2014

Death and Taxes: The Crushing Tax Burden after a Student Loan Is Discharged Due to Death of a Student

Terran Chambers

Note

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Francisco Reynoso knows first-hand the heavy burden of student loan debt.[1] Though Mr. Reynoso did not take out a single student loan, agreeing to cosign his deceased son's loans is forcing him into bankruptcy.[2] Proud that his son, Freddy, would be the first in the family to attend college, Mr. Reynoso decided to cosign Freddy's private student loans in 2005.[3] After graduation, while on his way back from a job interview, Freddy lost control of his car and died.[4] Although many of Freddy's loans were discharged, relieving Mr. Reynoso of repayment obligations, the Internal Revenue Service (IRS) regards these loans as income for Mr. Reynoso, triggering the obligation to pay taxes on the nearly $200,000.[5] Thus, with an annual income of merely $21,000, and $200,000 of new taxable income that he has not actually realized, Mr. Reynoso is forced to explore bankruptcy as his only option.[6]

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* J.D. Candidate 2014, University of Minnesota Law School; B.A. 2011, University of North Dakota. Thank you to Professor Amy Monahan for her invaluable insight and guidance, and the staff and board of the *Minnesota Law Review* for their hard work on this piece. A special thanks to my entire family, from Grandma Ike down to Baby Madden, for providing me much needed support and encouragement throughout the years.

1. Marian Wang, *Grieving Father Struggles to Pay Dead Son's Student Loans*, PROPUBLICA (June 14, 2012, 8:05 AM), http://www.propublica.org/article/grieving-father-struggles-to-pay-dead-sons-student-loans.

2. *Id.*

3. *Id.*

4. *Id.*

5. *Id.*

6. *Id.*

The Internal Revenue Code (IRC) requires the taxpayer to pay taxes on all gross income.[7] As a general rule, the IRC includes discharges of indebtedness as gross income for tax purposes.[8] Loan proceeds are not included in gross income because of the obligation to repay that money.[9] However, once the lender removes the obligation by discharging the debt, the IRS considers the loan income, and subjects it to taxation.[10]

Congress has carved out multiple exceptions to this general rule in situations where it would not be equitable or a matter of good public policy to tax discharged debt.[11] For example, loans discharged in bankruptcy and foreclosure are not considered income.[12]

The Department of Education and the nation's largest private lenders discharge student loans in the event of the borrower's death.[13] Due to impracticality, the IRS does not attempt to recover taxes on discharged loans from deceased students.[14]

7. *See* 26 U.S.C. § 61(a) (2012) ("Except as otherwise provided in this subtitle, gross income means all income from whatever source derived . . . .").

8. *Id.* § 61(a)(12).

9. *See Tax Benefits for Education: Information Center*, IRS, http://www.irs.gov/uac/Tax-Benefits-for-Education:-Information-Center (last visited Apr. 4, 2014).

10. 26 U.S.C. § 61(a)(12) (including "income from discharge of indebtedness" as gross income).

11. *Id.* § 108(a)(1).

12. *Id.* § 108(a)(1)(A), (E). This temporary provision was extended through 2013. Hubble Smith, *'Fiscal Cliff' Vote Included Extension of Mortgage Forgiveness Debt Relief Act*, LAS VEGAS REV. J., Jan. 3, 2013, http://www.reviewjournal.com/business/banking/fiscal-cliff-vote-included-extension-mortgage-forgiveness-debt-relief-act. It has not been renewed for 2014. Heidi Kasama, *Mortgage Forgiveness Debt Relief Act Has Not Been Extended*, LAS VEGAS REV. J., Mar. 8, 2014, http://www.reviewjournal.com/real-estate/mortgage-forgiveness-debt-relief-act-has-not-been-extended.

13. *See Total and Permanent Disability Claims on Private Student Loans*, DISABLED WORLD (May 16, 2010), http://www.disabled-world.com/disability/finance/student-loan-claims.php (announcing Sallie Mae, the nation's largest private education lender, instituted a new total and permanent disability provision as well as a death of the primary borrower provision for private student loans); *Wells Fargo Enhances Student Loan Products to Include Loan Forgiveness*, WELLS FARGO (Dec. 17, 2010), https://www.wellsfargo.com/press/2010/20101217_EFS (announcing its new loan forgiveness policy adopted to ease the burden of families and cosigners in the event of death or disability); *When Can My Federal Student Loans Be Forgiven, Canceled, or Discharged?*, FED. STUDENT AID, http://studentaid.ed.gov/repay-loans/forgiveness-cancellation#when-can-my-federal (last visited Apr. 4, 2014).

14. *See, e.g.*, Robert W. Wood, *There's No Escape: Death, Taxes and Student Loans*, FORBES, Sept. 20, 2012, http://www.forbes.com/sites/robertwood/2012/09/20/theres-no-escape-death-taxes-and-student-loans/ ("[T]he IRS doesn't try to collect from a deceased borrower."); Ani Barsamian, *Mother*

However, if a parent is connected to the loan (private cosigners and federal student loans parents take out on behalf of their student child[15]), the IRS will recover taxes on it by including it in the parents' tax returns.[16]

By failing to create a student loan death discharge tax exception, Congress has created inconsistencies and poor public policy. This practice is inconsistent with the exclusions currently provided by Congress. Further, it effectively serves to discourage individuals from cosigning loans, potentially preventing students from seeking higher education.[17] This poor public policy primarily affects low income individuals who are more likely to utilize financial assistance.[18]

This Note argues that Congress should exclude student loan debts discharged due to death of a student from gross income as a matter of equity and public policy. Part I describes the current state of the US tax law as it relates to discharging debts. Part II analyzes the legislative history, tax policy, and public policy implications of the existing exclusions to reporting discharged debt as income, and compares them to student loan debt discharged in death. Part III draws from the current exclusions to recommend legislative reforms. Specifically, this Note proposes excluding from IRS income calculations student loan debt discharged when the borrower was a current student or within ten years of the educating period.

I. LOAN TYPES AND THE TAX CONSEQUENCES OF DISCHARGE

Each year, students take out more than $100 billion in federal education loans and $10 billion in private student loans.[19] Student loans may come from the US federal government or

Forced to Pay Taxes on Deceased Child's Student Loans, LAWINFO, http://blog.lawinfo.com/2012/09/21/mother-forced-to-pay-taxes-on-deceased-childs-student-loans/ (last visited Apr. 4, 2014) ("When the borrower dies, the IRS will not seek taxes. But when the borrower is a parent, it will." (quoting another source) (internal quotation marks omitted)).

15. For simplicity, this Note refers to all potential cosigners as "parents," while realizing that other individuals may cosign a private loan.

16. *See* Wang, *supra* note 1.

17. *See id*. (detailing the harsh financial aftermath encountered by a low-income father who cosigned for his son's student loans).

18. *See id.* (explaining the difficult decision to cosign student loans on a $21,000 yearly salary).

19. *Student Loans*, FINAID, http://www.finaid.org/loans/ (last visited Apr. 4, 2014).

private sources such as a bank or a financial institution.[20] In 2007–2008, two-thirds of students receiving a four-year undergraduate Bachelor's degree graduated with debt, with an average debt of $23,186.[21] Since 2003–2004, the average cumulative debt increased by 5.6%, or $1,139, each year.[22] With rising levels of student loan debt, the US Department of Education has seen increasing rates of default.[23]

Part A of this section will discuss federal student loans, and Part B will discuss private student loans. Part C will explain the tax consequences of discharging indebtedness, and Part D will discuss the exceptions to the discharge of indebtedness rule.

