



July 14, 2008

Nikki Harris  
U.S. Department of Education  
1990 K Street, NW  
Room 8033  
Washington, DC 20006-8502

Dear Ms. Harris:

On behalf of the Project on Student Debt, I am writing to comment on Docket ID ED-2008-OPE-0009: the notice of proposed rulemaking to implement the Title IV loan provisions in the College Cost Reduction and Access Act of 2007 (CCRAA), published in the Federal Register on July 1, 2008.

The Project on Student Debt is an initiative of the Institute for College Access & Success, a nonpartisan, not-for-profit organization working to make higher education more available and affordable for people of all backgrounds. The Project identifies cost-effective policies that expand educational opportunity, protect family financial security, and advance economic competitiveness by reducing the burden of student debt. The new income-based repayment program (IBR) established by the CCRAA is modeled on a policy proposal that the Project developed with support from students, parents, lenders, and the higher education community.

Our goal in commenting on these regulations is to ensure that policies designed to make student loans more fair and manageable, and to encourage participation in higher education and public service, are as accessible and beneficial as possible to borrowers and their families. Our comments also recognize the Department's – and borrowers' – interest in effective and efficient administration.

We commend the Department and those involved in the rulemaking process for their thoughtful and thorough approach to implementing this complex new law, and for their sincere efforts to address the needs and concerns of students and borrowers. Overall, the proposed regulations will serve past, present, and future student-loan borrowers well. They will help encourage students of modest means to go to and get through college, and ensure that responsible borrowers can afford to serve their country and community, start a family, save for retirement, and contribute to their own children's education.

However, our analysis of the proposed regulations for IBR, and of the loan forgiveness program for public service employees, did identify two areas where the rules would create significant obstacles for borrowers attempting to access the new loan repayment and forgiveness benefits established by the CCRAA. As discussed in more detail below, one problematic provision would subject some married borrowers who participate in IBR

to higher loan payments – as much as 100 percent higher – than it would unmarried borrowers in identical circumstances. The other would leave borrowers in the dark – for 10 years or longer – about whether or not their jobs are eligible for public service loan forgiveness. These obstacles undermine the new law’s intent, and we call on the Department to remove them before the regulations become final. We also identified several additional issues that we believe would benefit from further clarification in the final regulations.

**Our comments below are listed in the order they appear in the Federal Register. Where our comments are identical for both the FFEL and Direct loan programs, we have repeated them in the relevant section. Double-underlined text indicates our proposed changes to the regulations as currently written.**

### **682.215 Income-based repayment plan.**

- (a) currently states in part:

(a) Definitions. As used in this section—(1) Adjusted gross income (AGI) means the borrower’s adjusted gross income as reported to the Internal Revenue Service. For a married borrower filing jointly, AGI includes both the borrower’s and spouse’s income. For a married borrower filing separately, AGI includes only the borrower’s income.

(2) Eligible loan means any outstanding loan made to a borrower under the FFEL or Direct Loan programs except for a FFEL or Direct PLUS loan made to a parent borrower or a FFEL or Direct Consolidation Loan that repaid a FFEL or Direct PLUS Loan made to a parent borrower.

IBR was designed to limit student loan payments to an affordable level for borrowers: no more than 15 percent of borrowers’ discretionary income, as consistent with Congress’ intent in enacting the CCRAA. However, under current proposed rules, when two married individuals both have student loan debt and file taxes jointly, they could be expected to *pay up to double the monthly loan payment* of two unmarried borrowers in otherwise identical situations. That is, each borrower could be stuck with payments representing up to 30 percent of their discretionary income.

The double-counting penalty occurs because the rules in (a)(1) assume each spouse has access to the couple’s total discretionary income, without regard for the fact that that the other spouse is also making loan payments from the same discretionary income.

It is neither appropriate nor equitable to suggest that this problem is solved if married borrowers file their taxes separately, as is allowed under Public Law 110-153. Filing separately makes married borrowers ineligible for a number of valuable tax benefits. The tax penalties that result from filing separately can eliminate or even exceed any IBR benefits gained.

Several examples of the tax benefits that couples filing separately are forced to forgo, and the associated costs, are detailed in the attached memo from Pugh et al. Some examples include the Earned Income Tax Credit, which can be worth thousands of dollars each year to low-income families with children, the Child and Dependent Care Credit, and the Hope and Lifetime Learning Credits.

There is no compelling reason to require taxpayers to give up tax benefits that they would otherwise be entitled to solely because they are repaying their student loans under the IBR program. To address this inequity and to make the treatment of dual-borrower couples consistent with Congress' intent to limit IBR payments to no more than 15 percent of discretionary income, we recommend that both spouses' debt be considered in determining eligibility for and payments under IBR.

We recommend that the Secretary use her regulatory authority to make the following simple clarification:

(2) Eligible loan means any outstanding loan made to a borrower (or to the borrower's spouse, if applicable) under the FFEL or Direct Loan programs except for a FFEL or Direct PLUS loan made to a parent borrower or a FFEL or Direct Consolidation Loan that repaid a FFEL or Direct PLUS Loan made to a parent borrower.

No further special rule is needed, because section (b)(1)(i) of the regulations already provides for a method of allocating IBR payment amounts to multiple loans on a proportional basis.

- (b) currently states in part:

(b) Repayment plan. (1) A borrower may elect the income-based repayment plan only if the borrower has a partial financial hardship.

While this language works for most borrowers, one group will face a Catch-22: those who have partially paid down their principal and have less than 10 years remaining on their loans. For this group, loan payments are high enough relative to income that they should be eligible for IBR, but they are blocked from access to the lower IBR payments. While their payments are not affordable under IBR's definition of partial financial hardship, they are only eligible to enter IBR if a *lower but hypothetical* 10-year payment on their *current* balance is not affordable. We recommend the following change to prevent this coverage gap:

(b) Repayment plan. (1) A borrower may elect the income-based repayment plan only if the borrower has a partial financial hardship or is in a repayment plan with current monthly payments that exceed 15 percent of the amount by which the borrower's AGI exceeds 150 percent of the poverty line income applicable to the borrower's family size, divided by 12.

