

Date of Hearing: May 1, 2023

ASSEMBLY COMMITTEE ON REVENUE AND TAXATION
Jacqui Irwin, Chair

AB 26 (Mike Fong) – As Amended April 20, 2023

SUSPENSE

Majority vote. Tax levy. Fiscal committee.

SUBJECT: Personal Income Tax Law: exclusion: federal student loan debt relief plan

SUMMARY: Excludes from gross income, for purposes of the Personal Income Tax (PIT) Law, amounts of up to \$20,000 in "qualified student loan debt" that is discharged under the U.S. Department of Education's student loan debt relief plan, as specified. Specifically, **this bill:**

- 1) Excludes from gross income, for taxable years beginning on or after January 1, 2023, and before January 1, 2028, 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 (October 12, 2022)), as administered by the U.S. Department of Education pursuant to Section 1098bb of Title 20 of the United States Code.
- 2) Defines the following terms for purposes of this bill:
 - a) "Federal Pell Grant" is a grant made pursuant to Section 1070a of Title 20 of the United States Code; and,
 - b) "Qualified student loan debt" is up to \$20,000 for individuals who received a Federal Pell Grant, who meet the federal income requirements for debt cancellation, and whose eligible federal loans are discharged by the U.S. Department of Education, and up to \$10,000 for individuals who have not received a Federal Pell Grant, who meet the federal income requirements for debt cancellation, and whose eligible federal loans are discharged by the U.S. Department of Education.
- 3) Provides that nothing in this bill is intended to limit the application of the American Rescue Plan Act of 2021 (Public Law 117-2) relating to special rules for discharges in 2021 through 2025, or any act that would incorporate the amendments made by the American Rescue Plan Act of 2021 to Internal Revenue Code (IRC) Section 108(f)(5), relating to the special rules for discharges in 2021 through 2025.
- 4) Finds and declares the following for the purposes of satisfying the requirements of Revenue and Taxation Code (R&TC) Section 41:
 - a) The specific goals, purposes, and objectives of this bill are:
 - i) To recognize the financial hardship that Californians with federal student loan debts have endured as a result of the COVID-19 pandemic; and,

- ii) To maximize the benefits of the federal student loan debt relief plan and provide some financial relief to an estimated 4,000,000 Californians who are eligible for the program.
- b) To measure whether this bill achieves its intended purpose, the following performance indicators are required:
 - i) The number of taxpayers excluding income pursuant to this bill; and,
 - ii) The total dollar amount of income excluded pursuant to this bill.
- 5) Requires the Legislative Analyst's Office (LAO) to submit a report to the Legislature by January 1, 2025, estimating the number of taxpayers excluding income pursuant to this bill and the total dollar amount of income excluded.
- 6) Takes immediate effect as a tax levy.
- 7) Repeals these provisions on December 1, 2028.

EXISTING FEDERAL LAW:

- 1) Defines "gross income", unless otherwise provided, to include all income from whatever source derived, including but not limited to income from discharge of indebtedness. (IRC Section 61(a)(12).)
- 2) Excludes from gross income amounts received resulting from the discharge of certain student loans for individuals who are employed by a qualifying government or not-for-profit organization, as specified. (IRC Section 108(f).)
- 3) Excludes from gross income, for taxable years 2021 through 2025, any amount received resulting from the discharge of any loan provided expressly for postsecondary educational expenses, whether provided by a public or private lender, as specified. (IRC Section 108(f)(5).)
- 4) Authorizes the Secretary of Education to waive or modify statutory or regulatory provisions applicable to Federal student financial assistance programs as deemed necessary by the Secretary in connection with a war or other military operation or national emergency. (Title 20 of the United States Code, Section 1098bb.)

EXISTING STATE LAW:

- 1) Conforms, with modifications, to the definition of gross income in IRC Section 61 for purposes of the PIT Law. (R&TC Section 17071.)
- 2) Excludes from gross income any loan amount repaid by the U.S. Secretary of Education or canceled pursuant to Section 1087e(e) of Title 20 of the United States Code relating to income-contingent repayment. (R&TC Section 17132.11.)
- 3) Excludes from gross income amounts received resulting from the Forgivable Loan Program provided by the California State University. (R&TC Section 17134.)

- 4) Excludes from gross income amounts received resulting from discharged loans for individuals who attended certain for-profit postsecondary institutions. (R&TC Section 17144.6.)

FISCAL EFFECT: The Franchise Tax Board (FTB) estimates General Fund revenue losses of \$850 million in Fiscal Year (FY) 2023-24 and \$450 million in FY 2024-25.

