FEDERAL INCOME TAX RESTRUCTURING PROPOSALS:

The Potential Impact on Colleges and Universities

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America's colleges and universities face major new challenges as they confront substantial reductions in direct federal support. While the level of funding these institutions receive from governmental sources continues to decline, the need for computers, classroom facilities, laboratories, and scholarships only increases. In light of the fundamental role higher education plays in our society and in our individual lives, this is precisely the wrong time to reduce the traditional tax support afforded to colleges and universities. As the presidential candidates and Congress evaluate replacing the existing income tax, they must consider that variations on the flat tax, the VAT, and a national sales tax would eliminate tax incentives for charitable giving and tax exempt financing. Enacting any of these proposals without incorporating some specific measures to replace these tax supports would certainly have a grave impact on higher education.

The success of the American model in marshaling private generosity to foster public programs is nowhere more clearly evident than in our colleges and universities. America's colleges and universities are a key resource for ensuring long-term economic growth and international competitiveness. These institutions train the skilled and flexible workers business needs, nurture the scientific research that has made American industry a leader in new technology, and foster the spirit of innovation that is essential to a vital economy. Equally important, higher education broadens the base of individuals who benefit from the economic prosperity it helps create. Throughout the twentieth century, higher educational institutions have been the stepping stone for countless Americans to live richer and more productive lives.

In recognition of the substantial public benefits colleges and universities provide, they have long enjoyed favorable tax status. The unique tax treatment of colleges and universities is deeply rooted in our common law tradition and has played a critical role in fostering the development of higher education. The three principal federal tax benefits bestowed on nonprofit educational organizations are (1) exemption from federal income tax, (2) eligibility to receive deductible contributions, and (3) access to tax-exempt financing. Each of these benefits is vitally important to the financial health of our system of higher education.

Four major pieces of proposed legislation may impact the availability of these benefits to colleges and universities. The National Retail Sales Tax Act of 1996, The Armey/Shelby Flat Tax Proposal, The USA Tax Act of 1995, and The Gephardt 10% Tax Proposal all contain provisions impacting the benefits that institutions of higher education now receive.

THE NATIONAL RETAIL SALES TAX ACT OF 1996

On March 6, 1996, Representatives Schaefer, Tauzin, Chrysler, Bono, Hefley, Linder and Stump introduced the "National Retail Sales Tax Act of 1996" (H.R. 3039). This bill repeals the income tax and in its place imposes a 15% national retail sales tax on the use, consumption, or enjoyment of any taxable property or services produced or rendered within or without the United States. Under this bill, the sellers of goods or services must collect the tax and remit it to the government. The tax does not apply to items purchased for resale, purchased to produce taxable property or services, or items exported from the United States for use, consumption, or enjoyment outside of the United States. The bill also provides a limited exemption for payments of dues or contributions to qualified organizations and a credit for nonprofit organizations' labor costs.

H.R. 3039 generally represents a negative result for tax-exempt colleges and universities. Implicit in the bill due to its repeal of the personal income tax are two negative results:

- "Tax-exempt" bonds lose their preferred status as all interest becomes tax-exempt; and
- The benefit of the charitable contribution deduction is effectively eliminated.

In addition, the bill contains two provisions that would erode the income tax exemption of many colleges and universities. The first provision makes it clear that only tuition payments, and not room and board or other university charges, would be exempt from the retail sales tax. The second provision lays down the general rule that payments to qualified not-for-profit organizations for otherwise taxable property or services are exempt from tax only if they are not commercially available. Since the non-tuition goods and services provided by most colleges and universities are currently offered by competing for-profit companies (i.e., they are commercially available), colleges and universities will not fully retain their favorable tax-exempt status under the bill.

Any limitation on the deductibility of charitable contributions will have a significant impact on those colleges and universities which are heavily supported by donations. A shift to a national sales tax would necessarily eliminate the deduction because tax is imposed on individual transactions rather than on an individual's income. In other words, if there is no income tax, there can be no deductions from income for tax purposes. By eliminating the income tax and itemized deductions, this bill would therefore eliminate incentives for charitable giving by taxpayers who are normally motivated by the itemized deduction for donations to colleges and universities.

THE ARMEY/SHELBY FLAT TAX

On January 19, 1995, Rep. Richard Armey (R-Tex), the House Majority Leader, reintroduced in revised form a flat tax proposal (H.R. 2060) that would replace the current individual and corporate income taxes and the estate tax. On the same day, the bill was also introduced in the Senate by Sen. Richard Shelby (R-Ala) (S. 1050).

The proposed flat tax applies a flat 17 percent rate (20 percent in the first two years) to business receipts and individuals' compensation. Tax-exempt organizations would be liable for an excise tax equal to 17 percent (20 percent in the first two years) of the value of non-cash compensation provided to their employees.

Under the Armey/Shelby flat tax, the business tax is imposed on business receipts reduced by purchases from other businesses. Tax depreciation is eliminated and replaced by expensing of new capital expenditures. No deduction is allowed for most interest expenses, taxes, employee fringe benefits, or charitable contributions. The Armey/Shelby proposal maintains a deduction for employee wages and qualified pension contributions, but not for other employee fringe benefits.

