

Student Loans & Bankruptcy

Student loans are difficult, but not impossible, to discharge in bankruptcy. To do so, you must show that payment of the debt “will impose an undue hardship on you and your dependents.”

Undue Hardship

Courts use different tests to evaluate whether a particular borrower has shown an undue hardship. A common test is the Brunner test which requires a showing that 1) the debtor cannot maintain, based on current income and expenses, a “minimal” standard of living for the debtor and the debtor’s dependents if forced to repay the student loans; 2) additional circumstances exist indicating that this state of affairs is likely to persist for a significant portion of the repayment period of the student loans; and 3) the debtor has made good faith efforts to repay the loans. (*Brunner v. New York State Higher Educ. Servs. Corp.*, 831 F. 2d 395 (2d Cir. 1987)). Not all courts use this test. Some courts will be more flexible, some less.

If you can successfully prove undue hardship, your student loan will be completely canceled. Filing for bankruptcy also automatically protects you from collection actions on all of your debts, at least until the bankruptcy case is resolved or until the creditor gets permission from the court to start collecting again.

Assuming you can discharge your student loan debt by proving hardship, bankruptcy may be a good option for you. It is a good idea to first consult with a lawyer or other professional to understand other pros and cons associated with bankruptcy. For example, a bankruptcy can remain part of your credit history for ten years. There are costs associated with filing for bankruptcy as well as a number of procedural hurdles. There are also limits on how often you can file for bankruptcy.

How to Discharge Student Loans in Bankruptcy

Whether a student loan is discharged based on hardship is not automatically determined in the bankruptcy process. You must file a petition (called an adversary proceeding) to get a determination. This [sample](#) gives you an idea of what your complaint should look like.

If you already filed for bankruptcy, but did not request a determination of undue hardship, you may reopen your bankruptcy case at any time in order to file this proceeding. You should be able to do this without payment of an additional filing fee. Chapter 7 of NCLC's [Student Loan Law](#) manual includes extensive information about discharging student loans in bankruptcy.

UNDUE HARDSHIP EXAMPLES

It is up to the court to decide whether you meet the “undue hardship” standard. Here are a few examples of successful and unsuccessful cases.

1. A 58 year old I.R.S. employee making about \$38,000/year was able to get his loans discharged. He had taken out the loans to attend a chiropractic program which he never completed. His overall expenses were about equal to his income. He was able to show that it was unlikely that his income would increase until his planned retirement at age 65. He was single with no dependents and had health problems. The court found that he had acted in good faith even though he had never made any voluntary student loan payments.
2. A college-educated married couple proved undue hardship and were able to discharge their loans. They both worked, but had income barely above poverty level. The court noted that the borrowers worked in worthwhile, although low-paying careers. One worked as a teacher's aide and the other as a teacher working with emotionally disturbed children. Even with a very frugal budget, they had \$400 more a month in expenses than income. Their expenses included \$100 monthly tuition to

send their daughter to private school. Relatives paid for most of this and the couple testified that they objected to the public school's corporal punishment policy. In agreeing to discharge the loans, the court also found that the couple had acted in good faith because they asked about the possibility of a more affordable repayment plan. Not all courts are as sympathetic to borrowers who work in low-paying careers. For example, one borrower was denied a discharge because he worked as a cellist for an orchestra and taught music part-time. The court suggested that this borrower could find higher-paying work. Another court came up with the same result for a pastor. The court found that it was the borrower's choice to work as a pastor for a start-up church rather than try to find a higher paying job.

3. A number of courts have granted discharges in cases where the borrower did not benefit from the education or went to a fraudulent school.
4. There have been mixed results when borrowers have tried to show that their financial difficulties will persist into the future. For example, one court found that a borrower's alcoholism was not an insurmountable problem, but some borrowers have won these cases. In one case, a borrower's testimony about her mental impairment, including evidence that she received Social Security benefits, was enough to convince the court of undue hardship. The court agreed with the borrower that her ongoing mental illness was likely to continue to interfere with her ability to work.

Even if you cannot prove undue hardship, you still might want to consider repaying your student loans through a Chapter 13 bankruptcy plan.

