Department of Legislative Services
Maryland General Assembly
2014 Session

FISCAL AND POLICY NOTE

Senate Bill 632 (Senator Madaleno, *et al.*)
Budget and Taxation

Income Tax Credit - Student Loan Payments

This bill creates a credit against the State income tax for qualified student loan payments. The amount of the credit is equal to 50% of the amount paid on a qualified student loan during the tax year, not to exceed $2,500 or 20% of the average annual tuition charged by institutions of higher education in the State. The Comptroller is required to adopt regulations to implement the bill and specify the documentation necessary to claim the credit.

The bill takes effect July 1, 2014, and applies to tax year 2014 and beyond.

Fiscal Summary

State Effect: General fund revenues decrease by at least $363.3 million in FY 2015 due to tax credits claimed against the personal income tax. Future year revenue decreases reflect a 7% annual increase in eligible student loan payments. General fund expenditures increase by $48,000 in FY 2015 due to one-time implementation costs at the Comptroller's Office.

($ in millions)	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019
GF Revenue	($363.3)	($388.8)	($416.0)	($445.1)	($476.3)
GF Expenditure	$.0	$0	$0	$0	$0
Net Effect	($363.4)	($388.8)	($416.0)	($445.1)	($476.3)

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

Local Effect: None.

Small Business Effect: None.

Analysis

Bill Summary: The bill creates a State income tax credit equal to 50% of the amount paid on a qualified student loan in the tax year. The amount of the credit cannot exceed $2,500 or 20% of the average annual tuition charged by institutions of higher education in the State. If the amount of the tax credit exceeds the total tax liability in the tax year, the taxpayer can claim a refund in the amount of the excess.

In order to qualify (1) the student loan must be incurred to receive a baccalaureate or graduate level degree from an institution of higher education in the State; and (2) the taxpayer is a State resident who received a baccalaureate or graduate level degree from the institution. An institution of higher education is an institution of postsecondary education located in the State that generally limits enrollment to graduates of secondary schools and awards degrees at the baccalaureate or graduate level and includes public, private nonprofit, and for-profit institutions.

The Comptroller is required to adopt regulations to implement the bill and specify the documentation necessary to claim the tax credit.

Current Law: No similar State income tax credit exists.

Certain interest paid on student loans may qualify for a federal income tax deduction. Maryland conforms to federal tax law, so any amount deducted under federal law flows through for Maryland income tax purposes. Section 221 of the Internal Revenue Code allows a deduction of up to $2,500 of the student loan interest paid during the year on a qualified student loan. A taxpayer is not required to itemize deductions in order to claim the deduction. The deduction begins to phase out for taxpayers with modified adjusted gross income in excess of $60,000 ($120,000 for joint returns) and is completely phased out for taxpayers with modified adjusted gross income of $75,000 or more ($155,000 or more for joint returns). In tax year 2011, 187,237 Maryland taxpayers deducted a total of $187.5 million in eligible student loan interest, or an average of about $1,000 per return. This federal deduction decreased State revenues by an estimated $9.0 million and local revenues by $5.6 million in fiscal 2012.

Publication 970 of the Internal Revenue Service outlines the available federal tax benefits for college and post-graduate education, including the favorable tax treatment of certain:

- canceled student loans;
- student loan repayment assistance;
- tuition and fees;
- education savings accounts;

- qualified tuition programs;
- early distributions from any type of individual retirement arrangement for the education costs;
- use of savings bonds for education costs;
- employer-provided educational benefits; and
- deductions for work-related education.

Maryland generally conforms to the federal tax treatment of these benefits, except for federal deduction for qualified tuition and related expenses. Taxpayers who claim the federal deduction are required to add back the amount deducted when calculating Maryland adjusted gross income.

The Department of Budget and Management estimates that these specified federal and State tax benefits will reduce State revenues by about $68.2 million in fiscal 2014.

