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The Closure of Institutions of Higher Education: Student Options, Borrower Relief, and Other Implications

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Summary

When an institution of higher education (IHE) permanently closes, a student's postsecondary education may be disrupted. Students enrolled at closing IHEs may face numerous issues and may be required to make difficult decisions in the wake of a closure. Two key issues students may face when their IHEs close relate to their academic plans and their personal finances.

The academic issues faced by students when their schools permanently close include whether they will continue to pursue their postsecondary education, and if so, where and how they might do so. Students deciding to continue their postsecondary education have several options. They may participate in a teach-out offered by the closing institution or by another institution. A teach-out is a plan that provides students with the opportunity to complete their program of study after a school's closure. Students may also be able to transfer the credits they previously earned at the closed IHE to another IHE. If a student is able to transfer some or all of the previously earned credits, he or she would not be required to repeat the classes those credits represent at the new institution; if a student is unable to transfer previously earned credits, the student may be required to repeat the classes those credits represent at the new IHE. Decisions regarding the acceptance of credit transfers are within the discretion of the accepting IHE.

The financial issues faced by students when their schools permanently close include whether they are responsible for repaying any loans borrowed to attend a closed school and how they might finance any additional postsecondary education they pursue. In general, a closed school loan discharge is available to a borrower of federal student loans made under Title IV of the Higher Education Act (P.L. 89-329, as amended), if the student was enrolled at the IHE when it closed or if the student withdrew from the IHE within 120 or 180 days prior to its closure, depending on when the loan was borrowed. Additionally, the student must have been unable to complete his or her program of study at the closed school or a comparable program at another IHE, either through a teach-out agreement or by transferring any credits to another IHE. Borrowers ineligible for a closed school discharge may be able to have eligible Title IV federal student loans discharged by successfully asserting as a borrower defense to repayment (BDR) certain acts or omissions of an IHE, if the cause of action directly relates to the loan or educational services for which the loan was provided. Whether a borrower may have discharged all or part of any private education loans borrowed to attend the closed IHE may depend on the loan's terms and conditions.

Some students may also face issues regarding how they might finance future postsecondary educational pursuits. If a borrower receives a closed school discharge or has a successful BDR claim, the discharged loan will not count against the borrower's Subsidized Loan usage period, which typically limits certain borrowers' receipt of Direct Subsidized Loans for a period equal to 150% of the published length of his or her academic program, and a borrower's statutory annual and aggregate borrowing limits on Direct Subsidized and Direct Unsubsidized Loans are unlikely to be affected. Students who receive a Pell Grant for enrollment at a school that closed may have an equivalent amount of Pell Grant eligibility restored. Likewise, if the student used GI Bill educational benefits from the Department of Veterans Affairs for attendance at a closed school, those benefits can be restored.

Students may be reimbursed for payments on charges levied by closed IHEs that are not covered by other sources from a State Tuition Recovery Fund (STRF). The availability of and student eligibility for such funds vary by state, and not all states operate STRFs. Finally, the receipt of any of the above-mentioned benefits may have federal and state income tax implications, including the potential creation of a federal income tax liability for borrowers who have certain loans discharged.

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Introduction

In academic year (AY) 2018-2019, approximately 6,400 institutions of higher education (IHEs), enrolling about 26.5 million postsecondary education students,¹ participated in the federal student aid programs authorized under Title IV of the Higher Education Act of 1965 (HEA; P.L. 89-329, as amended).² These IHEs ranged in sector, size, and educational programs offered. They comprised all sectors (i.e., public, private nonprofit, and proprietary), with some IHEs enrolling as few as three students and others enrolling over 174,000 in a single year.³ Offered educational programs varied from certificate programs in career and technical fields to doctoral and professional degree programs.

Most of these IHEs operate from year to year with few severe financial or operational concerns; however, each year, a few do face such concerns, which may cause them to cease or significantly curtail operations. The recent permanent closure of multiple large, proprietary (or private, for-profit) IHEs has brought into focus the extent to which a postsecondary student's education may be disrupted by a school closure.⁴ However, even in instances of a small IHE's closure, student concerns remain the same. Concerns include the following, among others: Can they continue their postsecondary education at another school? How will they finance future postsecondary educational pursuits? Are they liable for repaying loans they may have borrowed to pursue a postsecondary credential that they were unable to obtain because of an IHE's closure?

This report provides an explanation of the options a postsecondary student may pursue in the event the IHE he or she attends permanently closes, any financial relief that may be available to such students, and other practical implications for students following a school's closure. First, this report describes the academic options available to such students, such as participating in a teach-out or transferring to a new IHE. Next, it discusses issues related to financing a postsecondary education, including the extent to which borrowers may have any loans borrowed to finance educational expenses discharged due to a school closure and whether future financial assistance, including federal student loans, Pell Grants, and GI Bill educational benefits, may be available to students should they decide to continue their postsecondary education at another IHE. This report then describes additional relief that may be available to students who attended IHEs that closed, such as the potential to have tuition that has been paid reimbursed through a state tuition recovery fund. Finally, this report describes some potential income tax implications for students when their IHE has closed, including the extent to which they may incur a federal income tax liability for loans discharged and whether higher education tax credits remain available to them in future years.

The **Appendix** provides a list of abbreviations used in this report.

¹ U.S. Department of Education, National Center for Education Statistics, Integrated Postsecondary Education Data System (IPEDS).

² 20 U.S.C. 1001, et seq.

³ U.S. Department of Education, National Center for Education Statistics, Integrated Postsecondary Education Data System (IPEDS).

⁴ For additional information on one of these closures, see CRS Report R44068, *Effect of Corinthian Colleges' Closure on Student Financial Aid: Frequently Asked Questions*.

Academic Options and Consequences

In the event of a school closure, currently enrolled students must consider their academic options, including whether they will continue pursuing their postsecondary education, and if so, where. Two options that may be available to students include teach-outs and credit transfer.

Teach-Out Plans and Agreements

To participate in the Title IV federal student aid programs, an IHE must, among other requirements, agree to submit a teach-out plan to its accrediting agency if it intends to close a location that provides 100% of at least one educational program offered by the IHE or if it intends to otherwise cease operations.⁵ As part of a teach-out plan, an IHE may enter into a teach-out agreement with another IHE to provide the closing IHE's students with an educational program of similar content.

Teach-Out Plans

A *teach-out plan* is an institution's "written plan that provides for the equitable treatment of students if [the IHE] ceases to operate before all students have completed their program of study."⁶ Generally, accrediting agencies establish the criteria IHEs must meet when submitting a teach-out plan; thus, there are few standard components of a teach-out plan. U.S. Department of Education (ED) regulations, however, require accrediting agencies to evaluate teach-out plans to ensure they include a list of currently enrolled students, academic programs offered by the IHE, and the names of other IHEs "that offer similar programs and that could potentially enter into a teach-out agreement with the institution."⁷ Beyond these basic requirements, an IHE may be required by its accrediting agency to include in a teach-out plan provisions for students to complete their programs of study within a reasonable amount of time, a communication plan to affected parties (e.g., faculty and students) informing them of the impending closure, and information on how students may access their institutional records.⁸ Teach-out plan provisions may be completed at the closing school or at another IHE.

Teach-Out Agreements

As part of a teach-out plan, an IHE may enter into a *teach-out agreement* with another IHE. A teach-out agreement is an agreement between the closing IHE and another IHE that provides the closing IHE's students with a reasonable opportunity to complete their programs of study at the other IHE (known as the *teach-out institution*).⁹ Teach-out agreements are used when an IHE ceases operations (or plans to cease operations) before all of its enrolled students are able to

⁵ 34 C.F.R. §668.14(b)(31). In addition, 30 C.F.R. §602.25(c) specifies a number of other instances in which an IHE may be required to submit a teach-out plan to its accrediting agency.

⁶ HEA §487(f)(2).

⁷ 34 C.F.R. §602.24(c)(3).

⁸ See, for example, Higher Learning Commission, "Commission Approval of Institutional Teach-Out Arrangements," <https://www.hlcommission.org/Policies/teach-out-arrangements.html?highlight=WyJ0ZWJjaC1vdXQilLCJwbGFuIiwicGxhbidzIiwidGVhY2gtb3V0IHBSYW4iXQ==>, accessed October 30, 2020; and Middle States Commission on Higher Education, "Teach-Out Plans and Agreements Procedures," January 1, 2019, <file:///C:/Users/adhegi/Downloads/teach-out-plans-and-agreements-procedures.pdf>.

⁹ 34 C.F.R. §600.2.

complete their programs of study.¹⁰ Generally, regulations do not require that a closing IHE enter into a teach-out agreement with another IHE.¹¹ However, if a teach-out agreement is entered into, ED regulations require that an accrediting agency must require the closing institution to include in the agreement:

- a complete list of students enrolled in each program at the closing IHE and the program requirements each student has completed;
- a plan to provide all potentially eligible students with information about closed school loan discharge and any applicable state refund policies;
- a record retention plan;¹² and
- a statement to students of the tuition and fees and credits that will be accepted by the teach-out institution.¹³

When implemented, teach-out agreements may take a variety of forms. For instance, a teach-out agreement may provide that the teach-out institution will provide the faculty and student supports necessary to deliver the closing IHE's educational programs at the closing IHE's facilities for the remainder of the academic year in which the closing IHE ceases operations.¹⁴ In other instances, a teach-out agreement may provide educational programs to the closing IHE's students at the teach-out institution's facilities.

In the event an IHE closes without a teach-out plan or agreement in place, the IHE's accrediting agency must work with ED and appropriate state agencies to assist students in finding opportunities to complete their postsecondary education.¹⁵

Credit Transfer

In lieu of a teach-out, students of closed IHEs may be able to continue their postsecondary education by transferring some or all of the credits earned at the closed IHE to another IHE. In general, credit transfer is the process of one institution (the accepting institution) measuring a student's prior learning (typically via coursework) at another institution (the sending institution) and comparing that prior learning against educational offerings at the accepting institution. The accepting institution determines whether a student's prior learning meets its standards and whether the prior learning is applicable to its educational programs. If it determines the prior learning meets its standards, the accepting institutions gives credit toward its educational programs for the prior learning, such that a student transferring credits need not repeat all or part of a program's curriculum. Transfer-of-credit policies are determined by individual IHEs.

To smooth the credit transfer process, some IHEs have entered into articulation agreements. Articulation agreements are agreements between two or more IHEs demonstrating that a student's

¹⁰ 34 C.F.R. §600.2.

¹¹ An accrediting agency may, but is not required to, require an IHE it accredits or preaccredits to enter into a teach-out agreement as part of its teach-out plan. 34 C.F.R. §602.24(c)(5). Regulations also specify that an accrediting agency must require an IHE it accredits or preaccredits to submit a teach-out plan and, if practicable, teach-out agreements to the agency for approval when the IHE notifies the agency that it intends to cease operations. 34 C.F.R. §602.24(c)(2).

¹² A record retention plan must be provided to all enrolled students and must delineate the final disposition of *teach-out records*, which include student transcripts, billing, and financial aid records.

¹³ 34 C.F.R. §602.24(c)(6).

¹⁴ See, for example, Southern New Hampshire University, "Southern New Hampshire University to Lead 'Teach-Out' of all Daniel Webster College Programs," press release, September 13, 2016.

¹⁵ 34 C.F.R. §602.24(d).

prior learning from a sending IHE meets the accepting IHE's standards. Typically, they guarantee acceptance of at least some credits earned at the sending institution by the accepting institution.

The HEA does not require Title IV participating IHEs to maintain transfer-of-credit policies nor does it specify requirements for transfer-of-credit policies for IHEs that do have them. The HEA, however, does require that Title IV participating IHEs make publicly available any transfer-of-credit policies they may have in place.¹⁶ In disclosing transfer-of-credit policies, accepting IHEs must include information on the criteria the institution uses in evaluating credit transfers, and all institutions that are parties to articulation agreements must disclose a list of IHEs with which it has articulation agreements.

