

TEB Phase II - Lesson 9

IRC § 144(b) – Qualified Student Loan Bonds

IRC § 150(d) – Qualified Scholarship Funding Bonds

Overview

Introduction Lesson 9 continues the discussion of qualified private activity bonds by focusing on qualified student loan and scholarship funding bonds.

Objectives At the end of this lesson, you will be able to:

- Define a qualified student loan bond
- Explain the special arbitrage rules governing issues financing student loans
- Define qualified scholarship funding bonds
- Explain the significance of the Health Care and Education Reconciliation Act of 2010, Title II, Subtitle A, Part II, with respect to student loan bonds and qualified scholarship funding bonds

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Qualified Student Loan Bonds

Use of Proceeds Section 144(b)(1) provides that a qualified student loan bond means any bond if:

- 90 percent or more of the net proceeds of the issue are to be used directly or indirectly to make or finance student loans under the Guaranteed Student Loan program or Parents Loans for Undergraduate Students program under the *Higher Education Act of 1965*. This loan program is known as the Federal Family Education Loan Program (FFELP), under which education loans are indirectly federally guaranteed loans. **Note:** This program was discontinued for loans originated after June 30, 2010 (see “Sunset” section below). (See § 144(b)(1)(A).)

OR

- 95 percent or more of the net proceeds of the issue of which are to be used directly or indirectly to make or finance student loans under a program of general application approved by the state, as long as, the loan does not exceed the difference between the total cost of attendance and other forms of student assistance for which the student may be eligible. (See § 144(b)(1)(B).)

Eligible Borrowers

For purposes of § 144(b)(1)(B), an eligible borrower of an original loan is a student (with or without a co-obligor or guarantor) or a parent (with or without a co-obligor or guarantor) borrowing for the benefit of a child who is a student. An eligible borrower of a refinancing loan under § 144(b)(1)(B) is the student or parent borrower of the original loan. (See Notice 2015-78.)

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Qualified Student Loan Bonds, Continued

**State Residency
(Student Nexus
Requirement)**

According to § 144(b)(3), for the loan to be qualified under § 144(b)(1), the student must have a nexus to the state. This is known as the student nexus requirement. Section § 144(b)(3) specifies that either the student must be:

- A resident of the state from which the volume cap allocation for the related qualified student loan bonds was derived,

OR

- Enrolled at an educational institution located in such state.

To clarify the application of this requirement, additional guidance is provided in Notice 2015-78.

The student nexus requirement applies to the student beneficiary of the loan, even if the borrower is the parent of the student beneficiary.

An original loan meets the student nexus requirement if, at the time the original loan is originated, the student beneficiary is a resident of the state from which the volume cap for the qualified student loan bonds that finance the original loan is derived or is enrolled at an educational institution located in that state.

A refinancing loan meets the student nexus requirement if: (1) at the time the original loan was originated, the student beneficiary was a resident of the state from which the volume cap for the qualified student loan bonds that finance the refinancing loan is derived or was enrolled at an educational institution located in that state; or (2) at the time the refinancing loan is originated, the student beneficiary of the original loan resides in the state from which the volume cap for the qualified student loan bonds that finance the refinancing loan is derived or is a student enrolled in an educational institution located in that state.

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Qualified Student Loan Bonds, Continued

State Residency (Student Nexus Requirement)
(continued) In the case of refunding bonds for which no volume cap is required under § 146, the student nexus requirement is applied with respect to the State from which the volume cap on the refunded bonds (or in a series of refundings, the original bonds) was derived. (See Notice 2015-78.)

Non-discrimination Proceeds of bonds issued under § 144(b)(1)(A) may not be used to finance loans under a program which discriminates on the basis of the location of the educational institution in which the student is enrolled.

Arbitrage Rules

Temporary Period

Section 148(c)(2)(A) provides that proceeds of an issue that are to be used to finance student loans under § 144(b)(1)(A) may be invested without regard to yield restriction for an initial temporary period equal to 6 months. (See also Regulation § 1.148-2(e)(4)(i).) For bonds issued prior to January 1, 1989, this temporary period was 18 months.

Any proceeds received as a result of a repayment of a loan may be invested without regard to yield restriction for a temporary period equal to 3 months. *See § 148(c)(2)(B) and Regulation § 1.148-2(e)(4)(ii).*

Yield on the Student Loans

The yield on the student loans that are considered program investments may not exceed 2 percentage points over the yield on the related issue of bonds. The loan yield is measured in the aggregate for all loans allocable to a single bond issue, not for individual loans. *See Regulation § 1.148-2(d)(2)(iv) and § 1.148-5(b)(2)(i).* For a definition of program investment, see Phase II, Lesson 2 and Regulation § 1.148-1(b).

Note

There are other arbitrage and rebate rules applicable to qualified student loan bonds that are described in Phase I, Lesson 5.

