

TUITION TAX RELIEF ACT OF 1978

FEBRUARY 28 (legislative day, FEBRUARY 6), 1978.—Ordered to be printed

MR. MOYNIHAN, from the Committee on Finance,
submitted the following

REPORT

[To accompany H.R. 3946]

The Committee on Finance, to which was referred the bill (H.R. 3946) to suspend for a temporary period the duty on certain wool, having considered same, reports favorably with an amendment and with an amendment to the title and recommends that the bill as amended do pass.

House bill.—H.R. 3946 as it passed the House would suspend for a temporary period the duties on certain wool.

Committee bill.—The substance of the House bill was approved by the Senate as a provision of H.R. 3093 on September 15, 1977. The House agreed to the Senate amendments to H.R. 3093 on October 25, 1977, and that bill became Public Law 95-162 on November 8, 1977. The committee amendment strikes all after the enacting clause, and inserts in lieu thereof the committee's decisions with respect to refundable Federal income tax credits for educational expenses. The amendment is shown in italic in the bill as reported.

I. SUMMARY

The bill provides a refundable tax credit for certain educational expenses paid by an individual for himself, his spouse, or his dependents. The benefits provided by the bill will become effective in three stages. Beginning August 1, 1978, individuals will be entitled to claim a credit in an amount equal to 50 percent of tuition and fees, with a maximum credit of \$250 per student for expenses in an undergraduate college or a postsecondary vocational school. On August 1, 1980, the credit will be increased to maximum of \$500 per student, and will be expanded to cover tuition and fees for elementary and secondary schools (including vocational secondary schools). The credit will be

fully effective on August 1, 1981, when it will be extended to cover the expenses of graduate students and part-time students.

II. EXPLANATION

Present law

Present law provides no tax credit, deduction, or other tax benefit for personal educational expenses. However, there are a number of provisions in present law which provide indirect tax benefits to students, their families, or to other individuals and institutions involved in education.

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

Individuals generally may exclude from income amounts received as scholarships and fellowships (sec. 117). The exclusion also covers incidental amounts received to cover expenses for travel, research, clerical help, and equipment when they are expended for these purposes. The exclusion for scholarships and fellowship grants is restricted to educational grants by relatively disinterested grantors who do not require any significant consideration (e.g., promises of future services) from the recipient. Similarly, the Internal Revenue Service regards tuition postponement to be a loan and therefore not includible as income to the student (Rev. Rul. 72-2, 1972-1 C.B. 19).

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

Other provisions which benefit education in general and sometimes students in particular include the exclusion from income of gifts (sec. 102), which may comprise a large portion of a student's support, and the charitable contribution deduction for contributions to educational institutions (sec. 170). Several provisions, such as the exclusion of interest on State and municipal bonds (sec. 103) and the deduction for State and local taxes (sec. 164) indirectly assist publicly-supported educational institutions by easing the financial burden on State and local governments.

Reasons for change

The committee is concerned about the increase in costs of post-secondary education. Tuition costs for both public and private institutions have increased rapidly in recent years and are expected to continue to increase. The overall cost of a private college education rose 119 percent between 1964 and 1976. The cost of attending a public

university increased by 99 percent during the same period. These escalating costs are making it increasingly difficult for many parents to provide their dependents with a college education. The committee believes that families who do not qualify for financial aid and who cannot keep up with the increase in educational expenses need assistance to meet the increased cost of a college education. The committee also believes that the tax credit approach is preferable to an expanded system of need-based aid. A tax credit involves no significant administrative burden and has no impact on the personal privacy of taxpayers.