- (d)(2) currently states:

(2) If a borrower no longer wishes to pay under the income-based repayment plan, the borrower must pay under the FFEL standard repayment plan and the loan holder recalculates the borrower's monthly payment based on—

- (i) The time remaining under the maximum ten-year repayment period for the amount of the borrower's loans that were outstanding at the time the borrower discontinued paying under the income-based repayment plan; or
- (ii) For a Consolidation Loan, the applicable repayment period remaining specified in Sec. 682.209(h)(2) for the total amount of that loan and the balance of other student loans that was outstanding at the time the borrower discontinued paying under the income-based repayment plan.

There are two problems with this language. First, it does not make clear whether the time the borrower has spent in IBR is excluded from or included in the calculation of the “time remaining” in the applicable repayment period. For this purpose, the time in IBR should be treated like a deferral or forbearance: it should *not* count as part of the fixed-length repayment periods.

Second, the language implies that a post-IBR borrower would no longer have access to repayment plans for which he would otherwise be eligible (e.g. extended, graduated, etc.). Our understanding from the discussion at negotiated rulemaking was that denying access to repayment plans was *not* the intent of the language. A clause should be added to make that clear.

We recommend making the following additions to the current rules:

(2) If a borrower no longer wishes to pay under the income-based repayment plan, the borrower must pay under the FFEL standard repayment plan, or any other payment plan for which he or she would be otherwise eligible, and the loan holder recalculates the borrower's monthly payment based on—

.....

(iii) For the purposes of determining the time remaining under (i) or (ii), the time the borrower spent in the Income Based Repayment Program shall not be included.

### **685.209 Income contingent repayment plan.**

- (c)(4)(ii)(B) currently states in part:

(c) *Other features of the income contingent repayment plan*

(4) Repayment period.

.....

(ii) The repayment period includes—

(B) Periods in which the borrower makes reduced monthly payments under the income-based repayment plan or a recalculated reduced monthly payment after the borrower no longer has a partial financial hardship or stops making income-based payments, as provided in Sec. 685.221(d)(i).

While we agree with the intent of this section, the term “recalculated reduced monthly payment” is confusing. We suggest removing the word “reduced.” In addition, we believe the “(1)” is missing from the section reference, which should be Sec. 685.221(d)(1)(i).

- (c)(4)(ii) (F) and (G) currently states:

(F) Periods after October 1, 2007, in which the borrower makes monthly payments under any other repayment plan that are not less than the amount required under the standard repayment plan described in Sec. 685.208(b);  
or  
(G) Periods of economic hardship deferment after October 1, 2007.

As the preceding section (E) discusses “borrowers who entered repayment before October 1, 2007,” sections (F) and (G) should be amended to say, “Periods beginning on or after October 1, 2007,” to be inclusive of all dates.

### **685.219 Public Service Loan Forgiveness Program.**

- (b)(1) currently states:

(b) Definitions. The following definitions apply to this section:

.....

Full-time (1) means working in qualifying employment in one or more jobs for the greater of--

- (i)(A) An annual average of at least 30 hours per week, or
- (B) For a contractual or employment period of at least 8 months, an average of 30 hours per week; or
- (ii) The number of hours the employer considers full-time.

Clause (ii) creates an unnecessary inequity by penalizing individuals whose employers consider full-time to be more than 30 hours per week. It also hurts someone who works at several qualifying jobs that individually are less than 30 hours or the number of hours their employer considers full-time, but combined are more than this amount. Deleting section (ii) would ensure that all borrowers are treated equitably with regard to how much they have to work to qualify for public service loan forgiveness.

(b)(2) currently states in part:

(2) .....

Government employee means an individual who is employed by a local, State, Federal, or Tribal government.

.....

This definition, while intended to be highly inclusive, could be interpreted to exclude entities that should rightly be considered governmental. In fact, we have already heard from borrowers who are confused about whether entities such as regional transit agencies or public universities qualify. Since Congress and the Department clearly intended to include such entities, we suggest adding the following clarification:

(2) Government employee means an individual who is employed by a local, State, Federal, or Tribal government, including an intergovernmental or public regional agency, or a public primary, secondary, or higher education institution, district or system.

- (e) currently states in part:

(e) Application. (1) After making the 120 monthly qualifying payments on the eligible loans for which loan forgiveness is requested, a borrower may request loan forgiveness on a form provided by the Secretary.

The Public Service Loan Forgiveness program is supposed to encourage people to serve their country and community in government and nonprofit jobs. However, under the proposed regulations, borrowers in public service occupations would be left in the dark for years about whether and when they will qualify for forgiveness.

Borrowers need to know if their time in a particular job will count towards the required 10 years of public service *before* they can make informed career and financial decisions, or know when it is appropriate to apply for loan forgiveness. The proposed rules would require borrowers to fully document 10 or more years of employment history *after the fact*, submit all that documentation to the Department, and simply hope for the best. This is an unreasonable burden on borrowers. We ask that you fix this problem by developing a system that lets borrowers confirm and track their eligibility for this form of loan forgiveness, so that they have a clear incentive to enter and continue in public service.

In the preamble to the proposed regulations, the Department gives three reasons for declining to address this issue in the regulations or in practice: it is “operational rather than regulatory”; it will be hard to administer because not everyone who asks for certification will ultimately meet the requirements for forgiveness; and documentation is the borrower’s responsibility. This logic is wrong. First, it is no more operational than the need for a form to apply for

forgiveness, which is not specified in statute but is directly addressed in the proposed regulations as cited above. Second, giving borrowers clear, periodic confirmation of how many more years of eligible work and payments are required before they qualify for forgiveness will provide an incentive to continue in public service and ultimately meet the forgiveness requirements, and reduce the number of unqualified borrowers applying for forgiveness. Third, while borrowers certainly have the primary responsibility for securing documentation of their eligibility, the Department is the only entity that can confirm eligibility and provide such documentation.

We suggest that language be added as indicated below:

(e) Application. (1) After making not fewer than 12 monthly payments, a borrower may request a confirmation of eligible payments and employment on a form provided by the Secretary.

(2) After making 120 monthly qualifying payments on the eligible loans for which loan forgiveness is requested, a borrower may request loan forgiveness on a form provided by the Secretary.

#### **685.221 Income-based repayment plan.**

- (a) currently states in part:

(a) Definitions. As used in this section—(1) Adjusted gross income (AGI) means the borrower’s adjusted gross income as reported to the Internal Revenue Service. For a married borrower filing jointly, AGI includes both the borrower’s and spouse’s income. For a married borrower filing separately, AGI includes only the borrower’s income.

