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The Dark Side of Payroll Withholding to Repay Student Loans

SLBA
Student Loan Borrower Assistance

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"When wages are garnished, an employer withholds money from an employee's paycheck and sends these funds to a creditor until the established debt is paid in full. The impact is often humiliating and stressful for employees. It can result in decreased productivity and motivation that can be detrimental to the affected employee, workplace, and employer."

— ADP, Garnishment: The Untold Story (2014)

Summary

The U.S. Senate Committee on Health, Education, Labor and Pensions Chair Lamar Alexander and others have proposed a program of mandatory automatic deductions from student loan borrowers' paychecks.[1] While the student loan repayment system is in desperate need of simplification and overhaul, forced automatic payroll withholding misses the mark.

There are approximately 44 million student loan borrowers in the United States. Almost 9 million of those borrowers—approximately one in five—are in default on their federal student loans.[2] Any student loan repayment program must be flexible enough to take into account the individual circumstances of these 44 million student loan borrowers and must take into account how their financial circumstances may change from month to month with fluctuations in income and expenses.

Because of the inadequacies of the current situation, some have called for a radical change to our student loan system. Senator Alexander proposes a system that would require borrowers to repay their loans through their employers, who would withhold payments from borrowers' paychecks based on either an income driven repayment formula or the standard ten year repayment.[3]

Many student loan borrowers do not have stable employment, work multiple jobs, or work in the gig economy. For borrowers with tight budgets that need to be navigated on a monthly basis, forced automatic payroll withholding may mean diverting money away from rent, heat, or food in order to pay their student loans. Borrowers should continue to be able to prioritize their expenses and debts in a way that allows them to meet their other obligations, too. Payments should always be voluntary and affordable.

What are Income Driven Repayment (IDR) Plans?

Income-driven repayment plans can help borrowers keep their loan payments affordable with payment caps based on their income and family size. There are a number of income-driven repayment (IDR) plans: Income-Based Repayment (IBR), Pay As You Earn (PAYE), Revised Pay As You Earn (REPAYE) and Income Contingent Repayment (ICR). Generally, payment amounts under an IDR plan is a percentage of the student loan borrower's discretionary income. The percentage is different depending on the plan.

A program of mandatory automatic payroll deductions to repay student loans would face numerous problems, including:

- Income-driven repayment plans (IDR) are an important option for many borrowers, but forcing them into an inflexible withholding requirement will cause serious problems for many borrowers with special circumstances.
- Mandatory withholding based on the size of a paycheck does not account for borrowers with seasonal or other fluctuating income.
- In some months, a fixed withholding amount coupled with unusual expenses may deprive a family of sufficient income for heat, rent, food, or medicine.
- Requiring thousands of employers to apply a complicated formula to withhold wages will inevitably result in costly errors.
- Employers computing withholding for student loan repayments will need to be informed about student loan borrowers' personal financial information and loan borrowing, invading employees' privacy.
- Employers will be liable to student loan borrowers if they withhold too much and liable to the United States if they withhold too little, placing obligations on businesses that they do not want and that have no connection to their business. The result may be employment discrimination against the very Americans to whom the United States offered student loans as a way to help them obtain employment.

Mandatory Payroll Withholding Will be Unaffordable for Many Families

Proponents have claimed that payroll withholding will be better for struggling borrowers because the payments will be tied to income. The current IDR already are an important option for low-income borrowers.[4] However, IDR plans do not work for everyone. The current IDR formula calculates payments as a percentage of the borrower's adjusted gross income above 150 percent of the federal poverty level for the borrower's household size. While the formula works for many borrowers, that amount is still unaffordable for others. This is particularly the case with borrowers with fluctuating incomes and fluctuating expenses. Forced payroll withholding will place these families in an untenable situation.

A recent study found that families experienced an average of five months per year with either a spike or dip in their finances.[5] While low-income households experienced higher rates of income volatility, middle-class families experienced them as well. This means that even if a borrower's annual income suggests that his or her income may be sufficient to cover the monthly student loan payment, the reality of month-to-month budgeting does not ensure that this is true. In addition, IDR formulas fail to take into consideration the varying cost of living in different communities and individualized expenses such as medical care, childcare, and care of older parents or other dependents.

For some families, any amount of mandatory payroll withholding will be unaffordable. Forcing deductions from already inadequate paychecks will leave the family even less for basic necessities. The family will not have the option of forgoing a student loan payment in a tough month to allow payment for medicine, heat, food, or rent.

