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The Closure of Institutions of Higher Education: Student Options, Borrower Relief, and Implications

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Summary

The recent closures of multiple large, private for-profit institutions of higher education (IHEs), such as those owned by Corinthian Colleges, Inc. (e.g., Heald College) and ITT Educational Services (e.g., ITT Technical Institutes) have brought into focus the extent to which a student's postsecondary education may be disrupted by a school closure. The closures of these IHEs also highlighted the numerous issues students may face when their institutions close and the difficult decisions they may be required to make in the wake of a closure. Two key issues students may face when their IHE closes relate to their academic plans and their personal finances.

The academic issues faced by students when their schools close include whether they will continue to pursue their postsecondary education, and if so, where and how they might do so. Students deciding to continue their postsecondary education have several options. They may participate in a teach-out offered by the closing institution or by another institution. A teach-out is a plan that provides students with the opportunity to complete their program of study after a school has closed. In conjunction with or in lieu of participating in a teach-out, students may also be able to transfer the credits they previously earned at the closed IHE to another IHE. If a student is able to transfer some or all of their previously earned credits, he or she would not be required to repeat the classes those credits represent at the new institution; if a student is unable to transfer all or some of his or her previously earned credits, the student may be required to repeat the classes those credits represent at the new IHE. Decisions regarding the acceptance of credit transfers are within the discretion of the accepting IHE.

The financial issues faced by students when their schools close include whether they are responsible for repaying any loans borrowed to attend a closed school and how they might finance any additional postsecondary education they pursue. In general, a closed school loan discharge is available to a borrower of federal student loans made under Title IV of the Higher Education Act of 1965 (HEA) if the student was enrolled at the IHE when it closed or if the student withdrew from the IHE within 120 days prior to its closure. In addition, the student must have been unable to complete his or her program of study at the closed school or a comparable program at another IHE, either through a teach-out agreement or by transferring any credits to another IHE. Borrowers ineligible for a closed school discharge may be eligible to have their Federal Direct Loan and Federal Family Education Loan program loans discharged by successfully asserting as a borrower defense to repayment (BDR) certain acts or omissions of an IHE, if the cause of action directly relates to the loan or educational services for which the loan was provided. Whether a borrower may have all or part of any private education loans borrowed to attend the closed IHE discharged depends on the loan's terms and conditions.

Some students may also face issues regarding how they might finance future postsecondary educational pursuits. If a borrower receives a closed school discharge or has a successful BDR claim, his or her eligibility for future Direct Subsidized Loans is unlikely to be affected. Moreover, a borrower's statutory annual and aggregate borrowing limits on Direct Subsidized and Unsubsidized Loans are unlikely to be affected. Students who receive a Pell Grant for enrollment at a school that closed may have an equivalent amount of Pell eligibility restored. Likewise, if the student used GI Bill educational benefits for attendance at a closed school, those benefits can be restored.

Students may be reimbursed for payments on charges levied by closed IHEs that are not covered by other sources from a State Tuition Recovery Fund (STRF). The availability of and student eligibility for such funds vary by state, and not all states operate STRFs. Finally, the receipt of any of the above-mentioned benefits may have federal and state income tax implications,

including the potential creation of a federal income tax liability for borrowers who have certain loans discharged.

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Introduction

In award year (AY) 2015-2016, approximately 6,700 institutions of higher education (IHEs), enrolling over 27 million postsecondary education students, participated in the federal student aid programs authorized under Title IV of the Higher Education Act of 1965 (HEA; P.L. 89-329, as amended).¹ These IHEs ranged in sector, size, and educational programs offered. They comprised all sectors (i.e., public, private nonprofit, and private for-profit), with some IHEs enrolling as few as one student and others enrolling over 236,000 in a single year. Offered educational programs varied from certificate programs in career and technical fields to doctoral and professional degree programs.

Most of these IHEs operate from year-to-year with few financial or operational concerns; however, each year, a few do face such concerns, which may cause them to cease or significantly curtail operations. The recent closure of multiple large, private, for-profit IHEs has brought into focus the extent to which a postsecondary student's education may be disrupted by a school closure.² However, even in instances of a small IHE's closure, student concerns remain the same: Can they continue their postsecondary education at another school? How will they finance future postsecondary educational pursuits? Are they liable for repaying loans they may have borrowed to pursue a postsecondary credential that they were unable to obtain because of an IHE's closure?

This report provides an explanation of the options a postsecondary student may pursue in the event the IHE he or she attends closes, any financial relief that may be available to such students, and other practical implications for students following a school's closure. First, this report describes the academic options available to such students, such as participating in a teach-out or transferring to a new IHE. Next, it discusses issues related to financing a postsecondary education, including the extent to which borrowers may have any loans borrowed to finance educational expenses discharged due to a school closure and whether future financial assistance, including federal student loans, Pell Grants, and GI educational benefits, may be available to students should they decide to continue their postsecondary education at another IHE. This report then describes additional relief that may be available to students who attended IHEs that closed, such as the potential to have tuition paid reimbursed through a state tuition recovery fund. Finally, this report describes some potential income tax implications for students when their IHE has closed, including the extent to which they may incur a federal income tax liability for loans discharged and whether higher education tax credits remain available to them in future years.

Academic Options and Consequences

In the event of a school closure, currently enrolled students must consider their academic options, including whether they will continue pursuing their postsecondary education, and if so, where. Two options that may be available to students include teach-outs and credit transfer.

Teach-Out Plans and Agreements

To participate in the Title IV federal student aid programs, an IHE must, among other requirements, agree to submit a teach-out plan to its accrediting agency, if it intends to close a

¹ U.S. Department of Education, Integrated Postsecondary Education Data System (IPEDS).

² For additional information on some of these closures, see CRS Report R44068, *Effect of Corinthian Colleges' Closure on Student Financial Aid: Frequently Asked Questions*, by Alexandra Hegji; and CRS Insight IN10577, *The Closure of ITT Technical Institute*, by Alexandra Hegji (available upon request).

location that provides 100% of at least one educational program offered by the IHE or if it intends to otherwise cease operations.³ As part of a teach-out plan, an IHE may enter into a teach-out agreement with another IHE to provide the closing IHE's students with an educational program of similar content.

Teach-Out Plans

A teach-out plan is an institution's "written plan that provides for the equitable treatment of students if [the IHE] ceases to operate before all students have completed their program of study."⁴ Accrediting agencies establish the criteria IHEs must meet when submitting a teach-out plan; thus, there are no standard components of a teach-out plan. Typically, however, in a teach-out plan, an IHE may be required to include provisions for students to complete their credentials within a reasonable amount of time, a communication plan to affected parties (e.g., faculty and students) informing them of the impending closure, and information on how students may access their institutional records.⁵ Teach-out plans are typically used when an IHE is not closing immediately and is able to teach-out its own students prior to its closure.

Teach-Out Agreements

As part of a teach-out plan, an IHE may enter into a teach-out agreement with another IHE, under which the new IHE must

- provide students with an educational program that is of an acceptable quality and is reasonably similar in content, structure, and scheduling to that provided by the closing IHE;
- be accredited or preaccredited by a nationally recognized accrediting agency, remain stable, carry out its mission, and meet all obligations to its current students; and
- demonstrate that it can provide students with access to its services without requiring students to move or travel a substantial distance.⁶

In addition, teach-out agreements may establish the cost of attendance for students being taught out.⁷

Teach-out agreements are typically used when an IHE is closing immediately and is unable to continue providing instruction to its students to allow them to complete their course of study before the school's closure. When implemented, teach-out agreements may take a variety of

³ 34 C.F.R. §668.14(b)(31). In addition, IHEs are required to submit teach-out plans to their accreditors when ED initiates an emergency action against or limitation, suspension, or termination of an IHE's participation in an HEA Title IV program; when an IHE's accrediting agency acts to withdraw, terminate, or suspend an IHE's accreditation or preaccreditation; when the IHE's legal authorization to operate within a state is revoked.

