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Subgroup/Office of Origin: National Economic Council

Series/Staff Member: Bob Shireman

Subseries:

OA/ID Number: 13223

FolderID:

Folder Title:
HOPE [Hope and Opportunity for Postsecondary Education]: Options

Stack:	Row:	Section:	Shelf:	Position:
S	15	2	1	2

-10

B-1 [illegible]

- No ded.

- No B

- No [illegible] offset
w/ JCT, [illegible] ded.

Sr. Cam i [illegible]

~~[illegible]~~

- HR. 1627
[illegible] [illegible]
- $200, 45-60 [illegible]
- incl. parent

- Ed

Pauline Abernathy
Office of the Deputy Secretary
U.S. Department of Education
600 Independence Avenue, SW
Washington, DC 20202-0500
Phone (202) 401-1000
Fax (202) 401-9027

TO: Bob S

FAX: 3 pp

PAGES (including cover page): 456-2223

FROM: **Pauline Abernathy**

RE: Have you seen this from Breaux/Kerrey Staff? Note HOPE phase-out.

DRAFT

ALTERNATIVE CHILD CREDIT/EDUCATION ASSISTANCE PROPOSAL

KIDSAVE SPECIFICATIONS

This proposal integrates three key elements identified by the budget negotiators as being integral to the tax package now under consideration: a $500 tax credit to families with children, assistance with higher education expenses and expanded incentives for savings and retirement security.

- The proposal provides a $250 per child tax credit for children up to age 18. The credit is increased to $500 if that amount is contributed in the child's name to an IRA-like account that contains an education component. The credit is phased out for single filers with income between $50,000 and $75,000 and joint filers with income between $75,000 and $100,000. Taxpayers who exceed the income limits could contribute after-tax dollars to a KidSave account, the earnings on which would be tax deferred. Taxpayers who would not qualify for a credit because they have no tax liability could also open an account with after-tax dollars.

- Similar to IRAs, withdrawals are limited to the child's reaching age 59 1/2 or the child becoming disabled. Unlike IRAs, up to one-half of the account can be withdrawn tax and penalty free to pay for qualified higher education expenses (tuition and fees). Also unlike IRAs, penalties on early withdrawals for other than qualified education expenses would be 50% plus the applicable taxes in order to ensure that the money is used for education and retirement purposes.

$500 a year set aside from birth to age 18 would, at ten percent interest, grow to $1.3 million by the time the child reached age 59 1/2, the age at which IRA funds can start to be withdrawn with no

penalty. At age 18, the $500 per year investment would be worth over $25,000.

HOPE SCHOLARSHIP COMPONENT

- The proposal also provides for a significant Hope Scholarship phased out over five years, as follows:
  Year 1---$1500
  Year 2---$1250
  Year 3---$1000
  Year 4---$750
  Year 5---$500

The same income phase-out limits that apply to KidSave apply to the HOPE Scholarship.

The phase-out period is designed to complement the early years of the KidSave account.

OTHER EDUCATION INCENTIVES

- Student Loan Interest Deduction--Provides for an income tax deduction for up to $2,500 of student loan interest. The deduction would be allowed only with respect to interest paid on a qualified education loan during the first 60 months of interest payments. The same income phase-out limits as apply to the KidSave account apply to the student loan interest deduction.

- The proposal permanently extends the income tax exclusion for employer-provided education.

- The proposal allows tax-free withdrawals from qualified state-sponsored tuition programs.

May 21, 1997

MEMORANDUM FOR GENE SPERLING

FROM: Bob Shireman
SUBJECT: Education Tax Issues

Based on my discussions with Mike Smith and Karl Scholz, both Education and Treasury will recommend eliminating the grade requirement and dropping the offset of Federal grants (the Pell offset). To pay for those changes and reduce the cost overall, the Education Department is inclined to preserve the $1500 credit but pare back the deduction, while Treasury is inclined to reduce the size of the credit but maintain the deduction as much as possible.

The Education Department's package would look something like this:

--No B- requirement, *but in order to get the second $1500 credit, the recipient would have to have finished the first full academic year* (this would reduce the cost of eliminating the grade requirement to something less than the estimated $2.2 billion, though Treasury does not expect the difference would be significant).

--No Pell offset (cost $3 billion).

--Limit the value of the deduction to 15% of the tuition and fees paid (saves $4 billion).

Treasury is looking at something like this:

--No B- requirement

--No Pell offset

--Reduce the credit to $1200 or $1000

--If necessary, maintain the deduction at $5000 rather than increasing it to $10,000

Treasury is looking at both $30 billion and $35 billion options, given Rangel's interests.

<u>The Rangel bill</u>

The elementary-secondary portion of Rep. Rangel's legislation includes two tax credits:

- **Bonds for School-Business Academies.** Tax credits equal to the interest that would need to be paid on bonds used for public "Academies" in EZ/ECs or high-poverty schools.

To qualify its bonds, the school would need to demonstrate significant commitments of equipment, time, or money from private businesses. **Essentially, the tax credit would be the interest payment to the bond holder.** Bond proceeds could be used for construction and renovation, equipment, curriculum development, and teacher training. The credits would be limited to an amount nationally, and would be allocated to States according to population in poverty.

Treasury would not likely support an allocable credit model like Rangel has proposed, and it is not appropriate to fund expenses like teacher training and curriculum development from bonds. However, Treasury is looking at alternatives along these lines that might provide for some tax benefit targeted to school construction and renovation bonds.

- **WOTC eligibility for Academy graduates**. Employers who hire graduates within six months of leaving an academy would be entitled to a tax credit of 20% of the first $6,000 of wages paid during the first year of employment.

One of the focuses of the School-to-Work program is for students to see how the work world is connected to their education. The Education Department has discussed the idea of using the WOTC idea to provide incentives for businesses to hire students *while they are still in school,* where there are school-business partnerships that link academics to the work site. (Apparently the old TJTC included "cooperative education," which is similar to the school-to-work model. Bringing it back might be controversial).

Packages: Smith

1. Credit: Base = 18.6

   o No B- Average: +2.2
   (Daschle/Kennedy
   //Clay/Rangel) Replace B- with

   O Either Satisfactory progress 0.0

   or

   o Eligible as a first year (freshman) and after completion of first year as a second year student (sophomore): Reinforces completion of first year and moving into second. Saves $s since many do not complete first year and move on to second. Reinforces President's 2 full years of college commitment -1.5???(from base of no B- ave.)

   o Eliminate Hope offset for Pell entirely +3.0

   Or

   By 50% = $0.9

   Net Credit roughly +4.0

2. Deduction: 10,000 deduction

   o Change to max benefit of $1500

   Or

   o A credit worth 15% of tuition -$4.0

3. Add

   o Tax free loan forgiveness +0.015
   o Student loan interest deduction +0.7

   Net total about +1.0

4. Commit to 127 and 10% Small Business Deduction outside of $35 million +2.4

DRAFT Comparison of Education Tax Proposals
(1997-2002 cost estimates where available)

	Administration	Senate Republicans	Senate Democrats	Rep. Rangel
Tuition Credit	$1,500 First 2 years Non-refundable Offset by grant aid B avg. 2nd year ($28.9 Billion JCT)		$1,500 First 2 years Refundable B avg. High School	$1,500/$1,000 Frosh-Soph/Jun-Sen Refundable No offset Satis. Acad. Prog.
Tuition Deduction	$10,000 ($11.6 Billion JCT)		$10,000	
Savings	Flexible IRAs	Bob Dole Accounts $1,000/year tax-free ($1.8 Billion JCT)		
Student Loan Interest Deduction		$2,500/year ($0.7 Billion JCT)	Yes	
Pre-paid tuition		Make tax-exempt ($0.6 Billion JCT)		
Sec. 127 (Employer-paid tuition)	$5,250 Extend to 2000 Small business cred.	$5,250 Permanent ($3.5 Billion JCT)		$5,250 Permanent Small business cred.

Work-study		Exclude from taxation ($0.4 Billion JCT)		
School Construction				Tax subsidy for bond interest at high-poverty schools
Employment				WOTC eligibility for hiring graduates from high-poverty schools
Exclude student loan forgiveness from taxation (income-contingent and community service)	Yes			Yes

Rubin, Smith, Mazur, Maw, Alicia Munnell, Alan Cohen, Linda —, Orszag
Dave, Summers

5/[illegible]/97

- B - average position

- Package w/ $500 credit

-

Linda

- Engaging w/ Archer & Roth — "immediately"

ideas:

Archer: Prob. Savings

Mangel: $5-6 billion — Bonds / academies (but it's a 30 yr. tax credit)

- Refundability of HOPE Credit — "ESSENTIAL"

- Taxable bonds

- Feds pay i

- No

- Credit ad have to be = 18% principal
6% i 30 yrs...

- [illegible]

[Exempt i = benefits rich]

W&M: Prog
- Archer w/ Cams
1-2

- "Postsecondary" danger
Rangel → don't go for the $38

- Breaux can strike a deal w/ Repubs
Landrieu

- Mase let HOPE run on integrated kidsave proposal...

$10,000 - Have them relax [illegible] affordability. -

Different agenda

- House W & M

- Senate Finance

- Colleges

Get them to do kidsave outside of the $35

DO IT AS PART OF THE CHILDREN'S TAX CREDIT. → Daschle...

?

- Moynihan?
- Sec. 127
- Chiropractors.

Bipartisan mtg w/ Senate

127

MPB - i ded. on loans

Graham prepaid ed'n

+ Kenney-Brown + And rore

Negotiating

- Have Work + Colleges - manageable.-
- Snake Rn. is biggest prob.

Klein → our own $135 B tax plg. - sell it.

PDR/Alan: It should expand... (use the 2nd 5yr $)

Gene

- Our ed'n - ~~ED for credit~~
- Medicare - an IRA + child care credit
- ~~Marginal~~ - Marginal's - expand in 2nd 5

35

70

£110

→ Wk w/ Gingrich

Pkg.
- Infrastructure - Daschle
- Sen. Byrd & Harris - a wedge

Refund.
Gore & Pres departures...
Kidsave refundability - perhaps

Rangel - saffron w/[illegible] Ray Gomez
Harvey/Rubin → meet w/him.

* Daschle
(* Kennedy)

Tax Cut
- Package
- Principles

Rubin
(1) Options - add Kidsave
(2) Daschle - stay Sen. Finance activity
- After mtg w/ Erskine
(3)
(4) How to engage w/ Reber etc.

Clarksburg

- Charleston job Corps Ctr
  - cost overruns

- Harper's Ferry

Q & A
- increasing college costs
- aid
- [illegible] yours

Rushdoos

Bill's approach:

- No 13 - —— 2nd yr - use complete first ac. year
- no bill
- completion of return & fees

stand

Outside the $ 35

Sec. 127

~~Savings~~

Savings

Timing: Need to know today so

all ent...

SENATE DEMOCRATS

Tier #1

Daschle*
Kennedy
Moynihan

FINANCE

Tier #2

Breaux*
Conrad
Graham*

LABOR & HR

Tier #3

Dodd*
Harkin
Reed

REPUBLICANS

Tier #1

Lott
Jeffords
Roth

FINANCE

Tier #2

Chafee
Grassley*
Hatch
Jeffords
Mack

LABOR & HR

Tier #3

Frist
DeWine
Warner
Coats (retiring)/Collins

* Senators up for reelection in 1998

HIGHER ED. GROUPS

Tier # 1

ACE

Tier #2

NAICU
AASCU
AACC
NASULGC
AAU

Tier #3

NASFAA
USSA

HOUSE DEMOCRATS

Tier #1

Gephardt
Rangel
Clay

ED. & THE WORKFORCE

Tier #2

Miller
Kildee

Tier #3

Andrews
Roemer
Scott

WAYS & MEANS

Tier #2

Stark
Matsui
Kennedy
Levin

Tier #3

Cardin
Lewis
Neal

REPUBLICANS

Tier #1

Gingrich
Archer
Goodling

ED & the WORKFORCE

Tier #2

Petri
McKeon
Roukema
Castle
Riggs

WAYS & MEANS

Tier #2

Shaw
Johnson
Dunn

Tier #3

Houghton

Kidscape
- Look @ as 1 MA @ dual credit?
- No dedic prom
- lifelong learning -

Karl & Mark

Range
- add a targeted group...
- all through-pub schools
- WOTC
- LOTS of schools

1.

2. Bonds - school const'n
- Bonds (comm bonds) / loose
- mech. a sc.

$5-6 billion for others...

3. $30 billion for
- Dean
- all kids and
- best - long prob. - all will claim no
be indep.
on se fem. aid. distinguish
of dep.
- more are diff...
- double dipping...

* Cooperative Ed'n was a targeted group...
'95 fully for. Ed.

*10:30 –

Clay

- Larry → Bob Graham – enrollment responses

☐ fax

Fordax
– Clontas. notes

– Mark Moran

- 'Kid save'
  Breaux, Lieb, Kerrey
  - should we embrace ??
  - carrying child credit into a IRA in name of child... age 18 – go back for edn...

- Rangel's bill – how to move

- WPFC – day – host dinner...

