May 9, 2019

The Honorable Richard Neal
Chairman
Committee on Ways and Means
U.S. House of Representatives
Washington, DC 20515

The Honorable Kevin Brady
Ranking Member
Committee on Ways and Means
U.S. House of Representatives
Washington, DC 20515

The Honorable Chuck Grassley
Chairman
Committee on Finance
United States Senate
Washington, DC 20510

The Honorable Ron Wyden
Ranking Member
Committee on Finance
United States Senate
Washington, DC 20510

RE: Taxability of Scholarships and Grants under the Tax Cuts and Jobs Act

Dear Chairman Neal, Chairman Grassley, Ranking Member Brady and Ranking Member Wyden:

I am writing today to urge you to swiftly correct a mistake made in the Tax Cuts and Jobs Act of 2017 (TCJA) that has inadvertently caused harm to many low- and middle-income students who rely on scholarship aid to pay for their college education.

As you are aware, college scholarships and/or grants have been exempt from federal income tax since 1986 if they are used to pay for tuition, required fees, books, supplies, and equipment. However, scholarships and/or grants for non-tuition expenses like room and board are taxed as a form of unearned income under the so-called “kiddie tax.”

Prior to the TCJA, children subject to the kiddie tax had their net unearned income (total unearned income less $2,100) subject to the marginal tax rate of their parents, which for low-income students is almost always low. The kiddie tax applies to full-time college students under age 24. The TJCA changed the rate rules for the tax. Instead of taxing a child’s net unearned income at his or her parent’s rates, the kiddie tax now applies the rates used for trusts and estates, which are higher and highly compressed compared to the tax rates for individual income filers.

Unfortunately, these changes to the kiddie tax sharply increased the tax levied on the portion of scholarships set aside for expenses such as room and board that colleges and universities award to students from families of little or modest means. Now these students are being taxed at the same rates as wealthy individuals.
Consider the impact on a full-time undergraduate student, claimed as a dependent by her parents, who have an income of $50,000 a year and jointly file as a married couple. In this example, the student receives a full scholarship for the total cost of the education at a private university, which includes tuition, room and board, books, and supplies.

Roughly $11,500 of the scholarship is subject to taxation, because it pays for room and board and similar expenses. If that money was taxed under the same 12 percent rate that applies to the student’s parents’ regular income, the amount owed now would be less than $1,400. But because it is taxed at the much higher trust and estates rates the amount owed is more than $2,600, an 85 percent increase.

Academic, need-based scholarship students are not the only ones impacted by the amended kiddie tax. College athletes on full scholarships, which include money for housing and other non-tuition expenses, are also impacted by the kiddie tax changes, many of whom, of course, come from economically disadvantaged families. Based on Department of Education data, the increased tax on scholarship/grant aid could affect nearly 1.4 million students and their families.

The problems caused by the change to the kiddie tax extend beyond higher education. We understand from news reports that some “Gold Star” families receiving survivor benefits also are affected.

I am confident that the adverse impact from the TCJA changes to the kiddie tax is an unintended consequence, which I believe you will be anxious to correct. We stand ready to provide more information and to work with you on rectifying this unfortunate situation.

Sincerely,

Ted Mitchell
President

cc: Members of the Ways and Means Committee
    Members of the Finance Committee