Students who attended a closed IHE may decide to continue their postsecondary education at another IHE and may wish to transfer credits earned at the closed IHE to the new IHE. Typically, students must initiate the credit-transfer process by expressing interest in transferring credit to another IHE.¹⁷ The IHE would then inform the student of next steps the student must take to enroll. Because IHEs set their own credit transfer criteria, credit transfer may not be guaranteed.¹⁸ Thus, some students may have all or a large proportion of their previously earned credits transferred to an accepting IHE and may experience little to no disruption or delay in their postsecondary educational pursuits, while others may have few or no credits transferred to an accepting IHE and may experience significant disruptions and delays in their postsecondary education. In addition, a student may incur greater financial obligations (e.g., student loans) if he or she must repeat coursework because credit from the closed school did not transfer.

Finally, students who successfully transfer some or all of their previously earned credits would be required to meet the accepting IHE's satisfactory academic progress (SAP) policies to maintain eligibility to receive Title IV funds at the accepting IHE.¹⁹ IHEs may establish their own SAP policies, but these policies must meet minimum federal standards, which must establish a minimum grade point average (or equivalent) and a maximum time frame in which students must complete their education program (pace of completion).²⁰ Only transfer credits that count toward a student's educational program at the accepting IHE are included in the accepting IHE's calculation of SAP.²¹ Thus, if a student is unable to transfer any credits from a closed IHE to another IHE, the student's previously earned credits will not count toward the accepting IHE's SAP calculation and would not have the potential to affect the student's aid eligibility with respect to SAP at the new IHE. However, should some or all of a student's previously earned credits from a closed IHE transfer to another IHE, depending on the accepting IHE's specific

¹⁶ HEA §485(h).

¹⁷ In some cases, a teach-out agreement may specify that the credits a student earned at the closed institution will transfer to the new IHE. See, for example, Higher Learning Commission, "Teach-Out Requirements: Provisional Plan and Teach-Out Agreements," September 2019, <https://downloadna11.springcm.com/content/DownloadDocuments.ashx?Selection=Document%2C73d8aaaf-d1fb-df11-bf75-001cc448da6a%3B&aid=5968>, accessed October 30, 2020.

¹⁸ For information on how often credits transfer, see Sean Anthony Simone, *Transferability of Postsecondary Credit Following Student Transfer or Coenrollment: Statistical Analysis Report*, National Center for Education Statistics, NCES 2014-163, August 2014.

¹⁹ HEA §484(c).

²⁰ 34 C.F.R. §668.34. A student's pace of completion is calculated by dividing the total number of credits a student has successfully completed by the number of credits the student has attempted. A student becomes ineligible for Title IV aid when it is mathematically impossible for him or her to complete their course of study within 150% of the length of the program (e.g., six years for a full-time, full-year four-year program) for undergraduate students and within the maximum time frame established by the IHE for graduate students.

²¹ U.S. Department of Education, *2018-2019 Federal Student Aid Handbook*, vol. 1, p. 16.

SAP policy, a student's Title IV eligibility may be affected such that he or she may not be meeting the accepting IHE's SAP policies and thus may be ineligible for Title IV aid at the accepting IHE.²²

Financial Options and Consequences

Along with considering academic options in the event of a school closure, students may also need to consider the financial options available to them. Students may have received financial assistance to help finance their education at the closed school and may need to seek financial assistance should they decide to continue pursuing a postsecondary education. Considerations for students who borrowed funds (or parents who borrowed funds on behalf of a student) to finance their education at a closed school include whether they are responsible for repaying any loans borrowed to attend the school. Considerations for students who wish to continue their education at another IHE include the extent to which their eligibility for various forms of financial aid (e.g., Direct Loans, Pell Grants, GI Bill Educational Benefits) may be affected by their previous use of those benefits at the closed school.

Federal Student Loan Discharge

Students who attended a school that closed (or the parents of students who attend a school that closed) may have borrowed federal student loans to help finance their postsecondary education at the closed school. In some instances, borrowers may receive some relief from being required to repay their loans, depending on the type of loan they seek to have discharged and their specific circumstances.

For HEA Title IV federal student loans (i.e., loans made under the Direct Loan, Federal Family Education Loan [FFEL], and Perkins Loan programs), borrowers may be provided some relief from being required to repay their federal student loans through a closed school loan discharge. In addition, borrowers who are ineligible for a closed school loan discharge may, in certain circumstances, seek debt relief on their Title IV student loans by asserting a borrower defense to repayment (BDR) for certain acts or omissions of an IHE, if the cause of action directly relates to the loan or educational services for which the loan was provided. The availability of a BDR claim may be closely related to a school's closure, as oftentimes, a BDR claim is predicated on misleading representations of an IHE relating to the educational services provided, and in recent years allegations of misrepresentation have played a part in the ultimate closure of some IHEs.²³

Prior to 2016, regulatory provisions addressed closed school discharge standards and procedures and, in a somewhat limited manner, BDR standards and procedures. On November 1, 2016, ED

²² In general, it appears that a student's pace of completion is unlikely to be affected by a credit transfer, as typically, only successfully completed courses at the original IHEs may be transferred to an accepting institution. However, successful course completion is defined by individual IHEs. Thus, should an accepting IHE define successful completion as any grade higher than an F (or its equivalent), then a student might be able to transfer credits from a class in which he or she earned, for instance, a D. This D would be included in the accepting IHE's calculation of the student's grade point average for purposes of determining SAP. Such grades may have the effect of bringing the student's GPA below the federally required C minimum, such that he or she may become ineligible for Title IV student aid at the accepting institution.

²³ For instance, in 2014 ED placed restrictions to Title IV aid on IHEs owned by Corinthian Colleges, Inc. (CCI) to address concerns relating to a variety of practices, including inconsistencies in job placement rates that had been presented to students. In response to its limited access to federal student aid funds, CCI closed and sold many of its IHEs. CRS Report R44068, *Effect of Corinthian Colleges' Closure on Student Financial Aid: Frequently Asked Questions*.

promulgated regulations (2016 regulations) intended to create a more robust set of standards and streamlined procedures for assessing BDR claims and to make some changes to the closed school discharge procedures.²⁴ These regulations took effect October 16, 2018.²⁵ Subsequently, in 2019, ED promulgated new closed school discharge and BDR regulations (2019 regulations) that made significant changes to the 2016 regulations.²⁶ The 2019 regulations went into effect on July 1, 2020.

Due to the various changes made to the regulations in recent years, borrower eligibility standards for closed school discharge and BDR may vary depending on when a loan was first disbursed. The following sections describe the general eligibility criteria for each of these types of discharge by cohort.

Closed School Loan Discharge

Students who attended a school that closed (or their parents) may be eligible to have the full balance of the outstanding HEA Title IV loans they borrowed to attend the IHE discharged. In general, borrowers of Title IV loans may be eligible to have the full balance of their outstanding HEA Title IV loans discharged (including any accrued interest and collection costs) if they, or the student on whose behalf a parent borrowed in the case of Parent PLUS Loans, are unable to complete the program in which they enrolled due to the closure of the school.²⁷ Borrowers who have their loans discharged due to a school closure are also eligible to be reimbursed for any amounts previously paid or collected on those loans, and if any adverse credit history was associated with the loan (e.g., default), the loan discharge will be reported to credit bureaus so that they may delete the adverse credit history associated with the loan.²⁸

Closed School Loan Discharge Eligibility

In general, to be eligible for loan discharge due to school closure, a student must have been enrolled in an IHE when it closed or must have withdrawn from the IHE within a specified period of time prior to its closure (referred to as the *look back period*). For loans first disbursed prior to July 1, 2020, the look back period is 120 days (i.e., the students must have withdrawn from the IHE within 120 days prior to its closure). For loans disbursed on or after July 1, 2020,²⁹ the look

²⁴ Department of Education, “Student Assistance General Provisions, Federal Perkins Loan Program, Federal Family Education Loan Program, William D. Ford Federal Direct Loan Program, and Teacher Education Assistance for College and Higher Education Grant Program,” 81 *Federal Register* 75926, November 1, 2016.

²⁵ Initially, the regulations were scheduled to take effect on July 1, 2017, but prior to the effective date, ED issued a final rule establishing July 1, 2020, as the new effective date. Following a series of lawsuits, a court vacated the delay of the 2016 regulations. Thus, the 2016 regulations went into effect October 16, 2018. Department of Education, “Student Assistance General Provisions, Federal Perkins Loan Program, Federal Family Education Loan Program, William D. Ford Federal Direct Loan Program, and Teacher Education Assistance for College and Higher Education Grant Program,” 83 *Federal Register* 6458, February 14, 2018; *Bauer v. DeVos*, 332 F. Supp. 3d 186 (D.C. Cir. 2018). See also, *Cal. Ass’n of Private Postsecondary Schs. v. DeVos*, 344 F. Supp. 3d 158 (D.C. Cir. 2018).

²⁶ Department of Education, “Student Assistance General Provisions, Federal Family Education Loan Program, and William D. Ford Federal Direct Loan Program,” 84 *Federal Register* 49788, September 23, 2019.

²⁷ HEA §437(c)(1); HEA §455(a)(1); HEA §464(g). In some instances, borrowers who are ineligible to have their federal student loans discharged due to school closure may be able to seek debt relief for their Direct Loan and FFEL program loans for a variety of other reasons. For additional information, see CRS Report R40122, *Federal Student Loans Made Under the Federal Family Education Loan Program and the William D. Ford Federal Direct Loan Program: Terms and Conditions for Borrowers*.

²⁸ 34 C.F.R. §§674.33(g)(2); 682.402(d)(2); 685.214(b).

²⁹ The SAFRA Act (P.L. 111-152, Title II, Part A) terminated the authority to make new FFEL program loans after

back period is 180 days.³⁰ In addition, the student must have been unable to complete his or her program of study at the closed school (including through a teach-out plan) or in a comparable³¹ program at another IHE, either through a teach-out plan or agreement or by transferring any credits to another IHE.³²

If the closing school offers the option for students to complete their education through a teach-out plan or agreement, a student may refuse the option, and the borrower may still qualify for closed school loan discharge.

Alternatively, if a student transfers credits to a new school but completes an entirely different program of study at the new school, then the borrower is eligible for loan discharge, regardless of the fact that some credits from the closed IHE may have transferred to the new IHE. This is because the program at the new school is entirely different from the one for which the loans were intended at the previous school.³³

Finally, to obtain a closed school loan discharge a borrower must cooperate with ED in any judicial or administrative proceeding brought by ED to recover amounts discharged from the school.³⁴ If a borrower fails to cooperate with ED, the loan discharge may be revoked.³⁵

Closed School Loan Discharge Procedures

To receive a closed school loan discharge, all borrowers, regardless of when their loan was first disbursed, may apply for such discharge. Borrowers whose IHEs closed on or after November 1, 2013, and before July 1, 2020, may have their loans automatically discharged by the Secretary of Education (the Secretary) in certain circumstances.

Borrowers applying for a closed school loan discharge must fill out the closed school loan discharge application and return it to their loan servicer.³⁶ Generally, while a borrower's loan discharge application is pending, the borrower's loan is placed in forbearance until a discharge decision is made.³⁷ Under forbearance, a borrower is able to temporarily stop making payments or reduce the monthly payments on his or her federal student loans. During this time, interest

June 30, 2010. The authorization to make new Perkins Loans expired on September 30, 2017. Thus, Direct Loans are the only type of loan that could be made on or after July 1, 2020, and that could qualify for the new closed school discharge standard.

³⁰ 34 C.F.R. §§674.33(g)(4); 682.402(d)(1); 685.214(c). The Secretary may extend the look back period in exceptional circumstances. The definition of *exceptional circumstances* varies depending on when the loan was first disbursed.

³¹ 34 C.F.R. §§674.33(g)(4); 682.402(d)(1); 685.214(c); U.S. Department of Education “Loan Discharge Application: School Closure,” OMB No. 1845-0058, expiration date September 30, 2020.

