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Student Loan Repayment and Wage Withholding
Employer Reporting Burden

Set reader up
- Summary

Department of Education

Characteristics

- Withholding program similar to a savings bond campaign or employer charitable contribution program.
- Soft compliance
  - Education first contacts borrowers if either a nonpayment or underpayment is detected.
  - Borrower attempts to resolve issues with employers before involving Education.
- Program requires minimal reporting by employers

Burden Estimation Methodology

- Two-part estimate
  - Fixed Costs: The monthly cost to an employer who withholds student loan payments from employee's payroll and remits the amount to Education. This cost represents the system maintenance (updating of records and other changes to the system) and the cost of recordkeeping. *Based on the number of firms participating*
  - Variable Costs: The transaction cost (on a per employee basis) of actually withholding, reporting and remitting payments to the Department of Education. *Based on the number of borrowers who elect to repay through wage withholding.*
- Unit costs between mandatory and voluntary withholding programs are identical. could voluntary be cheaper?
- The differences in employer burden between mandatory and voluntary withholding stem from the number of firms offering withholding and the number of borrowers participating (Mandatory is the extreme version of voluntary).

Data

- Payroll Frequency Distribution
  - Biweekly (36.3%), Weekly (31.5%), Bimonthly (25.2%), Monthly (7.0%)
- Monthly fixed costs: \$42.00 *based on data pertaining to administrative wage garnishment*
- Variable costs: \$2.50 per individual transaction (Note: the transaction fees vary according to state. The maximum fee allowed is \$5.00 per transaction)
- *Source: Automatic Data Processing, Inc.* based on discussion w/ payroll associations

Assumptions:

- While a total of 20 million loans are in repayment, ~~only~~ 6 million loans being repaid through wage withholding (represents a steady state condition)
- 4 million employers affected by mandatory, while 2 million participate under a voluntary

same # of owns?

Burden under a Voluntary Withholding Program Administered By Education

<u>Fixed Costs</u>

- Based on the recordkeeping required by employers
  2 million x $42.00 x 12 = $1,008 million

<u>Variable Costs</u>

- Total Transactions per year: 196 million (from above)

(3) Transaction Costs
196 million x $2.5 = $490.6 million

<u>Total Burden = Fixed Costs + Variable Costs</u>
$1,008 million + $490.6 = **$1,498.6 million per year**

Burden under a Mandatory Withholding Program Administered by Education

<u>Fixed Costs</u>

- Based on the recordkeeping required by employers--
  4 million x $42.00 x 12 = $2,016 million

<u>Variable Costs</u>

(1) Total Transactions per year (based on the number of employees participating)
Biweekly: 6 million x .363 x 26 = 56.63 million
Weekly: 6 million x .315 x 52 = 98.28 million
Bimonthly: 6 million x .252 x 24 = 36.29 million
Monthly: 6 million x .07 x 12 = 5.04 million
Total Transactions per year: 196 million

(2) Transaction Costs
196 million x $2.5 = $490.6 million

<u>Total Burden = Fixed Costs + Variable Costs</u>

- $2,016 million + $490.6 = **$2,506.6 million per year**

Per Firm

	Fixed Costs	Variable Costs	Total Cost
Voluntary			
Mandatory			

Analysis of Burden

- Firms withholding for student loans face high fixed costs of $504 per year.
- Under the Mandatory Withholding Program, the average cost per firm is $626.65 per year (or $52.22 per month), representing only a slight increase over the fixed cost.

Sensitivity Analysis

- Exempt firms with fewer than 50 employees from a mandated program
- assume full participation by the remaining firms (Approximately 174,000)
- 6 million loans repaid through wage withholding
- Total Burden of $578.6 million (Fixed Costs= $88 M, Variable costs=$490.6 M)
- Average Burden per loan: $96.5--Average burden per firm: $3,325

Internal Revenue Service

Characteristics

- Withholding program separate from the tax program, but with similar characteristics in terms of the reporting requirements
- Hard compliance
  - The IRS would contact the employer if nonpayment or underpayment is detected
  - Employers would be required to keep and submit detailed records with each transaction
  - The IRS would only contact the borrower if the employer demonstrated that the borrower did not specify enough withholding to cover the liability
- Program requires stringent reporting by employers