⁴ HEA §487(f)(2).

⁵ See, for example, Higher Learning Commission, "Teach-Out Requirements: Provisional Plan and Teach-Out Agreements" <https://downloadna11.springcm.com/content/DownloadDocuments.ashx?Selection=Document%2C73d8aaaf-d1fb-df11-bf75-001cc448da6a%3B&aid=5968>, accessed February 1, 2018; and Southern Association of Colleges and Schools, Commission on Colleges, "Substantive Change For SACSCOC Accredited Institutions," pp. 22-23, <http://www.sacscoc.org/pdf/081705/SubstantiveChange.pdf>, accessed February 1, 2018.

⁶ 34 C.F.R. §602.24(c).

⁷ See, for example, Higher Learning Commission, "Teach-Out requirements: Provisional Plan and Teach-Out Agreements", p. 3, <https://downloadna11.springcm.com/content/DownloadDocuments.ashx?Selection=Document%2C73d8aaaf-d1fb-df11-bf75-001cc448da6a%3B&aid=5968>, accessed February 1, 2018.

forms. For instance, a teach-out agreement may provide that the teach-out institution will provide the faculty and student supports necessary to deliver the closing IHE's educational programs at the closing IHE's facilities for the remainder of the academic year in which the closing IHE ceases operations,⁸ while in other instances, a teach-out agreement may provide educational programs to the closing IHE's students at the teach-out IHE's facilities.

In some instances, a student may be unable to complete his or her educational program during the duration of the teach-out plan or agreement (e.g., the teach-out plan would occur over the course of a single academic year, but the student must complete at least two more academic years before earning a degree). In these instances, students would need to make arrangements to transfer to another IHE to receive their credentials.

In the event an IHE closes without a teach-out plan or agreement in place, the IHE's accrediting agency must work with ED and appropriate state agencies to assist students in finding opportunities to complete their postsecondary education.⁹

Credit Transfer

In lieu of or in conjunction with a teach-out, students of closed IHEs may be able to continue their postsecondary education by transferring some or all of the credits earned at the closed IHE to another IHE. In general, credit transfer is the process of one institution (the accepting institution) measuring a student's prior learning (typically via coursework) at another institution (the sending institution) and comparing that prior learning against educational offerings at the accepting institution. The accepting institution determines whether a student's prior learning meets its standards and whether the prior learning is applicable to its educational programs. If it determines the prior learning meets its standards, the accepting institutions gives credit toward its educational programs for the prior learning, such that a student transferring credits need not repeat all or part of a program's curriculum. Transfer-of-credit policies are determined by individual IHEs.

To smooth the credit transfer process, some IHEs have entered into articulation agreements. Articulation agreements are agreements between two or more IHEs demonstrating that a student's prior learning from a sending IHE meets the accepting IHE's standards. Typically, they guarantee acceptance of at least some credits earned at the sending institution by the accepting institution.

The HEA does not require Title IV participating IHEs to maintain transfer-of-credit policies nor does it specify requirements for transfer-of-credit policies for IHEs that do have them. The HEA does, however, require that Title IV participating IHEs make publicly available any transfer-of-credit policies they may have in place.¹⁰ In disclosing transfer-of-credit policies, accepting IHEs must include information on the criteria the institution uses in evaluating credit transfers, and all institutions that are parties to articulation agreements must disclose a list of IHEs with which it has articulation agreements.

Students who attended a closed IHE may decide to continue their postsecondary education at another IHE and may wish to transfer credits earned at the closed IHE to the new IHE. This may be done in conjunction with or separate from a teach-out.¹¹ Typically, students must initiate the

⁸ See, for example, Southern New Hampshire University, "Southern New Hampshire University to Lead 'Teach-Out' of all Daniel Webster College Programs," press release, September 13, 2016.

⁹ 34 C.F.R. §602.24(d).

¹⁰ HEA §485(h).

¹¹ For example, a student may participate in a teach-out of the closed institution for an academic year but may need to (continued...)

credit-transfer process by expressing interest in transferring credit to another IHE. The IHE would then inform the student of next steps the student must take to enroll. Because IHEs set their own credit transfer criteria, credit transfer may not be guaranteed.¹² Thus, some students may have all or a large proportion of their previously earned credits transferred to an accepting IHE and may experience little to no disruption or delay in their postsecondary educational pursuits, while others may have few or no credits transferred to an accepting IHE and may experience significant disruptions and delays in their postsecondary education. In addition, a student may incur greater financial obligations (e.g., student loans) if he or she must repeat coursework because credit from the closed school did not transfer.

Finally, students who successfully transfer some or all of their previously earned credits would be required to meet the accepting IHE's satisfactory academic progress (SAP) policies to maintain eligibility to receive Title IV funds at the accepting IHE.¹³ IHEs may establish their own SAP policies, but these policies must meet minimum federal standards, which must establish a minimum grade point average (or equivalent) and a maximum time frame in which students must complete their education program (pace of completion).¹⁴ Only transfer credits that count toward a student's educational program at the accepting IHE are included in the accepting IHE's calculation of SAP.¹⁵ Thus, if a student is unable to transfer any credits from a closed IHE to another IHE, the student's previously earned credits will not count toward the accepting IHE's SAP calculation and would not have the potential to affect the student's aid eligibility with respect to SAP at the new IHE. However, should some or all of a student's previously earned credits from a closed IHE transfer to another IHE, depending on the accepting IHE's specific SAP policy, a student's Title IV eligibility may be affected such that he or she may not be meeting the IHE's SAP policies and thus may be ineligible for Title IV aid at the accepting IHE.¹⁶

Financial Options and Consequences

Along with considering academic options in the event of a school closure, students may also need to consider the financial options available to them, as they may have received financial assistance

(...continued)

complete an additional academic year to complete his or her credential. The student may transfer credits earned prior to and during the teach-out to another IHE.

¹² For information on how often credits transfer, see Sean Anthony Simone, *Transferability of Postsecondary Credit Following Student Transfer or Coenrollment: Statistical Analysis Report*, National Center for Education Statistics, NCES 2014-163, August 2014.

¹³ HEA §484(c).

¹⁴ 34 C.F.R. §668.34. A student's pace of completion is calculated by dividing the total number of credits a student has successfully completed by the number of credits the student has attempted. A student becomes ineligible for Title IV aid when it is mathematically impossible for him or her to complete their course of study within 150% of the length of the program (e.g., six years for a full-time, full-year four-year program) for undergraduate students and within the maximum time frame established by the IHE for graduate students.

¹⁵ U.S. Department of Education, *2016-2017 Federal Student Aid Handbook*, vol. 1, p. 14.

¹⁶ In general, it appears that a student's pace of completion is unlikely to be affected by a credit transfer, as typically, only successfully completed courses at the original IHEs may be transferred to an accepting institution. However, successful course completion is defined by individual IHEs. Thus, should an accepting IHE define successful completion as any grade higher than an F (or its equivalent), then a student might be able to transfer credits from a class in which he or she earned, for instance, a D. This D would be included in the accepting IHE's calculation of the student's grade point average for purposes of determining SAP. Such grades may have the effect of bringing the student's GPA below the federally required C minimum, such that he or she may become ineligible for Title IV student aid at the accepting institution.

to help finance their education at the closed school and may need to seek financial assistance should they decide to continue pursuing a postsecondary education. Considerations for students who borrowed money (or parents who borrowed funds on behalf of a student) to finance their education at a closed school include whether they are responsible for repaying any loans borrowed to attend the school. Considerations for students who wish to continue their education at another IHE include the extent to which their eligibility for various forms of financial aid (e.g., Direct Loans, Pell Grants, GI Bill Educational Benefits) may be affected by their previous use of those benefits at the closed school.

