

Bankrupt Your Student Loans and Other Discharge Strategies

By Chuck Stewart, Ph.D.

Search the web with the keywords “bankruptcy” and “student loans” and you find either many listings for lending institutions trying to get you to take out another loan or you see articles telling you that it is impossible to bankrupt student loans. Some sites will qualify their answer and say that it is “virtually” impossible to bankrupt student loans, that it is very difficult and you must use an attorney. None of these statements are true. You can bankrupt your student loans, you can do it yourself and the steps are actually easy.

Below is a summary of the salient points given in *Bankrupt Your Student Loans and Other Discharge Strategies* by Chuck Stewart, Ph.D. (ISBN 978-1-4259-2855-1) Here is an author who has been through the process, successfully bankrupting \$54,000 in student loans, and has written a clear, step-by-step, instruction manual to help other honest debtors in their efforts to have their student loans discharged through bankruptcy or Compromise or Write-Off.

This article reviews what is needed to bankrupt student loans through the adversary proceeding and also explores many other discharge strategies. Since the book came out, a recurring question comes from people who completed a bankruptcy sometime in the past. They thought it was impossible to bankrupt their student loans and did not include them. Now that they hear it may have been possible to bankrupt their student loans they are angry at the misinformation that stuck them with their loans. They want to know if it is possible to still obtain a discharge. A number of people are currently attempting to reopen their bankruptcy for that very purpose. The book and website—www.BankruptYourStudentLoans.com— gives an update on this process along with sample forms filed with the courts.

Attorneys, the Department of Education, and others will tell you that you should not try representing yourself. One man who bought the book, simply whited-out sections of the sample documents found in the book, hand-printed in his information, filed, and won a discharge of his entire student loan debt of \$225,000. Was it stressful? Yes. Was it easy? Actually the steps were easy, it was the uncertainty of appearing in court that was emotionally difficult. Currently, educational videos are being created for viewing at www.BankruptYourStudentLoans.com to help with the difficulties related to self-representation.

History

Bankruptcy courts originally treated student loans the same as any other unsecured debt. Student loans could be listed in a bankruptcy filing and fully discharged. However, in 1976 Congress modified the Higher Education Act of 1965 and required student loans to be nondischargeable unless: (a) the debt first became due more than 5 years before the date of filing of the bankruptcy, or, (b) failure to discharge the debt would cause “undue hardship” to the debtor or to dependents of the debtor. In 1990, Congress extended the 5 year rule to 7 years and eventually eliminated the time limit altogether in 1998. Thus, the only option debtors currently have for bankrupting their student loans under 11 U.S.C.A.

Bankruptcy Reform Act (1998) §523(a)(8) is to prove repaying their student loans would cause an “undue hardship.”

“Undue Hardship” Analysis

Unfortunately, Congress failed to define the term “undue hardship.” A review of the discussion and debate by the legislature regarding the education amendment is unrevealing as to the meaning of undue hardship. Thus, it has been left up to the courts to determine its meaning. Aggressive defense by Department of Education attorneys has influenced the court to a decidedly rigid interpretation. In general, for a debtor to qualify for an undue hardship discharge of student loan debt, the debtor must be living at, or below, the Federal Poverty Guideline and have no hope for increased future income substantial enough to make payments on the loans.

Over the past quarter-century, courts have developed many tests to determine the existence of undue hardship. The leading test used in most court is the Brunner Test. Other tests include the Bryant Poverty Test, Totality of the Circumstances Test, and the Johnson Test. A review of these tests locate some common characteristics used by courts to determine undue hardship. These include:

Characteristic A: An evaluation of the debtor’s current living condition and the impact that has on the ability to repay the loan while maintaining a “minimal living” standard.

Characteristic B: The debtor’s future prospects for repaying the loan.

Characteristic C: Evaluate whether or not the debtor demonstrated good faith during loan repayment.

There are two steps involved to demonstrate Characteristic A— (1) Every court reviews the debtor’s current living condition and evaluates it against the Federal Poverty Guidelines. Debtors with incomes above poverty will be scrutinized by the courts to assure all expenses are “minimized.” Expenditures will be compared to an “idealized” debtor of similar situation but at the official poverty level. (2) Once the court is satisfied the debtor has minimized living expenses, the court evaluates whether repaying the student loans will push the debtor down to or below the poverty level.

Characteristic B is impossible to predict. Courts have recognized the folly in trying to predict future income, but it has not stopped them from including it in their analysis. Courts have considered many factors that may affect future earnings including personal limitations such as: (1) medical limitations, (2) support of dependents (and their medical conditions, if applicable), and (3) lack of useable job skills. Courts have also considered some external factors such as age discrimination (for debtors over age 50), having been labeled a whistleblower, and other social and cultural factors that affect the ability to obtain gainful employment.

Congress was most concerned with debtors who seemingly “defrauded” the government by bankrupting their student loans soon after graduation. To reinforce that concern, courts want debtors to demonstrate “good faith” attempts at repaying student loans.

Characteristic C, Good Faith, means that the debtor must show that he or she made

payments on student loans whenever his or her income was above the poverty level, or, when there was insufficient income, he or she obtain deferments or forbearances to keep the loan in good standing.

Income Contingency Repayment (ICR) Plan

Even if a debtor clearly demonstrates that the undue hardship analysis applies to his or her case, the Income Contingency Repayment (ICR) Plan may unravel the case. The ICR allows student loan repayment to increase or decrease according to the income of the debtor. As such, if the debtor's income is below the Federal Poverty Guideline, then the payment drops to zero. The plan lasts for 25 years and any outstanding debt is discharge. However, the loan discharged amount is treated as income by the IRS and income taxes will be due.

