

IV. EDUCATION INCENTIVES
 A. MODIFICATIONS TO EDUCATION IRAS (SEC.
 401 AND 414 OF THE SENATE AMENDMENT AND
 SECS. 530 AND 127 OF THE CODE)

PRESENT LAW

In general

Section 530 of the Code provides tax-exempt status to education individual retirement accounts (“education IRAs”), meaning certain trusts or custodial accounts which are created or organized in the United States exclusively for the purpose of paying the qualified higher education expenses of a designated beneficiary. Contributions to education IRAs may be made only in cash.²² Annual contributions to education IRAs may not exceed \$500 per beneficiary (except in cases involving certain tax-free rollovers, as described below) and may not be made after the designated beneficiary reaches age 18.

Phase-out of contribution limit

The \$500 annual contribution limit for education IRAs is generally phased-out ratably for contributors with modified adjusted gross income (between \$95,000 and \$110,000). The phase-out range for married taxpayers filing a joint return is \$150,000 to \$160,000 of modified adjusted gross income. Individuals with modified adjusted gross income above the phase-out range are not allowed to make contributions to an education IRA established on behalf of any individual.

Treatment of distributions

Earnings on contributions to an education IRA generally are subject to tax when withdrawn. However, distributions from an education IRA are excludable from the gross income of the beneficiary to the extent that the total distribution does not exceed the “qualified higher education expenses” incurred by the beneficiary during the year the distribution is made.

If the qualified higher education expenses of the beneficiary for the year are less than the total amount of the distribution (i.e., contributions and earnings combined) from an education IRA, then the qualified higher

education expenses are deemed to be paid from a pro-rata share of both the principal and earnings components of the distribution. Thus, in such a case, only a portion of the earnings are excludable (i.e., the portion of the earnings based on the ratio that the qualified higher education expenses bear to the total amount of the distribution) and the remaining portion of the earnings is includable in the beneficiary’s gross income.

The earnings portion of a distribution from an education IRA that is includable in income is also subject to an additional 10-percent tax. The 10-percent additional tax does not apply if a distribution is made on account of the death or disability of the designated beneficiary, or on account of a scholarship received by the designated beneficiary.

The additional 10-percent tax also does not apply to the distribution of any contribution to an education IRA made during the taxable year if such distribution is made on or before the date that a return is required to be filed (including extensions of time) by the beneficiary for the taxable year during which the contribution was made (or, if the beneficiary is not required to file such a return, April 15th of the year following the taxable year during which the contribution was made).

Present law allows tax-free transfers or rollovers of account balances from one education IRA benefiting one beneficiary to another education IRA benefiting another beneficiary (as well as redesignations of the named beneficiary), provided that the new beneficiary is a member of the family of the old beneficiary and is under age 30.

Any balance remaining in an education IRA is deemed to be distributed within 30 days after the date that the beneficiary reaches age 30 (or, if earlier, within 30 days of the date that the beneficiary dies).

Qualified higher education expenses

The term “qualified higher education expenses” includes tuition, fees, books, supplies, and equipment required for the enrollment or attendance of the designated beneficiary at an eligible education institution, regardless of whether the beneficiary is enrolled at an eligible educational institution on a full-time, half-time, or less than half-time basis. Qualified higher education expenses include expenses with respect to undergraduate or graduate-level courses. In addition, qualified higher education expenses include amounts paid or incurred to purchase tuition credits (or to make contributions to an account) under a qualified State tuition program, as defined in section 529, for the benefit of the beneficiary of the education IRA.

Moreover, qualified higher education expenses include, within limits, room and board expenses for any academic period during which the beneficiary is at least a half-time student. Room and board expenses that may be treated as qualified higher education expenses are limited to the minimum room and board allowance applicable to the student in calculating costs of attendance for Federal financial aid programs under section 472 of the Higher Education Act of 1965, as in effect on the date of enactment of the Small Business Job Protection Act of 1996 (August 20, 1996). Thus, room and board expenses cannot exceed the following amounts: (1) for a student living at home with parents or guardians, \$1,500 per academic year; (2) for a student living in housing owned or operated by the eligible education institution, the institution’s “normal” room and board charge; and (3) for all other students, \$2,500 per academic year.

Qualified higher education expenses generally include only out-of-pocket expenses. Such qualified higher education expenses do

²²Special estate and gift tax rules apply to contributions made to and distributions made from education IRAs.

not include expenses covered by educational assistance for the benefit of the beneficiary that is excludable from gross income. Thus, total qualified higher education expenses are reduced by scholarship or fellowship grants excludable from gross income under present-law section 117, as well as any other tax-free educational benefits, such as employer-provided educational assistance that is excludable from the employee's gross income under section 127.

Present law also provides that if any qualified higher education expenses are taken into account in determining the amount of the exclusion for a distribution from an education IRA, then no deduction (e.g., for trade or business expenses), exclusion (e.g., for interest on education savings bonds) or credit is allowed with respect to such expenses.

Eligible educational institutions are defined by reference to section 481 of the Higher Education Act of 1965. Such institutions generally are accredited post-secondary educational institutions offering credit toward a bachelor's degree, an associate's degree, a graduate-level or professional degree, or another recognized post-secondary credential. Certain proprietary institutions and post-secondary vocational institutions also are eligible institutions. The institution must be eligible to participate in Department of Education student aid programs.

Time for making contributions

Contributions to an education IRA for a taxable year are taken into account in the taxable year in which they are made.

Coordination with HOPE and Lifetime Learning credits

If an exclusion from gross income is allowed for distributions from an education IRA with respect to an individual, then neither the HOPE nor Lifetime Learning credit may be claimed in the same taxable year with respect to the same individual. However, an individual may elect to waive the exclusion with respect to distributions from an education IRA. If such a waiver is made, then the HOPE or Lifetime Learning credit may be claimed with respect to the individual for the taxable year.

Coordination with qualified tuition programs

An excise tax is imposed on contributions to an education IRA for a year if contributions are made by anyone to a qualified State tuition program on behalf of the same beneficiary in the same year. The excise tax is equal to 6 percent of the contributions to the education IRA. The excise tax is imposed each year after the contribution is made, unless the contributions are withdrawn.

HOUSE BILL

No provision.

SENATE AMENDMENT

Annual contribution limit

The Senate amendment increases the annual limit on contributions to education IRAs from \$500 to \$2,000. Thus, aggregate contributions that may be made by all contributors to one (or more) education IRAs established on behalf of any particular beneficiary is limited to \$2,000 for each year.

Qualified education expenses

The Senate amendment expands the definition of qualified education expenses that may be paid tax-free from an education IRA to include "qualified elementary and secondary school expenses," meaning expenses for (1) tuition, fees, academic tutoring, special need services, books, supplies, and other equipment incurred in connection with the enrollment or attendance of the beneficiary at a public, private, or religious school providing elementary or secondary education (kindergarten through grade 12) as deter-

mined under State law, (2) room and board, uniforms, transportation, and supplementary items or services (including extended day programs) required or provided by such a school in connection with such enrollment or attendance of the beneficiary, and (3) the purchase of any computer technology or equipment (as defined in sec. 170(e)(6)(F)(i)) or Internet access and related services, if such technology, equipment, or services are to be used by the beneficiary and the beneficiary's family during any of the years the beneficiary is in school. Computer software primarily involving sports, games, or hobbies is not considered a qualified elementary and secondary school expense unless the software is educational in nature.

Phase-out of contribution limit

The Senate amendment increases the phase-out range for married taxpayers filing a joint return so that it is twice the range for single taxpayers. Thus, the phase-out range for married taxpayers filing a joint return is \$190,000 to \$220,000 of modified adjusted gross income.