Loan Discharge

In some instances, individuals who borrowed funds to finance postsecondary education expenses may be provided some relief from being required to repay their loans, depending on the type of loan they seek to have discharged and specific borrower circumstances.

Federal Student Loans

Students who attended a school that closed (or the parents of students who attend a school that closed) may have borrowed federal student loans to help finance their postsecondary education at the closed school. For HEA Title IV federal student loans (i.e., loans made under the Direct Loan [DL], Federal Family Education Loan [FFEL], and Perkins Loan programs), borrowers may be provided some relief from being required to repay their federal student loans through a closed school loan discharge.

Closed School Loan Discharge

Students who attended a school that closed (or their parents) may be eligible to have the full balance of the outstanding HEA Title IV loans they borrowed to attend the IHE discharged. In general, borrowers of Title IV loans may be eligible to have the full balance of their outstanding HEA Title IV loans discharged (including any accrued interest and collection costs) if they, or the student on whose behalf a parent borrowed in the case of Parent PLUS Loans, are unable to complete the program in which they enrolled due to the closure of the school.¹⁷ Borrowers who have their loans discharged due to a school closure are also eligible to be reimbursed for any amounts previously paid on those loans, and if any adverse credit history was associated with the loan (e.g., default), the loan discharge will be reported to credit bureaus so that they may delete the adverse credit history associated with the loan.¹⁸

Closed School Loan Discharge Eligibility

Typically, to be eligible for loan discharge due to school closure, a student must have been enrolled in an IHE when it closed or must have withdrawn from the IHE within 120 days prior to its closure.¹⁹ In addition, the student must have been unable to complete his or her program of

¹⁷ HEA §437(c)(1); HEA §455(a)(1); HEA §464(g). In some instances, borrowers who are ineligible to have their federal student loans discharged due to school closure may be able to seek debt relief for their DL and FFEL program loans for a variety of other reasons. For additional information, see CRS Report R40122, *Federal Student Loans Made Under the Federal Family Education Loan Program and the William D. Ford Federal Direct Loan Program: Terms and Conditions for Borrowers*, by David P. Smole.

¹⁸ 34 C.F.R. §§674.32(g)(2)(iv); 682.402(d)(2)(iv); 685.214(a)(4).

¹⁹ The Secretary may extend the 120-day period in exceptional circumstances.

study at the closed school or in a similar²⁰ program at another IHE, either through a teach-out agreement or by transferring any credits to another IHE.²¹

If the closing school offers the option for students to complete their education through a teach-out agreement with another IHE, a student may refuse the option, and the borrower may still qualify for loan discharge. However, if a student refuses the teach-out, later enrolls at another IHE in a program similar to the one in which he or she had been enrolled, receives transfer credit for work completed at the closed school, and completes the program at the new IHE, then the borrower may not qualify for closed school discharge.

Alternatively, if a student transferred credits to a new school but completed an entirely different program of study at the new school, then the borrower is eligible for loan discharge, as the program at the new school is entirely different than the one for which the loans were intended at the previous school, regardless of the fact that some credits from the closed IHE may have transferred to the new IHE.²²

Finally, to obtain discharge a borrower must cooperate with ED in any judicial or administrative proceeding brought by ED to recover amounts discharged from the school.²³ If a borrower fails to cooperate with ED, the loan discharge may be revoked.²⁴

Closed School Loan Discharge Procedures

Borrowers seeking a closed school discharge must fill out the closed school loan discharge application and return it to their loan servicer.²⁵ Generally, while a borrower's loan discharge application is being considered, the borrower's loan is placed in forbearance until a discharge decision is made.²⁶ Under forbearance, a borrower is able to stop making payments or reduce their monthly payments on their federal student loans for up to 12 months. During this time, interest continues to accrue on both subsidized and unsubsidized loans. In addition, collections on an eligible defaulted loan cease, although a borrower may continue to make payments on the loan.

Borrowers may initiate the closed school loan discharge process on their own; however, the Secretary of Education (the Secretary), or the guaranty agency for purposes of FFEL program loans, is required to identify all borrowers who may be eligible for a closed school discharge upon a school's closure and mail to each borrower a discharge application and an explanation of

²⁰ There is no formal definition of "similar program"; however, information made available by ED to former Corinthian Colleges students provided an illustrative example of when a program might be considered comparable, stating "for instance, if you were taking a criminal justice program and you transferred to another criminal justice program, that would be a transfer to a similar program ... " Borrowers self-certify whether their new program of study is similar to their program of study at the closed school. U.S. Department of Education, Office of Federal Student Aid, "Information About Debt Relief for Corinthian Colleges Students," <https://studentaid.ed.gov/sa/about/announcements/corinthian>, accessed February 1, 2018.

²¹ 34 C.F.R. §§674.32(g)(4); 682.402(d); & 685.214(c). See also, U.S. Department of Education, Federal Student Aid, "Frequently Asked Questions About Corinthian Colleges," Question 9, <https://studentaid.ed.gov/sa/about/announcements/corinthian/faq#loan-discharge>, accessed February 1, 2018.

²² U.S. Department of Education, Federal Student Aid, "Q&A on Closed School Discharge," <https://studentaid.ed.gov/sa/repay-loans/forgiveness-cancellation/closed-school#q-and-a>, accessed February 1, 2018.

²³ For instance, the borrower may be required to provide testimony supporting a request for discharge.

²⁴ 34 C.F.R. §§674.33(g); 682.402(d); 685.214(c) & (d).

²⁵ Ibid. See also, U.S. Department of Education, "Loan Discharge Application: School Closure," OMB No. 1845-0058.

²⁶ Unlike the FFEL and DL programs, it appears that IHEs are not required to place a student's Perkins Loan in forbearance while his or her closed school loan discharge application is being processed; however, the IHE is required to cease collections on any defaulted Perkins Loans.

qualifications and procedures for obtaining a discharge, if the borrower's address is known.²⁷ After the Secretary sends notice to a borrower, the Secretary ceases collections on any defaulted loans and places any other loans in forbearance. The borrower then has 60 days in which to submit a closed school discharge application. If the borrower fails to submit such an application within the 60-day time frame, the Secretary continues collections on defaulted loans and any other loans are taken out of forbearance. Should a borrower not submit a closed school discharge application within the 60-day time frame, he or she may submit a closed school discharge application at any time for consideration.

The Secretary is also authorized to discharge a loan without an application from the borrower if the Secretary determines that, based on information in the Secretary's possession, the borrower qualifies for the discharge.²⁸

Borrower Defense to Repayment

Borrowers who attended a closed school but who are ineligible for a closed school loan discharge may, in certain circumstances, seek debt relief on their FFEL or DL program loans by asserting as a borrower defense to repayment (BDR), certain "acts or omissions of an institution of higher education."²⁹ An IHE's acts or omissions must "give rise to a cause of action against the school under applicable State law," and the cause of action must directly relate to the loan or educational services for which the loan was provided.³⁰ There are no BDR provisions for Perkins Loans. The availability of a BDR claim may be closely related to a school's closure, as oftentimes, a BDR claim is predicated on misleading representations of an IHE relating to the educational services provided, and in recent years, allegations of misrepresentation have played a part in the ultimate closure of some IHEs.³¹

If a borrower's BDR is successful, ED will determine the amount of debt relief to which the borrower is entitled, which can include relief from repaying all or part of the outstanding loan balances and any reimbursement for previous amounts paid toward the loan. Additionally, if an adverse credit history was associated with the loan (e.g., default), the loan discharge will be

²⁷ If the borrower's address is unknown, ED attempts to locate the borrower by consulting with a variety of parties, including the closed school, the school's accrediting agency, and the school's licensing agency.

