

**Franchise Tax Board****ANALYSIS OF ORIGINAL BILL**

Author: Muratsuchi Analyst: Jon Feenstra Bill Number: AB 461  
Related Bills: See Legislative History Telephone: 845-4870 Introduced Date: February 13, 2017  
Attorney: Bruce Langston Sponsor: \_\_\_\_\_

**SUBJECT:** Student Loan Debt Relief

**SUMMARY**

This bill would, under the Personal Income Tax law, modify the cancelled or repaid student loans that are excluded from gross income.

**RECOMMENDATION – NO POSITION****REASON FOR THE BILL**

The reason for the bill is to alleviate the burden that student loan debt places on Californians who are struggling to establish their careers, start families, and purchase homes in the years following graduation by ensuring that Californians whose student loan debt is forgiven or repaid by the federal government are not penalized through taxation of their forgiven or repaid loan debt.

**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, 2017.

**FEDERAL/STATE LAW****Federal Law***Student Loan Forgiveness in General*

Under federal and state law, gross income generally includes the discharge of indebtedness of the taxpayer. Under an exception to this general rule, gross income does not include any amount from the forgiveness (in whole or in part) of certain student loans, provided that the forgiveness is contingent on the student's working for a certain period of time in certain professions for any of a broad class of employers.

Student loans eligible for this special rule must be made to an individual to assist the individual in attending an educational institution that normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of students in attendance at the place where its education activities are regularly carried on. Loan proceeds may be used not only for tuition and required fees, but also to cover room and board expenses. The loan must be made by: (1) the United States (or an instrumentality or agency thereof), (2) a state (or any political subdivision thereof), (3) certain tax-exempt public benefit corporations that control a state, county, or municipal hospital and whose employees have been deemed to be public employees under state law, or (4) an educational organization that originally received the funds from which the loan was made from the United States, a state, or a tax-exempt public benefit corporation.

In addition, an individual's gross income does not include amounts from the cancellation of loans made by educational organizations (and certain tax-exempt organizations in the case of refinancing loans) out of private, nongovernmental funds if the proceeds of such loans are used to pay costs of attendance at an educational institution or to refinance any outstanding student loans (not just loans made by educational organizations) and the student is not employed by the lender organization. In the case of such loans made or refinanced by educational organizations (or refinancing loans made by certain tax-exempt organizations), cancellation of the student loan must be contingent upon the student working in an occupation or area with unmet needs and such work must be performed for, or under the direction of, a tax-exempt charitable organization or a governmental entity.

Finally, an individual's gross income does not include any loan repayment amount received under the National Health Service Corps loan repayment program or certain state loan repayment programs.

#### *Federal Income-Based Repayment Programs and Loan Cancellation*

Students with higher education expenses may be eligible to borrow money for their education through the Direct Loan Program.<sup>1</sup> Prior to July 1, 2010, they may also have been eligible to borrow money through the Family Education Loan Program. Both programs are administered by the U.S. Department of Education. Each program provides borrowers with an option for repaying the loan that is related to the borrower's income level after college (the income-contingent and the income-based repayment options). Under both of these options, borrowers complete their repayment obligation when they have repaid the loan in full, with interest, or have made those payments that are required under the plan for 25 years.<sup>2</sup> For those who reach the 25-year point, any remaining loan balance is cancelled. Under current federal law, any loan balance cancelled by these programs is considered gross income to the borrower.

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<sup>1</sup> William D. Ford Federal Direct Loan Program; Title 20, sections 1087a through 1087j.

<sup>2</sup> The 25-year payment-period requirement is reduced to 20 years with respect to any loan made to a new borrower on or after July 1, 2014.

### *Repayment Plan for Public Service Employees*

The Public Service Loan Forgiveness (PSLF) Program cancels the remaining balance on certain federal loans made under the Direct Loan Program after 120 qualifying monthly payments are received under a qualifying repayment plan while the borrower works full-time for a qualifying employer. A qualifying monthly payment is made:

- After October 1, 2007;
- Under a qualifying repayment plan;
- For the full amount due as shown on your bill;
- No later than 15 days after your due date; and
- While employed full-time by a qualifying employer.

