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Tax Policy and Tuition Credit Legislation: Federal Income Tax Allowances for Personal Costs of Higher Education

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The federal income tax law does not give an allowance for personal costs of ordinary higher education.¹ College and university tuition, fees and other costs usually cannot be deducted or otherwise used

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1. The federal income tax does allow a deduction for some expenditures for supplementary, continuation, or refresher courses as trade or business expenses or costs of producing income. See Treas. Reg. § 1.162-5 (T.D. 6291, amended by T.D. 6918, 1967) "Expenses for Education." See also *Coughlin v. Commissioner*, 203 F.2d 307 (2d Cir. 1953). However, most expenditures for higher education—tuition and other costs for graduate as well as undergraduate students—are treated as nondeductible "personal, living, or family expenses" under *Int. Rev. Code of 1954*, § 262 and accordingly cannot be deducted. Nor can they be added to the basis of an asset to create a tax loss or to reduce taxable gain upon eventual sale of the asset or to give rise to depreciation or amortization deductions.

For a review of the tax treatment of personal educational expenditures, see Goode, *Educational Expenditures and the Income Tax* in *ECONOMICS OF HIGHER EDUCATION* 282-84 (Mushkin ed. 1962). See also Heckerling, *The Federal Taxation of Legal Education: Past, Present, and Proposed*, 27 *OHIO ST. L.J.* 117 (1966); Wolfman, *The Cost of Education and the Federal Income Tax* (Proceedings of the Twenty-Ninth Annual Judicial Conference, Third Judicial Circuit of the United States), 42 *F.R.D.* 535 (1966) [hereinafter cited as Wolfman]. See generally CHOMMIE, *FEDERAL INCOME TAXATION* 79-83 (1968); Chommie, *Federal Income Taxation: Transactions in Aid of Education*, 58 *DICK. L. REV.* 93, 189, 291 (1954); Note, *Federal Tax Incentives for Higher Education*, 76 *HARV. L. REV.* 369, 382 (1962) [hereinafter cited as *Federal Tax Incentives*]. Of course, the taxpayer's personal costs of higher education may be lessened by federal income tax allowances available to institutions of higher learning in such forms as exemption from tax on their income, charitable contribution deductions allowed to benefactors of such institutions, or by the exclusion from the student's income of qualified scholarships.

to reduce federal income tax liability; rather, they must be paid with after-tax dollars.

Three times in recent years the United States Senate has passed a bill that would give some form of federal income tax allowance for the personal costs of higher education.² Each time House and other objections killed the bill in conference. Nevertheless, such proposals revive, claim popular appeal and merit careful, systematic policy analysis—more of which remains to be given.³ This Article examines a variety

2. Of the myriad House and Senate Bills annually introduced to install tax allowances for expenses of higher education very few, if any, reach the floor of either chamber for a vote. Occasionally, a proposal has reached the floor, not by surviving committee but as an amendment to current revenue or tax bills. Three times in recent years the Senate has adopted an amendment endorsing such a tax credit. Most recently, the Senate voted 56-27 to accept an amendment, sponsored by Senators Hollings and Ribicoff, to the Revenue Bill of 1971, allowing a tax credit of up to \$325 for qualified expenses of higher education. 117 CONG. REC. 18,612 (daily ed.) (Nov. 15, 1971). The credit was, however, eliminated in the conference committee. Two years earlier, in working toward the Tax Reform Act of 1969, the Senate passed another of Senator Ribicoff's amendments providing for a similar tax credit, only to see it meet the same fate as the 1971 version, reportedly in part due to the opposition of Congressman Wilbur Mills. 115 CONG. REC. 37305 (1969). Another Ribicoff amendment was passed by the Senate but deleted during conference in 1967. 113 CONG. REC. 9688 (1967).

Similar amendments to annual revenue or tax bills were rejected by close votes in the Senate in 1966 and 1964. 112 CONG. REC. 5464 (1966); 110 CONG. REC. 1839 (1964). See note 15 *infra*.

In the fall of 1972, a tuition tax credit for higher education was buried by the House Ways and Means Committee, amidst discussion of proposals for elementary and secondary school tuition tax credits. All the credits proposals were criticized by some representatives of organized labor and of the American Federation of Teachers in particular as tax loopholes for the well-to-do, but were supported by others, including representatives of Catholic Laity, as needed aid for private education. See, e.g., BNA DAILY TAX REPORT G-4 (Sept. 6, 1972).

3. Some leading sources on the subject of income tax allowances for the personal costs of higher education include: R. FREEMAN, CRISIS IN COLLEGE FINANCE? 187-236 (1965) [hereinafter cited CRISIS IN COLLEGE FINANCE?]; C.H. KAHN, PERSONAL DEDUCTIONS IN THE FEDERAL INCOME TAX 15-16, 31 & n.13 (1960) (referring to early discussions of the deductibility of education expenses); Brannon, *Student Aid in Higher Education: Scholarships, Loans and Tuition Tax Credit or Deduction*, Part V of a Symposium on Taxation and Education, The Proceedings of the Special Conference of the American Alumni Council, Airline House, Feb. 7 & 8, 1966 (ed. by Finehout); Cartter, *Tax Reliefs and the Burden of College Costs*, 44 EDUC. REC. 324 (1963); Freeman, *Federal Assistance to Higher Education Through Income Tax Credits* in THE ECONOMICS AND FINANCING OF HIGHER EDUCATION IN THE UNITED STATES (a compendium of papers submitted to the Joint Econ. Comm., 91st Cong., 1st Sess., 1969) [hereinafter cited as Freeman, *Federal Assistance to Higher Education*]; Freeman, *Tax Credits For Parents* in FINANCING HIGHER EDUCATION: ALTERNATIVES FOR THE FEDERAL GOVERNMENT 201 (American College Testing Program, Monograph No. 5, Orwig ed. 1971); Goode, *supra* note 1, at 281; Heckerling, *The Federal Taxation of Legal Education: Past, Present, and Proposed*, 27 OHIO ST. L.J. 117 (1966) (arguing for capitalization and amortization of law school education as an investment in human capital); Meck, *The Tax Credit Proposal* in HIGHER EDUCATION IN THE UNITED STATES 93 (S.E. Harris ed. 1960) [hereinafter cited as Meck]; Wolfman, *supra*

of proposals for a higher education federal income tax allowance, both because of their own importance and as examples of problems and opportunities presented by other federal income tax allowances or subsidies such as tuition tax credits for elementary and secondary education.⁴ The analysis isolates several of the purposes a higher education

note 1, at 535-51; *Federal Tax Incentives*, *supra* note 1, at 382-85.

See also K. GORDON, AGENDA FOR THE NATION 270 (1968); H. LEVIN & J. OSMAN, ALTERNATIVE METHODS OF STATE SUPPORT FOR INDEPENDENT HIGHER EDUCATION IN CALIFORNIA *passim* (Feb. 1970) (taking a look at tax credits as well as vouchers, scholarships or direct aid to institutions).

4. This Article focuses on tax aid to higher education and does not discuss proposals for tax allowances for the personal costs of private primary and secondary education. The constitutional problems concerning aid to parochial schools on both the college and the primary and secondary levels are also not discussed. Nonetheless, much of the analysis that follows is applicable to the problems of primary and secondary education as well as to the problems of higher education. The tuition tax credit bills that have been proposed for secondary and primary education costs resemble the Senate-enacted bills for higher education.

Recently, President Nixon and other officials in the Administration have endorsed the enactment of a federal income tax allowance for the personal costs—tuition in particular—of private primary and secondary school attendance. The President's Commission on School Finance (the McElroy Commission) and the President's Panel on Nonpublic Education recommended them. See *Tax Credits: Key Item in Latest Plan to Aid Church Schools*, U.S. NEWS AND WORLD REPORT, May 1, 1972, at 36 (reporting that President Nixon had told Catholic educators in Philadelphia on April 6, that he was "irrevocably committed" to helping nonpublic schools overcome their financial crisis).

Following the recommendation of the President's Panel on Nonpublic Education, President Nixon expressed enthusiasm for tuition tax credits for children enrolled in private schools. See, e.g., *The Wall Street Journal*, S.F. ed., Friday, April 21, 1972, at 1, col. 2 & 3. See also N.Y. Times, Oct. 26, 1972, at 1, col. 8 (radio address by the President supporting federal tax allowances for nonpublic schools). The President reportedly favored a federal income tax credit of as much as \$200 per child as the way to aid nonprofit private schools, which primarily means parochial schools. Senator and 1972 presidential candidate McGovern also has expressed support for a federal tax credit to aid parochial schools. N.Y. Times, Sept. 20, at 1, cols. 2 & 3, at 34, cols. 2-4.

In April 1972, Representative Wilbur Mills, Chairman of the House Ways and Means Committee—a longtime foe of educational tax credits—co-sponsored a bill to authorize tuition tax credits for private elementary and secondary schools. (H.R. 13495, 92d Cong., 2d Sess. 1972). This bill was designed to allow income tax credits for 50 percent of tuition up to \$400 for each dependent enrolled in a nonpublic school. The credit would be reduced for taxpayers with adjusted gross incomes over \$25,000. See BNA DAILY TAX REPORT G-6 (June 27, 1972). Several parallel bills were pending during 1972 under bipartisan sponsorship. None passed in 1972.

Similar bills, providing for state income tax credits, have been introduced in state legislatures. See, e.g., Cal. A.B. 1724 (introduced March 15, 1972). The bill passed both houses of the legislature. S.F. Sunday Examiner & Chronicle, Dec. 3, 1972, § A, at 7, col. 2. It was signed into law by Governor Reagan on December 21, 1972. See S.F. Chronicle, Dec. 22, 1972, at 8, cols. 1-4.

On the subject of tax allowances for elementary and secondary education, see generally THE PRESIDENT'S COMMISSION ON SCHOOL FINANCE, SCHOOLS, PEOPLE AND MONEY, THE NEED FOR EDUCATIONAL REFORM xvi, 56 (1972). See also Maxwell & Weinstein, *A Tax Credit for Certain Educational Expenses* and Freeman, *Income Tax Credits for Tuition and Gifts in Nonpublic School Education* in TAX CREDITS FOR EDUCATION (prepared for President's Commission on School Finance, 1971).

tax allowance might serve—perfecting the definition of taxable income; improving tax equity; subsidizing education; redistributing income, wealth or educational opportunity; correcting misallocation of education resources—and examines the issues and approaches each purpose suggests. The wisdom of involving the federal government rather than leaving these problems to state and local governments is also discussed. Finally, the effectiveness of a tax allowance is compared to a direct government subsidy.

I

LEGISLATIVE BACKGROUND

The recent history of proposals for an education allowance in the income tax goes back at least as far as the early 1950's when efforts were made to obtain special tax deductions or exemptions for parents of college students.⁵ These efforts were motivated by the well-intended but rather blunt notion that government should help families burdened with the costs of higher education and by the desire to aid educational institutions, many of which were facing or anticipating severe financial problems.

A tax allowance in the form of a deduction from income provides an income-variant benefit under a graduated income tax such as ours, a benefit that gives greater tax relief to a high-income taxpayer than to a low-income taxpayer. A \$100 deduction, for example, saves \$70

5. Early suggestions for the deduction, or capitalization and amortization of educational costs can be found in the reports of Congressional committee hearings. See, e.g., *Hearings on General Revenue Revision Before the House Comm. on Ways and Means*, 83rd Cong., 1st Sess., pt. 1 (1953); SECOND REPORT TO THE PRESIDENT, PRESIDENT'S COMMITTEE ON EDUCATION BEYOND HIGH SCHOOL 56, 90 (1957); 108 CONG. REC. 1552 (Senate 1962); 109 CONG. REC. 13354 (House 1963). See also KAHN, *supra* note 3, at 31 n.13. For still earlier recommendations, see STRAYER, *THE TAXATION OF SMALL INCOMES* 71, 116-18 (1939). Meck, *supra* note 3, at 93, reports attempts to enact a deduction for education costs in connection with the 1954 Code. See also CRISIS IN COLLEGE FINANCE?, *supra* note 3, at 190-93; H. GROVES, *FEDERAL TAX TREATMENT OF THE FAMILY* 41-42 (1963). The President's Committee on Education Beyond High School in 1957 supported an allowance in the form of a deduction or a credit for students or their parents. See *Federal Tax Incentives*, *supra* note 1, at 382 n.116.

The Tax Section of The American Bar Association worked out a limited deduction plan in 1954. It would have allowed a deduction for 30 percent of educational expenses up to a maximum amount. This plan enjoyed vigorous support from the Association of American Colleges, the American Alumni Council, The U.S. National Student Association, the American Council on Education, and others. See CRISIS IN COLLEGE FINANCE?, *supra* note 3, at 192-93.

Tax allowances for tuition paid to educational institutions have often been proposed as an alternative to direct federal aid, which in the instance of religious schools would violate the first amendment. See Katz, *Freedom of Religion and State Neutrality*, 20 U. CHI. L. REV. 440 (1953). See also note 116 *infra*.

tax for the high-bracket taxpayer whose marginal rate reaches 70 percent, while only \$20 for the low-bracket taxpayer whose marginal tax rate climbs only to 20 percent. And it saves nothing at all for someone who pays no tax—either because he has no income, because other allowances fully offset his income or because he evades tax. Furthermore, if an education expense is allowed only as a personal, nonbusiness deduction like that for charitable contributions or medical expenses, it is unavailable to a taxpayer who does not itemize his deductions but elects the standard deduction instead, a choice made by a large proportion of taxpayers. Perhaps due to recognition of the income-variant benefit of a deduction and its unavailability to many taxpayers, no special deduction for college expenses has been enacted, either as an additional exemption per se, or as a personal or as a business deduction.⁶ However, by virtue of the child's status as a student, a child remains a dependent for whom the parent can claim a dependency exemption if the parent contributes over half the child's support, even though the child has attained the age of 19 and has substantial income.⁷

The movement in favor of a deduction soon transformed into a movement favoring an income tax credit.⁸ A credit, unlike a usual deduction or exemption, gives an income-constant benefit. The creditable amount is subtracted directly from the taxpayer's bill, not from his income. Consequently it gives a "dollar for dollar" benefit to high- and low-income taxpayers alike, so long as both have precredit tax liability equal to or in excess of the available credit. A tax credit can also take the form of a sliding credit that diminishes with income or with expenditure on education or on some other basis.⁹

6. See generally Goode, *supra* note 1, at 300, on the deduction and extra exemption plans. The technical defects of the deduction and exemption plans were remarked in Cartter, *supra* note 3, at 324. See also Meck, *supra* note 3, at 93. Pertinent Congressional debates include a comparison of a tax deduction with a tax credit by Representative Burns. See 109 CONG. REC. 1236 (Senate 1963).

7. INT. REV. CODE OF 1954, § 151(e)(4). See text accompanying note 66 *infra*. An additional exemption is discussed in S. HARRIS, HIGHER EDUCATION: RESOURCES AND FINANCE 316 (1962). Attempts to give still more personal exemptions, or a larger personal exemption, to a student or to his parents, have failed. See CRISIS IN COLLEGE FINANCE?, *supra* note 3, at 191.

8. See CRISIS IN COLLEGE FINANCE?, *supra* note 3, at 192. Actually, some of the early proposals included a credit as well as a deduction. See, e.g., U.S. PRESIDENT'S COMMITTEE ON EDUCATION BEYOND HIGH SCHOOL, SECOND REPORT TO THE PRESIDENT 11, 56, 19 (1957) (favoring a deduction or a credit). The American Council on Education supported a 30 percent credit as early as 1955. American Council on Education, A Proposed Tax Credit Plan to Aid Students in Institutions of Higher Learning, February 1, 1955. For a complete list of education tax incentive bills introduced in the 83d to 86th Congresses, see FOUNDATION FOR VOLUNTARY WELFARE, TAX INCENTIVES FOR EDUCATIONAL EXPENSES (1961).

9. A tax credit can be made progressive, of course, by structuring it so that a

A tax credit proposal was put forward before the House Ways and Means Committee on January 15, 1958 by John Meck, acting as Chairman of the Committee on Taxation of the American Council on Education.¹⁰ His proposal would have limited the credit to 30 percent of tuition and related fees, with a maximum credit of \$450 allowable. Meck reported substantial support for the credit, especially from parents and college presidents; he also admitted some opposition, coming from at least two directions. Some theoreticians objected to further eroding the tax base by any allowance for education. The Treasury, perceiving much the same effect, opposed a revenue loss which it then estimated would be from \$150 to \$500 million in taxes each year. The tax credit did not become law at that time.¹¹

By 1964, supporters of the tax credit approach had further refined the technique, and it was vigorously championed in the Senate by Senator Abraham Ribicoff. The tax credit then proposed (and rejected by the Senate) involved a percentage of tuition, a flat dollar ceiling of \$325 and a graduation clause that withdrew the credit, by

taxpayer in the lower brackets would receive a high percentage credit and a taxpayer in the higher brackets would receive a low percentage credit—both having made the same dollar level expenditure on education.

One simple technique is to treat the allowance itself—whether that allowance be in the form of a flat credit, a deduction, an exemption, or some other form—as taxable income. Therefore, a taxpayer who receives a \$100 exemption or credit or deduction must treat that \$100 as taxable income. If he is in the 70 percent bracket, 70 percent of that allowance will be recaptured. If he is in the 14 percent bracket, only 14 percent will be recaptured. In general, no apparent reason supports the exclusion of a tax incentive from income, except perhaps that many incentives, such as scholarships, are also excluded. Cf. Surrey, *Tax Incentives As A Device for Implementing Government Policy: A Comparison With Direct Government Expenditures*, 83 HARV. L. REV. 705, 723 (1970).

10. See Meck, *supra* note 3, at 93. Actually, the American Council on Education proposed a 30 percent credit against tax in 1955. See American Council on Education, *supra* note 8. The American Council on Education's support for tax credits reached a peak with John Meck's testimony in 1958. See S. HARRIS, *supra* note 7, at 316; Meck, *supra* note 3, at 93-95. More recently, the American Council on Education has tended to prefer opportunity grants, loans and work study programs. See AMERICAN COUNCIL ON EDUCATION, COMMITMENT TO EXPANDING OPPORTUNITY: PROPOSALS FOR FEDERAL ACTION IN EDUCATION 9 (1965). The ACE has also supported direct appropriations for support of institutions of higher learning. See AMERICAN COUNCIL ON EDUCATION, THE FEDERAL INVESTMENT IN HIGHER EDUCATION: THE NEED FOR COMMITMENT 15 (1967).

11. The revenue loss for a tax credit plan was estimated in 1960 to range from \$290 million (assuming no tuition increase resulting from the credit) to \$415 million (assuming a tuition increase following the credit). See ABA, SECTION OF TAXATION, 1960 PROGRAM AND COMMITTEE REPORTS 66. A short history of early proposals for a tax deduction, credit or other allowance is given in *Federal Tax Incentives*, *supra* note 1, at 382-83. See also Freeman, *Last Chance to Save Private Colleges* in FINANCING HIGHER EDUCATION: ALTERNATIVES FOR THE FEDERAL GOVERNMENT 213-18 (Orwig ed. 1971) [hereinafter cited as Freeman, *Last Chance to Save*], giving a short history and an appeal for tax credit proposals,

steps, as a taxpayer's income increased.¹² The scale of diminishing percentages of tuition, and the ceiling of \$325, were designed to provide a relatively greater tax benefit for education obtained at a state college or university or other low-tuition institution, where the tax credit would equal a higher percentage of educational expenditures than at a high-tuition school.¹³ Above the point at which the \$325 ceiling took hold, no further credit would result from added expenditures on education. Senators with such apparent diversity of views as Humphrey and Goldwater have supported the sliding credit plan.¹⁴

The tax credit approach was opposed by some who thought that even though it might enable schools to raise tuition levels or otherwise to release some scholarship funds for more needy students,¹⁵ it would

12. See note 19 *infra*.

13. See R. WOLK, *ALTERNATIVE METHODS OF FEDERAL FUNDING FOR HIGHER EDUCATION* 40 (Carnegie Comm. on Higher Education, 1968) [hereinafter cited as WOLK]. See also *CRISIS IN COLLEGE FINANCE?*, *supra* note 3, at 200 (attributing this intention to Senator Ribicoff).

14. See *CRISIS IN COLLEGE FINANCE?*, *supra* note 3, at 198.

15. See, e.g., Kett, *Federal Aid to Higher Education Through 1976* in *THE ECONOMICS AND FINANCING OF HIGHER EDUCATION IN THE UNITED STATES* 599, 605 (a compendium of papers submitted to the Joint Econ. Comm., 91st Cong., 1st Sess., 1969). See also WOLK, *supra* note 13, at 72, 120; *Federal Tax Incentives*, *supra* note 1, at 382-83.

The Treasury Department opposed the 1964 Ribicoff bill on the ground that federal assistance by measures other than tax allowances would be more efficient and more equitable. The department also argued that use of the tax system would interfere with proposals for direct aid and that the revenue cost, estimated to be \$750 million then and to rise to \$1.3 billion by 1970 would be excessive. See letter from then Assistant Secretary of the Treasury Stanley S. Surrey to Committee Chairman Lister Hill, in *Hearings on S. 2490 Before the Subcomm. on Education of the Comm. on Labor and Public Welfare*, 88th Cong., 2d Sess., at 77-78 (1964). See also *id.* at 254-55 (remarks of Senator Morse arguing that the Ribicoff tax allowance proposal was a devious way to get federal money into private religious schools). See also *id.* at 260, 620-23 (remarks of President Harrington of the University of Wisconsin and Senator McGovern arguing that a tax credit would cut into the tax base, discriminate against the low income parent and the low income student, and eventually result in an increase in tuition with no real relief to the taxpayer). For a synopsis of the Treasury Department's views in opposition to the 1963-64 Ribicoff bill (an amendment to the Revenue Act of 1964) see 110 CONG. REC. 1801-02 (1964). For the debates on the bill see *id.* at 1774-1810, 1828-39. The Ribicoff tax credit proposal was debated and defeated in the Senate again in 1966. See 112 CONG. REC. 4996-99, 5188-90, 5442-64 (1966).

Tuition tax credits have been opposed in a booklet entitled *Tax Credit Legislation: Will It Ease Or Increase The Burden of Rising College Costs?* (published by the National Association of State Universities and Land-grant Colleges and the Association of State Colleges and Universities).

The early tax-credit proposals were sometimes called "upside-down scholarships," because they would not help a family that had no tax liability and would give greater benefits as families' incomes and expenditures on education increased. See statement of the Office of the Secretary of the Treasury, Office of Tax Analysis, July 14, 1965, in Heller, *U.S. Tax Policy for 1958*, 6 CANADIAN TAX J. 92, 95 (1958). Of course, the characteristics of later legislative proposals make them less vulnerable to some of these criticisms of the early bills.

fail to provide aid to those who needed it most: to low income families, who would have little or no tax liability for the credit to offset. Consequently, in 1967, Senator Prouty attempted to amend the Ribicoff bill expressly to provide a refund to a taxpayer whose tax credit(s) exceeded his tax liability.¹⁶ Although the Prouty amendment was rejected by the Senate, the refund credit became the model for later proposals, including those passed by the Senate (but defeated in conference) in 1969 and 1971.¹⁷

The 1971 version of the tax credit bill, as passed by the Senate,¹⁸ permitted a 75 percent credit for higher education expenses up to \$200, an additional 25 percent for expenses of \$200 to \$500, and an additional 10 percent for expenses of \$500 to \$1500. (Thus the maximum credit allowable would be \$325.) The credit could be prorated among several people bearing the cost of a single student's education. The credit would phase out for high-income taxpayers; specifically, the credit would be reduced by an amount equal to one percent of the taxpayer's adjusted gross income over \$25,000. Expenses of higher education were defined to include tuition and fees, but not meals, lodging, or other personal expenses. Eligible institutions included those offering post-12th-grade instruction: colleges and universities and also

Arguments against the early tax credit legislation proposed also can be found in an analysis by then Acting Director of the Office of Tax Analysis of the U.S. Treasury Department, Gerard M. Brannon. Brannon, *supra* note 3, at 133-40.

16. In April 1967, Senator Ribicoff's bill passed the Senate by a vote of 52 to 26, but the Prouty amendment, which Ribicoff opposed, did not. See WOLK, *supra* note 13, at 38. The Senate rejected the Prouty amendment shortly before it passed the Ribicoff bill. See 113 CONG. REC. 9665 (beginning of debates on Ribicoff amendment), 9681 (Prouty amendment offered), 9687 (Prouty amendment defeated), 9688 (Ribicoff amendment passed) (1967).

Conceivably, the refund feature of the Prouty amendment could further jeopardize the constitutional status of income tax credits for students at church-connected schools. See note 257 *infra* and accompanying text. However, in *Tilton v. Richardson*, 403 U.S. 672 (1971), the Supreme Court left some room for benefits indirectly accruing to a religious institution when the principal or primary purpose of the law is a legitimate secular objective appropriate for governmental action. See also *Lemon v. Kurtzman*, 403 U.S. 602 (1971); Note, *Education Vouchers: The Fruit of the Lemon Tree*, 22 STAN. L. REV. 687 (1972).

17. The Senate, looking toward the Tax Reform Act of 1969, passed the Ribicoff-Dominick tuition tax credit proposal in 1969. See 115 CONG. REC. 37,289-305 (1969). The revenue cost was then reported to be \$1.7 billion per year. *Id.* at 37,299. Again in 1971 the Hollings-Ribicoff bill was passed by the Senate and killed by the House. See 117 CONG. REC., 318, 606-12 (1971). See also *Hearings on H.R. 10947 Before the Comm. on Finance of the U.S. Senate*, 92d Cong., 1st Sess., at 430, 434, 438-39 (remarks of Senator Hollings). The revenue cost estimate at this time was pegged at \$1.8 billion plus an undetermined amount for the added feature of a positive payment, a refund like Senator Prouty's, if the credit exceeded the tax. In the hearings, the tuition tax credit was smothered by attention to other matters.

many business, trade or technical schools. The amount of higher education expenditures eligible for the credit would be reduced by scholarships or veterans' benefits not included in gross income. If the credit exceeded the taxpayer's tax liability after reduction by other credits, the excess would be refunded to the taxpayer. Finally, no trade or business expense deduction could be taken under I.R.C. §162 for an education expense for which a credit had been taken unless the taxpayer waived the credit.¹⁹ This version of the tax credit proposal, benefiting from the legislative processes of prior years, is the most sophisticated piece of such legislation yet passed by the Senate.²⁰ Nevertheless it failed to be enacted, only to reappear in 1972 for consideration. It failed once again.²¹ Support for such a tax credit, viewed

18. The 1971 Senate bill was Section 317 ("Higher Education Expenses Credit") of H.R. 10947, passed by the Senate on November 22, 1971. See 117 CONG. REC. 19,363 (1971); 58 CCH 1971 STAND. FED. TAX REP. 55 (extra ed. Nov. 26, 1971).

19. This 1971 version differed in some small respects from the Ribicoff 1971 bill and from earlier versions. The Ribicoff bill, S. 111, 92d Cong., 1st Sess. (1971), would have allowed a credit for 100 percent of the first \$200, 25 percent of the next \$300, and 5 percent of the next \$1000, still totaling \$325 at most. The phase-out would have reduced the credit by 2 percent of adjusted gross income over \$15,000, and no rebate would have been given if the credit exceeded tax. There also was no allowance for expenses for noncredit or recreational courses if the individual was not a candidate for a degree. The 1969 Ribicoff bill passed by the Senate, H.R. 13270, 91st Cong., 1st Sess., section 915 (1969), was identical to his 1971 bill with the exception that the definition of "state" was broadened to include U.S. territories. In 1967 two bills were introduced. One by Ribicoff, H.R. 6950, 90th Cong., 2d Sess. (1967), passed the Senate in a form identical to that passed in 1971, but allowed no rebate. The second bill, offered by Prouty as a substitute for Ribicoff's bill, but rejected, allowed a credit of 100 percent of \$200, 10 percent of the next \$300, and 5 percent of the next \$1000, totaling \$280 at most. The phase-out reduced the credit by 2 percent for adjusted gross income over \$15,000, and provision was made for a rebate if the credit exceeded tax liability. Ribicoff's 1966 bill, H.R. 12752, 90th Cong., 2d Sess. (1966), and the 1964 version, H.R. 8363, 88th Cong., 2d Sess. (1964), were each rejected by the Senate but were identical to the approved 1971 version except that the definition of institution of higher education did not include business, trade, or technical schools and no rebate was allowed.