(2) Eligible loan means any outstanding loan made to a borrower under the FFEL or Direct Loan programs except for a FFEL or Direct PLUS loan made to a parent borrower or a FFEL or Direct Consolidation Loan that repaid a FFEL or Direct PLUS Loan made to a parent borrower.

IBR was designed to limit student loan payments to an affordable level for borrowers: no more than 15 percent of borrowers’ discretionary income, as consistent with Congress’ intent in enacting the CCRAA. However, under current proposed rules, when two married individuals both have student loan debt and file taxes jointly, they could be expected to pay *up to double the monthly loan payment* of two unmarried borrowers in otherwise identical situations. That is, each borrower could be stuck with payments representing up to 30 percent of their discretionary income.

The double-counting penalty occurs because the rules in (a)(1) assume each spouse has access to the couple’s total discretionary income, without regard for the fact that the other spouse is also making loan payments from the same discretionary income.

It is neither appropriate nor equitable to suggest that this problem is solved if married borrowers file their taxes separately, as is allowed under Public Law 110-153. Filing separately makes married borrowers ineligible for a number of valuable tax benefits. The tax penalties that result from filing separately can eliminate or even exceed any benefits gained from IBR.

Several examples of the tax benefits that couples filing separately are forced to forgo, and the associated costs, are detailed in the attached memo from Pugh et al. Some examples include the Earned Income Tax Credit, which can be worth thousands of dollars each year to low-income families with children, the Child and Dependent Care Credit, and the Hope and Lifetime Learning Credits.

There is no compelling reason to require taxpayers to give up tax benefits that they would otherwise be entitled to solely because they are repaying their student loans under the IBR program. To address this inequity and to make the treatment of dual-borrower couples consistent with Congress' intent to limit IBR payments to no more than 15 percent of discretionary income, we recommend that both spouses' debt be considered in determining eligibility for and payments under IBR.

We recommend that the Secretary use her regulatory authority to make the following simple clarification:

(2) Eligible loan means any outstanding loan made to a borrower (or to the borrower's spouse, if applicable) under the FFEL or Direct Loan programs except for a FFEL or Direct PLUS loan made to a parent borrower or a FFEL or Direct Consolidation Loan that repaid a FFEL or Direct PLUS Loan made to a parent borrower.

No further special rule is needed, because section (b)(1)(i) of the regulations already provides for a method of allocating IBR payment amounts to multiple loans on a proportional basis.

- (b) currently states in part:

(b) Terms of the repayment plan.

(1) A borrower may select the income-based repayment plan only if the borrower has a partial financial hardship.

While this language works for most borrowers, one group will face a Catch-22: those who have partially paid down their principal and have less than 10 years remaining on their loans. For this group, loan payments are high enough relative to income that they should be eligible for IBR, but they are blocked from access to the lower IBR payments. While their payments are not affordable under IBR's definition of partial financial hardship, they are only eligible to enter IBR if a lower but hypothetical 10-year payment on their current balance is not affordable. We recommend the following change to prevent this coverage gap:

(b) Terms of the repayment plan.

(1) A borrower may select the income-based repayment plan only if the borrower has a partial financial hardship or is in a repayment plan with current monthly payments that exceed 15 percent of the amount by which the borrower's AGI exceeds 150 percent of the poverty line income applicable to the borrower's family size, divided by 12.

- (d)(2) reads as follows:

(2) If a borrower no longer wishes to pay under the income-based payment plan, the borrower must pay under the standard repayment plan and the Secretary recalculates the borrower's monthly payment based on—

- (i) A maximum ten-year repayment period for the amount of the borrower's loans that were outstanding at the time the borrower discontinued paying under the income-based repayment plan; or
- (ii) For a Direct Consolidation Loan, the applicable repayment period specified in Sec. 685.208(j) for the amount of the borrower's loan that was outstanding at the time the borrower discontinued paying under the income-based repayment plan.

There are two problems with this language. First, it does not make clear whether the time the borrower has spent in IBR is excluded from or included in the calculation of the “time remaining” in the applicable repayment period. For this purpose, the time in IBR should be treated like a deferral or forbearance: it should *not* count as part of the fixed-length repayment periods.

Second, the language implies that a post-IBR borrower would no longer have access to repayment plans for which he would otherwise be eligible (e.g. extended, graduated, etc.). Our understanding from the discussion at negotiated rulemaking was that denying access to repayment plans was *not* the intent of the language. A clause should be added to make that clear.

We recommend making the following additions to the current rules:

(2) If a borrower no longer wishes to pay under the income-based repayment plan, the borrower must pay under the FFEL standard repayment plan, or any other payment plan for which he or she would be otherwise eligible, and the loan holder recalculates the borrower's monthly payment based on—

...

(iii) For the purposes of determining the time remaining under (i) or (ii), the time the borrower spent in the Income Based Repayment Program shall not be included.

- (e)(1)(B) states as follows:

(B) If a borrower's AGI is not available, or the Secretary believes that the borrower's reported AGI does not reasonably reflect the borrower's current income, the Secretary may use other documentation provided by the borrower to verify income; and

(ii) Annually certify the borrower's family size. If the borrower fails to certify family size, the Secretary assumes a family size of one for that year.

As no section (i) appears before (ii), we ask the Department to please clarify whether section (i) was accidentally omitted, or whether (ii) should simply be renamed as "(i)."

Thank you for the opportunity to comment on this notice of proposed rulemaking. If you have questions regarding these comments, please do not hesitate to contact me by phone at (510) 559-9509, or via email at [rshireman@ticas.org](mailto:rshireman@ticas.org).

Sincerely,

Robert Shireman  
President

Attachment to the Project on Student Debt's  
comment on Docket ID ED-2008-OPE-0009

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July 7, 2008

Robert Shireman  
President  
The Institute For College Access & Success  
2054 University Ave, Suite 500  
Berkeley, CA 94704

Dear Mr. Shireman:

You have requested our assistance, as attorneys who practice federal income tax law, in preparing a position paper that addresses the federal income tax treatment of married individuals under the income based repayment program that was enacted as part of the College Cost Reduction and Access Act of 2007. As we have discussed, the attached position paper illustrates issues that arise under the statute for married couples who may be eligible for reduced loan payments under the Act.

