

# ANALYSIS OF AMENDED BILL

Author: Nguyen, et al. Analyst: Scott McFarlane Bill Number: SB 150  
 See Legislative History  
 Related Bills: History Telephone: 845-6075 Amended Dates: May 14, 2015 & June 4, 2015  
 Attorney: Bruce Langston Sponsor \_\_\_\_\_

<b>SUBJECT:</b>	Student Loan Forgiveness Debt Relief
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**SUMMARY**

This bill would provide an exclusion from gross income for student loans that are forgiven when the borrower is unable to complete a program of study because a school closes or does something wrong.

**RECOMMENDATION**

No position.

**Summary of Amendments**

As introduced January 29, 2015, this bill contained provisions that would make non-substantive changes to the Education Code. The May 14, 2015, amendments removed the Education Code provisions and added the provisions discussed in this analysis. The June 4, 2015, amendments made a minor technical change. This is the department’s first analysis of this bill.

**REASON FOR THE BILL**

The reason for the bill is to provide state tax relief to students who have student loans forgiven as a result of the closure of Corinthian Colleges and similar closures, and as a result of certain circumstances that are beyond the students’ control.

**EFFECTIVE/OPERATIVE DATE**

As a tax levy, this bill would be effective immediately upon enactment and operative for discharges of indebtedness occurring on or after January 1, 2015.

**BACKGROUND**

Over the past six months, following enforcement actions by the federal government and other authorities, Corinthian Colleges, Inc., sold most of its schools and later closed the remaining ones. On February 2, 2015, Corinthian finalized a sale of most of its locations to Zenith Education Group. (Some of these schools are scheduled to close after all currently enrolled students have completed their studies.) Then, on April 27, 2015, Corinthian abruptly closed its remaining 30 locations—including two satellite campuses—across the country.

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On June 8, 2015, the U.S. Department of Education announced a series of steps to support students who attended Corinthian schools.<sup>1</sup> For some students, this may include forgiveness of their student loans. Specifically, students may be eligible for loan forgiveness if they attended a Corinthian school that closed on April 27, 2015, or if they believe they were defrauded by the Corinthian school they attended or that the school otherwise engaged in actions that violated applicable state law—regardless of whether that school closed. As described below, student loans forgiven as a result of a school closure or a school violation of state law are generally includable in gross income, unless the borrower is insolvent.

## **FEDERAL/STATE LAW**

### **Federal Law**

#### *Student Loan Forgiveness in General*

Individuals who take out student loans are responsible for making loan payments, and if the loan is forgiven, individuals must generally include the amount that was forgiven in their gross income for tax purposes, unless a specific exclusion is provided.

#### *Specific Exclusions for Forgiven Student Loans*

Under IRC section 108(f), if a student loan is made by a qualified lender to assist an individual in attending an eligible educational institution and contains a provision that all or part of the debt will be forgiven if the individual works for a certain period of time in certain professions, then the forgiveness of that loan is excludable from income.

Qualified lenders include:

1. The United States, or an instrumentality thereof,
2. A state, territory, or possession of the United States, or the District of Columbia, or any political subdivision thereof,
3. A public benefit corporation that is tax exempt under IRC section 501(c)(3) that has assumed control of a state, county, or municipal hospital, and whose employees are considered public employees under state law, and
4. An eligible educational institution, if the loan is made:
  - a. As part of an agreement with an entity described above in (1), (2), or (3), under which the funds to make the loan were provided to the educational institution, or

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<sup>1</sup> <https://studentaid.ed.gov/sa/about/announcements/corinthian>.

- b. Under a program of the educational institution that is designed to encourage its students to serve in occupations with unmet needs or in areas with unmet needs where the services provided by the students (or former students) are for or under the direction of a governmental unit or a tax-exempt IRC section 501(c)(3) organization. Occupations with unmet needs include medicine, nursing, teaching, and law.

An eligible educational institution is an educational institution that maintains a regular faculty and curriculum and normally has a regularly-enrolled body of students in attendance at the place where it carries on its educational activities.

IRC section 108(f) also provides an income exclusion for amounts received under the National Health Service Corps loan repayment program or certain state loan forgiveness and repayment programs that are intended to provide for the increased availability of health care services in underserved or health professional shortage areas (as determined by the state).

#### *Closed School Discharge*

Federal Student Aid, an Office of the U.S. Department of Education, has a program that forgives student loans in a limited number of circumstances,<sup>2</sup> including what's referred to as a closed school discharge, which means a student loan may be forgiven if a student's school closes while they're enrolled and the student cannot complete their program of study because of the closure, or if a student withdraws from the school within 120 days of the school's closure. However, there is no specific exclusion from income for such forgiveness, meaning student loans that are forgiven as a result of a school closure are generally includable in the borrower's income.<sup>3</sup>

#### **State Law**

California law conforms to the federal income tax rules relating to the forgiveness of student loans.<sup>4</sup>

#### **THIS BILL**

This bill would provide an exclusion from California gross income for income that would otherwise result from a forgiven student loan of an eligible individual.

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<sup>2</sup> Other circumstances in which a student loan may be forgiven include a total and permanent disability discharge, a death discharge, and a false certification of student eligibility or unauthorized payment discharge.

<sup>3</sup> Insolvent individuals may exclude from gross income forgiven student loans to the extent of their insolvency. IRC section 108(a)(1)(B).