Background:

Student Loan Debt and Delinquency

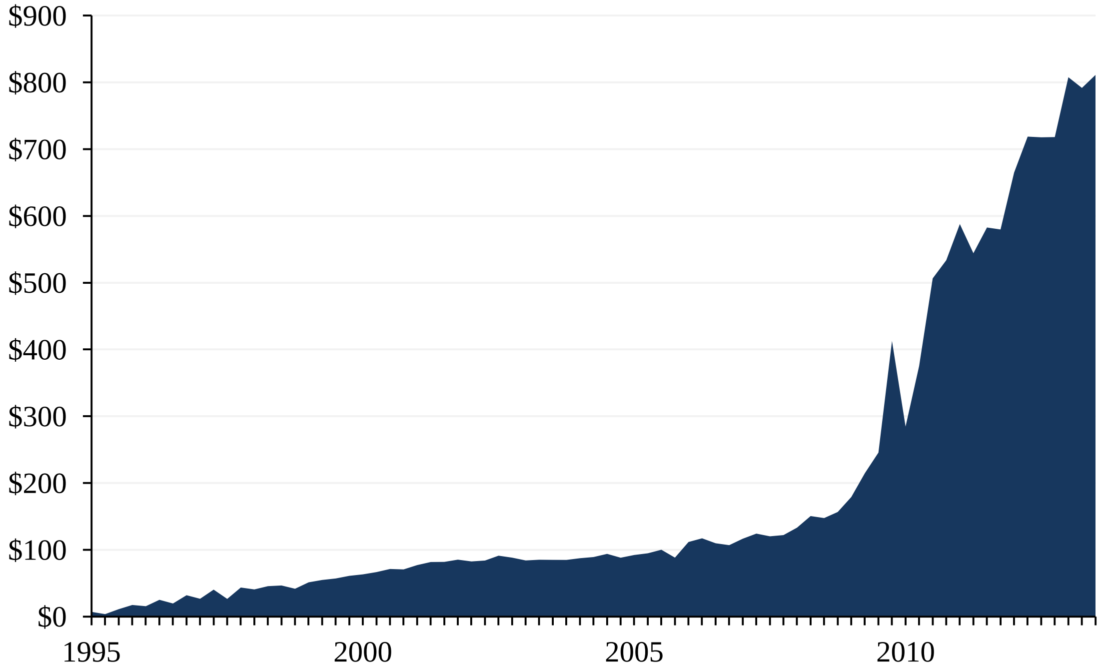
A report from the Federal Reserve Bank of New York estimates that U.S. student loan debt totaled $1.08 trillion at the end of 2013, an increase of $114 billion over 2012. Student loan debt is the only type of debt to continue to rise during the Great Recession and is now the second largest total debt balance after mortgage debt. Student loan debt has almost tripled between 2004 and 2012, and 60% of borrowers have a balance of greater than $10,000.

The Federal Reserve notes that factors driving the increase in student loan debt include increased higher education enrollment, the rising cost of higher education, students staying longer and more often attending graduate school, lower repayment rates, and the difficulty in discharging debt. The Federal Reserve has also expressed concern that high levels of student debt and delinquency reduces borrowers' ability to acquire other types of credit, which may hamper the recovery of the housing market, a key driver of economic growth.

The growth in outstanding student loan debt has also been accompanied by a marked increase in student loan delinquency. At the end of 2013 about 11.5% of all student loans were seriously delinquent (at least 90 days delinquent); this was the highest delinquency rate of any loan type.

The Household Debt and Credit Report of the New York Federal Reserve has reported student loan debt since 2003, and other Federal Reserve reports have tracked the level of student loan assets, a different measure, for longer periods. **Exhibit 1** shows the growth in the level of student loan assets since 1995, as reported by the St. Louis Federal Reserve.