Special needs beneficiaries

The Senate amendment provides that the rule prohibiting contributions to an education IRA after the beneficiary attains 18 does not apply in the case of a special needs beneficiary (as defined by Treasury Department regulations). In addition, a deemed distribution of any balance in an education IRA does not occur when a special needs beneficiary reaches age 30. Finally, the age 30 limitation does not apply in the case of a rollover contribution for the benefit of a special needs beneficiary or a change in beneficiaries to a special needs beneficiary.

Contributions by persons other than individuals

The Senate amendment clarifies that corporations and other entities (including tax-exempt organizations) are permitted to make contributions to education IRAs, regardless of the income of the corporation or entity during the year of the contribution.

Exclusion for employer contributions

The Senate amendment provides an exclusion from gross income for certain employer contributions to an education IRA for the employee, the employee's spouse, or a lineal descendant of the employee or his or her spouse (provided such individual otherwise meets the eligibility requirements for education IRAs). The maximum amount excludable is \$500 per year per each beneficiary. Thus, for example, if an employee has two children under age 18, the employer could contribute \$500 each year to an education IRA for each child. The exclusion does not apply to self-employed individuals. The employer is required to report the amount of any education IRA contributions on the employee's W-2 for the year.

In order to be excludable from gross income, the contribution must be made pursuant to a plan that meets the requirements of an educational assistance program under section 127.²³ Thus, for example, the plan must be in writing and must satisfy non-discrimination rules.

Education IRA contributions that are excludable from gross income are treated as earnings for purposes of determining the amount includable in gross income, if any, due to a withdrawal from the education IRA.

The exclusion does not apply for Social Security tax purposes.

²³ Contributions to education IRAs are not subject to the \$5,250 annual limit on the exclusion for employer-provided educational assistance, and are not taken into account for purposes of applying that limit to other education assistance. Rather, such contributions are subject to the \$500 per beneficiary limit described above.

Contributions permitted until April 15

Under the Senate amendment, individual contributors to education IRAs are deemed to have made a contribution on the last day of the preceding taxable year if the contribution is made on account of such taxable year and is made not later than the time prescribed by law for filing the individual's Federal income tax return for such taxable year (not including extensions). Thus, individual contributors generally may make contributions for a year until April 15 of the following year.

Qualified room and board expenses

The Senate amendment modifies the definition of room and board expenses considered to be qualified higher education expenses. This modification is described with the provisions relating to qualified tuition programs, below.

Coordination with HOPE and Lifetime Learning credits

The Senate amendment allows a taxpayer to claim a HOPE credit or Lifetime Learning credit for a taxable year and to exclude from gross income amounts distributed (both the contributions and the earnings portions) from an education IRA on behalf of the same student as long as the distribution is not used for the same educational expenses for which a credit was claimed.

Coordination with qualified tuition programs

The Senate amendment repeals the excise tax on contributions made by any person to an education IRA on behalf of a beneficiary during any taxable year in which any contributions are made by anyone to a qualified State tuition program on behalf of the same beneficiary.

If distributions from education IRAs and qualified tuition programs exceed the beneficiary's qualified higher education expenses for the year (after reduction by amounts used in claiming the HOPE or Lifetime Learning credit), the beneficiary is required to allocate the expenses between the distributions to determine the amount includable in income.

Effective date

The provisions modifying education IRAs are effective for taxable years beginning after December 31, 2001.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment, except that the conference agreement does not include the exclusion for employer contributions. As under the Senate amendment, the conference agreement provides that certain age limitations do not apply in the case of special needs beneficiaries. The conferees intend that Treasury regulations will define a special needs beneficiary to include an individual who because of a physical, mental, or emotional condition (including learning disability) requires additional time to complete his or her education. The conference agreement clarifies the rule relating to computer software by providing that computer software involving sports, games, or hobbies is not considered a qualified elementary and secondary school expense unless the software is predominantly educational in nature.

Effective date.—The conference agreement follows the Senate amendment.

B. PRIVATE PREPAID TUITION PROGRAMS; EXCLUSION FROM GROSS INCOME OF EDUCATION DISTRIBUTIONS FROM QUALIFIED TUITION PROGRAMS (SEC. 402 OF THE SENATE AMENDMENT AND SEC. 529 OF THE CODE)

PRESENT LAW

Section 529 of the Code provides tax-exempt status to "qualified State tuition programs," meaning certain programs established and maintained by a State (or agency

or instrumentality thereof) under which persons may (1) purchase tuition credits or certificates on behalf of a designated beneficiary that entitle the beneficiary to a waiver or payment of qualified higher education expenses of the beneficiary, or (2) make contributions to an account that is established for the purpose of meeting qualified higher education expenses of the designated beneficiary of the account (a "savings account plan"). The term "qualified higher education expenses" generally has the same meaning as does the term for purposes of education IRAs (as described above) and, thus, includes expenses for tuition, fees, books, supplies, and equipment required for the enrollment or attendance at an eligible educational institution,²⁴ as well as certain room and board expenses for any period during which the student is at least a half-time student.

No amount is included in the gross income of a contributor to, or a beneficiary of, a qualified State tuition program with respect to any distribution from, or earnings under, such program, except that (1) amounts distributed or educational benefits provided to a beneficiary are included in the beneficiary's gross income (unless excludable under another Code section) to the extent such amounts or the value of the educational benefits exceed contributions made on behalf of the beneficiary, and (2) amounts distributed to a contributor (e.g., when a parent receives a refund) are included in the contributor's gross income to the extent such amounts exceed contributions made on behalf of the beneficiary.²⁵

A qualified State tuition program is required to provide that purchases or contributions only be made in cash.²⁶ Contributors and beneficiaries are not allowed to direct the investment of contributions to the program (or earnings thereon). The program is required to maintain a separate accounting for each designated beneficiary. A specified individual must be designated as the beneficiary at the commencement of participation in a qualified State tuition program (i.e., when contributions are first made to purchase an interest in such a program), unless interests in such a program are purchased by a State or local government or a tax-exempt charity described in section 501(c)(3) as part of a scholarship program operated by such government or charity under which beneficiaries to be named in the future will receive such interests as scholarships.

A transfer of credits (or other amounts) from one account benefiting one designated beneficiary to another account benefiting a different beneficiary is considered a distribution (as is a change in the designated beneficiary of an interest in a qualified State tuition program), unless the beneficiaries are members of the same family. For this purpose, the term "member of the family" means: (1) the spouse of the beneficiary; (2) a son or daughter of the beneficiary or a descendant of either; (3) a stepson or stepdaughter of the beneficiary; (4) a brother, sister, stepbrother or stepsister of the beneficiary; (5) the father or mother of the beneficiary or an ancestor of either; (6) a stepfather or stepmother of the beneficiary; (7) a son or daughter of a brother or sister of the beneficiary; (8) a brother or sister of the father or mother of the beneficiary; (9) a son-in-law, daughter-in-law, father-in-law, moth-

er-in-law, brother-in-law, or sister-in-law of the beneficiary; or (10) the spouse of any person described in (2)-(9).

Earnings on an account may be refunded to a contributor or beneficiary, but the State or instrumentality must impose a more than de minimis monetary penalty unless the refund is (1) used for qualified higher education expenses of the beneficiary, (2) made on account of the death or disability of the beneficiary, (3) made on account of a scholarship received by the beneficiary, or (4) a rollover distribution.

To the extent that a distribution from a qualified State tuition program is used to pay for qualified tuition and related expenses (as defined in sec. 25A(f)(1)), the beneficiary (or another taxpayer claiming the beneficiary as a dependent) may claim the HOPE credit or Lifetime Learning credit with respect to such tuition and related expenses (assuming that the other requirements for claiming the HOPE credit or Lifetime Learning credit are satisfied and the modified AGI phase-out for those credits does not apply).

HOUSE BILL

No provision.