A. FEDERAL LOANS

The US Department of Education has a variety of borrowing options for students, including the Direct Loan, the Federal Perkins Loan, and the Federal Family Education Loan (FFEL) Programs.[24] Federal loans differ in significant ways from private loans.[25] Most notably, federal loans lack a cosigner requirement.[26] As a result, more students are eligible for federal

20. *Federal Student Loans for College or Career School Are an Investment in Your Future*, FED. STUDENT AID, http://studentaid.ed.gov/types/loans (last visited Apr. 4, 2014).

21. *Student Loans*, *supra* note 19.

22. *Id.*

23. *See* Press Release, U.S. Dep't of Educ., First Official Three-Year Student Loan Default Rates Published (Sept. 28, 2012), *available at* http://www.ed.gov/news/press-releases/first-official-three-year-student-loan-default-rates-published ("The two-year [cohort default rates] increased over last year's rates for both the public and private non-profit sectors, rising from 7.2 percent to 8.3 percent for public institutions, and from 4.6 percent to 5.2 percent for private non-profit institutions.").

24. *What Types of Student Loans Are Available?*, FED. STUDENT AID, http://studentaid.ed.gov/types/loans#what-types-of-federal-student-loans-are-available (last visited Apr. 4, 2014). As a result of the Health Care and Education Reconciliation Act of 2010, the Federal Family Education Loan Program is not issuing new loans. *See FFEL Program Lender and Guaranty Agency Reports*, FED. STUDENT AID, http://studentaid.ed.gov/about/data-center/lender-guaranty (last visited Apr. 4, 2014).

25. *What Are the Differences Between Federal and Private Student Loans?*, FED. STUDENT AID, http://studentaid.ed.gov/types/loans/federal-vs-private (last visited Apr. 4, 2014).

26. *Why Get a Federal Student Loan?*, FED. STUDENT AID, http://studentaid.ed.gov/es/sites/default/files/why-get-fed-loan.pdf (last visited Apr. 4, 2014).

loans, despite a potential lack of credit history, and are directly liable for the loan repayment.[27]

Repayment options are flexible with federal loans. Generally, federal loans allow the borrower to defer, postpone, or lower payments if the borrower is experiencing financial difficulty or hardship.[28] The federal government recognizes numerous ways education loans may be completely forgiven outside of bankruptcy, including death and total and permanent disability, among others.[29] If a borrower simply cannot make payments and does not qualify for loan forgiveness, the federal government will occasionally settle a debt for less than what is owed.[30] Federal student loans are only dischargeable in bankruptcy in the exceedingly rare case where a borrower can show "undue hardship."[31]

B. PRIVATE LOANS

Private institutions offer many different types of non-federal student loans.[32] The five largest private lenders of student loans are Sallie Mae, Wells Fargo, Discover, NelNet, and JPMorgan Chase.[33] Unlike the federal government, private lenders require students with limited credit history to seek creditworthy cosigners before loan approval.[34] Cosigners agree to

27. *Cf. Important Things to Know When Considering a Cosigner*, SALLIEMAE, https://www.salliemae.com/student-loans/loan-servicing/cosigning/ (last visited Apr. 4, 2014) (requiring students with limited credit history to seek a cosigner to increase their chances of eligibility for loans from private lenders).

28. *What Are the Differences Between Federal and Private Student Loans?*, *supra* note 25.

29. *When Can My Federal Student Loans Be Forgiven, Canceled, or Discharged?*, *supra* note 13.

30. *Student Loan Debt Settlements*, FINAID, http://www.finaid.org/loans/settlements.phtml (last visited Apr. 4, 2014).

31. Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, 11 U.S.C. § 523(a)(8) (2012).

32. *Student Loans Through Banks*, C. SCHOLARSHIPS, http://www.collegescholarships.org/loans/educational-bank-loans.htm (last visited Apr. 4, 2014).

33. Sarah Jaffe, *Meet 5 Big Lenders Profiting from the $1 Trillion Student Debt Bubble (Hint: You Know Some of Them Already)*, ALTERNET (Nov. 28, 2011), http://www.alternet.org/story/153200/meet_5_big_lenders_profiting_from_the_%241_trillion_student_debt_bubble_%28hint%3A_you_know_some_of_them_already%29?page=0%2C0.

34. *Important Things to Know When Considering a Cosigner*, *supra* note 27.

be fully responsible for the student's loan obligations should the student become unable to make payments for any reason.[35]

Repayment options are less flexible for private loans. Unlike the federal government, private lenders may not offer forbearance or deferment options, and often will not forgive portions of the loan.[36] Additionally, unlike the federal government, most private lenders do not specify instances in which borrowers may qualify for a loan discharge outside of bankruptcy.[37] Recently, however, both Sallie Mae and Wells Fargo instituted "total and permanent disability" provisions as well as "death to the primary borrower" provisions for their private student loans.[38]

Despite these stark differences, studies show that many students and families are unaware of the differences between federal and private loans.[39]

C. Tax Consequences of Discharging a Loan

While federal (and recently some private) borrowers offer discharge options when borrowers are unable to repay their loans, many of these options may create tax liabilities. The current US tax system imposes a tax on the net taxable income of all qualifying individuals.[40] The income tax system is progressive, meaning it takes a larger percentage of income from higher-income groups than from lower-income groups, and is based on each group's ability to pay.[41] Taxable income is determined

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35. *Id.*

36. *What Are the Differences Between Federal and Private Student Loans?*, *supra* note 25.

37. *See, e.g.*, *Repaying Your Student Loans*, SALLIEMAE, https://www.collegeanswer.com/manage-your-money/manage-student-loans/student-loan-repayment-options/default.aspx (last visited Apr. 4, 2014) (failing to discuss specific instances in which a borrower may qualify for loan discharge).

38. *Total and Permanent Disability Claims on Private Student Loans*, *supra* note 13; *Wells Fargo Enhances Student Loan Products to Include Loan Forgiveness*, *supra* note 13.

39. A survey by Young Invincibles, a youth advocacy nonprofit in Washington, D.C., shows that among students who took out private student loans, nearly 70% were not informed of their options. Christina Couch, *6 Things You Should Know About Private Loans*, BANKRATE.COM (Aug. 2, 2012), http://www.bankrate.com/finance/college-finance/private-student-loans.aspx.

40. 26 U.S.C. § 1 (2012) (defining the tax brackets applicable to married individuals, surviving spouses, heads of households, unmarried individuals, trusts and estates, unearned income of children, etc.).

41. *The Whys of Taxes: Fairness in Taxes*, IRS, http://apps.irs.gov/app/understandingTaxes/student/whys_thm03_les03.jsp (last visited Apr. 4, 2014). The tax system is divided into seven brackets: 10% ($2,250–$11,325), 15%

by beginning with gross income.[42] Section 61 of the IRC defines gross income as "income from whatever source derived," and includes, among other things, compensation for services, income derived from business, and gains derived from dealings in property.[43] Subtracting above the line deductions from gross income leaves a taxpayer with his adjusted gross income.[44] Subtracting itemized deductions and personal exemptions from adjusted gross income leaves a taxpayer with his taxable income.[45]

Money acquired through loans is not considered part of a taxpayer's gross income because the attached obligation to repay all loan proceeds means the borrower has not appreciated any real increase in gross income.[46] However, § 61(a)(12) of the IRC includes "income from discharge of indebtedness" as gross income.[47] Therefore, once the borrower is no longer obligated to repay a debt because a lender discharged it, the loan proceeds may be considered income.[48] For example, if an individual receives a loan for $10,000 and subsequently defaults on the loan after paying back $2,000, the lender may discharge the remaining $8,000, creating $8,000 of taxable income for the borrower. Because the borrower is not required to repay the loan, the borrower has experienced an increase in his wealth of $8,000.

