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WILL THE OUTCOME DIFFER FROM THE INTENT?

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ABSTRACT

The Basic Opportunity Grants symbolize one approach to the financing of higher education. In this paper, the formula of the grant is tested against the theory and practice of negative income taxation. A key concept in both Basic Opportunity Grants and in other types of income taxation is that of the family unit whose income must be counted in calculating benefits. This concept is critical to the success or failure of the Basic Opportunity Grant in achieving the aims that have been set for it. The conclusion is that college students cannot be held in dependent status in many cases and that this means that some of the arguments for the Basic Opportunity Grants are questionable.

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The Basic Opportunity Grants authorized by the Education Amendments of 1972 signal a new era in the financing of higher education. Although not yet fully funded by the Congress, these grants are hailed by many, including the Carnegie Commission on Higher Education, as an important step toward a new balance in sources of funds which will feature (a) a larger role for the federal government; (b) higher tuition charges, particularly at public schools; and (c) money payments to students, rather than to institutions, that vary directly with cost of school attended and inversely with "family resources."

This new pattern of funding is seen by the Carnegie Commission as necessary to the achievement of three major goals:

> (1) To minimize the financial obstacle to college attendance, and thus to implement the principle of universal access to college education.
>
> (2) To seek to improve equity in the funding pattern of higher education, both in direct charges to students and parents, and in indirect charges to the taxpayers in general.
>
> (3) To retain and strengthen the vitality of the diverse system of public and private institutions of higher education.*

In this paper we do not quarrel with those three goals. However, we do question whether the Basic Opportunity Grant (BOG) approach will, in fact, turn out to be supportive of them. We conclude that a likely result,

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*Higher Education: Who Pays? Who Benefits? Who Should Pay?, a Report and Recommendations by the Carnegie Commission on Higher Education, McGraw-Hill Book Company, June 1973, p. 102.

quite different from the one intended by proponents of BOG, is a pattern of grants relatively invariant to family income through the range occupied by most families. In addition, the maximum grant will be insufficient to induce college attendance by any large number of college age youngsters from low-income families.

Formula for Calculating Basic Opportunity Grants

The BOG formula may be thought of as a variant of a negative income tax, wherein the three key variables are the maximum grant payable (the guarantee), the rate at which the grant is reduced as family income increases (the implicit tax rate), and the level of family income at which the grant is reduced to zero (the break-even level of income). Several significant details need to be legislated in any real-life redistributional program of negative income tax character: (1) the bases for variation of the guarantee; (2) the persons to be included in the family unit; (3) the itemization of income to be counted, excluded, or deducted; and (4) the income accounting period.

The first indications of how BOG would actually work when and if it is fully funded are found in tentative regulations prepared by the Office of Education and published in Vol. 28, No. 33 of the Federal Register, February 2, 1973. According to these regulations, it would work in the following fashion.

The guarantee is to equal one-half the cost (including living expenses) of going to a school but cannot exceed $1,400. No grant of less than $200 is payable. The guarantee is reduced dollar for dollar by student receipt of social security or veterans benefits related to school attendance. It is further reduced by an amount equal to 5 percent of parents' net assets in excess of $7,500 and by 33 1/3 percent of a student's net assets. The

guarantee is increased if a family has more than one dependent in post-secondary school.

The family unit varies by whether the student is classified as "dependent" or "independent." If he is dependent, the family unit, whose income and resources are relevant in calculating the amount of the grant, includes the student, the parent or other person who claims the student as his dependent, the spouse of the parent unless separated or divorced, and others claimed as dependents. In the case of an independent student, the family unit includes the student, his or her spouse, and other dependents.

Income to be counted includes all items in adjusted gross income under the federal income tax, plus a number of items that are not, such as the full amount of realized capital gains and public assistance benefits. Excludable and deductible income is equal in amount to federal income tax paid, a family size offset ($4,300 for a family of four, but only $700 for the single, independent student), extraordinary medical expenses and casualty loss, 50 percent of up to $3,000 of earnings of a lesser-paid spouse or of a single parent, up to $600 earnings of a dependent student and each other dependent, and gifts from outside the family unit. The tax rate on these exclusions and deductions is zero.

The income accounting period is the calendar year prior to the beginning of the school term.

