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Education Has Been "Dumbed Down" in Tax Reform

Melanie McCoskey
University of Akron

Doron Narotzki
University of Akron

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Education Has Been "Dumbed Down" in Tax Reform

by

Melanie McCoskey and Doron Narotzki***

Abstract

With promises of "Make America Great Again" and tax reform for "middle-class" Americans, the current federal government administration has implied that the average American would become more prosperous under this tax system. It is no surprise that most middle-class Americans view a college education as a requirement for achieving a better life. However, under the TCJA, education has not fared well, and in reality, students from many low- and moderate-income families will face reduced scholarships from elite schools, thereby reducing diversity on these campuses. Other proposed changes to education in the original tax bill, which were later removed, are also addressed as future legislative changes may revisit them.

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* Associate Professor of Tax and Bernat Family Fellow, George W. Daverio School of Accountancy, College of Business, University of Akron.

** Assistant Professor of Tax and the Frank & Karen Steininger Faculty Fellow, George W. Daverio School of Accountancy, College of Business, University of Akron.

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I. Introduction

President Trump has touted tax reform[1] as a major benefit to "middle-class" Americans. Defining the middle class is difficult, but, according to the U.S. Department of Commerce, middle-class Americans have common aspirations for themselves and their children—they want "economic stability and therefore desire to own a home and save for retirement. They want economic opportunities for their children and therefore want to provide them with a college education."[2] Middle-class families believe that college will create future economic opportunities for their children, so they plan and save for college educations for those children. Currently, parents have several avenues to help with giving their children a college education, including savings plans such as 529 plans and Coverdell savings plans, education credits and tuition deductions, and of course, scholarships from educational institutions.

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1. Samuel A. Donaldson, *Understanding the Tax Cuts and Jobs Act* (Ga. St. Univ. Coll. of Law, Legal Studies Research Paper No. 2018-07, 2018), https://ssrn.com/abstract=3096078. Donaldson states that "[w]hereas the Tax Reform Act of 1986 was the product of years of bipartisan negotiation, the Tax Cuts and Jobs Act was the product of a deeply partisan and largely closed-door process." *Id.*

2. U.S. Dep't of Commerce, Econ. & Statistics Admin., Middle Class in America 1 (2010).

The initial version of the Tax Cuts and Jobs Act[3] (TCJA) passed by the House of Representatives affected many of the provisions that help middle-class families provide their children with a college education. According to an analysis prepared by the nonpartisan Joint Committee on Taxation,[4] those changes were expected to increase the cost of college education by $71 billion over the next decade.[5] Fortunately, most of these provisions were not included in the final version of the tax law; even so, the costs to higher education will likely exceed amounts projected, as addressed in this Essay. Further, this Essay will also address the education incentives that were initially included in the House Bill but not the final version of the tax law, as they are likely targets for future tax legislation.

II. The Middle Class and Education

Middle-class families want economic opportunities for their children and therefore want to provide them with a college education.[6] A report issued stated that education and training have become "nearly the *only*

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3. H.R. 1, 115th Cong. (2017). TCJA was the original name assigned to the legislation, but the Senate parliamentarian ruled that the title could not be used. For additional information, see Daniel Shaviro, *Start Making Sense: The Act with No Name* (Dec. 21, 2017), https://danshaviro.blogspot.com/2017/12/the-act-with-no-name.html. However, since most commentators still utilize that name, we will do the same.

4. The description on the web page states:

> The Joint Committee on Taxation is a nonpartisan committee of the United States Congress, originally established under the Revenue Act of 1926. The Joint Committee operates with an experienced professional staff of Ph.D economists, attorneys, and accountants, who assist Members of the majority and minority parties in both houses of Congress on tax legislation.

Overview, Joint Comm. on Tax'n, https://www.jct.gov/about-us/overview.html (last visited Oct. 19, 2019).

5. *Estimated Revenue Effects of H.R. 1, JCX-54-17*, Joint Comm. on Tax'n (Nov. 11, 2017), https://www.jct.gov/publications.html?func=startdown&id=5034.

6. *See* U.S. Dep't of Commerce, *supra* note 2.

means of economic mobility."[7] A study on middle-class America noted, however, that "[i]t is more difficult now than in the past for many people to achieve middle class status because prices for certain key goods—health care, college and housing—have gone up faster than income."[8] The study indicated that middle-class families rely heavily on financial aid to cover the cost of a college education.[9] As such, it should be important that colleges have the ability to award as much in scholarships as possible. However, one of the biggest changes to education in the 2017 TCJA generates the opposite result, as described in the next Part.

III. Excise Tax on Private Universities' Net Investment Income

With the 1.4% tax on net investment income on private colleges and universities,[10] it is likely that scholarships will be reduced. Scholarships are discretionary expenses of a university, much more so than salaries, utilities, and insurance. The National Association of College and University Business Officers (NACUBO) and Commonfund Institute complete a study each year on college and university endowments.[11] Their 2018 report indicated that the rate of return (net of fees) for fiscal year (FY) 2017 was 12.2%. Table 1 reports private colleges and universities with endowments of more than $500,000 per student and the amount of the school's endowment. That endowment is multiplied by the 12.2% average rate of return to compute the endowment's income that would be subject to the tax. The 1.4% tax is then computed on the income. Per these calculations, the tax will raise approximately $330 million for the U.S. government, which is greater than the $200 million projected by the Joint Committee on Taxation in the December 18, 2017, analysis.[12]

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7. Joni E. Finney et al., *College Opportunity at Risk: An Assessment of the States*, Penn Graduate Sch. of Educ. 6 (June 2018), https://irhe.gse.upenn.edu/sites/default/files/College-Opportunity-at-Risk-2018.pdf.

8. *See* U.S. Dep't of Commerce, *supra* note 2, *Principal Findings*.

9. *See id.* at 16 & 18.

10. I.R.C. § 4968.

11. NACUBO, Tax Primer: A Brief Introduction to Higher Education Tax Policy Issues (2018).

12. *Estimated Budget Effects of the Conference Agreement for H.R. 1, JCX-67-17*, Joint Comm. on Tax'n (Dec. 18, 2017), https://www.jct.gov/publications.html?func=startdown&id=5053 [hereinafter JCX-67-17].

