The Hope and Opportunity for Postsecondary Education (HOPE) Act of 1997

President Clinton's Higher Education Initiative with State-by-State Analysis

March 20, 1997

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President Clinton's Hope and Opportunity for Postsecondary Education (HOPE) Act of 1997

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TODAY, THE PRESIDENT WILL SEND TO CONGRESS NEW LEGISLATION TO HELP OPEN THE DOORS OF COLLEGE TO MORE AMERICANS. The Hope and Opportunity for Postsecondary Education (HOPE) Act of 1997 -- part of President Clinton's five-year balanced budget -- includes a $10,000 tuition tax deduction, a $1,500 Hope Scholarship tax credit, a substantial Pell Grant expansion and increase, a cut in student loan fees, new educational assistance from employers, and other provisions. The new legislation provides:

- √ **$38.4 billion over five years in tax relief** for middle-income families struggling to pay for college and make ends meet.
- √ **At least $40 billion in Pell Grants** over five years to provide more tuition assistance to low- and moderate-income families, the largest increase in two decades.
- √ **$2.6 billion in savings over five years in reduced loan fees** for student loan borrowers -- putting more money into the hands of students when they pay tuition bills and other college expenses.
- √ **Financial support for worker training** through the tuition deduction and the extension of the tax-free treatment of up to $5,250 per employee in employer-provided educational assistance.

KEY ELEMENTS OF THE HOPE ACT OF 1997

- **Includes a $1,500 per student HOPE Scholarship tax credit** for tuition and fees in the student's first year and another $1,500 in the second year if the student earns at least a B minus average. That credit will help 4.2 million students in 1998.
- **Provides a $10,000 tuition tax deduction** for higher education and training, which is expected to help the families of 8.1 million students in 1998.
- **Provides the largest Pell Grant increase in two decades** -- from $2,700 in FY 1997 to $3,000 in FY 1998. Over 3.6 million students now eligible will receive an increase of up to $300. This increase and other changes will make an additional 348,000 families eligible for the grant.
- **Lowers fees and reduces interest rates for millions of student borrowers.**

OVER 250 COLLEGE PRESIDENTS EXPRESS SUPPORT FOR THE PRESIDENT'S HIGHER EDUCATION PLAN. Already, over 250 college presidents -- representing community colleges, public and private colleges and universities -- have expressed support for the President's higher education initiatives.

NEW STATE-BY-STATE ANALYSIS SHOWS EVERY REGION OF THE COUNTRY BENEFITTING FROM THE HOPE ACT. For the 1998-99 academic year, these proposals will provide nearly $1.7 billion in Federal benefits for students in California, and over $300 million for students in Virginia.

Benefits to Students under Hope and Opportunity for Postsecondary Education Act of 1997

(dollars in millions)

State	Total Pell Budget Authority in Award Year 1998-99	Combined Tax Benefits for Calendar Year 1998	Cut in Student Loan Fees for Award Year 1998-99	Total Benefits for Award Year 1998-99
Alabama	$144.2	$92	$5.8	$242.0
Alaska	8.7	13	0.3	21.9
Arizona	135.8	115	10.3	261.1
Arkansas	76.3	37	3.0	116.3
California	873.8	777	46.0	1696.7
Colorado	98.2	103	8.5	209.6
Connecticut	47.2	70	5.2	122.3
Delaware	10.4	20	1.0	31.4
District of Columbia	19.8	35	6.4	61.2
Florida	358.5	260	19.5	638.0
Georgia	168.8	125	11.6	305.4
Hawaii	14.5	29	0.8	44.2
Idaho	40.8	24	2.2	67.1
Illinois	275.1	314	20.0	609.0
Indiana	139.0	122	11.1	272.1
Iowa	93.0	71	8.4	172.4
Kansas	82.3	71	4.6	157.9
Kentucky	125.6	72	5.6	203.3
Louisiana	175.9	78	9.1	263.0
Maine	28.1	24	2.2	54.3
Maryland	99.0	114	6.1	219.1
Massachusetts	153.1	180	18.9	352.0
Michigan	248.7	231	15.3	495.0
Minnesota	128.9	121	9.6	259.6
Mississippi	111.4	45	3.7	160.2
Missouri	146.5	122	11.2	279.7
Montana	34.2	15	1.9	51.1
Nebraska	50.4	49	3.9	103.4
Nevada	15.9	28	1.1	45.0
New Hampshire	23.5	27	2.7	53.1
New Jersey	145.5	143	7.9	296.4
New Mexico	64.6	41	2.5	108.1
New York	744.6	422	42.6	1209.2
North Carolina	157.4	157	10.8	325.1
North Dakota	28.4	16	1.8	46.2
Ohio	288.4	226	20.7	535.1
Oklahoma	129.8	73	6.1	208.9
Oregon	74.8	69	5.8	149.6
Pennsylvania	294.7	256	27.9	578.6
Puerto Rico	412.3	--	2.6	414.9
Rhode Island	32.2	32	3.5	67.6
South Carolina	94.3	71	5.5	170.8
South Dakota	29.9	14	1.9	45.8
Tennessee	136.9	99	8.1	244.0
Texas	495.7	395	25.1	915.8
Utah	82.1	59	3.2	144.3
Vermont	16.2	15	2.2	33.4
Virginia	143.8	151	11.4	306.2
Washington	132.7	120	8.9	261.7
West Virginia	59.2	35	3.0	97.2
Wisconsin	115.7	130	8.5	254.3
Wyoming	16.1	13	0.7	29.9
Outlying Areas	12.1	0	0.0	12.1
TOTAL	$7,635.0	$5,921.0	$466.5	$14,022.5

Pell Benefits to Students under the President's FY1998 Budget Policy

(Recipients in thousands, dollars in millions)

State	Total Pell Recipients in Award Year 1998-99	Increase in Pell Recipients From Award Year 1997-98	Total Pell Budget Authority in Award Year 1998-99	Increase in 1998 Pell Budget Authority from 1997
Alabama	79.3	6.9	$144.2	$32.4
Alaska	4.6	0.4	8.7	1.9
Arizona	72.7	6.3	135.8	30.5
Arkansas	39.1	3.4	76.3	17.2
California	431.6	37.5	873.8	196.4
Colorado	53.7	4.7	98.2	22.1
Connecticut	26.9	2.3	47.2	10.6
Delaware	6.1	0.5	10.4	2.3
District of Columbia	10.6	0.9	19.8	4.5
Florida	189.5	16.4	358.5	80.6
Georgia	99	8.6	168.8	37.9
Hawaii	7.7	0.7	14.5	3.3
Idaho	21	1.8	40.8	9.2
Illinois	149.7	13	275.1	61.8
Indiana	77.4	6.7	139.0	31.2
Iowa	51.8	4.5	93.0	20.9
Kansas	45.2	3.9	82.3	18.5
Kentucky	65.2	5.7	125.6	28.2
Louisiana	86.2	7.5	175.9	39.5
Maine	15.2	1.3	28.1	6.3
Maryland	55.1	4.8	99.0	22.3
Massachusetts	82.1	7.1	153.1	34.4
Michigan	138.6	12	248.7	55.9
Minnesota	73.9	6.4	128.9	29.0
Mississippi	54.8	4.8	111.4	25.0
Missouri	80.5	7	146.5	32.9
Montana	17.5	1.5	34.2	7.7
Nebraska	29.3	2.5	50.4	11.3
Nevada	9.1	0.8	15.9	3.6
New Hampshire	13.2	1.1	23.5	5.3
New Jersey	75.7	6.6	145.5	32.7
New Mexico	33.7	2.9	64.6	14.5
New York	369.5	32.1	744.6	167.3
North Carolina	85.9	7.5	157.4	35.4
North Dakota	15	1.3	28.4	6.4
Ohio	158.3	13.7	288.4	64.8
Oklahoma	67.8	5.9	129.8	29.2
Oregon	40.5	3.5	74.8	16.8
Pennsylvania	156.4	13.6	294.7	66.2
Puerto Rico	180.5	15.7	412.3	92.7
Rhode Island	17.9	1.6	32.2	7.2
South Carolina	53.1	4.6	94.3	21.2
South Dakota	16.2	1.4	29.9	6.7
Tennessee	72.7	6.3	136.9	30.8
Texas	266.4	23.1	495.7	111.4
Utah	46	4	82.1	18.4
Vermont	9.3	0.8	16.2	3.6
Virginia	79.4	6.9	143.8	32.3
Washington	69.6	6	132.7	29.8
West Virginia	29.7	2.6	59.2	13.3
Wisconsin	64.5	5.6	115.7	26.0
Wyoming	8.7	0.8	16.1	3.6
Outlying Areas	6	0.5	12.1	2.7
TOTAL	4,009.4	348	$7,635.0	$1,716.0

Explanation of State-by-State Tables

Table 1 -- Benefits to Students under the HOPE Act

The first column provides the total estimated Pell Grant funding in the 1998-99 academic year for students attending postsecondary institutions in the State.

The second column provides the total estimated reduction in taxes (as a result of the HOPE Scholarship and the higher education tax deduction) in the 1998 calendar year for students attending postsecondary institutions in the State.

The third column provides the total estimated reduction in loan fees in the 1998-99 academic year for students and parents attending postsecondary institutions in the State.

The final column is a total of the first three columns: **the total benefit for students in the State.**

Table 2 -- Pell Grant Benefits to Students

For students attending postsecondary institutions in the State in the 1998-99 academic year:

- the first column shows the number of Pell Grant recipients;
- the second column shows the increase in the number of recipients over the previous year;
- the third column shows the total Pell Grant funding; and
- the fourth column shows the increased Pell Grant funding over the previous year.

Methodology of State-by-State Analysis

Pell Grant Budget Authority for Academic Year 1998-99
Estimates are based on 1998-99 Pell Grant projections, adjusted by the 1994-95 academic year distribution of Pell recipients and funding among different States.

Combined Tax Benefits for Calendar Year 1998
Using a nationally-representative sample of postsecondary students, we first determined the likelihood of a Pell and non-Pell recipient receiving a tax benefit. Using these data and the Pell Grant distributions discussed above, we estimated the number of students that would receive a tax benefit in each state. We then used this relative distribution of tax beneficiaries to allocate calendar year 1998 benefit amounts ($5.9 billion) among the States.

Cuts in Student Loan Origination Fees for Academic Year 1998-99
Estimates are based on projected loan amounts and number of borrowers for academic year 1998-99, and the historical distribution of loans by State. Two percent of Stafford (subsidized) loan volume and one percent of unsubsidized loan volume equal the estimated student savings by State.

Highlights of the
Hope and Opportunity for Postsecondary Education (HOPE) Act of 1997

INITIATIVE	DESCRIPTION	AMOUNT	IMPACT
Title I: Higher Education Tax Incentives			
HOPE Scholarship Tax Credit	Up to $1,500 per-student tax credit for tuition and fees in student's first year and another $1,500 in the second year if student earns at least a B-average.	$18.6 billion over five years.	Expected to help 4.2 million students in 1998.
$10,000 Tax Deduction for Higher Education and Training	Phases up from $5,000 in 1997 to a $10,000 maximum deduction in 1999 for tuition and fees. Also available for training and lifelong learning.	$17.5 billion over five years.	Expected to help 8.1 million students in 1998.
Tax-Free Education Savings*	Families with incomes up to $100,000 would be eligible for IRAs, and could make penalty-free withdrawals for higher education.	Education specific estimates not available.	Combined with tax deduction, IRA used for education will never be taxed. Will make over 20 million families eligible for such a benefit.
Educational Assistance from Employers	Extends tax exclusion for employer-provided education assistance through 2000, for both undergraduate and graduate education. Also provides tax credit to small businesses.	$2.4 billion between 1997-2001.	Benefits 1.7 million employees a year.
Community Service: Loan Forgiveness	Tax relief for community service loan forgiveness and for borrowers who repay through the income contingent repayment plan for 25 years.	$15 million over five years.	Not available.
Title II: Financial Aid for Needy Students			
Pell Grant Increase and Expansion	Largest increase in two decades -- from $2,700 in FY97 to $3,000 in FY98. Combined with the FY97 increase, the maximum grant has increased $530 since FY96.	At least $40 billion over five years. $1.7 billion more in 1998 than the FY97 appropriation -- a 25% increase in aid.	Over 3.6 million students now eligible will receive an increase up to $300. This increase will also make an additional 130,000 families eligible for the grant.
Pell Grant Expansion for Older, Low-Income Students	Increases eligibility for older, low-income students to receive a Pell Grant.	$3.9 billion over five years.	An additional 218,000 low-income students generally aged 24 or over will be newly eligible for Pell Grants. The new recipients will receive, on average, a grant of $1,431.
Cut in Student Loan Fees	Cuts loan fees from 4% to 2% on need-based Stafford loans -- and to 3% on other loans for students and parents.	$2.6 billion in savings for borrowers over five years	Loan fees will be cut in half for 4 million low- and middle-income students, and by a quarter for 2.5 million other loans.

*The IRA proposal is not part of the HOPE Act but will be transmitted to Congress separately.