Sincerely,

Cary D. Pugh  
Andrew Grossman  
Nick Caton

Attachment

## Married Borrowers and the Income-Based Repayment Program

### Executive Summary

On September 27, 2007, President Bush signed into law the College Cost Reduction and Access Act of 2007 ("CCRAA"),<sup>1</sup> which increased federal funding for education grants and amended federal student loan programs. In addition to the Federal Stafford Loan interest rate cut, two provisions in particular were aimed at reducing the burden of educational debt: (i) the "income-based repayment" program ("IBR"), which provides a mechanism whereby borrowers may make loan payments based on a limited percentage of their income (the "IBR payment cap"); and (ii) loan forgiveness for borrowers who spend at least ten years employed in a "public service job."

There are two public policy issues that arise with regard to married borrowers and IBR. First, there is a potential *marriage penalty*. A single borrower who would otherwise benefit from a reduced payment under IBR may lose part or all of the benefit of IBR if married as a result of the income earned by his or her spouse. This may or may not be an appropriate result from a policy standpoint, inasmuch as it creates a financial disincentive to marriage. This paper, however, does not address this penalty.

In addition, a significant *double-counting penalty* arises when both spouses have student loan debt. If each spouse's IBR payment is calculated using the couple's joint income, the couple's aggregate IBR payment could be up to 30% of their "discretionary income." This result is inconsistent with Congress' intent in enacting the CCRAA, which was to limit borrower's loan payments to 15% of their discretionary income. For the purposes of IBR, discretionary income is any income in excess of 150% of the federal poverty level for the borrower's family size

Three months after passing the CCRAA, Congress passed a "technical correction" that provides that a couple's joint income will not be considered in calculating a married borrower's IBR payment cap *if* the borrower and his or her spouse file their taxes separately. While there is little legislative history that would indicate Congress's intent, this amendment may have been primarily intended to address the marriage penalty described above. Although the technical correction does provide a route for couples to avoid the double-counting penalty as well, as discussed more fully below, married borrowers become ineligible for a number of valuable tax benefits if they file their taxes separately. The resulting tax costs can eliminate or even exceed the IBR benefits gained by filing separately. Accordingly, the technical correction does not adequately address the double-counting penalty.

Organizations that supported the CCRAA and IBR expected that the Secretary of Education, in implementing the CCRAA, would exercise her authority<sup>2</sup> to establish the appropriate special rule

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<sup>1</sup> Pub. L. No. 110-84.

<sup>2</sup> The Secretary has broad authority to regulate: she "is authorized to make, promulgate, issue, rescind, and amend rules and regulations ... governing the applicable programs administered by[ ] the Department." 20 U.S.C. § 1221e-3. Specifically, the Secretary has the authority to "prescribe such regulations as may be necessary to carry out the purposes of [the Federal Family Education Loan Program, 20 U.S.C. §§ 1071, et. seq]." 20 U.S.C. § 1082.

for situations in which both spouses have student loans.<sup>3</sup> The proposed rules published in the *Federal Register* on July 1, 2008, contain no special rule and thus married borrowers will be subject to the double-counting penalty unless those regulations are amended. This paper discusses the double-counting penalty in detail and proposes various solutions to accommodate borrowers who wish to take advantage of the IBR program while filing a joint return.

## Background

IBR is designed to limit a borrower's student loan payments to an affordable level given his or her income. Under IBR, monthly payments are determined using a formula based on the borrower's federal Adjusted Gross Income ("AGI"), and interest generally accrues but does not compound until the borrower's income levels rises. If the borrower still has loan debt after 25 years of payments, the remaining principal and interest is forgiven.

### *Payment Cap*

Under IBR, the borrower's monthly payment is capped at 15% of "discretionary income", which is defined as the amount by which the borrower's AGI exceeds 150% of the poverty level for the borrower's family size, divided by twelve. Any amount that would otherwise be due in excess of the cap is deferred. In the event the borrower's AGI rises to the point that the borrower can afford a standard ten-year payment (as calculated when entering IBR), any deferred interest is added to the principal of the loan. Below is how borrowers' IBR monthly payment cap will be calculated under current rules:

$$\text{Monthly Payment Cap} = 15\% * \left( \frac{\text{Adjusted Gross Income} - 150\% \text{ of Poverty Level for Family Size}}{12} \right)$$

For example, consider a single borrower with \$75,000 in debt at the current unsubsidized Stafford interest rate of 6.8% and \$25,000 in debt at the current Grad PLUS rate of 8.5%. Assume that the borrower has an AGI of \$50,000 and that the federal poverty level for a single person is \$10,400.<sup>4</sup> On a standard ten-year payment schedule, the borrower's monthly payment would be \$1,172.71 initially, \$602.08 of which would be interest. Under IBR, the same borrower's monthly payments would be approximately \$430.00. If the borrower's income rises such that the payment provided for under IBR would be \$1,172.71 the borrower makes that standard payment and the amount of interest previously deferred is added to the principal of the loan. In this example, assuming 2008 poverty levels, this would happen if the borrower's AGI were \$109,417 or more.

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<sup>3</sup> For example, in the existing Income-Contingent Repayment program, spousal debts are considered jointly against the joint income.

<sup>4</sup> The 2008 poverty level for the 48 contiguous states, DC, and citizens living abroad is \$10,400. Alaska and Hawaii's poverty levels are somewhat higher (\$13,000 and \$11,960, respectively).

## *Treatment of Married Borrowers Under IBR*

The CCRAA bases the calculation of a borrower's discretionary income on his or her AGI for federal income tax purposes.<sup>5</sup> A married borrower, however, generally does not have an individual AGI: if the couple files their tax return jointly, he or she will have a joint AGI with his or her spouse. The vast majority of married couples file their income taxes jointly. In 2005, for instance, the Internal Revenue Service received 52,505,729 returns from couples who filed their taxes jointly, and only 2,462,804 returns from married individuals who were filing separately from their spouse.<sup>6</sup> Thus, approximately only 1 in 50 married couples will file their returns separately. This is due to the many tax disadvantages faced by couples who file separately, which are described in more detail below.