20. Apparently, H.R. 10947, looking toward the Revenue Act of 1971, was submitted early in 1971. The Senate Report on H.R. 10947 was sent to the Senate on Nov. 9, 1971 without mention of a higher education expense credit. S. REP. NO. 437, 92d Cong., 1st Sess. (1971) on The Revenue Act of 1971. Senator Hollings proposed an amendment to H.R. 10947 before the Senate on Nov. 9, 1971. On Nov. 15, 1971 the Senate voted 56-27 to add the Hollings amendment. Between Nov. 15 and Dec. 2, 1971 the Senate [S. REP. NO. 553, 92d Cong., 1st Sess. (1971)] and House [H.R. REP. NO. 708, 92d Cong., 1st Sess. (1971)] reported on the Hollings amendment. On December 2, 1971 the Senate and House approved H.R. 10947 without the tax credit, and it became law on Dec. 10, 1971. The Association of American Universities, The American Association of State Colleges and Universities and the National Association of State Universities and Land Grant Colleges, The U.S. Treasury Department and the Carnegie Commission on Higher Education have opposed tax deduction or tax credit or rebate plans. See WOLK, *supra* note 13, at 72-73, 120-21. President Nixon's Task Force on Education reportedly also has expressed opposition.

21. On October 3, 1972, the House Ways and Means Committee voted down a

perhaps as middle class legislation, reportedly is growing since the passage of substantial federal grant and loan programs in 1972 for the primary benefit of low-income individuals.

Tax credit legislation and deduction proposals are by no means the only forms of federal income tax allowance that have been proposed to Congress. Other suggestions have included the following: an extra personal exemption for students or their parents;²² a rule al-

proposal to give a tax credit for tuition at colleges, whether public or private. At the same time, the Committee tentatively agreed on a bill [which later became H.R. 17072, 92d Cong., 2d Sess. (1972)] to give a tax credit for one-half the cost of tuition (up to a ceiling of \$200) for children attending private elementary and secondary schools. See 21 HIGHER EDUC. & NAT'L AFFAIRS, No. 38, at 2 (1972). Aware that Congress planned to adjourn in mid-October, the Committee knew that neither bill had much chance of enactment in 1972. Neither was enacted, although H.R. 17072 was introduced in the House on October 11, 1972 and referred to the Committee on Ways and Means. See N.Y. Times, Oct. 4, 1972, at 1, cols. 7-8 (city ed.).

The A.C.L.U. had opposed the lower school credit, as did the National Jewish Community Relations Advisory Council. The National School Boards Association recommended support but with amendments. The Parents' Council of Independent Schools of Western New York urged Congress to give "some form of tax credit" directly to parents of children in private schools. See 173 BNA, DAILY TAX REP. G-3 (1972).

Revenue loss estimates by the Joint Committee on Internal Revenue came to \$584 million for the 1972 tuition tax credit for elementary and secondary private school students. The Treasury Department believed that amount to be a reasonable estimate for a refundable credit if tuitions did not rise, but with predictable tuition increases the Treasury foresaw a revenue loss of \$790 million if no refund were provided and \$970 million for a refundable bill. See 21 HIGHER EDUC. & NAT'L AFFAIRS No. 32, at 2 (1972), reporting the statement of George P. Schultz, Secretary of the Treasury, before the House Ways and Means Comm., Aug. 14, 1972.

In 1971, the Treasury Department estimated that the revenue cost of the 1967 Ribicoff tax credit legislation would be \$1.85 billion at 1969 levels and would cost \$2.2 billion in 1972. Letter from Gerard M. Brannon, then Associate Director, Office of Tax Analysis, Office of the Secretary of the Treasury, to the author, July 27, 1971.

The later Ribicoff proposal, with a credit of 100 percent of the first \$200, 25 percent of the next \$300 and 5 percent of the next \$1000 of tuition with a phase-out at 3.25 percent of adjusted gross income over \$20,000 was estimated to cost \$2.1 billion in 1969 and \$2.5 billion in 1972. *Id.* Another variation that was similar except for a phase-out beginning at \$15,000 was estimated at \$2.0 billion in 1969 and \$2.4 billion in 1972. *Id.*

22. See S. HARRIS, *supra* note 7, at 316. An example is a bill introduced by Senator Fulbright in 1957. See 103 CONG. REC. 352 (1957). One author has recommended a double exemption for working students, although he regards the special exemption for students as it now exists as a very poor attempt to encourage education. See H. GROVES, *supra* note 5, at 16, 39-43, 46, 100.

A sampling of foreign tax systems shows some attempts to make tax allowances for education costs. In The Netherlands, an extra exemption is granted to a taxpayer for supporting the education of a dependent. A child under the age of 16 qualifies for two exemptions if educated away from home, and a child between 16 and 27, if away from home, qualifies for three exemptions, or if at home, for two. Each exemption for a dependent amounts to 420 fl. U.K. BOARD OF INLAND REVENUE, 5 INCOME TAXES OUTSIDE THE UNITED KINGDOM, 1969, at 319, 334 (1971). In Germany, expenses incurred by a taxpayer in the course of professional training, either for himself

lowing a student to capitalize education expenses and amortize them

or his wife, are deductible up to 900 DM per year, or 1200 DM if the student is living away from home. 3 *Id.* at 138. Canada allows a deduction of total fees (if in excess of \$25) to students enrolled at educational institutions in Canada. A deduction is also allowed of fees paid for education abroad if the duration of the course exceeds 13 consecutive weeks. Parents, and some other supporting relatives, are allowed a deduction of \$300 for each dependent up to 16 years of age and \$550 for each child between the ages of 16 and 21 who is enrolled at an educational institution. 2 *Id.* at 23, 24. In Norway, taxpayers having dependent school-going children between the ages 17 and 25 qualify for an income tax rebate on a progressive scale (viz., first child Kr. 700, 2d child Kr. 800, 3d and each additional child, Kr. 1200). This rebate for education of children is in addition to a tax-free allowance of Kr. 27,000 available to individuals with dependents. Additional benefits are also available to a family with children up to 16 years of age under the Social Security laws. FOREIGN TAX LAW ASSOCIATION, NORWAY INCOME TAX SERVICE 18, 19 (1971). In Australia, a taxpayer is allowed a deduction of actual expenses up to \$300 for the full-time education of each child under 21. U.K. BOARD OF INLAND REVENUE, 1 INCOME TAXES OUTSIDE THE UNITED KINGDOM, 1969, at 64 (1971). In Colombia, a deduction of up to P. 500 is available to the taxpayer for payments made to an educational institution on behalf of each dependent if the taxpayer's income falls below a certain level (P. 36,000). If taxable income exceeds P. 36,000 or the family is educating five or more children, 50 percent of the above-mentioned deduction is allowed. This deduction is in addition to a general deduction of P. 2,000 for each child of the taxpayer. FOREIGN TAX LAW ASSOCIATION, COLOMBIA INCOME TAX SERVICE 20, 28 (1972).

In Japan, in addition to the normal deduction which a taxpayer can take for each dependent (90,000 yen), a working student is entitled to a "personal circumstances" allowance of 90,000 yen if his taxable income is less than 250,000 yen. U.K. BOARD OF INLAND REVENUE, 5 INCOME TAXES OUTSIDE THE UNITED KINGDOM, 1969, at 15 (1971). In addition to the normal deduction allowed for dependent children under 16, in England the taxpayer is entitled to a deduction of £165 for each full-time student dependent over the age of 16. This deduction can be claimed by the taxpayer for any dependent over the age of 16, irrespective of whether the dependent is his child or not. FOREIGN TAX LAW ASSOCIATION, UNITED KINGDOM TAX SERVICE 183-84 (1972).

Canada has allowed a deduction to students for tuition and fees at university or other post-secondary educational institutions (even if the fees are paid by parents or others). See CAN. REV. STAT. c. I-5 § 11(1)(0.1)(P) (1970); Sec. 11(1)(qb), (qc) of the Income Tax Act; R. GOODE, THE INDIVIDUAL INCOME TAX 84 (1964). The Carter Commission recommended that a credit system be substituted for the deduction. That Commission proposed a credit for one-fourth of "fees" paid in post-secondary education, allowed to the taxable "unit" of which the student is a member, plus an unusual credit to the student's "unit" of up to \$300 for living costs if he is not a dependent child. A carryforward of unused credits would be permitted. This recommendation is related to the Commission's decision to include dependent children in the family unit for tax purposes. See 3 REPORT OF THE ROYAL COMMISSION ON TAXATION 110, 229-33, 236-37 (limited ed. 1966); 6 *Id.* at 84-86.

In Indiana, a state income tax credit is allowed for a contribution to or for the benefit of Indiana colleges. See IND. STAT. ANN. § 64-3222(b) (Supp. 1972). In Minnesota, a deduction is allowed for state income tax purposes for tuition and transportation, up to \$200, for each dependent in elementary and secondary school. MINN. STAT. ANN. § 290.09(22) (1962). In 1971, Minnesota enacted a credit against state personal income tax for pupils in non-public private and secondary schools, with a maximum credit of \$50 for kindergarteners, \$100 for elementary students, and \$140 for high school students, with an overriding ceiling of \$100 per pupil unit per household, and with a rebate provision. MINN. STAT. ANN. § 290.086 (Supp. 1972-73). Another formula injects a factor for the income and operating costs of the

through annual deductions over the "useful life of that education,"²³ deferral of income tax otherwise due during student years, no matter what the source of the income;²⁴ an outright cash scholarship of up to \$1,200, reduced by the amount of income tax paid by the student or his family for the prior years;²⁵ government loans to students to be repaid by means of a surtax on their incomes during later earning years;²⁶ permitting tax deductible contributions over a period of pre-college years to a trust fund and taxing only the principal upon termination or withdrawal, thus postponing tax and allowing interest to accumulate tax free;²⁷ a federal income tax credit for payments of state taxes, or any new or increased state taxes levied to finance education,²⁸ and still more could be noted.²⁹

school. If the taxpayer elects the credit, he is ineligible for the deduction. MINN. STAT. ANN. § 290.087(1) (Supp. 1972-73). As to California, see note 4 *supra*.

Vermont grants a \$10 credit to any resident taxpayer who is a student, without any rebate. (The effect is to reduce costs for residents vis-a-vis out-of-staters.)

Hawaii has a system of tax credits for higher and lower education. The credit varies with family income up to a ceiling on the credit and on family income. Supposedly this credit was designed to counteract the drop-out problem in Hawaii, a seemingly weak approach since the credit to parents cannot exceed \$20 per student in high school or \$50 per student in higher education. See Maxwell & Weinstein, *A Tax Credit for Certain Educational Expenses* in TAX CREDITS FOR EDUCATION 1, 17 (a report submitted to the President's Commission on School Finance, 1971).

23. See, e.g., Goode, *supra* note 1; Wolfman, *supra* note 1.

24. See *Federal Tax Incentives*, *supra* note 1, at 383.

25. Senator Pell made this proposal in 1971. S. BILL No. 659, 92d Cong., 1st Sess., pt. D, § 142 (proposal prior to amendment, 1971). See note 205 *infra*.

26. This proposal has become known as the "Zacharias Plan" or the "Education Opportunity Bank." See R. HARTMAN, CREDIT FOR COLLEGE 80 (1971). A panel of the President's Science Advisory Committee suggested a government established "educational opportunity bank" in 1967. Under this plan a student could borrow to finance undergraduate and possibly graduate education and repay the loan by a percentage of income after graduation, such as 1 percent of gross income over thirty years for each \$3000 borrowed, with an option to repay the principal balance at any time plus 6 percent interest. See N.Y. Times, Sept. 8, 1967, at 1, col. 2. See also Vickrey, *A Proposal For Student Loans* in ECONOMICS OF HIGHER EDUCATION 268, 271 (Mushkin ed. 1962) (advocating a deduction for repayments, which themselves are computed as a percentage of income above an exemption level, so that the combined rates of income tax and repayment rates do not take too much of the alumnus' earnings; as an alternative, Vickrey suggests taxing the original payments to the student as income and allowing a complete deduction for subsequent repayments out of earnings, as interest and amortization payments on the loan).

27. See Carter, *supra* note 3, at 328.

28. See J. MAXWELL, TAX CREDITS AND INTERGOVERNMENTAL FISCAL RELATIONS 67, 125 (1962); Heller, *A Proposal for Financing Tax-Supported Education*, 28 HARV. EDUC. REV. 214 (1958). See also G. BREAK, INTERGOVERNMENTAL FISCAL RELATIONS IN THE UNITED STATES 42 (1967). One example of such legislation is a bill introduced in 1963 by Representative Hall to give homeowners a federal income tax credit for that portion of their real property taxes used for the maintenance, operation and construction of public elementary and secondary schools. 109 CONG. REC. 1638 (daily ed. Feb. 4, 1963).

29. Other plans include such ideas as indirect support by some form of tax

Another tax-related solution to the problem of higher education costs is the growing practice by colleges and universities of deferring tuition payments until after graduation.³⁰ Under one plan, a student agrees to pay the school a percentage of his income annually for up to 35 years. Thus, a graduate with high earnings may wind up paying more than a low wage earner. The maximum obligation is 150 percent of the deferred amount plus interest. Low-income students must at least repay the basic tuition without interest.

The Internal Revenue Service treats the deferred tuition as a loan to the student, rather than as taxable income. Interest on the delayed amount is deductible; principal payments are not. The difference between the more affluent graduate's high payments and the poor alumnus' relatively low outlays will not be considered taxable income to those paying less and will be treated as deductible interest for those paying more.³¹

credit, instead of a deduction, for gifts to educational institutions. See letter from John Morse, Director of the American Council on Education, Commission on Federal Relations, to the author, March 6, 1971. As to the analogous problem of secondary and elementary education costs, income tax credits for residential school property taxes have been proposed. See Freeman, *Should States Finance the Schools?*, Wall St. Journal, Mar. 31, 1972, at 4, cols. 4 & 6; address by Roger A. Freeman, *Should Local School Support be Abolished?*, National School Board Association 32d Annual Convention, San Francisco, Calif., April 14, 1972.

The Supreme Court ruled unconstitutional an Ohio law providing a direct subsidy in the form of \$90 per year tuition reimbursement to parents of private and parochial school students. *Essex v. Wolman*, 41 U.S.L.W. 3167 (U.S. Oct. 10, 1972). After the lower court had ruled against the subsidy, Ohio enacted a tax credit for parents of private and parochial school students. That law also has been struck down. See *Kosydar v. Wolman*, 41 U.S.L.W. 2348 (S.D. Ohio Dec. 29, 1972). Representative Green, in her omnibus higher education bill, H.R. 16098 introduced in February 1970, included a mechanism whereby higher education institutions would refund to self-supporting students the income tax paid on their earnings, if the tax were not less than \$50 nor more than \$600. The federal government would then reimburse the schools for these payments.

The 1969 Tax Reform Act affords some tax aid to working students by way of a higher low-income allowance (or minimum standard deduction) and by an exemption from withholding in instances where no ultimate tax liability is likely to exist. Other tax oriented proposals are mentioned in *Federal Tax Incentives*, *supra* note 1, at 382-83.

On September 29, 1972, Senators Mansfield and Aiken introduced a bill to give human beings a tax depletion allowance as generous as the one provided for oil wells. See S.F. Chronicle, Sept. 30, 1972, at 1, cols. 2 & 3. The bill proposed a 10 percent deduction for earned income of salaried individuals. Up to 23 percent would be allowed for those in physically hazardous occupations. The purpose was to acknowledge the "physical, mental and emotional stress incurred in connection with the production of income during the year." Although this "depletion allowance" does not gear the tax benefit directly to education or investment, it would do so indirectly since lifetime incomes tend to rise with higher education. See note 149 *infra*.

30. See generally R. HARTMAN, *supra* note 26.

31. Wall St. Journal, Feb. 2, 1972, at 1, col. 5 (S.F. ed.). On student loans generally see R. HARTMAN, *supra* note 26. Duke University School of Law has adopted a deferred tuition plan with a percentage of income repayment provision. See AALS Committee on Minority Groups Newsletter, No. 71-4, Oct. 1971, at 2.

Although these other proposals have been studied and have gathered some support, the tax credit plan seems to have no equal for endurance and vitality. Some of the goals it seeks to accomplish probably are shared by the other plans; other goals may be peculiar to it. Its merits and defects may in part stem from its character as a tax allowance rather than as an outright payment, as a subsidy nominally to students rather than to schools; other of its advantages and disadvantages may be peculiar to its tax form as a credit rather than as a current deduction or amortization allowance.³²

II

POSSIBLE PURPOSES OF A HIGHER EDUCATION TAX ALLOWANCE

To evaluate proposals for a higher education tax allowance, it is critical to grasp the goals the allowance is intended to serve because they will affect several characteristics of the legislation: the scope and form of the allowance, the beneficiaries of the allowance and the period for which the allowance will be given. The goals of the various tax allowance plans that have been proposed have not been clearly articulated or isolated. Nevertheless, a review of the form and nature of these proposals gives some clue to the purposes they are designed to serve.³³

One purpose sometimes suggested is to improve the tax law's definition of taxable income by allowing a current deduction, or other allowance such as amortization deductions, for education as a cost of earning income.³⁴ This would aim at reversing what many perceive as a bias in the tax law against "human capital" as distinguished from other forms of capital.³⁵ A second purpose is to make the tax system

32. See text accompanying notes 240-60 *infra*.

33. In the absence of a full-blown analysis by the proponents of these allowances, one is left with the task of inferring purposes from the form and the terms of the proposal and then evaluating the proposal against the inferred purposes. In addition to this "interior evidence," "exterior evidence" such as statements by proponents may also aid in the evaluation.

Few proponents of some form of tax allowance for costs of higher (or secondary and primary) education have put forward much more than a call to arms, an appeal to given attitudes, and references to the heavy burdens of paying college costs. See, e.g., NATIONAL SCIENCE FOUNDATION, BASIC RESEARCH—A NATIONAL RESOURCE 50 (1957); THE PRESIDENT'S COMMITTEE ON EDUCATION BEYOND HIGH SCHOOL, SECOND REPORT TO THE PRESIDENT 11, 19, 56 (1957). Freeman reports that A Citizens National Committee for Higher Education favored tax credits for college expenses simply as "the most promising immediate way of strengthening higher educational finances." Freeman, *Last Chance to Save*, *supra* note 11, at 201, 218 n.13. See also THE PRESIDENT'S COMM. ON SCHOOL FINANCE, SCHOOLS, PEOPLE AND MONEY xvi, 56 (final report 1972).

34. See, e.g., Goode, *supra* note 1, at 281, 284-92; Wolfman, *supra* note 1, at 535-51.

35. See, e.g., T. SCHULTZ, INVESTMENT IN HUMAN CAPITAL 43, 45-46, 163 (1971) [hereinafter cited as SCHULTZ, INVESTMENT].

more equitable by focusing on the different taxpaying abilities of students and their families as compared to other taxpayers.³⁶ A third prime purpose of tax allowances seems to be to subsidize educational institutions or students, and the families of students enrolled in educational institutions, or both.³⁷ A fourth purpose may be to increase access to education for certain people, particularly the poor and the culturally deprived;³⁸ in other words, to redistribute educational services. Such redistribution may be sought on the basis of wealth or across geographical lines. A fifth and related purpose may be to correct a misallocation of resources in the economy.³⁹ Thus, for example, relative costs and benefits between private and public institutions of higher learning and among their students may be rearranged to provide more support for private education.⁴⁰

An assessment of the merits of a tax allowance and of the tax credit plan in particular requires an examination of the purposes sought to be served and reasons for federal government support for higher education, an evaluation of the tax allowance technique and its effectiveness in reaching its intended goals, and a comparison with other support forms.⁴¹

36. See text accompanying notes 117-40 *infra*.

37. Aid to students and their families has often been announced as a main goal of tuition tax credit legislation. See, e.g., Freeman, *Federal Assistance to Higher Education*, *supra* note 3, at 677; CRISIS IN COLLEGE FINANCE?, *supra* note 3, at 189-90. Aid to colleges and universities likewise has been emphasized as a leading goal of tuition tax credits, linked to student aid by the certainty that educational institutions would capture some portion of a given credit. See, e.g., Freeman, *Federal Assistance to Higher Education*, *supra*, at 679-80; CRISIS IN COLLEGE FINANCE?, *supra*, at 189-90.

For a presentation of the financial plight in which private colleges and universities find themselves, see W.G. BOWEN, *THE ECONOMICS OF THE MAJOR PRIVATE UNIVERSITIES* (1968). Bowen examines the problem of educational productivity not rising as fast as productivity in the rest of the economy. Therefore, if faculty and staff pay scales are to keep pace with pay scales elsewhere, labor costs per unit of education production must rise, thereby increasing per student costs. Average college costs and the manner in which students pay them have been broken down to show differences between men and women, blacks and whites, residents and commuters and to show the proportions of costs borne by parents, grants, loans, jobs, and other resources. See *The Chronicle of Higher Educ.*, March 20, 1972, at 5 (reporting study by Haven and Horsch, *How College Students Finance Their Educations*).

38. See text accompanying notes 193-209 *infra*.

39. See text accompanying notes 217-26 *infra*.

40. See text accompanying notes 136-38 *infra*.

41. One of the most active and analytical proponents of a tax allowance, particularly a tuition tax credit, has been Roger Freeman, a Senior Fellow at the Hoover Institution on War, Revolution and Peace, Stanford University. See CRISIS IN COLLEGE FINANCE?, *supra* note 3, at 187-236 (on tax credit legislation and Freeman's role in devising the diminishing credit device). Freeman, *Income Tax Credits for Tuitions and Gifts in Non-public School Education* in TAX CREDITS FOR EDUCATION 24 (prepared for the President's Commission on School Finance, 1971), emphasizing elementary and secondary schools; Freeman, *Federal Assistance to Higher Education*, *supra* note 3, at 655.

See also Maxwell & Weinstein, *A Tax Credit for Certain Educational Expenses*

A. To Perfect the Definition of Income

The federal income tax has its roots in an effort to identify and to tax something that might loosely be called "net income," gross income minus the costs of producing it. This effort suggests one theoretical ground for an income tax allowance for education costs: to perfect the income tax law's definition of taxable or net income.⁴² To do this, the argument runs, the tax law should allow a student either currently to deduct the expenses of his education or to capitalize them and to amortize that amount over the useful life of the education on the theory that the cost of education represents the cost of producing later income.⁴³ By analogy, if a taxpayer purchases equipment or real property with a limited useful life for business use or for the production of income, his investment cost would be amortized and charged off against income. Deductions against income would be allowed over the useful life of the asset acquired, in amounts eventually equal to the historic investment cost. Consequently, receipts would be reduced to "net income" and only the "income" component would be taxed; no tax would be imposed on a return of his capital invested. Likewise, runs the argument, an investment of money in education constitutes an investment in "human capital,"⁴⁴ and this investment in human capital should be depreciable since it has a limited useful life in income-producing activity.⁴⁵

in TAX CREDITS FOR EDUCATION 1 (prepared for the President's Commission on School Finance, 1971), emphasizing secondary and elementary education.

42. The definition of income argument has most persuasively been made by Richard Goode in Goode, *supra* note 1, at 281, 284-85.

43. See, e.g., Goode, *supra* note 1, at 284-85, 291-92. However, tax relief for the parent, as distinguished from tax relief for the child, cannot readily be defended as a cost of producing income. See, e.g., Wolfman, *supra* note 1, at 539.

In general, more thought needs to be given to the characterization of an expenditure by parents to create or improve an income producing asset embedded in another person, their child. In a way, this is nothing more than a gift or intergenerational inheritance, which the gift and estate or inheritance taxes should comprehend. But one might view the parents' expense as a cost of purchasing insurance on the theory that higher income children will constitute a family resource that may aid the parents later. Even if the children do not directly support their parents during old age or disability, the children as a class will pay social security and other taxes that support programs of medical care, old age assistance, and disability insurance for the older generation. Thus, college expenses by parents may actually constitute investment in human capital for the parents' own benefit as well as for the children's.

44. Other investments in human capital would include medical care and even food and shelter.

The phrase "human capital" has been given great impetus by Theodore W. Schultz, in SCHULTZ, INVESTMENT, *supra* note 35. See generally, for an excellent introduction to investing in education, I. GOFFMAN, J. DAVIS & J. MORRALL, THE CONCEPT OF EDUCATION AS AN INVESTMENT, A REPORT SUBMITTED TO THE PRESIDENT'S COMMISSION ON SCHOOL FINANCE (1971) [hereinafter cited as GOFFMAN].

45. See GOFFMAN, *supra* note 44, at 10; Goode, *supra* note 1, at 284-85; Wolfman, *supra* note 1, at 546-49.

Moreover, permitting a current deduction or eventual depreciation or amortization deductions in an amount equal to investment cost would correct the federal income tax law's apparent bias against investment in human capital.⁴⁶ That bias can be seen not only in the failure to allow deduction of education expenses but more generally in disallowance of other expenses incurred in earning income by personal efforts—commuting and clothing expenses along with the other added costs incurred when one gives up a life of leisure for work. This bias against investment in human capital also can be perceived in the tax law's apparent favoritism for income earned by capital. The favorable rate of tax on long-term capital gains,⁴⁷ the full deduction of business costs,⁴⁸ and of interest,⁴⁹ the advantageous timing given to some capital costs through an election to deduct them currently (rather than to capitalize and deduct them later),⁵⁰ the low tax on net gains but high deduction of net losses on certain transactions in business-related property,⁵¹ the percentage depletion allowance for mineral extraction,⁵² opportunities to shift or split income from property by gift or trust or incorporation,⁵³ opportunities to defer tax on gains in property by timing their realization or by making nonrecognition exchanges or sales and reinvestments,⁵⁴ and the tax-exempt status of interest on municipal bonds⁵⁵ can all be viewed as products of a bias in the tax law that runs against investment in human capital.⁵⁶ An education expense deduction or amortization rule would help balance the scale to the extent expenses of education are costs of producing income, investments with a limited useful life, and

46. See G. BECKER, *HUMAN CAPITAL (A THEORETICAL AND EMPIRICAL ANALYSIS WITH SPECIAL REFERENCE TO EDUCATION)* 115 (1964) [hereinafter cited as G. BECKER, *HUMAN CAPITAL*]; GOFFMAN, *supra* note 44, at 10; GOODE, *THE INDIVIDUAL INCOME TAX* 82-93 (1964); SCHULTZ, *INVESTMENT*, *supra* note 35, at 34, 43, 163; T. SCHULTZ, *THE ECONOMIC VALUE OF EDUCATION* 69 (1963); Goode, *supra* note 1, at 281. See also Due, *The Taxation of Wealth* in *PUBLIC FINANCE* 129, 139 (Houghton ed. 1970), observing that the usual wealth tax, which accepts only non-human capital in its base, would induce people to invest more in education.

47. See INT. REV. CODE OF 1954, §§ 1201 & 1202 and their supporting rules.

48. See INT. REV. CODE OF 1954, §§ 162 & 212.

49. See INT. REV. CODE OF 1954, § 163.

50. See, e.g., INT. REV. CODE OF 1954, § 173.

51. See INT. REV. CODE OF 1954, § 1231.

52. See INT. REV. CODE OF 1954, § 613.

53. See generally A. KRAGEN & J. McNULTY, *FEDERAL INCOME TAXATION, CASES AND MATERIALS* 237-341 (1970); J. McNULTY, *FEDERAL INCOME TAXATION OF INDIVIDUALS IN A NUTSHELL* 206-47 (1972).