It is often stated by Department of Education attorneys that ICR makes it impossible for debtors to discharge their student loans in bankruptcy. They contend that anyone can make "zero dollar" payments, thus negating the undue hardship exception of §523(a)(8). In many cases this is true. But for some debtors the ICR is inappropriate. For example, imagine being 65 year or older living on SSI or on a fixed income and then a large tax liability descends upon you for debt discharged at the end of an ICR plan. That would place an undue hardship upon you. In fact, the ICR is really inappropriate for anyone over the age of 40 because of the tax liability at the end of the repayment period.

Regardless, debtors planning an adversary proceeding must prepare a robust response to the Income Contingency Repayment Plan.

Filing the Bankruptcy and Adversary Proceeding

Student loans are listed in the bankruptcy as one of the outstanding debts held by the debtor. The debtor must then file an Adversary Proceeding in conjunction with the bankruptcy case within 60 days of the meeting with the creditors. The adversary proceeding is against the Department of Education (or other guarantee lender) and asks the court to determine if the "undue hardship" clause applies. If the court decides §523(a)(8) applies to the case, then the student loans are discharged through the bankruptcy.

There is research to show that debtors who file their own Chapter 7 bankruptcy and adversary proceeding prevail more often than if an attorney is used. Most attorneys will not touch an adversary proceeding on student loans, and those that do, want at least \$10,000 up front with additional high hourly fees. You know your situation best and will probably represent yourself better than any attorney. Even if you retain an attorney, you will have to perform most of the financial research needed to prove undue hardship. If you do file your own case, you may want to retain an attorney or paralegal to help with some of the steps, forms, or language.

Here is where strategy comes into play. You really do not want to go to trial. In *Bankrupt Your Student Loans and Other Discharge Strategies*, a chapter is devoted to an analysis of court cases. Often courts give irrational responses and rule against debtors with clear cases of hardship. Most courts analyze the debtor at the Federal Poverty Level whereas a

minority of courts performs the same analysis at a middle class income level. Because Congress failed to clearly define “undue hardship,” the courts have ruled all over the place; and there is no consistency even between courts using the same test.

The better tactic is to settle out of court with the Department of Education or renegotiate the loan and stipulate that to the court. For example, you could convince the Department of Education to accept 10 cents on the dollar as banks often do with bad debt. Say a \$60,000 loan is reduced to \$6,000 paid over 5 years (i.e., \$50/month) with the remaining \$54,000 discharged through the Chapter 7 bankruptcy. By discharging the debt through bankruptcy, there is no income reported to the IRS with no resulting income tax. You and the Department of Education create a Stipulation to the new repayment plan and submit it to the court for approval without trial.

Debtors need to prepare like they are going to trial. Each of the Characteristics and ICR discussed above must be addressed in full. It is not difficult work, just detailed and tedious. It is advisable to create worksheets to systematically organize financial details and write, in your own words, responses to each item. Research will be needed to obtain current financial guidelines for the Federal Poverty Level and typical expenditures for similarly situated debtors reported by the IRS. This research helps to establish that you have not been negligent in your spending. *Bankrupt Your Student Loans and Other Discharge Strategies* has created a systematic approach to proving “undue hardship” with the use of worksheets, sample forms, and extensive Appendix. By gathering all these materials together, you will be able to aggressively negotiate with the Department of Education before the trial. Hopefully, you will succeed and avoid a judge making the final decision.

It is impossible to write in general terms about how the adversary proceeding will proceed. Each court is different and each case is different. However, like with other civil complaints, there are usually the following steps:

- Filing the Complaint with Proof of Service
- Status Hearing
- Mediation (or the use of Interrogatories)
- Pre-Trial Hearing
- Trial

It is before the Mediation that you present your case to the Department of Education. This is your opportunity to try and renegotiate your loan: including having it completely discharged. More often than not, the attorney for the Department of Education will play hardball citing the ICR as the reason you cannot prevail with the undue hardship argument. You continue to negotiate with the Department of Education after the Mediation and address those questions that came up during the Mediation. In many cases, they will accept the offer if it is reasonable rather than risk losing at Trial.

Other Forms of Discharges

Even in situations where debtors do not file bankruptcy, there is the opportunity to have student loans discharged through the little known processes of Compromise or Write-Off. Instead of filing suit and having the case decided at trial, the debtor negotiates directly with the Department of Education to discharge the loan. Why would they do this? It costs money to keep dead loans in the system. Also, there are government directives allowing the Department to discharge loans through Compromise or Write-Off. Regardless if a bankruptcy or Compromise or Write-Off is planned, the process of proving “undue hardship” remains the same.

Should You Try?

It may be obvious, but if you don't attempt to have your student loans discharged you will be stuck with them. For many people, this means for life. You will probably never be able to buy a house or the American Dream. A simple loan of \$20,000 (which is now the average loan students have upon leaving college) can balloon to \$100,000 or more in a few years. Many people have hundreds of thousands of dollars in outstanding student loans. How will they ever be able to pay them off? The cost for filing an adversary proceeding is zero. So, if you represent yourself, the cost is only your time. What have you got to lose?

The above article was a brief summary of *Bankrupt Your Student Loans and Other Discharge Strategies* by Chuck Stewart, Ph.D. (ISBN 978-1-4259-2855-1). It is the only book to give step-by-step instructions for filing and arguing an adversary proceeding to discharge student loans through bankruptcy. It is written in plain English, with a minimum of legalese, and can be purchased directly from AuthorHouse.com. Please visit www.BankruptYourStudentLoans.com.