- refundability

Comparison Of Senate, Clinton Student Aid Tax Proposals

	Senate Republicans	Senate Democrats	President Clinton
Student loan interest deductions	Would limit deduction to a maximum of $2,500 annually. Limited to individuals making $65,000 or less or joint filers making $85,000 or less.	Would place annual limit on deduction. Limited to individuals making $70,000 or less or joint filers making $100,000 or less.	
$1,500 tax credit for first two years of postsecondary education (Hope Scholarship)		Students would need a 'B' average in high school and have to remain drug-free. Would apply to individuals making $70,000 or less and joint filers making $100,000 or less.	Students would need a 'B' average in the first year of college and no drug-related convictions to receive the credit. Would apply to individuals making $70,000 or less or joint filers making $90,000 or less.
$10,000 deduction for postsecondary expenses		Would allow individuals making $70,000 or less or joint filers making $100,000 or less to deduct up to $10,000 annually.	Would allow individuals making $70,000 or less or joint filers making $90,000 or less to deduct up to $10,000.
Education savings accounts	Each Bob Dole Education Investment Account would allow a family to save up to $1,000 annually, tax-free.		Proposes more flexible Individual Retirement Accounts that could be used for education expenses.
Pre-paid tuition	Would make spending from state pre-paid tuition plans tax-exempt.		
Work-Study	Would make earnings from Work-Study jobs tax-exempt for students.		
Employer-provided tuition	Would permanently extend Section 127 of the federal tax code, allowing students to receive up to $5,250 in education costs paid by an employer tax-free.		

+ [illegible]

5/20/97

Kool

- Allocable credits

- D.C. experience
Dangerous direction for
new policy

- Generic bonds - more placable.
Credit Score-Cole - loved expert, along w/
× Doly Livingston

$35 [illegible]

Sec. 127 [illegible]

$30
5 [illegible]

where is Prez?

Hope $1200 or $1000

suburbans

$10,000 tuition deducting

- Prez - Planned scope then...

Senate Finance Com [illegible]

Options

$1000 HOPE - No [illegible] - Drop fell offset

$5000 deduction

* Thus savings

May 20, 1997

MEMORANDUM FOR GENE SPERLING

FROM: Bob Shireman
SUBJECT: HOPE Options for this afternoon's meeting

I expect that the Education Department will present the following option, which, based on the previous cost estimates, would probably meet the "roughly $35 billion" test (JCT might cost it a little higher, so this depends on the results of the JCT and Treasury effort to work together):

--No B- requirement, *but in order to get the second $1500 credit, the recipient would have to have finished the first full academic year* (this would reduce the cost of eliminating the grade requirement to something less than the estimated $2.2 billion).

--No Pell offset (cost $3 billion).

--Limit the value of the deduction to 15% of the tuition and fees paid (saves $4 billion).

Considerations:

--Limiting the second-year credit to those who finish the first year is intended to encourage full-time attendance. It will make the credit less valuable for "lifelong learning," although it may help to push them toward completion of the first and second year.

--Eliminating the Pell offset will create a class of people who do not have tax liabilities but who are eligible for the credit, creating an argument for refundability. However, this moves in a progressive direction and may be enough to satisfy critics concerned about low-income students.

Timing

After tomorrow, Secretary Riley is out of town, and after Thursday, Congress is gone. **So if we are going to get buy-in from Democrats on the Hill, we need to move very rapidly**. If we agree on a package today, there should be Riley/Rubin meetings tomorrow with:

Daschle	Gephardt
Kennedy	Rangel
Moynihan	Clay

and a Riley call to Stan Ikenberry at ACE.

May 20, 1997

NOTE TO: MIKE SMITH AND DAVID LONGANECKER

FROM: MAUREEN MCLAUGHLIN Maureen

As you requested, this note examines options to change the HOPE scholarship tax credit and the deduction to address Congressional and community concerns and to lower costs slightly.

Estimated Cost of Current Proposals

The HOPE scholarship tax credit and $10,000 deduction are estimated to cost $36.2 billion over five years -- $1.2 billion more than $35 billion included in the President's budget agreement with Congress. Sec. 127 and the 10 percent small business credit cost $2.4 billion and tax-free loan forgiveness equals $15 million. Education specific estimates for the IRA are not available but the entire IRA is estimated to cost $5.5 billion over the five-year period.

Options for the Credit and Deduction

This section discusses several possible changes to the credit and deduction.

- **Removing the B minus requirement** would increase costs by $2.2 billion over five years. This grade requirement, which is not included in the Rangel bill (HR 1512), has been a lightning rod for the proposal ever since the President first announced it. Critics have opposed it on grounds of fairness, grade inflation and IRS intrusion into academic affairs at colleges and universities. The real question is whether--or what--we suggest as a substitute for the grade requirement to emphasize academic performance.

  - Many have suggested the satisfactory progress requirements used in the student aid programs as a replacement. Because these requirements have no teeth, using satisfactory progress would have no real effect and would not encourage or reward high academic achievement.

  - Requiring students to finish the first year of postsecondary education before receiving the second year of the credit could replace the grade requirement. This would encourage completion of the first year, which increases the likelihood that students will go on to complete their education, something we want to encourage. It would make the tax form somewhat more complicated, however.

- **Eliminating the HOPE offset for federal grants--mostly Pell grants**--would increase costs by $3 billion over five years. Offsetting HOPE with 50 percent of Pell Grants instead of 100 percent would cost $930 million more than the current proposal. Reducing the Pell Grant offset would increase the amount of aid going to lower-income families and thereby address equity concerns raised by many. The Rangel bill eliminates the entire offset for federal grants.

Since the options discussed above increase significantly the costs of the credit, we need to look at additional options that reduce costs in order to stay within the $35 billion total included in the budget agreement. These options can focus on either the credit, the deduction, or both.

- o **Limiting the deduction for higher income families** would reduce costs and address concerns that higher-income families are benefiting more than lower-income families. Currently higher-income families receive a $2,800 benefit for a $10,000 deduction while lower-income families with the same deduction receive a $1,500 tax benefit. Congressman Rangel replaced the deduction with a credit for four years of education--$1500 for the first two years and $1,000 for the next two years (cost estimates for Rangel's bill are unavailable). Several options are available:

  - -- **Replace the deduction with a 15 percent credit,** which is estimated to reduce costs by $4 billion over five years. This option--which would provide a credit of 15 percent of tuition up to $10,000--would limit the value of the credit to $1,500 for all income levels. It would maintain tuition sensitivity, which NAICU should like, and would address concerns of tuition inflation since tuition would not be reflected on a dollar-for-dollar basis. This also puts the maximum value ($1500) on an equal footing. If for all students we want to keep the use of a "deduction" for education after the first two years, we could construct the deduction in such a way that it was equivalent to a 15 percent credit. It would be somewhat more complicated to explain, however, and the tax form would be slightly more complicated.

  - -- **Replace the deduction with a 20 percent credit,** which costs $170 million more than current estimates. This option is basically a wash in terms of overall costs.

  - -- **Continue the current deduction proposal but limit the value of the deduction to $1500** rather than the current effective limit of $2800. We do not have cost estimates but know that this option would save less than the 15 percent credit discussed above. It is likely to be more complicated to implement than the 15 percent credit but it does maintain the deduction, which some in the community want.

- o **Lowering the income caps for eligibility for the credit and the deduction** would lower costs and address equity concerns raised by some critics. We do not have cost estimates on these options but the income caps would have to be reduced significantly to save large amounts of money. Depending on how much the caps were reduced, the larger values of the deduction for higher income families would continue.

o **Reducing the maximum tax credit to $1,200** is another way to reduce costs--$2.8 billion over five years. I personally recommend against this because the $1500 is tied to the average community college tuition (and required fees), which strongly supports the universal access message.

Treasury has also estimated the effects of one package: offset HOPE by 50 percent of federal grants; replace the deduction with a 15 percent credit; and eliminate the B minus requirement. This package would reduce the costs of the credit and deduction to $35.4 billion over five years. This package would move towards Congressman Rangel's proposal by eliminating the grade requirement, offsetting the credit by half of federal grants, and moving away from the higher limits on the deduction for higher income students. Congressman Rangel's proposal includes a refundable tax credit with the college or univesity paying the refundable portion to students in the same way grants are provided to students. We see many problems associated with refundability and this mechanism of institutional payments. We should stress, instead, the need to increase Pell Grants for the neediest students as a much simpler and straightforward mechanism for helping the neediest students.

Senator Breaux has proposed Kid Save, a proposal to combine savings and education incentives and a child credit. This idea, which is very interesting, would transform the child credit into a retirement savings account similar to an IRA, except that children would be allowed to take a long-term loan against half of the accumulated balance for higher education. White House staff are interested in exploring this in the context of the child credit, not as a substitute to the credit or deduction.

All cost estimates discussed here come from Treasury. I assume, however, that the binding cost estimates for the budget resolution--and subsequent legislation--will be JTC's estimates. According to Treasury, JTC's estimates of the President's credit and deduction were similar to the Administration's estimates but the breakdown between the credit and deduction were quite different, with JTC estimating less than a third of the costs attached to the deduction rather than the 50-50 split estimated by Treasury.

Gene: TIMING

Process: Tier 1

Barello
Kelly
Maya

Ralph
Marzel
Clax

Tier 2

Breaux
Conrad
Graham

Todd
Harlan
Reed

Kimmel

LHR

then Rosenberg..

- Poll ?

- What's on our RE/EC ?

S. A. Noe

02/06/97 05:33:13 PM

Record Type: Record

To: Robert M. Shireman/OMB/EOP, Patricia A. Smith/OMB/EOP

cc: Timothy A. Rosado/OMB/EOP, Leslie S. Mustain/OMB/EOP

Subject:

Below is a table of estimated costs of S.1 (Republican's higher education tax proposal called "Affordable College Act"). These estimates are done by Joint Committee on Taxation. (Treasury's estimates of these proposals will be available soon.) I have 10-year cost estimates for these proposals. Let me know if you want that information, too.

Once I receive cost estimates of Democrat tax proposals, I'll share with you.

--

		Fiscal Years 1997-2002							
Proposal	Effective	1997	1998	1999	2000	2001	2002	**Total**	
1. Dole Ed Savings Acct	12/31/96	-0.1	-0.2	-0.3	-0.4	-0.4	-0.4	-1.8	
2. Perm. extension of section 127	12/31/96	-0.2	-0.4	-0.7	-0.7	-0.7	-0.8	-3.5	
3. Pre-Paid Tuition	12/31/96	(*)	-0.1	-0.1	-0.1	-0.1	-0.1	-0.6	
4. Student Loan Interest	12/31/96	(*)	-0.1	-0.1	-0.1	-0.2	-0.2	-0.7	
5. Work-Study	12/31/96	(*)	-0.1	-0.1	-0.1	-0.1	-0.1	-0.4	
		Total	-0.3	-0.9	-1.3	-1.4	-1.5	-1.6	-7.0

Note: Details may not add to total due to rounding.
(*) Loss of less than $50 million

----

1. Dole Education Savings Account --Permit $1,000 per-year non-deductible contribution to an education investment account for a child under the age of 19.

2. Permanent extension of section 127 -- Extend permanently employer-provided educational assistance for graduate (effective 6/30/96) and undergraduates.

3. Pre-paid tuition -- Allow tax-free withdrawls from qualified State-sponsored tuition programs.

4. Student loan Interest -- Allow student loan interest deduction up to $2,500 (above-the-line deduction); phase out $45,000-$65,000 singles/$65,000-$85,000 joint filers.

5. Work-Study -- Make earnings form Federal Work-Study jobs tax exempt for students.

The Secretary of the Treasury and the Secretary of Education, operating in close consultation, will have authority to issue regulations to implement the provisions. The Secretary of the Treasury generally would be authorized to issue regulations to implement this section of the Internal Revenue Code. For example, the Secretary of the Treasury would have authority to issue regulations providing appropriate rules for recordkeeping and information reporting. These regulations would address the information reports institutions of higher education would file to assist students and the IRS in determining whether a student meets the eligibility requirements for the credit and calculating the amount of the credit that is potentially available. However, certain terms would be defined by reference to the Higher Education Act of 1965. The Secretary of Education would have the authority to issue regulations under those provisions as well as authority to define other education terms as necessary. The Secretary of the Treasury and the Secretary of Education would coordinate their work in developing their respective regulations.

Exec Sec to Staff

JOHN BREAUX
LOUISIANA

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CHIEF DEPUTY WHIP

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May 9, 1997

Mr. Lawrence H. Summers
Deputy Secretary of the Treasury
1500 Pennsylvania Ave. NW
Washington, DC 20220

Dear Larry:

Based on your discussions with Senator Breaux earlier this week, we are sending you more detailed information about the KidSave proposal. This proposal, originally conceived by Senators Kerrey and Lieberman, would combine many of the key elements the budget negotiators have identified as being integral to a tax package, namely savings and education incentives and a child credit. A variation was also included in the Centrist Coalition budget proposal last year and has widespread support in the Senate.

