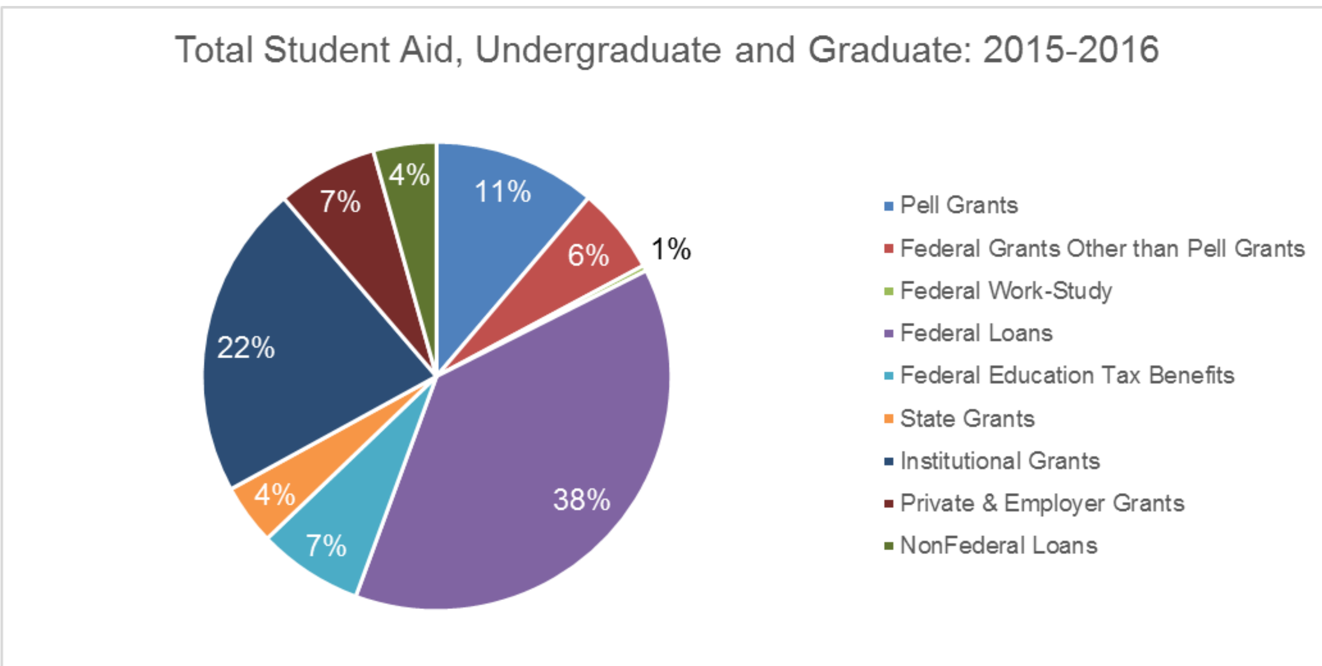
A primer on the types of higher education tax benefits available to families.

The federal government provides financial assistance for higher education in four broad categories – grants, work study, loans and tax benefits. For the majority of the last fifty years and ever since the federal government first began providing financial assistance for higher education in the 1950s, the dominant forms of aid have been grants, work study assistance, and loans.



SOURCE: TRENDS IN STUDENT AID 2016

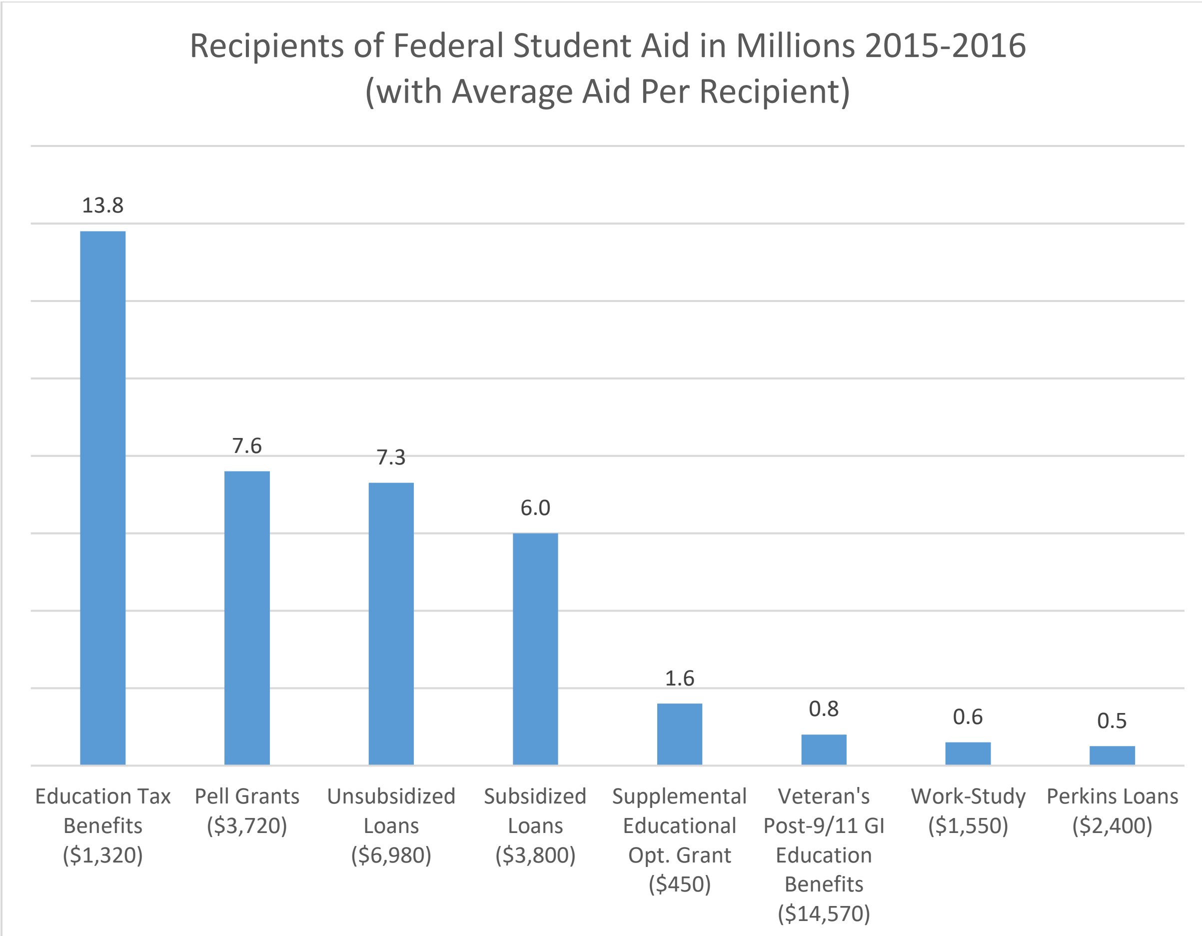
Since the mid-1990s, however, federal income tax benefits have increasingly become a part of the student financial aid landscape. Over the last decade, federal expenditures (foregone tax revenue) in the form of higher education tax benefits have increased 109 percent. In 2015-2016, federal education tax benefits made up seven percent of total student aid (federal, state, institutional, private, including loans) for postsecondary education. Looking only at federal student aid in that year, education tax benefits constituted $18.3 billion, or 11.5 percent, of the $158.3 billion in financial assistance, including loans.