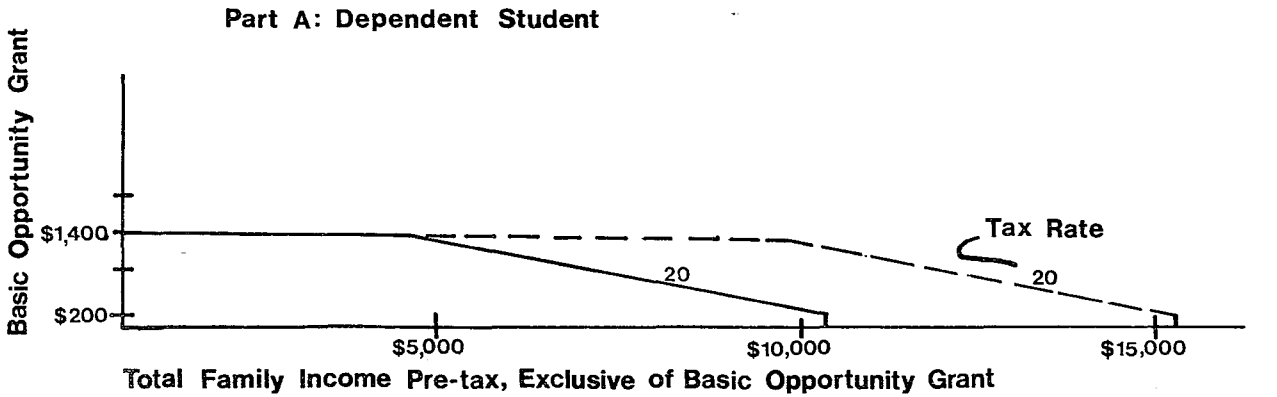
The tax rate in the case of a family of a dependent student, is 20 percent on the first $5,000 of income beyond exclusions and deductions, and 30 percent on additional income. For an independent student, the tax rate is 75 percent if single, 50 percent if married, and 40 percent if the student is married and has additional dependents.

Calculation of grants may be visualized by reference to Figure 1 and Table 1. Part A shows the case of a dependent student, assuming a school costing $2,800 or more, a family of four, only one student in post-secondary school, parental assets under $7,500 and student assets of zero. In this case the maximum grant payable (or guarantee) is $1,400 and is undiminished by the first $4,300 of income, which is equal to the family size offset. At this point the "expected family contribution" is the full cost of going to school (let's assume that is $2,800) less the $1,400 grant, or $1,400. Additional income will be taxed, if there are no other excluded or deducted items, at 20 percent. This would mean a break-even income of $10,300, indicated by the solid line. Recall that the minimum grant payable is $200. However, it is likely that there will be some exclusions or deductions. If they total $5,000, as shown on the dotted line, the break-even income becomes $15,300, and the grant payable at, say, $10,000 of pre-tax income is $1,260.

Part B shows the case of an independent student, assuming zero assets. If he is single and earns no more than $700, he receives the maximum grant of $1,400. The break-even income point for him if he receives no gifts is $2,300. (This means that he cannot fully finance school costs of $2,800 while receiving a partial BOG grant. This is a major defect.) However, if he receives $600 in gifts, the break-even moves to $2,900 (not shown in the figure). If the student marries, the family size offset jumps from $700 to $2,800, and with a tax rate of 50 percent the break-even jumps to $5,600. Exclusions and deductions might well move the break-even to $7,600 (shown by the dotted line). The regulations are silent with regard to the case of a married couple, both of whom go to school.

