Date of Hearing: May 5, 2025

ASSEMBLY COMMITTEE ON REVENUE AND TAXATION
Mike Gipson, Chair

AB 386 (Tangipa) – As Amended April 28, 2025

SUSPENSE

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, 2027, and before January 1, 2032, 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) "Qualified full-time employee" is an individual employed by a "qualified taxpayer" for at least six months during the taxable year 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 taxpayer whose employees do not perform jobs described in Section 1087e(m)(3)(B) of Title 20 of the United States Code.

   d) "Student loan" is defined by cross reference to Internal Revenue Code (IRC) Section 108.

3) Provides that "qualified full-time employee" does not include an employee who receives more than $125,000 in wages or salary from the qualified taxpayer during the taxable year.

4) Requires, in order to be eligible for this credit, a qualified taxpayer to request a credit reservation from the Franchise Tax Board (FTB) during the month of July for each taxable year, or within 30 days of the start of their taxable year if the qualified taxpayer's taxable year begins after July, in the form and manner prescribed by the FTB.

5) Requires the FTB, in coordination with the Student Aid Commission, to approve tentative credit reservations with respect to qualified expenditures incurred during the taxable year for qualified taxpayers, subject to the cap established by this bill.

6) Requires the FTB, in approving applications, to give priority to applications submitted by qualified taxpayers that satisfy at least one of the following categories:

   a) Businesses that are owned by veterans;

   b) Employers with no more than 500 employees at any time during the taxable year; or,

   c) Businesses that are owned by disabled individuals.

7) 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.

8) 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" for taxable years beginning on or after January 1, 2027, and before January 1, 2032.

9) 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 qualifying employer 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 qualifying employer.

   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.

   c) "Qualified taxpayer" is an individual with adjusted gross income that does not exceed the following:

      i) In the case of spouses filing a joint return, heads of household, or a surviving spouse, $250,000; or,

      ii) In the case of any other individual, $125,000.

10) 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.

11) 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.

12) Takes immediate effect as a tax levy.

13) Sunsets the statutory provisions for the credit and gross income exclusion on December 1, 2032.

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: Regarding the prior version of the bill, the FTB estimated 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. An updated revenue estimate of the bill as recently amended is pending; however, the amendments likely result in slightly lower revenue losses than originally estimated.

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. Employees that receive more than $125,000 in wages or salary from an otherwise qualified employer would not be eligible for the credit or income exclusion. 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 or 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 $38,168[1]. 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

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

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 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?

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

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

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 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) *Technical consideration*: As recently amended, this bill requires the FTB to provide a report to the Legislature by December 1, 2028. Given that the expenditures become operative in taxable years beginning on or after January 1, 2027, the FTB likely will not have completed processing of the returns necessary to provide the report with specified performance indicators to the Legislature by this deadline. If the author's intent is to review a report with complete information, the report deadline should be extended.

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

Society of Human Resources Management

Opposition

California Tax Reform Association
CFT- a Union of Educators & Classified Professionals, AFT, AFL-CIO

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