SENATE AMENDMENT

Qualified tuition program

The Senate amendment expands the definition of "qualified tuition program" to include certain prepaid tuition programs established and maintained by one or more eligible educational institutions (which may be private institutions) that satisfy the requirements under section 529 (other than the present-law State sponsorship rule). In the case of a qualified tuition program maintained by one or more private eligible educational institutions, persons are able to purchase tuition credits or certificates on behalf of a designated beneficiary (as set forth in sec. 529(b)(1)(A)(i)), but would not be able to make contributions to a savings account plan (as described in sec. 529(b)(1)(A)(ii)). Except to the extent provided in regulations, a tuition program maintained by a private institution is not treated as qualified unless it has received a ruling or determination from the IRS that the program satisfies applicable requirements.

Exclusion from gross income

Under the Senate amendment, an exclusion from gross income is provided for distributions made in taxable years beginning after December 31, 2001, from qualified State tuition programs to the extent that the distribution is used to pay for qualified higher education expenses. This exclusion from gross income is extended to distributions from qualified tuition programs established and maintained by an entity other than a State (or agency or instrumentality thereof) for distributions made in taxable years after December 31, 2003.

Qualified higher education expenses

The Senate amendment provides that, for purposes of the exclusion for distributions from qualified tuition plans, the maximum room and board allowance is the amount applicable to the student in calculating costs of attendance for Federal financial aid programs under section 472 of the Higher Education Act of 1965, as in effect on the date of enactment, or, in the case of a student living in housing owned or operated by an eligible educational institution, the actual amount charged the student by the educational institution for room and board.²⁷

Coordination with HOPE and Lifetime Learning credits

The Senate amendment allows a taxpayer to claim a HOPE credit or Lifetime Learning credit for a taxable year and to exclude from gross income amounts distributed (both the principal and the earnings portions) from a qualified tuition program on behalf of the same student as long as the distribution is not used for the same expenses for which a credit was claimed.

Rollovers for benefit of same beneficiary

The Senate amendment provides that a transfer of credits (or other amounts) from one qualified tuition program for the benefit of a designated beneficiary to another qualified tuition program for the benefit of the same beneficiary is not considered a distribution. This rollover treatment does not apply to more than one transfer within any 12-month period with respect to the same beneficiary.

Member of family

The Senate amendment provides that, for purposes of tax-free rollovers and changes of designated beneficiaries, a "member of the family" includes first cousins of the original beneficiary.

Effective date

The provisions are effective for taxable years beginning after December 31, 2001, except that the exclusion from gross income for certain distributions from a qualified tuition program established and maintained by an entity other than a State (or agency or instrumentality thereof) is effective for taxable years beginning after December 31, 2003.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment, with modifications. The conference agreement modifies the definition of qualified higher education expenses to include expenses of a special needs beneficiary which are necessary in connection with his or her enrollment or attendance at the eligible education institution.²⁸ A special needs beneficiary would be defined as under the provisions relating to education IRAs, described above.

The conference agreement repeals the present-law rule that a qualified State tuition program must impose a more than de minimis monetary penalty on any refund of earnings not used for qualified higher education expenses of the beneficiary (except in certain circumstances). Instead, the conference agreement imposes an additional 10-percent tax on the amount of a distribution from a qualified tuition plan that is includible in gross income (like the additional tax that applies to such distributions from education IRAs). The same exceptions that apply to the 10-percent additional tax with respect to education IRAs apply. A special rule applies because the exclusion for earnings on distributions used for qualified higher education expenses does not apply to qualified tuition programs of private institutions until 2004. Under the special rule, the additional 10-percent tax does not apply to any payment in a taxable year beginning before January 1, 2004, which is includible in gross income but used for qualified higher education expenses. Thus, for example, the earnings portion of a distribution from a qualified tuition program of a private institution that is made in 2003 and that is used for qualified higher education expenses is not subject to the additional tax, even though the earnings portion is includible in gross income. Conforming the penalty to the education IRA provisions will make it easier

²⁴An "eligible education institution" is defined the same for purposes of education IRAs (described above) and qualified State tuition programs.

²⁵Distributions from qualified State tuition programs are treated as representing a pro-rata share of the contributions and earnings in the account.

²⁶Special estate and gift tax rules apply to contributions made to and distributions made from qualified State tuition programs.

²⁷This definition also applies to distributions from education IRAs.

²⁸This definition also applies to distributions from education IRAs.

for taxpayers to allocate expenses between the various education tax incentives.²⁹ For example, under the conference agreement, a taxpayer who receives distributions from an education IRA and a qualified tuition program in the same year is required to allocate qualified expenses in order to determine the amount excludable from income. Other interactions between the various provisions also arise under the conference agreement. For example, a taxpayer may need to know the amount excludable from income due to a distribution from a qualified tuition program in order to determine the amount of expenses eligible for the tuition deduction. The conferees expect that the Secretary will exercise the existing authority under sections 529(d) and 530(h) to require appropriate reporting, e.g., the amount of distributions and the earnings portions of distributions (taxable and nontaxable), to facilitate the provisions of the conference agreement.

The conference agreement provides that, in order for a tuition program of a private eligible education institution to be a qualified tuition program, assets of the program must be held in a trust created or organized in the United States for the exclusive benefit of designated beneficiaries that complies with the requirements under section 408(a)(2) and (5). Under these rules, the trustee must be a bank or other person who demonstrates that it will administer the trust in accordance with applicable requirements and the assets of the trust may not be commingled with other property except in a common trust fund or common investment fund.

As under the Senate amendment, the conference agreement provides that a transfer of credits (or other amounts) from one qualified tuition program for the benefit of a designated beneficiary to another qualified tuition program for the benefit of the same beneficiary is not considered a distribution. This rollover treatment does not apply to more than one transfer within any 12-month period with respect to the same beneficiary. The conferees intend that this provision will allow, for example, transfers between a prepaid tuition program and a savings program maintained by the same State and between a State plan and a private prepaid tuition program.

C. EXCLUSION FOR EMPLOYER-PROVIDED EDUCATIONAL ASSISTANCE (SEC. 411 OF THE SENATE AMENDMENT AND SEC. 127 OF THE CODE)

PRESENT LAW

Educational expenses paid by an employer for its employees are generally deductible by the employer.

Employer-paid educational expenses are excludable from the gross income and wages of an employee if provided under a section 127 educational assistance plan or if the expenses qualify as a working condition fringe benefit under section 132. Section 127 provides an exclusion of \$5,250 annually for employer-provided educational assistance. The exclusion does not apply to graduate courses beginning after June 30, 1996. The exclusion for employer-provided educational assistance for undergraduate courses expires with respect to courses beginning after December 31, 2001.

In order for the exclusion to apply, certain requirements must be satisfied. The educational assistance must be provided pursuant to a separate written plan of the employer. The educational assistance program must not discriminate in favor of highly compensated employees. In addition, not more than five percent of the amounts paid

or incurred by the employer during the year for educational assistance under a qualified educational assistance plan can be provided for the class of individuals consisting of more than five percent owners of the employer (and their spouses and dependents).

Educational expenses that do not qualify for the section 127 exclusion may be excludable from income as a working condition fringe benefit.³⁰ In general, education qualifies as a working condition fringe benefit if the employee could have deducted the education expenses under section 162 if the employee paid for the education. In general, education expenses are deductible by an individual under section 162 if the education (1) maintains or improves a skill required in a trade or business currently engaged in by the taxpayer, or (2) meets the express requirements of the taxpayer's employer, applicable law or regulations imposed as a condition of continued employment. However, education expenses are generally not deductible if they relate to certain minimum educational requirements or to education or training that enables a taxpayer to begin working in a new trade or business.³¹

HOUSE BILL

No provision.

SENATE AMENDMENT

The provision extends the exclusion for employer-provided educational assistance to graduate education and makes the exclusion (as applied to both undergraduate and graduate education) permanent.