Figure 1

Illustration of Basic Opportunity Grant Variation with Family and Income Status



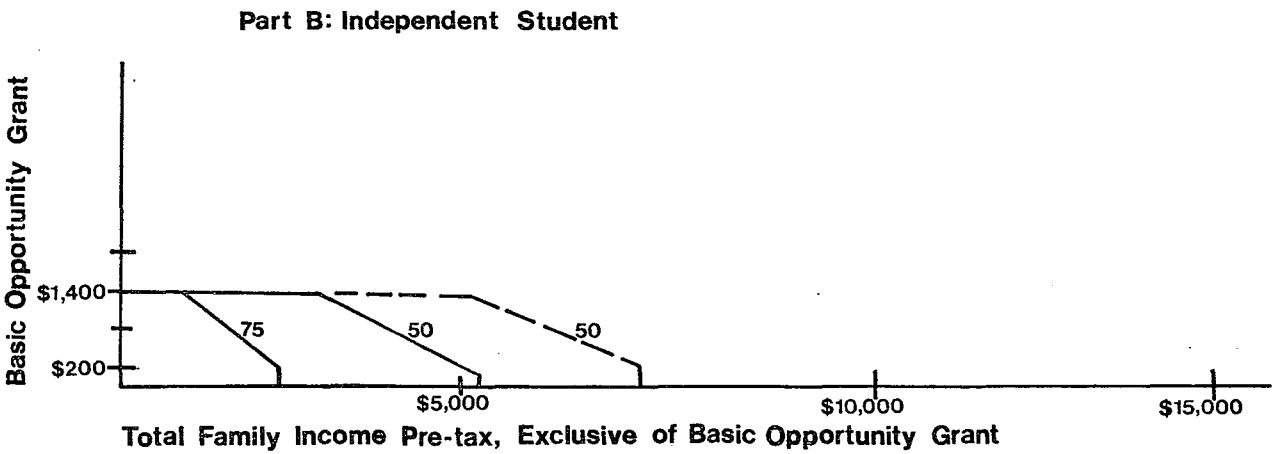


TABLE 1

ILLUSTRATION OF BASIC OPPORTUNITY GRANT VARIATION
WITH FAMILY AND INCOME STATUS

Total Family Income, Pre-Tax	Family Size Offset	Countable Income (with no deductions)	Basic Opportunity Grant (with no deductions)	Assumed Deductions	Countable Income (with deductions in (5))	Basic Opportunity Grant (with deductions in (5))
(1)	(2)	(3)	(4)	(5)	(6)	(7)
Part A: Dependent Student						
$ 0	$4,300	$ 0	$1,400	$ 0	$ 0	$1,400
4,300	4,300	0	1,400	0	0	1,400
7,300	4,300	3,000	800	2,000	1,000	1,200
10,300	4,300	6,000	200	3,000	3,000	800
10,301	4,300	6,001	0	--	--	--
15,300	4,300	11,000	--	5,000	6,000	200
Part B: Independent Student						
Single						
$ 0	$ 700	$ 0	$1,400			
700	700	0	1,400			
1,400	700	700	875			
2,300	700	1,600	200			
2,301	700	--	0			
Married						
0	2,800	0	1,400	$ 0	$ 0	$1,400
2,800	2,800	0	1,400	0	0	1,400
4,200	2,800	1,400	700	1,400	0	1,400
5,200	2,800	2,400	200	2,000	400	1,200
6,000	2,800	3,200	--	2,000	1,200	600
7,200	2,800	4,400	--	2,000	2,400	200

Other Matters that Will Determine How BOG Grants Vary with Family Income

The regulations contain several provisions that will make for more constancy of grants across the range of family incomes than is suggested by Figure 1 and Table 1. The first of these sets the maximum grant at 50 percent of school cost up to $1,400. Presumably, most youngsters from low-income families will go to low cost schools and those from higher income families will go to higher cost schools, so the average grant to low-income families will be less than $1,400 and the average grant to middle-income families will be close to $1,400. The magnitude of this effect will depend on whether youngsters from low-income families are induced to attend college by the program. That, in turn, depends partly on what happens to tuition levels. Clearly, more students from low-income families would be encouraged to attend if the guarantee were set at $1,400 regardless of school attended.

Second, the regulations would permit a family to move the student's dependency to the income tax return of a lower income member. This could be, for example, the income tax return of the mother who is separated from her husband.

Third, BOG regulations do not assume that all students are dependent and, hence, that the family of the student's parents is the relevant family. The legislation permits a classification of "independent" students, the effect of which may serve to further reduce the variation of actual grants across the range of family income.

To be classified as independent a student must not be claimed as an exemption for income tax purposes, except by a spouse, in either the calendar year prior to or during the school year, must not receive gifts

from home of more than $600 in either year, and must not live at home during either year.

Some students are, of course, necessarily independent, with no parent or other person contributing anything to their support. Others are, or could be, partially self-supporting, and could become "independent" for purposes of the Basic Opportunity Grants program.

A look at Figure 1 or Table 1 suggests that a family interested in maximizing the size of their BOG grant has little or no incentive to convert the student to independent status so long as total income is below about $10,000 for a family of four. Let us assume a case where the gain would be clear. Suppose a student from a family with $20,000 income moves away from home on January 1 to start his freshman year. He is not eligible for any grant that year, but he finances himself with a gift of $600 from his parents, earnings of $700, and a loan of $1,500. Alternatively, he could get the $1,500 as a gift from his grandparents, or out of his own assets. In any event, this would qualify him in his sophomore year to get a $1,400 grant, which together with $500 from his parents and $700 of earnings would almost cover his school cost. (We are ignoring the student's expenses for the summer.) The parents would lose the tax advantage (about $800) of claiming the student as an exemption for four years and get in return $4,200, or three years of maximum BOG grants.

Converting to "independent student" status will be eased for students from affluent families by failure of the regulations to mention loans, some gifts, or insurance. Presumably, a student could borrow from his parents or grandparents or co-sign a note from a bank with his parents, and have the loan cancelled or repaid by the parent after the student graduates. Gifts from relatives other than parents are not mentioned, and

the careful timing of gifts could get one around the intent of the regulations. The regulations seem to ignore gifts like use of a car, or house, or textbooks owned by a parent. Trust funds and pensions are mentioned, but insurance policies are not. Suppose a student is a beneficiary of an endowment policy which pays him $1,000 on his 18th birthday. Apparently the $1,000 is not counted as income, and if spent by the next application date (apparently there will be a certain date for assessing assets) it would not affect his BOG grant. The definition of countable assets sounds loose enough to allow a clever student to avoid having any. Needless to say, enforcement of provisions relating to loans and gifts will be very difficult.

