BILL ANALYSIS

Department, Board, Or Commission	Authors	Bill Number
Franchise Tax Board	**Nguyen, et al.**	**SB 150**

SUBJECT

Student Loan Forgiveness Debt Relief

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.

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.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment and specifically operative for discharges of indebtedness occurring on or after January 1, 2015, and before January 1, 2020.

BACKGROUND

Following enforcement actions by the federal government and other authorities, Corinthian Colleges, Inc., sold most of its schools and later closed the remaining ones; that is, on February 2, 2015, Corinthian finalized a sale of most of its locations to Zenith Education Group, and on April 27, 2015, Corinthian abruptly closed its remaining 30 locations—including two satellite campuses—across the country.

On June 8, 2015, the U.S. Department of Education announced a series of steps to support students who attended Corinthian schools. 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.

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Date
9/15/15

FEDERAL/STATE 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

    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,[1] 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.[2]

State Law

California law conforms to the federal income tax rules relating to the forgiveness of student loans.[3]

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.

A student loan would mean either of the following:

1. Any loan made by a qualified lender 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; or
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 individual would be an eligible individual for a taxable year if any of the following apply during the taxable year:

1. The individual is granted a discharge 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;

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[1] 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.

[2] Insolvent individuals may exclude from gross income forgiven student loans to the extent of their insolvency. IRC section 108(a)(1)(B).

[3] R&TC sections 17131 and 17134.1.

2. The individual is granted a discharge pursuant to Paragraph 23 of the William D. Ford Federal Direct Loan Program Borrower's Rights and Responsibilities Statement[4] 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; or
3. The individual attended a Corinthian Colleges, Inc., school on or before May 1, 2015, is granted a discharge of any student loan made in connection with attending that school, and that discharge is not excludable from gross income as a result of the reasons listed in 1 or 2, above.

This exclusion would apply to discharges of indebtedness occurring on or after January 1, 2015, and before January 1, 2020, and would be repealed as of December 1, 2020.

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.

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[4] Paragraph 23 of the William D. Ford Federal Direct Loan Program Borrower's Rights and Responsibilities Statement, as of the date of this analysis, 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.

ECONOMIC IMPACT

Revenue Estimate

Estimated Revenue Impact of SB 150 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.[5]

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.

APPOINTMENTS

None.

SUPPORT/OPPOSITION[6]

Support: California Community Colleges Chancellor's Office, State Board of Equalization Vice Chair, George Runner.

Opposition: None on file.

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[5] The 2015 estimated loss is significantly higher than losses estimated for subsequent years because of the 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 before January 1, 2020, this bill could result in substantial additional revenue losses as a result of such closures.

[6] From the August 31, 2015, Senate Floor analysis.

VOTES

	Date	Yes	No
Concurrence	09/11/15	40	0
Assembly Floor	09/11/15	79	0
Senate Floor	09/01/15	39	0

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