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bankruptcy in 2016.

Jul. 09, 2019



Good news for people who had private student loans from the now-defunct ITT Technical schools: those student loans have been canceled.

But there a catch: They may owe taxes, as the IRS views the loan cancellation as income.

Pennsylvania's attorney general last week announced a national settlement for more than \$168 million in debt relief for 18,000 former students of ITT Tech. In Pennsylvania, 570 former ITT Tech students are eligible for \$5.3 million in debt relief.

ITT Tech pressured students by pulling them out of class and threatening expulsion if

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"If someone forgives a debt, it is as if someone gave you money, and you paid off the loan," said Jane Scaccetti, cofounder of the Drucker & Scaccetti tax accounting firm.

There are further quirks. Federal loans that are discharged are not viewed as income. But discharged private loans are still viewed as income by the IRS, said Student Loan Doctor founder Sonia Lewis, who operates a debt counseling business in Philadelphia.

The IRS issued guidance after the for-profit Corinthian Colleges closed, advising that federal loans are not taxable. In July 2018, the Department of Treasury issued a ruling extending the 2015 relief for Corinthian federal student loan borrowers to Corinthian private student loan borrowers. Members of Congress are urging the IRS to do the same for students with private loans.

But that's not the law of the land yet.

"I'm still excited about the settlement for ITT Tech students," said Lewis, who has worked with over 5,000 college loan debtors in the last three years.

"In many cases, private lenders can garnishee wages to pay loans, but now the ITT Tech collections have to stop. And besides," Lewis said, "paying tax on these discharged private loan debts is better than having your pay garnisheed. At least you have control of your paycheck."

She said ITT Tech students should expect a 1099-C tax form in the mail.

In the meantime, she said, "we're waiting on the current administration to pass a law allowing discharge of private loans to also be nontaxable."

If you owe tax

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Otherwise, you can try negotiating a settlement with the IRS by submitting an offer in compromise. In that case, you will need to file IRS Form 656.

Finally, you can ask the IRS for a payment plan to spread out the tax bill over multiple installments.

“Let's say you have \$25,000 in loans canceled,” said Kantrowitz. “The IRS treats that as \$25,000 in income, so assuming a marginal tax rate of 24 percent, you would owe about \$6,000 in taxes.”

Your death actually can improve matters: Section 11031 of the Tax Cuts and Jobs Act of 2017 established an exclusion from income for discharges of federal and private student loans due to death or disability in effect from 2018 through 2025.

However, “the discharge of the (ITT) student loans is not due to death or disability. Accordingly, the new law does not apply,” Kantrowitz said. “Plus, these were private loans. So the settlement merely cancels the remaining debt and clears the credit histories.”

If you were an ITT Tech or other for-profit college student, contact the Pennsylvania Attorney General's office hotline: 1-800-441-2555. Or you can email scams@attorneygeneral.gov; complaint forms are available on the website at www.attorneygeneral.gov.

Tax credit as solution

Philadelphia City Councilman David Oh introduced a bill on June 20 which offers a tax credit of up to \$7,500 over five years for residents with over \$35,000 in student debt. Hearings take place in the fall.

His proposed legislation allows up to \$1,500 in tax credits a year applied to the city

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Under her plan, Americans with student debt would not have to pay income taxes on canceled loans.

“This new type of student loan forgiveness would join the ranks of other exceptions to cancellation of debt income,” wrote Adele Kilgus, a CPA with Drucker & Scaccetti, in a note to clients last month.

Warren claims debt forgiveness would be paid for by what she coined the “Ultra-Millionaire Tax,” although Kilgus is dubious.

“As tax geeks, whenever we hear about new proposed legislation, we like to get to the nitty-gritty of its tax impact. Sen. Warren, as president or not, will have an uphill battle getting this bill through both houses” of Congress, she said.

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