SENATE COMMITTEE ON GOVERNANCE AND FINANCE
Senator Anna M. Caballero, Chair
2023 - 2024 Regular

Bill No:	SB 1	**Hearing Date:**	4/26/23
Author:	Glazer	**Tax Levy:**	No
Version:	3/30/23	**Fiscal:**	Yes
Consultant:	Deitchman		

PERSONAL INCOME TAX LAW: EXCLUSION: STUDENT LOAN DEBT

Provides an income exclusion for student loan debt forgiven under the American Rescue Plan Act of 2021.

Background

Tax expenditures. California law allows various income tax credits, deductions, exemptions, and exclusions. The Legislature enacts such tax incentives either to compensate taxpayers for incurring certain expenses, such as child adoption, or to influence certain behavior, such as charitable giving. The Legislature uses tax incentives to encourage taxpayers to do something that but for the tax credit, they would otherwise not do. The Department of Finance is required annually to publish a list of tax expenditures, currently totaling around $87 billion per year.

Cancellation of debt. When a lender cancels a borrower's debt, federal and state law generally treat the amount of debt cancelled as income taxable to the borrower. Taxpayers do not include borrowed funds in income in the year he or she receives loan proceeds because of the obligation to repay the loan; the taxpayer is financially no better off because the loan must be repaid. When lenders reduce the repayable amount, the taxpayer realizes a gain in his or her financial situation because a portion of the loan proceeds that have already been received and not previously taxed need not be repaid. In *U.S .v. Kirby Lumber Co.,* 284 US 1 (1931), the United States Supreme Court held that a company that had issued $12 million in bonds and later repurchased some of them at less than their face amount generated a taxable gain. Congress subsequently deemed cancelled debt as income, with exceptions for:

- Debts discharged in bankruptcy,
- When the taxpayer is insolvent, debt discharge is excluded up to the amount of the insolvency, but triggers specified basis adjustments,
- Certain farm debts, and
- Debt discharge resulting from a non-recourse loan in foreclosure.

Generally, a taxpayer excludes student loan forgiveness from his or her income if the forgiveness is contingent upon the student working for a specific number of years in certain professions. For example, if a taxpayer participates in a public service loan forgiveness program, a teacher loan forgiveness program, or a law school loan repayment assistance program, the taxpayer can exclude the cancelled debt from income. A taxpayer can also exclude his or her forgiven student loan debt from income due to death or disability. In other words, if the taxpayer dies or becomes disabled and can no longer repay the loan, then the taxpayer does not have to include the loan forgiveness as income. Additionally, if a taxpayer's student loan is forgiven and the taxpayer is insolvent, then he or she does not have to include the amount forgiven in gross income.

The Legislature has allowed forgiven loan amounts to be excluded from taxable income when the borrower is unable to complete a program of study because a school closes, does something wrong, or fails to do something it should have (SB 105, Nguyen, 2015, and SB 63, Hertzberg, 2019).

American Rescue Plan Act of 2021. Enacted by President Biden on March 11, 2021, the American Rescue Plan Act of 2021 modified the treatment of student loan forgiveness for discharges in 2021 through 2025. For federal tax purposes, individuals may be able to exclude forgiven student debt loan amounts from gross income if the loan was one of the following:

- A loan for postsecondary educational expenses;
- A private education loan;
- A loan from an educational organization described in section 170(b)(1)(A)(ii) of the IRC related to an educational organization;
- A loan from an organization exempt from tax under section 501(a) to refinance a student loan.

Seeking to align the state more closely with federal law, the author wants to provide an income exclusion for student loan forgiven under the American Rescue Plan Act of 2021.

Proposed Law

Senate Bill 1, for taxable years 2021 through 2026, excludes from gross income any student loan amount that was forgiven under the American Rescue Plan, as specified.

The bill states that it intends to comply with the provisions of Revenue and Taxation Code Section 41.

State Revenue Impact

Pending.

Comments

1. Purpose of the bill. According to the author, “It's time to put an end to the crushing weight of student loan debt. In California alone, borrowers hold a staggering $142.7 billion in federal student loan debt, and the burden of this debt can last for a lifetime. But even if federal debt forgiveness programs are put in place, borrowers may still be hit with unexpected tax liabilities because of current state tax law. This is simply unfair. Students should not have to bear this financial burden for a lifetime just to get a degree. By waiving state taxes on forgiven student loan debt, Californians could receive up to $1.3 billion in relief. This action is necessary to help alleviate this burden and promote economic security.”

2. Revenue loss. Existing tax law provides various credits, deductions, exclusions, and exemptions for certain taxpayers. Since these items are enacted to accomplish some governmental purpose and determined to have a cost — in the form of foregone revenues — state law refers to them as "tax expenditures." This bill would create a new tax expenditure, costing the General Fund in foregone revenue. As a result, the state will have to reduce spending or increase taxes to match the foregone revenue. The Committee may wish to consider whether SB 1 is worth the tradeoff of spending cuts and/or raising taxes.

3. Governor's Budget. The Governor's proposed budget issued in January includes proposed trailer bill language that would exclude from an individual's gross income, for taxable years beginning on or after January 1, 2022, any amount of qualified student loan debt, as defined that is discharged under the Biden-Harris administration's 2022 federal student loan debt relief plan.

4. Missing Section 41. Section 41 of the Revenue and Taxation Code, requires any bill authorizing a new tax expenditure to contain, among other things, specific goals, purposes, and objectives that the tax expenditure will achieve, and detailed performance indicators, along with data collection and reporting requirements (SB 1335, Leno, 2014). SB 1 does not include the reporting metrics needed to comply with Section 41, however it does include language that states that it plans to comply with the provisions. The Committee may wish to consider amending the bill to add the Section 41 reporting requirements.

Support and Opposition (4/21/23)

Support: None submitted.

Opposition: None submitted.

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