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When Is (or Isn't) a Private "Education Loan" "Qualified"?

When Is (or Isn't) a Private "Education Loan" "Qualified"?

By Justin R. Storer

A debtor's prebankruptcy liabilities are generally dischargeable, if not excluded from discharge by § 523(a) of the Bankruptcy Code.[1] Among the debts listed there (and so, in their particular instance, requiring a finding of "undue hardship" to be discharged) are several types of educational debts. These are itemized at § 523(a)(8): (1) educational benefit overpayments or loans made, insured or guaranteed (or funded, in whole or in part) by a governmental unit or nonprofit institution; (2) obligations to repay funds received as an educational benefit, scholarship; or stipend; and (3) "any other educational loan that is a qualified education loan, as defined in § 221(d)(1) of the Internal Revenue Code of 1986[.]"[2]

The third category can be rephrased as a "qualified private educational loan" (distinct from a government-backed "public" student loan).[3] That is to say, for a private educational loan to be nondischargeable, it must "qualified," and the Internal Revenue Code sets forth the conditions for qualification. One case described the investigation from there as a "nesting doll,"[4] but a better analogy might be a labyrinth.

Defining "Qualified"

Section 221 is, at the foreground, about the conditions under which a borrower can take student loan interest payments as a tax deduction. Pursuant to § 221(d)(1), a "qualified education loan" means "any indebtedness incurred by the taxpayer solely to pay qualified higher education expenses — (A) which are incurred on behalf of the taxpayer, the taxpayer's spouse, or any dependent of the taxpayer as of the time the indebtedness was incurred, (B) which are paid or incurred within a reasonable period of time before or after the indebtedness is incurred, and (C) which are attributable to education furnished during a period during which the recipient was an eligible student."

Another defined term in the Internal Revenue Code, "qualified higher education expenses" are (simplified) "the cost of attendance (as defined in § 472 of the Higher Education Act of 1965, 20 U.S.C. 1087ll…) at an eligible educational institution…."[5] From there, we have to define "cost of attendance" and "eligible educational institution."

Section 1087ll sprawls but generally lists a series of expenses that comprise the "cost of attendance," including sums for tuition and fees, room and board, books, materials, supplies and "miscellaneous personal expenses" for enrolled students. These are amounts determined by the university, not just whatever the student ends up having paid.[6] These amounts are reported by the university to the Integrated Postsecondary Education Data System (IPEDS) maintained by the National Center for Education Statistics, a federal agency under the Department of Education.[7]

Section 1091(a)(1) broadly requires that the student must be enrolled or accepted for enrollment in a program leading to a recognized educational credential at an institution of higher education that is an "eligible institution" in accordance with the provisions of 20 U.S.C. § 1094.[8] Finally, § 1094 describes the "program participation agreements" by which a school can be a "Title IV" school and thus eligible to participate in federal student financial aid programs.

Going back to § 221(d)(1)(C), there's one last fork in the road (before we get to the hanging paragraph, discussed at the end of this article): The borrower must also be an "eligible student." Section § 221(d)(3) specifies that "eligible student" is defined elsewhere, at 26 U.S.C. § 25A(b)(3). An "eligible student," ultimately, is one who is carrying at least half the normal full-time workload for the course of study the student is pursuing, and who meets the requirements of 20 U.S.C. § 1091(a)(1), as it was in effect on the day that § 25A(b)(3) was enacted.[9]

"Incurring" the "Cost of Attendance"

The case law on "student loan" dischargeability is primarily generated by debtors arguing that a debt should be dischargeable (or not presumptively nondischargeable). All the same, as the party seeking to except a debt from discharge, once an action commences, the initial burden is on the creditor to show that their debt is a qualified educational loan within the parameters of § 523(a)(8)(B).[10]

Given the foregoing, then, the private lender brings its claim into § 523(a)(8)(B) by establishing that the student for whom the debts were incurred was an eligible student attending an eligible institution, and that the loan was "incurred" to pay the "cost of attendance."[11]