³² 34 C.F.R. §§674.33(g)(4), 682.402(d)(3), 685.214(c)..

³³ U.S. Department of Education, Federal Student Aid, “Q&A on Closed School Discharge,” <https://studentaid.ed.gov/sa/repay-loans/forgiveness-cancellation/closed-school#q-and-a>, accessed October 30, 2020.

³⁴ For instance, the borrower may be required to provide testimony supporting a request for discharge.

³⁵ 34 C.F.R. §§674.33(g), 682.402(d), 685.214(d).

³⁶ U.S. Department of Education, “Loan Discharge Application: School Closure,” OMB No. 1845-0058.

³⁷ 34 C.F.R. §§674.33, 682.211(f)(8), 685.205(b)(6). Unlike the FFEL and Direct Loan programs, the Perkins Loan program regulations do not specify that an IHE must place a borrower's loan in forbearance while his or her closed school loan discharge application is being processed; however, the regulations do state that an IHE may place a borrower's loan in forbearance due to several specified reasons “or for other acceptable reasons.” (34 C.F.R. §674.33(d)(5)(ii)) In addition, in certain stages of the closed school loan discharge application process, an IHE (or ED, in the case of Perkins Loans held by ED) may be required to suspend efforts to collect on a borrower's Perkins Loans. 34 C.F.R. §674.33(g)(8).

continues to accrue on both subsidized and unsubsidized loans. In addition, collections on an eligible defaulted loan cease, although a borrower may continue to make payments on the loan.

Borrowers may initiate the closed school loan discharge process on their own;³⁸ however, the Secretary³⁹ is required to identify all borrowers who may be eligible for a closed school loan discharge upon a school's closure and mail to each borrower a discharge application and an explanation of qualifications and procedures for obtaining a discharge, if the borrower's address is known.⁴⁰ Procedures following borrower notification vary somewhat depending on whether loans were disbursed before July 1, 2020, or on or after that date. In general, however, after the Secretary sends notice to a borrower, the Secretary suspends any effort to collect a borrower's defaulted loans. The borrower then has 60 days in which to submit a closed school loan discharge application. If the borrower fails to submit such an application within the 60-day time frame, the Secretary resumes collections,⁴¹ but the borrower may still submit a closed school loan discharge application at any time for consideration.

Alternatively, for borrowers whose schools closed on or after November 1, 2013, and before July 1, 2020, the Secretary will automatically discharge a borrower's loans if the Secretary determines that the borrower did not subsequently reenroll in any Title IV eligible institution within three years after the school closed. For all loans, regardless of when the school closed, a borrower's loans also may be automatically discharged if the Secretary determines the borrower qualifies for the loan discharge based on information within ED's possession.⁴²

Relief Provided

If a borrower receives a closed school discharge, the full balance of the outstanding Title IV loan borrowed to attend the IHE is discharged and the borrower is qualified to be reimbursed for any

³⁸ Accrediting agencies must require IHEs they accredit or preaccredit to include in any teach-out agreement a "plan to provide all potentially eligible students with information about how to obtain a closed school discharge ..." 34 C.F.R. §602.24(c)(6)(ii).

³⁹ The following paragraphs generally describe the procedures associated with closed school loan discharges as specified in regulations. The descriptions herein are drawn from the regulations specific to the Direct Loan program (34 C.F.R. §685.214), but are generally applicable to the Perkins Loan and FFEL programs as well. However, because parties other than ED may be responsible for administrative functions associated with closed school loan discharges in the Perkins Loan and FFEL programs, the tasks described in this report may vary somewhat from what Perkins Loan and FFEL program loan holders other than ED may be required to undertake. Closed school loan discharge procedures specific to the Perkins Loan program and the FFEL program can be found at 34 C.F.R. §674.33 and 34 C.F.R. §682.402, respectively.

⁴⁰ If the borrower's address is unknown, ED attempts to locate the borrower by consulting with a variety of parties, including the closed school, the school's accrediting agency, and the school's licensing agency. 34 C.F.R. §685.214(f)(3) and (g)(3).

⁴¹ Upon resuming collection on a borrower's loans, ED grants forbearance of principal and interest for the period during which the collection activity was suspended and may capitalize any interest accrued but not paid during that time. 34 C.F.R. §685.214(f)(4) and (g)(4).

⁴² 34 C.F.R. §685.214(c)(3). In the instance of a FFEL program loan, ED may automatically discharge a borrower's FFEL program loan if he or she qualified for and received a closed school loan discharge of his or her Direct Loan program or Perkins Loan program loans. Similarly, ED may automatically discharge a borrower's Perkins Loan program loan if he or she qualified for and received a closed school loan discharge of his or her Direct Loan program or FFEL program loan and "was unable to receive a discharge on his or her ... Perkins Loan because the Secretary of Education lacked statutory authority to discharge the loan." See 34 C.F.R. §§682.402(d)(8), 674.33(g)(3). The Perkins Loan provisions appear to apply largely to Perkins Loan program loans made prior to 1998, when ED did not have legal authority to discharge such loans due to a school's closure. The rationale behind the FFEL program loan provisions is not explicitly identified in materials located and reviewed for this report. See 64 *Federal Register* 41236, July 29, 1999.

amounts previously paid or collected on those loans. In addition, for loans that were considered in default, ED is to consider such loans as not in default following discharge, and the borrower is to regain eligibility to receive additional Title IV assistance.⁴³ Finally, ED is to update reports to consumer reporting agencies so that they may delete any adverse credit history associated with the loan.⁴⁴

Borrower Defense to Repayment

Even if student-borrowers who attended a closed school (or parent-borrowers in the case of Parent PLUS Loans) are ineligible for a closed school loan discharge, they may, in certain circumstances, seek debt relief on their Title IV student loans by asserting as a borrower defense to repayment (BDR) certain acts or omissions of an IHE, if the cause of action directly relates to the loan or educational services for which the loan was provided. The availability of a BDR claim may be closely related to a school's closure, as oftentimes, a BDR claim is predicated on misleading representations of an IHE relating to the educational services provided, and in recent years, allegations of misrepresentation have played a part in the ultimate closure of some IHEs.⁴⁵ Whether a borrower may seek this type of relief depends on the type of Title IV loan borrowed. The standard under which a BDR may be reviewed also depends on the type of Title IV loan borrowed and when the loan was disbursed.

If a borrower's BDR is successful, ED is to determine the amount of debt relief to which the borrower is entitled, which can include relief from repaying all or part of the outstanding loan balance and reimbursement for previous amounts paid toward or collected on the loan. Additionally, if an adverse credit history was associated with the loan (e.g., default), the loan discharge is to be reported to consumer reporting agencies so that they may delete the adverse credit history associated with the loan.⁴⁶

Applicable Borrower Defense to Repayment Standards

The HEA specifies that Direct Loan borrowers may assert as a defense to repayment certain "acts or omissions of an institution of higher education."⁴⁷ Although this statutory language is specific to Direct Loans, implementing regulations have expanded the instances in which a borrower of a non-Direct Loan may assert a BDR claim. Thus, loans that are potentially eligible for discharge under a BDR claim include Direct Loan program loans, and FFEL program loans and Perkins Loans program loans, if they are first consolidated into a Direct Consolidation Loan.⁴⁸

⁴³ Individuals become ineligible for additional Title IV student aid if they default on a Title IV loan. HEA §484(a)(3).

⁴⁴ 34 C.F.R. §§674.33(g)(2), 682.402(d)(2), 685.214(b).

⁴⁵ For instance, in 2014, ED placed restrictions to Title IV aid on IHEs owned by Corinthian Colleges, Inc. (CCI) to address concerns relating to a variety of practices, including inconsistencies in job placement rates that had been presented to students. In response to its limited access to federal student aid funds, CCI closed and sold many of its IHEs. CRS Report R44068, *Effect of Corinthian Colleges' Closure on Student Financial Aid: Frequently Asked Questions*.

⁴⁶ 34 C.F.R. §§ 685.206(e)(12) and 685.222(i)(7)(ii).

⁴⁷ HEA §455(h).

⁴⁸ Other non-Direct Loan program loans that are potentially eligible for discharge under a BDR claim if they are first consolidated into a Direct Consolidation Loan include Health Professions Student Loans, Loans for Disadvantaged students made under Title VII-A-II of the Public Health Service Act, Health Education Assistance Loans, and Nursing Loans made under part E of the Public Health Service Act. 34 C.F.R. §685.212(k)(2).

In addition, even if a FFEL program loan is not consolidated into a Direct Consolidation Loan, FFEL program regulations specify instances in which a FFEL program loan may not be legally enforceable, such that a borrower need not repay it. ED has stated that the claims a borrower could bring as a defense against repayment under the FFEL program are the same as the pre-July 1, 2017, standard (discussed later in this report) that could be brought under the Direct Loan program.⁴⁹ Perkins Loan program loans that are not consolidated into Direct Consolidation Loans are not eligible for BDR relief.

In general, three separate BDR standards may be applied to eligible student loans under the Direct Loan program regulations. The applicable BDR standard to be used largely depends on when the Direct Loan was made.

Eligible loans made prior to July 1, 2017

For eligible loans made prior to July 1, 2017 (pre-July 1, 2017, standard), a borrower may assert as a defense to repayment an IHE's acts or omissions that "would give rise to a cause of action against the school under applicable State law." The IHE's acts or omissions must relate to the making of the loan for enrollment at the IHE or the provision of educational services for which the loan was provided.⁵⁰

Eligible loans made on or after July 1, 2017, and before July 1, 2020

For eligible loans made on or after July 1, 2017, and before July 1, 2020 (July 1, 2017-June 30, 2020, standard), a borrower may assert as a defense to repayment one of the following, as it relates to the making of a borrower's loan for enrollment at the IHE or the provision of the educational services for which the loan was made:⁵¹

- A non-default, contested state or federal court judgment against an IHE;
- A breach of contract by an IHE,⁵² where an IHE failed to perform obligations under the terms of a contract with a student, such as the provision of specific programs or services; or
- A substantial misrepresentation by an IHE that the borrower "reasonably relied on to the borrower's detriment when the borrower decided to attend, or to continue attending, the school" or decided to take out certain loans.

For purposes of this BDR standard, a substantial misrepresentation is "any false, erroneous, or misleading statement an [IHE] or one of its representatives ... makes directly or indirectly to a student, prospective student or any member of the public, or to an accrediting agency, to a State agency, or to the Secretary" on which "the person to whom it was made could reasonably be expected to rely, or has reasonably relied, to that person's detriment." An IHE is deemed to have made a substantial misrepresentation when it (or its representatives) makes a "substantial

⁴⁹ To assert a successful BDR claim, FFEL borrowers must satisfy the general pre-July 1, 2017, BDR standards and must also prove additional components, such as showing that the FFEL lender offered payment or other benefits to the IHE for referring borrowers to the specific FFEL lender. These standards apply to FFEL program loans held by private sector and state-based entities and those owned by ED. 34 C.F.R. §682.209(g) and U.S. Department of Education, "Notice of Interpretation," 60 *Federal Register* 37768-37770, July 21, 1995.

⁵⁰ 34 C.F.R. §685.206(c).

⁵¹ 34 C.F.R. §685.222(b)-(d).