Summary of the Hope and Opportunity for Postsecondary Education (HOPE) Act of 1997

March 20, 1997

Today's employers look for job applicants with more than a high school diploma. Since the success of the post-World War II GI Bill, the Federal Government has expanded college aid, making it possible for more Americans to attend college. But for too many, the financial strains of continuing their education are still severe. The President's Hope and Opportunity for Postsecondary Education (HOPE) Act of 1997 ensures that these barriers to higher education continue to fall for all Americans and provides tax relief for middle-income families struggling to pay for college.

Title I: HIGHER EDUCATION TAX INCENTIVES

HOPE Scholarship Tax Credits

- Up to a $1,500 per student credit for tuition and fees for course work beginning on or after July 1, 1997.

- Credit can be claimed in two tax years for any student who has not finished 13th and 14th years of education.

  The tax credit is expected to help 4.2 million students (1998), and would save families $18.6 billion over five years.

The non-refundable tax credit is available for students enrolled on at least a half-time basis during the first two years of postsecondary education. The credit may be claimed in no more than two years. To receive the credit for the second time, the student must have at least a B minus grade point average in course work completed before that year. Federal grants (but not loans or work-study) generally would reduce the allowable tax credit. No credit would be available for any student convicted of a drug-related felony.

The credit would be phased out for taxpayers filing a joint return with adjusted gross income between $80,000 and $100,000. For taxpayers filing single and head-of-household returns, the credit would be phased out for adjusted gross income between $50,000 and 70,000. (The phase-out ranges and the amount of the credit would be indexed).

Tax Deduction for Higher Education and Training

- $10,000 per family maximum deduction for lifelong learning ($5,000 maximum in 1997 and 1998).

- Available for job training and re-training, in addition to traditional undergraduate and graduate education.

  Deduction is "above the line" -- available even if the taxpayer does not itemize.

- Expected to help 8.1 million students (1998), and would save families $17.5 billion over five years.

The deduction could be claimed for out-of-pocket tuition and fees paid for any student enrolled at least half-time in a degree or certificate program, including graduate programs, at an eligible postsecondary institution. In addition, the deduction would be available for the cost of training -- whether or not it leads to a degree -- that helps the student, older worker, or job-seeker improve or acquire job skills. A student in the first two years of postsecondary education could choose either the credit or the deduction, but not both. The deduction phases in, beginning with a $5,000 maximum per family for payments made after December 31, 1996 to cover course work beginning on or after July 1, 1997. It increases to a $10,000 maximum deduction beginning in 1999. The deduction would be phased out at the same income levels as the credit.

Tax-free Education Savings*

- Families with incomes up to $100,000 would be eligible for IRAs, and could make penalty-free withdrawals for higher education.

- Combined with tuition deduction (above), the IRA savings spent by middle-income families on tuition and fees would never be taxed.

* As part of his balanced budget plan, the President has proposed a number of changes to IRAs to make it possible for families to use them to pay for education tax-free. Although the specific legislation providing for these changes is not included in the HOPE Act, it will be transmitted to Congress soon.

The President's budget plan would allow IRAs to be used for postsecondary education expenses free from early withdrawal tax penalties, and would make over 20 million families eligible to make tax-deductible IRA contributions. Currently, if an individual (or spouse) already participates in an employer's retirement plan, eligibility is phased out for taxpayers filing a joint return with adjusted gross income between $40,000 and $50,000 (between $25,000 and $35,000 for single filers). The proposal would expand the phase-out ranges for 1997 through 1999 to $70,000 to $90,000 for joint filers ($45,000 to $65,000 for single). Beginning in 2000, the phase-out range would match the ranges described for the higher education tax credit. The proposal would also create a special IRA that could be used to save for education and other needs, subject to the same income limits.

Educational Assistance from Employers

- Extends tax exclusion for employer-provided education assistance (Section 127) through the year 2000, for both undergraduate and graduate education.

- Tax credit to encourage small businesses to offer educational assistance to employees.

- Benefits 1.7 million employees a year.

The current exclusion from an employee's income of up to $5,250 per year of postsecondary educational assistance provided by an employer expires this year, and expired for graduate-level assistance last year. The President would extend the exclusion, and reinstate the graduate-level component, through the year 2000. In addition, for 1998-2000, small businesses would be given a new incentive to provide educational assistance to their employees through a ten-percent tax credit for amounts paid under an employer-provided educational assistance program for education provided by a third party.

Community Service: Loan Forgiveness

- Tax-free loan cancellation for public service and forgiveness under the income contingent repayment plan.

Under current law, a charity or private educational institution that forgives a loan as part of a program that enables graduates working in certain professions (such as rural medicine or teaching) to pay off their student loans through community service must report the loan forgiveness as income to the graduate. This proposal would exclude the loan forgiveness from an individual's income and clarify that the same treatment would be provided for forgiveness under the income contingent loan repayment plan for direct loans.

Title II: FINANCIAL AID FOR NEEDY STUDENTS

Pell Grant Increase and Expansion

- Largest increase in Pell Grants in two decades.
- $300 boost in the Pell Grant maximum, to a $3,000 maximum award. Since FY 1996, the maximum award will have increased $530.
- A 25 percent funding increase over last year -- $1.7 billion more than the FY 1997 appropriation.
- 3.6 million students now receiving Pell Grants will be eligible to receive an increase of up to $300. The increase will make 130,000 more moderate-income families eligible for the grant.
- Older student provision will make Pell Grants available to additional 218,000 low-income students generally aged 24 or over.
- With these changes, the number of Pell Grant recipients will exceed 4 million in FY 1998.
- At least $40 billion available for Pell Grants for needy students over five years.

Pell Grants are the foundation of student aid for low- and moderate-income families. Increasing the maximum award to $3,000 provides more aid to currently eligible students, and makes an additional 130,000 students eligible for the grants. In addition, the proposal would increase the eligibility of older, low-income students. With this change, more low-income students who are 24 years old or older and financially independent from parents would receive a Pell Grant. Pell Grants are particularly beneficial for low-income students who have little or no tax liability because of the high award level and its availability for all four years of undergraduate education.

Cut Student Loan Fees and Interest

- Borrower-paid loan fees cut in half for 4 million low- and middle-income students, and by a quarter for 2.5 million other loans to student and parent borrowers.
- $2.6 billion in borrower savings over five years produced by the fee cut alone.

- Interest rate during in-school period cut for 2 million students, saving them an additional $1 billion.

Before 1993, borrowers lost up to 8 percent of their student loans in required fees before the money ever reached them. In 1993, the President's aggressive student loan reforms spurred a 50 percent cut in allowable fees that has already saved families nearly $2 billion. The President's plan proposes -- for both the Direct and guaranteed loan programs -- to cut loan fees from 4 percent to just 2 percent on need-based Stafford loans, and to 3 percent on other loans for students and parents.

The Congressional Budget Office and other analysts have noted that lender costs during the in-school period -- when students are not required to make payments on their loans -- are very low. The budget reduces the interest rate during that period by one percentage point.

The proposal provides these benefits to students while saving taxpayers $3.5 billion over five years by streamlining the guaranty agency system to make it more efficient and cost effective and by eliminating excess lender profits.

College Work-Study*

- Budget funds 1 million College Work-Study slots by the year 2000.

- Incentives to reach the goal of 100,000 work-study reading tutors by 1999.

The President's 1998 budget also increases aid for students through subsidized jobs in the College Work-Study program. The President has called on colleges to commit half of the increased funding since FY 1996, $120 million for FY 1998, to supporting community service jobs. The Secretary of Education recently waived the institution's required portion of the awards for students that participate as reading tutors -- part of America's Reading Challenge, helping to ensure that every child can read independently and well by the end of third grade. The President's budget is on a path to achieve the President's goal to raise the number of Work-Study recipients to a million by the year 2000, and 100,000 reading tutors by 1999.

* College Work-Study proposal is included in the President's budget request and appropriations language but not in the HOPE Act.

Case Studies:
How the President's Higher Education Proposals Benefit Typical American Families

<u>Two Examples of How to Save for College Tax-Free</u>

Taken together, the Administration's proposal to allow penalty-free withdrawals from IRAs for college tuition and the tuition tax deduction allow families to save tax-free for their children's education. Families pay no income taxes on money they contribute to an IRA, and the interest accumulates tax-free. Under the Administration's proposal, families would be allowed to withdraw money from their IRA to pay higher education expenses without paying the usual excise tax. And because they can deduct tuition expenses of up to $10,000 per year from taxable income, they will not have to pay the income tax normally due on IRA withdrawals. *This adds up to tax-free saving for college.*

The following examples demonstrate how the Administration's proposals help families save for their children's college tuition:

Example 1
$35,000 Family Income

A family with combined income of $35,000 per year in a 15% marginal tax bracket saving for college expenses of $10,000 per year for 4 years. The family earns an 8% annual return.

- Under the Administration's proposal this family would need to put $955 per year in before tax savings into an IRA for 18 years.

- Without the Administration's proposal, the same family would need to put away almost $1,090 per year *after taxes*. That means that they need to earn more than $1,280 per year *before taxes*, **a difference of $325 per year to reach the same savings goal.**

Example 2
$60,000 Family Income

A family with combined income of $60,000 per year in a 28% marginal tax bracket saving for college expenses of $10,000 per year for 4 years. The family earns an 8% annual return.

- Under the Administration's proposal this family would need to put $955 per year in before-tax savings into an IRA for 18 years.

- Without the Administration's proposal, the same family would need to put away $1,220 per year *after taxes*. That means that they need to earn nearly $1,700 per year *before taxes*, **a difference of almost $750 per year to reach the same savings goal.**

Four Examples of How the HOPE Act Works

The tax liabilities used in the following four examples are based on the personal exemption, standard deduction and the beginning point for the 28 percent rate bracket assumed to be in effect in 1998, the first year the increased Pell Grants will be available under the President's proposal. Under the proposal, the maximum tuition deduction for 1998 is $5,000. It is $10,000 for years thereafter. Tax liabilities are estimated on the assumption that itemized deductions of 18 percent of adjusted gross income are claimed if that amount exceeds the standard deduction.

Example 3
$60,000 Family Income
Married Couple With One Child in College
1998 Benefit: $1,500

Larry and Jill O'Neill are a married couple with two children. Larry and Jill earn $60,000 in 1998. They claim both children as dependents because they provide more than half of their support. Bobby, the O'Neills' older child, enrolls as a freshman in a community college in the fall of 1998 and is charged $1,500 in tuition and required fees. Bobby's parents pay his tuition. Under the President's proposals, the O'Neill are entitled to a HOPE Scholarship tuition credit of $1,500. (Because a credit is being claimed for Bobby's freshman year, his grade point average does not affect his eligibility for the credit.) The credit reduces their tax liability by $1,500. **Thus, the O'Neills get a total benefit of $1,500 from the President's proposals.**

Without the President's Proposals	With the President's Proposals
Tuition cost: $1,500	Tuition cost: $1,500
Pell grant: $0	Pell grant: $0
Tax liability: $5,760	Tax liability: $4,260

Example 4
$10,000 income
Independent College Student
1998 Benefit: $3,458

Joe Jefferson is a college freshman in the fall of 1998. He is single and supports himself. He earns $10,000 in 1998. In September 1998, Joe enrolls in college and pays $3,025 in tuition and required fees for the fall semester. In December he is charged $3,025 in tuition and fees for the spring semester. Under the President's proposals, Joe is entitled to a Pell grant of $3,000 that he uses to pay part of his tuition. He pays the remaining $3,050 with a combination of savings and loans. Under the President's proposals, he is entitled to a tuition deduction for his $3,050 payment. The deduction reduces Joe's tax bill by $458, which is more than his total tax liability for the year. **Thus, Joe gets a total benefit of $3,458 from the President's proposals, $3000 in Pell Grants and $458 in reduced taxes.**

Without the President's Proposals	With the President's Proposals
Tuition cost: $6,050	Tuition cost: $6,050
Pell grant: $0	Pell grant: $3,000
Tax liability: $458 (less $3 EITC)	Tax liability: $0 (plus $3 EITC refund)

Example 5
$30,000 Family Income
Married Couple with One Child in College
1998 Benefit: $1,050

Victor and Susan Montoya are a married couple with one child, Maria. Tom and Susan earn $30,000 in 1998. They claim Maria as a dependent because they provide more than half of her support. Maria attends college for two semesters in 1998 and is charged $6,850 in tuition and required fees at the beginning of the year. Under the President's proposals, Maria receives a Pell grant for $1,850. Her parents pay $1,000 of her tuition. She pays the rest of the tuition bill with a combination of savings and loans. Under the President's proposals, the Montoyas are entitled to a tuition deduction for the $5,000 their family has paid in tuition and required fees. The deduction reduces the Montoyas' tax bill by $750. **Thus, the Montoyas get a total benefit of $1,050 from the President's proposals, $300 in additional Pell Grants and $750 in reduced taxes.**

Without the President's Proposals	With the President's Proposals
Tuition cost: $6,850	Tuition cost: $6,850
Pell grant: $1,550	Pell grant: $1,850
Tax liability: $2,220	Tax liability: $1,470

Example 6
$90,000 Family Income
Married Couple With Two Children in College
1998 Benefit: $1,450

Paul and Debbie Green are a married couple with two children, David and Barbara. Paul and Debbie have income of $90,000 in 1998 (including income from an IRA withdrawal, described below). They claim David and Barbara as dependents because they provide more than half of their support. In 1998, David is enrolled in college for the second semester of his junior year and the first semester of his senior year. Barbara is enrolled in the second semester of her freshman year and the first semester of her sophomore year. At the beginning of 1998, Barbara has a B+ grade point average. David's bill for tuition and required fees is $5,000, and Barbara's is $1,500. Paul and Debbie pay their children's tuition and required fees with a combination of savings, including $2,000 they withdraw from their IRAs, and loans. Under the President's proposals, they avoid any penalty for early withdrawal from their IRAs, and they are entitled to a credit of $750 for Barbara's tuition and a deduction of $2,500 for David's tuition. (Because their income places them in the middle of the $80,000 to $100,000 phase-out range, they claim half the maximum credit and deduction.) The credit and the deduction reduce their tax liability by $1,450. **Thus, the Greens get a total benefit of $1,450 from the President's proposals.**

Without the President's Proposals	With the President's Proposals
Tuition cost: $6,500	Tuition cost: $6,500
Pell grant: $0	Pell grant: $0
Tax liability: $12,128	Tax liability: $10,678
Penalty for early withdrawal: $200.	

