent with a daughter and a granddaughter who also has a son and a grandson cannot change the beneficiary from the granddaughter to the grandson. It is just not permitted. A simple change would fix that.

Finally, there should be a level playing field across States. Some States subsidize their programs by giving their residents tax benefits that only apply through participation in the State program. Smaller States depend on attracting out-of-State residents to cover their expenses, and Congressional help here would be appreciated.

One aspect of the programs that does work well, is State sponsorship. The State treasurers have run these well. They have been very interested in the public interest, and the public has come to trust the programs, partly because the States are involved. The State treasurers have indicated their interest in keeping it that way.

Let me make four quick points with respect to the education IRA, then one that covers both, then I will conclude. The education IRA has not been the subject of great demand by our customers. The $500 contribution limit seems to be the biggest disatisfier by our customers. Raising the limit to $5,000 would be a great help.

If more people were eligible to contribute, that would help also. If contributions did not have to cease by age 18 and be withdrawn by age 30, more people would be interested. Finally, if people did not have to give up tax-free treatment from their education IRAs to make use of HOPE and lifetime scholarship credits, that would also be a benefit.

Finally, there is one tax trap that cuts across both programs. Consider a parent who invests $500 for their child in an education IRA and a grandparent who invests $5,000 in a State's Section 529 program.

The entire contribution to the 529 program is considered an excess contribution to the education IRA, and the beneficiary is hit with a 6 percent excise tax—that is $300—each and every year until the offending contribution is withdrawn.

That can be a substantial sum by the time the beneficiary goes to college and it is discovered that both kinds of accounts were set up; parents and grandparents frequently do not talk to each other about these things.

That concludes my oral testimony. I ask that my written testimony be placed in the record. I would be happy to answer any questions.

The CHAIRMAN. Yes. All written testimony of every witness will be placed in the record.

[The prepared statement of Mr. Pearlman appears in the appendix.]

The CHAIRMAN. Dr. Maguire?

STATEMENT OF STEVEN MAGUIRE, PH.D., ANALYST IN PUBLIC FINANCE, CONGRESSIONAL RESEARCH SERVICE, WASHINGTON, DC

Dr. MAGUIRE. Mr. Chairman and members of the committee, thank you for inviting me to testify before you today.

The title of this hearing, Making Education More Affordable: The Tax Code as a Student Aide, is interesting to me as a student loan borrower and as an economist. From an economist's perspective, there are two ways to make education relatively less expensive in the short run: subsidize demand or subsidize supply. Most of the witnesses testifying before me have approached the topic from the demand side, and my charge is to look at the supply side.

The Federal Government provides support for public schools directly and indirectly. The direct Federal support, such as funds for disadvantaged and disabled students, provided about 6 percent of total public school revenue in 1997.

Alternatively, indirect support, which is offered primarily through tax-exempt bonds and qualified zone academy bonds is difficult to accurately quantify because an indirect subsidy is not explicitly on-budget.

To help clarify, I will describe the tax benefits of tax-exempt bonds and QZABs. First, tax-exempt bonds. The tax exemption means a bond holder, in most cases, does not have to pay any income tax on the interest earned from the bonds.

Consequently, schools pay less than the market rate of interest on their debt. In 1997, the estimated interest cost saving to public schools was about 1 percent of total public school revenue, not very much.

In terms of efficiency, tax-exempt bonds may not be the ideal means of subsidizing schools. The interest costs savings to the school is relatively constant, whereas the revenue loss to the Federal Government increases with the bond holder's marginal tax rate.

In fact, bond holders in marginal tax rates above the market clearing tax rate receive a tax benefit that is greater than the interest cost savings to the local government. For this reason, one dollar of Federal revenue lost does not equal one dollar of subsidy to schools.

The second type of indirect subsidy is QZABs. These bonds offer a much deeper, though better targeted, subsidy to public schools than do traditional tax-exempt bonds. The Federal Government allows the holders of these bonds to claim an annual tax credit equal to the prevailing taxable interest rate, multiplied by the size of the loan.

The Federal tax credit is in lieu of interest payments from the issuer, which means the issuer does not pay any interest on the borrowed funds. The loan is interest-free. Because the Federal Government is effectively paying all the interest, the subsidy for these bonds is two to three times that of tax-exempt bonds.

There are limits placed on the QZABs program. QZAB debt capacity is set at $400 million annually for each of 1998, 1999, 2000, and 2001. This annual limit would have been just over 1 percent of total public school capital outlays in fiscal year 1997. The estimated revenue loss from 1998 to 2009 of the QZABs is about $650 million.

The legislative proposals will probably need to address current QZAB rules to increase the attractiveness of the bonds to investors. For example, under rules of the current QZAB program, if a bondholder holds tax credits that exceed its tax liability, the unused tax credits are forfeited.

Allowing the bondholder to carry the credit forward to the next year is clearly advantageous to the bondholder, and indirectly to the issuer. The increased demand for QZABs resulting from the looser restrictions would most likely allow issuers to offer their bonds at a higher price and lower cost.

Second, QZAB principal and the accompanying tax credit cannot be separated and then marketed. Allowing investors to sell the stripped QZAB credits, which are effectively backed by the Federal Government and, thus, riskless, would provide some flexibility to the bondholder.

Most likely, the riskless credits will be sold at a premium to another investor in a lower marginal tax bracket to whom the credits are more valuable. The increased flexibility and rate of return could then increase investor demand for the bonds. A stripping provision will more than likely increase the cost to the Federal Government of tax credit bonds.

Finally, qualified zone academy bondholders can claim a tax credit only once a year on the anniversary of the original issue date. However, corporate taxpayers pay estimated taxes on a quarterly basis. Changing the annual credit to a quarterly credit better matches the timing of estimated tax payments and the QZAB tax credit.

In summary, current Federal expenditures on the provision of public education through bonds is minimal. Proposals to expand the Federal role will likely build on existing programs, much like proposals introduced in the 106th Congress.

I now welcome any questions.

[The prepared statement of Dr. Maguire appears in the appendix.]

The CHAIRMAN. This is the order we will take questions: myself, then Senator Baucus, Mrs. Lincoln, Mr. Kerry, Mrs. Snowe, Mr. Torricelli, and Mr. Graham. If that seems odd because some people were here ahead of others, we go by the way that people come, so if they step out and come back, they still keep their order.

I am going to start with you, Dr. Maguire. We will use 5-minute turns for everybody, including the Chairman.

For some of the proposals that are before Congress for helping with building, the argument is there is not the tax base or the resource base to build buildings. A lot of that has been centered on the needs of urban America, and a lot of those formulas have tended to benefit urban America more than rural America.

I want to raise the point with you that sometimes we have problems in rural America, like in my State of Iowa, when you would have low farm prices, you could have a decrease in valuations very much so. Maybe in Montana it could be because of restrictions on logging, mining, or even the condition of those industries. That tends to reduce property values and has consequently placed a significant economic barrier in rural communities to issue school bonds.

In your opinion, would the lowering of property values in rural America from reduced farm values or limitations on any of these industries we have in rural America place a burden, a real economic burden, on these rural communities and counties for issuing of school bonds?

Dr. MAGUIRE. Yes, sir. Bond buyers want to get paid back, and if it looks like a school district may have difficulty, for whatever reason, one of them perhaps being dropping property values, it is clear that it will be more difficult for that school district to raise money and to sell bonds. If they do, it will probably be at a higher rate, a higher cost, to compensate for the anticipated risk involved.

The CHAIRMAN. Ms. Sheppard, I would turn to you on another issue. We talk a lot here in the Finance Committee on tax codes, and acronyms, and everything like that. Sometimes it is easiest to understand why changes are necessary by understanding how they would affect individuals.

So you know about the $2,500 cap limit and on raising income limitations. We have even a third component, that there is this 60-month cap on the deduction of interest that a taxpayer can take on a student loan. Could you explain to the committee how these three provisions would affect you and students like you?

Ms. SHEPPARD. Currently as it stands, I am not sure that I would be eligible for the benefit unless the income ceiling was raised. Normally, a dentist going into practice initially would probably exceed those income limits.

Putting them all together, if the 60-month limit were extended and the $2,500 cap, as well as raising the income limitations, it would benefit me and other dental students by giving us the opportunity to practice in areas such as rural Iowa, where we do not have so much of a worry about being able to pay back our student loan debt. It would also give us the opportunity to serve all patients, not just patients who can only pay the full amount for their treatment.

The CHAIRMAN. Mr. Carter, how prevalent is the issue you raised about teachers having these out-of-pocket expenses you have referred to? Quite frankly, how many other teachers from your school are making payments from their own pockets, and would they likely benefit from the $100 tax credit such as Senator Collins and Senator Kyl were talking about?

Mr. CARTER. I received e-mails back from 30 teachers out of 100 in our school district. Every one of them had out-of-pocket expenses. My guess would be, over 90 percent of our faculty spend money out-of-pocket, ranging from $50 a year to $1,000 or $1,500. The bill certainly would give tax relief to us. It would help us out. As I said, teachers do not make very much money, and anything you can do to help us would be appreciated.

The CHAIRMAN. Ms. Parker, what role does employer-provided education play in keeping your employees up-to-date in current developments or emerging technologies; what classes do you intend to hold in-house versus sending workers to local colleges or universities for Section 127-type classes?

Ms. PARKER. As far as keeping them up-to-date on current trends, as we move our employees into more responsible positions, obviously the complexity of their job changes and they have to know more about technology. Probably, as we are sitting here today, something in technology has changed. It is critical, in the banking industry, that they are current in technology.

But additionally, as they move into more complex positions, their role moves from a tactical role into a more strategic role, which may require them to have a stronger knowledge of project management or some statistical type of role.

I will give you an example, if I might. We recruit junior military officers into our bank, and they bring in a huge amount of management experience, but they lack that business acumen.

We recently had one of our junior military officers come in, he started as a branch manager, felt like he wanted to move his career forward, went back to graduate school, and now he is one of our sitting presidents. The reason that he wanted to go to graduate school is that he knew that he had a deficit in that business acumen, and that is a positive from that respect.

As far as in-house courses that we offer, we do have a training department but it is very focused on one particular area, and that is our branch system, because that is our largest group of employees.

Now, even though we have so many others that can provide banking services, people still like to come to our branches and it is critical that they have the skills to do the job.

We do not have the budget, nor do we have the resources to have the type of training in-house that a student would get from going to a university.

The CHAIRMAN. Thank you, Ms. Parker.

Now, Senator Baucus.

Senator BAUCUS. Thank you, Mr. Chairman.

Ms. Parker, I appreciate your support for Section 127. It just seems to me that, generally speaking, if the President proposes, say, for a $25,000 a year waitress, that he talks about a $600 tax break, that that is great, and the waitress would certainly like that, but I would guess that the waitress would like to have a better-paying job.

The more we have incentives and the more opportunities are available for that waitress to get a better-paying job, is it not more likely to be through developing a higher skill set or being better educated?

Is the waitress then more likely, do you think, to get a better job, or how much more likely if he or she has a chance—in this case, the waitress—and 127 is not applicable here, but other programs, how much of a difference do you think that is going to make? Basically, that woman probably wants more income.

Ms. PARKER. Right.

Senator BAUCUS. She would prefer more income than a tax break, probably. A better-paying job, probably.

Ms. PARKER. As far as the better-paying job, I will give you a couple of examples within our own company, in fact, within our own department. The teller that I was making reference to that came into our organization, when she secured her human resources degree and we moved her into the staffing department, she saw a 15 percent increase in her pay.

We had another employee also in our human resources department that was one of our administrative assistants. She delayed her schooling due to family demands. She went back to school and got her human resources degree. She moved into our training department and saw a 29 percent increase in her pay. So I think the expectation, as far as when you get additional schooling, is there.

Senator BAUCUS. Right. Now, why would an employer want to provide educational assistance to an employee, if that employee, because he or she gets better training, will move on to a better, higher paying job with some other company, someplace else? Do employers not sometimes worry about that when they train their employees?

Ms. PARKER. Oh, yes. We do. We do. Loyalty, obviously, these days is something that we wish there was more of. What we really focus on at Amsouth, is when you join Amsouth it is a career, which is the reason we make tuition reimbursement available. We have an internal job posting system that, if you go back to school and you get additional education, you secure your degree, you can move into other positions.

Senator BAUCUS. So it is your point that you can build loyalty with these kinds of things.

Ms. PARKER. Yes, sir. That actually is very objective of what we try and do there. Talent is still scarce, even though they say that the economy is taking a downturn. The talent out there is still very scarce and it is better to grow from within, and it certainly helps employee morale.

Senator BAUCUS. I was just thinking as you were speaking there, and I was taken, as I think we all were by Mr. Carter's testimony, just how hard teachers work and what low pay they get, and all their frustrations. It is known.

Most of us want to try to find some way to increase teacher salaries, in addition to telling you, Mr. Carter, we care and we appreciate it. The thought occurred to me, and it is far out but there is a bit of an analogy here, that employees who work for your company and who get tax-free education assistance provided by their employer, I was just wondering if somehow teachers could get tax-free benefits for the value added that they teach to their kids, or for the increased skill sets that they have in teaching their kids, whether it is taking courses, or what.

I do not know if one could find a good analogy here or not. I am just trying to think of a way to help teachers get higher salaries and get higher income, because it is really needed. In my State of Montana, teachers are leaving because salaries are so low. Administrators are leaving because salaries are so low.

I guess what I am really driving at, Mr. Carter, is in addition to getting a credit for your expenses, what else is really needed? When you were driving here or flying here from Iowa thinking about all of this, what does this really come down to?

A credit for expenses, we are sympathetic to it, but that is kind of rewarding districts for not paying you enough or for not providing for these other expenses, whether it is books, computers, or whatnot.

Clearly, I think we want school districts to have the resources to provide all these services rather than have to give teachers a credit for paying for it out of their own pocket. What should we do? What should be done?

Mr. CARTER. Well, I do not know. I was just thankful today, when the bell rang, and you guys did not get up and walk out, as that is what has happened for 23 years. [Laughter.] I just think that, at some point, society has to decide that what I do is as important as what other professionals do. I think it is just a matter of deciding, as a culture, that education is important. From Congress, gosh, I do not know. My salary is locally controlled, State-controlled.

Senator BAUCUS. I think you have pretty much answered the question: it comes down to priorities within this culture.

Years ago, I learned when I was in Japan that the Japanese Government had automatically paid teachers 10 percent more than the average civil servant salary. They had trust funds for paying for teachers' salaries. I had a wild idea years ago, and probably should have followed up on it, and that is, put a tax on the manufacture of new TV sets and put those dollars into a trust fund for teachers, just as a way to kind of discourage some of the excessive TV that people watch, and to encourage more incentives for teachers to want to go into the profession.

Mr. CARTER. Well, as I said earlier, my biggest concern, because I am going to retire in 10 years, is who are we going to attract to teach the next generation? Very few kids with ACT scores over 27 and GPAs over 3.7 are going into teaching, and that concerns me a great deal. I am afraid that I am a dying breed.

Senator BAUCUS. Thank you very much.

The CHAIRMAN. Mrs. Lincoln, then Mr. Kerry.

OPENING STATEMENT OF HON. BLANCHE L. LINCOLN, A U.S. SENATOR FROM ARKANSAS

Senator LINCOLN. Thank you, Mr. Chairman. I want to compliment you and Senator Baucus for this hearing, because I do think it is so essential that we make educating our children and our future workforce a priority.

I would like to compliment Ms. Sheppard, soon to be Dr. Sheppard, for the issue that she has brought up, and the fact that she wants to stay at home in Iowa. I come from a small town, a seventh generation farm family. I was discussing with my mother just this morning the problems that they were having, that none of the young people are staying in our small communities in our rural areas, because they cannot afford to.

One of our biggest problems in Arkansas in keeping doctors and physicians in our rural areas and in the rural loan program, is that they buy themselves out of the program, they never serve in those under-served areas because they cannot afford to.

When they can go to a city and they can repay that loan more quickly and get themselves out of debt, it just makes so much more sense to them financially, and certainly for the quality of life for their families, too.

So, it is a very important point, and I am pleased that you brought it up and recognized it, and we can pay more attention to the opportunities that we have here in the committee.

Mr. Carter, I certainly understand the problem that you bring to the committee and that you have been discussing today. I am very fortunate to have been the recipient of many teachers like yourself who took a great deal of care in my upbringing and in my education in the public schools of Arkansas, and I am eternally indebted to them.

My sister, who is also a teacher in the public schools in Arkansas, expressed to me so many times, not only did she spend her money to supply the classroom, because she taught kindergarten and first grade and she ran out of supply money almost every year before February, but she also had to spend her money on feeding children that came to school hungry just so they would be capable of paying attention.

Those are the problems our teachers are facing today, and we have got to support them. We have got to elevate them to a position of respect, which is a huge part of it—they certainly deserve it—but without a doubt making sure that it is something they can make a living at. In Arkansas, less than 25 percent of our teachers are under the age of 40. We are going to hit a brick wall pretty soon where no one is going into the teaching profession.

My concern about the program that has been talked about here is what we are encouraging as a Federal Government, encouraging an activity. By that, I mean do we want to move the incentive to supply students away from parents and States?

Are we taking some of the heat off of our Governors, off of our States from being able to supply you with the increase in terms of income that you deserve and that you need to be able to better yourself, and we are putting it into the hands of the individual teachers.

Will parents not really see that teachers are getting a credit and decide to just let the teachers do the buying? Unfortunately, we have seen a lot of that happen, where parents are just letting go of those responsibilities they have and letting teachers do that when they can.

Is this a real Federal tax issue or is there some other way—I echo what Senator Baucus said—that we can help encourage and support our teachers? One of the things that we have done, along with Senator Kerry and Senator Graham on our Three R's, is to increase by 100 percent the professional development resources from a Federal level for our teachers, knowing full well that they have got to expend dollars in order to see the professional development they want. I see the need and I want to help desperately.

I just don't want to put us in a situation where we are taking the responsibility off of those areas and putting more responsibility on you and not giving you what you really need, because a $100 tax credit for teachers, if you are a teacher in Arkansas making a salary in Arkansas and you have got two kids, you are not going to have anything to deduct it from. So, it may not even benefit you at all, the percentage of teachers that would take advantage of it.

I do not know if you have any comments. I certainly would encourage you to look at a multitude of ways, because I am ready to help you any way I can.

Mr. CARTER. My comment about parents—and I do not mean to sound cynical, I said I love my job—at the last parent/teacher conference I had a less than 15 percent turnout for conferences.

Senator LINCOLN. Right.

Mr. CARTER. I think there is a tremendous amount of apathy among parents already. Frankly, I do not care where the money comes from, I just want to educate the kids. I do not care if it comes from you, the State, the parents, charities; it does not matter to me.

Senator LINCOLN. Absolutely.

Mr. CARTER. A lot of times it is out of my pocket. But that is for you guys to debate, I guess. But parents do not really care that much anymore.

Senator LINCOLN. No. It is unfortunate.

Can I just ask one last question? I am getting low on my time. Many in Arkansas depend on community colleges and vo-tech schools to further their education while they work to support their families. Maybe Mr. Pearlman might be the best one to answer this one. The HOPE scholarship is very limited to students hoping to attend a community college or vo-tech, for lots of reasons.

One problem for the low-income people, is because the scholarship is a credit. Potential community college students still have to come up with the tuition payments before they can really further their education. That credit is nice on tax day, but the money is not there on the day of matriculation.

The question would be, and I suppose to Mr. Pearlman, probably is the best, if you could answer this question, what type of logistical problems would we foresee for community colleges if Congress allowed their students HOPE credits to be somehow forwarded or held in a trust by community colleges so their students could actually have the money up front when they need it?

That might be something that Ms. Parker might comment on as well. But we have found in Arkansas that we really cannot take as much advantage of that for the kind of training that we need for some of the workforce that we are losing.

Mr. PEARLMAN. I am flattered by your consideration of me as an expert on the HOPE scholarship, but I am really not. Our expertise is in the administration of the Section 529 programs. I will defer to Ms. Parker on that.

Senator LINCOLN. Yes.

Ms. PARKER. I am not sure that I can answer your question. I think there could be some benefit for some coordination of funds. The way that we pay tuition reimbursement is according to the grades that they obtain through their course work, so that reimbursement actually occurs at the end of their quarter or semester. So, they do not have that up-front funding.

Senator LINCOLN. I just would hope that we could further the discussion later on, Mr. Chairman, also to include employees in a second language. That was the only other question I had for Ms. Parker. I hope we will have an opportunity to seize on some ideas of how we can encourage, and whether it is important to businesses, with the growing increase.

I know in Arkansas, we had an increase of 149 percent last year, the largest percentage in the Nation. But second languages and third languages, we certainly do not look seriously at them as other nations do, and it might be a way that business could really encourage us in some of these education credits.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Kerry?

OPENING STATEMENT OF HON. JOHN F. KERRY, A U.S. SENATOR FROM MASSACHUSETTS

Senator KERRY. Mr. Chairman, thank you very much. Thank you for having this hearing.

I have been listening with interest to the panel that we had previously of our colleagues. It is interesting. We have a deductibility of interest for student loans proposal, an education savings account proposal, qualified State tuition plans, employer-provided tuition assistance, unreimbursed expenses, tax-exempt, general bond, and so forth, for construction, all the way ranging through tuition schemes to sort of help parents be able to send their kids to school.

I would say to you, Mr. Chairman, that there is in the confluence of all of those colleagues who have come here this morning a pretty sound warning system, if you will, or an alarm bell that ought to go off to every Senator with respect to the level of tax cut that is being proposed and how it may be targeted versus the priority that we have heard underscored here today.

We have had a private conversation about it, Mr. Chairman, but I do think that these priorities are bipartisan. We had Senator McConnell here, Senator Sessions, Senator Allen, Senator Hutchinson, Senator Susan Collins, so we have a very strong bipartisan statement about the priorities of the Nation.

There is no other way to attract people to teaching other than raising the salaries, other than having people like Mr. Carter who just come out of commitment. But they are less and less because so many people, as we have heard from Ms. Sheppard and others, who finish their education with extraordinary loan burdens. If you get out of school with $50,000 to $100,000 worth of loans, or more, in some cases, you really do not have much choice.

In about a week or so, Senator Jeffords and I are introducing the Nursing Reinvestment Act. I invited my colleagues to join in that. But we are finding the same crisis with respect to nursing. The average current nursing professional is 43 years old, close to nearing retirement.

Nurses under the age of 30 represent only 10 percent of our current workforce. Professors of nursing, the average faculty member, is currently 51 years old. So we are losing experienced nurses, we are losing the teachers who teach them.

Seventy-five percent of nurses in the American Nurses Association recently responded that the quality of nursing care at the facility at which they themselves work had declined in the past years, and 56 percent of them believed that the time they have available for patient care has decreased.

More than 40 percent of nurses surveyed said they would not feel comfortable having a family member cared for in their own health care facility. I will tell you that a nurse in my State said to me, I would have to be unconscious for them to drag me in there for treatment at the place she was working.

Now, we can sort of toy with these things as priorities or we can get serious about them. I would say to the Ranking Member, I am working on legislation that is a sliding scale. I would love to do no sliding scale; I am not sure we can afford it. But we need to give a tax exemption of some level to everyone who goes into teaching.

I remember, in Vietnam, if you went over you got combat pay. There are some schools where you ought to get combat pay in this country. But the fact is, the only way you are going to attract people in an economy where you can get out of college and go earn $60,000, $70,000 or better in many different, new enterprises in the country, when you start at $27,000 or $30,000 teaching, and work after you get a master's degree and 15 years in service you get into the high $30,000's, $40,000's, then ultimately, with doctorate and otherwise time in service, you may get in the $60,000's.

I think in New York it may be $68,000, $70,000, one of the highest in the country. There are few that match those levels. That is after a career. So you are saying to teachers, do not ever expect to send your kid to one of those schools Senator Biden was talking about earlier here.

You are saying to most people you are asking to go into the profession, do not expect to have a private cottage by the sea, like many Americans who aspire to that, do not have the same vacation aspirations, and your children are going to be treated differently, they will go to a State college because you cannot afford to do otherwise, unless we do all these things.

I think the financing mechanisms we come up with are absolutely critical, Mr. Chairman. I would invite the Ranking Member and others on the committee to join me. Hopefully we can come up with a figure we can afford in terms of this exemption. But it is the only way that we are going to attract people into teaching.

We have to build some 24,000 new schools. The school construction program itself, we are going to go from 52 million students to 54, 55 million in the next eight years. So you have a huge school construction effort we have got to make.

Dr. Maguire, my question to you quickly, as the time expires, is of the bonding proposal and the tax-exempt proposal, which do you believe is the most effective of the $1,000 bond, the private activity bond, the tax credit bond, or the expanded arbitrage in leveraging the capacity of schools to be built? I would just ask you quickly, because I do not want to abuse the time.

Dr. MAGUIRE. Since it is quickly, maybe I should defer and respond in writing. I do not think, in this forum, it would be best for a CRS employee to espouse one view or one particular proposal over another.

Senator KERRY. All right. Do you accept, if I could, Mr. Chairman, quickly, that the tax credit bond plan, I understand, the benefit to the school would be as much as $622 on a $1,000 bond, whereas, last year CRS said that under the arbitrage proposal of $1,000 bond there is only a $24 benefit. Do you concur with that, or are you not prepared at this point?

Dr. MAGUIRE. Not having it in front of me, I do not think I can concur. The QZAB is more money to the school.

Senator KERRY. Mr. Chairman, I will submit it in writing, if I could, and follow up with a couple of other questions. I thank the Chairman.

The CHAIRMAN. From members who are here and not here, you may get questions to answer in writing. We would like to have a response within 14 days.

The CHAIRMAN. Senator Snowe?

OPENING STATEMENT OF HON. OLYMPIA J. SNOWE, A U.S. SENATOR FROM MAINE

Senator SNOWE. Thank you, Mr. Chairman. I certainly applaud you for focusing a single hearing on the issues of affordable higher education because clearly it is a priority for so many of us here in the Congress, and it certainly will be a priority as we begin to address these issues within the budget this year, and hopefully as well in the tax plan, because we have to provide incentives.

It was interesting to hear the variety of educational initiatives that you proposed and that we should consider and explore. It is obvious that we are going to have to decide which initiatives are going to be the most beneficial and of the most value. We have tried over the years to increase the PELL grants.

Even though we have done that, they still lag behind in terms of the cost of higher education. Students are accumulating more debt, and did accumulate more debt in the 1990's than they did in the three previous decades combined. We have seen the cost of education increase anywhere from 3, to 4, to 5 percent with respect to tuition costs on an annual basis, and certainly that was the case in the year 2000. So on and on it goes.

We will have to really try to focus on those issues that could be a premium for students seeking higher education. I think in America, if there is any one goal we should have, it is to ensure that everybody has access to a quality higher education, and affordable education, because it really, truly does make the difference in closing the income gap in America.

Ms. Sheppard, I would like to start with you. You mentioned that you and your husband have accumulated, which is obviously a hardship as you are seeking to buy a house, buy a car.

In fact, some of the statistics suggest now that more young people, once they graduate from college, are deferring the buying of a house in greater numbers, deferring buying a car for many years in greater numbers, simply because they have got this overhead of debt.

