BILL ANALYSIS

Department, Board, Or Commission	Author	Bill Number
Franchise Tax Board	**Muratsuchi & Ridley-Thomas**	**AB 461**

SUBJECT: Student Loan Debt Relief

SUMMARY

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

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, and before January 1, 2022.

FEDERAL LAW

Student Loan Forgiveness in General

Under federal and state law, gross income generally includes the amount of any 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 exception to the general 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.[1] Prior to July 1, 2010, students 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.[2] 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.

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;

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[1] William D. Ford Federal Direct Loan Program; Title 20, United States Code (U.S.C.), sections 1087a through 1087j.
[2] 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.

- 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 governmental 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.[3]

STATE LAW

California law generally conforms to the federal income tax rules relating to the cancellation of student loans as of the specified date.[4] 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.[5] 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 forgiven as a result of the closure of Corinthian Colleges and similar closures.[6]

THIS BILL

This bill would, under the PITL, for taxable years beginning on or after January 1, 2017, and before January 1, 2022, exclude from gross income student loan debt that is cancelled or repaid under the Income Contingent Repayment plan, the Pay As You Earn Repayment plan, and the Revised Pay As You Earn Repayment plan as administered by the U.S. Department of Education.[7]

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[3] Title 20, U.S.C., section 1078(b)(9)(A)(i).
[4] Revenue and Taxation (R&TC) sections 17024.5 and 17132.
[5] R&TC section 17132.11.
[6] R&TC section 17144.7.
[7] Repayment plans repaid or cancelled as authorized under Title 20, U.S.C., section 1087e(e).

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 was unable to 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, 2013/2014), 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).

FISCAL IMPACT

This bill would not impact the department's costs.

ECONOMIC IMPACT

Revenue Estimate

This bill would result in the following revenue loss:

Estimated Revenue Impact of AB 461 Assumed Enactment After June 30, 2017		
2017-18	2018-19	2019-20
- $0	- $6,000	- $30,000

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

Revenue Discussion

Income-Contingent Repayment

Under federal law, the earliest that qualified student debt may be forgiven is 2019, so there would be no revenue impact prior to fiscal year 2018-19. Based on a proration of Joint Committee on Taxation estimates, it is estimated that the revenue loss to California from this proposal would be approximately $6,000 in fiscal year 2018-19, $30,000 in fiscal year 2019-20, $30,000 in fiscal year 2020-21, and $10,000 in fiscal year 2021-22.

Pay As You Earn

The proposal to exclude from gross income any loans forgiven under this type of repayment plan would not have a revenue impact until fiscal year 2032-33. To qualify for this type of repayment plan, an individual is required to have a loan disbursement on or after October 1, 2011, and make 20 years of qualifying payments.

Revised Pay As You Earn

The majority of the impact from forgiven loans taken under the Revised Pay As You Earn Plan would begin in fiscal year 2035-36.[8] The U.S. Department of Education finalized the regulation creating this type of repayment plan on October 27, 2015. It is available to all outstanding student loans that meet certain criteria. Similar to Pay As You Earn, this type of repayment plan also requires 20 years of qualifying payments for undergraduate loans (25 years for graduate) to receive loan forgiveness; however, qualifying payments include payments made under Income-Based Repayment plans and Income-Contingent Repayment plans as well as Pay As You Earn.

The new loan forgiveness programs, Pay As You Earn and Revised Pay As You Earn, offered by the U.S. Department of Education have significantly increased the number of individuals participating in loan forgiveness programs, and as such the federal government has been raising their projected costs for income driven repayment plans in recent years. Therefore, the proposal's impact on the budget could be significantly larger than the impact for Income-Based Repayment and Income-Contingent Repayment plans when individuals are eligible for loan forgiveness in 2035-36.[9]

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[8] Because Revised Pay As You Earn considers payments made under other income driven payment plans as qualified payments some of the revenue impact associated with Revised Pay As You Earn could occur prior to the 2035-36 fiscal year.

- If the taxpayer was participating in Income-Contingent Repayment and switched to Revised Pay As You Earn, the impact of debt forgiveness would occur in 2018-2019.
- If the taxpayer was participating in Income-Based Repayment and switched to Revised Pay As You Earn, the impact of debt forgiveness would occur in 2034-35.
- If the taxpayer was participating in Pay As You Earn and switched to Revised Pay As You Earn, the impact of this proposal would occur in 2031-32.

[9] Ibid.

APPOINTMENTS

None.

SUPPORT/OPPOSITION[10]

Support: California Association of Nonprofits, California Academy of Family Physicians; Faculty Association of California Community Colleges, and the Institute for College Access & Success.

Opposition: None on File.

VOTES

	Date	Yes	No
Senate Floor	09/14/17	40	0
Assembly Floor	05/31/17	76	0

LEGISLATIVE STAFF CONTACT

Contact	Work
Marybel Batjer, Agency Secretary, GovOps	916-651-9024
Khaim Morton, Legislative Deputy, GovOps	916-651-9100
Selvi Stanislaus, Executive Officer, FTB	916-845-4543
Diane Deatherage, Legislative Director, FTB	916-845-6333

[10] As noted in the Senate Governance and Finance Committee analysis dated June 30, 2017.