⁵² A contract between an IHE and a borrower could include, for instance, an enrollment agreement, a school catalog, or a student handbook. Department of Education, "Student Assistance General Provisions, Federal Perkins Loan Program, Federal Family Education Loan Program, William D. Ford Federal Direct Loan Program, and Teacher Education Assistance for College and Higher Education Grant Program," 81 *Federal Register* 39341, June 16, 2016.

misrepresentation about the nature of its educational programs, its financial charges, or the employability of its graduates.”⁵³

Eligible loans made on or after July 1, 2020

For eligible loans made on or after July 1, 2020 (post-June 30, 2020, standard), a borrower may assert a defense to repayment if he or she can establish that

- the IHE made a misrepresentation of a material fact upon which the borrower reasonably relied in deciding to obtain an eligible loan; and
- the borrower was “financially harmed by the misrepresentation.”⁵⁴

For purposes of this BDR standard, a misrepresentation is a false, misleading, or deceptive statement, act, or omission by an IHE to a borrower that (1) was made with knowledge of its false, misleading, or deceptive nature or with a reckless disregard for the truth and (2) directly relates to the student’s enrollment (or continued enrollment) at the IHE or the provision of educational services for which the loan was made.⁵⁵ In addition, *financial harm* is defined as “the amount of monetary loss that a borrower incurs as a consequence of a misrepresentation,”⁵⁶ and regulations explicitly state that ED does not consider the act of taking out a loan, alone, as evidence of financial harm.⁵⁷

As indicated above, the BDR standard applied in a borrower’s case may depend to a large extent on the date on which a borrower’s loans were disbursed. However, other considerations that relate to the type of federal student loan made also play a role in determining which BDR standard may apply in a borrower’s case, but only with respect to the July 1, 2017-June 30, 2020, standard.

In general, for Direct Loan program loans not paid off through a Direct Consolidation Loan, the BDR standard used would depend on the date on which a borrower’s loans were disbursed. For all FFEL program loans not paid off through a Direct Consolidation Loan, the pre-July 1, 2017, standard would apply.

For loans paid off through a Direct Consolidation Loan, the BDR standard used would depend on the date on which the Direct Consolidation Loan was made, and in some cases, on the date the underlying Direct Loan was disbursed. Specifically, for Direct Consolidation Loans made prior to July 1, 2017, the pre-July 1, 2017, standard would apply. For Direct Consolidation Loans made on or after July 1, 2017, and before July 1, 2020, the eligible non-Direct Loan program loan components of the Direct Consolidation Loan would be subject to the July 1, 2017-June 30, 2020 standard, and the Direct Loan program loan components of the Direct Consolidation Loan would be subject to the BDR standard in effect when the Direct Loan program loans were first disbursed (either the pre-July 1, 2017, standard or the July 1, 2017-June 30, 2020, standard). Finally, for

⁵³ 34 C.F.R. §668.71(b) and (c).

⁵⁴ 34 C.F.R. §685.222(e)(2).

⁵⁵ 34 C.F.R. §685.206(e)(3). Evidence that a misrepresentation occurred includes, for example, actual licensure passage or employment rates that are materially different from those included in the institution’s marketing materials or the inclusion in the institution’s marketing materials of communications to students about the widespread or general transferability of credits that are in practice only transferable in limited circumstances.

⁵⁶ 34 C.F.R. §685.206(e)(4).

⁵⁷ Evidence of financial harm may include, for example, the borrower’s “inability to secure employment in the field of study for which the institution expressly guaranteed employment,” and “the borrower’s inability to complete the program [of study] because the institution no longer offers a requirement necessary for completion of the program ... and the institution did not provide for an acceptable alternative requirement to enable completion of the program.”

Direct Consolidation Loans made on or after July 1, 2020, the post-June 30, 2020, standard would apply, regardless of underlying loan type.⁵⁸

Table 1 depicts the BDR standard that would apply based on type of federal student loan at issue and the date on which the loan was disbursed.

Table 1. Borrower Defense to Repayment Standard Used
By loan type and disbursement date

Loan Type and Disbursement Date	BDR Standard Applied		
	Pre-July 1, 2017	July 1, 2017-June 30, 2020	Post-June 30, 2020
Direct Loan Program Subsidized, Unsubsidized, and PLUS Loans			
Disbursed pre-July 1, 2017	✓		
Disbursed July 1, 2017-June 30, 2020		✓	
Disbursed after June 30, 2020			✓
FFEL Program Subsidized, Unsubsidized, PLUS, and Consolidation Loans^a			
Disbursed at any time ^b	✓		
Direct Loan Program Consolidation Loans			
Disbursed pre-July 1, 2017	✓		
Disbursed July 1, 2017-June 30, 2020			
Underlying Direct Loan Program Subsidized, Unsubsidized, and PLUS Loans disbursed pre-July 1, 2017	✓		
Underlying Direct Loan Program Subsidized, Unsubsidized, and PLUS Loans disbursed July 1, 2017-June 30, 2020		✓	
Underlying Eligible Non-Direct Loan Program Loans ^c disbursed pre-July 1, 2017 ^c		✓	
Underlying Eligible Non-Direct Loan Program Loans disbursed July 1, 2017-June 30, 2020 ^c		✓	
Disbursed after June 30, 2020			✓

Source: CRS analysis of 34 C.F.R. §§682.209(g), 685.206, 685.212, and 685.222.

- a. FFEL program borrowers must satisfy the general pre-July 1, 2017, BDR standards and must prove additional factors, such as showing that the FFEL lender offered payment or other benefits to the IHE for referring borrowers to the specific FFEL lender. 34 C.F.R. §682.209(g).
- b. The SAFRA Act (P.L. 111-152, Title II, Part A) terminated the authority to make new FFEL program loans after June 30, 2010.
- c. Eligible non-Direct Loan program loans include FFEL program loans, Perkins Loan program loans, Health Professions Student Loans, Loans for Disadvantaged students made under Title VII-A-II of the Public Health

⁵⁸ 34 C.F.R. §685.212(k).

Service Act, Health Education Assistance Loans, and Nursing Loans made under part E of the Public Health Service Act.

BDR Procedures

Regulations establish procedures through which a BDR claim may be asserted on a borrower's Direct Loan program loans. For Direct Loan program loans made before July 1, 2020, BDR procedures include an individual claim process and a group claim process. For Direct Loan program loans made on or after July 1, 2020, only an individual claim process is available. In addition, differing statutes of limitations may apply to BDR claims, depending on when the Direct Loan program loan was first made. This section of the report briefly describes the procedures for Direct Loan program loans (including Direct Consolidation Loans that repaid eligible non-Direct Loan program loans for which a borrower asserts a BDR claim). Direct Loan program loans are loans for which BDR claims may be more likely to be asserted, given that Direct Loan program borrowers account for approximately 83% of all borrowers with outstanding Title IV loans.⁵⁹ The procedures described herein would not apply to ED-owned FFEL program loans or to FFEL program loans held by private and state-based entities that are not consolidated into Direct Consolidation Loans.⁶⁰ For such ED-owned FFEL program loans, ED would review and adjudicate any BDR claims.⁶¹ For such FFEL program loans not owned by ED, BDR claims procedures may vary by loan holder.⁶²

For all types of Direct Loan program BDR procedures, to obtain relief a borrower must cooperate with ED in any relevant proceeding. If a borrower fails to cooperate with ED, the relief may be revoked.⁶³

Individual Claim Process

In general, the process through which an individual may assert a BDR application applies to the borrower regardless of when his or her loan was first disbursed.⁶⁴ To assert a BDR claim as an individual,⁶⁵ a borrower must submit a BDR application,⁶⁶ which among other items requires the borrower to provide evidence that supports his or her BDR claim. Upon receipt of the application and while the BDR claim is evaluated, ED places any non-defaulted Direct Loans into

⁵⁹ Office of Federal Student Aid, Data Center, "Federal Student Aid Portfolio Summary," FY2020 Q2.

⁶⁰ Under the FFEL program, loans were originated and serviced by private sector and state-based lenders and were funded with nonfederal capital. ED guaranteed lenders against loss (e.g., through borrower default or discharge due to death or permanent disability). Although FFEL program loans were last disbursed in 2010, many remain outstanding. In some instances, private or state-based lenders continue to service FFEL program loans. In other instances, ED has purchased FFEL program loans from the lenders and is now the owner of the loans. In these cases, the loans are serviced by ED-contracted student loan servicers.

⁶¹ Upon submitting a BDR claim on an ED-owned FFEL program loan that is not consolidated into a Direct Consolidation Loan, the loan is placed into forbearance, or collections are paused, while the claim is being reviewed. CRS email communication with U.S. Department of Education personnel on October 13, 2020.

⁶² Borrowers of such loans must contact the holder of their FFEL program loans for information on the BDR process. Upon submitting a BDR claim on an FFEL program loan not owned by ED, the borrower is offered to opportunity to request that his or her loan be placed in forbearance while the claim is being reviewed. U.S. Department of Education, Application for Borrower Defense to Loan Repayment, OMB No. 1845-0146.

⁶³ 34 C.F.R. §§685.206(e)(14), 685.222(j).

⁶⁴ In some instances, there are slight differences between the individual claim process for Direct Loan program loans made prior to July 1, 2020, and for Direct Loan program loans made on or after July 1, 2020. In general, those differences are beyond the scope of this report.

⁶⁵ 34 C.F.R. §§685.206(e)(8)-(13), 685.222(e).

⁶⁶ See U.S. Department of Education, "Application for Borrower Defense to Loan Repayment," OMB No. 1845-0146.

forbearance.⁶⁷ If a borrower with a FFEL program loan files a BDR claim with ED, ED notifies the lender or loan holder, as appropriate.⁶⁸ The lender places the loan in forbearance in yearly increments,⁶⁹ and the loan holder ceases collection on any defaulted loans while a borrower's BDR claim is being evaluated.⁷⁰ If ED determines that the borrower would be eligible for relief if he or she consolidated the FFEL program loan into a Direct Consolidation Loan, the borrower would then be able to consolidate the loan into a Direct Consolidation Loan⁷¹ and receive BDR relief.⁷² If ED determines that the borrower would not qualify for BDR, then the loan is removed from forbearance or collections resume, as appropriate.⁷³

To determine whether an individual qualifies for BDR relief, upon receipt of an individual BDR application, ED notifies the IHE against which the BDR claim is asserted and reviews any evidence submitted by the borrower and other relevant information, such as ED records and any response submitted by the IHE. After considering the submissions and evidence, ED issues a written decision on the claim and notifies the borrower⁷⁴ of the decision and any relief the borrower will receive.⁷⁵ For loans made prior to July 1, 2020, if a borrower's claim is denied in full or in part, the borrower may request that ED reconsider his or her claim upon the identification of new evidence.⁷⁶ For loans made on or after July 1, 2020, a determination of a borrower's BDR claim by ED is not subject to appeal within ED.⁷⁷ For loans made at any time, ED may reopen a BDR application to consider evidence that was not considered in the previous decision.⁷⁸

Group Claim Process

A group BDR claim process is available for Direct Loan program loans made prior to July 1, 2020.⁷⁹ Under these procedures, upon consideration of factors such as a common set of facts and

⁶⁷ 34 C.F.R. §§685.205(b)(6), 685.206(e)(8), 685.222(e)(2). During forbearance, interest continues to accrue on both subsidized and unsubsidized loans. A borrower may opt out of forbearance and continue making payments on his or her loan. For Direct Loans made prior to July 1, 2020, ED also suspends collections on defaulted loans. 34 C.F.R. §685.222(e)(2)(ii). For Direct Loans made on or after July 1, 2020, regulations are silent regarding whether ED suspends collections on defaulted loans.

⁶⁸ The regulations are silent regarding whether lenders of Perkins Loans are required to place Perkins Loans into forbearance or to cease collections on Perkins Loans should a Perkins Loan borrower file a BDR claim with ED. ED has indicated it is not its current practice to request or require Perkins Loan holders or servicers to place borrowers into forbearance or to cease collections on a Perkins Loan for purposes of BDR. CRS email communication with U.S. Department of Education personnel on October 13, 2020.

⁶⁹ A borrower may opt out of forbearance and continue making payments on his or her loan. 34 C.F.R. §682.211(i)(7).

⁷⁰ 34 C.F.R. §682.410(b)(6)(ii).

⁷¹ If borrowers choose to not consolidate their FFEL program loans into a Direct Consolidation Loan, they may still pursue a BDR claim under the FFEL program BDR standards and procedures.

⁷² The loan would remain in forbearance until the loan is consolidated. 34 C.F.R. §682.211(i)(7).

⁷³ 34 C.F.R. §§682.211(i)(7), 682.410(b)(6)(iii).

