STATE OF CALIFORNIA
Franchise Tax Board

Bill Analysis

Author: Tangipa

Sponsor:

Related Bills: See Legislative History

Bill Number: AB 386

Introduced: February 3, 2025

SUBJECT

Student Loan Payments Tax Credit

SUMMARY

This bill, under the Personal Income Tax Law (PITL) and Corporate Tax Law (CTL), would for taxable years beginning on or after January 1, 2026, and before January 1, 2031, allow a tax credit for qualified taxpayers that pay student loan payments on behalf of their full-time employees if they apply for and receive a credit reservation from the Franchise Tax Board (FTB).

This bill would also provide, under the PITL, a gross income exclusion to the full-time employee receiving the student loan payments made by a qualifying employer.

RECOMMENDATION

No position—The three-member Franchise Tax Board has not formally voted or taken a position on this bill.

SUMMARY OF AMENDMENTS

Not applicable.

REASON FOR THE BILL

The reason for this bill is to encourage employers to assist in reducing the burden of student loan payments on their employees.

ANALYSIS

Tax Credit

This bill would, under the PITL and CTL, for taxable years beginning on or after January 1, 2026, and before January 1, 2031, allow a tax credit for qualified taxpayers for an amount equal to the taxpayer's qualified expenditures during the taxable year. This provision defines the following terms:

- A "qualified taxpayer" means a business whose employees do not perform public services jobs as described in Section 1087e(m)(3)(B) of the Title 20 of the United States Code.

- A "qualified expenditure" means all student loan payments made by a qualified taxpayer during the taxable year on behalf of a full-time employee, not to exceed $3,000 per full-time employee.
- A "full-time employee" is an employee of the qualified taxpayer who is either paid wages for services not fewer than an average of 35 hours per week or is a salaried employee within the meaning of section 515 of the Labor Code.

The total aggregate amount that would be allocated by credit reservation to all qualified taxpayers would not exceed $25,000,000 per calendar year. A qualified taxpayer would be required to request a tentative credit reservation from the FTB in the form and manner prescribed by the FTB. In addition, the qualified taxpayer would be required to provide all necessary information as determined by the FTB.

The FTB would be required to begin accepting applications for a tentative credit reservation on July 1 of each calendar year. This would be on the following dates:

- On July 1, 2025, for taxable years beginning on January 1, 2026, and before December 31, 2026,
- On July 1, 2026, for taxable years beginning on January 1, 2027, and before December 31, 2027,
- On July 1, 2027, for taxable years beginning on January 1, 2028, and before December 31, 2028,
- On July 1, 2028, for taxable years beginning on January 1, 2029, and before December 31, 2029, and
- On July 1, 2029, for taxable years beginning on January 1, 2030, and before December 31, 2030.

In addition, the FTB would be required to approve applications and provide priority to applications submitted by qualified taxpayers that have at least one of the following criteria:

- Businesses owned by veterans,
- Businesses owned by women,
- Employers that employ no more than 500 employees during the taxable year,
- Businesses that are minority owned, or
- Businesses owned by disabled individuals.

Excess credits could be carried over to reduce the "net tax" in the following taxable year, and the next three succeeding years, if necessary, until the credit is exhausted. Any deduction or credit otherwise allowed for a qualified expenditure made by the qualified taxpayer as a trade or business expense would be reduced by the amount of this credit.

In addition, the FTB would have the authority to adopt rules, guidelines and procedures necessary or appropriate to carry out the provisions of the bill, including providing guidelines regarding the allocation of the credit allowed.

This credit would remain operative until December 1, 2031, and as of that date is repealed.

Gross Income Exclusion

This bill would, under the PITL, for taxable years beginning on or after January 1, 2026, and before January 1, 2031, would provide a gross income exclusion for student loan payments made by a qualifying employer on behalf a taxpayer that is a full-time employee of that qualifying employer. This provision defines the following terms:

- A "full-time employee" is an employee of the qualified taxpayer who is either paid wages for services not fewer than an average of 35 hours per week or is a salaried employee within the meaning of Section 515 of the Labor Code.
- A "qualifying employer" means a business whose employees do not perform public services jobs as described in Section 1087e(m)(3)(B) of the Title 20 of the United States Code.