KidSave would transform the child credit into a long-term retirement savings account similar to an IRA, with one exception: children would be allowed to take a long-term loan against 1/2 of the accumulated balance for their higher education. The beauty of this proposal is that while assets are being accumulated to provide for a child's education and retirement, those assets are also making an important contribution to the U.S. economy by creating a pool of savings available for investment.

Thanks to the wonders of compound interest, $500 a year set aside from birth to age 18 would, at ten percent interest per year, grow to $1.3 million by the time the child reached age 59 1/2, the age at which IRA funds can start to be withdrawn with no penalty. At age 18, the $500 per year investment would be worth over $25,000.

By our calculations, the maximum amount that would be made available for a student's four years of college under the Administration's proposals would be $11,200 (four years of $10,000 deductions for a student from a family in the 28 percent tax bracket). A child whose parents had fully participated in KidSave from ages 0-18 would have over $12,500 available for their education, or more if the limitation on the amount that could be borrowed was lifted. There are other moving parts in this proposal, as well, such as family income limits, the cash back amount of the credit, and the element of refundability which could be adjusted to fit within revenue constraints or to better direct the benefit or define the policy.

KidSave, unlike the other proposals on the table, gives our children a tangible financial head start for the rest of their lives and increases our national savings rate while providing an additional means of financing higher education. We would welcome the opportunity to sit down with you to explore this idea further.

Sincerely,

John B. Breaux

J. Robert Kerrey

Joseph I. Lieberman

EXECUTIVE OFFICE OF THE PRESIDENT
COUNCIL OF ECONOMIC ADVISERS
WASHINGTON, D.C. 20500

November 20, 1995

cc: J. Stiglitz
M. Jolin
M. Baily
L. Sheiner
T. Kane

MEMORANDUM FOR ERIC J. TODER
DEPUTY ASSISTANT SECRETARY (TAX ANALYSIS)
DEPARTMENT OF THE TREASURY

FROM: ALICIA H. MUNNELL

SUBJECT: Kidsave Proposal

Senator Lieberman recently sent a letter to the President detailing his "Kidsave" proposal. The President seemed interested in the possibility of "Kidsave" being introduced into the upcoming reconciliation debate. Laura Tyson asked that we develop some variations on Senator Lieberman's proposal and then work with Treasury to cost them out and, perhaps, come up with desirable modifications. This memo is our attempt at the first task--developing some basic alternatives. We would like to meet with you and your staff to actively engage in the second and third tasks--costing out these alternatives and developing more promising ones. Please call me at 395-5036 or Mark Mazur at 395-5147 if you have any questions.

1. **Basic Kidsave:** This proposal would substitute for both the child tax credit and the President's proposed tuition tax deduction. For taxpayers with children, the proposal offers a $500 refundable tax credit for each child under age 18 that would be deposited into a special IRA-type account. The account would be in the child's name and would be treated like a "back-loaded" IRA, so that qualified withdrawals would not be included in the taxpayer's gross income. Qualified withdrawals include college expenses (defined broadly, as in the proposed tuition tax deduction). Funds remaining in the account at age 59-1/2 could be withdrawn without penalty and income tax.

If a taxpayer deposits $500 each year for 18 years into the "Kidsave account," the balance would likely grow large enough to approximately cover 4 years of tuition at a public university. In addition, the proposal would provide substantial college help even for children now entering high school.

The proposal should use the simple concept of "qualified child" as defined in the earned income credit (basically a child living with the taxpayer, without regard to support) to determine eligibility for the credit. Otherwise, some children may not receive the benefit of Kidsave.

2. **Kidsave with a Government Match:** This proposal offers a $400 refundable tax credit per child for each child under age 18. If the entire $400 is deposited into a special IRA-type account (a "Kidsave Account"), the Federal Government matches the contribution with an additional $100 (again, through a refundable tax credit). As in the basic Kidsave proposal, the account would be in the child's name and would be treated like a "back-loaded" IRA (with the educational expense withdrawal and age 59-1/2 provisions).

3. **Kidsave with Hardship Borrowing:** Add to the Basic Kidsave proposal the ability for the taxpayer (e.g., parent) to borrow against the Kidsave Account balance in the event of financial hardship. The borrowing must carry a reasonable interest rate and must be repaid within a reasonable time period.

4. **Kidsave for High-schoolers:** The proposal offers a $500 refundable tax credit for each child over age 13 and under age 18 that would be deposited into a special IRA-type account. As in the basic Kidsave proposal, the account would be in the child's name and would be treated like a "back-loaded" IRA (with the educational expense withdrawal and age 59-1/2 provisions). (This proposal is intended to substitute for the proposed tuition tax deduction, not the child-based tax credit.)

5. **Kidsave for High-schoolers plus Graduation Bonus:** Same as Alternative 4 (Kidsave for High-schoolers) but with an additional $1,000 refundable tax credit when the child graduates from high school. All monies would be deposited into the Kidsave Account, which would be treated like a "back-loaded" IRA (with the educational expense withdrawal and age 59-1/2 provisions).

002

United States Senate

WASHINGTON, DC 20510-0703

OFFICIAL BUSINESS

THE PRESIDENT HAS SEEN
11-10-95

U.S.S.

Leon/Laura
This is very good. I think gives us some options that are substantively appealing
B

The Honorable William J. Clinton
President of the United States
1600 Pennsylvania Avenue, NW
Washington, DC

Translation

Leon / Laura
This is very good. I think
it gives us some options that
are substantively appealing.
B.

11/10/95 15:35

JOSEPH I. LIEBERMAN
CONNECTICUT

COMMITTEES:
ARMED SERVICES
ENVIRONMENT AND PUBLIC WORKS
GOVERNMENTAL AFFAIRS
SMALL BUSINESS

THE PRESIDENT HAS SEEN
11-10-95

United States Senate

WASHINGTON, DC 20510

SENATE OFFICE BUILDING
WASHINGTON, DC 20510
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ONE COMMERCIAL PLAZA
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TOLL FREE: 1-800-225-5605

November 9, 1995

The Honorable William J. Clinton
President of the United States
1600 Pennsylvania Avenue, N.W.
Washington, D.C.

PERSONAL AND CONFIDENTIAL

Dear Mr. President:

The pending budget reconciliation legislation may present an opportunity, in the "end game" stage, for moderate Democrats to alter the tone and substance of the budget debate in a positive way. In particular, it may present you an opportunity to put your stamp on this legislation, and take credit for some new important provisions. These provisions could, in turn, make the bill more palatable to Democrats, and help encourage some in our party to accept the legislation.

From the perspective of most moderates in Congress, the outlines of a compromise seem fairly clear: a softening of the cuts in Medicare, Medicaid, student loans and the EITC, combined with a CPI adjustment and a reduced but still significant tax cut package (including capital gains and a middle-class credit). Obviously, many, and probably most, Democrats still will be reluctant to vote for such a package. A key question is whether you could negotiate some "enhancements" that could significantly improve the package and make it more acceptable to the party.

Below are three initiatives I have been involved in that I believe could be of use to you. I hope you will consider actively supporting them. I believe these "enhancements" would not only improve the package but would find signficant Republican support as well.

Enterprise Zones: I understand from Pat Griffin that you are considering a new enterprise zone initiative at the time of your State of the Union address. Allow me to suggest a modification of that timetable. I understand that the Republicans are working on an urban enterprise initiative for the beginning of January as a major part of their new legislative agenda for next year. Since your proposal would be announced a number of weeks later, their proposal could diminish the freshness of your own.. In addition, the big tax legislation is scheduled for this year, with no tax bill next year, so funding is available for an initiative now, and is unlikely to available later. Put simply, we have money on the table now, and nothing in 1996. It seems to me you could take advantage of this situation. You could insist on an enterprise zone tax provision in the budget reconciliation negotiations, using, say, $5 billion of the huge tax numbers under consideration, and get credit for having achieved something very significant for the economic recovery of our cities; you could also use this provision to help bring around Democrats. You could still go with an additional initiative in January, building on what you may be able to achieve in the budget bill now.

I've been working with Senator Spencer Abraham on an enhanced enterprise community bill, S. 1252. Building on the enterprise community and empowerment zone initiative you helped finally get off the ground in 1993, we are working to provide additional tax and housing incentives to the approximately 100 areas already designated by your Administration as enterprise communities, but which (unlike the nine empowerment zones) received minimal financial benefits. Joining us as cosponsors of this bill are Senators Moseley-Braun, Breaux, DeWine, Santorum and Frist. We have strong bipartisan support from the left and right wings of both parties. The mayors also have been giving us a lot of support and help.

Jack Kemp observed a few weeks back at a hearing on S. 1252, "absent in all of the talk about the budget legislation has been one important word: 'jobs.'" As he put it, "The real train wreck is what those 400,000 men were saying on the Mall a few days ago: that there are not enough jobs in America. We are not creating enough opportunities for people to become entrepreneurs, to become owners, to become homeowners, to become business owners. To get jobs not only as truck drivers, but someday to own the truck and maybe start a little trucking company." I know that you strongly believe we ought to be doing more to help economically distressed urban and rural areas in this country. You've made a good start by identifying a number of those areas as enterprise communities and empowerment zones. Now, I think you could use the opportunity of this tax bill to do more. I'd like to help in that effort to build on the work we started in 1993, sooner rather than later. I think there is strong Republican support that could help get this done, if you propose it.

<u>Savings/Investment Initiative ("Kidsave"):</u> I'd also ask that you take a look at "KidSave," a proposal I've been working on with Senator Bob Kerrey, to transform the $500 middle-class tax credit being considered by the Conrgess into a long-term retirement savings account. KidSave allows parents to set aside an annual $500 credit in an IRA in their child's name. The tax-deferred account would be governed by IRA rules with one exception: children would be allowed to take a ten year loan against this money for their higher education. Thanks to the wonders of compound interest, $500 a year set aside from birth to age 18 would, at ten percent interest a year, grow to $1.3 million by the time the child reached age 59½, the age at which IRA funds can start to be withdrawn with no penalty. To paraphrase Huey Long, you could make every kid a king. More important, this proposal would transform what is yet another consumption-oriented entitlement program, into a long term savings and investment vehicle. In a comparatively short time it would become the largest savings pool in the world. Given our disasterously low national savings rate, it could become a critical investment in our future.

Good

Like you, I believe that one of the greatest challenges we face is how to create economic opportunity and wealth for the working families of this country. We both understand that Congress is divided between those who would like to cut taxes for middle-class families now and those who would prefer to balance the budget first. I believe that KidSave can bridge that divide because it is a better kind of tax cut, one that helps us address the nation's savings and investment crisis even as it provides tax relief. It achieves the same economic goal as balancing the budget: promoting savings. And best of all, unlike any other proposal, KidSave gives our children a tangible, financial head start on the rest of their lives.

I also understand that political realities may be such that Kidsave would have to be offered as an option to a $500 credit for parents. If that were the case, I would suggest that parents who opt to save for their children's future through KidSave be offered a "sweeter" incentive to do so, say $650 or $700. As I understand it, Laura Tyson and her staff are looking closely at this proposal and believe this proposal could be economically important. Both the Concord Coalition and the AARP have endorsed it - practically the first time they have agreed on anything. It could be a major new initiative that you could take credit for in the "end game" that would be very attractive to the middle class, and acceptable to most Republicans (both Roth and Domenici are likely supporters).

<u>Capital Gains:</u> Obviously, our party is going to have difficulty swallowing a capital gains tax cut. However, as you know, I have long supported such a cut and I'm delighted that you have left the door open on this issue. First, I believe that the Republicans will have to have a broad-based capital gains provision for a compromise to be accepted by their party. Second, I believe the additional "targeted" feature in the Senate capital gains version could give you a sound reason for accepting a broad capital gains provision. The targeted feature in the Senate bill is modelled on the provisions you advocated in your 1993 legislation, providing an additional capital gains cut for investors who are willing to invest in riskier new issues of small business stock. You are strongly identified with a targeted capital gains cut and I think you can rightly claim this provision as your own. As you know, IRS regulations blocked the full implementation of your provision; the Senate targeted provision corrects these problems. I believe the Republicans, led by Sen. Hatch, would support you if you insisted on this provision. While I can't promise you that a broad based capital gains tax would ever be embraced by most of our party, the targeted feature may help make a capital gains provision more acceptable since there have been numerous Democratic supporters of this approach in both Houses of Congress.

In spite of all of the talk of class warfare, I know you recognize that a capital gains cut is distinct from a cut in income taxes: we are not cutting income taxes for the wealthy, we are cutting the rate at which we tax people who are willing to invest their money in places where that investment has benefits for our overall economy. Additionally, it bears repeating that anyone with money in a mutual fund or with a stock purchase plan at their workplace has a stake in the capital gains debate. In 1994 alone, at least 310 large companies with over 8 million workers offered all of their employees the right to acquire company stock. Each of these workers and their spouses and their children stand to gain from a cut in the capital gains rate.

I believe that all three of these proposals are very much in keeping with your idea of encouraging citizens to act in the public interest as well as their own interest, through incentives, rather than through new and often duplicative social programs. I think these three "enhancements" could be helpful in generating support in our party for a compromise that you are going to have to engineer. If you are interested, would be delighted to talk to you or your staff about them further as the process moves forward, if you are interested.