Regardless of the exact amount of revenue raised, this amount is relatively insignificant given that the total revenue loss from the TCJA is projected to be $135.7 billion in the first year alone.[13] Assuming scholarships include complete tuition remission only, Table 1 also reports the reduced number of scholarships per institution, for a total number of reduced scholarships exceeding 6,600. Based on the number of students attending these schools, this represents a decrease in the number of enrolled students from a low of 1.66% for Duke University to a high of 10.77% for Princeton University, with an average decrease in student enrollment of 3.83%. The results could be much higher than reported if students would have attended the schools on partial, rather than full, tuition scholarships.

One significant impact of reduced scholarships could be a negative effect on economic diversity. Most of the Ivy League schools and others in the top tier of American universities give needs-based scholarships only,[14] thereby increasing the economic diversity of their student populations. When Michael Bloomberg gave $1.8 billion to Johns Hopkins University in November 2018 specifically for financial aid, he stated "[t]his will make admissions at Hopkins forever need-blind; finances will never again factor into decisions. . . . And, it will make the campus more socio-economically diverse."[15] In fact, none of the elite schools that will be subject to the 1.4% excise tax gives meaningful merit-based scholarships. See Table 2 for a list of ranked schools that do give merit-based scholarships.[16]

The increase in the revenue to the federal government from the excise tax on college endowments is low, but if the cost of that revenue generation comes at the cost of reduced scholarships at these universities, then "middle-class Americans" whose children have worked hard throughout school in hopes of qualifying for a scholarship at one of these excellent private educations institutions may be out of luck.

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13. *Id.* at 8.

14. Stephen Ngo, *Do Ivy League Schools Give Merit Scholarships?*, Edmit, https://www.edmit.me/blog/do-ivy-league-schools-give-merit-scholarships (last visited Oct. 18, 2019).

15. Michael R. Bloomberg, Opinion, *Why I'm Giving $1.8 Billion for College Financial Aid* (Nov. 18, 2018), https://www.nytimes.com/2018/11/18/opinion/bloomberg-college-donation-financial-aid.html.

16. Farran Powell, *12 Colleges That Give Merit Aid to the Most Students*, U.S. News & World Rep. (Nov. 12, 2018, 9:00 AM), https://www.usnews.com/education/best-colleges/the-short-list-college/articles/colleges-that-give-merit-aid-to-the-most-students.

A. Taxing Tax-Exempt Entities

There is some historical basis for an excise tax on a tax-exempt entity. Tax-exempt private foundations have been taxed since the Tax Reform Act of 1969.[17] The Treasury Department issued a report in 1965 that detailed major abuses by private foundations, and the tax law enacted in 1969 was designed to prevent or curb those abuses.[18] The House Ways and Means Committee indicated that the reasons for the tax were two-fold: one, since the benefits of government were enjoyed by all, then some of the costs of those benefits should be borne by those with the ability to pay. Second, the tax on private foundations was in the nature of a user fee due to the extensive monitoring that the government has to do to ensure that all regulations regarding their tax-exempt status were met. The Committee Chairman explained that the tax was to be levied on private foundations only, and not public charities, because public charities generally expend their funds quickly while private foundations retain their funds and only distribute their income generated on those funds.

Once the law got to the Senate, the Senate Finance Committee and the Joint Committee on Taxation issued a summary of the house bill.[19] The summary listed arguments for and against the tax on the net investment income of private foundations as follows:

Arguments for the tax:

1. Foundations enjoy the benefits of the government and should therefore share some of the costs,

2. The tax is modest and therefore will not hamper the operations of the foundations and will help fund some of the government's costs in ensuring that foundations distribute their funds to tax-exempt entities, and

3. The tax will encourage greater public contributions, rather than one-time contributions by individuals or a family.

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17. P.L. 91-172 (enacted as I.R.C. § 4940).

18. U.S. Treas. Dep't, US Treasury Department Report on Private Foundations, 89th Cong., 1st Sess., at 3.

19. Joint Comm. on Tax'n & Comm. on Fin., 91st Cong., JCS-61-69, Summary of H.R. 13270, The Tax Reform Act of 1969 (as passed by the House of Representatives) 11–12 (1969).

Arguments against the tax:

1. The tax will undermine the underlying tax-exempt status of private foundations that has been long-standing,

2. The tax will fall heaviest on those entities that have a profitable investment portfolio and will reduce the funds available for charitable distributions,

3. Efficient foundation management will be discouraged because the greater the income, the higher the tax, and

4. The tax will be unfair by singling out private foundations versus public charities.

The Chair of the House Ways and Means Committee stated that the distinction between taxing private foundations but not public charities was that public charities expend their funds quickly whereas private foundations generally only expend the income from their assets. Note that this distinction is not true for public versus private college foundations—both, regardless of asset size, expend only earnings on assets and rarely dip into the corpus of those assets. However, Ohio State University was recently scrutinized for dipping into one of its endowments accounts and expending millions of dollars in "development fees," stating that this is a widespread practice among universities and charitable entities.[20]

Amid this scrutiny of the operations of private foundations, the first excise tax on private foundations' net investment income was passed in 1969 at a rate of 4%. The tax rate was reduced to 2% in 1978, and in 1984 a lower 1% rate was created for exempt operating foundations. One reason for the rate decrease is that a 1978 Senate Report found that the tax had "produced more than twice the revenue needed to finance the operations of the Internal Revenue Service with respect to tax-exempt organizations."[21] In fact, the tax produced more revenue

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20. Randy Ludlow, *Moritz Family Fights Ohio State for Using Endowment to Pay for Fundraising*, Columbus Dispatch (Sept. 17, 2018, 6:42 AM), https://www.dispatch.com/news/20180917/moritz-family-fights-ohio-state-for-using-endowment-to-pay-for-fundraising.

