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

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June 16, 2017
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 defense to repayment (DTR) 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 DTR claim, his or her eligibility for future Direct Subsidized Loans and Pell Grants 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. However, if the borrower used GI Bill educational benefits for attendance at a closed school, those benefits cannot be restored for purposes of attending another institution.

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 (STF). 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) 2014-2015, approximately 7,300 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 295,000 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

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.
location that provides 100% of at least one educational program offered by the IHE or if it intends to otherwise cease operations. 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.” Accreditors 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. 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.

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

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 forms.

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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).


6 34 C.F.R. §602.24(c).

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, 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.

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. 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. Typically, students must initiate the

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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.


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. 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.

### 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. In addition, the student must have been unable to complete his or her program of

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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).
study at the closed school or in a similar program at another IHE, either through a teach-out agreement or by transferring any credits to another IHE.\textsuperscript{19}

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.\textsuperscript{21}

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.\textsuperscript{22} If a borrower fails to cooperate with ED, the loan discharge may be revoked.\textsuperscript{23}

\textit{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.\textsuperscript{24} 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.\textsuperscript{25} 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

\textsuperscript{19} 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 September 28, 2016.


\textsuperscript{22} For instance, the borrower may be required to provide testimony supporting a request for discharge.

\textsuperscript{23} 34 C.F.R. §§674.33(g); 682.402(d); 685.214(c) & (d).

\textsuperscript{24} Ibid. See also, U.S. Department of Education, “Loan Discharge Application: School Closure,” OMB No. 1845-0058.

\textsuperscript{25} 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. 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. Moreover, recently promulgated regulations specify that with respect to IHEs that closed on or after November 1, 2013, the Secretary may discharge a borrower’s loans without an application if the borrower did not re-enroll in any Title IV participating IHE within three years of the school’s closure. These new regulations have not yet been implemented, but ED has indicated it will implement them as soon as “operationally possible.”

**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 defense to repayment (DTR), certain “acts or omissions of an institution of higher education.” 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. There are no borrower DTR provisions for Perkins Loans. The availability of a DTR claim may be closely related to a school’s closure, as oftentimes, a DTR 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.

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26 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. In addition, recently promulgated regulations, which become effective July 1, 2017, require IHEs to provide all enrolled students with a closed school discharge application and a written statement describing the benefits and the consequences of a closed school discharge after ED initiates an action to terminate the participation of the school in any HEA Title IV program or after the occurrence of any of the event that would require the IHE to submit a teach-out plan to its accreditor. U.S. Department of Education, “Student Assistance General Provisions: Final Regulations,” 81 Federal Register 76070, November 1, 2016.

27 34 C.F.R. §§674.32(g); 682.402(d); 685.214(c)(2).

28 81 Federal Register 75928, November 1, 2016. HEA §482(c) requires that regulations affecting Title IV programs be published in final form by November 1, prior to the start of the award year (July 1) to which they apply. The same section, however, authorizes the Secretary to designate any regulation as one that an entity subject to the regulations may choose to implement earlier and the conditions for early implementation.

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
If a borrower’s DTR 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 reported to credit bureaus so that it may delete the adverse credit history associated with the loan.\(^{32}\)

**DTR Eligibility**

For DL program loans, ED has determined in regulations that institutional acts and omissions for which a Direct Loan borrower may assert a DTR 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 DTR claim is dependent on the laws of the applicable state.\(^{34}\) For FFEL program loans, borrowers must satisfy the DL program DTR 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 DTR standards differ from DL program DTR standards, and DTR 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 DTR 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 DTR discharge of the Direct Consolidation Loan.

In addition to being eligible to have loans discharged after a successful DTR 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 loans\(^{37}\) may not be reimbursable. Specifically, payments

\[(\text{continued})\]


32 34 C.F.R. §685.206(c).


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.


37 Under the FFEL program, loans were originated and serviced by private sector and state-based lenders and were (continued...)
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 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 DTR discharge.  

**DTR Procedures**

Current regulations are silent regarding the process a borrower must follow to assert a DTR claim; however, ED recently developed a universal DTR application for borrowers of DL program loans to pursue a DTR claim. As of February 1, 2017, the universal application is the only DTR application accepted by ED.

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 forbearance 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.

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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.
The forbearance or stopped collections affects all of a borrower’s ED-held student loans, including those loans ineligible for a DTR claim.41

While an individual’s loan is in forbearance, ED reviews the DTR 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.

Individuals who wish to consolidate their ED-held FFEL or Perkins Loan program loans into a DL Consolidation loan to pursue a DTR 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 DTR 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 his loans into a DL Consolidation loan to have the loans discharged.42

For those FFEL program loans not held by ED, DTR claims procedures may vary by lender. Borrowers of such loans must contact their lender for information on the DTR process. In general, private sector holders of FFEL program loans are not required to grant a forbearance or to cease collections they evaluate a DTR 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 DTR claim if the loans were consolidated into a Direct Consolidation Loan.