Sincerely,

Joseph I. Lieberman

with every good wish

MAZUR_M @ A1
04/28/97 02:52:00 PM

Record Type: Record

To: Robert M. Shireman

cc:
Subject: RE: IRAs

Bob,
Senator Lieberman had a proposal called "Kidsave" where a taxpayer got a tax credit for each kid (I think it was $500 per kid) and then would put the money into a tax-favored account to pay for college (or if the child did not go to college or need the money, it could be rolled into an IRA). The idea was that a substantial sum could be accumulated over 18 years to pay for college and if the money went into an IRA, it could eventually grow to a large sum (e.g., Lieberman used to claim $1 million).

We at CEA thought this was a good idea (better than the tuition tax deduction/credit). You will note that it is very similar to the Dole Account proposal. (What does this say about CEA's politics?) I am not sure about the revenue cost, but probably can dig up some estimates of the Lieberman proposal.

I think people can set up their own accounts along these lines by using the proposed $500 per child tax credit and the IRA proposals with penalty-free withdrawals for education to achieve the same result (though in a less-elegant fashion).

My inclination would be to resurrect the Lieberman "Kidsave" idea and see if it has any appeal in this context. (Are you talking about replacing the proposed education tax subsidies with this?) A second-best approach would be to advertise the "self-help" nature of the President's education tax incentive and IRA proposals to permit tax-free saving for education.

Please call me at x55147 if you want to discuss this further.
mark

Plan 1

- Add → Credit / $8000
- credit @ $1200
- Amp B -

- No credit.
- No B -

- reduce $1200
- No offset / 80%

April 24, 1997

MEMORANDUM FOR GENE SPERLING

FROM: BOB SHIREMAN

RE: HOPE Scholarships and the Higher Education Tax Deduction

As you know, Treasury's estimate of the revenue loss from the higher education tax proposals is $36.2 billion, with roughly half the cost associated with each proposal (the credit cost $18.6 and the deduction cost $17.6). The Joint Committee on Taxation estimated the revenue loss of the two proposals at a total of $40.6 billion -- but the most dramatic difference is the split: the HOPE tax credit cost $28.9 billion while the deduction cost $11.6. Given that the JTC's estimates will likely be used for any budget agreement, this changes the dynamics of some of the options.

Treasury hopes to be able to get JTC to estimate **one** package over the next few days, and would like your input on what that would be. Unfortunately, the options are painful. Here are some ideas:

Cutting costs: If our aim is to reduce the JTC-estimated costs by $10 billion while making the package more progressive, then it is probably necessary to drop the deduction altogether. Doing that alone would probably bring the costs to about $30 billion.

Grade requirement: If we then want to eliminate the grade requirement, then we need to find a way to reduce the cost of the credit by roughly an equal amount. Under Treasury estimates, the reduction of the credit to $1200 ($2.8 billion savings) would more than cover eliminating the B- requirement ($2.2 billion cost).

Package 1: This results in one possible package for JTC to cost out: Eliminate the deduction, reduce the credit to $1200, and eliminate the B- grade requirement.

Pell offset: With Package 1, some will still criticize the credit for defining out the low-income population by offsetting the credit for every dollar of a Federal grant. Under Treasury estimates, eliminating this offset would cost $3 billion (while reducing it in half would cost $0.9 billion). To offset this, we would probably need to reduce the credit even further, to $1000.

Package 2: Eliminate the deduction, reduce the credit to $1000, eliminate the B- grade requirement, and eliminate the offset of Pell.

A $1500, 50% credit: Instead of reducing the size of the credit, one other way to reduce the cost of the credit is to apply the credit to 50% of a student's net tuition costs. This would help to address tuition inflation arguments, because students would always pay 50% of any tuition increase. On the other hand, this would not provide universal access to community college, and would tend to shift the subsidy to somewhat higher tuition institutions. I could explore with Treasury whether this might reduce the costs of the credit enough to address the grade requirement and Pell offset.

Package 3: Eliminate the deduction, change HOPE to a $1500 50% credit against tuition, eliminate the B-grade requirement, and eliminate the offset of Pell.

There are other directions we could go. For example, we could eliminate the credit and turn the deduction into a 20% credit. That would give us a "tax credit," while preserving the lifelong learning aspects of the current deduction.

Let me know what you would like me to pursue with Treasury.

JTC HOPE $ 28,933

deduction 11,614

Robert M. Shireman
04/22/97 10:34:13 PM

Record Type: Record

To: Gene B. Sperling/OPD/EOP

cc: Russell W. Horwitz/OPD/EOP, Melissa Green/OPD/EOP
Subject: HOPE Options

The higher education tax credit and deduction cost $36.2 billion. Below are estimates of the cost of changes that we discussed with Treasury and OMB:

- Package: (1) Offset Pell Grants by 50%, (2) replace the deduction with a 15% credit, and (3) eliminate the B- grade requirement: costs $755 million **less**.
- Offset HOPE by 50% of Pell Grants: costs $930 million more.
- Eliminate Pell offset of HOPE: costs $2,997 million more.
- Reduce tax credit to $1200: costs $2,771 million **less**.
- 15% credit replaces deduction: costs 4,041 million less.
- 20% credit replaces deduction: costs $169 million more (basically a wash)
- No B- requirement: costs $2,228 million more.

The estimates above are *not* additive, due to interactions.

– Ded. $5K 1.8

– Elimination deduction 16.887 $ 13.214

– No B- $2,228

PM priority

- air 5 -
- air [illegible]
- [illegible]

10% of ? $2000 [illegible] ?

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.

Issues: --Maximum available only to those at the highest-cost institutions (same as is true with the deduction).

4. Offset Pell Grant by only 50 cents on the dollar

$2.2 billion increase (neutral if combined with a $5,000 indexed deduction)

Justification: --Provide more assistance to lower-income families

Issues: --Some families will not benefit because the credit is not refundable.
--Still need to provide data on Federal grant aid in order to reduce allowable credit.

5. No offset of Pell Grants (and other Federal grant aid) this is now a viable option

– New estimate is $3 billion + —

~~$6.6~~ billion (neutral if combined with a $3,000 deduction)

Justification: --Provide more assistance to lower-income families.
--Reduce amount of data needed for determining credit amount on tax forms.

Issues: --Some families will not benefit because the credit is not refundable.

4/18/97

Tempt

Preferred Careers

- B
- Pell offset / red. / elim.

- Ded. - lower
- 15%

~~What~~ tuition ↑ / $ 1 credit

Savers : No deduction - Benefits higher income families...
or
less

~~Disc~~

Discretionary

PROTECT PELL FUNDS

(Perhaps do increase but wait on ind. student $)

~~to $300~~

- Interest deduction : capped at $4-5,000, ~~lasts~~ 8 yr.
- process graduated. ? ?

Robert M. Shireman
04/21/97 01:05:23 AM

Record Type: Record

To: S. A. Noe/OMB/EOP

cc:
Subject: Cost estimates

I wasn't finished

---------------------- Forwarded by Robert M. Shireman/OPD/EOP on 04/21/97 01:11 AM ---------------------------

Robert M. Shireman
04/21/97 01:03:43 AM

Record Type: Record

To: S. A. Noe/OMB/EOP

cc:
Subject: Cost estimates

"Cocktail": 50% Pell offset, 15% credit replaces deduction, and no B---costs $755 million less

50% Pell offset in HOPE: costs $930 million

Eliminate Pell offset of HOPE: $2,997 million ~~[illegible]~~

Reduce tax credit to $1200: ~~$2,771 million~~ $2,087

15% credit replaces deduction: 4,041 million

20% credit replaces deduction: costs $169 million more (basically a wash)

No B- requirement: costs 2,228 million

Karl

① [illegible] - [illegible] - this weekend

[illegible] #

Geithner - ½ offset

15% credit

No B -

758 million

235.4

[illegible] - ½ offset -

930 million

$3 billion

(2.977)

~~[illegible]~~ $1200 credit

~~$~~ 2.771

15% credit

- 44,041

20% credit

- 169 million — aasli

No B-

- $2.228 billion

4/16/97

Flanagan

Advocates always regressive

-Credit - ~~con take~~ → $2800 credit

- not dollar for dollar match on tuition.

- not offset Pell, or more years of school

-Concerned about 2 yrs then working...

" " emphasis on training

-backing out of graduate then baccalaureate ...

Registration

HOPE Options 4/8/97

Grade req't -

Drop Grade req't

1 * - Lower to 5K - 1.8

- Elim. ded. - 13.3

+ no B-

4 * - 50% Pell offset + 2.2 Scbr. [illegible] ??

- No offset + 6.6

7 * - 15% credit - + 4 - [illegible] will resist...

Elim. Deduction

Issues: Lifelong Learning

GH

- Reducing credit - okay ([illegible])

- 20% credit - that's what Gore supported... Treasury + NEC opinion...

up to $10K - family benefit...

→ Menu of progressivity options

(38)

1 - 1-4-7

2 20% credit

3 reducing credit $1500 → 1200

4 - Dump B - SAP

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:

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$1.8 billion reduction

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$13.3 billion net reduction

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--Grade requirement is part of a "responsibility" and "work hard" message.

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

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$4 billion reduction

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Issues: --Maximum available only to those at the highest-cost institutions (same as is true with the deduction).

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$2.2 billion increase (neutral if combined with a $5,000 indexed deduction)

Justification: --Provide more assistance to lower-income families

Issues: --Some families will not benefit because the credit is not refundable.
--Still need to provide data on Federal grant aid in order to reduce allowable credit.

5. No offset of Pell Grants (and other Federal grant aid) — this is now a viable option

— New estimate is $3 billion + —
~~$6.6~~ billion (neutral if combined with a $3,000 deduction)

Justification: --Provide more assistance to lower-income families.
--Reduce amount of data needed for determining credit amount on tax forms.

Issues: --Some families will not benefit because the credit is not refundable.

Other ideas which you may want to consider:

A. Cover half of tuition expenses, rather than all tuition expenses up to the maximum credit/deduction

Reduced cost (not estimated by Treasury)

Justification: --Mitigates pressure for tuition increases, because students would always pay at least half of the increase.

Issues: --Credit would no longer "cover tuition and fees at a typical community college".

B. Package: Eliminate deduction, no B- requirement, no offset of Pell.

Justification and Issues: see individual pieces, above.

C. Package: Same as B but add that the credit is available for *any* two years of postsecondary education (not just first two years). This is the package being considered by the student groups.

Justification: --Benefit would be available even to people who have already completed or had some college (balances the elimination of the deduction).

Issues: Cost is probably high.

D. Package: Same as B, but also allow the credit for part-time and non-degree/certificate students.

Justification: --Provides the "lifelong learning" benefit that the deduction would have allowed (and provides a better benefit because it's a credit).

Issues: --Would need to re-open issue of providing a smaller maximum credit for students who are not full time. (Otherwise, someone could lose their eligibility for any further credit while using very little of it).
--"Lifelong learning" credit would be available only for those without two years in college. The deduction currently allows it for anyone with any level of education.

E. Apply the credit to "cost of attendance" rather than tuition and required fees (while eliminating the deduction, and no B- or Pell offset in the credit).

Justification: --Simplifies the credit so that it is more like the child tax credit: If you or a dependent are in college on at least a half-time basis, you get the credit.
--Significantly reduces administrative burdens: IRS would only need to confirm enrollment, since cost-of-attendance would always exceed $1,500.
--Minimizes potential for tuition inflation because credit is uncoupled from the tuition figure.

Issues: --Treasury has not supported benefits that apply to "living expenses," which are included in cost of attendance.
--May create incentive to enroll in low-cost colleges in order to get amount by which the credit exceeds the tuition. (Though the opportunity costs of doing so would likely rule it out for most people).
--Cost is probably high -- probably would need to be combined with a reduction in the credit amount.

F. Lower the income phase-outs (currently at $80-$100,000 for joint filers).

Justification: --Some have criticized the availability of the tax benefits to families making $90,000.

Issues: --IRA proposals also use the same income phase-out levels.

- Cathy & Bruce — eager to expand
ed'n community meetings ...

- Obey — pushing for dist'l analyses
scary crisply...
- Maureen, Danny, Jim Nuss & ~~[illegible]~~

Maureen — ~~was going to call Karl?~~

UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF POSTSECONDARY EDUCATION

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Fax Cover Sheet

Number of pages following cover sheet: 1

TO: Bob Shireman **FAX:** 456-2223

FROM:

Maureen A. McLaughlin ✓

Francine Picoult

Lynn Mahaffie

Sandy Wood

Tia Cosey

MESSAGE:

Three estimates we did on changes to HOPE -- eliminate grade requirement
-- don't subtract Pell from credit (subtract from tuition)
-- cap deduction at 15%
All estimates assume $5,000 deduction
We're working on more - Maureen

	Changes from "Baseline" Policy					
	No Grade Requirement		No Pell Subtraction		15% Limit on Deduction	
	Number	Amount	Number	Amount	Number	Amount
Credit	21.8%	23.7%	5.5%	8.0%	0.0%	0.0%
Deduction	-9.4%	-9.5%	-2.6%	-3.3%	0.0%	-5.7%
Total	1.2%	8.0%	0.1%	2.7%	0.0%	-2.7%

	Changes from "Baseline" Policy					
	No Grade Requirement		No Pell Subtraction		15% Limit on Deduction	
	Number	Amount	Number	Amount	Number	Amount
Credit	906.3	$513.0	228.8	$173.6	0.4	$0.3
Deduction	-758.9	-183.5	-212.5	-63.7	-0.4	-109.8
Total	147.4	$329.5	16.3	$109.9	0.0	-$109.4

$5,000 max ded.