21. S. Rep. No. 95-1263 (1978).

than the IRS required to govern compliance for ALL tax-exempt entities, not just the private foundations that were subject to the tax. Secondly, it is important to note that the tax was not placed into a trust fund that the government used to monitor tax-exempt entities, leading one author to posit that "the tax's purpose was more penal than pecuniary."[22] A tax on private colleges and universities with high levels of endowments per student could also be viewed as punishment by the current administration, especially given that the schools that are subject to the tax are historically liberal. For instance, almost 93% of the political contributions to candidates during the 2008 presidential election made by law professors were made to Democratic candidates, and in schools like Harvard, Chicago, Michigan, Stanford, Texas, Berkeley, and Penn the percentage donated to Democratic candidates was 100%.[23] The trend toward Democratic support by wealthy colleges continues, at schools like Harvard, for example, where 84% of all faculty who made campaign contributions between 2011 and the third quarter of 2014 contributed to federal Democratic campaigns and political action committees.[24]

A second reason for the rate decrease is that a 1974 Senate Subcommittee on Foundations concluded that a rate reduction "would also produce a direct, dollar-for-dollar increase in the funds distributed annually by private foundations for charitable purposes."[25] A Senate Report in 1978 noted that "[i]n many cases, the tax actually reduced charitable expenditures."[26] This same result of reduced charitable expenditures is expected if a similar tax is placed upon college endowment funds, resulting in fewer scholarships being offered to students.

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22. William J. Lehrfeld, *The Annual Tax on Foundation Income; Rules Governing Distributions of Income*, 29 NYU Inst. Fed. Tax'n 1799, 1802 (1971).

23. Paul Caron, *Law Prof Presidential Campaign Contributions: 95% to Obama, 5% to McCain*, TaxProf Blog (Sept. 10, 2008), https://taxprof.typepad.com/taxprof_blog/ 2008/09/law-prof-presid.html.

24. Paul Caron, *Charitable Donations to Colleges Reached All-Time High in 2014 ($38 Billion)*, TaxProf Blog (Jan. 28, 2015), https://taxprof.typepad.com/taxprof_blog/2015/01/charitable-donations.html.

25. 120 Cong. Rec. 33,952, 33,954 (1974).The report also noted that a second reason for the rate decrease in 1978 was that the tax rate of 4% had generated twice as much revenue as the government expended in compliance activities for all tax-exempt entities.

26. S. Rep. No. 95-1263 (1978).

When the 2017 excise tax on college and university endowments passed the House of Representatives, the American Council on Education (ACE) wrote to the members of the House Ways and Means Committee and stated:

> H.R. 1 fundamentally changes the way nonprofits are treated by creating a new and unprecedented tax on endowments of some private colleges and universities. This provision undermines the very nature of the tax-exempt status of private colleges and universities. While the new excise tax is currently focused on private institutions, we strongly oppose this new excise tax and the precedent it sets for all of higher education.
>
> Investment income from endowments is used every day to support nearly every aspect of an institution's operations, including all the components vital to its mission and the delivery of a high quality, affordable education, from financial aid to research and student retention and success programs. An endowment is not a single entity that can be used for any purpose. Rather, it is a permanent investment fund consisting of often thousands of separate accounts designed for the needs of the present and the future. Under H.R. 1 potentially large amounts of endowment dollars would be redirected to the federal government, taking them away from providing scholarships to our students and supporting research and education. It also would effectively be a tax on donors' contributions and shift money from the dedicated purpose for the donation. Roughly 160 institutions will likely be affected by this provision, and we strongly object to it.[27]

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27. Letter from Ted Mitchell, President, Am. Council on Educ., to Kevin Brady, Ways & Means Comm. (Nov. 6, 2017), https://www.acenet.edu/news-room/Documents/Letter-on-House-Tax-Cuts-and-Jobs-Act.pdf [hereinafter ACE Letter]. Note that approximately 160 institutions would have been subjected to the excise tax as originally passed by the House of Representatives. The final version, passed by both houses of Congress, subjects approximately more than 50 institutions to the tax.

B. Previous Congressional Focus on University Endowments

Concern regarding the level of college endowments has been increasing for a decade.[28] The Senate Finance Committee, in response to a 2008 report issued by the NACUBO, sent a letter to 136 colleges and universities (both public and private) with endowments of $500 million or more. The letter requested information on tuition, university grants, how the institution recruits students from low-income families, and the institution's annual endowment payout.[29] In discussing the reasoning for the inquiry, the two authors of the letter state:

> I have been encouraged by the recent changes that several universities have made to ensure access to higher education for low and middle income students. We need to engage America's colleges and universities to come together to address the fact that college tuition for young Americans and their families is increasing at a faster rate than inflation, . . . The questions we put forward in this letter will help Congress better understand how colleges use their endowments to make certain that talented young folks in Montana and across the country aren't left out of the classroom.[30]

Grassley said,

> Tuition has gone up, college presidents' salaries have gone up, and endowments continue to go up and up. We need to start seeing tuition relief for families go up just as fast. It's fair to ask whether a college kid should have to wash dishes in the dining hall to pay his tuition

28. James Sweeney, *Excise Tax on Investment Income of Private Colleges and Universities*, RSM Int'l (Jan. 26, 2018), https://rsmus.com/what-we-do/services/tax/federal-tax/excise-tax-on-investment-income-of-private-colleges-and-universi.html.

29. *Baucus, Grassley Write to 136 Colleges, Seek Details of Endowment Pay-Outs, Student Aid*, U.S. Senate Comm. on Fin. (Jan. 24, 2008), https://www.finance.senate.gov/release/baucus-grassley-write-to-136-colleges-seek-details-of-endowment-pay-outs-student-aid.

30. *Id.*

> when his college has a billion dollars in the bank. We're giving well-funded colleges a chance to describe what they're doing to help students. More information will help Congress make informed decisions about a potential pay-out requirement and allow universities to show what they can accomplish on their own initiative.[31]

Grassley was a vocal criticizer of wealthy endowments that generated high investment returns but did not pay out much of those earnings. His scrutiny is "widely credited with spurring more generous, no-loan financial aid packages for low- and middle-income students at the wealthiest institutions."[32] However, this issue was dropped when the financial recession began in 2008 but was revived again in 2015, as noted next.