In addition to the rising costs of postsecondary education, the cost of nonpublic elementary and secondary education has increased substantially in recent years, and enrollment in nonpublic schools has dropped sharply. At the same time, the cost of public schools is rising substantially, and taxes keep increasing to meet this cost. The committee believes that nonpublic school parents who must pay for the increased costs of both public and nonpublic schools, even though they relieve the public schools of the cost of educating their children, also should receive tax relief for their children's educational expenses. The committee also feels that nonpublic schools represent an integral part of American society, reflecting the diversity of the country, and providing citizens with important opportunities to obtain the education they deem best suited to individual needs and family values. By assisting citizens to select and pay for such education, the tax relief provided by this bill is intended to reinforce and sustain the Nation's historic pattern of diverse educational offerings in both the public and the nonpublic sectors.

In the interest of equity and in order to provide assistance to the greatest number of individuals, the committee made the credit refundable. Thus, individuals who have no tax liability, or whose tax liability would be too small to benefit fully from a tax credit, also will receive help from this bill. It is estimated that 85 percent of total benefits of this credit will accrue to families with adjusted gross incomes below \$30,000 per annum (based on full implementation of the \$500 maximum tuition credit but at 1978 income levels and 1978 cost levels).

More than 16 million students are potential beneficiaries of this legislation. At the present time there are approximately 11.3 million persons enrolled in tuition-charging postsecondary institutions and approximately 5 million more in tuition-charging elementary and secondary schools.¹ It is estimated that approximately 75 percent of the benefit from this legislation will accrue to postsecondary students and their families, while about 25 percent will accrue to those in elementary and secondary schools.

Explanation of provisions

The bill provides a refundable tax credit for certain educational expenses paid by an individual for himself, his spouse, or his dependents (as defined in sec. 152).²

¹ Source: "Projections of Education Statistics to 1985-86," National Center for Education Statistics (GPO, 1977).

² Under section 152, the term "dependent" means certain individuals who are related to the taxpayer (or are members of his household) and who receive over half of their annual support for him.

The benefits provided by the bill take effect in three stages. Effective August 1, 1978, a credit will be allowed for 50 percent of the amount paid for educational expenses incurred on or after that date with a maximum credit of \$250 with respect to the expenses of any eligible individual who is a full-time college undergraduate or postsecondary vocational school student. On August 1, 1980, the credit will be increased to a maximum of \$500 with respect to educational expenses incurred on or after that date for any eligible individual and will be expanded to cover students in elementary and secondary schools (including vocational secondary schools). Finally the credit will be expanded to educational expenses paid and incurred for graduate students and part-time students on or after August 1, 1981. No credit will be allowed at any time for recreational courses.

In any taxable year where payments are made for an eligible individual's educational expenses incurred both before August 1, 1980, and after July 31, 1980, the maximum credit for that individual's expenses is \$500, but only \$500 of the expenses incurred before August 1, 1980, may be taken into account in computing the credit. Thus, for example, if for a taxable year a taxpayer pays \$600 for educational expenses incurred before August 1, 1980, and pays an additional \$800 for educational expenses incurred after July 31, 1980, the taxpayer is entitled to claim a total credit of \$500 for that taxable year for that individual.

In determining the credit for the entire year, the taxpayer must make separate computations for the periods before August 1, 1980, and after July 31, 1980. Although the taxpayer has \$600 of expenses for the first part of the year, only \$500 of those expenses may be taken into account in computing the credit. For the second part of the year, the taxpayer has expenses of \$800; however, the \$1,000 ceiling for the second part of the year must be reduced by the amount of expenses taken into account for the credit for the first part of the year (\$500). Therefore, eligible expenses for the second part of the year are \$500 (\$1,000 minus \$500). The taxpayer's credit for the entire year is \$500 50 percent of $(\$500 + \$500)$.

No educational expenses paid or incurred for secondary or elementary schools (including vocational secondary schools) before August 1, 1980, may be taken into account in claiming a credit. No amount paid or incurred before August 1, 1981, for graduate study or for an individual who is a part-time student may be taken into account in claiming the credit.

The credit will be allowed for educational expenses paid prior to August 1, 1981, for postsecondary education only if the expenses are related to courses of instruction for which credit is allowable toward a baccalaureate or associate degree by an institution of higher education or toward a certificate of required course work at a postsecondary vocational school.

