

Student Loan Borrowers Beware: You May Owe State Tax on the Forgiven Debt Even If You Do Not Receive an IRS Form 1099-C

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As reported late last year, the IRS announced in Notice 2022-1 (Notice) that lenders are not required to, and should not, issue IRS Forms 1099-C when certain student loan debts are forgiven. The Notice was in response to amendments made to Section 108 of the Internal Revenue Code (Code) by the American Rescue Plan Act of 2021, which expanded the types of discharges (forgiveness) of student loan debt that will be excluded from income. The Biden-Harris Administration's Student Debt Relief Plan further expands the types of student loans that will be forgiven.

By way of background, when a lender files an IRS Form 1099-C with the IRS (and furnishes a copy to the borrower) it is notifying the IRS and the borrower of the amount of debt being forgiven. Besides informing the borrower of the amount of debt being forgiven, the IRS Form 1099-C is a reminder to the borrower that tax may be due on the debt forgiveness.

While student loan debt forgiveness may be excludible from income for federal income tax purposes, some states do not exclude such debt forgiveness from income for state income tax purposes. This means the borrower may have to pay state income tax on the forgiven student loan debt.

If the IRS and borrower do not receive an IRS Form 1099-C from a lender when a debt is forgiven, they do not have a verified statement of the amount being forgiven.

Student loan borrowers who have debt forgiven need to know if their state will tax the debt forgiveness. If so, they must receive from the lender a clear statement of the amount of debt being forgiven. This amount may need to be added back to their adjusted gross income reported on their IRS tax return to determine their state taxable income.

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