Total and Permanent Disability Discharge for Federal Student Loan Borrowers

Student Aid Bill of Rights: Protecting the Social Security Benefits for Borrowers with Disabilities

In 2015 the President announced the Student Aid Bill of Rights, which included a number of efforts to make it easier and fairer for millions of Americans to pay for higher education. One such measure directs the Department of Education (ED) and the Social Security Administration (SSA) to work together to ensure that disability insurance recipients who are eligible for a loan discharge can avoid having their Social Security disability payments offset to repay defaulted loans. The two agencies are proactively identifying borrowers who may be eligible for loan discharge in order to protect their Social Security benefits from offset and ensure they are able to access the benefits to which they are entitled.

How are potentially impacted borrowers identified?

Under the Higher Education Act, student loan borrowers who are totally and permanently disabled are eligible to have their Federal loans discharged, which means that they no longer owe the outstanding amount. However, there is no discharge for partial disability or for short-term disability. Many borrowers who are eligible for this benefit are unaware that they can apply for a loan discharge and do not understand the discharge process.

At the direction of the President through the Student Aid Bill of Rights, SSA and ED have established a new process that allows ED to more easily identify borrowers who are eligible for a disability-related discharge and reach out to those borrowers to help them apply for and receive the benefit. The new process greatly simplifies the steps needed to obtain a disability-related discharge by empowering the two agencies to compare data to document a borrower's eligibility.

What happens once a borrower is identified?

Because loan discharges may be considered taxable income, ED cannot automatically grant a loan discharge to these borrowers. Instead, ED will contact borrowers identified through a data match (between ED and SSA) with customized letters through Nelnet, the Department of Education contractor that processes these cases. The outreach will provide borrowers with a simple application they can sign and return to start the process toward loan discharge. The borrowers will not be required to make payments for up to 120 days after the letter and application is mailed. This 120-day suspension does not include suspension of offsets of other Federal payments like tax refunds or Social Security Payments. However, once the application is processed and approved, any payments received after the disability date, voluntary or otherwise, will be refunded.

Once the borrower returns the signed application the process for the loans to be discharged begins. If the borrower does not return the application within the 120-day suspension period the suspension will expire and the borrower will return to his or her normal payment schedule. It should also be noted that once this initial 120-day suspension expires the borrower cannot receive another suspension--though the borrower could continue with the TPD process and/or submit another TPD application in the future. For more answers to specific questions about the TPD program, please consult the FAQ page on Nelnet's website: https://disabilitydischarge.com/faqs.

When will identified borrowers receive their letters?

The first set of borrower notifications will begin in mid-April and will be followed up with a second letter 120 days after the initial letter if a signed application is not received. Due to the volume of borrowers identified and to ensure good customer service, the notifications will be sent over a 16-week period. ED will monitor the contacts, and if able to effectively handle additional volumes without affecting customer service, additional letters will be mailed ahead of schedule.

How many borrowers have been identified through the match thus far?

In December of 2015 and March of 2016, ED and SSA completed the first set of matches. ED sent in excess of 42 million borrower records to SSA, which identified borrowers who are receiving disability payments and have a designation of Medical Improvement Not Expected (MINE) status that qualifies them for a disability-related loan discharge. Roughly 400,000 borrowers were identified as potentially eligible for loan discharge. The match will continue on a quarterly basis to identify additional potentially eligible borrowers.

What happens after a borrower applies for the loan discharge?

If a borrower is approved for a loan discharge based on total and permanent disability, the Department will contact the borrower's loan holders and instruct them to transfer the loans to the Department. During this time no payments will be due and any payments received after disability approval will be returned.

There is a three-year monitoring period that begins on the date the discharge is approved. If, during this three-year period, the borrower receives any new Direct Loans, Perkins Loans, or TEACH Grants, or starts earning above the poverty guideline for a family size of two, the borrower will be returned to a repayment status and will have to re-start loan payments. The poverty line for a family of two in 2016 currently $16,020 in all states except Alaska, where it is $20,020, and Hawaii, where it is $18,430. For more information about poverty guidelines, please visit https://aspe.hhs.gov/poverty-guidelines.

A loan discharge is not final until the monitoring period is completed, except in rare cases.

What does a borrower need to do during the three-year monitoring period?

During this monitoring period, the borrower must provide documentation about his or her earned income annually so that the Department can determine if the borrower's earnings are below the poverty line for a family of two. The borrower will receive a form from Nelnet on the anniversary of the borrower's discharge.

For more information about what happens after you are approved for a discharge please visit https://disabilitydischarge.com/faqs.

Is the discharge of a student loan for Total and Permanent Disability (TPD) taxable?

Loan balances that are discharged are generally considered income for federal tax purposes and possibly for state tax purposes in the year they are considered discharged. Under the Total and Permanent Disability Discharge process, a student loan will be considered discharged at the end of the three-year monitoring period. A discharged loan amount is generally treated as income and can result in income tax liability, but exceptions are available in some circumstances. For example, section 108(a)(1)(B) of the Internal Revenue Code generally allows a taxpayer to exclude a discharged loan from income if the discharge occurs when the taxpayer is considered "insolvent" for tax purposes. A taxpayer is considered "insolvent" if the taxpayer's liabilities (including the loan that is being discharged) exceed the taxpayer's assets at the time of the discharge. Under this insolvency exclusion, a taxpayer is able to exclude the amount of discharged debt from income to the extent that the taxpayer's liabilities exceed the fair market value of his or her assets. In general, to claim the insolvency exclusion, a taxpayer must submit information about his or her assets and liabilities to the IRS on a Form 982, Reduction of Tax Attributes Due to Discharge of Indebtedness (and Section 1082 Basis Adjustment), with his or her Federal income tax return.