54. See KRAGEN & McNULTY, *supra* note 53, at 157-236; McNULTY, *supra* note 53, at 165-205.

55. See INT. REV. CODE OF 1954, § 103.

56. Other features of the tax law can be viewed as supporting investment in "human capital." See, e.g., INT. REV. CODE OF 1954, § 213 (deduction for extraordinary medical expenses).

costs of producing an income-generating asset that gradually is sold over the life of the person educated.⁵⁷

1. *What Costs Should Be Included?*

If a deduction (or capitalization and amortization) is deemed desirable to improve the definition of income, a significant difficulty is determining what portion, if any, of education expenses such as tuition and fees does in fact amount to a cost of producing income, as distinguished from personal consumption or personal investment expenditures. For a professional student such as a law student, would income-producing costs include all his tuition and educational or instructional fees? Or, are part of those fees paid to admit him to the purely personal delights of legal instruction, the elevated social status of the legal profession and related disciplines, bettered marital opportunities, parental approval, daily classroom entertainment, generally sharpened intellectual powers, and other personal fringe benefits of a legal education? Education expenditures, in other words, can be seen as, at least in part, expenditures for present or for future consumption. To separate the investment component from the consumption component of tuition charges, even for vocational, professional, or graduate school, proves very difficult, if not impossible.

The difficulty of estimating what portion of tuition and fees paid by a college student pursuing a nonprofessional or nonvocational curriculum appropriately constitutes "investment" in an income-producing asset, rather than an expenditure for current, or future consumption, proves still greater. It might seem to some that the costs of an undergraduate's work in General Studies, English, or history are insufficiently connected to specific income-producing activities to be regarded as a cost allocable to such income and therefore must be regarded as personal in character just like the costs of his childhood food and shelter, music lessons or summer camp.

This reasoning may appear to apply even more forcefully to the

57. As Richard Goode has stated:

The logic of the net income tax seems to imply that persons who make expenditures for education that increases their earning power, or that is intended to do so, should be permitted to capitalize these outlays and write them off against taxable income through depreciation or amortization allowances. Income-producing educational expenditures are investments with a limited life and, if it is feasible, they should be given the same income tax treatment as other investments. Failure to allow tax-free recovery of educational outlays means that the income tax falls in part on the return of capital rather than on net income.

Goode, *supra* note 1, at 284. Bernard Wolfman also cogently argues for a deduction or amortization treatment. See Wolfman, *supra* note 1, at 546-51.

student whose college education is not likely to or does not lead to production of any taxable income at all. The college graduate who does not work outside the home, for example, might be happier, more cultivated, more likely to marry "better" or to raise children more elegantly because of higher education, but most or all those benefits, if any, are unproductive of present or future income actually taxable to him or her. A modern example might be a post-graduate drop-out, or someone who radically changes career to one not requiring or using college education very much at all.

Some undergraduate education may in fact yield future income, either directly or indirectly. But it is certain that some portion of college tuition, however difficult to determine what portion, purchases immediate or future recreation, pleasure, social, psychic, or economic benefits that will never be taxed as income to the student. That portion, great or small, should not be deducted, or capitalized and amortized, if the purpose of an education expense deduction is to perfect the law's definition of taxable income.

There remains the question whether expenditures other than tuition and fees should properly be considered as investment costs, in whole or in part. What about student health, student athletic or student government fees, for example? Book charges? Travel costs? Bar review and bar examination fees?⁵⁸ More importantly, what of expenditures for food and shelter? One could say that costs of food and shelter are inherently personal expenses that cannot be treated as costs of producing income, since they would exist whether or not the person remained in school. But one also might argue that for people not attending school, such food and shelter costs would be borne out of earned income that the student must forego for the sake of academic life. This reasoning suggests that a deduction possibly should be allowed for food and shelter costs paid out of capital (savings) or borrowed funds, although the tax law usually does not take this ap-

58. If tuition and fees were the only costs treated as deductible or depreciable investments for tax purposes, a notable difference in the tax allowances between high-tuition private colleges and low-tuition public universities would at once emerge. Some have therefore argued that total college costs should be eligible for the tax allowance, to avoid favoring high tuition schools and students. See Cartter, *supra* note 3, at 331. This reasoning, however, may fail to take into account the tax-free subsidy implicit in low tuition institutions. See text accompanying notes 76-81 *infra*.

Within the expenditures eligible for the allowance, Goode would include tuition and fees, books and equipment and necessary travel relating to eligible education. Normal living expenses would not be allowed. Additional living expenses could either be disallowed or a small, flat fixed allowance could be given to students who live away from home. Presumably, travel such as commuting would not be allowed even though it met the "necessary" test or a "but for" test. See Goode, *supra* note 1, at 290.

proach, and the question parallels the issue of deducting or capitalizing foregone income itself.⁵⁹

What of the student's foregone income? Can foregoing income be seen as a "cost" of education or vocational training such that a tax basis should be allowed and a current deduction or amortization of capital be permitted? One is tempted to answer that foregone income cannot properly be viewed as a tax cost of higher education, since the foregoing of such income is matched by the absence of any tax on it, so that the taxpayer and government are "even."⁶⁰ But that answer is not wholly satisfactory, because the high school or college graduate who goes to work rather than attending college or graduate school earns a salary, pays tax on it, and has "after-tax-dollars" left over, dollars that the student, at least in the short run, must forego.⁶¹ This de-

59. Food and shelter are not always inherently or absolutely treated as non-deductible personal costs for federal income tax purposes. For example, I.R.C. § 162 allows as a deduction amounts expended for meals and lodging while away from home in the pursuit of a trade or business. Might not the student who by necessity or choice attends an out-of-town professional school claim such a § 162(a) deduction, or at least might he not argue that he should be given an analogous allowance? If a student works part time and thus meets his room and board costs out of current income, time spent in school or studying reduces his current income-producing time and leaves him with income, even after-tax income, foregone. Another view may be that school merely consumes some of his leisure time. Since our tax law does not tax the imputed value of leisure as income, the reduction of "after tax leisure" does not constitute an expenditure to be deducted or amortized. In any event, some excess food and lodging costs may be attributable to student status.

60. Foregone earnings make up an opportunity cost of education and constitute part of the student's investment in education. However, these costs are already free of tax. See Goode, *supra* note 1, at 282. To put it another way, education in some or all instances could be viewed as supplanting leisure, which is an untaxed form of income. To be sure, leisure itself has an opportunity cost, measurable in income foregone. So, the opportunity cost analysis remains intact. Richard Goode would not allow foregone earnings to be treated as part of the costs for income tax purposes, because they already are free of income tax. He notes that students and others who directly invest their time and energy in the creation of an income yielding asset enjoy an immediate write-off of the investment costs. Because of the time factor and problems of uncertainty, he concludes that this immediate write-off is more valuable than a series of depreciation or amortization charges over time. He goes on to note that the income tax does not directly reduce the capacity of the student to invest his time in his education, in contrast to a person who works for wages and who must pay an income tax which leaves him less to invest. See Goode, *supra* note 1, at 290. See also notes 181-82 *infra*.

See generally Blitz, *The Nation's Educational Outlay*, and Blitz, *A Calculation of Income Foregone by Students: Supplement to "The Nation's Educational Outlay"* in *ECONOMICS OF HIGHER EDUCATION* 147, 390 (Mushkin ed. 1962). Recently students were shown to bear approximately 85 percent of the economic costs of higher education, if foregone earnings are included. Foregone earnings, room, board, clothing, and other living costs averaged a total of \$4,100; tuition averaged \$400, for a total of \$4500 out of an estimated total cost of \$5300. See H. R. BOWEN, *THE FINANCE OF HIGHER EDUCATION* 5 (1968).

61. The high school graduate who goes to work, compared to his college student or vocational school contemporary, is not granted an allowance for "depletion," "per-

ficiency could be viewed as an investment of after-tax-dollars that the student should later be permitted to recover tax free.⁶² The federal income tax law, however, does not elsewhere acknowledge the loss of, or failure to receive, the after-tax dollar component of lost or unreceived income.⁶³ Moreover, to acknowledge the after-tax-dollar

sonal depreciation," or other such tax recognition of the human costs of working for a living. See *Heisler v. United States*, 463 F.2d 375 (9th Cir. 1972) (elderly attorney argued unsuccessfully for a personal depletion allowance). The college student who similarly incurs non-monetary costs and burdens during his training or education, however, is not permitted such a "depletion" allowance either, and his costs, which include an educational investment, exceed those of the student who does not pursue post-secondary training or education.

62. Foregone earnings are included as a cost of schooling for some purposes, such as to calculate the rate of return to investment in schooling. See T. SCHULTZ, *THE ECONOMIC VALUE OF EDUCATION*, *supra* note 46, at 31; SCHULTZ, *INVESTMENT*, *supra* note 35, at 82, 102 (on foregone earnings as opportunity costs, the value of the time that students allocate to education, and empirical problems of determining them). Schultz asserts that earnings foregone by students compose well over half of the real costs of human capital formation by higher education. *Id.* at 167; Schultz, *Capital Formation by Education*, 68 J. POL. ECON. 571 (1960). Others have similarly come to regard foregone income as a very large economic and practical barrier to higher education, especially for youths from poor families which by tradition as well as immediate necessity expect their children to go to work and contribute to the family budget, or at least their own support, at an early age.

However, if the after-tax value of forgone earnings is to be treated as a cost, some way must be devised to determine what after-tax value such earnings would reach in the case of each student or all students. This involves asking the unanswerable question "What job would the student have been able to find and take if he were not a student, and what would be the amount of his after-tax earnings from that employment?"

Such a question cannot be answered for each student individually under any system that could be reasonably well administered. One solution, therefore, is to refuse to treat such costs as eligible for a tax allowance. Another solution would be to give a fixed amount, perhaps based on average or median incomes of student-aged people and average effective income tax rates on such average earnings. Such a flat rule would disfavor those students who bear a very high opportunity cost because they could, at least for the brief period that covers the student years, earn a relatively high income as compared with other students who, during an equivalent period, could not earn very much. Also, the flat rule would treat equally those students who, because of factors such as personal or family wealth and the like, would have very different income tax burdens to bear even if they had equal incomes from personal efforts substituting for their efforts as students. These flaws seem smaller, however, than those of the present system which disregards the opportunity costs of foregone earnings altogether. The present system is particularly hard on those students and families for whom the opportunity costs are hardest to bear, namely those students and families with small income and wealth and those families with a number of dependents who, as a matter of fact, tend to look to the young person for support during those years when he would be a student were it not for those support requirements. See also Bailey & Schotta, *Private and Social Rates of Return to Education of Academicians*, 62 AMER. ECON. REV. 19 (1972), estimating the impact of foregone earnings on the rate of return on personal investment in graduate education.

63. See generally such rules as those presupposing basis for a loss deduction, under INT. REV. CODE OF 1954, § 165, a charitable contribution under § 170, or a bad debt under § 166. See *Escofil v. Commissioner*, 464 F.2d 358, 359 (3d Cir. 1972), which refers to the "settled precedent denying a cash basis taxpayer any deduction for the loss of anticipated receipts which the taxpayer will never be required to report as

component of foregone income in the calculation of an education expense allowance would be politically difficult, technically hard to regulate, inequitable by comparison with other comparable situations, and therefore theoretically unsound.

2. *Compensating Tax Benefits*

An argument for education expense deductions predicated on the tax law's perceived bias against investment in human capital threatens to run aground on an even more fundamental criticism: perhaps the tax law is not biased against education investment at all. First of all, a number of explicit, special provisions in the federal income tax give direct benefits to students, their families, or to other participants in the business of education. Perhaps the most obvious is the exclusion of scholarships and fellowships from gross income.⁶⁴ Similarly, the I.R.S. regards tuition postponement as a loan and therefore not includible as income to the student.⁶⁵ Another favorable provision is the additional exemption afforded parents of a student who has attained the age of 19 and is, therefore, no longer eligible for an ordinary exemption as a dependent "child."⁶⁶ For that matter, the personal and dependency exemptions and the standard deduction may well reflect an education expense component of the cost of living.⁶⁷ Other tax rules of considerable benefit to education in general and sometimes to students in particular include the exclusion from income of gifts⁶⁸ which often comprise a large part of a student's means of support, and even, though less directly, the charitable contribution deduction for gifts to educational institutions⁶⁹, the tax exemption for in-

income." See also *Alsop v. Commissioner*, 290 F.2d 726 (2d Cir. 1961); William Fox, 37 P-H TAX CT. REP. & MEM. DEC. ¶ 68,154, 757 (1968).

64. See INT. REV. CODE OF 1954, § 117. Also, scholarship aid need not be accounted for in determining whether a taxpayer provides more than half the support of a child for whom a dependency exemption is claimed. INT. REV. CODE OF 1954, § 152(d).

65. See Rev. Rul. 72-2, 1972-2 INT. REV. BULL. No. 11. Correspondingly, repayment of the principal does not give rise to a deduction. Interest payments, however, are deductible.

66. INT. REV. CODE OF 1954, § 151(e)(1) & (4). See KAHN, *supra* note 3, at 16; *Federal Tax Incentives*, *supra* note 1, at 382. Senator Fulbright and others have sought to legislate an extra personal exemption or two to aid persons who would be denied the benefit of a cost of education deduction because they use the standard deduction. See CRISIS IN COLLEGE FINANCE?, *supra* note 3, at 191.

67. Deductions for personal and dependency exemptions are allowed by INT. REV. CODE OF 1954, § 151.

68. INT. REV. CODE OF 1954, § 102.

69. INT. REV. CODE OF 1954, § 170(b)(1)(A)(ii). See generally R. DESMOND, EDUCATION AND TAX MOTIVATED GIVING: THE FEDERAL TAX HISTORY OF LIFE INCOME AND ANNUITY GIFTS *passim* (1967), for a history of the federal tax law's incentive for charitable gifts. See McNamera, *New Threats to Private Giving*, CHANGE, Nov. 1972,

come of educational institutions⁷⁰ and teachers' retirement fund associations.⁷¹ Other tax provisions, such as the exclusion of interest on state and municipal bonds⁷² and the deduction for state and local taxes⁷³ indirectly assist public-supported institutions of higher learning by easing the financial burden on state and local governments, thus eventually reducing costs to students. Income splitting through contributions of income-producing property to a trust, the income from which is not taxed if used for the college education of the settlor's child, is another device that may be used to advantage by students and their families.⁷⁴ Also, Social Security benefits, which are tax free, are increased or maintained longer if a child of a deceased enrollee qualifies as a student.⁷⁵

Much more important to the theory of a tax benefit for education viewed as an investment in human capital, however, is an *implicit* allowance in the federal income tax law: the failure to tax a student on the increase in his earning power and the receipt of other benefits from education, to the extent they exceed his cost, as those forms of "income" inure to his benefit. Our tax law does not say that a student realizes income as he learns information or skills or as he successfully passes courses or even when he receives his degree or certification or license to practice a lucrative profession. Yet the student grows in net worth as he passes through these stages in the educational process; he or she enjoys an implicit capital gain. Nevertheless, the tax law does not tax unrealized income, imputed income, and most nonmarket benefits, all of which a truly comprehensive income tax would include in its base. Present law thereby exempts from income a very important flow of benefits and increase in worth enjoyed by a person who gets an education.⁷⁶

at 12-13 for a report on fears that proposed "reforms" in the federal tax allowance for charitable contributions will have a serious detrimental effect on private support of colleges and universities. See TAX INSTITUTE OF AMERICA, TAX IMPACTS ON PHILANTHROPY 47-100 (1972) (effects of 1969 Tax Reform Act on philanthropic giving).

70. INT. REV. CODE OF 1954, § 501(c)(3).

71. INT. REV. CODE OF 1954, § 501(c)(11).

72. INT. REV. CODE OF 1954, § 103.

73. See INT. REV. CODE OF 1954, § 164.

74. See generally INT. REV. CODE OF 1954, §§ 671-78.

75. 42 U.S.C. § 402(d) (1970).

76. A truly comprehensive income tax base would include all "net accretion(s) to economic power between two points in time," or all "market value of rights exercised in consumption [plus] the change in the value of the store of property rights between the beginning and end of the period in question." The quotations are taken from the famous Haig-Simons definition of income. See R. MAGILL, TAXABLE INCOME 16 (1936); H.C. SIMONS, PERSONAL INCOME TAXATION 50 (1958).

Rolph and Break observe that an equitable net worth tax would require inclusion of the capital value of human earning power in its tax base. E. ROLPH & G. BREAK, PUBLIC FINANCE 196-200 (1961).

Another unstated exclusion is that a student is not taxed on the difference between what his education actually costs and what he pays for it.⁷⁷ Such a difference does exist.⁷⁸ Even at an expensive private college or university, the student pays for only a fraction of the value of what he receives. At a state college or university that charges little or no tuition to resident students, the gap between price and the cost or value of what is received becomes enormous. And the student receives these benefits tax free.

These unstated exclusions, of course, often amount only to a deferral of tax, not to total forgiveness. A student whose earning power is increased by an excellent legal or medical, vocational or gen-

77. The income tax omits to tax several student benefits that a truly comprehensive definition of income would include. In the aggregate, they amount to the extent, if any, to which the value of what he receives in a given year exceeds the price he pays (however defined). Broken down, these benefits consist of bargain purchases of education and training (an investment component), current consumption (such as socializing with other students, inexpensive access to concerts and lectures, and similar pleasures that accompany student status), and personal investment in future consumption (such as the post-graduation enjoyment of literature, art or music begun in college, later status and job satisfaction).

Even if the law only forgave tax on the implicit capital gain in the student viewed as an income producing asset, the allowance would amount to a large and valuable exemption. This failure to tax the implicit capital gain (the difference between the increase in his capital value and the cost of such increase to him) amounts to "instant depreciation." In contrast, a truly comprehensive income tax would tax the student on that gain at once and then probably would let him capitalize and amortize the full costs of his education, including the subsidy—since that subsidy was taxed to him when he received it. The result would be symmetrical. Existing tax law is symmetrical too, but not equivalent to the more comprehensive version. Existing law does not tax the gain and does not allow amortization of that gain as a cost, or amortization of other costs. So, the student is taxed in full on later earnings, without any offset for education costs, but he avoids tax at the time he receives a subsidized education. In effect, tax on the value to him of his education is deferred until he earns taxable income, if ever. Deferring the tax provides a cost reduction and a liquidity advantage to the student, since his ability to pay tax is low while he is a student and higher later as a recipient of taxable income. Thus, this instant depreciation amounts to an enormous income tax allowance and a tax subsidy for bargain priced education.

Becker estimated that the present value of the depreciation unknowingly permitted by the tax law often exceeds that explicitly allowed on physical assets depreciated over a five or ten year period, or longer. The absence of a depreciation allowance on human capital, he suggests, is more than offset by the implicit allowance. See G. BECKER, *supra* note 46, at 14, 148-49 (1964). In the event of on-the-job training, and because foregone earnings are instantly deducted (or omitted from accrued taxable income), a negative depreciation term would have to be subtracted, as the capital value of the person rose, if depreciation were allowed. Since indirect costs amount, in Becker's estimation, to 75 percent of the private costs of college education, the instant write-off and departure from a truly comprehensive, accrual basis, computation of income have a very high value. *Id.* at 148-49. See also notes 183-85 *infra*.

78. See Goode, *supra* note 1, at 284-85. See also Brannon, *supra* note 3, at 134-35; Blum, *Senator Humphrey's Tax-Credit Bill*, 34 J. OF HIGHER EDUC. 479, 484 (1963) (estimating that tuition then composed one-eighth of the full cost of education at a public institution and one-half the full cost at a private institution).

eral undergraduate education will eventually pay more tax than his less educated counterpart who skipped college to go to work, if and when the educated person earns income and thereby "cashes in" on his educational benefits. If he earns more than the high school graduate, he will pay more tax and, if the graduated tax rate structure works according to theory, he will pay not only proportionately but progressively more tax.⁷⁹

At least two cautionary points must be added. First, the deferral does in fact turn into total forgiveness if or to the extent the college graduate gets a pay-off on his education in nontaxable forms.⁸⁰ So, a college graduate who gets more out of life, and who brings the benefits of education to his spouse, children, parents, siblings, hobbies, and nontaxable activities, will never pay tax on those benefits. Nonmarket economic benefits, including self-service, family, social, cultural, and political advantages and pleasures, even the option to continue education or training at still higher levels, all can inure to the benefit of the educated or trained person as a result of the education or training.⁸¹ Other income, received in cash or its equivalent, goes untaxed if it falls within an explicit allowance or exclusion such as that for interest on some state and local bonds. So, the unstated exclusion does more than merely defer tax on some financial as well as nonfinancial benefits of education, because those benefits—through other characteristics of our tax law—escape tax, even when they eventually are "realized."

Secondly, a deferral of tax can be virtually equivalent to forgiveness. For example, a deferral of tax for 15 years for a profitable taxpayer is approximately as valuable as total forgiveness would be, since his retained tax money earns compound interest or investment profits.⁸² For the student who would have had to borrow to pay the tax

79. See PECHMAN, *FEDERAL TAX POLICY* 69 (rev. ed. 1971) for a visual presentation of the differences between nominal and effective federal individual income tax rates after the 1969 Tax Reform Act. The extent to which the benefits of education and resulting greater productivity are reflected in higher income taxable to the graduate during his or her working years depends on how well the market internalizes those benefits directly to the graduate and on the comprehensiveness of the tax law's definition of taxable income, as well as on personal peculiarities of the individual such as motivation, health, age, and career choice.

80. Such non-taxable forms include income implicitly or explicitly excluded from the federal income tax base, whether it is received in monetary or nonmonetary forms. Examples are fellowships, imputed income from owner-occupied homes or owner-used durable goods, self-services and family services, some employee fringe-benefits, social security and welfare payments, tax-exempt interest, and the untaxed one-half of long term capital gains.

81. See Weisbrod, *External Effects of Investment in Education* in *ECONOMICS OF EDUCATION* 1, 156, 169-70 (Blaug ed. 1968).

82. The deferral amounts to an interest-free loan from the government. See the reported comments of Professor Surrey on the "deferral" of taxes on 50 percent of a

during his student years, deferral avoids the necessity to pay interest on borrowed funds. Thus, deferral of tax on the income that accrues as a person becomes educated amounts to a very large tax allowance and thereby to a subsidy for students and the education "business." Also, a student may manipulate the taxation of any financial pay-off on his education by levelling it over years, timing the realization for low-bracket years, shifting some of it to low-bracket taxpayers, turning it into capital gains, and otherwise reducing the tax cost from what it would have been if imposed when accrued.⁸³

However much the unstated exclusion may seem to compensate for the absence of amortization treatment of education costs, the tax law's disallowance of such costs does not stem from a conscious recognition of the unstated subsidy. That subsidy itself may be nonrational or even perverse in its operation; the tax treatment of it and of outright education costs appears equally incoherent or perverse. The two together have not been shown to provide a good overall system.⁸⁴ To perfect the definition of taxable income, capitalization and amortization of the investment component of education expenditures should be allowed. The unstated exclusion for bargain pricing of education or for unrealized capital gain in the human asset—a tax break by no means peculiar to subsidies for education or for investment in human capital—should be evaluated separately and corrected, or not, apart from the question of amortizing education costs. There follows an effort to develop a model of an appropriate tax system consistent with the purpose of improving the definition of taxable income by making an explicit allowance for the personal costs of higher education.

3. *Implications of Purpose To Improve Definition of Income*

a. Identity of recipient. Some implications for the nature of the tax allowance flow from focusing on perfection of taxable income as the goal to be served. To illustrate, the tax allowance should be given to

Domestic International Sales Corporation's income. Wall St. Journal, Dec. 22, 1971, at 1, col. 5.

83. Finally, to the extent the market system does not internalize the benefits of a student's education, any external benefits will never be taxed to the student—but that is as it should be, from the perspective of improving the tax law's definition of taxable income. By the same token, costs that are not internalized should not be credited to the student in determining the tax treatment of the rewards of his education, in any event.

84. In fact, the tax treatment of the unstated exclusion may aggravate the problem. Students who receive the smallest outright subsidy, in the form of below-cost tuition charges, also suffer the smallest tax benefit, in that a smaller amount of "income" is tax free to them. The smaller the outright low-tuition subsidy, the smaller the implicit tax subsidy too. Conversely, the below-cost level of tuition rates does ameliorate but does not justify the unfairness of the tax law's refusal to allow education costs to be written off against taxable income.

the person whose income will be affected by the education, namely the student—rather than to the student's parents or others who might be given the allowance were a different goal to be served. Even if the student does not pay for his own education, expenditures by his parents, spouse, or other benefactors could be viewed as gifts to the student and deductible or capitalized in the same way it is possible for a taxpayer to depreciate an asset acquired as a gift or purchased with gift money and used in a trade or business or in the production of income.⁸⁵

b. Form of allowance. Given a goal of perfecting the definition of income, the allowance should probably take the form of a deduction, more particularly deductions, from income over the useful life of the education, rather than as a credit or some other form. To more accurately reflect the fact that some portion at least of education expenses functions as a cost of producing later income, the allowance should enable a person who makes expenditures for education that increase his earning power, or that are intended to increase his earning power, to capitalize those outlays and write them off against his taxable income through depreciation or amortization allowances.⁸⁶ The form of an allowance meant to perfect the law's definition of taxable income differs from the form of an allowance given for ability-to-pay reasons or to subsidize and encourage family support of students. To implement the latter goal, a tax deduction or tax credit probably should be allowed to the parents, students or other people who provide the resources for the educational expenditure.

c. Costs to be allowed. If the purpose of the allowance is to perfect

85. The basis for amortizing an investment of property obtained by gift differs from that for amortizing an investment obtained by purchase or exchange. See INT. REV. CODE OF 1954, §§ 1011, 1014, 1015. Similar impact should follow in the education setting, complicated perhaps by whether the contributions by others qualified as excluded scholarships or fellowships under INT. REV. CODE OF 1954, § 117. But § 117 merely parallels the gift exclusion of § 102, so perhaps no different consequences would be required.

The approach that allows a student to capitalize expenditures made by others would imply that in order to prevent an undue double tax benefit, eligible educational expenditures should not be considered "support" under INT. REV. CODE OF 1954, § 152(a) in determining whether a student is a dependent for tax purposes. See Goode, *supra* note 1, at 286. Also, it can be argued that the capitalized and amortized expenditures should not include the value of scholarships and other grants, since such grants are presumably intended to promote general welfare rather than the economic interest of the recipient. *Id.*

86. Among others, Vickrey recommended that training expenses be amortized against subsequent income. See W.S. VICKREY, AGENDA FOR PROGRESSIVE TAXATION 123-26, 399 (1947). See also R. GOODE, THE INDIVIDUAL INCOME TAX 82-93 (1964). An allowance in the form of a tax deduction or tax credit would properly flow to parents or other supporters of a student's education if an education allowance were to serve different goals—for example, to subsidize and encourage family support of students or to aid those unable to afford higher education costs. See text accompanying notes 141-91 *infra*.

the definition of income, it should cover every expenditure that in fact is a cost of producing future income. Therefore, the allowance probably should extend not only to all tuition charges, current or deferred, but also to other expenditures or costs (probably excluding opportunity costs in the form of foregone earnings)⁸⁷ that can be related directly to the income-producing purpose which lies at the heart of the allowance,⁸⁸ so long as the aggregate costs exceed the consumption benefits received and the personal investment made by the student.

