Talking points on student loan provisions in the House tax reform proposal

Possible tax code revisions are about to be taken up by the House of Representatives. The draft legislation may be revised significantly before it is brought to the House floor for a vote and many factors are in play. However, the proposal currently includes tax changes that would affect student loans.

Current law:

- Eligible individuals can now claim up to $2,500 a year in student loan interest as a deduction. (The loan principal is not deductible.) As an "above the line" adjustment that does not require itemized deductions, this can amount to a maximum $625 a year in reduced tax burden (depending on the taxpayer's income).
- This deduction is only available to borrowers with a modified adjusted gross income of less than $80,000 ($160,000 for married couples filing jointly.) The benefit is gradually reduced once the borrower earns at least $65,000 (or $130,000 for couples). As a result, the deduction is more likely to benefit resident physicians before they enter full-time practice.
- About 12 million people claimed the student loan interest deduction in 2015, according to the IRS. (More than 40 million Americans have student debt.)

Proposed changes:

- Section 1204 would repeal the deduction for interest on education loans.
- It would also repeal the deduction for tuition and related expenses and the exclusion for employer-provided education assistance.
- The bill would also change current law to exclude from taxable income the discharge of student debt resulting from death or total disability, and it would exclude from income repayment of a taxpayer's loans pursuant to the Indian Health Service Loan Repayment Program.
- The American Opportunity Tax Credit, which allows qualified families who are paying for college out-of-pocket to claim up to $2,500 per student, would be preserved under the House plan. (A fifth postsecondary year would be added at $1,250.)

Mitigating factors:

- Most of those who are currently eligible to claim the student loan interest deduction (e.g., resident physicians) now qualify for the standard personal deduction of $6,350. Under the House plan, this deduction would increase to $12,000 a year. (For joint filers, the increase goes from $12,700 to $24,000.)

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- Taxpayers with incomes below $65,000 also would receive a marginal rate cut.
- <u>Even though the student loan interest deduction is "above the line," it is highly likely that most taxpayers affected by its repeal would, overall, still have a reduced tax burden under the House proposal because</u> of the higher standard deduction and marginal rate cut.
- Even if the federal student loan interest deduction is repealed by Congress, borrowers may still qualify for a state income tax deduction. Thirty-seven states and D.C. offer a similar benefit, according to The Pew Charitable Trusts.

Strategic factors:

- The tax bill includes proposals that would literally affect all Americans; it does not single out medical school graduates with debt.
- Medical school graduates often have high student debt, but the benefits they currently receive through the tax code are limited, and generally phase out completely by the time they enter practice.
- When the House bill is considered as a whole, it appears the tax code revisions will be far more favorable to individuals who currently qualify for the student loan interest deduction. Given the scope of the legislation, the lack of net financial harm makes the case for retaining the deduction less compelling on Capitol Hill given there are many others (e.g., charities, individuals owning property in states that are highly taxed) who may be adversely affected and will be exerting pressure on legislators.

Timing:

- The House Ways and Means Committee plans to mark up the legislation the week of November 6. It is possible that other provisions (e.g., repeal of the individual and employer mandates to purchase health insurance) could be added to the bill.
- The legislation is tentatively scheduled for a vote on the House floor the week of November 13.
- The Senate has not yet released its version of the tax legislation. That is expected by the week of November 13, with a floor vote optimistically planned before Thanksgiving.

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Tax Cuts and Jobs Act: Potential Impact on Medical Students and Residents

Repeal of Student Loan Interest Payment Deduction

2017		PROPOSED UNDER TRUMP'S TAX PLAN	
10%	$0 – $9,325	12%	$0 – $45,000
15%	$9,326 – $37,950		
25%	$37,951 – $91,900	25%	$45,001 – $200,000
28%	$91,901 – $191,650		
33%	$191,651 – $416,700	35%	$200,001 – $500,000
35%	$416,701 – $418,400	39.6%	$500,001 or more
39.6%	$418,401 or more		
Standard deduction:	**$6,350**	Standard deduction:	**$12,000**
Personal exemption:	**$4,050**	Personal exemption:	**Eliminated**

(Dollar figures above refer to income and percentages refer to tax rates)

	Current Law*	TCJA*
Average Resident Gross Salary†	$57,200	$57,200
Max. SL interest deduction††	$2,500	**repealed**
MAGI**	$54,700	$57,200
Standard Deduction	$6,350	$12,000
Personal Exemption	$4,050	**repealed**
Taxable Income	$44,300	$45,200
Marginal Tax Rate°	25%	25%
Effective Tax Rate°	11.90%	9.52%
Total Federal Income Tax Burden	**$6,813.75**	**$5,450**

Difference **$1,363.75**

*This analysis assumes a single resident who takes the standard deduction under current law
**This MAGI assumes no other above-the-line deductions
† https://www.medscape.com/slideshow/residents-salary-and-debt-report-2017-6008931
†† https://www.irs.gov/publications/p970#idm140532120617808
°**Marginal rate** = percentage of tax taken from next dollar earned; however, under TCJA in this example, only last $200 of taxable income ($45,200) is taxed at the 25% marginal rate, with the first $45,000 taxed at 12% (see chart). **Effective rate** = tax burden as percentage of gross income

Educational tax credits

- **American Opportunity Tax Credit (AOTC), Hope Scholarship Credit (HSC), and Lifetime Learning Credit (LLC) consolidated**: HSC and LLC repealed; AOTC extended at ½ rate for 1 additional year; eligibility and provisions for first 4 years of AOTC unchanged from current law
- **Loss of HSC partially offset by extension of the AOTC**: ½ rate AOTC available for only 1 year instead of 2 like HSC, while providing a maximum annual dollar amount of credit equal to the annual amount for HSC ($1500), thus halving the total credit an eligible individual may receive. However, its means-testing threshold is significantly higher ($80-90K vs. $40-50K), and up to $500 of this credit is refundable, vs. none of the HSC
- **No apparent compensatory provision for repeal of LLC**. However, the LLC is **nonrefundable** - only students with incomes can benefit
- Also, a work-eligible SSN now must be provided to claim the AOTC refund

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