Under the proposed IBR rules, most married borrowers' *total combined* AGI will be used to determine *each* spouse's individual discretionary income. This calculation results in a form of double-counting in which married borrowers' combined IBR payments could significantly exceed 15% of their combined discretionary income (up to a ceiling of 30%). In effect, *a household with two married borrowers could be expected to pay up to double the monthly loan payments of a household with two unmarried borrowers in otherwise identical situations.*

It is important to understand why this state of affairs is objectionable as a matter of policy. The IBR program was built on the tenet that borrowers would not have to pay more than 15% of their discretionary income in student loan payments.<sup>7</sup> If only one married borrower is making his or her payments under the IBR program, the borrower's spouse's income is included in the calculation of discretionary income. Reasonable people can disagree as to whether or not this is an appropriate result.<sup>8</sup> However, when *both* spouses are making payments under IBR, both spouses' incomes are used for the purposes of computing discretionary income - *twice*. In other words, each spouse's payment cap is determined based on the couple's collective discretionary income without regard to the fact that the other spouse is also making loan payments from the same discretionary income. This double-counting can result in the spouses' making total payments that far exceed 15% of their discretionary income, a significant deviation from congressional intent.

For example, consider again the hypothetical single borrower described above, but assume that this borrower has a spouse with an identical income and student loan debt. The borrower's IBR payment would now be calculated as if the borrower earned \$100,000 per year. This would result in a monthly payment of approximately \$987 in the first year of repayment, more than twice the

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<sup>5</sup> Sec. 493C(a)(3)(B)(i) of the Higher Education Act references "the borrower's, and the borrower's spouse's (If applicable), adjusted gross income" when referring to the AGI amounts used to compute the minimum loan payments to be made under IBR.

<sup>6</sup> See SOI Tax Stats- Individual Statistical Tables By Filing Status, Table 1.2, available at <http://www.irs.gov/taxstats/indtaxstats/article/0,,id=96978,00.html>.

<sup>7</sup> H.R. Rep. 110-210.

<sup>8</sup> Although it should be noted that, in light of the technical correction passed in December of 2007, discussed below, it seems apparent that Congress does not have an objection to including only one spouse's income in the calculation of that spouse's discretionary income.

amount due when the borrower was unmarried. Importantly, the spouse will also have to make monthly payments of \$987, bringing the couple's total monthly payments to \$1,974. Had the spouses remained unmarried, their monthly payments would have totaled \$860.

This result is clearly contrary to congressional intent. In this example, the married borrowers would be making a total of \$23,688 in annual payments on their student loans, which amounts to 23.6% of their AGI and 30% of their discretionary income. In comparison, a single borrower with the same profile as the spouses' combined profile (i.e., with loans totaling \$200,000 and AGI totaling \$100,000), would initially make monthly payments of approximately \$1,055. This amounts to 12.6% of the borrower's AGI and 15% of the borrower's discretionary income. Thus, by any measure, the otherwise identically situated married borrowers pay significantly more per month. There is no indication Congress intended this incongruous result.

### *Technical Correction*

Congress did pass a "technical correction" allowing the discretionary income calculation to be made using only the borrower's AGI *if* the borrower and his or her spouse file their income taxes separately.<sup>9</sup> However, as explained below, we have determined that this solution is inadequate and problematic. Married couples who file their tax returns separately are forced to forgo a number of valuable tax benefits that would have been available had they filed jointly. Married couples should not be forced to give up these benefits to retain the benefits of IBR. In addition, under current law, married couples will be forced to perform a complex comparison of the costs and benefits of filing separately as opposed to filing jointly, and to do so with any degree of accuracy requires considerable expertise in both federal and state tax policy (as well as the ability to predict future earnings, as we will discuss later).

## **Disadvantages to Filing Separately**

For spouses with identical or roughly identical incomes, the current tax rate structure<sup>10</sup> places couples who file jointly and couples who file separately on equal footing. However, in the case of a married couple where one spouse earns significantly more than the other, filing separately presents a disadvantage.

For example, if a couple with taxable income of \$150,000 per year files jointly, assuming they had no tax credits, they would have tax liability of \$30,993. If each spouse had taxable income of \$75,000 per year and they filed separately, their overall tax would be identical. However, if one spouse had taxable income of \$125,000, while the other spouse had taxable income of \$25,000, their overall tax liability would be \$34,209. This 9% difference is caused by the allocation of income that occurs when couples file jointly: when filing jointly, the couples' highest marginal rate is 28%; when filing separately, the higher earning spouse's highest marginal tax rate is 33%. As the couple's incomes grow farther apart, this effect only grows worse.

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<sup>9</sup> Pub. L. No. 110-153.

<sup>10</sup> See Appendix for current tax rate structure for married couples filing jointly and separately.

In addition to being subject to higher rates, married couples that file separately are also denied access to a variety of important tax credits and deductions that are available to married couples that file jointly. These tax benefits can be worth thousands of dollars.

Therefore, a married couple who files their taxes separately can be disadvantaged relative to similarly situated couples who file joint returns. A representative sample<sup>11</sup> of such disadvantages, each of which could affect a borrower who is making loan repayments under IBR, is provided below.

#### *Child and Dependent Care Credits and Exclusions*

The Internal Revenue Code ("the Code")<sup>12</sup> grants taxpayers a non-refundable credit for amounts spent to care for a child or other dependent, provided that the "expenses are incurred to enable the taxpayer to be gainfully employed."<sup>13</sup> The amount of the credit ranges (depending on the income of the taxpayer) from 35% to 20% of the amount spent on dependent care, with a maximum of \$3,000 per year in the event the taxpayer is supporting one "qualifying individual", or \$6,000 if the taxpayer is supporting two or more "qualifying individuals".<sup>14</sup> This credit is *not available* to married taxpayers who file separate returns.<sup>15</sup>

In addition, taxpayers may exclude from income amounts paid by the taxpayer's employer for dependent care assistance provided to the taxpayer.<sup>16</sup> A taxpayer may exclude up to \$5,000 paid by an employer for dependent care assistance unless the taxpayer is married filing a separate return, in which case the taxpayer may only exclude \$2,500 from gross income.<sup>17</sup> This provision puts couples who file separately at a disadvantage. If a couple files separately and one spouse's employer provides \$4,000 in dependent care assistance, the spouse may exclude only \$2,500 from his or her AGI.<sup>18</sup> As a result, the spouse must include the remaining \$1,500 in gross income. Had the couple filed jointly, the entire \$4,000 would be excludable.

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<sup>11</sup> Several major tax advantages that are only available to married taxpayers when they file jointly are listed in this document as examples, but this is far from a comprehensive list.

<sup>12</sup> Unless otherwise indicated, all section references refer to the Internal Revenue Code of 1986, as amended.