Senator Schumer earlier had mentioned legislation that he and I are sponsoring which would provide for the deduction of tuition expenses up to $12,000 a year. How do you think that would have affected your debt load?

Ms. SHEPPARD. I think it would definitely improve our situation. It would give me, particularly, an opportunity to set up a practice. The average cost of starting a dental practice nationally, I believe, is anywhere from $125,000 to $250,000. Any sort of tax relief that we could get from this, that would help considerably.

Senator SNOWE. I am building upon the legislation that the Chairman has introduced with respect to the interest paid on student loans. The Chairman's and Senator Baucus' proposal would eliminate the 60-month time period. I would convert that to a tax credit as opposed to a tax deduction as well for the first $1,500 of interest.

Ms. SHEPPARD. I believe that would help.

Senator SNOWE. That would be helpful as well.

Ms. SHEPPARD. Yes.

Senator SNOWE. Mr. Pearlman, you have offered a number of initiatives and proposals in your legislation. How do you think the tuition deduction would be helpful for paying down expenses?

Mr. PEARLMAN. I cannot quantify an answer on that. It is not something I have thought about or was prepared for coming in today, so I will defer to people who have spent time on that issue.

Senator SNOWE. Yes. I think some of the issues that you have raised, I thought a number of them were very good. It basically focuses on individuals who really do think well in advance, and prepare well in advance, in setting aside costs for their children's higher education.

Many people are not in a position 10 years out, 15 years out, to do that. That is why I think this also would complement the types of things you are suggesting in improving the 529s, so that people readily can have the availability of the Tax Code in order to provide a substantial deduction in their tuition expenses.

Mr. PEARLMAN. There is no question that any tax relief will help. The form it takes, obviously, is for people like you to decide.

Senator SNOWE. Of the number of proposals that you have offered, which of those are of most importance to you?

Mr. PEARLMAN. I think the most important is tax-free treatment for the Section 529 programs. 529s have become incredibly popular, both with grandparents, parents, and with the State sponsors over the last three or 4 years.

For example, the three programs administered by Fidelity have over $800 million in them, about half of which came in the last 12 months. By the end of this year, it is anticipated that there will be about 43 programs of the savings type offered by the States, and about 22 of the prepaid tuition types, and many States are actually offering, or will offer, both. I think that is where the greatest growth is, and probably will be for the next few years.

Senator SNOWE. Thank you.

Dr. Maguire, on the issue of school construction, it is indisputable about the necessity of addressing the modernization of school infrastructure in America. I have introduced my own legislation that would use the exchange stabilization fund for low-interest/no-interest cost to municipalities, tying it to the Federal Government's commitment to funding its share of special education.

I noticed that you had mentioned the QZAB program. That will probably be of little benefit to a State like Maine because of the corporate entities. We do not have large businesses in many of the communities in which to enter into a partnership, and the restrictions that are placed on that program.

Dr. MAGUIRE. Correct.

Senator SNOWE. So you are acknowledging that it is of limited value to many States across the country, particularly rural ones.

Dr. MAGUIRE. I guess I should not go that far. As you noted, there is a 10 percent private match to go with the QZABs. I know that Kentucky has had no problem coming up with the private match. As far as Maine, I do not know what is going on in Maine. But it could be an impediment, and some have suggested that that 10 percent requirement be removed and make it easier for schools to borrow from.

Senator SNOWE. Thank you.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Snowe, thank you.

Now, Senator Graham from Florida.

Senator GRAHAM. Thank you very much, Mr. Chairman. I wish to express my thanks for the panel's very insightful comments.

I would like to use my time to concentrate on a couple of issues. First, Section 529 prepaid college tuition programs. My State was the second State to adopt this program, and now has some 600,000 prepaid college tuition contracts in force. We will have, within the next few years, some 80,000 students in our State universities who are attending with their tuition paid through a prepaid college contract.

There are a couple of questions or challenges that are looming, and I would like to see what you would suggest any Federal role might be in these, or suggestions as to what the State might do.

Our State, Florida, has been a relatively low tuition State. Faced with the kind of financial problems that now many other States are dealing with, there are proposals for substantial increases in tuition fees.

This is going to result in a group of students who have had their tuition paid through a contract that was predicated on the tuition as it existed at the time the contract was issued, paying substantially lower tuition than those students who come in at the rate as it exists when they commence their college education.

Do you see that as a problem, and if so, do you have any recommendations?

Mr. PEARLMAN. That is certainly a problem. Obviously, the State transfers the risk to itself when it issues a prepaid tuition contract, and for that reason some States have been reluctant to offer prepaid programs.

As I mentioned a moment ago, by the end of this year there will be 43 States with savings-type programs, as opposed to 22 with prepaid tuition programs. In the savings program, the risk, if you will, is shifted to the consumer rather than to the State, and I think that is a consideration for Florida, as well as others. Florida, I know, will offer a savings-type program before this year is up.

Senator GRAHAM. For those States like Florida where we have such a significant commitment to the prepaid tuition approach to assisting families in meeting their future educational costs, do you have any suggestions as to what they might do within their programs to deal with this issue of the potential of substantially increased tuition during the duration of that contract?

Mr. PEARLMAN. I do not. The States obviously have consulted with actuaries and other people who are more expert in long-term matching of assets and liabilities in these programs, and I am not an expert in that area.

Senator GRAHAM. Another related issue, is we have had in Florida a single board of regents which has set the tuition, subject to legislative approval, for all of the universities and they have been generally the same, and the variations, if there were any variations, were limited from campus to campus. Now we are moving into a pro system in which there will be individual trustees over each university, with those trustees able to set the tuition for that campus.

One of the expectations—in fact, one of the rationales for doing this—is that there are going to be differentials in tuition from campus to campus. Since the prepaid college tuition contracts guarantee your admission to any of the universities—and in our case that is 10 universities—to which you can be admitted, that is going to result in some contracts being worth substantially more than others, based on where the child elects and can, in fact, be admitted. Again, any comment on that issue?

Mr. PEARLMAN. I can only offer two suggestions. One, the National Association of State Treasurers and its College Savings Plan Network is a very good resource for addressing these kinds of problems which a number of States have faced.

Two, Massachusetts has a program that is very well worth looking at. Eighty-eight of the 91 4-year institutions of higher education in Massachusetts are part of Massachusetts' prepaid program, and they have structured it so as to tie the number of credit hours at a given institution according to the tuition that is actually charged there.

Senator GRAHAM. If I can just move quickly to my second issue, which is school construction, an area that I have had a long interest in, it seems to me that we do not need to think of these alternative methods of Federal assistance to local school construction as being competitors.

I would use the analogy of a cafeteria. The fact is, a rural school district, whether it is in my State of Florida, or in Iowa, or anyplace, is different than an inner city school district, and it is different than a suburban school district in its needs, in its financing capabilities.

From State to State there are different laws and constitutional provisions that affect how schools can finance their rehabilitation or new facility construction.

So it seems to me that what the Federal Government ought to offer, is a variety of school construction plans, and then let individual school districts or States select which, if any, are appropriate to their particular needs. I wonder if you could comment on the cafeteria plan as opposed to the one-shoe-fits-all plan.

Dr. MAGUIRE. Well, the way the question was phrased, it might be difficult for me to maintain that balance between partisanship.

The problem, the way I see it, is within States there is disparity between different counties, different jurisdictions, and the role of the State may be to equalize things, and then the Federal role may be to equalize between States, the spending on education, that is.

The one-shoe-fits-all probably is correct, and particularly Florida has a very large immigrant population and a large population growth, period, is going to be in a much different situation than Maine. So it is true, it may be best for State and local governments to decide what they need, and the more choices they have, obviously, the better for them.

Senator GRAHAM. Mr. Chairman, would you mind if I asked one follow-up question to that?

One potential method of school construction finance which has not received a lot of discussion, is the extension of the private activity bonds which are now used extensively in areas such as transportation. They are used in private education facilities, but are not currently legally available to public education.

There should be amendments to the private activity bond law to make public schools an eligible participant in the private activity bond, which is an attempt to somewhat have a marriage of private capital and public need for whatever the purpose is, and we are suggesting public schools as an appropriate purpose.

Do you know enough about that issue to have a comment on it?

Dr. MAGUIRE. I do not know about private activity bonds. That may help, but if a school district is having trouble raising money on its own, then simply allowing it to issue private activity bonds.

There is still the fundamental problem of, how is it going to get paid back? If it is in a poor area and you give money to a private corporation to build a school and they sell bonds, how are they going to get paid back? So, it may help, but I am not sure. I am not an expert in that, particularly.

Senator GRAHAM. Would you see it as being a potentially appropriate addition to this cafeteria of options so that those school districts who do not suffer from the restrictions you just outlined might be able to access this?

Dr. MAGUIRE. Well, I think we would have to do a little more history behind why the private activity bond legislation is the way it is, and we have been slowly pecking away, or we have gradually expanded, what is considered private activity, circumventing laws that were passed in the 1960's, or changing laws that were passed in the 1960's.

Senator GRAHAM. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Graham.

I have got about five more minutes that I would like to ask questions, then we will be done.

I think I will start with Mr. Pearlman, whether or not you believe that a consortium of private and independent colleges and universities should be permitted to offer prepaid college tuition or college savings plans.

Mr. PEARLMAN. Those are interesting proposals. I have seen a number of them in the last month or so. Again, we are not experts at Fidelity in anything beyond the current programs, as we currently administer them for three States, and they are all structured in a particular way. How any of these proposals would affect the current structure is unclear to us, and we just do not have the expertise to get there yet.

The CHAIRMAN. Even though you do not know the details of them, do you oppose the concept?

Mr. PEARLMAN. We serve the States. The States are the ones who came to get Section 529 enacted. Our dealings are with State treasurers and others in that area.

I cannot speak for Fidelity, but I can tell you that the States have indicated their interest in maintaining the programs at the State level through the treasurers and other officials who do them now.

The CHAIRMAN. My second question may be a little more difficult for you to answer, and I am not sure there is an answer, because it is kind of, which comes first, the chicken or the egg. But there has been some discussion about how Federal tax policy in education areas may not make it easier for families to afford a college education for their children because the schools, the universities, might simply raise their costs because there is some sort of Federal subsidy that might make it easier for the kids to go to school, even in light of the higher costs.

Do you have any feeling whether these sorts of subsidies—and they could include the PEL grant, the guaranteed savings plans, we are talking about all of the above—are more likely to cause costs to go up?

Mr. PEARLMAN. That is a very complex question. There are so many moving parts to that. We would be happy to respond in writing to any particular questions after the hearing, but I would offer just one or two observations right now.

Financial aid is an area we have looked at because it intersects with the treatment of 529 plans. Even in the area of financial aid, there is inconsistent treatment. For example, a prepaid tuition program under Section 529 is a bad thing from a financial aid perspective.

Under the Federal aid formulas, those dollars are considered to be the student's dollars and they reduce the available help by one dollar for every dollar that is in the program.

A savings program is treated much more favorably. A parent, for example, who holds an account for their child, that is only treated to a 35 percent reduction, 35 cents on the dollar, and if the grandparent holds the account, it is not subject to a reduction at all.

There are a whole host of things that go in here, and there is no simple answer to any one of the questions. We would be happy to take a list of written questions and try to respond to them one at a time.

The CHAIRMAN. Dr. Maguire, has your agency or your research ever done anything in that area of whether or not any sorts of these Federal subsidies, through savings programs or even direct subsidies for young people to go to college, have caused college tuition to go up just because there are more resources available?

Dr. MAGUIRE. I am not aware of any. I can find out, though, certainly.

The CHAIRMAN. Thank you.

I am going to ask my final question of Mr. Carter. It is directed, kind of, towards programs that have been set out here before us today, and other issues before Congress, to have bonding programs by the Federal Government to build buildings. You said your building is very old, 1916, as I think you said.

But also, some of those have a great deal of decision making by the Department of Education here in Washington, DC. I suppose someplace you have got to have some central administration of it, but I guess I am always looking for concerns about Washington education bureaucrats wanting to run local education too much.

I just was wondering, from your standpoint, whether or not that is a concern of yours as you look at these various efforts, not just related to school buildings. It would include that, and maybe any other education programs, whether or not there is concern on your part that local control is going to be lost, or is this something that most teachers are oblivious to because the needs of education are so great?

Mr. CARTER. Most teachers that I know feel, as do I, that control needs to stay at the local level. I will give you a classic example. My community in West Liberty has the largest per capita immigrant population in Iowa, 35 percent Latino, 5 percent Asian.

A nearby community of West Branch, where Herbert Hoover was born, is completely white and has one of the fastest growing GDPs in the State of Iowa. For you to make decisions about school needs from Washington about bonding issues for those two communities would be virtually impossible. I just do not think it could be done. I think local control is the way, and it needs to stay there.

The CHAIRMAN. All right.

Unless Senator Graham has a follow-up, I think we will call the hearing to a close. But I have to thank you, because some of you have come from long distances. We thank you for taking time out of your busy schedule to help us form the necessary background for making all of these policy decisions, which hopefully, because education is an early issue in the Congress of the United States, we will be dealing with these issues, I would bet, within the next month. So, you can watch on C–SPAN to see how much progress we are making.

Thank you all very much for your cooperation. The hearing is adjourned.

[Whereupon, at 11:20 a.m., the hearing was concluded.]

APPENDIX

Additional Material Submitted for the Record

Prepared Statement of Hon. George Allen

Mr. Chairman, first, I would like to thank you for inviting me speak on education and the need for significant education tax relief for families.

The idea that tax relief can improve education is common sense: by enabling parents to keep more of their income, they will be able to better afford education-related costs and take advantage of additional education opportunities.

Education-related tax relief follows the principle that parental involvement is a cornerstone for academic success. Parents, better than anyone, know the special needs of their own children. Providing families greater financial resources to invest in their children's education serves to encourage parental involvement and empower parents to help their own children learn and succeed in school.

Specifically, Mr. Chairman, I would like to take this opportunity to talk about my Education Opportunity Tax Credit, which builds upon the ideals of greater financial freedom, parental control and greater access to technology for all students.

My legislation provides families with a refundable $1,000 per child tax credit to help defray the cost of K–12 education expenses. Parents would be able to apply the credit toward the cost of education-related expenses, specifically computers and computer-related technology, education software and tutoring.

The maximum credit available per year is capped at $2,000 per family and would not apply toward the cost of tuition.

My legislation adds to the quality of the education experience by making sure parents keep more of their dollars, empowering them to make education decisions.

Let me give the Committee a quick example: An average American family of four making $38,900, after it pays its federal, state, and local taxes, pays for its housing and clothing, buys its food, makes the car payment, pay the gas, and puts away a pitifully inadequate average of .4% of its income into savings, has about $150 a month left for everything else.

Then, if you look at the average of a little over $150 per year that parents need to spend to make sure their children are adequately supplied for school, the average family has a little over $125 per month in real discretionary income left, or $1,500 per year. That's before signing kids up for Little League, before taking the family to a baseball game, or even a long weekend at the grandparents' house.

But the average computer, Mr. Chairman, costs well over $1,500, and that doesn't even include a printer, software, or signing up for an Internet provider like AOL. Buying a computer for the average family is simply financially impossible.

That's the added benefit of this credit, Mr. Chairman, in that it can make great strides in eliminating the Digital Divide. Although computers and Internet access are coming down in price, they are still sufficiently expensive that household income remains an important factor in determining access.

Without access to quality technology, economically disadvantaged children are placed at an early and distinct disadvantage in the classroom, and later, in the workplace.

Providing working families with the resources they need to afford the most up-to-date learning technologies in their own homes will help to close the divide and provide all children with the opportunity to gain from participation in the New Economy.

Through this substantial tax benefit, all families would now have access to a full spectrum of available education opportunities and supplemental services.

Parents would be able to take advantage of academic tutorial services, bring up-to-date computer technology into their homes or purchase education software and afford Internet access.

And by making the Education Opportunity Tax Credit refundable, every family, no matter what their income level, will be able to partake in its benefits.

Parents will have choice, but they will not be forced to choose between basic necessities and their children's educational needs.

Mr. Chairman, families must have access to a wide choice of education opportunities to provide their children with the most appropriate education tools, including technology-related materials, to ensure their success in school and beyond. And in this case, it will be the families, and not federal bureaucrats, who make those family education funding decisions.

The Education Opportunity Tax Credit encourages parental involvement and empowers parents to make the best decision concerning their children's education needs.

Thank you, Mr. Chairman.

PREPARED STATEMENT OF HON. JOSEPH R. BIDEN, JR.

Mr. Chairman, thank you for the opportunity to appear before your committee today to discuss an issue that is extremely important to me, and to the future of our county—and that's how we help American families afford the cost of a college education.

I know that I do not need to convince you, Mr. Chairman, about the importance of this issue. Earlier this year, you and the ranking member, Senator Baucus, introduced proposals—which I wholeheartedly support—to extend the tax deductibility of student loan interest and to make permanent the tax-free status of tuition assistance individuals receive from their employers.

Your legislation, and similar efforts such as the $12,000 tuition tax deduction proposal that Senator Schumer and I have sponsored, underscore what we all know to be true: A college degree is no longer a luxury—it is a necessity.

But for too many middle class families in our county—those who are also saving for retirement, and helping their elderly parents with prescription drug costs or long-term care—the price of tuition has put a college education out of reach.

When I went to college, it cost about $800 a year. That meant, for a family making about $12,000 a year, that the cost of college was about 6 or 7 percent of that family's income.

Today, the costs are enormous and, frankly, unrealistic. According to the College Board, the 100-year-old association that surveys college costs annually, the average cost this year for attending a public 4-year college, including tuition, fees, room, and board, are $8,470. For a private 4-year school, these costs have risen to an astonishing average of $22,541.

If you want your child to go to one of the best private schools, like Harvard or Yale, you're looking at more than 40 percent of the average family's income.

And to go to one of the best state schools, like the University of Delaware, you're still talking about more than 15 percent of your income.

Mr. Chairman, how can we expect families to dream of a better and brighter future for their children, when the cost of attending even some public universities rivals their home mortgage payments? Quite simply, we can't.

That is why in 1995, I first offered an amendment to permit a $10,000 tuition tax deduction, and in 1996 and again in 1997, I introduced my so-called GET AHEAD bill, which approached this problem from many different angles: scholarships, tax deductions, and savings plans.

I was very pleased that a number of the changes I had called for were included in the 1997 tax bill. These included permitting a tax deduction for certain student loan interest payments, and the establishment of Education Savings Accounts (like IRAs) to help prepare for college costs.

We also enacted the Hope Scholarship—a tax credit of up to $1,500 for the first two years of college, and the Lifelong Learning Credit—which permits a 20 percent tax credit on up to $5,000 worth of higher education expenses. And the amount of higher education expenses eligible for the 20 percent tax credit will rise to $10,000 in the year 2003.

But we can, and should, do more.

Mr. Chairman, the steps we took in 1997—while important—should be seen as only the beginning to a multifaceted approach to solving this problem.

The proposals that you and Senator Baucus introduced earlier this year will undoubtedly be central parts of any tuition assistance legislation enacted in this Congress.

But I would ask you, and the other members of this committee, to also consider the Schumer-Biden proposal.

This proposal, which Senator Schumer and I offered as an amendment last year, will build on the reforms we enacted in 1997 by letting most taxpayers take up to $12,000 worth of deductions each year for college tuition and fees. This will actually cut taxes for some families and individuals by more than $3,000 each year.

Take for example a family with joint income of $80,000 a year and three children—one of which is attending a private university at a cost of $16,000 a year.

Like many families today, this family probably has a mortgage payment, child care costs, prescription drug costs, savings for retirement, and far to many other costs that compete for their income. Yet they also have to worry about covering the tuition needed to send their son or daughter to college. Under our proposal, that family would save $3,360 a year. That's real money that could help this families make ends meet.

And to ensure that this assistance reaches even more families, I also believe it is important that we consider broadening the income ranges for the families eligible for this assistance.

Mr. Chairman, the dream of every American is to provide for their child a better life than they had themselves. Helping families to be able to afford to put their children through college moves us closer to achieving that dream.

And it is a critical investment in the future of our country—to make sure that we have a workforce that is better educated and better trained than ever before in our history.

I would hope that as this committee looks at the many tax cut proposals that come before us this year, you will choose to make smart investments that will help more American families send their children to college. Because, Mr. Chairman, these tax relief proposals will not only put money in the pockets of families to help spur the economy, but they are the investments that will ensure a brighter future for all our children and help guarantee a prosperous America down the road.

Prepared Statement of Tom Carter

Good Morning, my name is Tom Carter. I have taught and coached in the West Liberty School district in East Central Iowa for twenty three years. My subject areas are Economics and Global Issues, and I have coached football, basketball, baseball, and golf. I want to say at the very outset that I love teaching, and I love my students. I chose my career because I wanted to help students the way my teachers and coaches helped me. I hope I have been successful in that endeavor. I am not here today to complain nor will I portray the role of a martyr. My educators and why I feel Congress should help teachers in this area.

Simply put, teachers are being asked to do more with less in our society. While the world has become far more complex with growing populations, increasing economic development, and a huge information and technology boom, public schools have cut budgets for teachers for textbooks, supplies, and materials. In my school, the budget teachers have for supplies is one hundred dollars per year One only needs to examine our catalog for a few minutes to know that this is woefully inadequate. My subject area is on a rotation for new textbooks with other disciplines, and only recently did I get a text for my Global Issues class that did not have maps of the Soviet Union, and did not address the implications of the Berlin Wall for world peace. Two weeks ago, our superintendent sent us a memo that we must cut two hundred fifty thousand dollars from our already decimated budget next year. This will result in a loss of teaching positions and a decrease in allotments for supplies. Once again, I will be asked to do more with less resources.

Most people do not understand that requisition process, and why it can result in out of pocket costs to teachers. Teachers requisition items first to building principals and then to superintendents. If a request is denied, teachers can plead their case. If rejected again, we must decide if the resource is important enough to pay ourselves. Often, requisitions are denied because administrators may not understand why it is important. This is not an assessment of blame, but rather an explanation of the process. Teachers are trying to serve students, while superintendents must balance needs with scarce resources. A quick story might illustrate the point.

Greg Guinn, West Liberty's AD and business teacher of 33 years, and a man I call my mentor, told me Monday night the following story. He received many new computers in his business classroom. One of the by-products of computers is heat, and his classroom became extremely warm, well over 80 degrees. He requisitioned a cooling unit, but was rejected. In our building, built in 1916, climate is controlled by opening and shutting windows. Senator Grassley can tell you that this is dangerous in Iowa, as the weather changes every 10 minutes. An unforeseen problem occurred when bees attacked students and teachers in the fall. In fact, I was stung three times. Mr. Guinn decided that, for the health and education of his students, he would purchase an air conditioner. He spent $537 on a whirlpool unit from his own salary. Because of scarce resources and differing perspectives on needs, teachers and administrators struggle with this issue quite frequently.

Hence, I am often placed in the untenable position on a daily, weekly and monthly basis of either providing an inferior education for my students, or finding funds elsewhere. Often, "elsewhere" means out of my pocket. In the past year, I have purchased CD Roms, computer software, supplementary textbooks, and a variety of other materials in the amount of nearly five hundred dollars. On Monday, I e-mailed my colleagues in the district, and asked them to send their largest out of pocket expenditure in their careers as well as their average annual expenses. I found that the largest ranged from one hundred to fifteen hundred dollars. The average in my district from the replies I received was approximately four hundred dollars.

Teachers do this without complaint, and often without recognition or even immediate appreciation from those we serve. We do this because we love our students. The reward in our profession is a belated note from a graduated student that simply says thank you for helping me in my life.

Elementary teachers spend hundreds of dollars per year on construction paper, glue, crayons, markers, etc., while junior high and high school teachers buy supplementary materials out of pocket. In my subject area, social studies, it is necessary to purchase these materials because the world changes every day. Textbooks are outdated in a year, often in six months. Maps change every year, and the amount of information on the Internet doubles every six months. In order to keep up with the rapid change that we see in the world, we must purchase magazines, newspapers, texts, and computer software. Otherwise, our curriculum is quickly made irrelevant. Science teachers must also purchase materials outside the school budget as it seems scientists discover something new every day. Again, teachers are faced on a weekly basis with a dilemma: Do we use our existing materials and provide an inferior education, or do we buy the necessary materials ourselves. In most cases, the teachers with whom I work choose the latter.

I feel it is important at this juncture to note that nearly a third of Iowa's teachers will be retiring in the next ten years. Meanwhile, according to the Des Moines Register, twenty eight percent of Iowa's new teachers quit after only three years in the profession, and seventeen percent quit in their first year. Recently, I asked a group of talented seniors how many were considering teaching as a profession. After a brief bout of snickering, none was affirmative, and when I asked why not, their reply was unanimous: Why would we want to enter a low paying career filled with so much frustration?

The bill you are discussing today is part of a much larger question. What is the future of education in America in this millenium? Who will teach our children? Why should a young person enter the profession when he or she must pay for expenses out of their own pocket while making twenty three thousand dollars per year? I fear that I am a dying breed, and unless governments can make teaching a more attractive career, the best and brightest will choose other professions. It is simply not reasonable to expect teachers to impart a new millenium education with budgets made in the 1980's. This paradigm won't work.

I can state with certainty that most teachers are not driven by material rewards. We teach to serve our students and to help society. Our frustration with our profession often stems not from the behavior and performance of our students, but rather with our inability to provide them with the quality of education we desire. Congress today can send a message to every school district in the United States. The message, I hope, is that you appreciate our efforts, and that you understand the sacrifices we make every day. By giving us even small economic incentives, such as tax breaks for out of pocket expenses, you will give us more than a few hundred extra dollars in our pockets. You will give us the only reward that means anything to teachers, which is appreciation for what we do. And, you will send a message to seniors in high school, that teaching is a valued profession worthy of investigation.

It has been an honor and a privilege for me to come to Washington today, and I thank you for listening to my remarks. I only ask that you help teachers to do our jobs, so we can remove the label "A Nation At Risk", and replace it with "Number One In The World". Thank you.

RESPONSES TO QUESTIONS FROM SENATOR HATCH

Question: There are several proposals pending before the Congress that would provide tax relief to teachers. Some of these proposals include allowing teachers to deduct their professional development expenses. At least one of the proposals, however, restricts the type of professional development activities eligible for deduction. For example, one proposal permits the deduction only for professional development courses directly related to the academic subjects in which the teacher provides instruction. Is there any merit to allowing teachers to deduct professional development costs that do not directly relate to the academic subjects in which an eligible teacher provides instruction? Please elaborate, if possible.

Answer: I feel costs incurred in the following areas should be deductible:

1. Development of second language capabilities, especially Spanish (in view of changing demographic patterns)
2. Development of classroom management skills, management of crisis situations, etc.
3. Development of improvement in instructional design and curricular matters
4. Development of counseling skills, preparation for guidance counseling, etc.
5. Progress toward administrative degrees (particularly with current pending shortage in this field)
6. Improvement of technology skills.