An infinitival phrase ("to pay the cost of attendance") speaks to "the purpose or aim" of the verb ("incurred").[12] If the debtor borrowed the money for the purpose of paying the cost of attendance at an eligible educational institution, the actual use to which the debtor put the money is generally understood not to be a factor. This is consistent with caselaw on other elements of § 523(a)(8), holding that it is "the purpose of a loan which determines whether it is 'educational.'"[13] Succinctly, "A loan's purpose is centrally discerned from the lender's agreement with the borrower."[14]

In In re Crawford, as the court was ruling that the borrower's debt was a qualified education loan, it noted that "Sallie Mae additionally required [the student] to submit self-certification forms identifying [the university's] cost of attendance for the periods covered by the proposed loan.... Notably, the loan documents signed by the Debtor state 'You agree that your loan will be used solely to pay qualified higher education expenses of [the] Student at the School.'"[15]

Courts tend to focus on the loan's stated purpose at origination. In Mazloom, a debtor's loan documents listed her medical college, funds were sent to that college, and the debtor received a Truth-In-Lending statement providing that the loan was to pay for an education from that medical college — but the debtor had actually been accepted into a "twinning program" with that medical college, which was an eligible educational institution, and another school, which was not.[16]

The bankruptcy court found that the appropriate analysis was to "look only to the specific initial purpose of the loan to determine whether a debtor's loan falls within the scope of § 523(a)(8)(B)."[17] Finding that because the Debtor's stated purpose for the loan was "the cost of attendance" at the medical college (as her loan documents recited), the analysis would end there. "The plain text of § 523(a)(8)(B)," the court wrote, "requires looking to the stated purpose of the loan at the time of the agreement, rather than supplementing the stated purpose with ancillary information from the debtor's use of the loan funds."[18]

That is not to say that the contract has always been the only document that courts have examined to discern the intent of the transaction: 26 U.S.C. § 221, remember, is about the tax-deductibility of student loan interest. Creditors argued, with success, that a debtor conceded

that the debt at issue was a "qualified education loan" by way of taking the student loan interest deduction on her taxes.[19]

Mixed-Use Loans

Doubling back, a (generally) nondischargeable qualified education loan is "any indebtedness incurred by the taxpayer solely to pay qualified higher education expenses."[20] Focusing on "solely to pay" opens up the possibility that, if a penny of the loan was to pay any amount other than the "costs of attendance" as determined under § 1087ll, the entire debt was not a "qualified education loan," and so was never caught up by the § 523(a)(8)(B) exclusion from discharge; the debt simply is dischargeable tout court, undue hardship or no. Put bluntly, "For a loan to be 'qualified' under § 523(a)(8)(B), the student must attend an eligible educational institution and the loan must fund only qualified higher education expenses."[21]

In In re Pearson, the Ninth Circuit Bankruptcy Appellate Panel recently considered a loan the debtor borrowed from his (by now former) in-laws that enabled him to obtain a medical degree from St. George's University School of Medicine, including completing undergraduate prerequisites at St. George's University.[22] The twist, however, is that only the School of Medicine was an eligible institution — not the university itself.[23] After trial, the bankruptcy court entered a written decision holding that because some of the debt satisfied the definition of "qualified educational loan," this share of the debt wasn't discharged. The BAP agreed that some of the debt was not "qualified," but disagreed with the bankruptcy court about what that meant: The BAP found that the bankruptcy court erred in only discharging the "unqualified" portion of the debt, for multiple reasons. It said that the entire debt should have been discharged:

First, § 523(a)(8)(B) excepts from discharge "an educational loan that is a qualified education loan." … Either the educational loan is a qualified education loan, or it is not. Second, the bankruptcy court's interpretation of IRC § 221(d) gives no effect to the term "solely." […] Section 523(a)(8)(B) requires the entire educational loan to be a qualified education loan, and the plain language of IRC § 221(d) requires a qualified education loan to be incurred for a single purpose: to pay qualified higher education expenses.[24]

In another case, a debtor's private loan to study for the bar exam was found not to be "qualified," and so generally dischargeable, when the bar loan was "used for expenses incurred after attendance at an eligible educational institution," during which time it was not

