

Taxation of Student Loan Forgiveness

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Federal and state law offer many exemptions for discharged student loans

Discharges of indebtedness are included in the Internal Revenue Code's definition of gross income, meaning the default rule is that forgiven loans are subject to federal and state income taxes. However, state and federal law have provisions that exclude some student loan forgiveness from income taxes.

Congress exempted a broad array of student loan forgiveness programs from the federal income tax in the American Rescue Plan Act (ARPA) of 2021. While that exclusion expires for federal purposes after 2025, Minnesota's income tax code includes that exclusion permanently.

There is a permanent federal income tax exemption for certain student loan forgiveness programs, and Minnesota has adopted that exclusion. The permanent federal exclusion from gross income covers:

- Public Service Loan Forgiveness (PSLF)
- Loans forgiven under certain programs where an individual worked in a specific profession for a specific period of time
- Loans discharged due to certain extenuating circumstances, including death, disability, or the closure or false certification of the educational institution

The federal American Rescue Plan Act (ARPA) included a broad but temporary student loan exclusion; Minnesota has adopted that exclusion permanently

ARPA offered a broad exclusion from gross income for discharged student debt.¹ The ARPA exclusion is effective for tax years 2021 to 2025, and covers most loans for postsecondary expenses that were made, issued, or guaranteed by the federal government, a state government, postsecondary institutions, and private loans and loans by certain educational organizations. While this exclusion expires federally after tax year 2025, Minnesota established an income tax subtraction that permanently incorporates the ARPA exclusion into its tax code. As a result, the broad federal exclusion in ARPA does not expire for state income tax purposes.

Some loan forgiveness programs targeting specific professions are exempt from federal and state income taxes

Loan forgiveness that is excluded from gross income federally is also exempt from Minnesota tax if the state has "conformed" to the federal exclusion. Minnesota has conformed to an exclusion for loans that were forgiven pursuant to a provision of the loan in which part or all of the loan would be forgiven if an individual worked in a certain profession for a certain period of time. As a result, loan forgiveness through the following programs is not subject to federal or state tax:

- The Public Service Loan Forgiveness (PSLF) Program
- The National Health Service Corps Scholarship Program
- Forgiveness programs for health professionals administered by the Department of Health
- The John R. Justice loan repayment program for prosecutors and public defenders

¹ American Rescue Plan Act, Public Law No. 117-2, section 9675.

Loans forgiven in extenuating circumstances may also be exempt from federal and state taxes

Minnesota and federal law permanently exclude from gross income any student loans that were discharged in certain extenuating circumstances, including:

- Due to the death or disability of a borrower; or
- Due to the closure or false certification of the educational institution.

In the future, some student loan forgiveness may be taxable federally, but exempt from Minnesota income tax

Loan forgiveness through some federal loan forgiveness programs is only nontaxable due to the temporary ARPA exemption discussed above. If Congress does not extend the exemption after tax year 2025, loan forgiveness through the following programs will be taxable federally, but exempt from Minnesota taxes (because Minnesota permanently adopted the ARPA exclusion):

- The Saving on A Valuable Education (SAVE) Plan
- Pay-As-You-Earn (PAYE) and Revised Pay-As-You-Earn (REPAYE) programs
- Income-Contingent Repayment (ICR) and Income-Based Repayment (IBR) programs

The tax treatment of Office of Higher Education programs varies

The Office of Higher Education (OHE) administers a number of loan forgiveness/repayment assistance programs, but those programs are likely not covered by the federal exclusion because the loans are not actually discharged by the lender. Instead, these programs give money to a borrower to repay an outstanding student loan. In other words, under these state programs, loans are not being *forgiven* (or “discharged”); the state is simply assisting the borrower with loan repayment. A federal tax court opinion² held that the federal exclusion (IRC section 108(f)) does not apply to repayment assistance programs where there was not an actual discharge of indebtedness by the lender.

Minnesota’s income tax subtraction for student loan forgiveness explicitly excludes the Teacher Shortage Loan Forgiveness Program from state income taxes—as a result, loan forgiveness through that program is not subject to state income taxes, even though it is taxable federally.

Minnesota’s subtraction does not mention other OHE loan forgiveness/repayment assistance programs. As a result, assistance through the following programs is subject to state and federal tax:

- The Minnesota Agricultural Education Loan Forgiveness Program
- The Minnesota Aviation Degree Loan Forgiveness Program

Loan forgiveness through the Minnesota Rural Veterinarian Loan Forgiveness Program may be taxable for the same reason as the programs mentioned above, unless the program is covered by the federal exemption for state loan forgiveness programs designed to promote the availability of health care.



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² *Moloney v. Comm’r*, No. 21859-04S, 2006 WL 995393, at *5 (T.C. Apr. 17, 2006) (“In no event may section 108(f) apply unless there is in fact a discharge of a student loan.”)