Question: Some proposals also would limit the ability of a teacher to take a deduction based on the duration of the professional development course. Is it your experience that one-day or short-term workshops or conferences have professional merit and should be included as deductible costs under a teacher tax relief proposal? Please elaborate, if possible. What restrictions, if any, on the duration of an eligible course of instruction should the Congress impose?

Answer: I feel that any course that is of adequate duration to merit one semester hour of credit from an academic institution (usually, about 15 hours of class time or two workshop days) should be deductible on taxes. Congress may need to decide what types of courses and what institutions are acceptable as there are certainly “fluff” classes from poor institutions available for very cheap tuition. I realize this could be problematic and subjective, but it should be a consideration.

RESPONSES TO QUESTIONS FROM SENATOR TORRICELLI

Question: Many schools throughout this country rely on teachers to spend their personal funds for their classrooms and students. I support Congressional efforts to allow teachers to make these out-of-pocket expenses tax deductible.

However, teachers are not the only ones being asked to do more. Middle American parents are also being asked to spend additional funds on things that schools once provided, like transportation, school uniforms, and after school programs. If families need to spend more for their children's schooling, we need to encourage them to save more for their children. Senators Hutchinson, Breaux and I have introduced Education Savings Accounts, or ESAs, to help families save for their children's education. ESAs help families by increasing the limit of the existing Education IRA from $500 to $2000, and allowing funds to be used for elementary and secondary expenses.

Have you noticed a trend in your school, or other schools, where activities that were once free now have a cost to parents and students?

Do families in your school district or nearby schools have to pay for their own transportation or after school programs?

Does it make sense to allow parents to save money in accounts to be used for education purposes in order to pay for these new expenses?

Answer: Yes, certainly more costs are incurred by parents now than in the past. Textbook fees have gone up. Most schools require activity fees to pay for sports, band, chorus, etc. Many kids buy their own uniforms (jerseys, etc) in athletics and in music. Field trip fees are often paid for by students and parents. Though not “required”, athletic shoes cost many families several hundred dollars per year. Students must often pay for photocopies, especially when doing research projects. Occasionally, software and other technological devices must be purchased in order to compete in a modern classroom.

In our school, students do not have to pay for transportation costs or after school programs. However, I am told that in area schools, this is not the case. I am not qualified to answer this question accurately for you.

I feel an ESA would be appropriate for parents. I am uncertain that $2000 is an appropriate amount, but do feel raising the current from $500 would be a good move. As a parent of three children, I certainly spend more than $500 a year on materials and costs outside of the classroom, not to mention the money I spend as a teacher on my classes (as I stated on Capitol Hill). I do have a concern, however, that these funds would be used to allow students to transfer from a public school to a parochial or private school. Open enrollment laws are hurting our school a great deal, and an ESA that encourages this would further harm our community. I feel there should be restrictions in this department, especially in view of the new measures being enacted in the field of education, vouchers, etc.

PREPARED STATEMENT OF HON. SUSAN M. COLLINS

Mr. Chairman, I would like to thank you and Senator Baucus for convening this hearing today to discuss proposals to provide tax relief to assist our nation's students and educators. I am particularly pleased that you have chosen to discuss S. 203, the Teacher Support Act of 2001, a bill I introduced on January 30, 2001 with my good friends, Senators Kyl and Landrieu.

Our bill has two major provisions. First, it will allow teachers and teacher's aides to take an above-the-line deduction for their professional development expenses. Thus, educators will not be excluded from assistance simply because they don't itemize their deductions. Second, the bill will grant educators a tax credit of up to $100 for books, supplies, and equipment that they purchase for their students. According to a study by the National Education Association, the average public school teacher spends more than $400 annually on classroom materials. This sacrifice is typical of the dedication of so many teachers to their students.

While our bill provides financial assistance to educators, its ultimate beneficiaries will be their students. Other than involved parents, a well-qualified teacher is the most important prerequisite for student success. Educational researchers have demonstrated the close relationship between qualified educators and successful students. Moreover, educators themselves understand how important professional development is to maintaining and extending their levels of competence. When I meet with teachers from Maine, they repeatedly tell me of their need for more professional development and the scarcity of financial support for this worthy pursuit. As President Bush has put it, "Teachers sometimes lead with their hearts and pay with their wallets."

The willingness of Maine's educators to fund their own professional development activities has impressed me deeply. For example, an English teacher who serves on my Educational Policy Advisory Committee told me of spending her own money to attend a curriculum conference. She is typical of many educators who generously reach into their own pockets to pay for professional development and to purchase materials that enhance their teaching.

Let me explain how our bill works in terms of real dollars. In my home State, the average yearly starting salary of a public school teacher is $23,300. Under current law, a teacher earning this salary could not deduct the first $466 in professional development that he or she paid for out of pocket. Moreover, professional development expenses above $466 could be deducted only if the teacher itemized his or her deductions, which only about one-third of all teachers now do.

Our bill would enable all educators, regardless of whether or not they itemize their deductions, to receive tax relief for all qualified professional development expenses.

I greatly admire the many educators who have voluntarily financed additional education to improve their skills and to serve their students better and who purchase books, supplies, equipment, and other materials that enhance their teaching. I hope that this change in our tax code will encourage educators to continue to take formal course work in the subject matter that they teach and to attend conferences to give them new ideas for presenting course work in a challenging manner. This bill will reimburse educators for a small part of what they invest in our children's future.

Mr. Chairman, this would be money well spent. Investing in education helps us to build one of the most important assets for our country's future, a well-educated population. We need to ensure that our public schools have the best educators possible in order to bring out the very best in our students.

Last year, Senator Kyl and I, and our colleague and friend, Senator Coverdell, offered a similar version of this legislation as an amendment to the Affordable Education Act of 2000. Our amendment enjoyed overwhelming support and passed the Senate by a vote of 98–0. Unfortunately, the underlying bill was not taken up by the House of Representatives.

This year, we are very pleased that President Bush has made the classroom supplies portion of our bill part of his education platform, and that our legislation has received the support of the National Education Association. Our hope is that the bill will become law before the end of the year.

I thank the Committee for its consideration of this important piece of legislation.

nea

NATIONAL EDUCATION ASSOCIATION

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GOVERNMENT RELATIONS
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January 31, 2001

Senator Susan Collins
United States Senate
Washington, DC 20510

Dear Senator Collins:

On behalf of the National Education Association's (NEA) 2.6 million members, we would like to express our support for your proposed legislation that would provide a tax credit for teachers' out-of-pocket classroom expenses and a deduction for professional development expenses.

As you know, teacher quality is the single most critical factor in maximizing student achievement. Ongoing professional development is essential to ensure that teachers stay up-to-date on the skills and knowledge necessary to prepare students for the challenges of the 21st century. Your legislation will make a critical difference in helping teachers access quality training.

In addition, your legislation will make a real difference for teachers who reach into their own pockets to pay for necessary classroom materials, including books, pencils, paper, and art supplies. A 1996 NEA study found that the average K-12 teacher spent over $400 a year out of personal funds for classroom supplies. For teachers earning modest salaries, the purchase of classroom supplies represents a considerable expense for which they often must sacrifice other personal needs.

We are particularly pleased that your bill would provide tax relief to education employees working less than full time. Many classroom aides and other vital education employees work less than full time, while still facing the same out-of-pocket expenses as full-time teachers.

We thank you for your leadership in introducing this important legislation and look forward to working with you to support our nation's teachers.

Sincerely,

Mary Elizabeth Teasley

Mary Elizabeth Teasley
Director of Government Relations

PREPARED STATEMENT OF HON. TOM HARKIN

Chairman Grassley, Senator Baucus, thank you for providing me with this opportunity to testify at this important hearing on education tax and savings incentives. There is no issue of greater importance to the future of our nation than education.

In 1998, the American Society of Civil Engineers issued this Report Card for America's Infrastructure. As members of the committee can see, they report serious problems with the physical infrastructure in our nation. However, the most alarming finding is the failing grade given to schools in the U.S.—the only area to receive a failing grade.

It is a national disgrace that the nicest places our kids see are shopping malls, sports arenas, and movie theaters, and the most rundown place they see is their school. What signal are we sending them about the value we place on them, their education and future?

Modernizing and repairing our nation's schools is something I've been advocating for over a decade now. I secured $100 million in the FY 1995 appropriations bill as a down payment on a school modernization program and was disappointed when those funds were rescinded.

But we made real progress last year with the passage of a $1 billion initiative to make emergency repairs. That was a bipartisan agreement I hammered out with Congressman Goodling, Senator Specter, and the White House.

We need to build on our success. Last year, Senator Robb and I offered legislation to provide tax credits for school construction projects. This legislation was similar to bipartisan legislation in the House by Reps. Nancy Johnson and Charles Rangel.

This year I will join forces with Reps. Johnson and Rangel and introduce the America's Better Classrooms Act in the Senate. This legislation would leverage $1.7 billion in tax credits over five years to pay the interest on $25 billion in school modernization bonds. We'll be introducing that bill after the President's Day recess, and I urge the Committee to include school modernization tax credit bonds in the legislation you are developing.

I know this approach will work because it mirrors a successful school construction demonstration program I started in Iowa in 1997. The Iowa demonstration is a two-prong response to our school modernization needs. First, we provide grants to local school districts to make urgent repairs to remedy fire code violations. Second, grants are made to local school districts to subsidize a portion of the cost for a new construction project.

The program has been a big success. During the first two years of the demonstration, federal funds of $14.7 million supported projects totaling $142 million—each federal dollar leveraged $10.33.

There is a legitimate federal role in helping fix our nation's crumbling schools, and we can do so without undermining local control of education. This federal role is recognized by President Bush who is recommending an expanded use of private activity bonds for school construction projects. I know there are members of this Committee, both Democrats and Republicans, who support this expansion, but I believe we need to do more than the President has proposed.

Over the past few years we have had several partisan skirmishes related to school construction. This is a new year, a new Congress, and a new Administration. I am hopeful we will be able to work together to craft a bill that includes school modernization tax credit bonds to underwrite $25 billion in new school construction projects.

Thank you for providing me with this opportunity to testify, and I look forward to working with you and members of the Committee on this important issue.

Attachment.

ASCE

American Society of Civil Engineers

1998 Report Card for America's Infrastructure

Subject	Grade	Comments
Roads	D-	More than half (59 percent) of our roadways are in poor, mediocre or fair condition. More than 70 percent of peak-hour traffic occurs in congested conditions. It will cost $263 billion to eliminate the backlog of needs and maintain repair levels. Another $94 billion is needed for modest improvement -- a $357 billion total.
Bridges	C-	Nearly one of every three bridges (31.4 percent) is rated structurally deficient or functionally obsolete. It will require $80 billion to eliminate the current backlog of bridge deficiencies and maintain repair levels.
Mass Transit	C	Twenty percent of buses, 23 percent of rail vehicles, and 38 percent of rural and specialized vehicles are in deficient condition. Twenty-one percent of rail track requires improvement. Forty-eight percent of rail maintenance buildings, 65 percent of rail yards and 46 percent of signals and communication equipment are in fair or poor condition. The investment needed to maintain conditions is $39 billion. It would take up to $72 billion to improve conditions.
Aviation	C-	There are 22 airports that are seriously congested. Passenger enplanements are expected to climb 3.9 percent annually to 827.1 million in 2008. At current capacity, this growth will lead to gridlock by 2004 or 2005. Estimates for capital investment needs range from $40-60 billion in the next five years to meet design requirements and expand capacity to meet demand.
Schools	F	One-third of all schools need extensive repair or replacement. Nearly 60 percent of schools have at least one major building problem, and more than half have inadequate environmental conditions. Forty-six percent lack basic wiring to support computer systems. It will cost about $112 billion to repair, renovate and modernize our schools. Another $60 billion in new construction is needed to accommodate the 3 million new students expected in the next decade.
Drinking Water	D	More than 16,000 community water systems (29 percent) did not comply with the Safe Drinking Water Act standards in 1993. The total infrastructure need remains large -- $138.4 billion. More than $76.8 billion of that is needed right now to protect public health.
Wastewater	D+	Today, 60 percent of our rivers and lakes are fishable and swimmable. There remain an estimated 300,000 to 400,000 contaminated groundwater sites. America needs to invest roughly $140 billion over the next 20 years in its wastewater treatment systems. An additional 2,000 plants may be necessary by the year 2016.
Dams	D	There are 2,100 regulated dams that are considered unsafe. Every state has at least one high-hazard dam, which upon failure would cause significant loss of life and property. There were more than 200 documented dam failures across the nation in the past few years. It would cost about $1 billion to rehabilitate documented unsafe dams.
Solid Waste	C-	Total non-hazardous municipal solid waste will increase from 208 to 218 million tons annually by the year 2000, even though the per capita waste generation rate will decrease from 1,606 to 1,570 pounds per person per year. Total expenditures for managing non-hazardous municipal solid waste in 1991 were $18 billion and are expected to reach $75 billion by the year 2000.
Hazardous Waste	D-	More than 530 million tons of municipal and industrial hazardous waste is generated in the U.S. each year. Since 1980, only 423 (32 percent) of the 1,200 Superfund sites on the National Priorities List have been cleaned up. The NPL is expected to grow to 2,000 in the next several years. The price tag for Superfund and related clean up programs is an estimated $750 billion and could rise to $1 trillion over the next 30 years.

America's Infrastructure G.P.A. = D
Total Investment Needs = $1.3 Trillion
(estimated five-year need)

A = Exceptional
B = Good
C = Mediocre
D = Poor
F = Inadequate

Each category was evaluated on the basis of condition and performance, capacity vs. need, and funding vs. need.

American Society of Civil Engineers Washington Office 1015 15th Street NW

PREPARED STATEMENT OF HON. TIM HUTCHINSON

Chairman Grassley, Senator Baucus, members of the Committee, thank you for inviting me here today to testify in support of legislation I have introduced with my colleague Senator Torricelli to expand education savings accounts. I am honored to take up this fight from the previous sponsor of the legislation, Senator Paul Coverdell of Georgia, and in his honor, this legislation is named after him.

Like similar legislation that has passed the Senate in both the 105th and 106th Congresses, the "Coverdell Education Savings Accounts Act of 2001," allows parents, grandparents, or other scholarship sponsors to establish an education savings account to save for a child's education expenses. As you know, the Taxpayer Relief Act of 1997 allowed families to establish education individual retirement accounts for higher education expenses, but only allows contributions of $500 per year. This legislation would build on that by increasing the annual limit on contributions to $2,000 per child per year. It also expands the accounts so that savings may be used for elementary and secondary education expenses, including tutoring, special needs services, books, home computers, and tuition.

Contrary to popular belief, this is not a proposal to take money away from public schools. Instead, it encourages investment in all our schools. Parents would be saving their own money, not spending government funds, to help their children receive the best education possible. In fact, 75 percent of the parents who open these accounts will have children enrolled in public elementary and secondary schools. Education Savings Accounts benefit lower- and middle-class families who currently struggle to meet the education needs of their children.

Education savings accounts place the power of education in the hands of those who should be in control—parents. These accounts allow parents to invest their own money over time to plan for their children's future. Parents would have a real incentive to save for their children's education expenses, and as these accounts accumulate interest, they can have significant resources to pay for many of the services associated with educating their child. Even public education is no longer free. Parents often have to pay for education expenses out of their own pocket. In states like Arkansas where families in rural areas often do not have a choice about where to send their children to school, these accounts can help pay for distance learning programs, home computers, after-school programs, or additional tutoring.

In addition, one of the most important aspects of this legislation is that corporations, charitable organizations, foundations, and unions can contribute to education savings accounts. This will inject billions of new dollars into education that would not have been spent previously. Critics sometimes say that this legislation would do nothing for lower-class families who cannot afford to invest in an education savings account. Companies and unions could offer education savings accounts as benefits for their employees that could supplement amounts saved by low- and middle-income families.

This legislation leaves public money in public schools. Education savings accounts use private, after-tax dollars, not government funding. Instead of creating new federal education programs, we should allow parents to realize a maximum return on their savings by emphasizing the importance of saving for their children's education. It is estimated that education savings accounts will infuse more than $12 billion in additional funding into education, which far outweighs the cost of the bill. There is no better way to stress the importance of education than to make parents' dollars count.

President Bush included Education Savings Accounts in his tax plan, and I am encouraged by his support. I support him in his efforts to raise the limit on each account to $5,000, and would be happy to work with the Committee to find an agreeable amount for any legislation that you may consider. Thank you for allowing me the opportunity to speak in support of education savings accounts, and I look forward to hearing any thoughts you may have on this matter.

Prepared Statement of Hon. John F. Kerry

Mr. Chairman, I would like to thank you for holding this hearing today on education tax issues, which are of critical importance to me and to the constituents I represent in Massachusetts. I so frequently hear from parents, teachers, students, and school officials about the need to make higher education affordable and the need for the federal government to help states and localities deal with the overcrowding and deterioration of our nation's public schools.

The General Accounting Office estimated in 1995 that it will cost more than $112 billion to bring the existing education infrastructure up to the state of good repair. In my opinion, the federal government has not done its part to help states and localities address this tremendous need. But it's not just the renovation of existing schools that merits our close attention. There is also a tremendous need to build new schools for the rapidly growing school-age population. The National Center for Education Statistics estimates that elementary and secondary enrollment will swell from 52.7 million in 1998 to 54.3 million by 2008. School districts will need to build 2,400 new public schools by the year 2003 and thousands more in later years to accommodate growing enrollments. I would also just like to point out that unlike the school-age growth that occurred when the baby boom generation went to school, experts predict that the current growth in the numbers of school-age children is not likely to drop-off, but to grow slowly for at least the next ten years.

I am sympathetic to the argument made by some of my colleagues that because providing a free, public education to every child is the domain of states and localities that the federal government does not have an appropriate role in the provision of educational services. But I do disagree with my colleagues on this point, because I believe that the federal government can actually play a vitally important, non-intrusive role in supporting our public schools. As a society we have an obligation to give all of our children a free and public education. Safe schools free of overcrowded classrooms should be considered part of our commitment to providing a free, public education. And what we are hearing from our schools, from our parents, from our students is that they need help providing that education.

I am also very concerned about the rising costs of a college education. Our economy and our society more now than ever require that we produce a skilled workforce. But the cost to obtain a four-year degree at either or public or a private institution has increased dramatically. According to the National Commission on the Cost of Higher Education (1998), since the early 1980s, college tuition has increased annually at two to three times the rate of inflation. Between 1981 and 1995, tuition at 4-year public colleges and universities increased 234%, while during the same time period, median household income rose 82% and the consumer price index rose only 74%. Further, the typical bill for tuition, fees, room, board, books and incidentals at public institutions is $510,069, a whopping 23% of the average American family's household income.

More and more, college is the gateway to the American dream. The increasing importance of education to our society's prosperity underscores the need to grow our national investment in education. According to the Department of Education and the National Center for Education Statistics, in 1998 young men with a bachelor's degree earned 150 percent the salaryof their peers with no more than a high school diploma—and young women with a college degree earned twice as much as high school graduates. An investment in college earns a 12 percent return, nearly twice the historical average of the stock market. When I read statistics like these I am reminded of just how significant a role we do play—and should continue to play—to ensure that all those who wish to pursue a higher education are able to do so.

I am delighted that once again the Finance Committee has agreed that these are important priorities that merit the close review of this Committee. I look forward to discussing these issues with the panelists and with my colleagues. I genuinely hope that we come together and support federal funding to help our states and localities renovate existing schools and build new schools, and ensure that a college education is within reach for all Americans.

Thank you, Mr. Chairman.

Prepared Statement of Hon. Jon Kyl

I would like to commend Chairman Grassley for making education the subject of the first committee hearing—other than hearings on nominations—of the 107th Congress. The American people have told us in poll after poll that improving education is their highest priority. Moreover, if we can get education right in our country, almost everything else should follow from an advantage in national defense, to better trade and economic opportunities, to revitalized values.

While debates about education policy, particularly at the federal level, too often fracture along partisan lines, I am pleased that one of the bills the committee will review today—the Teacher Support Act that Senator Collins and I introduced on January 30—has proven that it commands consensus support.

Working together last year, Senator Collins and I, with invaluable assistance from our departed colleague Paul Coverdell, persuaded the Senate to pass almost identical legislation by a vote of 98–0. Like the amendment approved by the Senate last year, the Teacher Support Act would provide an annual tax credit of up to $100 for teachers' un-reimbursed classroom expenditures that are qualified under the Internal Revenue Code. For amounts over $100, teachers would continue to use the deductions allowed for such expenses under current law.

We know the need this legislation addresses is real. According to a recent study by the NEA, the average K through 12 teacher spent $408 every year on classroom materials. needed for education but not supplied by the schools. These materials include everything from books, workbooks. erasers, paper, pens, equipment related to classroom instruction, and professional enrichment programs.

In my discussions with teachers—public and private—I have been amazed to learn that many use their own money to cover the cost of classroom materials that are not supplied by their school or school district. I have attended intense meetings in which Arizona teachers have related to me, in confidence, that they have used money from the family budget, without telling their spouses, for needed classroom supplies, and that though they feel wracked with guilt, they would do it again for their students. Today, the committee will hear testimony from Tom Carter of West Liberty, Iowa, a social studies teacher who has had similar experiences. The Teacher Support Act stands for the idea that Tom Carter and his fellow teachers should not feel compelled to make such sacrifices.

Though there is no absolute linkage between personal contributions for school supplies and the quality of the teaching, there likely is some correlation between the two, given the degree of commitment evidenced by these teachers who are spending their own money. To the extent this is true, the proposal will have the effect of encouraging instruction of the highest quality.

I am pleased that President Bush campaigned on a similar proposal last year. and that hehas included it in the education package he announced last month. This legislation sends a much-needed message to the hard-working teachers of this country that they have our support. and that. working together. we can improve education for America's children.

Again, Mr. Chairman, I would like to thank you for holding this hearing. and I look forward to working with my colleagues on the committee to advancing legislation that promotes good education in our country.

PREPARED STATEMENT OF DR. STEVEN MAGUIRE

Background

In a June 2000 report, the National Center for Education Statistics projected that the nation's schools needed about $127 billion to repair or upgrade facilities to good overall condition.[1] The size of the apparent under-funding of school infrastructure investment has renewed interest in the role of the federal government in financing public school construction.

At present, federal support of public schools is generally provided by two means: 1) direct on-budget spending programs; and 2) indirect support for capital investment through the tax system. Direct spending is generally intended to implement a particular education policy goal whereas indirect support through favorable tax laws is unrelated, in most cases, to a specific education policy objective.

Direct federal spending plays a relatively small role in the finances of public elementary-secondary education. Public school funding was $307.5 billion in FY97 and of that the federal government provided about $19.7 billion or 6.4%.[2] Most of the federal government's $19.7 billion was designated for disadvantaged and disabled students, with little if any designated for school construction or renovation. More generally, public schools spent about $32.4 billion on capital outlays and $6.6 billion in interest on $125.7 billion of debt outstanding. Table 1 below provides a summary of public schools finances.

Table 1. Public Elementary-Secondary Education Finances, FY97

Budget Item	Amount (in $ millions)	Percent of Total
Total Revenue	$307,471	100.00%
From Federal	$19,737	6.42%
From State	$149,946	48.77%
From Local	$137,788	44.81%
Total Expenditure	$312,150	100.00%
Current Operations	$272,094	87.17%
Capital Outlays	$32,434	10.39%
Other	$7,623	2.44%

Source: U.S. Census Bureau, *Public Education Finances, 1997*, 1997 Census of Governments, Volume 4, Government Finances, May, 2000.

The indirect federal tax subsidy, which is not reflected in on-budget numbers, plays an even smaller role than direct federal direct spending. In FY97, the federal government

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[1] U.S. Department of Education, *Condition of America's Public School Facilities: 1999*, Office of Educational Research and Improvement, National Center for Education Statistics, Statistical Analysis Report 2000-032, June 2000. The sampling error on the estimate is ±$7.2 billion.

[2] U.S. Census Bureau, *Public Education Finances, 1997*, 1997 Census of Governments, Volume 4, Government Finances, May, 2000.

provided a subsidy through a tax exemption for bonds of roughly $2.9 billion on the debt outstanding, or about 1.0% of public school own-source revenue.[3] Another indirect subsidy, a tax credit for the holders of Qualified Zone Academy Bonds (QZABs), is discussed in more detail later in this testimony.

In summary, the following facts about federal support for public school finance seem clear:

- the federal role is small compared to state and local support;
- direct federal support is targeted to the disadvantaged and the disabled, and to school system support; and
- the current indirect federal tax subsidy for public school infrastructure investment is minimal.

State and Local Government Public School Capital Investment

The estimated $127 billion shortfall in public school infrastructure investment appears large but must be viewed in the broader economic picture of state and local government budgets. Investment in education infrastructure is but one of many infrastructure needs state and local governments must satisfy. For example, they also make capital investments in sewage treatment plants, roads, and prisons. Residents determine the level of investment for each of the purposes through voting. In theory, the investments with the highest return, either social or financial, are the first projects undertaken. Voters may decide that investment in school infrastructure may be more or less desirable than other types of public capital investment.

However, voters have not neglected the apparent need for new capital investment in public schools. The approval rate of school bond referenda has averaged just over 59% for the last 12 years (1988 through 1999) and the share of dollars approved is slightly higher at almost 64% over the same period. The approval rate and the dollar share of approved referenda have gradually increased since 1996. Table 2 reports the annual approval rate for school bond referenda for the 1988 to 1999 period.

In addition, the value of approved referenda has increased significantly in the latter half of the 1990s. For the period 1991 to 1995, the inflation-adjusted annual average value of approved bond referenda was just over $4.2 billion. In contrast, from 1996 to 1999, the average was $13.6 billion, an over three-fold increase. Of course, this may be a temporary increase in borrowing (and in turn spending) in response to the growing economy rather than a permanent shift in voter preferences. Nevertheless, with the school age population growing at less than 1.4% annually over the same period, the increased borrowing may help satisfy some of the pressing public school infrastructure needs.

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[3] CRS estimated this federal subsidy by multiplying the interest rate spread between high-grade taxable corporate bonds and high-grade tax-exempt municipal bonds by total debt outstanding.

Table 2. School Bond Referenda Approval Rates 1988 to 1999

Year	Share of Issues	Share of Dollars
1988	65.7%	77.6%
1989	58.0%	73.6%
1990	57.3%	70.7%
1991	49.9%	49.0%
1992	53.2%	60.4%
1993	56.8%	48.4%
1994	59.2%	51.6%
1995	55.3%	54.4%
1996	58.6%	69.1%
1997	61.9%	61.9%
1998	66.8%	82.4%
1999	66.0%	67.2%
Average	59.1%	63.9%

Source: *The Bond Buyer Yearbook*, Securities Data Company, various annual editions.

In summary, state and local investment in public schools appears to have increased over the last four years. However, it is uncertain if the increased investment is addressing the infrastructure needs of public schools in a manner consistent with federal education policy objectives.