<sup>13</sup> Section 21(b)(2)(A).

<sup>14</sup> A "qualifying individual" is defined under Section 21(b)(1)(A) as either a dependent of the taxpayer who has not attained the age of 13, or a dependent of the taxpayer who is physically or mentally incapable of caring for himself or herself and who has the same principal place of abode as the taxpayer for more than one-half of the taxable year.

<sup>15</sup> Section 21(e)(3).

<sup>16</sup> Section 129(a)(1).

<sup>17</sup> Section 129(a)(2)(A). Section 129 also applies to expenses paid out of a flexible spending account or a cafeteria plan. *See* Prop Regs. 1.125-5(j); 1.125-6(a)(4).

<sup>18</sup> When a married couple files their taxes separately, only one spouse may claim each dependent.

## *Adoption Expenses and Assistance Programs*

In general, taxpayers may claim a credit for certain adoption expenses.<sup>19</sup> Subject to income limitations, the credit may cover up to \$10,000 in adoption related expenses including adoption fees, court costs, attorney fees, and other expenses related to the adoption. This credit is denied to married individuals who file a separate return.<sup>20</sup> In addition, a taxpayer may exclude up to \$10,000 from gross income if an employer provides an adoption assistance program to the taxpayer as employee.<sup>21</sup> This exclusion, however, is *not available* to married taxpayers who file separate returns.<sup>22</sup>

## *Education Provisions*

The Code provides two refundable credits that taxpayers may take with respect to tuition and related educational expenses. The Hope Credit is available only for the first two years of undergraduate education, and thus is not likely to be used by taxpayers who are repaying their student loans (except in the case of those borrowers who are still paying off their own student loans while their children attend college). However, the Lifetime Learning Credit, which, subject to income limitations, can be as large as \$2,000, can be claimed with respect to any qualified tuition expenses on post-secondary education. Thus, borrowers who are repaying their undergraduate loans on IBR, for instance, may qualify for the Lifetime Learning Credit if they are attending graduate school. Married taxpayers who file their returns separately are *ineligible* to claim the education credits.<sup>23</sup>

A taxpayer can opt not to take these education credits, and instead deduct qualified tuition and related expenses from AGI.<sup>24</sup> The maximum deduction allowed is \$4,000, subject to a phase out when an individual's AGI exceeds \$80,000 (\$160,000 in the case of a joint return). For married taxpayers, this deduction is *only available if a joint return is filed*.<sup>25</sup>

Furthermore, taxpayers may generally exclude from their gross income any amount redeemed from U.S. savings bonds that is used to pay for higher education expenses.<sup>26</sup> This exclusion, however, is *not available* to married taxpayers who file separate returns.<sup>27</sup>

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<sup>19</sup> Section 23(a).

<sup>20</sup> Section 23(f)(1).

<sup>21</sup> Section 137.

<sup>22</sup> Section 137(e).

<sup>23</sup> Section 25A(g)(6).

<sup>24</sup> Section 222(a). For an analysis of when a taxpayer might choose this option, see Deborah H. Schenk & Andrew L. Grossman, *The Failure of Education Tax Incentives*, at 9, available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1006593#PaperDownload](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1006593#PaperDownload).

<sup>25</sup> Section 222(d)(4).

<sup>26</sup> Section 135(a).

<sup>27</sup> Section 135(d)(3).

Finally, taxpayers are entitled to a deduction for interest they have paid on qualified student loans.<sup>28</sup> The maximum deduction is \$2,500. This deduction is phased out as a taxpayer's "modified adjusted gross income" increases above \$50,000, or \$100,000 for joint filers.<sup>29</sup> For a married taxpayer to qualify for this deduction, the individual *must file a joint return* with his or her spouse.<sup>30</sup>

### *The Earned Income Tax Credit*

The Earned Income Tax Credit (EITC) is a refundable credit available to taxpayers who earn income below a certain level.<sup>31</sup> It was designed to offset the regressive effect of payroll taxes on low-income working families. The amount of the EITC varies based on the number of dependents the taxpayer has and the taxpayer's income. The maximum EITC for a household with at least two qualifying children was \$4,716 in 2007. A married taxpayer is *only eligible for the EITC if he or she files a joint return*.<sup>32</sup>

### *The Alternative Minimum Tax*

The Code imposes an alternative minimum tax ("AMT") that is based on a measure of taxable income that disallows many exemptions and deductions.<sup>33</sup> For all individual taxpayers other than married taxpayers who file separately, the AMT imposes a tax on taxpayers' "alternative minimum taxable income" of 26% on all income up to \$175,000 above a specified exemption amount, and 28% on all income above that level. For married individuals filing separately, \$87,500 is substituted for \$175,000, and the exemption amount is also halved. As a result, couples with income that is not evenly split are more likely to be subject to the AMT, and higher taxes, if they file their taxes separately.

## **Examples of the Tax Effect of Married Couples Filing Separately**

This section provides three examples of hypothetical married taxpayers, filing their income taxes in 2007. Each example addresses one or more of the disadvantages listed above, and is designed to demonstrate the magnitude of the difference in tax liability married taxpayers could face should they file separately rather than jointly.<sup>34</sup> Married couples filing separately could also face additional state tax liabilities not analyzed here.

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<sup>28</sup> Section 221(a)

<sup>29</sup> Section 221(b)(2). For the definition of modified adjusted gross income, see Section 221(b)(2)(C).

<sup>30</sup> Section 221(e)(2).

<sup>31</sup> Section 32.

<sup>32</sup> Section 32(d).

<sup>33</sup> Section 55.

<sup>34</sup> These examples contain a number of simplifying assumptions and should not be relied upon as a reflection of any particular taxpayer's tax liability.

### Example 1

Arturo and Beatriz are married taxpayers with equal income. They have one child, Carlos, age four. Both spouses earn \$50,000. Beatriz is attending graduate school at night, paying tuition of \$10,000. The couple also spends \$5,000 a year on qualified day care.

When filing a joint return, the couple will take a standard deduction of \$10,700, and will take three exemptions totaling \$10,200. This yields taxable income of \$79,100. Tax on this amount is \$12,629. The couple will receive a \$600 credit for child care expenses, a \$1,400 credit for education expenses, and a child tax credit of \$1,000. This reduces the couple's overall tax liability to \$9,629.

