

Date of Hearing: January 20, 2022

ASSEMBLY COMMITTEE ON APPROPRIATIONS

Chris Holden, Chair

AB 704 (Mayes) – As Amended January 12, 2022

Policy Committee: Revenue and Taxation

Vote: 6 - 1

Urgency: Yes

State Mandated Local Program: No

Reimbursable: No

**SUMMARY:**

This bill, for taxable years beginning January 1, 2023, and before January 1, 2028, expands the tax deduction allowed for interest paid on qualified education loans under the Personal Income Tax (PIT) Law. This bill states the goal of expanding the tax deduction and requires the Franchise Tax Board (FTB) to annually review and provide a report on the deduction's effectiveness.

**FISCAL EFFECT:**

- 1) General Fund (GF) revenue loss of approximately \$20 million in fiscal year (FY) 2023-24, \$37 million in FY 2024-25 and \$40 million in FY 2025-26.
- 2) Costs of an unknown amount to the FTB to update existing tax forms and information systems and provide the report.

**COMMENTS:**

- 1) **Purpose.** According to the author, this bill removes the annual student loan interest deduction cap of \$2,500. The author notes "California cannot forgive student loan debt, but it can make it easier on borrowers and reward them for attaining a higher degree when tax season comes around." Proponents include associations representing various occupations and taxpayers, stating this bill would help alleviate the economic impact of student loan debt. This bill is opposed by an education organization, stating this bill would divert funding from public education.
- 2) **Existing Federal and State Tax Deduction for Student Loan Debt.** Existing federal and state law allows an "above-the-line" PIT deduction for certain expenses when calculating adjusted gross income (AGI), including interest on education loans. The student interest loan deduction is limited to \$2,500 and phases out as AGI increases. By removing the \$2,500 cap for state PIT deductions, this bill allows taxpayers to deduct the full amount of interest from AGI and increases the value of the tax benefit.
- 3) **Tax Expenditure vs. Direct Expenditure.** The various tax credits, deductions, exclusions and exemptions in existing law, such as the student interest loan deduction, are tax "expenditures" generally enacted to accomplish some governmental purpose, with a determinable cost associated with each in the form of foregone revenues. By expanding the tax deduction for student loan debt, this bill increases a tax expenditure.

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 reviewed less frequently than direct expenditures once they are put in place, which may result in tax expenditures remaining part of the tax code without demonstrating any public benefit. 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.

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