Tax-exempt Bonds

Tax-exempt bond financing is attractive to public schools because the interest rate on these bonds is lower than the interest rate on taxable bonds. The resulting transfer to state and local governments is equal to the difference between the interest rate on tax-exempt bonds and taxable bonds of equal term and risk.[4] In 1999, the spread between taxable bonds and tax-exempt bonds was 1.61%. Thus, for every $100 in tax-exempt bonds issued in 1999, the federal government effectively passed along savings of $1.61 in interest cost per year to state and local governments.[5]

In terms of efficiency, the subsidy is questionable: for every dollar of lost federal tax revenue, the state and local government typically receives less than a dollar of interest cost saving.[6] The following numerical example best illustrates the inefficiency of the

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[4] Most tax-exempt bonds are long-term bonds, meaning they have terms of 13 months or more. In 1998, almost 90% of municipal bonds were long-term bonds.

[5] The calculations presented here do not include state and local income taxes that may apply to the interest income of the bondholders.

[6] Ronald C. Fisher, *State and Local Public Finance*, 2^{nd} ed. (Chicago: Irwin Publishing, 1996), (continued...)

federal subsidy through tax-exempt bond interest. The example uses the 1999 average tax-exempt bond interest of 5.43% and the 1999 average interest rate on high grade corporate bonds of 7.04%.[7]

The interest cost saving to the state and local government is the same regardless of the tax status of the bond purchaser, whereas the tax savings to the purchaser (and the corresponding revenue loss to the federal government) rises with his marginal tax bracket (see Table 3 for a numerical example). The federal revenue loss arising from the tax exemption is approximately the tax saving of the investor. For example, when an investor in the 39.6% bracket buys a tax-exempt bond at 5.43% with a face value of $10,000 rather than taxable bond of equal face value at 7.04%, the federal government loses $279 (39.6% multiplied by the $704 interest payment if the bond were taxable) of tax revenue, but the state and local government receives an interest cost savings of only $161. Table 3 compares the varying federal revenue loss to the interest cost saving of the state and local government for taxpayers in different marginal tax brackets. In each case, the revenue loss to the federal government exceeds the cost saving to the sub-federal government.

Table 3. Federal Cost and Local Benefit from Tax-Exempt Bonds at Different Marginal Income Tax Rates

(Estimates are for $10,000 tax-exempt bond with a 5.43% rate compared to a taxable bond with a 7.04% rate)

Investor's Marginal Tax Rate	Income Tax Saving to the Investor Through Purchase of Tax-Exempt Bonds	Interest Cost Saving of the Local Government from Tax- Exempt Status of Bonds
15%*	$106	$161
23%**	$161	$161
28%	$197	$161
31%	$218	$161
36%	$253	$161
39.6%	$279	$161

*Investors in the 15% bracket are not typical tax-exempt bond investors. The after tax return of taxable bonds is actually higher.
**This tax rate is the hypothetical market clearing marginal tax rate.

Qualified Zone Academy Bonds

To encourage more school renovation and repair (but not new construction), Congress passed legislation in 1997 (P.L. 105-34) that lowers the cost of borrowing for

[6] (...continued)
p. 256.

[7] U.S. Council of Economic Advisors, *Economic Report of the President*, (Washington: January 2001), Table B-73.

some school districts through debt instruments called Qualified Zone Academy Bonds or QZABs. The QZAB program was extended for two additional years in 1999 by Public Law 106-170.[8]

Specifically, the zone academy (typically a state education authority or a local school district) receives a zero interest rate loan for school renovation and the lender is allowed a tax credit against federal income taxes. The 1997 legislation limited the volume of such debt to $400 million annually for 1998 and 1999. The program was extended in 1999 with another $400 million for each 2000 and 2001 for a total of $1.6 billion over the four-year life of the program. Following is a brief overview of the zone academy program.

QZAB. A QZAB is a bond issued by a state or local government, containing provisions requiring that:

1) 95% of the proceeds be used for the purpose of renovating, providing equipment to, developing course materials for use at, or training teachers and other school personnel in a *qualified zone academy*, and

2) private entities promise to contribute to the *qualified zone academy* certain equipment, technical assistance or training, employee services, or other property or services with a value equal to at least 10% of the bond proceeds.[9]

Qualified Zone Academy. A school qualifies as a zone academy if:

1) the school is a public school that provides education and training below the college level,

2) the school operates a special academic program in cooperation with businesses to enhance the academic curriculum and increase graduation and employment rates, and

3) either (a) the school is located in an empowerment zone or enterprise community (including empowerment zones designated or authorized to be designated under the Act), or (b) it is reasonably expected that at least 35% of the students at the school will be eligible for free or reduced-cost lunches under the school lunch program established under the National School Lunch Act.[10]

QZAB Capacity. The states, which allocate bond capacity to the local academies, can carry forward any unused bond capacity within certain time limits. The allocation to

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[8] For a more extensive review of QZABs see: U.S. Library of Congress, Congressional Research Service, *Qualified Zone Academy Bonds: A Description of Tax Credit Bonds*, by Steven Maguire, CRS report RS20606.

[9] U.S. Congress, Joint Committee on Taxation, *General Explanation of Tax Legislation Enacted in 1997*, Joint Committee Print, part 2, 105th Cong., 1st sess. (Washington: GPO, 1997), pp. 40-41.

[10] Ibid.

the states is made on the basis of their portion of individuals below the poverty line. The 1998 and 1999 QZAB allocations must be made by December 31 of 2001 and 2002 respectively; the 2000 and 2001 allocations must be used by December 31, 2002 and 2003 respectively. QZAB buyers–limited to banks, insurance companies, and corporations actively engaged in the business of lending money–are allowed to claim an annual federal tax credit for the life of the bond. The federal tax credit is in lieu of interest payments from the issuer.

QZAB Term and Credit Rate. The maximum term "shall be the term which the Secretary [of the Treasury] estimates will result in the present value of the obligation to repay the principal on the bond being equal to 50% of the face amount of the bond."[11] The term has varied between 12 and 14 years because fluctuating interest rates change the present- value estimate. On February 9, 2001, the credit rate was 6.99% and the term 14 years.

The credit is equal to the credit rate set by the Department of Treasury multiplied by the face value of the bond. Because the credit is included in taxable income, investors require an after-tax yield equivalent to that of taxable bonds. For this reason, the Treasury establishes the credit rate based upon the average yield of a mix of high grade-corporate bond yields with maturities of 10 years or more.

Analysis of the Current QZAB Program

Three General Types of Bonds. Many different types of bonds are available to investors. This discussion and analysis is limited to three general categories. One, the QZABs described above; two, bonds whose interest payment is included in taxable income (taxable bonds); and, three, bonds whose interest payment is **not** included in taxable federal income (tax-exempt bonds). The potential federal revenue effect of the three bonds is presented in Table 4. The most expensive bond in terms of federal revenue forgone is the QZAB. Taxable bonds are the least expensive because they do not generate a federal revenue loss.

The three types of bonds in Table 4's example have a face value of $100 and an after-tax return of 4.55%. The difference between the taxable-bond interest rate and the tax-exempt bond interest rate is calculated to maintain equivalent after-tax returns. In theory, the after-tax return of the two investments should converge, all else equal.

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[11] 26 U.S.C. 1397E. The term of the bond is equal to the following: $\log(2)/\log(1+r)$. The variable r is the "discount rate of the average annual interest rate of the tax-exempt obligations having a term of 10 years or more which are issued during the month."

Table 4. Calculating the Implicit Subsidy to a Hypothetical QZAB Issuer

Values are in Dollars per $100 of Bond Proceeds Assuming a Corporate Taxpayer is in the 35% Marginal Tax Bracket					
(a)	(b)	(c)	(d)	(e)	(f)
Type of Bond	Issuer Pays	Lender Receives (pre-tax)	Taxes Paid by Lender	Federal Tax Revenue from Bond	Implicit Subsidy to Issuer
Taxable	7.00	7.00	2.45	2.45	0.00
Tax-exempt	4.55	4.55	0.00	0.00	2.45
QZABs[a]	0.00	7.00[b]	2.45	-4.55	7.00

[a] This estimate assumes the bond holder qualifies and has tax liability.
[b] This is received as a credit.

The second column (b) represents the amount an issuer must pay for use of loaned funds.[12] Clearly, the QZAB, where the federal government pays for the zone academy's use of the borrowed funds, is the most advantageous to the issuer. The lender is indifferent among the three because the after-tax return is fixed in this example at $4.55 dollars for every $100 borrowed.

Column (d) presents the taxable interest income multiplied by the corporate taxpayer's tax rate (35% in our example).[13] Both the **taxable bond** interest and the **QZAB** tax credit are included in taxable income, thus both generate federal revenue. However, the QZAB also provides a tax credit and creates a revenue loss equal to the tax credit rate multiplied by the bond face value. As reported in column (e), the tax credit (which is based upon the taxable bond interest rate) results in a net revenue loss equal to the interest rate on tax-exempt bonds (2.45%-7.00%=-4.55%). The 2.45% is the additional federal revenue from inclusion of the credit in income and the 7.00% is the tax credit allowance.

Column (f) presents the implicit federal subsidy to the issuer. The subsidy is measured by the percentage points *below* the taxable bond interest rate (arising from the favorable tax treatment) that the borrower paid for the use of funds. Generally, there is not a tax advantage to holding taxable bonds. With tax-exempt debt, the subsidy is the difference between taxable and tax-exempt bond interest rates, or 2.45% in our example. And finally, for QZABs, because there is little or no interest cost to the borrower, the subsidy is equal to the taxable bond interest rate.

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[12] Not mentioned in this report are the gains to tax-exempt bondholders in marginal income tax brackets *above* the market clearing rate. The after-tax equivalency between tax-exempt debt and taxable debt depends upon the marginal tax rate, which we implicitly assume is constant.

[13] If the marginal tax rate were lower, the federal loss from QZABs would be larger. A lower marginal tax rate generates less revenue from inclusion of the credit in taxable income though the credit is a fixed rate regardless of marginal tax rate.

Table 5 presents the estimated potential federal revenue loss, in nominal dollars, of the present QZAB program through 2009. The Joint Committee on Taxation (JCT) published estimates of the revenue loss for each QZAB law (P.L. 105-34 and P.L. 106-170) and the total revenue loss presented in the last column is the sum of the two estimates. The 1997 estimates (for P.L. 105-34) for 2008 and 2009 were not reported.

Table 5. Estimated Federal Revenue Loss Generated by QZABs
(in millions of dollars)

Year	P.L. 105-34, Aug. 5, 1997, (H.R. 2014)[a]	P.L. 106-170, Dec. 17, 1999, (H.R. 1180)[b]	Total Estimated QZAB Revenue Loss
1998	$8	--	$8
1999	$27	--	$27
2000	$43	$3	$46
2001	$47	$11	$58
2002	$47	$20	$67
2003	$47	$28	$75
2004	$47	$30	$77
2005	$47	$30	$77
2006	$47	$30	$77
2007	$47	$30	$77
2008	--	$30	$30
2009	--	$30	$30
Total	$407	$242	$649

[a] U.S. Congress, JCT, *General Explanation of Tax Legislation Enacted in 1997,* joint committee print, part 2, 105th Cong., 1st sess. (Washington: GPO, 1997), p. 515. [b] U.S. Congress, JCT, *Estimated Budget Effects of the Revenue Provisions Included in the Conference Agreement for H.R. 1180,* JCX-86-99, 106th Congress, 1st session (Washington: GPO, 1999), p. 1.

The estimates are in nominal dollars and thus do not account for the time value of money. Generally, the loans for construction today will be repaid (through credits) in later years with "cheaper" dollars. The real revenue loss relative to the construction cost is overstated for this reason.

Proposed Legislation in the 106th Congress

H.R. 4094. This Legislation, introduced by Representative Nancy Johnson on March 28, 2000, would establish Qualified School Construction Bonds (QSCBs) whose proceeds would be used for "the construction, rehabilitation, or repair of a public school facility or for the acquisition of land on which such a facility is to be constructed...."[14] The QSCBs and the existing QZABs are identified jointly in the legislation as "School Modernization Bonds." QSCBs, which are modeled after QZABs, would not be more than 15 years in term and the national limit would be $11 billion each year for 2001 and 2002. Indian

[14] The bill requires that 95% of the proceeds must be used for the stated purpose.

schools would be allocated $200 million annually for 2001 and 2002 which would be administered by the Department of the Interior.

QSCBs Allocation. The annual $11 billion QSCB limit for 2001 and 2002 would be allocated in the following manner.

- The states would receive 60% of the limit. The limit would be allocated to each state in proportion to the respective number of children who are at least age five and not yet 18. The unused annual portion of the state limit could be carried forward to the next year.

- The 100 largest educational agencies would receive the remaining 40% of the limit. The largest educational agencies are defined as those with the largest number of children aged five through 17 living in families below the poverty line. Alternatively, the Secretary of Education may determine that not more than 25 local education agencies are in particular need of assistance (other than 100 described above). The amount allocated to each of the local educational agencies would be proportional to the Basic Grants it received under Title 1 of the Elementary and Secondary Education Act.[15]

QSCB Arbitrage Limits. Bond arbitrage means selling bonds and using the proceeds to invest in other bonds and other taxable instruments.[16] For construction projects where the payments are often spread out, such as school construction, investing otherwise idle bond proceeds is considered a reasonable financial management tool.

Without any federal restrictions, state and local governments engaged in bond arbitrage could issue tax-exempt bonds and use the proceeds to purchase higher yielding taxable securities. This type of arbitrage would lower federal tax revenues. Hence, the federal government limits the type of investments and the length of time the proceeds from the issuance of tax-exempt municipal bonds can be held before expenditure on the designated project. Tax-exempt bond issues that have unspent proceeds in excess of the allowed amounts during a three-year spend-down schedule must rebate any arbitrage earnings to the Department of the Treasury. Bond issues are considered to be taxable arbitrage bonds if a governmental unit, in violation of the arbitrage restriction in the tax code, invests a substantial portion of the proceeds "to acquire higher yielding investments, or to replace funds which were used directly or indirectly to acquire higher yielding investments."[17]

Under H.R. 4094, 10% of QSCB proceeds must be spent within six months of the original issue. The remaining proceeds, including any interest earnings from temporary investments, must be spent within 36 months of the original issue.

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[15] For an explanation of the formula, please see CRS Report RL30491, *Education for the Disadvantaged: ESEA Title I Allocation Formula Provisions*, by Wayne Riddle.

[16] For an overview of tax-exempt bonds, see CRS Report RL30368, *Tax-Exempt Bonds: A Description of State and Local Government Debt*, by Steven Maguire.

[17] 26 I.R.C. Sec. 148(a).

QZAB Expansion. The legislation would also increase the 2001 QZAB limit to $1.4 billion from $400 million, and extend the initiative with another $1.4 billion in debt capacity for 2002. H.R. 4094 would also expand QZAB spending to include new school construction. Presently, 95% of QZAB proceeds must be used only in a qualified zone academy for the purposes of renovating, providing equipment, developing course materials, or training teachers and other school personnel. In addition to extending and expanding the QZAB program, the legislation would modify the technical details of the QZAB tax credit mechanism to conform with the new QSCB tax credit mechanism.

H.R. 4094 also proposes removing the restriction on eligible QZAB holders. Under current law, only banks, insurance companies, and corporations actively engaged in lending money, are allowed to hold QZABs.

H.R. 5542. This proposal would relax many of the arbitrage restrictions on QZABs and would adopt changes in the tax credit mechanism similar to those proposed by H.R. 4094. The legislation would also expand the definition of private-activity bonds. Two components would loosen arbitrage rules.

Expand the small-issuer definition. Under present law, arbitrage earnings from bonds issued for school capital expenditures are not rebated to the federal government if the issuer is defined as a "small issuer." A small issuer is an entity that does not issue more than $10 million in a calendar year. H.R. 5542 would raise the small issuer threshold to $15 million. The change would expand the number of entities that can use the federal tax-exemption and thus would also increase the accompanying arbitrage earnings of the issuers. According to sponsors, the additional arbitrage earnings are intended to substitute for state and local taxes.

Extend the Time Allowed for Spending Bond Proceeds. H.R. 5542 would also extend the spend-down period for school construction bond proceeds to four years from the current two years. This provision would allow sub-national governments to accumulate arbitrage earnings over a longer period which would not have to be rebated to the federal government. Again, this provision would allow sub-national governments to substitute state and local tax revenue with arbitrage earnings generated by the federal tax exemption.

Expansion of the Definition of Private Activity Bonds. H.R. 5542 would create a "qualified public educational facility" bond which would not be subject to state private activity bond capacity limits. However, the legislation would impose an individual limit on the states "...equal to the greater of $10 multiplied by the State population, or $5 million." A qualified facility is "...part of a public elementary school or public secondary school, and owned by a private, for-profit corporation pursuant to a public-private partnership agreement with a State or local educational agency." Although the individual cap may limit the potential federal revenue loss, the loss would necessarily increase with this provision.

QZAB Expansion. In addition to adjustments in arbitrage rules and expanding the exempt facility definition, H.R. 5542 would extend the existing QZAB school modernization program with an additional $400 million in each of 2002 and 2003. The legislation would also create a second type of QZAB that does not require the private

10% private partnership contribution that existing QZABs include. The annual limit for these bonds is $5 billion in each of 2001, 2002, and 2003. Half of the annual state allocation is determined by the State's share of the population and the other half by the State's share of the population below the poverty level of income.

Other Adjustments. H.R. 5542 would hold the issuer responsible if the QZAB should fall out of compliance with the designated rules of the QZAB program. Under current law, the bondholder is responsible for ensuring that the bond proceeds are spent on qualified activities.

Tax Credit Modifications Common to Both Bills

The tax credit modifications, which would apply to both QSCBs, QZABs (identified jointly in H.R. 4094 as "Public School Modernization Bonds"), and the QZABs in H.R. 5542 are intended to make the bonds more attractive to potential investors. Specifically, the legislation would:

- change the credit allowance date from annually to quarterly with the credits equal to 25% of the annual credit allowed on the 15th of March, June, September, and December;
- allow excess tax credits to be carried forward; and
- (only in the case of H.R. 4094) allow the potential stream of tax credits to be "stripped" from the bonds, thus, allowing the bondholder to sell credits to the highest bidder.

Discussion of Modifications. Presently, QZAB holders can claim the tax credit only once a year on the anniversary of the original issue date. However, corporate taxpayers pay estimated taxes on a quarterly basis. Changing the annual credit to a quarterly credit better matches the timing of quarterly estimated tax payments to the tax credit.

Under rules of the current QZAB program, if a bondholder holds tax credits that exceed its tax liability, the unused tax credits are forfeited. Allowing the bondholder to carry the credit forward to the next year is clearly advantageous to the bondholder and indirectly to the issuer. The increased demand for QZABs would most likely allow issuers to offer their bonds at a higher price.

Stripping the tax credits from the principal effectively allows a separation of the risk arising from principal repayment and the tax credit. At present, the fixed credit rate and the stated objective of QZABs to allow bond issuance without discount or interest cost does not provide for interest rate adjustments to compensate for default risk. In contrast, conventional bonds sold by a low-rated issuer offer a higher return (typically through higher interest payments) to compensate investors for the relatively higher risk of default. Because the credit rate of QZABs is fixed by the Secretary of the Treasury, issuers cannot modify the rate of return to entice investors.

Allowing investors to sell the stripped credits, which are effectively backed by the federal government and thus riskless, would provide some flexibility to the bondholder. Most likely, the riskless credits would be sold at a premium to another investor in a *lower* marginal tax bracket to whom the credits are more valuable.[18] The increased flexibility and rate of return could then increase investor demand for the bonds. The stripping provision will more than likely increase the cost to the federal government of tax credit bonds.

Generally, the tax credit modifications of the type offered by H.R. 4094 and H.R. 5542 would have made existing QZABs, the proposed QSCBs, and the modified QZABs more attractive investment instruments. The increased attractiveness of the bonds would have then made it easier for issuers to sell all QZABs and QSCBs.

Additional Provisions in H.R. 4094

In addition to the changes described earlier, Section 3 of H.R. 4094 would impose labor standards and hiring requirements on the construction projects funded by QZABs and QSCBs.

First, the legislation would require that the construction workers be paid in accordance with Section 439 of the General Education Provisions Act (GEPA). GEPA stipulates that the school construction project workers "...shall be paid wages at rates not less than those prevailing on similar construction and minor remodeling in the locality as determined by the Secretary of Labor in accordance with the Davis-Bacon Act as amended (40 U.S.C. 276a-276a-5)." This provision may or may not raise the cost of school construction and modernization. However, any significant increase in construction activity would lead to higher construction worker wages in the area even without the Davis-Bacon provision.

Second, local contractors would be given priority in awarding contracts. In effect, this provision limits the potential supply of workers and contractors. In theory, limiting the supply in a factor market (economists identify labor and capital as factors of production) generally leads to a higher cost for that factor; although, as noted, the purpose of this component was to promote local employment.

Third, each state would be required to establish a specialized training program designed to ensure that local skilled workers will be available for the construction or reconstruction project funded by the bonds. Theoretically, this provision would expand the available labor force or increase the supply of qualified construction workers. The increased supply of skilled construction workers may have been effective in its intended objective of satisfying the anticipated increase in demand for those workers.

Summary

The QZAB program represents a shift in the burden of financing the renovation of qualified institutions from state and local taxpayers to federal taxpayers. For every dollar of spending on school infrastructure through the QZAB program, the implicit subsidy by

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[18] Recall that the credit is included in taxable income and thus increases tax liability. An investor in a lower marginal bracket will see its liability increase *less* because of the credit, yet receive the same credit as a taxpayer in a higher marginal tax bracket.

federal taxpayers and benefit to borrowers appears to be almost three times[19] as much as an alternative financing mechanism: traditional tax-exempt municipal bonds. And, as indicated by Table 5, the Joint Committee on Taxation has estimated the federal revenue loss to be about $649 million through 2009. However, the federal revenue loss for the entire program is probably greater (in nominal dollars) than this estimate because the bonds are outstanding for 12 or 15 years, or well beyond 2009. For example, QZABs issued in 1998 will not expire until 2010 and those issued in 2001 may not expire until 2016. Alternatively, the time value of money does attenuate the potential *real*, i.e. inflation adjusted, revenue loss from the QZAB program.

[19] The implicit subsidy for tax-exempt bonds is the difference between its interest rate and the interest rate on taxable bonds (2.45% in our example). For tax credit bonds, it is the taxable bond interest rate (7.0% in our example).

Congressional Research Service

Memorandum March 9, 2001

TO: Senate Finance Committee
Attention: Gina Falconio

FROM: Steven Maguire
Analyst in Public Finance
Government and Finance Division

SUBJECT: Tax Credit Bonds for School Construction: Questions for the Record

This memorandum is in response to Senator Torricelli's request for additional information following the Senate Finance Committee's February 14, 2001 hearing on tax incentives for education. At that hearing, I testified about the use of tax-exempt bonds and tax credit bonds for school construction. After the hearing, I received a letter from your office dated February 21, 2001, requesting answers to two specific questions.

Enclosed is my response to Senator Torricelli's questions.

What effect would it have on schools if the federal government took care of the interest on their school construction loans?

Proponents of tax credit bonds believe the bonds will lead to additional school construction and renovation. The lower financing costs, they argue, could lead to the following outcomes in the short-run:

- better maintained schools,
- more new schools with better amenities,
- less reliance on bond referenda for school construction, and
- to the extent better physical surroundings improve education, the quality of human capital created by public schools may also increase.

However, over time, the same economic forces that led to the current status of school infrastructure may reappear. In theory, the current condition of schools reflects the budget preferences of citizens as expressed through elected representatives. Each jurisdiction decides independently on the amount of spending to devote to school construction.[1] State and local governments are responsible for the provision of many other public goods in addition to primary and secondary school construction including: teacher salaries, fire and police protection, waste treatment, roads, sewers, and post-secondary education. In theory, lowering the interest cost of school capital investment relative to other types of investment, may encourage more school construction. Alternatively, economists can also show that the lower financing cost could lead to an equal amount–or perhaps even less–school capital investment.

For example, assume a local government has decided to build a two-lane bridge and a new school. Before the introduction of tax credit bonds for new school construction[2], it tentatively decided to sell traditional general government bonds and split the proceeds between the two projects. With the expansion of tax credit bonds, the jurisdiction would have two financing mechanisms available assuming the jurisdiction qualified for the tax credit bond program. It is then likely that the tax credit bonds would be used for the new school and traditional tax-exempt bonds for the bridge. Because financing the school is considerably less expensive with tax credit bonds–it does not have to pay any interest on the borrowed funds–the locality may decide to use the amount saved to build a four-lane bridge. Or, it may lower local taxes by the amount of the savings. Thus, the lower financing cost of tax credit bonds will not necessarily lead to greater investment in school infrastructure.

Do you have an estimate on how much money schools would be able to leverage if federal tax credit bonds were enacted into law?

Currently, most school construction is financed through tax-exempt bonds. The primary tax credit bond proposals for school renovation and construction offered in the 106th Congress were H.R. 4094 (N. Johnson) and Title V of H.R. 5542 (Armey). I assume that tax credit bonds would substitute for traditional tax-exempt bonds. For a summary of the legislation, see CRS Report RS20713, *School Modernization Bonds: An Explanation of*

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[1] States often impose rules to ensure minimum levels of financing for schools through equalization rules. Nevertheless, to the extent schools rely on local taxes, such as local property taxes, there will be significant variation in the condition of schools from among jurisdictions.

[2] Under current law, QZABs cannot be used for new school construction. In the 106th, H.R. 4094 (N. Johnson) would have allowed new construction.

Selected Legislation of the 106th Congress. For a general description of tax credit bonds and tax-exempt bonds, see CRS Report RS20699, *Funding School Renovation: Qualified Zone Academy Bonds vs. Tax-exempt Bonds.* Table 1 briefly summarizes the additional funding for tax credit bonds as proposed in the legislation mentioned above.

Table 1. Principal Amounts of Selected Tax Credit Bond Proposals in the 106th Congress

H.R. 4094	QSCBs*	Indian Schools	New QZABs*	Total
2001	$11,000,000,000	$200,000,000	$1,000,000,000	$12,200,000,000
2002	$11,000,000,000	$200,000,000	$1,400,000,000	$12,600,000,000
			Total:	$24,800,000,000
H.R. 5542		QZABs II	New QZABs	Total
2001		$5,000,000,000	--	$5,000,000,000
2002		$5,000,000,000	$400,000,000	$5,400,000,000
2003		$5,000,000,000	$400,000,000	$5,400,000,000
			Total:	$15,800,000,000

*QSCBs are qualified school construction bonds and QZABs are qualified zone academy bonds.

To determine the amount of additional money schools could leverage with tax credit bonds relative to traditional tax-exempt bonds, I have calculated the total financing cost of an equal amount of initial principal for each financial instrument. The money "saved" through issuing tax credit bonds would then be available for more capital investment. However, as noted above, the savings from tax credit bonds may substitute for other types of capital investment or a reduction taxes.

Table 2 below compares the cost of the two tax credit bond proposals (summarized above) introduced in the 106th Congress to traditional tax-exempt bonds. Several assumptions have been made to arrive at the cost estimates. First, it is assumed that the local government will have to establish a "sinking fund" for the repayment the tax credit bond principal at the end of the 15 year bond term.[3] A sinking fund is an account a borrower establishes for eventual repayment of loan principal. The sinking fund is not an explicit requirement of tax credit bonds, however, lenders will likely require borrowers to offer some assurance that the principal will be repaid, a sinking fund provides that assurance. The money in the sinking fund is assumed to earn a return of 3.44% in 2001 and 3.94% in 2002 and 2003.[4]

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[3] In bond finance jargon, when borrowers sell a bond they are said to be "floating" a bond issue. A sinking fund follows the analogy. The periodic payments to the fund are used to eventually "sink" the bond.