Number of beneficiaries in thousands.
Amount of benefits in millions.

4/1/97

Karl

reduction - 5 x 13

Lower ded. to 5000 unindexed 1.8

No ded & no B— $13.3

Δ ded. to nonref 15% credit $4

50% offset of bill + $2.2

— accrual of deduction to $5000 indexed

No offset + 6.6

accrual - $3000 deduction..

Karl

- ALTC mtg @ 2:00

- can't be on our room faxing an "just" the ed'l proposals..

- Michael Moynihan - will be done shortly...

i:\data\98bud\taxopt1.wp

Options for the HOPE Scholarship and Tuition Tax Deduction Proposals

SUMMARY OF OPTIONS

The President's FY 1998 Budget includes two major tax relief proposals in the area of postsecondary education: the HOPE Scholarship and the Tuition Tax Deduction. The HOPE tax credit proposal is intended to make 2 years of college as universal as high school; the tax deduction proposal, to encourage lifelong learning (including job training) and investment in higher education generally (including graduate study).

While trying to preserve the essential features of the President's proposals, we have come up with eight possible modifications that would reduce administrative burdens or overall cost or would meet other design concerns.

The cost estimates given below are very rough at this point. They are derived from simple calculations on old data, carried out ***without benefit of input from Treasury or Education***. As such, they should be considered as ballpark figures. The options are not cumulative (i.e., the cost of Option 3 does not assume that Option 2 has already been selected.)

Options (details follow)	Rough Effects on Cost (fiscal years 1997-2002)
1. Drop the grade requirement in HOPE.	+$2.5 billion
2. Cover only 50 percent of tuition and fees, up to a maximum credit of $1,500 and a maximum deduction of $10,000.	reduction
3. Lower the maximum deduction from $10,000 to $5,000.	-$3.6 billion
4. Eliminate the deduction entirely.	-$17.6 billion
5. Reduce the amount of the credit by only 50 percent of non-taxable Federal grants (e.g. Pell grants).	increase
6. Expand credits to non-degree students.	+$8 to $9 billion
7. Use cost of attendance instead of tuition and fees.	large increase
8. Reduce the maximum credit from $1,500 to $1,200.	- $3 to $4 billion

Basic Features of HOPE and Tuition Tax Deduction Proposals

	HOPE	Tuition Tax Deduction
Maximum Benefit	Non-refundable credit of up to $1,500 per year	A deduction of up to $5,000 per year in 1997 and 1998 ($10,000 in 1999 and thereafter)
Benefit Coverage	Tuition and fees paid for the first two years of postsecondary education	Tuition and fees paid for any year of postsecondary education or for job training or career-enhancing courses
Student Coverage	Degree- or certificate-seeking students enrolled at least half-time	Degree-, certificate- or non-degree-seeking students enrolled at least half-time; and any part-time students taking courses that would acquire or improve their job skills
Benefit Calculation	Credit value is minimum of (tuition and fees minus non-federal grants OR $1,500), less any Federal grants (e.g., Pell Grants).	Deduction value equals a household's marginal Federal income tax rate multiplied by tuition expenses, after the expenses are reduced by any tax-exempt scholarships or any Federal or non-Federal grants.
Grade Requirement	To be eligible for the second-year credit, a student must maintain a B minus grade point average in his/her first year of college.	None
Drug-Free Requirement	Students must have not been convicted of drug-related felonies.	None
Income Phase-out	For married joint filers, AGIs between $80,000 and $100,000; for individual filers, AGIs between $50,000 and $70,000	Same as in the credit proposal
Benefit Availability	Twice in lifetime On a per-student basis	No time limit On a per-tax-filing unit basis
Total Cost	$18.6 billion in 1997-2002	$17.6 billion in 1997-2002

Major Concerns/Weaknesses

- Poor targeting: These tax proposals are not targeted sufficiently for low-income students. (1) Subtracting Pell grants from tuition to determine tax credit eligibility results in very few needy students receiving a credit. (2) Compared to the credit, the deduction provides more benefits to higher-income families than to lower-income families.

- Tuition inflation: With the vast majority of students receiving tax relief, colleges may have less incentive to hold down tuition increases.

- Administrative burden: Schools would have to bear a new reporting burden (e.g., collecting and sending to students, parents, and IRS various types of information, such as social security numbers of the taxpayer and student, the amount of tuition and fees paid, grade point average, and drug conviction records.)

- Grade inflation: The grade requirement in HOPE might result in grade inflation.

Eight Possible Options

Option 1: Drop the Grade Requirement in HOPE.

- PRO: Eliminates concerns about grade inflation and Federal intrusion into private education matters; and reduces the administrative burdens on schools and IRS to some extent.

- CON: Inconsistent with the President's emphasis on high standards.

- Cost: Increases the credit cost by $2.5 billion from 1997 to 2002.

Option 2: Reduce tuition coverage from 100 percent to 50 percent.

In the current proposal, the credit is available at a dollar-per-dollar rate for the first $1,500 of first- and second-year tuition and fees; the deduction, at a dollar-per-dollar rate for the first $10,000 ($5,000 in 1997 and 1998) tuition and fees. Under this option, the credit would cover only 50 cents per dollar of tuition and fees, up to a maximum credit of $1,500; the deduction would work the same way as the credit, up to a maximum deduction of $10,000 ($5,000 in 1997 and 1998).

- PRO: Mitigates the pressure to increase tuition expenses. Under this option, compared to the current proposal, consumers would be more sensitive to price increase because they would have to pay at least half of any increase.

- CON: Reduce disproportionately aid for students at low-cost schools; does not eliminate completely the pressure to increase tuition expenses.

- Saving: Unknown reduction in cost

Option 3: Lower the maximum deduction from $10,000 to $5,000.

Among juniors, seniors, graduate students, and individuals taking career- or job-skill-enhancing courses, higher-income families would receive more benefits than lower-income families under the current deduction proposal. In addition, for freshmen and sophomores who are eligible for the credit or deduction, the maximum tax saving from the $10,000 deduction (in 1999 and thereafter) would exceed the maximum credit value of $1,500. (For instance, in 1999, a high-income student with a C plus grade average point could receive up to a $2,800 tax benefit, whereas a middle-income student with a A minus grade average point would be eligible for no more than a $1,500 tax benefit.)

- PRO: Prevents the maximum tax benefit under the deduction from exceeding the $1,500 maximum tax credit, and reduce the difference in maximum benefits that higher- and lower-income families would be eligible to receive.

- CON: Reduces benefits to students attending higher-cost schools.

- Saving: Reduces the deduction cost by $8 - $9 billion between 1997 and 2002.

Option 4: Eliminate deduction entirely.

- PRO: Addresses many issues concerning unfair tax treatments of higher- and lower-income families.

- CON: Excludes all students beyond their first two years of college, those in non-degree programs, part-time students enrolled less than half-time, and all graduate students, because the credit does not cover these students. This option would therefore upset job-training/labor constituents and might be perceived as a retreat from the Administration's commitment to lifelong learning. (See Option 6, which partially addresses this concern)

- Saving: Saves $17.6 billion (the total deduction cost) from 1997 to 2002.

Option 5: Reduce the amount of credit by 50 percent, not 100 percent, of Federal grants.

Under the current proposal, the amount of tax credit is reduced at a dollar-per-dollar rate for Pell and other non-taxable Federal grants. This option would reduce the credit amount to a 50 cents-per-dollar rate for Pell and other Federal grants. For example, under the current design, a student receiving a $1,000 Pell grant would be eligible for no more than a $500 tax credit (a total of $1,500 Pell/tax benefit); whereas under this option, the student would be eligible for up to a $1,000 tax credit (a total of $2,000 Pell/tax benefit).

- PRO: Moderately mitigates the targeting problems in the current proposal by providing more benefits to Pell (and other Federal grant) recipients who have tax liability.

- CON: Increases the cost significantly.

- Cost: Unknown increase in cost.

Option 6: Expand credits to non-degree students and part-time students.

If the deduction were to be eliminated entirely (Option 4), it might be desirable to modify the current HOPE proposal in this way to keep it consistent with the President's commitment to job training. For most taxpayers, the credit would be a better benefit than the deduction.

- PRO: Consistent with the President's emphasis on job training and lifelong learning.
- CON: Raises the cost significantly; and requires schools to report more students.
- Cost: Increase the credit cost by $8 - $9 billion between 1997 and 2002.

Option 7: Use cost of attendance instead of tuition and fees.

In the current proposal, "out-of-pocket" tuition and fees paid by the student/parent(s) are eligible for a credit or deduction. This option would make not only tuition and fees but also all other expenses (including room and board, transportation cost, books, and supplies) eligible for a tax benefit. [The existing student financial aid (e.g., Pell Grant) is permitted to cover cost of attendance as well as tuition and fees.]

- PRO: Helps many needy students; essentially allows for anyone within the eligible income range to claim the $1,500 maximum credit (like the child credit); may reduce the pressure to increase tuition since cost of attendance is already well over $1,500 for nearly all students.
- CON: Increase the cost significantly; if strictly enforced, could add administrative burden on schools and place a verification burden on the IRS.
- Cost: Large increase

Option 8: Reduce the maximum credit from $1,500 to $1,200.

- PRO: Reduces the cost.
- CON: According to 1994 data, $1,200 is roughly the national average for tuition and fees at community colleges. But under this option, two years of college education would not be free for the 40 percent of community college students (1994 share) who pay more than $1,200 in tuition. In 18 states (including MA, MD, MN, NH, NY, and OH), there are no community college charging less than $1,200 for tuition.
- Saving: Lowers the credit cost by $3 - $4 billion between 1997 and 2002

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
1 deduction sr. (401s								
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 — Exempt middle class from AMT								
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.

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

- o 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.

<u>Alternatives</u>

- o 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).

- o 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.

<u>Additional features of the Middle-Class tax relief package</u>

- o 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

- o 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

- 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.

- 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.

- 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

- 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

- 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

- 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

- 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.

THE WHITE HOUSE

WASHINGTON

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. Grade Requirement

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

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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.

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:

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[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.

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

I. 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.*

aascu

FAX

American Association of State Colleges and Universities
One Dupont Circle/Suite 700/Washington, DC 20036-1192
phone 202/293-7070 • fax 202/296-5819

X Urgent FAX

Date: 5/22/97

To: BOB SHIREMAN

Affiliation:

Fax #: 456-2223

From: HILARY GOLDMANN

AASCU Account Code: # of Pgs: (including cover page)

Message: Per your Request.
Interest deduction Recommendation's from AASCU's testimony Before WAYS & MEANS.

BARMAK WILL CALL YOU LATER

FINAL

Statement

before the

Committee on Ways and Means
U.S. House of Representatives

Hearing on Education and Training Tax Provisions
of the Administration's Fiscal Year 1998 Budget Proposal

March 5, 1997

James B. Appleberry
President
American Association of State Colleges and Universities (AASCU)

on behalf of

American Association of State Colleges and Universities (AASCU)
Hispanic Association of Colleges and Universities (HACU)
National Association for Equal Opportunity in Higher Education (NAFEO)
National Association of State Universities and Land-Grant Colleges (NASULGC)
United Negro College Fund (UNCF)
United States Student Association (USSA)

Mr. Chairman, the example I just provided should not, in any way, be construed as implying our opposition to the latter example's effects in terms of tax relief. Rather, our misgivings have to do with the disparity between the benefits the two families would receive. The targeting of the proposed tax benefits, as shown in this example, bears an inverse relationship to where federal dollars would produce the greatest net national gains in college attendance. Families in the upper-income quartile already participate in higher education at near-saturation rates. College participation rates for children from families at or below the national median family income (about $40,000) could, on the other hand, be dramatically increased through better targeting of this proposal at them. Two important changes could substantially improve this proposal:

- The formula for determination of allowable expenses should be changed from the proposed "tuition and fees minus grants" to "cost of attendance minus grants." Cost of attendance is defined by Congress in current law, HEA, Title IV, Part F (20 U.S.C. 1087qq).

- To offset the increased federal cost of broadening the definition of allowable expenses, the maximum deduction could be reduced.

These two changes, while still not providing new educational benefits to our lowest-income citizens, would better focus this proposal on moderate- and middle-income Americans.

An Alternative Policy Option

Alternatively, the Committee may wish to substitute tax deductibility of student loan interest payment for deductibility of tuition. Such a substitution would, in effect, treat loan financing of investments in higher education the way home mortgage loans are treated under current tax law. We believe the very same logic that led Congress to create deductibility of home mortgage interest instead of deductibility of purchase price of homes applies in the case of higher education. AASCU supports an "above-the-line" deduction of up to $2,500 of annual student loan interest payments with income-phase outs similar to the Administration's proposal. Our proposed substitution has several important advantages, and I should point out that slightly different versions of tax deductibility of student loan interest payments are included in both, S.1 and S. 12.