**Recently Promulgated DTR Regulations**

On November 1, 2016 ED promulgated new regulations intended to create a more robust set of standards and streamlined procedures for assessing DTR claims.43 These regulations were scheduled to become effective on July 1, 2017; however, citing pending litigation regarding the recently promulgated regulations, ED recently announced it would postpone the effective date of the new regulations until the litigation is resolved.44 ED also recently announced its intention to begin a negotiated rulemaking process to revise the DTR standards.45 It is unclear how the current or recently promulgated DTR standards may be revised in the negotiated rulemaking process.

This section of the report describes the recently promulgated DTR regulations as they appeared in the Federal Register on November 1, 2016.

Under the recently promulgated DTR regulations, in general, borrowers with DL program loans first disbursed on or after July 1, 2017, may assert as a DTR one of the following, as it relates to

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42 81 Federal Register 76079, November 1, 2016.
43 Ibid. at p. 75926.
the making of a borrower’s DL for enrollment at the IHE or the provision of educational services for which the DL was provided:

1. a state or federal court judgment against an IHE;
2. a breach of contract by an IHE, where an IHE failed to perform obligations, such as the provision of specific programs or services; or
3. a substantial misrepresentation by an IHE on which a borrower reasonably relied when the borrower decided to attend, or continue attending, the IHE.

For borrowers with DL program loans first disbursed prior to July 1, 2017, or FFEL program loans, the DTR standards would remain the same as described in the previous section.

As with the pre-July 1, 2017 DTR practices described above, the new DTR standards will permit borrowers of FFEL and Perkins Loan program loans to consolidate those loans into a Direct Consolidation Loan and pursue a potential discharge under a DTR claim. The DTR standards used to determine loan discharge eligibility for the loans paid off through consolidation would depend on a variety of factors including whether the loan(s) paid off by the Direct Consolidation Loan and for which a DTR claim is being asserted is a DL, FFEL, or Perkins Loan program loan and, in some instances, the date on which the Direct Consolidation Loan was first made. The standards that would apply to the underlying loan(s) of a Direct Consolidation Loan are as follows:

- **Direct Loans paid off through consolidation:** The DTR standard used would depend on the first date on which an underlying Direct Loan to which a DTR claim applies was made. If an underlying Direct Loan was made prior to July 1, 2017, then the pre-July 1, 2017 DTR standards would be used. If all the underlying Direct Loans were made after July 1, 2017, then the post-July 1, 2017 standards would be used.

- **Other eligible loans paid off through consolidation:** The DTR standard used would depend on the date on which the Direct Consolidation Loan was made. If the Direct Consolidation Loan was made prior to July 1, 2017, then the pre-July 1, 2017 standards would apply to the underlying loans. If the Direct Consolidation Loan was made after July 1, 2017, then the post-July 1, 2017 standards would apply.

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46 A contract between an IHE and a borrower could include, for instance, an enrollment agreement, school catalogs, or student handbooks.

47 The new regulations define misrepresentation “as any statement that omits information in such a way as to make the statement false, erroneous, or misleading.” Examples of misrepresentations that may give rise to a DTR claim are those that relate to an IHE’s educational programs, financial charges, or the employability of its graduates. See 81 Federal Register 75937, November 1, 2016.

48 In determining the extent to which a borrower relied on a misrepresentation, an ED official may consider a variety of factors including, for instance, whether the IHE demanded that the borrower immediately make enrollment and unreasonably pressured the borrower, or took advantage of the borrower’s lack of knowledge. See 81 Federal Register 76083, November 1, 2016.

49 In general, individuals who have previously consolidated their federal student loans under the FFEL program are ineligible to consolidate their loans a second time. However, such individuals may consolidate their previously consolidated loans into a Direct Consolidation Loan for purposes of pursuing a DTR claim under the post-July 1, 2017 procedures.

50 Borrowers may also consolidate Health Professions Student Loans, Loans for Disadvantaged Students made under Title VII-A-II of the Public Health Service Act, Nursing Loans made under part E of the Public Health Service Act, or Health Education Assistance Loans into a Direct Consolidation Loan and, thus, pursue a potential discharge under a DTR claim.
standards would apply to these loans. In either case, the applicable Direct Loan DTR standard (as opposed to the FFEL DTR standard) would be applied.

Thus, the DTR standard to be used with respect to Direct Consolidation Loans would be dependent upon the date on which the underlying loans were classified as being Direct Loans.

