

Bond Case Briefs

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Mintz Levin: Helpful News from IRS on Student Loan Bonds.

On November 13, the IRS issued Notice 2015-78, providing favorable guidance on topics of interest to providers of “supplemental” or “alternative” student loans financed with tax-exempt bonds and to underwriters of such student loan bonds. Such guidance confirms that loans financeable under such programs include (i) parent loans as well as student loans and (ii) loans that refinance or consolidate prior loans that were or could have been financed on a tax-exempt basis.

Tax-exempt bonds used to finance student loans, so-called “qualified student loan bonds,” come in two flavors under the Internal Revenue Code, those issued to finance federally-guaranteed loans made under the Federal Family Education Loan Program (“FFELP”) and those issued to finance certain loans issued under programs created by the states, generally known as “supplemental” or “alternative” loan programs. While the FFELP program, historically much larger, terminated in 2010, tax-exempt financing for new loans under state supplemental programs has continued in approximately fifteen states.

Notice 2015-78 appears to have been prompted by recent efforts by governmental issuers to provide refinancing of student loan debt through non-federally guaranteed “consolidation loans”, which presented questions on which the IRS had not previously provided guidance. The IRS also used the notice as an opportunity to address selected other issues applicable to all tax-exempt financed supplemental loans, not just refinancing loans. The Notice clarifies the following:

Eligible Borrowers. Notwithstanding the widespread practice of making higher education loans to parents, a practice provided for by statute under FFELP through the Parent Loan to Undergraduate Students (PLUS) program, the IRS had expressed concerns in the context of ruling request discussions about whether loans to parents were bond-financeable student loans. Notice 2015-78 clarifies that the student, the parent, or both can be an eligible borrower of a bond-financed “student loan.” The Notice attempts to provide a similar rule for refinancing loans, stating, “An eligible borrower of a refinancing loan ... is the student or parent borrower of the original loan.” In the refinancing loan context the Notice’s particular wording leaves unclear whether if the sole borrower on the original loan was the parent, the sole borrower on the refinancing loan can be the proud young graduate who wishes to take on the debt through a consolidation loan. Such a fact pattern clearly satisfies the policy underlying this otherwise expansively drafted notice.

Nexus to State. The Internal Revenue Code requires the student to be a resident of the state which provides the “volume cap” allocation for the bonds or enrolled at an educational institution in that state. In the case of a refinancing or consolidation loan, there has been some question whether such “nexus” is required to be established at the time the original loan was made or at the time the refinancing loan is made. The Notice provides the broadest rule, stating that a “refinancing loan,” including a loan which allows the borrower to consolidate prior debt, complies with the statutory nexus requirement either if that requirement was satisfied at the time of the original loan or if it is satisfied at the time of the refinancing loan. If reliance is placed on nexus at the time the original loan is made, in the case of a consolidation loan care may need to be exercised to establish nexus for all underlying loans.

Loan Size. The Code limits supplemental loans to “the difference between the total cost of attendance and other forms of student assistance ... for which the student borrower may be eligible.” The “may be eligible” language has resulted in troublesome challenges in IRS audits, where IRS agents have suggested that issuers might be responsible for documenting that students actually had applied for all other potentially available student assistance, or obligated to downsize loans by the amount of other student assistance that was hypothetically available but not received by the student. The Notice confirms that tax-exempt bond issuers may rely on certifications from the student’s school as to total cost of attendance and as to other student assistance. Further, the school may rely on definitions provided under the Higher Education Act, including a definition of “estimated financed assistance” which looks only to assistance the student “will receive.”

Type of Loans Eligible for Refinancing. The Notice states that supplemental student loan bonds can be used to refinance not only original loans which were themselves supplemental loans but also other loans, “for example, a FFELP loan or a student loan made by a private lender, provided that the refinancing loan meets all of the requirements for a State Supplemental Loan.” Although not addressed by the Notice, it should be noted that tax-exempt bonds issued to refinance prior loans, including consolidation of prior loans, generally will require an allocation of state volume cap, which in some states is a scarce commodity. The need for volume cap may be avoided to the extent the refinancing loans made with proceeds of a bond issue refinance loans financed with other tax-exempt bonds issued by the same issuer or a related issuer and the payoffs on the refinanced loans are applied to redeem such other tax-exempt bonds in a manner that qualifies for the volume cap exception for current refunding bonds.

As a general proposition, the national student loan market is growing and dynamic. Notice 2015-78 will assist governmental issuers in fulfilling their intended role.

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The content of this article is intended to provide a general guide to the subject matter. Specialist advice should be sought about your specific circumstances.