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The Tax Deduction for Classroom Expenses of Elementary and Secondary School Teachers

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Summary

An above-the-line deduction for certain classroom expenses paid or incurred during the school year by eligible elementary and secondary school (K-12) teachers, among other educators, was authorized in the Job Creation and Worker Assistance Act of 2002 (P.L. 107-147). The classroom expense deduction was made available to eligible educators for tax years 2002 and 2003. It expired on January 1, 2004. H.R. 3025 and S. 2050 include extension of the educator classroom expense deduction. Two proposals that address tax issues beyond education (H.R. 3521 and S. 1896) would extend the teacher deduction as well. This report describes the classroom expense deduction, its interaction with other tax provisions, and proposals made concerning the tax benefit during the 108th Congress. The report will be updated based on legislative activity.

Introduction

As part of P.L. 107-147, Congress initiated a new temporary tax benefit to help K-12 teachers, among other school personnel, defray some of the expenditures they voluntarily make to enhance the quality of their students' education. Specifically, eligible educators employed by public (including charter) and private K-12 schools (as determined by state law) could claim an above-the-line deduction for certain expenses they paid or incurred in tax years 2002 and 2003 for use in their classrooms.

This is the first of a number of education-related tax provisions due to expire that Congress recently expanded or initiated on a temporary basis. Previously, in the Economic Growth and Tax Relief Reconciliation Act of 2001 (P.L. 107-16), Congress created a new higher education deduction through 2005 and expanded two tax-favored

education savings vehicles through 2010, all with the goal of making K-12 and/or higher education more affordable for students and their families.¹

Characteristics of the Educator Classroom Expense Deduction

Section 62(a)(2)(D) of the Internal Revenue Code (IRC) states that an eligible educator may, for tax years beginning during 2002 or 2003, subtract from gross income up to \$250 in expenses associated with their purchase of the following items *for use by the educator in the classroom*: books; supplies (other than nonathletic supplies for health or physical education courses); computer equipment, software, and services; other equipment; and supplementary materials.² Homeschooling expenses are not mentioned.

These expenses can be deducted as an adjustment to gross income. The “above-the-line” adjustment can be taken whether or not taxpayers itemize their deductions on Schedule A of Form 1040.

An eligible educator is defined, in Section 62(d)(1)(A), to be an individual who *with respect to any tax year* is a

- *K-12 teacher,*
- *instructor,*
- *counselor,*
- *principal, or*
- *aide*

in a school for a minimum of 900 hours in a school year.

The amount of deductible classroom expenses is not limited by the taxpayer’s income. However, educators must reduce the total amount they have expended on eligible items by any interest from an Education Savings Bond, or a distribution from a Qualified Tuition (Section 529) Program or Coverdell Education Savings Account that was excluded from income. In other words, if educators or members of their tax filing unit utilize earnings from these savings vehicles to pay tuition or other qualified educational expenses, only the classroom expenses that exceed the value of these income exclusions are deductible.

¹ For information on these education tax benefits see CRS Report RL31129, *Higher Education Tax Credits and Deduction: An Overview of the Benefits and Their Relationship to Traditional Student Aid*, by Adam Stoll, James B. Stedman, and Linda Levine; CRS Report RL31214, *Saving for College Through Qualified Tuition (Section 529) Programs*, by Linda Levine; and CRS Report RL32155, *Tax-Favored Higher Education Savings Benefits and Their Relationship to Traditional Federal Student Aid*, by Linda Levine and James B. Stedman.

² Classroom expenses that may be deducted also must qualify under Section 162 as trade or business expenses (i.e., the expenses must be ordinary and necessary but not capital in nature). Presumably, then, the cost of computers (as well as computer software with a useful life of more than 1 year) must be capitalized and their depreciation claimed as an educator classroom expense deduction or as a miscellaneous deduction. The latter tax benefit is addressed later in this report.

The allowable amount of expenses would be entered on Form 1040 or Form 1040A on the line labeled “educator expenses.” Filers of 1040EZ cannot take this adjustment to income.

