Good News for Student Loan Borrowers

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You may have read that the Biden Administration issued an executive order cancelling up to $10,000 of student loan debt for borrowers. The program extends to the remaining balance on all so-called federal 'direct loans,' the now-defunct Perkins Loans taken out directly from colleges, and any non-Direct loans held by the federal government. There are some 43 million individuals in America who are carrying the burden of these debt obligations, and for an estimated 15-20 million of them, the executive action would entirely eliminate their loan balances.

However, this cancellation would only be available to people with income under $125,000 for single individuals, under $250,000 for married couples. (Current students with debt are eligible for relief; however, if the student is currently claimed as a dependent on the parents' income tax return, then the parents' income would be used to determine eligibility.)

Meanwhile, up to $20,000 in student debt would be forgiven for Pell Grant recipients, with the same income thresholds.

At the same time, the executive order specifies that all federal student loan payments (and accrued interest) would be delayed once again, through December 31, 2022. This is likely the final moratorium, which would end the Covid-driven pause in student loan payments.

The program also creates a new Income-Driven Repayment plan that would limit payments on federal undergraduate loans to 5% of the borrower's discretionary income and would forgive loans with less than $12,000 remaining to be paid off after ten years of payments. This will affect many borrowers, who, if the executive order only pays off part of their loan balance, will have to resume making loan payments in January.

Before anyone starts counting on the savings, it's important to note that here will inevitably be lawsuits against the plan; some states are already readying their legal objections. Meanwhile, it has not yet been announced exactly how the White House would define 'income' for the purposes of loan forgiveness, although the obvious guess would be the adjusted gross income (AGI) on a person's (or couples') tax return. Interestingly, the announcement specified that the measuring years would be 2020 or 2021, meaning that if a person's (or couples') income falls below the threshold in either tax year, that person (or couple) would qualify. But if the income is even one dollar above those thresholds, there would be no debt qualification benefit.

Would the discharged debt count as taxable income? Apparently not. The American Rescue Plan Act of 2021 provided that most student debt discharged through 2025 (which, of course, includes the Biden Administration's current proposal) would be tax-free at the federal level. It is uncertain whether those states that collect state income tax would consider the debt cancellation to be taxable income.

It is also important to note that privately held student loans, from banks, are not eligible for debt relief under the new forgiveness plan. But, contrary to some reports, federal loans taken out for graduate school are eligible for relief, as are so-called Parent Plus loans—which means that some parents who have taken on debt on behalf of their students will be granted loan forgiveness.

How do the students apply? The eight million students who already have income information on file with the U.S. Department of Education will automatically receive forgiveness. Those who are not in the database will need to apply and submit proof of their income in order to qualify.

One more note: the Department of Education makes roughly $90 billion in new student loans every year—and there is currently no discussion about whether or how any of those loans might, in the future, be forgiven.

Sources:

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https://taxfoundation.org/student-loan-debt-forgiveness/

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