Student Aid for Higher Education in 2015 Dollars (numbers in millions)

	2005-2006	2010-2011	2015-2016	10 Year % Change
Pell Grants	$15,503	$39,055	$28,232	82%
Other Federal Grants (Including Veterans and Military)	$5,531	$14,113	$15,018	172%
Federal Loans	$70,626	$116,256	$95,826	36%
Federal Work-Study	$1,202	$1,067	$982	-18%
Federal Tax Benefits	$7,814	$21,689	$18,226	133%
State Grants	$8,602	$10,117	$10,526	22%
Institutional Grants	$29,082	$41,954	$54,705	88%
Private and Employer Grants	$11,517	$14,548	$17,426	51%

Source: Trends in Student Aid 2016

The number of students and families receiving tax benefits for postsecondary education was 13.8 million in 2015-2016, making this category of federal financial aid assistance the most utilized of all federal financial aid programs. Though they are the most used form of federal financial aid (with the exception of the Supplemental Educational Opportunity Grant), federal education tax benefits represent the smallest average amount of aid per individual with an average benefit of $1,320.



SOURCE: TRENDS IN STUDENT AID 2016

Types of Federal Higher Education Benefits

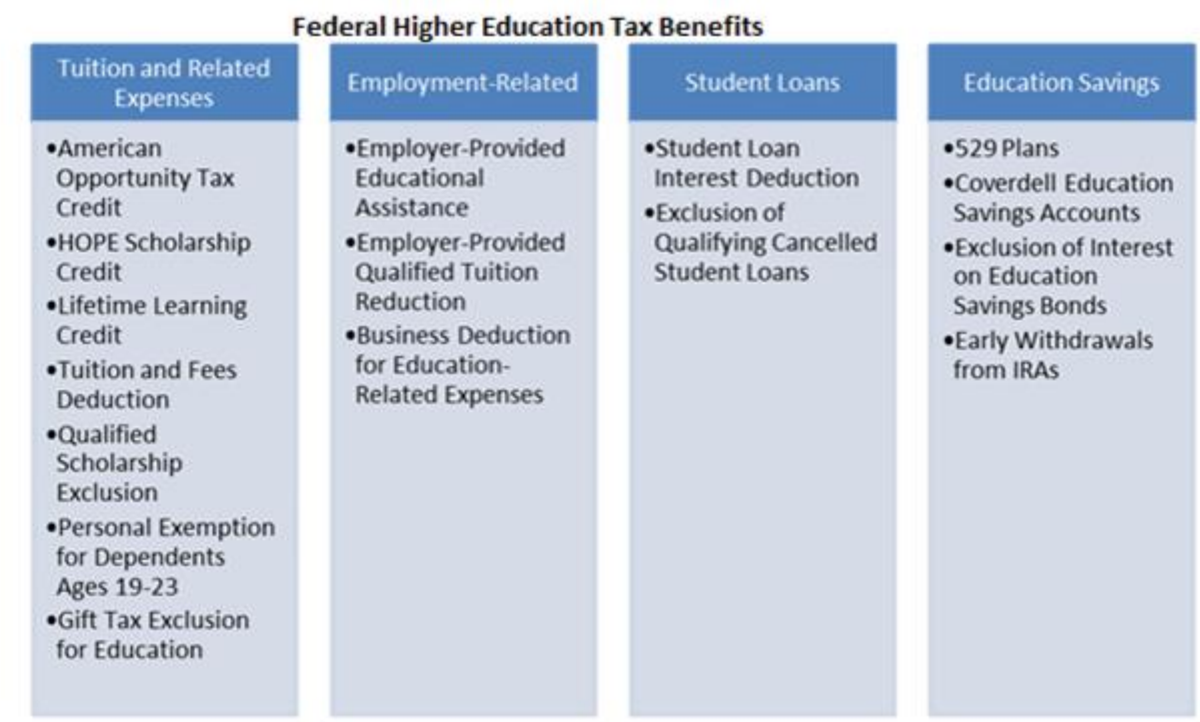
Generally speaking, the Internal Revenue Code provides four categories of tax benefits – credits, deductions, exemptions and exclusions. These benefits may either reduce an individual's tax liability (i.e., the amount of taxes an individual owes) or reduce the amount of an individual's income that is subject to taxation.

- **Tax Credit**: Tax credits reduce the amount of tax a tax filer owes on a dollar-for-dollar basis. A tax credit may be either nonrefundable or refundable. A nonrefundable credit can only reduce a tax filer's tax bill to $0 and cannot produce a tax refund where one did not already exist. A refundable tax credit, on the other hand, can exceed taxes owed and can result in a tax refund.
- **Tax Deduction**: Tax deductions reduce the amount of a tax filer's income that is subject to taxation. The eligible tax deduction amount is the amount of reduction to a taxpayer's taxable income. Thus, if an individual is eligible for a $2,000 tax deduction and his or her

taxable income is $50,000 prior to taking the deduction, the individual's taxable income after taking the deduction would be $48,000.

- **Tax Exemption**: Tax exemptions work in the same way as do tax deductions in reducing an individual's taxable income. The most common tax exemptions are the personal and dependent exemptions. Tax filers may claim a personal exemption for themselves and any dependents they support. The personal exemption for tax year 2016 is $4,050.
- **Tax Exclusion**: The Internal Revenue Code contains a number of provisions that explicitly exclude certain types of income or amounts of income from taxation. These types of income are not included as taxable income.

Over the years, Congress has enacted a number of tax benefits specifically to assist individuals and families in paying for college. These higher education tax benefits come in all types – credits, deductions, exemptions, and exclusions – and may broadly be divided into four categories: tax benefits for tuition and related expenses, employment-related higher education tax benefits, tax benefits for student loans, and tax benefits for education savings.



Many of these higher education tax benefits have been part of the Internal Revenue Code for several decades and some date back to the 1950s. Yet, prior to enactment of the Taxpayer Relief Act of 1997 (P.L. 105-34), tax benefits for higher education remained a relatively small part of the federal financial aid picture. Prior to the Taxpayer Relief Act of 1997, Congress enacted the following tax benefits for higher education:

- Personal Exemption for Dependents Ages 19-23
- Qualified Scholarship Exclusion

- Gift Tax Exclusion for Education
- Employer-Provided Educational Assistance
- Employer-Provided Qualified Tuition Reduction
- Business Deduction for Education-Related Expenses
- Student Loan Interest Deduction
- Exclusion of Qualifying Cancelled Student Loans
- 529 Plans
- Exclusion of Interest on Education Savings Bonds

When President Clinton announced his Administration's proposal for providing middle class families with tax credits to pay for college in 1996, the idea of using the Internal Revenue Code as a piece of the student financial aid puzzle firmly took hold. Middle class families who felt they were being priced out of college, but who did not qualify for Pell or subsidized loans, finally felt as if they were getting a "break" they deserved.