The standard for determining which educational expenditures are made for purposes that qualify the expenditures to be written off against income and which are made for other purposes will be difficult to determine. Perhaps the intent of the taxpayer should be very important, if not controlling, under an "ordinary and necessary" rule.⁸⁹ Or, some forms of education such as basic professional, technical and vocational education may be presumed to be motivated primarily by economic considerations, as would refresher courses and supplementary training that relate directly to the occupation of the trainee.⁹⁰

Still another approach is to fall back on categorical solutions. A

87. As to treating foregone earnings as a cost, see notes 60-63 *supra* and accompanying text.

88. Rationally, the model could extend the allowance to the after-tax opportunity costs of foregone earnings and to all outright expenditures for attendance in an educational program, for books and for other equipment used in the program, yet stop short of payments for room and board, medical services, social or athletic services and conclusively presume such items to be of a personal consumption, rather than an investment nature. Some question might be raised when those charges are compulsory and required in order to gain the educational benefits of the program. Even though they may be required and it can be shown that they would not be born otherwise, such payments probably should be regarded as small enough in amount and usually predominately personal in purpose and result as to warrant putting them beyond the reach of the tax allowance for educational expenditure.

89. See Goode, *supra* note 1, at 286-87.

90. Under this approach, elementary education would seem to have little economic motivation and thus to have no claim for consideration as an investment for income tax purposes. See Goode, *supra* note 1, at 287. Admittedly it is much more difficult to classify high school education and college liberal arts education. Both apparently increase earning capacity and are probably to some extent so motivated. Perhaps the correlation and probable causal relation between higher education and higher lifetime income is a sufficient ground for a full deduction for both. Surely it would be tricky to differentiate between students according to their course of study or department. The same problem exists, of course, under present Treas. Reg. § 1.162-5 [T.D. 6918, 1967-1 CUM. BULL. 36], which allows a deduction if and only if the expenditure can be shown to be an ordinary and necessary business expense in the sense that it maintains or improves skills required by the individual in his employment or other trade or business, or meets the express requirements of the individual's employer, or the requirements of applicable law and regulations, imposed as a condition to the retention by an individual of the established employment relationship, status, or rate of compensation. If the taxpayer cannot meet these tests, not only is a current deduction denied, but amortization, depreciation and all other allowances are precluded.

current deduction or amortization of educational expenditures could be allowed for costs relating to any program of study leading toward a degree from an accredited college or university, for vocational training at a recognized institution, and for supplementary or refresher courses of a predominately professional or vocational nature. Expenditures for ordinary high school studies probably would be classified as personal.⁹¹ Admittedly, such an approach would capitalize some educational expenditures that are in fact consumption rather than investment items, as measured by motivation or influence on income, and would deny an allowance for other legitimate costs of producing income.⁹² Evidence that the rate of private monetary return on total private costs of college education is high may, in part, justify this imprecise approach and make the resulting inequities seem less objectionable from both a theoretical perspective (perfecting the definition of taxable income) and a public policy perspective (subsidizing education, assisting poor students and families), especially when compared to the present practice of permitting practically no educational expenditure to be charged against taxable income.⁹³

A more refined suggestion for solving the problem of mixed consumption and investment expenditures on education would be to treat as investment a proportion of education costs that would vary with the different average contribution to future earnings of different kinds of education. For example, 100 percent of law school, medical school, or automobile mechanics' institute expenditures might be deductible while a smaller percentage of general college and university expenditures and a still smaller percentage of high school expenditures would be allowed.⁹⁴ Such an approach has the merit of recognizing the mixed nature of educational expenditures, but it in some ways ap-

91. Some difficulty inheres in denying an allowance for costs of high school education. However, since most young people now attend high school, one principal effect of granting an income tax allowance for the personal costs of such secondary education would be to encourage attendance at private schools. See Goode, *supra* note 1, at 289. Since free public schooling is generally available, such an allowance could not easily be defended on the theory of perfecting the definition of income, but the door is left open to defend such an allowance on some other grounds, such as those suggested in text accompanying notes 141-91 *infra*.

92. See Goode, *supra* note 1, at 288. Whether an expenditure is made for consumption or investment can be gauged by the taxpayer's motivation, the item's influence on income, or other tests. See text accompanying notes 87-95 *supra*.

93. See Goode, *supra* note 1, at 288. It is noteworthy that the conclusion in text depends not only on the implications of a purpose to perfect the definition of taxable income, but also on other considerations of "broad public policy," considerations which more directly enter into the discussion of tax credits and other allowances made for other purposes, to be analyzed in following sections of this Article.

94. See Goode, *supra* note 1, at 289-90. See also Schultz, *Investment in Human Capital*, 51 AM. ECON. REV. 11 (1961).

pears nearly as arbitrary as the categorical "all or none" rules suggested earlier.⁹⁵

All in all, the difficulties of sorting out deductible costs of education loom large. Undoubtedly, these difficulties have played an important role in defeating proposals for a tax allowance in prior years. Troublesome as the line-drawing or estimating may be, if theory calls for an allowance, some reasonably satisfying and workable "sorting" rules can be developed.

d. Income eligible for an education cost write-off. The strict logic of a federal income tax allowance in the form of a deduction for education costs, analogized to investment in depreciable machinery or equipment, implies an allowance only against income resulting from the investment in education. So, for example, the expenses of a legal education would be offset against income from practicing law or rendering other legal services, but not against income from inherited property. But, of course, professional education may contribute to the earning of income outside the field for which the taxpayer was most directly trained. Law school training, for example, may benefit a taxpayer who later enjoys earnings in politics, business, government, and other fields. Even if the taxpayer does not complete his legal education or ever become admitted to the bar, his future income may nevertheless be attributable, at least in part, to his investment in education.⁹⁶

In view of these difficult line-drawing problems, it does not seem feasible to require a direct causal link between the kind of education and source of earnings. One solution would be to limit the deductions or amortization charges to "earned income." Two problems then arise. First, education may make one a better investor and thus create some connection between education and unearned income.⁹⁷ Second, some taxpayers may, by virtue of their educations, enjoy increased personal service income that does not enter into the federal income tax law's definition of "gross income" or taxable income at all. A hackneyed example is that of the housewife, the value of whose services does not enter into the tax law's definition of taxable income for herself or to her spouse. Logically, she should be denied a write-off for educational costs since her services do not produce taxable income to her or her family, even though she may be better qualified to perform them as a

95. See Goode, *supra* note 1, at 290.

96. Indeed, in other contexts, business or investment costs can be written off against income of the same taxpayer even though the income cannot be traced to the cost being amortized. Perhaps this conventional approach would be workable and fair as to educational costs also.

97. See Goode, *supra* note 1, at 290-91.

result of her education.⁹⁸ A better solution would be to include the imputed value of her services in income, and to allow an offsetting education deduction for the cost of producing the income.

Certainly the easiest solution would be to rule all forms of taxable income eligible for the education expense allowance. Indeed, this approach applies to most business and investment costs, under existing tax law. To be sure, this may entitle some taxpayers to write off as investment in education some expenditures unrelated to their taxable income. Also, for a taxpayer who has income both from personal services attributable to his education and from inherited wealth or other property, the marginal effect and value of the amortization deduction will be influenced by the amount of investment income the taxpayer receives. These difficulties argue for the narrower rule which would limit the deduction or amortization charges to earned income.

e. Timing of allowance. If the education expenditures are to be charged off against income that, at least presumptively, results from the investment, another technical problem is the one of timing. Not an immediate deduction, but capitalization and amortization or depreciation deductions spread over a period of income-producing years seem required if the practice in analogous situations is followed.⁹⁹ Perhaps a current deduction would be appropriate for minor expenses and amortization for major outlays, thereby permitting the taxpayer to write off his major investment over his normal working life, on the assumption that such period will reflect the return on his investment. Obviously, such a general rule might depart from the actual facts in given cases, but would have the advantage of simplicity for taxpayer and Internal Revenue Service alike.

Another possibility would be to let the taxpayer write off the expenditures at any rate he chooses.¹⁰⁰ Although the natural tendency might be to take the deduction as soon as possible to get the immediate benefit of reduced taxes and, thus, to have the interest value of the

98. See *id.* at 291. The same logic, of course, would apply to other taxpayers who, for one reason or another, do not experience "income," as defined by the tax law, after or as a result of their education but who nevertheless experience "income" in the sense of the Haig-Simons definition.

Special emphasis is placed in text on the example of a housewife (or househusband) because her non-market use of education and training, particularly in transmitting social and cultural values and in producing intergenerational externalities, is so prominent, yet often under-credited. A case can be made for special subsidies for the education of women on this basis. See Nerlove, *On Tuition and the Costs of Higher Education: Prolegomena to a Conceptual Framework*, 80 J. POL. ECON. S178, S193-96 (1972). See also a report issued December 21, 1972 by the Department of Health, Education, and Welfare and entitled *Work in America*, suggesting that the work done by housewives be accounted for as such and recognized in determining pensions and government subsidies.

99. See INT. REV. CODE OF 1954, §§ 263, 167, 169.

100. See Goode, *supra* note 1, at 291-92.

tax reduction presently in hand, many taxpayers might prefer to spread the deduction over a longer period of time in order to offset income taxed at higher rates and also to provide a more even flow of after-tax income. A compromise would allow the taxpayer to amortize his major education expenses over a fixed period, such as twenty years, or over a period ending when the taxpayer reaches 65, whichever first occurs. All amortized expenses remaining at death could then be deducted in the last taxable year, much as the difference between depreciated costs and salvage value of a useless piece of depreciable property can be deducted from income in the year it is discarded. If a net loss resulted, a carry-back to prior taxable years could even be allowed. Similar treatment would be justified for a person who becomes unemployably disabled.¹⁰¹

f. Other ramifications. Finally, if a tuition or educational cost tax allowance is based on the theory that the costs are investments and thus resemble "business expenses," the allowance should be given tax stature equivalent to other business deductions. Specifically, the deduction should be taken from gross income in arriving at adjusted gross income, rather than from adjusted gross income in arriving at taxable income. The principal consequence of this structural location is that the deduction would be available to a taxpayer whether or not he itemized his deductions or took the percentage standard deduction instead. Similarly, the allowance should be given the same carry-forward and carry-back treatment given to other deductions predicated on a "cost of producing income" theory.

4. *Effects on Revenue, Prices, Investment, and Career Decisions*

Tax revenue would diminish if the Internal Revenue Code were amended to permit (1) a current deduction for minor educational expenses and (2) amortization of major outlays for education. The ultimate impact of revenue loss associated with one year's expenditures would, however, be felt only over a period of years roughly equal to the amortization period. Available data enable some approximate estimates to be made of the revenue loss resulting from the enactment of a deduction and amortization plan.¹⁰² One such estimate, made several years ago, projected amortizable or deductible expenditures for the year 1969-70 to be \$3.1 billion or more. On an assumption of a 25 percent marginal tax rate and a 10 percent wastage of deductions, the ultimate revenue loss for that year was estimated to total \$0.7 billion spread over a two-decade amortization period.¹⁰³

101. See *id.* at 292.

102. See, e.g., *id.* at 293.

103. See *id.* at 295.

Such estimates are and must be uncertain for several reasons. First, allowance must be made for educational expenditures by men and women who subsequently withdraw from the labor force (or, at least, the tax rolls) before their educational outlays are completely amortized. Assumptions must also be made about the extent of full employment, and an appropriate marginal tax rate must be selected on which to base the computation. In addition, an increase in enrollment and tuition charges must be predicted and some adjustment should be made for the increase in educational expenditures that directly will result from the introduction of the tax allowance itself. Finally, loss of revenue will be reduced by any increase in taxable income attributable to education stimulated or made possible by the tax-relief provision.¹⁰⁴

In addition to its impact on tax revenue, a deduction and amortization plan, or a credit plan, could be expected to influence the level of tuition charges made by educational institutions and the enrollment decisions made by students and potential students. The capacity of students and their families to pay tuition charges would increase to some extent, particularly if an allowance were combined with additional student loans and student loan guarantees. In fact, if loans were readily available and if the tax law provided for amortization of major educational expenditures, it might be possible for institutions to raise their tuition charges to cover the full marginal cost of instruction, especially in those disciplines that most reliably correlate with high incomes.¹⁰⁵

Students and their families have increasingly accepted the idea of borrowing to finance education. Moreover, the population at large seems to be more sophisticated about tax benefits and personal financial decisions than in prior years. As a consequence, the availability of tax amortization would tend to increase the willingness of students to borrow, and would probably encourage potential lenders to make more educational loans.¹⁰⁶

If one assumes that the ratio of tuition charges of public institutions to those of private ones remains relatively constant, then a tax allowance which reduces the tax cost of tuition payments would lead some students who might otherwise have enrolled at low-cost state universities and colleges to attend more expensive private schools. An amortization plan seems likely to have a lesser effect on this type of decision than would a current benefit in the form of a deduction or credit since the tax saving would be realized only over a period of years.¹⁰⁷

104. See *id.* at 293-95.

105. See generally *id.* at 296, citing Friedman, *The Role of Government in Education* in *ECONOMICS IN THE PUBLIC INTEREST* 123-44 (Solo ed. 1955).

106. See *id.* at 299.

107. See *id.* at 296.

Nevertheless, like any ungraduated or unlimited tax allowance, the amortization plan would probably stimulate enrollment in high-cost institutions more than in others. The magnitude of this influence seems very difficult to appraise.

Similarly, an amortization plan would have a relatively smaller influence than would a current allowance on total investment in education and on the choice of students between different occupations requiring differing levels of investment.¹⁰⁸ For one thing, the tax saving must be discounted because it is distributed over a period of years. For another, taxpayers probably give disproportionate weight to actual out-of-pocket outlays of money. Finally, even if tuition and fees were substantially increased, the tax benefits of an amortization plan would usually amount to a relatively small proportion of the total personal cost of higher education so long as foregone earnings were not subject to amortization. Altogether, tax saving through eventual amortization could not be expected to have a very strong influence on the level of educational expenditures or occupational choice.

Because an allowance in the form of amortization by deductions gives an income-variant benefit, proportionately greater relief would be given to high-income taxpayers than to those with low incomes. On the implicit assumption that the amortization allowance would influence enrollment decisions roughly in proportion to its ultimate financial benefit, one commentator has suggested that such a plan would accentuate the existing tendency for college and university students to be drawn from families with relatively high incomes. In contrast, a tax credit plan would give a tax benefit equal to a stated percentage of given expenditures and would provide an equal benefit for all taxpayers able to take advantage of a credit. As a result, it appears that a much larger part of the total tax reduction would accrue to the benefit of low-income and middle-income families under a tax credit plan than under a deduction or amortization plan costing the government the same amount of revenue foregone.¹⁰⁹

Either a tax credit or a deduction allowed to parents of college students would provide immediate tax relief, and over the long run the revenue effects would be about the same.¹¹⁰ However, a tax credit or immediate deduction for parents or others who meet the expenses

108. See *id.* at 297.

109. See *id.* at 301, citing *Stimulating Voluntary Giving to Higher Education and Other Programs*, prepared for the American Association for the Advancement of Science, at 109-30 (1958).

110. It cannot be concluded that a tax credit would bring about a greater or lesser revenue loss than a deduction of the same items because the revenue effect depends on whether the rate at which the credit is allowed is higher or lower than the weighted marginal rate of income tax. See Goode, *supra* note 1, at 301.

of students cannot easily be justified as an improvement in the definition of taxable income, because such allowances benefit someone other than the person whose earning capacity is increased by the educational experience. In fact, the tax relief occurs at a time before the investment income is received. Therefore, proposals for credits or deductions to parents must be seen more accurately to be subsidies given for the purpose of encouraging socially desirable activity.¹¹¹ Such proposals are not to be tested by the same logic as that applicable to attempts to refine the definition of taxable income. Instead, the subsidy proposals should be viewed in terms of their efficiency in stimulating additional expenditures of the kind desired and their effects on the distribution of benefits among potential beneficiaries. Also at issue should be whether the proposed tax benefit is for an expenditure that is as meritorious or as burdensome as those expenditures which are now receiving special tax treatment and whether it is more worthy or more difficult to bear than other perhaps socially desirable expenditures that do not presently receive any tax allowance.

For revenue reasons, simplicity, to prevent excessive erosion of the tax base, and to maintain the integrity of the tax system, some theorists attach overwhelming importance to keeping the income tax closely affiliated with the general principle of defining income. Once another tax subsidy is introduced into the Code, it is harder to resist still further proposals for additional subsidies. Therefore, for these theorists the federal tax allowance for personal costs of higher education should be justified, if at all, on the perfection of taxable income argument and should be constructed to accomplish only that purpose. Arguably, a tax allowance would do just that so long as it were directed toward students themselves, rather than parents or other benefactors.

If tuition charges increase and cover a larger proportion of college, university, and other post-secondary school education costs, the case for modification of the income tax to perfect the definition of taxable income will become more persuasive. Even if tuition were raised a great deal and covered a high proportion of the costs of instruction, however, foregone earnings would continue to compose a substantial personal cost of education beyond the high school level. Therefore, a tax allowance that applies only to out-of-pocket costs may not greatly influence education expenditures or access to educationally expensive occupations. Even so, it would seem desirable to recognize, for tax purposes, the extent to which educational expenditures are investments.

111. See Wolfman, *supra* note 1, at 540.

3. Summary

On balance, a deduction computed by capitalizing the taxpayer's educational expenditures and amortizing them over the useful life of the education seems to be the best way to construct a higher education tax allowance that rests on the theory of perfecting the definition of net income. A conceptually convincing case for constructing such an allowance can be made. Even though it would be difficult, if not impossible, to separate the investment component of the expenditure from the consumption component,¹¹² a roughly-hewn allowance would be preferable to no allowance at all.

Unfortunately, recommendations for a deduction or capital treatment followed by amortization have been caught in a cross-fire of arguments.¹¹³ Some of the arguments, such as the view that a deduction is the wrong form of allowance because it produces income-variant effects, are not appropriately addressed to an allowance which is put forward to improve the definition of taxable income. For, just as a deduction is the proper form of allowance for business expenses and other costs of producing income, a deduction is the proper form for an educational expenditure seen as a business expense or cost of producing income. At most there is a paradox, not a real contradiction, in favoring income tax amortization by the student and opposing it by his family. Amortization to the student is a net income technique; to the parent, a subsidy.¹¹⁴ In reality, however, the choice of an appropriate tax allowance approach must be concerned not only with perfecting the definition of taxable income, but also with policy considerations concerning the wisdom of subsidizing educational expenditures and the importance of accommodating different taxpaying abilities. Therefore the following sections analyze some of the arguments for and against education expense accommodations or subsidies and examines the forms they might take.

B. Taxpayer Equity

Another important argument for a tax allowance for education

112. See text accompanying notes 87-95 *supra*.

113. The most prominent argument against a deduction is that it provides an upside-down subsidy to education with a greater benefit to high-income taxpayers, and hence a credit would be preferable. See, e.g., Heller, *U.S. Tax Policy for 1958*, 6 CANADIAN TAX J. 92, 95 (1958). (Heller then goes on to disfavor a tax credit as a subsidy also.) This comparison presupposes that a deduction and a credit are both intended as subsidies. However, a deduction may be proposed to perfect the definition of income and a credit proposed as an incentive and subsidy.

Even a tax credit can turn out to be income-variant to the extent it is expenditure-variant, and can lead to price effects that disadvantage poorer taxpayers.

114. See Wolfman, *supra* note 1, at 549.

expenses lies rooted in notions of fairness.¹¹⁵ Such an argument emphasizes the reduced ability to pay federal income tax of a taxpayer burdened with tuition and other education costs. For example, two families of equal size and wealth, each with \$20,000 adjusted gross income, are in very different positions if the three children of one, but none of the other, are in college, vocational school or graduate school. Horizontal tax equity—that is, fairness among taxpayers similarly situated—and vertical equity, might be maximized by a tax allowance for the family with higher education costs.¹¹⁶

Education costs most certainly reduce discretionary or disposable income, and therefore resemble other expenditures, such as extraordinary medical expenses, charitable contributions, and casualty losses, for which a federal income tax allowance is given.¹¹⁷ Tuition bears some resemblance to these expenditures in ways relevant to the question of deductibility. Like an expenditure for medical care, for example, an expenditure on tuition is socially desirable; it is viewed by many taxpayers as a duty, a high priority expense to be borne for the benefit of one's children or other dependents; and the payment does reduce the capacity of the taxpayer to pay taxes and to spend on personal consumption. As such, the argument runs, the tuition deduction should be allowed. A lesser conclusion goes only so far as to say that an education deduction should be allowed only to the extent medical expense and charitable contribution deductions are allowed.¹¹⁸ Both horizontal and vertical equity—that is, fairness among taxpayers with different incomes—could thus be improved.¹¹⁹

115. Actually, tax equity in general is closely geared to the problem of perfecting the definition of taxable income; in any event, it can be viewed largely from that perspective.

116. See Krueger, *Comment*, 80 J. POL. ECON. S31 (1972) on the subject of who, student or family, should be treated as the "unit" for equity purposes and comparison.

117. See INT. REV. CODE OF 1954, §§ 213, 170 and 165(c)(3), respectively.

118. One of the most frequently heard objections to proposals for tuition credit legislation, on the floors of Congress and elsewhere, is that the tax base should not further be eroded. Desirable as a comprehensive definition of income would be, chances for eliminating many of its major erosions seem slim, despite the recent efforts of Congressman Wilbur Mills, Senators George McGovern and William Proxmire, economist Joseph Pechman, and many others. One might argue, therefore, that the advantages of a truly comprehensive tax base in principle outweigh the arguments for an education expense allowance, but that education expenditures are at least as deserving as existing deductions or exclusions that seem fated to remain, and, therefore, the education allowance should be added.

119. Former President Fels of Bennington College, in opposing the extensive use of student loans for repayment of higher tuition fees (especially necessitated at small, independent, liberal arts colleges like Bennington) argued that it would be

an abdication of our generation's responsibility to its children to allow them . . . to begin their mature lives saddled with the double debt of principal and interest. It is a contradiction of the ability-to-pay principle that underlies our tax structure to tax these youngsters equally, whatever their income

In opposition it may be asserted that an implicit tax allowance is already given for education expenditures since students are not taxed on the difference between what they pay in tuition and what an education actually is worth. Moreover, it may be asserted that education expenditures are inherently personal, "consumption-type" uses of income and hence should not be given any tax allowance either because these expenditures are more personal than medical, charitable, and other deductible items, or because medical and charitable expenses, too, should be disallowed. Of course, the Internal Revenue Code does not limit deductions to "trade or business" and "income-producing" expenditures. The Code permits deductions for some nonbusiness expenditures or losses (medical, charitable, interest on personal loans,¹²⁰ taxes on personal property or consumption,¹²¹ casualty losses on personal property, bad debt losses on personal loans)¹²² while not allowing a deduction for others (recreation, food, shelter, ordinary medical expenses, non-casualty loss, consumption of personal property, artistic, social, and sexual activities).¹²³ Some personal expenditures are deductible mainly for economic reasons (interest on home mortgages,¹²⁴ taxes on personal residences¹²⁵), or, in important part, because the personal item is hard to distinguish from the income-seeking item (nonbusiness bad debts,¹²⁶ interest on loans whose proceeds are mixed with other assets and used for mixed purposes¹²⁷). Some personal deductions are allowed mainly to encourage and subsidize the activity (char-

or assets, for a part of their education.

Fels, *We Need Both Public and Private Colleges* in STUDENT FINANCIAL AID AND NATIONAL PURPOSE 82, 83 (College Entrance Exam Bd. 1962). This argument surely thrusts in the direction of tax credits or outright government vouchers, reimbursement or direct payments of education costs, if not government financing of all institutions of higher learning, coordinated with a tax system more closely geared to ability to pay. See also KAHN, *supra* note 3, at 16, where he briefly compares a depreciation allowance as an adjustment for equity in terms of relative capacity to pay with a credit as an investment incentive.

Even if higher investment be shown to be a good investment for society, "the returns [to education] do not distribute themselves on a one-to-one basis to the recipients." Consequently, a system of loans may not be sufficient. See Statement by Edward Sanders, Director, Division of Student Financial Aid, U.S. Office of Education, in TAXATION AND EDUCATION 158 (Proceedings of the Special Conference of the American Alumni Council, Feb. 7 & 8, 1966).

120. INT. REV. CODE OF 1954, § 163.

121. INT. REV. CODE OF 1954, § 164.

122. INT. REV. CODE OF 1954, § 166.

123. See generally INT. REV. CODE OF 1954, § 262. More specifically, see the limitations in § 213 (ordinary medical expenses) and § 165 (non-casualty losses of personal property and the \$100 floor on deductible casualty losses).

124. INT. REV. CODE OF 1954, § 163.

125. INT. REV. CODE OF 1954, § 164.

126. INT. REV. CODE OF 1954, § 166(d).

127. See INT. REV. CODE OF 1954, § 163.

itable contributions,¹²⁸ medical expenses¹²⁹). Sometimes the reduced ability-to-pay-taxes rationale predominates (personal casualty and theft losses¹³⁰). Elsewhere, limitations on the amounts deductible, or limits on the form of deductibility, suggest that Congress has compromised between a deduction-denying view of the item as personal and a full deduction-granting view of it as a cost of producing income.¹³¹ Or, some limits may simply suggest an unwillingness further to lighten the tax burden.¹³²

It certainly may be argued that education expenditures are as desirable and as beneficial, socially and economically, as charitable contributions or medical expenditures.¹³³ On the other hand, if education costs are viewed as semi-involuntary expenditures that reduce ability to pay taxes, they resemble some nondeductible items (food, shelter) for which at most a personal or dependency exemption is allowed,¹³⁴ but they also resemble some costs for which a deduction is allowed (casualty loss of personal property, personal bad debt loss) or for which a deduction in the form of an exemption is allowed (support of dependents, old age, blindness).¹³⁵ In short, the tax law's variegated treatment of personal expenditures offers no clear guidance for handling education costs.

Equity considerations also invite a comparison between expenditures for public and private schools. Without an income tax allowance, families whose children attend high-tuition private colleges and universities are disfavored by the overall tax system. Students at low-tuition state schools receive untaxed "scholarships" in the form of discounts on the price charged them for their education. And the state taxes paid by their parents (and by all taxpayers, including the parents whose children attend expensive, private schools) to provide the low-tuition public education are deductible for federal income tax purposes. In short, tuition paid to a public school in the form of taxes is

128. INT. REV. CODE OF 1954, § 170.

129. INT. REV. CODE OF 1954, § 213.

130. INT. REV. CODE OF 1954, § 165(c).

131. See, e.g., INT. REV. CODE OF 1954, § 214 (dependent care expenses) and § 166(d) (non-business bad debts).

132. See, e.g., INT. REV. CODE OF 1954, § 274 (disallowance of such items as expensive business gifts and some entertainment expenses), § 218 (political contributions), § 170 (percentage limits on charitable contribution deductions), and § 163(d) (limitation on interest on investment indebtedness).

133. Specifically, compare the non-deductible status of tuition with the deductible status of a charitable contribution to the same school to support its educational program. See Freeman, *Federal Assistance to Higher Education*, *supra* note 3, at 665. See also text accompanying notes 141-228 *infra* for a discussion of the socially desirable and economically beneficial attributes of a cost of education tax allowance.

134. See INT. REV. CODE OF 1954, §§ 151-153.

135. See INT. REV. CODE OF 1954, § 151(c)-(e).

deductible; tuition paid to a private college is not. This tax differential accentuates the unfairness of making the parents of private college students, and childless taxpayers as well, pay state and local taxes to finance the education of students at public universities. Consequently, the argument goes, some or all of the tuition paid by families of students at private schools should be deductible from federal and state income taxes to help narrow the tax advantage enjoyed by families who pay no tuition and whose state taxes are deductible.

It seems by no means clear, however, that notions of tax equity require this result. For one thing, both sets of parents do pay state and local taxes and gain a deduction therefrom.¹³⁶ To be sure, the parents of a private school student do pay more, taxes plus tuition, than do the parents of the public university student. But the excess can appropriately be categorized as a personal consumption expenditure which they are free to make or not. Since their children presumably could attend public colleges and get much the same benefits, tuition-free, as those enjoyed by the families of children attending public school, they are not being treated unequally by the tax law. At most, the private school parents can complain that the price of sending their children to private school is not only added on top of their state and local tax bill but is not deductible and hence must be paid out of income after taxes. This is not so much an argument about equality or distributive justice as it is a prayer for relief on grounds of ability-to-pay.