- Because our most affluent citizens do not need to borrow, deductibility of student loan interest automatically shifts its subsidies toward the children of low- and middle-income families who had to finance college through borrowing.

- The benefits of interest deductibility are spread out over time, and would mitigate some of the ill effects of the student indebtedness on our economy. The adverse effects of college debt on career choices would be reduced. In addition, the savings realized by heavily debt-ridden graduates would enable them to participate in our economy in all of the advantageous ways that previous generations of graduates have.

- Because of the delayed and incremental nature of student loan interest deductibility, it would certainly not have the potential inflationary consequences that some have attributed to tuition deductibility. In addition, because the federal government itself sets the interest rate for student loans, the deductibility of interest payments would not result in higher rates.

- While the deductibility of tuition would do very little for graduate education, the deductibility of student loan interest would immediately become the largest form of financial aid for financing graduate study. As you are aware, student loans are the only broad-based form of financial aid for graduate students. While the federal government has a variety of small categorical grant and fellowship programs for graduate students, there is no analogue to Pell grants for graduate school. Because graduate students, while they are in school, tend to have very low annual incomes, the deductibility of tuition would provide only marginal benefits for them. The deductibility of student loan interest, on the other hand, precisely because it is better timed to provide steady relief over time, can provide a powerful incentive for more of our citizens to engage in graduate and advanced studies.

- A larger number of our citizens would benefit from a properly configured student loan interest deductibility provision than would from tuition tax deductibility.

Our Views on Hope Tax Credits

Mr. Chairman, allow me to now turn to the Hope tax credit proposal, and share AASCU's views regarding that initiative with you and the Committee.

As I have already mentioned, in calling for higher education tax credits, the President has proposed a major new mechanism of delivering new federal resources in support of higher education. The President has identified a new means, i.e, the use of the tax code, to realize a worthy goal, broader access to college. AASCU members enthusiastically support not only the President's stated goals, but his proposal that tax credits would be a powerful means to that end.

At the same time, however, we share the concerns of our colleagues regarding the details of the proposed tax credits.

- AASCU views the decision to turn what was originally a refundable tax credit into a non-refundable one as a step in the wrong direction. This change specifically channels the benefits of Hope tax credits from Americans for whom it could do the most good in terms of access. The difference between refundability and non-refundability is that the dollar amount of a family's tax liability becomes the de facto cap on its eligibility for benefits. If our goal is to open the doors of college to more Americans, our national self-interest would argue for the inclusion of our neediest citizens.

Jake Siewert
05/19/97 11:29:44 AM

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To: Robert M. Shireman/OPD/EOP, Charles R. Marr/OPD/EOP

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Subject: CNN: Inside Politics Weekend, 5/17/97

---------------------- Forwarded by Jake Siewert/OPD/EOP on 05/19/97 11:36 AM ---------------------------

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Subject: CNN: Inside Politics Weekend, 5/17/97

CNN ``INSIDE POLITICS WEEKEND''
HOST: WOLF BLITZER
GUEST: FRANKLIN RAINES, DIRECTOR, OMB
AIR TIME: 6:30 P.M. (EDT), SATURDAY, MAY 17, 1997

MR. BLITZER: Congressional Republicans and the White House reached an agreement on a balanced budget deal again. How happy was House Budget Committee Chairman John Kasich?

REP. JOHN KASICH (R-OH): (From videotape.) We are very, very, very happy. We have achieved the level of savings that we wanted both in the operations of the government, and at the same time, of course, very huge savings in entitlements. We are very happy with this result.

MR. BLITZER: White House Budget Director Frank Raines now joins us. How happy were you?

MR. RAINES: We're very pleased. We think it's a very good agreement, good for the nation, and I think very good for the reputation of the government. I think it's going to cause people to think their government can do the right thing again.

MR. BLITZER: All right, let me throw a little cold water on all the happiness out there.

Sixty-seven billion (dollars) you're projecting this year for the budget deficit. But it goes up next year to $90 billion, stays at $90 billion the year after that, and then it's even higher than it is now, $83 billion, the following year. So what's going on?

MR. RAINES: Well, what's really happening is we've had terrific news the last two years. The budget deficits have been far lower than we've expected. But we tried to be conservative in our estimates and not assume that that terrific news is going to continue. And so we're going to have the savings begin right away, offset somewhat by a tax cut. But we will be putting those savings in place and it will result in a balanced budget by 2002.

MR. BLITZER: Assuming everything works out and there's no major recession.

MR. RAINES: Assuming there's not a major recession. On the other hand, we've been underestimating deficit reduction by $50 billion a year. So our conservative estimates can take a little bit of bad news.

MR. BLITZER: Eventually the economy is going to have to go down. I mean, it's been going up and up and up for a long time, right?

MR. RAINES: Well, I assume that at least the economy will take a pause at some point. But we're getting rid of a structural budget deficit. We may see deficits caused by slowdowns in the economy, though our problem has been we've had a budget deficit even during good times. And that's what this agreement is meant to deal with.

MR. BLITZER: All right, let's talk about what most Americans out there are really interested in, what you worked on and what you will be working on in the coming months, tax cuts. A gross tax cut, you're projecting over the next five years, $135 billion, of which you have a commitment from the Republicans that $35 billion of that $135 billion, $35 billion will go to help higher education, post-secondary school education -- tax credits, tax deductions, all of which the president has proposed. Are these deductions, these credits, going to be across the board for everyone sending kids to college, or will there be a cap on family income?

MR. RAINES: Well, the exact structure hasn't been established, but it will be focused on middle-income and lower so that the benefit goes to those who need it the most.

MR. BLITZER: The president wanted it, what, phased out at $100,000 family income?

MR. RAINES: Yes. But we know that the exact terms are something we're going to have to work out. But we know that we've got $35 billion dedicated to post-secondary education. It's one of the largest increases in assistance for post-secondary education that we've ever seen.

MR. BLITZER: And what about the grades and everything? Are you going to have to have an A or a B in order to maintain those scholarships, the Hope scholarship that you're proposing?

MR. RAINES: I think we're going to try to simplify the program and try to deal with issues like that. We've gotten a lot of feedback that says that that may be a little too complicated to implement.

MR. BLITZER: It's going to have grade inflation. Teachers are going to be under a lot of pressure to give their students an A and a B; otherwise they lose their federal -- their grants.

MR. RAINES: Well, a lot of other scholarships are dependent on good progress. But we think that having the IRS trying to enforce grades may be going a little too far, and we're going to try to find a way to simplify the program.

MR. BLITZER: So if you're Bill Gates's kid and you're going to college, you're not going to get any tax credits or tax exemptions.

MR. RAINES: I don't think he ought to count on it.

MR. BLITZER: So $100,000, is that --

MR. RAINES: Again, it hasn't been set, but I believe it'll be targeted so that we are focusing the money on those who need it the most.

MR. BLITZER: We have a lot more to talk about; these tax cuts, what it's going to mean to our audience out there. Everyone is waiting. We have to unfortunately take a quick break. When we come back, we'll continue our discussion with Frank Raines.

(Announcements.)

MR. BLITZER: Welcome back to Inside Politics Weekend. We're talking about the budget with the budget director, Frank Raines.

You spoke about the $35 billion you're projecting for the education tax credits and deductions. You also have agreed on a $500 per-child tax credit. Again, is there a cap on family income in order to pay for this?

MR. RAINES: Well, we will have the availability of the credit phase out. Again, the exact number is something we're going to have to negotiate, but both Republicans and Democrats have supported a child tax credit to help people raise their kids. And I'm sure that's going to be in the bill.

MR. BLITZER: About $100,000 per family for the cap? Would you say that's a rough ballpark?

MR. RAINES: Well, I think we've had a different number than they've had, and we've also had a different age level. We went up to 13; they went to 18. So there are a number of these details that are going to have to be worked out.

MR. BLITZER: So you might split the difference, 15 or 16?

MR. RAINES: Well, it could be, or we might go all the way up to 18. We're not opposed to going to 18. It was simply a matter of affordability from our standpoint. And so we'll have to work with them to see how far we can make the dollar stretch.

MR. BLITZER: Eighteen and under or 17?

MR. RAINES: Eighteen and under.

MR. BLITZER: Eighteen. So if you're 18 years old, you get that tax credit --

MR. RAINES: That's correct.

MR. BLITZER: -- assuming the family cap -- the income is not too great. So rich people are not going to benefit from this one either.

MR. RAINES: No, that's right. We believe that these benefits should be targeted.

MR. BLITZER: How much will that cost approximately? If the education tax credit costs $35 billion over five years, how much will the $500 per-child tax credit cost?

MR. RAINES: Well, the Republican plan that I've seen cost between $70 billion and $100 billion a year.

MR. BLITZER: A year. So that's a lot more than you have in your plan.

MR. RAINES: I'm sorry, $70 billion to $100 billion over the five years.

MR. BLITZER: Over five years. All right.

MR. RAINES: So if you combine that with our education credit, these two take up the largest part of the taxes.

MR. BLITZER: But you've also agreed that there will be a broad-based capital gains tax cut. Right now it's 28 percent. That's going to be expensive as well, right?

MR. RAINES: Well, there is really actually no agreement on anything other than the education tax credit. We assume there will be the child credit, because we both support it. And we assume there will be a capital gains reduction because the Republicans have made that a very large issue for them. So we've got to figure out, though, how we take all of these demands and squeeze them into a very tight budget for tax cuts.

MR. BLITZER: Will the president go along with a broad-based capital gains tax cut? Right now it's 28 percent. Then they want to reduce it to maybe 21 percent or 18 percent. Would you accept that?

MR. RAINES: Well, I think it depends a lot on what it looks like in the end. We acknowledge that there will be such a provision in the tax bill and we'll be willing to look at them with an open mind as to exactly how it's structured.

MR. BLITZER: Do you want to give us a figure what you think the president could go along with in terms of cutting tax rates for capital gains?

MR. RAINES: I think it depends a lot on how much money we've got left in terms of after we've done the education credit and the child credit. So it's going to be difficult to speculate as to what can be done on capital gains.

MR. BLITZER: What about estate tax relief? Right now $600,000 per estate is tax-free. They want -- Newt Gingrich wants to kill the whole thing. But Bill Archer, the chairman of the House Ways & Means Committee, says maybe $1.2 million is a good figure. Is that a good figure for the president?

MR. RAINES: Well, that's very high. That's very expensive. The estate tax only applies to 1 percent of all decedents each year, and so it's only the very high incomes that it affects. And I think it's going to be very hard to get a large estate tax provision within this package. We would prefer to see it focused on those who have particular problems, farmers and those with small businesses who'd like to pass them on to their children.

MR. BLITZER: Well, it sounds to me like there's a lot of political differences, a lot of room for debate, and potentially a presidential veto.

MR. RAINES: Well, there's certainly a lot of room for debate. The tax writers on both sides said, ``Don't try to write the tax bill for us." So we didn't. And so the normal legislative process is going to reply to this tax bill. And Democrats and Republicans, working with the administration, are going to have to craft one.

MR. BLITZER: I noticed that in all of the praise for this deal, House Speaker Newt Gingrich, Trent Lott, the Senate majority leader, the Senate minority leader, Tom Daschle, all were glowing in their praise. Silent was the House minority leader, Dick Gephardt.

MR. RAINES: Well, I think he has said that he'd like to take a few days to look at it before he makes up his mind. And I'm very hopeful that in the end he will see that this is a good agreement, good for the country, good for Democrats, good for Republicans.

MR. BLITZER: You think that there could be a Democratic revolt in the House, though, led by Dick Gephardt?

MR. RAINES: I don't think so. I think certainly we won't get 100 percent of Democrats. But our goal was to get a majority of Democrats supporting this agreement, and I'm confident that we will have that.

MR. BLITZER: Do you think a majority of the Congressional Black Caucus will support this?

MR. RAINES: I think they can, and I think -- I've had a lot of discussions with them, and a lot of the programs that they care a lot about are protected in this agreement. And they've got Charlie Rangel leading their efforts in the Ways & Means Committee on the taxes.

MR. BLITZER: He's not enthusiastic about it. He was on the show two weeks ago.

MR. RAINES: Oh, I know he's got his own concerns. But I think this is a good agreement for them to work from. Particularly given that they're in the minority, this agreement gives them a strong bargaining position.

MR. BLITZER: Franklin Raines, you did what your predecessor, Leon Panetta, the budget (doctor?), didn't do. You managed to get this balanced budget agreement with the Republicans. Congratulations. We'll see if there really is a lot of devil in the details.

MR. RAINES: Thank you.

MR. BLITZER: Thank you very much for joining us.

Message Sent To:____

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

SECRETARY OF THE TREASURY

May 22, 1997

MEMORANDUM FOR GENE SPERLING

FROM: ROBERT E. RUBIN

SUBJECT: Tax Issues

Attached is a background memorandum for tomorrow's tax meeting.