($11,325–$39,150), 25% ($39,150–$91,600), 28% ($91,600–$188,600), 33% ($188,600–$407,350), 35% ($407,350–$409,000), and 39.6% ($409,000 and above). DEP'T OF THE TREASURY, IRS, PUBLICATION 15: EMPLOYER'S TAX GUIDE 44 (2014), *available at* http://www.irs.gov/pub/irs-pdf/p15.pdf. These monetary values apply to an annual payroll period for taxpayers filing as single individuals. *Id.* Therefore, an individual who earns $100,000 per year will be taxed on the first $9,075 ($11,325 minus $2,250) at 10%, the second $27,825 ($39,150 minus $11,325) at 15%, and so on, with the final $8,400 ($100,000 minus $91,600) taxed in the 28% bracket. *Id.*

42. *See* 26 U.S.C. § 61 (2012) (defining gross income).

43. *Id.*

44. *See id.* § 62 (defining adjusted gross income and listing the available above-the-line deductions).

45. *See id.* §§ 161–222 (defining itemized deductions for individuals and corporations); *id.* § 151 (defining personal exemptions).

46. 20 C.F.R. § 416.1103(f) (2013).

47. 26 U.S.C. § 61(a)(12).

48. *See id.* § 61 (defining income).

D. EXCEPTIONS TO INCLUDING DISCHARGE OF INDEBTEDNESS AS INCOME

Congress created several exceptions to § 61(a)(12), excluding certain debts from income when discharged by the lender.[49] The Mortgage Forgiveness Debt Relief Act of 2007 allows debtors in foreclosure to exclude the remainder of their mortgages, up to $1 million, from income.[50] Congress also provided an exception for debts discharged in bankruptcy and in the case of insolvency.[51] Specifically, 26 U.S.C. § 108 excludes "any amount which . . . would be includible in gross income by reason of the discharge (in whole or in part) of indebtedness of the taxpayer if—(A) the discharge occurs in a title 11 case, [and] (B) the discharge occurs when the taxpayer is insolvent . . . ."[52] Therefore, if an individual receives a loan for $10,000 and subsequently defaults on the loan after paying back $2,000, filing for chapter 11 bankruptcy or declaring insolvency will relieve the debtor of $8,000 of taxable income.[53]

Congress has not provided an exception for discharged student loans.[54] For federal student loans, when the deceased student is the borrower, no tax liability is assessed for the discharged student loans.[55] Many private lenders (excluding Sallie

49. *Id.* § 108. The most common situations when cancellation of debt income is not taxable involve: (1) qualified principal residence indebtedness, (2) bankruptcy, (3) insolvency, (4) certain farm debts, and (5) non-recourse loans. *Id.*

50. Mortgage Forgiveness Debt Relief Act of 2007, Pub. L. No. 110-142, 121 Stat. 1803 (2007) (codified as amended at 26 U.S.C. § 108 (2012)). This legislation was extended through 2013. Smith, *supra* note 12.

51. 26 U.S.C. § 108(a)(1)(A)–(B). Note that absent a showing of "undue hardship," student loans are not dischargeable in bankruptcy proceedings. 11 U.S.C. § 523(a)(8) (2012).

52. 26 U.S.C. § 108(a)(1)(A)–(B).

53. *Cf. id.* § 61(a)(12) (including discharge of indebtedness as gross income).

54. *See id.* § 108 (providing exceptions if (A) the discharge occurs in a title 11 case, (B) the discharge occurs when the taxpayer is insolvent, (C) the indebtedness discharge is qualified farm indebtedness, (D) in the case of a taxpayer other than a C corporation, the indebtedness discharged is qualified real property business indebtedness, or (E) the indebtedness discharged is qualified residence indebtedness which is discharged before January 1, 2013). *But see What Loans Are Eligible for Forgiveness?*, FED. STUDENT AID, http://www.studentaid.ed.gov/repay-loans/forgiveness-cancellation/charts/public-service#what-is-the-public (last visited Apr. 4, 2014) (stating that Direct student loans may be forgiven if the student engages in public service).

55. *See* Ian Duncan, *After Son's Death, Woman Faces Hefty Tax Bill on His Student Loans*, BALT. SUN, Sept. 18, 2012, http://www.baltimoresun.com/news/maryland/education/bs-md-co-student-loan-tax-bill-20120918,0,5404912

Mae and Wells Fargo) do not provide protections for borrowers in the case of death, leaving the cosigner with the remainder of any principal.[56] Even if a borrower or cosigner is able to negotiate a discharge of the principal, 26 U.S.C. § 61(a)(12) requires the discharged student loan to be reported as income.[57] In effect, if a parent who makes $20,000 a year has a student with $30,000 of private loans, and the student dies before making a loan payment, that parent may attempt to discharge the $30,000 in principal payments through a death-of-the-borrower provision.[58] Even if successful, the parent will now have $50,000 of taxable income to report in that year, as opposed to $20,000.[59] The parent will owe $7,793.25 in taxes (nearly 40% of his or her annual income), as opposed to $2,208.75 (11% of his or her annual income).[60] This creates obvious hardship for many parents and cosigners of private student loans who are forced to pay taxes on money they do not have, and is inconsistent with both the exclusions currently in place and public policy.

.story ("When the borrower dies, the IRS will not seek taxes—as happened with the loans Roswell Friend took out for himself.").

56. *See* Mary Pilon, *When Student Loans Live on After Death*, WALL ST. J., Aug. 7, 2010, http://online.wsj.com/news/articles/SB10001424052748704741904575409510529783860; *see also Total and Permanent Disability Claims on Private Student Loans*, *supra* note 13; *Wells Fargo Enhances Student Loan Products to Include Loan Forgiveness*, *supra* note 13; *When Can My Federal Student Loans Be Forgiven, Canceled, or Discharged?*, *supra* note 13 (providing for discharge of Direct, FEEL, and Perkins loans in the case of the borrower's death). *See generally Disability and Death*, STUDENT LOAN BORROWER ASSISTANCE, http://www.studentloanborrowerassistance.org/loan-cancellation/disability-and-death/ (last visited Apr. 4, 2014) (noting government loans do not survive the death of the student).

57. *See* 26 U.S.C. § 61(a)(12) (2012) (requiring income from discharge of indebtedness to be included as gross income); *id.* § 108 (listing exceptions to discharge of indebtedness as gross income).

58. *See Total and Permanent Disability Claims on Private Student Loans*, *supra* note 13. Note this only applies to private lenders such as Sallie Mae and Wells Fargo which provide discharge options in the case of the borrower's death. *See supra* text accompanying note 56.

59. *See* 26 U.S.C. § 61(a)(12) (requiring taxpayers to report discharge of indebtedness as income).

60. These figures calculated using 2014 annual payroll figures for taxpayers filing as individuals. *See supra* note 41.

II. THE INEQUITIES CREATED BY INCLUDING DISCHARGED PRIVATE LOANS IN THE CASE OF DEATH OF A PRIMARY BORROWER AS INCOME

The current state of the tax code fosters both inconsistency and poor public policy. Part A of this section discusses how failing to create a tax exception for student debt discharged when a student dies is inconsistent with other sections of the tax code. Part B of this section discusses how failing to provide this tax exception is inconsistent with tax policy and creates poor public policy.

