

Date of Hearing: March 17, 2025

ASSEMBLY COMMITTEE ON REVENUE AND TAXATION
Mike Gipson, Chair

AB 386 (Tangipa) – As Introduced February 3, 2025

Majority vote. Tax levy. Fiscal committee.

SUBJECT: Personal Income Tax Law: Corporation Tax Law: credits: student loan payments

SUMMARY: Allows a credit, under the Personal Income Tax (PIT) Law and the Corporation Tax (CT) Law, to an employer that makes student loan payments on behalf of a full-time employee, as specified, and excludes from the employee's gross income the amount of those student loan payments made by the employer on their behalf. Specifically, **this bill:**

- 1) Allows a credit for taxable years beginning on or after January 1, 2026, and before January 1, 2031, to a "qualified taxpayer" in an amount equal to the taxpayer's "qualified expenditures" during the taxable year.
- 2) Defines the following terms for purposes of the credits:
 - a) "Full-time employee" is an employee of a "qualified taxpayer" who satisfies either of the following:
 - i) Is paid wages by the qualified taxpayer for services not fewer than an average of 35 hours per week; or,
 - ii) Is a salaried employee and was paid compensation during the taxable year for full-time employment, within the meaning of Labor Code Section 515, by the qualified taxpayer.
 - b) "Qualified expenditure" means all student loan payments made by a qualified taxpayer on behalf of a full-time employee, not to exceed \$3,000 per full-time employee; and,
 - c) "Qualified taxpayer" is a business whose employees do not perform jobs described in Section 1087e(m)(3)(B) of Title 20 of the United States Code.
- 3) Requires the Franchise Tax Board (FTB) to do all of the following in relation to these credits:
 - a) Accept applications from taxpayers for tentative credit reservations beginning on July 1 of each year. Applications shall be made in the form and manner prescribed by the FTB.
 - b) Approve applications, giving priority to applications submitted by qualified taxpayers that satisfy at least one of the following categories:
 - i) Businesses that are owned by veterans;

- ii) Businesses that are owned by women;
 - iii) Employers with no more than 500 employees at any time during the taxable year;
 - iv) Businesses that are minority owned; or,
 - v) Businesses that are owned by disabled individuals.
- 4) Provides, for purposes of the credits, all of the following:
- a) Any unused credit amounts may be carried forward for a period of 3 years; and,
 - b) Any deduction or credit otherwise allowed for any qualified expenditure made by the qualified taxpayer as a trade or business expense shall be reduced by the amount of the credit allowed pursuant to this bill.
 - c) The total aggregate amount that may be allocated by credit reservations to all qualified taxpayers is limited to \$25 million per taxable year.
- 5) Excludes from gross income any student loan payments made by a "qualifying employer" on behalf of a taxpayer that is a full-time employee of that "qualifying employer".
- 6) Defines the following terms for purposes of the income exclusion:
- a) "Full-time employee" is an employee of a "qualified taxpayer" who satisfies either of the following:
 - i) Is paid wages by the qualified taxpayer for services not fewer than an average of 35 hours per week; or,
 - ii) Is a salaried employee and was paid compensation during the taxable year for full-time employment, within the meaning of Labor Code Section 515, by the qualified taxpayer.
 - b) "Qualifying employer" is a business whose employees do not perform jobs described in Section 1087e(m)(3)(B) of Title 20 of the United States Code.
- 7) Finds and declares the following for the purposes of satisfying the requirements of Revenue and Taxation Code (R&TC) Section 41:
- a) The specific goals, purposes, and objectives of this bill are to provide an additional incentive for individuals to encourage employers to assist in reducing the overwhelming burden of student loan payments on their employees; and,
 - b) To measure whether this bill achieves its intended purpose, the FTB shall prepare a written report on the following:
 - i) The number of taxpayers allowed a credit or exclusion; and,
 - ii) The total dollar amount of credits and exclusions allowed.

- 8) Requires the FTB to provide the written report to the Legislature detailing the performance indicators listed above on or before December 1, 2028, and annually thereafter.
- 9) Takes immediate effect as a tax levy.
- 10) Sunsets the statutory provisions for the credit and gross income exclusion on December 1, 2031.

