Less Student Debt from the Start:

What Role Should the Tax System Play?

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Testimony

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Chairman Wyden and Ranking Member Hatch, thank you for asking me to testify at today's hearing on college education and tuition.

I personally have had a long road through the higher education system -- leaving high school early with a GED; going to junior college; transferring to a private college for my bachelor's degree. Later, I went to law school at night at a public university while working full time. Finally, I studied for an advanced law degree in taxation from a private university while commuting four hours twice a week from DC to New York while working in the Senate. Between loans, grants, work, savings -- cotton, string and wire – my family and I – like many families -- got through it all. So Senators I've benefited from higher education and I've also seen a great deal of higher education at all levels.

The world is very different now – with skyrocketing tuition and a hard economy. I know you Senators hear every day the stories of families struggling to meet the costs of tuition. Cotton, string and wire aren't enough anymore.

It is for these reasons, that I believe the Committee has asked the exact right question – what can be done in the tax code to encourage colleges to control increases in tuition – and part and parcel – help all families meet the costs of college without risking their future economy security.

The short answer is that the Finance Committee can do a great deal on both these issues. To do so, the Committee needs to recognize two things – first, the enormous amount of taxpayer dollars that are being provided to colleges and universities every year though various provisions of the tax code; and second, that under current law, these billions of dollars are being provided without application of any real requirements, standards or incentives to control the ever increasing cost of tuition.

Also the Committee needs to engage in a thorough review of the billions of dollars dedicated to supporting colleges and universities – understanding what dollars are provided and what institutions are getting those taxpayer monies. Armed with that knowledge, the Committee should consider revisiting the policy choices it has made in the past – particularly looking at areas such as tax-exempt bonds which as I discuss below which are actually in some ways counterproductive to the goals of the Committee of encouraging low tuition costs for students from low and middle income families as well as veterans.

Standards for Taxpayer Dollars

Let's first talk about the taxpayer dollars that go to colleges and universities through the tax code. The value of the charitable status for colleges and universities I estimate (roughly) based on Joint Tax Committee estimates to be approximately $10 billion dollars a year at the federal level.

What are the key parts of these tax benefits? – tax-exempt bonds; donations to the college that are deductible from taxes; tax-free treatment of endowments; and generous tax treatment of university business activities.

Bottom line – colleges and universities receive a massive amount of money in taxpayer-funded subsidies every year. The tax code does not require of these colleges and universities any steps to control net and sticker tuition in return for this taxpayer money.

The question is then – should the Finance Committee consider creating tax code standards for colleges and universities to control net and sticker tuition -- requiring a focus on controlling spiraling costs of our colleges and universities -- in exchange for the billions of dollars they receive from taxpayers?

The tax code and regulations are filled with thousands of pages of examples of where standards are required for taxpayers to get other benefits – or to avoid paying tax.

It is also the case that the Finance Committee has placed detailed standards on charities – such as charitable hospitals and credit counseling centers – when it found that the general exemption rules were inadequate.[1]

[1] To the Committee's credit, led by then-Chairman Grassley, the Committee on a bipartisan basis placed basic standards for charitable hospitals and credit counseling centers (See Roger Colinvaux, "Charity in the 21st Century: Trending Toward Decay," Florida Tax Review, 2011). The requirements placed on charitable hospitals by this Committee have the potential to provide enormous benefit for the uninsured poor in this country (and in some cases have already helped the poorest significantly). The Committee has also heard thoughtful testimony (Roger Colinvaux, Senate Finance Committee "Tax Reform Options: 'Incentives for Charitable Giving," October 18, 2011) recently that it should revisit the bundling of charitable status – and the tax benefits of being a charity – and arguing that they don't have to go hand-in-hand.

Further, it is clear that the colleges and universities would be responsive to the Committee's actions. Colleges and universities already jump through a score of hoops in response to the US News and World Report ratings – taking dozens of steps to better place themselves in those rankings. Certainly colleges and universities will be responsive to Congressional establishment of standards when there is a great deal of money at stake. [2]

At the core it's simple – the Committee should consider establishing standards for colleges and universities – in short, to act charitably in return for the billions of dollars in subsidies they receive from the taxpayers.

What are the standards that the Committee could require of colleges and universities in return for the billions of dollars in subsidies they receive? The Committee should engage in a broad conversation on this matter – of both what those standards might be (and the timing of those standards) and how they best match with the tax incentives (also see the discussion below about the Committee also reprioritizing these incentives overall).