<sup>4</sup> R&TC sections 17131 and 17134.1.

A student loan would mean either of the following:

1. Any loan made by a qualified lender (as described above in the “Federal Law” section) to an individual to assist the individual in attending an educational organization that maintains a regular faculty and curriculum and normally has a regularly-enrolled body of students in attendance at the place where it carries on its educational activities.
2. Any student obligation note or other debt evidencing a loan to any individual for the purpose of attending a for-profit higher education company or for the purpose of consolidating or refinancing a loan used to attend a for-profit higher education company, which is either a guaranteed student loan, an educational loan, or a loan eligible for consolidation or refinancing under Part B of Title IV of the Higher Education Act of 1965, as amended (20 U.S.C. Sec. 1071 et seq.).

An eligible individual would mean an individual whose student loan is discharged (i.e., forgiven) pursuant to:

- The agreement between ECMC Group, Inc., Zenith Education Group, and the Consumer Financial Protection Bureau concerning the purchase of certain assets of Corinthian Colleges, Inc., dated February 2, 2015; or
- Paragraph 23 of the William D. Ford Federal Direct Loan Program Borrower’s Rights and Responsibilities Statement<sup>5</sup> because of either of the following:
  - The individual could not complete a program of study because the school closed; or
  - The individual successfully asserts that the school did something wrong or failed to do something that it should have done.

## **IMPLEMENTATION CONSIDERATIONS**

Implementing this bill would require some changes to the department’s operations, information systems, and tax forms and instructions, which could be accomplished during the normal annual update.

## **TECHNICAL CONSIDERATIONS**

Because the content of the William D. Ford Federal Direct Loan Program Borrower’s Rights and Responsibilities Statement could subsequently be revised, the author may want to consider replicating the circumstances described in paragraph 23 of that statement instead of referring to it. Department staff is available to work with the author’s office to resolve this and other considerations that may be identified.

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<sup>5</sup> Paragraph 23 of the William D. Ford Federal Direct Loan Program Borrower’s Rights and Responsibilities Statement provides that a student loan will be discharged (i.e., forgiven) if a student dies, becomes totally and permanently disabled, is unable to complete a program of study because of a school closure, has a loan in their name that was falsely certified as a result of a crime of identity theft, or if the school did not pay a refund of the student’s loan money that it was required to pay under federal regulations.

## LEGISLATIVE HISTORY

AB 1055 (Baker, et al., 2015/16) would provide an exclusion from gross income for student loans that are forgiven when the borrower is blind or disabled. AB 1055 is currently in the Assembly Revenue and Taxation Committee.

## OTHER STATES' INFORMATION

The states surveyed include *Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York*. These states were selected due to their similarities to California's economy, business entity types, and tax laws. *Florida* does not impose a personal income tax, thus a comparison to *Florida* is not applicable. A review of the remaining states' laws found that none provide an exclusion from gross income for income resulting from a student loan forgiven because a school closes or does something wrong.

## FISCAL IMPACT

This bill would not significantly impact the department's costs.

## ECONOMIC IMPACT

### Revenue Estimate

Estimated Revenue Impact of SB 150 As Amended May 14, 2015 & June 4, 2015 Assumed Enactment After June 30, 2015		
2015-16	2016-17	2017-18
- \$34,000,000	- \$100,000	- \$100,000

This estimate does not account for changes in employment, personal income, or gross state product that could result from this bill.

### Revenue Discussion

Based on data from the Consumer Financial Protection Bureau and other research, it is estimated that California borrowers would have approximately \$1.3 billion of student loans forgiven in 2015 because a school closes or does something wrong. This estimate accounts for an unusually large number of school closures in 2015.<sup>6</sup>

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<sup>6</sup> The 2015 estimated loss is significantly higher than losses estimated for subsequent years because of the known closure of all of the campuses of for-profit Corinthian Colleges, Inc., which is expected to result in an unusually large amount of student loans being forgiven in 2015. If there are subsequent closures of other large schools that impact borrowers in this state, this bill would result in substantial additional revenue losses as a result of such closures.

It is estimated that 30 percent of those forgiven student loans would be attributable to borrowers who are insolvent, thus excludable from income under current law. Of the remaining forgiven student loans, it is assumed that borrowers eligible for this bill's exclusion would have an average tax rate of 4 percent, resulting in an estimated \$34 million revenue loss for the 2015 tax year. The tax-year estimates are converted to fiscal-year estimates and rounded, as shown in the table above.

## **SUPPORT/OPPOSITION**

Support: None on file.

Opposition: None on file.

## **ARGUMENTS**

Proponents: Those in support of this bill may argue that it would help alleviate the substantial financial challenges of students who are unable to complete a program of study because a school closes or does something wrong.

Opponents: Those in opposition to this bill may oppose it solely for its cost.

## **LEGISLATIVE STAFF CONTACT**

Scott McFarlane  
Legislative Analyst, FTB  
(916) 845-6075  
[scott.mcfarlane@ftb.ca.gov](mailto:scott.mcfarlane@ftb.ca.gov)

Jame Eiserman  
Revenue Manager, FTB  
(916) 845-7484  
[jame.eiserman@ftb.ca.gov](mailto:jame.eiserman@ftb.ca.gov)

Gail Hall  
Legislative Director, FTB  
(916) 845-6333  
[gail.hall@ftb.ca.gov](mailto:gail.hall@ftb.ca.gov)