



Analysis of Amended Bill

Author: Wieckowski & Allen	Sponsor:	Bill Number: SB 477
Analyst: Jessica Deitchman	Phone: (916) 845-6310	Introduced February 21, 2019, and Amended April 24, 2019, May 7, 2019, May 17, 2019, & June 17, 2019
Attorney: Shane Hofeling	Related Bills: See Legislative History	

Subject: Qualified Student Loan Credit

Summary

This bill would, under the Personal Income Tax Law (PITL), allow a credit equal to the amount of interest paid during the taxable year on a qualified education loan.

Recommendation – No position.

Summary of Amendments

The April 24, 2019, amendments added a sunset and repeal date for the credit, reinstated the deduction upon sunset of the credit, and made several technical changes.

The May 7, 2019, amendments added a cap and Adjusted Gross Income (AGI) limitation on the credit.

The May 17, 2019, amendment modified the bill language to only provide a credit for student loan interest paid when an appropriation is made in the budget. These provisions also specify that the deduction allowed under current law would be allowed if the credit is unallocated in the budget.

The June 17, 2019, amendments added a coauthor, modified the operative date, specified when the limitation on the deduction for interest on education loans applies, and added uncodified language related to the reporting requirement for newly enacted credits.

This is the department's first analysis of the bill.

Reason for the Bill

The reason for the bill is to ease the burden on those with student loans by allowing a credit equal to the amount of interest paid.

Effective/Operative Date

As a tax levy, this bill would be effective immediately upon enactment and operative January 1 of the year it becomes effective. The credit would be specifically operative for taxable years beginning on or after January 1, 2020.

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 the lesser of \$2,500 each taxable year or the amount of student loan interest actually paid. The maximum deduction amount is not indexed for inflation.

In addition, the deduction is subject to phase-out ratably for individual taxpayers with modified AGI 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.

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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For purposes of the deduction, 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, under the PITL, for taxable years beginning on or after January 1, 2020, and before January 1, 2025, temporarily allow a credit in an amount equal to the interest paid by the taxpayer during the taxable year on a qualified education loan in lieu of the existing above the line deduction.

This credit would be limited to \$1,000 for individual taxpayers and \$2,000 for married filing jointly taxpayers. The credit would only be allowed to those taxpayers with the following adjusted gross income:

- For married filing a joint returns, \$200,000
- For other individuals, \$100,000

The bill would define the following terms and phrases:

- "Qualified education loan" means an indebtedness incurred by the taxpayer solely to pay for higher education expenses that are incurred on behalf of the taxpayer or the taxpayers' spouse or dependent, who is the taxpayers' spouse or dependent at the time the indebtedness is incurred.
 - Qualified education loan includes a refinance of indebtedness.
 - Qualified education loan excludes:
 - Indebtedness owed to a person who is related²
 - Indebtedness owed to a person by reason of a loan under a qualified employer plan³

² Within the mean of Section 267(b) or 707(b) of the Internal Revenue Code (IRC).

³ As defined in Section 72(p)(4) of the IRC.

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- “Dependent” has the same meaning as defined in Section 152 of the IRC.

The credit would be repealed by its own terms on December 1, 2025.

The above the line deduction would be reinstated for taxable years beginning on or after January 1, 2025, or for years when an appropriation is not provided for in the Budget Act during taxable years beginning on or after January 1, 2020, and before January 1, 2025. The limitation on the above the line deduction shall only apply to taxpayers who are, or were eligible for the credit that would be allowed by this bill, and shall not affect the allowance of a deduction for interest on education loans pursuant to subdivision (b) of Section 17201 for all other taxpayers.

Uncodified language, for purposes of complying with Section 41, would specify goals, purposes, and objectives of the credit that would be created by this bill as follows:

- Compensate taxpayers for the significant increases in tuition at higher educational institutions.
- Stimulate consumer spending and economic growth by providing more disposable income to reinvest in the economy.
- Aid in reducing the likelihood of student loan defaults, which have a major adverse impact on graduates' credit scores and therefore even broader implications for consumers.
- Incentivize college graduates to stay in California and to continue to be an integral part of the state's workforce, in turn increasing tax revenues and payments to California's public assistance programs, insurance system, and economy.

