Money Talks

September 2022

By David Helscher

On August 24, the President announced a plan for student loan debt relief. Federal student loan repayment was originally halted in March 2020 and repayment was set to resume a few days after August 24. The new plan extends the repayment pause through year end, offers partial debt cancellation, includes proposed updates to the Public Service Loan Forgiveness (PSLF) program and a new income-based repayment plan. Opponents of the plan are weighing a court challenge, but as of this writing, no court filings have taken place.

The new framework includes cancellation of $10,000 of federal student loan debt for borrowers with adjusted gross income of less than $125,000 ($250,000 for married filing jointly) based on income from 2020 or 2021, but not 2022 plus another $10,000 for Pell Grant recipients. The repayment pause is being extended one "final" time through December 31, 2022. Borrowers are expected to resume payments in January 2023.

Borrowers who are employed by a nonprofit organization, the military, or the government may be eligible to have their federal student loans forgiven through the PSLF program. These temporary changes waive certain eligibility criteria and make it easier for borrowers to receive credit for past periods of repayment that would otherwise not qualify for PSLF. These changes expire on October 31, 2022. Borrowers who might qualify for loan forgiveness or credit under the PSLF program due to these time-sensitive changes must apply to the program before October 31, 2022. More information can be obtained from the administration's PSLF website. In addition, the Department of Education has proposed allowing certain kinds of deferments and forbearances, such as those for Peace Corps and AmeriCorps service, National Guard duty, and military service, to count toward PSLF.

The Department of Education is proposing a new income-driven repayment plan. For undergraduate loans, it would cap monthly payments at 5% of a borrower's discretionary income (currently borrower's must pay 10% of their discretionary income). For borrowers with an original loan balance of $12,000 or less, the loan balance would be forgiven after 10 years of payments (currently borrowers must repay their loans for 20 years). The plan raises the amount of income considered non-discretionary, with the result that a borrower who earns an annual salary based on $15 minimum wage would not have to make payments. A borrower's unpaid monthly interest is covered so that the borrower's loan balance won't grow due to interest as long as the borrower is making monthly payments. Income recertification becomes automatic, allowing the Department of Education to retrieve income information every year instead of making borrowers recertify their income annually.

Loan cancellation will not be automatic. The Department of Education will be creating a "simple" application for borrowers to claim relief, which is to be available in early October. Once borrowers complete an application, their loan cancellation should be processed within 4-6 weeks. It is recommended that borrowers apply before November 15 in order to receive loan cancellation before the expiration of the payment pause on December 31, 2022.

Student loan relief will not be treated as taxable income at the Federal level. Tax treatment will vary at the state level. Current students are eligible if their loan was obtained prior to July 1, 2022. Borrowers that continued to make payments during the payment pause period can still qualify for loan cancellation if they meet the income guidelines. Graduate students with a federal loan or parent PLUS loans may also be eligible, if income limits are met. Private loans are not eligible.

Cancellation of student debt does not necessarily result in an adjustment to monthly payments. A borrower already in an income-driven plan generally won’t see changes to the monthly payment as the payment is based on discretionary income and household size, not the outstanding loan balance. Borrowers in a fixed payment plan could have their monthly payment recalculated by their loan servicer due to a lower outstanding balance after cancellation.