On January 15, 2015, NACUBO issued a report entitled *Building on 11.7% Gain in FY2013, Educational Endowments' Investment Returns Averaged 15.5% in FY2014*,[33] which indicated that college endowments averaged a 15.5% return on investments (net of fees) but only a 4.4% payout. In response to this report, the U.S. House Ways and Means Committee on Oversight held a hearing on October 7, 2015, regarding the rising costs of higher education. This hearing caused the Congressional Research Service (CRS) to issue a report in December 2015.[34] Key points from that report were:

- In 2014, college and university endowment assets were $516.0 billion. Endowment assets have been growing, in real terms, since 2009. Endowment assets

31. *Id.*

32. Michael Stratford, *Billion-Dollar Targets*, Inside Higher Ed. (Feb. 16, 2016), https://www.insidehighered.com/news/2016/02/16/congress-returns-scrutiny-wealthy-university-endowments.

33. *Building on 11.7% Gain in FY2013, Educational Endowments' Investment Returns Averaged 15.5% in FY2014*, NACUBO (Jan. 29, 2015), https://www.nacubo.org/Press-Releases/2015/Building%20on%20117%20Gain%20in%20FY2013%20Educational%20Endowments%20Investment%20Returns%20Averaged%20155%20in%20FY2014.

34. Molly F. Sherlock et al., Cong. Research Serv., College and University Endowments: Overview and Tax Policy Options (2015) [hereinafter CRS 2015]. A report issued May 4. 2018, found similar results for 2017. Molly F. Sherlock et al., Cong. Research Serv., College and University Endowments: Overview and Tax Policy Options (2018) [hereinafter CRS 2018].

fell during the 2007–2008 financial crisis, and took several years to fully recover.

- Endowment assets are concentrated, with 11% of institutions holding 74% of all endowment assets in 2014. Institutions with the largest endowments (Yale, Princeton, Harvard, and Stanford) each hold more than 4% of total endowment assets.

- The average spending (payout) rate from endowments in 2014 was 4.4%. Between 1998 and 2014, average payout rates have fluctuated between 4.2% and 5.1%. In recent years, institutions with larger endowments have tended to have higher payout rates.

- In 2014, endowment assets earned a rate of return of 15.5%, on average. Larger institutions tended to earn higher returns. Larger institutions also tended to have a larger share of assets invested in alternative strategies, including hedge funds and private equity.[35]

The 2015 CRS report discussed different policy options regarding the tax treatment of college and university endowments, including:

> (1) a payout requirement, possibly similar to that imposed on private foundations, requiring a certain percentage of funds be paid out annually in support of charitable activities; (2) a tax on endowment investment earnings; (3) a limitation on the charitable deduction for certain gifts to endowments; and (4) a change to the tax treatment of certain debt-financed investments in strategies often employed by endowments.[36]

In 2016, the Senate Finance Committee and the House Ways and Means Committee revisited the issue by writing a joint letter to 56 colleges and universities (private schools only) with endowments greater than $1 billion. The authors stated that they were gathering information

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35. CRS 2015, *supra* 34, *Summary* (emphasis in original removed).
36. *Id.*

in order to better understand "how colleges and universities are using endowment assets to fulfill their charitable and educational purposes" at a time when tuition rates were increasing faster than inflation.[37]

One notable point is that congressional scrutiny has focused on college and university endowments in years when those assets have generated a high return on their investments. Historically, however, returns have been much lower. The 2017 NACUBO reports that the average three-year return is 4.2%, the five-year return is 7.9%, and the ten-year return is 4.6%. As such, the long-term returns do not differ much from the payout percentages of approximately 4.2% each year.

Taxation of college endowments investment earnings has actually been proposed in the past. In 2014, Representative David Camp included a 1% tax on investment earnings for colleges and universities with endowments greater than $100,000 per student.[38] The Joint Committee on Taxation projected that the provision would increase government revenue of $1.7 billion over the ten-year period 2014–2023.[39]

Given this background on Congress's interest in college and university endowment funds, it is not surprising that the topic was included in the TCJA. The final provision, which imposes the 1.4% excise tax on private colleges and universities with endowment assets greater than $500,000 per student, is expected to generate $1.8 billion in revenue for the federal government over the ten-year period 2018–2027, according to the Joint Committee on Taxation report dated December 18, 2017.[40]

In September 2018, NACUBO issued a document detailing the effects of the expected effects of the TCJA on colleges and universities.[41] In this document, NACUBO states "[i]n recent years, lawmakers and others have focused their concerns on endowment spending for student

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37. Letter from Orrin Hatch, Chairman, Senate Comm. on Fin., Kevin Brady, Chairman, House Comm. on Ways & Means, & Peter J. Roskam, Chairman, House Comm. on Ways & Means Oversight Subcomm., to Steven Knapp, George Wash. Univ. (Feb. 8, 2016), https://www.documentcloud.org/documents/2711522-Congressional-Letter-to-Colleges-Re-Endowments.html.

38. Dave Camp, Comm. on Ways & Means, Tax Reform Act of 2014, Discussion Draft, Section-by-Section Summary, Section 5602, at 162, https://www.taxpayer.net/wp-content/uploads/ported/images/Ways%20and%20Means%20Section-by-Section%20Summary.pdf (last visited Oct.. 19, 2019) [hereinafter Camp Discussion Draft].

39. *Id*.

40. JCX-67-17, *supra* note 12, at 5, item L.1.

41. NACUBO, Tax Primer, *supra* note 11.

aid, with little recognition that endowment spending on other operational areas relieves tuition pressure.'"[42] The report also states that endowment managers are legally required to ensure financial soundness for the educational institution.

C. Other Effects of the Excise Tax

Finally, will a tax on university endowments decrease the amount that contributors donate to the endowments? The answer to this question is unknown, but contributions may decrease if donors are unhappy that some of the earnings on their donations will go to the federal government.

IV. Other Changes to Education in the TCJA

The following changes related to education were also included in the new tax law.

A. Changes to Qualified Tuition Programs

A Qualified Tuition Program[43] is a program in which a state or an agency of the state allows persons either to prepay college tuition costs or to make contributions to an account that is designed to save for college expenses for a specific beneficiary.[44] The earnings in these accounts grow tax-free and are never taxed as long as the distributions are used to pay for higher education expenses. These accounts do not have an annual limit imposed at the federal level regarding the contribution amount, unlike Coverdell Education Savings Accounts (ESAs), which limited the contributions to $2,000 per year per beneficiary and are allowed only for low- and moderate-income families.[45] As such, Qualified Tuition Programs are an extremely popular vehicle for saving for higher education expenses, with almost all states offering at least one plan.

