

Model Legislation: A Federal Tax Credit for Student Loan Interest

(a) TAX CREDIT FOR INTEREST ON EDUCATION LOANS.—Subpart C of part IV of subchapter A of chapter 1 of the Internal Revenue Code of 1986 (relating to refundable credits) is amended by redesignating section 36 as section 37 and by inserting after section 35 the following new section:

“SEC. 36. INTEREST ON EDUCATION LOANS.

“(a) ALLOWANCE OF CREDIT.—In the case of an individual, there shall be allowed as a credit against the tax imposed by this subtitle for the taxable year an amount determined in accordance with subsection (b).

“(b) AMOUNT OF CREDIT.—The amount determined in accordance with this subsection is an amount equal to the greater of—

“(1) 25 percent of the qualified interest paid by the taxpayer during the taxable year on any qualified education loan, or

“(2) the amount by which the total principal and interest paid by the taxpayer during the taxable year on any qualified education loan exceed 15 percent of the taxpayer’s qualified discretionary income for the taxable year.

“(c) MAXIMUM CREDIT

“(1) IN GENERAL.—Except as provided in paragraph (2), the credit allowed by subsection (a) for the taxable year shall not exceed the amount of qualified interest paid by the taxpayer during the taxable year on any qualified education loan.

“(2) LIMITATION BASED ON MODIFIED ADJUSTED GROSS INCOME.—

“(A) IN GENERAL.—If the modified adjusted gross income of the taxpayer for the taxable year exceeds \$50,000 (\$100,000 in the case of a joint return), the amount which would (but for this paragraph) be allowable as a credit under this section shall be reduced (but not below zero) by the amount

which bears the same ratio to the amount which would be so allowable as such excess bears to \$20,000 (\$40,000 in the case of a joint return).

“(B) MODIFIED ADJUSTED GROSS INCOME.—The term ‘modified adjusted gross income’ means adjusted gross income determined without regard to sections 199, 222, 911, 931, and 933.

“(C) INFLATION ADJUSTMENT.—In the case of any taxable year beginning after 2006, the \$50,000 and \$100,000 amounts referred to in subparagraph (A) shall be increased by an amount equal to—

“(i) such dollar amount, multiplied by

“(ii) the cost-of-living adjustment determined under section (1)(f)(3) for the calendar year in which the taxable year begins, by substituting ‘2005’ for ‘1992’

“(D) ROUNDING.—If any amount as adjusted under subparagraph (C) is not a multiple of \$50, such amount shall be rounded to the nearest multiple of \$50.

“(d) DEPENDENTS NOT ELIGIBLE FOR CREDIT.—No credit shall be allowed by this section to an individual for the taxable year if a deduction under section 151 with respect to such individual is allowed to another taxpayer for the taxable year beginning in the calendar year in which such individual’s taxable year begins.

“(e) DEFINITIONS.—For purposes of this section—

“(1) QUALIFIED INTEREST.—In the case of a taxable year, the term ‘qualified interest’ means the amount of interest paid on a qualified education loan during such taxable year, except that such amount shall not exceed \$4,000.

(2) QUALIFIED EDUCATION LOAN.—The term ‘qualified education loan’ means any indebtedness incurred by the taxpayer solely to pay qualified higher education expenses—

“(A) which are incurred on behalf of the taxpayer, the taxpayer’s spouse, or any dependent of the taxpayer as of the time the indebtedness was incurred,

“(B) which are paid or incurred within a reasonable period of time before or after the indebtedness is incurred, and

“(C) which are attributable to education furnished during a period during which the recipient was an eligible student.

Such term includes indebtedness used to refinance indebtedness which qualifies as a qualified education loan. The term ‘qualified education loan’ shall not include any indebtedness owed to a person who is related (within the meaning of section 267(b) or 707(b)(1)) to the taxpayer or to any person by reason of a loan under any qualified employer plan (as defined in section 72(p)(4)) or under any contract referred to in section 72(p)(5).

“(3) QUALIFIED HIGHER EDUCATION EXPENSES.—The term ‘qualified higher education expenses’ means the cost of attendance (as defined in section 472 of the Higher Education Act of 1965, 20 U.S.C. 1087ll, as in effect on the day before the date of the enactment of the Taxpayer Relief Act of 1997) at an eligible educational institution, reduced by the sum of—

“(A) the amount excluded from gross income under section 127, 135, 529, or 530 by reason of such expenses, and

“(B) the amount of any scholarship, allowance, or payment described in section 25A(g)(2).

For purposes of the preceding sentence, the term ‘eligible educational institution’ has the same meaning given such term by section 25A(f)(2), except that such term shall also include an institution conducting an internship or residency program leading to a degree or certificate awarded by an institution of higher education, a hospital, or a health care facility which offers postgraduate training.

“(4) QUALIFIED DISCRETIONARY INCOME.—With respect to a taxpayer—

“(A) IN GENERAL.—The term ‘qualified discretionary income’ means the taxpayer’s taxable income minus the qualified exemption amount.

“(B) QUALIFIED EXEMPTION AMOUNT.— The qualified exemption amount is the amount equal to \$3,000 multiplied by the number of exemptions allowed as deductions pursuant to section 151.

“(5) ELIGIBLE STUDENT.—The term ‘eligible student’ has the meaning given such term by section 25A(b)(3).

“(6) DEPENDENT.—The term ‘dependent’ has the meaning given such term by section 152 (determined without regard to subsections (b)(1), (b)(2), and (d)(1)(B) thereof).

“(f) SPECIAL RULES.—

“(1) DENIAL OF DOUBLE BENEFIT.—No credit shall be allowed under this section for any amount for which a credit is allowable under any other provision of this chapter.

“(2) MARRIED COUPLES MUST FILE JOINT RETURN.—If the taxpayer is married at the close of the taxable year, the credit shall be allowed under subsection (a) only if the taxpayer and the taxpayer’s spouse file a joint return for the taxable year.

“(3) MARITAL STATUS.—Marital status shall be determined in accordance with section 7703.”.

“(4) WORK REQUIREMENT.—No credit shall be allowed under this section if the taxpayer does not have earned income as defined in section 32(c)(2).”.

(c) REPEAL OF DEDUCTION FOR INTEREST ON EDUCATION LOANS.—Section 221 of the Internal Revenue Code of 1986 (relating to interest on education loans) is hereby repealed.

(d) CONFORMING AMENDMENTS [not included].