Take for example a single student loan borrower who works as a cashier in California and earns $26,112 per year, or $2,176 per month, an average salary for that occupation in that state, according to the Bureau of Labor Statistics (BLS).[6] Using the IRS national and local cost of living estimates, this borrower will face $3,254 a month in living expenses.[7] Thus, even before calculating this borrower's IDR payment, she faces a monthly deficit. Still, she would be required to pay $67 per month under the current Revised Pay As You Earn (REPAYE) repayment plan—the IDR plan that takes the *lowest* percentage of the borrower's earnings.[8]

Similarly, a high school teacher in Georgia who is earning $56,850 annually (or $4,738 monthly) and supporting a family of four is required to make a $166 monthly payment under the REPAYE plan. While, this teacher in theory has $306 remaining after subtracting expenses, this is unlikely to be a reality. Why? The IRS cost of living data does not take into consideration taxes and the BLS data reports pre-tax wages. These agencies take into consideration out-of-pocket medical expenses but not health insurance premiums, and the latter can easily be more than $306.

Critically, the IRS cost of living standards also leave out childcare expenses – costing on average between $647 and $1,227 per child per month in the markets described above. Thus, even households that appear to have a cushion over expenses under the IRS standards could see that cushion evaporate with just one or two children requiring childcare.

In short, any mandatory withholding from paychecks based on one formula, no matter how complex, cannot take into account families' dramatic differences in circumstances based on their community, their individual family needs, and the family's month to month changes.

Borrower Story: In Her Own Words

"I am a 39 yo single mother of 2. I went back to college later in life [] for a business degree in hopes of a better future for my children. I've been employed w/the same medical group for 12 years, not making much money & unfortunately, have not been able to find better employment due to the area and the economy. We are living paycheck to paycheck. We lost our apartment last year, August 2017, due to the tax refund being taken, something I usually rely on for the year . . . My children & I were fortunately able to move in with my mother, which we need to leave. I want to be able to get a place, but am unable to save any money for a down payment. As of Jan. 2017, now my wages are also being garnished and I am going to be unable to put my children in their sports (track/softball). I can barely afford food for us."*

*Borrower stories come from student loan borrowers who have contacted the National Consumer Law Center through the www.studentloanborrowerassistance.org. Potentially identifying information has been removed.

Borrower Story

Mary* has two children, one with severe special needs. She works part-time so that she can take her son to his medical appointments, and thus her family relied almost exclusively on her husband's state government job which paid $70,000 per year. Despite having a middle-class salary, their budget was stretched thin by co-pays, medication, childcare necessary to watch their second child while attending medical appointments, and a student loan. She wrote, "I did offer to pay [the servicer] $50-100 a month which is currently what we could afford. They want $600 a month which we absolutely cannot do. We cannot even do $300 a month. It would break us. Its really not that I don't want to pay it back . . . I just can't pay that large amount."

**Name changed to protect her privacy.*

Mandatory withdrawals will provide no flexibility to respond to these needs and will leave the family no option to alleviate the distress because their paycheck by law will be lower.

Proponents argue that these problems could be solved by raising the threshold for calculating payments or by offering employees the option of going to their employers and asking for forbearances and deferments. Raising the threshold would solve some of these problems, but not all. Some borrowers will always have extraordinary expenses, especially those with high medical expenses. And while forbearances and deferments are very useful short-term plans, borrowers may not seek out these options if they are uncomfortable revealing to their employers that they are experiencing financial distress. In addition, the burden on employers to resolve requests for forbearances and deferments could be significant, and employers are likely to be reluctant to jeopardize their relationship with employees by ruling on these requests.

Forced Payroll Withholding Inadequately Accounts for Fluctuating Income

A selling point of automatic payroll withholding is that the payment amount fluctuates as a borrower's income fluctuates. If a borrower loses her job, for example, her student loan payments would stop. Unfortunately, many low-income borrowers' experiences are much more complicated. Many of the borrowers at risk of defaulting have employment with inconsistent hours, work in the gig economy, work seasonally, or for other reasons do not have consistent wages. While these families manage their finances to account for this fluctuating income, excessive withholding in good months prevents families from using income from the good months to tide them over in the lean months.

A borrower with seasonal employment, for example, may have substantial income in some months and have a large student loan payment withheld. However, if the borrower has very little income during the rest of the year, those payments could be substantially greater than what the borrower would have paid under the current IDR plan. This may be money that the borrower was counting on to pay future expenses.