²⁸ 34 C.F.R. §§674.32(g); 682.402(d); 685.214(c)(2). Final Regulations promulgated in 2016 would have expanded the Secretary's authority to discharge a borrower's loan without an application. The implementation of those regulations has been delayed until July 1, 2019, and ED is currently undergoing a negotiated rulemaking process that may address this issue. See Department of Education, "Student Assistance General Provisions, Federal Perkins Loan Program, Federal Family Education Loan Program, William D. Ford Federal Direct Loan Program, and Teacher Education Assistance for College and Higher Education Grant Program," 83 *Federal Register* 6458, February 14, 2018.

²⁹ HEA §455(h).

³⁰ 34 C.F.R. §685.206(c). Regulations for the FFEL program provide instances in which an FFEL program loan may be legally unenforceable, such that a borrower need not repay it. While the language of the FFEL program regulations does not specifically identify acts or omissions by an institution as a defense against repayment, ED has stated that the claims a borrower could bring as a defense against repayment under the FFEL program are the same as those that could be brought under the DL program. See U.S. Department of Education, "Notice of Interpretation," 60 *Federal Register* 37768-37770, July 21, 1995. There are no similar provisions related to borrower defenses for Perkins Loans.

³¹ For instance, in 2014, ED placed restrictions to Title IV aid on IHEs owned by Corinthian Colleges, Inc. (CCI) to address concerns relating to a variety of practices, including inconsistencies in job placement rates that had been presented to students. In response to its limited access to federal student aid funds, CCI closed and sold many of its IHEs. CRS Report R44068, *Effect of Corinthian Colleges' Closure on Student Financial Aid: Frequently Asked Questions*, by Alexandra Hegji.

reported to credit bureaus so that it may delete the adverse credit history associated with the loan.³²

BDR Eligibility

For DL program loans, ED has determined in regulations that institutional acts and omissions for which a Direct Loan borrower may assert a BDR are those that would “give rise to a cause of action against the school under applicable State law.”³³ Additionally, a cause of action must directly relate to the loan or educational services for which the loan was provided; thus, availability of a BDR claim is dependent on the laws of the applicable state.³⁴ For FFEL program loans, borrowers must satisfy the DL program BDR standards and must also prove additional components, such as showing that the FFEL lender offered payment or other benefits to the IHE for referring borrowers to the specific FFEL lender.³⁵

Although FFEL program BDR standards differ from DL program BDR standards, and BDR is unavailable for Perkins Loans, ED has determined that for borrowers who have consolidated FFEL or Perkins Loans into a Direct Consolidation Loan, the underlying FFEL and Perkins Loans will be evaluated under the same BDR standards as a Direct Loan.³⁶ In addition, ED has determined that borrowers may prospectively consolidate their outstanding FFELs and Perkins Loans into a Direct Consolidation Loan for purposes of pursuing potential BDR discharge of the Direct Consolidation Loan.

In addition to being eligible to have loans discharged after a successful BDR claim, a borrower may also be eligible to have all or part of amounts previously paid on his or her loan reimbursed by ED. Payments on Direct Loans generally may be reimbursable by ED; however, some payments on ED-held FFEL program loans³⁷ may not be reimbursable. Specifically, payments previously made to a private holder of an FFEL program loan prior to being transferred to ED may not be reimbursed; rather, borrowers would need to pursue reimbursement directly from the previous private FFEL holder. The same holds true for FFEL program loans that were

³² 34 C.F.R. §685.206(c).

³³ Ibid. Regulations presume that a borrower BDR claim is raised only in response to “any proceeding to collect on a Direct Loan” (e.g., tax refund offset, wage garnishment proceedings). U.S. Department of Education, “Student Assistance General Provisions, Federal Perkins Loan Program, Federal Family Education Loan Program, William D. Ford Federal Direct Loan Program, and Teacher Education Assistance for College and Higher Education Grant Program; Proposed Rule,” 81 *Federal Register*, 39387, June 16, 2016.

³⁴ It is unclear which state law (e.g., the law of the state in which an IHE is located, the law of the state in which the borrower resides in the case of a student enrolled in distance education) may be applicable in any individual case. In addressing these issues, ED states “[t]his approach creates complexities in determining which State law applies and potential inequities, as students in one State may receive different relief than students in another State, despite having common facts and claims.” U.S. Department of Education, “Student Assistance General Provisions, Federal Perkins Loan Program, Federal Family Education Loan Program, William D. Ford Federal Direct Loan Program, and Teacher Education Assistance for College and Higher Education Grant Program; Proposed Rule,” 81 *Federal Register*, 39387, June 16, 2016.

³⁵ 34 C.F.R. §682.209(g). See also, Joseph Smith, *Fourth Report of the Special Master for Borrower Defense to the Under Secretary*, U.S. Department of Education, June 29, 2016, p. 4.

³⁶ Joseph Smith, *Fourth Report of the Special Master for Borrower Defense to the Under Secretary*, U.S. Department of Education, June 29, 2016, p. 4.

³⁷ Under the FFEL program, loans were originated and serviced by private sector and state-based lenders and were funded with nonfederal capital. ED guaranteed lenders against loss (e.g., through borrower default or discharge due to death or permanent disability). Although FFEL program loans were last disbursed in 2010, many remain outstanding. In some instances, private or state-based lenders continue to service FFEL program loans. In other instances, ED has purchased FFEL program loans from the lenders and is now the owner of the loans. In these cases, the loans are serviced by ED-contracted student loan servicers.

consolidated into a Direct Consolidation Loan. Any payments previously made on an FFEL program loan to a private holder cannot be reimbursed by ED, although a borrower could pursue reimbursement of those payments made from the previous private holder. Finally, no amounts of Perkins Loans paid prior to consolidation may be reimbursed, as Perkins Loans in and of themselves are ineligible for a BDR discharge.³⁸

BDR Procedures

Current regulations are silent regarding the process a borrower must follow to assert a BDR claim; however, ED has developed procedures through which borrowers may seek relief. Processes, policies, and guidance related to BDR procedures are subject to change or adjustment; the descriptions herein are accurate as of the date of this report.

ED recently developed a universal BDR application for borrowers of DL program loans to pursue a BDR claim.³⁹ As of February 1, 2017, the universal application is the only BDR application accepted by ED.⁴⁰

Using the universal application, borrowers of DL program loans must submit a variety of information to ED, which include but are not limited to

- borrower identifying and contact information;
- school name and location;
- dates of enrollment at the school and credential sought; and
- details about the IHE's actions that the borrower believes entitled him or her to debt relief, which could include information on how an IHE misled a student about employment prospects, program costs, transferability of credits to other IHEs, career or educational services offered, or the importance of immediately enrolling at the IHE and the consequences of not doing so.

Once ED receives the borrower's information and while the claim is evaluated, all ED-held federal student loans (i.e., Direct Loans and some Perkins Loans and FFEL program loans) are placed into forbearance⁴¹ and collections cease on eligible defaulted loans for up to 12 months, unless otherwise specified by the borrower. Borrowers are not required to provide additional documentation to have their loans placed in forbearance or to have collections cease. ED-contracted student loan servicers, which are responsible for many of the day-to-day administrative tasks associated with the federal student loan programs, will contact borrowers informing them that their loans have been placed in forbearance or that collections have stopped.

