

May 7, 2024

Lisa Brown
General Counsel
United States Department of Education
400 Maryland Avenue, SW
Washington, D.C. 20202

Re: Taxation Date of Total and Permanent Disability Discharge

Dear Ms. Brown:

We write from the New York Legal Assistance Group, the National Consumer Law Center (on behalf of its low-income clients), and the Education Debt Consumer Assistance Program, asking you to re-issue notices sent by Nelnet to borrowers receiving disability discharge that state that they will be sent 1099s at the end of the three-year post-discharge monitoring period and to clarify that the Department's position is that 1099s for Total and Permanent Disability (TPD) discharge are sent in the year that the discharge is granted (if at all).¹ We believe that the notices sent to borrowers are inconsistent with applicable law, and urge you to clarify the Department's position and issue corrected notices immediately. This issue is critical because the provision making TPD discharge temporarily non-taxable is set to expire at the end of 2025, meaning that if the position set forth in the notices were correct, borrowers receiving TPD discharge in 2023, 2024, and 2025 would receive a 1099, and be subject to a tax bill, in 2026, 2027, or 2028, absent further congressional intervention.

Specifically, Nelnet sends a notice to Borrowers receiving TPD discharge stating the following:

As a result of a change in tax law, loan balances that are discharged due to TPD are not considered income for federal tax purposes if you receive the discharge during the period from January 1, 2018, through December 31, 2025. If you qualify for a TPD discharge based on documentation from the VA, the date you are considered to have received the discharge for tax purposes is the date that we approve the discharge. **If you qualify for a TPD discharge based on documentation from the Social Security Administration or a licensed medical professional certification, the date you are considered to have received the discharge for tax purposes is the completion of your three-year post-discharge monitoring period.** (emphasis added).

By contrast, the Federal Student Aid website correctly states that these discharges are considered taxable on the date that the discharge is issued:

¹ We understand and agree with the Department's position, consistent with IRS guidance, that 1099s should not be issued for discharged federal student loans when those discharges are exempt from income for federal tax purposes, as all discharges currently are until the end of 2025. *See* Instructions for Lenders and Loan Servicers Regarding Certain Discharged Student Loans, IRS Notice 2022-1, available at <https://www.irs.gov/pub/irs-drop/n-22-01.pdf>. ("When all or a portion of a student loan described in section 108(f)(5) is discharged after December 31, 2020 and before January 1, 2026, an applicable entity is not required to, and should not, file a Form 1099-C. . . .").

If you received the TPD discharge during the period from Jan. 1, 2018, to Dec. 31, 2025, the discharge amount is not considered income for federal tax purposes.²

The FSA website is correct: a borrower receiving total and permanent disability has their debt formally and legally discharged at the moment the TPD discharge is granted, and so the 1099 is appropriately issued then—if at all. The applicable tax year for borrowers receiving TPD discharges in 2023, 2024, or 2025 is that same year, not three years later as the notices state. Because federal student loan discharges approved before the end of 2025 are not considered income for federal tax purposes, loans that are discharged before the end of 2025 should not generate 1099s at all.³ If Congress fails to extend the protection from tax consequences, then TPD discharges made in 2026 and later should generate 1099s in the same year as the discharge occurs.

Specifically, under IRS regulations, a 1099 must generally be issued upon the occurrence of an “identifiable event,” which includes, as applicable here, “[a] discharge of indebtedness pursuant to a decision by the [Department], or the application of a defined policy of the [Department], to discontinue collection activity and discharge debt.”⁴ There is no question that “discharge of indebtedness” that constitutes this “identifiable event” is the date that the TPD discharge is granted. Under the TPD statute, the Secretary “shall discharge” the loan of a borrower who meets the relevant criteria.⁵ Under the TPD regulation, a borrower’s debt “is discharged if the borrower becomes totally and permanently disabled . . . and satisfies the eligibility requirements in this section.”⁶ And under the relevant tax law, a debt is considered discharged at the moment it becomes clear that it will not have to be repaid. The inquiry for determining that status “must be the practical one of worthlessness of the debt”; that is, the question is *not* whether it would be “absolutely impossible that [the debt] could be repaid,” but rather whether, considering a practical assessment of the facts and circumstances, payment is unlikely.⁷ Further, even if there was ambiguity as to the date of the applicable identifiable event (and there is not), IRS regulations allow the Department as creditor to elect to send 1099s before that event, at its “discretion,” which would be appropriate for the Department to exercise in this circumstance.⁸

