NACUBO

A Brief Summary of Higher Education Tax Policies & Issues

February 18, 2025

Introduction

This document is designed to provide an overview of tax issues under consideration and scrutiny, and potentially in jeopardy, in the nation's capital. Congress has begun work to enact the priorities of the Trump administration, including extension of the 2017 Tax Cuts and Jobs Act, which is set to expire at the end of this year.

Will Congress limit or repeal existing support to students and families paying for college? Will there be further erosion of the fundamental concepts of tax-exempt status with measures that place additional regulatory compliance and financial burdens on institutions? What can colleges and universities do to enhance public understanding of nuanced and complicated issues?

NACUBO sent a January 31 letter to Congressional leadership and tax writers highlighting tax policy priorities of greatest concern to member institutions.

NACUBO urges business officers to use our letter to begin conversations with fellow administrators, campus government relations and communications officers, and others about how tax policy impacts everyday interactions with students and employees, and how seemingly slight changes can impact major strategic financial decisions. We urge you to consider your institution's tax priorities, and ensure presidents, chancellors, and trustees are well-versed in what these issues mean to your students, staff, and campus community.

As Congress moves to implement the Trump administration priorities, including extension of the provisions of the Tax Cuts and Jobs Act, it is possible that lawmakers could act—beneficially or detrimentally—on some of these issues in the coming weeks and months. Lawmakers are considering a range of tax and spending measures that could have serious financial consequences for colleges and universities, including—

- Cutting education tax credits and the student loan interest deduction
- Taxing scholarship and fellowship income
- Repealing charitable contribution deductions
- Eliminating tax-exempt bond financing
- Expanding the excise tax on endowments

These proposals are part of broader budget reconciliation efforts, where lawmakers are seeking offsets to help fund the extension of tax cuts and other federal priorities. If enacted, they would increase financial burdens on students and institutions, limit support for research, and weaken higher education's ability to serve its missions.

We encourage NACUBO member institutions to follow our coverage of these issues in *Current*, our weekly newsletter, and check for updates in *NACUBO on Your Side*. If you would like additional information, please contact NACUBO's federal affairs staff at advocacy@nacubo.org.

SUPPORT FOR STUDENTS

Education Tax Credits

The American Opportunity Tax Credit (AOTC) is a credit for qualified education expenses paid for an eligible student for the first four years of higher education. Taxpayers can get a maximum annual credit of $2,500 per eligible student. The amount of the credit is 100 percent of the first $2,000 of qualified education expenses paid for each eligible student and 25 percent of the next $2,000 of qualified education expenses paid for that student.

The Lifetime Learning credit (LLC) is for qualified tuition and related expenses paid for eligible students enrolled in an eligible educational institution. This credit can help pay for undergraduate, graduate, and professional degree courses—including courses to acquire or improve job skills. There is no limit on the number of years you can claim the credit. It is worth up to $2,000 per tax return.

Historically, NACUBO has supported simplification of the current system of education incentive tax credits through the creation of a single, permanent tax credit with automatic inflation adjustments, making it easier to use and more effective. A single, permanent, refundable credit, available beyond the first four years of college, and to both full-time and part-time learners, would negate the need for the separate higher education tax credit provisions.

There are currently proposals circulating in Congress to either eliminate or curtail both credits, which are instrumental in helping students and families pay for college.

Student Loan Interest Deduction

The student loan interest deduction allows certain individuals to deduct up to $2,500 in student loan interest, with a phase-out for certain taxpayers. Student loan interest is interest paid during the year on a qualified student loan. It includes both required and voluntarily prepaid interest payments. This deduction can be claimed as an adjustment to income, so it is available to non-itemizers.

Over the last several years, federal actions have increased the borrowing costs for students and recent graduates by implementing interest charges for graduate students while they

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are in school and by eliminating the six-month interest-free grace period that college graduates have traditionally received.

Congressional tax writers are currently considering eliminating the student loan interest deduction.

Section 127: Employer-Provided Tuition Assistance

Section 127 of the Internal Revenue Code allows all employers, including colleges and universities, to offer employees up to $5,250 annually in tax-free tuition assistance. Employers are never required to offer tuition aid under Section 127, but if they do, it must be offered to all employees on a non-discriminatory basis to ensure that the benefit does not favor the highly compensated.