However, to assist the Committee and encourage discussion, suggestions might include that: colleges and universities are eligible for certain tax benefits only as long as they meet some or all of the following standards:

1) keep growth of both sticker tuition and net tuition at a level of inflation or below (and/or that tuition remains below a certain dollar threshold).[3]

2) meet benchmarks for six-year, full-time freshman graduation rate; and,

3) students of the colleges and universities stay below a default rate on education loans. I would suggest as an added focus on the explosion of loans – that consideration be given to all colleges and universities (including for-profit entities) should assume some of the risk in these loans, that is, that they be required to have skin in the game on student loans – that they are

[2] When Senators Baucus and Grassley raised questions about college endowments – just questions – the giddyup by College Presidents was a wonder to behold – with many institutions swiftly making and announcing changes to their endowment policy, increasing payout and placing greater priority for helping low-income students. That was the response with just a few letters. But this only scratched the surface. Imagine the good that could be accomplished with binding standards on institutions to control tuition prices and prioritize performance outcomes.

[3] While it is outside of the scope of this hearing to discuss the reasons for tuition increases and the possibilities of controlling tuition increases, I note the following articles of interest: Delta Cost Project Issue Brief "Labor Intensive or Labor Expensive?" by Rita Kirchstein (February 2014); Delta Cost Project "Climbing Walls and Climbing Tuitions," by Rita Kirchstein and James Kadamus (December 2012); Goldwater Institute "Administrative Bloat at American Universities: The Real Reason for High Costs in Higher Education," by Jay Greene (August 2010); and, American Council of Trustees and Alumni "Cutting Costs: A Trustee's Guide to Tough Economic Times," by Michael Poliakoff are just a sample of the discussions out there on the topic. The impact of tuition increases at public universities due to reductions in state funding also should be recognized by the Committee.

responsible for a certain percentage of the amount that is loaned to their students and parents.[4]

The Committee may also wish to consider whether to reflect its priorities it makes sense to ensure equal opportunity for low and middle income families as well as veterans at colleges and universities receiving federal tax benefits.

These standards and best practices would place the right emphasis – controlling both net and sticker tuition.[5] Further, these benchmarks would ensure that colleges and universities are focused on helping students get their degrees and in a timely manner (the rising drop-out rate of our college students is a disaster); preparing students to be successful upon graduation; and, reduce the burden of overwhelming debt on students and their families.

The details of the best practices/standards can be debated (and fewer/more), the timing of the benchmarks are all fair points of discussion as the Committee considers what standards to place on colleges and universities in exchange for the billions of dollars they receive for the taxpayers.

I acknowledge that there are a great number of colleges and universities who are doing the right thing, or want to do the right thing regarding providing a good, affordable education.[6]

But the status quo is not working. Introducing standards provides a better path than the path we've been on -- of throwing ever-increasing taxpayer dollars at the problem and just hoping for good things to happen.[7] [8] Putting in place best practices/standards that tie tax

[4] See "Tough Love: Bottom-Line Quality Standards for Colleges" from the Education Trust – Michael Dannenberg and Mary Nguyen Barry (especially for proposals 2 and 3)(June 2014); and generally Stephen Burd, "Undermining Pell: How Colleges Compete for Wealthy Students and Leave the Low-Income Behind" from New American Foundation (May 2013).

[5] High sticker tuition harms both low and middle income families – with studies finding that higher sticker tuition results in overall higher net tuition for low income families – as well as middle-income -- and essentially serves as a hidden tax on struggling middle income families – See Burd, "Undermining Pell." See also "More Students Subsidize Classmates, by Douglas Belkin, Wall Street Journal, January 10, 2014.

[6] I am taken by the good work of colleges such as Berea, College of the Ozark and Brenau (See Scott Carlson – Chronicle of Higher Education, February 3, 2014, "Brenau U. a woman's college in Georgia is running million-dollar surpluses. Here's how.") as well as a good number of public and private colleges that are showing that it is possible to accomplish the trifecta of low tuition, welcome mat for low-income families and a good education (See Burd, Undermining Pell).

[7] See Andrew Gillen, "Introducing Bennett Hypothesis 2.0," Center for College Affordability and Productivity, 2012 and Dills, Hernandez-Julian, Hale, "Government Policy and Tuition in Higher Education, Mercatus Center, December 2013). Of particular interest to the Committee may also be the excellent work done by Nicholas Turner: "Who Benefits From Student Aid? The Economic Incidence of Tax-Based Federal Student Aid?" October 20, 2010 (Mr. Turner is now in the Office of Tax Analysis at the US Treasury).

[8] The Committee may want to consider these issues immediately – in its extension of the Charitable IRA rollover (which overwhelmingly benefits colleges and universities) the Committee may wish to consider requiring that on a going-forward basis

benefits to reining in tuition costs will put us on the right path to controlling tuition. All this good can be accomplished without a single additional tax dollar.