For information about this exclusion and discharges of debt in general, borrowers may want to review IRS Publication 4681 (available at https://www.irs.gov/pub/irs-pdf/p4681.pdf) or consult with a tax professional to determine how this affects personal taxes. To help a borrower file a tax return correctly, the Department will send an IRS Form 1099-C after the three-year monitoring period, if the discharged debt is $600 or more. This form will show the total amount of the discharged debt and the year it is considered to have been discharged. The Department will also send this information to the IRS.

When will the discharge of student debt be reported to the Internal Revenue Service (IRS)?

The discharged debt will be reported to the IRS when the discharge is considered final, generally upon the completion of the three-year monitoring period described above. After a borrower successfully completes the three-year monitoring period some or all of the discharged loan amount may be taxable. If the loan discharge is more than $600, the Department of Education will send the borrower a Form 1099-C at that time (however, if the loan is discharged for another reason prior to the end of the three-year period it will be reported to the IRS at the time and the borrower will receive a Form 1099-C).

Will the discharge of a loan affect a borrower's Social Security Disability Insurance (SSDI) or Supplemental Security Income (SSI) benefits?

Discharge of a federal student loan will not affect the benefits a borrower receives under either the SSDI or SSI program administered by the Social Security Administration. However, if a borrower's benefits are being garnished to repay a student loan, his or her benefits will no longer be reduced for this reason.

Will a loan discharge affect Medicaid eligibility?

Generally, the loan discharge will not affect Medicaid coverage. For Medicaid beneficiaries whose eligibility is based on "Modified Adjusted Gross Income" (MAGI), the discharge will not affect Medicaid coverage during the three-year monitoring period. If, after a final loan discharge, the discharge amount is considered taxable income, there generally would be no impact on Medicaid coverage. In very rare circumstances, a maximum of one month of coverage could be affected.

Will a borrower who receives a loan discharge lose access to Medicare?

The loan discharge will not affect a borrower's eligibility for Medicare and generally will not affect any subsidies a borrower might receive that help him or her pay for Medicare premiums and cost-sharing obligations.

Will a loan discharge affect a borrower's eligibility for advance payments of the premium tax credit received through the Health Insurance Marketplace?

The discharge of a loan for Total and Permanent Disability is generally considered taxable income for the year of the discharge and is considered part of a borrower's countable income (Modified Adjusted Gross Income) used to determine eligibility for the premium tax credit an individual may claim on his or her tax return, and for advance payments of the premium tax credit an individual may receive through the Marketplace. However, as described above, there are exceptions to a loan discharge counting as taxable income, including for households whose loan discharge exceeds their net assets. As stated above, under the Total and Permanent Disability discharge process, a student loan will be considered discharged and reported to the IRS at the end of the three-year monitoring period.

It is important that the borrower carefully consider the tax consequences of a loan discharge. Please consult a tax professional for advice about eligibility for a premium tax credit before deciding if a discharge is beneficial.

What should borrowers do if they are eligible for Total and Permanent Disability (TPD) loan discharge and are getting coverage through a health plan through the Health Insurance Marketplace?

Marketplace consumers who are eligible for and elect to receive a TPD loan discharge generally must report the amount of loan forgiveness as taxable income on their Marketplace application in the year the discharge is scheduled to become final. As stated above, under the Total and Permanent Disability discharge process a student loan will be considered discharged at the end of the three-year monitoring period. However, there are exceptions to the loan discharge counting as taxable income, including for households whose loan discharge exceeds their net assets. Consult a tax professional about the amount of income from a TPD loan discharge to report on the Marketplace application, if the borrower is unsure whether he or she qualifies for one of these exceptions. To learn more about what counts as income on the application click here.

In general, it is important for all individuals who have health insurance through the Marketplace to report any income changes, including loan discharges that are considered taxable income, within 30 days or as soon as possible. If a consumer does not report the change they could miss out on savings or end up having to pay money back when they file their federal income tax return. Consumers can report changes to the Marketplace 3 ways: Online via HealthCare.gov, by phone through the Marketplace Call Center at 1-800-318-2596 or (TTY: 1-855-889-4325), or in-person (locate in person help in your community at Localhelp.healthcare.gov)—not by mail. To learn more about how to report changes to the Marketplace click here.

For additional information, visit https://disabilitydischarge.com or contact the customer service center at 1-888-303-7818.

Sample Letter Excerpt:

U.S. Department of Education
Information about your federal student loan

Total and Permanent Disability Servicing Unit

April 18, 2016

Jane Doe
123 Main St
Any City, VA 123456

Borrower Name: Jane Doe
Account: A123

Dear Jane,

The U.S. Department of Education has received documentation from the Social Security Administration (SSA) showing that you may be eligible for a Total and Permanent Disability (TPD) discharge of your federal student loans. TPD discharge means that the remaining balance of your loans would be forgiven and you would not be required to make any further payments.