

Examples of Borrowers Eligible for Income-Based Repayment (IBR) and the Current Tax Consequences for Those Receiving Loan Forgiveness

The new Income-Based Repayment (IBR) program caps federal student loan payments at a share of a borrower's income and forgives any balance remaining after 25 years. However, under current law, the forgiven amount will be treated as taxable income. Concern about this potential tax liability may discourage many borrowers from taking advantage of IBR - exactly the borrowers that IBR was designed to help. By contrast, the amount forgiven after 10 years under the Public Service Loan Forgiveness (PSLF) program is not treated as taxable income. H.R. 2492 would exclude IBR forgiveness from taxation in the same way as forgiveness under PSLF.

In general, only those with low incomes relative to their debt for the entire 25 year repayment period will qualify for forgiveness in this program. Most borrowers in IBR will repay their student loans *in full*. Most will also pay *more* interest under IBR than under a 10-year standard repayment plan because they will make lower monthly payments over a longer period of time. IBR helps keep monthly payments manageable, providing relief when incomes are low or drop, and automatically increasing monthly payments when incomes rise.

Borrowers in Income-Based Repayment will repay *in full* if they:

<u>Have borrowed...</u>	<u>...And earn at least:</u> ¹
\$23,200 (the average for 2008 graduates)	\$26,000
\$100,000	\$58,000
\$175,000 (above average for medical school)	\$105,000 (after earning \$45,000 during their residency, and most doctors earn much more than \$105,000)

Following are six examples of individuals eligible for IBR and the current tax consequences for those receiving forgiveness.² In five of the examples below, the borrowers pay more in total under IBR than under a standard 10-year repayment plan but less than under a fixed 25-year repayment plan. The borrowers in examples 4 and 6 repay their loans in full after initially paying low monthly payments. The borrower in example 5 is the only one to pay less than under a standard 10-year repayment plan because the borrower is eligible for Public Service Loan Forgiveness.

¹ Assumes a single borrower without dependents, incomes grow 3% a year, with a CPI of 3% and a discount rate of 5.8%, using the online calculator available at: <http://www.finaid.org/calculators/scripts/ibr.cgi>. All incomes provided in this fact sheet are Adjusted Gross Incomes.

² All calculations are in 2009 dollars and assume current federal income tax brackets and rates. Each of the examples includes a recalculation of federal income tax forgiven converted from today's dollars into a future present value 25 years from now using the same assumptions as in footnote 1.

Example 1: Entrepreneur, married with two children

- Has \$33,000 in student loans
- Earns \$0 during business startup
- Earns \$50,000 a year after four years
- After 25 years in IBR:
 - Repaid entire loan principal **plus \$21,946**
 - **Owes \$4,713 in federal income tax** on the amount forgiven (the equivalent of \$1,151 in today's dollars)

	10-year Plan	25-year Plan	IBR *
Monthly payments	\$380	\$229	\$0 initially,** rising to \$288
Total payments	\$45,572	\$68,714	\$54,946
Amount forgiven			\$20,291
Estimated tax on forgiveness			\$4,713

* IBR payments increase as income increases.

**While this person is not earning any income, they pay \$0 initially until they start earning \$50,000 annually in their fifth year in IBR.

Example 2: Engineer, married with one child

- Has \$60,000 in student loans
- Earns \$50,000 at a manufacturing company
- After 25 years in IBR:
 - Repaid entire loan principal **plus \$63,241**
 - **Owes \$5,801 in federal income tax** on the amount forgiven (the equivalent of \$1,417 in today's dollars)

	10-year Plan	25-year Plan	IBR
Monthly payments	\$690	\$416	\$282 initially, rising to \$573
Total payments	\$82,858	\$124,935	\$123,241
Amount forgiven			\$23,202
Estimated tax on forgiveness			\$5,801

Example 3: Social worker, divorced with one child with a chronic illness

- Has \$55,000 in student loans from undergraduate and graduate school
- Earns \$40,000 as a contractor for a State agency (does not qualify for public service loan forgiveness)
- After 25 years in IBR:
 - Repaid entire loan principal **plus \$44,233**
 - **Owes \$9,541 in federal income tax** on the amount forgiven (the equivalent of \$2,331 in today's dollars)

	10-year Plan	25-year Plan	IBR
Monthly payments	\$633	\$382	\$227 initially, Rising to \$461
Total payments	\$75,953	\$114,522	\$99,233
Amount forgiven			\$38,417
Estimated tax on forgiveness			\$9,541

Example 4: Medical lab technician in a doctor's office

- Has \$25,000 in student loans
- Earns \$32,000
- **After 14 years** in IBR:
 - Repaid entire loan principal **plus \$14,932** in interest (no forgiveness)
 - IBR kept monthly payments lower than the standard 10-year repayment plan until the final year of repayment when income was high enough to pay more

	10-year Plan	25-year Plan	IBR
Monthly payments	\$288	\$174	\$197 initially, rising to \$288
Total payments	\$34,524	\$52,054	\$39,932
Amount forgiven			\$0
Tax on forgiveness			\$0

Example 5: Public school teacher, qualified for Public Service Loan Forgiveness (PSLF)

- Owes \$60,000 in student loans from undergraduate and graduate school
- Earns \$36,000 as a public school teacher
- **After 10 years** in IBR:
 - Repaid \$33,970 of \$60,000 principal
 - IBR keeps monthly payments manageable
 - **\$60,000 forgiven under PSLF is *not* taxed as income**

	10-year Plan	25-year Plan	IBR
Monthly payments	\$690	\$416	\$247 initially, rising to \$322
Total payments	\$82,858	\$124,935	\$33,970
Amount forgiven			\$60,000
Tax on forgiveness			\$0

Example 6: OB/GYN in private practice, married with two children

- Has \$192,000 in student loans
- Earns \$45,000 during 4-year residency and then earns \$190,000 in private practice
- **After 17.5 years** in IBR:
 - Repaid entire loan principal **plus \$161,318** (no forgiveness)
 - IBR allows borrower to have lower monthly payment while in residency and then have payments increase with income

	10-year Plan	25-year Plan	IBR
Monthly payments	\$2,210	\$1,333	\$149 initially, rising to \$2,210
Total payments	\$265,145	\$399,785	\$353,318
Amount forgiven			\$0
Tax on forgiveness			\$0

Please note: Unless otherwise stated, the above scenarios assume a household size of one, a student loan interest rate of 6.8%, and a 3% growth rate for the poverty level, consumer price index, and annual salary growth (with the exception of years where major salary jumps occur). Cited incomes are Adjusted Gross Incomes. These calculations also assume a 5.8% discount rate. IBR payment calculations attributed to FinAid! The SmartStudent Guide to Financial Aid's IBR calculator, located online at <http://www.finaid.org/calculators/scripts/ibr.cgi>.