Effective date.—The provision is effective with respect to courses beginning after December 31, 2001.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

D. MODIFICATIONS TO STUDENT LOAN INTEREST DEDUCTION (SEC. 412 OF THE SENATE AMENDMENT AND SEC. 221 OF THE CODE)

PRESENT LAW

Certain individuals may claim an above-the-line deduction for interest paid on qualified education loans, subject to a maximum annual deduction limit. The deduction is allowed only with respect to interest paid on a qualified education loan during the first 60 months in which interest payments are required. Required payments of interest generally do not include voluntary payments, such as interest payments made during a period of loan forbearance. Months during which interest payments are not required because the qualified education loan is in deferral or forbearance do not count against the 60-month period. No deduction is allowed to an individual if that individual is claimed as a dependent on another taxpayer's return for the taxable year.

A qualified education loan generally is defined as any indebtedness incurred solely to pay for certain costs of attendance (including room and board) of a student (who may be the taxpayer, the taxpayer's spouse, or any dependent of the taxpayer as of the time the indebtedness was incurred) who is enrolled in a degree program on at least a half-time basis at (1) an accredited post-secondary educational institution defined by reference to section 481 of the Higher Edu-

³⁰These rules also apply in the event that section 127 expires.

³¹In the case of an employee, education expenses (if not reimbursed by the employer) may be claimed as an itemized deduction only if such expenses, along with other miscellaneous expenses, exceed two percent of the taxpayer's AGI. An individual's total deductions may also be reduced by the overall limitation on itemized deductions under section 68. These limitations do not apply in determining whether an item is excludable from income as a working condition fringe benefit.

ation Act of 1965, or (2) an institution conducting an internship or residency program leading to a degree or certificate from an institution of higher education, a hospital, or a health care facility conducting post-graduate training.

The maximum allowable annual deduction is \$2,500. The deduction is phased-out ratably for single taxpayers with modified adjusted gross income between \$40,000 and \$55,000 and for married taxpayers filing joint returns with modified adjusted gross income between \$60,000 and \$75,000. The income ranges will be adjusted for inflation after 2002.

HOUSE BILL

No provision.

SENATE AMENDMENT

The Senate amendment increases the income phase-out ranges for eligibility for the student loan interest deduction to \$50,000 to \$65,000 for single taxpayers and to \$100,000 to \$130,000 for married taxpayers filing joint returns. These income phase-out ranges are adjusted annually for inflation after 2002.

The Senate amendment repeals both the limit on the number of months during which interest paid on a qualified education loan is deductible and the restriction that voluntary payments of interest are not deductible.

Effective date.—The provision is effective for interest paid on qualified education loans after December 31, 2001.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

E. ELIMINATE TAX ON AWARDS UNDER THE NATIONAL HEALTH SERVICE CORPS SCHOLARSHIP PROGRAM AND THE F. EDWARD HEBERT ARMED FORCES HEALTH PROFESSIONS SCHOLARSHIP AND FINANCIAL ASSISTANCE PROGRAM (SEC. 413 OF THE SENATE AMENDMENT AND SEC. 117 OF THE CODE)

PRESENT LAW

Section 117 excludes from gross income amounts received as a qualified scholarship by an individual who is a candidate for a degree and used for tuition and fees required for the enrollment or attendance (or for fees, books, supplies, and equipment required for courses of instruction) at a primary, secondary, or post-secondary educational institution. The tax-free treatment provided by section 117 does not extend to scholarship amounts covering regular living expenses, such as room and board. In addition to the exclusion for qualified scholarships, section 117 provides an exclusion from gross income for qualified tuition reductions for certain education provided to employees (and their spouses and dependents) of certain educational organizations.

The exclusion for qualified scholarships and qualified tuition reductions does not apply to any amount received by a student that represents payment for teaching, research, or other services by the student required as a condition for receiving the scholarship or tuition reduction.

The National Health Service Corps Scholarship Program (the "NHSC Scholarship Program") and the F. Edward Hebert Armed Forces Health Professions Scholarship and Financial Assistance Program (the "Armed Forces Scholarship Program") provide education awards to participants on the condition that the participants provide certain services. In the case of the NHSC Program, the recipient of the scholarship is obligated to provide medical services in a geographic area (or to an underserved population group or designated facility) identified by the Public Health Service as having a shortage of health care professionals. In the case of the Armed Forces Scholarship Program, the recipient of the scholarship is obligated to

²⁹The conferees also believe that this change is appropriate in light of the expansion of qualified tuition programs to include programs maintained by private institutions.

serve a certain number of years in the military at an armed forces medical facility. Because the recipients are required to perform services in exchange for the education awards, the awards used to pay higher education expenses are taxable income to the recipient.

HOUSE BILL

No provision.

SENATE AMENDMENT

The Senate amendment provides that amounts received by an individual under the NHSC Scholarship Program or the Armed Forces Scholarship Program are eligible for tax-free treatment as qualified scholarships under section 117, without regard to any service obligation by the recipient. As with other qualified scholarships under section 117, the tax-free treatment does not apply to amounts received by students for regular living expenses, including room and board.

Effective date.—The provision is effective for education awards received after December 31, 2001.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

F. TAX BENEFITS FOR CERTAIN TYPES OF BONDS FOR EDUCATIONAL FACILITIES AND ACTIVITIES (SECS. 421–422 OF THE SENATE AMENDMENT AND SECS. 142 AND 146–148 OF THE CODE)

PRESENT LAW

*Tax-exempt bonds**In general*

Interest on debt³² incurred by States or local governments is excluded from income if the proceeds of the borrowing are used to carry out governmental functions of those entities or the debt is repaid with governmental funds (sec. 103).³³ Like other activities carried out or paid for by States and local governments, the construction, renovation, and operation of public schools is an activity eligible for financing with the proceeds of tax-exempt bonds.

Interest on bonds that nominally are issued by States or local governments, but the proceeds of which are used (directly or indirectly) by a private person and payment of which is derived from funds of such a private person is taxable unless the purpose of the borrowing is approved specifically in the Code or in a non-Code provision of a revenue Act. These bonds are called “private activity bonds.”³⁴ The term “private person” includes the Federal Government and all other individuals and entities other than States or local governments.

Private activities eligible for financing with tax-exempt private activity bonds

Present law includes several exceptions permitting States or local governments to act as conduits providing tax-exempt financing for private activities. Both capital expenditures and limited working capital expenditures of charitable organizations described in section 501(c)(3) of the Code—including elementary, secondary, and post-secondary schools—may be financed with tax-exempt private activity bonds (“qualified 501(c)(3) bonds”).

States or local governments may issue tax-exempt “exempt-facility bonds” to finance property for certain private businesses. Business facilities eligible for this financing in-

clude transportation (airports, ports, local mass commuting, and high speed intercity rail facilities); privately owned and/or privately operated public works facilities (sewage, solid waste disposal, local district heating or cooling, and hazardous waste disposal facilities); privately-owned and/or operated low-income rental housing; and certain private facilities for the local furnishing of electricity or gas. A further provision allows tax-exempt financing for “environmental enhancements of hydro-electric generating facilities.” Tax-exempt financing also is authorized for capital expenditures for small manufacturing facilities and land and equipment for first-time farmers (“qualified small-issue bonds”), local redevelopment activities (“qualified redevelopment bonds”), and eligible empowerment zone and enterprise community businesses. Tax-exempt private activity bonds also may be issued to finance limited non-business purposes: certain student loans and mortgage loans for owner-occupied housing (“qualified mortgage bonds”) and “qualified veterans’ mortgage bonds”).

Private activity tax-exempt bonds may not be issued to finance schools for private, for-profit businesses.

In most cases, the aggregate volume of private activity tax-exempt bonds is restricted by annual aggregate volume limits imposed on bonds issued by issuers within each State. These annual volume limits are equal to \$62.50 per resident of the State, or \$187.5 million if greater. The volume limits are scheduled to increase to the greater of \$75 per resident of the State or \$225 million in calendar year 2002. After 2002, the volume limits will be indexed annually for inflation.