³⁸ Joseph Smith, *Fourth Report of the Special Master for Borrower Defense to the Under Secretary*, U.S. Department of Education, June 29, 2016, p. 4.

³⁹ U.S. Department of Education, *Application for Borrower Defense to Loan Repayment*, OMB No. 1845-0146, Exp. December 31, 2019.

⁴⁰ Prior to February 1, 2017, ED accepted other forms of applications. For instance, ED had previously established informal procedures for DL and ED-held FFEL programs loans under which borrowers would submit information similar to that in the universal form.

⁴¹ During forbearance, interest continues to accrue on both subsidized and unsubsidized loans. In response to delays in the BDR process, ED recently announced it will apply a credit to interest that accrues on loans starting one year after the BDR application is filed. See "Improved Borrower Defense Discharge Process Will Aid Defrauded Borrowers, Protect Taxpayers," press release, December 20, 2017, <https://www.ed.gov/news/press-releases/improved-borrower-defense-discharge-process-will-aid-defrauded-borrowers-protect-taxpayers>.

The forbearance or stopped collections affects all of a borrower's ED-held student loans, including those loans ineligible for a BDR claim.⁴²

While an individual's loan is in forbearance, ED reviews the BDR claim, makes a determination as to whether the borrower is eligible for discharge and reimbursement for amounts previously paid on the loan, and determines the precise amount of relief for which a borrower is eligible. Regulations are silent regarding how ED is to calculate appropriate amounts of relief for a borrower.⁴³

Individuals who wish to consolidate their ED-held FFEL or Perkins Loan program loans into a DL Consolidation loan to pursue a BDR claim may also submit the universal application to ED. Once the application is received, the borrower's loans will be placed into forbearance and collections on eligible defaulted loans will cease, unless otherwise specified by the borrower. ED will then review the application to determine whether it would approve the borrower's BDR claim if the borrower consolidated his or her loans. Should ED pre-approve such an application, a borrower would then only need to consolidate her or her loans into a DL Consolidation loan to have the loans discharged.⁴⁴

For those FFEL program loans not held by ED, BDR claims procedures may vary by lender. Borrowers of such loans must contact their lender for information on the BDR process. In general, private sector holders of FFEL program loans are not required to grant a forbearance or to cease collections they evaluate a BDR claim; however, loan holders are required to place a loan in forbearance or to cease collections if a borrower has submitted the universal application to ED to determine whether his or her loans would be eligible for discharge under a BDR claim if the loans were consolidated into a Direct Consolidation Loan.

BDR Negotiated Rulemaking

On November 1, 2016, ED promulgated new regulations intended to create a more robust set of standards and streamlined procedures for assessing BDR claims.⁴⁵ These regulations were scheduled to become effective on July 1, 2017; however, prior to the effective date, ED announced it would delay the implementation of these regulations until July 1, 2019.⁴⁶ ED is

⁴² U.S. Department of Education, Office of Federal Student Aid, "Forbearance/Stopped Collections Status," <https://studentaid.ed.gov/sa/repay-loans/forgiveness-cancellation/borrower-defense#forbearance-stopped-collections-status>, accessed February 1, 2018.

⁴³ Prior to December 20, 2017, ED had typically forgiven the entire balance of an individual's eligible loans associated with a BDR claim. On December 20, 2017, ED announced that, going forward, BDR claims of former CCI students, loans would be discharged under a tiered approach. This process will provide "tiers of relief to compensate former Corinthian students based on damages incurred." ED compares eligible BDR applicants' earnings against the earnings of their peers from "passing" gainful employment (GE) programs. Students whose current earnings are less than 50% of their peers from passing GE programs receive full debt relief. Students whose earnings are 50% or greater of their peers from passing GE programs receive proportionally tiered relief to compensate for the difference. For instance, if a student's current earnings are 70% of their peers' from passing GE programs, he or she has 30% of the debt discharged. For additional information, see U.S. Department of Education, "Improved Borrower Defense Discharge Process Will Aid Defrauded Borrowers, Protect Taxpayers," press release, December 20, 2017, <https://www.ed.gov/news/press-releases/improved-borrower-defense-discharge-process-will-aid-defrauded-borrowers-protect-taxpayers>.

⁴⁴ 81 *Federal Register* 75961, November 1, 2016.

⁴⁵ *Ibid.* at p. 75926.

⁴⁶ Department of Education, "Student Assistance General Provisions, Federal Perkins Loan Program, Federal Family Education Loan Program, William D. Ford Federal Direct Loan Program, and Teacher Education Assistance for College and Higher Education Grant Program," 82 *Federal Register* 49155, October 24, 2017.

currently undertaking a new negotiated rulemaking process to revise the BDR standards.⁴⁷ It is unclear how the BDR standards may be revised in the negotiated rulemaking process.

TEACH Grants

TEACH Grant recipients whose TEACH Grants have converted into a Direct Loan for failure to complete TEACH Grant service requirements may seek relief under either a closed school discharge or a successful BDR. Program regulations specify that for individuals who do not complete the program's teaching service requirements, the TEACH Grant converts into a DL and the individual "is eligible for all of the benefits of the Direct Loan Program."⁴⁸ Thus, so long as an individual meets all applicable closed school discharge or BDR criteria, they may be provided relief from repaying a TEACH Grant that has converted into a DL.⁴⁹

Private Education Loans

In some instances, students who attended a closed school may have borrowed private education loans to help finance their postsecondary education at the closed school. Private education loans are non-federal loans made to a student to help finance the cost of their postsecondary education. Unlike federal student loans, which have statutorily prescribed terms and conditions that are typically uniform in nature, private education loan terms and conditions are primarily governed by market conditions that may vary greatly, depending on a variety of factors such as the lender, the borrower's creditworthiness, and the market.⁵⁰ Thus, the extent to which a private education loan borrower may be provided relief from the requirement to repay their loans will largely depend on the individual private education loan's terms and conditions.⁵¹

Relief for Pell Grant Recipients⁵²

Pell Grant recipients who attended an IHE that closed may have some portion of their Pell eligibility restored. All Pell Grant recipients are subject to a cumulative lifetime eligibility cap on Pell Grant aid equal to 12 full-time semesters (or the equivalent). The HEA exempts from a student's lifetime eligibility cap the period of attendance at an IHE at which a student was unable

⁴⁷ For additional information, see Department of Education, "Borrower Defense and Financial Responsibility," <https://www2.ed.gov/policy/highered/reg/hearulemaking/2017/borrowerdefense.html>.

⁴⁸ 34 C.F.R. §686.43(b)(2).

⁴⁹ TEACH Grant regulations do not provide for a discharge of an individual's duty to meet TEACH Grant service requirements due to a school closure or BDR. However, an individual may request that his or her TEACH Grant be converted into a DL because he or she has decided not to fulfill the service requirements or "for any other reason." 34 C.F.R. §686.43(a). Thus, it appears an individual could request his or her TEACH Grant be converted into a DL and then seek relief from DL repayment under a closed school discharge or a BDR, while also not being required to meet TEACH Grant service requirements.

⁵⁰ For additional information on private education loans, see Consumer Financial Protection Bureau, "What are the different ways to pay for college or graduate school?," <https://www.consumerfinance.gov/ask-cfpb/what-are-the-different-ways-to-pay-for-college-or-graduate-school-en-545/>, accessed February 1, 2018.