Signed into law in 1997, the Taxpayer Relief Act of 1997 (P.L. 105-34) created four additional higher education tax benefits and reinstated the student loan interest deduction which had been eliminated from the tax code as part of the Tax Reform Act of 1986 (P.L. 99-514). The tax benefits in the 1997 Taxpayer Relief Act were:

- Hope Scholarship Credit
- Lifetime Learning Credit
- Student Loan Interest Deduction
- Coverdell Education Savings Accounts
- Cancellations of the Penalty for Early Withdrawals from Individual Retirement Accounts (IRAs)

In 2001, as part of the Economic Growth and Tax Relief Act of 2001 (P.L. 107-16), Congress added two new tax benefits – the tuition and fees deduction and tax-free distributions from 529 college savings plans. Then, as part of the American Recovery and Reinvestment Act of 2009 (P.L. 111-5), Congress temporarily replaced the Hope Scholarship Credit with the more generous American Opportunity Tax Credit. In 2015, lawmakers made the REPLACMENT permanent under the Protecting Americans from Tax Hikes (PATH) Act of 2015 (P.L. 114-113).

Most of these tax benefits have provisions that disallow tax filers from using the same qualified educational expense to claim more than one tax benefit. Because many tax filers may meet the qualifications for more than one tax benefit, individuals must examine each benefit separately to determine which offers the greatest financial benefit.

Current Considerations and Issues

Since enactment of the Taxpayer Relief Act of 1997 (P.L. 107-16), and the introduction of higher education tax credits, the popularity of using the Internal Revenue Code as a means of offering students and families, especially middle class families, financial aid to pay for college has grown. While popular, a number of reports have indicated that the sheer number of benefits and complex eligibility rules often make it difficult for families to understand the tax benefits for which they may be eligible and choose the tax benefit that is most financially beneficial to them.

A 2012 report issued by the Government Accountability Office (GAO) found that in tax year 2009 almost 14 percent of filers failed to claim a higher education credit or deduction for which they were eligible.[i] That same GAO report lays out a number of possible reasons for families either failing to claim a benefit for which they are eligible or for making a suboptimal choice (i.e., choosing a less financially beneficial option) in their selection of education tax benefits. These reasons include lack of awareness or misunderstanding of eligibility, confusion over the sheer number of provisions, similarity in provisions making it difficult to determine which one may be best, and differences in key definitions such as the multiple definitions for qualified education expenses.

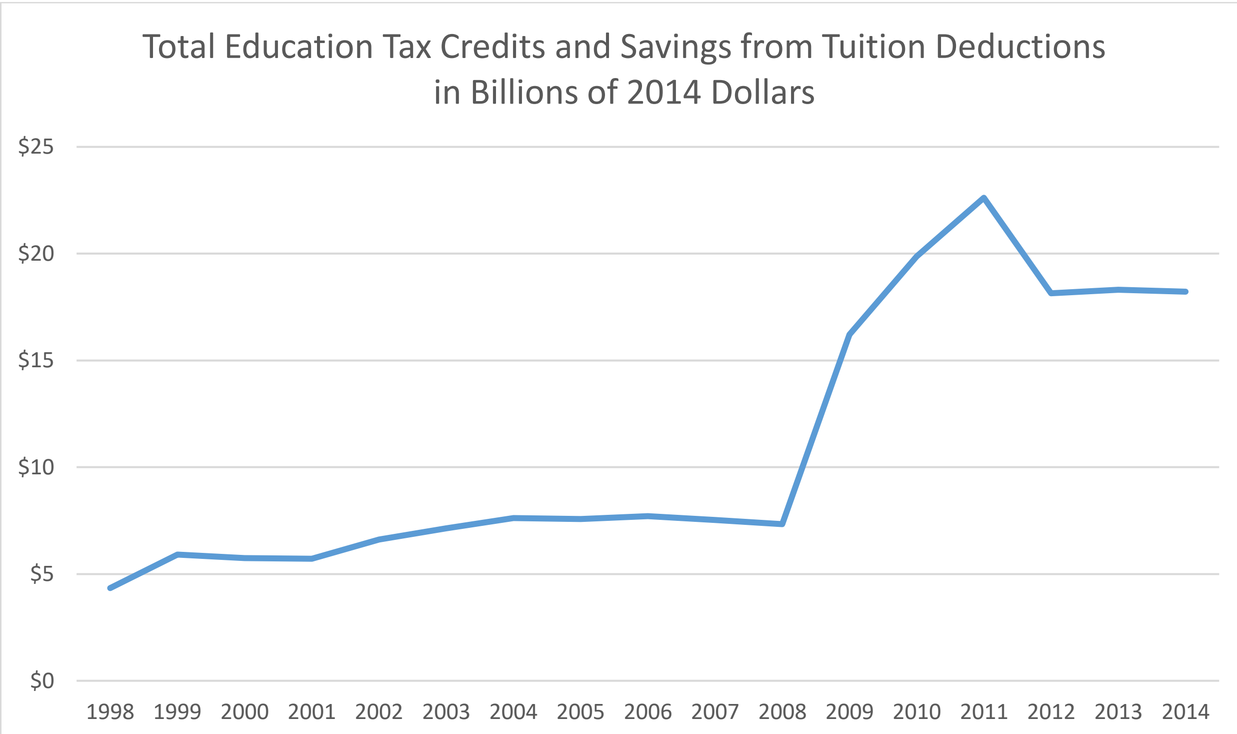
A 2015 report by New America also found that about 40 percent of undergraduate students are ineligible for any federal tuition tax benefit because they do not pay tuition or do not file taxes. Most of those families (63.5 percent) do not have any tuition or fee expenses net of other grants and scholarships and therefore have no expenses to offset. About 31 percent of those ineligible for a benefit did not file federal income taxes, making them ineligible. There is some overlap between these two groups. Many of these students attend community colleges, and a majority of them earn less than $30,000 per year.[ii]

