

December 14, 2022

Important Notice: State Tax Treatment of Federal Student Loan Forgiveness

The following important information is addressed in this notice:

- North Carolina’s tax treatment of federal student loan forgiveness.
- Instructions on how to make adjustments to North Carolina taxable income to account for differences in federal and State income tax law concerning student loan forgiveness.
- Information on how federal student loan forgiveness impacts interest on the underpayment of estimated tax.

Background

The United States Department of Education is responsible for the administration of the programs that allow borrowers forgiveness for their outstanding student loan liability. According to Federal Student Aid, “[t]he terms forgiveness, cancellation, and discharge mean nearly the same thing, but they’re used in different ways.”¹ For the purpose of this notice, forgiveness is meant to encompass all programs administered by the Federal Government where a borrower no longer is responsible for all or a portion of their student loan debt.

The United States Department of Education currently administers a number of loan forgiveness programs, including the Public Service Loan Forgiveness Program (“PSLF”).² In addition to these established programs, President Joseph R. Biden, Jr. [announced](#) earlier this year the Department of Education will provide up to \$20,000 in debt cancellation to Pell Grant recipients with loans held by the Department of Education, and up to \$10,000 in debt cancellation to non-Pell Grant recipients (collectively, “Executive Order Student Loan Relief”).³

The federal income tax consequences of student loan forgiveness is addressed in Section 108 of the Internal Revenue Code (“IRC”). Congress, in the American Rescue Plan Act of 2021 (“ARPA”), modified this section by temporarily expanding the types of student loan

¹ [Student Loan Forgiveness | Federal Student Aid](#)

² The Department cannot determine a taxpayer’s eligibility for any of the programs listed. Please contact the appropriate party to the extent you have questions about the forgiveness of your loans.

³ The status of this particular loan relief program is uncertain given recent decisions in two separate Federal lawsuits. The ongoing litigation has no impact on this notice and North Carolina’s treatment of student loan forgiveness for purposes of State income tax. If this should change, the Department will issue further guidance.

forgiveness that would not be treated as taxable income for purposes of federal income tax. This modification is set forth in Section 108(f)(5) of the IRC.

North Carolina did not adopt Section 108(f)(5) of the IRC for purposes of the State income tax. This Important Notice describes the impact of Student Loan Forgiveness on North Carolina individual income tax beginning with tax year 2022 based on North Carolina's current law.

Federal Income Tax Law

[Code § 61\(a\)](#) provides that gross income means all income from whatever source derived, including income from discharge of indebtedness.⁴

[Code § 108\(f\)\(5\)](#), as modified by section 9675 of ARPA, provides a "special rule" which excludes certain student loan debt discharged in 2021 through 2025 from gross income. According to this special rule, "[g]ross income does not include any amount which [but for Code § 108(f)(5)] would be includible in gross income by reason of the discharge (in whole or in part)" of certain specified types of student loans in 2021 through 2025. In effect, ARPA amended Code § 108(f)(5) to exclude from gross income most discharges of certain student loans for taxable years beginning on or after January 1, 2021 and ending on or before December 31, 2025, regardless of the reason for the discharge.⁵ Prior to ARPA, Code § 108(f)(5) only excluded from gross income certain student loan discharges on account of the death or total and permanent disability of the student.⁶

North Carolina Income Tax Law

[N.C. Gen. Stat. § 105-153.4](#) provides that for individuals who are residents of this State, nonresidents of this State, or part-year residents of this State, the term "North Carolina taxable income" refers to "the taxpayer's adjusted gross income" as modified in N.C. Gen. Stat. §§ 105-153.5 and 105.153.6.

[N.C. Gen. Stat. § 105-153.3](#) provides that a "taxpayer's adjusted gross income" is the taxpayer's federal adjusted gross income ("AGI") as defined in Code § 62.

[N.C. Gen. Stat. § 105-228.90\(b\)\(7\)](#) defines the term "Code" as the Code as enacted as of April 1, 2021, including any provisions enacted as of that date that become effective either before or after that.

[N.C. Gen. Stat. § 105-153.5\(c2\)\(22\)](#) requires an addition to AGI for the amount excluded from the taxpayer's gross income for the discharge of a student loan under Code § 108(f)(5) to the extent that the exclusion exceeds the amount allowed under the Code as enacted as of May 1, 2020. If the taxpayer is insolvent, as defined in Code § 108(d)(3), then the addition required

⁴ See [IRC § 61\(a\)\(11\)](#).

⁵ See [ARPA, § 9675](#).

⁶ See the [Tax Cuts and Jobs Act of 2017](#) ("TCJA") § 11031.

under N.C. Gen. Stat. § 105-153.5(c2)(22) is limited to the amount of discharge of student loan indebtedness excluded from AGI under Code § 108(f)(5) that exceeds the amount of discharge indebtedness that would have been excluded under Code § 108(a)(1)(B).

[N.C. Gen. Stat. § 105-163.15](#) requires that, “[i]n the case of any underpayment of the estimated tax by an individual, the Secretary shall assess interest in an amount determined by applying the applicable annual rate established under [N.C. Gen. Stat. § 105-241.21] to the amount of the underpayment for the period of the underpayment.” This section also provides the timing, amounts, and exceptions to the required installment payments necessary to prevent the underpayment of estimated tax by an individual.

[N.C. Gen. Stat. § 105-237\(a\)](#) provides that “[t]he Secretary may...[r]educe or waive any penalties provided for in this Subchapter” and “[r]educe or waive any interest provided for in this Subchapter on taxes imposed prior to or during a period for which a taxpayer has declared bankruptcy under Chapter 7 or Chapter 13 of Title 11 of the United States Code.”