The proposed flat tax poses three potential problems for tax-exempt colleges and universities:

- The continued exemption of tax-exempt colleges and universities is uncertain;
- By eliminating itemized deductions altogether, the flat tax eliminates the deduction for charitable contributions; and
- The flat tax eliminates the advantage tax-exempt bonds hold over taxable instruments because interest income is not taxable under the bill.

The treatment of tax-exempt organizations under the Armey/Shelby flat tax is uncertain because the bill contains no standards for exemption. Thus, the continued exempt status of colleges and universities is not guaranteed.

In addition, the Armey/Shelby flat tax eliminates the deduction for charitable contributions. The proposal is premised on the notion that if people have more money to spend due to lower income taxes, they will continue to make charitable contributions. However, this premise ignores the fact that the willingness of many charitable contributors to make donations results from the desire to take a deduction from their income for the amount donated. Under a flat tax regime, where there are no deductions or tax brackets, a significant incentive to donate is lost. Therefore, charitable donations are likely to decrease, even if individuals have more income.

Due to the elimination of basically all of the major tax advantages that colleges and universities currently maintain, the Armey/Shelby flat tax proposal is the one most threatening to the health of higher education institutions.

USA TAX ACT OF 1995 (S. 722)

On April 25, 1995, Sen. Pete Domenici (R-NM) and Sen. Sam Nunn (D-Ga) introduced the USA ("Unlimited Savings Allowance") Tax Act to replace the current individual and corporate income taxes and, effectively, the payroll tax. The USA tax has two parts: (1) for individuals, it would maintain progressive tax rates (up to 40%), but would tax only income that is consumed; and (2) for business, it would impose a flat, low-rate (11%) tax on a base similar to that of a subtraction method value-added tax.

The USA Tax Act has several drawbacks for tax-exempt colleges and universities:

The tax-exempt status of colleges and universities could be in jeopardy;

- The deduction for charitable contributions would be restricted; and
- Although the proposal technically preserves the exclusion for tax-exempt interest, increased tax incentives for other forms of savings would undermine its value.

The USA Tax Act would exempt from the business tax only a limited subset of presently tax-exempt nonprofit organizations. Generally, colleges and universities would retain their tax-exempt status, but the status of certain educational institutions could be in jeopardy. Think-tanks and other organizations "conducting research to educate Congress or the general public about public policy issues" would not be eligible for exemption. Many educational institutions could be classified as trying to "educate the general public about public policy issues," thereby losing their exemption.

Although the USA Tax maintains a deduction for charitable contributions to an educational institution, it would restrict the deduction for most contributions of property to the lesser of the donor's original cost basis or fair market value. In addition, if a taxpayer makes a contribution to an educational organization and as a result receives the right to purchase tickets to an athletic event at that institution, only 80% of that contribution shall be treated as a charitable contribution. Despite these limitations, this proposal is the one most acceptable to colleges and universities because most institutions will retain their tax-exempt status, and individuals will retain many of the tax incentives relating to educational institutions.

GEPHARDT 10% INCOME TAX

Rep. Richard Gephardt (D-Mo), the House Minority Leader, proposes to lower tax rates and in his words "radically reform" the tax system.[1]/ Rep. Gephardt's proposal has five tax rates, from 10 to 34 percent, with 75 percent of current taxpayers subject to the 10 percent tax rate. Gephardt's proposal maintains an income tax system but reduces tax rates. To achieve this, the current tax base would be "dramatically broadened."

Gephardt fails to indicate whether currently exempt organizations would maintain their exempt status. However, Gephardt calls for an elimination of all "special interest loopholes" and "virtually every deduction, credit, exclusion and adjustment." This includes the deduction for charitable contributions. His proposal also indicates that tax-exempt bonds will lose the advantage they held over taxable instruments.

Tax-exempt status for charitable and educational activities

Exemption from tax is the central element in the current system's treatment of charitable and educational organizations. The distinction between taxable and non-taxable organizations pervades the tax system and, more importantly, reinforces the fundamental distinction between enterprises organized for private gain and those created for public purposes. Moreover, the underlying policy rationale remains as compelling as ever: the public derives tremendous benefit from encouraging the commitment of private resources to nonprofit, non-governmental efforts to advance the public good.

Tax-exempt status is widely understood to bring not only benefits but to impose burdens as well. The grant of tax exemption draws charitable organizations into a framework of legal rules and IRS oversight aimed at encouraging organizations to maintain a single-minded focus on their public service mission.

All of the various categories of tax reform proposals under consideration -- flat taxes, taxes on consumed income, and business transaction taxes (both the VAT and sales tax) -- can, and should, be designed to incorporate exemption for charitable and educational organizations.

The charitable deduction

The current income tax system incorporates important tax incentives for charitable giving. Individual taxpayers who itemize their deductions are permitted, within broad limits, to deduct charitable contributions. Similar income tax deductions are provided for corporations and estates. Gifts of appreciated property receive favorable treatment, with donors generally permitted to deduct the full value of the appreciated asset on their tax returns.

