

Cancellation of student loans

The following outlines how the cancellation of your student loan will affect your tax liability.

In general, if a loan or other debt you owe is canceled, you must report the cancellation as income. This means that you will generally have income if your student loan is canceled. But if your student loan qualifies for the exception described below, you won't have income from the cancellation.

Many student loans contain a provision that all or part of the debt will be canceled if the student works for a certain period of time in certain professions for any of a broad class of employers (e.g., as a doctor for a public hospital in a rural area). If cancellation of all or part of your student loan is contingent on your fulfilling this type of service requirement, you won't have income if any part of the loan is canceled because you performed the required services. For example, if the terms of a \$100,000 loan under a medical educational loan program provide that one-fifth of the loan (\$20,000) will be canceled each year the student practices medicine in a qualifying state hospital, the student won't have to report the \$20,000 that's canceled each year because he or she performs those services.

Student loans that qualify for this exception are loans that are made to a student to help him attend a tax-exempt educational institution (one with a regular faculty and curriculum, and a regularly enrolled body of students in attendance where its education activities are regularly carried on).

Qualifying student loans may be made by government entities (e.g., the U.S., or a state), by tax-exempt public benefit corporations, or by tax-exempt educational institutions out of funds the institution received from a government entity or tax-exempt public benefit corporation. That is, loans made with *government* funds may qualify.

Loans made by tax-exempt educational institutions out of *private, nongovernment* funds also qualify, but only if the loan imposes a public service requirement. The institution must have made the loan under a program designed to encourage students to serve in occupations or areas with unmet needs, and the services provided by the student (or former student) must be for or under the direction of a governmental unit or a tax-exempt organization.

Qualifying student loans also include loans made to *refinance* another qualifying student loan. Thus, you won't have income from the cancellation of a loan made by a tax-exempt organization, where the proceeds of the loan are used to refinance an outstanding student loan. But this only applies if you wouldn't have income from the cancellation of the refinanced student loan. Also, the refinancing loan must be made under a program of the refinancing organization that requires the student to fulfill a public service requirement.

However, you will have income if your student loan (original or refinancing) is canceled because of services performed for an educational institution. This means that you can't be employed by the lender organization.

It is important to remember that the exception described above is tied to a public service requirement. You will have income from the cancellation of your student loan if you don't fulfill your public service obligation, or if the service obligation doesn't qualify for the

exclusion (e.g., because it specifies only the geographic area in which the services must be performed).