Burden Estimation Methodology

- Two-part estimate
  - Recordkeeping Burden:
    - The cost of identifying, annotating, or creating records specifically for student loan withholding.
    - Maintaining files of student loan withholdings
    - Setting up or revising the accounting system to withhold, remit, and report to the IRS specifically for student loans payments withheld.
  - Reporting Burden
    - The cost of completing the necessary forms and schedules necessary or massaging data into the required format for electronic submission to report the withholding of student loan payments
    - Reconciling accounts (not loan accounts, but the business' accounts)
    - Reading and understanding the instructions and regulations regarding student loan withholding and reporting
    - Verifying and correcting information
    - Certify the withholding report to the IRS, maintaining a record of the withholding

Data:

- Recordkeeping burden: 1 hour per form (represents the increase in recordkeeping attributed to student loans)
- Reporting Burden
  - Form 941 Burden (Employers' Quarterly Filing): 4.36 hours per form
  - Form 8109 Burden (Federal Tax Deposit): .04 hours per form
  - Total Reporting Burden: 4.4 hours per form
- *Source: Internal Revenue Service: Burden Estimation Models used for the Information Collection Budget - Data was adjusted downwards to account for the fact that student loans represents a marginal increase in the recordkeeping and reporting by a firm.*

Assumptions:
- Employers file student loan deposits on average of 18 times per year
- $10 per hour labor charge for converting hours to dollars
- 20 million loans in repayment, 6 million loans being repaid through wage withholding
- Under a mandatory program, all employers would be required to periodically report student loan withholdings (even if no employees had student loans) in order to ensure compliance with the requirement
- Under the voluntary program, only 2 million employers would elect to participate
- Approximately 6 million employers

Burden under a Voluntary Withholding System Administered by the IRS

<u>Recordkeeping Burden (Function of the number of employers and frequency)</u>
2 million x 1 hour x 18 = 36 million hours

<u>Reporting Burden</u>
2 million x 4.4 hours x 18 = 158.4 million hours

<u>Total Burden</u>
(1) 36 million + 158.4 million = 194.4 million hours

(2) 194.4 million hours x $10/hour – **$1,944 million**

Burden under a Mandatory Withholding Program Administered by the IRS

<u>Recordkeeping Burden (function of the number of employers and frequency)</u>
6 million x 18 x 1 hour = 108 million hours

<u>Reporting Burden</u>
6 million x 4.4 hours x 18 = 475.2 million hours

<u>Total Burden</u>
(1) 108 million + 475.2 million = 583.2 million hours

(2) 583.2 million hours x $10/hour = **$5,832 million**

Analysis of Burden
- This burden estimation methodology is inelastic with respect to the number of borrowers because the reporting data from which these estimates are derived represent the average time per firm--it doesn't matter whether the firm has 1 employee or 100,000 employees.
- Under the mandatory program, the high burden per loan ($967) represents the fact that all firms would be required to report student loan withholdings. Therefore, the average cost is pushed up to take into account that firms would be required to report to the IRS even though they did not have to withhold for student loans.

Develop alternative methodologies -- Methodology #2

Perhaps this could be called the "common sense option". We estimated that of the pool of x million borrowers that only y would actually participate in the program to do Z. We assumed a simple once a month option, letter and stamp cost of M. This is step 1. This is step 2. Here is the conclusion. Here is how we would analyze it. The kinds of conclusions that can be drawn from this option are N. Here is a unusual property of this model O.

Develop alternative methodologies -- Methodology #3

Develop a third approach here and explain it in the same way as before. Full disclosure, self sufficient explanations in all cases.

Try radical assumption. For example, half of businesses opt in to the program. Provide a range of costs.

Analyze and explain the Mandatory DoE option

Here is how this option works.

First, DoE contracts with a private company to do the following things.

Second, borrower gets a loan.

Third, this is what happens as a consequence.

Fourth, once repayment begins, this is what happens.

Fifth, under this scenario, a borrower would go to their employer and request X.

Sixth, the employer would then wire DoE funds for loan repayment on a monthly basis.

The costs associated with this option are:

Business

Government

Political

Convenience

Legislation required?

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Student Loan Repayment Through Wage Withholding

Option to implement the President's Vision Using Mandatory Wage Withholding Administered by the Department of Education

- Note: A voluntary system using wage withholding administered by Education would operate in the same manner as the mandatory system.