In contrast, several of the tax restructuring proposals currently being discussed would eliminate these incentives for charitable giving. For example, as mentioned above, the most widely discussed flat tax proposals would entirely eliminate the charitable deduction in the interest of broadening the tax base to achieve the lowest possible tax rate. Even if Congress enacted a flat tax that retained a deduction for charitable giving, the value the deduction for charities would be greatly reduced since its stimulus effect is a function of marginal tax rates which would be significantly lowered or flattened under a flat tax. Similarly, a shift to either a national sales tax or a VAT would necessarily eliminate the deduction since under both systems, tax is imposed on individual transactions rather than on an individual's aggregate annual income.

It is important to stress at the outset that excluding charitable contributions from taxable income -- or from taxable consumption -- has a strong conceptual justification entirely independent of any stimulative effect on charitable giving. Resources that an individual voluntarily turns over to a charity to advance public purposes are not available to the donor to finance either present or future consumption. In this sense, charitable contributions are qualitatively different from any other consumption or investment use of personal assets. Because these assets are neither consumed nor saved for future private consumption -- but, instead, are invested for public purposes --they are appropriately excluded from the tax base under either an income or consumption tax.

In considering the appropriate tax treatment of charitable contributions, it is also vital that Congress consider the importance of charitable giving to the ability of America's charities to meet their public service missions. For example, in 1994, voluntary contributions to higher education reached $12.35 billion. This amount represents a substantial and essential element in the overall financing of higher education.

Of course, a host of factors other than the charitable deduction motivate individuals to give to colleges and universities. For some donors, the decision to give may grow out of a conscious recognition that an institution played a critical role in setting the course of his or her life; others give because they believe that support for education is an investment in the future; still others may give simply because they have fond memories of their college years. Whatever the reason for giving in individual cases, however, it is clear that, particularly for larger givers, the charitable deduction plays a key role in increasing the amount given.

The current deduction lowers the after-tax price of giving for a top bracket taxpayer by roughly 40%. Taxpayers in lower brackets benefit from a smaller, though still substantial, reduction in the price of their charitable gifts. Accordingly, eliminating the deduction would substantially increase the real, after-tax cost of charitable giving for taxpayers who itemize their deductions.

Some proponents of structural tax reform suggest that the negative price effect of eliminating the charitable deduction would be largely, or even entirely, off-set by a countervailing "income effect." Empirical studies of charitable giving reveal that -- other things being equal -- donors increase the amount they give when they have more income. Noting this fact, some tax reform proponents argue that structural tax reform will trigger economic growth and increase incomes to a point where the income effect will prevent the level of charitable giving from dropping despite losing the deduction. While it is certainly to be hoped that tax restructuring could both be revenue neutral and stimulate increased economic growth, achieving these goals is highly uncertain.

A disproportionately large share of gifts to colleges and universities are made by taxpayers in higher brackets who receive the largest incentives to give under the current system. Accordingly, colleges and universities would be disproportionately hard-hit by eliminating the deduction.

Congress also needs to understand the direct impact that a reduction in giving to higher education would have on students struggling to pay for their education. America's colleges and universities share a commitment to subsidizing the costs of education for those who cannot afford to pay regular tuition. In large part because of that commitment, higher educational institutions, both public and independent, are able to serve students of widely varying economic means. Colleges and universities are under considerable financial stress, however, as costs continue to rise and direct support from government continues to decline. In this context, it is obvious that any drop in private giving would translate into fewer funds for scholarship aid and reduced access to higher education for America's young people.

A major impetus for the tax restructuring is a recognition that America needs to encourage increased savings and investment. At the same time, many in Congress are calling for increasing private initiatives to address important public needs. Given these two goals, it would be ironic indeed if tax restructuring were to eliminate or erode current tax incentives for charitable giving -- the one aspect of current tax law that most directly addresses both of these critical objectives. Should Congress decide to adopt a tax system that eliminates or significantly reduces the effectiveness of the charitable deduction, then it is critical that the new system incorporate comparable incentives for charitable giving.

Tax-exempt financing
The third important tax benefit granted to colleges and universities under the current tax rules is access to tax-exempt financing. By allowing purchasers of bonds issued on behalf of nonprofit educational organizations to exclude the interest they receive from their taxable income, the current tax system enables colleges and universities to borrow at rates between 1.5 and 2.0 percentage points lower than taxable rate. This rate differential has a significant impact on colleges and universities' borrowing costs. For example, a university that issued a thirty-year, tax-exempt bond for $10 million would pay $4.9 million more in interest if the bond were taxable.

Tax-exempt bonds are a crucial means of financing major capital expenditures for a wide range of large nonprofit organizations -- all of which are barred by state and federal law from raising funds by issuing stock. Such financing is particularly important for higher education because of the large and costly physical plant required for both education and research activities. A recent study estimates the capital construction needs of American colleges and universities for new construction and essential maintenance of existing facilities at $60 billion. Because of a lack of capital funding, many institutions face a major deferred maintenance problem. Moreover, this already serious situation is exacerbated by continuing reductions in direct support for higher education from the federal government.