To be sure, the absence of their children from public schools reduces the total cost of public education in that state, thus reducing the state and local tax bill for parents of public school students—for which the private school parents naturally enough think they deserve a tax reward. The private school parents also benefit, as taxpayers, from the reduced state or local taxes, but the amount of their benefit pales in comparison with the tuition they pay. Still, their argument should be addressed to the state and local tax and school system, it would seem, more than to the federal income tax. Their complaint does not focus so directly on a comparison between the deductibility of state and local taxes and the nondeductibility of tuition as it does on the perceived injustice of supporting no-tuition state colleges out of general state and local taxes, while providing less aid or none at all to private schools.¹³⁷

136. The federal income tax deductibility of state and local taxes produces an income-variant effect, thereby adding another element of regressivity to the federal-state tax system taken as a whole. A tax credit instead of a deduction, or a high-income phase-out of the deduction, for state taxes could counteract this impact.

137. Although this discussion has focused on a comparison of the burdens borne by parents of private school students and parents of public school students, the com-

To the extent the complaint of private school parents is based on unfairness in the federal tax system itself, the argument is that the tuition-free education received in public universities is not included in the gross income of those students or their families, while the earnings necessary to pay private school tuition are included in family income and not taken out again by a deduction, credit, or other allowance. This argument has some force, but its logic would also increase the tax bill of private school parents as well, since private school students also receive their education at a great discount, a discount that should be taxable if the bargain element at tuition-free or low tuition state schools is to be counted as income.¹³⁸ Whether any such inequity appears, in a comparison between non-deductible tuition and, for example, deductible charitable contributions and taxes, must be gauged with account fully taken of the income tax subsidy enjoyed by those who receive education at a discount that is enjoyed free of federal income tax.

In any event, the arguments based on horizontal and vertical equity within the tax system do not require a federal income tax allowance to make the correction. Direct subsidies in cash or vouchers from the government, or a tuition increase at public colleges, or other non-tax changes could address the perceived inequity.

If a net inequity is determined to exist and if a federal income tax allowance is chosen to correct it, the form of allowance need not be income-variant merely because other personal expense allowances in the tax law have this character. Better, an effort should be made to reform the other personal, nonbusiness tax subsidies (such as charitable contributions and medical expense and casualty loss) into a non-variant form, a credit instead of a deduction, and add the education allowance as an equal counterpart.

In sum, equitable arguments for a cost-of-education tax allowance appear inconclusive. The amount of the tax subsidy given for below-cost or below-value education is uncertain, the externalities and nonfinancial and consumer benefits indeterminate and the "equities" not a matter of common consensus.¹³⁹ Even so, if and to the extent the allowance is to be justified on ability-to-pay and incentive or public policy grounds, it should be granted to whomever actually pays or bears the costs. It should vary with the amount of the cost borne, and

parative burdens also affect students, as members of taxpaying households, dependents of taxpayers, taxpayers themselves, and future or past taxpayers.

138. See note 78 *supra*. The discount is further increased and made income-variant by its implicit exclusion from federal income tax. On the subject of costs per student and the discount at which education is priced in the U.S. and other countries see Harris, *Student Financing and Enrollment in Higher Education* in *FINANCING OF EDUCATION FOR ECONOMIC GROWTH* 213 (L. Reifman ed. 1966).

139. See generally Nerlove, *supra* note 98, at S191-93.

perhaps should vary (directly, not inversely) with adjusted gross income or some other measure of taxpaying ability. The Ribicoff-Dominick-Hollings tax credit plans bear these characteristics, suggesting that their *raison d'être* may lie largely in the "ability to pay" and the tax equity arguments, or at least that their underlying philosophy has become thickly overlaid by such considerations.¹⁴⁰

C. Subsidizing Education

A tax allowance for higher education expenses has been advocated on the ground that education is a "good thing," which government should support.¹⁴¹ The Senate's debates on tax credit bills carry this flavor, but do not refine the argument much further.¹⁴²

The theory, as indicated earlier, asserts that education can appropriately be viewed as a form of investment in human capital, just as the construction of a milling machine to be used in manufacturing constitutes investment in capital of another kind.¹⁴³ So, just as the investment tax credit¹⁴⁴ attempts to induce investment in milling machines and similar instruments of production, either because such capital and investment are regarded as a "good thing" or because such investment leads to other "good things" such as increased employment, incomes, and real welfare gains, a tax subsidy or direct expenditure subsidy for education may have similar incentive goals.¹⁴⁵ Or the aim

140. The legislative history and floor debates suggest that notions of equity and a concern not to benefit well-to-do taxpayers have shaped the proposed legislation in recent years. See the legislative history cited in notes 2 & 19-21 *supra*.

141. Proponents of tax credit legislation have frequently acknowledged that one of their major aims is to subsidize education, whether through aid to students, their families or institutions of higher learning. See, e.g., *Federal Assistance to Higher Education*, *supra* note 3. CRISIS IN COLLEGE FINANCE?, *supra* note 3, at 187-235 (1965).

142. See Senate debates cited in note 2 *supra*.

143. See text accompanying notes 46-56 *supra*. The core concept of investment in human beings came as something of a revolution in economic thought. See Bowman, *The Human Investment Revolution in Economic Thought*, 39 SOCIOLOGICAL J. 113 (1966); Taubman and Wales remark that the proposition that education can be treated as an investment in human capital "has proved to be powerful and illuminating in its own right, and a major ingredient in studies of the sources of economic growth and distribution of income." Taubman & Wales, *Earnings: Higher Education, Mental Ability and Screening* (to be published in 81 J. POL. ECON. (1973)). This concept proposes that people enhance their capabilities as producers and consumers by investment in themselves and that not all of the economic capabilities of people are given at birth but can be developed through activities that have the attributes of investment. See SCHULTZ, INVESTMENT, *supra* note 35, at 62. See also Schultz, *Capital Formation By Education*, 68 J. POL. ECON. 571 (1960); T. SCHULTZ, *supra* note 46, at 38-63 (1963). See generally GOFFMAN, *supra* note 44, a very useful exploration of issues with many helpful references. Similarly, see W. HANSEN & B. WEISBROD, BENEFITS, COSTS AND FINANCE OF PUBLIC HIGHER EDUCATION (1969) [hereinafter cited as HANSEN & WEISBROD]; G. BECKER, HUMAN CAPITAL, *supra* note 46.

144. INT. REV. CODE OF 1954, § 38.

145. Other precedents for using tax credits to advance social or economic objectives

may be to redistribute education, or income, or to reallocate resources.¹⁴⁶ Some goals may be more than just economic—for example, encouragement of the diversity of educational forms that might result from further subsidizing private education.¹⁴⁷ In any event, the following discussion focuses on subsidizing education, rather than perfecting the definition of taxable income, with particular emphasis on economic theory.

1. *Private Rates of Return on Investment in Education*

One convincing piece of evidence that investment in education should be encouraged would be a showing that the private rate of return on private or public investment in education is high, or at least that it is higher than the rate of return on other investments. A comparatively high private rate of return on education investments suggests that education yields great productivity and desirable qualities in graduates. It suggests that highly educated people are in

include the retirement credit, designed in part to equalize other retired persons with those receiving social security and similar payments tax free, INT. REV. CODE OF 1954, § 37; the partially tax-exempt interest credit, *id.*, § 35; the foreign tax credit, *id.*, § 33; and the new limited credit for contributions to political parties, *id.*, § 41. A tax credit has been proposed by the American Medical Association for the purchase of private medical insurance policies ("Medicredit"). TIME, July 5, 1971, at 41. See generally Rice, *Tax Reform and Tax Incentives*, 34 LAW & CONTEMP. PROB. 782 (1969).

On investment in education generally and the equity-efficiency problems in particular, see *Investment in Education: The Equity-Efficiency Quandary*, 80 J. POL. ECON. S1-292 (T. Schultz ed. 1972). On educational investment and economic growth see GOFFMAN, *supra* note 44, at 51-63.

146. See generally Hoenack, *The Efficient Allocation of Subsidies to College Students*, 61 AM. ECON. REV. 302 (1971); T. RIBICH, *EDUCATION AND POVERTY* (1968).

A plea has been heard from small liberal arts colleges for changes in the distribution of financial aid to education because voluntary contributions by alumni, foundations, and corporations as well as government grants, fellowships, and trainee programs have concentrated on a relatively small number of institutions. See Blum, *Senator Humphrey's Tax-Credit Bill*, 39 J. OF HIGHER EDUCATION 479, 480-81 (1963). A subsidy as widely diffused as a tax allowance or a voucher or cash distribution to students might ameliorate this concentration. Blum even suggests that unless further sources of income are found, only a small percentage of independent liberal arts colleges will survive the pressure of rising costs. *Id.* at 482.

147. To determine whether an increase in education consumption or investment is desirable from an economic point of view, one must examine the nonfinancial as well as the financial, and the social as well as the private returns on education spending. See T. SCHULTZ, *supra* note 46, at 38-63, indicating that the social rate of return on education is high and that education forms an important source of economic growth. One must also consider whether education in general, or education of certain kinds and of certain people, should be subsidized. Additionally, one should consider whether direct government aid as distinguished from private action to stimulate education is desirable on balance, and, if so, whether a tax allowance rather than direct government spending, or regulation, or compulsion by law is the best technique. If so, one must go on to design that form of tax allowance best suited to the goal.

relatively short supply. In other words, there well may be underinvestment in education. However, this underinvestment can be expected to take care of itself in time, if the market is working well. The high private rate of return will draw more resources into education investment, unless imperfections in the market stand in the way. A persisting high private rate of return therefore suggests a market imperfection and a need to divert resources to the high return area from areas where they are less productively employed. To optimize investment, a subsidy could be used. Only after a look at all financial and nonfinancial private benefits and costs, and total social costs and benefits, however, could one finally size up the economic case for a subsidy.¹⁴⁸

Some indications can be found that investments in education bear a high rate of financial return to graduates, as high or higher than most other investments.¹⁴⁹ The studies in this area, however, are rife with

148. See generally GOFFMAN, *supra* note 44, at 11-24, 43-51.

149. To determine the rate of return on investment in education, the costs as well as the benefits must be ascertained. See notes 207-08 *infra* and text accompanying notes 148-91 *infra*. Part of the evidence consists of showing a correlation between high income and higher education. See CARNEGIE COMMISSION ON HIGHER EDUCATION, *A DEGREE AND WHAT ELSE? THE CORRELATES AND CONSEQUENCES OF A COLLEGE EDUCATION* (1972) (covering nonfinancial as well as financial income). Another study recently reported by the Bureau of Labor Statistics showed that lifetime earnings for men tend to rise with years of school completed, even though it was predicted that the job market for college graduates would tighten through the 1970's. See note 207 *infra*. Becker determined that the after-tax rate of return on college level education was about 10 to 12 percent, compared to about seven percent in manufacturing. G. BECKER, *HUMAN CAPITAL*, *supra* note 46. See also Becker, *Underinvestment in College Education*, 50 AM. ECON. REV. 346-54 (1960). Becker's 1960 paper, though it was based only on figures for urban white males, did include foregone earnings in costs and did attempt to adjust for differential ability. He found a private monetary rate of return for 1940 of 12 1/2 percent. The rate dropped to 10 percent for 1950, largely due to higher income tax rates. See R. GOODE, *THE INDIVIDUAL INCOME TAX* 86 n.10 (1964). Consequently, Becker concluded, there was a significant underinvestment in college education. Becker, Wilkinson, Bailey, and Schotta all found a private and social rate of return to investment in undergraduate education in excess of 10 percent. See sources cited in Bailey & Schotta, *Private and Social Rates of Return to Education of Academicians*, 62 AMER. ECON. REV. 19, 30 (1972) [hereinafter cited as Bailey & Schotta]. Other authors too have decided that investment in education yields a favorable rate of return compared with other investments, that higher schooling correlates with higher incomes and that altogether there is evidence of underinvestment. See J. INNES, P. JACOBSON & R. PELLGRIN, *THE ECONOMIC RETURNS TO EDUCATION: A SURVEY OF THE FINDINGS* (1965) [hereinafter cited as INNES]; SCHULTZ, *INVESTMENT*, *supra* note 35, at 44-45; Griliches & Mason, *Education, Income and Ability*, 80 J. POL. ECON. S74 (1972); Hansen, *Total and Private Rates of Return to Investment in Schooling*, 71 J. POL. ECON. 128 (1963); HANSEN & WEISBROD, *supra* note 143, at 17-40; Miller, *Income and Education: Does Education Pay Off?* in *ECONOMICS OF HIGHER EDUCATION* 129 (S. Mushkin ed. 1962). For an excellent bibliography on the economic value of education and on its costs and other aspects, see T. SCHULTZ, *supra* note 46, 71-89 (1963).

On the economic returns to an investment in legal education, see Katzman, *Economically Speaking . . . Is A Legal Education Worth the Price?*, 54 A.B.A.J. 979 (1968), concluding that it is worth the price, even after taxes. On intangible benefits

theoretical and empirical difficulties. Correlation between high degrees and high incomes, for example, might be attributable to a screening process¹⁵⁰ or to unidentified common causes,¹⁵¹ rather than to increased productivity stemming from education.¹⁵² And it is difficult to adjust properly for differences in inherited ability, individual motivation, social class, on-the-job training, and other factors that correlate with life incomes. Nevertheless, a review of the economic literature leaves a residual conviction, which accords with anecdotal and impressionistic evidence, that education does contribute to higher income.¹⁵³

of a college education, see A DEGREE AND WHAT ELSE? THE CORRELATES AND CONSEQUENCES OF A COLLEGE EDUCATION, *supra*. In contrast, on the returns to post-graduate education, see Bailey and Schotta, *supra*, at 19.

However, caution has been urged in interpreting data showing a relatively high rate of return on educational investments. See Miller, *supra*, at 130-33. Becker's data have been interpreted to show only a disparity of one percent between the rate of return on education (nine percent) and on business capital (eight percent), without regard to indirect benefits and with the assumption that all costs are investment, not personal consumption. See Rivlin, *Research in the Economics of Higher Education: Progress and Problems* in ECONOMICS OF HIGHER EDUCATION, *supra*, at 357. Very recently, Schultz has expressed the conclusion that the private rate of return for investment in higher education can be compared with the private rates of return to other private investments. Schultz, *Optimal Investment in College Instruction: Equity and Efficiency*, 80 J. POL. ECON. S2 (1972).

150. "Screening" serves as a shorthand term for any process, including a certification or licensing device or a legitimate or unfounded bias that makes lack of education a barrier to entry to high-income occupations. See Taubman & Wales, *supra* note 143.

151. See generally Becker, *Comment*, 80 J. POL. ECON. S252 (1972); Griliches & Mason, *Education, Income and Ability*, 80 J. POL. ECON. S74 (1972); Hause, *Earnings Profile: Ability and Schooling*, 80 J. POL. ECON. S108 (1972); Solmon, *Schooling and Subsequent Success: Influence of Ability, Background and Formal Education* (unpublished manuscript to be included in a forthcoming book edited by Lewis Solmon and Paul Taubman); Taubman, *Comment*, 80 J. POL. ECON. S104-07 (1972); Weisbrod, *Comment*, 80 J. POL. ECON. S139 (1972).

152. See Taubman & Wales, *supra* note 143, at 1.

153. For an intelligent survey of the literature and problems, see Blaug, *The Rate of Return on Investment in Education* in ECONOMICS OF EDUCATION 1, 215, *passim* (M. Blaug ed. 1968). See also, marshalling the American evidence, G. BECKER, HUMAN CAPITAL, *supra* note 46, at 88; Solmon, *supra* note 151; Taubman & Wales, *supra* note 143 (finding some surprising inverse correlations between more schooling and higher incomes and emphasizing the "screening" role of higher education). See also INNES, *supra* note 149; HANSEN, EDUCATION, INCOME AND HUMAN CAPITAL, N.B.E.R. STUDIES IN INCOME AND WEALTH, No. 35 (1970), reviewed in 10 J. ECON. LIT. 111 (1972).

Recently, Professor Henry M. Levin of the Stanford University School of Education attempted to compute the cost of dropping out of school, in a study made for the Senate Select Committee on Equal Educational Opportunity. Focusing on the 3,180,000 American males who in 1972 were between 25 and 34 years of age and who had failed to win a high school diploma as of 1969, he determined that dropping out would cost them \$237 billion (about \$74,000 each) because of lower incomes during lifetime. He ascertained that the government also lost; it would have cost \$40 billion to complete the dropouts' education, but the tax revenues on their higher incomes would have been \$71 billion. See TIME, May 27, 1972, at 49.

If anything, some of the studies probably understate the return rate on investment in education by treating all expenditures on education as costs of producing future income, thereby overstating costs, and by ignoring or underestimating the current and deferred consumption and nonfinancial benefits of education. These benefits may take the form of psychic pleasure, prestige, the intangible but real benefits of literacy and good citizenship, increased pleasure in social and recreational activities, and the like.¹⁵⁴ It is possible that these nonfinancial factors escape the attention of, or at least are not given due credit by, a person contemplating higher education.¹⁵⁵ But if it can be shown that ad-

154. Some have asserted that rate of return analysis is fallacious because it fails to quantify the intangible benefits of education. Since rate of return analysis does attempt to take into account some external benefits, however, its inability to calculate the more intangible benefits neither renders it useless as an analytic tool nor relieves the policy-maker of the duty of making judgments about the noneconomic benefits of education. See generally HANSEN & WEISBROD, *supra* note 143, for a conceptual framework useful to a noneconomist.

155. GOFFMAN, *supra* note 44, at 20-24. The difficulty in dealing with nonfinancial benefits and costs is a prime source of imperfection in educational investment decisionmaking. Nonfinancial costs and benefits, to the graduate (private) and to society (social), may take the form of psychic pleasure or pain, diminished criminal behavior, loss of status or gain of prestige, increased (or decreased) pleasure in the social, recreational and personal dimensions of life, education in consumption (how to spend money effectively), an option to continue with further education, wider employment possibilities, a hedge against technological change, and a variety of nonmarket benefits. Failing to weigh these factors, or weighing them "incorrectly", may distort the investment decision. A boy who wants to be a doctor even though he would in most respects be more productive and happier as a lawyer or as a farmer, may overinvest or underinvest or otherwise inefficiently invest in education.

An excellent presentation of the nonfinancial benefits of education may be found in HANSEN & WEISBROD, *supra* note 143, at 7-16; Bowman, *Social Returns to Education*, 14 INT'L SOCIAL SCI. J. 647 (1962); Weisbrod, *External Effects of Investment in Education* in ECONOMICS OF EDUCATION 1, 156, *passim* (M. Blaug ed. 1968). Psychic income and other nonfinancial benefits are given a conceptual analysis in Nerlove, *supra* note 138, at S178. See also Simon and Ellison, *Does College Make a Person Healthy and Wise: A Social Psychiatric Overview of Research in Higher Education*, July 1972 (unpublished manuscript to be published in forthcoming book by Lewis Solmon and Paul Taubman).

At least until recent years, Americans popularly held the view that more education is a "good thing" and there almost cannot be too much of it. Educated Americans, and educators especially, felt that education was the key to the good life. Apart from higher productivity and, perhaps, higher incomes, the benefits of education were thought to include noncognitive development in such qualities as self-discipline, leadership and socialization, growth in ineffable qualities of the spirit, and humanistic and cultural levels of sensibility and pleasure exquisite in their exercise but denied to one without higher education. If that is what life and education in fact are like, underinvestment in education can be expected to persist, unless potential students can somehow be brought dimly but convincingly to perceive that nonfinancial joys and rewards lie just beyond the limits of their ability fully to comprehend and experience. It is certainly possible that many a person has foregone a better life (in nonfinancial terms) when he has decided against spending more on higher education. Also possible, however, is a persisting overinvestment in education by people who are led to exaggerate the nonfinancial rewards (or to underestimate the costs) of a college or

ditional benefits are captured by the individual student or his family in nonfinancial forms, the case for underinvestment is strengthened.¹⁵⁶

Underinvestment, if shown, could be the product of a bias in the tax law against investment in human capital, or could result if private returns to such investment fall short of social returns—that is, if society captures some of the benefits.¹⁵⁷ Nonetheless, the high level of private return to education, in nonfinancial as well as financial forms, suggests that there is an underinvestment in education.¹⁵⁸ From this conclusion, it is a short, though not a trouble-free, step to assert that to optimize investment, government should subsidize this high rate-of-return area of the economy.¹⁵⁹

graduate degree, or stemming from instances in which the private rate of return exceeds the social rate. Lack of information, failure correctly to perceive and approach the problem in nonfinancial as well as financial cost-benefit terms, or irrational influences that lead one to disregard or override the advice of such an analysis have led to overeducation for some.

Overinvestment in education seems indicated by the research of Taubman and Wales. Overinvestment, they note, could occur if the private rate of return to education is higher than the social rate, due to screening (which redistributes income by limiting supply), snobbery, or other market defects. See Taubman & Wales, *supra* note 143. However, this effect could be more apparent than real if there occurs an understatement of private costs or of social benefits of education.

Some attempts have been made to concretize and quantify some of the nonfinancial benefits of education to the educated person (internalized) or to others (externalized). One simple example has suggested itself—how much does a sophisticated tax system depend on literacy among the taxpayers? When taxpayers fill out their own tax returns, they use the benefits of their education, save money that otherwise would pay a tax advisor or accountant, thereby earning income once estimated at \$250 million per year (though it does not appear on their books or in national accounting as income) and, possibly, all enjoy a better, fairer, more efficient tax system than otherwise would be feasible. See Weisbrod, *supra* note 155, at 169.

156. See, e.g., INNES, *supra* note 149; SCHULTZ, INVESTMENT, *supra* note 35. Becker, *Underinvestment in College Education?*, 72 AM. ECON. REV. PROC. 346-54 (1959). See generally, as to nonfinancial internal (private) benefits, GOFFMAN, *supra* note 44, at 20-24; HIRSCH et al, SPILLOVER OF EDUCATION COSTS AND BENEFITS (1964); B. WEISBROD, EXTERNAL BENEFITS OF PUBLIC EDUCATION (1964). But see Taubman & Wales, *supra* note 143, concluding that if the supply of savings is fixed and if no allowance for externalities or consumption benefits is included, society has invested too many resources in education, compared to investment in physical capital. They also conclude that screening makes rates of return at the collegiate and other levels higher than they would be if free entry into high paying occupations existed. This causes an income redistribution effect that strengthens their conclusion that there is overinvestment.

One study indicates that the pecuniary private and social rates of return on investment in graduate education by future academicians are very, very low. Only "psychic income" and the opportunity for an attractive life style can account for the loss taken by a graduate student. See Bailey & Schotta, *supra* note 149, at 30.

157. SCHULTZ, INVESTMENT, *supra* note 35, at 44-45.

158. See text accompanying note 148 *supra*.

159. SCHULTZ, INVESTMENT, *supra* note 35, at 146; G. BECKER, HUMAN CAPITAL, *supra* note 46, at 117.

The mere fact that education is deemed to be a desirable activity or investment

When considering the case for a government subsidy, it is insufficient, of course, just to consider private benefits. Benefits to society, or externalities, must also be taken into account—that is, the total social rate of return must be considered.¹⁶⁰

Paradoxical though it may be to subsidize an area of the economy that enjoys high private rates of return on investments, a subsidy is called for if total social returns (including private returns) exceed to-

does not alone support the conclusion that education should be subsidized. If education, viewed as an investment, yields a high pay-off to people who invest in themselves, the high pay-off will lead to greater investment—given a free market situation—and an appropriate new equilibrium. Underinvestment in education will not long persist and no subsidy would be called for.

However, if the market does not operate freely, a subsidy may be required in order to correct for some imperfections in the market. For example, underinvestment in education could be expected to persist if there are large, net external benefits generated by education. The failure of the market to internalize all the benefits of education, to pay-off the investor, will cause aggregate underinvestment. However, the presence of net external benefits would serve as persuasive evidence of underinvestment only in a market that had no other imperfections or artificial influences, such as subsidies. But education is heavily subsidized—by below-cost pricing and the income tax's unstated exclusion. So the mere presence of net external benefits does not prove that underinvestment exists and that a subsidy is needed.

Market imperfections other than externalities could cause underinvestment in education—for example, a lack of information, liquidity problems, inability to insure against loss, risk aversion, or other barriers to entry into education. Steps to correct the imperfections would seem preferable to a subsidy.

If the private rate of return on educational investment is higher than the average rate of return on investment, one reason may be that the access price is too high for many potential investors. If this is in fact the reason, it means that low-income status is a self-perpetuating phenomenon. Since that is (presumably) socially undesirable, the access price should be lowered, either across-the-board, or for low-income families, through the technique of subsidization. Even if the private rate of return on investment in education is no greater than the rate of private return on other types of investments, or perhaps even lower, a subsidy could be needed. For if the social rate of return is very high it, together with the private of return may more than justify increased investment.

160. In some usages, the term "social rate of return" includes benefits, whether financial or nonfinancial, to persons other than the investor in education (externalities) as well as benefits to the investor himself (internalized benefits). Sometimes benefits from education are discussed in categories called "direct" and "indirect". See, e.g., Blaug, *supra* note 153, at 243-45. Indirect benefits would include spillover income gains to persons other than those who receive the education, spillover income gains to subsequent generations, nonfinancial advances such as supplying a convenient mechanism for discovering and cultivating potential talent, providing a means to assure occupational flexibility of the labor force, encouragement of lawful behavior and individual responsibility for social welfare, fostering political stability and transmission of a cultural heritage. Obviously, quantifying these benefits would be a formidable if not impossible task. Some indirect benefits perhaps can be quantified—the effect of better educated people on the earned income of the less well educated offers an example. *Id.* at 244. Other indirect benefits we cannot expect to quantify, yet they should not be ignored. For example, at least a minimum degree of literacy and of political stability are prerequisites to a market economy. See generally GOFFMAN, *supra* note 44, at 25-43.

tal social costs (including private costs) by a large margin—in other words, if the social rate of return to investment in education is a high rate.¹⁶¹ Necessarily then, the inquiry must turn to the externalities resulting from education.

2. Social Rate of Return

Education makes a significant contribution to economic growth and to society as a whole, in both financial and nonfinancial ways.¹⁶² Difficult as these benefits are to quantify or gauge even roughly, social returns to education should not be disregarded. Even experts who despair of quantifying the external benefits of education nevertheless believe that such benefits are an important component of the payoff on investment in education.¹⁶³ An examination of the economic externalities and geographical spillovers created by investment in education, factors that benefit other persons or society as a whole but not the student and therefore which tend to be disregarded by him or her as the investor, may help explain the alleged underinvestment in higher education¹⁶⁴ and aid in evaluating proposals for a tax subsidy.

In the language of economics, an externality consists of a favorable or unfavorable effect on one or more persons or firms that emanates from the actions of a different person or firm.¹⁶⁵ An external economy is a favorable effect; an external diseconomy refers to an external loss suffered by, or cost imposed upon, others. An externality is not confined to an individual economic unit but spills over to some of the rest of the economy, raising or lowering the level of real income and welfare generally.

Pollution of air or water is often cited as an example of an external diseconomy of manufacturing operations. A manufacturing firm that pours out smoke or effluents imposes costs on others that are not internalized in the firm's market transactions since this cost is not included in the price of goods sold. External economies may also result from individual or firm behavior. A commonplace example is the

161. To determine whether social rates of return exceed individual rates of return, social benefits must be compared to social costs and individual benefits must be compared to individual costs.

