Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	Ridley-Thomas	Analyst:	Diane Deatherage	Bill Number:	AB 755
Related Bills:	See Legislative History	Telephone:	845-4783	Introduced Date:	February 25, 2015
		Attorney:	Bruce Langston	Sponsor	

SUBJECT:	Student Loan Interest Deduction/Increase Amount Limit to $4,000

SUMMARY

This bill would increase the amount a taxpayer may deduct for student loan interest under the Personal Income Tax Law.

RECOMMENDATION

No position.

REASON FOR THE BILL

This bill would ease the financial burden for students and their families who are taking on more student loans with higher interest rates and help the economy by easing the financial burden of getting an education.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment and specifically operative for taxable years beginning on or after January 1, 2016.

FEDERAL/STATE LAW

Existing federal and state laws allow for the deduction of certain expenses when calculating adjusted gross income, such as moving expenses and interest on education loans (also known as student loans). Thus, all taxpayers with this type of expense receive the benefit of the deduction. These are known as "above-the-line" deductions.[1]

Under current federal and state law, the "above-the-line" deduction for interest paid on student loans is limited to a maximum amount of $2,500 each taxable year. The maximum deduction amount is not indexed for inflation.

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[1] Other "above-the-line" deductions include certain ordinary and necessary trade and business expenses, losses from the sale or exchange of certain property, contributions for pension, profit-sharing and annuity plans of self-employed individuals, retirement savings, and alimony.

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In addition, the deduction is subject to phase-out ratably for individual taxpayers with modified adjusted gross income of $65,000-$80,000 ($130,000 - $160,000 for joint returns).

The deduction is not allowed to an individual if that individual is claimed as a dependent on another taxpayer's return for the taxable year. A qualified education loan generally is defined as any indebtedness incurred to pay for the qualified higher education expenses of the taxpayer, the taxpayer's spouse, or any dependent of the taxpayer as of the time the indebtedness was incurred in attending (1) post-secondary educational institutions and certain vocational schools defined by reference to section 481 of the Higher Education Act of 1965, or (2) institutions conducting internship or residency programs leading to a degree or certificate from an institution of higher education, a hospital, or a health care facility conducting postgraduate training.

Qualified higher education expenses are defined as the student's cost of attendance as defined in section 472 of the Higher Education Act of 1965 (generally, tuition, fees, room and board, and related expenses), reduced by (1) any amount excluded from gross income for redemption of U.S. savings bonds, (2) any amount distributed from an education Individual Retirement Account (IRA) and excluded from gross income, and (3) the amount of any scholarship or fellowship grants excludable from gross income, as well as any other tax-free educational benefits, such as employer-provided educational assistance, that is excludable from the employee's gross income.

California law generally is in conformity with federal law as it relates to the “above-the-line” deduction for interest paid on student loans.

THIS BILL

This bill would increase the maximum allowable deduction for interest paid on student loans during a taxable year to $4,000.

IMPLEMENTATION CONSIDERATIONS

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

LEGISLATIVE HISTORY

AB 1613 (Scott, Chapter 792, Statutes of 1997) partially conformed California law to the federal law for the deduction for interest on certain education loans.

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. The remaining five states generally conform to federal law relating to student loan interest deductions.

In addition to the deduction based on federal law, *Massachusetts* allows a deduction for interest payments on certain education debt. The deduction applies only to undergraduate education loans; therefore, interest payments on graduate education loans are ineligible. The *Massachusetts* deduction is equal to 100 percent of the interest paid and is allowed regardless of the taxpayer's income. The same taxpayer may claim both deductions on the same return, provided the deductions are not taken for the same interest payments.

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

This bill would result in the following revenue loss:

Estimated Revenue Impact of AB 755 As Introduced February 25, 2015 Assumed Enactment After June 30, 2015 ($ in Millions)		
2015-16	2016-17	2017-18
- $0.6	- $1.1	- $1.1

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

Revenue Discussion

Using data from taxable year 2012 returns filed with the Franchise Tax Board, it was found that a student loan interest deduction was reported on one million tax returns. Data from the Federal Reserve Bank of New York shows that approximately 15 percent would have an annual interest deduction over $2,500. Due to the income limitation provisions, it is estimated that only 60 percent, or approximately 90,000 taxpayers, would be able to claim a deduction in excess of $2,500. The additional deduction for these taxpayers is expected to be $275 per taxpayer for a total estimated additional deduction of $25 million annually. Using an estimated average tax rate of 4 percent, the total impact would be approximately $1 million. This amount is grown, rounded, and converted to the fiscal year estimates reflected in the table above.

SUPPORT/OPPOSITION

Support: None provided.

Opposition: None provided.

ARGUMENTS

Proponents: Some may say that by allowing a larger deduction, a taxpayer may have more disposable income to reinvest in the economy.

Opponents: Some may argue that a larger student loan interest deduction should be replaced with reducing the cost for an education to lessen the need for large loans.

POLICY CONCERNS

This bill would create differences between federal and California tax law, thereby increasing the complexity of California tax return preparation, which could increase noncompliance.

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