HB 440

Department of Legislative Services

2011 Session

FISCAL AND POLICY NOTE

House Bill 440 (Delegates Mizeur and Rosenberg)
Ways and Means

Janet L. Hoffman Loan Assistance Repayment Program - Exemption from Taxation

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This bill exempts from the State income tax any amount received by an individual under the Janet L. Hoffman Loan Assistance Repayment Program (LARP). The Maryland Higher Education Commission (MHEC) is required to examine the feasibility of restructuring the program as a qualifying loan program under § 108(f) of the Internal Revenue Code (IRC) and report its findings to the Governor and the General Assembly by December 1, 2011.

The bill takes effect July 1, 2011, and applies to tax year 2011 and beyond.

Fiscal Summary

State Effect: General fund revenues decrease by $71,400 annually beginning in FY 2012 due to the exemption of loan repayments. General fund expenditures increase by $22,000 in FY 2012 for one-time tax form changes and computer programming modifications at the Comptroller's Office.

(in dollars)	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016
GF Revenue	($71,400)	($71,400)	($71,400)	($71,400)	($71,400)
GF Expenditure	$22,000	$0	$0	$0	$0
Net Effect	($93,400)	($71,400)	($71,400)	($71,400)	($71,400)

Note:() = decrease; GF = general funds; FF = federal funds; SF = special funds; - = indeterminate effect

Local Effect: Local income tax revenues decrease by $44,800 annually beginning in FY 2012. Local expenditures are not affected.

Small Business Effect: None.

Analysis

Current Law: Except as discussed below, any loan repayment amount received by an individual is treated as taxable income under federal tax law. Maryland conforms to federal tax law, any amount received is also taxable for State income tax purposes.

Relief from a debt generally causes the debtor to realize cancellation of debt income, and this income may be taxable. However, Section 108(f) of the IRC excludes from income certain student loan cancellation (forgiven) and student loan repayment assistance.

According to Internal Revenue Service (IRS) Publication 970, *Tax Benefits for Education*, to qualify for tax-free treatment under loan forgiveness, the loan must (1) contain a provision that all or part of the debt will be canceled if the borrower works for a minimum amount of time, in certain professions, and for any broad class of employers; and (2) have been made by a qualified lender to assist the borrower in attending an eligible educational institution. Qualified lenders include (1) federal, state, and local governments; (2) a tax-exempt public benefit corporation that has assumed control of a public hospital under certain circumstances; (3) an eligible education institution if the loan is received from one of the entities previously described; or (4) an eligible education institution under a program that is designed to encourage its students to serve in occupations with unmet needs or where the services required of the students are for or under the direction of a governmental unit or tax-exempt organization.

Loan repayment assistance programs generally provide help in repaying student loans for those who work in public service occupations or in areas with unmet needs. The IRS has determined that repayment assistance received under the following programs is tax free:

- National Health Service Corps loan repayment program;
- State programs eligible for funds under the Public Service Act; and
- Law school loan repayment assistant programs.

In 2006, the U.S. Tax Court ruled that a petitioner’s loan repayments received under LARP were not eligible for exclusion under Section 108(f).

Background: LARP provides loan repayment assistance in exchange for certain service commitments to help ensure that underserved areas of the State have sufficient numbers of primary care physicians, dentists, and professionals serving underserved areas of the State or low-income families. The program is subdivided into LARP, MDC-LARP, and MLARP.

LARP

Eligible employment fields include lawyers, nurses, nurse faculty members, physical and occupational therapists, social workers, speech pathologists, physician assistants, and certain teachers.

MDC-LARP

Practicing dentists can qualify for loan repayment for each year of obligated service and also receive a supplement to help defray associated tax liability. Individuals must agree to remain employed full time as a dentist with Medicaid recipients comprising at least 30% of the patient population. MDC-LARP has no income eligibility requirements, and award recipients are selected by the Department of Health and Mental Hygiene instead of Office of Student Financial Assistance (OSFA). Loan repayments under MDC-LARP are not taxable.

MLARP

Primary care physicians were eligible for a part of LARP known as LARP-PCS until the 2009 session, when Chapter 575 of 2009 established a separate Maryland Loan Assistance Repayment Program for primary care physicians. For MLARP, OSFA makes financial aid awards to assist in repaying loans owed by a physician who practices primary care for a nonprofit organization or government entity in an area of the State that has been federally designated as having a shortage of primary care or mental health providers. Likewise, OSFA makes financial aid awards to assist in repaying loans owed by a medical resident specializing in primary care who agrees to practice for at least two years as a primary care physician for a nonprofit organization or government agency in a geographic area of the State that has been federally designated. Chapter 575 also created a Maryland Loan Assistance Repayment Program Fund, consisting of revenue generated through an increase to the rate structure of all hospitals in the State and including $250,000 in federal State Loan Repayment Program funds to administer the program. Loan repayments under MLARP are not taxable.

State Revenues: Subtraction modifications can be claimed beginning in tax year 2011. The fiscal 2012 allowance includes $1.5 million in general funds for the program. Assuming the program is level funded, general fund revenues will decrease by $71,400 annually beginning in fiscal 2012.

State Expenditures: The Comptroller's Office reports that it will incur a one-time expenditure increase of $22,000 in fiscal 2012 to add the subtraction modification to the personal income tax form. This amount includes data processing changes to the SMART income tax return processing and imaging systems and systems testing.

Local Revenues: Local income tax revenues will decrease by $44,800 annually beginning in fiscal 2012.

Additional Information

Prior Introductions: HB 1274 of 2009 and HB 1408 of 2008 received a hearing in the House Ways and Means Committee, but no further action was taken.

Cross File: None.

Information Source(s): Internal Revenue Service, Department of Budget and Management, Maryland Higher Education Commission, Department of Health and Mental Hygiene, Comptroller's Office, Department of Legislative Services

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Analysis by: Robert J. Rehrmann

Direct Inquiries to:
(410) 946-5510
(301) 970-5510