When it was enacted as an expiring tax benefit in 1978, Section 127 was intended to allow employers to completely cover the cost of higher education. Unfortunately, the benefit amount of $5,250 annually has not been increased in 47 years. During the pandemic, Section 127 was expanded to include student loan repayment.

The benefits offered by Section 127 are a valuable tool for employers to attract the best possible employees and build a skilled workforce. Section 127 helps support U.S. competitiveness and could, if strengthened, become the benefit of choice for tuition assistance and loan repayment among employers.

NACUBO is a member of the **Section 127 Coalition**, a broad-based coalition of groups representing business, labor, and education dedicated to preserving and expanding Section 127 of the Internal Revenue Code, including the extension of student loan repayment, and to raise the yearly allowed limit.

Section 117: Nontaxability of Qualified Scholarships

Section 117 of the Internal Revenue Code allows degree-seeking students to exclude from taxable income certain scholarship amounts used to pay for qualified educational costs, such as tuition and related expenses including course-related fees, books, and required equipment. Room, board, transportation, and living expenses are not qualified expenses.

Under IRS rules, a student is eligible for tax exclusion under Section 117 if they—

- Attend primary or secondary school (K-12),
- Attend college to pursue a degree, or
- Attend an institution that offers a training program for employment in a recognized occupation.

The institution must have nationally recognized accreditation status and be authorized

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under federal or state law to provide a program of study.

Section 117(d) permits secondary and postsecondary educational institutions to provide employees and their spouses or dependents with tuition assistance (for undergraduate level tuition) excluded from taxable income.

If an institution chooses to offer this benefit, then all employees must be able to receive it. As a result, Section 117(d) provides a particularly important benefit to many middle- and low-income college employees. In fact, most employees benefiting from the provision are low- and middle-income.

In addition, Section 117(d) gives colleges and universities a crucial tool for recruiting and retaining valued employees, which is particularly important for many small, private schools in their efforts to attract and compete for top employees.

Section 117(d)(5) reduces the cost of graduate education and mitigates the tax liability of graduate students engaged in teaching and/or research as part of their academic programs. Without this provision, thousands of graduate students would be subjected to a major tax increase.

There are currently proposals in Congress to tax scholarship and fellowship income, effectively removing any of the above provisions that help students pursue their education.

CHARITABLE GIVING

Charitable donations help colleges and universities achieve their teaching, research, and public service missions. For more than 100 years, the charitable deduction has encouraged individuals to make significant, transformational gifts to educational institutions.

It is unlikely that the government could find a better way to leverage private investment than with the charitable deduction. With limited funding from federal and state governments and pressure to limit tuition increases, raising private support is crucial for colleges and universities.

From small colleges to large universities, charitable giving helps fuel commitments to providing an affordable, quality education.

The Tax Cuts and Jobs Act nearly doubled the standard deduction, and in so doing, effectively eliminated the charitable deduction for millions of taxpayers who no longer itemize their tax returns. Additionally, since the value of the charitable deduction is tied to a taxpayer's marginal tax rate, tax rate cuts automatically increase a donor's cost of giving.

Lawmakers have recently introduced legislation proposing a universal charitable above-the-line deduction that would be available to all taxpayers.

- Companion bills (S. 317/H.R. 801) introduced by Sens. James Lankford (R-OK) and Chris Coons (D-DE) along with Reps. Blake Moore (R-UT), Danny Davis (D-

IL), Carol Miller (R-WV), and Chris Pappas (D-NH) would extend the charitable deduction to all taxpayers, including those who do not itemize.

NACUBO is a member of the **Charitable Giving Coalition**. Established in 2009, the Charitable Giving Coalition's members include more than 60 diverse organizations representing private and community foundations, their grantees and independent charities, nonprofit organizations, and the associations and umbrella groups that serve their needs. The coalition is dedicated to preserving the charitable tax deduction, which is crucial to ensuring our nation's charities receive the funds necessary to fulfill their essential philanthropic missions. The coalition provides a unique and unified voice on Capitol Hill, including lobbying and grassroots advocacy on issues affecting the charitable deduction.