As mentioned above, most flat tax proposals explicitly exempt interest income from tax, and thus would eliminate the preferred status of college and university bonds, forcing them to pay the same interest rate as regular corporate bonds. A VAT or a sales tax would also erase the distinction between taxable and tax-exempt bonds. Some proponents of tax restructuring argue that shifting to a consumption-based tax will increase savings and cause interest rates to drop, so that charities and local governments will not see a rise in their borrowing costs. However, the impact of tax restructuring on general interest rates is far too uncertain to support the conclusion that elimination of tax-exemption financing will not have a major adverse impact on colleges and universities' ability to finance essential physical plans.

If Congress chooses to enact either a flat tax or a business transactions tax, serious thought needs to be given to how higher education -- as well as other charities and state and local governments -- will be given access to affordable credit.

Conclusion

Proponents of structural tax reform have promised to "tear the income tax out by its roots" or to end "the IRS as we know it". While such radical change may appeal to those who have had frustrating experiences with the federal tax bureaucracy, higher education has little to gain and much to lose if any of the tax reform proposals described above are enacted. The deductibility of charitable contributions, tax-exempt financing, and even the basic federal exemption of colleges and universities would all be eliminated or jeopardized under such proposals. With acknowledged dependence of American higher education on deductibility of contributions and tax-exempt financing to provide a quality education, it is imperative that the future administration and the Congress make appropriately conservative assumptions about increased economic growth when assessing the implications of tax restructuring proposals on colleges and universities.

[1] / All quoted remarks in this section come from the "Statement by House Democratic Leader Richard A. Gephardt on Gingrich-Dole Tax Commission Report", released January 16, 1996.

THE IMPACT OF CONGRESSIONAL ACTIONS ON FEDERAL STUDENT AID PROGRAMS

Prepared by the American Council on Education

The final days of the 104th Congress, which formally adjourned on Friday, October 4, produced a vastly different outcome for higher education funding than the prospect that emerged during the early days of the session. Higher education was among the big winners in the final 1997 budget package, with most programs receiving increases or at least level funding. In stark contrast, budget plans prepared in early 1995 as a supplement to the House Republicans' "Contract with America" proposed to cut the federal student loan program and end the in-school interest exemption, eliminate the campus-based student aid programs, substantially curtail the direct loan program, slash indirect cost reimbursements on federal research, and reduce funding for the National Institutes of Health (NIH) and National Science Foundation (NSF) significantly.

Seventy-three new Republicans were elected to the House of Representatives in November 1994, shifting control to the GOP for the first time in 40 years. With House Republicans strongly committed to balancing the federal budget, the GOP initially proposed severe cuts in federal student aid programs estimated to total between $18 billion and $24 billion over seven years. However, when the smoke cleared from the long and tortured budget process for fiscal year 1996, higher education programs had been spared all of the proposed cuts.

ALLIANCE EFFORTS PAY OFF

The efforts of the Alliance to Save Student Aid have been widely acknowledged to have played a key role in preserving student aid funding. Congress heard from thousands of concerned citizens who faxed, called, e-mailed, or wrote their members during the lengthy budget battles. As a result, Congress not only rejected proposed cuts in student aid programs that would have cost students and their families billions of dollars, it approved additional funding that will help keep the doors of college open for millions of Americans.

The success of the Alliance, a coalition of more than 50 national higher education associations, has been attributed in part to the fact that the group presented a united front, worked cooperatively, organized an extremely successful grassroots movement on campuses around the country that educated students about the issues and motivated them to action, and used new techniques to inform the debate.

For example, the Alliance utilized focus groups and survey research, which concluded that the public gives almost as much priority to student aid programs as to Social Security. By nine to one—89 percent to 10 percent—respondents to the survey favored maintaining at least the current level of funding for federal student aid. In addition, the Alliance established a home page on the World Wide Web (http://student-aid.nche.edu) to provide the higher education community and the public easy access to documents and information of importance on student aid issues.

A toll-free hotline, 1-800-574-4AID (4243), also helped tens of thousands of college students, members of their families, and others contact their congressional representatives to express their support for federal student aid. The hotline remains activated so that concerned individuals can call Congress to thank those representatives who supported funding for student aid programs, and to request support in the future from those who voted for the cuts. Proposals already have been advanced to rescind or repeal the funding increases when the 105th Congress convenes in 1997. The Alliance will continue the fight to preserve student aid as Congress considers the reauthorization of the Higher Education Act next year.

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The following summarizes the 1996 and 1997 appropriations process (see attached table) and highlights other legislation, both major and minor, debated or enacted in the 104th Congress that had an impact on higher education. In addition, a brief summary is provided of likely issues to be discussed during the Higher Education Act reauthorization process that the 105th Congress is expected to take up shortly after it is sworn in in January.

1996 & 1997 APPROPRIATIONS--FINAL

By the time the new Congress finally sent its balanced budget plan to the White House in October 1995 (which President Clinton vetoed), the only changes it proposed for the student loan system were a cap on direct lending (meaning that fewer schools would have been able to participate) and reductions in the subsidies paid to lenders in the Federal Family Educational Loan (FFEL) program. The in-school interest exemption was restored for both graduate and undergraduate students, and funding for the campus-based programs remained in place, except for a reduction in new capital contributions to the Perkins Loan program.

By the end of the 1997 budget process, the direct loan program had survived without changes, thus maintaining the free-market competition between direct lending and FFEL. Funding for the two major agencies that support scientific research and development—the National Institutes of Health (NIH) and the National Science Foundation (NSF)—actually had been increased above inflation.