⁷⁴ For Direct Loan program loans made after July 1, 2020, ED also notifies the IHE of the decision. 34 C.F.R. §685.206(e)(11)(i)(A).

⁷⁵ 34 C.F.R. §§685.222(e)(5), 685.206(e)(11).

⁷⁶ 34 C.F.R. §685.222(e)(5).

⁷⁷ 34 C.F.R. §685.206(e)(13).

⁷⁸ 34 C.F.R. §§685.212(e)(7), 685.222(e)(5)(ii). For loans made prior to July 1, 2020, ED may reopen a BDR application to consider new evidence at any time. For loans made on or after July 1, 2020, ED may reopen a BDR application to consider new evidence in a more limited set of circumstances relating to whether other adjudicatory bodies have made final decisions with respect to whether an IHE has made a misrepresentation.

⁷⁹ 34 C.F.R. §685.222(f).

claims or fiscal impact, the Secretary may initiate a process to determine whether a group of borrowers has a BDR claim. ED may identify members for a group BDR claim by either consolidating applications filed by individuals in the above-described process that have common facts and claims or by determining that there are common facts and claims that apply to borrowers who have not filed individual applications.

Loans of borrowers who have filed individual claims that are consolidated into a group BDR claim remain in forbearance or suspended collections as described in the previous section, and loans of identified group members who have not filed individual claims are placed in forbearance or suspended collections as described in the previous section. ED notifies identified group members of the group proceeding and informs them that they may opt out of the group proceeding.⁸⁰ ED also notifies the school against which the group BDR claim is asserted.

After identification of the relevant group of borrowers, ED conducts a fact-finding process, which, in general,⁸¹ consists of ED considering any evidence and arguments presented on behalf of the group, along with any additional information such as ED records or an IHE's response to the BDR claim. ED then issues a written decision on the claim and notifies the borrowers of any relief provided. If the claim is denied in full or in part, an individual may file a claim for individual relief as previously described. In addition, ED may reopen a BDR application at any time to consider evidence that was not considered in the previous decision.⁸² In certain circumstances, an IHE against which a group BDR claim has been brought may appeal ED's decision.⁸³

Relief Provided

Regulations specify the relief that may be afforded to a borrower who successfully asserts a BDR.⁸⁴ This section of the report focuses on BDR relief available to borrowers with Direct Loan program loans, including Direct Consolidation Loans that repaid eligible non-Direct Loan program loans. However, it should be noted that borrowers of FFEL program loans that have not been consolidated into Direct Consolidation Loans are eligible to have all or part of their loan discharged, and may be eligible to be reimbursed for payments previously paid toward or collected on the loans if certain conditions are met.⁸⁵ Borrowers of Perkins Loans are ineligible for BDR relief unless they first consolidate their loans into a Direct Consolidation Loan.

⁸⁰ It is unclear how a borrower who has successfully asserted an individual BDR claim may be affected by any subsequent group proceeding.

⁸¹ For the fact-finding portion of the group BDR claim, two slightly differing sets of procedures apply depending on whether the BDR claim relates to loans made to attend a school (1) that has closed and for which there is no financial protection or other entity that ED may recover losses from associated with the BDR claim, or (2) that is open or that has closed and for which there are financial protections or other entities from which ED may recover losses associated with BDR claims. This report only describes the general procedures applicable across both types of group BDR procedures.

⁸² 34 C.F.R. §685.222(g)(4).

⁸³ An IHE may appeal ED's decision if the BDR claims relate to loans made to attend an open school or a closed school for which there are financial protections or entities from which ED may recover losses.

⁸⁴ 34 C.F.R. §685.222(i).

⁸⁵ In general, FFEL program loans (both those owned and not owned by ED) may be discharged if a borrower satisfies the pre-July 1, 2017, BDR standards and proves additional factors, such as showing that the FFEL lender offered payment or other benefits to the IHE for referring borrowers to the specific FFEL lender. Payments made on FFEL program loans may also be reimbursable. To assert a BDR claim, a FFEL program loan borrower who decided not to consolidate his or her loan into a Direct Consolidation Loan can assert a BDR claim against any lender holding the loan, including ED in the instance of ED-owned loans, and may directly pursue reimbursement from the holder. 34

In general, regardless of when the Direct Loan program loan was disbursed, if a borrower's BDR application is approved, ED determines the appropriate amount of relief to award the borrower. Relief provided can include a discharge of all or part of the loan amounts (including costs and fees) owed to ED on the loan at issue and reimbursement of all or part of any amounts previously paid toward or collected on a borrower's loan.⁸⁶ The procedures to calculate the precise amount of relief to be provided, however, depend on the date on which the Direct Loan program loan was first disbursed.

To calculate the amount of relief to be provided on loans made prior to July 1, 2020,⁸⁷ ED takes into account a variety of factors, depending on which basis the BDR claim was brought.

- **Substantial misrepresentation:** ED is to factor the borrower's cost of attendance to attend the IHE, the value of the education the borrower received, "the value of the education that a reasonable borrower in the borrower's circumstances would have received ... the value of the education the borrower should have expected given the information provided to the borrower by the institution" and/or any other relevant factors.
- **Court judgment against the IHE:** If the judgment provides specific financial relief, ED will provide the unsatisfied amount of relief. If the judgment does not provide specific financial relief, ED "will rely on the holding of the case and applicable law to monetize the judgment."⁸⁸
- **Breach of contract by the IHE:** ED is to determine relief "based on the common law of contracts"⁸⁹ and other reasonable considerations.⁹⁰

The total amount of relief provided cannot exceed the amount of the loan and any associated costs and fees.⁹¹

For loans made on or after July 1, 2020, ED calculates the amount of relief to be provided by taking into account a borrower's application, the IHE's response to the borrower's application (including the financial harm alleged in the borrower's application), and any other evidence in ED's possession that had previously been provided to the borrower and the IHE in accordance

C.F.R. §682.209(g).

⁸⁶ Payments made of collections on Direct Loans, including Direct Consolidation Loans that repaid eligible non-Direct Loan program loans are reimbursable by ED if the payments were made directly to ED. Thus, payments made on non-Direct Loan program loans prior to consolidation are not reimbursable by ED. 34 C.F.R. §§685.212(k)(iv)(A), 685.206(e)(1)(iii)

⁸⁷ As previously described, for Direct Loan program loans made prior to July 1, 2020, payments made or collections on Direct Loans, including Direct Consolidation Loans that repaid eligible non-Direct Loan program loans, are reimbursable by ED if the borrower asserted the BDR claim within the applicable statute of limitations. 34 C.F.R. §§685.212(k)(1)(ii), 685.212(k)(2)(iii).

⁸⁸ 34 C.F.R. §685.222(i)(2)(ii).

⁸⁹ 34 C.F.R. §685.222(i)(2)(iii).

⁹⁰ ED may consider information derived from a sample of borrowers when determining relief for a group of borrowers. For all borrowers asserting a BDR claim, ED may also rely on conceptual examples of relief provided in the regulations. 34 C.F.R. §685.222(i)(4). See 34 C.F.R. Part 685, Subpart B, Appendix A.

⁹¹ In addition, the amount of relief provided will be reduced by any other monetary relief, such as a refund, debt forgiveness, or indemnification, received by the borrower and related to the borrower defense. 34 C.F.R. §685.222(i)(8).

with regulations.⁹² The total amount of relief provided can exceed the amount of financial harm alleged by the borrower, but cannot exceed the amount of the loan and any associated costs.⁹³

Regardless of when a Direct Loan was disbursed, relief other than monetary relief may be provided to a borrower. Such relief may include determining that the borrower is not in default on his or her loan and is eligible to receive additional Title IV assistance and updating reports to consumer reporting agencies so that they may delete any adverse credit history associated with the loan.⁹⁴

Teacher Education Assistance for College and Higher Education Grants (TEACH Grants)

TEACH Grant⁹⁵ recipients whose TEACH Grants have converted into a Direct Loan for failure to complete TEACH Grant service requirements may be able to seek relief under either a closed school loan discharge or a successful BDR. Program regulations specify that for individuals who do not complete the program's teaching service requirements, the TEACH Grant converts into a Direct Loan program loan and the individual "is eligible for all of the benefits of the Direct Loan Program."⁹⁶ Thus, if an individual meets all applicable closed school discharge or BDR criteria, they may be provided relief from repaying a TEACH Grant that has converted into a Direct Loan program loan.⁹⁷

Private Education Loan Relief

In some instances, students who attended a closed school may have borrowed private education loans to help finance their postsecondary education at the closed school. Private education loans are nonfederal loans made to a student to help finance the cost of their postsecondary education. Unlike federal student loans, which have statutorily prescribed terms and conditions that are typically uniform in nature, private education loan terms and conditions are primarily governed by market conditions that may vary greatly, depending on a variety of factors such as the lender, the borrower's creditworthiness, and the market.⁹⁸ Thus, the extent to which a private education loan borrower may be provided relief from the requirement to repay their loans may largely depend on the individual private education loan's terms and conditions.⁹⁹

⁹² 34 C.F.R. §685.206(e)(12)(i).

⁹³ In addition, the amount of relief provided will be reduced by any other monetary relief, such as a refund, debt forgiveness, or indemnification, received by the borrower and related to the borrower defense. 34 C.F.R. §685.206(e)(12)(i).

⁹⁴ 34 C.F.R. §§685.206(e)(12), 685.222(i)(7).

⁹⁵ For additional information on TEACH Grants, see CRS Report R46117, *TEACH Grants: A Primer*.

⁹⁶ 34 C.F.R. §686.43(c)(2).

⁹⁷ TEACH Grant regulations do not provide for a discharge of an individual's duty to meet TEACH Grant service requirements due to a school closure or BDR. However, an individual may request that his or her TEACH Grant be converted into a Direct Loan program loan because he or she has decided not to fulfill the service requirements or "for any other reason." 34 C.F.R. §686.43(a)(1). Thus, it appears an individual could request his or her TEACH Grant be converted into a Direct Loan program loan and then seek relief from Direct Loan repayment under a closed school loan discharge or a BDR, while also not being required to meet TEACH Grant service requirements. See also, Department of Education, *Office of Federal Student Aid, Teacher Education Assistance for College and Higher Education (TEACH Grant): Exit Counseling Guide*, June 2018, p. 27, <https://static.studentloans.gov/images/teachExitCounselingGuide.pdf>.

⁹⁸ For additional information on private education loans, see Department of Education, "Federal Versus Private Loans," <https://studentaid.ed.gov/sa/types/loans/federal-vs-private>, accessed October 30, 2020..

⁹⁹ In some instances, a private education loan lender or a third-party may agree to provide some debt relief to private

Relief for Pell Grant Recipients¹⁰⁰

Pell Grant recipients who attended an IHE that closed may have some portion of their Pell eligibility restored. All Pell Grant recipients are subject to a cumulative lifetime eligibility cap on Pell Grant aid equal to 12 full-time semesters (or the equivalent). The HEA exempts from a student's lifetime eligibility cap the period of attendance at an IHE at which a student was unable to complete a course of study because the IHE closed.¹⁰¹ ED uses its information technology systems to adjust Pell eligibility for those students who attended a closed school and were not reported as having “graduated” from that school.¹⁰² Following an adjustment, ED notifies students of the adjustment.

GI Bill Educational Assistance Benefits¹⁰³

GI Bill entitlement may be restored following a school closure. However, a school closure may result in some GI Bill participants receiving an overpayment of benefits that they would become responsible for repaying.

