



Bill Analysis

Author: Mike Fong and
Santiago

Sponsor:

Bill Number: AB 26

Related Bills: See Legislative
History

Introduced December 05,
2022, and Amended March
22, 2023

SUBJECT

Gross Income Exclusion for Federal Student Loan Debt Relief Plan

SUMMARY

This bill would, under the Personal Income Tax Law (PITL), exclude from gross income amounts discharged under the federal student loan debt relief plan.

RECOMMENDATION

No position.

SUMMARY OF AMENDMENTS

As introduced on December 5, 2022, the bill would, for taxable years beginning on or after January 1, 2022, exclude from gross income any amount of qualified student loan debt that is discharged under the federal student loan debt relief plan, require the Franchise Tax Board (FTB), under Section 41, to collect data about the exclusion and report that information to the Legislature by March 1, 2024, and make the provisions of the bill operative if the Legislature enacts a bill that incorporates into the Revenue and Taxation Code (RTC) the amendments made by the American Rescue Plan Act (ARPA) of 2021 (Public Law 117-2) relating to the special rules for discharges in 2021 through 2025.

The March 22, 2023, amendments added a co-author, revised the beginning taxable year from January 1, 2022, to January 1, 2023, removed the Section 41 reporting requirement for FTB, and removed the operative date language that required a bill that incorporated into the RTC the amendments made by ARPA of 2021 (Public Law 117-2).

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

REASON FOR THE BILL

The reason for the bill is to exclude certain student loan discharge of indebtedness from gross income.

Introduced December 5, 2022, and Amended March 22, 2023

ANALYSIS

This bill would, for taxable years beginning on or after January 1, 2023, exclude from gross income any amount of qualified student loan debt that is discharged under the federal student loan debt relief plan as described in the Federal Register (87 Fed. Reg. 61512) and administered by the United State (U.S.) Department of Education.

This bill defines the following terms:

- “Federal Pell Grant” would mean a grant made under Section 1070a of Title 20 of the U.S. Code.
- “Qualified student loan debt” would mean:
 - Up to \$20,000 for individuals who received a federal Pell Grant and meet the federal income requirement for debt cancellation and whose federal loans are discharged.
 - Up to \$10,000 for individuals who did not receive a federal Pell grant, meet the federal income requirement for debt cancellation, and whose federal loans are discharged.

This bill would not limit the application of the APRA of 2021 (Public Law 117-2) for discharges of student loan debt in 2021 through 2025 or any act that would incorporate amendments made by the ARPA to Section 108(f)(5) of the Internal Revenue Code (IRC) relating to special rules for discharges in 2021 through 2025.

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, 2023.

Federal/State Law

Federal Law

Biden-Harris Administration's Plan for Student Debt Relief

President Biden and Vice- President Harris created a student loan debt relief plan, also known as the Biden-Harris Administration's Plan for Student Debt Relief, that would provide loan forgiveness up to \$20,000 to Pell Grant recipients and up to \$10,000 to non-Pell Grant recipients whose adjusted gross income is less than \$125,000 (\$250,000 for individuals filing jointly or as a Head of Household, or as a qualifying widow(er)). On October 12, 2022, the federal Office of Postsecondary Education within the Department of Education “updated waivers and modifications of statutory and regulatory provisions governing the federal student financial aid programs under the authority of the Higher Education Relief Opportunities for Students Act of 2003,” (Summary of Federal Register 87FR 61512) to include the debt discharges under this student loan debt relief plan.

Introduced December 5, 2022, and Amended March 22, 2023

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 (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. (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.

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)).

The 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).)

Introduced December 5, 2022, and Amended March 22, 2023

State Law

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 cancellation or repayments, beginning on or after January 1, 2017, and before January 1, 2022. (RTC section 17132.11(b).)

For discharges of indebtedness occurring on or after January 1, 2015, and before January 1, 2020, existing state law excluded from an eligible individual's gross income amounts that would otherwise result from a student loan forgiven because of the closure of Corinthian Colleges and similar closures. (RTC section 17144.7.) This provision was repealed on December 1, 2020.

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.)

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.

Implementation Considerations

None noted.

Introduced December 5, 2022, and Amended March 22, 2023

Technical Considerations

None noted.

Policy Considerations

This bill does not have a sunset date, which is generally provided to allow periodic review of the effectiveness of income tax law changes by the Legislature.

If California does not conform to ARPA, the bill's provisions to incorporate ARPA may cause confusion with federal and state conformity. Alternatively, if there is conformity to ARPA, qualified student loan debt that is discharged under the federal student loan debt relief plan would be included in APRA. To ensure consistency with the author's intent, the author may want to amend the bill to remove subdivision (c).

This bill defines "qualified student loan debt" for individuals who received a federal Pell Grant, however it does not require that the loan debt be forgiven to qualify for the exclusion. To ensure consistency with the author's intent and the federal plan, the author may want to amend the bill to provide this clarification.

LEGISLATIVE HISTORY

AB 35 (Committee on Budget et al., 2023-2024) would, under the PITL, conform to the ARPA student loan provision that excludes from gross income certain student loan debt that is fully or partially discharged on or after January 1, 2021, and before January 1, 2026. AB 35 is in the Assembly Budget Committee.

AB 668 (Petrie-Norris, 2021-2022), under the PITL, would have conformed to the student loan forgiveness provisions under the ARPA for taxable years beginning on or after January 1, 2021, and before January 1, 2026. AB 668 was held in the Assembly Revenue and Taxation Committee.

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 1 (Glazer, 2023-2024) is related to this bill and is in the Senate Governance and Finance Committee.

Introduced December 5, 2022, and Amended March 22, 2023

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.

PROGRAM BACKGROUND

None noted.

FISCAL IMPACT

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

ECONOMIC IMPACT

Revenue Estimate

This bill would result in the following revenue loss:

Estimated Revenue Impact of AB 26 as Amended on March 22, 2023
 Assumed Enactment before June 30, 2023

(\$ in Millions)

Fiscal Year	Revenue
2022-2023	\$0
2023-2024	-\$850
2024-2025	-\$450

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. Department of Education's Federal Student Aid program, approximately 4 million Californians had \$150 billion dollars in federal student loans as of September 30, 2022. It is assumed that approximately 85 percent or 3.5 million taxpayers would earn income below the maximum allowed (\$125,000 for single or \$250,000 for married filing joint and head of household). Of these individuals, it is estimated that 65 percent would be Pell Grant recipients and qualify for up to \$20,000 in debt relief. Furthermore, it is assumed that if the remaining loan amounts were less

Introduced December 5, 2022, and Amended March 22, 2023

than the maximum amounts allowed (\$20,000 or \$10,000), the taxpayer would only exclude the remaining loan balance from income. Based on Department of Education's loan data, approximately 55 percent of Pell Grant recipients owe less than \$20,000 and approximately 30 percent of all others owe less than \$10,000. It is estimated that these individuals would qualify for approximately \$40 billion in student debt forgiveness. Applying an estimated average tax rate of 3.3 percent results in an estimated revenue loss of \$1.3 billion.

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

LEGAL IMPACT

None noted.

APPOINTMENTS

None noted.

SUPPORT/OPPOSITION

To be determined.

ARGUMENTS

To be determined.

LEGISLATIVE CONTACT

FTBLegislativeServices@ftb.ca.gov