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May 25, 2010

Should Student Loans be Subject to Bankruptcy?

There are certain types of debts that you cannot be forgiven of even under bankruptcy, such as child support and tax debt. Another such debt is student loans. When students take on too much debt in the form of student loans to obtain their degree, they may not have the means to repay these loans even when they graduate and start earning a living. The problem is compounded when these loans are taken from private lenders (as opposed to government backed loans).

In today's world, having a college degree is almost a must if you want to earn a decent salary. But too many people get into huge debts in order to get a degree, and when life's uncertainties happen such as an illness, economic recession or divorce it makes it difficult for them to continue paying for the loans.

The problem with student loans is that it cannot be easily wiped out by bankruptcy. In order to do so, you have to prove undue hardship, not just an inability to afford the repayments.

Before 2005, only government backed loans were non-dischargeable. The rationale for this is that borrowers who do not repay their loans would affect the national budget. In other words, the American public pays for the borrower's default, which is unfair. The same goes for loans that come from charitable or non-profit organizations. These organizations give out loans as a means to generate revenue since their core activities do not earn profit. Therefore, such loans should not be easily forgiven. Other categories of student loans such as private student loans were subject to cancellation if you come under bankruptcy protection.

But all of this changed in 2005 when the government put new legislation into effect designed to make it more difficult for people to be declared bankrupt. The new legislation was aimed at preventing people from defaulting on their loans without trying hard enough to repay them. This legislation was called the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA). One aspect of this legislation elevated the status of student loans (including private student loans) to prevent them from being dischargeable.

But elevating the status of private student loans does not make sense. They should be classified the same way as other commercial loans like car loans. But lenders of such loans argue that if

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private student loans are subject to discharge like other private consumer debts, it would make it harder for students to get such loans. Lenders would be fearful that students would take up a loan and immediately seek bankruptcy protection upon graduation even before they get a proper job. However, most borrowers are not frauds seeking to game the system. Furthermore, there is a means test in every state that determines who can file for bankruptcy.

Although there have been some attempts to change the status of private loans and allow borrowers to be forgiven of the debt in bankruptcy, they have not been successful.