- Builds on the widespread existing system of the employer effecting voluntary deductions from wages, such as deductions for charitable contributions, for 401(k)-type retirement programs, or for savings and savings bond programs.

- Utilizes the Education loan collection apparatus already in place.

- Is borrower focused, meaning that the amount withheld and reconciliation of amounts withheld are the responsibility of the borrower in communication with the Department of Education, similar to other borrower initiated wage deductions.

- A borrower focused system eases employer compliance, since ED would not require employer reports to demonstrate the status of revenue collections. Borrowers, notified of missing payments, would be an automatic compliance check.

- **Mechanics of the process:**

    - Education's contracted loan servicer (servicer) would furnish employers a description of the wage withholding program and all information necessary to make deductions and forward payments to the servicer.

    - The servicer would provide all student loan borrowers information regarding repayment options, including repayment methods, payment plans, and the amount of the monthly payment based on their choice of payment plan and other factors.

    - The borrower would notify his/her employer how much to withhold on a monthly basis, then the employer would begin salary deductions and forward payments monthly via EFT or check (can be a batch payment with individual breakout) to an address furnished to the borrower by the servicer.

    - The servicer would provide borrowers with periodic statements of the amounts received and the status of the account so the borrower could notify the employer and/or the servicer of any discrepancies.

    - Education would set up appropriate internal controls to identify missing payments and ensure employer and borrower compliance.

- The borrower would be relieved of all liability for payments withheld by the employer that were not forwarded to Education.

- **Costs:**

  - Monetary cost to employers using the wage garnishment model is estimated at $2.5 billion pcr year.

  - Using the ED system, data processing costs are relatively inexpensive, even if mandated. However, other significant costs occur due to back end transactions: coordination between payroll and personnel management; keeping and maintaining records; setting up and revising accounting system changes; resolving reconciliation problems; and fees for legal and professional advice.

  - The method should not involve significant government administrative costs but would require additional oversight related to employer compliance.

  - Political costs are significant, with the principal one being the cost burden placed on employers, especially small businesses. Payroll associations report widespread dissatisfaction with the increased number of government mandated wage withholdings and the complexity involved.

  - A second political cost is perceptions of federal intrusion that accompany a federal mandate. Employers perceive a mandate quite differently than an invitation to offer the same thing under the umbrella of an employee benefit.

  - A borrower focused wage withholding system administered by Education affords maximum convenience to the borrower, employer and the government and uses systems and technology already in place.

  - Legislation is required to mandate employers to withhold for student loan payments when requested by an employee.

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Describe split servicing between IRS and DoE

This is what would be required for split servicing, an option considered as Option X during the task force deliberations.

This is how it would work.

Advantages

Disadvantages

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Option to implement the President's Vision
Through Split Loan Servicing

- Borrowers can repay their loans according to 5 repayment plans: standard repayment plan (fixed payments for 10 years); extended repayment plan (fixed payments for 12 to 30 years depending on amount borrowed); graduated repayment plan (increasing payment amounts for 12 to 30 years depending on the amount borrowed); income contingent (varying payments for up to 25 years depending on amount of income, with forgiveness of balance at 26th year); alternative plan (unspecified conditions to meet special circumstances).

- For those borrowers who chose the income contingent repayment plan, IRS would collect loan payments on Education's behalf through additional tax withholdings specified by the borrower. Education would service all loans and collect loans under other repayment plans directly through (a) contracted servicer(s).

- Borrowers would reconcile tax withholdings between student loan and income tax liabilities on their income tax returns, and remit any differences, then IRS would remit collected amounts to Education's servicer.

- **Advantages:**

  - The borrower has the benefits of automatic wage withholding and loan payments with little or no inconvenience to the employer.

  - This method builds on an existing framework that all employers and employees are required to use.

  - The employer has no significant additional cost or administrative burden.

  - IRS could administer the system with little change in its present structure and could use the existing structure to respond to employer concerns and to enforce employer and borrower compliance provisions.

  - Although legislation would be required, the system could be effected soon after enactment.

- **Disadvantages**

  - Borrower focus groups and student associations have expressed clear opposition to IRS involvement in loan collections.