Arbitrage restrictions on tax-exempt bonds

The Federal income tax does not apply to the income of States and local governments that is derived from the exercise of an essential governmental function. To prevent these tax-exempt entities from issuing more Federally subsidized tax-exempt bonds than is necessary for the activity being financed or from issuing such bonds earlier than needed for the purpose of the borrowing, the Code includes arbitrage restrictions limiting the ability to profit from investment of tax-exempt bond proceeds. In general, arbitrage profits may be earned only during specified periods (e.g., defined “temporary periods” before funds are needed for the purpose of the borrowing) or on specified types of investments (e.g., “reasonably required reserve or replacement funds”). Subject to limited exceptions, profits that are earned during these periods or on such investments must be rebated to the Federal Government.

Present law includes three exceptions to the arbitrage rebate requirements applicable to education-related bonds. First, issuers of all types of tax-exempt bonds are not required to rebate arbitrage profits if all of the proceeds of the bonds are spent for the purpose of the borrowing within six months after issuance.³⁵

Second, in the case of bonds to finance certain construction activities, including school construction and renovation, the six-month period is extended to 24 months. Arbitrage profits earned on construction proceeds are not required to be rebated if all such proceeds (other than certain retainage amounts) are spent by the end of the 24-month period and prescribed intermediate spending percentages are satisfied.³⁶ Issuers qualifying

for this “construction bond” exception may elect to be subject to a fixed penalty payment regime in lieu of rebate if they fail to satisfy the spending requirements.

Third, governmental bonds issued by “small” governments are not subject to the rebate requirement. Small governments are defined as general purpose governmental units that issue no more than \$5 million of tax-exempt governmental bonds in a calendar year. The \$5 million limit is increased to \$10 million if at least \$5 million of the bonds are used to finance public schools.

Qualified zone academy bonds

As an alternative to traditional tax-exempt bonds, States and local governments are given the authority to issue “qualified zone academy bonds.” Under present law, a total of \$400 million of qualified zone academy bonds may be issued in each of 1998 through 2001. The \$400 million aggregate bond authority is allocated each year to the States according to their respective populations of individuals below the poverty line. Each State, in turn, allocates the credit to qualified zone academies within such State. A State may carry over any unused allocation for up to two years (three years for authority arising before 2000).

Certain financial institutions (i.e., banks, insurance companies, and corporations actively engaged in the business of lending money) that hold qualified zone academy bonds are entitled to a nonrefundable tax credit in an amount equal to a credit rate multiplied by the face amount of the bond. An eligible financial institution holding a qualified zone academy bond on the credit allowance date (i.e., each one-year anniversary of the issuance of the bond) is entitled to a credit. The credit amount is includable in gross income (as if it were a taxable interest payment on the bond), and the credit may be claimed against regular income tax and alternative minimum tax liability.

The Treasury Department sets the credit rate daily at a rate estimated to allow issuance of qualified zone academy bonds without discount and without interest cost to the issuer. The maximum term of the bonds also is determined by the Treasury Department, so that the present value of the obligation to repay the bond is 50 percent of the face value of the bond. Present value is determined using as a discount rate the average annual interest rate of tax-exempt obligations with a term of 10 years or more issued during the month.

“Qualified zone academy bonds” are defined as bonds issued by a State or local government, provided that: (1) at least 95 percent of the proceeds is used for the purpose of renovating, providing equipment to, developing course materials for use at, or training teachers and other school personnel in a “qualified zone academy” and (2) private entities have promised to contribute to the qualified zone academy certain equipment, technical assistance or training, employee services, or other property or services with a value equal to at least 10 percent of the bond proceeds.

A school is a “qualified zone academy” if (1) the school is a public school that provides education and training below the college level, (2) the school operates a special academic program in cooperation with businesses to enhance the academic curriculum and increase graduation and employment rates, and (3) either (a) the school is located in a designated empowerment zone or a designated enterprise community, or (b) it is reasonably expected that at least 35 percent of the students at the school will be eligible

must be spent for the purpose of the borrowing no later than 36 months after the bonds are issued.

³²Hereinafter referred to as “State or local government bonds.”

³³Interest on this debt is included in calculating the “adjusted current earnings” preference of the corporate alternative minimum tax.

³⁴Interest on private activity bonds (other than qualified 501(c)(3) bonds) is a preference item in calculating the alternative minimum tax.

³⁵In the case of governmental bonds (including bonds to finance public schools), the six-month expenditure exception is treated as satisfied if at least 95 percent of the proceeds is spent within six months and the remaining five percent is spent within 12 months after the bonds are issued.

³⁶Retainage amounts are limited to no more than five percent of the bond proceeds, and these amounts

for free or reduced-cost lunches under the school lunch program established under the National School Lunch Act.

HOUSE BILL

No provision.

SENATE AMENDMENT

Increase amount of governmental bonds that may be issued by governments qualifying for the "small governmental unit" arbitrage rebate exception

The additional amount of governmental bonds for public schools that small governmental units may issue without being subject to the arbitrage rebate requirements is increased from \$5 million to \$10 million. Thus, these governmental units may issue up to \$15 million of governmental bonds in a calendar year provided that at least \$10 million of the bonds are used to finance public school construction expenditures.

Allow issuance of tax-exempt private activity bonds for public school facilities

The private activities for which tax-exempt bonds may be issued are expanded to include elementary and secondary public school facilities which are owned by private, for-profit corporations pursuant to public-private partnership agreements with a State or local educational agency. The term school facility includes school buildings and functionally related and subordinate land (including stadiums or other athletic facilities primarily used for school events)³⁷ and depreciable personal property used in the school facility. The school facilities for which these bonds are issued must be operated by a public educational agency as part of a system of public schools.

A public-private partnership agreement is defined as an arrangement pursuant to which the for-profit corporate party constructs, rehabilitates, refurbishes or equips a school facility for a public school agency (typically pursuant to a lease arrangement). The agreement must provide that, at the end of the contract term, ownership of the bond-financed property is transferred to the public school agency party to the agreement for no additional consideration.

Issuance of these bonds is subject to a separate annual per-State private activity bond volume limit equal to \$10 per resident (\$5 million, if greater) in lieu of the present-law State private activity bond volume limits. As with the present-law State private activity bond volume limits, States can decide how to allocate the bond authority to State and local government agencies. Bond authority that is unused in the year in which it arises may be carried forward for up to three years for public school projects under rules similar to the carryforward rules of the present-law private activity bond volume limits.

Effective date

The provisions are effective for bonds issued after December 31, 2001.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

G. MODIFY RULES GOVERNING TAX-EXEMPT BONDS FOR SECTION 501(C)(3) ORGANIZATIONS AS APPLIED TO ORGANIZATIONS ENGAGED IN TIMBER CONSERVATION ACTIVITIES (SEC. 423 OF THE SENATE AMENDMENT AND SEC. 145 OF THE CODE)

PRESENT LAW

Interest on State or local government bonds is tax-exempt when the proceeds of the

bonds are used to finance activities carried out by or paid for by those governmental units. Interest on bonds issued by State or local governments acting as conduit borrowers for private businesses is taxable unless a specific exception is included in the Code. One such exemption allows tax-exempt bonds to be issued to finance activities of non-profit organizations described in Code section 501(c)(3) ("qualified 501(c)(3) bonds").

Qualified 501(c)(3) bonds may be issued only to finance exempt, as opposed to unrelated business, activities of these organizations. However, if the bonds are issued to finance property which is intended to be, or is in fact, sold to a private business while the bonds are outstanding, bond interest may be taxable. An example of such an issue would be qualified 501(c)(3) bonds issued to finance purchase of land and standing timber, when the timber was to be sold.

As is true of other private activities receiving tax-exempt financing, beneficiaries of qualified 501(c)(3) bonds are restricted in the arrangements they may have with private businesses relating to control and use of bond-financed property.

HOUSE BILL

No provision.