COLLEGE AND UNIVERSITY PRESIDENTS SUPPORT PRESIDENT CLINTON'S HIGHER EDUCATION INITIATIVE

Already, over 250 college presidents -- representing community colleges, public and private colleges and universities -- have expressed support for President Clinton's higher education initiatives.

- 70 community college presidents and 280 community college trustees signed the American Association of Community Colleges and Trustees letter of support for the President's higher education initiatives
- 105 private college presidents joined the president of Dickinson College in signing a letter of support for the President's initiatives
- 23 California State University presidents joined the Chancellor of the California State University System in a letter of support for the President's initiatives
- 63 Christian college presidents signed the Coalition for Christian Colleges & Universities letter commending the President for his higher education efforts
- The American Council on Education Board of Directors, which represents 1,700 college and university presidents, passed a resolution in support of the President's initiatives
- The National Association of Student Financial Aid Administrators, representing over 3,100 colleges and universities, expressed support for the President's initiatives

April 15, 1997

MEMORANDUM FOR GENE SPERLING

FROM: **BOB SHIREMAN**

RE: **HOPE Scholarship and tax deduction policy options**

Preliminary estimates from Treasury:

- Eliminating the Pell offset in Hope Scholarships would not be as expensive as anticipated: +$3 billion over the budget window (this is because many of the Pell recipients do not have tax liability and therefore would not benefit from the credit)..
- Replacing deduction with a 15% credit: -$4 billion.
- Your idea of replacing the deduction with a **20% credit: revenue neutral.**
- Eliminating the B- requirement: +$2.2 billion.
- Lower HOPE Scholarship to $1200: -$2.8 billion.

Treasury has not yet costed out the package that we asked them to look at (No B-, $5000 deduction, and reduced Pell offset).

April 7, 1997

MEMORANDUM FOR GENE SPERLING

FROM: **BOB SHIREMAN**

RE: **HOPE Scholarship and tax deduction policy options**

There are several reasons we may want to make changes to the higher education tax proposals:

- Cost reduction
- Simplification and Administrative issues
- Distributional issues
- Address "tuition inflation" and other arguments

HOPE and the tax deduction are estimated to cost $36.2 billion over the budget window ($18.6 and $17.6 billion, respectively). There *are* interactions: changes that are made to one of them can affect the cost of the other. For example, eliminating the deduction does not reduce the cost by the full $17.6 billion because doing so would cause some people to claim the credit who wouldn't have otherwise done so. Treasury has estimated the cost/savings from the following options:

1. Lower the deduction to $5,000 (not indexed) + No B - requirement

$1.8 billion reduction

Justification: Reduces regressivity (maximum benefit at 28% bracket reduced to $1,400).

2. Eliminate the deduction *and* eliminate the grade requirement in HOPE

$13.3 billion net reduction

Justification: --Eliminates regressive element of plan (the deduction).
--Eliminates "grade inflation" argument and related administrative problems.

Issues: --Remaining credit applies only to the first two years of college, leaving no tax benefit available for the remaining years (nor for job training, which the deduction allows).
--Grade requirement is part of a "responsibility" and "work hard" message.

3. Change deduction to a non-refundable 15% tax credit (maximum $1,500)

Maybe

$4 billion reduction

Justification: --Minimizes the regressivity of the deduction.

THE WHITE HOUSE

WASHINGTON

May 22, 1997

MEMORANDUM TO THE PRESIDENT

FROM: **GENE SPERLING**

SUBJECT: **Tax Cut Proposals for Budget**

Your economic team is meeting with you in the morning to go over options for going forward on the tax package. There are several processes, strategic and substantive issues we need to discuss with you in order for us to move forward.

1. Developing a Package: All of your advisors agree that we need to develop our sense of an overall $135 billion gross tax package. One reason for developing our tax package is that it allows us to work with Democrats to increase a commitment for our education tax package, by showing them that we can put together a package that could include their priorities. Currently, Republicans are telling Democrats that they could support other Democratic education tax cuts -- if they are paid for within our $35 billion tax cut. By putting together a package, we can show people like Breaux and Rangel that if they are committed to your higher education tax cuts, we could fit their priorities -- e.g., Kidsave, Rangel's initiatives, -- outside of the $35 billion.

2. Working with Democrats and Republicans: While part of the goal is putting together a set of ideas to get "buy-in" from the Democrats that unifies them, both Bob Rubin and John Hilley believe that the best way to proceed is to shop a $135 billion package with both Democrats and Republicans so that we are continuing to work in a bipartisan process. Therefore, while we would seek to unify Democrats with our $135 billion package, we would shop it and get input from all sides, as opposed to having a "Democratic package" that at this moment might alienate Republicans from working with us. As John states, this would be similar to our posture in March when we took the same one page budget summary and sought input and comments from both Democrats and Republicans.

Bob Rubin and his staff are already been involved in serious consultations. On Wednesday, Bob spoke with Archer for 30 minutes and met with Roth for over 45 minutes, while also speaking with Moynihan and Rangel and other House Ways and Means Democrats. Archer and Roth agreed with Bob to have their staffs meet with Treasury staff next so that they could review our $135 billion set of ideas for discussion.

3. Two Votes Strategy: Erskine cautions that all decisions should be considered against the backdrop of what best ensures that we preserve our two vote strategy.

4. Education Package: One of the main issues we need to decide is what alterations we need to make in our education proposals in order to garner adequate support from Democrats and the education community. Everyone agrees that we need to make the Hope Scholarship more progressive and in some way drop the B- requirement. Yet, in order to afford these changes, we need to decide whether and how to shave the Hope Scholarship or the $10,000 deduction. Attached is a decision memo that goes through the pros and cons of such choices.

5. New Education Ideas: Another decision is what additional ideas we may wish to consider, particularly from Charlie Rangel outside of the $35 billion.

6. Child Tax Credit/Kidsave: A major issue is whether to amend our child tax credit, to a "Kidsave" proposal, and whether we want to add refundability, or change the age or income limits. The current Treasury set of ideas does include a refundable Kidsave proposal.

7. Capital Gains Design: We must decide what capital gains proposal we want to present. This clearly involves not only where we want to end up on capital gains, but strategic questions of where we should start. Currently, the Treasury set of ideas includes a 50% exclusion, a Bumpers expansion, your home capital gains, and the Daschle estate tax cut.
One of the ideas you had mentioned was to include provisions with strong appeal to the small business and high technology community.

8. AMT Reform: Treasury believes there is strong policy rationale for AMT reform. In the current proposal, this is started in 2003. This allows more middle income tax relief to be included in the first five years, yet it fills the last five years with a sensible tax reform instead of an exploding capital gains tax cut. Is this something you are interested in proposing?

9. Additional Ideas: At your request, Treasury has also included a short description of a modified home office deduction and an increased health care deduction for the self-employed.

Attached are the following:

- **One Page Treasury Chart:** Following a meeting in Erskine's office, we agreed on a preliminary package to present you. The chart shows Treasury's estimates of what costs of the different proposals would be.

- **Treasury Background Paper:** Memo from Don Lubick that explains several of the provisions in the chart.

- **Education Tax Cut Pro/Con Memo:** This is a pro/con memo on the different options for reforming our tax proposals using ideas presented from both Secretary Riley, Treasury Department and other members of your economic team.

Illustrative Baseline Tax Package: Very Preliminary Treasury Estimates (except where noted)
Dollar amounts in millions, May 23, 1997

	1997	1998	1999	2000	2001	2002	1998-02	1998-07
Education package								
HOPE scholarship, $1,200; Tuition Deduction, $10,000 \1	-78	-4,242	-6,561	-8,461	-9,371	-10,198	-38,833	-94,560
Rangel K-12 school finance tax provision (not scored)								
Make Section 127 Permanent	-82	-645	-670	-730	-796	-833	-3,674	-8,443
Middle-Class Tax Relief and Saving Provisions								
Refundable Kidsave Credit \2	-568	-10,612	-10,930	-14,338	-17,889	-17,960	-71,729	-161,423
Individual AMT reform, start in 2003 \3	0	0	0	0	0	0	0	-37,472
Capital Gains and Estate Tax Relief								
50% CapGn Exclusion and 20% AMT	-702	-1,470	1,493	-1,643	-1,621	-1,549	-4,790	-11,009
Super-Bumpers Plug Number \4	0	-50	-150	-300	-400	-500	-1,400	-5,500
President's Home Sales Provisions \4	-60	-239	-222	-205	-187	-168	-1,021	-1,600
Daschle Estate Tax Proposals (JCT)	0	-440	-540	-640	-740	-840	-3,200	-10,200
Urban Initiatives								
Distressed Areas Initiatives (JCT) \5	-25	-172	-370	-464	-483	-487	-1,976	-4,063
Welfare-to-Work (JCT)	0	-41	-75	-95	-77	-41	-329	-353
Other Tax Incentives (JCT) \6	0	-57	-156	-285	-344	-420	-1,262	-9,422
One-year Extensions of Expiring Provisions (JCT)	-405	-958	-682	-398	-259	-127	-2,424	-2,459
Gross Tax Cut	-1,920	-18,926	-18,863	-27,559	-32,167	-33,123	-130,638	-346,504
Revenue Offsets	883	7,747	9,067	10,225	10,668	10,955	48,662	103,945
Total Net Cut	-1,037	-11,179	-9,796	-17,334	-21,499	-22,168	-81,976	-242,559

(Not including Rangel school construction program, expected to cost $3 billion through 2002 and $7 billion through 2007)

\1 The proposal drops the B- rule and Pell offset to HOPE.
\2 A refundable child credit for children under 13 with an optional $500 nondeductible IRA for education or retirement for each child credit allowed. The credit is $150 in 1997, $300 in 1998 and 1999, $500 in 2000 and indexed thereafter.
\3 Assumes the enactment of the Administration's child credit proposal. Among other things, it eliminates several inappropriate AMT preference items (most importantly, personal exemptions and the standard deduction), allows personal credits to offset AMT liability, and indexes the A
\4 Stacked after the 50% exclusion.
\5 Expand Empowerment Zones and Enterprise Communities, Brownfields, and CDFI.
\6 Equitable tolling, Puerto Rico Tax Credit, FSC software, and DC incentives.

May 22, 1997

MEMORANDUM TO THE PRESIDENT

FROM: **GENE SPERLING**

SUBJECT: **Education Tax Package**

This memo describes two basic approaches to changing the HOPE Scholarship and $10,000 tuition tax deduction proposals in order to (1) fit within the $35 billion allocation over 5 years, (2) address, to varying degrees, the concerns about possible grade inflation and tuition inflation raised by pundits, and (3) address issues of progressivity raised by key Democrats and education groups. The memo also describes other education tax items that could be included in an Administration tax package *outside* of the $35 billion that was reserved for your credit and deduction

Inside the $35 billion: HOPE and the Deduction

Treasury's estimate of the revenue loss from your two higher education tax proposals is $36.2 billion, with roughly half the cost associated with each proposal (the credit costs $18.6 billion and the deduction cost $17.6 billion).[1]

Both options 3 and 4 below are attempts to regain costs that would be the result of changes to the grade requirement and Pell offset, as described in 1 and 2.