Application of NC Tax Law

For individuals, the starting point for determining North Carolina taxable income is AGI as defined in the Code as of a certain date. North Carolina currently references the Code as of April 1, 2021. As such, to the extent North Carolina conforms to federal income tax law, North Carolina follows the Code in effect as of April 1, 2021.

To account for areas of federal income tax law North Carolina does not follow, an individual, in calculating NC taxable income, is required to add certain items to AGI that are not included in AGI, and is allowed to deduct certain items from AGI that are included in AGI.⁷

As noted previously, North Carolina did not adopt Code § 108(f)(5), as amended by section 9675 of ARPA. Subject to the exceptions listed below, an individual who excludes Federal Student Loan Relief from AGI under Code § 108(f)(5) as amended by ARPA (“Student Loan Exclusion”) must add back the excluded amount when calculating North Carolina taxable income for taxable years beginning on or after January 1, 2021.⁸

Exceptions

Importantly, student loan discharges under Code § 108(f)(5) on account of death or total and permanent disability are excluded entirely from gross income for federal and North Carolina

⁷ See [N.C. Gen. Stat. § 105-153.5](#).

⁸ The changes made by ARPA to section 108(f)(5) and North Carolina’s subsequent decoupling from those changes did not impact the tax treatment of student loan forgiveness excluded under other provisions of Code § 108(f), including Code § 108(f)(1) (Public Service Loan Forgiveness), Code § 108(f)(3) (“Exception for discharges on account of services performed for certain lenders”), and Code § 108(f)(4) (“Payments under national health service corps loan repayment program and certain state loan repayment programs”). Consequently, individuals are not required to add back the amount of forgiveness excluded under these Code sections when determining North Carolina taxable income.

income tax purposes to the extent the discharge qualifies under Code § 108(f)(5) as enacted as of May 1, 2020. In addition, an insolvent individual, as defined in Code § 108(d)(3), is only required to make the addition to the extent the Student Loan Exclusion exceeds the Student Loan Forgiveness Relief that would have been excluded under Code § 108(a)(1)(B) due to insolvency.⁹

How to Add Student Loan Debt to Federal AGI for North Carolina Tax Purposes

An individual required to file a North Carolina Individual Income Tax Return (“[Form D-400](#)”) who is required to add (all or a portion of) the Student Loan Exclusion to AGI must complete Form D-400 Schedule S, “N.C. Adjustments for Individuals” for the applicable tax year and enter the amount of the Student Loan Exclusion on the correct line. In addition, a part-year resident or nonresident of North Carolina must also complete Form D-400 Schedule PN, Part-Year Resident and Nonresident Schedule,” and Form D-400 Schedule PN-1, “Other Additions and Deduction,” for the applicable tax year and enter the amount of the Student Loan Exclusion on the correct line.

Note: Form D-400, Form D-400 Schedule S, Form D-400 Schedule PN, Form D-400 Schedule PN-1, and the instructions for each form for tax year 2022, will be available on the [Department’s website](#) in early January 2023.

Federal Student Loan Forgiveness and Estimated Tax Interest

An individual required to file Form D-400 for tax year 2022, who is required to add (all or a portion of) the Student Loan Exclusion to AGI may owe interest on the underpayment of estimated tax if the individual did not pay enough 2022 State income tax by means of North Carolina withholding or by making estimated tax payments directly to the State.¹⁰ An individual may be charged estimated tax interest if the payments are submitted late, even if the individual is due a refund when the tax return is filed. Moreover, the Department cannot waive any interest assessed on the underpayment of estimated income tax.¹¹

To avoid an assessment of interest on the underpayment of estimated income tax, an individual required to file a North Carolina Individual Income Tax Return (“[Form D-400](#)”) for tax year 2022, who is required to add (all or a portion of) the Student Loan Exclusion to AGI in tax year 2022, is strongly encouraged to complete the “Worksheet for Computation of N.C. Estimated Income Tax”¹² to determine if an additional estimated income tax payment should be made on or before January 15, 2023. **Note:** An individual can pay estimated income tax [online](#).

⁹ Instructions and forms for determining insolvency under this section of the Code are available from the [Internal Revenue Service](#).

¹⁰ See [N.C. Gen. Stat. § 105-163.41](#), and section XVII of the [2021 Personal Taxes Bulletin](#).

¹¹ See N.C. Gen. Stat. § 105-237.

¹² See Page 2 of Form NC-40.

Future Impacts and Assistance

The Department is monitoring any further enactments by the General Assembly that could change the taxability of student loan forgiveness in North Carolina. If amendments are made to North Carolina income tax law, an individual who filed their North Carolina Individual Income Tax Return prior to any action of the General Assembly and whose North Carolina taxable income is impacted by such action may file an amended return to request a refund of any overpaid tax within the statute of limitations to seek a refund.

If you have any questions about this notice, you may call the North Carolina Department of Revenue Customer Service line at 1-877-252-3052 (7:00 am until 4:30 pm EDT, Monday through Friday), or write to Customer Service, PO Box 1168, Raleigh, NC 27602-1168.

To the extent there is any change to a statute or regulation, or new case law subsequent to the date of this notice, the provisions in this important notice may be superseded or voided. To the extent that any provisions in any other notice, directive, technical bulletin, or published guidance regarding the subject of this notice and issued prior to this notice conflict with this important notice, the provisions contained in this important notice supersede the previous guidance.