⁵¹ In some instances, a private education loan lender or a third-party may agree to provide some debt relief to private education loan borrowers. For instance, a third-party agreed to provide approximately \$480 million in debt relief to former Corinthian Colleges students who borrowed private education loans to attend Corinthian Colleges. Consumer Financial Protection Bureau, "Special Bulletin for Current and Former Students Enrolled at Corinthian-Owned Schools," February 3, 2015, http://files.consumerfinance.gov/f/201502_cfpb_bulletin_current-and-former-students-enrolled-at-corinthian-owned-schools.pdf.

⁵² This section of the report was authored by Cassandria Dortch, Specialist in Education Policy, cdortch@crs.loc.gov, 7-0376.

to complete a course of study because the IHE closed.⁵³ ED uses its information technology systems to adjust Pell eligibility for those students who attended a closed school and were not reported as having “graduated” from that school.⁵⁴ Following an adjustment, ED notifies students of the adjustment.

GI Bill Educational Assistance Benefits⁵⁵

GI Bill entitlement may be restored following a school closure. However, a school closure may result in some GI Bill participants receiving an overpayment of benefits that they would become responsible for repaying.

Restoration of Entitlements

Prior to 2015, GI Bill entitlement was not restored for benefits received at an educational institution that later closed.

The Harry W. Colmery Veterans Educational Assistance Act of 2017 (P.L. 115-48) restores GI Bill entitlement for individuals affected by school closures. Generally, GI Bill recipients are entitled to benefits equal to 36 months of full-time enrollment (or the equivalent for part-time educational assistance) under one GI Bill. In the case of the Survivors’ and Dependents’ Educational Assistance Program (DEA; 38 U.S.C., Chapter 35), recipients who first enrolled in a program of education before August 1, 2018, have 45 months (or the equivalent for part-time educational assistance) of entitlement. Entitlement is restored for an incomplete course or program for which the individual is unable to receive credit or lost training time as a result of an educational institution closing. P.L. 115-48 applies to school closures occurring after January 1, 2015,⁵⁶ and the restoration of entitlement goes into effect November 14, 2017.

In addition to restoring such entitlement, P.L. 115-48 permits the VA to continue paying a Post-9/11 GI Bill housing allowance through the end of the academic term following such closure but no longer than 120 days. Entitlement is not charged for the interim housing allowance. The extension of benefits following such closure is only applicable to the Post-9/11 GI Bill. Eligibility for interim housing allowance payments begins August 16, 2017, and they are payable effective August 1, 2018.⁵⁷

Finally, P.L. 115-48 requires that the Department of Veterans Affairs (VA) notify affected individuals of imminent and actual school closures and notify them how such closure will affect their GI Bill entitlement.

⁵³ HEA §437(c)(3).

⁵⁴ ED began restoring Pell Grant lifetime eligibility in March 2017. Previously, ED had determined it did not have the statutory authority to restore Pell Grant lifetime eligibility limits in the event of a school closure; however, on October 28, 2016, ED determined it does, in fact, have the authority to do so. Department of Education, “U.S. Department of Education Announces Final Regulations to Protect Students and Taxpayers from Predatory Institutions,” press release, October 28, 2016, http://www.ed.gov/news/press-releases/us-department-education-announces-final-regulations-protect-students-and-taxpayers-predatory-institutions?utm_name=.

⁵⁵ This section of the report was authored by Cassandra Dortch, Specialist in Education Policy, cdortch@crs.loc.gov, 7-0376.

⁵⁶ The amount of entitlement restored for closures occurring from January 1, 2015, through August 16, 2017, is based on the entire period of the individual’s enrollment in the closed school.

⁵⁷ The later effective date gives the VA the opportunity to adapt its administrative processes and systems to make payments.

Overpayment of Benefits

Under general GI Bill regulations, if there are mitigating circumstances, a GI Bill participant who withdraws from all courses may remain eligible for benefits for the portion of the course completed. However, if there are no mitigating circumstances, the individual may be required to repay all benefits received for pursuit of the course. Mitigating circumstances are circumstances beyond the individual's control that prevent the individual from continuously pursuing a program of education. A school closing is considered to be a mitigating circumstance.⁵⁸

Some GI Bill benefits, such as advance payments and the Post-9/11 GI Bill tuition and fees payment, Yellow Ribbon payment, and books and supplies stipend, may be paid as a lump sum before or at the beginning of an academic term. An overpayment may occur for a prorated portion of those upfront payments if an individual is unable to complete the academic term without mitigating circumstances.⁵⁹

Under Post-9/11 GI Bill regulations, the VA may determine the ending date of educational assistance based on the facts found if an eligible individual's educational assistance must be discontinued for any reason not described in regulations.⁶⁰ A school that permanently closes may qualify as a reason not described in regulations.⁶¹

Additional Student Aid Eligibility

For students who wish to continue their education at another IHE, another financial consideration related to an IHE's closure is the extent to which the students' eligibility for various financial aid sources may be affected by their previous use of those benefits at the closed institution. In addition to the duration of eligibility limits generally placed on Pell Grants and GI educational benefits discussed in the previous section, other federal student aid eligibility criteria that could affect future receipt of additional Title IV student loans include borrowing limits and eligibility limitations for receipt of Direct Subsidized Loans.

Loan Limits

Generally, annual and aggregate borrowing limits apply to Title IV student loans. Annual loan limits prescribe the maximum principal amount that may be borrowed in an academic year, and aggregate limits apply to the total amount of outstanding Title IV loans that borrowers may accrue.⁶² Borrowing limits for DL and Perkins Loan program loans⁶³ vary by borrower academic

⁵⁸ The Department of Veterans Affairs (VA) automatically grants mitigating circumstances for up to six credits the first time a student reduces or terminates and mitigating circumstances must be considered. This automatic grant is called the 6-Credit Hour Exclusion.

⁵⁹ The VA has indicated that students may be subject to debt for the closure of ITT Tech if the students received benefits (books and supplies) for a term they are unable to complete. U.S. Department of Veterans Affairs, "More Information Concerning ITT Tech's Closure," September 13, 2016, available at <http://www.benefits.va.gov/gibill/>, as of October 14, 2016.

⁶⁰ 38 C.F.R. §21.9635(bb).

⁶¹ The VA has indicated that "no debts will be created against students because of the [Corinthian College] closure" unless the student dropped classes prior to the closure. U.S. Department of Veterans Affairs, "Corinthian College Students—What You Should Know," April 30, 2015, available at <http://www.benefits.va.gov/gibill/> as of December 14, 2015.

⁶² No aggregate limits are placed on PLUS Loans.

⁶³ Borrowing limits also applied to FFEL; however, the authority to disburse new FFEL program loans terminated in FY2010.

standing (e.g., grade or credential level), and in the case of DL program loans, by loan type (e.g., Subsidized or Unsubsidized Direct Loan), and dependency status.⁶⁴ For borrowers who receive a closed school discharge or whose loans have been discharged under a successful BDR claim, any discharged loans do not count against their annual and aggregate loan limits.⁶⁵

Eligibility for Direct Subsidized Loans

In general, for borrowers of Direct Subsidized Loans, the federal government pays the interest that accrues on the loan while the borrower is enrolled in school on at least a half-time basis, during a six-month grace period thereafter, and during periods of authorized deferment. Individuals who are new borrowers on or after July 1, 2013, may only receive Direct Subsidized Loans for a period of time equal to 150% of the published length of the borrower’s academic program (e.g., a borrower enrolled in a four-year degree program may receive six years’ worth of Direct Subsidized Loans).⁶⁶ However, for borrowers who receive a closed school loan discharge or who successfully assert a BDR claim, the discharged loan will not count against the borrower’s Subsidized Loan usage period.⁶⁷

State Tuition Recovery Funds

In addition to available debt relief, some states operate state tuition recovery funds (STRFs), which may reimburse students for charges paid to closed IHEs that are not covered by other sources. For example, a student may have his or her Direct Loan discharged due to school closure, and an STRF may provide relief to cover expenses such as cash payments made directly to a closed IHE for tuition payments or to provide relief on private student loans borrowed to attend an IHE. The availability of and eligibility for such funds vary by state; not all states operate STRFs.⁶⁸

Income Tax Consequences⁶⁹

Borrowers whose student loans are discharged due to school closure will be subject to federal and state income taxes on the discharged loans unless they qualify for an exception. Students who received funds from an STRF might similarly be subject to tax on any funds received, although the tax treatment of such funds is unclear. Additionally, there could be tax consequences for individuals who had previously claimed certain federal education tax benefits. This section

⁶⁴ For additional information on loan limits, see CRS Report R40122, *Federal Student Loans Made Under the Federal Family Education Loan Program and the William D. Ford Federal Direct Loan Program: Terms and Conditions for Borrowers*, by David P. Smole.