When filing separately, however, the couple will owe more. The spouse who claims the child as the dependent has a standard deduction of \$5,350 and exemptions totaling \$6,800, yielding taxable income of \$37,850. The tax on this amount is \$5,893. This spouse can take a child tax credit of \$1,000. Thus, this taxpayer's net tax liability is \$4,893. The spouse who does not claim the child as the dependent has a standard deduction of \$5,350 and a personal exemption of \$3,400, yielding taxable income of \$41,250. The tax on this amount is \$6,743. Thus, the couple will pay a total of \$11,636 in federal income taxes, an added tax of \$2,007, or *21% more than if they had filed jointly*. This difference is due primarily to the fact that the couple could not take a credit for either the amounts they spend on day care or the amount spent on tuition.

### Example 2

Adam and Barbara have two children, Cameron and Danielle, ages 11 and 9. Each spouse earns \$15,000.

If the couple files a joint return, after taking into account the standard deduction (\$10,700) and personal exemptions (\$13,600), the couple has taxable income of \$5,700. This taxable income level yields a tax of \$573. This amount is offset by a child tax credit of \$573. The couple will receive a refundable earned income credit of \$2,055 as well as an additional child tax credit of \$1,427, bringing their refund total to \$3,482.

However, if the couple filed their return separately, they would be liable for tax rather than receiving a refund. The spouse that claims the children as his or her dependents will have a standard deduction of \$5,350 and exemptions worth \$10,200, yielding taxable income of \$0. This taxpayer is eligible for a refundable child tax credit of \$488. The spouse that does not claim the children as dependents will have a standard deduction of \$5,350 and exemptions of \$3,400, yielding taxable income of \$6,250. The tax on this amount is \$628. Thus, the couple will have a net tax liability of \$140. Thus, the couple loses more than *10% of their combined annual income (\$3,622) by virtue of filing separately*. This is due primarily to the fact that the couple is not eligible for the Earned Income Tax Credit when they file their return separately.

### Example 3

Anne and Bobby are married residents of the District of Columbia.<sup>35</sup> Anne earns \$130,000, and Bobby earns \$30,000. They elect to itemize deductions rather than take the standard deduction. For the year 2007, they have made a total of \$25,000 in deductible interest payments on their home mortgage. Their local property taxes on their home total \$4,250. They have made total donations of \$2,500 to various charities. They also would have a federal tax deduction for \$9,707 in taxes they would owe to the District of Columbia. If the spouses were to file jointly, after taking into account the home mortgage interest payments, the state income and property tax payments, and the charitable contributions, the couple's itemized deductions amount to \$41,385. Their exemption amount is \$10,200, yielding taxable income of \$108,951. Federal income tax on this amount is \$19,951.

However, if the couple were to file separately, their total tax liability would be greater. Anne will claim the dependent and all of the deductions (her state income tax deduction will amount to \$7,328). Thus, she has itemized deductions of \$37,952 and exemptions of \$5,803. This yields taxable income of \$86,245. For a married taxpayer filing separately, this results in tax of \$18,639. However, Anne is subject to the AMT, which will bring Anne's total tax liability to \$19,825. Bobby must also itemize his deductions,<sup>36</sup> and therefore only deducts state taxes of \$1,602. Accounting for that and an exemption amount of \$3,355, Bobby's taxable income will be \$24,998. The tax on this amount is \$3,355. Thus, the couple's total tax liability is \$23,180. As a result of filing separately, the couple's tax liability increased by \$3,229, or *16% more than their tax liability* had they filed jointly. This is due to both the penalty that married taxpayers with differing incomes face with respect to the tax rates, and the fact that Anne will be subject to the AMT only if the couple files separately.

### **Comparing the Benefits of IBR Versus Filing Separately: A False Comparison**

The examples above that address the costs of filing separately as compared to filing jointly do not account for the benefit separate filers will receive in the form of lower IBR payments. *However, there is no compelling reason to require taxpayers to give up tax benefits that they would otherwise be entitled to solely because they are repaying their student loans under the IBR program.* Congress presumably enacted the tax benefits listed above either to encourage certain behaviors or to provide relief for taxpayers whose ability to pay tax was reduced in certain circumstances. It is difficult to see why an unrelated governmental benefit should in any way impact that incentive structure or Congress' judgment that taxpayers in those particular situations are less able to pay tax.

Just as important, however, if not more important, is the fact that although the benefits of IBR appear to be high, for many borrowers the benefits of making student loan repayments under IBR will not be nearly as beneficial as the reduced monthly payments alone might imply. When a borrower makes payments under IBR, the amounts that the borrower does not pay do not simply

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<sup>35</sup> For purposes of this example, D.C. income taxes are included only because they are relevant to the calculation of taxes owed under the AMT.

<sup>36</sup> If a married couple files separate returns, and if one spouse itemizes his or her deductions, then the other spouse must do the same.

disappear. Rather, those amounts, including interest, are deferred, extending the loan period (but not longer than 25 years, or 10 years in the case of Public Service Loan Forgiveness).<sup>37</sup>

Thus, for the majority of borrowers, reduced payments in IBR are better viewed as a loan rather than a grant. The program is designed to allow borrowers with relatively low incomes to make affordable student loan payments, but still requires borrowers to make all of the loan payments if and when they are able to do so. Therefore, the hypothetical taxpayer described in the background section of this paper does not truly “save” \$743 a month through participation in the IBR program, as any amount “saved” would be paid later by borrowers who are not low income long enough to have amounts forgiven.<sup>38</sup>

Thus, the IBR rules, as currently written, will leave many borrowers with a very difficult decision. Under the current rules, a married borrower may want to file his taxes separately so as to take advantage of the reduced loan payments under IBR, despite the fact that he may eventually end up fully repaying the loan with interest. Borrowers have no way of knowing if their future income will actually rise to a high enough level such that they will ultimately repay all of the forgone loan payments and interest. Thus, in determining whether to file separately or jointly, a married borrower must weigh the value of the immediate tax benefits that come with filing jointly against IBR benefits that, depending on future events, could have a net present value far less than the tax benefits that come with filing jointly.

## Potential Solutions

Married borrowers should be able to realize the full benefits of the IBR program without having to file their tax returns separately from their spouse and losing valuable tax benefits. This is not achieved easily, however, as the IBR payment cap is based on the borrower's AGI. A married taxpayer who files jointly does not have his or her own AGI. Rather, AGI is derived after combining the spouses' incomes and then adjusting this figure for various "above the line" deductions. Thus, a statutory fix that merely references the married borrower's "own" AGI is not an option: such a concept does not exist in the federal tax laws.