A. Including Discharged Private Student Loans as Income Is Inconsistent with Current Exclusions

Part 1 of this section compares debt discharged when a student dies to debt discharged in bankruptcy, and argues that both should be excused from taxation. Part 2 makes a similar comparison to debt discharged in foreclosure. Finally, Part 3 of this section compares the inequitable treatment of private and federal student loans in the case of student death.

1. Debts Discharged in Bankruptcy Are Not Included in Income

Including as income student loan debts discharged due to a student's death is inconsistent with the practice of excluding debts discharged through bankruptcy. Congress drafted 26 U.S.C. § 108(a)(1) to exclude from income debts discharged in a "Title 11 case" or when a taxpayer is "insolvent."[61] A debtor will qualify as a Title 11 bankruptcy case if he is under the jurisdiction of a bankruptcy court and is granted a discharge by that court.[62] A debtor will qualify as insolvent any time his liabilities exceed the fair market value of his assets.[63]

This legislation was originally drafted in 1980,[64] intending to give debtors a "fresh start" in times of financial crisis and bring the tax treatment of debt discharge in line with tax policy.[65] It provided that "no income is recognized by reason of debt discharge in bankruptcy, so that a debtor coming out of bank-

61. 26 U.S.C. § 108(a)(1); *see also* Frederick R. Parker, Jr., *A Primer on Income Taxes and the Cancellation of Debt*, 39 LA. B.J. 567, 569 (1992).

62. Parker, *supra* note 61, at 569.

63. *Id.*

64. Bankruptcy Tax Act of 1980, Pub. L. No. 96-589, 94 Stat. 3389 (codified as amended at 26 U.S.C. § 108 (2012)).

65. S. REP. NO. 96-1035, at 9–10 (1980).

ruptcy (or an insolvent debtor outside bankruptcy) is not burdened with an immediate tax liability."[66] Congress realized that discharging a debtor's obligations would not relieve his burden if he had to pay large sums in taxes.[67]

In addition to needing a fresh start, one practical obstacle faced by many debtors is a liquidity problem. Liquidity refers to the ability to quickly convert assets to money to satisfy liabilities.[68] When a debtor is insolvent (his liabilities are greater than his assets), he does not have adequate liquidity to satisfy his liabilities.[69] Because debtors often lack liquidity, courts have long recognized the necessity of excluding the insolvent debtor's discharged debt from income. For example, in 1930, the Court of Appeals for the Tenth Circuit drew a distinction between a solvent and an insolvent debtor, stating:

> Suppose an insolvent had assets of the value of $10,000 and owed $100,000; that its creditors agreed to settle for $20,000. . . . Could it be said the debtor received income in the sum of $80,000–eight times the total amount of its assets?[70]

The court answered no by excluding the discharge from income, since "when such indebtedness was discharged [the company's] liabilities were decreased but its assets remained exactly the same both before and after release of such indebtedness."[71] Thus, courts have recognized the inherent unfairness in taxing debtors for assets they do not have.[72]

As in bankruptcy, both the "fresh start" theory and the liquidity problem apply where parents of deceased student borrowers are left with large amounts of taxable income. As in

66. *Id.* at 10.

67. *See id.* at 9–10.

68. *See Liquid*, MERRIAM-WEBSTER, http://www.merriam-webster.com/dictionary/liquidity (last visited Apr. 4, 2014).

69. *See Insolvent*, MERRIAM-WEBSTER, http://www.merriam-webster.com/dictionary/insolvent (last visited Apr. 4, 2014).

70. Comm'r v. Simmons Gin Co., 43 F.2d 327, 329 (10th Cir. 1930).

71. *Id.*

72. *See, e.g.*, Helvering v. Am. Dental Co., 318 U.S. 322, 327 (1943) ("Possibly because it seems beyond the legislative purpose to exact income taxes for savings on debts, the courts have been astute to avoid taxing every balance sheet improvement brought about through a debt reduction."); Gibson v. Comm'r, 83 F.2d 869, 870 (3d Cir. 1936) ("If, however, a creditor merely desires to benefit a debtor and without any consideration therefor cancels the debt, the amount of the debt is a gift from the creditor to the debtor and need not be included in the latter's gross income."); Dallas Transfer & Terminal Warehouse Co. v. Comm'r, 70 F.2d 95, 96 (5th Cir. 1934) ("Taxable income is not acquired by a transaction which does not result in the taxpayer getting or having anything he did not have before.").

bankruptcy, relieving a parent of student loan obligations does not relieve the parent's burden if there is a corresponding tax bill. If creditors feel that forcing a parent to repay principals is inequitable to the extent that they are willing to forgo profits by discharging the obligation, the federal government should not undercut this effort by imposing a tax liability.

Additionally, parents like Francisco Reynoso will undoubtedly face a liquidity problem comparable to those faced with bankruptcy. With an annual salary of only $21,000 and nearly $200,000 of discharged student loans as income, Mr. Reynoso will be forced to report nearly ten times his actual realized income.[73] As the Tenth Circuit reasoned in 1930, although his liabilities were decreased, his assets remained exactly the same.[74]

Therefore, the same problems that arise when imposing a tax liability on indebtedness discharged through bankruptcy often apply when imposing tax liability on indebtedness discharged after death. Because Congress created an exception for debts discharged through bankruptcy, an exception for student loan debts discharged through death logically follows.

2. Debts Discharged in Foreclosure Are Not Included in Income

On December 20, 2007, Congress enacted the Mortgage Forgiveness Debt Relief Act of 2007.[75] This act excludes from a taxpayer's income a discharge of indebtedness on the taxpayer's primary principal residence through foreclosure.[76] Therefore, if a taxpayer experienced foreclosure between the years of 2007 and 2012, up to $2 million is excludable from his taxable income (or $1 million if filing individually).[77]

Congress's primary motivation behind this legislation was the failing housing market in 2007.[78] At that time, Congress predicted nearly two million Americans would lose their homes in the housing crisis.[79] Congress focused primarily on fairness and equity for taxpayers: it was not fair for an individual to

73. Wang, *supra* note 1.

74. *Simmons Gin Co.*, 43 F.2d at 329.

75. Pub. L. No. 110-142, 121 Stat. 1803 (codified as amended at 26 U.S.C. § 108 (2012)).

76. *Id.*

77. *Id.*

78. 153 CONG. REC. 35,952 (2007).

79. *Id.*

first have a bank foreclose on his home, and then receive a tax bill for it.[80] The Ways and Means Committee sought a solution that would "make it easier for those who get a raw deal or are having a hard time."[81] Eliminating this tax burden was the ultimate result.[82]

Deborah A. Geier, a prominent tax professor testifying before the Senate Finance Committee, drew a distinction between personal consumption (striking paint colors, unusual renovation choices) and market conditions (poor economy) to support this legislation.[83] She argued that a home's value loss can usually be attributed to uncontrollable market forces rather than to personal consumption, making it unfair to penalize the homeowner with a tax liability.[84] In sum, the argument states that when a taxpayer loses his home through no fault of his own, he should not be penalized with a tax bill.

Statistics reveal that the nation is experiencing a student loan debt crisis as acute as the housing crisis. Currently, sources estimate anywhere between $870 billion[85] and $1 trillion in outstanding student loan debt,[86] exceeding credit card debt ($693 billion) and auto loan debt ($730 billion).[87] Over 50% of borrowers with outstanding student loans have balances between $10,000 and $75,000.[88] Echoing the Ways and Means Committee's response to the housing crisis, general principals of fairness support relieving a portion of taxpayers of this stu-

80. *Id.*

81. 153 CONG. REC. 35,953 (2007).