1. <u>Grade Requirement</u>

The reasons for changing the grade requirement include: (1) administrative concerns raised by colleges, (2) "grade inflation" arguments from pundits, and (3) concerns that the requirement would not be applied equally across families, because middle income families at traditional colleges could still get as valuable a tax benefit through the tuition deduction (which

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[1]Joint Tax estimates have been higher -- a total of $40.6 billion, with $28.9 attributable to the credit, and $11.6 attributable to the deduction. The cooperative efforts between Joint Tax and Treasury, agreed to in the budget deal, may reduce this disparity.

has no grade requirement) even if ineligible for the credit. There are two possible alternatives:

1a. Satisfactory Academic Progress. Federal student aid programs currently require that, in order to continue receiving aid, the students must maintain "satisfactory academic progress." This roughly equates to "passing," and is defined and policed by the schools. This option is roughly equivalent to eliminating the grade requirement.

Pro: This is the measure that the colleges prefer, since it is already in use.

Con: This is not a rigorous requirement. We would not be able to argue that we are encouraging students to excel.

1b. Achieving Sophomore status. Under this approach, a student could not receive a second HOPE Scholarship until she had successfully completed one full academic year. (This would incorporate satisfactory academic progress as well).

Pro: A full-time start in college is strongly associated with retention and attaining a degree. This would encourage students to do more than take a few classes, or to continue with their studies beyond a semester or two. It provides an argument that we are not completely backing away from an accountability component within HOPE.

Con: This could be confusing to students and taxpayers who, based on information provided by the school, would have to switch from the credit to the deduction until they fully completed one year, then would switch back to the credit.

Eliminating the grade requirement (option 1a) costs $2.2 billion (assuming no other changes). Option 1b would probably cost slightly less, but has not been estimated.

2. Offset of Federal Grants ("Pell Offset")

In order to stretch the $1,500 credit further into the middle class, your HOPE Scholarship proposal currently makes Pell Grant recipients (and other Federal grant aid recipients) ineligible for the HOPE Scholarship if they receive $1,500 or more in Federal grants. Higher education organizations and Democrats in Congress have argued that this unfairly excludes low-income families from HOPE, leading to a more regressive proposal.[2]

There are two alternatives for the Pell Grant offset:

2a. Eliminate offset entirely. A student with a $3,000 Pell Grant could also receive a

[2] Ignoring the full $3,000 that the lowest income students can receive in Pell Grants, they argue that your Budget provides only $300 for the poor students (the Pell Grant *increase*), but $1,500 (HOPE) or even $2,800 (maximum $10,000 deduction at 28% bracket) for higher-income families.

$1,500 HOPE Scholarship, if the taxpayer paid enough tuition and fees and had tax liability to which to apply the credit. This option costs $3 billion when considered alone.

Pro: Makes the credit more progressive, addressing concerns of key Members of Congress and constituency groups (who have been reluctant to fight for the details of our proposal as currently drafted). Reduces the amount of data that the taxpayer and IRS will need to compute the credit.

Con: Cost which must be absorbed through other changes to the proposals.

2b. Offset grants by 50%. With this approach, a student's eligibility for the HOPE Scholarship would be reduced by half of the Federal grants received. This approach costs $0.9 billion when considered alone.

Pro: Costs less than eliminating the offset entirely.

Con: Excludes the *poorest* students from HOPE (those with maximum Pell Grants). Will not completely satisfy key Democrats and constituency groups. Would still require a "Federal grants" data element to be reported by colleges, and used by taxpayers and the IRS in computing the credit eligibility.

3. Education's approach: $1,500 Credit, Deduction capped at $1,500

The maximum HOPE Scholarship would remain at $1,500. The tax deduction would still apply to up to $5,000 of tuition and fees through 1998 and up to $10,000 thereafter. However, the value of the deduction would be reduced by either capping it at $1,500 or turning it into a 15% credit. With either approach, in the first two years of college, the HOPE Scholarship would never be less valuable than the deduction.

Education argues that this approach would (1) equalize the benefits between the credit and the deduction, addressing a criticism from some Democrats and higher education groups, and (2) maintains the commitment to provide access to the average community college.

The two approaches for achieving these objectives are:

1. Cap value at $1,500. The value of the deduction (tax bracket times applicable tuition and fees) could not exceed $1,500. A family in the 28% tax bracket would reach the cap at tuition and fees of $5,357. For tuition and fees up to that level, the deduction would continue to be more valuable for higher income families than for lower income families, because of their different tax brackets.

Pro: Middle class families in the 28% bracket, with a child at a public university or lower-cost private institution, would continue to get the full benefit of the deduction.

Con: Students at higher-cost private colleges would not benefit as much as under the current proposal.

ii. Set value of deduction at 15% of tuition and fees. The deduction would essentially be turned into a credit valued at 15% of the tuition and fees charged. The value of the deduction would not vary according to the family's tax bracket (except to the extent that a low-income family lacks tax liability to reduce).

Pro: More likely to be embraced by key Democrats and the education groups.

Con: Less helpful to middle-income families at moderate-cost colleges.

Neither of the approaches above would save enough to fully offset the elimination of the grade requirement and the Pell offset. One or both of them might offset a partial elimination of the grade requirement and Pell offset, as described in 1b and 2b.

4. Treasury's approach: $1,200 credit, $10,000 deduction.

The tax deduction would be unchanged: it would apply to up to $5,000 of tuition and fees through 1998 and up to $10,000 thereafter. The HOPE Scholarship would be reduced to a maximum of $1,200.

Pro: One benefit of reducing the HOPE credit is that it reduces any potential tuition inflation at community colleges, because fewer community colleges would have tuition and fees below that level.

Con: Increases the disparity between the value of the credit ($1,200) and the value of the deduction for a higher-income family ($2,800). The credit would not cover average community college tuition (now at $1,500).

This approach also would not save enough to fully offset the elimination of the grade requirement and the Pell offset. One or both of them might offset a partial elimination of the grade requirement and Pell offset, as described in 1b and 2b.

5. Reduce both the deduction and the credit

If you decide to completely eliminate both the grade requirement and the Pell offset (1a and 2a), it may be necessary to explore options that would reduce both the deduction and the credit in order to offset those costs. For example, a $1,200 HOPE Scholarship, and an $8,000 deduction, capped at a value of $1,200 or 15%, might yield the necessary savings.

Education tax items outside the $35 billion

The Administration's tax package could include several education-related tax items outside of the $35 billion allocation. While Chairman Archer's staff clearly want to use some of these other items in place of your HOPE Scholarship and tuition tax deduction, I strongly feel that we must hold firm to our strict interpretation of the letter, which reserves the roughly $35 billion for "postsecondary education, including a deduction and a credit. . . consistent with the objectives put forward in the HOPE scholarship and tuition tax proposals contained in the Administration's FY 1998 budget to assist middle-class parents." If we open up the $35 billion to other items this early in the process, we risk losing the HOPE Scholarship and tuition deduction.

The larger tax package could include:

- **A Rangel elementary-secondary provision.** Rep. Rangel has been helpful on HOPE Scholarships and the tax deduction, and very much wants to see some of his ideas incorporated into the Administration's tax package. Some possible directions are described below. Cost: perhaps $3-5 billion.

- **Student loan interest deduction.** Different proposals have been put forward by Senate Republicans, Senate Democrats, and House Democrats. Strongly supported by the higher education community. Cost ranges from less than $1 billion to $3 billion, depending on design (caps, income ranges, new versus old loans, and whether parents or just students are eligible).

- **Extending Section 127** (tax deduction for employer-paid education assistance). Senate Republicans have proposed making it permanent, while your 1998 Budget extended it through the year 2000. Sen. Moynihan is a strong supporter of this provision.

- **Education savings incentives,** loosely based on the Lieberman-Breaux "KidSave" proposal.

- **Community Service/Income Contingent Loan Forgiveness.** Exclusion from income of loans forgiven by a non-profit entity for community service, or loans forgiven under the Direct Loan Program's income-contingent repayment provisions. Part of your 1998 Budget, costs only $15 million.

- **Work-Study income exclusion.** Senate Republicans have proposed excluding income from the Federal Work-Study program from taxation. This costs $0.4 billion.

- **Pre-paid tuition plans.** Exempt withdrawals from taxation. This costs $0.6 billion.

Rangel's Education Empowerment Zones

Rep. Rangel recently introduced legislation that includes his version of the HOPE Scholarship (refundable), as well as his own proposal aimed at helping public elementary and secondary schools in poor areas. Rangel's legislation includes (1) a tax credit to subsidize bonds for construction, renovation, teacher training, and curriculum development for "academies" based on school-business partnerships in empowerment zones and empowerment communities or high-poverty schools in other areas, and (2) an expansion of the Work Opportunity Tax Credit to benefit employers who hire graduates within six months of leaving an academy.

There are a number of problems with the design of these proposals. However, we do feel that there are some useful concepts in the legislation, and that we can work with Mr. Rangel on one or more of the following approaches:

School Construction in EZ/ECs: A tax benefit to help reduce the cost of borrowing or other financing of school construction or renovation in high-poverty areas. This could include some of Rep. Rangel's conditions for business contributions and involvement, though that would be an awkward design.

Charter School Construction in EZ/ECs: A tax benefit to help reduce the cost of borrowing or other financing for the construction or renovation of public charter schools in high-poverty areas.

School-Business Partnerships in EZ/ECs: A tax benefit for contributions of money, equipment, or time associated with a partnership between a business and a school in a high-poverty area.

WOTC expansion to EZ/EC graduates: Like Mr. Rangel's proposal, expand the Work Opportunity Tax Credit to graduates of schools in EZ/ECs, or to schools that meet certain criteria (such as the Rangel "academies").

WOTC expansion for high school apprenticeships: expand the Work Opportunity Tax Credit to businesses that hire participants in school-business partnerships *while they are in school*.

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

May 22, 1997

MEMORANDUM FOR SECRETARY ROBERT E. RUBIN
DEPUTY SECRETARY SUMMERS

FROM: DONALD C. LUBICK DCL
ACTING ASSISTANT SECRETARY (TAX POLICY)

SUBJECT: Possible Tax Package

The attached table presents an illustrative budget package that fits within the recent budget agreement under very preliminary Treasury scoring. The package includes a number of features that will appeal to Congressional Democrats and some Republicans and reflects our current judgment about the outlines of a sound and politically popular package.

This memo highlights decisions that need to be considered if tax package recommendations are to be made publicly. The memo concludes with brief descriptions of several tax ideas appealing to small business that the President has asked about.

Education

- o The current education package contains a $1,200 HOPE credit, a $10,000 tuition deduction, drops the B- grade requirement and no longer offsets the HOPE credit by Pell grants and other federal aid that a student receives. This package costs $3.8 billion more than the $35 billion for education that is allocated within the budget agreement.

Alternatives

- o The Education Department has suggested an alternative with a $1,500 HOPE credit, with no B- and no Pell grant offset with a $10,000 tuition deduction that is either capped at $1,500 of tax reduction (so, for example, a family in the 28 percent bracket could deduct no more than $5,357) or converted into a credit equaling 15 percent of all higher education expenses, up to $10,000. In addition, the second year of the HOPE credit could only be received by students who have completed their full freshman year of school. We believe this package will cost roughly the same amount as the first package.

- o Either the amount of the tuition deduction, HOPE credit or both must be scaled back to meet the $35 billion revenue target, particularly under JCT scoring. In addition, many potential allies strongly urge us to alter or drop the B- requirement and eliminate the Pell grant offset.

Additional features of the education package

- With money outside the $35 billion, we propose to make permanent the exclusion of employer-provided educational assistance from taxable income (Section 127). This is a cause that has been championed by Senator Moynihan and others in the House and the Senate.

Additional Education Proposals that Could be Considered to Attract Support of Key Members of Congress

- School Construction: We have designed a tax proposal to aid school construction (and other activities) in poor neighborhoods, as urged by Congressman Rangel among others. The States and the District of Columbia would be permitted to allocate a fixed annual amount of tax credits (based on population), much as they do currently with low-income housing tax credits. The States could allocate the credits for projects in public schools located in empowerment zones, enterprise communities or that have a high percentage of low-income students. The schools could use the credits to help pay for construction and renovation projects by giving them as partial payment to developers who perform the construction work or by selling them. Each school would be allocated credits equal to a specified portion of construction costs with the balance to be covered by the State or the school districts.

- Expansion of the Work Opportunity Tax Credit: In addition to extending the credit for at least one year, it would be expanded so that employers hiring graduates of schools that have a high percentage of low-income students within one year of their graduation would be eligible to receive the work opportunity tax credit.

- Exemption for Withdrawals from State Prepaid Tuition Plans: Families that invest in plans that allow them to prepay college tuition not only would receive tax deferral on the annual increase in value of their investment as provided under current law but also an exemption from tax when the funds are applied to the child's tuition. The exemption would apply to plans like Florida's and Virginia's that allow parents to pay in full in advance for tuition, but not to some other states' plans that operate like mutual funds.

- Position on Deductibility of Student Loan Interest: We prefer our tuition credit and tuition deduction, which do not favor borrowing over saving to pay for college, to a student loan interest deduction, which does favor borrowing. A student loan interest deduction would provide relief, however, to many middle-income students and is administrable. Such a proposal is popular with certain Senators (e.g., Moseley-Braun) and thus may be included in a Congressional budget package.

