



Through teaching, research and innovation, and public service, America's colleges and universities make critical contributions to our society. Students who graduate from a college or university enjoy higher lifetime earnings, better health, and greater civic engagement. In addition, colleges and universities are often the largest and most stable employers in their communities, offering good wages and benefits. Traditional nonprofit public and private colleges and universities historically have been granted tax-exempt status, which permits them to use more resources to fund the educational activities, academic research, student financial aid, and community programs that fulfill their core missions of teaching, research, and public service. The Federal Tax Code impacts colleges and universities' missions through provisions affecting, among other things, aid to students; incentives for charitable giving; tax-exempt financing; unrelated business income; and the R&D tax credit.

The following are key provisions of the Tax Code affecting colleges and universities and their students and employers:

Aid to Students and Families - Saving for College

- ❖ Coverdell Education Savings Accounts (Section 530)
- ❖ Education Savings Plans (Section 529)

Aid to Students and Families - Paying for College and Managing Debt

Tuition and Related Expenses

- ❖ American Opportunity Tax Credit (AOTC) (Section 25A)
- ❖ Lifetime Learning Credit (Section 25A)
- ❖ Qualified Scholarship Exclusion (Section 117)
- ❖ Above-the-Line Tuition Deduction (Section 222) – expired on December 31, 2017

Employment-Related Tax Benefits

- ❖ Employer-Provided Educational Assistance (Section 127)
- ❖ Employer-Provided Qualified Tuition Reduction (Section 117(d))

Student Loan Tax Relief

- ❖ Student Loan Interest Deduction (SLID) (Section 221)
- ❖ Federal Loan Forgiveness Programs (Income-Based Repayment and Income Contingent Repayment) (Section 108)

Incentives for Charitable Giving

- ❖ Charitable Income Tax Deduction (Section 408)
- ❖ IRA Charitable Rollover (Section 408)

Additional Tax Code Provisions

- ❖ Tax-Exempt Bonds (Section 103 and Section 141)
- ❖ R&D Tax Credit (Section 41)
- ❖ Unrelated Business Income Tax (UBIT) (Section 501)

Aid to Students and Families – Saving for College

- ❖ **Coverdell Education Savings Accounts (Section 530)** – Under Section 530, individuals can contribute up to \$2,000 annually tax-free to pay for qualified education expenses of a designated beneficiary until the designated beneficiary reaches age 18 (except in the case of a special-needs beneficiary). Individuals remain eligible to contribute with a modified adjusted gross income between \$95,000 and \$110,000 (between \$190,000 and \$220,000 for joint filing). Qualified higher education expenses for Coverdell accounts are the same as the qualified expenses for 529 plans.
- ❖ **Section 529 Education Savings Plans (Section 529)** – Under Section 529, states are authorized to sponsor “Qualified Tuition Programs” that are tax-advantaged savings vehicles for qualified post-secondary education expenses, such as tuition, fees, books, required supplies, computer equipment and technology, and room and board. There are two types of 529 Plans: savings plans, which allow families to save for expenses, and pre-paid tuition programs, which generally allow families to make advance tuition payments to cover future attendance at a designated in-state public college or university system. Any U.S. resident or citizen, regardless of income, can open an account. Investments grow on a tax-deferred basis; earnings are free of federal income tax and redemptions are also exempt from federal income tax if used to pay for qualified education expenses.