82. *Id.*

83. *The Housing Decline: Extent of the Problem and Potential Remedies: Hearing Before the S. Comm. on Fin.*, 110th Cong. 8–9 (2007) (statement of Deborah A. Geier, Professor of Law, Cleveland-Marshall College of Law).

84. *Id.*; *cf.* Rue Toland, *No Tax for "Phantom Income": How Congress Failed to Encourage Responsible Housing Consumption with its Recent Tax Legislation*, 85 CHI.-KENT L. REV. 345 (2010) (arguing that the housing crisis was caused by irresponsible behavior on the part of homebuyers); *Foreclosure Statistics*, NEIGHBORWORKS AM., http://www.fdic.gov/about/comein/files/foreclosure_statistics.pdf (last visited Apr. 4, 2014) (reporting that most individuals in foreclosure have first-time loans and no savings, no available credit, and limited resources among extended family).

85. Meta Brown et al., *Grading Student Loans*, FED. RES. BANK N.Y. (Mar. 5, 2012), http://libertystreeteconomics.newyorkfed.org/2012/03/grading-student-loans.html.

86. Rohit Chopra, *Too Big to Fail: Student Debt Hits a Trillion*, CONSUMER FIN. PROTECTION BUREAU (Mar. 21, 2012), http://www.consumerfinance.gov/blog/too-big-to-fail-student-debt-hits-a-trillion/.

87. Brown et al., *supra* note 85.

88. *Id.*

dent loan tax burden when they "get a raw deal."[89] The unfairness of losing a child and being simultaneously strapped with a tax liability rivals the unfairness of losing a house and being simultaneously strapped with a tax liability.

Additionally, the same distinction applies between uncontrollable circumstances and personal consumption with regard to student loan debt. To illustrate, a homeowner may experience foreclosure due to declining home value because he undertook unpopular renovations, or because of uncontrollable market forces.[90] Similarly, an individual may experience difficulty repaying student loans because of poor financial planning, or because of uncontrollable situations.[91] If Congress distinguishes between personal consumption and uncontrollable market forces with regard to foreclosure, the distinction should also apply to student loans.

Therefore, in consideration of the student loan crisis and the uncontrollable nature of losing a child, Congress should create an exception for student loan death discharges similar to the foreclosure exception.

3. Federal Student Loans Discharged Due to Death of the Borrower Are Not Included in Income

Including in income student loan debts discharged by death is inconsistent with current IRS treatment of federal loans borrowed by students. Despite 26 U.S.C. § 61(a)(12),[92] the IRS does not attempt to collect taxes on discharged federal student loans from a deceased student's estate,[93] and because there is no cosigner, it cannot collect from a parent.[94] If the exact same loan is a private loan, the IRS collects taxes on its dis-

89. *See* 153 CONG. REC. 35,953 (2007). The Ways and Means Committee sought to relieve taxpayers who experienced foreclosure of the additional burden of a tax liability, as they had already experienced enough hardship. *See generally id.*

90. *See id.* (arguing for an exception for those who lose their home as a result of uncontrollable market forces, not as a result of personal consumption).

91. *Cf. Effects of Over Borrowing*, IOWA C. STUDENT AID COMMISSION, http://www.iowacollegeaid.gov/content/effects-over-borrowing (last visited Apr. 4, 2014) (cautioning students to take only as much student aid as necessary).

92. 26 U.S.C. § 61(a)(12) (2012) includes discharge of indebtedness as taxable income.

93. *See* Duncan, *supra* note 55; Wood, *supra* note 14; Barsamian, *supra* note 14.

94. *Why Get a Federal Student Loan?*, *supra* note 26 (illustrating the lack of a cosigner requirement).

charge.[95] There is no logical explanation for this glaring inequity. Some may argue that (1) this is just one of many differences between federal and private loans and (2) despite these differences, borrowers *chose* the private loans.

While it is true that federal and private loans have a panoply of differences aside from tax treatment, there are distinguishable differences at the *institutional* level. Private lenders institute their own payment schedules, default options, and interest rates, while federal lenders comply with federal regulations.[96] As businesses, private lenders have an incentive to make choices that will maximize their returns. Therefore, borrowers can logically expect many differences between private and federal lenders. However, a single agency, the IRS, sets the tax consequences for both private and federal lenders.[97] Therefore, while some differences are a result of each institution choosing its own requirements, the tax consequences are a result of one agency responding to identical situations with opposite solutions. While the IRS, like private businesses, has a compelling interest in raising funds, unlike private businesses, it is a public government agency working for the people. As such, it should not be strategically exacting funds from one segment of a population and not its nearly identical other without justification.

Secondly, for many students who borrow privately, it was not an informed choice. The costs of tuition are increasing faster than federal borrowing limits, requiring many borrowers to seek private student loans after exhausting their federal borrowing limits.[98] Further, studies show a large number of borrowers are unaware of the differences between federal and pri-

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95. *See supra* note 93. Note also that private student loans make up a significant portion of student loan debt. *Student Loan Debt Statistics*, AM. STUDENT ASSISTANCE, http://www.asa.org/policy/resources/stats/ (last visited Apr. 4, 2014). As of 2012, there was roughly $150 billion of outstanding private student loan debt. *Id.*

96. *Compare Rates and Terms*, SALLIEMAE, https://www.salliemae.com/student-loans/smart-option-student-loan/ (last visited Apr. 4, 2014) (setting rates and terms for its private student loans), *with* Jenna Johnson, *Obama Signs Student Loan Interest Rate Legislation into Law*, WASH. POST, Aug. 9, 2013, http://www.washingtonpost.com/politics/obama-signs-student-loan-interest-rate-legislation-into-law/2013/08/09/98fb0426-00f2-11e3-9711-3708310f6f4d_story.html (setting rates and terms for all federal student loans).

97. *See* 26 U.S.C. § 108.

98. *See infra* text accompanying notes 122–24.

vate student loans, and lenders do not make the distinctions clear.[99]

Therefore, because many students are required to seek private student loans and are unaware of the cosigner consequences, and because there is no rational reason for the differential tax treatment of private and federal loans, an exception for discharged student loans in case of death is necessary.

B. INCLUDING STUDENT LOANS DISCHARGED DUE TO DEATH OF THE BORROWER AS INCOME IS INCONSISTENT WITH BOTH TAX AND PUBLIC POLICY

Part 1 of this section discusses how failing to create a tax exception for discharged student loan debt when a student dies is inconsistent with two often cited theories of tax policy. Part 2 discusses how failing to create such an exception creates poor public policy.

1. Taxing the Discharged Student Loans of a Deceased Borrower Is Inconsistent with the "Benefit Received" and "Ability to Pay" Theories of Tax Policy

The two major theories of tax policy are the "benefit received" theory[100] and the "ability to pay" theory.[101] While some argue that the "benefit received" theory has been replaced by the "ability to pay" theory, many policy theorists agree that our

99. Katy Hopkins, *5 Common Private Student Loan Complaints*, U.S. NEWS & WORLD REP., July 31, 2012, http://www.usnews.com/education/best-colleges/paying-for-college/articles/2012/07/31/5-common-private-student-loan-complaints (finding that nearly 20% of borrowers surveyed were confused about the difference between private and federal loans); *see also* Couch, *supra* note 39 (explaining a study showing that among students who took out private student loans, nearly 70% were not informed of their options); *Durbin to Students and Parents: Beware Dramatic Differences Between Student Loan Options*, DICK DURBIN: U.S. SENATOR FOR ILL. (Aug. 20, 2012), http://www.durbin.senate.gov/public/index.cfm/pressreleases?ID=4acac041-2d8a-4aa7-a666-d9fe06554a68 (illustrating an example in which a student would have chosen federal student loans with higher consumer protections had she known the differences). *See generally Forgiveness, Cancellation, and Discharge*, FED. STUDENT AID, http://studentaid.ed.gov/repay-loans/forgiveness-cancellation#im-a-parent (last visited Apr. 4, 2014) (stating with regard to Parent Plus Loans: "the loan may be discharged if the child for whom you borrowed dies, or if you die or become totally and permanently disabled," but making no mention of tax consequences).