Today, I spoke with Chairman Archer for a half-hour and met with Chairman Roth and his staff for 45 minutes. In addition, I spoke with Senator Moynihan, met with Ways & Means Democratic Members and staff and spoke with John Hilley.

Archer and Roth agreed to have our staffs meet next week, and I suggest that Linda Robertson and our Tax Policy team work with their staffs on our $135 billion set of ideas for discussion. We would then see where we were at the end of next week.

This seems like the best way to engage in a bipartisan process and engage with the Democrats (vs. presenting a Democratic package this Friday).

Attachment

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.

<u>Alternatives</u>

- 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.

<u>Additional features of the Middle-Class tax relief package</u>

- 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

- 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

- 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

- 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.

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.

UNITED STATES DEPARTMENT OF EDUCATION

THE SECRETARY

May 22, 1997

JB

JK

MEMORANDUM FOR THE PRESIDENT

FROM: SECRETARY RICHARD RILEY

RE: Higher education tax package option

As you requested, this memo describes the potential compromise tax package we discussed today. This compromise would keep the maximum HOPE tax credit at $1,500 -- the average community college tuition -- while addressing concerns about the grade requirement and providing additional tax benefits to lower income families. It pays for these changes by reducing the maximum benefit of our tuition deduction for families in the 28% bracket, but provides additional assistance to families in this bracket by restoring the student loan interest deduction. The attached table summarizes this compromise package, which would likely cost between $36 and $39 billion over 5 years. All budget estimates are from the Treasury Department. The National Economic Council is sending you another memo describing a range of proposals for your consideration.

Current Proposal: **5-year cost: $36.2 billion**

HOPE Scholarship tax credit of up to $1,500 for the first two years.
- Credit is offset by the amount of federal grants received, mostly Pell grants.
- Need at least a B- average in the first year to receive credit in the second year.

Tax deduction for tuition and fees, up to $5,000 in 1997-98 and up to $10,000 after 1998, for lifelong education and training.

Possible Compromise Package: **5-year cost: between $36-$39 billion**

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

This package would eliminate our 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.

The higher education community strongly supports this change, alleging that our proposal would lead to grade inflation and IRS intrusion into academic affairs, while unfairly affecting disadvantaged students. Representative Rangel's bill makes this same change. The Senate Minority bill substitutes a high school grade requirement for our college grade requirement, but this might limit access for students who did not do well in high school.

2. **HOPE Tax Credit: Eliminate or reduce 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, many people have recommended eliminating or reducing this offset. This compromise package could either eliminate the offset completely or offset only 50% of federal grants. Eliminating the offset for federal grants, which both Rep. Rangel's bill and the Senate Minority bill propose, costs $3 billion over 5 years. Offsetting 50% of grants costs only $930 million over 5 years because the poorest students would continue to receive little or no benefit from the HOPE tax credit.

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. This affects families in the 28% tax bracket (above $60,000 of AGI). It could be achieved in either of two ways:

a) Limit the value of the deduction to 15% of tuition and fees, up to $1,500.
b) Cap the maximum benefit of deducting up to $10,000 in tuition and fees at $1,500.

The first method would reduce the benefits to those in the 28% bracket somewhat more than the second, is more sensitive to differences in tuition costs, and would save $4.0 billion over 5 years. The second method would save somewhat less than the first, but we do not yet have an estimate. Rep. Rangel's bill does not contain any tuition deduction, and instead makes a refundable credit available for four years (up to $1,500 in the first two years and up to $1,000 in the next two years). The Senate Minority bill is nearly identical to our FY98 Budget proposal.

4. **Student loan interest deductibility and tax-free student loan forgiveness**

To provide additional assistance to families, and especially those in the 28% bracket who would benefit less under the change described above, this package would reinstate the tax deductibility of interest on any student or parent higher education loan, which was eliminated in the Tax Reform Act of 1986. The Senate Majority version of this proposal phases out the deduction for families with incomes between $65,000-$85,000, and costs $700 million over 5 years. The Senate Minority version phases out the interest deduction between $80,000-$100,000, providing greater benefits to those in the 28% bracket, and would therefore cost more although we do not yet have an estimate. This package would also include our FY98 Budget proposal to eliminate the taxation of student loans when they are forgiven for those engaged in community service ($15 million over 5 years).

This package would also commit to extending Section 127 and establishing a 10% tax credit for small businesses that provide education and training, but it would not include the cost in the $35 billion reserved for the HOPE tax credit and $10,000 tax deduction. Our FY98 extends Section 127 through the year 2000 and establishes the small business tax credit, costing $2.4 billion over 5 years. Extending Section 127 through the year 2002 and establishing the small business tax credit would cost $3.7 billion over 5 years.

Possible Higher Education Tax Package

	5-year cost ($ billions)	
Proposal in FY98 Budget:	**$36.2**	
Possible Compromise Package:		
1. Substitute satisfactory progress requirement for the B- requirement	+$2.2	
2. Eliminate or reduce the HOPE offset for Pell and other federal grants	+$3.0 or +$0.9	
Eliminate the offset		*+$3.0*
Offset only 50% of grants		*+$0.9*
3. Cap the benefit of the deduction at $1,500	-$4.0 or less	
Cap at 15% of tuition, up to $1,500		*-$4.0*
Cap the maximum deduction at $1,500		*less than -$4.0*
4. Student loan interest deduction (Senate Majority version) and tax-free loan forgiveness	+$0.7	
Net change from compromise package:	between $0 and +$3	
Total Cost:	**$36-$39 billion**	

May 22, 1997

MEMORANDUM FOR BOB SHIREMAN

FROM: PATRICIA MCNEIL Trish McNeil

SUBJECT: Tax Credit Provisions of H.R. 1512

As you requested I am forwarding to you the following background information that I hope will be helpful in estimating the cost of possible alternatives to Congressman Rangel's proposal to provide tax credits for hiring career academy graduates in EZ-EC communities. Norris Dickard of my staff conducted the research and if you have any questions you can reach either of us at 205-5451.

I. The Rangel Proposal

Title 1 of H.R. 1512 would provide a framework for states and local communities to offer 'no cost' bonds to finance the establishment of "specialized career academies" in Empowerment Zones and Enterprise Communities. The monies would be used for the construction or renovation of career academies, the purchase of equipment, development of curriculum, and provisions of teacher training. Employers who hire graduates of such academies would be entitled to a tax credit. If a graduate is eligible under the current Work Opportunity Tax Credit (described in more detail below), then the employer would get a 35 percent tax credit up to the first $6,000 in wages during the first year of employment. H.R. 1512 would extend the WOTC to graduates of qualified zone academy graduates who aren't otherwise eligible for the WOTC credit and reduce the credit for those individuals from 35 percent to 20 percent. It also makes the WOTC permanent.

Congressman Rangel wants a tax-based approach to secondary school improvement in order to work on these ideas in the Ways and Means Committee. Others within the Department have looked at the bond provisions of the bill. OVAE was asked to review the tax credit provisions.

It is our belief that, if tax credits are offered, it is much more preferable to provide them to employers who hire young people while they are still in school, as part of a paid work-based learning or internship experience linked to classroom learning (the school-to-work model). Congressman Rangel has been a long-time supporter of the targeted jobs tax credit. He's unlikely to give up the idea of a tax credit for hiring graduates of the academy. Thus, we would suggest an amendment to his bill that would make the credit available either to offset the costs of paid work-based learning or to hire graduates of career academies.

II. The Potential Value of a Tax Credit to Employers Who Provide Work-Based Learning Opportunities.

There are four primary reasons why a tax credit for paid work-based learning makes sense. (1) Work-based learning linked to classroom learning is a powerful learning tool for young people (it helps kids make sense of what they learn in school, gives them a chance to explore careers, and offers a mentor to provide extra adult support to students); (2) Paid work-based learning provides students with money while they learn (most kids work during high school and work-based learning provides, in addition to cash, both structure and meaning to that work); (3) A tax credit to hire students right out of high school sends the wrong message. It suggests that these kids don't need to go on to postsecondary. We want to encourage kids to have options -- both college and careers. A tax credit for work-based learning encourages school completion and supports the President's commitment to the importance of a 13th and 14th year of schooling; and (4) An internship gives an employer an opportunity to "try-out" a student without a commitment to hire. Employers are often more willing to take a chance on a student under these circumstances. Once the student is on-board, employers often want to hire kids who have interned with them. Employers may even be willing to have students continue working part-time while they are in college and to contribute to college costs.

A number of states are trying employer subsidies and/or tax credits as incentives to make work-based learning slots available to students in school-to-work initiatives. Wisconsin, offers grants to employers. The state recently conducted a survey of graduates from their apprenticeship programs. The survey found that 75 percent of the youth apprentices had been offered full-time jobs by their employers, 65 percent of them chose to combine work with further education, and 73 percent enrolled in post-secondary education and training. Employers surveyed were overwhelmingly supportive of the apprenticeship program and believed it was beneficial to their companies. In Wisconsin, small businesses more than larger businesses were apt to say they would not provide work-based learning without the incentives.

According to the National Governors' Association, three other states have tax credit proposals: Arizona, Colorado and Illinois. Here's how they work:

- **Arizona** provides a tax credit to employers for up to $2000, or 10% of wages, for registered apprentices.
- **Colorado** offers a 3 percent tax credit on wages to any employer who offers work-based learning experiences to school-to-work students and also provides a credit for any unemployment insurance payments incurred..
- **Illinois** offers a tax credit to employers equal to 20 percent of payroll costs for students involved in Tech-Prep work-based learning experiences. (IL doesn't yet have a STWO implementation grant.)

III. Previous and Current Tax Credits

The Targeted Jobs Tax Credit (TJTC) was originally authorized in 1978 and contained provisions to provide tax credits to employers who hired certain targeted groups. Among them:

- a tax credit for employing adults of up to 40 percent of their first $6,000 in wages -- for a total credit of $2,400.

- a tax credit of 40 percent of the first $3,000 in wages for employing economically disadvantaged youth aged 18 to 22 in summer jobs

- **a tax credit for economically disadvantaged youth aged 16-19 participating in qualified Co-Op Education programs.**

The Work Opportunity Tax Credit (WOTC), authorized by the Small Business Job Protection Act of 1996 (P.L. 104-188), is a federal income tax credit that encourages employers to hire certain job seekers. It can reduce employer federal tax liability by as much as $2,100 per qualified worker, or $2,050 per qualified summer youth. It replaced the TJTC. It applies to new employees hired after September 30, 1996 and before October 1, 1997. The new employee must belong to one of seven target groups:

- a member of a family that is receiving or recently received Aid to Families with Dependent Children (AFDC) or Temporary Assistance for Needy Families (TANF)

- an 18-24 year-old member of a family that is receiving or recently received food stamps,

- an 18-24 year-old resident of one of the 105 federally designated urban or rural Empowerment Zones or Enterprise Communities,

- a 16-17 year old EZ/EC resident hired between May 1 and September 15, 1997 as a Summer Youth Employee,

- a veteran who is a member of a family that is receiving or recently received AFDC, TANF or food stamps,

- a disabled person who completed or is completing rehabilitative services from a State or the VA, or

- an ex-felon who is a member of a low-income family.

The President's FY98 budget proposes to reauthorize WOTC for one-year and add able-bodied individuals affected by the new food stamp rules to the list of eligible groups and enhance the credit for long-term welfare recipients.

IV. Estimating the Cost and Take-Up Rates of a Tax Credit for Work-Based Learning

There are a couple of major problems with estimating the cost of extending the tax credit to youth in work-based learning in the EZ/EC. First, after trying HUD and Agriculture we could not come up with a number for how many residents live in EZ/EC zones. Second, there is no way of knowing how many academies might be started or how many youth might actually participate in work-based learning.

For our purposes, a good guess might be up to one academy per zone and 100 students per academy. (Most current academies, either within larger schools or stand alone operations, have about 200-300 students in grades 9-12 or 10-12.) In terms of the type and amount of the credit, it seems prudent to use the same criteria for the work-based learning credit as for the after graduation hiring credit. I'd stick with 35 percent of the first $6000 wages for the credit and not bother with trying to estimate how many students might be from out of the zone and thus eligible for the reduced credit. (To do otherwise, would create a real paperwork burden for schools.)

Hope this is helpful. Call if you have questions.

UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF VOCATIONAL AND ADULT EDUCATION

THE ASSISTANT SECRETARY

FAX

TO: Bob Shireman

FROM: Trish McNeil

DATE: 5-22-97

NAME OF SENDER:

OUR TELEPHONE NUMBER: 205-8257

YOUR TELEPHONE NUMBER: 456-2803

YOUR FAX NUMBER: 456-2223

NUMBER OF PAGES INCLUDING COVER SHEET: 5

RESPONSE REQUESTED: YES____ NO____

NOTES:

Hope this is helpful.

UNITED STATES DEPARTMENT OF EDUCATION

THE DEPUTY SECRETARY

600 Independence Avenue, SW
FOB-10, Rm 6261
Washington, DC 20202-0500

Telephone Number: (202) 401-1000 Fax Number: (202) 401-3095

FAX COVER SHEET

TO: Gene Sperling / Bob Shireman

FAX: 456-2878 456-2323

FROM: Mike Smith

NUMBER OF PAGES TO FOLLOW, INCLUDING COVER SHEET: 4

IF YOU DID NOT RECEIVE THE COMPLETE TRANSMISSION, PLEASE CALL (202) 401-1000.