Figure 2

Tax Benefit Eligibility of all Undergraduates, 2011–2012

SOURCE: NEW AMERICA

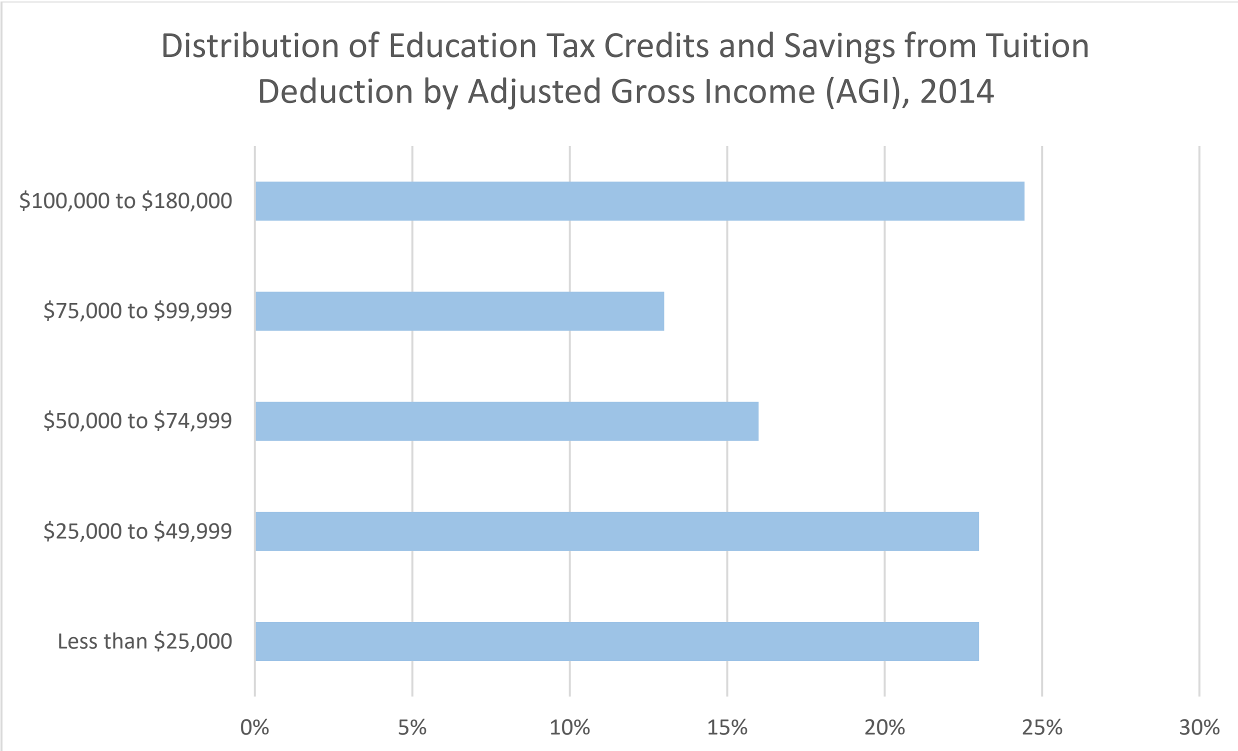
Growth in the uptake of these tax credits and deductions was relatively flat for much of the 2000s, but their popularity and uptake have more than doubled in recent years. This uptick was caused almost exclusively by the introduction of the more generous American Opportunity Tax Credit in 2009. In 2014, 13.8 million tax filers benefited from a federal tuition tax credit or deduction for a total of $18.2 billion in tax savings.



SOURCE: TRENDS IN STUDENT AID 2016

At a time of budget constraints, some have questioned whether spending on tax benefits might better be directed towards traditional financial aid programs – Pell, loans, work study, etc., especially those traditional programs that are more targeted to lower-income families and students. In 2014, 53 percent of higher education tax benefits went to families with adjusted gross incomes above $50,000, with 24 percent going to families with adjusted gross incomes above $100,000. Additionally, for both the credits and the deduction, the average tax savings per recipient is greater for both middle and upper-income families.

Analysis by New America provides yet another perspective for policymakers regarding the targeting of tuition tax benefits. The breakdown of tax benefit eligibility by institution type (i.e. four-year public, community college, etc.) reveals that students attending more expensive private and non-profit and for-profit schools are over represented among undergraduates eligible for tax benefits. Students attending lower cost public four-year and community colleges are underrepresented. Students at lower cost schools incur lower out-of-pocket costs after grant aid is factored in and therefore have few costs with which to claim a tuition tax benefit.[iii]



SOURCE: TRENDS IN STUDENT AID 2016

A final set of considerations related to higher education tax benefits concerns their effectiveness in meeting public policy goals. A GAO report in response to Congressional inquiries on the effectiveness of both Title IV and federal higher education tax benefits found that research into the effects of these programs on college attendance, choice, cost, persistence, and completion is scant and questions of effectiveness remain largely unanswered.[iv] As Congress takes up comprehensive tax reform and the re-authorization of the Higher Education Act for consideration, questions related to the purposes, target populations, and effectiveness of all forms of federal financial assistance for higher education – education tax benefits and traditional Title IV aid – may be in order.

Details of Federal Higher Education Tax Benefits

American Opportunity Tax Credit (IRC Sec. 25A)
The American Opportunity Tax Credit (AOTC) is for undergraduate education. As mentioned earlier, the AOTC is a more generous version of the original Hope Scholarship Credit that it replaced. In addition to the AOTC providing a higher maximum benefit than Hope, the AOTC covers four years of college as opposed to two, has higher income phase-out limits, and has a broader definition of qualified education expenses. The AOTC is also a partially refundable credit. Thus, under the non-refundable Hope, if a tax filer has $0 tax liability, the tax filer receives no financial benefit. However, under AOTC, which is partially refundable, a tax filer with $0 tax liability may still receive a financial benefit of up to $1,000, provided he has

incurred that much in tuition expenses. Many students and families who have no federal tax liability qualify for enough grant aid that they do not pay any tuition expenses.

Details of the features of the American Opportunity Tax Credit follow.

	American Opportunity Tax Credit
Type of Tax Benefit	Partially-refundable tax credit for qualified education expenses. 40 percent of the credit is refundable up to $1,000.
Amount of Benefit	Maximum $2,500 credit per eligible student. The amount of the credit is the sum of 100 percent of the first $2,000 of qualified education expenses, and 25 percent of the next $2,000 of qualified education expenses.
Qualifying Income Limits	$90,000 modified adjusted gross income if single with a phase-out of maximum benefit for those with incomes between $80,000 and $90,000. $180,000 modified adjusted gross income if married filing jointly with a phase-out of maximum benefit for couples with incomes between $160,000 and $180,000.
Qualified Education Expenses	Tuition, fees required for enrollment or attendance at an eligible educational institution, and course-related expenses for books supplies, and equipment. Qualified education expenses do

	not include room and board, medical expenses, insurance, transportation, or similar personal, living, or family expenses.
Qualifying Education Level	First 4 years of undergraduate education.
Eligible Student	Student enrolled at least half-time in a program leading to a degree, credential, or other recognized educational credential at an eligible education institution who is either the tax filer, tax filer's spouse, or dependent for whom tax filer claims an exemption. To be eligible, a student must also not have been convicted of a felony for possessing or distributing a controlled substance.
Number of Years of Availability	Available only for the first 4 tax years per eligible student, including any years the Hope credit was claimed.
Eligible Educational Institution	Any educational institution eligible to participate in a student aid program administered by the U.S. Department of Education.

Lifetime Leaning Credit (IRC Sec. 25A)

Unlike the American Opportunity Tax Credit and the Hope Credit which are both for undergraduate education exclusively, the Lifetime Learning Credit may be used at any postsecondary education level – undergraduate or graduate. Additionally, while a student must be enrolled on at least a half-time basis and in a program leading to a degree or credential to qualify for the AOTC or Hope, to claim the Lifetime Learning Credit a student need only enroll in one or more classes that may or may not lead to a degree or credential.