100. *See* Steven A. Bank, *Origins of a Flat Tax*, 73 DENV. U. L. REV. 329, 338 (1996).

101. Stephen Utz, *Ability to Pay*, 23 WHITTIER L. REV. 867, 867–68 (2002).

tax system is not purely one or the other, but a mix of both.[102] Under the "benefit received" theory, citizens pay taxes according to the benefits they appreciate.[103] The government should not be able to take more from an individual in taxes than it provides in benefits.[104] Public college tuition, national park fees, and gas excise taxes are all examples of a benefit theory tax.[105] In essence, individuals pay these taxes at higher rates the more they consume government services.[106]

Imposing a tax on parents who assisted a deceased student in financing education is inconsistent with the benefit received theory, as the taxpayer has accrued no benefit. To the contrary, a parent has experienced the serious loss of both a child and a large monetary investment in that child's education. Taxpayers in this situation have nothing to show in terms of a benefit: neither the student nor the taxpayer retained the benefits of the education.

Opponents may claim the benefit received is the discharged debt, as the taxpayer now has fewer liabilities. However, 26 U.S.C. § 61(a)(12) requires the taxpayer to include *income* from the discharge of indebtedness in his taxable income.[107] Discharging a student's loan creates no income for the parent. Contrarily, when a creditor forgives a debtor's defaulted car loan, the debtor obtains the benefit of the vehicle; when a credit card company forgives a debtor's credit card debt, the debtor obtains the benefit of all the purchased assets; when a bank forgives a debtor's personal loan, the debtor obtains the benefit of the borrowed money.[108] To the contrary, a parent is no better off after the discharge of a deceased student's loan than before the discharge, as there has been no realization of income.[109]

102. *Id.*

103. *See* Bank, *supra* note 100.

104. Donna M. Bryne, *Locke, Property, and Progressive Taxes*, 78 NEB. L. REV. 700, 728 (1999).

105. These fees all represent costs of government provided services. *See Benefit Theory of Taxation*, MERRIAM-WEBSTER, http://www.merriam-webster.com/dictionary/benefit%20theory%20of%20taxation (last visited Apr. 4, 2014) (defining "benefit theory of taxation" as "the theory that taxes should be considered as payments for services rendered by the state to the taxpayers and so proportioned").

106. Bank, *supra* note 100.

107. 26 U.S.C. § 61(a)(12) (2012).

108. Note that while the debtors would retain the assets, they may be subject to taxation on this forgiven debt. *Id.*

109. *See, e.g.*, Patricia Somers & James M. Hollis, *Student Loan Discharge*

Under the benefit received theory, where a taxpayer experiences a benefit, he should be assessed taxes.[110] Congress again created exceptions to this general rule in cases of bankruptcy and foreclosure.[111] When taxpayers declare bankruptcy, they often relieve themselves of debts from which they have derived significant benefit.[112] Debtors may amass large amounts of debt while obtaining the benefits of lavish assets,[113] vacations, etc. In bankruptcy, debtors exempt large amounts of their assets and escape any tax burden on the discharged debt.[114] Similarly, in instances of foreclosure, homeowners obtain the benefit of their homes for years before it is foreclosed. Notwithstanding, Congress carved out exceptions for both by making them tax free.

Next, the "ability to pay" theory holds that individuals should pay taxes according to their wealth: the higher an individual's capacity to pay taxes, the higher the taxes he should pay.[115] The more money one earns in income, the higher his income is taxed according to the applicable tax brackets.[116] As a general rule, individuals seeking financial assistance through loans are likely among society's least able to pay. Further, as discussed next, individuals who are affected most harshly are those in the lowest income brackets.

Assuming first that all economic classes of students borrow equally, low income families are impacted more severely by the practice of including discharged student loan debt in income. For example, a student from a family with $30,000 of income and a student from a family with $100,000 of income both die with $20,000 of outstanding private student loans. The lower income family now has $50,000 of taxable income, 40% of which

Through Bankruptcy, 4 AM. BANKR. INST. L. REV. 457, 466 (1996) (discussing numerous cases in which, although student loan debt is rarely dischargeable in bankruptcy, discharge was allowed because the cosigner debtor had "received no 'educational benefit' from the loans").

110. *See* Bank, *supra* note 100.

111. *See supra* text accompanying notes 61–84 (discussing the discharge of indebtedness exceptions for bankruptcy and foreclosure).

112. As of 2012, the United States' credit card debt was $693 billion, and total auto loan debt was $730 billion. Brown et al., *supra* note 85. Debtors can derive much enjoyment from automobiles and many assets purchased by credit cards. *Id.*

113. 11 U.S.C. § 522 (2012) (detailing exemptions for debtor assets in bankruptcy).

114. *See* 26 U.S.C. § 108(a)(1) (2012) (excluding debts discharged in a "Title 11 case" or when a taxpayer is "insolvent").

115. Utz, *supra* note 101, at 867–68.

116. *Id.*

is "phantom income" they never actually realized.[117] By contrast, the higher income family now has $120,000 of taxable income, only 17% of which is phantom income.

Making matters worse, lower income students borrow at higher rates.[118] Students are counseled to borrow federal student loans whenever possible, but because these students often require more financial assistance, they reach the federal borrowing limits more frequently than higher income students, requiring them to seek loans from private lenders.[119] This makes lower income borrowers more likely to be private loan borrowers faced with a tax liability in the event of death. Therefore, those affected most frequently are often the least able to pay.

In conclusion, it is inconsistent with the tax policy to include in income discharge of indebtedness from student loans discharged due to death. First, under the "benefit received theory," the taxpayer has received no benefit from this debt. Second, under the "ability to pay theory," the taxpayer from a low income family is affected more often and more harshly, and is thus the least able to pay. Therefore, because low income taxpayers are the least able to pay, under this particular theory they should not be subject to taxation.

117. Phantom income has been defined as "fictitious income never realized . . . when a lender forgives part of the debt owed . . . ." Toland, *supra* note 84, at 352–53.

118. In 2007–2008, a study divided student borrowers seeking bachelor degrees into categories by their parents' income. SANDY BAUM & PATRICIA STEELE, COLLEGEBOARD, WHO BORROWS MOST?: BACHELOR DEGREE RECIPIENTS WITH HIGH LEVELS OF STUDENT DEBT 4 (2010), *available at* http://advocacy.collegeboard.org/sites/default/files/Trends-Who-Borrows-Most-Brief.pdf. The lowest income students had parents making $30,000 a year or less. *Id.* The highest income students had parents making $100,000 or more. *Id.* Out of the lowest income students in 2007–2008, 27% had zero student debt, compared with 52% of the highest income students. *Id.* Similarly, 6% of the lowest income students had cumulative loan totals of $30,500 or less, compared to only 39% of the highest income students. *Id.* Lastly, 13% of the lowest income students had cumulative debt over $30,500, while only 9% of the highest income students had cumulative loan totals over $30,500. *Id.*

119. During the 2011–2012 and 2012–2013 school years, college freshmen could borrow a maximum of $5,500 in Stafford loans ($9,500 if independent). *Federal Stafford Student Loan Limits*, CHI. ST. U., http://www.csu.edu/financialaid/documents/staffordlimits20122013_002.pdf (last visited Apr. 4, 2014).