  - Results in critical disparities in treatment between income contingent loan borrowers, other direct loan borrowers and guaranteed student loan borrowers that would be capitalized upon by banks and guaranty agencies to discourage participation in the direct loan program, such as:

- Borrowers enduring significant income loss (unemployment, job change, child birth) would have an 18 month lag until prior loan payments could be adjusted against current loan repayment obligations. All borrowers would have to endure the inconvenience of later reconciliations when switching plans.

- Loan repayment shortfalls would be treated as tax liabilities subject to all the IRS collection tools.

- Borrowers would not be able to easily monitor the effect of monthly payments on principle reduction, which information might prompt them to change to more advantageous payment plans.

- Seriously hampers the ability of Education (and IRS) to reconcile payments with liabilities due to an 18 month lag in receiving payment information and need to segregate student loan payments from universe of tax receipts.

- Education would not be able to comply with financial management requirements specified in the Credit Reform Act of 1990 or the Chief Financial Officer's Act of 1990 because of the 18 month lag.

- Critics and analysts have pointed out repeatedly that to prevent fraud and abuse, Education needs access to real time data for efficiency in loan servicing, monitoring of school performance, budget forecasting, and financial management purposes.

- IRS involvement in collection activities not related to tax collection has resulted in a decline in voluntary tax compliance.

- IRS has not established a good record in collecting the relatively small debts represented by Education loans.

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Compare service delivery advantages and disadvantages between IRS and DoE

For example:

IRS has the following record on compliance and experience working with a large base of payers. They have an existing system which is national in scope, in place, feared but honest, and expert in the collection and service areas.

IRS has the following disadvantages as a service provider:

Overburdened
In the middle of a major reorganization.

DoE, on the other hand, has the following strengths...

... and the following weaknesses.

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Service Delivery Advantages and Disadvantages: IRS vs ED

- **IRS Advantages**
  - The payroll deductions are automatic from the borrower's perspective and pose nearly no additional burden from the employer's perspective.
- **IRS Disadvantages**
  - Student loan borrowers do not want IRS involvement in loan collections.
  - Borrowers would be limited to wage withholding under the income contingent repayment plan even if other plans were more advantageous.
  - Unless IRS set up a customer service operation, IRS could not provide the borrower with advice and counsel, the key aspect of service.
  - Borrowers could not monitor payments on an ongoing basis and evaluate the effects of payments on interest and principle until well over a year passed.
  - Reconciliation of taxpayer accounts by taxpayers to segregate tax and student loan liabilities is certain to cause the borrower frustration, especially in the event of shortfalls, when the shortfall becomes a tax liability subject to imposing tax collection rules.
  - Reconciliation of payment data between IRS and Education, coupled with a large lag time, is certain to delay accurate postings to many student accounts.
- **ED Advantages**
  - The borrower could use wage withholding to repay loans under the most advantageous loan repayment plan, not only the income contingent plan.
  - The borrower's payments would be made automatically, but the borrower would have the advantage of following his/her account balance and monitoring the effect of payments on principal and interest.
  - From the student's perspective, ED is perceived as consumer oriented and customer friendly.
  - ED can provide one-stop shopping. ED would be accountable for customer service for all aspects of student financial assistance administration and ED will be able to control the outcomes.
  - ED would be able to provide the borrower more relief in the event of a loan repayment shortfall than would be available to the borrower incurring a tax

liability.

- Because there are necessary linkages between aspects of program administration and subsequent loan service and collection, customer service would be strengthened if responsibilities for it are carried out by a single agency.

- With its close relationship to the schools and the continuous relationship it establishes with the students beginning in the earliest stages of the loan cycle, together with its familiarity with the programs it administers, ED is in the best position to advise a student on loan repayment throughout the repayment process.

- In general, withholding the payments and forwarding them to ED would be no more difficult than the common practice of withholding charity contributions or payments to a credit union, which is not possible with an IRS tax based system.

- The Department of Education has developed the infrastructure necessary to administer a centralized loan program that includes wage withholding as an option.

- Through its experience with the guaranteed loan program and the Perkins Student Loan program, ED has gained the institutional knowledge that would permit effective administration, with servicers to provide state of the art operational capability.

- **ED Disadvantages**

  - In terms of service delivery, there are no disadvantages to using ED as the primary servicer.

