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## What every student loan borrower needs to know about the new relief law

Although the new law does not cancel any student loans outright, it might foreshadow more extensive changes ahead.

RICHARD L. KAPLAN



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A change with enormous implications for student loan borrowers was enacted as part of the American Rescue Plan Act. This change declares that any student loan that is forgiven during the next five years will be considered tax-free income by the federal government. This provision is of inestimable value to student borrowers who qualify and perhaps to others for the implicit message it sends about possible changes in the status of student loans generally.

When a person borrows money for any purpose – be it to finance an automobile, a home, a business, or an education, the receipt of loan proceeds is not considered taxable income because the borrower must pay back these loan proceeds at some point. But if, as it turns out, the borrower is not required to pay back the loan, then the rationale for excluding loan proceeds from taxable income dissolves and the forgiven loan becomes taxable.

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The tax code has several exceptions to this logical treatment, one of which deals with student loans. If the loan requires a student to work “for a certain period of time in certain professions” in exchange for having the loan “discharged,” then that discharged debt is excluded from taxable income. A similar exception applies to students who work for public interest organizations such as public defender offices or nonprofit hospitals for at least ten years. But other than these two situations, when a student loan is forgiven, the balance that is released is generally taxable.

The new provision pertains to so-called “income-based repayment” student loans that require a person to pay amounts based on their annual income for twenty or twenty-five years, depending upon the specific program involved. After that time, any remaining loan balance is forgiven. Prior to enactment of this new provision, that remaining loan balance was taxable in the year the loan was forgiven. The new provision, however, makes the forgiven loan balance tax-free if the forgiveness takes place during 2021 through 2025.

This provision is notable for three distinct reasons. First, although all the other payments and tax credits included in the American Rescue Plan Act apply only to 2021, this provision

applies for five full years. Second, there is no dollar limitation on the amount of forgiven debt that can be treated as tax-free income. And third, there is no income limitation regarding which taxpayers can take advantage of this provision, unlike the other benefits provided in the new law.

This new provision is a huge benefit to taxpayers who complete their required payback period during the five years of this provision's duration, and other student borrowers can hope that this provision might be extended after 2025. Although the new law does not cancel any student loans outright, it might foreshadow more extensive changes ahead.

**Richard L. Kaplan** is Guy Raymond Jones Chair in Law at the University of Illinois College of Law in Urbana-Champaign.

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