Middle Class Tax Relief and Saving Provisions

- The baseline package contains a refundable "Kidsave" credit based on the child credit in your FY98 Budget. Kidsave proposals combine a child tax credit with a tax-preferred saving vehicle that can be used for the child's education and for retirement (of the taxpayer). Kidsave is popular with many moderate Senators, particularly Breaux and Kerry. The particular version shown in the baseline package is refundable, which would help draw a striking contrast between the distributional effect of likely Congressional taxes packages and ours.

Alternatives

- An alternative would drop refundability and instead extend the child credit in your FY98 budget to children under 18 (the Budget proposal gives a credit for children under 13).

- Kidsave proposals cleverly combine an education saving mechanism with the child credit (our version would make contributions to the education saving account optional). An alternative would be to have separate child credit and IRA proposals, as was done in the FY98 Budget. IRAs, particularly backloaded IRAs, are very costly in years beyond 2002. Adding our IRA Budget proposals would cost about $15 billion through 2002 under JCT scoring.

Additional features of the Middle-Class tax relief package

- The large tax cuts agreed to in the second five years of the package provide an excellent opportunity to reform the individual Alternative Minimum Tax in a sound tax policy way and better distributed to the middle class. Currently only 600,000 taxpayers are affected by the AMT. By 2007, however, as many as 9 million taxpayers may be affected by the AMT, many of whom will be ordinary taxpayers since even the personal exemptions, standard deduction and state and local taxes are treated as preference items. The AMT will also start to claw back HOPE credits and the child credit. Fixing the AMT is important for the long-run health of the income tax, but is very expensive since the costs of doing so increase sharply beyond 2002. We propose to tackle this problem when the AMT problem becomes important, namely after 2002.

Small Business and Capital Gains Tax Relief

- The baseline package contains a 50 percent exclusion for long-term capital gains (so the maximum tax rate is 20 percent); a small business/venture capital proposal for capital gains relief, supported particularly by the biotech and computer industry; and the home sales provision in your FY98 budget. Note that Treasury and JCT scoring of capital gains has differed substantially in the past.

More Detail on Special Rules for Small Businesses and Small Business Investment Companies

- o Individuals' long-term capital gains would be taxed at one half of the statutory rate applicable to ordinary income -- the maximum rate would be reduced from 28 to 19.8 percent. Correspondingly, the maximum rate on the sale of small business stock held for more than five years would be reduced from approximately 14 percent to 9.9 percent (from 21 percent to 15 percent for taxpayers subject to the alternative minimum tax).

  - The size of companies eligible for these special rules would be increased from $50 million of gross assets to $100 million of gross assets and the limitation on the amount of gain that could be excluded (currently $10 million) would be eliminated.

  - This proposal would also adopt some of the changes to the 1993 small business stock provision previously suggested by Senators Daschle, Lieberman and Hatch and by Congressman Matsui (among others). This proposal is particularly favored by venture capital and biotechnology firms.

- o Under a separate proposal, a specialized small business investment company (SBIC) would be allowed under special rules to qualify for an exemption from entity-level corporate tax to the extent it distributed its income currently. Alternatively, during a specified period, any SBIC would be permitted to convert tax-free to a partnership. In addition, the rules that provide for exclusion of gain on securities when there is a roll-over to a SBIC would be liberalized for individuals, and would be extended to corporations. These rules would increase the exclusion for capital gains on SBIC stock from 50 to 60 percent, extend the preference for corporate taxpayers, and liberalize certain other rules.

  - These changes have been proposed by Congressman Jefferson who has advocated them as a means of improving capital access for minority-owned businesses.

- o This package should receive wide political support, yet is designed to not unduly favor very high-income taxpayers and cause the net tax cut to explode in years beyond 2002.

Estate Tax Relief for Family Farms and Closely-Held Small Businesses

- o The baseline package includes the estate tax proposals for special relief to farms and small businesses sponsored by Senator Daschle. They would create an estate tax exemption for the first $900,000 of value in a "qualified family-owned business interest" (in addition to the $600,000 unified credit). The proposal would also increase the amount of estates eligible for the special 4 percent interest rate on deferred payments, as in your FY98 Budget.

Urban initiatives and other Budget items

- o The baseline package contains a complete set of FY98 Budget initiatives, including the expansion of EZs and ECs, Brownfields, CDFI and the welfare-to-work tax credit and tax incentives for FSC software, D.C., and Puerto Rico, and the equitable tolling provision. It extends expiring provisions that we do not make permanent, including the R&E tax credit, deduction for contributions of appreciated stock to private foundations, the work opportunity tax credit and the orphan drug tax credit.

Increase Deduction for Self-Employed Health Insurance

- o You have asked us to think about increasing the deduction for the purchase of health insurance for the self-employed. The Small Business Job Protection Act of 1996 gradually increases the deduction for self-employed health insurance costs from 30 percent in 1996 to 80 percent in 2006 and thereafter. It has been proposed that the deduction should be increased to 100 percent. The proponents argue that the proposal would provide parity with the employer-provided health insurance deduction, which is 100 percent. However, most employers do not cover 100 percent of their employees' insurance costs. Thus, current law is closer to parity so the proposal to increase the deduction for self-employed health insurance is overly generous. It should also be noted that no tax subsidy is presently provided to encourage employees without employer-provided insurance to purchase their own health insurance. There are approximately nine million employees who purchase their own insurance, as compared to three million self-employed individuals who claim the self-employed health insurance deduction.

Modification to the Home Office Deduction

- o You also asked us to think about modifications to the home office deduction. A home office business expense deduction could be allowed where substantial and essential administrative or management activities of the taxpayer's business are conducted on a regular basis in the taxpayer's home, provided the taxpayer has no other location for performing these activities. The current-law limitation that the deduction is available only with respect to that portion of the home that is used exclusively for business purposes, and is so used on a regular basis, would also continue to apply. This proposal has been estimated to cost roughly $650 million through 2002, assuming a January 1, 1997, effective date.

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

May 25, 1997

MEMORANDUM FOR THE PRESIDENT

FROM: LAWRENCE SUMMERS
DEPUTY TREASURY SECRETARY

SUBJECT: Education Packages

This memo presents Treasury estimates of several possible combinations of the HOPE scholarship and tuition deduction as well as several other education proposals. The packages illustrate the tradeoffs necessary to fit the HOPE scholarship and tuition deduction into the $35 billion agreement. These tradeoffs are necessary in order to offset the increased costs of the package that would result from dropping the B- requirement (as requested by the education lobby) and the Pell grant offset (as requested by Congressional Democrats). Dropping these two items is estimated to cost approximately $5.3 billion through 2002.

Each of the options set forth below would eliminate the Pell grant offset and the B- restriction. Each option would fully phase in the complete education package by 2003, so the tuition deduction would be $10,000 and the HOPE Scholarship would be $1,500. The effective date of the options has been moved back to January 1, 1998, which saves roughly $2.5 billion. Please note that the Joint Tax Committee may score these proposals as being more expensive than shown in the table.

Education Packages: Preliminary Treasury Estimates, (Dollar amounts in billions)

	1998-2002	1998-2007
HOPE Scholarship, $1,200; Tuition Deduction, $10,000[1]	35.2	92.8
HOPE Scholarship, $1,000; Tuition Deduction, $10,000[2]	34.1	91.7
HOPE Scholarship, $1,500; Tuition Deduction @15% credit[3]	34.9	92.5
Phased in HOPE Scholarship; Phased in Tuition Deduction[4]	35.0	92.6

[1]The tuition deduction starts at $5,000 through 1999, and increases to $10,000 thereafter.

[2]The tuition deduction starts at $10,000 in 1998.

[3]This variation converts the tuition deduction into a 15 percent credit on expenses up to $10,000 ($5,000 in 1998).

[4]The tuition deduction starts at $5,000 through 2000, and increases to $10,000 thereafter. The HOPE credit starts at $1,200 through 2000, and increases to $1,500 thereafter.

o The crucial design choice that needs your guidance is whether the HOPE scholarship, the tuition deduction, or both should be trimmed to fit the education into the $35 billion agreement.

___ Trim the HOPE credit (As in package #1 above) ___ Trim the deduction (as in package #3 above) ___ Phase in both (as in package #4 above)

- There are additional possible variations of the packages. Elimination of the Pell offset could be phased in, though this would not save a lot since completely eliminating the Pell offset costs roughly $3 billion through 2002. The income phaseout ranges could also be altered (the credit and deduction phase out for joint filers with incomes between $80,000 and $100,000 and single filers with income between $50,000 and $70,000).

Additional Features of the Education Packages

o With money outside the $35 billion, we propose to make permanent the exclusion of employer-provided educational assistance from taxable income (Section 127). This is a cause that has been championed by Senator Moynihan and others in the House and the Senate. Doing so will cost roughly $3.7 billion through 2002.

o A student loan interest deduction would provide relief to many middle-income students and is politically popular. Adopting the student loan interest deduction in the Republican Leadership education bill (S.1) would cost $1.8 billion under Treasury scoring (and $0.7 billion under Joint Tax scoring).

- The proposal to deduct student loan interest would provide a $2,500 above-the-line deduction, phased out at $45,000 to $65,000 for single filers and $65,000 to $85,000 for joint filers.

o We are developing proposals to aid school construction (and other activities) in poor neighborhoods, as urged by Congressman Rangel and others.

THE WHITE HOUSE
WASHINGTON

May 25, 1997

MEMORANDUM TO THE PRESIDENT

FROM: **GENE SPERLING**

SUBJECT: **Tax Package**

At the close of the meeting on tax issues Friday morning, we said we would provide you with memos on the form of the capital gains tax cut and the education package. Those memos are attached, along with a memo that Secretary Riley sent to me.

Capital Gains

On capital gains, most of your advisors, including me, believe that the best approach may be to lead with a 40% exclusion of capital gains, as well as an expansion of the Bumpers capital gains relief for the sale of small business stock. Some Democrats will not be satisfied with this approach because it does not have a populist component. But its advantage, as Summers notes, is that it allows you to start with a broad-based capital gains cut that still gives us room to bargain. Bob Rubin, Larry Summers, Ron Klain, John Hilley, Frank Raines and myself all concur that it is best to start with a broad-based cut that leaves you some room to bargain. A 40% exclusion is one, but not the only approach, that would meet that standard.

You will note on the capital gains memo that there are two options listed that actually raise revenues over both the five and ten-year period. These options set specific rate schedules -- as opposed to broad rate exemptions -- which lead to less generous capital gains tax cuts to those in the 31% and 28% brackets. For example, while a 50% exclusion would mean someone in the 31% bracket pays 15.5% and someone in the 28% bracket pays 14%, under the specific rate schedule listed here, both would pay the higher rate of 20%.

Capital gains tax cuts that have significant tax relief for people in the highest marginal rates and only smaller tax rate reduction for those in 28% and 31% brackets tend to raise revenues for the following reasons:

When there is a significant capital gains tax reduction, there is a scoring assumption that upper income taxpayers will realize significant capital gains <u>that they would not have otherwise realized within a five or ten-year window</u>. Therefore, even though tax rates are being reduced, revenues increase because of the increased amount of capital gains realizations occurring within the five and ten-year period. Hence, over a five to ten-year window, significant capital gains tax cuts on those at the 39.6% bracket will tend to raise revenue.

On the other hand, there is a scoring assumption that capital gains tax cuts on those in the 31% and 28% brackets reduce rates on many realizations <u>that would have happened anyway during the five to ten year budget window</u>. Therefore, significant reductions on capital gains rates on those in the 31% and 28% brackets tend to cost revenues. Consequently, options that have significant rate cuts for those in the 39.6% bracket while only smaller tax cuts for those in 31% and 28% brackets can have the cumulative impact of raising revenues within the budget cycle.

My personal view, and one that is shared by many of your economic advisors, is that a capital gains cut that raised revenues would be very poorly received particularly among Democrats and commentators.

Education

On education, the choices are to reduce the credit, reduce the value of the deduction, or to phase both of them in slowly. The cost estimates are preliminary, so any option you choose may need to be adjusted somewhat in order to not exceed the $35 billion allocation. As you will see from Riley's memo, he feels strongly that the credit should be maintained at $1500 (he presents an option similar to Treasury's third option).

While I think there is significant substantive merit to Secretary Riley's option, in light of the criteria you have expressed for laying out an education tax package, myself , Frank Raines, John Hilley, and Ron Klain would all support a proposal that would keep both your $10,000 deduction and $1,500 credit and save costs by simply phasing them in. The Treasury option that meets that standard is option four which phases in both the HOPE Scholarship and $10,000 deduction so that they are at their full amount, $1500 and $10,000, by the fourth year of your budget plan -- Fiscal Year 2001.

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

May 23, 1997

MEMORANDUM FOR THE PRESIDENT

FROM: **LAWRENCE SUMMERS**
DEPUTY TREASURY SECRETARY

SUBJECT: Capital Gains Relief Package

This memo provides several options for broad-based capital gains tax relief. Our recommended option is a 40 percent exclusion for capital gains (with the AMT rate on capital gains reduced to 20 percent). This leaves room for negotiating a slightly higher exclusion, but holding firm against capital gains indexing. We would also recommend that a capital gains relief package include expansion of the Bumpers targeted capital gains relief presently provided to holdings of small business stock (as described more fully below), and our budget proposal to exclude up to $500,000 of capital gains from the sale of principal residences for married couples filing jointly ($250,000 for other taxpayers). We intend to provide you next week with a memo regarding capital gains indexing, which will detail the problems that would result from allowing indexing.