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42. *Id.* at 6.

43. Also known as a 529 plan, because the tax law regarding these plans is located in I.R.C. § 529.

44. Prepaid tuition programs can be established by states or qualifying educational institutions. However, these prepaid plans have not fared well as increases in tuition have far outpaced the returns that these funds can earn on their investments.

45. I.R.C. § 530.

Two changes were made to qualified tuition plans in the Tax Cuts and Jobs Act. The first is that the account owners are now allowed to withdraw up to $10,000 annually to pay for K–12 tuition expenses. While this change allows the account owner more flexibility, it defeats the purpose of saving for higher education expenses. Further, given that higher education expenses are increasing dramatically, it is likely that families will need more, not less, in these Qualified Tuition Programs.

The second change to these plans allows for tax-free rollovers into ABLE accounts. According to the ABLE National Resource Center, an ABLE Account is a "tax-advantaged savings accounts for individuals with disabilities. They were created as a result of the passage of the Stephen Beck Jr., Achieving a Better Life Experience Act of 2014, better known as the ABLE Act."[46] ABLE accounts allow people with disabilities to save for future expenses without decreasing any public benefits they receive, which may be limited if the individual has more than $2,000 in saving accounts. This change in the tax law will be beneficial to taxpayers who have started saving for a child's higher education and then it transpires that the child will likely never go to college due to a disability.

B. Repeal of Higher Education Expense Deduction[47]

An above-the-line deduction for higher education expenses originated in 2002 for those taxpayers who chose to take a deduction rather than a credit. This deduction was allowed for low- to moderate-income households, according to the following tiers:

> $4,000 for taxpayers with income up to $65,000 ($130,000 for joint returns);
>
> $2,000 for taxpayers with income in excess of $65,000 ($130,000 for joint returns) but not more than $80,000 ($160,000 for joint returns); and
>
> $0 for all other taxpayers.[48]

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46. *What Is ABLE?*, ABLE Nat'l Res. Ctr., https://www.ablenrc.org/employers/what-is-able/ (last visited Oct. 19, 2019).

47. Although this repeal was not part of the TCJA, it was later (in 2018) extended only to tax years ending no later than December 31, 2017, and so is included in this Essay. I.R.C. § 222(e).

48. I.R.C. § 222(b).

The deduction was scheduled to expire at the end of 2016. The TCJA extended it for one additional year, but it has not been extended past 2017.[49] Many low- to middle-income taxpayers utilized the deduction. In 2016, the latest year for which data is available, the IRS Statistics of Income report indicates that almost 1.7 million tax returns claimed the deduction for a total approximately $4 billion dollars, averaging over $2,300 per return on which a deduction was taken.[50] If these taxpayers had an average tax rate of say 25%, this deduction saved each one an average of $575, reducing the cost of the tuition and fees to approximately $1,725, a significant savings for taxpayers in these lower- to middle-income tax brackets.

Note that the proposal to eliminate the deduction for qualified tuition and related expenses was included in Representative Camp's 2014 proposal, but the Joint Committee on Taxation estimated that its repeal would not have any revenue effect on the government.[51]

C. Qualified Tuition Programs

Both changes related to qualifying distributions from Qualified Tuition Programs (529 plans) are considered middle-class friendly. First, qualifying higher education expenses would include books, supplies, and equipment (no mention of tuition) required for enrollment in an apprentice program. Secondly, unborn children can be beneficiaries of Qualified Tuition Programs, but this includes only children in utero. With the high cost of college tuition, it is prudent to begin saving for college at the earliest possible date. The proposal stated that the child can be "at any stage of development," but must be "carried in the womb." This would preclude parents from making contributions to a Qualified Tuition Program on behalf of an embryo that is frozen or still in the "test tube" before it has been implanted into the mother's womb. This provision is probably necessary given the available technology regarding reproduction. Interestingly, the proposal indicates that a child in utero means "a member of the species homo sapiens," indicating that the drafters of the legislation believed that some taxpayers may save for college for other-than-human children. This provision is probably unnecessary,

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49. I.R.C. § 222(e).

50. IRS Pub. 4801, Individual Income Tax Returns Line Item Estimates 15–16, line 34 (2016) [hereinafter IRS Pub. 4801].

51. Camp Discussion Draft, *supra* note 38.

because, even though it has been reported that people’s pets have received college diplomas, the authors of this Essay are categorically unaware of any “pet parents” using tax-favored vehicles to save for this eventuality.

D. Discharge of Student Loans

In general, taxpayers must recognize taxable income when liabilities against them are discharged. The new tax law excludes from taxable income any discharge of student loans as a result of death or total and permanent disability of the student. The exclusion provision will sunset on December 31, 2025.

V. Proposed Changes That Were Not Enacted

The initial version of the TCJA passed by the House of Representatives included many of the provisions that help middle-class families provide their children with a college education. Those changes were expected to increase the cost of college education by $71 billion over the next decade.[52] Why these educational benefits were targeted to increase tax revenues is unclear, especially when considering that the total ten-year loss of tax revenue due to the tax law changes for individuals, amounts to $1,126.6 billion dollars, based upon the December 18, 2017, Joint Committee on Taxation analysis.[53] Of that amount, $83.0 billion results from changes to the estate tax rules (doubling the exemption amount for years 2018–2025) and $637.1 billion from the changes to the Alternative Minimum Tax (AMT) for the same time period.[54] Those two changes benefit wealthy Americans only, yet they account for 64% of the lost revenue from individuals to the federal government. As politicians touted the new tax law as beneficial to middle-class Americans, it is hard to visualize how increasing the tax cost of college education, coupled with stark decreases in taxes for the wealthy, can possibly be consistent with the claims made by lawmakers.

The following provisions were not included in the final version of the tax law but are addressed here as they are likely targets for future tax legislation.

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52. JCX-67-17, *supra* note 12.
53. *Id.* at 3.
54. *Id.* at 2.