This gross income exclusion would remain operative until January 1, 2031, and as of that date is repealed.

Section 41 Reporting

This bill contains language to comply with Revenue and Taxation Code (RTC) section 41, stating that the goal of the credit and exclusion is to encourage employers to assist their full-time employees with reducing the overwhelming burden of student loan payments.

The bill would also require the FTB to submit a report to the Legislature, on or before December 1, 2028, that would be used to measure the effectiveness of the credit and exclusion. The report would be required to include the number of taxpayers allowed a credit and the total dollar amount of the credits allowed.

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, 2026, and before January 1, 2031.

Federal/State Law

Federal and state laws provide various tax credits designed to provide tax relief for taxpayers who incur certain expenses (e.g., child adoption) or to influence behavior, including business practices and decisions (e.g., research credits, hiring credits). These credits generally are designed to provide incentives for taxpayers to perform various actions or activities that they may not otherwise be undertaken.

Federal and state laws provide that gross income includes all income from whatever source derived, including compensation for services, business income, gains from property, interest, dividends, rents, and royalties, unless specifically excluded. Types of income currently excluded include amounts received as a gift or inheritance, certain compensation for injuries and sickness, educational assistance programs, foster care payments, interest received on certain state or federal obligations, and qualified scholarships.

Also, 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 certain employers. (Internal Revenue Code (IRC) section 108(f).) The American Rescue Plan Act of 2021 (ARPA) (Public Law 117-2) also 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).) California conforms to this provision of the ARPA and additionally allows an exclusion from gross income for student loan debt that is repaid by the U.S. Department of Education or cancelled under the income-based repayment programs administered by the U.S. Department of Education.

Under existing state law, legislation that would create a new tax expenditure, which includes a credit, deduction, exemption, or any other tax benefit as provided for by the state, is required to include specific goals, purposes, objectives, detailed performance indicators, and data collection requirements to allow the Legislature to evaluate the effectiveness of the tax benefit. Legislation that would create an income exclusion would not require detailed performance indicators and data collection requirements performance measures if the Legislature determines there is no available data to collect and report.

Implementation Considerations

The FTB has identified the following implementation considerations for purposes of a high-level discussion; additional considerations may be identified as the bill moves through the legislative process. FTB staff is available to work with the author's office to resolve these and other considerations that may be identified.

The bill uses the term “student loan payment” throughout the bill. However, the bill does not define the term and this could lead to taxpayer confusion. For clarity, the author may wish to amend the bill to define this term using federal terms and definitions that identify certain types of student loans or education loans that are eligible for tax incentives (i.e. IRC sections 108(f)(2), 221(d)(1)).

The bill would require the FTB to approve applications and give priority to applicants whose business are either owned by veterans, women, minority, disabled individuals, or businesses who employ no more than 500 employees. The FTB does not have expertise to determine if applicants meet the bill’s requirements and taxpayers may challenge the FTB’s determination on which applicants were given priority. Typically, credits involving areas for which the FTB does not have the expertise are certified by another agency that has the relevant expertise. The author may wish to amend the bill to include a certifying agency to verify applicant requirements and to add language that FTB’s determination cannot be challenged in administrative or judicial proceedings.

In addition, this bill would require the FTB to begin accepting applications for a tentative credit reservation on July 1, 2025. However, implementation of the bill’s provisions would not begin until after the enactment of this bill. The author may wish to delay the operation of the bill to allow FTB additional time for implementation of the reservation system to the earliest date of July 1, 2027.

Technical Considerations

For consistency and clarity, the following changes are recommended:

- In Section 23632(f), replace the term “net tax” with “tax”.
- In Section 17053.83 (g) and 23632 (g) remove the phrase “as a trade or business expense”.
- In Section 17053.83 (b)(3) and 23632(b)(3) replace the term “business” with “taxpayer”.
- In Section 17053.83(h) and 23632(h) should be amended to strike out “The Franchise Tax Board may prescribe rules, guidelines, or procedures necessary or appropriate to carry out the purposes of this section, including any guidelines regarding the allocation of the credit allowed under this section.” and insert “The Franchise Tax Board may prescribe regulations necessary or appropriate to carry out the purposes of this section”.