The previous rules for reimbursement of previously paid amounts described in the previous section remain the same.\(^{51}\)

In addition, new DTR procedures will be available to all DL program borrowers, regardless of when their loans were first disbursed, and DTR procedures for non-DL program loans held by ED and for federal loans not held by ED (e.g., privately held FFEL program loans) would remain the same as under the current process. Under the new regulations, ED created separate processes under which individuals or groups may assert a DTR claim for DTR claims related to DL program loans. Under the individual claim process, a borrower will be required to submit the currently available universal DTR application to ED that, among other items, provides evidence to support his or her claim. An ED official will then review the application to determine whether the borrower is eligible for loan discharge, conduct a fact-finding process to resolve the claim, and issue a written decision on the matter.\(^{52}\) If ED denies the DTR claim in full or in part, the borrower may request reconsideration of the matter upon submission of new evidence.\(^{53}\)

Alternatively, ED may consolidate individual DTR applications into a single group claim or may determine that common facts apply to a group of borrowers who have not filed individual DTR applications.\(^{54}\) ED may consider a group DTR claim based on an analysis of several factors including whether there exists a common set of facts and claims among group members.\(^{55}\) Should ED decide to consider the group DTR claim, an ED official will present the group DTR claim to a hearing official in a fact-finding process on the group’s behalf. The precise procedures for the fact-finding process will depend on whether the DTR claims relate to a closed IHE or an open IHE.

When an IHE has closed and has not provided financial protection to ED (e.g., a letter of credit, which is collateral assuring ED that sufficient funds are available to cover institutional obligations such as student refunds, if needed), a hearing official would review the group’s claim and make a determination on the claim. When an IHE is open and a group DTR claim has been submitted, a hearing official would resolve the group DTR claim and determine any liability the IHE may owe ED for any amounts discharged. An IHE may appeal the decision to the Secretary of Education (the Secretary). For both the closed and open IHE processes, if a DTR claim is denied in whole or in part, an individual borrower may request the Secretary reconsider the DTR claim upon identification of new evidence that supports the borrower’s individual DTR claim.\(^{56}\)

\(^{51}\) The Final Rules also create statutes of limitations for when borrowers may assert DTR claims for loan discharge and reimbursement for previously made payments. For loans made prior to July 1, 2017, the applicable state’s statute of limitations applies. For loans made prior to July 1, 2017, the statute of limitations would depend on the specific DTR claim made (e.g., breach of contract, substantial misrepresentation) and whether the borrower is seeking loan discharge or reimbursement for previously made payments on the loan.

\(^{52}\) As part of the fact-finding process, ED will notify the IHE of the DTR application and consider any response or submission from the IHE.

\(^{53}\) 81 Federal Register 76083-76084, November 1, 2016.

\(^{54}\) Identified individuals of a group may opt out of the group and pursue an individual DTR claim.

\(^{55}\) ED may identify a group of borrowers based on individually filed DTR claims or on any other source of information.

\(^{56}\) 81 Federal Register 76084, November 1, 2016.
Upon receipt of any DTR claim, ED will place into forbearance any nondefaulted loans and cease collections on defaulted loans for which the DTR claim is asserted.\textsuperscript{57} The forbearance and ceased collections will remain in place until a decision has been made on the DTR claim. Borrowers will be given the option to opt out of forbearance or ceased collections. If a DTR claim is denied in whole or in part, a loan will return to its status prior to claim submission (e.g., default, repayment).

Finally, if a DTR claim is approved, an ED official or a hearing official that heard the DTR claim will determine the appropriate amount of relief to which a borrower is entitled, which may include the discharge of all outstanding amounts owed on a loan and all payments previously made on the loan, or some lesser amount. The amount of relief provided will depend on the basis of the DTR claim (e.g., substantial misrepresentation, breach of contract). For instance, relief provided based on a substantial misrepresentation claim will factor, among other considerations, the cost of attendance to attend the IHE and the value of the education the borrower received.\textsuperscript{58}

Relief provided based on a judgment against a school will depend on whether the judgment awards specific financial relief and applicable law to monetize a judgment in the event the judgment does not provide specific financial relief. Finally, relief provided based on a breach of contract will be determined “according to the common law of contracts” and other reasonable considerations. In no event can the amount of relief granted for a successful DTR claim exceed the amount of the loan and any associated costs and fees. Moreover, any relief granted will be reduced by any amount of refund, reimbursement, debt discharge, or other financial benefit received by or on behalf of the borrower that was related to the DTR claim.\textsuperscript{59}

**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 DTR. 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.”\textsuperscript{60} Thus, so long as an individual meets all applicable closed school discharge or DTR criteria, they may be provided relief from repaying a TEACH Grant that has converted into a DL.\textsuperscript{61}

\textsuperscript{57} The new regulations specifically require private holders of FFELs to place FFELs into forbearance while a DTR claim is being assessed. In addition, these provisions have been designated for early implementation; thus, ED and private loan holders may place borrowers in forbearance while their DTR claim is being processed prior to July 1, 2017.

