STATE OF CALIFORNIA
Franchise Tax Board

Bill Analysis

Author: Chad Mayes	Sponsor:	Bill Number: AB 704
	Related Bills: See Legislative History	Introduced: February 16, 2021

SUBJECT

Personal Income Tax Deduction for Qualified Education Loans

SUMMARY

This bill, under Personal Income Tax Law (PITL), would temporarily allow a deduction in the amount of the interest paid by the taxpayer during the taxable year on a qualified education loan as defined.

RECOMMENDATION

No position.

SUMMARY OF AMENDMENTS

Not applicable.

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, 2022, and before January 1, 2027, would allow a deduction from gross income equal to the interest paid by the taxpayer during the taxable year on a qualified education loan. The deduction is subject to carryover in the following and succeeding taxable years if necessary.

This bill would define the following terms:

1. "Qualified education loan" means an indebtedness incurred by the taxpayer to pay for higher education expenses incurred on behalf of the taxpayer or their spouse or dependent who is the taxpayer's spouse or dependent at the time the indebtedness is incurred and includes indebtedness used to refinance indebtedness that qualified as a qualified education loan. "Qualified education loan" does not include indebtedness owed to a related person as defined in Internal Revenue Code (IRC) section 267(b) or 707(b) or owed to a person by reason of a loan under a qualified employer plan.
2. "Higher education expenses" means the expenses of attendance at an institution of higher education as defined by IRC section 529(e)(3), and does not include expenses of enrollment or attendance at an elementary or secondary public, private or religious school.
3. "Dependent" has the same meaning as the term is defined by IRC section 152 with some exceptions.

This bill states an intent to comply with the reporting requirements of Section 41.

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, 2022, and before January 1, 2027.

Federal/State Law

Existing federal and state laws allow for the deduction of certain expenses when calculating adjusted gross income, 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).

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

For purposes of state income tax law, adjusted gross income (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 limiting the deduction with respect to elementary and secondary education expenses, thereby increasing the complexity of California tax return preparation.

Technical Considerations

Under Revenue and Taxation Code (RTC) section 41, legislation that would create a new tax expenditure, which includes a credit, deduction, exclusion, exemption, or any other tax benefit as provided for by the state, is required to include specific goals, purposes, objectives, and performance measures to allow the Legislature to evaluate the effectiveness of the tax benefit. The author may want to amend this bill to specify the RTC section 41 requirements.

The existing language could be read to create a new double deduction for the same interest expenses. For clarity, it is suggested that the phrase "in lieu of the deduction provided by Section 221 of the IRC" be added after "allowed in determining adjusted gross income" in new subdivision (d) of section 17072.

Policy Considerations

This bill would allow for an unlimited carryover period. Consequently, the department would be required to retain the carryover on the tax forms indefinitely. Credits are generally enacted with a limited carryover period because experience shows credits typically are exhausted within eight years of being earned.

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 was held at the Committee on Revenue and Taxation without further action.

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

Revenue Estimate

This bill would result in the following revenue loss:

Estimated Revenue Impact of AB704 as Introduced February 16, 2021
Assumed Enactment after June 30, 2021

($ in Millions)

Fiscal Year	Revenue
2021-2022	-$20
2022-2023	-$37
2023-2024	-$40

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.

APPOINTMENTS

None noted.

SUPPORT/OPPOSITION

To be determined.

ARGUMENTS

To be determined.

LEGISLATIVE CONTACT

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