Aid to Students and Families – Paying for College & Managing Debt

Tuition and Related Expenses

- ❖ **American Opportunity Tax Credit (AOTC) (Section 25A)** – Under Section 25A, the AOTC provides for a maximum tax credit of \$2,500 that may be claimed for qualified tuition, fees, and required course materials expenses of each student in a taxpayer’s family. To use the credit, a student must be enrolled: at least half-time; during the first four years of postsecondary education; and in a program leading to a degree, certificate, or other recognized credential. The AOTC is subject to an income phase-out between \$80,000 and \$90,000 for individuals and between \$160,000 and \$180,000 for joint filers.). Up to 40% of the AOTC is refundable. The AOTC was made permanent by the Protecting Americans from Tax Hikes (PATH) Act of 2015.
- ❖ **Lifetime Learning Credit (Section 25A)** – This is a permanent non-refundable tax credit under Section 25A, the credit is a non-refundable tax credit. Under this credit, a taxpayer can claim up to 20 percent of the taxpayer’s first \$10,000 – for a maximum of \$2,000 (not indexed for inflation) – of qualified tuition and fees paid for all eligible students in a family during each calendar year. In contrast to the AOTC, there is no limit on the number of years that the credit may be claimed for each student; also in contrast, eligible expenses are limited to tuition and fees paid for the student. The credit can be claimed for a student enrolled in an undergraduate or graduate degree program or any course of instruction at an eligible school to acquire or improve the student’s job skills. The credit phases out for a taxpayer with a modified adjusted gross income between \$55,000 and \$65,000 (between \$110,000 and \$130,000 for joint filers) and the income phase-outs are adjusted for inflation.

- ❖ **Qualified Scholarship Exclusion (Section 117)** – Section 117 excludes scholarship, fellowship, and grant funds (including Pell Grants) from taxable income for a student at a college or university who uses the funds for the payment of tuition and fees, books, supplies, and equipment. But funds used for living expenses, such as room and board, are not excludable from income and are therefore subject to taxation. In addition, scholarship, fellowship, and grant funds received in exchange for teaching or research services are subject to taxation.
- ❖ **Above-the-Line Tuition Deduction (Section 222)** – *expired on December 31, 2017*. Under Section 222, the above-the-line deduction for qualified tuition and related expenses allowed students or their parents to deduct up to \$4,000 per year in eligible higher education expenses from their taxable income. Eligible expenses were limited to tuition and fees paid for the student. To claim the deduction, a student must have been enrolled in one or more courses at the undergraduate or graduate level. The deduction was subject to an income phase-out for taxpayers with incomes of up to \$80,000 (\$160,000 for joint filers).

Employment-Related Tax Benefits

- ❖ **Employer-Provided Educational Assistance (Section 127)** – Section 127 allows employers to offer their employees up to \$5,250 annually in tax-free educational assistance for undergraduate or graduate-level courses. Tax-free educational assistance benefits include payments for tuition, fees and similar expenses, books, supplies, and equipment. The payments do not have to be for work-related courses. Section 127 was permanently extended by the American Taxpayer Relief Tax Act of 2012.
- ❖ **Employer-Provided Qualified Tuition Reduction (Section 117(d))** – Section 117(d) permits educational institutions, including colleges and universities, to provide their employees and/or their employees' spouses and dependents with tuition reductions that are excluded from taxable income. This long-standing provision helps employees and members of their families afford a college education. As such, the benefit gives colleges and universities an important tool for recruiting and retaining valued employees – ranging from faculty to administrative staff and maintenance and janitorial staff. Section 117(d) is also enormously important for graduate students serving as teaching or research assistants. To reduce the cost of graduate education, many universities provide these graduate students with a non-taxable tuition reduction under Section 117(d)(5); repeal of this provision would result in thousands of graduate students being subjected to a significant tax increase and potentially result in increased student debt, as many of these students – the vast majority of whom have very low incomes – would be forced to borrow to pay these taxes.

Student Loan Tax Relief

- ❖ **Student Loan Interest Deduction (SLID) (Section 221)** – This above-the-line deduction under Section 221 permits taxpayers with income between \$65,000 and \$80,000 (\$130,000-\$160,000 for joint filers) to deduct up to \$2,500 in federal student loan interest payments each year. To qualify, a loan must have been taken out solely to pay for qualified education expenses, such as tuition and fees, room and board, and books. SLID is taken as an adjustment to income and therefore can be claimed even if a taxpayer does not itemize deductions. Certain elements of SLID were permanently extended by the American Taxpayer Relief Tax Act of 2012.

