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Income Contingent Repayment Plans, Part 1

When you pay off your student loans based on the income contingent repayment plan, your monthly payments are based strictly on your income and the amount of debt you had. Your monthly payments also fluctuate annually as your income changes. Income contingent plans let you take as long as 25 years. And these loans feature a unique characteristic not found in any of the other loan programs: after 25 years worth of payments, whatever you owe is written off—you don't have to pay it!

That may sound like a great deal. And perhaps it could be—if the law concerning student loans gets changed in the future. For now, however, under current regulations, any amount of your student loan debt that gets written off by the government after your 25-year repayment is considered taxable income to you. So you could be 55 or 60 years old, expecting to finally be rid of your college debt burden, when the government has one last nasty financial surprise in store for you. Imagine what a shock that must be to some people who actually pay their loans for decades and then get hit with taxes on the written-off portion of their student loans!

With an income contingent plan, you must make payments of at least $5 a month. Because of how interest is treated within income contingent repayment plans, experts say you should not prepay these loans, unlike the other three types of student loan repayment programs. If you'd like to move from one plan to another, you're allowed to swap out of repayment plan once a year, provided the maximum loan term for the new plan is longer than the amount of time your loans have already been in repayment. For example, let's say you signed up long ago for a 30-year extended payment plan, and now you're in year 27 of the plan. You can't switch into the 25-year income contingent repayment plan and have the remaining balance written off. The government won't fall for that.

Income contingent payment plans are appropriate if you have seasonal work, income that varies wildly from time to time, or if you work on commissions that can be difficult to predict. By using an income-sensitive plan, you'll be protected from any downturns in your financial life if you or your business isn't earning as much money as you'd hoped.

Because this method of repayment is based on your income—no matter how small it might be—the positive part of this program is that you should always be able to afford your student loan bills. The downside to this repayment plan, though, is that if you have a really good year or some really high-earning months, your student loans will likely take a chunk out of money you'd probably like to use or enjoy in some other fashion.