In all, Congress approved and the President signed seven of the 13 regular appropriations bills for fiscal 1997. The funding allocations for the other six appropriations bills were wrapped into an omnibus appropriations measure, H.R. 3610, which was approved by a 370-37 vote on September 30, just hours before the start of the new fiscal year. The bill contains funding for the departments of Education, Health and Human Services, Labor, Defense, Commerce, Justice, State, Treasury, and Interior.

The outcome of the fiscal 1997 budget process was even more beneficial for higher education, and was much quicker and easier, than the year-and-a-half struggle over 1996 appropriations. In the end, unprecedented funding increases for many higher education programs had been approved, due in part to a bidding war to preserve education funding that erupted at the eleventh hour during conference proceedings.

The generous funding allocations were largely the result of Republican lawmakers' desire to avoid battling with the Clinton administration over funding levels and to avert the politically damaging government shutdowns that occurred last year when budget agreements could not be reached. In addition to wanting to complete action before the start of the fiscal year on Oct. 1, the lawmakers wanted to adjourn to allow time to campaign for the upcoming elections. To accomplish that goal, Congress was forced to yield substantially to the president's budget request, adding roughly $3 billion to the Department of Education.

When the dust settled, the department had received overall funding of $31.1 billion, compared with $29.1 billion in 1996. Discretionary spending for the department was set at $26.3 billion—$4.8 billion more than last year's level. The increased funding will be paid for through the sale of parts of the broadcast spectrum, a reduction in defense spending, and a one-time assessment on savings and loans.

Major Student Aid Programs

Funding for major student aid programs increased by $1.3 billion, from $6.3 billion in 1996 to $7.6 billion in 1997. The bill provides significant increases for the Federal Work-Study program (from $616 million in 1996 to $830 million in 1997, surpassing Clinton's budget request of $679 million); Perkins Loan capital contributions (from $93.3 million to $158 million); State Student Incentive Grants (SSIG), which had been slated for elimination under earlier budget proposals (but instead were increased from $31 million to $50 million); and Pell Grants (from $4.9 billion to $5.9 billion). The Pell Grant maximum award was increased by $230, from $2,470 to the president's request of $2,700—the largest single year increase in the award since the 1974-75 school year. In addition, President Clinton has endorsed a 33 percent increase in the maximum Pell award to $3,128 in 2002.

Scholarships, Fellowships, and Other Programs

Several aid programs, including Early Intervention Scholarships, TRIO, Areas of National Need, International Studies, and Fulbright-Hayes, received slight increases, while funding for Adult Education Basic Grants rose by almost $100 million. Also, the Supplemental Educational Opportunity Grant (SEOG) program, Byrd Honors Scholarships, Strengthening Institutions, Hispanic Serving Institutions, Urban Community Service, Strengthening HBCUs, Minority Science Improvement, and Tech Prep were level funded (see attached table for dollar amounts).

Science and Research Funding

Both NSF and NIH received funding increases for fiscal 1997. Under the Veterans Affairs, Housing and Urban Development, and Independent Agencies (VA-HUD) appropriations bill (H.R. 3666), NSF received an overall appropriation of $3.27 billion, a $50 million (1.5 percent) increase over last year's appropriation and $5 million less than Clinton's request. Research and related activities were set at $2.43 billion, an increase of $118 million. NSF's education and human resources division received $619 million, up from $599 million. The bill provided no funds for the academic research infrastructure program.

The NIH appropriation of $12.7 billion is $371 million more than Clinton's request and represents a 6.9 percent increase over fiscal 1996. The research accounts received a 6.5 percent increase, with the remaining new funds targeted to NIH's Office of the Director and facilities programs, including $90 million for a new NIH clinical center.

Clinton's 1997 budget would have funded university-based research at $13 billion, an increase of $155 million over 1996; increased National Science Foundation funding by 3 percent over the 1995 level; and raised funding for the National Institutes of Health by 10 percent over 1995.

National Endowments for the Humanities (NEH) and Arts (NEA)

Despite efforts by Republicans to eliminate the NEA and NEH, both programs were level-funded for 1997, receiving the same appropriations as in 1996. The NEA received $99.5 million (down from $162 million in 1995) and the NEH $110 million (down from $172 million). The White House requested $136 million for each agency for 1997.

AmeriCorps

Although many Republican lawmakers oppose President Clinton's AmeriCorps program and proposed to kill it, the national service initiative received $402.5 million in the VA-HUD appropriations bill. The spending plan approved by the House would have eliminated all funding for the program.

One of President Clinton's signature programs, AmeriCorps began in 1995 as a public-private partnership in which states elect to compete for AmeriCorps members. Participants perform service to meet human, environmental, public safety, and educational needs in return for vouchers for education, vocational training, or student loan repayments. The program has been under attack by Republicans since its inception as a "bureaucratic charity" that pays volunteers who otherwise would work for free. However, Clinton vetoed last year's VA-HUD bill partly because it did not contain funding for AmeriCorps, and threatened to do so again this year unless funding was approved.