The point is that students from high-income families may qualify for maximum grants under the BOG program if they want to go to the trouble of establishing independent status. Perversely, the program will make it difficult for a student from a low-income family to go this route. Suppose a parent from such a family declines to supply any income information or to make any financial contribution. The fact that the student lived at home in the base year would disqualify him for a grant as an independent student. If he earned $2,800 to cover his freshman year expenses he would thereby disqualify himself for a grant in his sophomore year, since that amount is beyond his break-even income of $2,300. (We referred to this anomaly in discussing the calculation of grants earlier.)

Practicability of Forcing "Dependent" Status of Students

The difficulties of making a sensible distinction between dependent and independent students points to the possibility of a complete breakdown of the BOG system of conditioning grants on parental income. The definition of a family unit is troublesome in all redistributive schemes. In the

income tax, a taxpayer does not have to claim anyone as a dependent or as a joint filer but he is allowed to do so if he finds it to his advantage, which he will in a wide variety of cases. Frequently, however, it is to his advantage to allow family members, including minors, to file separately and thereby to split the total family income in the face of a schedule of progressive rates.

This permissiveness is recognized as inappropriate in the case of a negative income tax, and most writers on this form of taxation have advocated a form of compulsory joint filing by spouses and their children. The only type of negative income tax in which this might not be necessary is one where the guarantee is a flat amount per adult (above age 18 or 21) and a flat amount per child, and where the implicit tax rate is flat from the first dollar of includable income. A weak point in the case for negative income taxation is the response to the question: Are you going to allow the teenage son or daughter of an affluent parent to file separately and claim the full guarantee? A fact of life is that many 18 to 25 year olds are alternately in and out of the family unit. One crude way to deal with this is simply to make people ineligible to file separately unless they are married or over, say, 21 years of age. Any decision on this point is awkward when the target group is the college-age population.

The same problem of defining the family unit has a rich history in the law of public assistance. In every one of the categorical relief programs the legislative and judicial record has been one of narrowing the family unit and of limiting the number of people whose resources are counted in calculating the grant. Thus, most states gradually came to ignore the resources of adult children in computing Old Age Assistance payments. Aid to Families with Dependent Children (AFDC) once counted the income of the

parent of the mother, but that has long since ceased to be the case. The "expected family contribution" of an absent father used to be counted, but courts have ruled it is unconstitutional to count anything other than the actual contribution received in calculating AFDC benefits.

Perhaps most relevant to our consideration of BOG is a recent case in this tradition of welfare law, namely U.S. Department of Agriculture v. Murry, 41 LW 5099, U.S. Sup. Ct. No. 72-848, June 25, 1973. In that case the U.S. Supreme Court ruled that it is unconstitutional to deny food stamp benefits to persons aged 18 or older who are or recently have been claimed as income tax dependents. The Court said that the legislative purpose of helping people who were in need was inconsistent with the irrebuttable presumption that they were not needy simply because someone else had claimed them as a dependent. The Court said,

> We conclude that the deduction taken for the benefit of the parent in the prior year is not a rational measure of the need of a different household with whom the child of the tax-deducting parents lives and rests on an irrebuttable presumption often contrary to fact. It therefore lacks critical ingredients of due process.... (41 LW at 5101)

It would seem plausible that the BOG's provision that denies a student's right to file as an independent student by an irrebuttable presumption related to his being claimed as a tax dependent would be struck down on the reasoning used in the Murry case. If this were to happen, the calculation of grants for students who opted to file as independent would have to be re-designed to take account of "actual" parental contributions rather than "expected" ones. This would require a fundamental reorientation in both the philosophy and practice of student financial aid.

Conclusion

Our predictions are that the goals stated by the Carnegie Commission will be only imperfectly served by the Basic Opportunity Grants program. Whether it will further the purpose of inducing more enrollments by students from low-income families will depend, in part, on how much tuitions rise. Such enrollments could be further encouraged by raising the maximum grant above the present "half-cost up to $1,400" rule. However, that would run the risk of encouraging more students from affluent families to go the "independent student" route, a route which the courts are likely to open wider. That, in turn, would frustrate the goal of having parents pay for college along ability-to-pay lines and, at the same time, produce a pattern of relatively flat grants for students from all family backgrounds. It would, incidentally, mean that the BOG program would cost more to fund than has been estimated. With regard to the third goal, namely, preserving private schools, BOG would be supportive, especially if it were associated with differential tuition increases by the public schools. In short, the effects of the BOG program are likely to fall far short of the expectations for it.