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Develop a blend of carrot and stick options for the DoE mandatory and voluntary options

Mandatory

With respect to DoE,

Voluntary

Carrot and stick options for ED mandatory and voluntary options

- **Mandatory option carrots**
  - Excluding employers with fewer than 10 employees from the requirement would exempt over 75 percent of the employers but reach about 85 percent of the employees.
  - Reimburse employers for all or a portion of costs. Note: (Reimbursements would increase administrative burden considerably because of unavoidable government accountability standards. In addition to the budget impact, increasing direct loan program expenses has a high political cost).
- **Mandatory option sticks**
  - Obtain legislation providing for civil penalties for non-compliance.
- **Voluntary option carrots**
  - About 80 percent of the employees in the U.S. are employed by businesses that participate in the savings bond program. Interest level in wage withholding to repay student loans should be higher than interest in savings bond participation, which would increase demands on employers.
  - In terms of number of employees, only the top 25 percent of the employers have to participate to afford wage withholding to 85 percent of the employees.
  - Employers could be offered cash incentives to cover expenses (Note: subject to the cautions cited under mandatory carrots.)
  - Using a wage withholding system based on the model of voluntary deductions from salary as an employee benefit.
  - Initiate public service advertising campaign, utilizing trade and payroll providers and associations, to promote wage withholding as a public service and employee benefit.
  - Prepare instructional and software packages to assist employers in effecting the option.
  - Enlist payroll servicers, such as ADP, to assist ED in developing the operational aspects of the voluntary option as a simple and inexpensive service.
- **Voluntary option sticks** are not necessary.

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Develop a meno of options from the student's perspective

Show the effects of major options on students "choice set".

Wage Withholding from the Student's Perspective

- Initially and at intervals, all borrowers will be thoroughly advised about repayment options and plans. They will be specifically advised that some plans are preferable to others in terms of interest savings through more rapid principle reduction. For many borrowers, the income contingent repayment plan may not be the best choice.

- A voluntary or mandatory system of wage withholding as an automatic monthly loan repayment method, whether administered by ED or IRS, produces the same results from the borrower's perspective.

- A borrower would choose the ED administered system over the IRS system, because the IRS system limits the borrower to the income contingent repayment plan, which may not be the preferable choice for reducing interest payments.

- Borrowers would feel burdened using the IRS tax system, when tax returns were filed. Psychologically, they would be confronted with perceptibly large tax deductions. In addition, they may be confronted by unanticipated underpayments.

- Borrowers using the IRS tax system, who encountered problems, would have to coordinate between IRS and ED, both of which may not be coordinated with the other because of the volume of filers at tax time, but especially because of the 18 month information lag. Borrowers would be very frustrated.

- A borrower using the ED administered system would receive periodic updates, at least quarterly, on the status of his/her account, including interest and principle.

- With current account information and only one point of contact, borrowers under an ED administered system would be able to easily change payment plans, yet continue to use wage withholding.

- Borrowers under an ED administered plan could easily stop wage withholding without enduring later reconciliations.

- Under the ED administered system, a borrower/employee could have all of the benefits of wage withholding, without dealing with the bureaucracy of the employer's personnel office, by authorizing the employer to pay salary through electronic funds transfer to the employee's bank account and authorizing the bank to transfer funds to an ED account. ADP advises that a large percentage of businesses use electronic funds transfers to pay employee salaries.

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STUDENT LOAN REPAYMENT AND WAGE WITHHOLDING EMPLOYER REPORTING BURDEN

