Lesson 9

Qualified Student Loan Bonds and Qualified Scholarship Funding Bonds

Overview

Introduction

Lesson 9 continues the text's 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.

Contents

This lesson contains the following topics:

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 a program of general application to which the Higher Education Act of 1965 applies, otherwise known as the Federal Family Education Loan Program (FFELP). This program include Stafford loans (formerly known as Guaranteed Student Loans), Parents Loans for Undergraduate Students (PLUS loans), and consolidation loans. (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).)

State Residency

According to § 144(b)(3), for the loan to be qualified under § 144(b)(1), 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
- the student must be enrolled at an educational institution located in such state

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 after August 15, 1986, and 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 Loan

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. (See Regulation § 1.148-2(d)(2)(iv).) Note, however, a special rule for certain refunding bonds in Regulation § 1.148-11(e). For student loans that are not program investments, the yield on the loans may not exceed one-eight of one percentage point over the yield on the issue. (See Regulation § 1.148-2(d)(2)(i).)

For 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.

Qualified Scholarship Funding Bonds

Definition

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

(i) 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

(ii) is 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 (net of expenses, debt service, and reserves) 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 and Other Services

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

- In PLR 9407016, a corporation proposed to provide *loan origination* services and loan servicing services for loans it would acquire. The PLR concludes that the loan origination services, but not the loan servicing services, would cause the corporation not to be described in § 150(d).

- Similarly, in PLR 9126019, a corporation was permitted to provide *loan-servicing* services for loans it would acquire.

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 FFELP effective June 30, 2010. After that date no new loan may be made or guaranteed under the FFELP.
§144(b)(1)(A) Will Become Obsolete	Although § 144(b)(1)(A) was not repealed, because no loans described therein may be made after June 30, 2010, no "new money" bonds may be issued under this provision after this date, only refunding bonds.
§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 Will Become 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 new money 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 the FFELP, 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
– is organized at the request of a state or political subdivision of the state.

A qualified scholarship funding bond is a private activity bond which must be <u>qualified</u> 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 FFELP effective June 30, 2010. After that date, no new loan may be made or guaranteed in connection with the FFELP.

Preview 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) the issuer elects, in lieu of a tax credit to the holder, to receive a direct pay refundable credit. 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.