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occurs. The creditor will

Ken Berry • Sep. 07, 2022

All is forgiven! (Well, maybe not *all*.) On August 24, President Biden announced plans to forgive federal student loan debts for many borrowers. In addition, the president is extending the "payment pause" on qualified student loans through the end of the year. The pause was scheduled to end on August 31.

Icing on the cake: Under recent legislation—in the form of the American Rescue Plan Act (the ARPA)—borrowers who benefit from a discharge of a student loan may also avoid federal income tax. The ARPA provision on tax exemptions lasts through 2025.

Let’s take a closer look at the latest developments in this area.

have been expanded in recent years through legislation enacted during the pandemic. Now the tax exemption becomes even more valuable thanks to the announcement by the president.

Specifically, the Biden administration is cancelling up to $10,000 in federal student debt for most borrowers and up to $20,000 for Pell Grant recipients. But the relief isn’t available to some moderate-to-high income debtors. To qualify, you must have earnings of less than $125,000 a year as a single individual or $250,000 for joint filers. Also, the relief is capped at the amount of a borrower’s outstanding eligible debt, as per the Department of Education.

This turns out to be a good deal for qualified borrowers.

Example: Suppose your twenty-something child has an annual salary of $50,000. Under the graduated tax rate structure, they re in the 12% marginal tax bracket. If your child is forgiven on the maximum in federal student loans, they don’t have to come up with $10,000, plus they save $1,200 in federal income tax.

The government is in the process of setting up the mechanism for claiming this relief. More details will be available shortly.

Caution: The APRA tax provision doesn’t apply on the state income tax level. Therefore, borrowers in certain states—including Arkansas; Hawaii; Idaho; Kentucky; Massachusetts; Minnesota; Mississippi; New York; Pennsylvania; South Carolina; Virginia; West Virginia; and Wisconsin—may face state income tax liability. Consult with your professional tax advisor concerning your situation.

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