

Model Legislation: A Federal Tax Credit for Student Loan Interest

Section-by-Section Analysis

Amends the Internal Revenue Code to create a refundable credit for interest paid on educational loans (replacing the current student loan interest deduction).

- The amount of the credit is the greater of:
 - 25 percent of the qualified interest a taxpayer paid on qualified educational loans during the taxable year; or
 - The amount by which a taxpayer's loan payments (interest and principal) for qualified loans exceed 15 percent of his/her qualified discretionary income for the taxable year, not to exceed the qualified interest paid.

The current deduction provides taxpayers with a maximum benefit of 25 percent of the qualified interest paid (the highest marginal tax rate for eligible taxpayers), so those who currently benefit from the deduction are held harmless in the conversion to a credit.

- The credit phases out between \$50,000 and \$70,000 for single filers (\$100,000 and \$140,000 for joint filers) of modified adjusted gross income (gross income before the application of certain deductions). The level of the income phase-out will be annually increased to adjust for inflation. *The current deduction phases out between \$50,000 and \$65,000 (\$100,000 and \$130,000 for joint filers).*
- A taxpayer is not eligible for the credit if he or she is claimed as a dependent by another taxpayer.
- A taxpayer must be working (have earned income) in order to take the credit. *This is not a requirement of the current deduction.*
- The credit is refundable and therefore available to taxpayers without income tax liability. *The current deduction provides no benefit to taxpayers who do not have income tax liability.*
- Definitions

- “Qualified interest” refers to the amount of interest paid on a qualified education loan during a taxable year, capped at \$4,000. For those with high loan burdens (payments more than 15% of discretionary income, as described below) the credit would be worth up to \$4,000. For those with lower loan burdens, the credit would be worth up to \$1,000 (25 percent of \$4,000). *The current deduction is for up to \$2,500 of interest and is worth up to \$625 (25 percent of \$2,500.)*
 - “Qualified educational loan” means any indebtedness incurred by the taxpayer to pay for qualified higher educational expenses on behalf of the taxpayer, a spouse or other dependent.
 - “Qualified higher education expenses” means the cost of attendance as defined in the Higher Education Act of 1965 (tuition, fees, room and board, books, transportation and related expenses), reduced by grants and scholarships received.
 - “Qualified discretionary income” is the taxpayer’s taxable income minus \$3,000 for each exemption allowed (generally one exemption for each family member).
 - “Eligible student” is a person enrolled at least half-time in a degree or certificate program at an institution of higher education. *This is the same definition used for the current deduction and the Hope Scholarship Credit.*
 - “Dependent” is a taxpayer’s dependent for tax purposes (as defined in section 152 of the Internal Revenue Code).
- A double benefit cannot be claimed, if a credit is allowable for the same claimed interest in another provision of the tax code.
 - Married couples must file a joint tax return to qualify for the credit.
 - This legislation repeals the current deduction for student loan interest, section 221 of the Internal Revenue Code.