Senate Fiscal Agency
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BILL ANALYSIS

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Senate Bill 642 (Substitute S-1 as passed by the Senate)
Sponsor: Senator Rick Jones
Committee: Veterans, Military Affairs and Homeland Security

Date Completed: 4-9-18

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 has been 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 would amend the Income Tax Act to allow, for tax years beginning after December 31, 2017, 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, as defined in the Internal Revenue Code, subject to various adjustments. For tax years beginning after December 31, 2017, the bill would allow a taxpayer who was a disabled veteran to deduct, to the extent not deducted in determining adjusted gross income, 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.

MCL 206.30

BACKGROUND

According to the website of the Office of Federal Student Aid (within the U.S. Department of

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

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.

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.)

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 is the same as the Internal Revenue Code's, these veterans have received relatively large State income tax bills, as well. According to testimony before the Senate Committee on Veterans, Military Affairs and Homeland Security, some veterans have had liens placed on their homes, and their benefit payments have been garnished to pay the State and Federal income taxes due on the forgiven debt. While this was addressed at the Federal level, for loans discharged after 2017, the bill would remedy the situation at the State level, by allowing veterans who are disabled as a result of their service to be relieved of a tax liability that they cannot afford to pay.

Legislative Analyst: Jeff Mann

FISCAL IMPACT

The bill would reduce State General Fund and School Aid Fund revenue by approximately $100,000 per year, with the majority of the impact reducing General Fund revenue. Under current law, the School Aid Fund receives approximately 23.8% of gross individual income tax revenue. If all of the income excluded from the tax base as a result of the bill were reflected in lower payments under individual income tax withholding, estimated payments, and annual payments, then the bill would reduce School Aid Fund revenue by approximately $23,800 per year. To the extent that taxpayers' withholding and estimated payments remained unchanged, and that taxpayers received a refund from the State when they filed their annual return, School Aid Fund revenue would not be affected by the bill and all of the revenue reduction would lower General Fund revenue.

Fiscal Analyst: David Zin

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