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

Linda Levine
Specialist in Labor Economics
Domestic Social Policy Division

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). Some 10 months after the temporary deduction's expiration, the Working Families Tax Relief Act of 2004 (H.R. 1308) was passed and signed by the President (P.L. 108-311); the act extended the educator classroom expense deduction from its expiration date of December 31, 2004 to December 31, 2005. Although bills to modify or extend the deduction previously were introduced during the 109th Congress, none proceeded as far as has tax reconciliation legislation. Both H.R. 4297 and S. 2020 would extend the educator classroom expense deduction for one year through December 31, 2006. This report describes the income tax deduction, its interaction with other provisions in the Internal Revenue Code, and current proposals concerning the income tax benefit for eligible educators. It will be updated as legislative activity occurs.

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.

Almost 10 months after the deduction expired on January 1, 2004, the 108th Congress passed H.R. 1308, The Working Families Tax Relief Act of 2004. The President signed the bill on October 4, 2004. Among many other things, P.L. 108-311 extends the provision retroactive to its expiration date and through December 31, 2005. The classroom expense deduction was not included in either the House- or Senate-passed version of the bill. It first appeared in the conference report (H.Rept. 108-696).

The classroom expense deduction is one of a number of temporary education-related tax provisions that Congress has to periodically reconsider. (For additional information see CRS Report RS21870, *Education Tax Benefits: Are They Permanent or Temporary?*, by Linda Levine.) Legislation introduced in the 109th Congress to amend or extend the classroom expense deduction beyond its December 31, 2005 expiration date is discussed at the end of this report.

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.¹ 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.

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 distribution from a 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.

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.

¹ 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 one year) must be capitalized and their depreciation claimed as an educator classroom expense deduction or as a miscellaneous itemized deduction. The latter tax benefit is addressed later in this report.

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 coexists with the temporary targeted deduction and continues to be available to educators.²

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.³ 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).

² 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 for those expenses common to the two Code provisions.

³ 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.

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.⁴ 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.⁵

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.

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

⁴ 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.

⁵ The limitation on itemized deductions for higher income taxpayers is set to phase-out effective Jan. 1, 2006, and to be completely eliminated effective Jan. 1, 2010; the elimination of the limitation is set to expire on Dec. 31, 2010, absent congressional action.

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.

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 FY2006 budget request, the Administration proposed making the educator expense deduction permanent and raising the limit to \$400. It also sought to clarify the 900-hours rule by specifying that it refers to “a school year ending during the taxable year.” In addition, the definition of eligible expenses would be expanded to include training related to current teaching positions. 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 Further, taxpayers would be required to keep receipts of eligible expenses as well as “a certification from a principal or other school official that the expenditures qualified.” The revenue loss associated with the Administration’s proposal is estimated to be more than \$1.1 billion over the FY2006-FY2010 period.⁸

Although bills to modify or extend the educator classroom expense deduction previously were introduced during the 109th Congress,⁹ none advanced as far as has tax reconciliation legislation. H.R. 4297 (the Tax Relief Reconciliation Act of 2005) and S. 2020 (the Tax Relief Act of 2005) would extend the deduction for one year through December 31, 2006. The Joint Committee on Taxation estimates the revenue effect of a one-year extension could be \$60 million in FY2006 and \$139 million in FY2007 for a total of \$199 million over the FY2006-FY2010 period. The Ways and Means Committee

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 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 2006 Revenue Proposals*, Feb. 2005.

⁹ H.R. 2868 would raise the limit on eligible expenses to \$400 for full-time educators and to \$250 or other eligible individuals. Eligible educators are defined as (1) K-12 teachers, instructors, counselors, principals, or aides in a school for at least 450 hours during a school year which ends during a taxable year, and (2) teachers, instructors, counselors, or aides in a preschool program for at least 450 hours during a taxable year. A full-time educator is one who works 900 hours. The bill would extend the deduction through 2014 as well. In contrast, H.R. 2989 would make an increased deduction (to \$400) permanent. It also would expand expenses to cover professional development. And, the bill adds the phrase “ending during the taxable year.” While S. 1218 too would make the benefit permanent, it calls for a greater increase in the amount of the deduction (to \$500).

approved H.R. 4297 on November 16, 2005. The Senate passed S. 2020 on November 17, 2005.

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