Exhibit 1
Value of Total Student Loan Assets
Calendar 1995-2013
(Seasonally Adjusted Annual Rate, $ in Millions)



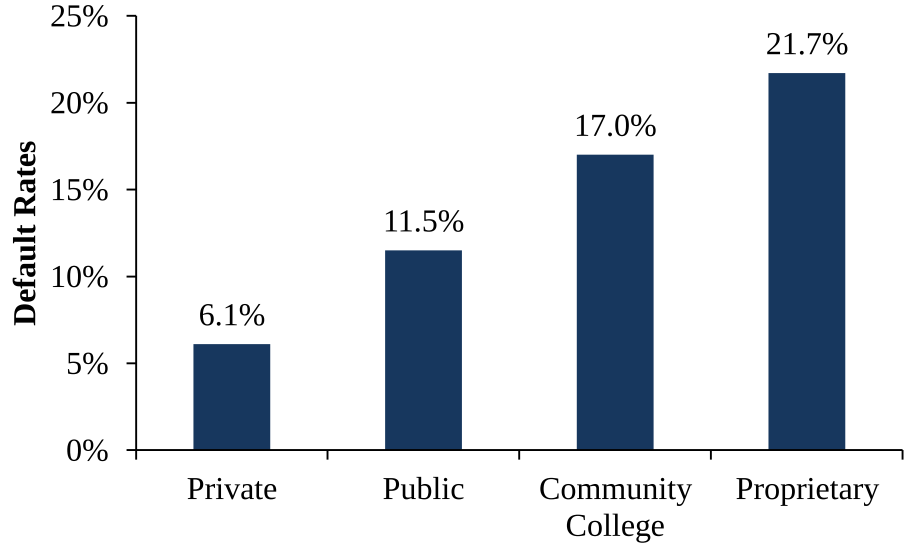
Source: Federal Reserve Bank of St. Louis

According to the Project on Student Loan Debt, the average debt of 2012 college graduates from Maryland institutions was $25,951, twenty-sixth highest in the nation. These estimates include only public and nonprofit four-year institutions. The Federal Reserve estimates that 16.7% of all Maryland individuals with a credit report has a student loan, compared with 16.2% nationwide. According to the Federal Reserve, the average Maryland student loan borrower reported a balance of $28,330, above the national average of $24,800 and the highest of any state.

The Federal Student Aid Operation Performance Division calculates federal student loan default rates by institution. These "cohort" default rates are available annually and also reported as three-year default rates – schools with default rates in excess of 30% are subject to certain action to manage default rates. Default rates were available for about