Solomon Amendment

The omnibus spending bill contained a revised version of an amendment by Rep. Gerald Solomon (R-NY) that bans federal grants or contracts to universities that deny access to campus to ROTC or military recruiters. A similar provision was contained in the Energy Department appropriation approved by Congress and signed by the president.

Known as the "Solomon Amendment" for its sponsor, the provision is aimed at institutions that deny access to military recruiters in protest of the military's policy against homosexuals. The measure makes colleges and universities that bar military recruiters or ROTC from their campuses and deny access to student records by recruiters ineligible to receive any research grants or other federal assistance.

The higher education community opposed the Solomon amendment because it makes funding for research and student aid contingent upon government review of institutional policies that are unrelated to science or education. In addition, the original version of the amendment would have required colleges and universities to provide military recruiters access to a host of information on students that many institutions do not currently have; the cost and effort required to establish new databases would have been prohibitive.

However, the revisions that were made in this amendment address some of the higher education community's concerns over such a ban. The final version of the amendment requires institutions only to provide basic information (a student's name, address, and telephone number) to military recruiters. It exempts religious institutions, and makes it clear that if a specific department or program (e.g., a law school) denies access to ROTC or military recruiters, only grants or contracts to that specific department or program will be affected. Most importantly, it requires a determination of the validity of the complaint to be made before funds may be cut off.

The final version of the amendment specifies that the Department of Defense determines whether colleges and universities are in compliance with the law.

Deeming and Deportation Provisions in Immigration Bill

The immigration bill that was passed as part of the omnibus spending bill does not include the restrictive deeming and deportation provisions that would have been triggered when permanent resident aliens applied for federal means-tested benefits. Therefore, under the law, permanent resident alien students will continue to be able to receive federal student aid.

The deeming provision would have required that the income and assets of a sponsor be deemed fully available to support the legal immigrant student. Under the deportation provision, legal immigrants who participated in federal, state, or local need-based assistance programs, including Pell Grants or student loans, for a total of 12 months during their first five years in the United States would have been deported as a "public charge."

OTHER STUDENT AID LEGISLATION IN THE 104TH CONGRESS

Guaranteed Loan Programs

The Federal Direct Student Loan program was opposed strongly by Republicans throughout the budget process. Efforts to kill the program, cap it, revise the budget rules to make direct lending appear more costly than the Federal Family Education Loan (FFEL) program, or to minimize advantages that direct lending has over FFEL all failed. As a result, direct lending looks much like it did upon enactment.

Under direct lending, established in August 1993, schools make loans directly to students from funds provided by the Department of Education, removing banks from the process. The program simplifies the loan process and allows borrowers' monthly loan repayments to be based on their postgraduate incomes. The existence of both direct lending and FFEL has brought competition to the federal loan programs and has resulted in improved service and operations.

Originally, the legislation establishing the program called for at least 60 percent of new borrowing to be done under direct lending by 1998; however, the success of the program and the potential for budget savings led Clinton in his 1996 budget request to call for full implementation by 1998. Republicans, however, proposed capping the program at 40 percent of new borrowing. This plan was one of the major items in dispute in the 1996 omnibus appropriations bill. That provision was dropped in favor of one that allows schools to choose to participate in one program or the other.

Section 127

The Small Business Job Protection Act (PL 104-188), signed into law by President Clinton on Aug. 20, includes a provision that reinstates Section 127 of the Internal Revenue Code. Section 127, which allows employers to provide their workers with up to $5,250 per year in nontaxable educational expenses, expired on Dec. 31, 1994.

The law extends the tax exemption retroactively. It provides the tax break only for graduate courses begun by June 30, 1996. The exemption for undergraduate study would apply to courses undertaken by July 1, 1997. Originally, Congress wanted the exclusion for undergraduate students to expire after May 31, 1997, but due to a "snafu," the statutory language mandates the provision to expire on the later date.

The Internal Revenue Service (IRS), meanwhile, has established a set of special procedures designed to expedite refunds to employees and employers who participated in employer-provided educational assistance plans in 1995 and 1996. Refunds are available for both companies and their workers. The IRS guidelines state that employees who previously paid taxes for employer-provided educational assistance now can get refunds of federal income, Social Security, and Medicare taxes paid in 1995, and Social Security and Medicare taxes paid in 1996. Employers can obtain refunds for Social Security, Medicare, and unemployment taxes that they paid on the education benefit.

Information on the procedures to follow to receive an expedited refund is available from the IRS at (800) 829-1040 or on the IRS home page at http://www.irs.ustreas.gov.