[4] The 2001 interest rate is the State and Local Government Series (SLGS) demand deposit rate as of March 9, 2001, and the 2002 and 2003 rates are estimates based on the SLGS rate. The higher rate was chosen because it seems unlikely that interest rates will remain constant. A higher rate makes the sinking fund grow faster, thus lowering the cost.

The last column of Table 2 is the estimated difference between the payments to the sinking fund and the annual payments necessary to pay off a tax-exempt bond issue of equal size. Because tax-exempt bonds must pay interest as well as retire the principal, the difference is roughly the interest payments of tax-exempt bonds less the opportunity cost of the funds committed to the tax credit bond sinking fund. The interest rate on the tax-exempt bonds issued in 2001 was assumed to be 4.5%, approximating the rate as of March 7, 2000 and projected to be 5.0% for both 2002 and 2003. If the borrower is not required to establish a sinking fund, the advantage to tax credit bonds would be greater.

Table 2. Comparison of Tax Credit Bond Legislation Proposed in the 106th Congress to Traditional Tax-Exempt Bonds
(in billions)

Year	Principal	H.R. 4094 Tax Credit Bond Payments to Sinking Fund	Traditional Tax-Exempt Bonds Repayment of Principal plus Interest	Additional "Leverage" From Tax Credit Bonds
2001	$12.20	$9.53	$17.03	$7.50
2002	$12.60	$9.48	$18.21	$8.73
			Total:	$16.23*

Year	Principal	H.R. 5542 Tax Credit Bonds Payments to Sinking Fund	Traditional Tax-Exempt Bonds Repayment of Principal plus Interest	Additional "Leverage" From Tax Credit Bonds
2001	$5.00	$3.90	$6.98	$3.08
2002	$5.40	$4.06	$7.80	$3.74
2003	$5.40	$4.06	$7.80	$3.74
			Total:	$10.56*

*The estimates are in nominal dollars and represent the simple summation of difference between annual payments for the tax credit bond sinking fund and the annual payments on a traditional tax-exempt bond. The state or local government would have to calculate the present value of the stream of future savings to arrive upon the additional construction funds available today.

As indicated by Table 2, tax-credit bonds should be attractive to state and local governments for capital investment is school infrastructure. However, a potential implicit "cost" of some tax credit bonds has not been mentioned in this memorandum. School districts currently issuing Qualified Zone Academy Bonds are required to include a match from a private entity equal to 10% of bond principal. Finding a private entity to match the bond proceeds may be difficult for some jurisdictions since the match is essentially a "gift" without any future obligation.

PREPARED STATEMENT OF HON. MITCH MCCONNELL

Mr. Chairman, I am honored to again come before the Senate FinanceCommittee to discuss a bill which focuses on an important issue facing American families today—paying for the education of their children. I have long believed that we need to make college education more affordable, and my legislation, the Setting Aside for a Valuable Education, or SAVE, Act, will do that by making savings in qualified tuition savings plans entirely tax-free.

HISTORICAL BACKGROUND

Mr. Chairman I have worked for the past six years to make saving for college easier for American families by providing ways to help them keep pace with the rising cost of a college education through tax incentives. In 1994, I introduced the first bill to make education savings in state tuition plans exempt from taxation. Since that time, Congress has made significant progress toward achieving this important goal.

In 1996, I was able to include a provision in the Small Business Job Protection Act that clarified the tax treatment of state-sponsored savings plans and the participants' investment. This measure established that account earnings on the savings plans are to be included in gross income when distributions to attend school are made. This was an important change because it removed the tax uncertainty that was hindering the effectiveness of the plans and helped families who are trying to saving for their children's future education needs. Before this clarification, it appeared that account earnings may be taxed annually, which would have deterred saving for education expenses. Also, my language shifted the tax burden upon distribution of the funds from the parent to the student, who is generally taxed at a lower rate.

The following year, the Taxpayer Relief Act of 1997 included several important legislative initiatives that maximized flexibility to families with investments in long-term education savings plans. Through this vehicle, I was pleased to be able to expand the definition of "eligible education expenses" to include room and board costs so that these expenses—often as much as one-half the entire cost of college—also received the deferred tax treatment. Secondly, I was able to include a provision which expanded the definition of "eligible institutions" to include all schools, including certain proprietary schools, which are eligible under the Department of Education's student aid program. Finally, I was pleased that the Taxpayer Relief Act included a more detailed definition of the term "member of family" to allow tax-free transfers of credits or account balances in a qualified tuition program to additional family members in the event that the named beneficiary does not attend college.

However, while I am proud of these initial success stories, I will continue to press to make education savings entirely tax free. While the end is in sight, we cannot claim victory until we achieve this goal. In fact, the need for education savings tax relief is more acute then ever as recent studies demonstrate that we must still continue to encourage parents to adopt a long-term savings approach for their children's future education.

PROBLEM: THE RISING COSTS OF COLLEGE

According to the College Board, during the 2000–2001 academic school year, the average tuition at four-year public colleges rose between 4.4 and 5.2 percent. It is important to note that this increase was higher than the 1999 tuition increase of 3.4 percent. In addition, the College Board estimated that room and board charges would increase between 4 and 5 percent for the next year.

What is most frustrating is that despite the recent economic boom, the cost of a college education continues to rise at a rate faster than many families can afford. According to the College Board, since 1980 the price of a college education has been rising between two and three times the Consumer Price Index. In fact, tuition and fees for a four year college education has risen 115 percent over inflation since the 1980–81 school year, while median household income has risen only 20 percent. Over the past decade, tuition has increased between 32 and 49 percent, while family income over the same period has increased just 4 percent.

As a result, more and more families are forced to rely on financial aid to meet tuition costs. In fact, a majority of all college students utilize some amount of financial assistance. The amount of financial aid available to students and their families for the 1999–2000 school year topped $68 billion, more than 4% above than the previous year. However, there has been a marked trend from grant-based assistance programs to loan-based assistance programs, and today many students are forced to borrow in order to attend college. This shift toward loans increases the financial burden of attending college because students and families must then assume interest costs that can add thousands to the total cost of tuition.

We must not forget that compounded interest cuts both ways. For those students who must borrow, compounded interest is a burden, for those students and families who save, it is a blessing. By saving, participants can keep pace, or even ahead of, tuition increases. By borrowing, students bear added interest costs that add thousands to the total cost of tuition. Savings have a positive impact by reducing the need for students to borrow tens of thousands of dollars in student loans. This will help make need-based grants, which target low-income families, better meet the demands of those who are in most need.

Mr. Chairman, the need for rewarding long-term saving for college is clear. My legislation will recognize and award savings while allowing students and families that are participating in these state-sponsored plans to be exempt from federal income tax when the funds are used for qualified educational purposes. This bill will finish what I started in 1994.

SOLUTION: STATE TUITION AND SAVINGS PLANS

Mr. Chairman, as a result of our actions over the last several years, a majority of the states have implemented tuition savings plans for their residents. In the mid-1980s, states first began to recognize the difficulty that families faced in keeping pace with the rising cost of education. States like Kentucky, Florida, Ohio, and Michigan were among the first to start programs aimed at helping families save for their children's college education. Other states have since followed suit, and currently 48 states have some form of tuition savings plans.

Today, there are nearly one million savers who have contributed over $2 billion in education savings. In the Commonwealth of Kentucky alone, 3,250 beneficiaries have active accounts and have accumulated $13 million in savings. With average monthly contributions as low as $110, and nearly 60% of the participating families earning a household income of under $60,000 annually, state-sponsored tuition plans clearly benefit middle-class families—the exact Americans who deserve and need such relief.

THE MCCONNELL SAVE ACT

In addition to accomplishing my long-sought goal of making savings in tuition savings plans entirely tax-free, the SAVE Act, includes several other new provisions. It allows private institutions to establish their own qualified prepaid tuition programs, and at the same time includes important consumer protections to ensure that these new plans operate in a fiscally responsible manner. The SAVE Act also modifies the cap on room and board expenses to more accurately reflect the cost of attending an institution of higher learning. The final important change made in the SAVE Act is a provision allowing for one annual rollover between Section 529 plans to meet the needs of our increasingly mobile society.

Mr. Chairman, I have worked closely with state plan administrators over the years seeking both their advice and support. When I introduce the SAVE Act this afternoon, I will be honored once again to have the endorsement of the National Association of State Treasurers and the College Savings Plans Network. They have worked tirelessly in support of this legislation because they know it is in the best interests of plan participants-families who care about their children's education. In addition, state-sponsored tuition savings plans have recently been touted as one of the best ways to save for a college education by such influential magazines as Money, Fortune, and Business Week.

This overwhelming support for these programs underscores my belief that we have a real opportunity to go even further toward making college affordable for American families. It is in our national interest to maintain a quality and affordable education system for all families—not merely those fortunate to have the resources. My legislation rewards parents who are serious about their children's future and who are committed over the long-term to the education of their children by providing a significant tax break for all savers nationwide. This will reduce the cost of education and will not unnecessarily burden future generations with thousands of dollars in loans.

Mr.Chairman, college is a lifelong investment. We must take steps to ensure that higher education is within the reach of every child so that they are prepared to meet the challenges they will face in our increasingly competitive world. We must make it easier for families to save for college, and we can do so this year by providing total tax freedom for education savings. My bill will make these tuition savings plans entirely tax-free when the money is drawn out to pay for college, and I believe that my legislation is the best approach to ensuring that our children can obtain a higher education without mortgaging their futures.

Mr. Chairman, I would like to thank you and the entire Senate Committee on Finance for allowing me the opportunity to testify. I look forward to working with all on this vital national priority.

PREPARED STATEMENT OF JANET PARKER, SPHR

Good morning Mr. Chairman and Members of the Committee.

My name is Janet Parker, SPHR, and I am the Senior Vice President of Employee Relations for AmSouth Bank. AmSouth is a regional bank holding company headquartered in Birmingham, Alabama, with $38.9 billion in assets, 600 branch banking offices, and 1,250 ATMs. AmSouth has its origins with the First National Bank of Birmingham, established approximately 120 years ago and has since grown to operate in Alabama, Tennessee, Florida, Georgia, Mississippi, and Louisiana. We are a leader among regional banks in the Southeast and are the 20th largest financial institution in the country. I am also on the National Board of Directors of the Society for Human Resource Management (SHRM).

I am here today on behalf of the Society for Human Resource Management and the Section 127 Coalition. The Society for Human Resource Management is the leading voice of the human resource profession. SHRM provides education and information services, conferences and seminars, government and media representation, online services and publications to more than 150,000 professional and student members throughout the world. The Society is the world's largest human resource management association.

The Section 127 Coalition is a diverse group of more than 100 business, labor, and education organizations that are committed to making the exclusion for employer provided educational assistance found in section 127 of the Internal Revenue Code (IRC), a permanent part of the tax code and to reinstate the provision for graduate-level education.

I'd like to start by thanking Ranking Minority Member Baucus and Chairman Grassley for introducing S. 133, legislation to make permanent the Section 127 tax exclusion and to extend Section 127 to cover graduate education. I'd also like to thank the Committee for its past support of this legislation.

I am here today to urge bipartisan Congressional support for this very important legislation. As the Committee knows, Section 127 allows public or private employers to provide up to $5,250 per year to each of their employees in tax-free reimbursement for tuition, books, and fees for job or non-job related education. This legislation, when fully enacted, will provide incentives for employees to improve their skills through continuing educational opportunities, assist workers in developing a greater level of technical competency, and help to ensure that America stays competitive and has the best-educated workforce, as we continue to compete in an integrated and global market place. Section 127 is a purely private sector initiative and the one vehicle that encourages employer investment and support in providing educational assistance to workers. There is no large bureaucracy to administer the program, no agency to require oversight. Like any other benefit, employers are not required to provide section 127 benefits to their employees.

In the highly competitive banking and finance business, AmSouth competes not only for customers but employees as well. To continue to thrive and be successful in a record low unemployment rate environment, we at AmSouth are very careful to make sure we offer competitive salaries and benefits to attract and retain the best employees. Our tuition reimbursement program is one of the best benefits that we make available for our employees. Tuition reimbursement is available for all employees including those who work part-time (reimbursement is pro-rated based on the number of hours they work).

In 2000, we had 182 employees who utilized AmSouth's tuition reimbursement program. The majority of these employees participating in the program were non-exempt, with their average salary between $17,000 and $28,000.

As the war for talent continues, tuition reimbursement has been an instrumental recruiting tool to attract and retain employees. For instance, one of our departments was experiencing difficulty in getting employees to work extended hours (5 PM–8 PM) during the normal work-week. With the tuition reimbursement benefit and a commitment to provide students time off during exams, we were able to employ students to work the extended hours. In fact, one of the students was awarded a superior performance award for his outstanding contribution.

As the above example indicates, tuition reimbursement is a win-win for both the employers and the employee. Employers provide these benefits to their employees because they see value and a return on the investment in their employee's education. Employers get a better educated and often more highly skilled employee. Employees use Section 127 benefits to improve basic skills and to advance in their careers. In addition, recipients of Section 127 benefits are not your typical students. This is the case at AmSouth. As mentioned above, most of AmSouth recipients are working in a full-time capacity, balancing their work and educational pursuits. They choose to return to school on a part time basis to improve their skills and educational qualifications and, in turn, improve their career opportunities. For example, one of the recruiters in our staffing department lived on campus for a year after completing high school. Like many traditional students, she found it was too expensive and had to drop out. She obtained a job as a Teller and through AmSouth's tuition reimbursement program became a non-traditional student. After six years of working full-time and going to school, she graduated with a Human Resources degree. She was promoted to a recruiter that resulted in a 15% pay increase. She is now our teller recruiter and can share her own success story as a result of our tuition reimbursement program.

Section 127 is used by both new employees and those with many years of experience. As employees mature in their jobs, they often see opportunities that were not available when they initially were employed with AmSouth. However, demands of family may prevent the employee from obtaining the training they need to move into a different career. The executive administrative assistant in Human Resources always knew she could do more but did not have the formal education to pursue other opportunities. After her children were grown, she went back to school at night to secure a degree in human resources. After graduation, she moved into an instructional designer position in our training department. Her salary has increased 29 percent.

Since its creation in 1978 however, the provision has expired and been extended ten times. The current extension of section 127 was contained in The Ticket to Work Incentives Act of 1999, which extended section 127 from May 31, 2000 to December 31, 2001 for undergraduate-level courses only. The provision excluding graduate-level educational assistance expired on July 1, 1996 and has yet to be reinstated. In fact, due to the uncertainty of the tax exemption benefit, a statement has been placed in the AmSouth employee guidelines stating that this benefit could be considered as taxable income.

When Section 127 expires tuition-related expenses are shared by the employer and the employee. (Regardless of whether Section 127 is available however, employers may still deduct the cost of the training from their taxable earnings) In the absence of Section 127, the money an employee receives for educational assistance for non-job related courses must be considered income and taxed accordingly. That means the employer must pay the requisite employer's share of social security and Medicare taxes (FICA). Meanwhile, the employee must pay the remaining social security taxes, as well as all federal, state and local income taxes. Thus a student who received the maximum $5,250 benefit could owe as much as 40 percent of that money in taxes. In Alabama the tax implication for tellers, whose average income is $16,000 per year, would be $2,084.26.

As employers provide resources for training and education efforts aimed at improving their workforce as an investment in "human capital", it is unfortunate that when educational assistance is provided by an employer, it may be taxable. This often requires out-of-pocket tax payments from those least able to pay. More often than not this potential tax liability provide a disincentive for many employees that are pursuing additional educational opportunities.

Clearly, all employee benefits are voluntary, including Section 127. Not every employer offers pension benefits, life insurance or health care coverage to their employees. As with any other benefit (health care, retirement, life insurance, etc.), employers do provide these benefits because they see value and a return on the investment in their employee's education. In addition, the U.S. Congress and the federal government have made these benefits tax exempt for public policy reasons, e.g. increasing the private retirement savings rate and providing affordable access to health care services. Congress recognized the importance of encouraging employers to provide educational assistance to employees in the past by creating IRC section 127. It is time now to make that commitment permanent for both undergraduate and graduate education.

Greater global interaction and competition are increasingly requiring that individuals in the workforce maintain a greater level of technical competency skills. This skill level includes graduate-level education. To stay competitive in a global environment, employers and the United States have a direct interest in ensuring the best-education workforce. Increasingly, over the next decade, American workers will need some post-secondary education and training to keep pace with rapid changes in the workplace and the applications of technology in jobs.

Section 127 is a key tool in increasing productivity and competitiveness and it assists employers in recruiting, training and retaining workers. The yearly expiration of Section 127 causes a great deal of confusion as employers rework payroll systems and change training programs. Similarly, employees find their efforts to further their education put on hold. We greatly appreciate your leadership to make Section 127 permanent. I appreciate the opportunity to address the Committee and hope that you will continue to turn to the Coalition and SHRM for assistance concerning Section 127. I will be happy to answer any questions you may have concerning this important issue.

PREPARED STATEMENT OF DAVID J. PEARLMAN

INTRODUCTION

Mr. Chairman, Ranking Member Baucus and other distinguished members of the Finance Committee, I am David Pearlman, Vice President and Associate General Counsel at Fidelity Investments. I am pleased and honored to testify before the Committee today.

Fidelity Investments is the nation's largest mutual fund company with over $900 billion in assets under management, serving over 16 million customers, and is also the nation's largest 401(k) and IRA provider and a leading on-line discount brokerage firm from which many IRAs, small business retirement plans and college savings plans are marketed, sold andadministered.

Today, I will outline some of the advantages and drawbacks of section 529 education savings programs and Education IRAs and make some suggestions designed to increase the attractiveness of both programs to parents and grandparents of higher-education bound students.

In 1996, Congress adopted section 529 of the Internal Revenue Code, which governs qualified State tuition programs, and section 530, which governs Education IRAs. Since then Fidelity Investments has worked to help develop and implement the qualified State tuition programs of Delaware, Massachusetts and New Hampshire, for which Fidelity serves as administrator and investment manager. I will refer to qualified State tuition programs as "section 529 programs" and I will discuss these first in my testimony.

Also since 1996, Fidelity Investments has followed the developments with respect to Education IRAs. However, for a variety of reasons that I will discuss in a few minutes, Fidelity Investments does not currently offer an Education IRA.

SECTION 529 PROGRAMS

Background

Before section 529 of the Internal Revenue Code was enacted, a few states sponsored higher education savings programs on their own. The first prepaid tuition programs were adopted by Michigan, Florida and Wyoming in 1987 and 1988, and a number of states soon followed. In their purest form, prepaid tuition programs allow a person to purchase tomorrow's higher education at today's prices through the purchase of tuition credits at certain state higher education institutions. With the cost of college rising more rapidly than many other costs during the last decade, many parents and grandparents found prepaid tuition programs attractive. The IRS and the states differed on the correct approach to the tax treatment of the assets held in these programs. As a result, Congress intervened in 1996 and enacted section 529 of the Internal Revenue Code to settle such issues, but that in turn gave rise to a host of new issues.

Section 529 covers two types of programs: the "prepaid tuition" programs mentioned above and what have come to be called "college savings" programs. Generally, under prepaid tuition programs, a higher education student is entitled to benefits in terms of credit hours, semesters of covered expenses or the like. Students generally derive the full benefits of a prepaid tuition program only if they attend an institution of higher education that has agreed to participate in the program. In practice this almost always means a school in the state that sponsors the program. As you might guess, it is difficult for some parents, grandparents and other family members who fund these accounts for children to determine early in a child's life where they want to attend college. Nonetheless, a number of prepaid tuition programs have fared well, particularly in Texas, Florida and Pennsylvania, because of their well-established and popular state-sponsored higher education institutions.

In contrast, college savings programs are purely dollar-based education savings accounts. They work much like 401(k) plans. The value of an account in a savings program is independent of what school the student ultimately attends, and the student's ultimate choice of schools is not limited by participation in a particular state's program.

There is only one savings program, Kentucky's, that predates section 529. A small number (including those of New Hampshire and Delaware) had begun operation by mid-1998. By the end of 2000 approximately 45 states were operating savings programs, prepaid programs, or both. Most but not all states have contracted administration and investment of their savings programs to private sector vendors. A list of educational savings programs by state, indicating the type of program and the date of commencement, is attached as Appendix A. Please note that not all prepaid tuition programs intend to qualify under section 529.

Regardless of whether a section 529 program is a prepaid tuition program or a savings program, the tax treatment is the same. There are two principal income tax advantages. First, federal income tax is deferred on the account's earnings until distributions are made from the program Second, if the student attends a qualified higher education institution (one that is accredited and eligible to participate in federal student aid programs), the tax on the earnings is payable by the student, at the student's tax rate. Non-qualified distributions are generally taxed to the individual who contributed to the account and subject to a penalty of 10% of the amount of gain distributed to discourage these distributions.

Second, 529 programs also enjoy gift and estate tax advantages. Contributions are completed gifts when made, so death of the contributor does not result in estate tax due on the amount in the 529 program. Furthermore, the law permits a contributor to allocate five years' worth of annual gift tax exclusions to a contribution to a 529 program in a single year. Thus, up to a $50,000 contribution can be made to 529 program free of gift tax. Our experience is that large contributions to 529 programs are relatively rare and that most contributions are much smaller and made on a monthly basis. Approximately two-thirds of contributors to Fidelity-administered programs make contributions monthly, many for the program minimum of $50. For the three programs administered by Fidelity, the average account size is approximately $7,500.

One requirement of section 529 is that the state, not the contributor or the student, directs investments in college savings programs. The IRS has permitted states to offer a choice of investment programs to which contributions to college savings programs can be invested, but self-direction of the underlying investments is not permitted. Fidelity has devised an investment strategy based on the age of the child that provides for less investment risk as the child nears college age.

The public is becoming increasingly aware of college savings programs. The three programs served by Fidelity Investments attracted nearly $400 million in contributions in 2000, and have total assets today of more than $800 million, representing contributions from more than 100,000 individuals. Total assets in all savings programs are now estimated to be approximately $2.5 billion nationally.

Suggested Revisions to College Savings Programs

Our experience tells us that changes in the law would further assist those saving for college. We have identified seven changes that if enacted, would improve the attractiveness of college savings programs to parents and grandparents who are most likely to establish them on behalf of children or grandchildren. Grandparents now account for nearly one in seven dollars invested in college savings programs. Like the retirement IRA, college savings programs must be extensively marketed to raise the public's awareness of the benefits of the programs. The fixes that I will suggest will make them more useful to families concerned about the cost of their children's education and eliminate many of the unexpected tax burdens surrounding these plans. Some of the proposed fixes would also resolve issues under the proposed regulations under section 529. The states, through the College Savings Plan Network, have had numerous discussions with the IRS and the Treasury Department about many troublesome aspects of the proposed regulations, which were proposed in 1998. In our estimation the proposed regulations do not reflect Congressional intent in a number of important areas. We look forward to working with the Treasury and the IRS to revisit these proposed regulations.

First, distributions used for qualified higher education expenses should be tax-free. Under current law, the student is taxed on the earnings from his or her college savings account. This is a tax-trap for students and parents. Most students will not have the money to pay the tax bill. It is logical to assume that parents and grandparents will be called upon to pay this tax bill which will be unexpected in many instances. Congress twice has approved tax-free treatment, in 2000 and in 1999.

Second, 529 accounts should be completely portable. Currently, it is possible to move from one 529 program to another, but only if the beneficiary of the account is changed. This is often a problem for families that move from one state to another before their children attend college and wish to participate in the program offered by their new state of residence, or for those who simply find another state's program to be more attractive than their own. A family with two or more children must swap the children's accounts to move to another program, and a family with only one child cannot switch to another program at all.

Third, 529 accounts should be protected in bankruptcy, through provisions similar to those protecting qualified retirement plans. A provision to do this was contained in the bankruptcy bill vetoed by President Clinton in 2000 and should be included in this year's legislation. Only a few states have provisions to prevent money earmarked for a student's education from being seized by creditors of the account contributor.

Fourth, the definition of qualified higher education expenses should be amended. The statute currently limits the maximum amount of qualified higher education expenses for room and board to the minimum amount charged by an institution to any student, unfairly penalizing students whose actual expenses are higher, usually the result of living off campus or in on-campus housing other than the least attractive dorm.

Fifth, the statute needs to be corrected to address a potential inequity in the gift tax consequences in administering an education savings account. Under current law, a student beneficiary of the account could be subject to gift tax if the person funding the account changes the account'sbeneficiary to a child in a younger generation. A child typically has no control over his or her education savings account. To impose a tax because of the actions of others is not only unfair, but likely unconstitutional.

Sixth, the definition of family members who can benefit from an education savings account should be expanded to include first cousins. This would enable a grandparent to change the beneficiary of an education savings account from one grandchild to another, something not possible under current law.

And seventh, and not the least important, Congress should level the playing field with respect to the way states treat college savings plans for state taxes. A number of states have adopted tax subsidies for their residents, conditioned on participation in the state's own 529 program. This provides a disincentive for a resident of such a state to seek out a potentially better program offered by another state and disadvantages smaller states and rural states that typically seek to cover their costs by offering their programs to residents of other states. Disparate state tax subsidies, coupled with the competition among the states and their use of private sector vendors, may also be unconstitutional under the Commerce Clause. Most importantly, it is also unfair to families who move from state to state and lose the tax benefits of the prior state's program. To solve this problem, a qualification provision should be added to section 529, requiring that a state provide the same tax treatment to its residents no matter which state's 529 program they choose.

Before I comment on the Education IRA, there is one aspect of current law that should not be changed despite a few proposals to do so last Congress. This is the provision that limits the sponsorship of 529 programs to states, state agencies and state instrumentalities. State supervision of the plans has imbued them with the trust of the public and provides for stability over time. States can supervise, change and remove private sector service providers as needed. Following a clear mandate from Congress in 1996, most states and their financial service providers have invested significant time and money in developing their 529 programs. States partner with outside vendors like Fidelity Investments because the states often lack the resources to set up and administer their own plans. A sizeable investment of time and money is required by states and their financial service providers to get a college savings plan up and running and marketed. States and their outside vendors usually enter into long-term contracts which gives both sides a chance to recover their costs of setting up a new college savings program. As a result, many states provide the outside vendor with the right to withdraw from the program if subsequent legislation substantially diminishes the attractiveness of the program. This could happen if quasi-state and wholly private entities like student loan marketers are permitted to offer these plans without direct state sponsorship. Early withdrawal by vendors would place great burdens on these states and potentially strand hundreds of thousands of contributors and beneficiaries until the states develop their own administrative and investment management capabilities.

EDUCATION IRAS

Education IRAs were created by Congress in 1996. They provide the opportunity to direct one's own investments and receive distributions free from federal income tax if used to pay for qualified higher education expenses. Education IRAs also enjoy favorable estate and gift tax treatment similar to that afforded section 529 programs. However, our review of the market indicates that the Education IRA has not proved popular with families for a variety of reasons not the least of which is the low annual contribution limit of $500.