<u>Broad-based capital gains tax relief</u>

The following table provides the cost estimates for various broad-based capital gains options that we have considered:

Preliminary Treasury Estimates, (Dollar amounts in billions)[1]		
	1998-2002	1998-2007
40% capital gains exclusion (w/ 20% AMT rate)	**-$2.7**	**-$15.2**
40% capital gains exclusion (w/o AMT preference)	-$10.6	-$34.0
50% capital gains exclusion (w/o AMT preference)	-$18.3	-$55.3
50% capital gains exclusion, plus indexing starting 1/1/97	-$32.3	-$96.9
Separate rate schedule: 10.5% for 15% bracket taxpayers, 20% for other taxpayers; 20% AMT rate	+$13.4	+$15.3
Separate rate schedule: 7.5% for 15% bracket taxpayers, 20% for other taxpayers; 20% AMT rate	+$8.2	+$3.7

[1] All of the estimates shown include the cost of the proposed exclusion for sales of principal residences, which costs $1.4 billion through 2002 and $2.3 billion through 2007. However, they do not include the proposed expansion of the Bumpers targeted capital gains provision.

o **Replace the current maximum rate on capital gains with a percentage exclusion.** This provides the same proportional reduction in the rate on capital gains for taxpayers in all tax rate brackets. Thus, in contrast to current law (which provides a maximum capital gains rate of 28 percent benefitting only higher income taxpayers), the proposal would provide capital gains relief for low and middle income taxpayers. A 50 percent exclusion would lower the top rate on capital gains from 28 percent to 19.8 percent. Several current Republican bills include a 50 percent exclusion for capital gains. For AMT purposes, capital gains would be subject to a special 20 percent rate, rather than the regular AMT rates of 26 or 28 percent. This ensures that the top capital gains rate is 20 percent for both regular tax and AMT purposes.

o **Separate rate schedule applicable to capital gains.** An alternative means of providing rate relief would be to tax capital gains under a separate rate schedule. For example, a special rate schedule could be established with a rate of 7.5 percent for taxpayers in the 15 percent bracket and a rate of 20 percent for taxpayers in higher tax brackets. A special AMT rate of 20 percent would apply.

Thus, in contrast to a percentage exclusion, taxpayers in tax brackets ranging from 28 percent to 39.6 percent would be subject to the same special capital gains rate. This causes a separate rate schedule of this type to be much less expensive than a percentage exclusion because the greatest benefits are given to high bracket taxpayers who are more likely to have induced realizations from the proposal. Conversely, less revenue is spent on lower bracket taxpayers who are less likely to change their realization pattern as a result of the proposal. Obviously, this type of separate rate schedule is more regressive than an across-the-board exclusion.

<u>Expand Bumpers targeted capital gains relief for the sale of small business stock.</u>

In 1993, targeted capital gains relief was added under section 1202, largely at the behest of Senator Bumpers, for sales of small business stock. Section 1202 presently provides a 50 percent exclusion for capital gains from the sale of qualified small business stock held for more than 5 years. If additional targeted capital gains relief is desired, Section 1202 could be expanded by: (1) eliminating the $10 million limitation on eligible gain, and (2) increasing the size of qualified businesses from $50 million of gross assets to $100 million of gross assets. Also, if a broad-based capital gains exclusion were adopted, we would recommend that the exclusion under section 1202 be increased correspondingly to 75 percent, i.e., the maximum rate under section 1202 would be reduced to 9.9 percent (15 percent for taxpayers subject to the AMT). Certain technical changes would also be made.

These changes are similar to proposed changes to section 1202 made by Senators Daschle, Lieberman and Hatch and by Congressman Matsui (among others).

UNITED STATES DEPARTMENT OF EDUCATION

THE SECRETARY

May 23, 1997

MEMORANDUM FOR GENE SPERLING

FROM: SECRETARY RICHARD RILEY

RE: Recommended compromise higher education tax package

I describe below a compromise $35 billion higher education tax package that would eliminate the B- requirement and eliminate entirely the HOPE offset for Pell and other federal grants while keeping the maximum HOPE tax credit at $1,500 -- the average community college tuition. It pays for these changes by making the tax credit and tuition deduction effective January 1, 1998 rather than June 1, 1997, and by capping the value of the tax deduction at 15% of tuition, up to a maximum of $1,500. I strongly favor this approach over one that would reduce the size of the HOPE tax credit for the following reasons:

The compromise package described below which maintains the $1,500 tax credit would:

- Make the average community college free.
- Still provide significant benefits to families in the 28% tax bracket (over $60,000 AGI) because families with more than one child could take the tax credit for each child in their first or second year of college at the same time that they take the tax deduction for their other children or for themselves (i.e. the credit is per person while the $10,000 tuition deduction is per family). In addition, we would help families in the 28% bracket by reinstating the student loan interest deduction, paid for outside the $35 billion.
- Make the package more progressive, ensuring that the balanced budget plan is more progressive, and even more so when viewed in combination with the 1993 Economic Plan.
- Simplify the proposal by equalizing the maximum value of the credit and the deduction.

Reducing the HOPE tax credit to $1,200 and maintaining the tuition deduction as is would:

- Make it very difficult to say that the tax credit would make the average community college free because the average community college tuition is $1,500. *Over half the States* now have estimated average community college tuitions above $1,200.
- Make it difficult to argue with others against lowering the credit further because the level would no longer be tied to the average community college tuition.
- Leave us highly vulnerable to Congress amending our proposal to cap the deduction at $1,500 and using the savings for a different Congressional proposal. Congressional Minority, the higher education community, and pundits have criticized our deduction as regressive. *Thus, we could very well end up with a tax credit below $1,500 and a reduced tuition deduction.* And once we propose lowering the tax credit, it is very unlikely that we could raise it back up to $1,500.

Recommended Compromise Package: **5-year cost: $35 billion**

1. **HOPE Tax Credit: Require satisfactory progress rather than at least a B-**

This package would eliminate the B- requirement for eligibility for a second HOPE tax credit, but would continue to require responsibility by applying the "satisfactory progress" requirements now used for eligibility for student aid programs. These rules require that students maintain at least a C average or meet other standards set by the institution. This change would increase costs by $2.2 billion over 5 years.

2. **HOPE Tax Credit: Eliminate the offset for Pell and other federal grants**

Our FY98 Budget proposal deducts the value of any Pell or other federal grant from the value of the HOPE tax credit. To provide more assistance to lower income students, this compromise package would eliminate the offset completely, as both Rep. Rangel's bill and the Senate Minority bill propose. This costs an additional $3 billion over 5 years.

3. **Tax Deduction: Cap the benefit at $1,500**

To offset the cost of the above changes, this package would reduce the maximum benefit of our proposed tax deduction from $2,800 to $1,500 by limiting the value of the deduction to 15% of tuition and fees, up to a maximum of $1,500. This would respond to criticism that the deduction is regressive while maintaining its sensitivity to tuition amounts. The higher education community and Hill Democrats would strongly supported this change, and it would save $4.0 billion over 5 years. To provide additional assistance to families in the 28% bracket who would benefit less than under our original proposal, I recommend reinstating tax deductibility of interest on student or parent higher education loans, paid for outside the $35 billion reserved for the tax credit and tuition deduction.

4. **Make the tax credit and deduction effective for studies begun after January 1, 1998 instead of after June 1, 1997**

Our FY98 Budget proposed making the tax credit and tuition deduction effective for studies begun after June 1, 1997. However, at this point, it would be very difficult, if not impossible, for the IRS, Education Department, and higher education institutions to implement the change for tax year 1997. Therefore, this package would make these changes effective for studies begun after January 1, 1998 (tax year 1998), which preliminary Education Department analysis suggests might save $2.3 billion over 5 years.

This package would also commit to reinstating the deductibility of interest on any student or parent higher education loan (Senate Minority version which has the higher phased out range benefiting those in the 28% bracket), extending Section 127, establishing a 10% tax credit for small businesses that provide education and training, and allowing tax-free forgiveness of student loans for those engaged in community service, but would pay for these proposals outside the $35 billion reserved for the HOPE tax credit and $10,000 tax deduction.

Compromise Higher Education Tax Package

	5-year cost ($ billions)
Proposal in FY98 Budget:	**$36.1**
Possible Compromise Package:	
1. Substitute satisfactory progress requirement for the B- requirement	+$2.2
2. Eliminate HOPE offset for Pell and other federal grants	+$3.0
3. Cap the value of the tax deduction at 15% of tuition, up to $1,500	-$4.0
4. Make the tax credit and tuition deduction available for studies begun after January 1, 1998	est. -$2.3 (Treasury estimate not yet available)
Net change:	-$1.1
Total Cost:	**$35 billion**

Outside of the $35 billion reserved for the HOPE tax credit and tuition deduction, this compromise package would reinstate the student loan interest deduction (Senate Minority version which has the higher phase-out range benefiting those in the 28% bracket), extend Section 127, establish a small business tax credit for education and training, and allow tax-free loan forgiveness for people engaged in community service.

THE WHITE HOUSE

WASHINGTON

June 7, 1997

MEMORANDUM FOR THE PRESIDENT

FROM: **GENE SPERLING**

SUBJECT: **Background for calls on education tax package**

The attached memorandum provides some background for your calls to Senate Finance Democrats about our education tax package. It refutes four major false claims about the package, including some misleading claims arising from the recent CRS report. Our proposal has three objectives: to provide a tax cut for middle-class American families, to expand educational opportunities, and to provide a platform for boosting college enrollment.

- **Cuts taxes.** Our education tax proposals were always intended to be both a targeted tax cut for hard-pressed middle-income families and an incentive for increased college enrollment. Critics complain that the proposal will provide a "windfall" to families that would have sent a family member to college even without the program. But that "windfall" is actually tax relief for middle-class American families, and we are not embarrassed to be cutting taxes for families doing the right thing. Even middle-class families earning $60,000 to $80,000 a year can be hard-pressed financially if they have 2 children in college.

- **Expands educational opportunities.** In addition to being a tax cut, the package is also an education policy intended to induce more Americans to go to college, to take more classes while at college, to enroll at a better school, or to focus on their studies full-time rather than being forced to work while in school. The success of the package should not be judged simply on the basis of enrollment changes, but rather by both the quantity and the quality of the education it encourages.

- **Provides a platform.** The package provides a platform for talking about education. The HOPE Scholarship and the tuition deduction will draw continuing national attention to the idea that more Americans should seek post-secondary educational opportunities. The package is also extremely popular with the American public.

Contrary to some assertions, the findings of the CRS report support the two objectives of our approach. According to the CRS analysis, the vast majority of the tax subsidies will show up either in lower taxes or in more people going to college -- not in higher tuition -- and thus support the joint objectives of the initiative. For example, under one scenario highlighted in the summary of the report, 48 percent of the tax subsidy for the first two years of college would be used for more (or higher quality) schooling, and 42 percent of the tax subsidy would provide tax relief for middle-class families squeezed by the higher costs of college.

Finally, it is important to note that we are proposing our own Kidsave-type program outside of the $35 billion narked for the credit and deduction. As part of our child tax credits, families will have the option of depositing the 00 credit into a backloaded IRA that would allow families to save and pay for college tax-free. It may also be th noting that many of the complaints that are being made about our credit and deduction also apply to the Kidsave program. For example, Kidsave would provide a "windfall" to those families who would have struggled to save and pay for college even without the program.

FALSE CLAIMS ABOUT THE PRESIDENT'S HIGHER EDUCATION TAX PROPOSALS
June 7, 1997

BACKGROUND ON RECENT CRS REPORT

The Congressional Research Service recently issued a study ("Tax Subsidies for Higher Education: An Analysis of the Administration's Proposal") that has been characterized by some as concluding that the Administration's HOPE Scholarship and tuition deduction proposals will result principally in a "windfall" to families and will prompt only a limited percentage of students to pursue additional education. In fact, the report's findings are supportive of the objectives of the Administration's education initiatives.

FALSE CLAIM #1: TAX CUTS WILL ONLY SPUR TUITION INFLATION

- **The CRS report strongly contradicts the claims of some critics who have charged that the Administration's education tax proposals would only result in higher tuition.**

  The most important conclusion of the CRS report is that only a very small part of the tax subsidies will feed higher tuitions. The vast majority will therefore either pay for additional education or provide a tax cut for hard-working American families. According to the CRS report, less than 1/3 and perhaps even less than 1/10 of the value of the tax subsidies would manifest itself in higher tuitions:

  > "Overall, this analysis suggests that only a small portion of the subsidy will appear as a tuition increase, probably less than a third of the subsidy value and perhaps even less than ten percent." [CRS, 5/30/97, page 19]

- The limited effect on tuitions means that the **vast majority of the tax subsidy would pay for either more (or higher quality) education or a middle-class tax cut to make college less expensive.** This confirms what the Administration has been arguing all along: that the HOPE Scholarship and the tuition deduction will provide tax relief to middle class families at a time when they need it most -- when they are putting themselves or their children through college.