⁶⁵ HEA §§425(a)(2), 437(c)(3), 464(g)(3). See also, U.S. Department of Education, Office of Federal Student Aid, “Frequently Asked Questions About the Closure of ITT Technical Institutes,” <https://studentaid.ed.gov/sa/about/announcements/itt/faq>, accessed February 1, 2018.

⁶⁶ HEA §455(q).

⁶⁷ HEA §437(c)(3). See also, U.S. Department of Education, “Student Assistance General Provisions, Federal Perkins Loan Program, William D. Ford Federal Direct Loan Program, and Teacher Education Assistance for College and Higher Education Grant Program; Proposed Rule,” 81 *Federal Register* 39355, June 16, 2016.

⁶⁸ For additional information, see National Consumer Law Center, Student Loan Borrower Assistance Project, “State Programs,” <http://www.studentloanborrowerassistance.org/loan-cancellation/state-programs/>, accessed February 1, 2018.

⁶⁹ This section was written by Margot Crandall-Hollick, Specialist in Public Finance (mcrandallhollick@crs.loc.gov, 7-7582) and Erika Lunder, Legislative Attorney (elunder@crs.loc.gov, 7-4538).

examines the potential federal and state tax consequences that may arise for these borrowers and students.

Federal Tax Treatment of Cancelled Debt

Under the Internal Revenue Code (IRC), borrowers whose debt is forgiven must generally include the amount of the canceled debt in income when determining their federal income tax liability.⁷⁰ In other words, they are subject to tax on the amount of the discharged loan. There are, however, various exceptions to this rule under which a borrower may exclude from income all or part of the forgiven debt.⁷¹

The HEA contains several exceptions providing for certain student loan discharges. These exceptions apply to borrowers of FFELs, Direct Loans, and Perkins Loans who borrowed such loans to attend any IHE and whose loans are discharged due to school closure.⁷² Under the HEA exceptions, these borrowers will not be subject to federal income taxes on the discharged amounts so long as the student borrowers (or students on whose behalf a parent borrowed) meet the general criteria regarding the discharge of debt tied to closed schools described earlier in this report.⁷³

The HEA does not address the tax treatment of (1) federal student loans discharged due to a successful borrower defense to repayment or (2) private education loans that are discharged under any circumstances. As such, in these cases, the borrowers will be taxed on the amount of the discharged loan unless they qualify for an exception found outside of the HEA. Federal tax law provides several exceptions that may be relevant to borrowers whose loans are discharged. For example, IRC Section 108 excludes forgiven debt if the taxpayer is insolvent.⁷⁴ Thus, borrowers whose liabilities exceed the fair market value of their assets immediately prior to discharge will not be taxed on the discharged student loan.⁷⁵ Another example of an exception that might be relevant is the disputed debt doctrine. Under this doctrine, a discharged loan is not considered income for federal tax purposes if the loan was based on fraud or misrepresentation by the lender.⁷⁶ Guidance issued by the Internal Revenue Service (IRS) in 2015 illustrates how the doctrine might be applied in the student loan context. The guidance provides that former students of Corinthian Colleges, Inc. whose federal student loans are discharged under a defense against repayment claim will not be taxed on the discharged amounts because many would likely qualify under the disputed debt doctrine due to the school's fraudulent behavior.⁷⁷

In order to exclude a discharged loan from income, borrowers must determine that they qualify for an exception based on their individual circumstances and be able to show that the

⁷⁰ 26 U.S.C. §61(a)(12); Treas. Reg. §1.61-12. *See also* United States v. Kirby Lumber Co., 284 U.S. 1, 3 (1931) (treating discharged indebtedness as income at a time when the IRC did not yet address its tax treatment).

⁷¹ *See*, for example, 26 U.S.C. §108 (allowing taxpayers to exclude canceled debt under certain conditions).

⁷² HEA §§437(c)(4), 464(g)(4), and 455(a)(1).

⁷³ HEA §§437(c)(4), 464(g)(4), and 455(a)(1). *See also* Rev. Proc. 2015-57, 2015-51 I.R.B. 863 (providing that former students of Corinthian Colleges, Inc., whose federal student loans are discharged under the closed school discharge procedure will not be taxed on the amounts, citing to these statutes).

⁷⁴ 26 U.S.C. §108(a)(1)(B).

⁷⁵ *Ibid.* §108(a)(3).

⁷⁶ *See*, for example, *Preslar v. Comm'r*, 167 F.3d 1323, 1329 (10th Cir. 1999); *Zarin v. Comm'r*, 916 F.2d 110, 115 (3rd Cir. 1990).

⁷⁷ Rev. Proc. 2015-57, 2015-51 I.R.B. 863.

determination is correct if the IRS contests it. If the IRS disagrees and assesses tax based on the amount of the discharged loan, the taxpayer may challenge the assessment in federal court.⁷⁸

Federal Tax Treatment of State Tuition Recovery Funds

Students who receive funds from STRFs might also face federal tax consequences, although the tax treatment is less clear. As a general rule, any amount received by a taxpayer is includible in gross income, and potentially subject to taxation, unless specifically excluded by law.⁷⁹ It is not clear how this principle applies in the context of STRF payments, as there do not appear to be court decisions or IRS guidance addressing the issue. There are several theories under which students could arguably exclude the payments from income, depending on their circumstances and the specifics of the state's plan. For example, the payment might be treated as a non-taxable reimbursement of tuition, scholarship, or state benefit.⁸⁰ If the payment is excluded from the student's income, the student may be required to account for previously claimed federal education tax benefits, as discussed below.

Federal Higher Education Tax Benefits

Along with the potential taxation of discharged student loans and amounts received from STRFs, a school's closure or the discharge of a borrower's student loan may have consequences related to higher education tax benefits. While there are a variety of federal tax benefits that help offset some of the costs of a higher education, four are relevant for purposes of this report for reasons discussed below.⁸¹ These four benefits include the following:

- **The student loan interest deduction**, under which qualifying taxpayers may annually deduct up to \$2,500 of student loan interest for the entire duration of repayment.⁸²
- **The tuition and fees deduction**, which allows taxpayers to reduce their income subject to tax for tuition and fees paid annually, up to \$4,000, depending on their income level.⁸³

⁷⁸ The borrower may file suit in the U.S. Tax Court prior to paying the disputed amount, or in the U.S. Tax Court or appropriate federal district court after paying such amount. See 26 U.S.C. §§6213(a), 7421; 28 U.S.C. §1340. See also 26 U.S.C. §6201(d) (providing that if an information return filed by a third party serves as the basis for the IRS's determination that a taxpayer owes tax, the IRS then has the burden of producing reasonable and probative information concerning the alleged deficiency). This provision may be relevant for student borrowers because their discharged loans should be reported by the lender to the IRS on an information return. *Ibid* §6050P.

