

MEMORANDUM

DATE: October 28, 2022
TO: All clients
FROM: Wendy J. Manson, CPA, and William J. Palazzolo, Esq.
RE: Student loan forgiveness

The Biden Administration recently announced that it plans to cancel up to \$20,000 in federal student loan debt, which is likely to affect many of the nearly 43 million Americans who borrowed to attend college.

Also, under the plan, the pause on student loan payments that was instituted in 2020 as a response to the COVID-19 pandemic was extended again, through December 31, 2022.

Eligible borrowers

Current students and borrowers who have federally held undergraduate, graduate, and Parent PLUS loans that were distributed on or before June 30, 2022, are eligible for the relief.

Single borrowers earning less than \$125,000 per year, or households earning less than \$250,000, are eligible for loan forgiveness. Students who are dependents for tax purposes need to use their parent's income to determine if they are eligible for the forgiveness. Borrowers who fall under the income caps and received Pell Grants in college will receive up to \$20,000 in forgiveness. Otherwise, the borrower is entitled to forgiveness up to \$10,000.

The plan recently was changed to no longer include borrowers who have Perkins loans or Federal Family Education Loans held commercially rather than by the Education Department. Borrowers with these loans must have applied to consolidate the loans into a federal direct loan before September 29, 2022, to be eligible for forgiveness. The plan originally gave these borrowers until December 31, 2023, to consolidate and apply for the forgiveness.

Applications for relief

Applications to apply are available at the website www.StudentAid.gov. Borrowers are asked to complete a few basic personal identification questions, including Social Security number, and to review the eligibility requirements before signing and certifying the application. Borrowers do not have to attach any proof of documentation that they qualify, but they do sign the form acknowledging they will provide proof of income if asked.

Once borrowers submit their application, the Education Department is trying to grant relief within four to six weeks.

The Education Department advises borrowers to apply before November 15, 2022, to receive relief before the payment pause expires at the end of December. However, that timeline could be impacted by current litigation that seeks to block the plan from going through. Borrowers will have the choice to use either their 2021 or 2020 tax return information when applying for loan forgiveness. Even if borrowers have a single income above \$125,000 or a household income above \$250,000 at the time of the announcement, they can still qualify if their income in 2021 or 2020 was under the threshold.

For current students, the Education Department will have income data for any borrowers who completed the FAFSA in 2021-2022. For borrowers who were a dependent during the 2021-2022 school year, the Department of Education will use the income information from their parents to calculate loan cancellation eligibility.

Relief amount

Relief is capped at the amount of your outstanding debt. For example, a student who made payments to bring their balance down to \$15,000 but is entitled to \$20,000 in forgiveness would only receive \$15,000 in relief. The Education Department hasn't indicated that it will reimburse borrowers for payments made during the pandemic pause.

However, borrowers can contact their loan servicer to request a refund for any payments they made since the pause began on March 13, 2020. But borrowers should be aware that accepting a refund would result in that money being added back to the loan balance.

Taxability of relief

While debt forgiveness is ordinarily taxable income, it will not be counted toward federal taxable income as part of the Biden Administration's plan. The American Rescue Plan Act of 2021 allows canceled student loan debt to be federally tax-free through 2025. However, in some states, borrowers could potentially have to pay state income tax on the amount of forgiveness they receive.

While most states align their state income tax codes with the federal income tax code for simplicity, some states make changes or have entirely separate tax codes. At least seven states have statutes that could result in borrowers having to pay state income tax on their debt relief, barring any legislative change. Those states are Arkansas, California, Indiana, Minnesota, Mississippi, North Carolina, and Wisconsin. Additional states might follow suit and elect to tax this debt forgiveness as well in the future.

No relief for private student loans

The Biden Administration's debt relief plan does not apply to borrowers with private student loans. Borrowers who consolidated federal loans with a private company are also ineligible because their loans are no longer held by the federal government.

Legal challenges

On October 21, 2022, a federal appeals court issued an administrative stay that will temporarily block the Biden Administration's loan forgiveness plan. The Eighth Circuit Court of Appeals is considering the motion, leaving in limbo the nearly 22 million borrowers who have already applied for the forgiveness plan.

The motion now puts into question whether the loan forgiveness plan can be implemented before January 1, 2023, when student loan payments are set to resume after the pandemic-induced pause. Biden has said the latest payment pause would be the final one.