A credit is allowed only once for each taxable year with respect to the educational expenses of any one individual. An individual may not claim any credit for his educational expenses if the individual himself is a dependent of another taxpayer. Thus, a student whose parents are entitled to claim a personal exemption for him may not claim a credit for his own educational expenses; however, the student's parents may

claim a credit only for educational expenses which they have paid for the student. A taxpayer may claim a credit for a spouse's educational expenses only if the taxpayer may claim a personal exemption for his spouse or if the taxpayer files a joint return with his spouse.

Offsets

Any amounts taken into account as educational expenses of a student in determining a credit must be reduced by educational assistance which is not required to be included in gross income either by the student or by the individual claiming the credit. Thus, the expenses against which the 50-percent credit applies must be reduced (1) by scholarships or fellowship grants excludible from gross income under section 117; (2) by any other educational assistance or payment for educational expenses, or conditioned on attendance at an eligible institution which is not includible in gross income by any U.S. law (for example, amounts received under the Armed Forces Health Professions Scholarship Program through calendar year 1979); and (3) any educational assistance received pursuant to chapter 32, 34, or 35 of title 38 of the United States Code (relating to Veterans' benefits). However, no offset is required for a gift, bequest, devise, or inheritance within the meaning of section 102(a) of the Internal Revenue Code. Thus, for example, grandparents' gifts to grandchildren would not be offsets.

Reductions for tax-free assistance are to be matched against the educational expenses for which the assistance is granted. Thus, if a taxpayer pays educational expenses in 1982 and claims a credit for that year, any educational assistance received in 1983 relating to the expenses paid in 1982 is to reduce the amount of expenses which may be taken into account in computing the credit for 1982.

If amounts received as scholarships or fellowships, other educational assistance or payments excludable from income, or educational assistance pursuant to chapter 32, 34 or 35 of title 38 of the U.S. Code are not apportioned by the grantor or donor between the educational expenses eligible for the credit and other expenses which may not be taken into account in determining the credit, the Internal Revenue Service may issue regulations for determining a reasonable allocation in cases where such an allocation can be made; otherwise, it is to be presumed that such tax-free amounts are to be applied first in reducing tuition and fees, that is, educational expenses eligible for the credit. However, if a reasonable allocation or apportionment is made by the donor or grantor in providing such assistance, the apportionment or allocation is to be recognized in applying the offset rule.

Disallowance of expenses as deduction or credit

An individual may claim no deduction or credit under any other section of the Code for any educational expenses which he has taken into account in determining the amount of an educational expense credit which he claims. However, a taxpayer may elect not to claim an educational expense credit and may claim any other deduction or credit to which he is entitled with regard to the educational expenses. Thus, for example, a calendar year taxpayer who incurs job-related educational expenses of \$1,000 in 1983 must choose between claiming an educational tax credit of \$500 (under the new credit added by this amendment) or a trade or business expense deduction of \$1,000 (sec.

162). If a calendar year taxpayer incurs job-related educational expenses of \$2,000 in 1982, he may claim an educational expense credit of \$500 *and* a trade or business expense deduction of \$1,000; or the taxpayer may elect not to claim any educational expense credit and may deduct the full \$2,000 of educational expenses as trade or business expenses.

Definitions

The term "educational expenses" (that is, expenses taken into account in determining a credit) means tuition and fees required for a student's enrollment or attendance at an eligible educational institution. The term includes the normal annual, semester, course, or credit charges assessed by educational institutions as well as such required miscellaneous charges as registration fees and required course fees, for example, laboratory fees which are required for registration in courses involving laboratory work. Expenses which may not be counted in determining a credit include any amount paid, directly or indirectly, for books, supplies, and equipment for courses of instruction, or for meals, lodging, transportation, or similar personal, living, or family expenses.

Eligible educational expenses for elementary and secondary schools are limited to tuition and fees for grades one through twelve. No credit is allowed with respect to expenses paid or incurred for education below the first grade level or for attendance at a kindergarten or nursery.