2. Including Student Loans Discharged Due to the Death of the Borrower as Income Is Inconsistent with Public Policy.

Failing to exclude discharged private loans[120] and parent loans[121] from income may discourage parents from assisting students financially with higher education and will leave financially vulnerable families without an avenue to escape crushing debt.

The sobering reality is that the costs of education are increasing rapidly each year,[122] and are well beyond the limits of federal loans.[123] Therefore, although federal student loans are a more attractive option, many students are unable to satisfy their financial obligation with federal loans alone, forcing them to seek private loans.[124]

This tax practice leaves families permanently trapped with debt.[125] Imposing a large tax liability on a lower income family increases the risk of insolvency and forces them into bankruptcy. Because tax debt is very rarely dischargeable in bankruptcy,[126] many low income families assigned with a tax burden after a student loan is discharged due to student death are left with large permanent debt. Imposing permanent debt on a taxpayer will affect his life in all financial transactions going forward, greatly impairing his ability to be a contributing member of society. Inflicting this heavy burden on an individual requires a compelling justification not present with the current provision.

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120. *See Important Things to Know When Considering a Cosigner*, *supra* note 27; *see also Student Loan Debt Statistics*, *supra* note 95 (stating the nation currently has $150 billion of outstanding private student loan debt).

121. *See What Types of Student Loans Are Available?*, *supra* note 24 (listing Direct PLUS loans as an option for parents borrowing on their student's behalf).

122. *See, e.g.*, *Tuition at Public Colleges Rises 4.8%*, CNNMONEY (Oct. 24, 2012, 10:35 AM), http://money.cnn.com/2012/10/24/pf/college/public-college-tuition/ (noting the net price of public college for in-state students rose nearly twice the rate of inflation for the 2012–2013 school year).

123. David K. Randall, *Choosing Federal or Private Student Loans*, FORBES, April 22, 2009, http://www.forbes.com/2009/04/22/student-loans-moneybuilder-personal-finance-loans.html (noting the "costs of college have increased well beyond the limits of federal loans").

124. *Id.* (stating private loans "fill the breach" between the federal limit and the cost of school).

125. *See supra* text accompanying notes 117–19.

126. 11 U.S.C. § 523 (2012).

This result will ultimately lead to fewer parents agreeing to cosign for their children's student loans.[127] Currently, borrowers are largely unaware of the differences between private and federal student loans, and few are deterred by the fear of potential debt.[128] However, increased media attention is raising awareness rapidly. In addition to the Reynoso family, other families such as the Newsomes,[129] the Friends,[130] and the Bryskis[131] all recently gained public attention for their plight. Additionally, the House of Representatives recently considered the Christopher Bryski Loan Protection Act, which would require private lenders to explain to borrowers the cosigner obligations in the event of a student's death.[132] Regardless of the ultimate fate of this legislation, the fact remains that individuals are becoming increasingly aware of the current state of the law. As the media draws more and more attention to parents struggling under mountains of student loan tax debt, fewer parents may agree to act as cosigners, resulting in an increase in students unable to fund higher education.

It has long been a goal of our tax policy to foster education for students, particularly those with the least access to it.[133] Requiring parents to pay taxes on discharged student loan debt serves to discourage parents from assisting their children in financing higher education, a decision that may disproportionately affect lower income students. Imposing a potentially nondischargeable debt on families seeking education is contrary to the goal of bettering all individuals through financial independence and access to higher education.

127. *See, e.g.*, Justin Harelik, *Top 10 Reasons Not to Co-sign on a Loan*, BANKRATE (Feb. 14, 2013), http://www.bankrate.com/finance/debt/reasons-not-to-co-sign-loan.aspx (stating the tax consequences of "debt forgiveness income" is one good reason to never cosign any type of loan).

128. *See* Hopkins, *supra* note 99.

129. Libby Kane, *When a Recent Grad Dies, Who Should Pay the Student Loan Debt?*, LEARNVEST (Mar. 18, 2013), http://www.learnvest.com/2013/03/when-a-recent-grad-dies-who-should-pay-the-student-loan-debt/.

130. Wood, *supra* note 14.

131. Pilon, *supra* note 56.

132. H.R. 2961, 113th Cong. (2013).

133. *See* 26 U.S.C. § 25A (2012) (offering education credits as tax incentives to pursue higher education).

III. CONGRESS SHOULD CREATE AN EXCLUSION IN 26 U.S.C. § 108 FOR STUDENT LOAN DEBTS DISCHARGED DUE TO DEATH OF A STUDENT

Currently, 26 U.S.C. § 108 provides exceptions for discharges occurring: (A) in a Title 11 bankruptcy case, (B) when the taxpayer is insolvent, (C) when the debt is qualified farm indebtedness, (D) when the debt is qualified real property business indebtedness, and (E) when the debt is qualified principal residence indebtedness.[134] Because including student loan debt discharged due to the death of a student as taxable income is inconsistent with the current exclusions, inconsistent with current federal practices for taxing discharged student loan debt, and inconsistent with both tax policy and public policy, Congress should add a provision to § 108 allowing all student loan debt discharged due to the death of a student to be excluded from income for taxation purposes.[135] Part A of this section proposes statutory language, Part B explains how this language will protect against taxpayer abuse, and Part C discusses the political feasibility of this tax exception.

A. Proposed Statutory Language

To resolve the inequities resulting from including discharged student loan debt as income, Congress should draft 26 U.S.C. § 108(a)(1)(F) to read:

> Gross income does not include any amount which (but for this subsection) would be includible in gross income by reason of the discharge (in whole or in part) of indebtedness of the taxpayer if the indebtedness discharged is qualified student loan indebtedness which is discharged due to the death of the student within 10 years of the cessation of the educating period.

This language is directly patterned after similar provisions in Title 26, and includes similar "defined terms" routinely used by Congress to limit a provision's applicability and protect against tax abuse. For example, the "educating period" would be defined to require enrollment on at least a half time basis in a degree, certificate, or other program leading to a recognized educational credential at an institution of higher education.[136]

134. *Id.* § 108.

135. Note this would not affect private lenders who currently do not choose to discharge student loan debt upon the death of a student borrower.

136. *See* 20 U.S.C. § 1091 (2012) (using similar language); *id.* § 1094 (listing the requirements for an eligible institution to participate in programs of educational assistance); 26 U.S.C. § 25A (requiring student eligibility requirements for the Hope and Lifetime Learning Credits).

Next, a "qualified student loan" is one that is used for "qualified higher education expenses."[137] Consistently utilized through Title 26, these include "tuition, fees, books, supplies, and equipment required for the enrollment or attendance of a designated beneficiary at an eligible educational institution"[138] and "reasonable costs for such period . . . incurred by the designated beneficiary for room and board while attending such institution," subject to certain limitations.[139]

Lastly, studies show that many students repay their loans using a standard ten year repayment plan.[140] The ten year limitation seeks to balance two competing interests: giving the student adequate time to repay student loan debt, and limiting the amount of benefit received from the education, in compliance with tax policy. For example, students who die three years after graduation likely have outstanding debt and have appreciated little benefit, much less than that of someone who dies forty years after graduation.

The added provision would create consistency with the bankruptcy and foreclosure provisions, provide relief for individuals facing bankruptcy due to phantom income taxation, help alleviate the student loan crisis, create parity between federal and private student loans at the hands of the IRS, and encourage parents to continue cosigning.