	ED VOLUNTARY	ED MANDATORY	IRS VOLUNTARY	IRS MANDATORY
RECORD KEEPING	**$42.00 MONTHLY FIXED COST PER EMPLOYER** 2 million employers x $42 x 12 months = **$1,008 million cost**	**$42.00 MONTHLY FIXED COST PER EMPLOYER** 4 million employers x $42 x 12 months = **$2,016 million cost**	**1 EXTRA HOUR PER FORM** 2 million x 1 hr x 18 deposits = 36 million extra hours = **$360 million cost**	**1 EXTRA HOUR PER FORM** 6 million x 1 hr x 18 deposits = 108 million extra hour = **$1,080 million cost**
TRANSACTION COSTS	**$2.50 PER TRANSACTION** 196 million transactions x $2.5 = **$4,906 million**	**$2.50 PER TRANSACTION** 196 million transactions x $2.5 = **$4,906 million**	**N/A** IRS is already processing tax forms	**N/A** IRS is already processing tax forms
REPORTING BURDEN	N/A	N/A	**4.4 HOURS** 2 million x 4.4 hours x 18 deposits = **1,584 million hours**	**4.4 HOURS** 6 million x 4.4 hours x 18 deposits = **1,584 million hours**
TOTAL BURDEN	**$1,498.6 MILLION PER YEAR** $1,008 million + $490.6 = $1,498.6 million	**$2,506.6 MILLION PER YEAR** $2,016 million + $490.6 = $2,506.6 million	**$1,944 MILLION** 36 million + 158.4 million = 194.4 million x $10/hour = 1,944 million	**$5,832 MILLION** 108 million + 475.2 million = 583.2 million x $10/hour = $5,832 million

STUDENT LOAN REPAYMENT AND WAGE WITHHOLDING EMPLOYER REPORTING BURDEN

	ED VOLUNTARY	ED MANDATORY	IRS VOLUNTARY	IRS MANDATORY
RECORD KEEPING	**$42.00 MONTHLY FIXED COST PER EMPLOYER** 2 million employers x $42 x 12 months = **$1,008 Billion cost**	**$42.00 MONTHLY FIXED COST PER EMPLOYER** 4 million employers x $42 x 12 months = **$2,016 Billion cost**	**1 EXTRA HOUR PER FORM** 2 million x 1 hr x 18 deposits = 36 million extra hours = **$360 million cost**	**1 EXTRA HOUR PER FORM** 6 million x 1 hr x 18 deposits = 108 million extra hour = **$1,080 Billion cost**
TRANSACTION COSTS	**$2.50 PER TRANSACTION** 196 million transactions x $2.5 = **$490.6 million**	**$2.50 PER TRANSACTION** 196 million transactions x $2.5 = **$490.6 million**	**N/A** IRS is already processing tax forms	**N/A** IRS is already processing tax forms
REPORTING BURDEN	**N/A**	**N/A**	**4.4 HOURS** 2 million x 4.4 hours x 18 deposits x $10/hr = **$1.584 Billion**	**4.4 HOURS** 2 million x 4.4 hours x 18 deposits x $10/hr = **$~~1.584~~ Billion**
TOTAL BURDEN	**$1,498.6 BILLION PER YEAR** $1,008 million + $490.6 = $1,498.6 million	**$2,506.6 BILLION PER YEAR** $2,016 million + $490.6 = $2,506.6 million	**$1,944 BILLION** 36 million + 158.4 million = 194.4 million x $10/hour = 1,944 million	**$5,832 BILLION** 108 million + 475.2 million = 583.2 million x $10/hour = $5,832 million

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The Economy Under President Clinton:

The First Twenty Months

October 7, 1994

STUDENT LOAN REPAYMENT AND WAGE WITHHOLDING COMPLIANCE COSTS

	ED VOLUNTARY[1]	ED MANDATORY[2]	IRS VOLUNTARY[1]	IRS MANDATORY[2]
FIXED COSTS	138 thousand employers x $42 x 12 months= $70 million	822 thousand employers x $42 x 12 months = $415 million	138 thousand x 1 hour x 18 deposits x $10/hr. = $25 million	822 thousand x 1 hour x 18 deposits x $10/hr. = $148 million
TRANSACTION COSTS	65 million transactions x $2.5 = $165 million	144 million transactions x $2.5 = $360 million	N/A IRS is already processing tax forms	N/A IRS is already processing tax forms
WITHHOLDING REPORTING COSTS	N/A	N/A	(138 thousand * 4.4 + 5.9 million * .04) * 18 * $10 = $153 million	(822 thousand * 4.4 + 5.2 million * .04) * 18 * $10 = $687 million
TOTAL COSTS	$235 million ($118 per borrower)	$775 million ($176 per borrower)	$178 million ($89 per borrower)	$835 million ($190 per borrower)

[1]Assumes 2 million employees working in 138 thousand firms use withholding.

[2]Assumes 4.4 million employees working in 822 thousand firms use withholding; firms with fewer than 20 employees exempt from mandate.