THE 105TH CONGRESS

Higher Education Reauthorization

Congress will take up reauthorization of the Higher Education Act early next year. Although it is difficult to project what will happen, given the current uncertain political environment, at least modest changes in federal student aid programs are likely. The higher education community has established task forces to look at issues of concern that will be discussed during reauthorization, including:

- *Repeal of Funding Increases*—As indicated earlier, some members of Congress have proposed rescinding or repealing the additional funding for education programs approved in the final days of the 104th Congress. The outcome of the election in large part will determine whether such proposals are considered seriously.
- *Changes in Loan Programs*—The task forces will stay alert for any changes in the federal student loan programs that would increase the cost of loans (or alter their terms) in ways that would harm borrowers. Although a repeat of the 1995 effort by House Republicans to eliminate the in-school interest exemption is unlikely, such a proposal could emerge as part of a broad-scale effort to balance the federal budget (e.g., a reconciliation package). In addition, proposals could be offered during reauthorization to make changes in the loan programs that would be financed by cuts elsewhere in the programs. Under current budget rules, increases in entitlement spending must be paid for by other changes in entitlements. Thus, a proposal to increase loan limits for borrowers, for example, would have to be financed by other cuts in the loan programs.
- *Campus-Based Programs*—Maintaining the three campus-based student aid programs—Federal Work-Study, Supplemental Educational Opportunity Grants, and Perkins Loans—also will be a priority of the higher education community. A major threat to these programs is a proposal to combine them into a single block grant and turn the money over to state governments to distribute to colleges. If the programs lack political support in a state, it could be just a matter of time before they lose all funding.
- *Pell Grants*—In addition, the task forces will be concerned about making certain that the low-income focus of the Pell Grant program is not diluted further in the future. Possible changes during reauthorization include "front-loading" Pell Grants so that students get grants only in their first and second years. With constant funding, this would permit an increase in the maximum award and reduce the need for student borrowing in community colleges; however, it also would further segregate higher education by income.
- *Remedial Courses*—Other issues of importance include proposals by some policy makers to eliminate remedial courses from eligibility for federal student aid (at present, all courses that count for academic credit are eligible; federal student aid funds cannot be used for non-credit courses). The reasoning behind such proposals is to reduce the number of eligible students and permit more federal aid to go to those who are "academically prepared" for college. Most students taking remedial courses are from low-income families, and many are

members of minority groups. Since a large number of students take only a few remedial courses, it is unclear how much money would be saved by such a proposal. It also is unclear how the federal government would define remedial education in a way that would respect institutional diversity.

- *Merit In Aid Programs*—On the flip side of proposals limiting remedial education are plans to reward "merit" in the student aid programs. While some members of Congress want to restrict student aid to the academically able, others would give a bonus to those who meet a specified definition of merit. How "merit" is defined is a big uncertainty. Federal student aid never has been conditioned on merit, and any effort to do so is bound to be problematic.

Tax Issues

A number of tax issues are likely to be debated in the 105th Congress, including:

- *Education and Job Training Tax Deductions*—The president this year renewed his proposal to allow families to deduct up to $10,000 for payments for any family member for college tuition or training costs, and likely will do so again next year. Under the plan submitted with his proposed fiscal 1997 budget, the maximum deduction would have been limited to $5,000 annually from 1996 through 1998 before expanding to $10,000 in 1999 and thereafter. The full deduction would have been available only to families with annual incomes below $100,000, and would have been phased down for those with incomes up to $120,000. On June 4, as part of his plan to guarantee access to college (see next item), the president revised the proposed deduction so that it would be phased out at incomes between $80,000 and $100,000 for joint filers and between $50,000 and $70,000 for single filers.
- *Tax Credit for Higher Education*—This provision was not included in the president's original budget request. On June 4, President Clinton unveiled the HOPE Scholarship Plan, which would provide up to $1,500 in a refundable tax credit to full-time college students during their freshman year. A credit of $750 would be available to part-time students. Students would be eligible for an identical tax credit in their sophomore year if they "stay off drugs and earn at least a 'B' average in their first year." Students and their families could elect to take either the tax credit or the tax deduction, but not both.
- *Special Individual Retirement Accounts* —Households would be permitted to withdraw their IRA savings penalty-free if the funds are used to pay postsecondary education costs, buy or build a first home, cover living costs if unemployed, or pay catastrophic medical expenses.
- *Pension Simplification*—Proposals under consideration would, among other things, allow exempt organizations to maintain 401(k) plans; repeal family aggregation rules; simplify the definition of highly compensated employees; simplify nondiscrimination testing for 401(k) plans; and modify deferred compensation plans of governments and tax-exempt organizations.

The New Era of Choices in Electricity for Colleges and Universities

by Sheldon E. Steinbach
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Sheldon E. Steinbach

Institutions of higher education, some of whose campuses exceed the size of many small towns, are major consumers of electricity. In total, colleges and universities spend between $6 billion and $7. billion per year on electricity; the bill for a major research university may be as high as $13 million. At the average college, one-third of the operations and maintenance budget goes toward utilities.

Despite conservation efforts, expanding technical needs are likely to continue to fuel a growth in demand for electrical power by colleges and universities. At the same time, institutions are facing considerable pressure to limit tuition increases, making it very difficult to pass the higher costs on to consumers.

With these facts in mind, the American Council on Education (ACE) recently filed comments with the Federal Energy Regulatory Commission (FERC) supporting efforts to open the wholesale bulk power markets to competition. Our submission maintains that such competition has the potential to reduce significantly the costs of electricity to institutions of higher education.

While FERC has advocated greater wholesale competition, it also has proposed to allow utilities to recover through surcharges to purchasers the cost of assets that are rendered uneconomic or "stranded" by the move to a competitive market. Various sources estimate that utilities may have $135 billion or more in assets that exceed likely market rates. ACE has proposed several ways to deal with stranded costs while maximizing the benefits of competition, including phasing out the right to recover them over a defined period.

