



## **Analysis of Original Bill**

Author: Voepel, et al.

Sponsor:

Bill Number: AB 2478

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Introduced: February 14, 2018

Attorney: Bruce Langston

Related Bills: See Legislative  
History

**Subject:** Gross Income Exclusion – Student Loan Assistance

### **Summary**

This bill would, under the Personal Income Tax Law, allow an employee to exclude from gross income the principal or interest on qualified education loans paid or incurred by the employer on the employee's behalf.

**Recommendation - No position.**

### **Reason for the Bill**

The reason for the bill is to lighten the burden that student loan debt places on Californians.

### **Effective/Operative Date**

As a tax levy, this bill would be effective immediately upon enactment and operative for payment made by employers beginning on January 1, 2018.

### **Federal/State Law**

Existing federal and state laws provide that certain types of income are excluded from gross income, such as amounts received as a gift or inheritance, certain compensation for injuries and sickness, qualified scholarships, educational assistance programs, foster care payments, and interest received on certain state or federal obligations.

Existing federal law<sup>1</sup> provides an exclusion of up to \$5,250 per year from gross income of an employee, for educational assistance furnished pursuant to an educational assistance program by an employer, for expenses incurred by, or on behalf of, an employee for education of the employee.

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<sup>1</sup> Internal Revenue Code (IRC) section 127.

Existing federal law<sup>2</sup> allows a deduction in computing adjusted gross income for interest paid during the taxable year on a qualified education loan. The amount of the student loan interest deduction begins at \$2,500 and reduces gradually as the taxpayer's modified adjusted gross income increases.

"Qualified education loan", pursuant to IRC section 221, means indebtedness incurred by the taxpayer solely to pay qualified higher education expenses:

- incurred on behalf of the taxpayer, the taxpayer's spouse, or any dependent of the taxpayer at the time the indebtedness was incurred,
- paid or incurred within a reasonable period of time before the indebtedness was incurred, and
- attributable to education furnished during a period during which the recipient was an eligible student, including indebtedness used to refinance qualified education loan indebtedness.

"Qualified educational loan" specifically excludes any indebtedness owed to a person who is related to the taxpayer<sup>3</sup> or to any person by reason of a loan under any qualified employer plan<sup>4</sup> or under any contract referred to in IRC section 72(p)(5).

"Qualified higher education expenses" means the cost of attendance, including tuition and fees, allowances for books, supplies, transportation, room and board, and miscellaneous expenses (as defined in section 472 of the Higher Education Act of 1965, 20 U.S.C. 108711) at an eligible educational institution, reduced by the sum of:

- the amount of such expenses excluded from gross income under IRC section 127, 135, 529, or 530, and
- the amount of any scholarship, allowance, or payment described in IRC section 25A(g)(2).

"Eligible student" means a student who meets section 484(a)(1) of the Higher Education Act of 1965,<sup>5</sup> and is carrying at least one-half of a normal full-time work load.

"Eligible education institution" means an institution described in section 481 of the Higher Education Act of 1965,<sup>6</sup> including institutions conducting internships or residency programs leading to a degree or certificate awarded by an institution of higher learning, a hospital, or a health care facility which offers postgraduate training.

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<sup>2</sup> IRC Section 221.

<sup>3</sup> As specified in IRC section 267(b) or 707(b)(1).

<sup>4</sup> As defined in IRC section 72(p)(4).

<sup>5</sup> 20 U.S.C. 1091(a)(1).

<sup>6</sup> 20 U.S.C. 1088.

Existing state law related to the educational assistance program exclusion<sup>7</sup> conforms, with some differences, to the federal exclusion for educational assistance under IRC section 127.

### **This Bill**

This bill would provide an exclusion from gross income of an employee, up to \$5,250 per calendar year, for amounts paid or incurred by the employer beginning January 1, 2018, to the employee or to a lender, of principal or interest on any qualified education loan, defined by IRC section 221, relating to interest on education loans, incurred by the employee.

### **Implementation Considerations**

The department has identified the following implementation concerns. Department staff is available to work with the author's office to resolve these and other concerns that may be identified.

It is unclear whether income exclusion under this bill would be subject to the existing \$5,250 annual limit or its own \$5,250 limit. To avoid disputes between taxpayers and the department, this bill should be amended.

The exclusion from income would apply to payments on specified educational indebtedness for the education of the taxpayer (employee), their spouse, or their dependent. If this is contrary to the author's intent, this bill should be amended.

If this bill is enacted in late September or October of 2018, the department would have developed the forms and instructions for the 2018 taxable year. Thus, the department may incur additional costs to develop alternative forms and instructions in the short time frame necessary to ensure they are available for taxpayers to comply with the reporting requirement.

### **Legislative History**

AB 511 (Alquist, Chapter 107, Statutes of 2000), among other things, added amounts paid or incurred by an employer for an employee to take graduate level courses as payments that may be excluded, up to \$5,250 per calendar year, from the employee's gross income. This exclusion applies to any course or education taken at the graduate level beginning on or after January 1, 2000.

### **Other States' Information**

The states surveyed include, *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.

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<sup>7</sup> Revenue and Taxation Code section 17151.

*Illinois, Michigan, and Minnesota* laws lack a similar exclusion.

*Massachusetts* and *New York* allow an exclusion for qualified educational expenses reimbursed to an employee under an employer-provided education assistance program for qualified educational expenses for undergraduate and graduate education expenses up to the federal annual maximum of \$5,250 per calendar year.

### **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 2478 as Introduced February 14, 2018  
For Taxable Years Beginning On or After January 1, 2018  
Assumed Enactment after June 30, 2018

(\$ in Millions)

Fiscal Year	Revenue
2018-2019	- \$38
2019-2020	- \$26
2020-2021	- \$27

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill or for the net final payment method of accrual.

#### Revenue Discussion

Based on data from the Department of Education, Consumer Financial Protection Bureau, and other sources, it is estimated that Californians hold an estimated \$180 billion in student loan debt, making the average student loan outstanding approximately \$33,000 in taxable year 2018. Using data for current interest deductions on student loans from the Franchise Tax Board's Personal Income Tax sample, there will be an estimated \$3.4 billion in student loan repayments in the 2018 taxable year. Based on available literature, it is assumed that 10 percent of repayments, or \$340 million, would be paid by employers and excluded from income pursuant to this bill resulting from the educational indebtedness of the employee, their spouse, or their dependent. This revenue estimate assumes a new annual income exclusion limit of \$5,250 for payment of principal and interest paid for by an employer as proposed by this bill.

Assuming an effective tax rate of 7 percent, the bill would result in a revenue loss of approximately \$24 million for the 2018 taxable year. The tax-year estimates are then converted to fiscal years, then rounded to arrive at the figures in the above table.

### **Support/Opposition**

Support: None provided.

Opposition: None provided.

### **Arguments**

Proponents: Some may argue that this bill would improve affordability of higher-level education by excluding an employer's student loan payment assistance from an employee's gross income.

Opponents: Some may argue that this bill while well-intentioned does not go far enough because post-secondary education is necessary to earn a "living-wage" in the state and should be provided at no cost to all Californians.

### **Policy Concerns**

This bill would establish an income exclusion for which federal law has no counterpart, thus increasing nonconformity.

The exclusion would be allowed for expenses paid or incurred on loans for education at an institution located either inside or outside California.

An employee located outside this state could benefit from this exclusion, thereby extending the benefit beyond the borders of California. Clarification is necessary if this is contrary to the author's intent.

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