

STUDENT LOAN INCOME TAX DEDUCTION FOR DISABLED VETERANS

Phone: (517) 373-8080
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Senate Bill 25 (S-1) as passed by the Senate
Sponsor: Sen. Tom Barrett
House Committee: Tax Policy
Senate Committee: Finance
Complete to 4-20-21

Analysis available at
<http://www.legislature.mi.gov>

SUMMARY:

Senate Bill 25 would amend the Income Tax Act to allow a deduction of some income attributed to cancellation or discharge of a student loan for disabled veterans.

Under the bill, for the 2016, 2017, 2018, and 2019 tax years, and for every tax year from 2025 onward, a taxpayer who is a *disabled veteran* could deduct, to the extent included in adjusted gross income, income reported at the federal level attributable to the cancellation or discharge of a student loan by the U.S. Department of Education pursuant to the total and permanent disability discharge program.

Disabled veteran would mean an individual who meets either of the following criteria:

- Has been determined by the U.S. Department of Veterans Affairs (VA) to be permanently and totally disabled as a result of military service and entitled to veterans' benefits at the 100% rate.
- Has been rated by the VA as individually unemployable.

The bill's enacting language states that it is intended to be retroactive, with the deduction applying to the 2016, 2017, 2018, and 2019 tax years.

MCL 206.30

FISCAL IMPACT:

Although the bill is retroactive for tax years 2016 through 2019, because student loan disability discharges are generally not taxable for tax years 2018 and 2019, the impact of the retroactivity is limited to just tax years 2016 and 2017. Further, since there is a four-year limit on filing amended returns, unless qualified for an extension, the deadline for filing an amended tax year 2016 return has already passed. Therefore, the retroactivity is restricted to tax year 2017 returns, assuming amending returns are filed by April 18, 2022.

Using data from the U.S. Department of Education on student loan discharges during the period between 2014 and 2018 along with 2017 data from the VA to estimate the number of potentially eligible veterans in Michigan, exempting student loan discharges for 100% disabled veterans in tax year 2017 would reduce income tax revenue by about \$350,000.

Because filing amended returns to claim the exemption would result in higher refunds, the bill would reduce general fund revenue in the year in which the amended returns are filed.

The federal American Rescue Plan Act exempts student loan discharges through the 2025 tax year, so under the provisions of the bill there would be no revenue impact in Michigan until tax year 2026 (FY 2025-26) for student loans discharged after tax year 2019. At that point, due to projected increases in the number of eligible veterans and student loan debt, the bill would be expected to reduce income tax revenue by about \$1.5 million per year. To the extent that the reduction is realized through gross income tax collections (withholding, estimated payments, and annual payments), the School Aid Fund would absorb about 23.8% of the impact, with the rest coming from the general fund. If the reduction is a result of higher refunds, the impact would be borne by the general fund.

Legislative Analyst: Jenny McInerney
Fiscal Analyst: Jim Stansell

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