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Tax Consequences of Loan Discharges for Borrowers in Income-Driven Repayment Plans

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Income-driven repayment (IDR) plans help millions of federal student loan borrowers manage their debt and avoid default by providing the assurance of manageable monthly payments tied to their income and family size, as well as a light at the end of the tunnel so that student loan payments do not last the rest of their lives. These plans provide relief when borrowers' incomes are low or drop, and increase their payments when incomes rise.

Many borrowers in IDR will repay their loans in full, and many will *pay more* interest in IDR than under a 10-year standard repayment plan because they will make lower monthly payments over a longer period of time. However, **those who do receive a discharge of remaining debt after 20 or 25 years of responsible payments may face an unaffordable tax liability**, because these discharged amounts are treated as taxable income under current law.

Regardless of the reason, discharged or forgiven student loan debt should never be treated as taxable income. Debt forgiven under IDR is not a windfall of income, and borrowers should not be hit with a large tax bill after making responsible payments for so many years, particularly since the borrowers who end up receiving student loan forgiveness will be those with low incomes relative to their debt for a long period of time. It serves no policy goal for the government-as-lender to forgive debt so that a borrower may move on only to have the government-as-tax-collector immediately demand further payment.

Concern about this tax liability, which could run into the many thousands of dollars, discourages some borrowers from enrolling in IDR—including struggling borrowers who may be at risk of delinquency or default. Eliminating the taxation of debt forgiven under IDR would also correct the inequity reflected in current law, which exempts from taxation debt forgiven due to school closures or for pursuing public service careers, while taxing the same loan forgiveness when it occurs for someone who has become totally and permanently disabled or who has made 20 or 25 years of income-driven payments.

The table below and Examples 1 and 2 on the next page illustrate the many borrowers who will repay their loans in full in IDR. Examples 3, 4, and 5 show the significant potential tax consequences for certain borrowers who have debt discharged under IDR. All of the examples compare the most recent income-driven plans to fixed-payment 10-year and 25-year repayment plans. For more details about the IDR plans and the borrower scenarios and assumptions for Examples 1-5, see page 5.

Borrowers in income-driven repayment plans will repay *in full* (including all interest) if they:[1]

Borrowed in federal student loans:	And earn at least:		
	Original IBR (15%, 25 years)	2014 IBR, PAYE (10%, 20 years)	REPAYE (10%, 20 or 25 years)
$30,000[2]	$26,800	$36,250	$35,850
$100,000	$53,200	$83,200	$70,900

[1] Incomes are adjusted gross incomes (AGI) in current dollars, rounded up to the nearest $50. Calculations assume a single borrower without dependents, and that AGI increases 4% a year. The $30,000 debt is assumed to be from undergraduate study only, while the $100,000 debt includes loans from graduate school.

[2] The average debt of 2015 BA recipients who borrowed to attend public and private nonprofit colleges was $30,100. For more information, see TICAS. 2016. *Student Debt and the Class of 2015.* http://ticas.org/sites/default/files/pub_files/classof2015.pdf.

Example 1: Middle-income family (married with one child)

This family ***repays in full*** under all IDR plans and ***pays more in total*** than under a 10-year standard plan, but their monthly payments are more manageable under IDR.

- $50,000 in combined federal undergraduate student loans
- $60,000 a year in combined income
- Has a child in year 8

	10-Year Plan	25-Year Plan	Original IBR (15%, 25 Years)	2014 IBR, PAYE (10%, 20 Years)	REPAYE (10%, 20 or 25 years)[3]
Monthly payments	$580	$350	$450 initially, rising to $580[4]	$300 initially, rising to $580	$300 initially, rising to $620
Total payments	$69,050	$104,100	$73,250	$94,800	$94,750
Amount discharged	n/a	n/a	$0	$0	$0

- After 11 years and 6 months in Original IBR:
  - They repay the entire loan principal ***plus $23,250*** in interest (no forgiveness)
- After 18 years and 8 months in PAYE or 2014 IBR:
  - They repay the entire loan principal ***plus $44,800*** in interest (no forgiveness)
- After 18 years and 7 months in REPAYE:
  - They repay the entire loan principal ***plus $44,750*** in interest (no forgiveness)
- In all of the IDR plans, they ***pay more in total*** than under 10-year standard repayment

Example 2: Lawyers (married with one child)

This family also ***repays in full*** under all IDR plans and ***pays more in total*** than under a 10-year standard plan, but their monthly payments are more manageable under IDR.