The bill provides a special definition of the term "full-time student" for purposes of the "full-time student" limitation applicable prior to August 1, 1981.³ The term means any student who, during any four calendar months during a calendar year in which the taxable year of the taxpayer begins, is a full-time student at an eligible educational institution.

Before August 1, 1980, an "eligible education institution" is an institution of higher education (but not including a graduate school) or a postsecondary vocational school in the 50 States and the District of Columbia. On August 1, 1981, the term broadens to include secondary schools and elementary schools, including vocational high schools. Graduate schools are treated as eligible educational institutions after July 31, 1981.

In order to qualify as eligible education institutions, secondary and elementary schools which are privately operated must meet two requirements. First, such schools must be approved or accredited under State law. In the case of a State which does not formally approve or accredit private elementary or secondary schools, a private elementary or secondary school will be treated as an eligible institution if attendance at the school meets the State's compulsory attendance requirement. Second, privately operated schools also must qualify for tax-exempt status under section 501(c)(3) of the Internal Revenue Code. (Schools which discriminate on the basis of race are denied tax-exempt status under case law interpreting section 501(c)(3).)

³ The definition of full-time student for purposes of the credit for educational expenses differs from the definition of student in section 151(e)(4) (relating to deductions for personal exemptions), which provides a 5-month rule.

The terms "elementary school" and "secondary school" include facilities which offer education for individuals who are physically or mentally handicapped as a substitute for public elementary or secondary education.

Relationship of credit to other educational assistance programs

The committee intends that the educational expenses credit provide individuals with additional educational assistance and not affect their eligibility for, nor the amount of the assistance to which they are entitled, under any other program. Therefore, the bill specifically provides that any refund or reduction in tax liability enjoyed by any individual as a result of claiming a credit for educational expenses is not to be taken into account as income or receipts in determining the individual's eligibility (or any other individual's eligibility) for benefits or assistance, or the amount or extent of benefits or assistance, under any Federal educational assistance program or under any State or local educational assistance program which is financed in whole or in part with Federal funds.

Examination of books and records

The bill contains a provision to give assurance that there will be no unnecessary interference with the activities of a church or convention or association of churches where a school is operated, supervised or controlled in conjunction with it. As a result, the bill provides that the books and records of a school operated in conjunction with a church may be examined by the Internal Revenue Service only to the extent necessary to determine that the school is an eligible educational institution. In all other respects, the burden then is upon the taxpayer to prove that he is eligible for the tax credit. It is his responsibility, for example, to establish the amount paid and that this amount was paid for tuition, in the same manner as is provided under present law, in verifying charitable contribution deductions.

Judicial review

The committee believes that the provisions of this bill are valid legislation under the Constitution. The bill will benefit a broader class of beneficiaries than any legislation of this type on which the Supreme Court has ruled so far. However, in order to resolve expeditiously any questions which may arise concerning its constitutionality, the bill provides for the expeditious disposition of legal proceedings brought with respect to any provision of the credit or with respect to any other provision of the Internal Revenue Code which relates to the credit. Expeditious review will reduce the administrative problems and the costs which would arise inevitably for both taxpayers and the Internal Revenue Service if the validity of any provision of the credit is in doubt when it becomes effective, or if any provision is determined to be invalid after it has become effective.

The bill therefore provides that if any judicial proceeding is brought in a U.S. district court concerning the constitutional validity of any provision of the tuition tax credit, the district court shall immediately certify all questions involving the constitutionality of that provision to the United States Court of Appeals for the circuit involved. The Court of Appeals shall hear the matter sitting en banc.

An appeal from a decision of the Court of Appeals is to be brought directly to the U.S. Supreme Court within 20 days after the decision of the appellate court is entered. The bill indicates the committee's intention that the Court of Appeals and the Supreme Court of the United States advance on their dockets and expedite to the greatest extent possible the disposition of any challenge to the constitutionality of any provision of the tax credit for educational expenses.