SENATE AMENDMENT

The Senate amendment modifies the rules governing issuance of qualified 501(c)(3) bonds to permit issuance of long-term bonds for the acquisition of timber land by organizations a principal purpose of which is conservation of that land as timber land. Under these rules, the bonds will not have to be repaid (to avoid loss of tax-exemption on interest) when the timber is harvested and sold. In addition, the Senate amendment provision allows these section 501(c)(3) organizations to enter into certain otherwise prohibited timber management arrangements with private businesses without losing tax-exemption on bonds used to finance the property and timber.

Effective date.—The provision is effective for bonds issued after December 31, 2001, and before January 1, 2005.

CONFERENCE AGREEMENT

The conference agreement does not include the Senate amendment provision.

H. DEDUCTION FOR QUALIFIED HIGHER EDUCATION EXPENSES (SEC. 431 OF THE SENATE AMENDMENT AND NEW SEC. 222 OF THE CODE)

PRESENT LAW

Deduction for education expenses

Under present law, an individual taxpayer generally may not deduct the education and training expenses of the taxpayer or the taxpayer's dependents. However, a deduction for education expenses generally is allowed under Internal Revenue Code ("the Code") section 162 if the education or training (1) maintains or improves a skill required in a trade or business currently engaged in by the taxpayer, or (2) meets the express requirements of the taxpayer's employer, or requirements of applicable law or regulations, imposed as a condition of continued employment (Treas. Reg. sec. 1.162-5). Education expenses are not deductible if they relate to certain minimum educational requirements or to education or training that enables a taxpayer to begin working in a new trade or business. In the case of an employee, education expenses (if not reimbursed by the employer) may be claimed as an itemized deduction only if such expenses meet the above described criteria for deductibility under section 162 and only to the extent that the expenses, along with other miscellaneous deductions, exceed two percent of the taxpayer's adjusted gross income.

*HOPE and Lifetime Learning credits**HOPE credit*

Under present law, individual taxpayers are allowed to claim a nonrefundable credit, the "HOPE" credit, against Federal income taxes of up to \$1,500 per student per year for qualified tuition and related expenses paid for the first two years of the student's post secondary education in a degree or certificate program. The HOPE credit rate is 100 percent on the first \$1,000 of qualified tuition and related expenses, and 50 percent on the next \$1,000 of qualified tuition and related expenses.³⁸ The qualified tuition and related expenses must be incurred on behalf of the taxpayer, the taxpayer's spouse, or a dependent of the taxpayer. The HOPE credit is available with respect to an individual student for two taxable years, provided that the student has not completed the first two years of post-secondary education before the beginning of the second taxable year.³⁹ The HOPE credit that a taxpayer may otherwise claim is phased-out ratably for taxpayers with modified AGI between \$40,000 and \$50,000 (\$80,000 and \$100,000 for joint returns). For taxable years beginning after 2001, the \$1,500 maximum HOPE credit amount and the AGI phase-out ranges are indexed for inflation.

The HOPE credit is available for "qualified tuition and related expenses," which include tuition and fees required to be paid to an eligible educational institution as a condition of enrollment or attendance of an eligible student at the institution. Charges and fees associated with meals, lodging, insurance, transportation, and similar personal, living, or family expenses are not eligible for the credit. The expenses of education involving sports, games, or hobbies are not qualified tuition and related expenses unless this education is part of the student's degree program.

Qualified tuition and related expenses generally include only out-of-pocket expenses. Qualified tuition and related expenses do not include expenses covered by employer-provided educational assistance and scholarships that are not required to be included in the gross income of either the student or the taxpayer claiming the credit. Thus, total qualified tuition and related expenses are reduced by any scholarship or fellowship grants excludable from gross income under section 117 and any other tax free educational benefits received by the student (or the taxpayer claiming the credit) during the taxable year.

Lifetime Learning credit

Individual taxpayers are allowed to claim a nonrefundable credit, the Lifetime Learning credit, against Federal income taxes equal to 20 percent of qualified tuition and related expenses incurred during the taxable year on behalf of the taxpayer, the taxpayer's spouse, or any dependents. For expenses paid after June 30, 1998, and prior to January 1, 2003, up to \$5,000 of qualified tuition and related expenses per taxpayer return are eligible for the Lifetime Learning credit (i.e., the maximum credit per taxpayer return is \$1,000). For expenses paid after December 31, 2002, up to \$10,000 of qualified tuition and related expenses per taxpayer return will be eligible for the Lifetime Learning credit (i.e., the maximum credit per taxpayer return will be \$2,000).

In contrast to the HOPE credit, a taxpayer may claim the Lifetime Learning credit for

³⁸Thus, an eligible student who incurs \$1,000 of qualified tuition and related expenses is eligible (subject to the AGI phase-out) for a \$1,000 HOPE credit. If an eligible student incurs \$2,000 of qualified tuition and related expenses, then he or she is eligible for a \$1,500 HOPE credit.

³⁹The HOPE credit may not be claimed against a taxpayer's alternative minimum tax liability.

³⁷The present-law limit on the amount of the proceeds of a private activity bond issue that may be used to finance land acquisition does not apply to these bonds.

an unlimited number of taxable years. Also in contrast to the HOPE credit, the maximum amount of the Lifetime Learning credit that may be claimed on a taxpayer's return will not vary based on the number of students in the taxpayer's family—that is, the HOPE credit is computed on a per student basis, while the Lifetime Learning credit is computed on a family wide basis. The Lifetime Learning credit amount that a taxpayer may otherwise claim is phased-out ratably for taxpayers with modified AGI between \$40,000 and \$50,000 (\$80,000 and \$100,000 for joint returns).

HOUSE BILL

No provision.

SENATE AMENDMENT

The Senate amendment permits taxpayers an above-the-line deduction for qualified higher education expenses paid by the taxpayer during a taxable year. Qualified higher education expenses are defined in the same manner as for purposes of the HOPE credit.

In 2002 and 2003, taxpayers with adjusted gross income⁴⁰ that does not exceed \$65,000 (\$130,000 in the case of married couples filing joint returns) are entitled to a maximum deduction of \$3,000 per year. Taxpayers with adjusted gross income above these thresholds would not be entitled to a deduction. In 2004 and 2005, taxpayers with adjusted gross income that does not exceed \$65,000 (\$130,000 in the case of married taxpayers filing joint returns) are entitled to a maximum deduction of \$5,000 and taxpayers with adjusted gross income that does not exceed \$80,000 (\$160,000 in the case of married taxpayers filing joint returns) are entitled to a maximum deduction of \$2,000.

Taxpayers are not eligible to claim the deduction and a HOPE or Lifetime Learning Credit in the same year with respect to the same student. A taxpayer may not claim a deduction for amounts taken into account in determining the amount excludable due to a distribution (i.e., the earnings and contribution portion of a distribution) from an education IRA or the amount of interest excludable with respect to education savings bonds. A taxpayer may not claim a deduction for the amount of a distribution from a qualified tuition plan that is excludable from income; however, a taxpayer may claim a deduction for the amount of a distribution from a qualified tuition plan that is not attributable to earnings. Thus, for example, if a taxpayer receives a distribution of \$100 from a qualified tuition plan which is used for tuition, \$10 of which represents earnings, the taxpayer would be entitled to claim the deduction with respect to the \$90 representing a return of contributions. On the other hand, if the distribution were from an education IRA, the \$90 would not be eligible for the deduction.

Effective date.—The provision is effective for payments made in taxable years beginning after December 31, 2001, and before January 1, 2006.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment with the modification that the maximum deduction in 2004 and 2005 is \$4,000 for taxpayers with adjusted gross income that does not exceed \$65,000 (\$130,000 in the case of married taxpayers filing joint returns).