Restoration of Entitlements

Generally, GI Bill recipients are entitled to benefits equal to 36 months of full-time enrollment (or the equivalent for part-time educational assistance) under one GI Bill. In the case of the Survivors' and Dependents' Educational Assistance Program (DEA; 38 U.S.C., Chapter 35), recipients who first enrolled in a program of education before August 1, 2018, have 45 months (or the equivalent for part-time educational assistance) of entitlement. Prior to 2015, GI Bill entitlement was not restored for benefits received at an educational institution that later closed.¹⁰⁴

For school closures occurring after January 1, 2015, entitlement is restored for an incomplete course or program for which the individual is unable to receive credit or lost training time as a result of an educational institution closing.¹⁰⁵ In addition to restoring such entitlement, the Department of Veterans Affairs (VA) is authorized to continue paying a Post-9/11 GI Bill housing

education loan borrowers. See, for example, Consumer Financial Protection Bureau, “Special Bulletin for Current and Former Students Enrolled at Corinthian-Owned Schools,” February 3, 2015, http://files.consumerfinance.gov/f/201502_cfpb_bulletin_current-and-former-students-enrolled-at-corinthian-owned-schools.pdf.

¹⁰⁰ This section of the report was authored by Cassandra Dortch, CRS Specialist in Education Policy. For additional background information, see CRS Report R45418, *Federal Pell Grant Program of the Higher Education Act: Primer*.

¹⁰¹ HEA §437(c)(3).

¹⁰² ED began restoring Pell Grant lifetime eligibility in March 2017. Previously, ED had determined it did not have the statutory authority to restore Pell Grant lifetime eligibility limits in the event of a school closure; however, on October 28, 2016, ED determined it does, in fact, have the authority to do so. Department of Education, “U.S. Department of Education Announces Final Regulations to Protect Students and Taxpayers from Predatory Institutions,” press release, October 28, 2016, http://www.ed.gov/news/press-releases/us-department-education-announces-final-regulations-protect-students-and-taxpayers-predatory-institutions?utm_name=.

¹⁰³ This section of the report was authored by Cassandra Dortch, CRS Specialist in Education Policy.

¹⁰⁴ The Harry W. Colmery Veterans Educational Assistance Act of 2017 (P.L. 115-48) authorizes the restoration of GI Bill entitlement for individuals affected by school closures. For additional information about P.L. 115-48, see CRS Report R45205, *Harry W. Colmery Veterans Educational Assistance Act of 2017 (P.L. 115-48)*.

¹⁰⁵ The amount of entitlement restored for closures occurring from January 1, 2015, through August 16, 2017, is based on the entire period of the individual's enrollment in the closed school. The restoration of entitlement went into effect November 14, 2017.

allowance through the end of the academic term following such closure, but no longer than 120 days. Entitlement is not charged for the interim housing allowance.¹⁰⁶

Special provisions apply for school closures during the period beginning on March 1, 2020, and ending on December 31, 2020, including academic terms beginning during the period.¹⁰⁷ If an individual is enrolled in a program or course of education that “is provided by an educational institution that is closed by reasons of an emergency situation,”¹⁰⁸ his or her GI Bill and Vocational Readiness and Employment (VR&E) payments¹⁰⁹ may be extended for up to four weeks thereafter.

The VA notifies affected individuals of imminent and actual school closures and notifies them how such closure will affect their GI Bill entitlement. GI Bill participants must apply for benefit restoration and the housing allowance extension.

Overpayment of Benefits

Under general GI Bill regulations, if there are mitigating circumstances, a GI Bill participant who withdraws from all courses may remain eligible for benefits for the portion of the course completed. However, if there are no mitigating circumstances, the individual may be required to repay all benefits received for pursuit of the course. Mitigating circumstances are circumstances beyond the individual’s control that prevent the individual from continuously pursuing a program of education. A school closing is considered a mitigating circumstance.¹¹⁰

Some GI Bill benefits, such as advance payments and the Post-9/11 GI Bill tuition and fees payment, Yellow Ribbon payment, and books and supplies stipend, may be paid as a lump sum before or at the beginning of an academic term. An overpayment may occur for a prorated portion of those upfront payments if an individual is unable to complete the academic term without mitigating circumstances.¹¹¹

Under Post-9/11 GI Bill regulations, the VA may determine the ending date of educational assistance based on the facts found if an eligible individual’s educational assistance must be discontinued for any reason not described in regulations.¹¹² The permanent closure of a school may qualify as a reason not described in regulations.¹¹³

¹⁰⁶ Eligibility for interim housing allowance payments began August 16, 2017. The interim housing allowance payments were payable effective August 1, 2018. The later effective date gave the VA the opportunity to adapt its administrative processes and systems to make payments. For information about the Post-9/11 GI Bill, see CRS Report R42755, *The Post-9/11 GI Bill: A Primer*.

¹⁰⁷ For more information, see CRS Report R46340, *Federal Response to COVID-19: Department of Veterans Affairs*, section “Student Veteran Coronavirus Response Act of 2020 (P.L. 116-140).”

¹⁰⁸ Section 4 of the Student Veterans Coronavirus Response Act of 2020, (P.L. 116-140).

¹⁰⁹ VR&E is a veterans entitlement program that provides job training and other employment-related services to veterans with service-connected disabilities. For more information, see CRS Report RL34627, *Veterans’ Benefits: The Vocational Rehabilitation and Employment Program*.

¹¹⁰ The Department of Veterans Affairs (VA) automatically grants mitigating circumstances for up to six credits the first time a student reduces or terminates and mitigating circumstances must be considered. This automatic grant is called the 6-Credit Hour Exclusion.

¹¹¹ The VA has indicated that students may be subject to debt for the closure of ITT Tech if the students received benefits (books and supplies) for a term they are unable to complete. U.S. Department of Veterans Affairs, “More Information Concerning ITT Tech’s Closure,” September 13, 2016, available at <http://www.benefits.va.gov/gibill/>, as of October 14, 2016.

¹¹² 38 C.F.R. §21.9635(bb).

¹¹³ The VA has indicated that “no debts will be created against students because of the [Corinthian College] closure”

Additional Student Aid Eligibility

For students who wish to continue their education at another IHE, another financial consideration related to an IHE's closure is the extent to which the students' eligibility for various financial aid sources may be affected by their previous use of those benefits at the closed institution. In addition to the duration of eligibility limits generally placed on Pell Grants and GI Bill educational benefits discussed in the previous section, other federal student aid eligibility criteria that could affect future receipt of additional Title IV student loans include borrowing limits and eligibility limitations for receipt of Direct Subsidized Loans.

Loan Limits

Generally, annual and aggregate borrowing limits apply to Title IV student loans. Annual loan limits prescribe the maximum principal amount that may be borrowed in an academic year, and aggregate limits apply to the total amount of outstanding Title IV loans that borrowers may accrue.¹¹⁴ Borrowing limits for Direct Loan program loans¹¹⁵ vary by borrower academic standing (e.g., grade or credential level), loan type (e.g., Subsidized or Unsubsidized Direct Loan), and dependency status.¹¹⁶ For borrowers who receive a closed school discharge or whose loans have been discharged under a successful BDR claim, any discharged loans do not count against their annual and aggregate loan limits.¹¹⁷

Eligibility for Direct Subsidized Loans

In general, for borrowers of Direct Subsidized Loans, the federal government pays the interest that accrues on the loan while the borrower is enrolled in school on at least a half-time basis, during a six-month grace period thereafter, and during periods of authorized deferment. Individuals who are new borrowers on or after July 1, 2013, may only receive Direct Subsidized Loans for a period of time equal to 150% of the published length of the borrower's academic program (e.g., a borrower enrolled in a four-year degree program may receive six years' worth of Direct Subsidized Loans).¹¹⁸ However, for borrowers who receive a closed school loan discharge or who successfully assert a BDR claim, the discharged loan will not count against the borrower's Subsidized Loan usage period.¹¹⁹

unless the student dropped classes prior to the closure. U.S. Department of Veterans Affairs, "Corinthian College Students—What You Should Know," April 30, 2015, available at <http://www.benefits.va.gov/gibill/> as of December 14, 2015.

¹¹⁴ No aggregate limits are placed on PLUS Loans.

¹¹⁵ Borrowing limits also applied to FFEL and Perkins Loans; however, the authority to award new FFEL program loans was terminated in FY2010 and the authority to award new Perkins Loans expired on September 30, 2017.

¹¹⁶ For additional information on loan limits, see CRS Report R45931, *Federal Student Loans Made Through the William D. Ford Federal Direct Loan Program: Terms and Conditions for Borrowers*.

¹¹⁷ HEA §§425(a)(2), 437(c)(3), 455(a)(1). See also, U.S. Department of Education, Office of Federal Student Aid, "Frequently Asked Questions About the Closure of ITT Technical Institutes," <https://studentaid.ed.gov/sa/about/announcements/itt/faq>, accessed October 30, 2020.

¹¹⁸ HEA §455(q).

¹¹⁹ HEA §437(c)(3) and 34 C.F.R. §685.200(f)(3) and (4).

State Tuition Recovery Funds (STRF)

In addition to available debt relief, some states operate state tuition recovery funds (STRFs), which may reimburse students for charges paid to closed IHEs that are not covered by other sources. For example, a student may have his or her Direct Loan discharged due to school closure, and an STRF may provide relief to cover expenses such as cash payments that had been made directly to a closed IHE for tuition payments or may provide relief on private student loans borrowed to attend an IHE that has since closed. The availability of and eligibility for such funds vary by state; not all states operate STRFs.¹²⁰

Income Tax Consequences

Borrowers whose student loans are discharged due to school closure will be subject to federal and state income taxes on the discharged loans, unless they qualify for an exception. Students who received funds from an STRF might similarly be subject to tax on any funds received, although the tax treatment of such funds is unclear. Additionally, there could be tax consequences for individuals who had previously claimed certain federal education tax benefits. This section examines the potential federal and state tax consequences that may arise for these borrowers and students.

Federal Tax Treatment of Discharged Debt¹²¹

Under the Internal Revenue Code (IRC), borrowers whose debt is forgiven must generally include the amount of the discharged debt in income when determining their federal income tax liability.¹²² In other words, they are subject to tax on the amount of the discharged loan.¹²³ There are various exceptions to this rule under which a borrower may exclude from income all or part of the discharged debt.¹²⁴

The HEA contains several exceptions providing for certain student loan discharges to be excluded from gross income. These exceptions apply to FFEL, Direct Loan, and Perkins Loan program borrowers who took out loans to attend any IHE and whose loans are discharged under the HEA's closed school discharge process.¹²⁵ Under the HEA exceptions, these borrowers will not be subject to federal income taxes on the discharged amounts so long as the student borrowers (or students on whose behalf a parent borrowed) meet the general criteria regarding the discharge of debt tied to closed schools described earlier in this report.¹²⁶

¹²⁰ Department of Education, Office of Federal Student Aid, "Am I eligible for relief through a state tuition recovery fund?", https://studentaid.gov/help-center/answers/topic/managing_your_account/article/eligibility-for-relief-through-state-tuition-recovery-fund, accessed October 30, 2020.

¹²¹ This section was authored by Milan N. Ball, CRS Legislative Attorney.

¹²² 26 U.S.C. §61(a)(11); Treas. Reg. §1.61-12(a).

¹²³ See, for example, *United States v. Kirby Lumber Co.*, 284 U.S. 1, 3 (1931) (treating discharged indebtedness as income at a time when the IRC did not yet address its tax treatment).

¹²⁴ See, for example, 26 U.S.C. §108 (allowing taxpayers to exclude discharged debt under certain conditions).

¹²⁵ HEA §§437(c)(4), 464(g)(4), and 455(a)(1).

