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BILL ANALYSIS

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Senate Bill 25 (as introduced 1-13-21)
Sponsor: Senator Tom Barrett
Committee: Finance

Date Completed: 3-3-21

CONTENT

The bill would amend the Income Tax Act to allow, for tax years beginning after December 31, 2021, a disabled veteran to deduct income attributable to the cancellation or discharge of a student loan under the Total and Permanent Disability Discharge Program.

Under the Act, for a person other than a corporation, estate, or trust, "taxable income" means adjusted gross income, as defined in the Internal Revenue Code, subject to various adjustments. For tax years beginning after December 31, 2021, the bill would allow a taxpayer who was a disabled veteran to deduct, to the extent not deducted in determining adjusted gross income (AGI), income reported on a Federal income tax Form 1099-C that was attributable to the cancellation or discharge of a student loan by the United States Department of Education under the Total and Permanent Disability Discharge Program.

"Disabled veteran" would mean an individual who either: a) has been determined by the United States 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; or b) has been rated by the VA as individually unemployable.

MCL 206.30

BACKGROUND

According to the website of the Office of Federal Student Aid (within the US Department of Education), a total and permanent disability discharge relieves an individual from having to repay certain student loans (loans issued under the Direct Loan program, the Perkins Loan program, or Federal Family Education Loans), or complete a Teacher Education Assistance for College and Higher Education Grant service obligation. Before those obligations can be discharged, the loan or grant recipient must demonstrate to the US Department of Education that he or she is totally and permanently disabled.

An individual can demonstrate total and permanent disability in one of three ways. A recipient who is a veteran can submit documentation from the VA showing that he or she is unemployable because of a service-connected disability. If the recipient receives Social Security Disability Insurance or Supplemental Security Income benefits, he or she can submit a Social Security Administration (SSA) notice of award for benefits stating that his or her next-scheduled disability review will be within five to seven years from the date of his or her most recent SSA disability determination. Alternatively, an individual may submit a certification from his or her physician that he or she is unable to engage in any substantial

gainful activity by reason of a medically determinable physical or mental impairment that: a) can be expected to result in death; b) has lasted for a continuous period of not less than 60 months; or c) can be expected to last for a continuous period of not less than 60 months.

Legislative Analyst: Christian Schmidt

FISCAL IMPACT

The bill would reduce revenue by approximately $1.2 million per year, assuming that language in the bill is not altered to match similar language in other subsections for similar subtractions. If the language is altered, the bill likely would have no fiscal impact until fiscal year 2026-27.

According to statistics from the US Veterans Administration, in 2018 there were approximately 18,000 individuals in Michigan who were rated as 100% disabled, one of several qualifications under the bill. It is unknown how many of them have student loan debt, the value of their debt, or how many would seek a discharge under Federal programs. Over a five-year period from 2014-2018, there were 715,800 borrowers nationally who received discharges under the Total and Permanent Disability Discharge Program for $17.8 billion of principal and $1.8 billion of interest. Statewide data are not available, of which a subset of those were veterans. Disabled veterans living in Michigan represent approximately 2.3% of the total nationally. Assuming Michigan's disabled veteran population exhibits the same average student loan debt characteristics as the average borrower who received a discharge nationally, the data would suggest that by 2021, approximately 875 disabled veterans located in Michigan per year would be affected involving approximately $27.7 million of income would be reported on a 1099-C form, and the bill would result in a revenue loss of approximately $1.2 million per year.

Currently, Federal law exempts student loan discharges issued between January 1, 2018, and December 31, 2025, from Federal adjusted gross income. As a result, no discharges that occur during that time period have been, or will be, included in the Michigan tax base.

The bill would allow an eligible taxpayer to "deduct, to the extent not deducted in determining adjusted gross income, income reported on a federal income tax form 1099-C that is attributable to cancellation or discharge of a student loan…." However, because of current Federal provisions, affected taxpayers are unlikely to have deducted the 1099-C income from their return because it would not have been included at all. Federal guidance indicates disabled veterans who receive loan discharges should keep the 1099-C for record-keeping purposes but does not require them to report the income when calculating AGI. As a result, the current language of the bill would allow taxpayers who were not required to include the income then to deduct an amount equal to their 1099-C amount, thus essentially providing a "double-deduction" for the discharge. The language does not require that the discharge amount be included in AGI before it is deducted—only that it be listed on a 1099-C form.

The section of statute amended by the bill contains numerous provisions through which eligible taxpayers may subtract various amounts when calculating their income subject to the Michigan individual income tax. Subsections (d), (e), (f), (o), (p), (q), (s), (t)(ii), (t)(iii), (u), (v), (w)(i), (x)(ii), (x)(iii)m, (y) and (z) all include subtraction provisions. However, the language in those sections allows eligible taxpayers to "deduct, to the extent included in adjusted gross income". In other words, the deduction is allowed only if the relevant amount was included in Federal AGI.

If the language in the bill were changed to allow the deduction only if the discharged amounts were included in Federal AGI, then for any discharges between now and December 31, 2025, the bill would have no impact: Federal AGI would not include the discharged amounts and so

a) they would not be taxed under current law, and b) the bill would not represent anything different from current law.

Between now and tax year 2026, when the bill first would have an impact if the language were modified, it is unknown how student borrowing amounts (and tuition rates) are likely to change, or how rates of loan discharge under the Total and Permanent Disability Discharge Program may change. However, assuming current individual income tax rates, growing the 2014-2018 average loan discharge amount at 5.0% per year for eight years (from 2018 to 2026), and adjusting for the 12.1% average annual increase in the veteran population at 100% disability over the 2015-2019 period, would increase the revenue reduction to approximately $2.7 million per year beginning with tax year 2026. If the language were not changed, the bill would reduce revenue by approximately $1.2 million per year beginning with tax year 2021.

Any revenue reduction under the bill could affect either gross collections from withholding, estimated, and annual payments and/or individual income tax refunds. Any increase in refunds would affect only General Fund revenue. However, any 23.8% of any reduction in gross collections would lower School Aid Fund revenue, with any remaining reduction lowering General Fund revenue.

Fiscal Analyst: David Zin

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