Separability

The bill specifically provides that a judicial decision holding any provision of the educational expenses credit (or any other Code section relating to this credit) or the application of any provision of the credit to any person or in any circumstances to be invalid shall not affect the remainder of the credit provisions nor the application of the other provisions to other persons or circumstances.

Effective date

The bill applies to amounts paid after July 31, 1978 (in taxable years ending after that date) for educational expenses incurred after that date.

III. COSTS OF CARRYING OUT THE BILL AND VOTE OF THE COMMITTEE IN REPORTING H.R. 3946, AS AMENDED

Budget Effect

In compliance with section 252(a) of the Legislative Reorganization Act of 1970, the following statement is made relative to the costs incurred in carrying out H.R. 3946, as amended by the committee. The committee estimates that the credit allowed by this bill will decrease budget receipts by \$39 million in fiscal year 1978, by \$916 million in fiscal year 1979, by \$1418 million in fiscal year 1980, by \$2835 million in fiscal year 1981, by \$4479 million in fiscal year 1982, and by \$5290 million in fiscal year 1983.

The Treasury Department agrees with this statement.

Vote of the Committee

In compliance with section 133 of the Legislative Reorganization Act of 1946, the following statement is made relative to the vote by the committee. The bill was ordered favorably reported by a voice vote after the following rollcall vote on the amendment in the nature of a substitute: In favor (14) : Messrs. Long, Ribicoff, Gravel, Hathaway, Haskell, Matsunaga, Moynihan, Curtis, Hansen, Dole, Packwood, Roth, Laxalt, and Danforth; opposed (1) Bentsen; present (1) Byrd (Va.).

IV. REGULATORY IMPACT OF THE BILL AND OTHER MATTERS TO BE DISCUSSED UNDER SENATE RULES

Regulatory Impact

Pursuant to rule XXIX of the Standing Rules of the Senate, as amended by S. Res. 4 (February 4, 1977), the committee makes the following statement concerning the regulatory impact that might be incurred in carrying out the provisions of this bill.

A. Numbers of individuals and businesses who would be regulated.—The bill does not regulate individuals or businesses but generally provides tax relief to a large number of individuals.

B. Economic impact of regulation on persons affected.—The tax relief provided by this bill will reduce the cost of certain educational activities and thereby assist both students and their families to undertake and continue education.

C. Impact on personal privacy.—The bill has minimal impact on the personal privacy of taxpayers.

D. Determination of the amount of paperwork.—The bill will require additional tax computations and in some cases an additional tax form for individuals who elect it. Most of this paper work will require only the assembly of information which is already in the taxpayer's records. The time to assemble such information will vary with taxpayers but in no case should it be more than negligible. There will be no expense associated with claiming the relief provided by this bill.

Budget Impact of the Bill

In accordance with section 403 of the Budget Act, the committee advises that the Director of the Congressional Budget Office has not submitted a separate cost estimate for comparison with the committee's budget estimates because it was impracticable to do so before the bill was reported due to temporary interruption of the Congressional Budget Office computer operations.

In compliance with section 308(a)(1) of the Budget Act, the committee notes that refundable tax credits have been treated as reductions of revenue under Senate budgetary conventions. Consistent with this convention, the bill does not provide any new budget authority; therefore no allocations are involved.

In compliance with section 308(a)(2) of the Budget Act with respect to tax expenditures, and after consultation with the Director of the Congressional Budget Office, the committee states that the bill would provide new and increased tax expenditures. The tax expenditures for fiscal years 1978–85 are the same as the amounts stated in Part III in the discussion of the bill's "Budget Effect."

V. CHANGES IN EXISTING LAW

In the opinion of the committee, it is necessary in order to expedite the business of the Senate, to dispense with the requirements of subsection 4 of rule XXIX of the Standing Rules of the Senate (relating to the showing of changes in existing law made by the bill, as reported).