MESSAGE:

This was fax to Secretary Riley on Air Force One.

UNITED STATES DEPARTMENT OF EDUCATION

THE SECRETARY

May 22, 1997

MEMORANDUM FOR THE PRESIDENT

FROM: SECRETARY RICHARD RILEY

RE: Higher education tax package option

As you requested, this memo describes the potential compromise tax package we discussed today. This compromise would keep the maximum HOPE tax credit at $1,500 -- the average community college tuition -- while addressing concerns about the grade requirement and providing additional tax benefits to lower income families. It pays for these changes by reducing the maximum benefit of our tuition deduction for families in the 28% bracket, but provides additional assistance to families in this bracket by restoring the student loan interest deduction. The attached table summarizes this compromise package, which would likely cost between $36 and $39 billion over 5 years. All budget estimates are from the Treasury Department. The National Economic Council is sending you another memo describing a range of proposals for your consideration.

<u>Current Proposal</u>: **5-year cost: $36.2 billion**

HOPE Scholarship tax credit of up to $1,500 for the first two years.
- -Credit is offset by the amount of federal grants received, mostly Pell grants.
- -Need at least a B- average in the first year to receive credit in the second year.

Tax deduction for tuition and fees, up to $5,000 in 1997-98 and up to $10,000 after 1998, for lifelong education and training.

<u>Possible Compromise Package</u>: **5-year cost: between $36-$39 billion**

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

This package would eliminate our 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.

The higher education community strongly supports this change, alleging that our proposal would lead to grade inflation and IRS intrusion into academic affairs, while unfairly affecting disadvantaged students. Representative Rangel's bill makes this same change. The Senate Minority bill substitutes a high school grade requirement for our college grade requirement, but this might limit access for students who did not do well in high school.

600 INDEPENDENCE AVE., S.W. WASHINGTON, D.C. 20202-0100

2. **HOPE Tax Credit: Eliminate or reduce 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, many people have recommended eliminating or reducing this offset. This compromise package could either eliminate the offset completely or offset only 50% of federal grants. Eliminating the offset for federal grants, which both Rep. Rangel's bill and the Senate Minority bill propose, costs $3 billion over 5 years. Offsetting 50% of grants costs only $930 million over 5 years because the poorest students would continue to receive little or no benefit from the HOPE tax credit.

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. This affects families in the 28% tax bracket (above $60,000 of AGI). It could be achieved in either of two ways:

a) Limit the value of the deduction to 15% of tuition and fees, up to $1,500.
b) Cap the maximum benefit of deducting up to $10,000 in tuition and fees at $1,500.

The first method would reduce the benefits to those in the 28% bracket somewhat more than the second, is more sensitive to differences in tuition costs, and would save $4.0 billion over 5 years. The second method would save somewhat less than the first, but we do not yet have an estimate. Rep. Rangel's bill does not contain any tuition deduction, and instead makes a refundable credit available for four years (up to $1,500 in the first two years and up to $1,000 in the next two years). The Senate Minority bill is nearly identical to our FY98 Budget proposal.

4. **Student loan interest deductibility and tax-free student loan forgiveness**

To provide additional assistance to families, and especially those in the 28% bracket who would benefit less under the change described above, this package would reinstate the tax deductibility of interest on any student or parent higher education loan, which was eliminated in the Tax Reform Act of 1986. The Senate Majority version of this proposal phases out the deduction for families with incomes between $65,000-$85,000, and costs $700 million over 5 years. The Senate Minority version phases out the interest deduction between $80,000-$100,000, providing greater benefits to those in the 28% bracket, and would therefore cost more although we do not yet have an estimate. This package would also include our FY98 Budget proposal to eliminate the taxation of student loans when they are forgiven for those engaged in community service ($15 million over 5 years).

This package would also commit to extending Section 127 and establishing a 10% tax credit for small businesses that provide education and training, but it would not include the cost in the $35 billion reserved for the HOPE tax credit and $10,000 tax deduction. Our FY98 extends Section 127 through the year 2000 and establishes the small business tax credit, costing $2.4 billion over 5 years. Extending Section 127 through the year 2002 and establishing the small business tax credit would cost $3.7 billion over 5 years.

Possible Higher Education Tax Package

	5-year cost ($ billions)	
Proposal in FY98 Budget:	**$36.2**	
Possible Compromise Package:		
1. Substitute satisfactory progress requirement for the B- requirement	+$2.2	
2. Eliminate or reduce the HOPE offset for Pell and other federal grants	+$3.0 or +$0.9	
Eliminate the offset		*+$3.0*
Offset only 50% of grants		*+$0.9*
3. Cap the benefit of the deduction at $1,500	-$4.0 or less	
Cap at 15% of tuition, up to $1,500		*-$4.0*
Cap the maximum deduction at $1,500		*less than -$4.0*
4. Student loan interest deduction (Senate Majority version) and tax-free loan forgiveness	+$0.7	
Net change from compromise package:	between $0 and +$3	
Total Cost:	**$36-$39 billion**	

UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF POSTSECONDARY EDUCATION

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Fax Cover Sheet

Number of pages following cover sheet: 8

TO: Bob Shireman **FAX:**

FROM:

Maureen A. McLaughlin ✓

Francine Picoult

Lynn Mahaffie

Sandy Wood

Tia Cosey

MESSAGE:

Bob - a few comments from Pauline Mike & me. Pse call

Maureen

(202) ~~237-5899~~

Mike Fomay 622-0273 -1906

May 22, 1997

DRAFT MEMORANDUM

FROM:
SUBJECT: Education Tax Issues

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 which we recommend be included in an Administration tax package *outside* of the $35 billion that was reserved for your credit and deduction.

All estimates are for the period 1998-2002.

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] There are significant interactions, so savings options are ususally not additive.

1. Grade Requirement

All of your advisors agree that the B- grade requirement for the second HOPE Scholarship needs to be changed, for three reasons: (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 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.

[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. Depending on the results of the cooperative efforts between Joint Tax and Treasury, there may be a need to further pare down any package that is developed now using Treasury estimates.

Maybe raising red flag; hopefully the numbers will come closer together when Treasury & JTC work together.

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 costs about $2.2 billion. Option 1b may cost slightly less (it has not yet been estimated).

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

In order to stretch the $1500 credit further into the middle class, your proposal makes Pell Grant recipients (and other Federal grant aid recipients) ineligible for the HOPE Scholarship if they receive $1500 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. Ignoring the full $3000 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 $1500 (HOPE) or even $2800 (deduction at 28% bracket) for higher-income families.

All of your advisors agree that it would be appropriate to address this issue, for both political and policy reasons. The trade-off is that, like eliminating the grade requirement, some offsetting changes will need to be made to reduce the cost of the education tax proposals (those options are presented next).[2] There are two alternatives, with most of your advisors leaning toward option 2a:

2a. Eliminate offset entirely. A student with a $3000 Pell Grant could also receive a $1500 HOPE Scholarship, if he paid enough tuition and fees and had tax liability to which to apply the credit. This option costs $3 billion.

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: Costs $3 billion, requiring 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 that she receives. This approach costs $0.9 billion.

Pro: Costs $2.1 billion less than eliminating the offset entirely.

Con: May not 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. - Lowest income students are excluded.

Note: lowest income benefit little or not at all from this.

3. Fitting within $35 billion

If we address either or both of the above issues, then the cost of the overall package will need to be reduced in order to fit within the $35 billion allocation. We have identified two basic approaches. The first attempts to preserve the credit at [close to] its current level, ~~while~~ reducing the value of the deduction. The second preserves the credit while reducing the deduction. reversed order

3a. Preserve credit, reduce deduction. The HOPE Scholarship would remain at $1500.[3] ~~The tax~~ deduction would still apply to up to $5,000 of tuition and fees through the year ~~2000~~ 98 and up to $10,000 thereafter. However, the value of the deduction would

current proposal - 1997 + 1998

[2] It should also be noted that not all poor families will be able to take advantage of the credit, even without the Pell offset, because the credit is not refundable. Refundability would both create political problems with Republicans as well as increase costs beyond what ~~can be absorbed~~ within the $35 billion allocation.

reason for Pell Grant increase

[3] Even with this option, the tax credit may ultimately need to be reduced in size during the legislative process, because of the nature of Joint Tax's estimates. (The budget deal calls for Treasury and Joint Tax to work together on cost estimates. Because Joint Tax assumes much heavier costs associated with the credit, any movement toward JCT's methodology reduces the amount of savings we can get by reducing the deduction.

Same comment as p. 2

Need pro + con of the two approaches -- credit vs deduction

be reduced by either capping it at $1500 or turning it into a 15% credit. With either approach, in the first two years of college, the HOPE Scholarship would always be more valuable:

why? Not always

cd. be same

i. **Cap value at $1500.** 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. This would save ______.

PROS -- equalizes maximum credit and deduction at $1500

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.

Compared to current proposal, this is less regressive

Con: Key Democrats and groups may argue that this approach is regressive, because a poorer student at the same university cited above would receive less of a benefit.

ii. ~~**Turn**~~ Set value of **deduction** ~~into~~ at **15%** ~~credit~~ of tuition & fees. The deduction would essentially be turned into a credit valued at 15% of the tuition and fees charged. The value of the ~~credit~~ 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).

$4b

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

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

Assuming that the grade requirement is changed to satisfactory progress (1a), and the Pell offset is eliminated (2a), this package would total ________ with option (i), or ______ with option (ii).

$2.8b

3b. Preserve deduction, reduce credit to $1200. The tax deduction would be unchanged: it would apply to up to $5,000 of tuition and fees through the year 2000 and up to $10,000 thereafter. The HOPE Scholarship would be reduced to a maximum of $1200. Assuming that the grade requirement is changed to satisfactory progress (1a), and the Pell offset is eliminated (2a), this package would total ________.

$39

increases disparity 1200 max vs 2800 max

Pro: Reducing the credit helps to address the "tuition inflation" argument, because fewer community colleges would have tuition and fees below that level.

Con: The credit would not cover average community college tuition (now at

1997 + 1998

$1,500).

Education tax items outside the $35 billion

We recommend that the Administration's tax package 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, we 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 that we have developed would 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 $5 billion.

Community really wants this.

- **Student loan interest deduction.** Different proposals have been put forward by Senate Republicans, Senate Democrats, and House Democrats. Cost ranges from less than $1 billion to $3 billion, depending on design (caps, income ranges, new versus old loans).

- **Extending Section 127** (tax deduction for employer-paid education assistance). Senate Republicans have proposed making it permanent (Cost ___), while your budget extended it through the year 2000 (Cost ____). Sen. Moynihan is a strong supporter of this provision. 98 budget

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

- **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. 98 budget $15 Million

ICR(?) in 98 budget —

Other items that have been proposed in Congress, but that we are *not* currently including in our package:

- **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. [Need description]. 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 other high-poverty schools, and (2) an expansion of the Work Opportunity Tax Credit to employers who hire graduates within six months of leaving an academy.

One of the focuses of the School-to-Work program is for students to see how the work world is connected to their education. The Education Department has discussed the idea of using the WOTC idea to provide incentives for businesses to hire students *while they are still in school*, where there are school-business partnerships that link academics to the work site. (Apparently the old TJTC included "cooperative education," which is similar to the school-to-work model. Bringing it back might be controversial).

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.

Pro: Addresses a critical need; moves forward on an issue that had to be dropped during budget negotiations.

Con:

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 schools in high-poverty areas.

Pro: Builds on Charter School program.

Con: Most Charter Schools are created from existing schools. Construction and renovation funding is usually not the limiting factor.

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.

Pro: Builds on the School-to-Work program, promoting more partnerships at the neediest schools.

Con:

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").

Pro:

Con:

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.*

Pro: The best school-to-work programs provide students with some *paid* work experience, connecting that to their academics in school. This would encourage businesses to offer these paid internships. Builds on the School-to-Work Opportunities Act.

Con:

Education Tax Issues
Summary of Decision Options

Current Proposal:

$1,500 Hope Scholarship
$10,000 Deduction
Total 5 year Cost: $36.2 billion

Cost Raising Modifications that Respond to Criticisms

1) Drop Grade Requirement. Replace with:

a) Satisfactory Academic Progress — **Cost: $2.2 billion**

or

b) Achieving Sophomore Status — **Cost: <\$2.2 billion**

2) Pell Grant Offset

a) Eliminate (get Pell and Hope) — **Cost: $3 billion**

or

b) Offset Pell by 50% (Every $1 Pell, lose $0.50 Hope) — **Cost: $0.9 billion**

Cost Cutting Modifications to fit within $35 billion

A) Preserve HOPE -- Reduce Deduction

i) Cap value of deduction at $1,500 — **Saves:**

or

ii) 15% Maximum — **Saves:**

B) Preserve Deduction -- Reduce HOPE to $1,200 — **Saves:**