Announcement 2012-14 (Qualified SLB VCAP program)

In 2012, the IRS issued Announcement 2012-14, which set forth terms under which an issuer of qualified student loan bonds could enter into a voluntary closing agreement to resolve certain issues regarding actions relating to the allocation of student loans.

As described in the announcement, some issuers of qualified student loan bonds allocated original student loans made or acquired with gross proceeds of an issue of bonds, and subsequently reallocated the original student loans to other bond issues. These subsequent reallocations were made for reasons other than a refunding, the universal cap rule, or the sale, discharge, or other actual disposition of the original student loans, and as such, were not permissible. *See Regulation § 1.148-6(d)(2)(iii).*

As a result of these impermissible reallocations, the issuers were not able to establish the bond issues to which the original student loans were properly allocable as purpose investments. As a result, the issuers could not establish that the bonds were not arbitrage bonds.

Qualified Scholarship Funding Bonds

Definition

Section 150(d) provides that a qualified scholarship funding bond is a bond issued by a corporation which is:

- (i) a not-for-profit corporation established and operated exclusively for the purpose of acquiring student loans incurred under the *Higher Education Act of 1965*, and
- (ii) organized at the request of a state or political subdivision of the state.

The corporation should be required by its organizational documents or by state law to devote any income to the purchase of additional student loans or to pay over its income to the United States.

A qualified scholarship funding bond must also qualify under § 144(b) as a qualified student loan bond.

Treated as State or Local Bond

A bond issued by a corporation described above is treated as a state or local bond.

Loan Origination Services

The corporation described above must be operated exclusively for acquiring student loans.

- In PLR 9407016, a corporation which provided *loan origination* services and loan servicing services in its operations, was not described in § 150(d) because it performed loan origination services.
 - However, in PLR 9126019, a corporation was permitted to provide *loan-servicing* services.
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Sunset of Guaranteed Student Loans

Health Care and Education Reconciliation Act of 2010

Part II of Subtitle A of Title II of the Health Care and Education Reconciliation Act of 2010 terminated the guaranteed student loan program effective June 30, 2010. After that date no loan may be made or guaranteed in connection with a program of general application to which the Higher Education Act of 1965 applied, under which education loans are indirectly federally guaranteed (FFELP) loans. The FFELP loans eligible for tax-exempt financing under § 144(b)(1)(A) include, among other types of loans, loans made to parents of undergraduate students under the program known as the “PLUS” loan program.

§144(b)(1)(A) is obsolete

Although § 144(b)(1)(A) was not repealed, its provisions have been rendered obsolete because no loans described therein may be made after June 30, 2010.

§144(b)(1)(B) survives with limited application

Pursuant to IRC § 144(b)(1)(B) it is still possible to issue qualified student loan bonds for the purpose of acquiring private, non-federally guaranteed, student loans.

Qualified Scholarship Funding Bonds obsolete

The issuer of a qualified scholarship funding bond must be a corporation established and operated exclusively for the purpose of acquiring student loan notes incurred under the Higher Education Act of 1965. After June 30, 2010 there will be no new loans of that type for such a corporation to acquire and, therefore, no reason to issue bonds. If an existing scholarship funding corporation elects to cease its status as a qualified scholarship funding corporation under § 150(d)(3), such an election does not affect the treatment of interest on previously issued bonds under § 103.

Summary

Review of Lesson 9

Lesson 9 discussed qualified student loan bonds and qualified scholarship funding bonds.

Generally, qualified student loan bonds are bonds where:

- 90 percent or more of the net proceeds are used to finance student loans under one of two programs provided by the *Higher Education Act of 1965*, OR
- 95 percent or more of the net proceeds are used to finance student loans under a program approved by the state.

In addition to the generally applicable arbitrage and rebate rules, special rules also apply to these bonds.

A qualified scholarship funding bond is a bond issued by a corporation which is:

- A not-for-profit corporation established and operated exclusively for the purpose of acquiring student loans incurred under the *Higher Education Act of 1965*, AND
- Organized at the request of a state or political subdivision of the state.

A qualified scholarship fund bond is a private activity bond which must be qualified for interest to be paid on the bond to be excludable from gross income. Therefore, these bonds must also be analyzed under the rules for qualified student loan bonds contained in § 144(b).

Part II of Subtitle A of Title II of the Health Care and Education Reconciliation Act of 2010 terminated the guaranteed student loan (FFELP) program effective June 30, 2010. After that date, no loan may be made or guaranteed in connection with the program of general application to which the Higher Education Act of 1965 applied.

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Summary, Continued

Review of Lesson 10

Lesson 10 introduces qualified tax credit bonds. Qualified tax credit bonds are bonds issued under § 54A that are 1) issued as taxable bonds and provide a credit to the holder of such bond, or 2) issued as taxable bonds and under § 6431(f) elect in lieu of a tax credit a direct pay refundable credit to the issuer of such bonds.

In addition to satisfying certain conditions applicable to tax-exempt bonds, qualified tax credit bonds have their own unique conditions which you will explore in Lesson 10.