A. Revised Educational Credits

The original plan enacted by the House of Representatives actually increased the American Opportunity Credit, which allows a credit of $2,500 per year (up to $1,000 is refundable). The legislation called for a fifth-year credit of up to $1,250 (up to $500 refundable). Adding this fifth year makes sense, given that college students attend for five calendar years (beginning in the fall of their freshman year and ending in spring of their senior year. However, if adding this fifth year credit might encourage students to stay in school longer, it may not be advantageous to either the student (who has a higher likelihood of not completing the degree if attendance is less than full-time) or the institutions of higher education, which may be penalized via state funding if students take longer than four academic years to complete their degree. Under current law, if a fifth calendar year of college education is required, the tax system allows taxpayers to utilize the nonrefundable Lifetime Learning Credit. The tax law passed by the House of Representatives would have eliminated the Lifetime Learning Credit. The combination of the additional year for the American Opportunity Credit, along with the elimination of the Lifetime Learning Credit, was referred to as the enhanced American Opportunity Tax Credit (enhanced AOTC). Concern about these changes caused the ACE, in their letter to the House Ways and Means Committee to state:

> [W]e are extremely concerned that the "enhanced" AOTC, as written, would preclude graduate students, part-time students, lifelong learners (particularly those seeking retraining), and any student taking longer than five years to finish their education from accessing the AOTC, adversely impacting their financial ability to pursue a degree or lifelong learning. Indeed, under the changes proposed in the bill, many non-traditional students—the fastest growing segment of students in higher education—would lose significant tax benefits they currently rely upon to help finance their higher education.[55]

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55. ACE Letter, *supra* note 27.

B. Taxability of Tuition Waivers

Tuition waivers are offered to both graduate students and undergraduate students. The effect on graduate students is addressed first.

A tuition waiver occurs when, for example, a Master's student grades papers or performs research, and, in addition to a low hourly wage, receives a tuition waiver. While the effect of such a provision would only affect a small number of individuals and have only a negligible effect on government revenues, the effect on individual students would be extremely harmful. Consider, for example, a Ph.D. student who earns a $30,000 annual stipend for being a teaching assistant. In addition to the stipend, the student also receives a tuition waiver of $65,000. If the tuition waiver is included in the student's taxable income, the student has $95,000 of income, resulting in a tax liability for the year of $14,209.50,[56] which is almost half of the student's cash stipend! If only the $30,000 stipend is taxed, the student's federal tax liability would be $1,969.50.[57] Further, given that most states with income taxes "piggy-back" off the federal return by starting with federal adjusted gross income, the state tax owed by the Ph.D. student listed above could be an additional $2,656.26[58] if the tuition waiver were included in income.

Once again, higher education students, especially those who attend a private school that has high tuition rates and who receive a tuition waiver, would be severely punished if this provision had been included in the final tax bill. Indeed, graduate students around the nation engaged in campus protests[59] after this measure was included in the

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56. Income of $95,000 less $12,000 standard deduction yields taxable income of $83,000, and the tax is calculated as: $14,089.50 + (24% of the excess over $82,500) = $14,209.50.

57. Income of $30,000 less $12,000 standard deduction yields taxable income of $18,000, and the tax is calculated as: $952.50 + (12% of the excess over $9,525) = $1,969.50.

58. $3,331.26 with tuition waiver included in income ($2,345.63 + (4.75% ($83,000 - $62,250)) versus $675 without the tuition waiver included in income $18,000 * 3.75%.

59. *See, e.g.*, Katie Reilly, *'Hell Hath No Fury Like Hungry Grad Students.' Protests Against GOP Tax Bill Hit 40 Universities*, TIME (Nov. 29, 2017, 8:19 PM), https://time.com/5041947/graduate-student-protest-gop-tax-bill/; Teresa Watanabe & Rosanna Xia, *Graduate Students Nationwide Protest*

House version of the bill. Universities and other associations strongly advocated for elimination of this provision of the proposed tax law change, with the ACE letter authors stating:

> Roughly 145,000 graduate students received a tuition reduction in 2011–2012. Repeal of this provision would result in thousands of graduate students being subjected to a major tax increase. The provision is also critical to the research endeavor at major universities, particularly in the crucial science, technology, engineering and math (STEM) fields. According to data from the Department of Education, 57 percent of tuition reductions went to graduate students in STEM programs.[60]

Like the excise tax on university endowments, taxation of tuition waivers appears to punish those students at Ivy League and other top-tier universities, as those schools generally charge higher tuition, thereby subjecting the students to higher taxes than those who receive tuition waivers from public universities, which generally have lower tuition rates. Furthermore, while the tax cost to individual students at private educational institutions would be steep, the amount of additional tax revenue estimated to be collected by the federal government was deemed to be negligible, further indicating that the punitive nature to Ivy League schools and their students. Fortunately, for those graduate students who would have been affected, this specific provision was not included in the final version of the tax law.

For undergraduate students, tuition waivers are available to employees and members of the employee's family, such as children. The APLU writes:

> Under the Internal Revenue Code, if an institution chooses to offer tuition discounts to employees, spouses, and their dependents, then all employees must be eligible. The provision benefits a range of employees, including administrative staff, maintenance and janitorial

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House Bill, Saying It Could Cost Them Thousands, L.A. Times (Nov. 29, 2017, 7:10 PM), https://www.latimes.com/local/lanow/la-me-grad-student-tax-protest-20171129-story.html.

60. ACE Letter, *supra* note 27 (footnote omitted).

> staff, and faculty. According to a 2017 survey conducted by the College and University Professional Association for Human Resources, the majority of employees benefitting from the provision are low and middle income. Fifty percent of recipients of tuition reductions earned $50,000 or less and 78 percent earned $75,000 or less. If [this benefit were] repealed, taxable income would increase sharply for those receiving tuition benefits thus providing a disincentive for employees to utilize the benefit and advance their career and life prospects.[61]

Note that the proposal to eliminate the exclusion of qualified tuition reductions was included in Representative Camp's 2014 proposal and expected to generate $2.5 billion in revenue for the government during the period 2014–2023.[62]

C. Deduction for Student Loan Interest

Students generally must begin repaying student loans six months after graduation. Currently, former students (or their parents, if the parents have taken out the loans) can deduct up to $2,500 of student loan interest. This deduction is limited to low- and middle-income taxpayers, as the deduction is phased-out for married filing jointly taxpayers with income exceeding $135,000 and is completely phased-out when the modified adjusted gross income reaches $165,000 in 2018.[63]

For 2016, the latest year for which data is available, the IRS Statistics of Income reports that 13,446,150 tax returns claimed the student loan interest deduction, for a total deduction amount of $12,396,180,000, which averages $922 per tax return on which the deduction was

61. Letter from Peter McPherson, President, Ass'n of Pub. & Land-Grant Univs., to Kevin Brady, Chairman, & Richard Neal, Ranking Member, House Ways & Means Comm. (Nov. 6, 2017), http://www.aplu.org/news-and-media/News/public-research-universities-detail-deep-concerns-over-tax-bill.

