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Tax reform and higher education

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Now that the Tax Cuts and Job Act of 2017 has been passed it is possible to examine the implications for higher education. The tax reform bill is of particular interest to higher education because from its earliest drafts, Congress, and the House of Representatives, in particular, seemed to target higher education in ways that would raise costs for families and students. This apparent objective flies in the face the increasing need for investments in human capital for young people (see here and here) and of vocal concerns about the increasing costs of a college education (see here here and here).

The initial version of the tax reform included the taxing of tuition benefits for employees, graduate students and employees dependents. It eliminated the deduction for student loan interest, as well as tax-free financing for private college and university capital projects. The bill also proposed a 2% tax on endowment returns that would have affected about 250 institutions (Saint John’s University would have fallen just outside the original threshold). These provisions naturally spurred institutions, students and families to lobby Congress, arguing that the proposed changes would make it harder for students to afford what is increasingly becoming a required credential for the middle class and for institutions to hold down tuition costs.

In the end, the outcome was not as dire as first feared, as the Senate bill, which was largely the basis for the final bill, was not as punitive toward higher education .* The taxing of tuition benefits was removed from the final bill. The deductibility of student loan interest was retained
and only with refinancing of capital projects does the interest become taxable. The endowment tax remained but was dropped to 1.4% of investment returns and the endowment per student threshold was raised to $500,000, which dropped the number of institutions affected to approximately 32.

From the perspective of the academy and economic research that emphasizes the importance of investment in human capital for long-run economic growth, good sense mostly prevailed.

Yet three questions remain.

1. **Why would Congress punish private institutions?** The endowment tax will only apply to private institutions despite the fact that many public institutions also have billion dollar endowments. One of the strengths of the American higher education system is the diversity of options available to students: 4500+ institutions of higher education, of which 2200+ are four year degree granting institutions. Private institutions range widely in size, program offerings and the nature of the student experience. They are also among some of the world’s finest schools and draw many thousands of the best international students in the world to the United States. While private institutions do benefits from some government grant and loan programs, they do not directly seek government revenues in the way public institutions do. Anything that would weaken this sector seems to be cutting off one’s educational nose to spite one’s growth-focused face.

2. **Why tax endowments?** While endowments certainly confer prestige and have a significant impact in some rankings, they serve a very important role in providing financial stability in uncertain times and allow institutions to make a long run reputational/quality promise to students and faculty. Endowments also, in normal economic times when market returns are at long-run historic levels, allow for institutions to do some combination of: covering costs that rise usually rise faster than inflation (labor costs), moderating tuition increases and increasing programming, research activity or educational quality. In short, endowments provide an important source of revenue that allows institutions, at least potentially, to control tuition while maintaining institutional quality. Taxing them makes this less possible. In addition, the gifts that schools used to build their endowments were given with the understanding that the returns would be untaxed, as colleges and universities are
non-profits. This new provision obviously violates that understanding and potentially impacts future giving. Furthermore, it opens the door for taxing any charitable institution’s endowment, from less well-off schools to foundations of any kind. This change represents a fundamental change in the way charitable organizations are treated in tax law.

3. **Have Congressional and public attitudes toward higher education changed?**

This last question strikes me as the most important one. Some commentators have observed that the provision targeting higher education are primarily political. The Minding the Campus blog argues:

> Public attitudes toward universities have distinctly soured in recent years. What the public perceives as outrageous student behavior, feckless university leadership, and excessive tuition fees has combined with a growing hostility by Republican lawmakers angered over the large political donations and public criticism that academics have made attempting to oust them from office. Lawmakers are growing tired of feeding the mouths that bite them. Revenues raised by taxing colleges can modestly help fund other tax reductions that lawmakers want to make, which are probably economically beneficial to the well over 90 percent of the population living outside the Ivory Towers of Academia.

This hypothesis does not address why the provisions in the new tax law focus on private institutions (recall incidents at Berkley and Evergreen State), but it is consistent with the current contentious political environment.

If this interpretation of the tax provisions is accurate, the question for higher education and the public is whether these views are temporary or represent a fundamental shift in attitudes. There is very strong evidence that a well-educated populace plays an important role in long-run economic growth (for example see [here](#) and [here](#)). There is also evidence that the changing role of technology in the economy is requiring a *more educated workforce*. All of which suggests that higher education has and will continue to play a central role in the prosperity of individuals,
their families and the country as a whole.

To let politics get in the way of educating young people, either on campuses or in legislative bodies, will leave us all poorer.

*One other provision in the final version of the tax law that is likely to impact colleges and universities is the doubling of the standard deduction, which will cause the number of itemizing taxpayer to drop from about 30% of taxpayers to 5%. Though this change was largely aimed at tax simplification rather than targeting higher education and other charities.

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