

Billionaire's Gift Could Carry Tax Consequences for Students

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Payments by a billionaire benefactor to erase student loan debts for recent graduates of a Georgia college could be considered taxable income for the students, according to

tax law experts.

Robert Smith's May 19 announcement that his family will establish a grant to pay off student loans for Morehouse College's entire 2019 graduating class raises thorny income tax issues, according to Philip Hackney of the University of Pittsburgh School of Law.

"I think a combination of Robert Smith and his attorneys and Morehouse and their attorneys should be extremely conscientious of the potential for taxable income to these students," Hackney told *Tax Notes*.

Because the payments will not directly pay for schooling, they are not scholarships, Hackney explained. "I think the natural kind of sense to deal with this is to maybe think about it as income," he said.

The payments also could be viewed as canceling indebtedness income, which could be problematic for the students, Hackney said. "They're being absolved from having to pay money back to the lender that they borrowed from," he said.

On the other hand, if the payments are "done well," they could be considered a gift, in which case there would be no tax consequences to the students, Hackney said.

Which Rule Rules?

The question is whether the cancellation of indebtedness rule under section 108 trumps the gift rule under section 102 and makes the gift taxable, said Alexander L. Reid of

Morgan Lewis & Bockius LLP. He said the gift treatment would likely prevail and the students would not be taxed.

It could also depend on how the donor makes the contribution, Reid said.

"If he wants to get a charitable contribution deduction, he would need to make the gift to a tax-exempt entity such as the school rather than directly to the students," Reid explained. "If the school then cancels the debt, it might receive different tax treatment under section 108(f), which applies specifically to discharged student loans and only applies in certain limited circumstances."

Ellen P. Aprill of Loyola Law School doubts that the donated amounts would be considered gifts from Morehouse excluded under section 102. The school can make tax-free gifts only to its charitable class, and only if other provisions do not make the amounts income, she said.

"I am not confident that graduates with debt form a charitable class," Aprill said. "I know that many law schools that make grants or forgive debt for former students to help pay loans treat these amounts as income to the student."

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