Offering Tax Incentives to Ease Student Loan Debt

BY ANDREW SMALLEY

With over $1.6 trillion in outstanding debt, student loan borrowing has eclipsed both credit card debt and auto loans as the second highest source of consumer debt, trailing only home mortgages. More than half of students who enroll in college borrow to fund their education and nearly 45 million Americans still owe a student loan balance. While debt levels vary by degree and major, of particular concern is that nearly 4 million students have dropped out of college without a degree but with student loan debt. Additionally, this debt does not just affect young adults. More than 2.8 million Americans older than 60 have taken out at least one student loan, often to support the education of a family member.

Borrowers with student loan balances experience less financial security than students without loan balances. Young adults with student loans accumulate, on average, 50% less retirement wealth by age 30 than adults without an outstanding loan balance. The broader economic effects of student loan debt have been well-documented, with numerous studies showing the adverse consequences of debt on indicators from homeownership among young adults to small business formation and growth.

Student loan debt is also particularly crippling for borrowers of color. A report from the Brookings Institution found that Black college graduates owe, on average, $7,400 more than white borrowers. A 2019 study found that two decades after a student starts college, a typical Black student still owes

Did You Know?

• More than half of students borrow to fund their postsecondary education.
• Over 2.8 million Americans older than 60 have taken out at least one student loan.
• Since 2019, legislators in 26 states have introduced over 100 bills related to student loan tax credits or deductions.
95% of his or her loan balance compared to a typical white borrower, who owes only 6%.

**State Action**

States have worked to address the student loan crisis in several ways. At least a dozen states have enacted legislation to increase borrower protections and strengthen oversight of student loan servicers. In 2019, legislators in 18 states created or modified loan forgiveness programs to provide borrowers with debt relief or payment support in exchange for work or service in specific fields for a period of time. Many states develop these programs to address debt relief as well as economic development and talent retention. States have also explored using tax incentives to help borrowers address repayment challenges and advance these strategies.

Many states have created tax credits for student loan debt payments or interest. Since 2017, Minnesota has offered a Student Loan Tax Credit of up to $500 for each resident (and $1,000 per couple) making payments on qualifying education loans. The credit amount depends on a resident’s income, loan payments and loan amounts. Maryland offers the Student Loan Debt Relief Tax Credit for students who have incurred at least $20,000 in student loan debt and have a remaining balance of at least $5,000. Recipients of the tax credit must submit proof that they used the tax credit to pay down qualifying student loans. In 2019, the state awarded nearly $9 million in tax credits to over 9,000 residents. In Maine, the Opportunity Maine Tax Credit offers college graduates who live and work in the state various tax credits. The amount and structure of the credit vary based on the degree earned and the student’s year of graduation.

In 2020, nearly 20 states have considered almost 50 bills related to student loan tax credits or deductions. Michigan and Illinois are considering bills to create new student loan tax credits, while pending bills in Delaware and Pennsylvania would expand tax credits related to the interest charged on student loans.

Some states are also looking to align student loan tax credits more closely with employers and broader statewide retention strategies. These bills aim to support employers who pay portions of their employees’ student loans or support workers in a certain profession or industry. These programs attempt to target many young adults’ substantial student loan debt balances and leverage incentives to help them repay that debt. For businesses, this offers an opportunity to both attract and retain talent. According to a survey, 86% of young adult workers said they would commit to their employer for five years if the employer helped pay off their student loans.

In 2019, Connecticut lawmakers passed SB 72, which establishes a tax credit for employers who make payments on loans issued to their employees. Beginning in the 2022 tax year, employers will be provided with a 50% tax credit of up to $2,625 per year for payments made on a student loan. Employees must be a state resident, recent college graduate and employed full time in the state. Massachusetts, Ohio and Vermont are considering similar legislation in 2020.

Other states have considered more targeted student loan debt relief. A pending New Jersey bill would provide STEM employers with tax credits for graduates who live and work in the state.

**Federal Action**

Most student loan borrowers are eligible for a tax deduction of up to $2,500 a year on interest paid for student loans used for higher education expenses. Filers in all 50 states and the District of Columbia can claim the federal student loan interest tax deduction and 37 states and the District of Columbia allow taxpayers to deduct student loan interest from their taxable state income.

As part of relief for the COVID-19 pandemic, the federal Coronavirus Aid, Relief, and Economic Security (CARES) Act passed in March provides significant student loan relief in the form of deferring payments and waiving interest until Sept. 30, 2020. The legislation also allows companies to offer up to $5,250 toward an employee’s student loan payments on a tax-free basis through the end of 2020. These payments would include private student loans and would be excluded from income and payroll taxes for both the employee and employer.