This bill uses the terms “qualified taxpayer” and “taxpayer” interchangeably. For clarity, the author should amend the bill to use exclusively “qualified taxpayer”.

The bill provisions specify a repeal date of January 1, 2031. However, the bill provisions would apply for calendar and fiscal years beginning on or before January 1, 2031. To retain the provisions “in law” until the day after the last day of the fiscal year beginning December 1, 2030, the author may wish to change the repeal date to December 1, 2031.

Policy Considerations

Differences in timing for calendar and fiscal year taxpayers for the tentative credit reservation system can cause implementation challenges and create uncertainty in the process for both the FTB and taxpayers. Based on these concerns, alternative reservation system processing and application dates should be revised.

This bill as drafted would allow a taxpayer to hire an employee temporarily and still be allowed this credit. The author may wish to amend the bill to add a length of employment requirement such as an employee must have been employed for at least on year of employment or an average of 35 hours per week for 52 weeks.

LEGISLATIVE HISTORY

AB 509 (Fong, 2023/2024) would have, under the PITL, created a gross income exclusion for qualified education loan payments made by an employer on an employee’s behalf. AB 509 did not pass out of the Assembly by the constitutional deadline.

SB 424 (Durazo, et al., 2021/2022) would have, under the PITL and CTL, created the California Homeless Hiring Credit available to a qualified taxpayer that employs a person who is homeless or someone who is receiving supportive services from a homeless services provider. SB 424 did not pass out of the Senate by the constitutional deadline.

AB 1169 (Frazier, 2019/2020) would have, under the PITL, allowed a credit to a qualified employer for wages paid to qualified employees. AB 1169 did not pass out of the Assembly by the constitutional deadline.

AB 1726 (Arambula, 2019/2020) would have, under the PITL and the CTL, provided a tax credit to certain employers that hire employees who are members of a targeted group. AB 1726 did not pass out of the Assembly by the constitutional deadline.

AB 2041 (Dahle, 2019/2020) would have, under the PITL and the CTL, established a credit for qualified wages paid to a qualified employee that is a former foster youth or ex-offender that is age 18 to 25 by a qualified taxpayer. AB 2041 did not pass out of the Assembly by the constitutional deadline.

SB 1333 (Durazo, et al., 2019/2020), would have created the California Homeless Hiring Tax Credit available to a qualified taxpayer that employs a homeless individual. SB 1333 did not pass out of the Senate by the constitutional deadline.

PROGRAM BACKGROUND

None noted.

OTHER STATES' INFORMATION

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 result in the following revenue loss:

Estimated Revenue Impact of AB 386 as Introduced February 3, 2025
Assumed Enactment after June 30, 2025

($ in Millions)

Fiscal Year	Revenue
2025-2026	-$150
2026-2027	-$270
2027-2028	-$290

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

Credit

This bill would allow a credit equal to all student loan payments made by a qualified taxpayer on behalf of a qualified full-time employee, not to exceed $3,000 per full-time employee. This estimate assumed the credit cap of $25 million per calendar year would be fully allocated.

It is estimated that approximately 90 percent, or $22 million would be generated by taxpayers with sufficient tax liability to offset with the credit. Of that amount, nearly 60 percent, or $13 million, would be claimed in the year generated and the remaining credit would be used over the subsequent four years.

To arrive at the offsetting tax effect of expense deduction that would otherwise be allowed under current law, it is estimated that qualified taxpayers would be able to deduct approximately $25 million in qualified expenses in taxable year 2026. Applying an average tax rate of 7 percent, would result in an offsetting revenue gain of $1.8 million. The resulting net revenue loss, for taxable year 2026, would be approximately $11 million.

Exclusion

Data from the U.S. Department of Education and other various sources indicates that approximately 4 million Californians will hold an estimated $160 billion in student loan debt in the 2026 taxable year. Of that, 30 percent, or $5 billion is estimated to be paid off by employers through direct loan payments on behalf of their employees and would be excluded from taxable income. Applying an average tax rate of 5 percent would result in a revenue loss of about $250 million in the 2026 taxable year.

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.

EQUITY IMPACT

None noted.

APPOINTMENTS

None noted.

SUPPORT/OPPOSITION

To be determined.

ARGUMENTS

To be determined.

LEGISLATIVE CONTACT

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