TAX-EXEMPT BOND FINANCING

Public colleges and universities are typically a component of state or local governments, while private institutions are recognized as tax-exempt organizations under Section 501(c)(3) of the Internal Revenue Code. Tax-exempt bond financing available to public institutions is also referred to as municipal bonds; similar financing is currently available to nonprofit colleges and universities (and some public institutions) as qualified 501(c)(3) private activity bonds. The nonprofit educational institution borrower, not the governmental body issuer, is solely responsible for and liable to repay the bonds.

Private nonprofit colleges and universities, just like their public counterparts, rely on these financial instruments to acquire, construct, renovate, and expand capital infrastructure, such as academic buildings, residence halls, modern energy plants, and more.

For colleges and universities, the interest rates on municipal bonds and private activity bonds are significantly lower than on taxable bonds, thus creating beneficial financial terms. For example, a recent analysis found that the interest rate reduction can be as much as 210 basis points, or 2.1%. This translates to significant savings on multi-million-dollar construction projects, which are often financed over a 30-year period. By reducing the cost of borrowing, colleges and universities can keep tuition rates lower than they might if they had to rely on taxable financing.

For many institutions, revenue from tuition or from restricted gifts simply does not provide sufficient funds to build, expand, and renovate as is necessary to meet their respective missions, and taxable debt is costlier, often by a material amount. In fact, many smaller, lower, or nonrated institutions would not be able to access the taxable market at all, which has many diverse types of purchasers. Banks would have much less interest in purchasing nonprofit education debt.

Advance refunding of bonds (the ability to refinance tax-exempt bonds at lower interest rates), was eliminated in 2017 by the Tax Cuts and Jobs Act. Current proposals exist to

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eliminate or limit the availability of tax-exempt bonds to offset the cost of enacting Trump administration priorities, such as immigration reform, the nontaxability of tips, and the extension of the Tax Cuts and Jobs Act.

ENDOWMENTS

Endowments are critical to providing student financial aid (scholarships). They also serve as funding sources for faculty, libraries, laboratories, campus housing, student services, and other essential components of a student's education. Endowments also support research and public service missions, such as innovations in nanotechnology, medical research, or university-based youth and community development programs.

Over the years, lawmakers and others have focused their concerns on endowment spending for student aid, with little recognition that endowment spending on other operational areas relieves tuition pressure. Many fail to realize that covering institutional costs with endowment payouts eases the need to pay for necessary institutional expenses with tuition dollars or other revenue. Often, endowments are repeatedly mischaracterized as instruments allowing institutions to "profit" from their investments, as a corporation would. However, colleges and universities are not corporations. They were founded and operate to serve societal needs and deliver benefits to students, rather than generating profits for shareholders' individual private gain. It is students who benefit from their institution's endowment.

Also missing from public debate is recognition that endowment managers are legally obligated to support current students and operations, while balancing asset management goals to ensure financial soundness for the institution in the future.

Endowed funds—at colleges, universities, and many other private 501(c)3 organizations—represent the institution's or organization's promise to donors to use income and investment gains generated by their gifts to support an aspect of the university's mission, usually in perpetuity. Colleges and universities, large and small, maintain endowments or other reserves that enable them to respond to unforeseen changes or seize new opportunities in pursuit of their missions.

The Excise Tax on Net Investment Income ("the Endowment Tax")

The Tax Cuts and Jobs Act imposed a 1.4 percent excise tax on the net investment income of certain private colleges and universities if they have at least 500 students, with more than 50 percent of those students located in the United States, and assets (other than those used directly in carrying out the institution's educational purposes) valued at the close of the preceding tax year of at least $500,000 per full-time student.

Rather than direct more resources to support students, this tax has made fewer dollars available for scholarships, student services, research, and campus operating expenses; the

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tax represents a departure from the federal government's commitment to philanthropic freedom—the right of Americans to choose how and where to spend their charitable assets. Since the enactment of Tax Cuts and Jobs Act, several legislative proposals have been introduced that would expand the scope and increase the tax rate, and more are expected this year.

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