⁷⁹ *Ibid*. §61(a).

⁸⁰ See, for example, *Comm'r v. Glenshaw Glass Co.* 348 U.S. 426, 431 (1955) (interpreting "gross income" to mean "accessions to wealth, clearly realized, and over which the taxpayers have complete dominion") (emphasis added); 26 U.S.C. §117 (excluding qualifying scholarships from income); Rev. Rul. 2003-12, 2003-1 C.B. 283 (discussing the general welfare exclusion, which has been developed by the IRS through a series of administrative rulings and excludes qualifying governmental benefits from income).

⁸¹ For a summary of all higher education tax benefits that a student may be eligible for, including benefits for student debt and for saving for higher education, see CRS Report R41967, *Higher Education Tax Benefits: Brief Overview and Budgetary Effects*, by Margot L. Crandall-Hollick.

⁸² 26 U.S.C. §221.

⁸³ *Ibid* §222. The ultimate tax savings from the tuition and fees deduction depends on the taxpayer's marginal tax rate. For example, if the taxpayer's top tax rate is 10%, deducting \$4,000 will reduce tax liability by \$400; however, if the taxpayer's top tax rate is 25%, the same deduction will reduce tax liability by \$1,000.

- **The Lifetime Learning Credit (LLC)**, under which qualifying taxpayers may annually reduce their tax liability for tuition and fees paid, up to \$2,000.⁸⁴ The LLC is a non-refundable credit, meaning any amount of the credit in excess of income tax liability is effectively forfeited by the taxpayer.
- **The American Opportunity Tax Credit (AOTC)**, under which qualifying taxpayers can reduce tax liability by \$2,500 per student annually (depending on eligible expenses and the taxpayer income level).⁸⁵ The AOTC can be claimed for tuition and fees and books, supplies, and equipment, but not room and board.⁸⁶ Additionally, the AOTC is a refundable credit, which means taxpayers with little to no tax liability can receive up to \$1,000 of the AOTC as a refund check.⁸⁷

Tuition and fees paid with the proceeds of a loan can count toward claiming these tax benefits, but any aid that is tax-free, such as a Pell Grant, must generally reduce the amount of expenses against which the benefits may be claimed.⁸⁸ As a general rule, either the parent or the student who pays the qualifying education expenses will claim the tax benefit, depending on whether the student is the parent's dependent for tax purposes.⁸⁹ Taxpayers can generally only claim one tax benefit per student annually.⁹⁰

Availability of Benefits for Students Whose School Has Closed

Students who continue to pursue higher education after a school closure are eligible for these education tax benefits, pursuant to the requirements applicable to all taxpayers. However, in some instances, a taxpayer who claims the AOTC may be ineligible for the credit in future years due to statutory restrictions on the period of education for which students may claim the credit. Specifically, the AOTC can only be claimed for expenses incurred during the first four years of a postsecondary education, irrespective of whether those first four years lead to a postsecondary credential.⁹¹ Therefore, for example, it appears that if a student attended a school for three years and that school closed, the maximum remaining time the student could claim the AOTC is one additional year. There is seemingly no IRS guidance or case law addressing how this requirement is applied in the context of students whose schools have closed, including students who may have to pay back previously claimed credits (discussed below).

The other three benefits contain no limits on the period of education in which students may claim them.

⁸⁴ Ibid §25A(c).

⁸⁵ Ibid. §25A(i). For a detailed overview of the AOTC, see CRS Report R42561, *The American Opportunity Tax Credit: Overview, Analysis, and Policy Options*, by Margot L. Crandall-Hollick.

⁸⁶ 26 U.S.C. §25A(i)(3).

⁸⁷ Ibid. §25A(i)(5).

⁸⁸ Ibid. §§25A(g)(2), 221(d)(2), 222(c)(2)(B).

⁸⁹ Ibid. §§25A(g)(3) & (5), 221(c), 222(c)(3); Treas. Reg. §1.25A-5(a). See also Treas. Reg. §1.25A-5(b) (treating expenses paid by a third party, such as grandparents or non-custodial parents, as paid by the student under certain circumstances).

⁹⁰ See, for example, 26 U.S.C. §§25A(c), 221(e)(1), 222(c)(1) & (2).

⁹¹ Ibid. §25A(b)(2)(A) & (C), (i)(2).

Federal Tax Treatment of Previously Claimed Education Tax Benefits

Taxpayers may be required to account for previously claimed education tax benefits if they subsequently qualify to exclude discharged student loans or STRF payments. The borrowers who might be affected are those who

- claimed the LLC or AOTC for expenses that were paid with the proceeds from a student loan that was subsequently discharged,
- deducted expenses for tuition and fees that were paid with the proceeds from a student loan that was subsequently discharged,
- deducted interest on a student loan that was subsequently discharged, or
- claimed a tax credit (i.e., the LLC or AOTC) or a deduction (for tuition and fees or student loan interest) for expenses that were reimbursed by an STRF payment.⁹²

In order to prevent these borrowers from getting the double benefit of both (1) a credit or deduction and (2) the exclusion of the discharged loan or STRF payment, such borrowers may be required to pay back the value of the credit or deduction.⁹³ However, there may be circumstances in which the IRS will not require a taxpayer to account for previously claimed tax benefits. For example, in the 2015 guidance addressing former students of Corinthian Colleges, Inc., the IRS announced that it will not require these borrowers to account for previously claimed education tax benefits.⁹⁴ The IRS did not explain its reasoning in reaching this determination,⁹⁵ and it is not clear the extent to which the agency may provide similar benefits to other borrowers.

State Income Tax Consequences

A school closure or the discharge of a student loan may also result in state income tax consequences. Most states use the IRC's definition of income as the starting point for computing state income tax liability.⁹⁶ As such, to the extent that the borrower must pay federal income tax on the discharged debt or account for previously claimed federal education tax benefits, he or she may be taxed at the state level as well. Similarly, to the extent that the borrower qualifies to exclude the amounts from federal income taxation, such treatment may also apply at the state level. However, while most state tax codes follow the IRC, states are not required to adopt the federal definition of income and, thus, some states may provide for different tax treatment. Furthermore, states with their own education tax benefits or tuition recovery funds may have laws or policies specifically addressing the state tax treatment of the benefits and funds.

⁹² Note that these tax consequences might also apply to any taxpayers who claimed the Hope Scholarship Credit, which was replaced by the AOTC beginning in 2009. See American Recovery and Reinvestment Act of 2009, P.L. 111-5, §1004, 123 Stat. 115, 313 (2009). The Hope credit is codified at 26 U.S.C. §25A(b).

⁹³ See *Hillsboro Nat'l Bank v. Comm'r*, 460 U.S. 370, 377-80 (1983) (discussing the origin of the judicially developed tax benefit rule, which prevents taxpayers from receiving double tax benefits on the same income or transaction); 26 U.S.C. §111 (partially codifying the tax benefit rule); Treas. Reg. §1.25A-5(f)(3), (4) (requiring the education tax credits be recaptured if the taxpayer receives a refund of the expenses).

⁹⁴ Rev. Proc. 2015-57, 2015-51 I.R.B. 863.

⁹⁵ *Ibid.*

⁹⁶ See *Personal Income Tax Quick Answer Charts: Starting Point for Personal Income Tax*, State Tax Guide (CCH) ¶700-003 (Nov. 30, 2016) (showing that most states use the federal definition of gross income, adjusted gross income, or taxable income as the basis for computing state individual income tax liability).

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