



Bill Analysis

Author: Bauer-Kahan

Sponsor:

Bill Number: AB 1860

Related Bills: See Legislative
History

Introduced: January 18, 2024

SUBJECT

Gross Income Exclusion – Discharged Debt

SUMMARY

This bill, under the Personal Income Tax Law (PITL), would exclude from gross income qualified discharge of indebtedness income by nonprofit organizations for student loan and medical debt.

RECOMMENDATION

No position.

SUMMARY OF AMENDMENTS

Not applicable.

REASON FOR THE BILL

The reason for the bill is to provide that discharged debt for eligible student loans and medical debt is excluded from gross income.

ANALYSIS

This bill, for taxable years beginning on or after January 1, 2024, and before January 1, 2029, would exclude from gross income qualified discharge of indebtedness income.

This bill defines the following terms:

“Qualified discharge of indebtedness income” would mean income that arises from the discharge of a debt if the debt discharged satisfies both of the following conditions:

- The source of the debt was either a student loan or medical debt.
- The debt was discharged, or otherwise terminated, by a qualified entity.

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“Qualified discharge of debt income” would not include income resulting from the discharge of a debt if the discharge is in exchange for services provided to the qualifying entity.

“Qualifying entity” would mean an entity that is exempt from federal income taxation pursuant to Section 501(c)(3) of the Internal Revenue Code (IRC).

“Student loan” would have the same meaning as defined in Civil Code section 1788.100(q) and includes specified exceptions. That code section defines the types of loans to include any loan made solely for use to finance a postsecondary education and costs of attendance at a postsecondary institution, including, but not limited to, tuition, fees, books and supplies, room and board, transportation, and miscellaneous personal expenses. “Student loan” includes a loan made to refinance a student loan.

The bill includes Revenue and Taxation Code (RTC) section 41 requirements and provides that the goal, purpose, and objective of the exclusion is to provide relief to individuals that would otherwise be penalized for the gratuity of nonprofit organizations.

The performance indicators for the Legislature to use in determining whether the income exclusion achieves this goal would be the number of taxpayers excluding discharged indebtedness from income, and the total dollar value of income excluded.

This bill would require the Legislative Analyst’s Office to submit a report to the Legislature that estimates the number of taxpayers with discharged indebtedness excluded from income and estimates the total dollar value of the qualified discharge of indebtedness income received, to the extent data is available.

The exclusion would be repealed on December 1, 2029.

Effective/Operative Date

As a tax levy, this bill would be effective immediately upon enactment and operative for taxable years beginning on or after January 1, 2024, and before January 1, 2029.

Federal/State Law

Federal Law

Forgiven Debt

Gross income, defined by IRC section 61, which California generally follows under RTC sections 17071 and 24271, is broadly defined, and generally consists of all income from all sources, such as compensation for services, business income, interest, rents, dividends, and gains from the sale of property. Only items that are specifically exempt may be excluded from gross income.

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Generally, if a debt owed by a taxpayer is canceled or forgiven, other than as a gift or bequest, the taxpayer must include the canceled amount in income. There are certain exceptions to this, such as when a taxpayer is insolvent.

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 in certain professions for any of a broad class of employers. IRC section 108(f).)

Student loans eligible for this exception to the general rule must be made to an individual to assist the individual in attending an educational organization 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 (U.S.) (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 U.S., a state, or a tax-exempt public benefit corporation. (IRC section 108(f)(2).)

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. (IRC section 108(f)(3).) 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. (IRC section 108(f)(5).)

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. (IRC section 108(f)(4).)

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The American Rescue Plan Act of 2021 (ARPA) (Public Law 117-2) expanded the types of student loan discharges that are excluded from gross income for tax years beginning after December 31, 2020, and before January 1, 2026, as described above. (IRC Section 108(f)(5).)

Tax Attributes

Gross income does not include any amount that would be includible in gross income by reason of the discharge of indebtedness of the taxpayer if the discharge occurs because of bankruptcy, the discharge occurs when the taxpayer is insolvent, or the indebtedness discharged is qualified farm indebtedness.

The amount excluded from gross income described above shall be applied to reduce the following tax attributes:

- Net operating loss (NOL) for the taxable year of the discharge and any NOL carryover to that year.
- Any general business credit carryover to or from the taxable year of the discharge.
- The amount of the minimum tax credit available as of the beginning of the taxable year prior to the year of discharge.
- Any net capital loss for the taxable year of discharge or carryovers to that taxable year.
- The basis of the taxpayer's property.
- Any passive activity loss or credit carryover.
- Foreign tax credit carryovers.

Reductions in tax attributes do not apply to the exclusion for student loan forgiveness under IRC section 108(f).