- ❖ **Federal Loan Forgiveness Programs (IBR and ICR) (Section 108)** – The federal government under Section 108 offers four major federal student loan forgiveness programs. Under the terms of two of them – the Public Service Loan Forgiveness (PSLF) and the Teacher Loan Forgiveness Program (TEACH) – the amount of the loan forgiven is not subject to federal income tax. This is not the case for the other two programs – Income Based Repayment (IBR) and Income Contingent Repayment (ICR). Rather, a borrower who receives loan forgiveness is subject to income tax on the amount of the loan forgiven.

Incentives for Charitable Giving

- ❖ **Charitable Income Tax Deduction (Section 408)** – Tax law under Section 408 permits taxpayers to partially deduct gifts made to charities organized under Tax Code Section 501(c)(3). Although donors make charitable gifts for many reasons, it is well established that the charitable tax deduction is an effective incentive that helps generate and sustain donations. Charitable deductions are generally limited to no more than 60 percent of a taxpayer's AGI. In this challenging economic climate, charitable gifts are an increasingly critical source of support for colleges and universities. In 2017, colleges and universities received \$43.6 billion in charitable gifts to support their missions of teaching, research, and public service. Some gifts are used to fund current operations; however, many gifts are given specifically to an institution's endowment to support specific purposes or activities – such as student scholarships or medical research – for many years to come.
- ❖ **IRA Charitable Rollover (Section 408)** – The IRA Charitable Rollover tax incentive allows individuals age 70½ and older to donate up to \$100,000 per tax year directly from their Individual Retirement Accounts (IRAs) and Roth IRAs to public charities, including colleges and universities, without having to count the distributions as taxable income. The IRA Charitable Rollover is an important addition to the federal income tax code that further incentivizes charitable giving. It is particularly beneficial to so-called “non-itemizers” – individuals who do not itemize tax deductions. The IRA Charitable Rollover was permanently extended by the 2015 PATH Act.

Additional Tax Code Provisions

- ❖ **Tax-Exempt Bonds (Section 103 and Section 141)** – Under Tax Code Section 103(a), the interest earned on tax-exempt bonds issued by state and local governments is generally exempt from tax. State and local governments can issue two kinds of tax-exempt bonds referred to as *governmental bonds* and *qualified private activity bonds*. Colleges and universities use these financial instruments to acquire, construct or expand their capital infrastructure, ranging from academic buildings and residence halls to energy plants and athletic facilities. The interest rate on tax-exempt bonds is usually lower than on taxable bonds and these lower interest rates can create substantial savings by reducing the cost of expensive construction projects. Tax-exempt bonds must meet specific requirements, however. In order for a bond to maintain tax-exempt status under Section 141, for example, private business use of a tax-exempt bond-financed project cannot exceed ten percent. Activity conducted under research partnerships between universities and private entities can contribute to this private business use limit, although Treasury regulations provide narrow safe harbor provisions for public-private research.
- ❖ **R&D Tax Credit (Section 41)** – The R&D tax credit is a business tax credit under Section 41 for qualified research expenses that can be deducted from overall corporate income taxes. Current law allows companies to claim the credit for R&D activities conducted at universities or other qualifying organizations, including research consortiums which may include universities. Universities benefit indirectly from the R&D tax credit.

The tax credit encourages industry to take on new R&D challenges that are important to industry but also well-suited to academic research. When companies contract with universities to conduct R&D, faculty and students benefit from receiving complex academic and practical research problems and the financial support to study them. The R&D tax credit, in turn, promotes greater collaboration between industry and universities, including employment opportunities for students and graduates. The R&D tax credit also fosters start-up companies, many of which grow out of new technologies developed at universities.

- ❖ **Unrelated Business Income Tax (UBIT) (Section 501)** – Although colleges and universities are tax-exempt entities, under Section 501 they are subject to tax on any unrelated business income they may generate. Recurring UBIT issues for higher education institutions include: 1) determining whether a particular activity is educational in nature, and therefore, qualifies for tax-exempt treatment; and 2) determining whether a non-educational activity is exempt from UBIT because income from the activity fits within a statutory exemption. An example of a university income-generating activity that is subject to UBIT is income from sales of non-educational materials such as CDs, DVDs, and other gift items by a campus bookstore.

AAU includes 62 distinguished public and private research universities dedicated to improving human life through education, research, and discovery.