Shouldn't you be able to discharge your student loans in a bankruptcy?

Many students today leave college and graduate schools with mounting bills before they ever commence their employment life. In many cases these student loans can amount to an excess of $200,000. The monthly payments new graduates face can be as significant as $1,200 per month. Couple that payment with the uncertainty of the US and world economy and the situation truly appears to be grim. Many of today's young professionals and working class amass large unsecured debt through credit card purchases just to get by. They do not earn even as much money as the median person in their state. Many have purchased homes with current fair market values worth many thousands of dollars less then their mortgages, and in many cases fall behind on their payments. What are their options negotiate with their creditors? If these debtors can not afford to commit to the massive payments, then negotiation is not an option. Their only true salvation is a chapter 7 bankruptcy.

The debtors certainly can get some relief from filing for bankruptcy. If they have incurred massive credit card debt, medical bills, or even judgments for failure to pay debts, those all can be wiped out as unsecured debt. If they can not afford their home, they can always walk away from it. Even if the bank can not recoup their money and obtains a deficiency judgment against the debtor, that judgment is not secured as the mortgage was, it can also be stripped. However, many young debtors largest concern and most significant payment comes in the form of their student loan. What happens to that debt? Currently, a student loan is not secured in any collateral, but it is considered a priority debt, and can not be wiped out quite so easily.

In order for a debt to be discharged, it first must be classified as a consumer debt. The debt must have been incurred for a personal, household or family purpose. For example, most courts have held that taxes are not consumer debts within the meaning of the Bankruptcy Code. Debts incurred in the production of income are generally not considered consumer debts. Compass Bank v. Meyer (*In re* Meyer), 296 B.R. 849 (2003). Other courts, including two courts of appeals, have adopted the "profit motive" test. Baskin v. G. Fox and Co., 550 F. Supp. 64 (D. Conn. 1982). Under this test, a debt is not a consumer debt if it "was incurred with an eye toward profit." *In re* Booth, 858 F.2d 1051, 1055, (5th Cir. 1988). If a debt is incurred partly for business purposes and partly for personal, family or household purposes, the term "primarily" in the definition suggests that whether the debt is a "consumer debt" should depend upon which purpose predominates. Presumably, this determination would normally turn on the purpose for which most of the funds were obtained. In re Booth. Under this test, courts have concluded that student loans may or may not be consumer debts, depending in part on the motivation for obtaining them. *In re* Stewart, 175 F.3d 796 (B.A.P. 10th Cir. 1997). The court held a student loan classification depends on facts; in the case, classification of a portion of medical school loans as consumer debt was not erroneous.

If a court determines that a student loan is a consumer debt, which in and of itself still will not provide grounds to discharge the loan. A court must find pursuant to Section

523(a)(8) of the US Bankruptcy Code, that the student loan qualifies as an "undue hardship which allows the court to discharge an otherwise nondischargeable priority debt if excluding the debt from discharge will necessitate an undue hardship on the debtor or the debtor's dependents. Such a judicial decision is discretionary with the bankruptcy judge in determining whether payment of the debt will cause undue hardship on the debtor, thus defeating the "fresh start" concept of the bankruptcy laws.

The most widely used test for evaluating the dischargeability of a student loan under section 523(a)(8) states that the debt is dischargeable if three conditions are met:

1. The debtor cannot maintain, based on current income and expenses, a "minimal" standard of living if forced to repay the loans;
2. There are indications that the state of affairs is likely to persist for a significant portion of the repayment period; and
3. The debtor made good faith efforts to repay the loans. Brunner v. New York State Higher Educ. Servs. Corp., 831 F.2d 395 (2d Cir. 1987)

The Supreme Court has stated that section 523(a)(8) is "self-executing" and that "[u]nless the debtor affirmatively secures a hardship determination, the discharge order will not include a student loan debt." Tennessee Student Assistance Corp. v. Hood, 541 U.S. 440 (2004). In other words, student loan debt remains due until there is a determination that the loan is dischargeable. Underwood v. United Student Aid Funds, Inc. (*In re* Underwood), 299 B.R. 471 (Bankr. S.D. Ohio 2003).

To demonstrate the current criteria used by the Bankruptcy court to discharge a student loan, the district of Massachusetts has set a high bar. The debtor was a 32 year old unmarried woman who suffered from relapsing, recurring Multiple Sclerosis. The debtor's currently monthly income totaled $ 1101. The court found that the debtor's minimum expenses exceed her income. The debtor would have to give up her telephone and her gas money to become even marginally solvent. The court also found that the debtor had made Herculean efforts to both find work of a type she could perform and actually work despite facing daunting physical obstacles. Finally, the court found that the debtor's current condition, which had worsened since she first became symptomatic, would continue to impair her ability to find employment that would improve her financial status. The court reasoned in part that it had been able to observe many of the debtor's symptoms first-hand. Denittis v. Educ. Credit Mgmt. Corp. (In re Denittis), 362 B.R. 57 (First Circuit for the District of Massachusetts 2007).

As a further example of how precarious a debtor's situation must be, the same court as above denied the debtor's motion to discharge her student loan. The court held the educational loans were not dischargeable under 11 U.S.C.S. § 523(a)(8) because the debtor's prospects for increasing income over time were promising and, by slightly cutting her expenses, she could make the minimal payments towards her student loan obligations under the Income Contingent Repayment Plan. Brunell v. Citibank (SD) N.A. (In re Brunell), 356 B.R. 567 (1st Circuit, 2006).

The forgoing article on bankruptcy relief from student loans was drafted by Attorney Michael Goldstein, a Massachusetts Bankruptcy Attorney.