I. CREDIT FOR INTEREST ON QUALIFIED HIGHER EDUCATION LOANS (SEC. 432 OF THE SENATE AMENDMENT AND NEW SEC. 25B OF THE CODE)

PRESENT LAW

An above-the-line deduction for interest paid on qualified education loans is per-

mitted during the first 60 months in which interest payments are required. Required payments of interest generally do not include voluntary payments, such as interest payments made during a period of loan forbearance. Months during which interest payments are not required because the qualified education loan is in deferral or forbearance do not count against the 60-month period. No deduction is allowed to an individual if that individual is claimed as a dependent on another taxpayer's return for the taxable year.

The maximum allowable annual deduction is \$2,500. The deduction is phased-out ratably for single taxpayers with modified adjusted gross income between \$40,000 and \$55,000 and for married taxpayers filing joint returns with modified adjusted gross income between \$60,000 and \$75,000. The income ranges will be adjusted for inflation after 2002.⁴¹

A qualified education loan generally is defined as any indebtedness incurred solely to pay for certain costs of attendance (including room and board) of a student (who may be the taxpayer, the taxpayer's spouse, or any dependent of the taxpayer as of the time the indebtedness was incurred) who is enrolled in a degree program on at least a half-time basis at (1) an accredited post-secondary educational institution defined by reference to section 481 of the Higher Education Act of 1965, or (2) an institution conducting an internship or residency program leading to a degree or certificate from an institution of higher education, a hospital, or a health care facility conducting post-graduate training.

HOUSE BILL

No provision.

SENATE AMENDMENT

The Senate amendment permits taxpayers a nonrefundable personal credit for interest paid on qualified education loans during the first 60 months in which interest payments are required. The maximum annual credit available would be \$500.

The credit is phased-out for single taxpayers with modified adjusted gross income between \$35,000 and \$45,000 and for married taxpayers filing joint returns with modified adjusted gross income between \$70,000 and \$90,000. These income phase-out ranges would be adjusted annually for inflation after 2009.

A taxpayer taking the credit in a taxable year for payment of interest on a qualified education loan would not be allowed a student loan interest deduction in such taxable year. Similarly, if the taxpayer took a deduction, the taxpayer would not qualify for the credit.

Effective date.—The provision is effective for taxable years beginning after December 31, 2008.

CONFERENCE AGREEMENT

The conference agreement does not include the Senate amendment provision.

J. DEDUCTION FOR QUALIFIED EMERGENCY RESPONSE EXPENSES OF ELIGIBLE EMERGENCY RESPONSE PROFESSIONALS (SEC. 433 OF THE SENATE AMENDMENT AND NEW SEC. 224 OF THE CODE)

PRESENT LAW

Employee business expenses are deductible only as an itemized deduction and only to the extent that the expenses, along with the taxpayer's other allowable miscellaneous itemized deductions, exceed two percent of the taxpayer's adjusted gross income. Itemized deductions may be further reduced by the overall limitation on itemized deductions, which generally applies to taxpayers with adjusted gross income in excess of \$132,950 (for 2001).

HOUSE BILL

No provision.

SENATE AMENDMENT

The Senate amendment provides an above-the-line deduction for qualified expenses paid or incurred during the taxable year by an eligible emergency response professional.

An eligible emergency response professional is (1) a full-time employee of a police or fire department organized and operated by a government to provide police protection or firefighting or emergency medical services within its jurisdiction, (2) a licensed emergency medical technician employed by a State or nonprofit agency to provide emergency medical services, or (3) a member of a volunteer fire department organized to provide firefighting or emergency medical services within an area that is not provided with other firefighting services. Qualified expenses means unreimbursed expenses for police and firefighter activities (as determined by the Secretary of Treasury).

No other deduction or credit is allowed with respect to the amount taken into account under this provision. A deduction is allowed for qualified expenses under the provision only to the extent the amount of such expenses exceeds the amount excludable under the provisions relating to education savings bonds, education IRAs, and qualified tuition plans.

Effective date.—The Senate amendment applies to taxable years beginning after December 31, 2001, and before January 1, 2007.

CONFERENCE AGREEMENT

The conference agreement does not include the Senate amendment provision.

K. ENHANCED DEDUCTION FOR CHARITABLE CONTRIBUTION OF BOOK INVENTORY FOR EDUCATIONAL PURPOSES (SEC. 434 OF THE SENATE AMENDMENT AND SEC. 170 OF THE CODE)

PRESENT LAW

In the case of a charitable contribution of inventory or other ordinary-income or short-term capital gain property, the amount of the deduction is limited to the taxpayer's basis in the property. In the case of a charitable contribution of tangible personal property, the deduction is limited to the taxpayer's basis in such property if the use by the recipient charitable organization is unrelated to the organization's tax-exempt purpose. In cases involving contributions to a private foundation (other than certain private operating foundations), the amount of the deduction is limited to the taxpayer's basis in the property.

Under present law, a taxpayer's deduction for charitable contributions of book inventory generally is limited to the taxpayer's basis (typically, cost) in the inventory. However, certain corporations may claim a deduction in excess of basis for certain charitable contributions to charitable organizations other than private non-operating foundations. This enhanced deduction is equal to the lesser of (1) basis plus one-half of the item's appreciated value (i.e., basis plus one half of fair market value minus basis) or (2) two times basis. To be eligible for an enhanced deduction, (1) the use of the property by the donee must be related to the donee's exempt purpose and be used by the donee solely for the care of the ill, the needy, or infants; (2) the property must not be transferred by the donee in exchange for money, other property, or services; and (3) the taxpayer must receive a written statement from the donee agreeing to such conditions on use of the contributed property. The taxpayer also must establish that the fair market value of the donated item exceeds basis.

HOUSE BILL

No provision.

⁴⁰The provision contains ordering rules for use in determining adjusted gross income for purposes of the deduction.

⁴¹Another section of the Senate amendment makes certain modifications to present law.

SENATE AMENDMENT

The Senate amendment provides that contributions of book inventory to certain educational organizations are entitled to the present-law enhanced deduction. Eligible educational organizations are (1) educational organizations that normally maintain a regular faculty and curriculum and normally have a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on; (2) charities organized primarily for purposes of supporting elementary and secondary education; and (3) charities organized primarily to make books available to the general public at no cost or to operate a literacy program. Present-law requirements relating to use of the property by the donee and provision of a written statement by the donee apply.

Effective date.—The deduction for contributions of book inventory for educational purposes applies to contributions made after the date of enactment.

CONFERENCE AGREEMENT

The conference agreement does not include the Senate amendment provision.

L. DEDUCTION FOR QUALIFIED PROFESSIONAL DEVELOPMENT EXPENSES OF ELEMENTARY AND SECONDARY SCHOOL TEACHERS (SEC. 442 OF THE SENATE AMENDMENT AND NEW SEC. 223 OF THE CODE)

PRESENT LAW

Deduction for education expenses

Under present law, an individual taxpayer generally may not deduct the education and training expenses of the taxpayer or the taxpayer's dependents. However, a deduction for education expenses generally is allowed under Internal Revenue Code ("the Code") section 162 if the education or training (1) maintains or improves a skill required in a trade or business currently engaged in by the taxpayer, or (2) meets the express requirements of the taxpayer's employer, or requirements of applicable law or regulations, imposed as a condition of continued employment (Treas. Reg. sec. 1.162-5). Education expenses are not deductible if they relate to certain minimum educational requirements or to education or training that enables a taxpayer to begin working in a new trade or business. In the case of an employee, education expenses (if not reimbursed by the employer) may be claimed as an itemized deduction only if such expenses meet the above described criteria for deductibility under section 162 and only to the extent that the expenses, along with other miscellaneous deductions, exceed two percent of the taxpayer's adjusted gross income.