¹²⁶ *Ibid.* §§437(c)(4), 464(g)(4), and 455(a)(1); see also Rev. Proc. 2020-11, 2020-6 I.R.B. 406 (establishing a safe harbor extending the discharge of indebtedness income tax relief provided under Rev. Proc. 2015-57, 2015-51 I.R.B. 863 and Rev. Proc. 2017-24, 2017-7 I.R.B. 916, to additional taxpayers who took out federal student loans to finance attendance at IHEs, as defined in 20 U.S.C. §1001(a) or (b), and proprietary IHEs, as defined in 20 U.S.C. §1002(b), and whose federal student loans were discharged under the closed school discharge process); Rev. Proc. 2017-24, 2017-7 I.R.B. 916 (explaining the IRS will not assert that taxpayers who took out federal student loans to finance

The HEA does not address the tax treatment of (1) FFEL and Direct Loan program loans discharged due to a successful borrower defense to repayment claim¹²⁷ or (2) FFEL, Direct Loan, Perkins Loan program loans, and private education loans that are discharged under other circumstances.¹²⁸ As such, in these cases, the borrowers will be taxed on the amount of the discharged loan unless they qualify for an exception found outside of the HEA. The IRC provides several statutory exceptions that may be relevant to borrowers whose loans are discharged.¹²⁹ For example, IRC Section 108(a)(1)(B) excludes discharged debt if the taxpayer is insolvent.¹³⁰ Taxpayers are insolvent if their liabilities, including the student loan to be discharged, exceed the fair market value of their assets immediately prior to discharge.¹³¹ The amount of the discharged student loan excluded cannot exceed the amount by which the taxpayer is insolvent.¹³²

There are also common law exceptions to recognizing income from the discharge of indebtedness. For example, courts have found a discharged loan was not income for federal tax purposes where fraudulent or material misrepresentations induced the taxpayer to take out the loan.¹³³ Another exception that might be relevant is the contested liability doctrine, also known as the disputed debt doctrine.¹³⁴ Under the contested liability doctrine, if a taxpayer challenges the amount of debt owed in good faith and the debt is subsequently settled, then the settlement

attendance at American Career Institutes, Inc. and whose federal student loans are discharged under the closed school discharge process must recognize income as a result of the discharge); Rev. Proc. 2015-57, 2015-51 I.R.B. 863 (explaining the IRS will not assert that taxpayers who took out federal student loans to finance attendance at Corinthian Colleges, Inc. and whose federal student loans are discharged under the closed school discharge process must recognize income as a result of the discharge).

¹²⁷ See HEA §455(h); 34 C.F.R. §682.209(g).

¹²⁸ FFEL, Direct Loan, and Perkins Loan program loans, and private education loans discharged after December 31, 2017, and before January 1, 2026, due to the death or total and permanent disability of the student *may* be excluded from gross income for purposes of federal income taxation. 26 U.S.C. §108(f)(5); see 15 U.S.C. §1650; HEA §§437(a),(d), 464(c)(1)(F). FFEL and Direct Loan program PLUS Loans may be ineligible for relief under IRC Section 108(f)(5) because of cross references to statutory language referring to parent borrowers and defining *student loan*. 26 U.S.C. §108(f)(2), (5) (excluding discharges pursuant to Section 437(d) of the HEA of loans described in Section 108(f)(2)); see HEA §437(d) (“If a student on whose behalf a *parent has received a loan* described in section 1078-2 of this title [(HEA §428B)] dies, then the Secretary shall discharge the borrower’s liability on the loan by repaying the amount owed on the loan.” (emphasis added)); 26 U.S.C. §108(f)(2) (“For purposes of this subsection, the term ‘student loan’ means any loan to *an individual to assist the individual* in attending an educational organization.” (emphasis added)).

¹²⁹ See, for example, 26 U.S.C. §108(a)(1)(B) (excluding income arising from discharge of indebtedness when the taxpayer is insolvent); *ibid.* §108(f)(1) (excluding income arising from discharge of indebtedness when a student loan is forgiven because the taxpayer worked for a designated length of time “in certain professions for any of a broad class of employers”); *ibid.* §108(f)(5) (excluding income arising from discharge of indebtedness when federal student loans or private education loans are discharged on account of death or disability of the student).

¹³⁰ 26 U.S.C. §108(a)(1)(B).

¹³¹ *Ibid.* §108(d)(3).

¹³² *Ibid.* §108(a)(3).

¹³³ See, for example, *Comm’r v. Sherman*, 135 F.2d 68, 70 (6th Cir. 1943).

¹³⁴ See, for example, *N. Sorbel, Inc. v. Comm’r*, 40 B.T.A. 1263, 1265 (1939). There is a split among the circuits regarding when the application of the contested liability doctrine is barred. *Estate of Smith v. Comm’r*, 198 F.3d 515, 530–31 (5th Cir. 1999). The Tenth Circuit has ruled that the contested liability doctrine only applies to unliquidated debts—debts for which the amount owed cannot be determined. *Preslar v. Comm’r*, 167 F.3d 1323, 1328 (10th Cir. 1999); see also *Zarin v. Comm’r*, 92 T.C. 1084, 1095–96, *rev’d*, 916 F.2d 110 (3rd Cir. 1990). The Sixth Circuit has ruled that the contested liability doctrine also applies to liquidated debts when there is a question regarding the debt’s enforceability because “the amount of the debt, and not just the liability thereon, is in dispute.” *Zarin*, 916 F.2d 110 at 116 (applying the contested liability doctrine where a creditor-resort provided a taxpayer with \$3.4 million dollars of gambling chips and the parties subsequently settled debt for \$500,000 after the taxpayer challenged the enforceability of the debt under state law).

establishes “the amount of debt cognizable for tax purposes.”¹³⁵ Thus, the settlement does not produce discharge of indebtedness income.¹³⁶

Recent guidance issued by the Internal Revenue Service (IRS) illustrates how these statutory and common law exceptions might be applied in the student loan context. In 2015, the IRS issued Revenue Procedure 2015-57 stating it would not assert that taxpayers who took out federal student loans to finance attendance at schools owned by Corinthian Colleges, Inc. (CCI) and whose loans are discharged by ED under the defense to repayment process must recognize gross income on the discharged amounts.¹³⁷ In the 2015 guidance, the IRS explained it believed most borrowers would qualify for a statutory or common law exception excluding “all or substantially all” of their discharged loans “based on fraudulent misrepresentations made by the colleges to students, the insolvency exclusion, or another tax law authority.”¹³⁸

Two years later, in Revenue Procedure 2017-24, the IRS extended this same relief to taxpayers who took out federal student loans to finance attendance at schools owned by American Career Institutes, Inc. (ACI).¹³⁹ The following year, the IRS issued Revenue Procedure 2018-39, which stated that the IRS would provide similar relief to taxpayers who took out *private student loans* to finance attendance at schools owned by CCI or ACI and whose loans are discharged due to legal causes of action against CCI, ACI, and certain private lenders.¹⁴⁰ The 2018 guidance explains that the Treasury Department and the IRS concluded most taxpayers would qualify for a statutory or common law exception excluding “all or substantially all” of their discharged loans “based on the insolvency exclusion; fraudulent or material misrepresentations made by CCI, ACI, or certain private lenders to the students; or another tax law authority.”¹⁴¹

In 2020, the IRS issued Revenue Procedure 2020-11, which established a safe harbor extending the discharge of indebtedness income tax relief provided under Revenue Procedure 2015-57, Revenue Procedure 2017-24, and Revenue Procedure 2018-39 to borrowers who took out loans to finance attendance at IHEs and proprietary IHEs not owned by CCI or ACI.¹⁴² These taxpayers are eligible for the safe harbor if their Direct Loan program loans are discharged under the defense to repayment discharge process or if their private student loans are discharged based on a settlement of a legal cause of action resolving various allegations of unlawful business practices.¹⁴³ The guidance explains that the Treasury Department and the IRS believe most of these taxpayers would be able to exclude “all or substantially all” of the discharged loans “based on the insolvency exclusion under section 108(a)(1)(B) of the [IRC]; fraudulent or material misrepresentations made by such [IHEs] or [proprietary IHEs] or certain private lenders to the students; or other tax law authority.”¹⁴⁴

¹³⁵ *Preslar*, 167 F.3d at 1327 (quoting *Zarin*, 916 F.2d at 115).

¹³⁶ See, for example, *N. Sorbel*, 40 B.T.A. at 1265; *Zarin*, 916 F.2d at 117.

¹³⁷ Rev. Proc. 2015-57, §1, 2015-51 I.R.B. 863.

¹³⁸ Rev. Proc. 2015-57, §2.03, 2015-51 I.R.B. 863.

¹³⁹ Rev. Proc. 2017-24, 2017-07 I.R.B. 916.

¹⁴⁰ Rev. Proc. 2018-39, §3, 2018-34 I.R.B. 319.

¹⁴¹ Rev. Proc. 2018-39, §2.05, 2018-34 I.R.B. 319.

¹⁴² Rev. Proc. 2020-11, §1, 2020-6 I.R.B. 406; Rev. Proc. 2020-11, §3.02, 2020-6 I.R.B. 406 (“[N]onprofit schools that meet the definition of an ‘institution of higher education’ under 20 U.S.C. § 1001(a) or (b), or for-profit schools that meet the definition of a ‘proprietary institution of higher education’ under 20 U.S.C. § 1002(b).”).

¹⁴³ Rev. Proc. 2020-11, §4.01, 2020-6 I.R.B. 406.

¹⁴⁴ Rev. Proc. 2020-11, §2.08, 2020-6 I.R.B. 406.

To exclude a discharged loan from income, borrowers must determine that they qualify for an exception based on their individual circumstances and be able to show that the determination is correct if the IRS contests it.¹⁴⁵ If the IRS disagrees and assesses tax based on the amount of the discharged loan, the taxpayer may challenge the assessment in federal court.¹⁴⁶

Federal Tax Treatment of State Tuition Recovery Funds¹⁴⁷

As a general rule, anything of value received by a taxpayer is includible in gross income, and potentially subject to taxation, unless specifically excluded by law.¹⁴⁸ Therefore, questions may arise regarding whether students who receive payments from STRFs would need to include such payments in their gross income. Although there do not appear to be court decisions or IRS guidance directly addressing the tax consequences of STRF payments, there are several theories under which students could arguably exclude the payments from income, depending on their circumstances and the specifics of the state's plan.

First, it is unclear whether a payment from an STRF constitutes income. The Supreme Court has held that income means “instances of undeniable *accessions to wealth*,” and the IRS has previously stated that income requires “*economic gain*.”¹⁴⁹ For example, financial compensation in the form of a returned deposit or a payment to make an injured party whole is not income.¹⁵⁰ Arguably, an STRF payment that is reimbursing a taxpayer for unrecovered tuition payments would not be accurately characterized as income because it is not a “gain” or “accession to wealth” for the taxpayer. However, to the extent the STRF payment exceeds the loss suffered by the taxpayer, that excess would potentially be includible in gross income unless specifically excluded by law.¹⁵¹

Second, even if an STRF payment is excludable from the borrower's income, the borrower may be required to include some portion of the payment as income based on their prior tax filings. For example, a borrower may have previously claimed a deduction for certain educational expenses in a prior tax year, as discussed in the following section. If that borrower subsequently receives a

¹⁴⁵ See Rev. Proc. 2020-11, §4.01, 2020-6 I.R.B. 406.

¹⁴⁶ The borrower may file suit in the U.S. Tax Court prior to paying the disputed amount or in the U.S. Court of Federal Claims or the appropriate federal district court after paying such amount. See 26 U.S.C. §§6213(a), 7421; 28 U.S.C. §§1340, 1346(a). Under IRC Section 6201(d), if an information return filed by a third party serves as the basis for the IRS's determination that a taxpayer owes tax and the taxpayer has fully cooperated with the IRS, then the IRS has the burden of producing reasonable and probative information concerning the alleged deficiency. 26 U.S.C. §6201(d). This provision may be relevant for student borrowers because their discharged loans must be reported by the creditor to the IRS on an information return unless an exception applies. 26 U.S.C. §6050P; see, for example, Rev. Proc. 2020-11, §4.03, 2020-6 I.R.B. 406 (providing creditors with relief from information reporting); Rev. Proc. 2018-39, §3, 2018-34 I.R.B. 319 (providing creditors with relief from information reporting); Rev. Proc. 2017-24, §4, 2017-07 I.R.B. 916 (providing creditors with relief from information reporting and modifying Revenue Procedure 2015-57, 2015-51 I.R.B. 863, to provide creditors with relief from information reporting).

