

EXPANDING OPTIONS FOR FEDERAL STUDENT LOAN REPAYMENT

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Young lawyers in Oregon face the double hurdle of a soft job market and significant student loan debt. Borrowing is a necessity for law students; last year, annual tuition at Oregon's law schools ranged from \$28,000 to \$39,000. Many lawyers struggle to make loan payments because they are unemployed, working at a low-wage legal job, or covering the costs of the early years of solo practice.

Oregon's newer lawyers are not alone: the federal government's Consumer Financial Protection Bureau estimates that 37 million people in the United States owe a total of \$1 trillion in student loans. Eighty-five percent of the total loan burden – over \$850 million – is made up of federal student loans. Recent surveys show that a surprising number of borrowers are not aware of repayment plans that lower payments in the early years or over the total course of the loan. The government expanded these plans in 2007 and again in 2012. Two options may be especially helpful for low-income lawyers: Income-Based Repayment (IBR) and Pay-As-You-Earn (PAYE).

When borrowers enter repayment, most lenders automatically assign them to the Standard plan. Under the Standard plan, the monthly payment is fixed at an amount that will pay off the total loan amount (principal plus interest) in 10 years. The primary benefit of the Standard plan is the short repayment time: borrowers under this plan pay the least amount of interest over the life of the loan.

Unlike the Standard plan, Income-Based Repayment and Pay-As-You-Earn cap monthly payments based on the borrower's income, without regard to the total loan amount. Payments increase or decrease yearly as the borrower's income changes. The most enticing feature of IBR/PAYE, however, is loan forgiveness. Because payments are designed to accommodate income and not the total loan amount, borrowers may still have a significant amount of debt at the end of the repayment period. Under both plans, this remaining debt is simply cancelled. Although similar in design and intent, IBR and PAYE are not identical; see the chart below for some key differences.

	Income-Based Repayment	Pay-As-You-Earn
Which borrowers qualify for the plan?	<p>Any person who:</p> <ul style="list-style-type: none"> - Has eligible federal loans <p style="text-align: center;">AND</p> <ul style="list-style-type: none"> - Has a partial financial hardship 	<p>Any person who:</p> <ul style="list-style-type: none"> - Had no outstanding balance on a Direct Loan or Federal Family Education Loan (FFEL) as of October 1, 2007 <p style="text-align: center;">AND</p> <ul style="list-style-type: none"> - Received disbursement of a Direct Loan on or after October 1, 2011, <p style="text-align: center;">AND</p> <ul style="list-style-type: none"> - Has a partial financial hardship
Which loans are eligible for repayment under this plan?	Stafford, PLUS, and Consolidation loans made under the Direct <u>or</u> FFEL programs	All Stafford, PLUS, and Consolidation loans made under the Direct program
Which loans are ineligible?	<ul style="list-style-type: none"> - PLUS parent loans - Consolidation loans that include a PLUS parent loan - Private loans - Loans in default 	<ul style="list-style-type: none"> - Loans made under the FFEL program - PLUS parent loans - Consolidation loans that include a PLUS parent loan - Private loans - Loans in default
What is the payment cap?	15% of the borrower's discretionary income	10% of the borrower's discretionary income
What is the repayment period?	25 years, or 10 years for participants in the Public Service Loan Forgiveness Program	20 years, or 10 years for participants in the Public Service Loan Forgiveness Program

TERMS OF ART: PARTIAL FINANCIAL HARDSHIPS AND DISCRETIONARY INCOME

Lenders determine eligibility for IBR and PAYE by comparing a borrower's current Standard plan payment with the projected payment under IBR/PAYE. If the projected payment is lower, the borrower is deemed to have a "partial financial hardship." Both IBR and PAYE payment calculations use the borrower's federal student loan balance, adjusted gross income, federal income tax filing status, family size, and state of residence. Borrowers must apply to each lender separately for IBR/PAYE, but each lender will use the total amount of qualifying loans for the calculation, not just the loans held by that particular lender.

Discretionary income is defined as the borrower's adjusted gross income minus 150% of the borrower's federal poverty guideline. (These guidelines are based on family size and state of residence, and are available at <http://aspe.hhs.gov/>.) Documentation of income and family size must be submitted yearly, and payments are recalculated if the borrower's income changes. An increase in income can result in payments rising back to the level of the Standard plan payments, but the borrower remains enrolled in IBR or PAYE, and is still eligible for forgiveness at the end of the repayment period. A subsequent decrease in income will result in a return to lower payments.

TRUTH AND CONSEQUENCES

Qualifying for IBR or PAYE doesn't necessarily mean that a low-income lawyer should enroll. The Project on Student Debt, a non-profit research and policy group, predicts that most borrowers who enroll in IBR will pay their debt in full before reaching debt forgiveness, and enrolling will only result in paying more interest – sometimes a great deal more. For borrowers who reach forgiveness, there are serious tax considerations. The official government materials on these programs coyly state that the borrower "may" have to pay taxes on any loan amount that is forgiven, offering no further details. An IRS Revenue Ruling confirmed that debt forgiveness under IBR is taxable income for the year the debt is forgiven. Although PAYE was created later, it falls under the same rules. For a law school borrower with six-figure debt, the resulting loan forgiveness could result in a huge tax bill equal to several years' worth of payments. At least two bills have been introduced in Congress to modify or erase these tax consequences, but they didn't make it out of committee. Barring future Congressional action, debt forgiveness will come with a price.

One final note: Borrowers who intend to approach lenders with requests to switch to IBR or PAYE should first make their own determinations on qualification and predicted payments. Calculators for both programs are available online. Less scrupulous lenders may try to avoid lowering payments by claiming that the borrower does not have a partial financial hardship. Furthermore, several reports found willing lenders who accidentally miscalculated higher payments by using the borrower's gross income instead of adjusted gross income. A knowledgeable borrower will find a smoother road to affordable student loan payments.

For more information about these and other federal repayment options, see Studentaid.ed.gov or call the Federal Student Aid Information Center at 1-800-4-FED-AID.

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