



Bill Analysis

Author: Mayes

Sponsor:

Bill Number: AB 704

Related Bills: See Legislative
History

Amended: January 3, 2022,
and January 12, 2022

SUBJECT

Personal Income Tax Deduction for Qualified Education Loans

SUMMARY

This bill, under Personal Income Tax Law (PITL), would eliminate the maximum deduction limit for the deduction for interest paid by the taxpayer during the taxable year on a qualified education loan. This bill would also modify what expenses qualify for this deduction.

RECOMMENDATION

No position.

SUMMARY OF AMENDMENTS

The January 3, 2022, amendments revised the operative dates and extended the repeal date. This amendment also added specific Revenue and Taxation Code (RTC) Section 41 language.

The January 12, 2022, amendments removed the previous provisions that would have modified California's general conformity to the federal definition of adjusted gross income (AGI) and included the provisions discussed in the prior analysis as a deduction from gross income in the RTC.

REASON FOR THE BILL

The reason for this bill is to reduce the financial burden of higher education costs.

ANALYSIS

This bill would, under the PITL, for taxable years beginning on or after January 1, 2023, and before January 1, 2028, eliminate the limitation on the maximum amount of the deduction for interest paid by the taxpayer during the taxable year on a qualified education loan.

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This bill would modify California's conformity to the deduction for interest paid on a qualified education loan to pay for "higher education expenses" instead of "qualified higher education expenses."

This bill would define "higher education expenses" to mean the expenses of attendance at an institution of higher education as defined by IRC section 529(e)(3), relating to qualified higher education expenses, but would not include expenses of enrollment or attendance at an elementary or secondary public, private, or religious school.

This bill, for purposes of complying with Section 41 of the RTC would provide the following specific goals, purpose, and objectives:

1. The total number of taxpayers claiming the deduction allowed by this act.
2. A comparison of the amount deducted by individual taxpayers, as specified, to the amount deducted by those individual taxpayers in the years before the deduction was allowed.
3. A review of the income levels of all of the individual taxpayers claiming the deduction allowed by this act.

Beginning on January 1, 2024, and annually thereafter, the Franchise Tax Board would be required to review the effectiveness of the deduction allowed by this act and provide an annual written report of its findings to the legislature.

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, 2023, and before January 1, 2028.

Federal/State Law

Existing federal and state laws allow for the deduction of certain expenses when calculating AGI, such as certain ordinary and necessary trade and business expenses, losses from the sale or exchange of certain property, 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.

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

The deduction is subject to phase-out ratably for individual taxpayers with modified AGI of \$70,000-\$85,000 (\$140,000 - \$170,000 for joint returns).

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In addition, no deduction is allowed for any amount deducted under any other provisions of law.

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.

California law generally conforms with federal law as it relates to the "above-the-line" deduction for interest paid on student loans as of January 1, 2015.

Implementation Considerations

This bill would require the department to provide an annual written report to the legislature, as specified, that would be based on several reporting criteria. For clarity and data accessibility it is recommended to eliminate the requirement to compare deduction amounts taken in prior years, change the due date of the report to a date that will allow the department to collect the necessary data. The department is available to work with the author's office to provide specific language and resolve other considerations.

Technical Considerations

IRC 529(e)(3) defines "qualified higher education expenses." On page 4, line 1-2, strike out "the expenses of attendance at an institution of higher education, as provided" and insert "qualified higher education expenses, as defined".

On page 4, line 3, strike out "Notwithstanding Section 529(c)(7) of the Internal", strike out lines 4-6, and insert "For the purposes the definition of "higher education expenses" in this section, Section 529(c)(7) of the Internal Revenue Code shall not apply.

Policy Considerations

For purposes of state income tax law, AGI is defined by cross-reference to the IRC as gross income, which includes all income from whatever source derived, minus specific deductions. This bill would create differences between federal and California AGI, by removing the federal \$2,500 cap and excluding elementary and secondary education expenses from the deduction, thereby increasing the complexity of California tax return preparation.

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LEGISLATIVE HISTORY

SB 477 (Wieckowski & Allen, 2019/2020) would have allowed a credit, under the PITL, equal to the amount of interest paid during the taxable year on a qualified education loan. SB 477 did not pass out of the Assembly by the constitutional deadline.

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 did not pass out of the Assembly Revenue and Taxation Committee by the constitutional deadline.

PROGRAM BACKGROUND

None noted.

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

This bill would result in the following revenue loss:

Estimated Revenue Impact of AB 704 as Amended January 12, 2022
Assumed Enactment after June 30, 2022

(\$ in Millions)

Fiscal Year	Revenue
2022-2023	-\$26
2023-2024	-\$45
2024-2025	-\$46

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.

LEGAL IMPACT

None noted.

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APPOINTMENTS

None noted.

SUPPORT/OPPOSITION

None on file for current amendments.

ARGUMENTS

None on file for current amendments.

LEGISLATIVE CONTACT

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