EXISTING FEDERAL LAW:

- 1) Provides that all income from whatever source derived is taxable, unless otherwise excluded. (Internal Revenue Code (IRC) Section 61.)
- 2) Excludes from gross income amounts received resulting from the discharge of certain student loans for individuals who are employed by a qualifying government or not-for-profit organization, as specified. (IRC Section 108(f).)
- 3) Excludes from gross income, for taxable years 2021 through 2025, any amount received resulting from the discharge of any loan provided expressly for postsecondary educational expenses, whether provided by a public or private lender, as specified. (IRC Section 108(f)(5).)
- 4) Excludes from a taxpayer's gross income up to \$5,250 per year in payments received from an employer for tuition, fees, books, supplies, and equipment under the employer's educational assistance program. Includes in this exclusion amounts paid by an employer before January 1, 2026 towards the principal or interest of an employee's educational loan. (IRC Section 127.)
- 5) Provides that the Secretary of Education shall cancel the balance of interest and principal due on any eligible Federal Direct Loan not in default for a borrower who has made 120 qualifying monthly payments while being employed in a public service job, as specified. (Title 20, U.S. Code Section 1087e(m).)
- 6) Allows a deduction in computing adjusted gross income for interest paid during the taxable year on a qualified education loan, with a maximum of \$2,500 in eligible payments and reducing gradually as the taxpayer's modified adjusted gross income increases (IRC Section 221.)

EXISTING STATE LAW:

- 1) Conforms, with modifications, to the definition of gross income in IRC Section 61 for purposes of the PIT Law. (R&TC Section 17071.)
- 2) Generally conforms to the existing federal deduction of interest paid on a qualified education loan, with a maximum deduction of \$2,500.
- 3) Conforms to IRC Section 108(f)(5) relating to the special rule for discharges in 2021 through 2025. (R&TC Section 17144.8.)
- 4) Authorizes a stand-alone exclusion from gross income, mirrored on the federal exclusion, for amounts received by an employee from an employer for tuition, fees, books, supplies, and

equipment under the employer's educational assistance program, up to \$5,250. (R&TC Section 17151).

- 5) Excludes from gross income any loan amount repaid by the U.S. Secretary of Education or canceled pursuant to Section 1087e(e) of Title 20 of the United States Code relating to income-contingent repayment. (R&TC Section 17132.11.)
- 6) Excludes from gross income amounts received resulting from the Forgivable Loan Program provided by the California State University. (R&TC Section 17134.)
- 7) Excludes from gross income amounts received resulting from discharged loans for individuals who attended certain for-profit postsecondary institutions. (R&TC Section 17144.6.)

FISCAL EFFECT: The FTB estimates General Fund revenue losses of \$150 million in fiscal year (FY) 2025-26, \$270 million in FY 2026-27, and \$290 million in FY 2027-28.

COMMENTS:

- 1) The author has provided the following statement in support of this bill:

California businesses face growing challenges in attracting and retaining skilled workers due to the state's high cost of living and competitive job market. At the same time, many students are burdened with debt, limiting their career prospects. AB 386 addresses this disconnect by offering businesses a tax credit of up to \$3,000 per full-time employee, which will help reduce student loan debt while incentivize businesses to hire and retain talent. With a focus on small, veteran, woman, minority, and disabled-owned businesses, this bill strengthens California's economy, supports workforce development, and ensures financial stability for both employers and employees.

- 2) Writing in opposition to this bill, the California Tax Reform Association notes, in part:

While student debt relief is often considered appropriate and necessary, we oppose this bill because it provides relief in an arbitrary manner, not based on need but based on the interest and application to the FTB of an employer. This relief could very well be for a well-compensated or professional employees, and could become part of a pay package rather than necessary relief. While we appreciate that this credit is not open-ended because of the \$25 million limitation, there are no criteria for allocation, just whichever employer qualifies on a first-come bases and is willing to pay this debt. Some student debt—such as those for proprietary colleges which have useless degrees, or those in public service—are more appropriately discharged than others. This bill generates general fund and education revenue losses, without any criteria for determining whether discharge of student debt is appropriate in a particular case. And such determinations would be beyond the scope of the FTB.

- 3) Committee Staff Comments:

- a) *What does this bill do?* This bill provides two complementary tax benefits: i) a credit for employers of up to \$3,000 per full-time employee who has student loan payments made on their behalf by the employer, and ii) a corresponding income exclusion for the

employee for the amounts that were paid by the employer. Employers that satisfy the requirements under the existing Public Service Loan Forgiveness (PSLF) program, such as governmental agencies and nonprofit public benefit corporations, would not be eligible for the credit. No more than \$25 million of credits would be allowed in a calendar year.