62. Camp Discussion Draft, *supra* note 38.

63. I.R.C. § 221. In 2018, phase-out begins at $65,000 for Single and Head of Household filers. *See* I.R.C. § 221(f) (phase-outs adjusted for inflation). No deduction is allowed for married taxpayers who file separately. I.R.C. § 221(e)(2).

claimed.[64] Assuming a 15% tax rate, these taxpayers saved $163 in taxes by deducting their student loan interest. Collectively, the tax cost to the government was just over $2 billion, for a total of $20 million over the ten-year budget period covered by the tax law change. Once again, these amounts of lost tax savings are meaningful for the low- and middle-income taxpayers who would lose them, but immaterial when compared to the lost revenue of $846.2 billion over the ten-year period due to the estate tax changes and AMT repeal that benefit only wealthy Americans.

Note that the proposal to eliminate the deduction for student loan interest was included in Representative Camp's 2014 proposal and was expected to generate $13 billion in revenue for the government during the period 2014–2023.[65]

D. Employer-Provided Educational Assistance

Currently, employers may provide up to $5,250 of tax-free educational expenses for employees. This law was slated for repeal in one version of the new tax law, which would have been unfortunate, as one article reports the following:

> The provision for the tuition waivers benefits a range of employees, from administrative staff and faculty to maintenance and janitorial staff.
>
> According to a 2017 survey conducted by the College and University Professional Association for Human Resources, the majority of employees benefitting from the provision are low and middle income given that fifty percent of recipients of tuition reductions earned $50,000 or less and 78 percent earned $75,000 or less.
>
> If Section 117 were repealed, taxable income would increase sharply for those receiving tuition benefits thus providing a disincentive for employees to utilize the benefit and advance their career and life prospects.[66]

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64. IRS Pub. 4801, *supra* note 50, at 15–16, line 34.

65. Camp Discussion Draft, *supra* note 38.

66. Jamaal Abdul-Alim, *Higher Education Groups Take Aim at GOP Reform Bill*, Diverse Issues in Higher Educ. (Nov. 6, 2017), https://diverseeducation.com/article/104680/.

Note that the proposal to eliminate the exclusion of these educational assistance programs was included in Representative Camp's 2014 proposal and expected to generate $10.5 billion in revenue for the government during the period 2014–2023.[67]

E. Suspension of Deduction for Miscellaneous Itemized Deductions

If taxpayers were engaged in a trade or business, and incurred educational expenses, those were deductible as miscellaneous itemized deductions, subject to the 2% floor. Miscellaneous itemized deductions were suspended by the new tax law until tax years beginning after 2025.[68]

VI. Executive Compensation

Representative David Camp's tax reform proposal included a 25% excise tax on excess compensation for all tax-exempt entities. The provision stated that a tax-exempt organization would be subject to a 25% excise tax on compensation in excess of $1 million and would apply to the five highest paid employees of the tax year. This would create parity with the nondeductible compensation in excess of $1 million for executives of publicly traded corporations.[69] Once an employee was included in this category, the employee's wages would continue to be subject to the excise tax as long as the organization paid remuneration to that person. The tax also applied to excess parachute payments (payments contingent upon the person's separation of service from the organization that have an aggregate present value of three times the employee's base compensation). This excise tax was projected to increase government revenue by $4 billion over the ten-year period 2014–2023.[70]

During the House Ways and Means Subcommittee on Oversight held on October 7, 2015, discussions arose on the level of executive compensation by colleges and universities. As such, it is not surprising that this legislation was again proposed, and ultimately enacted, as part of the TCJA. The excise tax rate is 21%, consistent with the 21% flat tax

67. Camp Discussion Draft, *supra* note 38.

68. I.R.C. § 67(g).

69. Note that Camp's proposal included a flat 25% tax rate on corporations, which is why the excise tax was set at 25%.

70. Camp Discussion Draft, *supra* note 38.

rate imposed on corporations. The mechanics of the 21% excise tax imposed by the TCJA are identical to those proposed in 2014 by Representative Camp. According to the Joint Committee on Taxation Report on December 18, 2017, this measure is expected to generate $1.8 billion in revenue for the federal government over the ten-year period 2018–2027.[71]

VII. Other Considerations

Three other provisions enacted as part of the TCJA are expected to affect the dollar amount of contributions donated to colleges and universities and therefore potentially affect the amount of scholarships that low- and middle-income families receive. First, the increased standard deduction enacted by the TCJA will significantly reduce the number of taxpayers who itemize their deductions. Second, the substantial increase in the estate tax threshold will significantly reduce the number of estates that must pay estate taxes. Finally, the TCJA eliminated the 80% charitable contribution deduction for rights to purchase seats at athletic events. These three provisions are expected to decrease the amount of charitable giving to colleges and universities, and past history indicates the soundness of this expectation: Mark Rosenman, in an opinion for The Chronicle of Philanthropy, states that "[w]hen there was a one-year hiatus in [the estate] tax was in effect bequests dropped by over a third."[72]

VIII. Conclusion

Politicians touted the TCJA as tax reform for middle-class Americans. Middle-class Americans generally desire for their children to attain a college education, an achievement that is necessary for upward economic mobility, but is becoming more difficult as tuition rates increase at a rate much higher than increases to parents' salaries. As such, students rely more heavily on scholarships and loans to finance their college education. The provision in the TCJA that imposes an excise tax on university endowments at certain private educational institutions will likely decrease the dollar amount of scholarships that are available to students

