IRS Issues Tax Guidance on Discharged Student Loans

The Internal Revenue Service (IRS) has issued guidance for some taxpayers who took out federal or private student loans to finance attendance at a nonprofit or for-profit school.

The guidance offers relief for students whose loans have been discharged by the Department of Education and who meet specific criteria.

A discharge of indebtedness is a taxable event, the cancellation of debt is treated as income to the borrower.

Under this recent guidance affected students will not recognize income as a result of the discharge.

The guidance applies to students who:

- **Participated in Closed School discharge process.** The Closed School discharge process allows the Department of Education to discharge a federal student loan obtained by a student (or the student's parent) who attended school at the time it closed or who withdrew from the school just before it closed.

- **Borrowers who participated in the Defense to Repayment discharge process.** The Defense to Repayment process allows the Department of Education to discharge a Federal Direct Loan obtained by a student (or the student's parent) if the borrower can prove that a school's actions would give rise to a cause of action against the school under applicable state law.

- **Borrowers who participated in legal settlement discharge actions.** There have been several lawsuits brought by federal and state governmental agencies to resolve allegations of unlawful business practices, including unfair, deceptive, and abusive acts and practices, against for-profit schools and specific private lenders that offered student loans at those schools.
Student loan borrowers may also be to exclude income under fraudulent or material misrepresentations made by schools or specific private lenders to the students or other tax law authority.

Determining which exclusions might apply to individual taxpayers would require a detailed look at each taxpayer's facts and circumstances.

That creates a significant compliance burden for taxpayers and a disproportionate administrative burden on the IRS, therefore the IRS has established a safe harbor which can be found in Revenue Procedure 2020-11.

The relief is also extended to any creditor that would otherwise be required to file information returns and furnish statements to affected students.

To avoid confusion the IRS recommends that creditors not provide students (nor the IRS) with a Form 1099-C, Cancellation of Debt - Internal Revenue Service.

As usual the IRS has provided just enough information on this matter to cause confusion. More to follow.

We here at Muffoletto & Company believe that the more informed you are in regards to the rules and regulations that affect you the more we can be of service.

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