*HOPE and Lifetime Learning credits**HOPE credit*

Under present law, individual taxpayers are allowed to claim a nonrefundable credit, the "HOPE" credit, against Federal income taxes of up to \$1,500 per student per year for qualified tuition and related expenses paid for the first two years of the student's post secondary education in a degree or certificate program. The HOPE credit rate is 100 percent on the first \$1,000 of qualified tuition and related expenses, and 50 percent on the next \$1,000 of qualified tuition and related expenses.⁴² The qualified tuition and related expenses must be incurred on behalf of the taxpayer, the taxpayer's spouse, or a dependent of the taxpayer. The HOPE credit is available with respect to an individual stu-

dent for two taxable years, provided that the student has not completed the first two years of post-secondary education before the beginning of the second taxable year.⁴³ The HOPE credit that a taxpayer may otherwise claim is phased-out ratably for taxpayers with modified AGI between \$40,000 and \$50,000 (\$80,000 and \$100,000 for joint returns). For taxable years beginning after 2001, the \$1,500 maximum HOPE credit amount and the AGI phase-out ranges are indexed for inflation.

The HOPE credit is available for "qualified tuition and related expenses," which include tuition and fees required to be paid to an eligible educational institution as a condition of enrollment or attendance of an eligible student at the institution. Charges and fees associated with meals, lodging, insurance, transportation, and similar personal, living, or family expenses are not eligible for the credit. The expenses of education involving sports, games, or hobbies are not qualified tuition and related expenses unless this education is part of the student's degree program.

Qualified tuition and related expenses generally include only out-of-pocket expenses. Qualified tuition and related expenses do not include expenses covered by employer-provided educational assistance and scholarships that are not required to be included in the gross income of either the student or the taxpayer claiming the credit. Thus, total qualified tuition and related expenses are reduced by any scholarship or fellowship grants excludable from gross income under section 117 and any other tax free educational benefits received by the student (or the taxpayer claiming the credit) during the taxable year.

Lifetime Learning credit

Individual taxpayers are allowed to claim a nonrefundable credit, the Lifetime Learning credit, against Federal income taxes equal to 20 percent of qualified tuition and related expenses incurred during the taxable year on behalf of the taxpayer, the taxpayer's spouse, or any dependents. For expenses paid after June 30, 1998, and prior to January 1, 2003, up to \$5,000 of qualified tuition and related expenses per taxpayer return are eligible for the Lifetime Learning credit (i.e., the maximum credit per taxpayer return is \$1,000). For expenses paid after December 31, 2002, up to \$10,000 of qualified tuition and related expenses per taxpayer return will be eligible for the Lifetime Learning credit (i.e., the maximum credit per taxpayer return will be \$2,000).

In contrast to the HOPE credit, a taxpayer may claim the Lifetime Learning credit for an unlimited number of taxable years. Also in contrast to the HOPE credit, the maximum amount of the Lifetime Learning credit that may be claimed on a taxpayer's return will not vary based on the number of students in the taxpayer's family—that is, the HOPE credit is computed on a per student basis, while the Lifetime Learning credit is computed on a family wide basis. The Lifetime Learning credit amount that a taxpayer may otherwise claim is phased-out ratably for taxpayers with modified AGI between \$40,000 and \$50,000 (\$80,000 and \$100,000 for joint returns).

HOUSE BILL

No provision.

SENATE AMENDMENT

The Senate amendment provides an above-the-line deduction for up to \$500 of qualified professional development expenses paid or incurred during the taxable year. The deduction is available to kindergarten through

12th grade teachers, instructors, counselors, principals, or aides who work in an elementary or secondary school⁴⁴ for at least 900 hours during the school year.

Qualified professional development expenses are tuition, fees, books, supplies, equipment, and transportation required for the enrollment or attendance in a qualified course of instruction. A qualified course of instruction is a course which: (1) is (a) directly related to the curriculum and academic subjects in which the individual provides instruction, (b) designed to enhance the ability of the individual to understand and use State standards for the academic subjects in which the individual provides instruction, (c) designed to provide instruction in how to teach children with different learning styles, particularly children with disabilities and children with special learning needs (including children who are gifted and talented), or (d) designed to provide instruction in how to best discipline children in the classroom and identify early and appropriate interventions to help children described in (c) learn; (2) is tied to (a) challenging State or local content standards and student performance standards or (b) strategies and programs that demonstrate effectiveness in increasing student academic achievement and student performance, or substantially increasing the knowledge and teaching skills of the individual; (3) is of sufficient intensity and duration to have a positive and lasting impact on the performance of the individual in the classroom⁴⁵ (which does not include one-day or short-term workshops and conferences); and (3) is part of a program of professional development approved and certified by the appropriate local educational agency⁴⁶ as furthering the goals described in (1) and (2).

No other deduction or credit is allowed with respect to the amount taken into account under this provision. A deduction is allowed for qualified professional development expenses under the provision only to the extent the amount of such expenses exceeds the amount excludable under the provisions relating to education savings bonds, education IRAs, and qualified tuition plans.

Effective date.—The provision is effective for taxable years beginning after December 31, 2000, and expires on December 31, 2005.

CONFERENCE AGREEMENT

The conference agreement does not include the Senate amendment provision.

CREDIT FOR CLASSROOM MATERIALS (SEC. 443 OF THE SENATE AMENDMENT AND NEW SEC. 30B OF THE CODE)

PRESENT LAW

Unreimbursed employee business expenses are deductible only as an itemized deduction and only to the extent that the individual's total miscellaneous itemized deductions (including employee business expenses) exceed two percent of adjusted gross income.

Taxpayers who itemize deductions may claim a deduction for contributions to qualified charitable organizations. Total deductible contributions may not exceed 50 percent of adjusted gross income. Other limits apply

⁴²Thus, an eligible student who incurs \$1,000 of qualified tuition and related expenses is eligible (subject to the AGI phase-out) for a \$1,000 HOPE credit. If an eligible student incurs \$2,000 of qualified tuition and related expenses, then he or she is eligible for a \$1,500 HOPE credit.

⁴³The HOPE credit may not be claimed against a taxpayer's alternative minimum tax liability.

⁴⁴Elementary and secondary schools are defined by reference to section 14101 of the Elementary and Secondary Education Act of 1965.

⁴⁵One-day or short-term workshops and conferences do not satisfy this requirement. This requirement does not apply to an activity that is one component described in a long-term comprehensive professional development plan established by the individual and his or her supervisor based on an assessment of the needs of the individual, the individual's students, and the local educational agency involved.

⁴⁶Local education agency is as defined in section 14101 of the Elementary and Secondary Education Act of 1965, as in effect on the date of enactment.

in the case of contributions to certain organizations and certain property.

An individual's otherwise allowable itemized deductions may be further limited by the overall limitation on itemized deductions, which reduces itemized deductions for taxpayers with adjusted gross income in excess of \$132,950 (for 2001).

Depending on the particular facts and circumstances, a contribution by a teacher to the school and which he or she is employed may be deductible as an unreimbursed employee business expenses or as a charitable contribution.

HOUSE BILL

No provision.

SENATE AMENDMENT

The Senate amendment provides a non-refundable personal credit equal to 50 percent of the qualified elementary and secondary education expenses paid or incurred by an eligible educator during the taxable year. The maximum credit cannot exceed \$250 in any year. An eligible educators are kindergarten through 12th grade teachers, instructors, counselors, principals, or aides who work in an elementary or secondary school⁴⁷ for at least 900 hours during the school year. Qualified elementary and secondary education expenses are expenses for books, supplies (other than nonathletic supplies for courses of instruction in health or physical education), computer equipment (including related software and services) and other equipment, and supplementary materials used by an eligible educator in the classroom.

The credit may not exceed the excess (if any) of (1) the taxpayer's regular tax for the taxable year, reduced by the sum of certain other allowable credits over (2) the taxpayer's tentative minimum tax for the taxable year.

No deduction is allowed for any expense for which a credit is allowed under the provision.

A taxpayer may elect not to have the credit apply.

Effective date.—The provision is effective for taxable years beginning after December 31, 2001, and expires on December 31, 2005.

CONFERENCE AGREEMENT

The conference agreement does not include the Senate amendment provision.

⁴⁷Elementary and secondary schools are defined by reference to section 14101 of the Elementary and Secondary Education Act of 1965.