

# Taxation of Student Loan Forgiveness

December 2022

## Federal and state law offer many exemptions for discharged student loans, but some forgiven student loans may still be taxable in Minnesota

Discharged debt is included in the Internal Revenue Code's definition of gross income, meaning the default rule in the federal income tax code is that forgiven loans are subject to federal and state income taxes. However, federal law contains a number of permanent and temporary exclusions for discharged student debt. Minnesota has adopted many of those exemptions, meaning the discharged debt may not be taxable under the state's individual income tax.

Under federal law, there is a permanent exclusion from gross income for Public Service Loan Forgiveness, for loans discharged due to death or disability, and for loans forgiven under certain programs where an individual worked in a specific profession for a specific period of time. Minnesota has adopted all of those exemptions, meaning loan forgiveness under those programs is nontaxable.

Minnesota and federal law differ on two tax exemptions for forgiven student loans:

- Minnesota **has not adopted** the temporary exclusion from gross income that was enacted under the American Rescue Plan Act (ARPA) in March 2021. This exclusion covers the broad student debt relief proposal announced by President Biden in August 2022.<sup>1</sup> As a result, loan forgiveness under that program would be taxable for state purposes.
- Minnesota offers a state-specific tax exemption (subtraction) for some loan forgiveness programs that **are subject to federal income tax**. The exemption covers loan forgiveness under four federal income-based repayment plans and the Minnesota Teacher Shortage Loan forgiveness program.

## Congress enacted a broad but temporary exclusion for student loan forgiveness; Minnesota has not adopted that exclusion for state purposes

ARPA offered a broad exclusion from gross income for discharged student debt.<sup>2</sup> 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.

As a result of the ARPA exclusion, loan forgiveness under President Biden's proposed student debt relief will not be taxed federally. As of the end of the 2022 legislative session Minnesota had not conformed to the federal changes, meaning the proposed loan forgiveness would be taxed under current Minnesota law. In a future session, the legislature could opt to conform retroactively for tax year 2022.

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<sup>1</sup> White House, "FACT SHEET: President Biden Announces Student Loan Relief for Borrowers who Need it Most," August 24, 2022. <https://www.whitehouse.gov/briefing-room/statements-releases/2022/08/24/fact-sheet-president-biden-announces-student-loan-relief-for-borrowers-who-need-it-most/>

<sup>2</sup> American Rescue Plan Act, [Public Law 117-2, section 9675](#).

## **Some student loan forgiveness programs are exempted from federal and Minnesota income tax**

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

## **Loans forgiven in certain circumstances may also be exempt**

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.

## **Some loan forgiveness is taxable federally, but is exempt from Minnesota income tax**

Loan forgiveness through the following programs is included in gross income and is therefore taxable federally. However, Minnesota allows an individual income tax subtraction for debt that was discharged through the following programs:

- Income-Contingent Repayment (ICR) and Income-Based Repayment (IBR) programs
- Pay-As-You-Earn (PAYE) and Revised Pay-As-You-Earn (REPAYE) programs
- The Minnesota Teacher Shortage Loan Forgiveness program

## **Loan forgiveness provided through some Minnesota programs is likely taxable both federally and in Minnesota**

The law establishing the Minnesota subtraction does not reference other state loan forgiveness programs. As a result, debt discharged through the following programs would likely be 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 Large Animal 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 for health professionals.



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