

## SECTION 1. PURPOSE

This revenue procedure provides that the Internal Revenue Service (IRS) will not assert that certain taxpayers, whose Federal student loans are discharged under the Department of Education's "Defense to Repayment" discharge process, must recognize gross income as a result of this discharge process. This revenue procedure also identifies the statutory provisions under which taxpayers whose Federal student loans are discharged under the Department of Education's "Closed School" discharge process may exclude the discharged amount from gross income. In addition, this revenue procedure provides that the IRS will not assert that these taxpayers must increase their taxes owed in the year of a discharge as a result of either discharge process if in a prior taxable year they received an education credit under section 25A (Hope and Lifetime Learning Credits) or took a deduction under section 221 (interest on education loans) or section 222 (qualified tuition and related expenses) of the Internal Revenue Code (Code).

## SECTION 2. BACKGROUND

### .01 In general.

The Treasury Department and the IRS are aware that the Department of Education (ED) has begun a process for settling and discharging Federal student loans taken out to finance attendance at schools owned by Corinthian Colleges, Inc. ED has estimated that over 50,000 Corinthian borrowers may be eligible for discharges under this program. The discharges contemplated by ED for these loans are to be made

under one of the following processes: (i) the Closed School discharge process, or (ii) the Defense to Repayment discharge process based on misrepresentations made by the colleges. For more information, see Press Release, Dep't of Education, Fact Sheet: Protecting Students from Abusive Career Colleges (June 8, 2015), available at <http://www.ed.gov/news/press-release>.

In general, under the Higher Education Act of 1965 (HEA), the Closed School discharge process allows ED to discharge a Federal student loan obtained by a student, or by a parent on behalf of a student, who was attending a school at the time it closed or who withdrew from the school within a certain period prior to the closing date. See generally 20 U.S.C. § 1087(c) (Federal Family Education Loan (FFEL)); 20 U.S.C. § 1087dd(g) (Federal Perkins Loan); and 20 U.S.C. § 1087e(a)(1) (Federal Direct Loan). Under the HEA, the Defense to Repayment process requires ED to discharge a Federal Direct Loan if a student loan borrower establishes, as a defense against repayment, that a school's actions would give rise to a cause of action against the school under applicable state law. See generally 20 U.S.C. §1087e(h) and 34 C.F.R. § 685.206(c). FFEL loans may also be discharged under this process if certain additional requirements are met. See 34 C.F.R. § 682.209(g).

Section 61(a)(12) of the Code provides that gross income includes income from the discharge of indebtedness. There are, however, exceptions under which a taxpayer may not be required to include income from the discharge of indebtedness in gross income. The availability of these exceptions depends on a variety of factors, such as the circumstances of the loan's origination and the borrower's financial situation at the time of the loan's discharge. In some cases, a discharge may result in an increase in

gross income under the tax benefit rule, or an increase in tax liability due to a recapture of credits.

.02 Borrowers participating in Closed School discharge process.

The HEA provides statutory exclusions from gross income for Federal student loans discharged under the Closed School discharge process. See generally 20 U.S.C. § 1087ee(a)(5); 20 U.S.C. § 1087(c)(4) (FFEL); 20 U.S.C. § 1087dd(g)(4) (Federal Perkins Loan); and 20 U.S.C. § 1087e(a)(1) (Federal Direct Loan). Accordingly, a taxpayer whose Federal student loan is discharged under the Closed School discharge process will not recognize gross income as a result of the discharge, and the taxpayer should not report the amount of the discharged loan in gross income on his or her Federal income tax return.

.03 Borrowers participating in Defense to Repayment discharge process.

The HEA does not provide a statutory exclusion from gross income for Federal student loans discharged under the Defense to Repayment discharge process. However, a taxpayer may be able to exclude amounts discharged under this process from gross income under a provision of the Code or other tax law authorities.

For example, a borrower that has a liability reduced because of a legal infirmity that relates back to the original sale transaction (for example, fraud) may not have gross income to the extent of the debt reduction. This requires a case-by-case analysis of each transaction.

In addition, section 108(a)(1)(B) of the Code provides that a taxpayer may exclude from gross income a discharge of indebtedness that occurs when the taxpayer is insolvent (the “insolvency exclusion”). A taxpayer is insolvent if all of the taxpayer’s

liabilities exceed all of the taxpayer's assets immediately before the discharge. Under the insolvency exclusion, a taxpayer is able to exclude the amount of discharged debt from gross income to the extent that the taxpayer's liabilities exceed the fair market value of his or her assets.

The Treasury Department and the IRS believe that most borrowers whose Corinthian student loans are discharged under the Defense to Repayment discharge process would be able to exclude from gross income all or substantially all of the discharged amounts based on fraudulent misrepresentations made by the colleges to the students, the insolvency exclusion, or another tax law authority. However, determining whether one or more of these exceptions is available to each affected borrower would require a fact intensive analysis of the particular borrower's situation to determine the extent to which the discharged amount is eligible for exclusion under each of the potentially available exceptions. The Treasury Department and the IRS are concerned that such an analysis would impose a compliance burden on taxpayers, as well as an administrative burden on the IRS, that is excessive in relation to the amount of taxable income that would result. Accordingly, the IRS will not assert that a taxpayer within the scope of this revenue procedure recognizes gross income as a result of the Defense to Repayment discharge process.

### SECTION 3. SCOPE

The treatment provided in section 4 of this revenue procedure applies to any taxpayer who took out Federal student loans to finance attendance at a school owned by Corinthian Colleges, Inc. that are discharged under the Closed School discharge process or the Defense to Repayment discharge process.

## SECTION 4. APPLICATION

.01 Discharge of indebtedness income. The IRS will not assert that a taxpayer within the scope of this revenue procedure must recognize gross income as a result of the Defense to Repayment discharge process for discharged student loans that were taken out to finance attendance at a school owned by Corinthian Colleges, Inc. See section 2.02 of this revenue procedure for a general discussion regarding the exclusion from gross income for borrowers participating in the Closed School discharge process.

.02 Recapture of tax credits and tax benefit rule. The IRS will not assert that a taxpayer within the scope of this revenue procedure must increase his or her taxes owed in the year of a discharge, or in a prior year, as a result of either discharge process if in a prior year he or she received an education credit under section 25A attributable to payments made with proceeds of the discharged loan. In addition, the IRS also will not assert that a taxpayer within the scope of this revenue procedure must increase his or her income in the year of the discharge if he or she took a deduction under section 221 in a prior year attributable to interest paid on a discharged loan or a deduction under section 222 in a prior taxable year attributable to payments of qualified tuition and related expenses made with proceeds of the discharged loan.

## SECTION 5. EFFECTIVE DATE

This revenue procedure is effective for taxable years beginning on or after January 1, 2015, for Federal student loans discharged under ED's Closed School and Defense to Repayment discharge processes.

## SECTION 6. DRAFTING INFORMATION

The principal author of this revenue procedure is Craig Wojay of the Office of Associate Chief Counsel (Income Tax & Accounting). For further information regarding this revenue procedure, contact Mr. Wojay at (202) 317-4718 (not a toll-free call).