COMMENTS:

- 1) The author has provided the following statement in support of this bill:

Federal student loan debt relief is a crucial piece of California's economic recovery from the COVID-19 pandemic. AB 26 ensures that Californians who qualify for federal loan debt relief will not pay state taxes. We must do all that we can to support the millions of Californians who are working hard to get back on their feet and contribute to the state's economy.

- 2) In support of this bill, the American Federation of State, County and Municipal Employees (AFSCME), AFL-CIO notes, in part:

With rising inflation, increased gas prices, and the high cost of living in the state, the federal action on student debt relief will help Californians struggling to pay their bills each month. AB 26 is a simple measure that will prevent the relief waiver from the federal government to count against an individual's tax return and maximize the benefits of the federal student loan debt relief plan and provide some financial relief to [individuals] who are eligible for the program.

- 3) Committee Staff Comments:

- a) *U.S. Department of Education's student loan debt relief plan:* On August 24, 2022, President Biden announced a plan to cancel or reduce federal student loan balances for borrowers with annual income in 2020 or 2021 below \$125,000 for individuals or below \$250,000 for households. The program will generally offer cancellation of up to \$10,000 per eligible borrower, or up to \$20,000 of cancellation for eligible borrowers who are also prior Pell Grant recipients. According to the White House, roughly 20 million borrowers will be eligible to see their full remaining balance canceled, while another 23 million borrowers will be eligible to see their balance reduced. President Biden further argued that the burden of existing student debt falls disproportionately on Black borrowers, pointing out that 20 years after first enrolling in school, the typical Black borrower who started college in the 1995-96 school year still owed 95% of their original student debt.¹

According to the U.S. Department of Education, categorical cancellation seeks to address "the financial harms of the pandemic" by helping borrowers transition back to repayment status following the end of the pandemic-related pause on loan repayment, interest

¹ "FACT SHEET: President Biden Announces Student Loan Relief for Borrowers Who Need It Most." *The White House Briefing Room*. August 24, 2022. <https://www.whitehouse.gov/briefing-room/statements-releases/2022/08/24/fact-sheet-president-biden-announces-student-loan-relief-for-borrowers-who-need-it-most/>.

accrual, and involuntary collections.² In an opinion dated August 23, 2022, the Department of Justice's Office of Legal Counsel (OLC) concluded that the Higher Education Relief Opportunities for Students (HEROES) Act of 2003, as amended, authorizes the Secretary of Education to relieve borrowers of the obligation to repay federal student loans. This relief, OLC explained, could in some cases be justified under the HEROES Act as a response to the COVID-19 pandemic.

- b) *What does this bill do?* The American Rescue Plan Act of 2021 amended the IRC to provide that forgiven student loans are not considered income for Federal income tax purposes. This bill provides that similar but narrower treatment would apply for state income tax purposes. Specifically, this bill guarantees that taxpayers who had their student loans forgiven as part of the U.S. Department of Education's student loan debt relief plan are not required to report forgiven loan amounts as part of their income when filing their California income tax returns.
- c) *Pending litigation:* Two different challenges to the federal student debt relief plan are now before the U.S. Supreme Court. The first case, *Biden v. Nebraska*, was filed by six states with Republican attorneys general, who argue that the HEROES Act does not give the Secretary of Education the power to implement the debt-relief program and, moreover, that the plan violated the laws governing federal agencies. The second case, *Department of Education v. Brown*, was filed in Texas by two student-loan borrowers, Myra Brown and Alexander Taylor. Brown is not eligible for any relief under the Biden plan because her loans are not federal loans but are instead held by commercial lenders; Taylor is eligible for \$10,000 in relief but cannot obtain the full \$20,000 in relief available under the plan because he did not receive a Pell Grant.³ It is unknown when the U.S. Supreme Court will ultimately decide these cases, but many legal observers predict that the Court is unlikely to uphold the student debt relief plan.
- d) *Alternative routes:* California legislative leaders and the Governor have previously announced their support for legislation to provide equal treatment for state taxation purposes by excluding forgiven student loan amounts from taxable income. Accordingly, several bills on this subject have been introduced during this legislative session, including two budget trailer bills (AB 35 and SB 220). Unlike this bill, AB 35 and SB 220 simply conform state law to the special rules for discharges in 2021 through 2025 provided by the American Rescue Plan Act. This Committee may wish to consider if this bill is necessary in light of the uncertainty created by the pending litigation. Additionally, the Committee may wish to discuss whether it is prudent to limit the income exclusion to the specific student loan debt relief plan that may be overturned, rather than providing a more general income exclusion.