For-Profit Colleges

A brief point on for-profit colleges. As mentioned above, certainly for-profit colleges should also have skin in the game regarding student loans. I recognize that the for-profit entities don't benefit directly from taxpayer support. However, the for-profit colleges do indirectly benefit from the Hope/American Opportunity Credit and the Lifetime Learning Credit. I would suggest the Committee may wish to consider (and may want to extend to non-profit institutions) denying eligibility for these credits for newly enrolling students in certain instances, for example, if a for-profit college fails to meet the standards and best practices the Committee establishes for 6 year degree completion and low repayment of student loans.

Endowments

When I served as one of the Tax Counsels on the Committee, at the direction of Chairman Grassley and Ranking Member Baucus we began a bipartisan review of college endowments. The college endowments are subject to extraordinary taxpayer support – with donations to the endowment enjoying significant support from taxpayers (being tax deductible) and all the earnings of the endowment also being tax-free (and also therefore supported by taxpayers).

The review involved sending letters to approximately 100 colleges and universities with the largest endowments, meeting with scores of representatives and talking to a host of other interested parties.

In general, the review told us that most colleges with significant endowments can provide far more tuition support from their endowments. This is similar to a report by the New American Foundation which noted that:

> "79 private colleges with endowments of more than $250 million that charge low-income students an average net price over $10,000; 51 that charge over $15,000 and 26 that charge over $20,000." (Burd – Undermining Pell)

The average payout from the endowments we reviewed was consistently below 5% (the requirement in place for most private foundations) – often way below; the definition of endowment used by the universities was uncertain on the best of days (with sometimes

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Charitable IRA donations will only be allowed only for those colleges that have kept sticker and net tuition below the rate of inflation in the previous year (or other benchmarks could be considered). A small, but important, first step.

multiple pots of money given different labels); and how payout was calculated rarely had consistency and was often designed to provide the best optics possible.

Chairman Camp in his proposals for tax reform proposed a 1% excise tax on certain large private college endowments investment income. This limited tax proposal would alone raise raised $1.7 billion dollars over ten years (and gives a hint to the significant tax benefits provided by the taxpayers to these large tax-free endowments).

Setting aside placing an excise tax[9] – which the colleges and universities can't avoid regardless of payout under the Ways and Means Committee proposal – the Committee may wish to consider (as it has done with private foundations and more recently with supporting organizations) requiring a payout of the largest endowments.[10] While 5% is the payout for private foundations, the Committee should bear in mind that private foundations in most cases have all the money they are going to ever have (they generally don't do fundraising). However, colleges and universities with their large alumni base are constantly seeking and getting more funds (in fact, comments have been made that large endowments actually serve to discourage some alumni donations) – so therefore the Committee may wish to consider a different payout requirement.

While recognizing that there can be good years and down years, the most recent ten years numbers are that all endowments have a growth of 7.1% over that time period – with the larger endowments showing a growth of 8.3%. Growth this year was investment return of 11.7% over FY 2013 (which does not include additions to endowments from donations).

Private foundations, that don't receive additional funds and donations and thus rely on endowment income, have thrived with a 5% payout requirements over good years and bad years – colleges and universities can do the same.[11]

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[9] Also the Finance Committee should consider revisiting the issue of endowments (as well as private foundations) that make extensive use of offshore "blockers" to avoid what little tax (UBIT) they might owe – raised in Committee hearings in 2007.

[10] See generally "Rethinking Endowment Payout in Higher Education" by Paul Jansen, McKinsey & Company

[11] It has been argued that these monies in the endowment are somehow tied up though donor restrictions. In my view, that is far from clear. The simple reality is that these monies are not tied up in any significant manner that would prevent universities from substantively helping address the costs and burdens of tuition. Alumni dollars are commonly donated with little to no strings attached that would bar funds from being used to help students and in our review we found that it was often the case that limitations on the use of monies were put in place by the college itself – not the donor. From first-hand experience I can tell you that most donors are more than happy to be responsive to requests from college officials that there be greater freedom in the use of a donation – especially if it is meant to target aid to students.

The requirement of a payout on our largest endowments could cause a seismic change to the current landscape of tuition costs. When the staff on a bipartisan basis talked to one Ivy League representative – the representative stated that if the college was required to have a payout – (intending for us to view this with horror) – that this would mean undergraduate tuition would be free. I can't imagine a better outcome – that some of our best colleges could offer undergraduate tuition for free (or extremely low amounts) and being able to open their doors wide to the most qualified – not just the qualified who can pay. The signal to the rest of the country (where there is still in the minds of many an embrace of chivas regal effect – price equals value) that the best education can be had for free would turn the world upside down when it comes to tuition. Low-income families would realize that a good education is within their grasp. In addition, "free" would force all universities to more closely justify their cost (how can you tell them an education costs $60,000 when they've seen Yale is free) would have a profoundly positive ripple effect.