State Law

Student Loan Forgiveness

California law generally conforms to the federal income tax rules (IRC 108f) relating to student loan discharge of indebtedness as of January 1, 2015, with modifications. (RTC 17131.)

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For taxable years beginning on and after January 1, 2019, and before January 1, 2024, California provides an exclusion from gross income for the discharge of a student loan of an eligible individual. (RTC section 17144.6.) An individual would be eligible for the exclusion if any of the following apply:

- Is granted a discharge of any student loan because the individual successfully asserts that the school did something wrong or failed to do something that it should have done or because the individual could not complete a program of study due to the school closing.
- Attended a Brightwood College school on or before December 5, 2018, and is granted a discharge of any student loan made in connection with attending that school.
- Attended a location of The Art Institute of California and is granted a discharge of any student loan made in connection with attending that school.

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. This exclusion applies to discharges of indebtedness occurring on or after January 1, 2014. (RTC section 17132.11(a).)

Existing state law also excludes 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. (Title 20, U.S.C. section 1087e(e).) This exclusion applies to cancellations or repayments, beginning on or after January 1, 2017, and before January 1, 2022. (RTC section 17132.11(b).)

Existing state law excludes from gross income a student loan that is discharged due to the death or total and permanent disability of the student. This exclusion applies to loan discharges after December 31, 2018. (RTC section 17144.8(a).)

Existing state law also conforms to the federal expansion of eligible types of student loan discharges that are excluded from gross income for tax year beginning after December 31, 2020 and before January 1, 2026, per the federal American Rescue Plan Act of 2021 (ARPA) (Public Law 117-2). (RTC section 17144.8(c).)

Tax Attributes

California generally conforms to the IRC provisions relating to tax attributes with minor modifications. The amount excluded from gross income as a discharge of indebtedness due to bankruptcy, a discharge due to insolvency, or a discharged of qualified farm indebtedness shall reduce tax attributes, except for foreign tax credit carryovers. The reduction of tax attributes doesn't apply to the exclusion for student loan forgiveness provisions above.

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Implementation Considerations

The Franchise Tax Board (FTB) has identified the following implementation consideration and is available to work with the author's office to resolve these and other considerations that may be identified.

This bill uses undefined term "medical debt". The absence of definitions could lead to taxpayer confusion. For clarity, the author may wish to amend the bill to define this term.

Technical Considerations

None noted.

Policy Considerations

None noted.

LEGISLATIVE HISTORY

AB 26 (Fong 2023-2024) would provide a gross income exclusion for student loan debt forgiven under the U.S. Department of Education and Biden-Harris Administration's student loan debt relief plan. AB 26 did not pass out of the Assembly by the constitutional deadline.

SB 1 (Glazer 2023-2024) would provide a gross income exclusion for student loan debt forgiven under the U.S. Department of Education and Biden-Harris Administration's student loan debt relief plan. SB 1 did not pass out of the Senate by the constitutional deadline.

AB 91, (Burke, Chapter 39, Statutes of 2019) for taxable years beginning after December 31, 2018, under the PITL, provides that for discharges of indebtedness, certain student loans that are discharged on account of death or total and permanent disability of the student are also excluded from gross income.

AB 461 (Muratsuchi, Chapter 525, Statutes of 2017) for taxable years beginning on or after January 1, 2017, and before January 1, 2022, under the PITL, excludes 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.

SB 63 (Hertzberg, Chapter 468, Statutes of 2019) for taxable years beginning on and after January 1, 2019, and before January 1, 2024, under the PITL, provides an exclusion from gross income for income that would otherwise result from the discharge of a student loan of an eligible individual.

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PROGRAM BACKGROUND

None noted.

FISCAL IMPACT

The FTB's costs to implement this bill have yet to be determined. As the bill moves through the legislative process, costs will be determined.

ECONOMIC IMPACT

Revenue Estimate

This bill would allow a taxpayer a gross income exclusion if the taxpayer had either a student loan or medical debt that was discharged by an entity that is exempt from federal income taxation pursuant to section 501(c)(3) of the IRC. To determine the magnitude of the potential impact to the General Fund, both the number of taxpayers who would have debt forgiven under this program as well as the amount of debt that would be discharged by qualifying entities would need to be known. Because it is difficult to determine the number of taxpayers who would be impacted by this bill and the amount of debt that would be discharged, the revenue impact to the General Fund is unknown.

However, it is assumed that for every \$50 million of qualified debt that is discharged, and applying an average tax rate of 7.5 percent, the estimated revenue loss would be approximately \$4 million.

LEGAL IMPACT

None noted.

APPOINTMENTS

None noted.

SUPPORT/OPPOSITION

To be determined.

ARGUMENTS

To be determined.

LEGISLATIVE CONTACT

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