- **Any program to boost higher education has the potential to put upward pressure on tuition. But the evidence suggests that Federal aid does not have much effect on tuition costs.**

  > College tuition rose rapidly in the 1980's, but real Federal aid <u>fell</u> during that period -- by about 1 percent per year, according to data from the College Board and the Department of Education. During the 1970's, on the other hand, real Federal aid rose by 7 percent per year -- while real tuition levels remained flat.

- **Georgia's experience may illustrate the effects of competition in limiting price increases from scholarship programs.** In Georgia, where the Hope Scholarship was introduced in 1993, tuition costs at public 2-year community colleges rose 13 percent -- from $937 to $1,062 -- between the 1992-3 academic year, and the 1995-6 academic year. In the nation as a whole, tuition rose 21 percent -- from $1,026 to $1,245.

FALSE CLAIM #2: CRS REPORT FINDS LARGE "WINDFALLS" FROM PROPOSALS

- **Our education tax proposals were always intended to be a targeted tax cut for middle-income families.** We are not embarrassed to be cutting taxes for families who would have struggled to put their children through college even without the tax break.

- **The "windfalls" identified in the CRS report are actually tax cuts for hard-working American families to make college less expensive.** The report does conclude that some of the tax subsidy will benefit families that are already paying for a family member to attend college. But there's nothing wrong with that -- it is a stated goal of the proposal.

  Despite the terminology of the report, it is certainly not a "windfall" in the traditional sense of the word. Rather, it is a tax cut for middle-class American families with someone already in college (or who was already planning to attend college).

- **The shares of the tax subsidy paying for pure middle-income tax cuts and for additional education vary from scenario to scenario in the CRS report.**

- **One highlighted scenario finds that the benefits of the tax cut will be almost evenly split between these two outcomes.** The scenario, highlighted in the second paragraph of the summary, finds that:

  -- 48 percent of the tax subsidy for the first two years of college would be used for more (or higher quality) schooling, and

  -- 42 percent of the tax subsidy would provide tax relief for middle-class families squeezed by the higher costs of college.

  Other scenarios find a larger share going to tax relief, which is misleadingly labeled a "windfall."

- **The scenarios in the CRS report do not take account of the Administration's proposed Pell increase, and therefore understate the likely increase in educational output.** The study projects effects from the HOPE Scholarship and tuition deduction without taking account of the proposed increase in Pell grants that is a very important part of our package. The authors acknowledge that if they had taken the Pell increase into consideration, they would have projected a *greater increase* in educational output and less of a pure middle-class tax cut than their study found.

FALSE CLAIM #3: PROPOSALS HELP UPPER-INCOME FAMILIES THE MOST

- **Criticism, such as in the CRS report, often fails to reflect the proposed expansion in Pell grants -- the largest increase in two decades.** Four million students could receive a grant of up to $3000, an increase of $300 in the maximum grant.

- **The CRS report also pre-dates, and therefore fails to reflect, the Administration's changes that make the Hope scholarship more progressive.** Removing the Pell offset from the Hope program means that low-income students will be able to benefit from <u>both</u> the Pell grant and the Hope scholarship. As Stan Ikenberry, the President of the American Council of Education, wrote to Secretary Riley, this and other recent changes "represent a much improved package that will do a great deal to help families finance higher education." The omitted initiatives disproportionately benefit lower-income families.

- **Even without the Administration's recent changes and the Pell grant expansion, the report's findings indicate that the education tax proposals are relatively well-balanced -- and much more so than many other tax proposals.**

  The report concludes that more than half the benefits go to the 58 percent of families in the lowest tax bracket (less than $39,000 in taxable income on a joint return) -- even ignoring the expansion in the Pell grant program. The rest goes to the 42 percent of families who face marginal tax rates of 28 percent or more. As the report notes, "the 42 percent of families in the higher brackets receive 48 percent of the benefits for the credit/deduction proposal." [CRS, 5/30/97, page 22]

  By comparison, the Citizens for Tax Justice concluded that 68 percent of the benefits from a 19.6 maximum capital gains tax rate would go to the top 1 percent of households. [Citizens for Tax Justice, May 1997.]

- "It hits me in the face every day of my life that a very significant number of people are able to go to technical institutions and get training because financing is no longer a burden to them," said Ken Breeden, who supervises that part of the Georgia Hope Scholarship program. [Quoted in the *New York Times*, 3/3/97]

FALSE CLAIM #4: ADMINISTRATION'S PACKAGE IS NOT SUPPORTED BY THE EDUCATION COMMUNITY

- **Over 300 college presidents have expressed support for the Administration's higher education initiatives.**

- **Support is even stronger given the recent changes to the Administration's proposals.** Stanley Ikenberry, the President of the American Council of Education, recently wrote to Secretary Riley noting that the Administration's proposals "*represent a much improved package that will do a great deal to help families finance higher education. The Hope tax credit is a giant step in the direction of making the first two years of college a universal benefit.*"

- **The President's education package will have a positive psychological effect.** By highlighting the importance of education, the HOPE Scholarship and the tuition deduction will draw continuing national attention to the idea that more Americans should seek post-secondary educational opportunities.

THE WHITE HOUSE

Office of the Press Secretary

For Immediate Release June 9, 1997

PRESS BRIEFING BY
SECRETARY OF TREASURY BOB RUBIN AND
DIRECTOR OF THE NATIONAL ECONOMIC COUNCIL GENE SPERLING

The Briefing Room

1:58 P.M. EDT

MR. MCCURRY: Good afternoon, ladies and gentlemen. Earlier today an administration team led by Erskine Bowles, Treasury Secretary Rubin, and Gene Sperling, the President's National Economic Advisor, were on the Hill to hear from Chairman Archer of the House Ways and Means Committee further details about the tax package they have under discussion there. I guess at least Erskine and Secretary Rubin and Gene also -- no, afterwards -- had an opportunity to meet with Democrats on the House Ways and Means Committee. And I'd like Treasury Secretary Rubin to tell you about those meetings. Gene also can take any questions you might have.

Mr. Secretary.

SECRETARY RUBIN: Thank you, Mike. Let me give you a little sense of where we are, and then Gene and I would be happy to respond to questions.

What we basically -- our basic objective is to have a plan, a tax plan that is good for the American people, good for working people, good for average families, good for the economy, and that is permeated by fairness throughout. By that test, we have serious concerns with significant parts of the Chairman's mark that we have received today.

As you know, the President has focused on education, on child care, and on savings, all with the focus on middle income families, both to help middle income families directly through tax cuts and to promote behavior that is good for middle income families and good for the economy. With respect to the areas that we do have significant concerns about, we look forward to working with Congress and to ultimately winding up with a tax bill that meets the test that I mentioned a moment ago, and that is good for the American people and that we can enact into law.

With that, we would be happy to respond to questions.

Q What are your main objections?

SECRETARY RUBIN: Well, I think if you look at this there are a lot of problems that are going to need some serious attention. For example, the EITC -- this is a rather technical point, but it's an important point -- the EITC is stacked before the child tax credit, so that means that if you have an income that's in the EITC range, but we are paying taxes, you first have the EITC credit against it and then only if you have some taxable income left can you get to use the child tax credit. The basic -- the effect of it is to deny the child tax credit to what I would call the middle poor or the least well-off working people who are still paying taxes. That's because they take the tax credit first and then only if you have taxable income after that you get a child tax credit. It's called stacking.

We would do it exactly the opposite way -- we'd put the EITC after the child tax credit.

Q But your tax credit isn't --

SECRETARY RUBIN: Our child tax credit as we currently envision it would be refundable. But even leaving that issue aside, if you put the child tax credit first, even if it's nonrefundable, and you have taxable income, then you'd get the benefit of the nonrefundable tax credit. And EITC is refundable; even if you've exhausted your income, you'd get the benefit of the EITC because it's refundable. That I think is a very serious issue.

Secondly, our understanding is, although you don't see it from the sheet that you all probably have received and that we did receive, that the dependent care tax credit which people currently get is going to be adversely affected or reduced by virtue of this program. In the second five years, our understanding is that for each dollar of that credit that you get, your child tax credit is reduced by 50 cents. That's obviously bad for working mothers.

On the HOPE Scholarship, that's been changed so that instead of getting a full HOPE Scholarship for $1,500, what you get is 50 cents on the dollar up to $3,000. So if you go to a community college that has a tuition, say, of $1,200, under the President's plan you get a $1,200 tax credit; under this plan you get a $600 tax credit. Again, it will tend to disadvantage the less well-off in our society. And as you look through this program, in component after component that is what this program seems to have done. It seems to have moved the tax benefit away from the less well-off and even away from middle income people toward higher income people.

Q What do they say about that? Is that what they say they're doing?

SECRETARY RUBIN: That is what they're doing. These are obviously the kinds of issues we'll have to discuss with them.

Let me just mention one other, if I may. They totally eliminate the corporate alternative minimum tax in the second five years and they reduce the corporate alternative minimum tax in the first five years. That basically means that a lot of companies will be able to pay substantially lower taxes than they otherwise would, and some would be able to pay no taxes, even though under current tax law they would be viewed as profitable and paying significant taxes.

At the same time they do that, they have these other -- that costs a lot of money -- I think something like $17 billion, if I remember correctly, in the first -- I do remember correctly -- $17 billion the first five years and $34 billion over 10 years. At the same time they do that, in a lot of these other areas they're moved away from helping working families and average families.

Q You always knew that once you got into the details of writing this tax bill, $135 billion gross tax cut, there would be these disputes with the Republicans in Congress, so this is not a surprise.

SECRETARY RUBIN: These aren't details, Wolf. I would say these are really --

Q But these are the nuts and bolts of what the tax cuts are going to be, right?

SECRETARY RUBIN: Well, this is their tax cut program.

Q The only thing you agreed on with them, going into the balanced budget agreement, would be $135 billion in gross tax cuts, $35 billion of which would be earmarked towards education?

SECRETARY RUBIN: Well, toward the President's tax program.

Q For education.

SECRETARY RUBIN: Toward the President's tax program for education, that is correct.

Q Have they honored their commitment to you?

SECRETARY RUBIN: Well, beyond that, however, we have to determine whether we have legislation that we believe is good for the American people, or not. And that issue --

Q You always suspected that would be the case, right?

SECRETARY RUBIN: Wolf, I think there are two tests. One, as you correctly say is, have they met the test of the agreement. And with respect to the education piece, they have $31 billion of education. The HOPE, obviously, is modeled after the President's, but nevertheless it's significantly different for the reason I just discussed. It's worth half as much to somebody who goes to a community college with a $1,200 or $1,500 tuition. And the other piece is totally unrelated to the President's program. So I would say they are not consistent with the agreement with respect to education piece.

Beyond that, the test is the test that I mentioned -- do we have a tax bill that meets the interests of average and working families, and is good for the economy. And by that test, as I said a moment ago, I think there are significant concerns.

You used the word "details," though. I was just taking exception to that because I think this is much more than a question of details. This is a question of --

Q Are they reneging on the deal?

SECRETARY RUBIN: I don't think I would say that at this point. I think I would just say that we now have the mark and we have to work with Congress and our objective is to work with Congress to get a bill that, A, meets the agreements, and, B, meets the test that I mentioned before. And that's what we look forward to doing as we go forward.

Q -- tax bill the President would sign, you're saying?

SECRETARY RUBIN: I'm saying that we have significant concerns about significant portions -- serious concerns about significant portions of this, and we need to work with Congress to work our way through that.

Q Let me go back -- you say it's not consistent to the agreement vis-a-vis education. So you're saying that as to that $35 billion, that roughly $35 billion, they aren't following it or they are?

SECRETARY RUBIN: Well, on the roughly $35 billion, they've got $22 billion for a HOPE credit, which is modeled after the President's, but nevertheless is significantly different from the President's, for the reason that I described a moment ago. Just to repeat it once more, if you have, say, a $1,200 community college bill, our way you get a $1,200 credit, their way you get a $600 credit. And then the additional $9 billion roughly that they have in education is a totally different program than the President's deduction program.

Q But isn't this sort of one of those things where you had a chance --

SECRETARY RUBIN: And, of course, we were supposed to be roughly $35 billion, and this is $31 billion.

Q -- you had a chance to hammer up the best deal that you could; the $35 billion was what you could nail down to get the rest of the budget agreement -- isn't there a sense the Republicans can say, look, you knew that this was how we would write the bill for the rest and that's the way it goes?

SECRETARY RUBIN: No, I think that where we are -- the one commitment in there -- well, there are actually three commitments, aren't there. One is the total size of the tax package first five and second five years on a net basis, right? Second commitment is that it not explode, and we have not yet had a chance -- we've just gotten this -- we have not yet had a chance to do the analysis to determine what effects this would have out beyond the first 10 years and whether this does or does not explode. I do not have a view on that; we've got to do the analysis.