Here, the Department issues TPD discharges to borrowers who are totally and permanently disabled. Although borrowers who qualify for TPD discharge through SSA documentation or a medical professional’s certification will go through a three-year post-discharge monitoring period after discharge,

² See “If I receive a total and permanent disability (TPD) discharge on my loan, do I have to pay taxes on the discharged amount?” Federal Student Aid, U.S. Department of Education, available at <https://studentaid.gov/help-center/answers/article/do-i-pay-taxes-on-tpd-discharged-amount> (Accessed: 19 April 2024).

³ *Supra* n.1; see also Canceled Debts, Foreclosures, Repossessions, and Abandonments, IRS Publication 4681, available at <https://www.irs.gov/publications/p4681>. (“If you had a student loan that was discharged after December 31, 2020, and the amount of the discharged loan is nontaxable, you won’t receive a Form 1099-C from the lender or servicer of your student loan.”).

⁴ 26 C.F.R. § 1.6050P-1(b)(2)(G).

⁵ 20 U.S.C. § 1087(a)(1) (emphasis added).

⁶ 34 C.F.R. § 685.213(a)(1) (emphasis added).

⁷ *Brountas v Commr. of Internal Revenue*, 74 TC 1062, 1074 (Tax Court, 1980), vacated on other grounds. *Brountas v C. I. R.*, 692 F2d 152 (1st Cir 1982); *Martin v C.I.R.*, 21247-09S, 2011 WL 1899782, at *3 (Tax Court, May 19, 2011) (collecting cases).

⁸ 26 C.F.R. § 1.6050P-1(b)(3).

this monitoring period is not appropriately considered a *pre-discharge* period; it is, rather, a period of three years *after* the discharge. The change in the terms and significance of the reinstatement period, beginning when ED suspended income monitoring in the COVID-19 pandemic and then with the new TPD regulations in 2023 limiting reinstatement to borrowers who took out new student aid, meaningfully changes the date of discharge for tax purposes. Specifically, new regulations regarding TPD that went into effect on July 1, 2023 narrowed the scope of the monitoring that is conducted during this post-discharge period.⁹ Now, the only basis upon which a borrower’s discharged loans can be reinstated is “if, within 3 years after the date the Secretary granted the discharge, the borrower receives a new TEACH Grant or a new loan under the Direct Loan Program.”¹⁰ Thus, under the new regulations, a borrower receiving TPD knows that the discharged debt will never have to be repaid as long as the borrower refrains from applying for new grants and loans for three years. There is thus, upon the moment of discharge, no “reasonable expectation” that the debt will be required to be repaid.¹¹

The interpretation set forth here—that any taxability accrues upon the moment of discharge, not three years later—is also the only interpretation that is tenable within the plain meaning of the statute that provided for temporary relief from taxability of student loans through the end of 2025. That statute excludes from gross income “any amount which (but for this subsection) would be includible in gross income *by reason of the discharge (in whole or in part) after December 31, 2020, and before January 1, 2026.*”¹² As we are sure you can appreciate, this issue is critically important because any student loan “discharge” occurring through December 31, 2025, is not taxable.¹³ Thus, any borrowers who have received or will receive TPD in 2023, 2024, or 2025 should not accrue tax liability; and that was certainly the design of the statutory scheme. But the notices these borrowers received, stating that they will receive 1099s three years hence, undermines the letter and spirit of the tax forgiveness Congress granted. Accordingly, it is crucial that the Department clarify its position and send revised notices.

We respectfully request a written response to this letter by May 21, 2024.

⁹ Institutional Eligibility Under the Higher Education Act of 1965, as Amended; Student Assistance General Provisions; Federal Perkins Loan Program; Federal Family Education Loan Program; and William D. Ford Federal Direct Loan Program, 87 Fed. Reg. 65,904.

¹⁰ 34 C.F.R. § 685.213(b)(7)(i).

¹¹ *Cf. Alexander v. Commissioner of Internal Revenue*, 61 T.C. 278, 292 (Tax Court, 1974).

¹² 26 U.S.C. § 108(f)(5)(A)(i) (emphasis added).

¹³ *Id.*

Sincerely,



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