162. See note 156 *supra*; Goffman, *supra* note 44, at 25-43. See also notes 168-73 *infra* and accompanying text.

163. See Blaug, *supra* note 153, at 242-43.

164. See generally Baumol, *On Taxation and the Control of Externalities*, 62 AM. ECON. REV. 307 (1972). For a discussion of how sizeable external benefits not taken into account by the private decision-maker can undercut allocative efficiency and equity in the sense of income distribution, see B. WEISBROD, EXTERNAL BENEFITS OF PUBLIC EDUCATION 3-4 (1964).

165. See P. SAMUELSON, ECONOMICS 453 (8th ed. 1970).

desirable pollination of a neighbor's fruit trees by a beekeeper's honey bees.¹⁶⁶

Quite common are the externalities created by some government behavior. In particular, when government provides social benefits in the form of "public goods," such government activity creates external economic benefits. Many beneficial government activities are not rationed or priced because access cannot be limited; these usually create significant external economies. For example, a lighthouse is a "public good" since it warns all ships of rocks on the shore. Even if the lighthouse was originally built to warn government ships, its benefits spill over to all other ships using the sealanes. The benefits of the lighthouse cannot be rationed by price because no sailor feasibly can be barred from enjoying the benefits of the signal light's warning; the benefits are provided to additional sailors without additional cost.¹⁶⁷

Education produces significant externalities, both in the form of benefits and costs.¹⁶⁸ One commentator has observed that "while external effects are by no means confined to education, education is probably more likely to generate indirect benefits than any other single activity of comparable scope."¹⁶⁹ Among the more intangible benefits are advances in knowledge, a better informed electorate, a healthier populace, less crime, a convenient mechanism for discovering and cultivating potential talent, a means to assure occupational flexibility of the labor force, transmission of a cultural heritage, and enhancing the enjoyment of leisure by widening the intellectual and aesthetic horizons of the educated. Other benefits are more tangible and may be quantifiable—for example, spillover income gains to persons other than those who receive the education and to subsequent generations.¹⁷⁰ Without examining these and other externalities, it is impossible to reach rational conclusions about the real rate of return on investment in education since neither its

166. *Id.* at 151.

167. *Id.* at 166.

168. See generally Peacock & Wiseman, *Economic Growth and the Principles of Educational Finance in Developed Countries* in FINANCING OF EDUCATION FOR ECONOMIC GROWTH 89 (1966); ORGANIZATION FOR ECONOMIC COOPERATION AND DEVELOPMENT, ECONOMIC ASPECTS OF HIGHER EDUCATION (S. Harris ed. 1964); HANSEN & WEISBROD, *supra* note 143, *passim*; C. BENSON, THE ECONOMICS OF PUBLIC EDUCATION *passim* (2d ed. 1968) (esp. at 30 *et seq.* and a useful bibliography at 349); ECONOMICS OF EDUCATION 1, *passim* (M. Blaug ed. 1968); ECONOMICS OF EDUCATION 2, *passim* (M. Blaug ed. 1969); PERSPECTIVES ON THE ECONOMICS OF EDUCATION, *passim* (C. Benson ed. 1963) (esp. at 96-161); ECONOMICS OF HIGHER EDUCATION (S. Mushkin ed. 1962) (esp. A. Rivlin, *Research in The Economics of Higher Education: Progress and Problems*); T. SCHULTZ, *supra* note 46. More generally, on externalities and distributional considerations as reasons for government functioning in education, see DUE, GOVERNMENT FINANCE: ECONOMICS OF THE PUBLIC SECTOR 115-17 (1968).

169. See Bowen, *Assessing the Economic Contribution of Education* in ECONOMICS OF EDUCATION 1, 67, 85 (M. Blaug ed. 1968).

170. Blaug, *supra* note 153, at 244.

total cost or total benefits can be determined; neither will it be possible to discern why an underinvestment in higher education persists in a relatively free-market situation, and finally, whether government subsidization is therefore desirable.¹⁷¹ For example, consider a person who thinks about investing some amount—say \$20,000—to obtain a college education. Assume this person desires to be an inventor and after careful study concludes that a college education is an indispensable prerequisite. And, the study might even determine that the education would probably produce royalties or other earnings over the lifetime of this inventor that would exceed by \$120,000 the income he would have enjoyed had he foregone college and followed the most profitable career then open to him. The added income, the \$120,000, is an internalized financial benefit to him that he should consider when deciding whether to go to college. But it may be that his inventions would produce benefits worth millions of dollars to other people who could use the inventions directly or in making other products or in advancing public health. Not all of the financial benefits of his invention are captured by the market and returned to the inventor-investor.

The failure of all benefits from investment in education to return to the investor may cause (and explain) underinvestment in education. When a student or his family decides whether to invest \$20,000 in a college education they weigh the costs against the anticipated returns or benefits. Thus, the inventor might decide not to attend college, thereby accepting \$120,000 less in lifetime earnings (with a present value of, say, \$15,000 or \$25,000 after taxes) than he could have earned as an inventor. Yet society ought to see to it that he goes to college, even if society has to pay his way. For if society does pay the bill, it will, by hypothesis, reap a social return of millions on an investment of some \$20,000.¹⁷² If the inventor could be sure of reaping the millions, he might overcome his resistance and opt for college, but an additional return of \$120,000 over time and before taxes may not seem worth it to him, especially since uncertainties, not easily insured, usually are involved.

Because many effects of education inure to the benefit of people other than the potential student or his family, potential students may weigh the cost/benefit balance astutely for themselves but incorrectly from society's point of view. Too few students go on to college, it is possible, because the benefits (discounted for futurity, uncertainty, and future taxes) to them of higher education are outweighed by the costs to them, even though from society's point of view, the benefits to so-

171. See generally Nerlove, *supra* note 98.

172. As to increased tax revenues alone, see the study by H. Levin described in note 153, *supra*.

ciety or the economy as a whole would far outweigh the costs. Underinvestment in education results.¹⁷³

One cure for such underinvestment would be somehow to correct the market so that more, if not all, of the benefits of education are captured by the graduate.¹⁷⁴ Another approach would be a subsidy for students or colleges through the tax and transfer system, to reduce the costs that must be borne by those who invest in it or consume it. A tax exemption or credit for students or their families would be one way to reduce the private costs of education.

3. *Determining and Defining Costs of Education*

Just as it is difficult to determine, define, and measure the benefits of education, many difficulties inhere in determining costs of education, for purposes of calculating rate of return.¹⁷⁵ Costs of education include internal personal costs as well as external social costs, the latter, of course, being the most difficult to quantify and evaluate. A government expenditure or a tax subsidy is a prime example of a social cost.¹⁷⁶ Less visible social costs are the opportunities foregone by in-

173. The significant external benefits, both financial and nonfinancial, created by education provide one of the best reasons for giving a government subsidy. See Nerlove, *supra* note 98, at S178, S191-93. Also, the kinds of externalities perceived can suggest a focus for the subsidy. By way of example, if one thinks education helps parents transmit culture, knowledge, and skills to their children, and if one believes that mothers play a preeminent role in this transmission, women should arguably receive a greater education subsidy than men. See *id.* at S196. Similarly, if one believes that population growth should be controlled and that more higher education gives women more opportunities outside the home, which in turn decreases the birth rate, the subsidy may be appropriate. *Id.* at S189-90. In general, intergenerational equity and welfare also must be given regard when evaluating a proposed subsidy. More cannot be said here about the complexities of this question, however. See Pechman, *infra* note 192; Bowles, *infra* note 194.

174. If such additional benefits are not found, or surmised, it would be hard to explain persistent underinvestment in education, except perhaps by lack of foreknowledge (uncertainty), lack of liquidity, aversion to risk, the uninsurability of an education investment, internal nonfinancial costs and lack of adequate security for borrowing. These other causes, if established, would suggest other techniques, for example, tuition-postponement plans with a buy-out provision or with repayment geared to income, or greater publicity of educational opportunities and advantages. Of course, these techniques have problems of their own.

175. As to costs of education generally, see T. SCHULTZ, *supra* note 46, at 20-37. See also text accompanying notes 125-28 *supra*.

176. Given certain assumptions, education subsidies in 1971 deprived the federal government of \$550 million attributable to the additional exemption for students, \$275 million due to deductions of contributions to educational institutions, \$110 million due to the exclusion of scholarships and fellowships, and \$700 million due to the exclusion of certain veterans benefits, some of which may be educational support. See the latest tax expenditure budget of the U.S. Treasury attached as Appendix D to a Statement of the Honorable Edwin S. Cohen, Under Secretary of the Treasury, before the Joint Economic Committee, Congress of the United States, July 21, 1972. No figures were given for some of the implicit or unstated tax preferences enjoyed by education.

vesting in education rather than in other fields.¹⁷⁷ To the student, this means foregone income; to society, it means foregoing the student's net productivity (which may exceed or fall short of his foregone earnings). The most obvious personal cost of higher education is tuition and other educational fees paid by the student or his family.

Earlier passages have discussed what items should be included as costs when the purpose is to delineate what should be offset against gross income to perfect the definition of taxable income.¹⁷⁸ The question of what are the costs of education may differ, however, when the purpose of the inquiry is to determine the amount of a tax allowance that should be given to subsidize education. Foregone earnings¹⁷⁹ or the added expense of living away from home, for example, can be viewed as "costs" worthy of a subsidy designed to encourage education more readily than they can be viewed as costs of producing income. In fact, the failure to regard foregone income as a cost amounts to a failure to recognize one, if not the most, important impediment to college attendance, especially among low-income families.¹⁸⁰ For such families, it is often not enough for scholarship or government aid programs to relieve the burden of actual cash outlays for education. The family has come to depend upon the earnings of some or all of its children, particularly the older children, for family support and possibly for meeting educational costs of brothers and sisters. As a practical matter, unless a substitute is found for the foregone income, many working young people from such families will have to do without higher education.¹⁸¹

When the focus was on the goal of perfecting the definition of

177. The costing of capital formation by education is discussed in T. SCHULTZ, *INVESTMENT*, *supra* note 35, at 78-101. He essays an estimated calculation of resource costs of organized formal education in the United States, emphasizing foregone earnings of students and the resources to provide schools.

178. See text accompanying notes 87-95 *supra*.

179. As to income foregone as a cost to graduate students in particular, see Bailey & Schotta, *supra* note 149, at 19.

180. See, e.g., HANSEN & WEISBROD, *supra* note 143, at 41-54; Nerlove, *supra* note 98, at S178, S181. Obviously, foregone income constitutes a higher proportion of the cost of going to college at a public institution that charges little or no tuition than it does at a higher tuition institution. Scholarships can only partly equalize the two competing kinds of institutions.

181. See notes 60-63 *supra* and accompanying text. A taxpayer who foregoes income while working at the business of being a student fails to receive not only the dollars that would have gone back to the government in the form of income tax but also fails to receive the dollars that would have been retained after the imposition of an income tax rate less than 100 percent. In other words, the student who foregoes a salaried job in order to attend college or graduate school is out-of-pocket the dollars that would have remained as his take-home pay, net of income taxes, payroll taxes, and other levies. Also, his earning ability at part or even full-time jobs while in school probably falls short of the wages he could command were he not in school. See Nerlove, *supra* note 98, at S181. This is a real opportunity cost borne by the student.

taxable income, the denial of a tax allowance for foregone income seemed appropriate when balanced against the unstated exemption from tax of such foregone income. This argument is not as persuasive, however, when discussing the wisdom of a government subsidy. It is easy to conceive, for example, of a scholarship or fellowship program that would cover not only out-of-pocket expenditures for tuition, but also the student's foregone income and thereby permit payment of personal living costs not only for the student, but perhaps, in part, for his family as well. If such a direct subsidy is thinkable and appropriate, it should be no less appropriate when translated into a tax allowance intended to act as an incentive subsidy rather than to perfect taxable income.¹⁸²

One problem, of course, is how to treat the educational benefits that are not taxed—the unstated exclusions, such as the accrued but unrealized increase in a student's earning power, the psychic nonfinancial gains, and the ability to defer tax and spread it over a number of years.¹⁸³

182. By foregoing the net proceeds of salaried work, the student loses some economic resources which the tax law and transfer system may choose to take into account. If the tax system allowed a credit for foregone income (or for room and board expenditures when made, in effect, "out of" foregone income), the credit would serve to reduce the student's or family's income tax liability or to provide a refund, if the credit were treated like a credit for withheld taxes. See the Prouty amendment, described in text accompanying note 16 *supra*. When other tax allowances have been enacted to provide an indirect subsidy, to encourage socially desirable behavior, or to reflect a reduction in taxpaying ability, the tax system has departed from a strict net income framework. It might do the same for foregone income in an education subsidy.

183. See text accompanying notes 76-84 *supra*. A student whose lifetime earning power predictably increases by virtue of receiving higher education and a degree, or vocational or professional training, receives, enjoys, or accrues income during the period he obtains that training or at the moment of graduation or certification. For example, the law student who becomes a lawyer or the medical student who becomes a doctor upon receipt of a degree or certification or completion of additional training is wealthier at the end of his course of study than he was at the beginning; his ability to earn income, the amount of income that will or can come to him as a result of the same number of hours or the same approximate effort over his lifetime has increased. His capital value has risen, implicitly. Nevertheless, the tax system—for practical as well as perhaps for theoretical reasons—does not deem him to have realized income on the excess of this capital value increase over cost to him. He will not be taxable until such later time as cash or the equivalent of cash comes to him as a result of his efforts, which are made more productive by virtue of the education and training he has received. Psychic income, the consumption benefit of education at the time or later, is never taxed. This "unstated exclusion" for income that is just as real and, in theory, just as taxable as a cash salary, is a very important characteristic of our income tax structure and one which operates favorably for students, their families and other participants in the educational process. The unstated exclusion acts in some respects as a deferral of tax liability (or as immediate depreciation, since foregone earnings are implicitly subtracted from accrued taxable income). The deferral of tax and spreading it over a number of years, even if the student later enjoys a fairly high income and rises fairly high in the graduated rates of our tax schedule, is a very valuable tax benefit to the student. For example, suppose that education increases a student's anticipated lifetime earnings by \$100,000. The present value of that \$100,000 in future earnings

It is sometimes argued that such subsidies are so great that they obviate giving an additional allowance for student expenditures such as tuition and room and board, not to mention foregone income.¹⁸⁴

Recognition of the existence and the magnitude of these unstated exclusions, however, does not necessarily undermine the arguments for a government subsidy or tax allowance for educational costs. For one thing, the unstated exclusion is given to all students, whether needy or not. Thus, if a purpose of the government expenditure or tax allowance is to help needy students gain access to education, a grant or an explicit tax allowance might be given on top of the unstated exclusion. Secondly, the unstated exclusion enables high-income taxpayers to avoid a higher marginal tax rate than that similarly avoided by low-income taxpayers. In other words, the unstated exclusion, like a deduction, has a perversely income-variant quality: it provides a greater financial benefit to those who presumably need it least. Thirdly, the unstated exclusion for the increase in net worth and income earning capacity of an educated person, not to mention the consumption benefit, resembles many other unstated exclusions that exist in our tax law.¹⁸⁵

is some lesser amount, suppose \$40,000. The present value of the additional future earnings should be regarded as income, if a "pure" income tax were in effect, to the extent it exceeds the price paid for it by the purchaser. If that price amounted to \$15,000, tax would have to be paid on the implicit capital gain of \$25,000 during the years of education or at least upon graduation and certification. The student and his family do not have to pay that tax at that time. However, if and when the student later earns \$100,000 more during his lifetime than he otherwise would have earned, it (theoretically) will be taxed as income to him. The real cost of that tax on the additional \$100,000, spread over the student's lifetime and arising in later years, probably will be much less than the real cost of tax paid during the years of education or upon graduation on the present value of that education.

184. Becker estimates that the value of these unstated exclusions, including the instant depreciation unwittingly permitted by excluding foregone earnings, far exceed the tax benefit that would result if some or all costs of higher education were allowed as costs of producing income and a truly comprehensive tax base were employed. The "instant depreciation" of untaxed benefits is more valuable, he claims, than the gradual depreciation of all costs if the subsidies were included in income when received and then capitalized for later depreciation or amortization. Becker also argues that since indirect costs amount to about 75 percent of the private costs of a college education, the depreciation unknowingly permitted by excluding foregone earnings (and not insisting on a really comprehensive, accrual basis, calculation of income), translated into present value, often exceeds that depreciation explicitly allowed on real property and machinery over five years or 10 years or longer. See BECKER, *HUMAN CAPITAL*, *supra* note 46, at 148-49.

185. For example, increases in value of assets such as securities, real estate, and tangible personal property usually are not taxed until a sale or an exchange for other property produces a "realization". The gains may go altogether untaxed if the property is held by its owner until death, since death is not presently treated as an event of realization and because the legatees or heirs take as their basis the fair market value of the property at the time of death of the original owner. See INT. REV. CODE OF 1954, § 1014. Notwithstanding such an unstated exclusion for a definite increase in

Although the unstated exclusion for educational benefits may seem a significant departure from an ideal, comprehensive definition of "income," it fits rather comfortably in our present tax law's definition of income. The unstated exclusion does not protrude as a conscious subsidy or an extraordinary tax benefit. In fact, to suggest a reversal of this long-standing unstated exclusion would be to advocate erecting a new, very substantial and almost anomalous tax barrier to education. And finally, it is hardly unprecedented for the tax law to grant a tax allowance on top of an unstated exclusion, such as the one that presently benefits students.¹⁸⁶

The economic rate-of-return literature makes it clear that there may be good cause for public concern about the adequacy of educational expenditures, for many reasons. Not all the economic benefits of education accrue directly to students; there are economies of scale in operating educational institutions; capital markets are not freely accessible to private individuals; students are not perfectly informed about job opportunities and payoffs on education; risks are not easily protected against or privately insurable; many talented candidates do not reach post-secondary school education; inequalities by race, income, sex, parental and social background persist; resources are not efficiently allocated (as they are not likely to be in the absence of full marginal cost pricing of educational service); obtainable gains are lost, and unnecessary costs are still borne.¹⁸⁷ Also, since only part of the costs of education are met directly by students or their parents, the rest borne by taxpayers, contributors, institutions, and others, the social rate of return on investment in education probably differs from the private rate of return.¹⁸⁸ Most importantly, the probable high social rate of return on education investments suggests that not enough is being invested there. Partly because society suffers most from this underinvestment, some sort of government subsidy seems appropriate. The student costs that should be covered may include not only tuition, but also room and board and perhaps even foregone income. There is an instinctual aversion to the anomaly of permitting a

wealth, additional tax benefits are provided (in the form of capital gains rates, among other things) in the event of income taxation upon such gains.

186. See, e.g., INT. REV. CODE OF 1954, § 117 (exclusion for scholarships and fellowships).

187. See Peacock & Wiseman, *Economic Growth and the Principles of Educational Finance in Developed Countries* in O.E.C.D., FINANCING OF EDUCATION FOR ECONOMIC GROWTH 89-101 (1966), excerpted in ECONOMICS OF EDUCATION 2, 343 (M. Blaug ed. 1969), examining the gap between the economic literature and the needs of policy-makers. See also Blaug, *supra* note 153, at 250; Nerlove, *supra* note 98, at S213-14, *passim*.

188. The term "cost" is not one of obvious or unvarying meaning even when viewed solely from the perspective of the student or family. See text accompanying notes 57-63 *supra*.

tax allowance for all these items in the context of our present tax law. But when government tax programs are seen as a scholarship or fellowship scheme, the anomaly may disappear.

More work remains to be done to determine the benefits of education and training. Currently there has appeared a "backlash" of public sentiment about education, and the notion that society may have overinvested in at least some kinds of education is becoming increasingly popular. Consequently, any government action should be mindful of a need to redistribute resources among educational processes or among persons, but perhaps should not be aimed at a broadscale increase in investment in education.¹⁸⁹ Most importantly, consideration of any future tax or expenditure subsidy must not ignore existing tax allowances and direct programs (basic opportunity grants, federally and state insured loan programs, grants to institutions)—that is, the full context of public finance of higher education.¹⁹⁰

Unfortunately, the economic literature does not carry the policy-maker all the way to his goals: a decision about increasing or reducing government subsidies to education, an evaluation of whether the social opportunity cost of education exceeds its benefits, or vice-versa, and whether there is a case for more, or less, public investment in higher education.¹⁹¹

The determination of what is a cost when designing a government subsidy (by expenditure or tax allowance) for the personal costs of higher education, therefore, should focus on the policies of the program and the specific goals to which the aid is addressed. Such goals include not only the perfection of the definition of income, taxpayer equity, and the subsidization of education as a "good thing," but also redistribution of income and education according to wealth, effort, and geographical location, correction of a misallocation of resources, and other economic and noneconomic goals, some of which will be considered in the following sections.

D. Redistribution of Income, Wealth, and Opportunity

The preceding material on subsidizing education to increase investment and consumption has concentrated on increasing higher edu-

189. See text accompanying notes 192-214 *infra*.

190. See R.W. HARTMAN, HIGHER EDUCATION SUBSIDIES: AN ANALYSIS OF SELECTED PROGRAMS IN CURRENT LEGISLATION (Brookings Reprint No. 247, 1972); H. BOWEN & P. SERVELLE, WHO BENEFITS FROM HIGHER EDUCATION—AND WHO SHOULD PAY (E.R.I.C. Clearinghouse on Higher Education, pub. by Amer. Assoc. for Higher Education, August 1972).

191. Alternative or supplementary approaches to the direct rate-of-return approach that has been emphasized in prior pages, such as the forecasting-manpower-needs approach or the residual approach, do not seem to offer or compel any radical change in the analysis or conclusions about the state of knowledge about, or educational

cation spending of all kinds and by all possible consumers or investors. A further possibility exists: an education stimulus may be desirable for some people but not for others. Accordingly, government might decide to use a tax allowance or a direct governmental expenditure to effect redistribution among persons¹⁹² according to wealth, according to the absolute or relative financial contribution by a student or his family, or according to geographical lines, sex, race, age, or on other bases. The redistribution might be an effort to redistribute education itself and in particular to increase access to education for underprivileged people or people who are underinvesting in education. Perhaps another goal might be to accomplish a redistribution of income and wealth by redistributing educational access and opportunity.¹⁹³ In other words, the aim might be to redistribute financial returns to education, non-financial returns, or both.¹⁹⁴ Wise policy-making necessarily requires an analysis of the extent to which redistributing higher education can accomplish such aims, as well as an examination of the costs involved.¹⁹⁵

planning for, tax allowances or expenditure subsidies. See Bowen, *supra* note 169, at 67, 73, 96.

192. See Pechman, *Note on the Intergenerational Transfer of Public Higher Education Benefits*, 80 J. POL. ECON. S256 (1972).

193. Schultz argues that allowing the returns from public investment in human capital to accrue to the individuals in whom it is made may stem from welfare goals having to do with reducing the unequal distribution of personal income among individuals and families. See SCHULTZ, *INVESTMENT*, *supra* note 35, at 46.

Schultz also concludes that education unmistakably changes the personal distribution of income, though the degree of departure from neutrality in education's effect on distribution of personal income is little understood. And, taken altogether, the financing of higher education may prove to be regressive—depending on how it is financed and who receives its benefits. Nevertheless, Schultz concludes that, on the evidence, gains in higher education have been instrumental in reducing inequality in the distribution of personal income. Thus, he argues for better economic incentives (of which a tax allowance could be one) and better information for those who make the personal spending decisions. *Id.* at 174-77. But see C. JENKS, *INEQUALITY: A RE-ASSESSMENT OF THE EFFECT OF FAMILY AND SCHOOLING IN AMERICA* (1972), and Bane & Jencks, *The Schools and Equal Opportunity*, SATURDAY REVIEW OF EDUCATION, Sept. 16, 1972, at 27, asserting that schools have few long term effects on the later success of students who attend them and arguing that quality education will *not* reduce socioeconomic inequality. See also TIME, Sept. 18, 1972, at 41; Stevens, *Harvard Study Disputes Impact of Schooling on Future Income*, N.Y. TIMES, Sept. 8, 1972, at 1, cols. 7 & 8. See generally *Investment in Education: The Equity-Efficiency Quandary*, 80 J. POL. ECON. 51 (Schultz ed. 1972), concentrating on the effects of education upon the distribution of personal income.

One additional possibility should be raised. Because of geographical spillovers and economic externalities, the ultimate redistribution of income may not correspond to the impact of a tax allowance or direct subsidy. In fact, it could happen that increased education for some would result in a net welfare increase for all, not just for the direct beneficiaries of the redistribution scheme and the resulting education. Cf. B. WEISBROD, *EXTERNAL BENEFITS OF PUBLIC EDUCATION* (1964).

194. See generally Bowles, *Schooling and Inequality from Generation to Generation*, 80 J. POL. ECON. S219 (1972); Becker, *Comment*, 80 J. POL. ECON. S252 (1972).

195. Of course, access to the commodity called higher education is limited by entrance requirements as well as by price, a factor that must not be ignored.

If redistribution according to wealth is the aim of a higher education tax allowance, it should be designed to provide greater help to low-income taxpayers than to high-income taxpayers. Consequently, an ordinary deduction or amortization for the costs of education, however those costs are defined, would be singularly inappropriate. Such a deduction engenders an income-variant effect, providing greater tax relief to high-bracket taxpayers than to low-bracket taxpayers, per dollar of eligible expenditure on education. Consequently, if income redistribution is the goal a tax credit would be more suitable. Even a tax credit could operate perversely, if it led to tuition increases that widened the education-opportunity gap between people of ample and those of inoderate or insufficient means. A refund feature could counteract this price effect in part. And, a tax credit could be made income-variant in the other direction, by phasing out its benefits for taxpayers whose incomes climb to higher levels.¹⁹⁶

The tax credit bills most prominently presented by Senators Ribicoff and Dominick and those approved by the United States Senate in 1967, 1969, and 1971 have included such a phase-out.¹⁹⁷ Nevertheless, some object that these bills would still provide greater benefits to higher income families. Since, below the point at which the income phase-out begins, families who can afford to send their children to more expensive schools would receive a greater tax benefit than families who send their children to schools charging so little that the total costs are less than the amount for which the maximum credit is available.¹⁹⁸ Thus, below the cut-off point, the credit would be expenditure-variant and therefore perhaps, indirectly at least, income-variant.

Few of the tax allowances presently found in the Internal Revenue Code phase out with higher income.¹⁹⁹ In fact, in most instances, the tax allowance increases with income.²⁰⁰ There does not seem to

196. A recent precedent for such a phase-out was established by new INT. REV. CODE OF 1954, § 214, which provides a deduction for child and other dependent care expenses that phases out as the adjusted gross income of the taxpayer climbs into the middle and higher brackets. See also Leong & Rhyne, *Hawaii's Inversely Graduated Tax Credits*, 22 NAT'L TAX J. 446 (1969).

197. See notes 2 & 19 *supra*, and accompanying text.

198. The 1971 Senate-enacted bill would begin the high income phase-out at \$25,000 adjusted gross income. Whether families had incomes above or below that amount, the amount of available credit would still vary, depending on the level of eligible education expenditures actually made by the taxpayer.

199. No high income phase-out applies to most of the business deductions or to the mixed or personal deductions. New § 214 for child care expenses is one exception. Also, the higher ceiling on the capital gains alternative tax under § 1201, and the treatment of tax preferences under §§ 56-58 produces a high-income phase-out effect, particularly in the \$30,000 floor on the minimum tax of § 56. See also the floor under the medical expense deduction in § 213(a).