And then the third is, with respect to everything else, since the specifics were not laid out, it's like every other tax bill; we have to work together and see if we can arrive at a tax bill that we are both comfortable with and think serves the interest of the American people, and that's where we are right now.

Q -- their plan on the education tax credits mitigate some of the incentives that people have said for community colleges to simply raise their prices up to the maximum in order to take advantage of a tax subsidy -- it keeps the recipient of the education with a responsibility for some of the payment.

SECRETARY RUBIN: I don't think there is a material difference. If you look at CRS, they estimated if I remember correctly that 90 percent of our program would not affect tuition, so you're talking about 10 percent to begin with. So -- if you take the CRS study. So you're talking about, at most, 10 percent. So if theirs helps a little bit on that, maybe they've solved a little piece of what is, by CRS's estimation, a small problem to begin with. I do not think that's a significant argument.

Q How much of a problem do you have with Democrats on the HOPE Scholarships? Archer -- at least according to Archer, no Democrats stepped forward to defend it in his talks.

SECRETARY RUBIN: I think that you will find that the House Ways and Means Democrats -- I don't want to speak for other people, so I'll just -- well, let me say, I think you will find amongst House Ways and Means Democrats that there is coalescence around a HOPE Scholarship that has the principles of the President's HOPE Scholarship. That would be my judgment at this point.

Q -- is gauging their level of support is --

SECRETARY RUBIN: That is correct.

Q You may have noticed that the dollar has fallen to a six-month low. Has there been a change in policy, or do you still favor a strong dollar?

SECRETARY RUBIN: We favor a strong dollar as we always have, and I think that -- and for the reasons we always have -- helps keep inflation down, helps keep interest rates down, both of which are good for the economy.

Q Mr. Secretary, you say you do not regard this at this point as a breach of the budget agreement. Given the parliamentary mechanics, though, won't it be very difficult to fix this? And when would it become a breach?

SECRETARY RUBIN: Well, the question was, did I view this as a breach of the contract, and I said it seemed to me it was too early to be speaking in those kinds of terms. I do not think this is consistent with the agreement. (Laughter.) But I think that the attitude we should be taking, and we do take -- we want a bill that we can sign and that is good for the American people, and we look forward to working with Congress to get that sort of bill. This is the legislative process.

Q Is there anything you like in the package?

SECRETARY RUBIN: Yes, I think there are pieces that are worth nothing. That's a good -- yes.

Q What are they?

SECRETARY RUBIN: There is a substantial child tax credit. As you know, the President has always been an advocate of a substantial child tax credit. The two problems with this one are the EITC stacking problem, which sounds technical, but is not technical at all, that would adversely affect a lot of relatively poor or low-income working people.

Q How many?

SECRETARY RUBIN: I don't know how many yet, because we have to get this back and work on it.

And secondly, this dependent care issue, which is a very big issue for working mothers. And secondly, in the HOPE Scholarship program. While it is not -- it has the problem I mentioned, which is a big problem, relative to the President's program, it has elements of the President's program in it.

Q Mr. Secretary, what about the proposal to raise the inheritance tax limit to $1 million from $600,000 and to lower cap gains to 20 percent?

SECRETARY RUBIN: Well, in cap gains, they lower the top rate to 20 percent. They also have indexing, so that they're really providing a double benefit to people with respect to capital gains. We have always had very serious reservations about indexing partly because with indexing and lowering the top rates, you're providing an enormous set of benefits to people with large capital gains, partly because of complexity and in the case of the indexing because of the impacts it could have on the deficit in outer years.

Q Would you like to lower cap gains for people of lower income?

SECRETARY RUBIN: You're talking about taking the 10 percent? Well, we have never been in favor of a broad-based capital gains tax cut. On the other hand, we've always said that it's likely, since the Republicans do favor it, that there would be one in the final agreement. I think the best thing to say about a capital gains tax cut is that we're going to be working all these issues with Congress and we'll work our way through this. Indexing is the piece of capital gains that we are most troubled about.

Q And the inheritance tax?

SECRETARY RUBIN: Wolf, I don't want to get into individual provisions, but that doesn't -- it's not one that I mentioned as striking me as a serious concern, but we've got to go through this and analyze it and discuss it amongst ourselves.

MR. MCCURRY: There were two last questions back there, and then Ann.

Q The Archer proposal has the child tax credit going up to age 17.

SECRETARY RUBIN: Age 16, I think, isn't it?

Q The 17th birthday, yes. And as I recall, yours went up to age 13. Do you have a problem with the higher age, or are you willing to accept that?

SECRETARY RUBIN: Well, it's a question of how much money you want to spend on the child tax credit. And we think a child tax credit is a very good policy. The President has consistently advocated it, and it's just a question of how much you want to put in that pocket. That isn't a problem. We have to view that in the context of the overall package. But I think, taken in and of itself, I don't think we would have a problem with that.

Q Gene pointed out how hard it gets to change some of these things. What do you do now with it once you go through all this? What are you going to do?

SECRETARY RUBIN: We're going to be working with the various committees in Congress and continue working with the various committees in Congress and we'll have to see what the process are going forward.

Q Are you going to send objections up to these particular things you've highlighted today?

SECRETARY RUBIN: We just got this in the last couple of hours, so we've got to decide ourselves exactly what the best way is to progress. But we'll be working with both parties in both Houses.

MR. SPERLING: One thing I just wanted to add was, someone said, isn't this something you would expect. On the child tax credit, on arranging it so that it doesn't go to lower income working families, this was not part of their proposal in '95. The plan in '95 and '96 -- they did not do this. So this is a change in the way that even they've designed the child tax credit so that Bob -- we haven't had a chance to look at it, but the Center for Budget Priorities estimates that this would deny the child tax credit to as many as 4 million families that are in the, as the Secretary said, the lower working income families, which we think is a very questionable way to get additional savings.

And then, just on the child tax credit, on the child care tax credit, they're actually saying that on the outer years, for every dollar that you're getting on their new child tax credit, you would take away 50 cents of their child care dependent tax credits. So you have two families -- one family, they have a single person --one parent makes enough so the other parent can stay home -- they get the full child tax cut and they get the dependent care tax credit as it exists. The family next door, both parents have to work, which is the way it is for tens of millions of working families. They're saying that for that family who then needs to use the dependent care tax credit, they would take away 50 cents on every dollar. That is a very, very puzzling proposal.

THE PRESS: Thank you.

END 2:15 P.M. EDT

HOPE Scholarship Tax Credit, Tuition Deduction and Education Savings Incentives from Chairman Archer's Mark

HOPE Scholarship Tax Credit

Administration Proposal Taxpayers could claim a nonrefundable credit of up to $1500 in two taxable years for tuition and required fees incurred during the first two years of postsecondary education on behalf of the taxpayer, her spouse or dependents. To be eligible for the credit, a student must be enrolled at least half-time in a degree or certificate program at a qualified institution and must not have been convicted of a drug-related felony. In addition, the student must show satisfactory academic progress in the first year in order to qualify for the credit in the second year. (The B- average requirement has been dropped, and the maximum credit would NOT be reduced by federal grants.) The maximum credit would be indexed beginning in 1998. The credit would be phased out for individual taxpayers with agi between $50,000 and $70,000 and for joint filers with agi between $80,000 and $100,000. The thresholds would be indexed beginning in 2001. Taxpayers would have to choose either the HOPE credit or the tuition deduction for a student's expenses in a single year.

Chairman's Mark Taxpayers could claim a nonrefundable 50% credit for up to $3,000 in two taxable years for tuition, required fees and books incurred during the first two years of postsecondary education on behalf of the taxpayer, her spouse or dependents. To be eligible, the student must be enrolled at least half-time in a degree or certificate program at a qualified institution and not have been convicted of a drug-related felony. The maximum credit amount would be indexed for inflation beginning in 1998. The proposal would be effective for expenses paid after December 31, 1997 for education furnished in academic periods beginning after that date. The credit would be phased out for individual taxpayers with agi between $40,000 and $50,000 and joint filers with agi between $80,000 and $100,000. The thresholds would be indexed beginning in 2001. A taxpayer would have to choose either the HOPE credit or the tuition deduction for a student's expenses in a single year, provided the expenses were paid from a prepaid tuition plan or education investment account and were, therefore, eligible for the deduction.

Recommended Position Support, but only with significant modifications.

Revenue Estimate JCT: [$22b] over 5 years, [$49b] over 10 years.

Deduction for Expenses Paid from State-Sponsored or Private Tuition Program or Education Investment Account

Current Law A taxpayer who saves for higher education through a qualified state tuition program that meets the requirements of section 529 may defer tax on the earnings in the account until the time of withdrawal. When the funds are withdrawn, they are taxable to the party who withdraws them. Usually, this will be the student who is using the account to pay for school. However, it may be the parent or other account holder who wants a refund. If the designated beneficiary of an account is changed, and the new designated beneficiary is an ancestor, spouse, sibling, child, grandchild or other lineal descendant of the current beneficiary, or a spouse of any of the aforegoing, including the beneficiary, the change will not be treated as a distribution and will not trigger tax or a penalty. Generally, a state's educational savings plan will qualify under section 529 if the state establishes and maintains the plan, allows it to be used to save only for tuition, required fees and books, prohibits investment direction by participants and imposes a more than de minimis penalty on withdrawals not used for higher education expenses. Section 529 does not impose income limits or contribution limits, other than a general limit on funding the plan in excess of reasonable educational needs.

Chairman's Mark Taxpayers that paid tuition, required fees, books, room and board with money withdrawn from a state-sponsored tuition program, private tuition program (meaning one sponsored by an educational organization) or an education investment account could take an above-the-line deduction for up to $10,000 a year per student for those expenses. Also, the deduction cannot exceed the portion of the distribution that represents earnings, rather than contributions. A deduction would be available for room and board even if the student lives at home. The student can be the taxpayer, her spouse or her dependents. The deductions taken for a student could not exceed $40,000 for all taxable years. Deductions could not be taken for a student once the student completed the first four years of post-secondary education. If a parent claims a student as a dependent and takes a deduction for the student's expenses, the distribution from the state tuition program would be included in the parent's income rather than the student's. To be eligible, the student must be enrolled at least half-time in a degree or certificate program at an educational institution eligible to participate in federal student aid programs. The deduction would not be a preference item for the AMT.

In addition, the requirements of section 529 would be changed so that taxpayers could use state tuition programs and private tuition programs to save not only for tuition, fees and books, but also for room and board. Ways and Means intends to limit the maximum amount of deductible room and board to the amount the school allows when calculating costs of attendance for financial aid purposes. A technical correction later in the bill -- that is arguably not a technical -- would allow existing plans to continue accepting contributions on contracts that cover room and board made before section 529 was enacted.

Recommended Position Oppose.

Revenue Estimate JCT: [$889m] over 5 years, [$2.4b] over 10 years

Education Investment Accounts

Current Law Income earned in a prepaid tuition program established and maintained by anyone other than a state is not guaranteed to receive tax deferred treatment. Taxpayers who save for education expenses must pay tax annually on any income they earn on their savings.

Chairman's Mark Taxpayers would be permitted to establish education investment accounts in the same trust form used for IRAs. Up to $50,000 in aggregate cash contributions can be made on behalf of a single beneficiary. Earnings would accumulate tax free. Distributions would be eligible for the same tuition deduction available for distributions from state tuition programs. Contributions cannot be made after the beneficiary reaches age 18, and all amounts must be withdrawn by the time the child for whom the account is established reaches 30 or completes the first four years of post-secondary education. A 10% additional tax would generally apply on distributions not used for higher education expenses.

Recommended Position Oppose

Revenue Estimate JCT [$6.9b] over 5 years, [$22.4b] over ten years

Talking Points

Objections to Higher Education Proposals in Ways and Means Chairman's Mark

- As compared to the Administration's budget, the Chairman's mark redirects a large portion of benefits to higher income families that can afford to save to for higher education expenses. For families who need grants and loans to afford school, benefits are diminshed in the first two years of higher education and taken away entirely for later years.

- Under the Chairman's mark, a middle-income student who works all summer, saves her salary and uses it to pay her junior year tuition would receive no assistance. However, her classmate who spent the same summer on vacation could get up to a $10,000 deduction when she pays her tuition out of the educational investment account her well-to-do parents were able to fund.

- The Chairman's HOPE credit is less generous for students at community colleges and other low-price schools.

- The Chairman's package provides no support for education beyond the first four years of college and very little for workers and others who may return to school later in life. An older student cannot start an educational investment account -- contributions cannot be made after the beneficiary reaches 18 -- and cannot benefit from employer-provided educational assistance after 1997.

- The education investment account proposal creates a potential for abuse that will be difficult to prevent. Although aggregate contributions on behalf of a single beneficiary are limited to $50,000, financial institutions will have no way of knowing whether an account holder has other accounts elsewhere, and the IRS will find it difficult to keep a running total of contributions over many years. The IRA system works because it sets a maximum annual contribution that can be policed with simple annual information reporting.