First, increasing the annual contribution limit to $5,000 would boost their viability at a time when parents are increasingly concerned about escalating college education costs. Higher education expenses are rising faster than general consumer prices.

Second, strict income limits on eligibility to set up an Education IRA prevent many people from establishing them. Repealing these limits would make them understandable and universally attractive. Furthermore, we suspect that the complexity surrounding the Education IRA also deters otherwise eligible families from accounts. There is evidence to suggest that this is happening with respect to retirement IRAs as well.

Third, under current law, contributions cannot be made once the beneficiary reaches age 18, and complete distribution of the account must be made when the beneficiary reaches age 30. Many students do not begin school by age 18, and many do not complete their higher education until after age 30. Modifying or eliminating these restrictions would also help increase the attractiveness of the Education IRA for people attending college later in life.

And fourth, in order to make use of the Hope Scholarship or Lifetime Learning credits, the taxpayer must elect to give up the tax-free status of distributions in the year in which the credit is to be used. Repealing this provision would again be helpful.

INTERACTION BETWEEN EDUCATION IRAS AND SECTION 529 PROGRAMS

Before I conclude my testimony, there is one additional statutory problem that affects both Education IRAs and section 529 programs. To the extent that the combined contributions in the same calendar year to all section 529 programs and Education IRAs established on behalf of a particular beneficiary exceed the annual Education IRA limit of $500, these amounts constitute excess contributions to the Education IRA and are subject to an excise tax under Internal Revenue Code section 4973. The tax is equal to 6% of the amount contributed, and applies each year until the offending contribution(s) and all earnings thereon are withdrawn.

Since several family members may establish accounts for the same beneficiary without informing each other, there is a real risk that well-intentioned efforts may have severe adverse tax consequences. This portion of section 4973 should be repealed.

CONCLUSION

The benefits of section 529 programs are becoming better known across America as a result of the partnership between the states as sponsors and the financial services firms as administrators and investment advisors to many of these plans. As these programs become more popular, the complexity and unexpected tax consequences for families and students are coming to light. The suggested fixes that I have offered today would eliminate the looming tax bite of these programs to millions of families and make them easier to understand and administer. With these changes Congress will be helping a greater number of working families relieve the financial burden of providing a higher education for their loved ones.

Education IRAs have not proved popular because of a low maximum contribution limit and a number of adverse statutory provisions. Increasing the contribution limit and eliminating some or all of the adverse statutory provisions could make the Education IRA valuable for the American public and would cause financial service providers like Fidelity to revisit the feasibility of offering Education IRAs.

This concludes my testimony and I thank you for the opportunity to share my thoughts on this very important topic. I request that my written statement, including attachments, be included in the record and I would be happy to answer any questions.

Attachments.

APPENDIX A

COLLEGE SAVINGS PLANS NETWORK

State College Savings Plans Overview (*Italics* represent no residency requirements)

State	Name of Program	Operational	Program Type	Telephone
Alabama	Prepaid Affordable College Tuition	✔1990	Prepaid Tuition	800-252-7228
Alaska	Advance College Tuition Payment Program	✔1991	Prepaid Tuition	800-478-0003 (*)
	Alaska Savings Plan	May 2001	Savings Plan	907-474-5927
Arizona	Family College Savings Program	✔June-99	Savings Plan	602-229-2592
Arkansas	GIFT College Investing Plan	✔Dec-99	Savings Plan	877-442-6553
California	*Golden State ScholarShare Trust*	✔Oct-99	Savings Plan	877-728-4338
Colorado	*Colorado Prepaid Tuition Fund*	✔Sept-97	Prepaid Tuition	800-478-5651
	Colorado Savings Plan	✔Oct-99	Savings Plan	
Connecticut	*Connecticut Higher Education Trust*	✔Dec-97	Savings Plan	888-799-2438
Delaware	*Delaware College Investment Plan*	✔July-1998	Savings Plan	800-292-7935
Florida	Florida Prepaid College Program	✔1988	Prepaid Tuition	800-552-4723
	Florida College Savings Program	Spring 2001	Savings Plan	850-488-8514
Georgia	HOPE Scholarship		Scholarship	800-776-6878
	Legislation for savings did not pass in 2000, may be reintroduced in 2001.			
Hawaii	Hawaii College Savings Program	July 2001	Savings Plan	808-586-1518
Idaho	*Idaho College Savings Program*	2001	Savings Plan	208-334-3200
Illinois	College Illinois!	✔Oct-98	Prepaid Tuition	877-877-3724
	Bright Start College Savings Plan	✔Mar-00	Savings Plan	217-782-1319
Indiana	*Family College Savings Program*	✔1997	Savings Plan	888-814-6800
Iowa	*College Savings Iowa*	✔Sept-1998	Savings Plan	888-446-6696
Kansas	*Learning Quest Education Savings Plan*	✔July 2000	Savings Plan	785-296-3171
Kentucky	Education Savings Plan Trust	✔1990	Savings Plan	877-598-7878
	Guaranteed Pre-Paid College Tuition Plan	Fall 2001	Prepaid Tuition	502-564-4722
Louisiana	Louisiana START	✔July-97	Savings Plan	800-259-5626, ext. 0523
Maine	*NextGen College Investing Plan*	✔Aug-99	Savings Plan	877-668-1116
	Maine Prepaid Tuition Program	2001	Prepaid Tuition	877-668-1116
Maryland	Maryland Prepaid College Trust	✔Apr-1998	Prepaid Tuition	888-463-4723
	Maryland Savings Plan	2001	Savings	888-463-4723
Massachusetts	*U.Plan*	✔1995	Prepaid Plan	800-449-6332
	U.Fund	✔Mar-1999	Savings Plan	800-544-2776
Michigan	Michigan Education Trust	✔1988	Prepaid Tuition	800-638-4543
	Michigan Education Savings Program	✔Nov 2001	Savings Plan	800-638-4543
Minnesota	Minnesota EDVEST	Spring 2001	Savings Plan	800-657-3866, ext. 3201
Mississippi	Prepaid Affordable College Tuition	✔1997	Prepaid Tuition	800-987-4450
	Mississippi Affordable College Savings	Spring 2001	Savings	800-987-4450
Missouri	*Family Higher Education Savings Plan*	✔Nov-99	Savings Plan	888-414-6678
Montana	*Family Education Savings Program*	✔1998	Savings Plan	800-888-2723
Nebraska	*Nebraska College Savings Plan*	✔Jan-01	Savings Plan	402-471-2455
Nevada	Prepaid College Tuition Plan Trust Fund	✔Oct-98	Prepaid Tuition	888-477-2667
New Hampshire	*Unique College Investing Plan*	✔July-98	Savings Plan	800-544-1722
New Jersey	Better Educational Savings Trust	✔Aug-98	Savings Plan	877-465-2378
New Mexico	NM Prepaid Plan	✔Sept-00	Prepaid Tuition	800-279-9777
	NM Savings Plan	✔Sept-00	Savings Plan	800-279-9777
New York	*College Choice Tuition Savings Program*	✔Sept-1998	Savings Plan	877-697-2837
N. Carolina	College Vision Fund	✔June-1998	Savings Plan	800-600-3453
N. Dakota	*College SAVE*	2001	Savings Plan	800-472-2166
Ohio	CollegeAdvantage	✔1989	Guaranteed	800-233-6734
		✔Fall 2000	Savings Plan	800-233-6734

State	Name of Program	Operational	Program Type	Telephone
Oklahoma	Oklahoma College Savings Plan	✔Apr-2000	Savings Plan	405-858-4422
Oregon	Oregon College Savings Plan	✔Jan-2001	Savings Plan	866-772-8464
Pennsylvania	Guaranteed Savings Program	✔1993	Savings Plan	800-440-4000
	Investment Savings Program	2001	Savings Plan	800-440-4000
Rhode Island	*RI Higher Education Savings Trust*	✔Sept 24, 98	Savings Plan	877-474-4378
S. Carolina	SC Tuition Prepayment Program	✔Sept 98	Prepaid Tuition	888-772-4723
South Dakota	No program			
Tennessee	Tennessee BEST	✔1997	Prepaid Tuition	888-486-2378
	Investment Savings Program	✔2000	Savings Plan	888-486-2378
Texas	Texas Tomorrow Fund	✔1996	Prepaid Tuition	800-445-4723
Utah	*Educational Savings Plan Trust*	✔1996	Savings Plan	800-418-2551
Vermont	Vt. Higher Education Savings Plan	✔Dec-1999	Savings Plan	800-642-3177
Virginia	Prepaid Education Program	✔1996	Prepaid Tuition	888-567-0540
	Virginia Education Savings Trust	✔Dec-99	Savings Plan	888-567-0540
Washington	Guaranteed Education Tuition Program	✔Summer-98	Prepaid Tuition	877-438-8848
West Virginia	WV Prepaid College Plan	✔Oct 98	Prepaid Tuition	800-307-4701
	WV Investors Program	2001	Savings Plan	800-307-4701, ext. 2
Wisconsin	*EDVEST Wisconsin*	✔1997	Savings	888-338-3789
Wyoming	Advanced Payment for Higher Education Cost	✔1987-95	Prepaid Tuition (a)	307-766-5766
	Family College Savings Program	✔May 2000	Savings Plan	307-777-7408
Dist. of Columbia	National Capitol College Savings Trust proposed to DC Council			

KEY:
TBD - To be determined
Italics – no residency requirements
(*) - Toll free available for in-state calls only
✔ - Program operational

NOTES:
(a) Program suspended in 1995 because of non-participation, but counted as active because it is honoring previous contracts.

SOURCE: The College Savings Plans Network of the National Association of State Treasurers.

"THE NUMBERS"

Current Prepaid
20 (Alabama, Alaska, Colorado, Florida, Illinois, Maryland, Massachusetts, Michigan, Mississippi, Nevada, New Mexico, Ohio, Pennsylvania, South Carolina, Tennessee, Texas, Virginia, Washington, West Virginia, Wyoming)
Note: Wyoming program suspended.

Prepaid To Be Operational
2 (Kentucky, Maine)

Current Savings

33 (Arizona, Arkansas, California, Colorado, Connecticut, Delaware, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, Maine, Massachusetts, Michigan, Missouri, Montana, Nebraska, New Hampshire, New Jersey, New Mexico, New York, North Carolina, Ohio, Oklahoma, Oregon, Rhode Island, Tennessee, Utah, Vermont, Virginia, Wisconsin, Wyoming)

Savings To Be Operational
10 (Alaska, Florida, Hawaii, Idaho, Maryland, Minnesota, Mississippi, North Dakota, Pennsylvania, West Virginia)

Long Range Total: Prepaid=22 Savings=43 Total = **65**
Representing 48 states

529 Investment Plans

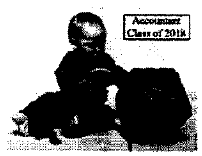
Fidelity Investments manages three 529 college investing plans. All three plans follow the same investment strategy and are available to any U.S. resident regardless of state residency. Please choose the plan you prefer, or if you have no preference, choose the UNIQUE plan.

New Hampshire's plan	Massachusetts' plan	Delaware's plan
The UNIQUE College Investing Plan	U.Fund College Investing Plan	college investment plan

★ The UNIQUE College Investing Plan ★ 1-800-544-1722

Overview

Overview



Each child is unique. A college investing plan should be too. That's why the State of New Hampshire has teamed with Fidelity Investments to offer you the UNIQUE College Investing Plan (the UNIQUE Plan).

The UNIQUE Plan is available to any U.S. resident. However, Fidelity also manages 529 investment plans for Massachusetts and Delaware. If you are a resident of one of those states, you may want to check into your state's plan.

Investment and Tax Benefits
- ability to give up to $50,000 federal gift tax free
- tax-advantaged growth of earnings
- a portfolio of Fidelity mutual funds tailored to the student's age

Portability and Flexibility
- the ability to save for college while retaining control of your assets
- the flexibility to use your investment at any accredited post-secondary school in the U.S.
- a high contribution limit

Affordability
- a low minimum investment requirement

The UNIQUE Plan is intended for individuals of all income levels with higher education goals for their children or loved ones. Parents, grandparents, other relatives and even family friends can all participate. Whether your beneficiary attends a private college, public university, graduate school, two-year community college, vocational-technical school, in- or out-of-state, the UNIQUE Plan can help you meet the significant financial challenge that lies ahead.

The only requirement for enjoying these unique benefits is that your investment be used to pay for qualified expenses at an accredited institution of higher education that is eligible to participate in certain federal student aid programs.

The UNIQUE Plan does not guarantee a rate of return and may not be right for everyone. However, if you are looking for a new way to invest for a child's higher education, it might be right for you.

- Download an Annual Report

- View Unique Portfolio Unit Values

- Download an enrollment kit

▪Request one by mail

▪Call 1-800-544-1722 to speak with a UNIQUE representative at Fidelity.

TOP

Investment and Tax Benefits

▪ **Professional investment management by Fidelity**. The UNIQUE Plan puts the investment expertise of Fidelity to work for you.[1] You purchase units of one of the UNIQUE Plan portfolios. Balancing investment risks against potential returns can be a difficult task -- especially if you do not have the time or the inclination to do so. Investments in the UNIQUE Plan portfolios are managed by Strategic Advisers, Inc., a Fidelity Investments company. An experienced portfolio manager will automatically determine the portfolio's investment mix and make appropriate adjustments according to your beneficiary's age.

When your beneficiary is ten or more years away from college age, the portfolio will be heavily invested in equity mutual funds for growth of capital. As your beneficiary nears college age, the portfolio will gradually shift emphasis to bond and money market mutual funds to potentially preserve capital that will be readily available for college expenses.

You can learn more about the UNIQUE Plan's asset allocation and investment strategy, and read about the portfolio manager of the plan.

▪ **Tax-advantaged earnings**. Earnings in your UNIQUE Plan account grow federal income tax-deferred. When assets are withdrawn for qualified expenses such as tuition, room and board, books, and required supplies, federal income taxes are payable by the beneficiary -- typically at his/her lower rate. For New Hampshire residents, qualified withdrawals are also completely exempt from the New Hampshire interest and dividends tax.[2] Non-residents are not subject to this tax. If you already have money set aside for college in a taxable account (such as a savings account), you may want to consider the tax benefits of moving it to the UNIQUE Plan. Consult your tax advisor for your particular situation.

▪ **Flexible investing plans**. Any resident of the U.S. age 18 or over can open an account for their beneficiary. You can get started for as little as $50 per month with automatic payments. There are no restrictions on participation based on your income. Parents, grandparents, other relatives and even family friends can open up accounts on behalf of the same beneficiary as long as the total amount in all accounts does not exceed the UNIQUE Plan limit of $166,600 per beneficiary.[3]

Also, a gift of more than $10,000 to a single person in one year is normally subject to federal gift tax. With the UNIQUE Plan, you can make a gift of up to $50,000 in one year without triggering the tax. To do this you must elect to treat the entire gift as a series of five equal annual gifts. And no additional gifts can be made over the five year period. Consult your tax adviser for your particular situation.

TOP

Portability and Flexibility

▪ **Portability to any school in the U.S.** Assets in the UNIQUE Plan can be used to pay for qualified higher education expenses at any accredited post-secondary institution in the United States that are eligible to participate in certain federal student aid programs. These include public and private colleges and universities, graduate schools, two-year community colleges and vocational-technical schools.

▪ **Change of beneficiaries**. Participants in the UNIQUE Plan retain control of their assets until account assets are withdrawn for qualified higher education expenses. Participants can change their beneficiary to be another family member of the original beneficiary without paying a penalty.[4]

▪ **Withdrawals for non-higher education purposes**. You can take money from your account at any time. If your beneficiary receives a scholarship for higher education expenses, you may withdraw an amount equal to the value of the scholarship from your account without paying a penalty. You may also make penalty-free withdrawals in the event of the death or disability of your beneficiary. Otherwise, earnings on non-qualified withdrawals will be taxed to you as ordinary income at your rate, and a federally mandated penalty equal to 10% of any investment gains distributed will apply.

TOP

Affordability

▪ **Affordable investments**. Investors who sign up for Fidelity's Automatic Account Builder® (FAAB) to make automatic payments directly from their bank accounts can open an account with a minimum initial investment of $50 a month or $150 per quarter. Otherwise, there is an initial minimum investment requirement of $1000.

▪ **Low fees and expenses**. The UNIQUE Plan charges an annual $30 maintenance fee per account which is waived if you sign up for FAAB or if the combined value of your account and any other accounts with the same named beneficiary is $25,000 or more. There is a daily charge at a rate equal to 0.30% ($3 per $1,000) of your account assets per year. Each of the mutual funds also has investment management fees and other expenses which vary from fund to fund. There are no sales loads imposed on your UNIQUE Plan purchase.

TOP

Important Point to Consider: Although the UNIQUE Plan has many benefits, it may not be appropriate for all investors. Please review your individual situation to make sure it is right for you.

- Download an Annual Report
- Download an enrollment kit
- View Unique Portfolio Unit Values
- Request one by mail
- Call 1-800-544-1722 to speak with a UNIQUE representative at Fidelity.

[1]Under federal law you cannot direct your own investments in the UNIQUE Plan.

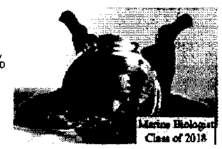
[2]If you are not a New Hampshire resident, you may want to investigate whether your state offers a plan with alternative tax advantages for its residents.

[3]This contribution limit is for 2001 only and will be adjusted annually to reflect the changing costs of higher education.

[4]The new Beneficiary must have one of the following relationships to the original Beneficiary: (1) son or daughter; (2) stepson or stepdaughter; (3) brother, sister, stepbrother, or stepsister; (4) father or mother, or an ancestor of either; (5) stepfather or stepmother; (6) son or daughter of a brother or sister; (7) brother or sister of the father or mother; and (8) son-in-law, daughter-in-law, father-in-law, mother-in-law, brother-in-law, or sister-in-law. The spouse of a family member is also considered a family member. However, if the new Beneficiary is a member of a younger generation than the previous Beneficiary, a federal generation-skipping gift tax may apply. The tax will apply in the year in which the money is distributed from an Account.

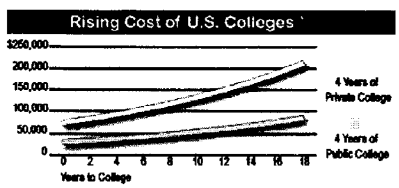
Fidelity Investments

The High Cost of College Today... and the Higher Cost Tomorrow



For the past 10 years, the average cost of college tuition and fees has risen nationally at a rate of about 5% per year, consistently outpacing the rate of overall inflation.[1] If current trends continue it is possible the average cost for a child entering college in 18 years may be more than $200,000 for a four-year private institution and as much as $85,000 for a four-year public institution.

Such sobering figures demonstrate that merely saving for college will not be enough. Traditional college planning vehicles such as CDs and savings bonds may not keep pace with the mounting expenses of higher education. However, starting early and investing regularly in a tax-advantaged account may give you a chance of beating college inflation.

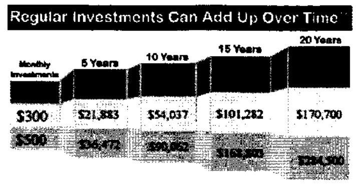


The UNIQUE Solution

Although the rising costs of college can certainly be daunting, the UNIQUE Plan recognizes that regular investments in a tax-advantaged account can potentially provide for a significant portion of future college expenses. Earnings from investments in the UNIQUE Plan grow federal income tax-deferred until the time of distribution. Withdrawals for qualified higher education expenses are taxed to the beneficiary – who typically will have a lower tax rate. For New Hampshire residents, qualified withdrawals are also completely exempt from the New Hampshire interest and dividends tax.[2] Non-residents are not subject to this tax. Such tax deferral puts the power of compounding to work for your account, which can grow much faster and larger than taxable savings plans.

Even small amounts, invested regularly, can make a big difference over the long term.

The UNIQUE Plan also puts the investment expertise of Fidelity to work for you. Balancing investment risks against potential returns can be a difficult task – especially if you do not have the time or the inclination to do so. Investments in the UNIQUE Plan portfolios are managed by Strategic Advisers, Inc., a Fidelity Investments company. An experienced portfolio manager will automatically determine the portfolio's investment mix and make appropriate adjustments according to your beneficiary's age.



The UNIQUE Plan Overview provides more information on the investment and tax benefits of the plan.

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Developing Your College Investing Plan

To put together a comprehensive college investing strategy, you'll first need to establish your investing goals. There are two important questions which you will need to answer:

- *What type of higher education are you investing for: public or private institution, 2-year community college or vocational-technical school?* The UNIQUE Plan can be used at any accredited post-secondary institution in the U.S. that is eligible to participate in certain federal student aid programs. But of course the cost of each – and therefore, the amount you'll need to invest – will vary.

- *How long before your child will enter college?* Since investments in the UNIQUE Plan are automatically allocated to specific portfolios based on your beneficiary's age, you will need to weigh the amount of your contributions against the investment objectives of each portfolio.

The College Cost Calculator can help you establish an annual, quarterly, or monthly investing target to help you reach your goal.

Download an enrollment kit, request one by mail, or call 1-800-544-1722 to speak with a UNIQUE Plan representative at Fidelity.

[1] College inflation rate based on information as of 9/98 from The College Board, a nonprofit scholastic service association of high schools and colleges.

[2] If you are not a New Hampshire resident, you may want to investigate whether your state offers a plan with alternative tax advantages for its residents.

* Assumes cost of college is growing at 5% each year, based on the rate at which college costs have been growing for the past two years according to the College Board, a nonprofit scholastic service association of high schools and colleges. Average annual cost for a four-year private college in the US is $20,940 and $8,435 for a four-year public college. These costs include tuition, fees, books, and room and board.

** This hypothetical example illustrates the future value of different regular monthly investments for different periods of time and assumes an annual effective investment return of 8%. This does not reflect an actual investment in the UNIQUE Plan and does not reflect any taxes. Unit price and return will vary, and different investments may perform better or worse than this example. Periodic investment plans do not assure a profit and do not protect against a loss in a declining market.

Fidelity Investments

The UNIQUE Plan's Investment and Asset Allocation Strategy

The UNIQUE Plan puts the investment expertise of Fidelity to work for you.[1] Strategic Advisers, Inc., a Fidelity Investments company, will manage the investment risk and return for each UNIQUE Plan portfolio of Fidelity equity, bond, and money market mutual funds.

The strategy behind the UNIQUE Plan portfolios is based on a balance between risk and return. To effectively manage risk, the UNIQUE Plan is composed of seven mutual fund portfolios generally comprised of stock, bond and money market mutual funds. Each portfolio is designed for a specific age range. Upon enrollment in the UNIQUE Plan, your beneficiary is automatically assigned to a certain portfolio based on date of birth. The asset allocation of this portfolio will change systematically over time.

The example to the left illustrates the gradual shift of asset allocation over 18 years for a newborn child enrolled in the UNIQUE Plan. The newborn child will be invested in a portfolio that holds a higher percentage of equity-based mutual funds.

As the child approaches college age (date of birth plus 18 years), the investment gradually shifts to a more conservative allocation. This gradual shift enables the participant, who can tolerate some short-term volatility, to pursue the advantages of the equity markets over the long term.

In years closer to college age, the asset allocation is designed to be more conservative in order to preserve capital. When the beneficiary reaches college age, the portfolio is comprised mostly of bond and money market funds. These more conservative holdings are designed to protect earnings at the time when it is expected that the participant will be withdrawing money to pay the beneficiary's higher education expenses.

Learn more about the portfolio manager of the UNIQUE Plan.

The UNIQUE Plan Portfolios: Underlying Mutual Funds

Your investment in the UNIQUE Plan will purchase units of one of the UNIQUE Plan's seven portfolios based on your beneficiary's age. Each portfolio of the UNIQUE Plan will invest in Fidelity mutual funds, including those listed below.

The funds are listed alphabetically within five categories. Historically, international equity funds have been more aggressive than domestic equity funds, domestic equity funds have been more aggressive than high yield fixed-income funds, and so forth.

You cannot invest directly in these mutual funds through the UNIQUE Plan.

International Equity Funds[2]
- Fidelity Diversified International Fund
- Fidelity Overseas Fund

Domestic Equity Funds
- Fidelity Blue Chip Growth Fund
- Fidelity Disciplined Equity Fund
- Fidelity Equity-Income Fund
- Fidelity Fund
- Fidelity Growth & Income Portfolio
- Fidelity Growth Company Fund
- Fidelity OTC Portfolio
- Fidelity Small Cap Selector

High Yield Fixed-Income Fund[3]
- Fidelity Capital & Income Fund

Fixed-Income Funds
- Fidelity Government Securities Fund
- Fidelity Intermediate Bond Fund
- Fidelity Investment Grade Bond Fund
- Fidelity Short-Term Bond Fund

Money Market Fund
- Fidelity Daily Income Trust

Download an enrollment kit, request one by mail, or call 1-800-544-1722 to speak with a UNIQUE Plan representative at Fidelity.

Fidelity 529 college investment plan contributions are used to purchase units of a Portfolio that holds shares of selected Fidelity mutual funds.

The Portfolio Unit Value is the current cost of one unit of the Portfolio. To determine your total current account value, multiply the number of Portfolio units in your account times the current Portfolio Unit Value.

Portfolio unit values are determined at the end of each business day and are subject to change without notice.

UNIQUE Portfolio Unit Values

[1] Under federal law you cannot direct your own investments in the UNIQUE Plan.

[2] Foreign investments involve greater risk than U.S. investments, including political and economic risks as well as currency fluctuations.

[3] The fund may invest in lower-quality debt securities, which generally offer higher yields than investment grade debt, but also carry more risk.

Fidelity Investments

★ The UNIQUE College Investing Plan ★ 1-800-544-1722

Portfolio Manager

The UNIQUE Plan's Portfolio Manager

Ren Cheng is the manager of the UNIQUE Plan portfolios. He is also co-manager of the Fidelity Freedom Funds^{SM}, which he has managed since their inception. He is also manager of structured investments for Fidelity Management Trust Company, which he has managed since 1994.

Mr. Cheng earned a BA in Economics from the National Taiwan University and an MS in Economics from Brown University. He is currently a Ph.D. candidate in Economics at Brown University.

Mr. Cheng joined Fidelity as a manager in 1994. Previously, he was a senior portfolio manager for Putnam Investments from 1985 to 1994.

Learn about the UNIQUE Plan's investment strategy.

Download an enrollment kit, request one by mail, or call 1-800-544-1722 to speak with a UNIQUE Plan representative at Fidelity.

Fidelity Investments

★ The UNIQUE College Investing Plan ★ 1-800-544-1722

Enrollment Kit

To receive an enrollment kit for the UNIQUE Plan:

1. Download the UNIQUE Plan enrollment kit electronically.

or

2. Request the UNIQUE Plan enrollment kit to be sent by mail.

Fidelity Investments

RESPONSES TO QUESTIONS FROM SENATOR TORRICELLI

Question: If we created ESAs, do you believe the industry would take the same approach as with Roth IRAs and aggressively market them so they become widely used?