The FTB, beginning on July 1 of each year, would be required to accept applications from taxpayers for a tentative credit reservation for the taxable year that includes January 1 of the calendar year following that date. Priority must be given to applications submitted by taxpayers that are businesses owned by veterans, women, minorities, and disabled individuals, as well as businesses with 500 or fewer employees.

- b) *Student debt in California:* The amount of student loan debt incurred by Californians is significant. The Education Data Initiative notes that 10% of Californians have student debt, totaling \$148.6 billion in 2024, equating to approximately 3.9 million Californians, with an average debt of \$38,168¹. Of these borrowers, 49.7% are under the age of 35 and 14.3% owe less than \$5,000. Roughly 20% of California borrowers owe between \$20,000 and \$40,000 in student loan debt, with 3.19% of California borrowers owing more than \$200,000 in student loan debt. Students pursuing graduate and professional degrees tend to accumulate the highest debt loads, which may also correspond with the expected earnings of a profession or vocation that requires the advanced degree.
- c) *Employers and education benefits for employees:* Tuition assistance is a long-established education benefit offered by some employers. As the cost of higher education and student debt loads increased, more employers sought to provide benefits that helped address a growing area of employee interest. According to the Society for Human Resource Management (SHRM), however, the percentage of companies offering tuition assistance has not rebounded since the 2007-09 recession. Fifty-one percent of respondents to the SHRM's 2018 Employee Benefits Survey said their companies offer undergraduate educational assistance, down from 66% in 2008; 49% offer graduate educational assistance, down from 61% in 2008.² Even with the relatively high prevalence of these programs among employers, participation rates have been low historically. Changes in the labor market and higher education are prompting companies to re-examine these benefits as short-term credentials become more popular, particularly in technology fields.³
- d) *Who would benefit?* Theoretically, employers already pay for an employee's student loans to the extent that the employee's salary is used to service a student loan. This bill could effectively provide an employee with a raise equal to taxes owed on those payments. Existing statute prohibits an educational assistance program from offering a

¹ Hanson, *Student Loan Debt by State*, EducationData.org (October 15, 2024). <https://educationdata.org/student-loan-debt-by-state>.

² Merrick, *Education Benefits Present a Learning Opportunity*, Society for Human Resource Management (February 28, 2019). <https://www.shrm.org/topics-tools/news/hr-magazine/education-benefits-present-learning-opportunity>.

³ Rosenbaum, *Amazon, Walmart, Target are paying for college, but money isn't everything in education*, CNBC (September 28, 2021). <https://www.cnbc.com/2021/09/28/the-boom-in-low-wage-worker-free-college-is-about-to-get-tested.html>.

choice to employees between educational assistance and other remuneration. However, could an employer offer a position at a reduced salary with the understanding that the corresponding payment of eligible student loans may attract candidates for employment, yet still not include this substitution as a condition of the employer assistance program?

Moreover, eligible employees in higher tax brackets would see a larger benefit than those at a lower tax bracket, corresponding to the progressivity of California's tax structure, and employees who effectively pay no taxes in California would likely see no benefit at all. While this bill does not address the rising cost of higher education, it could help relieve the burden faced by those with large amounts of student loan debt.

- e) *Tax benefits are a form of financial aid to students:* According to a report published by the Legislative Analyst's Office (LAO) in 2017, tax benefits are one of three main types of financial aid for students in California.⁴ The other two types of financial aid are "loans" and "gift aid." This bill provides financial aid to certain taxpayers with student loans in the form of two tax benefits.
- f) *What is a "tax expenditure"?* Existing law provides various credits, deductions, exclusions, and exemptions for particular taxpayer groups. In the late 1960s, U.S. Treasury officials began arguing that these features of the tax law should be referred to as "expenditures" since they are generally enacted to accomplish some governmental purpose and there is a determinable cost associated with each (in the form of foregone revenues).

As the Department of Finance notes in its annual Tax Expenditure Report, there are several key differences between tax expenditures and direct expenditures. First, tax expenditures are typically reviewed less frequently than direct expenditures. Second, there is generally no control over the amount of revenue losses associated with any given tax expenditure. Finally, it should also be noted that, once enacted, it takes a two-thirds vote to rescind an existing tax expenditure absent a sunset date. This effectively results in a "one-way ratchet" whereby tax expenditures can be conferred by majority vote, but cannot be rescinded, irrespective of their efficacy or cost, without a supermajority vote.