Some proposals deal with this type of situation by using a system similar to the way taxes are calculated.[9] Annually, borrowers must provide their income information to the government to calculate whether the correct payment amounts were withheld. If they overpaid on their student loans they get refunds, and if they underpaid they must make up the difference.

This process raises several concerns. If a borrower unexpectedly owes a large lump sum, this will almost certainly lead to default. In other cases, the system anticipates some borrowers have *too much* withheld which by definition will cause unnecessary hardship throughout the year. This process also creates a complex system placing burdens on both the students who will have to make an annual accounting every year and on the entity doing the administration (whether the United States or the employer). This process may even be more complicated for low-income borrowers than the present system as they will have to make not only monthly payments though their employer, but an annual payment to make up the remainder from the prior year.

Government Should Not Require Student Loans to be Paid Before Other Necessities.

As described, too many families are already unable to cover all of their expenses each month. This means that households are forced to make difficult choices about which bills to pay and which bills will go unpaid. Many of these households are making difficult choices about basic necessities, including whether to keep a roof over their heads or put food in their children's bellies. When a student loan payment is garnished from their paycheck, this deprives the family of control over their budget—they can no longer balance repaying their student loans against basic necessities like rent, heat, food, or prescriptions.

Borrower Story: In Their Own Words

"I owe [] about eight thousand dollars or something. I'm not able to pay them because I have to pay rent [], feed myself and pay for gas [to get] to and from work. . . . The department of education is garnishing my paychecks. Taking $100, or just about, every other week. I can't even afford my $400 rent anymore. I'll pay [it] back, I just can't afford this much being taken from me."

Borrowers should not be forced to repay their student loans before feeding their families, paying their rent, keeping the heat on, or buying critical medication. Automatic payroll withholding would force borrowers to do just that. Payroll withholding prioritizes student loan debt over every other item in a family's budget.

A report by the Consumer Financial Protection Bureau highlighted the struggles that many student loan borrowers face.[10] It found that older consumers with outstanding student loans are more likely than those without outstanding student loans to report that they have skipped necessary health care needs, such as prescription medicines, doctors' visits, and dental care because they could not afford it. The mandatory wage withholding proposal would only exacerbate this problem.

Payroll Withholding Will Be Overly Complex and Prone to Costly Errors

For many critics, the complexity of the current system is one of its major flaws. Indeed, IDR plans are complicated and expensive errors do occur. However, mandatory payroll withholding does not eliminate that complexity but instead amplifies it.

Proponents of payroll withholding have held up programs in Australia and other countries as models for our student loan system to emulate.[11] However, these proponents fail to take into consideration fundamental differences in the way that our student loan system determines affordability. Under our current IDR plans, repayments amounts are determined by looking at *both* income and family size.[12] Unlike the Australian model, under the IDR plans, spousal income is also considered in many circumstances. By contrast, models in other countries do not look at family size, which is simpler, but raises serious concerns about affordability for families.

In general, proponents of mandatory payroll withholding have not suggested using the Australian repayment formula, but rather keeping the current IDR formula. Combining the current IDR formula with mandatory payroll withholding is the worst of both models.

As imperfect as the current system is, it only requires borrowers on IDR to gather all the pieces of information needed to determine the repayment amount once per year. A mandatory payroll withholding system would require a lot of information not currently in the employer's possession to be gathered repeatedly throughout the year. While employers have real time information about at least part of a student loan borrower's income, they do not have access to the other pieces needed to calculate an IDR payment. For example, the student loan borrower's employer will have no access to spousal income, and should not have such access for privacy concerns. Even if the employer did have access, it would have to be continuous access or else a dip in spousal income would not be reflected in a reduction in the student loan borrower's withholding. Likewise, for borrowers with multiple jobs, unless employers have real time access to income earned at those other jobs, employers are likely to withhold too much or too little. The complexity of any viable formula will inevitably lead to employers erroneously taking out the wrong amount. Even if borrowers can eventually recover amounts improperly withheld by employers, even a short-term reduction of income can spell disaster for a borrower who is living paycheck to paycheck.

Mandatory Employer Withdrawals Will Inevitably Lead to Serious Privacy Concerns

Getting employers involved in administering student loan repayment will cause serious privacy concerns, requiring borrowers to disclose details about their personal lives or financial lives that employers are not normally entitled to know. Concerns about privacy may lead to borrowers paying the wrong amount on their student loans.