Lifetime Learning Credit	
Type of Tax Benefit	Non-refundable tax credit for qualified education expenses.
Amount of Benefit	Maximum $2,000 credit per tax return. The amount of the credit is 20 percent of the first $10,000 of qualified education expenses.
Qualifying Income Limits	$65,000 modified adjusted gross income if single with a phase-out of maximum benefit for those with incomes between $55,000 and $65,000. $130,000 modified adjusted gross income if married filing jointly with a phase-out of maximum benefit for couples with incomes between $110,000 and $130,000.
Qualified Education Expenses	Tuition and fees required for enrollment or attendance at an eligible educational institution. Student-activity fees and expenses for books, supplies, and equipment qualify only if a student must pay such fees and expenses to the institution as a condition of enrollment or attendance. Qualified education expenses do not include room and board, medical expenses, insurance, transportation, or similar personal, living, or family expenses.
Qualifying Education Level	Undergraduate and Graduate.
Eligible Student	Student enrolled in one or more courses at an eligible education institution who is either the tax filer, tax filer's spouse, or dependent for whom tax filer claims an exemption.
Number of Years of Availability	Available for an unlimited number of tax years.
	Any educational institution eligible to participate in a student aid

Tuition and Fees Deduction (IRC Sec. 222)

In 2001, Congress created a third tax benefit to assist families and students cover the cost of college. Similar to the Lifetime Learning Credit, the Tuition and Fees deduction covers both undergraduate and graduate education and may be used for one or more classes. Congress has typically only enacted the deduction on a temporary basis. In fact, the deduction was extended in time for the 2015 tax filing season.

In addition to being a deduction rather than a credit, the deduction also has higher income limits than the Lifetime credit (but not the American Opportunity Tax Credit). While the Lifetime credit phases out between $55,000 and $65,000 (single) / $110,000 and $130,000 (joint), the income limits for the Tuition and Fees Deduction were $80,000 for single filers and $160,000 for joint filers. However, the American Opportunity Tax Credit now has the highest income limits of the tax benefits for tuition, phasing out at $90,000 (single) / $180,000 (joint).

In recent years, the number of tax filers claiming the Tuition and Fees Deduction has dropped off considerably, falling from 4.6 million in 2008 to 1.7 million in 2014. This is due in large part to creation of the American Opportunity Tax Credit, which is partially refundable and which has even higher income limit phase outs than the Tuition and Fees Deduction. Filers claiming the Tuition and Fees deduction are likely graduate students or undergraduates enrolled beyond a fourth year, two groups who are ineligible for the American Opportunity Tax Credit.

Tuition and Fees Deduction	
Type of Tax Benefit	Tax deduction of qualified education expenses.
Amount of Benefit	Maximum annual benefit of $4,000.
Qualifying Income Limits	If single, head of household: • with a modified adjusted gross income (MAGI) not more than $65,000, maximum deduction is $4,000; • with a MAGI between $65,000 and $80,000, maximum deduction is $2,000; • with a MAGI more than $80,000, maximum deduction is $0. If married, filing jointly: • with a modified adjusted gross income (MAGI) not more than $130,000, maximum deduction is $4,000; • with a MAGI between $130,000 and $160,000, maximum deduction is $2,000; • with a MAGI more than $160,000, maximum deduction is $0.
Qualified Education Expenses	Tuition and fees required for enrollment or attendance at an eligible educational institution. Student-activity fees and expenses for books, supplies, and equipment qualify only if a student must pay such fees and expenses to the institution as a condition of enrollment or attendance. Qualified education expenses do not include room and board, medical expenses, insurance, transportation, or similar personal, living, or family expenses.
Qualifying Education Level	Undergraduate and Graduate.
Number of Years of Availability	Available for an unlimited number of tax years.
Eligible Student	Student enrolled in one or more courses at an eligible education institution who is either the tax filer, tax filer's spouse, or dependent for whom tax filer claims an exemption.
Eligible Educational Institution	Any educational institution eligible to participate in a student aid program administered by the U.S. Department of Education.

Exclusion for Qualified Scholarships (IRC Sec. 117)
One of the oldest tax benefits for higher education is the exclusion for qualified scholarships. Since 1954, tax filers have been able to exclude from their income all or part of the funds they receive through a scholarship. Up until the 1986 tax reform bill (P.L. 99-514), students could exclude scholarship funds for tuition and many other college expenses from their income. Today, however, students may only exclude those scholarship funds used to cover expenses directly related to education, e.g., tuition, fees, books. Scholarship funds used to cover room and board and other expenses are subject to taxation.

Personal Exemption for Dependents Ages 19-23 (IRC Sec. 151 & 152)
While typically a parent cannot claim a child over the age of 18 as a dependent for federal income tax purposes, if a child is ages 19-23 and is enrolled full time for at least five months of the year at a school with a regular teaching staff, course of study, and a regularly enrolled student body, a parent may claim a personal exemption for the child. For tax year 2016, a parent may receive a tax benefit of $4,050 for each qualifying dependent. For tax year 2013 and beyond, a personal exemption phase-out applies. The phase-out level for single tax filers begins at $259,400, and $311,300 for married couples filing jointly.

Gift Tax Exclusions for Higher Education Expenses (IRC Sec. 2503(b) and 2503(e))
Under current federal tax law, two gift tax exclusions exist that may be used to cover higher education expenses. First, under IRC Sec. 2503(b), a donor may give any individual up to $14,000 a year (tax year 2016 limit) for higher education expenses without incurring the federal gift tax. Second, in addition to the general annual gift tax exclusion, a donor may make a direct payment for tuition (no limit) to an institution of higher education on behalf of an individual without incurring the federal gift tax (IRC Sec. 2503(e)). This second gift tax exclusion is for tuition only and does not include payments for books, supplies, or room and board. There are no income restrictions on these gift tax exclusions.

Student Loan Interest Deduction (IRC Sec. 221)
The ability to take a federal deduction for interest paid on student loan debt is one of the oldest federal higher education tax benefits and one that has been allowed and disallowed at various points in time. Prior to 1986, student loan interest, like other types of personal debt (e.g., mortgage, credit card, auto), was deductible under the federal tax code. The 1986 comprehensive tax reform law (P.L. 99-514) disallowed deductions for all forms of personal debt interest other than mortgage interest, including student loan interest.