One seemingly attractive, but impractical, fix to this problem would be to determine the borrower's IBR cap by reference to the borrower's AGI as if the borrower had filed a federal income tax return separately from his or her spouse. The primary benefit offered by this solution is that it

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<sup>37</sup> For subsidized Stafford loans, the government covers any unpaid interest in IBR for the first three years. After that and for other types of loans, interest accrues. The accruing interest does not compound (interest charged on interest) until or unless the borrower no longer qualifies for reduced payments. In some circumstances, the deferred amounts of principal and/or interest will be forgiven. Forgiveness of any remaining balance will occur for borrowers who make qualifying payments on federal direct loans while working in a public service job for 120 months, or borrowers who make loan payments under the IBR program in either the direct or FFEL programs for 25 years.

<sup>38</sup> This is not to suggest that there is no element of a subsidy in the IBR program, even for those borrowers who do not receive loan forgiveness. The ability to extend a fixed-rate low-interest loan is a valuable benefit not available without government backing. The lack of compounding interest while interest is accruing adds to the value of that benefit.

would allow a borrower to account only for his or her income in computing the payment cap for IBR, without the borrower's having to forgo the tax advantages of filing jointly with his or her spouse. However, this solution would require the borrower to compute a separate hypothetical tax return, which could be extraordinarily complex. Furthermore, such a solution could create verification problems. Presumably, the Department of Education will require borrowers who are repaying their student loans under IBR to verify their AGI in some manner. Would a borrower who computes his payment cap using this hypothetical figure have to submit a hypothetical return to the Department of Education? Would such a return be subject to penalties of perjury? These are only a few of the issues that might arise under such a regime.

We believe there are two potential solutions to this problem that are administrable. The first solution fixes only the narrow problem with respect to married borrowers who are both making repayments under IBR. Recall that in such a circumstance, counting both spouses' income twice for the purposes of IBR repayments could lead to a circumstance in which the spouses are making loan payments well above 15% of their discretionary income. This problem can be fixed by *combining both spouses' debt in addition to both spouses' income* and calculating a total IBR payment cap for the couple. Then a proportion of the total payment can be assigned to each spouse based on their share of the couple's total student loan debt. This would ensure the spouses' payments together do not exceed 15% of their discretionary income. For each spouse, the monthly standard payment (MSP) would be determined using the following formula:

$$\text{MSP (Individual Spouse)} = \text{MSP (Couple)} * \left( \frac{\text{Spouse's Outstanding Loan Amount}}{\text{Total Outstanding Loan Amount}} \right)$$

Using this formula, if one spouse had a loan of \$30,000, and the other had a loan of \$60,000, although their combined AGI would be used in calculating each spouse's discretionary income, the former spouse's loan repayments would be limited to 5% of their discretionary income, while the latter spouse's would be limited to 10% of that amount.

The proposed rules published on July 1, 2008, include a similar proportionality concept in determining how an individual borrower's payment cap is to be distributed amongst loans held by multiple lenders.<sup>39</sup> The formula above effectively extends this concept to consider a spouse's loans, and preserves the congressional intent that no couple should devote more than 15% of their discretionary income to repaying their student loans.

An alternative solution is to amend the statute so that married borrowers compute their individual IBR cap using half of the couple's AGI. This solution would come closer to the solution arrived at in the technical correction passed in December of 2007, and would be relatively simple to administer. Under current law, borrowers who live in community property states<sup>40</sup> are already required to report half of their community income on their tax return when filing separately. This solution would treat all married borrowers in a similar way for the purposes of IBR, dividing their total income equally to determine the loan payment that each spouse can afford. Thus, for each spouse, the monthly standard payment would be determined using the formula below:

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<sup>39</sup> See Fed. Reg. 37,699 (July 1, 2008).

<sup>40</sup> These states are Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington and Wisconsin. See I.R.S. Pub. 555.

$$\text{MSP (Individual Spouse)} = 15\% * \left( \frac{\text{Half of Combined AGI} - 150\% \text{ of Poverty Level for Family Size}}{12} \right)$$

## Conclusion

The double-counting penalty, which causes married borrowers' aggregate IBR payment cap to be up to 30% of their discretionary income, is inconsistent with Congress' intent to limit borrowers' loan payments to 15% of their discretionary income. Accordingly, we believe the Secretary should amend the draft regulations issued on July 1, 2008, to conform with Congressional intent by eliminating the double-counting penalty. This could be achieved, for example, by considering both spouses' debt in addition to their combined income and calculating a total IBR payment cap for the couple. Each spouse would then pay a portion of this combined payment based on his or her proportion of the couple's total student loan debt. Alternatively, the double-counting penalty could be eliminated by determining each spouse's discretionary income using one half of the couple's AGI. Crucially, both of these solutions would limit borrowers' IBR payment cap to 15% of their discretionary income as Congress intended in enacting the CCRAA.

## Appendix

### Tax Rates

The current rates of federal income tax for married taxpayers filing a joint return are as follows:

<i>If the taxable income is:</i>	<i>The tax is:</i>
Not over \$15,650	10% of taxable income
Over \$15,650 but not over \$63,700	\$1,510, plus 15% of the excess over \$15,650
Over \$63,700 but not over \$128,500	\$8,772.50, plus 25% of the excess over \$63,700
Over \$128,500 but not over \$195,850	\$24,972.50, plus 28% of the excess over \$128,500
Over \$195,850 but not over \$349,700	\$43,830.50 plus 33% of the excess over \$195,850
\$349,700	\$94,601 plus 35% of the excess over \$349,700

For married taxpayers who file separately, however, the federal income tax rates are as follows:

<i>If the taxable income is:</i>	<i>The tax is:</i>
Not over \$7,825	10% of the taxable income
Over \$7,825 but not over \$31,850	\$782.50, plus 15% of the excess over \$7,825
Over \$31,850 but not over \$64,250	\$4,386.25, plus 25% of the excess over \$31,850
Over \$64,250 but not over \$97,925	\$12,486.25, plus 28% of the excess over \$64,250
Over \$97,925 but not over \$174,850	\$21,915.25, plus 33% of the excess over \$97,925
Over \$174,850	\$47,300.50, plus 35% of the excess over \$174,850