

Maryland

Tax Alert



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IMPACT OF FEDERAL STUDENT LOAN FORGIVENESS ON MARYLAND INDIVIDUAL INCOME TAX

On August 24, 2022, President Joseph R. Biden, Jr. announced the Department of Education will provide up to \$20,000 in debt cancellation to Pell Grant recipients with loans held by the Department of Education, and up to \$10,000 in debt cancellation to non-Pell Grant recipients.¹ Borrowers are eligible for this relief if their federal adjusted gross income (FAGI) is lower than the required threshold for their filing status.² If they file single or married filing separately at the federal level, their FAGI must be below \$125,000. If they file head of household, qualifying widow(er), or married filing jointly at the federal level, their FAGI must be below \$250,000. If they make less than the required income to file taxes at the federal level, they are not required to file a federal individual income tax return to qualify for forgiveness.

This Tax Alert describes the impact of that student loan debt cancellation on Maryland individual income tax beginning with tax year 2022.

Maryland Adjusted Gross Income

To the extent includable in FAGI, the amount of discharged student loan debt is subtracted from the FAGI of a Maryland resident to determine Maryland adjusted gross income.³ Discharged student loan debt excluded from FAGI due to changes made in the American Rescue Plan Act does not qualify for the subtraction.⁴

The subtraction for discharged student loan debt is claimed on Form 502SU. The total amount of subtractions claimed on Form 502SU is then reported on Form 502 using code letter “nn”. When claiming the subtraction modification, an individual must submit, with their Maryland state income tax return documentation from their lender stating the loans have been discharged. Spouses who file joint returns should combine their subtraction total on a single Form 502SU.

¹ The President’s student loan debt forgiveness program is the subject of several ongoing federal lawsuits. Those lawsuits have no bearing on this guidance. This Tax Alert will be updated if litigation changes the Maryland impact of the program.

² For additional information about federal student loan debt relief, visit <https://studentaid.gov/manage-loans/forgiveness-cancellation/debt-relief-info>.

³ Md. Code Ann., Tax-Gen. § 10-207(aa)(1).

⁴ I.R.C. § 108.

Maryland Student Loan Debt Relief Tax Credit

The Maryland Student Loan Debt Relief Tax Credit is a tax credit available to individuals with undergraduate or graduate student loan debt. A qualified individual wishing to claim the Maryland Student Loan Debt Relief Tax Credit must submit an annual application to the Maryland Higher Education Commission (MHEC).⁵ If the application is approved, the individual will receive a certificate from MHEC showing the tax year and maximum credit amount they may claim. An individual may claim a refundable credit against the State income tax for the tax year up to the amount certified by MHEC.

The credit must be used for the repayment of undergraduate or graduate student loan debt within two years of the close of the tax year for which the credit is claimed. If the individual does not provide documentation to MHEC showing the credit was used for repayment, the credit is subject to recapture.

Example: Debtor A applied for the credit for 2022. They were certified for a \$500 credit by MHEC and claimed the \$500 credit on their 2022 Maryland income tax return. They must use \$500 to repay undergraduate or graduate student loan debt by December 31, 2024. If they fail to provide documentation to MHEC showing they used \$500 to repay their student loan debt on or before December 31, 2024, they will receive a notice from the Comptroller recapturing the claimed \$500 credit.

If, as a result of debt forgiveness, Debtor A's outstanding student loan debt is less than the amount of the credit certified by MHEC, Debtor A may claim less than the full amount of the credit certified when they file their return.

If any amount of the credit claimed on the tax return is not used to repay undergraduate or graduate student loan debt, the entire credit amount must be repaid. If Debtor A already claimed the credit on their Maryland income tax return and, as the result of debt forgiveness, they can no longer use the full credit amount claimed to repay their student loan debt, they can either (1) amend their return to claim a lower credit amount or (2) allow the period to expire, requiring Debtor A to repay the full amount of the credit.

Questions and Answers

Q: Is the federal student loan forgiveness announced on August 24, 2022, subject to Maryland state income tax?

A: No. As a conformity state, Maryland generally follows federal treatment of taxable income. The American Rescue Plan Act excludes student loan forgiveness from FAGI. Even if it were included in FAGI, an individual may subtract the amount using the subtraction modification for discharged student loan indebtedness.

⁵ The deadline to apply for the Maryland Student Loan Debt Relief Tax Credit for tax year 2022 has passed. For additional information regarding the application, visit: <https://mhec.maryland.gov/preparing/Pages/StudentLoanDebtReliefTaxCredit.aspx>.

Q: Will I owe taxes on the Maryland Student Loan Debt Relief Tax Credit?

A: If the credit amount is used to repay student loan debt within the two-year time period, there will be no Maryland income tax due as a result of the Maryland Student Loan Debt Relief Tax Credit. In some cases, refunds, credits, or offsets of state and local income tax are taxable at the federal level for individuals who itemize their deductions.

Q: Am I required to file a Maryland state income tax return to apply for and/or claim the Maryland Student Loan Debt Relief Tax Credit even if I am not otherwise required to file a Maryland state income tax return?

A: Yes. MHEC requires attachment of a Maryland state income tax return to applications for the credit. Even if you are not otherwise required to file a Maryland state income tax return, you must file to complete the application. Additionally, because the credit is applied against Maryland state income tax due, you must file a Maryland state income tax return in order to claim the credit as a refund.

Q: If federal debt forgiveness reduces my outstanding undergraduate or graduate student loan debt below the threshold required to apply for the Maryland Student Loan Debt Relief Tax Credit (\$5,000) after I have submitted my application, can I still claim the credit?

A: Yes. Under Maryland law, you must have \$5,000 of outstanding undergraduate or graduate student loan debt at the time you submit the application to MHEC. If after submitting your application your outstanding student loan debt is less than \$5,000, you can still claim the credit.

Q: Am I required to claim the full credit amount certified by MHEC even if federal debt forgiveness reduces my outstanding undergraduate or graduate student loan debt below the certified credit amount?

A: No. You are not required to claim the full credit amount certified by MHEC. In fact, you should only claim the amount you intend to use to pay for outstanding undergraduate or graduate student loan debt. If any amount of the credit claimed on the tax return is not used to repay undergraduate or graduate student loan debt, you must repay the entire credit amount.

For questions regarding this Tax Alert, please contact the Taxpayer Services Division by phone at 410-260-7980 or 1-800-638-2937, or by email at TAXHELP@marylandtaxes.gov.