The ability to deduct student loan interest remained out of the tax code for the next ten years until passage of the Taxpayer Relief Act of 1997 (P.L. 105-34). This law restored the deduction; however, students were only able to take the deduction for the first five years of repayment. The Economic Growth and Tax Relief Reconciliation Act of 2001 (P.L. 107-16) temporarily lifted the five-year rule, and American Taxpayer Relief Act of 2012 (P.L. 112-240) permanently lifted the limit. Today, if student borrowers meet the other eligibility requirements, they may take the deduction for as many years as they pay interest on their student loans, federal or private. In tax year 2014, 12.1 million tax filers deducted $12.8 billion in student loan interest.[v]

Student Loan Interest Deduction	
Type of Tax Benefit	Tax deduction of interest paid on a qualifying student loan.
Amount of Benefit	Maximum annual benefit of $2,500.
Qualifying Income Limits	$80,000 modified adjusted gross income if single with a phase-out of maximum benefit for those with incomes between $65,000 and $80,000. $160,000 modified adjusted gross income if married filing jointly with a phase-out of maximum benefit for couples with incomes between $130,000 and $160,000.
Qualified Student Loan	A loan, federal or private, taken out solely to pay qualified education expenses. A taxpayer cannot deduct interest on a loan received from a related person (e.g., spouse, sibling, parents, grandparents, lineal descendants) and certain employer plans.
Qualified Education Expenses	Total costs of attending an eligible educational institution including tuition and fees, room and board, books, supplies, equipment, and other necessary expenses (e.g., transportation).
Qualifying Education Level	Undergraduate and Graduate.
Eligible Student	Student who enrolled at least half-time in a program leading to a degree, certificate, or other recognized educational credential.
Eligible Educational Institution	Any educational institution eligible to participate in a student aid program administered by the U.S. Department of Education.

Tax-Free Treatment of Student Loan Cancellations and Student Loan Repayment Assistance (IRC Sec. 108(f))

Generally, any portion of a student loan that is cancelled or forgiven must be included in gross income and therefore be subject to tax. However, in certain circumstances federal tax law excludes such loan forgiveness as taxable income. To qualify for tax-free treatment the loan must have been made by a qualified lender and require that the student work for a certain period of time, in a certain profession, and for any of a broad class of employers. Two of the best known examples of student loan cancellations qualifying for tax-free treatment are the Public Service Loan Forgiveness and Teacher Loan Forgiveness programs authorized under Title IV of the Higher Education Act.

Student Loan Cancellations	
Type of Tax Benefit	Exclusion of student loan cancellations from gross income.
Qualifying Income Limits	None.
Qualifying Student Loan	For the cancellation of a student loan to qualify for tax-free treatment, the loan must have been made by a qualified lender to assist a student in attending an eligible educational institution and contain a provision allowing all or part of the student loan debt be cancelled if the student work: • For a certain period of time; • In certain professions; and • For any of a broad class of employers.
Qualifying Education Level	Undergraduate and Graduate.
Eligible Educational Institution	An eligible educational institution is one that maintains a regular faculty and curriculum and one that normally has a regularly enrolled student body.
Qualified Lender	Qualified lenders include the following: • The United States, or an instrumentality of. • A state, territory, possession of the United States, the District of Columbia, or any political subdivision thereof. • A public benefit corporation that is tax exempt under section 501(c)(3); and that has assumed control of a state, county, or municipal hospital; and whose employees are considered public employees under state law. • An eligible educational institution, if the loan is made as part of an agreement with an entity described above under which the funds to make the loan were provided to the educational institution; or under a program of the educational institution designed to encourage students to serve in occupations with unmet needs (e.g., medicine, nursing, teaching, law) or in areas with unmet needs.

Additionally, payments that students receive from their participation in certain health service loan repayment programs are also tax-free. These programs are:

- The National Health Service Corps Loan Repayment Program.
- A state education loan repayment program eligible for funds under the Public Health Service Act.
- Any other state loan repayment or loan forgiveness program intended to increase the availability of health services in underserved or health shortage areas.

Over the years, Congress has added education-related provisions to the tax code to assist employers in attracting and retaining talented employees and to assist employees in continuing their education and obtaining new knowledge and skills. Three of these employment-related provisions are the Employer-Provided Educational Assistance provision, the Employer-Provided Qualified Tuition Plan, and the Business Deduction for Education-Related Expenses.

Employer-Provided Educational Assistance (IRC Sec. 127)
Under section 127 of the Internal Revenue Code, up to $5,250 received in employer-provided educational assistance may be excluded from an employee's gross income. This educational benefit may be used at either the undergraduate or graduate level and may be used for payments for tuition, fees, books, supplies, and equipment. Unlike the business deduction for education-related expenses discussed later, with few exceptions education courses covered by section 127 may be either job-related or non-job-related.
This exclusion for employer-provided educational assistance has its origins in the Revenue Act of 1978 (P.L. 95-600). Congress has extended this educational benefit many times over the last 30 years and most recently made the benefit permanent in 2013 as part of the American Taxpayer Relief Act of 2012 (P.L. 112-240).

Employer-Provided Educational Assistance	
Type of Tax Benefit	Exclusion of employer-provided educational assistance from taxable income.
Amount of Benefit	Maximum of $5,250 exclusion.
Qualifying Income Limits	None.
Qualified Education Expenses	Tuition, fees and similar expenses, books, supplies, and equipment. Education expenses do not include meals, lodging, or transportation; tools or supplies (other than textbooks) that students can keep after completing the course of instruction; courses involving sports, games, or hobbies unless they have a reasonable relationship to the employer's business or are required as part of a degree program.
Qualifying Education Level	Undergraduate and Graduate.
Number of Years of Availability	Available for an unlimited number of tax years.
Eligible Employer-Provided Educational Assistance Program	To qualify, the employer must have a written plan for its educational assistance program that provides the assistance exclusively to employees (i.e., not to employee spouses or dependents) and the plan must not favor highly compensated employees.

According to a 2010 study, close to 1 million employees annually benefit from employer-provided education assistance under section 127, and employees receiving this benefit have pursued their educations across various levels and academic disciplines.[vi] According to the same 2010 study, of the degrees pursued by beneficiaries in 2007-2008, 3 percent were at the certificate level, 26 percent were associate's degrees, 18 percent were bachelor's degrees, 36 percent were master's level degrees, 6 percent were other graduate level degrees, and 11 percent were not in a degree program.
Employer-Provided Qualified Tuition Reduction (IRC Sec. 117)
To attract and retain faculty and other employees, a number of institutions of higher education provide their employees and employees' spouses and dependents with a benefit to study tuition-free or at a reduced rate of tuition. Additionally, to attract high-quality graduate students, institutions will often waive or reduce tuition if a graduate student teaches or conducts research for the institution. Section 117 of the IRC provides for tax-free treatment of

such qualified tuition reductions. As indicated below, different rules apply at the graduate level and at education below the graduate level.

Employer-Provided Qualified Tuition Reduction	
Type of Tax Benefit	Exclusion of employer-provided qualified tuition reduction from gross income.
Amount of Benefit	Unlimited.
Qualifying Income Limits	None.
Qualifying Education Level	Undergraduate and Graduate.
Number of Years of Availability	Available for an unlimited number of tax years.
Eligible Educational Institution	To qualify, tuition reduction must be received by and used at an eligible educational institution which is one that maintains a regular faculty and curriculum and one that normally has a regularly enrolled student body.
Eligible Recipient	To qualify for tax-free treatment the tax filer's relationship to the eligible educational institution must meet the criteria below: Criteria for Education Below the Graduate Level (primary, elementary, secondary, undergraduate): • Current employee of the eligible educational institution; or • Former employee of the eligible educational institution who is retired or who left on disability; or • Widow or widower of an individual who died while an employee of the eligible educational institution or who retired or left on disability; or • Dependent child or spouse of an individual described above. Criteria for Graduate Level Education • Tuition reduction is provided by an eligible educational institution; and • Graduate student performs teaching or research activities for the educational institution.