Answer: S. 306 sets the limit on annual contributions by individuals at $2,000. It also provides that ESAs could be used for elementary and secondary school expenses. Three features of ESA, as proposed contemplated by S.306 would likely limit aggressive marketing of the product: the relatively low contribution limit; the shortened investment time frame; and the increased administrative expenses that would be associated with disbursements for elementary and secondary school expenses. By way of parallel, I note that the $2,000 annual limit on contributions to traditional IRAs (a product that has an investment time frame of more than double the ESA), will not result in a secure retirement for working Americans who do not have access to a workplace retirement plan when inflation is considered. As a result, marketing for traditional IRAs has not been a priority for many financial service firms over the last few years. However, if the annual contribution limit for the ESAs were $5,000, we believe financial service firms like Fidelity would aggressively market this important benefit.

Further, as noted in my testimony before the Committee on February 14, 2001, there are other provisions of section 530 of the Internal Revenue Code that should be addressed in order to make ESAs more attractive.

Question: Going back to the theme of marketing, do you think Fidelity and other firms would play a role in aggressively marketing ESAs to third parties to encourage corporations and others to invest in them to help more students?

Answer: For the same reasons stated in my answer with regard to individuals, I expect that Fidelity and other firms would not market aggressively to corporations or other entities under S. 306 as proposed unless the annual contribution limit for ESAs were at least $5,000.

PREPARED STATEMENT OF HON. CHARLES E. SCHUMER

Thank you Mr. Chairman. Thank you Senator Baucus and members of the committee for inviting me to talk about an issue of the highest priority—making college affordable for American families.

My colleagues, we hope that our children and our grandchildren will go to college because we know that if they don't they probably won't make it in today's competitive, global world.

And we hope that families throughout America send their children to college because we know that without a college education, not only will these children have a difficult time succeeding in the future, so will our country.

Because today, we live in an ideas-based, global economy where the strength of one's mind is more important the strength of one's back.

But we have a crisis in college tuition that threatens the economic well-being of millions of families and even the future of our country.

And the crisis is this: Since 1980, the cost of college tuition has quadrupled. It has increased at twice the rate of inflation. It has even increased faster than health care—which we all consider a national crisis.

In 1980, the cost of tuition—not including room and board—at a typical 4-year private college was $3,617. In 2000, it was $16,332.

Even the cost of public education has quadrupled from $804 in 1980 to $3,510 in 2000.

Student debt loads are surging. I surveyed schools across New York State and in the last four years student debt burdens have ballooned by 50%. And that doesn't include credit card debt. Nearly one million college students have credit card balances exceeding $7,000 and for most of these students the debt is from tuition, books, and basic living expenses.

Students are graduating from college under a mountain of debt. And yet, we know that if there is one piece of wisdom that we can impart to the nation's children it would be to go to college because that is the only way to succeed.

We have to help. And that is why I am working with Senators Snowe, Biden, Bayh, and Gordon Smith to introduce the Make College Affordable Act—a proposal to make college tuition affordable for millions of families and help those saddled with debt repay student loans.

Our bill would make up to $12,000 per year in college tuition tax deductible for anyone in the 28% tax bracket or less and would create a student loan interest tax credit, of which Senator Snowe has been a long-time champion, of up to $1,500 to help offset the cost of student loan repayments for single filers with incomes up to $50,000 and joint filers with incomes up to $80,000.

The bill would give taxpayers in the 28% bracket a maximum benefit of $3,360 per student per year for the tuition tax deduction and parents could choose between Hope Scholarships and the tax deduction based on what is best for them.

The Finance Committee this year will be considering legislation that reduces taxes.

And I would ask the Committee to include our proposal in its total tax relief package to help families afford college.

We would be doing millions of families and the entire nation a favor by making college affordable and within reach for average families.

PREPARED STATEMENT OF JEFF SESSIONS

Mr. Chairman, Senator Baucus, distinguished members of the Committee, I would like to thank you for holding this important hearing to discuss education reform and education tax issues. Americans are very concerned about education, and I am pleased to be able to discuss the concept of prepaid tuition and tuition savings plans and why they are so important to many responsible American families.

Mr. Chairman, American families have accrued more college debt in the 1990's than during the previous three decades combined. The reason is twofold: the federal government encourages borrowing by subsidizing student debt with interest rate breaks and penalizes savings for college by taxing the interest earned on those savings. These policies do not foster the highest and best values. Ideally, families should be encouraged, not discouraged, from saving.

In recent years, however, many families have tackled rising college tuition costs by taking advantage of tuition savings and prepaid college plans. This is a wonderful development. These plans allow families to purchase tuition credits years in advance. Families across the country are locking in tomorrow's college education at today's price. 48 states have or are in the process of establishing a tuition savings plan, a prepaid plan, or both. These plans are extremely popular with parents and students.

My home state of Alabama was one of the first in the nation to establish a prepaid college tuition. Nearly 50,000 Alabamians are currently enrolled in the Prepaid Alabama College Tuition Plan. Families across the state are setting aside a few dollars each month to pay for the future college education of their children.

But Mr. Chairman, Alabama is not the only success story. 18,000 children have been enrolled in the College Savings Iowa plan. 2,500 families in Montana are saving for their child's college education through the Montana Family Education Savings Program. 13,000 are enrolled in the Alaska Advance College Tuition Plan. 100,000 are participating in the Texas Tomorrow Fund. 7,000 children have accounts in the West Virginia Prepaid College Plan. 38,000 have joined the Maine Next Generation College Investing Plan. Over 10,000 parents have contracts in the Mississippi Prepaid Affordable College Tuition Program for their children. The list goes on, and the numbers are growing. As you can see, people across the country are wisely taking advantage of these plans.

It is important to note that the existing state prepaid and tuition savings plans show that working, middle-income families, not the rich, benefit the most. For example, 71% of the 600,000 participating families in the Florida Prepaid College Program have annual incomes under $50,000. In 1996, families with an annual income of less than $35,000 purchased 62 percent of the prepaid tuition contracts offered by the State of Pennsylvania. In Kentucky, in 1995, the average monthly contribution to a family's college savings account was $43.

Congress has supported participating families by expanding the scope of the prepaid tuition plans and by deferring the taxes on the interest earned until the beneficiary goes off to college. I believe that we must go one step further and make all of the interest earned in state and private tuition savings plans tax-free. Currently, the interest earned by families saving for college is taxed twice. Families are taxed on the income when they earn it, and then again on the interest that accrues from the savings.

This is why I am proud to have introduced the Collegiate Learning and Student Savings Act along with Senator Bob Graham. We are pleased to be joined in this effort by a bipartisan group of cosponsors including Senators Breaux, Gramm (TX), Murkowski, and Bingaman. This legislation is both sound education and tax policy that completely eliminates the federal taxes on the interest earned in all tuition savings and prepaid plans. We must stop penalizing families that are doing the right thing and saving money for their children's education. The inclusion of the CLASS Act in any tax bill this Committee passes will allow us to meet this goal. The cost is small—estimated at less than $200 million over five years—but it will give an extra incentive for families to be prudent savers for their child's college education.

Mr. Chairman, I'd like to thank you again for giving me the opportunity to testify here today and I look forward to working with you. Senator Baucus, and other committee members over the coming months on these and other initiatives which will help America's families afford a college education.

Prepared Statement of Kimberly Sheppard

On behalf of the approximately 144,000 members of the American Dental Association (ADA), I would like to thank you Mr. Chairman and the other members of the committee for the opportunity to testify on the student loan interest deduction issue. I am Kimberly Sheppard, a fourth year student at the University of Iowa's College of Dentistry.

Senator Grassley and Senator Baucus, the ADA was very pleased to be one of over 30 health care and education organizations to sign a letter in support of your bill, S. 152, which repeals the 60-month limit and increases the income limitation on the student loan interest deduction. This legislation is a significant improvement over current law. Should this bill pass, many more Americans who carry the burden of student loan debt will benefit.

In fact, the Association would support further expansion beyond the changes you have proposed in S. 152 by:

- Eliminating the annual $2,500 cap, and
- Raising the income limitations to $100,000 for a single filer and $150,000 for joint filers.

Just as individuals receive a mortgage interest deduction for investment in a home virtually without caps or income limits, the Association believes that an investment in education should be given comparable treatment. Both are sound public policy.

The current annual cap of $2,500 is inadequate to cover the significant student loan debt being carried by many of today's graduates. For example, the average debt of a graduate student from a private institution is $35,000, which results in interest payments of more than $2,700 annually. That debt load soars to $100,000 for dental school graduates with an annual interest payment of more than $7,700 each year.

Graduating Debt	Monthly Loan Payment	Interest over 12 months [1]	Interest over 5 years [2]	Total Interest Paid 10 years [3]	Total Interest Paid 25 years	Est. Salary Needed to Afford Repayment of Loan in 10 Years [4]
$5,000	$61	$400	$1,686	$2,359	XXXXXX	$7,359
$10,000	$122	$800	$3,372	$4,718	XXXXXX	$14,718
$15,000	$184	$1,200	$5,059	$7,077	$20,478	$22,077
$20,000	$245	$1,600	$6,745	$9,436	$27,307	$29,437
$25,000	$306	$1,941	$7,180	$11,796	$34,135	$36,795
$30,000	$367	$2,329	$8,616	$14,154	$40,957	$44,155
$35,000	$429	$2,717	$10,052	$16,514	$47,785	$51,513
$40,000	$490	$3,105	$11,488	$18,873	$54,614	$58,873
$45,000	$552	$3,494	$12,925	$21,232	$61,442	$66,232
$50,000	$613	$3,882	$14,361	$23,592	$68,264	$73,591
$60,000	$736	$4,658	$17,233	$28,309	$81,921	$88,310
$70,000	$858	$5,435	$20,105	$33,028	$95,571	$103,028
$80,000	$981	$6,211	$22,977	$37,746	$109,228	$117,746
$90,000	$1,103	$6,988	$25,850	$42,465	$122,878	$132,464
$100,000	$1,226	$7,764	$28,722	$47,182	$136,535	$147,183
$125,000	$1,533	$9,705	$35,902	$58,979	$170,670	$183,979
$150,000	$1,839	$11,646	$43,083	$70,775	$204,799	$220,774
$175,000	$2,146	$11,757	$69,763	$82,570	$238,934	$257,570
$200,000	$2,453	$13,437	$79,730	$94,366	$273,070	$294,366

(Prepared by the American Dental Education Association)

[1] Based on 10-year repayment plan.
[2] Based on 10-year repayment plan.
[3] Based on 10-year repayment plan.
[4] It is estimated that a borrower will need an annual salary of at least the amount indicated to be able to afford to repay the loan. The estimate assumes that 10% of a borrower's gross income will be devoted to repaying the loan.

As currently structured, too many young health professionals, particularly dentists and physicians, including those who struggle to pursue less lucrative careers in public service, research, and academia, are unable to fully utilize the student loan interest deduction because the income limitations and $2,500 cap are too low. In fact, the current income limit is so low that two married high school teachers making the average salary for their profession would not qualify for the deduction!

Compounding the fiscal problem of student loan debt for newly graduated dentists is the added costs associated with setting up a practice, which can range from $125,000 to $250,000. The high level of educational indebtedness combined with dental practice start-up costs can serve as a significant deterrent to opening a dental practice in rural communities or serving low-income patients.

The U.S. Surgeon General's "Oral Health in America" report last year identified a need to close the gap between the majority of Americans who enjoy the best dental care in the world and those who do not have sufficient access to dental services. The ADA has begun a legislative initiative with a goal of improving access to oral health care services for the poor and for those located in rural areas. Dentists with considerable debt are less likely to choose rural communities to establish a practice. Increasing the income limitations so that virtually all affected dentists are able to take advantage of the deduction will make it more feasible for young dentists to elect to practice in underserved locations.

The Surgeon General's report on oral health also speaks clearly to the need for enhanced research in oral health, specifically oral health's connection to other systemic diseases. The result of such research could save our country billions in health care costs.

Recruitment into academia and research is increasingly difficult. Dentistry has experienced a serious graying of its faculty. There are currently over 290 unfilled dental faculty positions in 45 dental schools of the nation's 55 dental schools. The ADA will soon be conducting an educational summit in an effort to identify the problems and possible solutions associated with this significant shortfall in faculty and other challenges facing dental students. To enhance research and ensure quality dental education in the future there must be sufficient incentives available to enable graduates to choose lower paying careers in research and academia. Raising the income limitations in current law would certainly help alleviate this shortfall problem.

With the probability of a tax bill coming before this committee this year, the ADA believes the time is right to expand student loan interest deduction by eliminating the 60-month rule, raising the income ceilings, and allowing for full deduction of interest paid for qualified student loans.

Thank you for your time and consideration of our position on the expansion of student loan interest deduction. We look forward to working with you on this issue, which is so fundamentally important to helping ensure that Americans continue to seek the training in higher education that is needed to compete in today's global marketplace.

COMMUNICATIONS

STATEMENT OF AMERICAN AIRLINES, INC., FORT WORTH, TEXAS

[SUBMITTED BY MITCHELL SALAMON, SENIOR TAX COUNSEL]

Mr. Chairman and members of the Committee, American Airlines appreciates the opportunity to submit written testimony to address the important role of Federal tax law in making education affordable in the "new economy." Specifically, we want to tell you about an exciting new program we are implementing to help our employees obtain the education they need to bridge the digital divide. And most importantly, we are here to urge you to pass an amendment to the Internal Revenue Code that would greatly enhance this process.

Last year, American Airlines and American Eagle joined the ranks of Ford Motor Company, Delta Airlines, Enron and Intel by announcing that we would implement an employer-subsidized home computer initiative for our workforce. Under our program, American subsidizes employee purchases of basic home computers with unlimited internet access. We anticipate spending over $45 million over a three-year period to put home computers into the hands of every employee that chooses to participate.

In addition to supplying the hardware, American is developing an intranet portal, which will provide an unprecedented opportunity to educate our employees. The catalog of issues accessible on the portal is wide-ranging. American Airlines also created and introduced Flagship University, a virtual institution and library that employees can access through the portal. Flagship University will deliver development programs on a variety of topics designed to instill knowledge and skills necessary to maximize the long-term potential of our employees.

American's home computer program is an employee education initiative that also translates into business sense for any company. Computer skills are an essential component of almost every function within our nation's economy. In light of the scope and complexity of the various industries throughout the U.S., a technically skilled workforce is vitally important. For example, American Airlines and American Eagle operate and maintain 970 aircraft serving 243 cities with 4,100 daily departures throughout the world. Together, we employ over 110,000 people. As you might expect, we rely heavily on advanced technology to run sophisticated management and maintenance systems, which are continuously modified and upgraded. Obviously, a workforce skilled in tomorrow's technology will contribute greatly to any company's primary goal of delivering the highest quality customer service.

So far, employee feedback has been overwhelmingly enthusiastic and enrollment is high. Participating employees pay American $12 per month for 3 years and may upgrade and obtain options directly through the vendor for an additional fee. Many employees have acknowledged that they would not be able to access a computer outside of work without the benefit of the program. Our employees are seizing this opportunity to enhance and develop their computer literacy; and, consequently, they will be prepared for work that will continue to evolve with the progression of the information age.

However, without a clarification of the tax laws, the potential for adverse tax consequences will be a significant impediment to implementing workforce initiatives that help employees gain the education they need to close the digital divide. The current tax rules are unclear whether employer-subsidized home computers will be characterized by the IRS as taxable compensation to employees. The potential tax burden will most certainly reduce the number of employees taking advantage of this opportunity and other employers from making similar investments in their workforces.

For this reason, we believe it is critical that Congress adopt legislation clarifying that employers can establish an employee education program providing subsidized computers and internet access to their employees as a tool for eliminating the digital divide. Internal Revenue Code section 127 provides a framework for programs similar to American's. However, the statutory language does not reflect the development of new tools of learning like the computer. Clarifying language stating how an employer can provide such computers and internet access to their employees would give the Treasury the necessary guidance for them to implement the provision for such programs.

Mr. Chairman, thank you for the opportunity to submit written testimony on this important issue.

Statement of the American Bankers Association

The American Bankers Association (ABA) is pleased to have an opportunity to submit this statement for the record on tax and savings incentives for education.

The American Bankers Association brings together all categories of banking institutions to best represent the interests of the rapidly changing industry. Its membership—which includes community, regional and money center banks and holding companies, as well as savings associations, trust companies and savings banks—makes ABA the largest banking trade association in the country.

EXCLUSION FOR EMPLOYER-PROVIDED EDUCATIONAL ASSISTANCE

At the outset, we would like to commend Senate Finance Committee Chairman Charles Grassley (R–IA) and Senator Max Baucus (D–MT) for having introduced the "Employee Educational Assistance Act" (S. 133), which would permanently extend Internal Revenue Code Section 127 for both graduate and undergraduate study. That legislation would encourage the retraining of employees to reflect the changing needs of the workplace.

Section 127 provides an exclusion of up to $5,250 per year of employer-provided educational assistance from an employee's gross income and wages, irrespective of whether the education is job-related. In the absence of this exclusion, educational assistance is excludable from income only if it is related to the employee's current job. The current law Section 127 exclusion expires December 31, 2001. Educational assistance for graduate-level courses expired July 1, 1996.

The ABA supports the permanent extension of the exclusion for employer-provided education and its expansion to include graduate education. The banking and financial services industries are experiencing dramatic technological changes. Well-educated workers are essential. This provision will expand educational opportunity and increase productivity. It will also assist in the training of employees to better face global competition. Moreover, employer provided educational assistance is a central component of the modern compensation package and is used to recruit and retain vital employees. We strongly support the permanent extension of this provision.

EDUCATION INDIVIDUAL RETIREMENT ACCOUNTS

We commend Senators Phil Gramm (R–TX) and Jon Kyl (R–AZ) for having introduced the "Tax Cut with a Purpose Act" (S. 35), and Senators Robert Torricelli (D–NJ), John Breaux (D–LA), Fred Thompson (R–TN) and Kyl for having introduced the "Coverdell Education Savings Accounts Act of 2001" (S. 306). Both pieces of legislation would expand education Individual Retirement Accounts (education IRAs).

Under current law (Internal Revenue Code Section 530), up to $500 per year may be deposited in an education IRA created exclusively to pay the qualified higher education expenses of a student. Deposits must be made before the student reaches age 18, and the contribution limit is phased out for taxpayers with modified adjusted gross income between $95,000 and $110,000 ($150,000 and $160,000 for married taxpayers filing a joint return). Generally, earnings on contributions to an education IRA are subject to tax when withdrawn. However, distributions from an education IRA are excludable from the gross income of the student to the extent that the distribution does not exceed the student's qualified higher education expenses for that year.

ABA supports the enactment of legislation to improve and expand tax incentives to promote savings. Currently, the savings rate as a percentage of personal disposable income is a negative. Over the last few years the rate of savings has been in a steady decline. Many economic analysts are concerned that taxpayers are not saving and investing sufficiently to meet anticipated needs. Further, current tax policy appears to reward immediate consumption and discourages savings and investment. We strongly support the proposals to raise contribution limits and eliminate income caps for education IRAs. Expanding education IRAs would do much to encourage household savings for education.

CONCLUSION

The ABA appreciates having this opportunity to present our views on the tax and savings incentives for education. We look forward to working with you in the future on these most important matters.

STATEMENT OF THE BOND MARKET ASSOCIATION

The Bond Market Association appreciates the opportunity to comment on proposals to lower the cost of state and local investment in school construction. The Bond Market Association represents securities firms and banks that underwrite, trade and sell debt securities both domestically and internationally. The Association's membership accounts for approximately 97 percent of the nation's bond underwriting activity.

We commend Senator Grassley for holding this hearing and for his commitment to finding answers to the need for more public school construction. President Bush has contributed to addressing this need with his proposal to authorize a new class of private-activity bond to finance public school construction through public-private partnerships. The idea has attracted bipartisan support with Sens. Grassley and Bob Graham and Rep. Clay Shaw sponsoring similar legislation (S. 526 and H.R. 2514) in the 106th Congress. Sen. Charles Robb also sponsored legislation (S. 1454) in the last Congress which included a similar provision.

In this statement, The Bond Market Association addresses the private-activity bond proposal as well as several other changes to the tax code that would expand the range of financing options and serve to lower the cost school districts pay for construction capital.

I. INTRODUCTION

The nation faces a school construction crisis. One-third of all elementary and secondary public schools, serving more than 14 million students, need extensive repair or renovation of one or more buildings, according to a 1996 General Accounting Office (GAO) report. Students attend schools with inadequate heating, plumbing and electrical systems that in some cases even fail to meet local health and safety codes. In other cases, students are forced into grossly overcrowded facilities.

Traditionally, nearly all the responsibility for financing public school construction and rehabilitation has been borne by state and especially local governments. Until recent years, this arrangement has served American students well. But rising costs have prevented local authorities from keeping pace with school construction and maintenance needs. The price tag for necessary school construction and renovation has soared into the billions across the nation today and is still growing.

Tax-exempt municipal bonds currently finance approximately 90 percent of all state and local investment in public schools. Municipal bonds provide an important source of federal assistance from the federal government to states and localities. Because the federal government foregoes the tax revenue on interest earned by investors on qualified municipal bonds, investors demand a much lower rate of interest than they otherwise would. States and localities benefit through a lower cost of capital. Bonds provide other benefits as well. They allow school districts to access the capital markets and receive federal assistance without any direct interference of the federal government. This helps concentrate decision making at the state and local level where needs are most accurately discerned. Bonds force a market test of investment projects, since investors must determine whether a school district can adequately support the debt service associated with new borrowing. Finally, compared to some federal programs that provide assistance to states and localities, federal administration of municipal bonds requires relatively little bureaucratic overhead.

As beneficial as tax-exempt bonds are in helping school districts finance construction and rehabilitation, the federal tax code contains a number of restrictions on the issuance and use of tax-exempt bonds that prevent school districts from using municipal bonds to their full potential. The Bond Market Association advocates several targeted proposals to expand the use of tax-exempt financing for school construction and provide substantial financial assistance to states and localities in financing more schools.

II. A NEW CLASS OF PRIVATE-ACTIVITY BOND FOR SCHOOL CONSTRUCTION

The tax code generally prohibits using tax-exempt bonds for projects where there is more than a *de minimis* level of private participation. Exceptions to this rule include bonds for solid waste facilities, water and sewer facilities, airports and seaports, low-income housing, economic development and a variety of other projects specified in the tax code. Public schools are specifically excluded from this list of exceptions. If public schools were included among the facilities eligible for public-private partnerships, it would be possible for a school district, in partnership with a private developer, to construct a new school facility using private-activity bonds. Such public-private partnerships could provide an efficient method for financing school construction.

Some of the restrictions on state and local borrowing are reasonable to ensure only worthy projects can benefit from the federal assistance inherent in the tax-exemption. But while few would argue public school construction and renovation is not a worthy project, it is singled out as one of the only types of traditional public infrastructure investment where tax-exempt bonds cannot be used in conjunction with public-private partnerships. Addressing this restriction would provide meaningful assistance to school districts by lowering the cost of financing for school construction projects.

More schools would be built and repaired. In some cases, public-private partnerships would accelerate construction projects that are in school districts' capital investment plans. Given the large number of exceptions to the private-use restriction, there is no policy justification for excluding public schools from the list of public-private projects eligible for tax-exempt financing.

The Bush Administration has proposed including schools on the eligible list for private-activity bonds. Under this proposal, private-activity bonds for school construction would be exempt from annual state volume caps for private-activity bonds. They would instead be subject to their own annual per-state caps equal to the greater of $10 per capita or $5 million. The Association urges Congress to enact legislation creating private-activity bonds for schools. The idea received bipartisan support in the 106th Congress.

III. ADDITIONAL ADVANCE REFUNDINGS FOR SCHOOL BONDS

When interest rates fall, homeowners often refinance their mortgages to reduce interests costs. Low interest rate environments provide the same incentive to state and local governments, including school districts, to refinance outstanding high-cost debt. In many cases, however, school districts can only redeem existing bonds on specific dates, known as call dates.

If a school district would benefit from a refunding transaction but the existing bonds are not currently eligible to be called, the school district can still refinance by undertaking an "advance refunding." The school district issues advance refunding bonds and the proceeds of the new bonds are held in reserve until the next call date to pay the interest and principal on the old bonds. Under current tax law restrictions, bonds issued prior to 1986 may be advance refunded twice. Bonds issued after 1985 may only be advance refunded once.

School districts that have already used their allowed advance refunding may not be able to refinance their bonds in an environment of declining interest rates. By lowering a school district's overall cost of servicing its outstanding debt, refinancing increases a school district's overall debt capacity and opens the door to additional bond issues for new construction. Refinancing, of course, can also free up financial resources for teacher salaries, textbooks and other needs.

Allowing school bond issuers to advance refund their outstanding school construction debt one additional time would lead to increased school construction and renovation. Legislation that would achieve this was introduced in the Senate and the House and enjoyed support from both sides of the aisle in the 106th Congress. The provision was contained in Sen. Robb's legislation and also in a bill (H.R. 2416) authored by Rep. Jerry Weller.

IV. EXPAND THE EXEMPTION FOR SMALL-ISSUER ARBITRAGE REBATE

Because the interest paid on tax-exempt bonds is free of taxation, the Internal Revenue Service (IRS) places restrictions on how the proceeds of the bonds can be invested. In the period between when bonds are sold and when the proceeds are paid out, the bond proceeds cannot be invested at a higher rate than is paid on the underlying bonds. If a school district does earn a profit from reinvesting the bond proceeds (referred to as arbitrage), the school district must rebate the money to the IRS.

The arbitrage rebate rule is a compliance burden for tax-exempt bond issuers, especially small and unsophisticated local governments and school districts. Determining the amount of arbitrage to rebate requires complex calculations, a job for which small school districts often hire an outside consultant. The rebates themselves are often small and it is not uncommon for school districts to pay more in compliance costs than they do in rebates.

Congress recognized this problem and created an exemption from the rebate rules for small issuers. Any school district issuing no more than $10 million in a year for construction does not need to rebate arbitrage. The Bond Market Association supports efforts in Congress to raise this limit to $25 million in recognition of the rising cost of school construction. This proposal would reduce the compliance burden for small school districts and would reduce the cost of financing school construction.

V. EXTEND THE "CONSTRUCTION SPEND-DOWN" EXEMPTION

Another exemption to the arbitrage rules is allowed for bonds issued for construction projects. As long as a local government spends the proceeds of a bond issue on a construction project according to a schedule where virtually all the proceeds are spent within two years, that bond is not subject to arbitrage restrictions. This exemption is useful in reducing the cost of state and local construction projects. However, the two-year schedule often limits the usefulness of this exemption to school districts that undertake multi-year construction and financing plans. Congress should extend the construction spend-down exemption from two years to four for bonds issued to finance school construction. This proposal would help reduce the cost of school construction projects and, as a result, generate more investment in school construction. Rep. Bill Archer, chairman of the Ways and Means Committee in the 106th Congress, authored legislation (H.R. 2488) that would have addressed the two arbitrage issues. The legislation sponsored by Sen. Graham and Rep. Shaw also contained the arbitrage provisions.