- $238,000 in combined federal loans, including debt from graduate school[5]
- $200,000 a year in combined income
- Has a child in year 4

	10-Year Plan	25-Year Plan	Original IBR (15%, 25 Years)	2014 IBR, PAYE (10%, 20 Years)	REPAYE (10%, 20 or 25 years)
Monthly payments	$2,740	$1,650	$2,200 initially, rising to $2,740	$1,460 initially, rising to $2,740	$1.460 initially, rising to $2,870
Total payments	$328,650	$495,550	$347,650	$441,950	$441,900
Amount discharged	n/a	n/a	$0	$0	$0

- After 11 years and 4 months in Original IBR:
  - They repay the entire loan principal ***plus $109,650*** in interest (no forgiveness)
- After 17 years and 11 months in PAYE or 2014 IBR:
  - They repay the entire loan principal ***plus $203,950*** in interest (no forgiveness)
- After 17 years and 11 months in REPAYE:
  - They repay the entire loan principal ***plus $203,900*** in interest (no forgiveness)
- In all of the IDR plans, they ***pay more in total*** than under 10-year standard repayment

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[3] The REPAYE plan discharges remaining balances after 20 years of payments for borrowers with only undergraduate debt, and after 25 years for borrowers with any debt from graduate school. For more information, see page 5.
[4] Monthly payment amounts in the current IDR plans increase as the borrower's income increases.
[5] The average law school graduate in 2012 who borrowed had $119,000 in federal debt from undergraduate and graduate studies. TICAS analysis of data from the U.S. Department of Education, National Postsecondary Student Aid Study (NPSAS), 2011-12.

Example 3: Small business owner (married with two children)

IDR helps keep this family's monthly payments manageable, particularly while building their business. However, taxing the amount discharged after 20 years of payments in PAYE or 2014 IBR ***would double the amount of taxes this family owes—adding $13,050 to their federal income tax bill for that year.***

- $50,000 in federal loans, including debt from graduate school
- Earns $0 for the first three years, while building a business
- Earns $45,000 per year starting in the fourth year
- Gets married in year 7. Spouse earns $30,000/year
- Has a child in year 9, and spouse begins working part-time, earning $20,000 a year. The couple has another child in year 11

	10-Year Plan	25-Year Plan	Original IBR (15%, 25 Years)	2014 IBR, PAYE (10%, 20 Years)	REPAYE (10%, 20 or 25 years)
Monthly payments	$580	$350	$0 initially, rising to $580	$0 initially, rising to $480	$0 initially, rising to $620
Total payments	$69,050	$104,100	$105,100	$71,650	$105,400
Amount discharged	n/a	n/a	$0	$46,150	$13,950
Tax on discharged amount	n/a	n/a	n/a	$13,050	$3,700

- After 20 years and 8 months in Original IBR:
  - Repays entire loan principal ***plus $55,100*** in interest (no forgiveness)
- After 20 years in PAYE or 2014 IBR:
  - Repays entire loan principal ***plus $21,650*** in interest
  - Owes $13,050 in federal income tax on the amount discharged, ***doubling tax burden***
- After 25 years in REPAYE:
  - Repays entire loan principal ***plus $55,400*** in interest
  - Owes $3,700 in federal income tax on the amount discharged, increasing tax burden ***by 18 percent***

Example 4: Engineer (married with two children)

IDR helps keeps this family's monthly payments manageable. However, taxing the amount discharged after 20 years of payments in PAYE or 2014 IBR ***increases the amount of taxes this family owes by 75 percent—adding almost $14,000 to their federal income tax bill for that year.***

- $60,000 in combined federal loans, including debt from graduate school
- Earns $60,000 a year as a civil engineer
- Has children in years 2 and 3
- Spouse does not work

	10-Year Plan	25-Year Plan	Original IBR (15%, 25 Years)	2014 IBR, PAYE (10%, 20 Years)	REPAYE (10%, 20 or 25 years)
Monthly payments	$690	$420	$450 initially, rising to $690	$300 initially, rising to $570	$300 initially, rising to $920
Total payments	$82,850	$124,950	$115,150	$87,400	$137,100
Amount discharged	n/a	n/a	$0	$53,750	$10,000
Tax on discharged amount	n/a	n/a	n/a	$13,700	$2,500