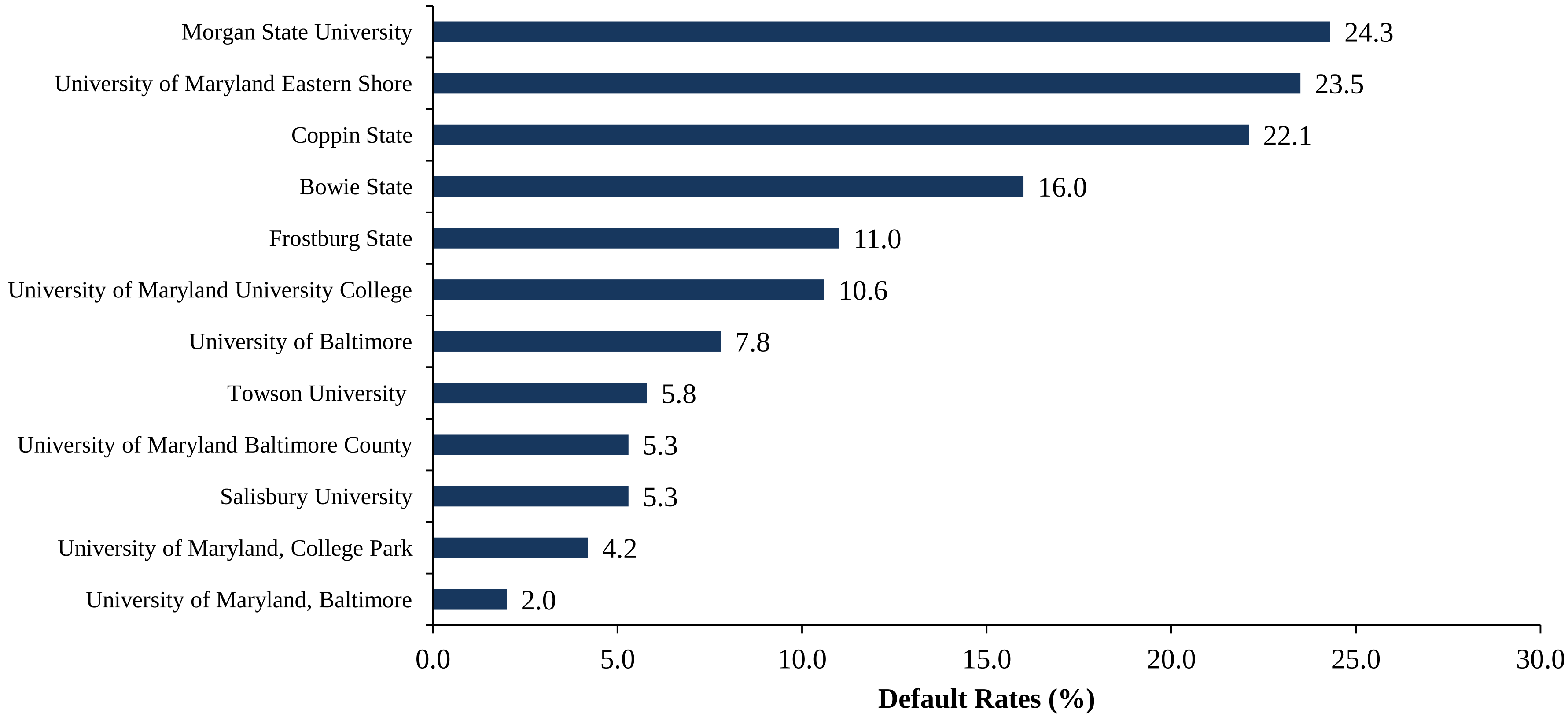
70 institutions in Maryland – four-year public and private universities, community colleges, and for-profit proprietary institutions. Although some proprietary institutions offer associate, baccalaureate, or graduate level degrees, most are vocational or technical schools. The U.S. Government Accounting Office recently examined student loan default rates and found that students who come from low-income backgrounds and from families who lack higher education are more likely to default on their loans, and data show that students from proprietary schools are more likely to come from low-income families and have parents who do not hold a college degree. Borrowers who are not successful in school and drop out also have high default rates. **Exhibit 2** shows fiscal 2010 default rates in Maryland by type of institution. **Exhibit 3** shows default rates for public four-year institutions.

Exhibit 2
Maryland Student Loan Default Rates by Type of Institution
Fiscal 2010



Source: Federal Student Aid Operation Performance Division

Exhibit 3
Fiscal 2010 Student Loan Default Rates
Four-year Public Institutions



Source: Federal Student Aid Operation Performance Division

The Project for Student Loan Debt estimated that of Maryland college graduates in 2012, those with the highest debt level graduated from Bowie State University ($26,000), University of Maryland Eastern Shore ($27,200), and Morgan State University ($36,100).

State Revenues: Tax credits may be claimed beginning in tax year 2014. As a result, general fund revenues will decrease by at least $363.3 million in fiscal 2015. This estimate is based on the following facts and assumptions:

- Based on U.S. Federal Reserve data it is estimated that approximately 725,000 Maryland residents have a student loan balance.
- Taxpayers claim an average credit of $2,000.
- Future credits increase by 7% annually.

Information is not available on the percentage of Maryland residents with a student loan that would meet the qualifications of the bill. It is assumed that 25% of individuals will qualify. Accordingly, revenue losses could be significantly higher than estimated if a higher percentage of individuals qualify.

State Expenditures: The Comptroller's Office reports that it would incur a one-time expenditure increase of $48,000 in fiscal 2015 to add the tax credit to the personal income tax form. This includes data processing changes to the SMART income tax return processing and imaging systems, and system testing.

Additional Information

Prior Introductions: None.

Cross File: HB 885 (Delegate Reznik, *et al.*) - Ways and Means.

Information Source(s): U.S. Census Bureau, U.S. Department of Education, U.S. Federal Reserve, U.S. General Accounting Office, Project on Student Loan Debt, Department of Legislative Services

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mc/jrb

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