"attributable to education furnished during a period during which the recipient was an eligible student."25

The § 221(d) Hanging Paragraph: More Obligations that Are (or Are Not) a "Qualified Education Loan"

Section 221(d)(1), which defines a "qualified education loan," concludes with a hanging paragraph specifying, first, that "[s]uch term includes indebtedness used to refinance indebtedness which qualifies as a qualified education loan." Neither the Bankruptcy Code nor the Internal Revenue Code actually define "refinance."26 In one case, the question presented was whether debt owed to the State of Colorado was excluded from discharge, as a refinance, when the state paid off a medical doctor's qualified educational loans in exchange for a commitment to practice in an underserved area of the state — but the debtor failed to work there as long as his contract required.27

Colorado argued that a refinance does not need to be in the form of a loan; it argued that, to be a qualified education loan, a refinance need only be a new obligation of some sort, an indebtedness used to refinance an indebtedness.28 But the district court held, with reference to Black's Law Dictionary, that a refinancing necessitated a new loan, not just a "payoff" of an old debt — going on to note, as well, that § 221(d)(1) refers specifically to loans, not a contract of the sort to which the debtor was a party, and that the debtor's agreement with the state lacked any provisions for any new loan that would take the place of an old loan.29

The hanging paragraph, after including refinancings, goes on to exclude any indebtedness owed to a person who is related to the taxpayer — the borrower, in this case — within the meanings of 26 U.S.C. § 267(b) or 707(b)(1). Under § 267(b), relationships include family members, including the borrower's brothers and sisters (whether by whole or half blood, it specifies), spouses, ancestors and lineal descendants.30 Section 267(b) goes on to enumerate other excluded relationships, such as an individual and a corporation when the individual owns more than 50 percent of the value of outstanding stock in that corporation, and various arrangements of trusts, trustees, beneficiaries and fiduciaries.

Only if a private educational loan is "qualified" does a borrower need to prove "undue hardship" to discharge that debt. Section 221(d) imposes numerous conditions for such a debt to be a "qualified educational loan." If any thread is missing from the whole tapestry, the borrower's debt is not of the nature contemplated in § 523(a)(8)(B).

Section 707(b)(1) adds in a partnership and a person owning, directly or indirectly, more than 50 percent of its capital interest, or profits ownership, in such partnership, or two partnerships

in which the same persons own more than 50 percent of those interests. Like a loan made from a direct family member, even if a partnership fitting this description makes what would otherwise be a "qualified education loan" to a debtor, that debt simply does not fit within the ambit of § 221(d)(1) and thus would be dischargeable. As the deductibility of interest payments to these related parties is prohibited, debts owed to those related parties are not excluded from discharge by § 523(a)(8)(B).

Conclusion

Only if a private educational loan is "qualified" does a borrower need to prove "undue hardship" to discharge that debt. Section 221(d) imposes numerous conditions for such a debt to be a "qualified educational loan." If any thread is missing from the whole tapestry, the borrower's debt is not of the nature contemplated in § 523(a)(8)(B). Rather than just assuming that every "student loan" falls into a broad presumptive exclusion from discharge, debtors and their counsel must critically examine the facts of the case, the loan documents and all of the attendant circumstances.

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- 1 See, e.g., 11 U.S.C. §§ 727(b), 1141(d)(2). The author thanks Chrystin Ondersma for her comments on an earlier draft of this article.
- 2 Which, although adopted by the Bankruptcy Code for its definition of "qualified education loan," is actually focused on when payments towards student loan interest might qualify for a tax deduction. Put succinctly, "Under Bankruptcy Code § 523(a)(8)(B), a student loan is nondischargeable if interest paid on the loan qualifies for a tax deduction…." In re Mallett, 625 B.R. 553 (Bankr. M.D. Fla. 2021).
- 3 See, e.g., Homaidan v. Sallie Mae Inc., 3 F.4th 595, 601 (2d Cir. 2021).
- 4 In re Mazloom, 648 B.R. 1, 11 (Bankr. N.D.N.Y. 2023).
- 5 26 U.S.C. § 221(d)(2).
- 6 See, e.g., In re Conti, 982 F.3d 445, 448 (6th Cir. 2020); see also In re Golden, 671 B.R. 544, 603-604 (Bankr. E.D.N.Y. 2025), for a brief discussion distinguishing "cost of attendance" under § 1087ll and the actual expenses incurred in education — what Golden terms the "total budget."