There are a few ambiguities concerning the deduction that relate to the hours requirement. While the educator presumably would claim the deduction for the tax year (January-December) during which they incurred unreimbursed classroom expenses, they must have worked 900 hours in a school during the school year (September-June) to be eligible for the tax benefit. Would an individual who began working as a teacher at the start of the September 2003-June 2004 school year be able to take the deduction in tax year 2003 for expenditures made during the first term if they had not yet fulfilled the hours rule but expected to do so by the end of the school year? The linkage between the hours rule and the school year suggests another unclear point: does the work time of eligible school personnel during July and August — as part of summer school or a year-round schedule, for example — count toward the requirement? A third issue that has been raised is the meaning of work hours. Although the language in the legislation and IRC speaks of an eligible educator as someone “in a school for at least 900 hours,” some have wondered whether the job-related time spent by educators at home could count toward the hours requirement.

Related Federal Tax Provisions

Trade or Business Expenses. There is a permanent deduction for trade or business expenses in Section 162 of the IRC. It coexisted with the temporary targeted deduction and continues to be available to educators.³

Although business expenses have been deductible for many years, concern about misuse led to the imposition of limitations on their deductibility. Trade or business expenses generally are a component of miscellaneous itemized deductions. Taxpayers can only take a deduction to the extent the total of miscellaneous deductions exceeds 2% of their adjusted gross income (AGI).

Eligible school personnel may want to utilize the Section 162 deduction because it covers a broader range of expenditures compared to the classroom expense deduction.⁴

³ Consequently, the addition of the classroom expense deduction has increased the complexity of the IRC in general and may have made completion of educators’ tax returns more complex and time-consuming in particular. With regard to the latter point, educators may want to compute their income tax liability two different ways to determine which deduction is more advantageous for them — once based upon use of the above-the-line deduction and a second time based upon use of the Section 162 (business or trade expense) deduction.

⁴ For example, Section 62(a)(2)(D) requires that items be used in the classroom by the individual who purchased them. Thus, principals apparently could not take the deduction for books they bought for the use of teachers in their classrooms. In addition, school counselors or other eligible educators who subscribe to professional journals or pay dues to professional societies and/or unions, for example, could apply these expenses toward the trade or business expense deduction but not the classroom expense deduction. Another example of a non-classroom expense covered by Section 162 is education related to one’s current job. This last unreimbursed job-related expense will be discussed later in the report.

But, to do so, they must itemize their deductions (i.e., they must have deductible expenses, such as interest on a home mortgage, that exceed the standard deduction).

Alternatively, the classroom expenses deduction allows educators to avoid having to meet the 2% of AGI floor on miscellaneous itemized deductions. Most other taxpayers with earned income who have trade or business expenses must exceed the 2% floor for miscellaneous expenses in order to take a deduction for job-related expenses.⁵ In addition, the miscellaneous itemized deduction for trade or business expenses is not allowed for purposes of the alternative minimum tax, unlike the treatment of above-the-line deductions.

The temporary above-the-line deduction also means that eligible educators in higher income families may not have to subject classroom expenses of \$250 or less to the limit on itemized deductions. Higher income taxpayers must reduce their allowable itemized deductions by 3% of their income in excess of an inflation-adjusted threshold. The reduction can never surpass 80% of the allowable deductions, excluding deductions taken for medical expenses, investment interest, and losses associated with casualty, theft, or wagering. This reduction is calculated after the 2% floor on miscellaneous itemized deductions. The limitation on itemized deductions for higher income taxpayers is set to phase-out effective January 1, 2006, and to be completely eliminated effective January 1, 2010; the elimination of the limitation is set to expire on December 31, 2010, absent congressional action.

Use of the educator classroom expense deduction also interacts with other tax provisions through its reduction of AGI. By lowering their AGI, the adjustment to income enables taxpayers to claim more of those deductions subject to an AGI floor (e.g., medical and miscellaneous deductions). It also may affect the amount of certain credits (e.g., the Earned Income Tax Credit).

Contributions to Schools. Educators continue to have another tax benefit available to them that could improve the quality of students' education. They, like other taxpayers, may make charitable contributions to public and private schools of magazine subscriptions, for example, that the schools then can distribute to those same teachers (or others) for classroom use.⁶

Educators and others can make such charitable contributions and avoid the previously discussed 2% floor applicable to miscellaneous itemized deductions. Taxpayers must be able to itemize their deductions to take a charitable contribution deduction, however.

⁵ Certain occupations that can fully deduct work-related expenses from gross income are performing artists, and state and local officials working on a fee basis. Individuals with disabilities also can fully deduct expenses they incur that enable them to work.