B. The Proposed Statutory Language Provides Protection Against Abuses

The proposed language contains many safeguards against abuses. Borrowing these protections directly from other sections of Title 26 where Congress previously anticipated tax abuse, the statute restricts (1) the amount of time the statute is applicable to ten years, (2) the amount of funding to which the statute applies to only that used for qualified educational expenses, and (3) the type of student who is eligible for the restriction to one that was enrolled in a degree granting program (4) on at least a half time basis at a qualified institution. These

137. Many sections of Title 26 reference "qualified education expenses." *See e.g.*, 26 U.S.C. § 221; *id.* § 72; *id.* § 530; *id.* § 25A; *id.* § 135.

138. *Id.* § 529.

139. *Id.*

140. Kim Clark, *Paying Back Your Student Loans*, CNNMONEY, http://money.cnn.com/101/college-101/student-loan-payment.moneymag/index.htm (last visited Apr. 4, 2014).

protections will help to ensure that taxpayers do not abuse the relief granted.

These safeguards seek to ease opponents' fears that students who have taken out excessive student loans to finance luxuries like cars, homes, or vacations will have their debt discharged in direct contrast to the "benefit received" theory.[141] Congress addressed this in the interest context.[142] By implementing the "qualified student loan" language referenced above, if a student is unable to show that a loan amount was used for an *enumerated qualified expense*,[143] that portion of the loan is not considered for exclusions.

Requiring students to be enrolled at least half time and in a degree-granting program eliminates the risk that students will enroll in one course repetitively to never trigger student loan responsibilities. Further, the ten year time limit eliminates the risk of older borrowers[144] holding onto student debt until death.

Opponents may generally argue that this solution creates a slippery slope for borrowers who experience unfortunate events beyond their control. An unfavorable job market, a company going out of business, an illness, a family emergency, etc. may all be unfortunate events that render a borrower unable to repay student loans.[145] This argument is without strength. Any decision that is made is accompanied by off-shoot scenarios which are similar, but distinctly different from the situation in focus.[146] A death is a clearly-defined situation which does not cre-

141. *See, e.g.*, Jasmine Sheffield, *Avoid Excessive Student Loans*, YAHOO!, http://voices.yahoo.com/avoid-excessive-student-loans-12053370.html (last visited Apr. 4, 2014) (illustrating the story of a student who regretfully took out excessive student loans to use for discretionary spending which "varied from eating at restaurants, shopping, and spring break vacations").

142. *See* 26 U.S.C. § 221 (detailing the requirements for the deductibility of interest on education loans).

143. *See supra* text accompanying note 137.

144. Thirty-nine percent of borrowers with outstanding student loan debt are over the age of 40. Brown et al., *supra* note 85.

145. *But cf.* Peter Coy, *The Needless Tragedy of Student Loan Defaults,* BLOOMBERG BUSINESSWEEK (Nov. 28, 2012), http://www.businessweek.com/articles/2012-11-28/the-needless-tragedy-of-student-loan-defaults (arguing that because of the multitude of ways to seek assistance through forbearance or deferment, "[t]here is actually no rational reason for a borrower to be delinquent or default on their loans").

146. Frederick Schauer, *Slippery Slopes*, 99 HARV. L. REV. 361, 369 (1985) (stating that the slippery slope argument implicitly concedes that the current solution is acceptable, but future situations may cause danger because they are distinctly different from the current, acceptable solution).

ate room for ambiguity or compromises. This hard and fast distinction will serve to avoid slippery slope tax evasion.

Finally, opponents may contend that application of this legislation is too narrow to warrant action. However, Americans as of 2012 owed more than $150 *billion* in outstanding private student loans.[147] Borrowing an average total of $29,400, college students graduating in 2012 relied on private student loans for about one-fifth of their debt.[148] Additionally, statistics from 2005 show that the mortality rate for individuals age 20 to 29 is nearly 100 per 100,000, over seven times the rate for individuals aged 10 to 14.[149] This issue is compounded by the fact that individuals of lower socioeconomic status, who borrow at a higher rate, experience premature mortality at a significantly higher rate than those of higher socioeconomic status.[150] Therefore, by modeling the proposed language directly after other provisions in Title 26, the proposed statute protects against many potential taxpayer abuses.

C. POLITICAL FEASIBILITY OF IMPLEMENTATION

Tax reform is not a new issue in Washington D.C, and politics plays a large role. The proposed addition to § 108 is unlikely to spur political turmoil, because the amount of revenue forgone by the provision is likely to be small.[151] Refusing to implement this policy will not lead to recaptured income. The lack of liquidity due to phantom income prevents many borrowers in this situation from paying the tax debt they are assigned. Logically, if an individual does not have discretionary income to finance higher education, that individual often will not have discretionary income to pay a large tax debt. As shown in cases like Mr. Reynoso's, rather than recovering significant tax reve-

147. CONSUMER FIN. PROT. BUREAU, PRIVATE STUDENT LOANS 3 (2012), *available at* http://files.consumerfinance.gov/f/201207_cfpb_Reports_Private-Student-Loans.pdf.

148. INST. FOR COLL. ACCESS & SUCCESS, STUDENT DEBT AND THE CLASS OF 2012, at 1 (2013), *available at* http://projectonstudentdebt.org/files/pub/classof2012.pdf.

149. Hsiang-Ching King et al., Ctrs. For Disease Control & Prevention, *Deaths: Final Data for 2005*, 56 NAT'L VITAL STAT. REP. 1, 21 tbl.3 (Apr. 24 2008), http://www.cdc.gov/nchs/data/nvsr/nvsr56/nvsr56_10.pdf.

150. Rhonda Jones-Webb et al., *Race, Socioeconomic Status, and Premature Mortality*, MINN. MED. (Feb. 2009), http://www.minnesotamedicine.com/PastIssues/PastIssues2009/February2009/ClinicalJonesWebbFebruary2009.aspx.

151. This Note concedes that exact mathematical calculations are unavailable.

nue, the result of this situation will often be bankruptcy for taxpayers. Therefore, the number of borrowers who are able to contribute to the tax base are likely insignificant.

Finally, politicians often receive negative publicity for voting against measures that are largely meant to provide necessary aid for struggling individuals. A quick glance at headlines will reveal those such as *What Kind of Politician Votes Against a Hurricane Relief Bill?*[152] and *Meet the 22 Republicans who Voted Against Protecting Women from Beatings*.[153] Similarly, politicians will be hard pressed to find a legitimate reason to vote against providing this life changing relief to individuals, like Mr. Reynoso, who are forced into financial ruin for nothing but attempting to promote higher education for his child.

CONCLUSION

Under the current tax code, when a taxpayer dies with outstanding student loans, that debt is often dischargeable under a provision of the Department of Education and two large private lenders. However, if the discharged student loan is a private student loan or a federal parent loan, this discharge of indebtedness is included in the parent's taxable income. This places many parents in financial straits, as they are forced to pay taxes on what is often a large amount of income they never realized.

This policy is inconsistent with current discharge of indebtedness exclusions under 26 U.S.C. § 108 as well as the practices of the IRS in cases of federal student loan discharges. Further, this is inconsistent with tax policy and encourages poor public policy results. To alleviate this problem, Congress should add an exception to 26 U.S.C. § 108 excluding from taxable income student loan debt discharged due to the death of a student within 10 years of ceasing an educational program.

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152. Elspeth Reeve, *What Kind of Politician Votes Against a Hurricane Relief Bill?*, THE WIRE (Jan. 4, 2013, 6:30 PM), http://www.theatlanticwire.com/politics/2013/01/hurricane-sandy-relief-bill-votes/60606/.

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