Colleges and universities have choices of companies from which to purchase insurance, computers, overnight mail services, and even natural gas. In fact, about the only purchase where we have no choice is the most essential—the electricity that runs an extraordinary range of campus activities. Under the current system, we are forced to pay a government-established price to a monopoly provider.

From the 1930s until recently, this system made some sense. Huge, centralized power plants were the most efficient way to generate electricity, which could not be transported economically over long distances. Regulators believed that creating monopoly utilities, with exclusive rights to serve a specific geographic area, was the only way to achieve relatively low-cost, reliable service.

However, things have changed. Due to technological advances, small generators now are at least as efficient as most large power plants, and electricity can be transported efficiently from region to region over a sophisticated national grid. So-called power marketers have emerged whose sole purpose is to acquire and resell electricity at competitive rates.

We also have learned that monopolies exact a price: because they are not subject to the discipline of competition, they do not have the same incentive to be efficient. In fact, utilities have reason to be inefficient because regulators set their rates based on the cost of providing service to their geographic area. The result is higher prices and no incentive to meet the needs of consumers.

Retail competition in electricity would fix that problem. Customers would be able to shop for the least expensive energy that meets their needs.

To accomplish competition at the retail level, we need to break the old monopoly model, much as FERC has done with the natural gas industry, and as Congress did in the new telecommunications law.

The focus must be on how to make the transition from a monopoly environment to a competitive one. A similar debate occurred in the change over to a competitive gas environment. For example, how long should the existing monopoly provider remain rate-regulated while alternative providers are given a chance to develop market presence? What degree of protection is owed to the monopoly utility's existing investments?

A plethora of issues relating to the appropriate roles of federal and state regulators also must be addressed.

Transition issues will be challenging, but they should not delay the achievement of the ultimate goal: a fully competitive electricity industry that provides the lowest possible prices and the widest possible choices for all consumers. ■

ENVIRONMENTAL LIABILITY: IT'S NOT ACADEMIC

Although many institutions have adopted sophisticated compliance systems, many have not adapted their operations to various environmental requirements. Some colleges and universities also have done little to protect their employees.

• BY SHELDON E. STEINBACH •

INCREASED PUBLIC CONCERN about the environment has led to a significant expansion of federal and state environmental laws in recent years. These laws no longer focus exclusively on industry but now extend to a broad spectrum of entities—including colleges and universities. Although it does not always make sense, most academic institutions are subject to many of the same requirements that apply to chemical manufacturing plants.

These environmental laws are implemented by thousands of regulations, creating an extremely complex regulatory scheme. Yet despite this complexity, environmental requirements are now being enforced—both civilly and criminally—in a more rigorous and nonselective fashion than ever before.

Government agencies and the courts assume that businesses and individuals who deal with chemicals—whether in a college laboratory, art studio, or in connection with printing a publication—are sophisticated enough to know about potential environmental hazards. Consequently, anyone who fails to comply can be held civilly, and perhaps criminally, responsible. This liability can extend beyond the institution to individuals, based on the reasoning that all responsible personnel—from a lab instructor to a college president—have a duty to ensure compliance with the environmental laws and protect against environmental risks.

Clearly, colleges and universities must meet these challenges. Although many institutions have adopted sophisticated compliance systems, others have not adapted their operations to various environmental regulations, much less developed cost-effective compliance strategies. They also have done little to protect their management and employees.

Why? One reason is that regulators traditionally have overlooked academic institutions in enforcing the laws. Colleges and universities typically do not generate hundreds of tons of hazardous waste or discharge thousands of pounds of pollutants into the water. However, as industrial facilities have improved their compliance status in recent years, state and federal environmental enforcement agencies have turned their attention to nontraditional targets, including academic institutions.

A number of inspections have led to substantial enforcement actions and hefty fines, based simply on the environmental reports filed by the institution. Yale and Stanford universities recently paid six-figure fines and agreed to correct their hazardous-waste handling and disposal practices. In announcing the settlement with Yale, EPA said it was "a reminder that even the most august academic institutions must be held fully accountable for adhering to the nation's environmental laws."

Although the penalties imposed on Stanford and Yale were substantial, they likely would have been much higher if the government had discovered similar violations at an industrial facility. With these and other enforcement actions as precedent, colleges and universities should expect greater scrutiny. Indeed, EPA already is pursuing academic institutions as responsible parties in the context of Superfund cost recovery.

Institutions that improve their environmental compliance systems will protect themselves and their personnel from criminal investigations as well. Environmental laws historically have included criminal penalties, even if an institution or individual did not intend to violate the law. Indeed, a failure to act has formed the basis for an array of environmental crimes.

Finally, academic institutions are also not being overlooked in the current wave of personal injury and tort suits. Subpar environmental compliance programs clearly enhance the chances for an accidental release or other unnecessary exposure to a toxic substance.

Although academic institutions always have had high regard for the health and safety of their campuses and their communities, their performance thus far in the environmental arena has not been exemplary. Institutions must pay closer attention to environmental laws and develop compliance systems as an integral part of everyday operations. Such planning represents prudent risk reduction and can produce substantial environmental benefits.

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