Senate Fiscal Agency
P.O. Box 30036
Lansing, Michigan 48909-7536

BILL ANALYSIS

Telephone: (517) 373-5383
Fax: (517) 373-1986

Senate Bill 25 (as enacted) **PUBLIC ACT 120 of 2021**
Sponsor: Senator Tom Barrett
Senate Committee: Finance
House Committee: Tax Policy

Date Completed: 4-19-22

RATIONALE

Under the United States Department of Education Total and Permanent Disability Discharge Program, an individual who owes money from certain student loans and is totally and permanently disabled may apply to have his or her Federal student loan debt discharged. The Program can be used by anyone who becomes totally and permanently disabled, including veterans. This allows those individuals to avoid having to repay that debt. However, until recently, the Internal Revenue Code treated student loan debt cancelled under the Program as gross income and, therefore, subject to Federal income tax.[1] Because Michigan's Income Tax Act defines "gross income" as that term is defined under the Internal Revenue Code, some individuals, including veterans who are disabled as a result of service-related injuries, who had tens or hundreds of thousands of dollars in student loan debt forgiven, evidently have received notices to pay tax on that income. To address this issue, it was suggested that, for purposes of Michigan income tax, a disabled veteran be allowed to deduct income resulting from the discharge of a student loan under the Program.

CONTENT

The bill amended the Income Tax Act to allow, for the 2016, 2017, 2018 and 2019 tax years and for each tax year beginning on and after January 1, 2025, a disabled veteran to deduct, to the extent included in adjusted gross income (AGI), income reported on a Federal income tax form 1099-C that is attributable to the cancellation or discharge of a student loan under the Total and Permanent Disability Discharge Program. As used in the bill, "disabled veteran" means an individual who meets either one of the following criteria: a) has been determined by the United States Department of Veterans Affairs 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 United States Department of Veterans Affairs as individually unemployable.

The bill states that it is intended to be retroactive and the deduction described above would apply retroactively effective for the 2016, 2017, 2018, and 2019 tax years.

The bill took effect December 7, 2021.

MCL 206.30

ARGUMENTS

(Please note: The arguments contained in this analysis originate from sources outside the Senate Fiscal Agency. The Senate Fiscal Agency neither supports nor opposes legislation.)

[1] The Tax Cuts and Jobs Act of 2017, signed into law on December 22, 2017, modified the treatment of student loans discharged on account of death or disability after December 31, 2017, such that the amount forgiven is not considered gross income.

Supporting Argument

The Federal government recognizes that when an individual is permanently and totally disabled, he or she is likely to be unable to pay back student loans. Accordingly, the Total and Permanent Disability Discharge Program allows disabled veterans and other individuals to apply for and receive forgiveness for their student loan debt. This is appropriate, especially for veterans who have suffered severe injuries in the course of their service. However, because the Internal Revenue Code, until recently, considered the amounts forgiven as gross income, injured veterans whose debts were forgiven have been subject to relatively large Federal income tax liabilities that are nearly as difficult to pay as the forgiven debt. In addition, because Michigan's definition of gross income generally is the same as the Internal Revenue Code's, these veterans have received relatively large State income tax bills, as well. While much of this has been addressed at the Federal level, it remained the case that a limited number of individuals were not included in the Federal efforts to resolve this issue and still owed substantial State taxes as a result of the forgiven debt. The bill remedies this situation at the State level, by allowing veterans who are disabled as a result of their service and not included in the Federal effort to be relieved of a State tax liability that they cannot afford to pay.

Legislative Analyst: Jeff Mann

FISCAL IMPACT

The retroactive provisions of the bill will reduce revenue by approximately $600,000 in fiscal year (FY) 2020-21, and the bill will not then have a fiscal impact until FY 2026-27, when it will reduce revenue by approximately $2.7 million per year.

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 will 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. Based on the total number of loan discharges known to originate with disability determinations from the Veterans Administration over the 2015-2018 period, and assuming Michigan's disabled veteran population exhibits the same average student loan debt characteristics as the average borrower who received a discharge nationally, the retroactive provisions of the bill will reduce individual income tax revenue by approximately $600,000 in FY 2020-21. Because the revenue impact from the retroactive provisions will be in the form of refund requests filed with amended returns, all of the impact will reduce General Fund revenue.

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

While the bill will allow an eligible taxpayer to deduct discharged amounts included in Federal AGI for tax years that begin on or after January 1, 2025, due to the Federal provisions, the bill will have no impact until January 1, 2026.

Beginning tax year 2026, the bill will reduce revenue by an amount that will depend on how student borrowing and tuition change, and how rates of loan discharge under the Total and Permanent Disability Discharge Program 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, the bill will increase the revenue reduction to approximately $2.7 million per year beginning with tax year 2026.

Beginning in tax year 2026, any revenue reduction under the bill may affect either gross collections from withholding, estimated, and annual payments and/or individual income tax refunds. Any increase in refunds will affect only General Fund revenue. However, 23.8% of any reduction in gross collections will lower School Aid Fund revenue, with any remaining reduction lowering General Fund revenue.

Fiscal Analyst: David Zin

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This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.