Franchise Tax Board

# ANALYSIS OF ORIGINAL BILL

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| Author: | Baker, et al. | Analyst: | Scott McFarlane | Bill Number: | AB 1055 |
| Related Bills: | None | Telephone: | 845-6075 | Introduced Date: | February 26, 2015 |
| | | Attorney: | Bruce Langston | Sponsor | |

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| **SUBJECT:** | Disability Student Loan Forgiveness Debt Relief |

## SUMMARY

This bill would provide an exclusion from gross income for student loans that are cancelled (forgiven) when the borrower is blind or disabled.

## RECOMMENDATION

No position.

### Summary of Suggested Amendments

Minor technical amendments are suggested.

## REASON FOR THE BILL

The reason for the bill is to provide tax relief to help alleviate the financial hardships of individuals who would otherwise incur tax liabilities when their student loans are forgiven when they are blind or disabled.

## 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.

## FEDERAL/STATE LAW

### Federal Law

*Student Loan Cancellation in General*

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

| Board Position: | | | | | | Executive Officer | Date |
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| ____ | S | ____ | NA | X | NP | Selvi Stanislaus | 5/8/15 |
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Cancelled (forgiven) student loans are excludible from gross income in certain circumstances, described below; however, there is no specific exclusion for student loans that are forgiven on account of an individual's blindness or disability.[1]

*Cancelled (Forgiven) Student Loans Currently Excludible from Gross Income*

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 canceled if the individual works for a certain period of time in certain professions, then cancellation (forgiveness) of that loan is excludible from income.

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.

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 in (1), (2), (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 IRC section 501(c)(3) organization is any corporation, community chest, fund, or foundation organized and operated exclusively for one or more of the following purposes: charitable, religious, educational, scientific, literary, testing for public safety, fostering national or international amateur sports competition (but only if none of its activities involve providing athletic facilities or equipment), and the prevention of cruelty to children or animals.

[1] Federal Student Aid, an Office of the U.S. Department of Education, has a program that forgives individuals from having to repay their student loans on the basis of the individual's disability, and there is no specific exclusion from gross income for such forgiveness; however, insolvent individuals may exclude from gross income forgiven student loans that would otherwise be includible in income to the extent of their insolvency.

The cancellation of an individual's student loan is not excludible from gross income if the loan was made by an educational institution and is canceled because of services the individual performed for the educational institution or other organization that provided the funds.

*Insolvency Exclusion*

The amount of an individual's cancellation-of-indebtedness income resulting from a cancelled (forgiven) student loan may be excluded from gross income if the individual is insolvent. The amount excludible from income is limited to the extent of the individual's insolvency.[2]

**State Law**

California law conforms to the federal income tax rules relating to the cancellation (forgiveness) of student loans, and to the insolvency exclusion.[3]

**THIS BILL**

This bill would provide an exclusion from California gross income for any student loan of an eligible individual that is canceled (forgiven).

An eligible individual would be an individual (1) for whom a disability certification has been filed with the Franchise Tax Board (FTB) for the taxable year, or (2) who is eligible for Social Security Disability Insurance benefits or Supplemental Security Income benefits based on blindness or disability.[4]

A disability certification would mean a certification to the satisfaction of the FTB, made by the eligible individual or the parent or guardian of the eligible individual, that the individual meets the requirements relating to blindness or disability and that includes a copy of the individual's diagnosis relating to the individual's relevant impairment or impairments, signed by a licensed physician.

**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.

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[2] IRC section 108(a)(1)(B). The insolvency exclusion does not apply to an insolvent debtor in a Title 11 bankruptcy case.

[3] R&TC section 17131.

[4] These are benefits, respectively, under Title II or Title XVI of the Social Security Act.

**TECHNICAL CONSIDERATIONS**

Amendments 1 through 3 are suggested to make minor technical changes.

**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 cancellation of a student loan when an individual is blind or disabled.

**FISCAL IMPACT**

The department's costs to implement this bill have yet to be determined. As the bill moves through the legislative process, costs will be identified and an appropriation will be requested, if necessary.

**ECONOMIC IMPACT**

**Revenue Estimate**

| Estimated Revenue Impact of AB 1055<br>As Introduced February 26, 2015<br>Assumed Enactment After June 30, 2015<br>($ in Millions) | | |
|---|---|---|
| 2015-16 | 2016-17 | 2017-18 |
| - $19 | - $12 | - $12 |

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 White House Budget Report for fiscal year 2016 and publications from the U. S. Department of Education, it is estimated that nationwide, approximately $3 billion in student loans were cancelled (forgiven) on account of an individual's blindness or disability in 2014. Based on national student loan statistics, California borrowers hold approximately 10 percent of the nation's student loan debt, meaning it is estimated that approximately $300 million of student loans held by California borrowers were cancelled (forgiven) on account of an individual's blindness or disability in 2014. It is assumed that California taxpayers who would be eligible for this exclusion would have an average tax rate of 4 percent, resulting in an estimated loss of approximately $12 million for tax year 2014 ($300,000,000 x 4% = $12,000,000). The estimate is converted into fiscal years and rounded to arrive at the amounts 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 blind and disabled individuals.

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

**LEGISLATIVE STAFF CONTACT**

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PROPOSED AMENDMENTS TO AB 1055
AS INTRODUCED FEBRUARY 26, 2015

AMENDMENT 1

On page 2, lines 6-7, strikeout "apply during the taxable year:", and insert:

apply:

AMENDMENT 2

On page 2, line 10, after "(42 U.S.C.)" insert:

during the taxable year

AMENDMENT 3

On page 2, line 12, after "Franchise Tax Board", insert:

with respect to the taxable year