71. JCX-67-17, *supra* note 12, at 5, item I.2.

72. Mark Rosenman, *Nonprofits and the People They Serve Lose Big in Tax Overhaul Bill*, Chron. Philanthropy (Nov. 15, 2017), https://www.philanthropy.com/article/Opinion-Nonprofitsthe/241775.

from middle-class families, significantly harming, rather than helping, middle-class families. The current administration, by taxing college endowments, has likely reduced the number of available scholarships by almost 7,000 full-time students. This will directly affect middle-class constituents, the very people the new tax law purported to help. Michael Bloomberg, in calling for federal and state governments to invest in college access, as he has done himself, states "[t]here may be no better investment that we can make in the future of the American dream—and the promise of equal opportunity for all."[73]

The new excise tax, in addition to making education more costly to middle-income Americans, seems to have a punitive nature to it. Although the issue of taxing college and university endowments has been proposed in the past, it is only the current administration that has actually passed the measure, which notably will not increase government revenue by a meaningful amount. Instead, the taxation of only private colleges and universities with endowments of $500,000 per student targets mainly the elite schools in the nation where the political climate at those schools often happens to oppose the current administration.

Finally, it seems as if this new excise tax legislation is simply aiming at an easy target, because, unlike individuals, universities do not vote and do not make political contributions to candidates. Further, unlike corporations, universities do not hire top politicians after they retire or lose their seat. As such, universities, especially the wealthy ones, are often seen as spoiled institutions who are detached from "the real world," and therefore the new legislation's focus on those that are simple and easy to target, especially when some of these elite schools are generating significant contributions from wealthy donors.

Other measures decreasing the affordability of higher education were proposed in the TCJA but fortunately were not ultimately enacted. These proposals are mentioned in this Essay because many have been proposed in the past and therefore are likely to become sources of consideration in the future.

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73. Bloomberg, *supra* note 15.

Table 1: Private Colleges and Universities with Endowments of more than $500,000 per Student and Breakdown of each School's Endowment[74]

Institution	FY 2017 Endowment Funds	FY 2017 Investment Income*	1.4% Tax**	FY 2017 Tuition	Reduced Scholarships***
Princeton University	23,812,241,000	2,905,093,402	40,671,308	47,140	862.78
Yale University	27,176,100,000	3,315,484,200	46,416,779	51,400	903.05
Stanford University	24,784,943,000	3,023,763,046	42,332,683	49,617	853.19
Harvard University	36,021,516,000	4,394,624,952	61,524,749	48,949	1,256.92
Pomona College	2,229,361,000	271,982,042	3,807,749	51,075	74.55
Massachusetts Institute of Technology	14,967,983,000	1,826,093,926	25,565,315	49,892	512.41
Swarthmore College	1,955,532,000	238,574,904	3,340,049	50,822	65.72
Amherst College	2,248,141,000	274,273,202	3,839,825	54,310	70.70
Williams College	2,508,773,000	306,070,306	4,284,984	53,550	80.02
Franklin W Olin College of Engineering	376,279,000	45,906,038	642,685	48,181	13.34
California Institute of Technology	2,606,505,000	317,993,610	4,451,911	49,908	89.20
Grinnell College	1,871,046,000	228,267,612	3,195,747	50,714	63.02
Washington and Lee University	1,547,135,000	188,750,470	2,642,507	50,170	52.67
Rice University	5,814,444,000	709,362,168	9,931,070	45,608	217.75
Cooper Union for the Advancement of Science and Art	798,919,000	97,468,118	1,364,554	43,850	31.12
Dartmouth College	4,956,494,000	604,692,268	8,465,692	53,368	158.63

University of Notre Dame	9,352,376,000	1,140,989,872	15,973,858	51,505	310.14
Wellesley College	1,930,752,000	235,551,744	3,297,724	51,148	64.47
Berea College	1,150,360,000	140,343,920	1,964,815	25,760	76.27
University of Richmond	2,373,506,000	289,567,732	4,053,948	50,910	79.63
Washington University in St Louis	7,860,774,000	959,014,428	13,426,202	51,533	260.54
Emory University	6,905,465,000	842,466,730	11,794,534	49,392	238.79
Smith College	1,767,466,000	215,630,852	3,018,832	50,044	60.32
Claremont McKenna College	784,363,000	95,692,286	1,339,692	49,045	27.32
Duke University	7,911,175,000	965,163,350	13,512,287	53,500	252.57
Totals	193,711,649,000	23,632,821,178	330,859,496		6,675.12

*The investment income is the amount of the endowment multiplied by the 12.2% average rate of return (net of fees) generated by endowments in FY 2017, as reported by the NACUBA (2018).

**The tax is computed as the Investment Income multiplied by the 1.4% tax rate.

***The number of reduced scholarships is computed as the tax divided by the cost of attendance.

74. The information in Table 1 is listed in order of highest endowment per student, and the data is derived from *Rankings: Largest College Endowment per Student—Highest Endowment per Student*, College Raptor, https://www.collegeraptor.com/college-rankings/details/EndowmentPerStudent (search generated Nov. 6, 2018; on file with authors) (used to determine which schools had an endowment of more than $500,000 per student); and *U.S. and Canadian Institutions Listed by Fiscal Year (FY) 2017 Endowment Market Value and Change in Endowment Market Value from FY2016 to FY2017 (2018)*, https://www.nacubo.org/-/media/Nacubo/Documents/EndowmentFiles/2017-Endowment-Market-Values.ashx?la=en&hash=E71088CDC05C76FCA30072DA109F91BBC10B0290 (used to determine the amount of the endowment).

Table 2: Twelve Colleges That Give Merit Aid to the Most Students[75]

School	Percentage of Full-time Students Awarded Merit Aid in 2018
Trinity University (TX)	49%
Furman University (SC)	48%
Samford University (AL)	47%
University of Puget Sound (WA)	47%
Cooper Union (NY)	46%
Hillsdale College (MI)	44%
Rhodes College (TN)	44%
College of Wooster (OH)	42%
Gonzaga University (WA)	42%
Birmingham-Southern College (AL)	41%
Denison University (OH)	41%
Oberlin College (OH)	41%

75. Powell, *supra* note 16.