CHAPTER 13 and STUDENT LOANS

A case under chapter 13 is often called "reorganization." In a chapter 13 case, you submit a plan to repay your creditors over time, usually from future income. These plans allow you to get caught up on mortgages or car loans and other secured debts. If you cannot discharge your student loans based on undue hardship in either a chapter 7 or

chapter 13 bankruptcy, there are still certain advantages to filing a chapter 13 bankruptcy. One advantage is that your chapter 13 plan, not your loan holder will determine the size of your student loan payments. You will make these court-determined payments while you are in the Chapter 13 plan, usually for three to five years. You will still owe the remainder of your student loans when you come out of bankruptcy, but you can try at this point to discharge the remainder based on undue hardship. While you are repaying through the bankruptcy court, there will be no collection actions taken against you. You may have other options, depending on how judges decide these cases in your judicial district. For example, some judges allow student loan borrowers to give priority to their student loans during the Chapter 13 plan. You should discuss these options with a [bankruptcy attorney](#).

When shopping around for a lawyer, make sure that you let the lawyer know that you want to discharge your student loans in bankruptcy. You should ask a lot of questions to see if the lawyer understands this process. It is not as straightforward as filing a regular Chapter 7 bankruptcy petition. You should assume the lawyer is not knowledgeable in this area if he tells you that student loans cannot be discharged in bankruptcy. The truth is that you can discharge your student loans if you can prove undue hardship. You should always have an opportunity to talk to a lawyer before you pay anything. Make sure you have a clear idea of what the lawyer will do for you and what you will be charged.

Bankruptcy Tips and FAQs

Q: Is every type of education debt so hard to discharge in bankruptcy?

A: No. Most, but not all, student loans will require proof of undue hardship to discharge in bankruptcy. You may be able to avoid this higher standard if you can show that your loans are not really “educational loans” as defined by the Bankruptcy Code. For example, the standard does not apply to payments for tuition or room and board if you

did not receive an extension of credit. Also, the higher standard applies only if you went to an “eligible educational institution.” That means an institution that is eligible to participate in one of the government student financial assistance programs. Most, but not all, schools fit this category. You should consult a lawyer for more information about whether your loans meet these definitions.

Q: I thought private student loans were treated differently in bankruptcy than federal student loans. Is this no longer true?

This used to be true, but the law was changed in 2005. The new law is effective for bankruptcy cases filed on October 17, 2005 or afterwards.

Q: If I was previously denied an undue hardship, can I renew my request?

A: Yes, if there has been a change in your circumstances.

Q: Do I have to show undue hardship if I am a co-signer on a student loan?

A: Courts have come to different conclusions on this issue, but most have held that co-signers must also prove undue hardship in order to discharge student loans in bankruptcy. As with all bankruptcy cases, it is advisable to consult an attorney if you are a co-signer and considering bankruptcy. The court cases on this issue (and other issues related to student loans and bankruptcy) are also discussed in [NCLC's Student Loan Law publication](#).

Q: Do I have to show that I've tried strategies other than bankruptcy in order to get a bankruptcy discharge?

A: This is not required, but many courts will want to see that you have tried other options such as the income-based repayment plans. You should be prepared to discuss any strategies you have tried or if you haven't tried anything, be prepared to explain why other options were not suitable for you

Q: Why are student loans treated differently in bankruptcy than other unsecured debts?

A: Please read this [report](#) and blog [article](#). The U.S. House of Representatives recently held [hearings](#) on this issue.

Q: Will interest on my student loans accrue during the course of my Chapter 13 plan?

A: Generally yes. You may be able to restructure or defer the interest that accrues during the plan, but this won't make it go away.

Q: Will a bankruptcy discharge of my student loans affect my future ability to get student loans?

A: It depends on the type of loan. Bankruptcy discharges should not affect your ability to get new federal loans and grants. PLUS loans are an exception.– The government will look at prior bankruptcies in considering your creditworthiness for a PLUS loan. A prior bankruptcy will affect your ability to get a private student loan and will also affect the cost of that loan. Private student lenders almost always use credit scores to evaluate loan applications. A bankruptcy discharge will lower your credit score.

This information comes from the National Consumer Law Center. This handout contains general information. It is not intended as a substitute for specific legal advice.