HB 196

Department of Legislative Services
Maryland General Assembly
2017 Session

FISCAL AND POLICY NOTE
First Reader

House Bill 196 (Delegate Tarlau, *et al.*)
Ways and Means

Income Tax - Subtraction Modification - Interest Paid on Student Loans

This bill creates a State income tax subtraction modification equal to 100% of the interest paid on a qualified student loan in the taxable year. In order to qualify, the student loan must be incurred to attend and receive a baccalaureate or graduate level degree from an institution of higher education and the taxpayer must be a State resident who has a federal adjusted gross income (FAGI) of less than $250,000. The Comptroller is required to adopt regulations to implement the bill and specify the documentation necessary to claim the subtraction.

The bill takes effect July 1, 2017, and applies to tax year 2017 and beyond.

Fiscal Summary

State Effect: General fund revenues decrease by $20.1 million in FY 2018 due to subtraction modifications claimed against the personal income tax. Future year revenue decreases reflect the estimated annual increase in eligible student loan interest payments. General fund expenditures increase by $53,000 in FY 2018 due to one-time computer programming expenses at the Comptroller's Office.

($ in millions)	FY 2018	FY 2019	FY 2020	FY 2021	FY 2022
GF Revenue	($20.1)	($22.6)	($25.4)	($28.5)	($32.1)
GF Expenditure	$0.1	$0	$0	$0	$0
Net Effect	($20.2)	($22.6)	($25.4)	($28.5)	($32.1)

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

Local Effect: Local revenues decrease by $13.1 million in FY 2018 and by $20.9 million in FY 2022. Local expenditures are not affected.

Small Business Effect: None.

Analysis

Current Law: Certain interest paid on student loans may qualify for a federal income tax deduction. Maryland generally 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. A qualified student loan is one that is used to pay for the qualified education expenses of attending an eligible educational institution, including graduate school. An eligible educational institution is any college, university, vocational school, or other postsecondary educational institution eligible to participate in a student aid program administered by the U.S. Department of Education. It includes virtually all accredited public, nonprofit, and for-profit postsecondary institutions. An eligible educational institution also includes an institution conducting an internship or residency program leading to a degree or certificate from an institution of higher education, a hospital, or a health care facility that offers postgraduate training.

The deduction begins to phase out for taxpayers with modified adjusted gross income in excess of $65,000 ($130,000 for joint returns) and is completely phased out for taxpayers with modified adjusted gross income of $80,000 or more ($160,000 or more for joint returns). Taxpayers who file married filing separately or who are claimed as dependents do not qualify. In tax year 2013, 211,520 Maryland taxpayers deducted a total of $222.5 million in eligible student loan interest, or an average of about $1,050 per return. The amount deducted was about $35.0 million more or about one-fifth higher than the amount deducted in tax year 2011.

Publication 970 of the Internal Revenue Service outlines the available federal tax benefits for education expenses, including the favorable tax treatment of certain:

- scholarships, grants, and tuition reductions;
- 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 used for 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 the 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.

Chapters 689 and 690 of 2016 established a refundable tax credit of up to $5,000 for qualified undergraduate student loan debt. Beginning in tax year 2017, individuals who have incurred $20,000 or more in undergraduate student loan debt and have at least $5,000 in outstanding undergraduate debt qualify for the credit, subject to specified conditions. The Maryland Higher Education Commission may approve up to $5 million in credits annually.

Background: A report from the Federal Reserve Bank of New York estimates that U.S. student loan debt totaled $1.20 trillion in the third quarter of 2013. Student loan debt continues to rise and is now the second largest total debt balance after mortgage debt. Student loan debt has almost tripled between 2006 and 2015, and 60% of borrowers have a balance of greater than $10,000. Currently, about 42.5 million borrowers have student loan debt, nearly double the number from 10 years ago, with average real debt per borrower increasing from about $19,000 to $27,000.

The Federal Reserve notes that factors driving the increase in student loan debt include increased enrollment, rising costs, 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 reduce 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. In the third quarter of 2013, an estimated 11.6% of all student loans were seriously delinquent (at least 90 days delinquent); this was the highest delinquency rate of any loan type. The Federal Reserve notes that due to data limitations the actual student loan delinquency rate could be as much as twice as high as the estimated rate.

According to the Project on Student Loan Debt, the average debt of 2012 college graduates from Maryland institutions was $27,457, the twentieth highest in the nation. About 58% of these graduates have a student loan debt, which ranked thirty-fourth among all states. 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 have 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.

According to the National Conference of State Legislatures, Maine, Massachusetts, and Rhode Island provide some type of tax credit or deduction for student loan debt or interest payments.

State Revenues: Subtraction modifications may be claimed beginning in tax year 2017. Revenue losses will occur due to taxpayers who pay student loan interest in the tax year and (1) currently qualify for and claim the federal student loan interest deduction and receive a federal and State tax reduction or (2) do not qualify for the federal deduction (including those whose incomes are too high, are claimed as dependents, or file married filing separately) but have FAGI of less than $250,000. In addition, the federal deduction is limited to $2,500 whereas there is no limitation on the amount of the subtraction modification proposed by the bill. Accordingly, additional revenue losses will occur from taxpayers who are able to deduct additional interest payments above the federal limit.

Conversely, the proposed State subtraction modification is limited to student loans incurred by individuals to attend and receive a baccalaureate or graduate level degree from an institution of higher education. Individuals who attend but do not receive a bachelor's or graduate degree or those that receive an associate's degree or attend a community college before transferring to a four-year college may not qualify for the subtraction modification.

As a result, general fund revenues will decrease by an estimated $20.1 million in fiscal 2018. **Exhibit 1** shows the estimated impact of the bill on State and local revenues.

Exhibit 1
State and Local Revenue Impacts
($ in Millions)

	FY 2018	FY 2019	FY 2020	FY 2021	FY 2022
State	($20.1)	($22.6)	($25.4)	($28.5)	($32.1)
Local	(13.1)	(14.8)	(16.6)	(18.6)	(20.9)
Total Revenues	**($33.3)**	**($37.4)**	**($42.0)**	**($47.1)**	**($53.0)**

This estimate is based on the following facts and assumptions:

- in tax year 2012, the Comptroller estimates that 191,927 Maryland residents filed both a federal and State income tax return and deducted on the federal return a total of $199.4 million in student loan interest payments;
- the number of claimants increases by 6% annually and the average deduction increases by 6% annually; and

- the additional revenue losses caused by individuals who do not qualify for the federal deduction but claim the State subtraction modification are partially offset by individuals who claim the federal deduction but do not qualify for the State subtraction modification.

State Expenditures: The Comptroller's Office reports that it will incur a one-time general fund expenditure increase of $53,000 in fiscal 2018 to add the subtraction to personal income tax forms. This 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 as a result of subtraction modifications claimed against the personal income tax. Local revenues will decrease by $13.1 million in fiscal 2018 and by $20.9 million in fiscal 2022, as shown in Exhibit 1.

Additional Information

Prior Introductions: HB 103 of 2016, a similar bill, received a hearing in the House Ways and Means Committee, but no further action was taken.

Cross File: None.

Information Source(s): Comptroller's Office; U.S. Federal Reserve; Internal Revenue Service; Project on Student Loan Debt; Department of Legislative Services

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mm/jrb

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