⁶ Section 170(c)(1) of the IRC relates to charitable contributions to public entities, including public schools. Section 170(c)(2) covers corporations, foundations, and other enterprises organized and operated exclusively for educational among other specified purposes (e.g., private schools and certain charitable organizations). Contributions to such education-related firms as learning centers, tutoring companies, or test preparation enterprises are not deductible expenses.

The choice between taking an educator classroom expense deduction and a charitable contribution deduction for computer expenses has an additional complication. When computers are taken as an educator expense deduction or a miscellaneous itemized deduction, taxpayers can consider only the depreciated value as a trade or business expense. When computers are donated to schools or certain charitable organizations, however, taxpayers can consider the actual value (e.g., purchase price if new and fair market value if used) as a charitable deduction.

Legislative Proposals

In its FY2005 budget request, the Administration proposes making the educator expense deduction permanent and raising the limit to \$400. It also has seeks to clarify the hours rule to specify that the 900 hours must be worked in “a school year ending during the taxable year.” In addition, the definition of eligible expenses would be expanded to include training related to a current teaching position. Travel or lodging expenses, and expenses associated with religious instruction or activities, would not be covered. To prevent taxpayers from obtaining multiple benefits for the same expenses, expenses used for the educator classroom expense deduction could not be used toward the miscellaneous itemized deduction or any other tax benefit, such as the Hope Scholarship and Lifetime Learning credits.⁷

The revenue loss associated with the Administration’s proposal is estimated to be more than \$1.2 billion over the FY2005-FY2009 period, including \$229 million in FY2005.⁸ Data drawn from 2002 income tax returns, the first year of the educator classroom expense deduction, are not yet available from the Internal Revenue Service.

A few bills related to K-12 educators’ classroom expenditures were proposed during the first session of the 108th Congress.⁹ One received floor action. On November 19, 2003, the Tax Relief Extension Act of 2003, H.R. 3521, which deals with expiring tax provisions generally and trade among other things, was introduced. The House passed H.R. 3521 on November 20. The legislation would extend the educator classroom expense deduction to tax years beginning during 2004. The identically titled S. 1896, which also was introduced on November 19, 2003 and referred to the Committee on Finance, was more narrowly framed. With regard to the deduction for educators’

⁷ Section 162 allows taxpayers to deduct unreimbursed education and training expenses if the training is related to the individual’s current trade or business and neither helps them meet the minimum requirements of their current fields nor prepares them to enter new fields. Taxpayers who take undergraduate and graduate courses (including one or more job skills classes) at an eligible institution of higher education can utilize the Lifetime Learning Credit (or the Higher Education Deduction through 2005) to cover tuition and required fees. These and other benefits associated with qualified educational expenses must be coordinated with one another when filing one’s federal income tax return.

⁸ U.S. Department of the Treasury, *General Explanations of the Administration’s Fiscal Year 2005 Revenue Proposals*, Feb. 2004.

⁹ H.R. 3025 would extend the deduction through Dec. 31, 2008. H.R. 785 and S. 695 would broaden eligible expenses to include professional development courses taken by the educator that are related to the subjects they teach and the students they instruct. The former would increase the maximum to \$400; the latter, to \$500.

classroom expenses, the bill aims to clarify the relationship between the tax year and school year: it would apply the deduction to tax years beginning during 2002, 2003, “and the period beginning after December 31, 2003, and before July 1, 2004,” and states that the \$250 limit on expenses is “for each taxable year or \$125 for such period.” Thus, it would extend the deduction through July 1, 2004 and limit deductible expenditures during the January 1, 2004-July 1, 2004 period to \$125.

Thus far in the second session of the 108th Congress, it appears that one bill (S. 2050) has been introduced concerning the deduction. It would make the classroom expense deduction permanent and retroactive to its December 31, 2003 expiration date. In addition, the bill would repeal the applicability of the sunset provisions in the Economic Growth and Tax Relief Reconciliation Act of 2001 to some of the education tax benefits included in that Act thereby maintaining enhancements to benefits slated to end after December 31, 2010 (e.g., expanding Coverdell Education Savings Accounts to families’ K-12 expenses and making qualified withdrawals from Section 529 Qualified Tuition Programs tax-free).