- After 18 years and 9 months in Original IBR:
  - Repays entire loan principal ***plus $55,150*** in interest (no forgiveness)
- After 20 years in PAYE or 2014 IBR:
  - Repays entire loan principal ***plus $27,400*** in interest
  - Owes $13,700 in federal income tax on the amount discharged, increasing tax burden ***by 75 percent***
- After 25 years in REPAYE:
  - Repays entire loan principal ***plus $77,100*** in interest
  - Owes $2,500 in federal income tax on the amount discharged, increasing tax burden ***by nine percent***

Example 5: Social worker (divorced with two children)

IDR helps keep this family's monthly payments manageable, particularly when the borrower is just starting out as a social worker. However, taxing the amount discharged after 20 years of payments in 2014 IBR or PAYE ***more than doubles the amount of taxes the family owes for the year, increasing their federal income taxes by more than $19,000.*** Taxing the amount discharged after 25 years of payments in REPAYE would increase the family's tax burden ***by more than $12,000.***

- $55,000 in federal loans from undergraduate and graduate school
- Earns $40,000 per year as a contractor for a State agency (does not qualify for Public Service Loan Forgiveness)
- Children are ages 8 and 10 when the borrower enters repayment

	10-Year Plan	**25-Year Plan**	**Original IBR (15%, 25 Years)**	**2014 IBR, PAYE (10%, 20 Years)**	**REPAYE (10%, 20 or 25 years)**
Monthly payments	$630	$380	$120 initially, rising to $630	$80 initially, rising to $470	$80 initially, rising to $590
Total payments	$75,950	$114,500	$125,950	$59,450	$91,700
Amount discharged	n/a	n/a	$11,400	$70,350	$43,850
Tax on discharged amount	n/a	n/a	$3,200	$19,300	$12,300

- After 25 years in Original IBR:
  - Repays entire loan principal ***plus $70,950*** in interest
  - Owes $3,200 in federal income tax on the amount discharged, increasing tax burden by 16 percent
- After 20 years in PAYE or 2014 IBR:
  - Repays entire loan principal ***plus $4,450*** in interest
  - Owes $19,300 in federal income tax on the amount discharged, ***more than doubling*** the taxes he owes for the year
- After 25 years in REPAYE:
  - Repays entire loan principal ***plus $36,700*** in interest
  - Owes $12,300 in federal income tax on the amount discharged, increasing his tax burden ***by almost two-thirds***
- Under all the IDR plans, monthly payments are much more manageable than under 10-year repayment
- If the social worker worked directly for the State agency, he could qualify for Public Service Loan Forgiveness (PSLF) after 10 years and his discharged loan amount would not be treated as taxable income

Information about the IDR plans

Borrowers currently have several IDR plan options.[6] For a summary of these plans, see http://bit.ly/IDRsummary.

- One IDR plan (Original Income-Based Repayment, or **Original IBR**) caps monthly loan payments at 15% of discretionary income and discharges any remaining debt after 25 years of payments.
- Two other plans (Pay As You Earn, or **PAYE, and 2014 IBR**) cap monthly payments at 10% of discretionary income and discharge remaining balances after 20 years of payments.
- The newest IDR plan (Revised Pay As You Earn, or **REPAYE**), caps monthly payments at 10% of discretionary income and discharges remaining balances after 20 years of payments for borrowers with only undergraduate debt, and after 25 years for borrowers with any debt from graduate school.

Details about Examples 1-5:

- All incomes in the examples are Adjusted Gross Incomes (AGIs) and all figures are in current dollars.
- Monthly loan payments are rounded to the nearest $10, and total payments and tax liability are rounded to the nearest $50.
- Unless otherwise noted, calculations assume that the borrower lives in one of the 48 contiguous states, the average interest rate on the borrower's loans is 6.8%, married borrowers file their taxes jointly, and AGI increases 4% a year.
- Calculations are based on 2017 federal poverty levels and 2016 federal income tax brackets and rates, and assume that the poverty level increases annually at the rate of inflation.
- All loan repayment amounts are calculated by TICAS.
- Estimated taxes paid are calculated using the Bankrate online tax calculator, available at http://www.bankrate.com/calculators/tax-planning/1040-form-tax-calculator.aspx.

[6] This document focuses on the most recent IDR plans, IBR, PAYE, and REPAYE. For more information about the IDR plans and the Department of Education's online repayment estimator, visit http://studentaid.gov/idr and http://ibrinfo.org. For information on TICAS' proposal to streamline the multiple current IDR plans into one improved plan, see http://bit.ly/2haTM3c.