¹⁴⁷ This section was authored by Edward C. Liu, CRS Legislative Attorney.

¹⁴⁸ *Ibid.* §61(a). Examples of items expressly excluded from gross income include certain gifts under IRC §102 and qualified scholarships under IRC §117.

¹⁴⁹ *Comm'r v. Glenshaw Glass Co.*, 348 U.S. 426, 431 (1955) (emphasis added); I.R.S. Gen. Couns. Mem. 38,569 (Nov. 26, 1980) (emphasis added).

¹⁵⁰ I.R.S. Gen. Couns. Mem. 38,569, at 2 (taxpayer realizes no income from payment to compensate for breach of contract).

¹⁵¹ See, for example, I.R.C. §117 (excluding qualifying scholarships from income); Rev. Rul. 2003-12, 2003-1 C.B. 283 (discussing the general welfare exclusion, which has been developed by the IRS through a series of administrative rulings and excludes means-tested governmental benefits from income).

STRF payment as reimbursement for those educational expenses, the “tax benefit doctrine” may require the STRF to be included in income, up to the amount of the previous deductions.¹⁵²

Federal Higher Education Tax Benefits¹⁵³

Along with the potential taxation of discharged student loans and amounts received from STRFs, a school’s closure or the discharge of a borrower’s student loan may have consequences related to higher education tax benefits. While there are a variety of federal tax benefits that help offset some of the costs of a higher education, four are relevant for purposes of this report for reasons discussed below.¹⁵⁴ These four benefits include the following:

- **The student loan interest deduction**, under which qualifying taxpayers may annually deduct up to \$2,500 of student loan interest for the entire duration of repayment.¹⁵⁵
- **The tuition and fees deduction**, which allows taxpayers to reduce their income subject to tax for tuition and fees paid annually, up to \$4,000, depending on their income level.¹⁵⁶ As of the date of this report, the tuition and fees deduction cannot be claimed on 2021 or subsequent tax returns.¹⁵⁷
- **The Lifetime Learning Credit (LLC)**, under which qualifying taxpayers may annually reduce their tax liability for tuition and fees paid, up to \$2,000.¹⁵⁸ The LLC is a nonrefundable credit, meaning any amount of the credit in excess of income tax liability is effectively forfeited by the taxpayer.
- **The American Opportunity Tax Credit (AOTC)**, under which qualifying taxpayers can reduce tax liability by \$2,500 per student annually (depending on eligible expenses and the taxpayer income level).¹⁵⁹ The AOTC can be claimed for tuition and fees and books, supplies, and equipment, but not room and board.¹⁶⁰ Unlike the LLC, the AOTC is a refundable credit, meaning taxpayers with little to no income tax liability may still be able to benefit from this tax provision. More specifically, a tax credit is refundable if, in cases where the credit is larger than the taxpayer’s income tax liability, the IRS refunds *all or part* of the difference. The refundable portion of the AOTC is calculated as 40% of the value of the credit the taxpayer is eligible for based on qualifying education expenses. Therefore, if the taxpayer was eligible for \$2,500 of the AOTC, but had

¹⁵² See *Hillsboro Nat. Bank v. Comm’r*, 460 U.S. 370, 377-82 (1983).

¹⁵³ This section was authored by Margot L. Crandall-Hollick, CRS Specialist in Public Finance.

¹⁵⁴ For a summary of all higher education tax benefits that a student may be eligible for, including benefits for student debt and for saving for higher education, see CRS Report R41967, *Higher Education Tax Benefits: Brief Overview and Budgetary Effects*.

¹⁵⁵ 26 U.S.C. §221.

¹⁵⁶ *Ibid* §222. The ultimate tax savings from the tuition and fees deduction depends on the taxpayer’s marginal tax rate. For example, if the taxpayer’s top tax rate is 10%, deducting \$4,000 will reduce tax liability by \$400; however, if the taxpayer’s top tax rate is 25%, the same deduction will reduce tax liability by \$1,000.

¹⁵⁷ Most recently, the deduction was extended for 2018, 2019 and 2020, in the Taxpayer Certainty and Disaster Tax Relief Act of 2019, enacted as Division Q of the Further Consolidated Appropriations Act, 2020 (P.L. 116-94).

¹⁵⁸ *Ibid* §25A(e).

¹⁵⁹ *Ibid*. §25A(i). For a detailed overview of the AOTC, see CRS Report R42561, *The American Opportunity Tax Credit: Overview, Analysis, and Policy Options*.

¹⁶⁰ 26 U.S.C. §25A(i)(3).

no tax liability, he or she could still receive \$1,000 (40% of \$2,500) as a refund.¹⁶¹

Tuition and fees paid with the proceeds of a loan can count toward claiming these tax benefits. Any aid that is tax-free, such as a Pell Grant, must generally reduce the amount of expenses used to calculate these tax benefits.¹⁶² As a general rule, either the parent or the student who pays the qualifying education expenses will claim the tax benefit, depending on whether the student is the parent's dependent for tax purposes.¹⁶³ Taxpayers can generally only claim one tax benefit per student annually.¹⁶⁴

Availability of Benefits for Students Whose School Has Closed

Students who continue to pursue higher education after a school closure are eligible for these education tax benefits, pursuant to the requirements applicable to all taxpayers. However, in some instances, a taxpayer who claims the AOTC may be ineligible for the credit in future years due to statutory restrictions on the period of education for which students may claim the credit. Specifically, the AOTC can only be claimed for expenses incurred during the first four years of a postsecondary education, irrespective of whether those first four years lead to a postsecondary credential.¹⁶⁵ Therefore, for example, it appears that if a student attended a school for three years and that school closed, the maximum remaining time the student could claim the AOTC is one additional year. There is seemingly no IRS guidance or case law addressing how this requirement is applied in the context of students whose schools have closed, including students who may have to pay back previously claimed credits (discussed below).

The other three benefits contain no limits on the period of education in which students may claim them.

Federal Tax Treatment of Previously Claimed Education Tax Benefits

Taxpayers may be required to account for previously claimed education tax benefits if they subsequently qualify to exclude discharged student loans or STRF payments. The borrowers who might be affected are those who

- claimed the LLC or AOTC for expenses that were paid with the proceeds from a student loan that was subsequently discharged,
- deducted expenses for tuition and fees that were paid with the proceeds from a student loan that was subsequently discharged,
- deducted interest on a student loan that was subsequently discharged, or

¹⁶¹ Ibid. §25A(i)(5).

¹⁶² Ibid. §§25A(g)(2), 221(d)(2), 222(c)(2)(B). Under Internal Revenue Code section 117, scholarship and fellowships, including Pell Grants, are generally tax-free to the extent they are used to pay for tuition and fees required for enrollment and attendance at an eligible educational institution by a qualified degree candidate. Insofar as scholarships and fellowships are used for other non-qualified expenses, like room and board, they will generally be taxable. Qualifying expenses for the purposes of calculating education tax benefits are not reduced by taxable scholarships or fellowships. For more information, see IRS Publication 970 (<https://www.irs.gov/forms-pubs/about-publication-970>).

¹⁶³ Ibid. §§25A(g)(3), 221(c), 222(c)(3); Treas. Reg. §1.25A-5(a). See also Treas. Reg. §1.25A-5(b) (treating expenses paid by a third party, such as grandparents or noncustodial parents, as paid by the student under certain circumstances).

¹⁶⁴ See, for example, 26 U.S.C. §§25A(c), 221(e)(1), 222(c)(1), (2).

¹⁶⁵ Ibid. §25A(b)(2)(A), (C), (i)(2).

- claimed a tax credit (i.e., the LLC or AOTC) or a deduction (for tuition and fees or student loan interest) for expenses that were reimbursed by an STRF payment.¹⁶⁶

To prevent these borrowers from getting the double benefit of both (1) a credit or deduction and (2) the exclusion of the discharged loan or STRF payment, such borrowers may be required to pay back the value of the credit or deduction.¹⁶⁷ However, there may be circumstances in which the IRS will not require a taxpayer to account for previously claimed tax benefits. For example, in its 2015, 2017, and 2018 guidance addressing former students of CCI and ACI, the IRS announced that it would not require these borrowers to account for previously claimed education tax benefits.¹⁶⁸ The IRS did not explain its reasoning in reaching this determination,¹⁶⁹ and it is not clear the extent to which the agency may provide similar benefits to other borrowers.

State Income Tax Consequences¹⁷⁰

A school closure or the discharge of a student loan may also result in state income tax consequences. Most states use the IRC's definition of income as the starting point for computing state income tax liability.¹⁷¹ As such, to the extent that the borrower must pay federal income tax on the discharged debt or account for previously claimed federal education tax benefits, he or she may be taxed at the state level as well. Similarly, to the extent that the borrower qualifies to exclude the amounts from federal income taxation, such treatment may also apply at the state level. However, while most state tax codes follow the IRC, states are not required to adopt the federal definition of income and, thus, some states may provide for different tax treatment.¹⁷² Furthermore, states with their own education tax benefits or tuition recovery funds may have laws or policies specifically addressing the state tax treatment of the benefits and funds.

¹⁶⁶ Note that these tax consequences might also apply to any taxpayers who claimed the Hope Scholarship Credit, which was replaced by the AOTC beginning in 2009. See American Recovery and Reinvestment Act of 2009, P.L. 111-5, §1004, 123 Stat. 115, 313 (2009). The Hope credit is codified at 26 U.S.C. §25A(b).

¹⁶⁷ See *Hillsboro Nat'l Bank v. Comm'r*, 460 U.S. 370, 377-80 (1983) (discussing the origin of the judicially developed tax benefit rule, which prevents taxpayers from receiving double tax benefits on the same income or transaction); 26 U.S.C. §111 (partially codifying the tax benefit rule); Treas. Reg. §1.25A-5(f)(3), (4) (requiring the education tax credits be recaptured if the taxpayer receives a refund of the expenses).

¹⁶⁸ Rev. Proc. 2015-57, 2015-51 I.R.B. 863; Rev. Proc. 2017-24, 2017-07 I.R.B. 916; Rev. Proc. 2018-39, 2018-34 I.R.B. 319.

¹⁶⁹ *Ibid.*

¹⁷⁰ This section was authored by Milan N. Ball, CRS Legislative Attorney.

¹⁷¹ See *Personal Income Tax Quick Answer Charts: Starting Point*, State Tax Guide (CCH) ¶700-003 (September 11, 2020) (showing that most states use the federal definition of gross income, adjusted gross income, or taxable income as the basis for computing state individual income tax liability).

¹⁷² U.S. CONST. amend. X ("The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people."); see also *Lawrence v. State Tax Comm'n of Mississippi*, 286 U.S. 276, 279-80 (1932) ("The obligation of one domiciled within a state to pay taxes there, arises from unilateral action of the state government in the exercise of the most plenary of sovereign powers, that to raise revenue to defray the expenses of government and to distribute its burdens equably among those who enjoy its benefits.... The Federal Constitution imposes on the states no particular modes of taxation, and apart from the specific grant to the federal government of the exclusive power to levy certain limited classes of taxes and to regulate interstate and foreign commerce, it leaves the states unrestricted in their power to tax those domiciled within them, so long as the tax imposed is upon property within the state or on privileges enjoyed there, and is not so palpably arbitrary or unreasonable as to infringe the Fourteenth Amendment." (internal citations omitted)).

Appendix. List of Abbreviations

The following are abbreviations used throughout this report.

ACI	American Career Institutes
AOTC	American Opportunity Tax Credit
BDR	Borrower defense to repayment
CCI	Corinthian Colleges, Inc.
ED	U.S. Department of Education
FFEL	Federal Family Education Loan
HEA	Higher Education Act
IHE	Institution of higher education
IRC	Internal Revenue Code
IRS	Internal Revenue Service
LLC	Lifetime Learning Credit
SAP	Satisfactory Academic Progress
STRF	State Tuition Recovery Fund
TEACH Grant	Teacher Education Assistance for College and Higher Education Grant
VA	Department of Veterans Affairs

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