- g) *Existing exclusions for loan forgiveness:* Since 2014, California has provided an exclusion from gross income resulting from student loan debt that is cancelled or repaid under the income-based repayment programs administered by the U.S. Department of Education. Existing state law also provides a gross income exclusion for loans forgiven because of the closure of certain for-profit colleges. Additionally, since 2018, California has excluded from gross income a student loan that is discharged due to the death or total and permanent disability of the student. Finally, California conformed to the gross income exclusion for forgiven student loans contained in the American Rescue Plan of 2021 (Public Law 117-2) for the 2021 through 2025 taxable years AB 111 (Committee on Budget), Chapter 5, Statutes of 2023.
- h) *Committee's tax expenditure policy:* Both R&TC Section 41 and Committee policy require any tax expenditure bill to outline specific goals, purposes, and objectives that the

⁴ *Overview of Student Loans*, LAO (2017). <https://lao.ca.gov/handouts/education/2017/Student-Loans-Overview-082917.pdf>.

tax expenditure will achieve, along with detailed performance indicators for the Legislature to use when measuring whether the tax expenditure meets those stated goals, purposes, and objectives. A tax expenditure bill will not be eligible for a Committee vote unless it has complied with these requirements.

In its current form, this bill states that the credit is designed to provide an additional incentive for individuals to encourage employers to assist in reducing the overwhelming burden of student loan payments on their employees. In addition, this bill provides that the credit's effectiveness shall be measured by the number of taxpayers claiming the credit, the total amount of credits allowed, the number of taxpayers excluding income pursuant to this bill, and the total amounts excluded pursuant to this bill.

In addition to the R&TC Section 41 requirements, this Committee's policy also requires that all tax expenditure proposals contain an appropriate sunset provision to be eligible for a vote. According to this policy, an "appropriate sunset provision" means five years, except in the case of a tax expenditure measure providing relief to California veterans, in which case "appropriate sunset provision" means ten years. This bill, as currently drafted, complies with the Committee's policy on sunset dates.

i) *Policy considerations:*

- i) *Tentative credit reservation not required:* This bill contains language requiring the FTB to create and accept applications for a tentative credit reservation system. As currently drafted, however, obtaining a tentative credit reservation from the FTB is not required for a taxpayer to claim and be allowed the credit. Absent this requirement, limiting the total amount of credits allowed to \$25 million would be impossible. This bill should be amended to either add that requirement to the credit provisions or eliminate the cap on the total amount of credits allowed.
- ii) *Preference language raises constitutional questions:* Pursuant to Proposition 209 of 1996, the California Constitution prohibits the state, local governments, districts, public universities, colleges, and schools, and other governmental instrumentalities from discriminating against or giving preferential treatment to any individual or group in public employment, public education, or public contracting on the basis of race, sex or ethnicity. Since Proposition 209's passage, California courts have invalidated a wide range of programs designed to improve outcomes for marginalized communities, including women and minority-owned contracting provisions (*Hi-Voltage Wire Works v. City of San Jose* (2000) 24 Cal. 4th 537) and hiring preferences (*Connerly v. State Personnel Board* (2001) 92 Cal.App. 4th 16). However, the courts have been careful to note that programs that broadly encourage "diversity" are permissible, as long as no one racial group or gender is explicitly given preference.⁵ As currently drafted, this bill requires the FTB to prioritize credit applications based on certain characteristics of the business owner, including their gender and whether they are a member of a minority group.

⁵ Liedtke, *Analysis of Assembly Constitutional Amendment 7 (Jackson)*, California Assembly Committee on Judiciary (June 13, 2023).

j) *Prior legislation:*

- i) AB 509 (Vince Fong), of the 2023-24 Legislative Session, would have expanded the definition of "educational assistance" and excluded from gross income of an employee payments made by an employer on or after January 1, 2024, and before January 1, 2026, that covered interest on education loans incurred by the employee for their own education. AB 509 was held on the Assembly Appropriations Committee's Suspense File.
- ii) AB 1729 (Voepel), of the 2021-22 Legislative Session, was substantially similar to AB 509 (Vince Fong). AB 1729 was held on the Assembly Appropriations Committee's Suspense File.
- iii) AB 511 (Alquist), Chapter 107, Statutes of 2000, added, on or after January 1, 2000, amounts paid or incurred by an employer for an employee to attend graduate level courses as payments that may be excluded from the employee's gross income, up to \$5,250 per calendar year, among other provisions.

REGISTERED SUPPORT / OPPOSITION:

Support

None on file

Opposition

California Tax Reform Association

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