² Liu. "Statutory Basis for Biden Administration Student Loan Forgiveness" *Congressional Research Service*. September 13, 2022. <https://crsreports.congress.gov/product/pdf/LSB/LSB10818>.

³ Howe. "In a pair of challenges to student-debt relief, big questions about agency authority and the right to sue." *SCOTUSBlog*. February 13, 2023. <https://www.scotusblog.com/2023/02/in-a-pair-of-challenges-to-student-debt-relief-big-questions-about-agency-authority-and-the-right-to-sue/>.

- e) *Existing exclusions for loan forgiveness:* Since 2014, California has provided an exclusion from gross income resulting from student loan debt that is cancelled or repaid under the income-based repayment programs administered by the U.S. Department of Education. Existing state law also provides a gross income exclusion for loans forgiven because of the closure of certain for-profit colleges. Additionally, since 2018, California has excluded from gross income a student loan that is discharged due to the death or total and permanent disability of the student.
- f) *What is a "tax expenditure"?* Existing law provides various credits, deductions, exclusions, and exemptions for particular taxpayer groups. In the late 1960s, U.S. Treasury officials began arguing that these features of the tax law should be referred to as "expenditures" since they are generally enacted to accomplish some governmental purpose and there is a determinable cost associated with each (in the form of foregone revenues).

As the Department of Finance notes in its annual Tax Expenditure Report, there are several key differences between tax expenditures and direct expenditures. First, tax expenditures are typically reviewed less frequently than direct expenditures. Second, there is generally no control over the amount of revenue losses associated with any given tax expenditure. Finally, it should also be noted that, once enacted, it takes a two-thirds vote to rescind an existing tax expenditure absent a sunset date. This effectively results in a "one-way ratchet" whereby tax expenditures can be conferred by majority vote, but cannot be rescinded, irrespective of their efficacy or cost, without a supermajority vote.

- g) *Committee's tax expenditure policy:* Both R&TC Section 41 and Committee policy require any tax expenditure bill to outline specific goals, purposes, and objectives that the tax expenditure will achieve, along with detailed performance indicators for the Legislature to use when measuring whether the tax expenditure meets those stated goals, purposes, and objectives. A tax expenditure bill will not be eligible for a Committee vote unless it has complied with these requirements.

In its current form, this bill states that the exclusion is designed to recognize the financial hardship that Californians with federal student loan debts have endured as a result of the COVID-19 pandemic and maximize the benefits of the federal student loan debt relief plan and provide some financial relief to an estimated 4,000,000 Californians who are eligible for the program. In addition, this bill provides that the exclusion's effectiveness shall be measured by the number of taxpayers excluding income pursuant to this bill and the total dollar amount of income excluded. This bill requires the LAO to submit a report to the Legislature by January 1, 2025, estimating the number of taxpayers excluding income pursuant to this bill and the total dollar amount of income excluded.

In addition to the R&TC Section 41 requirements, this Committee's policy also requires that all tax expenditure proposals contain an appropriate sunset provision to be eligible for a vote. According to this policy, an "appropriate sunset provision" means five years, except in the case of a tax expenditure measure providing relief to California veterans, in which case "appropriate sunset provision" means ten years. This bill contains a five-year sunset provision and therefore complies with the Committee's policy on sunset dates.

- h) *Related legislation:*

- i) SB 1 (Glazer), AB 35 (Committee on Budget) and SB 220 (Committee on Budget) would, for taxable years beginning on or after January 1, 2021, and before January 1, 2026, conform state law to the special rule for discharges codified in IRC Section 108(f)(5) by the American Rescue Plan Act of 2021. SB 1 is currently pending in the Senate Appropriations Committee. AB 35 and SB 220 are currently pending hearings before the Assembly and Senate Budget Committees, respectively.

- i) *Prior legislation:*
 - i) AB 668 (Petrie-Norris), of the 2021-22 Legislative Session, would have conformed to the student loan forgiveness provisions under the American Rescue Plan Act for taxable years beginning on or after January 1, 2021, and before January 1, 2026. AB 668 was never heard in this Committee.

 - ii) AB 91 (Burke), Chapter 39, Statutes of 2019, provided that discharges of indebtedness, under the PIT Law, for certain student loans that are discharged on account of death or total permanent disability of the student are excluded from gross income.

 - iii) AB 461 (Muratsuchi), Chapter 525, Statutes of 2017, excluded 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 for taxable years beginning on or after January 1, 2017, and before January 1, 2022.

REGISTERED SUPPORT / OPPOSITION:

Support

American Federation of State, County and Municipal Employees (AFSCME), AFL-CIO
California Federation of Teachers AFL-CIO
Student Senate for California Community Colleges

Opposition

None on file

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