- 7 This information is searchable at https://nces.ed.gov/ipeds.
- 8 Another path to the same result: "[A]n 'eligible [educational] institution' is treated by § 221(d)(1) as having the same meaning as in 26 U.S.C. § 25A(f)(2), which defines the term as an institution "which is eligible to participate in a program under title IV of [the Higher Education Act of 1965]." 26 U.S.C. § 25A(f)(2). Mazloom, 648 B.R. at 12.
- 9 Aug. 5, 1997.
- 10 Roth v. Educ. Credit Mgmt. Corp. (In re Roth), 490 B.R. 908, 916-17 (B.A.P. 9th Cir. 2013).
- 11 In re Crawford, 653 B.R. 627, 637-38 (Bankr. S.D. Ohio 2023).
- 12 Conti, 982 F.3d at 449, citing Murphy v. Smith, 583 U.S. 220, 223 (2018).
- 13 Id., citing Busson-Sokolik v. Milwaukee School of Engineering (In re Sokolik), 635 F.3d 261, 266 (7th Cir. 2011).
- 14 Id. Put differently, "Section 523(a)(8) is concerned with the circumstances surrounding the origination of the loan, rather than what benefits the debtor may have derived." In re Rumer, 469 B.R. 553, 562 (Bankr. M.D. Pa. 2012), citing In re Wills, 2010 WL 1688221 (S.D. Ind. April 23, 2010).
- 15 Crawford, 653 B.R. at 637.
- 16 Mazloom, 648 B.R. at 6.
- 17 Id. at 12.
- 18 Id.
- 19 Mallett, 625 B.R. at 558. The quoted text may bear a typo: The original lender in Mallett was the debtor's then-husband's grandmother, and after her death, her son took assignment of the loan; the Mallett opinion, midway through its page 555, begins spelling the family name with only one "t."
- 20 26 U.S.C. § 221(d)(1).
- 21 Homaidan, 3 F.4th at 601, fn. 3, emphasis added, citations omitted.
- 22 In re Pearson, 679 B.R. 580 (B.A.P. 9th Cir. 2026).

- 23 Id. at 585.
- 24 Id. at 589, paragraph breaks omitted. The BAP's order is currently on appeal by the lenders to the Ninth Circuit Court of Appeals in its case 26-1963.
- 25 Golden, 671 B.R. at 611.
- 26 In re Kurz, 660 F. Supp. 3d 1046, 1053 (D. Colo. 2023).
- 27 Id. at 1050.
- 28 Id.
- 29 Id. The district court also cites Merriam-Webster to similar effect. In one case, In re Conklin, 2020 WL 1672786, at *9 (W.D.N.C. 2020), the district court remanded to the bankruptcy court for a determination of, inter alia, whether a debt was or was not a refinancing, writing, "Finally, while there is not dispute that the original loan (the 'indebtedness which qualifies as a qualified educational loan') must be educational in nature, a refinance does not need to exhibit the same educational characteristics. Indeed, refinances almost never have the underlying purpose of funding a future education.... Rather, the intent behind refinancing a loan is almost always simply an intent to reorganize the debt and to create better terms on the loan."
- 30 Section 267(b)(1) incorporates by reference 26 U.S.C. § 267(c)(4), from which this list derives. Conklin concerned a loan made to a debtor by her onetime future in-laws, after the relationship broke off, and noted that "[t]here is no dispute between the parties [that they] are not related under this definition." Conklin, 2020 WL 1672786, at fn. 9.

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In re Mallett, 625 B.R. 553 (Bankr. M.D. Fla. 2021)
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