If mandatory wage withdrawal formulas are anything like current IDR formulas, they will require employees to inform their employers (instead of the United States) about their marital status, household size, unborn children who will be born in the payment year, their income from other jobs, and their spousal income. Employees will rightfully fear that such disclosures to their employer may result in employment discrimination. Other times, employees have strong personal reasons to keep certain information private.

Moreover, borrowers with extraordinary circumstances may face even greater privacy risks in accessing the benefits they need. For example, the response of proponents of payroll withholding to concerns about affordability for borrowers who have extraordinary expenses is often to build in exceptions such as forbearances and deferments in order to allow borrowers to temporarily suspend payments. But this may require employees to inform their employer of family issues totally unrelated to their employment.

Payroll Withholding Creates Liabilities for Employers

According to a study done by ADP, the payroll processing company, employers do not like wage garnishment because it sets them up for liability.[13] Employers can be liable to borrowers if they withhold too much from a borrower and they can be liable to the United States if they withhold too little. If wage withholding formulas are as complex as the basic IDR formula, many of the tens of thousands of affected employers will make withholding errors. Trained professionals currently compute IDR amounts inaccurately with astonishing frequency and one can expect even a higher error rate with untrained employers. This is likely to be a major burden for small business that do not have the financial resources to hire outside companies to calculate the withholding for them.

Additionally, given the amount of personal data required to administer the student loan repayment system, employees may be vulnerable to employment discrimination and employers vulnerable to discrimination lawsuits.

Conclusion

With 1 in 5 borrowers currently in default on their student loans, big changes are needed to help borrowers get the relief they need. Income-driven repayment plans help, but the system is too complicated and bureaucratic challenges too often lead borrowers to default. However, a mandatory payroll withholding system does not meet that need and will only make matters worse.

Payroll withholding forces families to prioritize student loan debt above basic necessities for their families and fails to ensure that payment amounts are affordable for all families. Any withholding formula will also fail to take into consideration the unique circumstances of the millions of affected families, including fluctuating incomes and unusual or individualized expenses. The mandatory nature of the withholding can lead to tragic consequences for families with non-standard situations.

Proponents of payroll withholding claim that measures can be taken to help borrowers in extreme situations. However, these measures actually *increase* the complexity and lack of basic privacy of the repayment system, thus undermining the ultimate goal of simplification. Even worse, it defeats the purpose of implementing a payroll withholding system.

For more information, contact the National Consumer Law Center, 617-542-8010.

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1. See e.g. Senator Lamar Alexander, Address at the American Enterprise Institute Higher Education Event (Feb. 4, 2019).
2. Kristen Blagg, Brookings Institute, The need for clear-eyed policymaking on student loan defaults, (Aug. 10, 2018.
3. Senator Lamar Alexander, Address at the American Enterprise Institute Higher Education Event (Feb. 4, 2019).
4. Consumer Financial Protection Bureau, *Student Loan Servicing* (Sept. 2015).
5. J. Morduch and R. Schneider, *Financial Diaries: How American Families Cope in a World of Uncertainty* (2017).
6. Bureau of Labor Statistics, Overview of BLS Wage Data by Area and Occupation (last modified Feb. 28, 2017).
7. Internal Revenue Service, Collection Financial Standards (eff. Mar. 26, 2018).
8. The Revised Pay as You Earn repayment plan requires borrowers to pay 10 percent of their adjusted gross income above 150 percent of federal poverty for the borrower's family size. 34 C.F.R. § 685,209(c). The example given in Sen. Alexander's proposal appears to have used the REPAYE formula to calculate the mandatory employer withholding amount.
9. See e.g., Susan Dynarski and Daniel Kreisman, *The Hamilton Project, Loans for Education Opportunity: Making Borrowing Work for Today's Students* (Oct. 2013).
10. Consumer Financial Protection Bureau, Office for Older Americans & Office for Students and Young Consumers, Snapshot of Older Consumers and Student Loan Debt (Jan. 2017).
11. See e.g., Helaine Olen, How Australia Gets Student Loans Right, *Slate* (Nov. 12, 2015).
12. National Consumer Law Center, Student Loan Law § 3.3 (5th ed. 2015), updated at www.nclc.org/library.
13. ADP, Garnishment: The Untold Story (2014).