SUMMARY
The Higher Education Affordability and Equity Act of 2005

BACKGROUND

The *Economic Growth Tax Relief Reconciliation Act of 2001* (EGTRRA) made several changes to the Internal Revenue Code which governs the taxation of the various college savings vehicles. These include education Individual Retirement Accounts (IRAs), qualified tuition programs (QTPs), 529 plans, including prepaid tuition accounts and savings accounts, and Coverdell Education Savings Accounts (ESAs). The modifications included in Title IV of EGTRRA were limited in their scope and effective temporarily. The proposed legislation aims to expand and make permanent the higher education affordability provisions of EGTRRA, as well as make other improvements in the tax treatment of various college aid and savings in order to increase education affordability in America.

PROPOSAL

Section 1. Short title: *Higher Education Affordability and Equity Act of 2005* (HEAEA)

Section 2. Expand the interest deduction for student loans by repealing the dollar limitation and increasing the phase-out beginning point.

Under current law, a taxpayer can deduct a maximum $2,500 in student loan interest which is reduced gradually for taxpayers whose income is between $50,000 and $65,000. The proposal repeals the $2,500 dollar limit and increases the phase-out point to begin at $100,000 and end at $115,000.

Section 3. Deduction for qualified higher education expenses made permanent.

Currently, an above-the-line deduction may be taken for expenses paid by the taxpayer during a taxable year for qualified higher education. In 2004 and 2005, taxpayers with adjusted gross income that does not exceed $65,000 ($130,000 for joint returns) are entitled to a maximum deduction of $4,000 and taxpayers with adjusted gross income that does not exceed $80,000 ($160,000 for joint returns) are entitled to a maximum deduction of $2,000. Current law expires at the end of 2005. The proposal leaves in place permanently the 2005 levels.

Section 4. Increase allowable contributions to ESAs from $2,000 to $5,000.

Section 5. Allow room and board to be treated like tuition scholarships for tax purposes.

Currently, amounts received as a scholarship or fellowship grant are excluded from income and are not subject to tax if the recipient is a student at a primary, secondary, or postsecondary educational institution *and* the funds are used for the payment of tuition and required fees, books, supplies, and equipment. However, amounts used for living expenses, including room and board, are not excludable from income and are therefore subject to tax. The proposal changes the definition to include room and board.

Section 6. Equalize the treatment of prepayment and savings plans in the context of need analysis.

For purposes of determining a *dependent* student's eligibility for financial aid for funds under the *Higher Education Act*, the proposal treats education savings accounts (e.g., 529 plans, ESAs) as an asset of the parent, regardless of whether it is technically owned by the student or the parent. For purposes of determining an *independent* student's eligibility, the proposal treats education savings accounts as the student's asset. By "moving" all plans into the same asset category, the proposal allows more generous aid consideration while not penalizing savings.

Section 7. Expansion of Hope Scholarship Tax Credit.

Currently, the Hope credit only covers tuition. The proposal expands the credit to include certain additional expenses, such as fees, books, supplies and equipment. It also excludes Federal Pell Grant and Supplemental Educational Opportunity Grant payments as mandatory reductions to expenses eligible for the Hope Scholarship Tax Credit so that financially needy students do not have their reduced by the amounts received.

Section 8. Make permanent the education affordability provisions included in EGTRRA.

The following provisions were enacted as a part of Title IV of EGTRRA. The proposal makes them permanent by repealing their December 31, 2010 sunset.
Education IRAs:

- Annual limit on contributions is $2,000;
- Qualified education expenses includes elementary and secondary school expenses;
- No marriage penalty for income limit eligibility;
- Same student can claim HOPE credit or Lifetime Learning credit while excluding from income IRA account distributions;
- Same student can contribute to an education IRA and a qualified State tuition program in the same year.

Private Prepaid Tuition Programs:

- Qualified tuition program (QTP) includes prepaid tuition programs established and maintained by one or more eligible educational institutions that satisfy the requirements under §529;
- Higher education expenses includes expenses for the special needs of a student;
- Distributions from QTPs are excluded from income if used to pay for higher ed expenses;
- Same student can claim HOPE credit or Lifetime Learning credit while excluding from income QTP distributions;
- Allow a student one rollover per year from one QTP to another;
- Distributions not used for higher education expenses are given the same additional tax that applies to education IRAs;
- Assets of QTPs of private institutions must be held in trust.

Exclusion for Employer-provided Educational Assistance: employed-provided assistance for education as applied to undergraduate and graduate education is excluded from gross income.
Treatment of National Health Service Corps Scholarship Program and Armed Forces Scholarship Program: amounts received under either program are eligible for tax-free treatment as qualified scholarships.