200. See, e.g., INT. REV. CODE OF 1954, § 170 (charitable contribution deduction). The floor under the medical expense deduction of § 213 does rise with income

be any constitutional or structural barrier, however, to making an educational tax allowance vary inversely with income, either by an explicit high-income phase-out clause, or by making the allowance itself an item of income against which the graduated rates apply.²⁰¹ Or, a tax allowance can be designed not to vary at all with income, thereby appearing to be redistributively neutral.²⁰²

Taxpayers with little or no income tax liability will benefit only slightly, if at all, under a tax credit plan unless such taxpayers receive refund credits for part or all of the amount by which the credit to which they are entitled exceeds their tax liability.²⁰³ Although one might have thought that any credit plan would automatically provide for a refund, the early proposals were not so viewed, and indeed the same Senate that passed a non-refund tax credit bill rejected an amendment that would have added an explicit refund provision.²⁰⁴

In any event a federal income tax allowance can be designed to provide greater benefits for taxpayers with lower incomes, thereby redistributing educational opportunities, incomes, or both. In fact, the

and thus the amount deductible may be smaller for a high-bracket taxpayer than for a low-bracket taxpayer. Nevertheless, the fact that the allowance is in the form of a deduction means that each deductible dollar will save more in tax for the high-bracket taxpayer than for the low-bracket taxpayer. And, if a high-income taxpayer spends more, he may obtain a deduction equal to that of a lower-income taxpayer who spends less.

201. See note 9 *supra*. A taxpayer could instead be given a percentage credit with the percentage equal to the difference between his marginal tax rate and 100 percent. Thus, a 70 percent taxpayer would get a credit equal to 30 percent of eligible costs. A poorer taxpayer in the 10 percent marginal bracket would get a 90 percent credit. See *Federal Tax Incentives*, *supra* note 1, at 384.

202. An income nonvariant (income-constant) allowance could consist of a credit equal to a fixed percentage of eligible education costs, no matter what the taxpayer's income. Such an allowance would still vary with amount of expenditure and thus may be somewhat income-variant or high-income correlated. Compare the proposal of the American Association for the Advancement of Science, years ago, for an income-constant tax benefit for all philanthropic contributors, high- and low-income taxpayers alike. See S. HARRIS, *HIGHER EDUCATION: RESOURCES AND FINANCE* 320 (1962).

203. The income needed to take full advantage of a given tuition tax credit can be calculated by reference to the tax liability at different levels of income for families of different sizes. Tax liability begins when a family's income exceeds available deductions and exemptions. At the bottom rates, additional (and hence taxable) income of less than \$1000 would allow full advantage of a \$100 credit; still more taxable income would be needed for the family to take full advantage of a \$200 or higher credit. With several dependent children in college, a married couple would need to have substantial taxable income before a \$200 per child credit could fully be employed to offset tax. Credits would be wasted at lower income levels, unless a refund were available. Self-supporting students at the college or graduate level, with low incomes, might often fall in the group whose tax liability falls short of the credit. Similarly, those who borrow to finance their education would lose benefit of the credit. A carry-forward of the credit, if not a refund, might help some low-income taxpayers, such as students, who anticipate higher incomes later.

204. See notes 16-17 *supra* and accompanying text.

redistributive purposes of such legislation make a tax allowance in some ways more attractive than other forms of government aid, since the tax allowance can easily be integrated with the income and tax liability determinations made by a taxpayer.²⁰⁵ The best approach would probably be to couple a refund provision with a credit or deduction that is graduated to diminish as adjusted gross income grows. A flat tax allowance such as an additional exemption or a tax allowance in the form of a straight deduction for costs of education, on the other hand, would seem particularly unsuitable for purposes of redistribution.

If redistribution according to wealth is to be an important goal or subgoal of the education subsidy, and especially if the amount of subsidy given is to vary with the amount of costs borne by the student and his family, foregone income should not be ignored inasmuch as foregone income constitutes a high percentage of the costs of higher education, particularly for poor families who find it difficult to bear any educational costs at all.²⁰⁶

Unfortunately, the evidence is not convincing that redistributing education will enhance income equality. There are, of course, indications that lifetime earnings tend to rise with years of school completed,²⁰⁷ as do other benefits.²⁰⁸ The conclusion, however, that more

205. Of course, people whose incomes fall below the tax return filing requirements would have to be brought into the system or separately involved. Either course of action entails administrative and compliance costs, as does a direct grant program. It is by no means necessary, however, that a phased-out allowance be cast in the form of a tax allowance. Senator Pell, for example, has introduced a bill to provide students with an outright government scholarship grant, the amount of the grant being reduced by the amount of the tax liability of the student or family paid that year for the preceding year. (S. 659, 92d Cong., 1st Sess. § 142 1971). The theory of the Pell bill, of course, was to use federal income tax paid for the prior year as a measure of ability to bear the current costs of higher education. Deficient as such an approach undoubtedly is in view of the frequent lack of correspondence between tax paid and actual income or ability to bear the costs of higher education, the Pell proposal shows that a plan for an outright grant of money can be combined with the tax law's measure of income or ability to pay without turning the form of aid into a tax allowance or refund credit. My own critical evaluation of the Pell bill in 1971 appeared as McNulty, Some Comments on Section 141 et. seq., Part D, Title I of S. 659, Appendix A to Kerr, Some Comments on Pending Higher Education Legislation, Particularly as They Relate to Carnegie Commission Proposals (mimeo, Carnegie Comm. on Higher Education, Berkeley, Calif., distributed to members of the House and Senate Committees having interests in legislation affecting higher education, May, 1971).

206. See H. BOWEN, *THE FINANCE OF HIGHER EDUCATION* 5 (1968); notes 60, 181-82 *supra*.

207. See Fried, *Job Market for The College Graduate Projected as Tighter Through 1970's*, N.Y. Times, Sept. 25, 1972, at 1, col. 6 (summarizing a report by Herbert Bienstock, Middle Atlantic Regional Director of the Labor Department's Bureau of Statistics). See also Bailey & Schotta, *supra* note 149; Katzman, *Economically Speaking . . . Is a Legal Education Worth the Price?*, 54 A.B.A.J. 979 (1968).

208. See *How to Stay Married: Learn and Earn More*, Oakland Tribune, Sept. 22,

education yields more productivity and hence more income and that a subsidy to higher education could, therefore, counterbalance the disadvantages suffered by underprivileged groups is far from clear.²⁰⁹ If more higher education to low-income people cannot reliably be expected to produce more income and wealth for them, absolute or relatively, neither a tax subsidy nor an outright grant should be enacted with that purpose.

1. *Redistribution Among Persons According to Financial Effort*

Another possible goal of a federal subsidy for personal costs of higher education would be to provide greater help to those students or families willing to bear higher amounts or percentages of effort to meet education costs, as an incentive, reward or rationing plan. Such a system would provide matching grants corresponding, under some formula, to the amount contributed by the recipient. A tax credit or other tax allowance that varies directly and proportionately with the amount of expenditure made by the student or his family would be a simple matching scheme. Thus, under a tax credit plan, the credit (and possibly refund) would increase as education expenditures grew. A deduction system would also give a larger allowance for a larger expenditure, although the actual tax benefit would vary with income unless specially limited.

A federal subsidy might well be planned to correspond with the effort of the student or his family, effort measured not in terms of absolute dollars but rather as a percentage of the family's ability to pay. Thus, a student or family willing to spend a large percentage of its wealth or income on education would receive a larger subsidy than a family willing to spend only a small percentage of income or wealth, even though the number of dollars expended by the latter family were substantial.²¹⁰ Such a system would mean that the student in a very

1972, at 5, col. 1 (reporting a U.S. Census Bureau study). For a convincing and important cost-benefit study, with policy analysis, see T. RIBICH, *supra* note 146.

209. See generally C. JENCKS et al., *INEQUALITY: A REASSESSMENT OF THE EFFECT OF FAMILY AND SCHOOLING IN AMERICA* (1972); Solmon, *supra* note 151; Taubman & Wales, *supra* note 143. See also review by Barkin, 9 J. OF ECON. LIT. No. 2 (1971) of I. BERG, *EDUCATION AND JOBS: THE GREAT TRAINING ROBBERY* (1970) in which Berg argues that formal education is not necessarily the road to higher productivity.

210. With the suggestion in text, compare the "family power equalizing" proposal of Coons & Sugarman, *Family Choice in Education: A Model State System For Vouchers*, 59 CALIF. L. REV. 321, 328-29 (1971). Coons and Sugarman propose a larger "voucher" or other direct government expenditure or subsidy be given to a student or family that spends a higher percentage of adjusted gross income on education. For example, a student could get a \$100 voucher if he spent 1 percent of his adjusted gross income on educational costs (however defined). By spending 2 percent of his adjusted gross income he would be entitled to a larger voucher, according to a proportional or graduated formula, probably with some absolute limits.

wealthy family would receive relatively little or no subsidy since even a large expenditure would amount to only a small percentage of the family's total wealth or income. Of course, although it becomes a simple matter to structure a federal income tax allowance geared to adjusted gross income, it is much more difficult to make the subsidy vary with the taxpayer's effort as gauged by percentage of wealth, simply because the federal income tax system does not include a measure of wealth in its usual processes.

2. *Geographical Redistribution*

A higher education tax allowance could also be structured to provide subsidies that varied on geographical grounds. An attempt might be made to provide a larger amount of federal aid to students or families in or from relatively poorer states or from states that spend *less* on education. The purpose might be to raise the standard of education (and income) in areas targeted for a larger subsidy, or to help correct for deficient primary and secondary schooling. Another possibility might be to provide greater federal aid to families and students in or from states that spend *more* on education per capita, or which exert more effort (tax effort). Effort could be determined by comparing education expenditures with ability to pay as measured by the share of that state or area of gross or net national product or tax revenues. Thus, the federal aid would act as an incentive or reward for high levels of state and local government investment in education.²¹¹ A tax allowance, just like a direct expenditure or voucher plan, could be established under some sliding scale that would withdraw or add a percentage of benefits according to the geographical location of the student, his family, or the school. Whether the aid would go to the student, his family, or the school depends on the purpose of such a geographical scheme. It is not commonplace, however, for federal tax allowances to vary according to geographical location, and some questions might be raised about the propriety or even the constitutionality of such a system.²¹²

211. These problems parallel those involved in constructing formulae for revenue sharing or other grants from the federal government to the states. One proposal advocates a federal tax credit for new state taxes earmarked for education spending. This tax credit would then amount to implicit revenue sharing geared to the apparent new tax effort of the state for educational purposes. See note 28 *supra*.

212. Some efforts were made in 1971 to install some geographically circumscribed tax incentives for inner-city rehabilitation, job training in areas of high unemployment, and the like. Most did not become law. For one that did, see INT. REV. CODE OF 1954, §§ 40, 50 (work incentive program expenses credit). Some provisions of long standing have explicit or at least direct geographical definitions. See INT. REV. CODE OF 1954, § 165(h) (disaster losses), § 165(i) (property confiscated by Cuba). Other provisions draw lines between domestic and foreign investment, income, or transac-

In addition, although a federal income tax allowance for personal costs of higher education can be as well scheduled and graduated along geographic lines as can a direct government expenditure, voucher, or other form of subsidy, the economic evidence to justify such a policy decision is lacking.²¹³

Even when addressing the problems of distribution and redistribution of costs and benefits of higher education, some analysts have concluded that existing state tax systems and low-cost public education programs do not constitute an effective device for shifting costs more heavily to those most able to bear them. Some suggest a "user charge" based on ability to pay for higher education with generous supplements to low-income students.²¹⁴ Or, going further, they resort to the classical economic approach: optimal pricing of education, so that the price of a unit of education equals the opportunity cost of resources used to produce it and both equal the benefits provided by an additional unit of education.²¹⁵

Even though a tax mechanism can be designed to attempt to redistribute education or wealth, or at least to counteract the maldistributive tendencies of some forms of tax allowance for education, the question remains whether public educational policy should be the instrument for achieving society's equity goals. Arguably, a negative income tax would be a far superior instrument. Education then should be self-financed by rich and poor students and families alike, rather than subsidizing the poor who obtain higher education at the expense of not only the rich but also the poor who do not go on to higher education.²¹⁶

tions. See, e.g., INT. REV. CODE OF 1954, § 48(a)(2) (investment credit available for domestic property but limited with respect to property constructed or completed outside the United States); §§ 921-22 (Western Hemisphere Trade Corporations); §§ 991-97 (Domestic International Sales Corporations).

213. The territorial spillovers of expenditures by states and localities on education would complicate considerably the construction of a program of geographically varied aid even after target areas had been designated. See notes 232-34 *infra* and accompanying text.

214. See HANSEN & WEISBROD, *supra* note 143, at 83-86.

215. *Id.* at 87-98.

216. See *id.* at 98-103; Krueger, *Comment*, 80 J. POL. ECON. S31 (1972). Improvements in the capital market and perhaps some government intervention would be required to make extensive self-financing feasible. Other public goods, such as on-campus basic research, perhaps should be financed by the tax system, but these are quite separable from the redistributive purposes of an education cost tax allowance. See Nerlove, *supra* note 98, at S202-11.

One commentator has stated:

To the extent that the distribution of tax burdens for the support of education differs substantially from the distribution of education benefits, it is likely that education will be either undersupported or oversupported from an allocative-efficiency standpoint, given the existing preference structure and distribution of income and wealth.

E. Tax Allowances To Correct Misallocation of Resources

Possibly another aim of a federal subsidy for education, and in particular of a federal income tax allowance for the personal costs of higher education, may be to correct misallocations of resources. Such misallocations may be thought to exist between expenditures on education compared with expenditures on other commodities and investments.²¹⁷ Another perceived misallocation may be that the wrong people are getting educated or, at least, that there is not an efficient allocation of educational resources among possible recipients.²¹⁸ A further misallocation may be thought to exist between public and private education.²¹⁹

As he adds, an objective of education may be to change this distribution. Weisbrod, *Education and Investment in Human Capital*, 70 J. POL. ECON. 106 (Supp. 1962), reprinted in *ECONOMICS OF EDUCATION* 1, 156, 181 (M. Blaug ed. 1968). See also B. WEISBROD, *EXTERNAL BENEFITS OF PUBLIC EDUCATION* (1964) (on allocative efficiency as well as equity, distribution of income, and spillovers).

See REPORT OF THE ROYAL COMMISSION ON TAXATION (Carter Report) Vol. 2 at 6, 11, 142, 177 (1966) for a discussion of optimal resource allocation as a reason for government subsidy to education. To replace the deduction system in Canada, the Commission recommended a tax credit system, *id.*, vol. 3 at 110, 213, 229-33, 236-37, with a carry-forward provision to assist in borrowing and repayment of education loans. *Id.*, vol. 6 at 84-86. An analysis of the effect of the proposed tax credit on taxable income was also made. *Id.*, vol. 6, at 20-21, 23-28. See also GOFFMAN, *supra* note 44, at 28-32.

217. On rate of return analysis and implications for allocating resources to education, see SCHULTZ, *INVESTMENT*, *supra* note 35, at 132. The concept of human capital and theories about its accumulation by education have important messages for developing economies and for growth planning in any economy. *Id.* See also *ECONOMICS OF EDUCATION* 1, 351-424 (M. Blaug ed. 1968) (part V, Educational Planning in Developing Countries). Tax policy, as well as expenditure subsidies, obviously bears on these dimensions of the problem. The problem is beset by difficulties in estimating the consumption value of education, the costs of education and the private and social, financial and nonfinancial returns to investment in education.

218. Some evidence has been adduced to show that the quality of an educational institution, measured by student quality and instructional quality, can affect future earnings of students, especially their long term earnings or later-life earnings. See Solmon, *supra* note 151. This conclusion might justify subsidizing at different rates based on quality indications. The difficulties of doing so are, for the most part, not peculiar to the tax form of the subsidy.

219. A tuition tax credit has been supported on the grounds that it would enable colleges to increase their tuition prices to a level nearer costs, and thus contribute to a more efficient allocation of resources. This would also tend to equalize the tuition charges of private and public institutions, and modify the allocation of resources accordingly. See Blum, *supra* note 44, at 485; Carter, *supra* note 3, at 329. A tuition tax credit or other federal income tax allowance would encourage a shift of public school students to private schools. In turn, this shift would enable private schools to raise their tuitions. If the purpose of reallocation is to assist the private institutions, however, a subsidy to students is an inefficient form since it diverts a portion of the benefits to the students or families to induce them to make the shift. Institutional grants, if constitutional and otherwise workable, would avoid this inefficiency. Perhaps another possibility, in theory, would be a tax credit allowed only for tuition paid to private schools, or a larger tax credit given for payments to private schools than the

To correct such misallocations, federal tax or expenditure subsidies might be given to education generally, so as to reduce its price and increase its consumption. As an alternative, the government might elect to provide such a subsidy for certain forms of education, as it did in the post-Sputnik era with direct federal aid for scientific education. Government might attempt to provide such aid to certain people, such as children from poor families, members of minority groups, and other identified members of the population who, it is thought, have been denied access to or have invested too little in education.²²⁰

Another step toward correcting misallocation of educational resources would be to perfect methods for evaluating educational expenditures in terms of economic rate of return. Economic rate of return, of course, is a theoretical concept that may bear an imperfect relationship to the decision making of students and their parents in view of the importance often placed on various non-economic considerations, because of imperfections in the market such as lack of knowledge, uninsurable risks, externalities, nonfinancial benefits, and liquidity problems.²²¹ Reactions may be imperfect, and "malinvestment" in education undoubtedly will occur. Nevertheless, tax or expenditure subsidy techniques based on rate of return thinking can contribute to an efficient allocation of investment resources to education.²²² Ideally, one way to perfect such a reallocation would be to make the price of higher education either equal the full cost of providing the education,²²³ or subject to competitive market pressures.²²⁴ At

credit allowed for public school costs. In all likelihood, parochial schools as well as other private schools would benefit from the education tax allowance. Private schools established as part of a resistance campaign against school desegregation might also be aided, but that problem could be expected to arise mainly at the secondary and elementary levels, rather than at the point of higher education, and could be handled by a rule, based on constitutional requirements, that would deny a tax allowance for tuition at segregated schools.

220. This idea has been mentioned earlier as an aspect of redistributing income and wealth, but it also carries resource allocation and efficiency dimensions. A tax allowance, however, may be peculiarly ill-suited to entice talented lower income groups into higher education. See Cartter, *supra* note 3, at 329. See also text accompanying notes 249-51 *infra*.

221. Schultz, like others who endorse economic analysis, acknowledges its limitations in these matters. See SCHULTZ, INVESTMENT, *supra* note 35, at 158.

222. See, e.g., *id.* at 146-47, 154, 157-88.

223. If educational services were "properly" priced, such "proper" prices would ration the available supply of higher educational services and reallocate scarce resources between the sectors producing higher educational services and the rest of the economy, among different types of educational institutions and among different parts of the same institution. See Nerlove, *supra* note 98, at S178-79. Proper pricing does not constitute a case against subsidizing higher education in a number of ways, since demand will tend to remain below socially optimal levels at a given level of tuition. *Id.* at S179.

Efficient or "proper" pricing to an economist means setting a price equal to the marginal opportunity cost of the resources used to produce the priced commodity or service when both price and marginal opportunity cost—value of the best alternative

present, higher education is provided at below-cost prices, even, apparently, in the most expensive private colleges and universities. If there were full-cost tuition or market priced tuition, loan funds or scholarship funds should be made available to people with inadequate means.²²⁵ Such students or families could then repay the loans with interest or could repay the advances in the form of a tax override on their income tax during the rest of their lives.²²⁶ Steps could also be taken to ensure that salaries, wages and other remuneration for services internalize more of the benefits of education, so that people would be induced to borrow, spend and bid for educational opportunity according to the real benefits that would return to such investment. It would then seem appropriate to allow students or their families to capitalize the investment component of their education expenditures for amortization purposes, as with any other investment.²²⁷ The consumption component should not be capitalized and amortized.

Another version of this same "market model" for the allocation of resources in education would be to provide an equal grant in cash to every eighteen-year-old person in the country.²²⁸ This cash grant could then be invested by him in education, if he chose to do so; if not,

use—equal the benefits that would be provided by an additional unit of the good. See HANSEN & WEISBROD, *supra* note 143, at 89. Economic writers have supported pricing at cost, using taxes and transfers to obtain welfare benefits. See, e.g., A. DANIÈRE, *HIGHER EDUCATION IN THE AMERICAN ECONOMY* ch. 2, *passim* (1964). See also Hoenack, *supra* note 146, at 302, *passim*.

224. Nerlove, *supra* note 98, at S178-82, discusses tuition as a price in the market. See also A. DANIÈRE, *supra* note 223, at ch. 2 (arguing for pricing at cost and using taxes or transfers to achieve desired welfare results); M. FRIEDMAN, *CAPITALISM AND FREEDOM* (1962) [reprinting Friedman, *The Role of Government in Higher Education* in *ECONOMICS AND THE PUBLIC INTEREST* 123-44 (Solo ed. 1955)].

225. See Nerlove, *supra* note 98, at S184-91. See also Zacharias, *Educational Opportunity Through Student Loans: An Approach to Higher Education Financing* in *THE ECONOMICS AND FINANCING OF HIGHER EDUCATION IN THE UNITED STATES* 652-64 (Joint Economic Comm., 91st Cong., 1st Sess. 1969).

226. Some of the private plans include income-contingent loan repayment terms. See R.W. HARTMAN, *CREDIT FOR COLLEGE*, *supra* note 26; Nerlove, *supra* note 98, at S188. On the equity problems of student loans and tuition pricing policies, see Hartman, *Equity Implications of State Tuition Policy and Student Loans*, 80 J. POL. ECON. S142 (1972); Tweeten, *Comment* (on Hartman's paper), 80 J. POL. ECON. S175 (1972).

227. Present law does not tax the student on his subsidy and it denies him a write-off for his subsidy and his own investment in education. The proposed market model would not provide any subsidy, or would tax the student on the subsidy as income and then allow a full write-off of investment costs over time. The proposed system would impose liquidity burdens on the student during his poor, student years, and would defer the tax allowance. Present law gives an immediate implicit tax allowance and defers tax until income earning years. This instant depreciation is much cheaper and easier for the student to bear. See note 77 *supra*.

228. Some analysts have advocated training grants in the neighborhood of \$5,000 to every 18-year-old, with interest on any unused balance, to subsidize students rather than schools. See HANSEN & WEISBROD, *supra* note 143, at 85.

he could spend or waste the money, or invest it in income-producing assets or save the money in a bank. The purpose would be to provide even the poor and underprivileged potential student with the cash means to "bid" for a place in institutions of higher education at prices accordingly determined by the bidding process.

III

REASONS FOR FEDERAL AID

Of remaining concern is whether the federal government rather than state or local governments should provide desired educational assistance, either through a direct subsidy or a tax allowance. Apart from the financial difficulties in which many state and local governments find themselves,²²⁹ several reasons suggest the desirability of a federal approach to the problem. First, underinvestment in education, if shown, would appear to be a national problem, even though it may congeal in particular localities.²³⁰ Problems of inadequate access to higher education and vocational training are closely related to problems of crime and unemployment, both of which are increasingly regarded as national problems. Our labor force is in many ways a national one and depends on education for its maintenance. Our national army, the migration that takes place from area to area and various nationwide economic and social phenomena associated with insufficient education,²³¹ all suggest a national approach to the problem of subsidizing higher education.

A somewhat more technical reason for urging a national approach involves the geographical spillovers education creates.²³² Some

229. Much of the financial plight of state and local governments and the gap between their revenues and expenditures or demands for expenditures stems from the low-income elasticity of the tax package used by such governments, and from increasing demands for local social and other services.

230. Ambiguity attends the use of "national" in this setting. National suggests "nationwide" but also suggests "of great importance" and "of importance to the whole nation, even to those areas not experiencing the under-spending directly." As to education of children viewed as a cost of providing a national labor force, see H. GROVES, *FEDERAL TAX TREATMENT OF THE FAMILY* 9, 39, 41-42 (1963). Cf. Harris, *Parent and Child—And Taxes: Some Problems in Dependency*, 1 *TAX REVISION COMPENDIUM* 531 (1959).

231. See generally C. BENSON, *PERSPECTIVES ON THE ECONOMICS OF EDUCATION* (1963); A. DANIÈRE, *supra* note 223.

232. See G. BREAK, *INTERGOVERNMENTAL FISCAL RELATIONS IN THE UNITED STATES* 42 (tax credits), 62-106 (spillover benefits considered in connection with functional grants in aid by the federal government) (1967). See also Rivlin & Weiss, *Social Goals and Federal Support of Higher Education—The Implications of Various Strategies in The Economics and Financing of Higher Education in The United States* 543 (Compendium of Papers submitted to the Joint Economic Comm., 91st Cong., 1st Sess., 1969); Freeman, *supra* note 3, at 664. Grubel & Scott, *The International Flow of Human Capital*, 56 *AM. ECON. REV.* 268-75 (1966); Hirsch, Segellhorst &

state and local governments, for example, may underinvest in public education, because many students educated there tend to leave the area. This enables other states to reap the benefits of part of the education subsidy provided by the home state.²³³ Or, the opposite may be true. There may be underinvestment in higher education in areas to which people tend to come because highly trained people can be obtained from the pool of graduates that develops by virtue of subsidies in other states. In any event, the migration of people before, during and after education, coupled with the potential magnitude of the aid that may appear desirable and a need for uniformity and integrated policy, suggest that the approach should be national.²³⁴

Even apart from migration, people's productivity and employment prospects are affected by the level of productivity of persons educated elsewhere. Tax burdens are affected by the level of welfare payments to, and tax payments by, persons educated elsewhere.²³⁵ The fiscal and welfare interdependence of states and localities with or without migration indicates that education subsidies should be, at least in large part, provided by the federal government.²³⁶ Hopefully, federal aid can be provided in a manner that will not encourage states and private sources to reduce their support.²³⁷

Marcus, Spillover of Public Education Costs and Benefits (Inst. of Gov't & Public Affairs and U.C.L.A. 1964). See also Thomas, *The International Circulation of Human Capital*, 5 MINERVA 479-504 (1967); Johnson & Scott, *Correspondence in Reply to "The International Circulation of Human Capital,"* 6 MINERVA 105-16 (1967); Thomas, *Reply to Correspondence*, 6 MINERVA 423 (1968). The last three sources are excerpted in *ECONOMICS OF EDUCATION* 2, 241-301 (M. Blaug ed. 1969).

233. It may even be that some states experience, or will experience, difficulty in collecting loans and deferred charges due to mobility of former students. See Cartter, *supra* note 3, at 330.

234. Such an approach could, however, employ categorical or functional or unrestricted grants-in-aid or revenue sharing and thus permit some direction at the local level as to how the money should be used. See generally CARNEGIE COMMISSION ON HIGHER EDUCATION, INSTITUTIONAL AID, FEDERAL SUPPORT TO COLLEGES AND UNIVERSITIES, A REPORT AND RECOMMENDATIONS 1-7 (1971), reproduced in *The Chronicle of Higher Education*, Dec. 13, 1971, at 6.

The fear has been expressed that a uniform national education tax allowance and incentive, as with the encouragement of philanthropy by tax incentives, would not allay and would, in fact, intensify differences between poor and wealthy states or areas, inasmuch as the wealthier areas would capture the largest share of the benefit. See *Federal Tax Incentives*, *supra* note 1, at 384. A geographical adjustment, as discussed at notes 211-13 *supra*, could be designed to counteract this tendency.

235. See B. WEISBROD, EXTERNAL BENEFITS OF PUBLIC EDUCATION 37-39, 106, 117-26 (1964).

236. See Hansen & Weisbrod, *Benefits and Costs of Public Higher Education in California* in CALIFORNIA LEGISLATURE JOINT COMMITTEE ON HIGHER EDUCATION, JOINT INTERIM COMMITTEE REPORT No. 7 (1967) (arguing for increased federal support in California because population mobility produces the effect that benefits do not always accrue to the taxing unit that subsidizes the education and because the federal tax system captures some benefit from each state's higher education program).