VI. ALLOW BANKS TO INVEST IN ANY TAX-EXEMPT SCHOOL CONSTRUCTION BOND

Commercial banks were once one of the most active groups of investors in the municipal bond market. In 1985, commercial banks held $232 billion of tax-exempt bonds and accounted for 27 percent of municipal bonds outstanding. A 1986 tax law, however, imposed a penalty on banks that earn tax-exempt interest. Banks have sold much of their tax-exempt bond portfolios as a result and now hold just $116 billion of tax-exempt bonds, or 7.4 percent of outstanding municipal debt. Banks today only invest in "bank qualified" bonds of municipalities issuing $10 million or less annually.

School districts that are able to issue bank-qualified bonds enjoy a cost of borrowing approximately ¼ percentage point lower than others. Under certain market conditions, the difference is even higher. The bank-qualified provision also permits local commercial banks to contribute to the public investment undertaken in their local jurisdictions.

Raising the limit for bank purchases of school construction bonds to include school districts that sell up to $25 million of bonds annually will help lower the financing costs for small school districts that generally have a more difficult time accessing the capital markets. It would directly reduce the cost of borrowing for new school construction. Sen. Graham's legislation included a provision to increase the maximum amount of bonds a school district can sell annually and still attract bank investment to $25 million.

VII. CONCLUSION

Tax-exempt municipal bonds play an essential role in financing the construction and renovation of public schools. Several federal tax code restrictions, however, prevent school districts from maximizing the benefit of municipal bonds to finance school construction and rehabilitation. The Bond Market Association advocates modifications of the tax code to expand the use of tax-exempt financing for school construction and provide substantial financial assistance to states and localities.

STATEMENT OF THE CONSUMER BANKERS ASSOCIATION IN SUPPORT OF THE EXTENSION OF THE DEDUCTION OF INTEREST ON QUALIFIED STUDENT LOANS

[SUBMITTED BY JOE BELEW, PRESIDENT]

Mr. Chairman and members of the Senate Finance Committee, the Consumer Bankers Association is pleased to submit this statement in support of the expansion of the deduction on student loan interest from federal income tax. This statement reflects the expertise and commitment of CBA's Education Funding Committee, a group of sixteen of the largest financial institutions participating in the federal student loan programs.

Each year, CBA members make more than $12 billion in loans to more than two million students and their families. This experience has provided student loan providers with first hand exposure to the challenges faced by many students in repaying their loans. The student loan interest deduction and the proposed expansion of it, is, in our view an important contribution to helping to keep college affordable.

CBA was please to support the student loan interest deduction as first enacted as part of P.L. 105–34, the Taxpayer Relief Act of 1997. The 1997 legislation provided for a maximum deduction of $2,500, subject to an income limitation and limited to the first sixty months of repayment. Both of these limitations were a function of budget limitations precluding the enactment of a larger deduction.

The major tax legislation expected to be considered by the Congress this year provides an excellent opportunity to expand the student loan interest deduction and provide well-targeted relief to taxpayers that need it most. The beneficiaries of the Chairman's bill, S. 152, are the most heavily indebted student loan borrowers. The relief they receive will not only help them repay their loans and meet other competing financial obligations, but will also contribute to avoiding student loan defaults by reducing the net costs of student loans.

The Chairman's bill enjoys the support of the entire of the higher education community. The Consumer Bankers Association is pleased to urge this committee to enact this legislation, this year.

As the Committee considers expansion of the deduction, one technical issue relating to it should be kept in mind. The issue arises from differences in the definition of interest under the Internal Revenue Code and the federal statute governing student loans, the Higher Education Act.

The Higher Education Act and the Department of Education's student loan regulations provide for capitalized interest to be treated, in all respects, as principal. Treasury's regulations, however, would require capitalized interest to be calculated separately from other principal. The result is that student loan servicers would have to maintain at considerable expense two separate sets of books on student loans in order to report interest for Higher Education Act purposes and to borrowers for the purpose of the student loan interest deduction.

Also, the Higher Education Act requires payment of origination fees and, in many cases, an insurance premium of student loans. Treasury's regulations call for the treatment of these fees as interest and the amortization of them over the life of the loan. This requirement would also require separate accounting by student loan servicers.

An additional problem relates to how payments received from borrowers are treated. The Higher Education Act requires that payments be first allocated to late fees or similar charges and then to interest and principal. The Treasury rules are again different in this regard.

Finally, it is important to note that in calculating interest on many student loans, the underlying student loan records necessary to comply with the proposed Treasury regulations no longer exists. This is especially true in the case of many loans subject to sale and loans originally made by lenders no longer in existence. The problem is particularly serious because many student loans were initially made in the 1980's.

One solution to this problem would be to adopt a technical amendment that would not alter the Internal Revenue Code treatment of interest, but would provide borrowers/taxpayers with the full benefit of the student loan interest deduction. Under the amendment, student loan lenders and holders could report either a) the amount of interest actually received by the borrowers, as defined under the Internal Revenue Code, or b) the amount of interest received as defined by the Higher Education Act and then adjusted by an additional percentage to reflect the average amount attributable to capitalized interest and origination fees. The result is to provide borrowers, on average, with the full amount of the benefit as intended by Congress.

The Consumer Bankers Association and other student loan provider groups would be pleased to work with this Committee in full support for S. 152 and also on addressing technical issues relating to the deduction. We appreciate the opportunity to submit this statement to this Committee and congratulate Chairman Grassley and Senator Baucus on the introduction of S. 152.

Statement of the Section 127 Coalition on the Permanent Extension of IRC Section 127 for Both Graduate and Undergraduate Courses

The Section 127 Coalition is a diverse group of business, labor, and education organizations that are committed to making the exclusion for undergraduate- and graduate-level employer-provided educational assistance found in Section 127 a permanent part of the tax code. The Coalition appreciates the opportunity to submit this written statement as the Senate Finance Committee considers several education-related tax provisions.

Section 127 allows workers to exclude up to $5,250 a year in reimbursements or direct payments for tuition, fees, and books for certain courses. The most recent extension of Section 127 occurred in an extenders package that was added to the Ticket to Work and Work Incentives Improvement Act of 1999, H.R. 1180 (PL No. 106–170). That legislation extended Section 127 through December 31, 2001. An extension for graduate-level courses was not included. Since July 1, 1996, educational assistance for graduate-level courses is taxable.

Legislation to permanently extend employer-provided education assistance and include coverage for graduate course work has recently been introduced in the Senate. Senators Max Baucus (D–MT) and Finance Committee Chairman Charles Grassley (R–IA) introduced S. 133 on January 22, 2001. In the House, Representatives Sander Levin (D–MI) and Clay Shaw (R–FL) will re-introduced companion legislation in the near future. Historically, legislation to permanently extend Section 127 for both graduate and undergraduate courses has enjoyed broad bipartisan support.

Legislation to permanently extend Section 127 and reinstate the provision for graduate-level educational assistance is extremely important as the U.S. strives to compete in an ever-increasing global market. Competition in this global environment requires employers to ensure that their employees have the greatest level of current technical and educational skills necessary to meet the challenges that they face. More and more often, employees are finding that a graduate-level degree is necessary for them to succeed in this environment. Over the next decade this trend will intensify, as American workers will need some postsecondary education and training to keep pace with rapid changes in the workplace and the applications of technology in their jobs. Yet employees that choose to participate in an employer-provided educational assistance plan, balance their work and educational lives, and labor toward a graduate degree, are taxed on the value of that benefit. At a time when the need for highly skilled workers with advanced degrees was debated in the last Congress, it is unfortunate that the one provision that encourages an employee to achieve a graduate degree is not even a part of the Internal Revenue Code.

Congressional action making Section 127 a permanent part of the tax code would remove the uncertainty and ambiguity that employees and employers now regularly face, and would be consistent with the intent of Congress when the provision was first enacted in 1978. At that time, supporters of employer-provided educational assistance hoped that the enactment of the provision would meet three broad goals: (1) reduce the complexity of the tax code; (2) reduce possible inequities among taxpayers; and (3) remove disincentives to upward mobility. Several studies have been conducted on section 127 reviewing the application, use, and effectiveness of the benefits. The two most recent studies on employer-provided educational assistance include a 1995 study conducted by the National Association of Independent Colleges and Universities (NAICU), entitled "Who Benefits from Section 127," and a Government Accounting Office (GAO) study completed in December of 1996 entitled, "Tax Expenditures: Information on Employer-Provided Educational Assistance" (GAO/GGD–97–28). Review of the information contained in these studies clearly demonstrates that the provision is meeting the original intent of Congress.

The permanent extension of Section 127 would reduce the complexity of the tax code. Prior to 1978, only educational assistance provided by an employer to an employee that related to the individual's job was excluded from an employee's gross taxable income (sections 62 and 132 of the Internal Revenue Code). The "job-related" test contained in Treasury Regulation 1.162–5 was confusing to both employers and employees and resulted in both the Internal Revenue Service and the courts making arbitrary decisions as to what type of employer-provided educational assistance successfully met the test of job-relatedness. Unlike other code sections that govern educational assistance, Section 127 does not require either an employer or employee to make a distinction between job-related and non-job related educational assistance in order for the employee to receive the assistance. Section 127 therefore ensures that administrative complexity is reduced and clarity is achieved for both the employer and employee.

If Congress fails to make Section 127 permanent, employers and employees will be continuously faced with the difficult task of determining whether educational assistance meets the "job-relatedness" test. As a result, the balance and equity among taxpayers that has been established through Section 127 would be eliminated and the opportunities for less-educated and skilled employees to improve their skills with additional training would be restricted significantly.

A permanent extension of Section 127 reduces possible inequities among taxpayers. This goal was especially important to Congressional sponsors of Section 127. Under the job-related test of sections 62 and 132, most entry-level employees are unable to claim an exclusion for an educational expense because their job descriptions and responsibilities are not broad enough to meet the test. In effect, only highly skilled individuals are able to use job-related educational assistance. The goal of Section 127 is to allow employees in lower-skilled positions the opportunity to receive educational assistance from their employer and for these individuals to utilize the benefit without the worry of the job-related test. According to the NAICU study, 43.6% of Section 127 beneficiaries were in clerical or secretarial positions.

Like any other benefit, employers are not required to provide Section 127 benefits to their employees. If an employer chooses to provide educational assistance benefits to its employees, the employer must offer the benefits to all employees on a nondiscriminatory basis that does not favor the highly compensated. This requirement, together with information from various studies, indicates that lower-skilled individuals are utilizing the benefit at a greater rate than those in more skill-intensive professions.

A permanent extension of Section 127 removes disincentives to upward mobility. While Section 127 provides the opportunity for individuals to advance, it does not guarantee it. Recipients of Section 127 are not traditional students: they are working, most of them in a full-time capacity. They choose to return to school on a part-time basis to improve their skills and educational qualifications. Without their employer's assistance, many of these individuals would not be able to pay for the education themselves. Each time the provision expires and employers begin to withhold taxes on the benefit, individuals relying on Section 127 discontinue or scale back their undergraduate and graduate educational pursuits because they cannot afford to even pay the taxes on the benefit. According to the NAICU study, 33 percent of Section 127 recipients were pursuing associate degrees, 23 percent were in bachelor's degree programs, and 13 percent were enrolled in programs that awarded undergraduate educational certificates. About 25 percent of the recipients were in master's degree programs or in "other graduate" programs—primarily graduate certificate programs. The number of students in doctoral (Ph.D., Ed.D., etc.) or professional (J.D., M.D., etc.) programs was too low to be measured. According to this same study, nearly 85 percent of Section 127 recipients earned less than $50,000 and 50 percent of the recipients earned less than $32,000. Clearly those who Section 127 was intended to benefit are using this opportunity to upgrade their skills, keep current in this rapidly changing technological environment, and potentially advance within their organization. Restoring graduate course eligibility will also decrease the complexity of some Section 127 benefits being taxable while others are not.

As Congress debates the role of the federal government in education, there are some important points to consider when contemplating a permanent extension of Section 127:

> Section 127 is Not a Government Program—This is a purely private sector initiative and the most significant provision encouraging employer investment in their worker's continuing education. There is no large bureaucracy to administer the program. In fact, 100 percent of every dollar spent by the employer goes toward the education of the employee. Like any other benefit, employers are not required to provide Section 127 benefits to their employees. Nevertheless, employers provide these benefits to their employees because they see value and a return on the investment in their employees' education. Employees use Section 127 benefits to keep current with changing trends in rapidly advancing fields as well as to improve basic skills.
>
> Section 127 Encourages Business Support and Partnership of Education Initiatives—This provision is a good proposal for employers and employees alike, encouraging partnerships between a company and its individual employees.

> Companies see Section 127 benefits as a prudent and an economically sound investment in its workforce because they receive, in return, a better educated and more technically skilled worker. Employees view Section 127 as a way to improve their work skills and advance up the ladder of success. These benefits also provide companies with additional flexibility for reorganization efforts which may be necessary, since educational assistance may be offered through an outreach program to their laid-off workers or be used to retrain employees for other positions.

The Coalition applauds the bipartisan efforts to make Section 127 permanent. The Ticket to Work Act reinstated Section 127 once again—the tenth time that the provision has been extended since it was first enacted as part of the Revenue Act of 1978. The on-again, off-again extension of Section 127—as well as the current absence of coverage for graduate work—causes uncertainty in the tax code, creates administrative difficulties for employers, corrodes our system of voluntary compliance with the tax laws, and leaves employees with unanticipated tax liabilities.

The continued education and development of the U.S. worker are fundamental to meeting the challenges of the international marketplace. The Coalition urges Congress to make a commitment to the continuing education of our work force by reinstating the exclusion for graduate courses and making Section 127 permanent.

Thank you for this opportunity to express our support for the permanent extension of Section 127.

THE SECTION 127 COALITION

National Association of Independent Colleges and Universities
National Association of Manufacturers
College and University Professional Association for Human Resources
International Personnel Management Association
American Council on Education
Agilent
United Auto Workers
University of Michigan
American Society of Mechanical Engineers
American Federation of State, County and Municipal Employees
American Association of Engineering Societies
American Institute of Chemical Engineers
Institute of Electric and Electronics Engineers-USA
National Society of Professional Engineers
American Society for Payroll Management
American Society for Training and Development
American Federation of Teachers
Association of Community College Trustees
The Council of Graduate Schools
National Association of State Universities and Land Grant Colleges
Marymount University
Telephone and Data Systems, Inc. and Subsidiaries

Tuition Plan

February 28, 2001

Senate Finance Committee
Senator Charles E. Grassley, Chair

Statement Regarding Education Tax Incentives, Expansion of IRC Section 529, S 289
Hearing Date: February 14, 2001

Tuition Plan Consortium is a group of 210 independent colleges and universities seeking to establish a prepaid tuition program. The consortium comprises schools large and small, from research universities to small rural colleges, located in 38 states plus the District.

The sole purpose of the non-profit group is to encourage American families to save for tuition. The families to be served are primarily middle income families. Research by the National Association of Independent Colleges and Universities indicates that average family incomes for students attending private colleges and universities is approximately the same as that of the families of students attending public universities. Private colleges and universities graduate 30% of the nation's students and offer many unique programs, nurturing environments, a wide variety of religious affiliations, and the opportunity for single-sex education.

Tuition Plan Consortium strongly supports S 289, the Sessions/Graham "Class Act" Bill. It would broaden the statutory provisions of IRC Section 529 to include application to groups of private colleges and universities, and it would make distributions from Section 529 plans tax exempt. These improvements are needed to provide families with greater incentives to save. Every tuition dollar saved obviates several dollars of student borrowing. Education debt burdens the students and their families, and often channels their careers into higher paying jobs instead of serving our society in such roles as teaching. We also believe that spread of prepaid tuition programs will be a factor in moderating the rate of tuition inflation.

We urge your support of S 289. Thank you for your consideration, and please call if we can provide any additional information or answer any questions.

Respectfully submitted,

Douglas M. Brown

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Tuition Plan

Tomorrow's Tuition Today

OVERVIEW

Tuition Plan is a not-for-profit national consortium of over 200 independent colleges and universities from 37 states and Washington, D.C. Membership reflects institutions with a broad range of educational missions. Tuition Plan Consortium is a self-governing, participatory organization that draws upon representatives of its member institutions for advice and guidance.

By joining Tuition Plan Consortium (TPC), these institutions have taken a leadership role in developing a program that will increase the affordability and access to private higher education. Tuition Plan's program will offer families the security of a guarantee against tuition inflation and the portability and flexibility of a national program.

The TPC program will be advantageous to colleges and universities as well. It will increase the size of the national pool of families who are able to send their children to independent colleges and universities and will help create parity with the growing number of state-sponsored prepaid programs.

Over the past ten years most states have set up college *savings* programs. These programs provide an investment vehicle but don't provide a tuition guarantee at any institution. Twenty-one states have set up prepaid tuition programs, and over $6 billion in assets have accumulated in state prepaid tuition plans. These programs guarantee tuition at universities within the state offering the program. The TPC program is very different in a number of aspects. Tuition Plan is a national program, not limited by state boundaries. The program is flexible, allowing students to use their full TPC benefit at any TPC member institution. It also permits any unused TPC benefit to be transferred to another member of the family.

Tuition Plan has selected TIAA-CREF to help invest its funds and administer the plan. TIAA-CREF is a well-recognized leader in serving the educational community, and our association with this organization is a strong advantage to our program.

We believe that the TPC program goes a long way in responding to the call of the National Commission on Cost of Higher Education to offer innovative products to the market. The program provides a unique product that will help families to assure that their children have real choice in their education. TPC membership also offers an excellent opportunity to provide a new service to alumni.

THE PROGRAM ESSENTIALS

Guarantees & Discounts- The TPC program is based on a fundamental guarantee offered by each member institution: that a given amount of educational services purchased today will be provided in the future at a guaranteed cost. That's why we describe TPC as "Tomorrow's Tuition Today." Tuition Plan institutions expect that over the long-term, investment returns will exceed the rate of tuition inflation. In determining its schedule of tuition charges, each member institution will be required to share a portion of the expected investment spread with Tuition Plan purchasers.

Tax Deferral- As certificates are prepayment for educational services to member institutions, all taxable gain on the purchase amount is deferred until time of distribution. This is similar to the advantages enjoyed by tuition programs offered by states. Tuition Plan is currently seeking legislative confirmation of its tax status.

Investment of Funds- The prepaid tuition accounts will be invested by TPC on behalf of the member institutions in a pooled investment fund, managed with the goal of producing long term appreciation of assets to exceed the average long term rate of tuition inflation. TIAA-CREF, under the direction of the Investment Committee of the Tuition Plan Board, will invest these funds to meet these goals. It is anticipated that, initially, the fund will invest in institutional funds of stocks, bonds, and money market instruments. As the investment fund grows in size, other investment vehicles will be added with the goal of increasing the fund's total return.

Administration- TPC is entering into an agreement with TIAA to provide administrative, service, and marketing support to the program. The program will operate under the specific committees of the Tuition Plan Board. Planned features include a toll-free marketing and service center, interactive web site, and institutional field support.

GOALS

The TPC program has been designed to operate in a method parallel to programs covered under Internal Revenue Code Section 529, the authority under which state plans operate. Its planned structure will allow the program to enjoy many of the same tax advantages as state plans, and Tuition Plan hopes to secure full equity with state plans under Section 529. In addition to offering input on such key issues as financial aid, product design and organizational structure, Tuition Plan Consortium members can play an influential role in helping to move enabling legislation.

TPC is pursuing a design and structure that will allow a market launch of the program during 2001. We are working with TIAA to develop systems, conduct further market research, and implement public relations and marketing efforts in anticipation of this launch date.

By launch date, our goal is to have over 250 member institutions nationwide.

HOW TO JOIN

There is currently a one-time $10,000 fee to join TPC to help defray initial development and operational costs. Payment may be spread over several fiscal years at the request of an institution. There are currently no other annual or membership fees.

For more information about TPC, please call **Douglas M. Brown**, President and CEO, **Nancy VanDevender,** Vice President, or **Diane Callahan**, Executive Assistant at *(toll free)* **877-874-0740** or e-mail dbrown-tpi@mindspring.com, nvan-tpi@mindspring.com or dcall-tpi@mindspring.com.

At TIAA-CREF, you can contact the Program Director, Timothy Lane, at 1-800-842-2733 ext. 2437 or by e-mail at tlane@tiaa-cref.org, or Senior Consultant, Michael Osso, at 1-800-842-2733 ext. 1876 or by email at mosso@tiaa-cref.org.

Tuition Plan

P. O. BOX 429, ALBUQUERQUE, NM 87103

877-874-0740 *(toll free)*

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Tuition Plan Consortium

Membership by State

211 as of February 21, 2001

Alabama
Birmingham Southern College
Faulkner University
Huntingdon College
Samford University
University of Mobile

Arizona
Grand Canyon University

Arkansas
Hendrix College

California
California Lutheran University
Chapman University
Claremont McKenna College
Loyola Marymount
Occidental College
Pepperdine University
Pomona College
Santa Clara University
Stanford University
University of Redlands
University of San Francisco
Univ. of Southern California
University of the Pacific
Westmont College
Whittier College

Colorado
Colorado College
Regis University
University of Denver

Connecticut
Fairfield University
Trinity College
Wesleyan University
Yale University

District of Columbia
American University
Catholic University of America
George Washington University
Georgetown University
Southeastern University

Florida
Eckerd College
Jacksonville University
Rollins College
Saint Leo University
University of Miami

Georgia
Agnes Scott College
Berry College
Emory University
Mercer University
Oglethorpe University
Spelman College
Wesleyan College

Idaho
Albertson College

Illinois
Augustana College
Bradley University
Knox College
Illinois Institute of Technology
Lake Forest College
Loyola University of Chicago
Monmouth College
Northwestern University
Olivet Nazarene University
University of Chicago

Indiana
DePauw University
Earlham College
University of Evansville
University of Notre Dame
Valparaiso University

Iowa
Luther College
Wartburg College

Kentucky
Centre College

Louisiana
Centenary College of Louisiana
Dillard University

Maine
Bowdoin College

Maryland
Goucher College
Hood College
Loyola College in Maryland
St. John's College

Massachusetts
Amherst College
Berklee College of Music
Boston University
Clark University
Mount Holyoke College
Smith College
Wellesley College
Wheaton College
Williams College

Michigan
Albion College
Hope College
Kalamazoo College

Minnesota
Carleton College
St. Olaf College

Mississippi
Millsaps College

Missouri
Drury College
Maryville University
Saint Louis University
Washington Univ. in St. Louis
Webster University

New Hampshire
Dartmouth College
Franklin Pierce College

New Jersey
Felician College
Princeton University
Stevens Institute of Technology

New Mexico
College of Santa Fe
St. John's College

New York
Alfred University
Barnard College
Colgate University
Columbia University
Cornell University
Elmira College
Hamilton College
Hobart & William Smith Colleges

Ithaca College
Medaille College
Nazareth College
New York University
Niagara University
Rensselaer Polytechnic Institute
Rochester Institute of Tech.
Saint Bonaventure University
Skidmore College
Syracuse University
University of Rochester
Vassar College

North Carolina

Catawba College
Davidson College
Duke University
Greensboro College
Guilford College
Methodist College
Wake Forest University

Ohio

Ashland University
Case Western Reserve Univ.
College of Wooster
Denison University
Hiram College
John Carroll University
Kenyon College
Mount Vernon Nazarene College
Oberlin College
Ohio Wesleyan University
Wittenberg University

Oklahoma

University of Tulsa

Oregon

Lewis & Clark College
Linfield College
Pacific University
Willamette University

Pennsylvania

Allegheny College
Bryn Mawr College
Bucknell University
Carnegie Mellon University
Dickinson College
Drexel University
Elizabethtown College
Franklin & Marshall College
Gannon University
Grove City College
Haverford College
Juniata College
Lafayette College
La Salle University
Lehigh University
Moravian College
Susquehanna University
Swarthmore College
University of Pennsylvania
Ursinus College
Villanova University
Waynesburg College
Westminster College

Rhode Island

Brown University
Rhode Island School of Design

South Carolina

Charleston Southern Univ.
Converse College
Furman University
Presbyterian College
Wofford College

Tennessee

Belmont University
Lambuth University
Rhodes College
Trevecca Nazarene University
University of the South
Vanderbilt University

Texas

Abilene Christian University
Austin College
Baylor University
Rice University
Saint Edward's University
Southern Methodist University
Southwestern University
Texas Christian University
Texas Lutheran University
Trinity University
University of Dallas
University of St. Thomas

Vermont

Middlebury College

Virginia

Bridgewater College
Eastern Mennonite University
Hampden-Sydney College
Hollins University
Mary Baldwin College
Randolph-Macon College
Randolph-Macon Woman's Col.
Shenandoah University
Sweet Briar College
University of Richmond
Virginia Wesleyan College
Washington & Lee University

Washington

Gonzaga University
Pacific Lutheran University
Seattle University
Seattle Pacific University
University of Puget Sound
Whitman College
Whitworth College

Wisconsin

Lawrence University
Ripon College

Helping Americans Pay for College: Private Prepaid Tuition Plans

Americans believe that higher education is essential and want their children to go to college. But families often do not adequately plan to meet the cost. In fact, 47% of families with college bound high school juniors and seniors have not established an educational savings plan. Not surprisingly, 87% more students have federally subsidized student loans than students ten years ago. Loans increase the out-of-pocket expense for college by two or three times over what it would be with a tuition plan. **Congress can encourage middle income families to save for their children's college education by equalizing and improving the tax benefits for Section 529 tuition programs.**

Issue

Extending Section 529 of the Internal Revenue Code to cover prepaid tuition programs offered by independent colleges and universities would provide the families of students attending private institutions with the same opportunity to pay college tuition ahead of time as students at public colleges. Tax incentives that would treat private prepaid tuition programs in a manner similar to state-sponsored qualified tuition plans would result in more families saving for college expenses. Changes to Section 529, that create a level playing field for families who want to lock in guaranteed future tuition costs at private colleges, have passed both the House and the Senate several times in the last years with bipartisan support.

Key Points

X A growing number of almost 200 private colleges and universities have joined together creating Tuition Plan Consortium (TPC). The TPC tuition plan would guarantee that families who put aside funds early will lock in future tuition, at TPC member colleges and universities, at a cost less than they would pay today. The lack of tax parity with state tuition plans is a key obstacle keeping independent colleges from offering a prepaid tuition program.

X Generally, state prepaid tuition plans only guarantee the cost of attendance at public colleges. Giving private sector prepaid tuition plans the same tax treatment as state tuition plans would complete the spectrum of tuition programs available. This added option will enable families to lock in the cost of education at private colleges.

X Prepaid tuition plans appeal to families with modest and middle incomes. Students in independent and public colleges come from similar economic backgrounds. 73 percent of all first-year students attending independent colleges come from families with household incomes of less than $100,000, while 81 percent of all first-year students at public colleges fall in that same range of household incomes. In fact, the average family income at many private colleges is less than the average family income at the major state university.

X The proposed change to Section 529 would allow private colleges to offer only prepaid tuition programs. Success of a private prepaid tuition plan depends on having a large and diversified group of colleges participating in its tuition program.

○