Business Deduction for Work-Related Education Expenses (IRC Sec. 162)
Employees who can itemize their deductions may be able to take a deduction for education expenses related to their work. To qualify for the deduction, the education must meet two tests. First, the education must be required by an employer or the law in order for the employee to keep his or her current salary, status, or job. Second, the education must maintain or improve skills needed in the employee’s present work. An example of a qualifying work-related education expense would be continuing education courses for certified public accountants. To maintain their license to practice, certified public accountants are required by law to take a given number of education courses each year.

Business Deduction for Work-Related Education	
Type of Tax Benefit	Tax deduction of work-related education expenses.
Qualifying Income Limits	None.
Qualifying Work-Related Education	To deduct the costs of qualifying work-related education as business expenses, the education must meet one of two tests: • The education is required by tax filer’s employer or the law in order to keep present salary, status, or job. • The education maintains or improves skills needed in tax filer’s present work. Education is not qualifying, however, if the education is needed to meet the minimum educational requirements of tax filer’s present trade or business or if it is part of a program of study that would qualify tax filer for a new trade or business.
Deductible Expenses	Deductible education expenses include tuition, books, supplies, lab fees, and similar items; certain transportation and travel costs; other education expenses.
Qualifying Education Level	Undergraduate and Graduate.

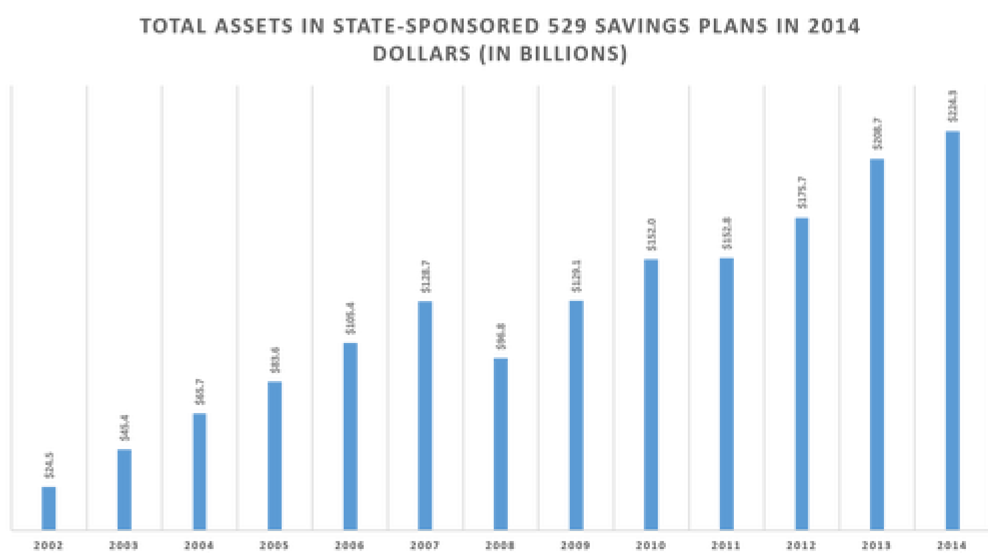
As the cost of college continued to escalate in the 1980s and 1990s, Congress turned to the tax code to create tax-preferred benefits for college savings. Over the years, Congress authorized two additional tax benefits for education savings – a tax exclusion for interest earned on education savings accounts (529 Plans) and the waiving of the penalty on early withdrawals from Individual Retirement Accounts used to pay for qualified education expenses.

529 Plans (IRC Sec. 529)
529 plans, named after the section of Internal Revenue Code that stipulates their tax treatment, were created by the states as state-sponsored investment vehicles to encourage families to save for college. The specific federal tax benefit of 529 plans to families is that the distributions are tax-free if used to pay for qualified higher education expenses.
The first such plan was created by the state of Michigan in 1986. Initial confusion regarding the tax treatment of these plans led the U.S. Congress to enact legislation to clarify their tax treatment. Congress first recognized 529 plans in the Small Business Job Protection Act of 1996 (P.L. 104-188) and made subsequent changes to them in 1997 under the Taxpayer Relief Act (P.L. 105-34). It should be noted that with respect to federal income taxes, these plans allowed for tax-free growth of investments, but distributions were fully taxable. In 2001, as part of a broader set of tax reforms, Congress made distributions tax-free and that rule was made

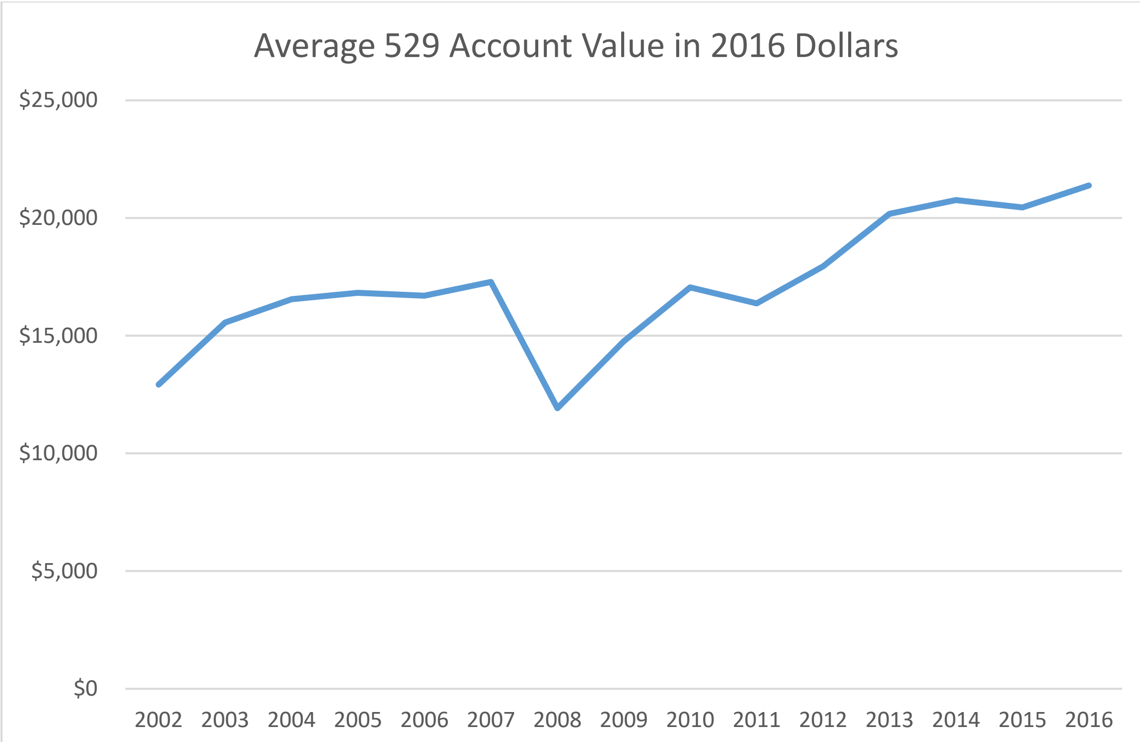
permanent in 2006.
Two types of 529 plans exist – prepaid tuition plans and college savings plans. While prepaid tuition and college savings plans have distinct differences, the federal tax treatment and benefit of these two types of plans is identical – under both types of 529s, distributions and withdrawals are tax-free if the funds are used to pay for qualified higher education expenses.

