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

BILL ANALYSIS

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

Senate Bill 25 (Substitute S-1)
Sponsor: Senator Tom Barrett
Committee: Finance

Date Completed: 3-10-21

CONTENT

The bill would amend the Income Tax Act to allow, for the 2016, 2017, 2018 and 2019 tax years and for each tax year that began on and after January 1, 2025, 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 (AGI), as defined in the Internal Revenue Code, subject to various adjustments. Under the bill, for the 2016, 2017, 2018 and 2019 tax years and for each tax year that began on and after January 1, 2025, the bill would allow a taxpayer who was a disabled veteran to deduct, to the extent included in 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.

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.

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 U.S. 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 retroactive provisions of the bill would reduce revenue by approximately $600,000 in fiscal year (FY) 2020-21, and the bill would not then have a fiscal impact until FY 2026-27, when it would 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 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. 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 would reduce individual income tax revenue by approximately $600,000 in FY 2020-21. Because revenue impact from the retroactive provisions would be in the form of refund requests filed with amended returns, all of the impact would 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 would 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 would have no impact until January 1, 2026.

Beginning tax year 2026, the bill would reduce revenue by an amount that would depend how student borrowing and tuition change, and how rates of loan discharge under the Total and Permanent Disability Discharge Program could 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.

Beginning in tax year 2026, 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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