The Committee should consider the question of whether it wants to have these large endowments – massively subsidized by all taxpayers – continue to sit and gather dust with a few pennies shaken out every so often. Or does the Committee want to instead dynamically change the landscape of college education. As discussed next – the real question for the Committee is – is there a better use of taxpayer-funded expenditures than subsidizing these large endowments that provide very little benefit to today's families struggling to pay tuition?

Where Should Taxpayer Subsidies to Education Go?

As I discussed at the beginning, I roughly estimate that taxpayer directly subsidize colleges and universities to the tune of $10 billion dollars a year.

These subsidies have basically grown over the years – unchecked and without any Congressional review or consideration.

I would encourage the Committee to ask some basic questions to perform a review of these subsidies/expenditures – ask the Treasury Department as well as the Joint Committee on Taxation to provide the Committee the following two items: First, a detailed analysis of the tax benefits (and the value) for higher education. While some of this work has been done – for example, the JCT's excellent brief, provides no discussion of the tax benefits of UBIT and college endowments. In addition, the estimates provided on tax expenditures often do not break out for just higher education (instead providing a more umbrella "education" – covering K-12 as well). In addition, while I've listed four major tax expenditures – there are others – example, that colleges can provide free tuition to the children of university presidents and professors – and it is tax-free, benefits of arbitrage of tax-exempt bonds, etc. The Committee needs the entire list.

Second, the Committee has always had an interest in understanding who (or what organizations) are getting the benefits of a tax policy and tax expenditures – in short a distributional table. The Committee should consider asking both Treasury and JCT to provide a distributional table of these education tax benefits – what institutions get the tax benefits?

The Committee will then have its eyes open to where the dollars are going – for example, how the dollars flow to institutions that are significantly serving students from low-income and middle-income families; dollar flow to institutions with large endowments; etc. The Committee will then be able to make informed decisions on whether the current policy is appropriate or whether there should be changes to that policy to reflect the goals of the Committee.

For example, the current allowance for tax-exempt bonds has many unintended consequences that the Committee should consider. In the Committee's hearing on colleges a few years back, Senators heard thoughtful testimony from Patricia McGuire, the President of Trinity College in DC (a college that educates many low-income students) discussing at length the problems of ratings agencies such as Moody's – and the detrimental impact of tax-exempt bonds. Just two brief excerpts from President McGuire's testimony:

> "Attaining and sustaining the best possible credit rating is one of the most important fiscal responsibilities of the leadership of any university. But the standards that Moody's and other credit ratings apply to determine the credit raking often work in conflict with other values that institutions might espouse, and that public policymakers might also consider very important. Perhaps the greatest irony in this entire conversation about the financial obligations of higher education is the fact that the most scrupulous discharge of the fiduciary duty of the president and trustees of the university might also offend public policy notions of affordability, access and fiscal restraint.
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> . . . we learned that our restrained tuition price and large volume of minority students (who are assumed to be very needy) would have a substantial negative impact on our ability to get a good rating.[12]

The Committee may in looking at these tax benefits – for instance in the case of tax-exempt bonds, which may in fact be counterproductive.[13] The Committee may wish to consider

[12] Patricia McGuire, President, Trinity University, Senate Finance Committee, "Report Card on Tax Exemptions and Incentives for Higher Education: Pass, Fail or Need Improvement?," December 5, 2006. See also Moody's Special Comment: "More US Colleges Face Stagnating Enrollment and Tuition Revenue, According to Moody's Survey," by Emily Schwarz and Karen Kedem(January 2013) and Moody's Rating Methodology: "US Not-for-Profit Private and Public Higher Education," by Karen Kedem, (August 2011).

[13] The Committee may also wish to review the CBO Study: "Tax Arbitrage by Colleges and Universities," April 2010 to determine whether these activities meet their policy goals.

whether more limited and targeted tax credit bonds might potentially do a great deal more to further public policy goals than the current law.

Mr. Chairman, this concludes my testimony – as you can see you and the Committee have great opportunities and possibilities to make changes for the good. Changes that will help families and students get a good education at a fair price; changes that will assist those great number of colleges and university leaders that are trying to do the right thing – and will benefit from better, targeted support and clear standards in the tax code; and, finally changes that will make Washington better stewards of the taxpayers' monies.