To measure whether the credit achieves its intended purpose, for those taxable years for which the credit allowed is not zero dollars (\$0), the Franchise Tax Board (FTB) shall prepare a written report on the following:

- The number of taxpayers claiming the credit.
- The average credit amount on tax returns claiming the credit.

The FTB would be required to provide the written report to the Senate Committee on Budget and Fiscal Review, the Assembly Committee on Budget, the Senate and Assembly Committees on Appropriations, the Senate Committee on Governance and Finance, and the Assembly Committee on Revenue and Taxation. The report must be in compliance with Section 9795 of the Government Code.

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Implementation Considerations

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

This bill uses a term that is undefined, i.e., "higher education expense." The absence of definitions to clarify these terms could lead to disputes with taxpayers and would complicate the administration of this bill. For clarity and ease of administration, it is recommended that the bill be amended to provide a definition, or a cross-reference to IRC section 529.

Technical Considerations

The bill uses superfluous language. It recommended that "under subdivision (b) of Section 17201" on page 3, lines 33, 34 and 39, be deleted.

Legislative History

AB 755 (Ridley-Thomas, 2015/2016) would have increased the maximum allowable deduction for interest paid on student loans during a taxable year to \$4,000. AB 755 failed to pass out of the Assembly Revenue and Taxation Committee by the constitutional deadline.

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. *Illinois, Massachusetts, Michigan* and *New York* lack a credit similar to the one this bill would provide.

Minnesota provides a credit equal to \$500 per year (\$1,000 for married filing a joint return, if both spouses made payments on their own qualified loans) for those that make payments on their postsecondary education loans.

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.

Economic Impact

Revenue Estimate

This bill would result in the following revenue loss:

Estimated Revenue Impact of SB 477 as Amended June 17, 2019
Assumed Enactment after June 30, 2019

(\$ in Millions)

Fiscal Year	Revenue
2019-2020	-\$600.0
2020-2021	-\$1,100.0
2021-2022	-\$1,100.0

This estimate assumes a specific appropriation of funds are made beginning in fiscal years 2019-2020 through 2024-2025. 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 U.S. Federal Reserve, it is estimated 3.7 million California taxpayers owe \$120 billion in qualified education loans. The National Student Loan Data Systems shows that approximately 55 percent, or 2 million taxpayers, with qualified education loans are currently making payments. Based on FTB data and applying the AGI limitations, as specified in the bill, it is estimated that \$2.2 billion of student loan interest would be paid in the 2020 taxable year. A review of the average annual interest payments made on student debt indicates that single taxpayer and married filing joint taxpayers annual interest payments would be less than the maximum credit allowed. Applying a credit percent of 100 percent results in an estimated \$2.2 billion in credit generated.

It is estimated that 60 percent, or \$1.3 billion, including non-resident taxpayers, would be generated by taxpayers who have a tax liability to offset the credit. Of that amount, 80 percent, or \$1.1 billion, would be claimed in the year generated and the remaining 20 percent would go unused.

To arrive at the offsetting tax effect of the student loan interest deduction that would otherwise be allowed under current law, it is estimated that qualified taxpayers would be unable to deduct approximately \$1.1 billion in interest expenses. Applying an average tax rate of 6 percent, results in an offsetting revenue gain of \$65 million, for a total net revenue loss of \$1.0 billion in the 2020 taxable year.

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The tax year estimates are converted to fiscal years estimates, and then rounded to arrive at the amounts shown in the above table.

Policy Concerns

This bill lacks carryover language. As a result, any unused credit would be lost if the taxpayer is unable to use the entire credit amount in the year claimed. The author may wish to add language allowing a limited carryover period.

Legislative Staff Contact

Jessica Deitchman
Legislative Analyst, FTB
(916) 845-6310
jessica.deitchman@ftb.ca.gov

Jame Eiserman
Revenue Manager, FTB
(916) 845-7484
jame.eiserman@ftb.ca.gov

Jahna Carlson
Acting Legislative Director, FTB
(916) 845-5683
jahna.carlson@ftb.ca.gov