237. See CARNEGIE COMMISSION, *supra* note 234.

IV

A TAX ALLOWANCE COMPARED TO A DIRECT
GOVERNMENT EXPENDITURE

It has become nearly an article of faith in some circles that a tax allowance should not be used in lieu of a direct government expenditure in order to subsidize activities or stimulate taxpayer behavior.²³⁸ Prior work surely has served to place a burden on anyone seeking to enact a new tax incentive to demonstrate why a direct government expenditure would not be better.²³⁹

This "comprehensive tax base" position recommends the elimination of tax allowances, tax preferences, tax loopholes, tax incentives

238. Proponents of this position favor a "comprehensive tax base." See generally Bittker, *A "Comprehensive Tax Base" as a Goal in Income Tax Reform*, 80 HARV. L. REV. 975 (1967) (criticizing the absolutist comprehensive tax base position); Pechman, *Comprehensive Income Taxation: A Comment*, 81 HARV. L. REV. 63 (1967); Galvin, *More on Boris Bittker and the Comprehensive Tax Base: The Practicalities of Tax Reform and the ABA's CSTR*, 81 HARV. L. REV. 1016 (1968); Bittker, *Comprehensive Income Taxation: A Response*, 81 HARV. L. REV. 1032 (1968).

One difficulty is that of differentiating tax allowances that fall in the category of indirect expenditure programs from allowances simply designed to calculate the tax base (such as net income) or to accomplish interpersonal equity by adjusting for ability to pay. See KAHN, *supra* note 3, at 12-16, 173-74 (1960); Bittker, *Accounting for Federal "Tax Subsidies" in the National Budget*, 22 NAT'L TAX J. 244 (1969); Surrey & Hellmuth, *The Tax Expenditure Budget—Response to Professor Bittker*, 22 NAT'L TAX J. 528 (1969); Surrey, *Federal Income Tax Reform: The Varied Approaches Necessary To Replace Tax Expenditures With Direct Governmental Assistance*, 84 HARV. L. REV. 352, 353-59 (1970) (reporting that the Treasury's approach has been to refer to "widely accepted definitions of income and standards of business accounting and . . . the generally accepted structure of an income tax." *Id.* at 354).

239. For a general comparison of tax allowances and direct governmental expenditures, see Surrey, *Tax Incentives as a Device For Implementing Government Policy: A Comparison with Direct Government Expenditures*, 83 HARV. L. REV. 705 (1970); Surrey, *Federal Income Tax Reform: The Varied Approaches Necessary to Replace Tax Expenditures with Direct Governmental Assistance*, 84 HARV. L. REV. 352 (1970); Wolfman, *Federal Tax Policy and the Support of Science*, 114 U. PA. L. REV. 171, 182-83 (1965). For another discussion of the expenditure aspect of deductions and exemptions, see Long & Mushkin, *Welfare Programs and Economic Growth and Stability* in FEDERAL EXPENDITURE POLICY FOR ECONOMIC GROWTH AND STABILITY 1028-31 (prepared for Subcomm. on Fiscal Policy of the Joint Economic Comm., 85th Cong., 1st Sess., 1957). Amortization of pollution control facilities is granted special treatment in INT. REV. CODE OF 1954, § 169, with which education expense amortization has evident analogies. See McDaniel & Kaplinsky, *The Use of the Federal Income Tax System to Combat Air and Water Pollution: A Case Study in Tax Expenditures*, 12 B.C. IND. & COM. L. REV. 351 (1971), analyzing the problem of tax expenditures and tax equity. Some brief comparisons have been made of a tax allowance and a direct government outlay for education. See, e.g., R. WOLK, *supra* note 13, at 72 (1968); Kerr, *New Challenges to the College and University* in AGENDA FOR THE NATION 237, 270 (K. Gordon ed. 1968).

See also 113 CONG. REC. 15369-71 (1967) for an address by Gardner Ackley, Chairman of the Council of Economic Advisors, on the use of tax incentives to accomplish national objectives such as aid to higher education.

and other tax provisions not required to reduce gross receipts or gross income to taxable or net income more or less as outlined by the Haig-Simons definition of income.²⁴⁰ Another point of view evaluates each tax allowance separately, without an absolute predisposition against the incentives or subsidies, to test its efficiency, advantages, and disadvantages in comparison with direct expenditures and other forms.²⁴¹

One objection to casting subsidies or incentives in the form of tax allowances has been that such tax allowances are not subjected to the kind of annual review applied to the regular expenditure budget of the federal government.²⁴² Although this argument is well founded up to a point, it would lose much of its force if the Treasury Department and the Congress truly relied on the Tax Expenditure Budget to identify and quantify the revenue losses or "tax expenditures" created by allowances used for subsidies or incentives.²⁴³ There may even be some merit in embedding an education subsidy in a tax law so that it is less likely than are outright grants or ordinary budget expenditures to be varied from year to year.

Tax allowances as subsidies or incentives have also been criticized because the amount provided depends on private decision-making and therefore remains hard to predict.²⁴⁴ Private decision-making, sometimes argued as a meritorious aspect of tax incentives,²⁴⁵ also affects and is affected by distortions introduced into the market and by un-neutralities in the allocation of resources.²⁴⁶ Not only is private decision-making affected by many factors unrelated to the purpose of the subsidy, but it will not be altered at all to the extent a tax relief provides a windfall to a taxpayer who would have behaved the same without the subsidy or incentive or for those "outside the tax system."²⁴⁷ Again, these objections are well taken to some extent but should not be exaggerated. The amount of revenue lost through some allowances can be estimated by cumulating the appropriate explicit deductions or

240. For reference to the Haig-Simons definition, see note 76 *supra*.

241. A profound proponent of this viewpoint is Professor Boris I. Bittker. See, e.g., Bittker, *A "Comprehensive Tax Base" as a Goal of Income Tax Reform*, 80 HARV. L. REV. 925 (1967); Bittker, *Comprehensive Income Taxation: A Response*, 81 HARV. L. REV. 1032 (1968).

242. See, e.g., Surrey, *Tax Incentives as a Device for Implementing Government Policy: A Comparison with Direct Government Expenditures*, 83 HARV. L. REV. 705, 728 (1970).

243. Periodic review of tax incentives, shelters, or subsidies, with a presumption or residual rule against reenactment would follow from suggestions made by Congressman Wilbur Mills and others in 1972. See Mills' Tax Shelter Termination Bill with its proposed Tax Policy Review Act, H.R. 15320, 92d Cong., 1st Sess. (1972).

244. See, e.g., Surrey, *supra* note 242, at 730-31.

245. *Id.* at 715, 718.

246. *Id.* at 725.

247. *Id.* at 719, 720.

credits shown on each tax return. The amount of a tax subsidy or incentive is less certain when it does not require specification on the return. For example, the loss of revenue due to the failure to tax the imputed rental value of owner occupied homes can be estimated in only a very rough way. Unfortunately, the best of such "tax expenditure" estimates do not afford truly accurate gauges of the amount of revenue that would be raised if the tax allowance were repealed. For, the repeal itself would change taxpayer behavior; the amount of the revenue lost would be affected by repealing the tax incentive to engage in tax reducing behavior.²⁴⁸

Another forceful objection to embedding incentives or subsidies in the tax system is that those incentives or subsidies often do not reach people who are not in the tax system; they provide no benefit to a taxpayer who has no taxable income, apart from the deduction. Personal allowances afford no aid to a taxpayer who elects the standard deduction.²⁴⁹ Or tax subsidies may be judged to be inequitable if income-variant.²⁵⁰ However, a federal tax allowance for education could be designed to benefit even those taxpayers without tax liability.²⁵¹ A tax credit with a refund provision, for example, could enable low-income persons to obtain a check from the government by filling out a tax return and showing a credit with no offsetting, or only partially offsetting, tax liability. The use of computers and simplified forms and widespread taxpayer advice would assist in making these tax benefits or allowances available to those not otherwise involved in the tax system.

Such a proposal, however, may fail to take due note of the difficulty of alerting and relying on millions of taxpayers, some of them poor, and many unsophisticated in tax matters, to understand, comply with, and react to complicated tax laws. Many may fail fully to take into account such matters as a tax allowance and a possible refund in the future when making plans in the present. In particular, it may prove unlikely or difficult for a poor and underprivileged child in a rural area or in the urban ghetto to make plans to go to college on the recognition that he or his family may enjoy reduced tax liability or an out-

248. For example, if the law no longer contained a charitable contribution deduction, contributions to charity would decrease. The amount of this decrease is speculative since the actual influence of the tax incentive is unknown. Expenditures in other deductible forms might increase. Therefore, the amount of revenue gained from repealing the charitable contribution deduction would not be equal to the amount of revenue that appears to be foregone when that deduction is in effect. Analysis of the benefits and costs to government if the deduction were repealed would also have to include the additional costs to government for assuming some of the functions that private charities could no longer perform.

249. See Surrey, *supra* note 242, at 720.

250. *Id.* at 720-25.

251. See the Prouty amendment referred to in note 16 *supra*.

right refund payment from the government some months hence. At the very least, it might become necessary to arrange some form of advance payment of such refunds so that students and their families would have cash on hand to meet their education costs.²⁵²

In addition, to place the education subsidy-incentive in the tax law arguably will damage the tax system,²⁵³ divide and complicate the consideration and administration of government programs,²⁵⁴ keep tax rates high by constricting the base and thus reduce revenues,²⁵⁵ and may take a toll in terms of waste, inefficiency, and inequity if not carefully protected.²⁵⁶ Careful protections in turn involve administrative and compliance costs just as they would in a direct subsidy program.

Of course there may be some advantages to using a federal income tax allowance rather than a direct government expenditure. Some believe, for instance, that a tax allowance would circumvent the constitutional barriers to direct government aid to schools and religious institutions.²⁵⁷ But the validity of this position remains uncertain at best. A second supposed advantage of the tax form of allowance is that it would avoid establishing a new government agency for granting scholarships. It must be remembered, however, that additional bureaucracy or administrative and compliance costs would also be sustained if an

252. In effect, a refund credit would provide a "negative income tax" for education, with installments to be paid out before the year end and a final reconciliation to be made on April 15. Loans from other sources might be a possible supplement, but again it may not be practical to expect all families to be able to take advantage of commercial loans, despite the widespread use by students of National Defense Education Act loans and Federally Insured Student loans in recent years.

253. See Surrey, *supra* note 242, at 731-32, for some suggestions as to how this could be damaging.

254. See *id.* at 728.

255. See *id.* at 725; S. HARRIS, HIGHER EDUCATION: RESOURCES AND FINANCE 323 (1962).

256. A tax credit would produce several complications—for example, an outright scholarship or fellowship would not be worth its face value but some lesser amount, such as 70 percent of its face value if there were a 30 percent credit otherwise applicable for the expenditure.

257. Cf. *Lemon v. Kurtzman*, 403 U.S. 602 (1971); *Walz v. Tax Comm.*, 397 U.S. 664 (1970). The newspaper reports of candidates' support during the 1972 elections for a tuition tax credit for secondary education emphasize that the primary purpose of the credit would be to aid parochial schools, and that many candidates supported the proposals to court votes from Roman Catholics. See, e.g., Kneeland, *McGovern For Tax Credit to Aid Parochial Schools*, N.Y. Times, Sept. 20, 1972, at 1, cols. 2 & 3. See also Burke, *Tax Relief for Parochial School Parents Voted by House Panel*, Los Angeles Times, Oct. 4, 1972, at 1, cols. 7 & 8, 20 cols. 3-8; *House Panel Favors Tax Credit For Tuition in Private Schools*, N.Y. Times Oct. 4, 1972, at 1, cols. 7-8, 26, col. 1, reporting that the House Ways and Means Committee had decided to make only half the tuition eligible for the credit because its members believed the tuition credit plan had a better chance of surviving a test of its constitutionality that way. See note 21 *supra*.

educational tax allowance were installed.²⁵⁸ A separate scholarship office also may better be able to adjust grants to need, academic qualifications and other education-related considerations.

Even if a subsidy-incentive is decided upon, therefore the case for casting it in the form of a tax allowance remains unproven.²⁵⁹ As distinguished from an allowance in the tax law to perfect its definition of taxable income or otherwise to improve the tax law itself, a subsidy-incentive should probably be granted in some form other than a federal income tax allowance—at least at this stage in the evaluation. Even though a form of tax allowance can be constructed to accomplish many of the incentive-subsidy goals and to avoid some of the inequities or inefficiencies of a plain deduction, a direct grant or other non-tax form probably would turn out to be equal or superior.²⁶⁰

V

FURTHER QUESTIONS ABOUT A TAX ALLOWANCE FOR EDUCATION

Of final importance is to ascertain the actual incidence and real impact of federal aid to higher education whether in the form of personal tax allowances or a direct government payment to students, their families, and institutions, or in voucher form. In each instance, the question is who will actually capture how much of the economic benefit of such government allowances or payments.²⁶¹

By placing additional funds and spending power in the hands of students and their families and thereby reducing the effective price of the eligible activity, education, the government will indirectly lead the providers of education and education-related commodities and services to raise their prices and also to expand their provision of the eligible

258. Cf. Surrey, *supra* note 242, at 716-19.

259. See, e.g., *id.* at 732-34.

260. See *id.* at 734-38; Moor, *The Federal Government Role in Higher Education* in *ECONOMICS OF HIGHER EDUCATION* 202, 216 (S. Mushkin ed. 1962) (suggesting that a direct scholarship program could be more precisely geared to the amount of need and the talents of individual applicants than could a tax allowance).

261. Some commentators have argued that the distributional effects of a tax deduction may be different from those implied by orthodox analysis; some persons who appear to gain from introducing a new tax deduction may lose, largely through political adjustments that produce changes in tax rates. A tax deduction given to reach optimality in the presence of external economies, as might be the case with an education cost allowance, may result in existing and potential purchasers of the externality-generating good (education) paying nearly all the net costs of internalizing the external economy, as a result of readjustments in tax rates or in the quantity of supply of a public good. In turn, people who are neither actual nor potential purchasers of the good but who do obtain the external benefits from the extension of its usage or provision may secure something for nothing, by virtue of the deduction and the following creation of still greater external economies. See generally Buchanan & Pauly, *On the Incidence of Tax Deductibility*, 23 *NAT'L TAX J.* 157, 158, 162-67 (1970).

activity. A new price and a new level of supply will be reached. Whether the subsidy takes the form of a direct grant, tax allowance, or education voucher, the students and their families will be better able to pay the tuition and other educational costs, and some of their other funds will be released for non-education consumption, savings, or investment.²⁶² However, education prices will rise, to some extent, so educational institutions will benefit.

To the extent that the economic benefits of an education allowance are captured by educational institutions, the result may accord with one important purpose of government assistance to education: to give additional aid to educational institutions. Some critics have argued, however, that, to the extent government assistance is advocated in order to provide additional help to students and their families, that aim will not be achieved by the dollars that find their way into the hands of the educational institutions. On the other hand, if the aim is to help the educational institutions it will not be satisfied to the extent students and their families capture the benefits. But, of course, there is nothing incoherent about a tax allowance which has as its aim helping students, their families, the educational institutions, and even the purveyors of other goods and services consumed by students, their families, educational institutions, and their staffs.

The problem of subsidy and access to education actually presents several different dimensions for someone designing a direct subsidy or tax allowance. To deal with students who drop out or do not attend higher education for financial reasons, it would be important to give a definite and immediate cash benefit sufficient to meet their need, but no more. To influence other students to attend college, when they are doubtful whether it pays to do so, an amortization of expenses over the lifetime of the income earner, to increase the private return to investment in education, would be suitable. To aid private or public institutions of higher learning, a program that subsidizes students in order to increase their demand for education or to enable more of them to go is inefficient in the fiscal sense because such an incentive-subsidy depends on the private decision-maker capturing some of the benefits in order to accomplish its purpose. Also, it may be important to ex-

262. Even if the payment by government is in some form other than cash, such as a tax allowance or an education voucher, that permits its use only to purchase education itself, that buying power releases the student's or family's other funds for the consumption of other commodities and services, for saving or investment. Tuition and related charges imposed by educational institutions would rise as a result of a new federal income tax allowance for such expenditures. Similarly, room and board charges by educational institutions and by private suppliers in the markets populated by students and their families might increase even if those expenditures were not treated as part of the costs of education by the new allowance.

amine whether institutions of higher learning do behave like profit-maximizers in the market. One difference, at least, may be that they limit access to their commodity by entrance requirements as well as by price and perhaps also by traditional notions of appropriate size, student body mix in terms of sex or geographical origin, and other considerations. In any event, the proponents of a tax allowance should be expected to acknowledge who its beneficiaries will be, to what extent and why. The problem of incidence is in no way escaped by making the subsidy a direct expenditure rather than a tax allowance, or vice-versa.

A related but probably tougher problem is to ascertain who actually pays for a government expenditure program, whether it be an outright expenditure or a tax expenditure by way of a tax allowance.²⁶³ Some recent work has turned up alarming evidence that free or low-cost public education may actually operate to distribute income from poorer to richer families, rather than the reverse, because of the manner in which it is financed.²⁶⁴ The overall evaluation depends on knowing what tax sources, by income level of taxpayers, by geographical location, or by some other gauge, pay for a particular expenditure or tax allowance program and how the distribution of benefits of a government expenditure, or tax allowance, program compares with the distribution of taxes that pay for these benefits. Is there an equi-proportional tax allocation of the burden of a tax-expenditure program? If so, then if a government's tax structure is progressive, the distribution of tax burdens for a new tax-expenditure program will also

263. See Buchanan & Pauly, *supra* note 261. See generally STAFF OF JOINT ECONOMIC COMM., 92d CONG., 1ST SESS., *THE ECONOMICS OF FEDERAL SUBSIDY PROGRAMS* (1972), at 7-21 (defining a subsidy), 27 (discussing tax subsidies in the form of income tax reductions), 52 (incidence of a subsidy—price effects), 61 (effectiveness of a subsidy—output effects), 69 (cost of subsidies—budgetary, administrative, excess burden, or efficiency loss), 72 (the cost of tax subsidies), 113 & 123 (manpower and education subsidies), 221 (list of special study papers, including papers by Mundell and Hartman on support of higher education).

264. See generally Hansen & Weisbrod, *Who Pays For A Public Expenditure Program?*, 24 NAT'L TAX J. 515 (1971), and sources cited therein. As to public higher education in particular, see HANSEN & WEISBROD, *supra* note 143, at 17-40, 55-86 (1969); Pechman, *The Distribution Effects of Public Higher Education in California*, 5 J. OF HUMAN RESOURCES 361-70 (1970).

Hansen and Weisbrod have suggested that, contrary to popular assumptions, a disproportionate amount of the tax costs of California's excellent low-tuition higher education system is borne by low-income taxpayers but that the benefits of the system go disproportionately to middle class and higher income families and students. Thus they found "a sizeable redistribution of income from lower to higher income." HANSEN & WEISBROD, *supra*, at 77. Their analysis has been seriously questioned, however. See Pechman, *supra*. See also BOWEN & SERVELLE, *supra* note 190; Grubb, *The Distribution of Costs and Benefits in an Urban School System*, 24 NAT'L TAX J. 1 (1971) (indicating that public education redistributes income from rich to poor and from non-whites to whites); Hartman, *A Comment on the Pechman-Hansen-Weisbrod Controversy*, 5 J. HUMAN RESOURCES 519-23 (1970).

be progressive, and vice versa.²⁶⁵ However, there is little or no reason to believe that things work this way. The equi-proportional allocation is largely an assumption. In marginal terms, the determinative question is: if federal government expenditures on education are increased, by a tax allowance or otherwise, and if everything else remains the same, which taxes, falling on which taxpayers will be raised, or what other expenditure (or tax allowance) program, benefitting which persons, would be reduced?²⁶⁶ Economic studies do not answer this question for an education tax allowance, nor does intuition help. A change in an expenditure or tax allowance may lead to compensating adjustments in the tax structure or in the expenditure structure, or both. No simple basis for allocating tax burdens for a tax allowance, assuming revenues are to remain constant or abandoning that assumption, seems reliable. The equi-proportional assumption has been well challenged and the marginal approach has presented a need for data that, at least so far, has not been met.²⁶⁷

In the absence of reliable conclusions about who would gain the benefits of a federal income tax allowance for personal costs of higher education and who would pay the costs of that tax allowance (in increased taxes or foregone benefits) either in the short run or when the dust has settled, a policymaker is left somewhere between extreme caution and despair. Not only the incentive-subsidy arguments for a tax allowance are undercut, but also the "tax equity" and even the "perfecting the definition of income" arguments are left almost hopelessly incomplete.²⁶⁸

OVERVIEW AND CONCLUSION

A principal difficulty in evaluating and constructing a good tax subsidy, or a direct expenditure subsidy, for higher education is determining the real rate of return on education.²⁶⁹ The data and the techniques so far in use seem inadequate to the task. To put a reliable dollar figure on the benefits that are received from education and thus to determine the rate of return on investment in education seems unlikely in the immediate future.

An important related difficulty is that of separating the consumer benefit from the income-producing investment made by a student or

265. See Hansen & Weisbrod, *Who Pays for a Public Expenditure Program*, 24 NAT'L TAX J. 515 (1971).

266. See *id.*, at 516. As the authors note, even "earmarking" taxes will not eliminate the problem.

267. Cf. *id.* at 517.

268. See generally Hansen, *Equity and the Finance of Higher Education*, 80 J. POL. ECON. S260 (1972). See also Brownlee, *Comment*, 80 J. POL. ECON. S274 (1972) (commenting on Hansen's article); Welch, *Comment*, J. POL. ECON. S277 (1972) (commenting on Hansen's article).

269. See notes 153-76 *supra* and accompanying text.

family bearing the costs of higher education. It does not seem likely that a reliable method of separating the consumption and investment components and of quantifying each will become available in the near future.

Another loose end is the unresolved problem of how to treat foregone income and whether to regard it as in any sense or any part a cost of higher education. One technique is to treat all, or part of it, as a cost and to allow it to be capitalized just as out of pocket expenditures would be. Another approach is to regard the foregone income simply as a failure to receive income that is not taxed and not as a cost allowable as a deduction or credit. Another possibility is to treat foregone income and the imputed value of low-cost education as income, tax it, and then capitalize some portion of it, to be amortized over the life of the education obtained. Still another possibility is to accept the fact that foregone income is not a cost in the sense that most costs of producing income are defined for tax purposes, but also to realize that it is a real economic barrier to education and therefore something that should be the focus of a subsidy or some form of relief in order to afford access to education for low-income students and families.

When the question is asked why higher education should be publicly financed or subsidized, the two answers most commonly given are those having to do with efficiency and equity.²⁷⁰ The usual efficiency argument is that external benefits produced by individuals who obtain higher education make the social rate of return higher than the private rate of return to education. Therefore, without a public subsidy, a less than optimal quality of education will be purchased and therefore society as a whole will suffer. The subsidy reduces private costs and thus raises the marginal private rate of return, ideally to the level of the social rate of return. Of course, to determine the subsidy level, the value of the external benefits must first be determined.

The equity justification insists that many qualified students cannot afford to pay the costs of higher education so that public subsidies should be provided to assist them. In the absence of such subsidies, the argument runs, access to higher education depends upon unequally distributed parental income and wealth rather than on the students' own ability to benefit from college. With an appropriate range of subsidies, the effects of differential economic position can be offset. This may be viewed as the question of vertical equity. This

270. The problems of equity that have received treatment in this Article have emphasized horizontal equity at the expense of vertical equity, have not exhausted the problems of equity raised by attempts to subsidize higher education and have not brought to the fore the confrontation between equity and allocative efficiency which pervade the area.

equity argument does not call for equal subsidy to all students but rather for a subsidy that will not provide any windfall to those people who are willing and able to pay an unsubsidized cost but will provide a sufficient subsidy so that those who are unwilling or unable to pay the unsubsidized cost will be willing to pay the lower, subsidized cost and will therefore obtain higher education. The objective of promoting greater equity may well come in conflict with the objective of obtaining economic efficiency. The vertical equity argument calls for a larger subsidy for poorer students or their families than for wealthier students, or at least for larger tax revenues from wealthier students and their families. The differential subsidy or increase in tax revenue might in turn reduce the amount of work effort supplied in the market or reduce the extent to which wealthier students attend college and university.²⁷¹ However, if market imperfections are causing both inequity and inefficiency, a subsidy or other remedy for the market defect will meet both problems and the tension between them will never materialize.

Perhaps the equity and ability-to-pay arguments, alone or combined with the perfection of taxable income or the incentive-subsidy, will be enough to persuade some legislators to enact a tax allowance or further direct subsidy. After all, information and analysis of other personal or mixed tax allowances or outright subsidies fall short of the demands impliedly made here for an education allowance. Nevertheless, in a policy climate of protecting or improving the integrity of the tax base, the use of a tax allowance for other than tax reasons should not be easily accepted.

Measured against the criteria and conclusions of this Article, federal tax credit legislation does not recommend itself, though it may be politically more saleable than and theoretically preferable to some other proposals. The preceding analysis tends to show that a strong conceptual argument can be made for a tax allowance for education costs to perfect the definition of taxable income. Such an allowance should take the form of capitalization and amortization of all outright expenditures on education that are ordinary and necessary costs of producing income by the student. The equity argument, though appealing in some ways, does not carry the burden and an education subsidy or redistribution or reallocation program would better be handled outside the income tax system.

The tax credit legislation that so nearly has become law in the last decade will not substantially improve the definition of taxable income, because the tax allowance is often given to someone other than the in-

271. For more on the subject of equity and efficiency, see Hansen, *Equity and The Finance of Higher Education*, 80 J. POL. ECON. S260 (1972).

come recipient, given at a time long before the income is earned, given in a form (a tax credit) that does not suit the purpose and is hedged about with restrictions (a \$325 ceiling and an income phase-out) that do not belong in a trade or business or cost of producing income allowance. The tax credit legislation must stand or fall as a subsidy or redistributor, or as a blunt move to readjust the tax burdens of middle-class families with children in post-secondary education. Unfortunately the need for and proper size of such a subsidy have not been demonstrated. If the tax credit were to lack a refund feature, as earlier bills did, it would be seriously deficient, almost indefensible, as a subsidy or incentive. It would poorly serve its equity goals. Even with a refund feature, the subsidy-incentive finds its way into the tax system by brute force, rather than an open embrace. Better to perfect the tax base by an appropriate amortization scheme and then to provide desired subsidies or incentives in separate, explicit programs with outright payments (or vouchers) given on the basis of need and merit as defined appropriately for the subsidy program—not as distorted or confined by an income tax context. Congressional dissatisfaction with the tax credit proposals and refusal to enact them, even in the face of strong and growing political pressures, may have followed from a sense of the deficiencies of these proposals.

In general, a tax apparatus can be designed to do almost anything that can be done with a direct government outlay, by way of recognizing or subsidizing the personal costs of higher education. For some few purposes, such as tax equity and perfecting the definition of taxable income, a tax allowance may have advantages over the direct government expenditure; for other purposes, such as subsidy and incentive, the tax allowance form of relief may be less desirable than a direct government expenditure. The important task is to determine the purpose and extent to which a federal subsidy or tax recognition of the personal costs of higher education is desirable and the amount that should be given.²⁷² In filtering out the goals of a proposed tax allowance or expenditure, analysts will progress far toward determining the form that it should be given: tax allowance or direct expenditure and if a tax allowance, to whom, when, how much, and what kind.²⁷³

272. See Denison, *Some Reflections*, 80 J. POL. ECON. S290 (1972); Johnson, *The Alternatives Before Us*, 80 J. POL. ECON. S280 (1972).

273. For an excellent statement of principles for any program of institutional support for higher education, see CARNEGIE COMM. ON HIGHER EDUCATION, INSTITUTIONAL AID, FEDERAL SUPPORT TO COLLEGES 2-4 (1972). For an analysis of existing federal subsidies to higher education, see Mundell, *Federal Aid to Higher Education: An Analysis of Federal Subsidies to Undergraduate Education*, at 407, and Hartman, *Higher Education Subsidies: An Analysis of Selected Programs in Current Legislation*, at 465, in THE ECONOMICS OF FEDERAL SUBSIDY PROGRAMS, part 4 (compendium of papers submitted to the Joint Economic Comm., 92d Cong., 2d Sess., 1972).