\textsuperscript{58} Appendix A to Subpart B of Part 685 provides conceptual examples of how an ED or hearing official might determine the amount of relief to which a borrower is entitled.

\textsuperscript{59} 81 Federal Register 76086, November 1, 2016.

\textsuperscript{60} 34 C.F.R. § 686.43(b)(2).

\textsuperscript{61} 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 DTR. 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 DTR, while also not being required to meet TEACH Grant service requirements.
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. 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.

Relief for Pell Grant Recipients

Pell Grant recipients who attended an IHE that closed may have some portion of their Pell lifetime eligibility limit 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). On October 28, 2016, ED announced plans to restore some portion of a student’s Pell lifetime eligibility limit in the event that the student is unable to complete his or her program as a result of a school closure. Additional details on implementation of the policy are forthcoming.

GI Bill Educational Assistance Benefits

There are no statutory or regulatory provisions that provide for the restoration of GI Bill educational assistance benefits used in association with enrollment at an educational institution or training establishment that subsequently closes; however, the closure may result in a student incurring a debt for any overpayment of GI Bill benefits received.

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, or in the case of the Survivors’ and Dependents’ Educational Assistance Program (DEA; 38 U.S.C., Chapter 35), 45 months (or the equivalent for part-time educational assistance). There are no provisions to restore

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63 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.

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


66 This section of the report was authored by Cassandria Dortch, Specialist in Education Policy, cdortch@crs.loc.gov, 7-0376.
a portion of a student’s GI Bill entitlement in the event of a school closure. Thus, for example, if a student used the equivalent of 12 months of entitlement at a particular institution prior to its closure, the student would have either 24 months of entitlement remaining under the GI Bill used (if other than DEA) or 33 months of entitlement remaining under DEA, to use at other institutions.

In addition, a school closure may result in some GI Bill participants receiving an overpayment of benefits for which they would become responsible for repaying. 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. For an individual with mitigating circumstances, the Department of Veterans Affairs (VA) calculates the benefits for which the participant is eligible based on the beginning date of the program and the following ending dates:

- for independent study (online education) or distance learning, the official date in accordance with the practices of the institution of higher learning;
- for correspondence training, the date of the last lesson serviced; and
- for all other programs of education, the last date of attendance, instruction, or training.67

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.68

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.69 A school that permanently closes may qualify as a reason not described in regulations.70

### 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

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67 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.

68 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.

69 38 C.F.R. §21.9635(bb).

70 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.
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.\(^{71}\) Borrowing limits for DL and Perkins Loan program loans\(^{72}\) vary by borrower academic 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.\(^{73}\) For borrowers who receive a closed school discharge or whose loans have been discharged under a successful DTR claim, any discharged loans do not count against their annual and aggregate loan limits.\(^{74}\)

**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).\(^{75}\) However, for borrowers who receive a closed school loan discharge or who successfully assert a DTR claim, the discharged loan will not count against the borrower’s Subsidized Loan usage period.\(^{76}\)

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\(^{71}\) No aggregate limits are placed on PLUS Loans.

\(^{72}\) Borrowing limits also applied to FFEL; however, the authority to disburse new FFEL program loans terminated in FY2010.

\(^{73}\) 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.


\(^{75}\) HEA §455(q).

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.\(^77\)

Income Tax Consequences\(^78\)

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 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.\(^79\) 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.\(^80\)

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.\(^81\) 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.\(^82\)

The HEA does not address the tax treatment of (1) federal student loans discharged due to a successful defense to repayment or (2) private education loans that are discharged under any

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\(^78\) 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).

\(^79\) 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).

\(^80\) See, for example, 26 U.S.C. §108 (allowing taxpayers to exclude canceled debt under certain conditions).

\(^81\) HEA §§437(c)(4), 464(g)(4), and 455(a)(1).

\(^82\) 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).
circumstances. As such, in these cases, the borrowers will be taxed on the amount of the discharge 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. 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. 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. 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.

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 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.

**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. 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. 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.

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84 Ibid. §108(a)(3).
85 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).
87 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.
88 Ibid. §61(a).
89 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).
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. 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.

- **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.

- **The Lifetime Learning Credit (LLC)**, under which qualifying taxpayers may annually reduce their tax liability for tuition and fees paid, up to $2,000. 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). The AOTC can be claimed for tuition and fees and books, supplies, and equipment, but not room and board. 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.

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. 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. Taxpayers can generally only claim one tax benefit per student annually.

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90 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.


92 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.

93 Ibid §25A(c).


96 Ibid. §25A(i)(5).

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

98 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).

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

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.

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. 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. The IRS did not explain its reasoning in reaching this determination, and it is not clear the extent to which the agency may provide similar benefits to other borrowers.

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100 Ibid. §25A(b)(2)(A) & (C), (i)(2).
102 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).
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. 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.

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(...continued)

104 See ibid.
105 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).