A qualifying employer is:

- A government organization at any level (federal, state, local, or tribal).
- A not-for-profit organization that is tax-exempt under Section 501(c)(3) of the Internal Revenue Code.
- Other types of not-for-profit organizations that provide certain types of qualifying public services.

A qualifying repayment plan includes all of the income-based repayment plans and the 10-year standard repayment plan.<sup>3</sup>

### **State Law**

California law generally conforms to the federal income tax rules relating to the cancellation of student loans as of the specified date.<sup>4</sup> In addition, the state has stand-alone provisions for which no similar federal provisions exist.

California allows an exclusion from gross income for student loan debt that is cancelled or repaid under the income-based repayment programs administered by the U.S. Department of Education.<sup>5</sup> This exclusion applies to discharges of indebtedness occurring on or after January 1, 2014.

For discharges of indebtedness occurring on or after January 1, 2015, and before January 1, 2020, existing state law excludes from an eligible individual's gross income amounts that would otherwise result from a student loan to provide state tax relief to students who have student loans forgiven as a result of the closure of Corinthian Colleges and similar closures.<sup>6</sup>

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<sup>3</sup> Title 20, section 1078(b)(9)(A)(i).

<sup>4</sup> Revenue and Taxation (R&TC) sections 17024.5 and 17132.

<sup>5</sup> R&TC section 17132.11.

<sup>6</sup> R&TC section 17144.7.

## **THIS BILL**

This bill would exclude from gross income student loan debt that is cancelled or repaid under loan repayment plans for public service employees that are administered by the U.S. Department of Education.

## **IMPLEMENTATION CONSIDERATIONS**

Implementing this bill would not significantly impact the department's programs or operations.

## **TECHNICAL CONSIDERATIONS**

The language that would exclude from gross income student loan debt that is cancelled or repaid under loan repayment plans for public service employees is unnecessary because existing state law, R&TC section 17132, provides this exclusion as of the specified date of January 1, 2015.<sup>7</sup>

## **LEGISLATIVE HISTORY**

SB 150 (Nguyen, et al., Chapter 650, Statutes of 2015) excludes from gross income several types of student loan debt that is discharged on or after January 1, 2015, and before January 1, 2020, including debt that is discharged, pursuant to discharge agreements between certain schools that closed, or other situations in which a student could not complete a program of study due to a school closing or doing something wrong.

SB 1271 (Evans & Leno, Chapter 841, Statutes of 2014) excludes from gross income student loan debt that is forgiven or repaid under the income-based repayment programs administered by the U.S. Department of Education.

SB 1003 (Evans, 2013/14), as amended June 30, 2014, was identical to SB 1271. SB 1003 was held in the Assembly Rules Committee.

## **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, and tax laws. A review of the laws of these states found that *Illinois, Massachusetts, Michigan, Minnesota, and New York* generally conform to the federal rules relating to income exclusions for certain forgiven student loans, but none were found to provide an exclusion similar to the one proposed by this bill (i.e., for amounts forgiven at the end of the repayment period for federal student loans using the federal income-based repayment programs).

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<sup>7</sup> R&TC section 17024.5.

## **FISCAL IMPACT**

This bill would not impact the department's costs.

## **ECONOMIC IMPACT**

Since California already excludes income from loans repaid or canceled under public service loan forgiveness programs, this bill would not impact the state's income tax revenue or the department's current programs or practices.

## **SUPPORT/OPPOSITION**

Support: Unknown

Opposition: Unknown

## **ARGUMENTS**

Proponents: Those in support of this bill may argue that the underlying program of debt forgiveness is contradicted by imposing a potential tax obligation when the debt is forgiven.

Opponents: Those who oppose this bill may argue that it is unnecessary because the income exclusion exists under current law.

## **LEGISLATIVE STAFF CONTACT**

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