Under a prepaid 529 plan, a contributor (e.g., parent, grandparent, family friend) purchases a percentage of future tuition costs at current prices. The initial idea of the prepaid tuition plans was to provide families with a hedge against tuition inflation. Although prepaid tuition plans were the first type of 529 plan, the number of such plans has dropped considerably as skyrocketing tuition costs have ballooned future obligations. This has resulted in a decline in the popularity of prepaid 529 plans. There are currently 17 prepaid 529 plans and ninety 529 college savings plans across the nation.
Under a 529 college savings plan, contributors invest in a portfolio of mutual funds, stocks, bonds, and other investments with the final value of the 529 account determined by the performance of the plan's investments. Many states offer a variety of 529 college savings plans some of which provide more aggressive investment opportunities as the beneficiary is younger and more conservative investments as the beneficiary approaches the age of enrolling in college.

Over the last decade, the total assets in state-sponsored 529 plans has grown considerably, from $45 billion in 2003 to $224 billion in 2014 (in constant 2014 dollars).



SOURCE: TRENDS IN STUDENT AID 2016



SOURCE: COLLEGE SAVINGS PLAN NETWORK

Additionally, in 2016, there were approximately 12.1 million 529 accounts with an average account value of $21,383. While the number of accounts and their assets have grown over time, still a very small number of American households have an account. According to the Federal Reserve's Survey of Consumer Finance, less than three percent of families save for college in a 529 or Coverdell account (discussed below). Further, those families with college savings plans are generally wealthier, having about three times the median income as families without a college savings account.

529 Qualified Tuition Programs	
Type of Tax Benefit	Earnings on savings not taxed.
Annual and Lifetime Contribution Limits	No annual contribution limits. All plan sponsors must, however establish an overall lifetime limit on contributions to an account to an amount "necessary to provide for the qualified higher education expenses of the beneficiary."
Qualifying Income Limits	None.
Qualified Education Expenses	Tuition and fees required for enrollment and attendance; course-related books, supplies, and equipment; room and board for students enrolled at least half-time; expenses for special needs services.
Qualifying Education Level	Undergraduate and Graduate.
Eligible Educational Institution	Any educational institution eligible to participate in a student aid program administered by the U.S. Department of Education.

Coverdell Education Savings Accounts (IRC Sec. 530)

Coverdell Education Savings Accounts, named after the late Senator Paul Coverdell (R-GA), are yet another tax-preferred savings vehicle for education. Similar to 529 plans, the investments in Coverdell accounts grow tax-free and the distributions are tax-free provided they are used for qualified education expenses. However, there are significant differences between the two. First, unlike 529 plans that are strictly for college education, a Coverdell can pay for education expenses at the elementary, secondary, or postsecondary levels. Additionally, unlike 529 plans that have no annual contribution limits to accounts and no income restrictions on contributors, Coverdell accounts limit annual account contributions to $2,000 and limit tax payers with an income of more than $110,000 (single)/$220,000 (joint) from making contributions. Finally, Coverdell accounts, a benefit provided for in the federal tax code, are neither state-sponsored nor state-run savings plans.

Coverdell Savings Accounts were first created as part of the Taxpayer Relief Act of 1997 (P.L. 105-34) and were initially called Education IRAs. Most recently, the $2,000 annual contribution limit was made permanent as part of the American Taxpayer Relief Act of 2012 (P.L. 112-240). Barring such a change, the annual limit would have dropped to $500 in 2013.

Coverdell Education Savings Accounts	
Type of Tax Benefit	Earnings on savings not taxed.
Annual Contribution Limits	$2,000 annual contribution from all contributors per beneficiary.
Qualifying Income Limits for Contributors	$110,000 modified adjusted gross income if single with a phase-out of maximum benefit for those with incomes between $95,000 and $110,000. $220,000 modified adjusted gross income if married filing jointly with a phase-out of maximum benefit for couples with incomes between $190,000 and $220,000.
Qualified Beneficiary	Contributions may be made to any beneficiary ages 18 or younger. Contributions may be made to beneficiaries older than age 18 who are special needs.
Qualified Education Expenses	Qualified Elementary and Secondary Expenses related to enrollment at an eligible elementary or secondary school: • Tuition and fees; books, supplies, and equipment; academic tutoring; special needs services for a special needs beneficiary; room and board; uniforms; transportation; supplementary items and services including extended day programs; computer technology, equipment, Internet access and related services. Qualified Higher Education expenses at an eligible educational institution: • Tuition and fees required for enrollment or attendance; course-related books, supplies, and equipment; room and board for students enrolled at least half-time; expenses for special needs services.
Qualifying Education Level	K-12, undergraduate, and graduate.
Eligible Educational Institution	Eligible elementary or secondary school is any public, private, or religious school that provides elementary or secondary education as determined under state law. Eligible postsecondary institution is any educational institution eligible to participate in a student aid program administered by the U.S. Department of Education.

Early Withdrawals from Individual Retirement Accounts (IRC Sec. 72(t))
Under normal circumstances, if an individual takes a distribution from an IRA – Traditional or Roth – before the age of 59 ½, the individual must pay a 10 percent penalty for the early distribution in addition to any regular income tax that is due. However, if the distribution is used to pay for qualified higher education expenses for the taxpayer, spouse, or dependents at any educational institution eligible to participate in a student aid program administered by the U.S. Department of Education, the 10 percent penalty is waived. Qualified education expenses are tuition, fees, books, supplies, and equipment required for attendance. If the student is enrolled on at least a half-time basis, room and board may be considered a qualified education expense.

Updated June 2017

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[i] U.S. Government Accountability Office (2012). Improved Tax Information Could Help Families Pay for College (GAO-12-560).
[ii] Delisle, Jason, and Kim Dancy. *A New Look at Tuition Tax Benefits*. Washington, DC, 2015. https://static.newamerica.org/attachments/10416-a-new-look-at-tuition-tax-benefits/TaxCredits11.2.277d3f7daa014d5a8632090f97641cee.pdf
[iii] Ibid
[iv] U.S. Government Accountability Office (2012). Improved Tax Information Could Help Families Pay for College (GAO-12-560).
[v] U.S. Internal Revenue Service (2014). "Statement of Income Tax Stats – Individual Statistical Tables by Size of Adjusted Gross Income". https://www.irs.gov/uac/soi-tax-stats-individual-statistical-tables-by-size-of-adjusted-gross-income.
[vi] National Association of Independent Colleges and Universities & Society for Human Resource Management (2010). Who Benefits from Section 127: A Study of Employee Education Assistance Provided under Section 127 of the Internal Revenue Code.