



DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D. C. 20224

OFFICE OF THE CHIEF COUNSEL

April 18, 2011

Number: **2011-0053**  
Release Date: 6/24/2011

CC:ITA:B04  
GENIN-149557-10

UIL: 61.00-00, 108.05-00

Attention:

Dear \_\_\_\_\_ :

This letter responds to your request for guidance concerning the tax consequences of loan repayments under the Civil Legal Assistance Attorney Student Loan Repayment Program (CLAARP) authorized by § 428L of the Higher Education Act of 1965 (HEA) as amended. 20 U.S.C. §1078-12. Specifically, you asked whether a borrower may exclude loan forgiveness amounts under CLAARP from gross income under § 108(f) of the Internal Revenue Code.

### HEA Student Loan Programs

The HEA authorizes three student loan programs: (1) the Direct Loan program, (2) the Federal Family Education Loan (FFEL) program, and (3) the Federal Perkins Loan (Perkins Loan) program, to assist students and parents in paying for postsecondary education.

Under the Direct Loan program, the Department of Education (DOED) makes subsidized and unsubsidized loans directly to students (Federal Direct Stafford/Ford Loans) with federal funds under Part D of Title IV of the HEA. 20 U.S.C. §1087a. The Direct Loan program also includes a Federal Direct Consolidation Loan Program under § 455(g) of the HEA (20 U.S.C. §1087e).

Under the FFEL program, private lenders, non-federal entities such as banks, savings and loan associations, credit unions, schools, and state and private nonprofit agencies, make loans with private funds under Part B of Title IV of the HEA. 20 U.S.C. § 1071 et seq. The FFEL program also includes a Federal Direct Consolidation Loan Program under § 428C of the HEA (20 U.S.C. §1078-3). A FFEL is generally insured by a state

or nonprofit private organization loan insurance program.<sup>1</sup> When a loan insurance program pays a lender for a loss due to a borrower's default, the federal government guarantees a percentage of this amount. 20 U.S.C. § 1078(c)(1). This percentage is generally limited to no more than 95 percent for recently issued loans, but it could be as high as 100 percent or as low as 75 percent. 20 U.S.C. § 1078(c)(1).

Under the Perkins Loan program, postsecondary institutions make low-interest loans to financially needy students from a fund capitalized by federal and institutional contributions, in a 3:1 ratio of federal to institutional contributions, under Part E of Title IV of the HEA. 20 U.S.C. § 1087aa. Currently, there is a loan forgiveness provision under the Perkins Loan program for a full-time attorney employed in a defender organization established in accordance with 18 U.S.C. § 3006A(g)(2).<sup>2</sup> 20 U.S.C. § 1087ee(a)(2)(F). Title 20 contains a specific exclusion from income for certain loan forgiveness under the Perkins Loan program. 20 U.S.C. § 1087ee(a)(5).

#### Civil Legal Assistance Attorney Student Loan Repayment Program

Section 428L of the HEA established CLAARP to encourage qualified individuals to enter and continue employment as civil legal assistance attorneys. Civil legal assistance attorneys must be employed, full-time, by either: (1) a nonprofit organization that provides legal assistance, without a fee, on civil matters to low-income individuals; or (2) a protection and advocacy system or client assistance program that provides legal assistance on civil matters to clients, and receives funding under specific Federal programs. Under this program, an eligible student loan borrower with one or more eligible loans may receive up to \$6,000 in student loan repayment for each year of completed service, up to an aggregate total of \$40,000. The program is funded from Congressional appropriations as specified in section 428L(i) of the HEA and is carried out by the Secretary of Education, who assumes "the obligation to repay a student loan, by direct payments on behalf of a borrower to the holder of such loan" for any borrower who meets the requirements of section 428L(c).

Under this program, civil legal assistance attorneys who meet certain requirements may have a portion of their Direct Loans, FFELs and Perkins Loans repaid by DOED after qualifying full-time employment for at least three years. Consolidated loans made by private lenders under § 428C of the HEA (20 U.S.C. §1078-3) or by DOED under § 455(g) of the HEA (20 U.S.C. §1087(e)) to the extent that the Consolidated Loan is used to repay a FFEL or Direct Loan will also qualify for repayment under CLAARP.

#### Tax Consequences of Student Loan Forgiveness under CLAARP

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<sup>1</sup> If the state is not served by a loan insurance program, a FFEL may be insured directly by DOED. Currently, every state is served by a loan insurance program. However, certain federally insured loans remain outstanding.

<sup>2</sup> This provision is in addition to loan repayment provided under CLAARP.

Section 61(a) of the Code provides that, except as otherwise provided in subtitle A, gross income means all income from whatever source derived. Section 61(a)(12) provides that gross income includes income from discharge of indebtedness.

Section 108(f)(1) of the Code provides that gross income does not include any amount that would be includible in gross income by reason of the discharge (in whole or in part) of any student loan if the discharge was pursuant to a provision of a loan under which all or part of the indebtedness of the individual would be discharged if the individual worked for a certain period of time in certain professions for any of a broad class of employers.

Section 108(f)(2) of the Code defines “student loan” as any loan to an individual to assist the individual in attending an educational organization described in § 170(b)(1)(A)(ii) made by

- (A) the United States, or an instrumentality or agency thereof,
- (B) a State, territory, or possession of the United States, or the District of Columbia, or any political subdivision thereof, or
- (C) a public benefit corporation
  - (i) which is exempt from taxation under § 501(c)(3),
  - (ii) which has assumed control over a State, county, or municipal hospital,
 and
  - (iii) whose employees have been deemed to be public employees under State law, or
- (D) any educational organization described in §170(b)(1)(A)(ii) if such loan is made
  - (i) pursuant to an agreement with any entity described in subparagraphs (A), (B), or (C) under which the funds from which the loan was made were provided to such educational organization, or
  - (ii) pursuant to a program of such educational organization which is designed to encourage its students to serve in occupations with unmet needs or in areas with unmet needs and under which the services provided by the students (or former students) are for or under the direction of a governmental unit or an organization described in § 501(c)(3) and exempt from tax under § 501(a).

In the case of a Direct Loan, DOED is the lender, and the loans qualify as “student loans” for purposes of § 108(f)(2)(A) of the Code. Additionally, CLAARP loan forgiveness is conditioned on the borrower working for a certain period of time in qualifying public service positions. Therefore, forgiveness under the Direct Loan program satisfies the requirements of § 108(f)(1), and a Direct Loan borrower may exclude loan forgiveness amounts under CLAARP from gross income under § 108(f)(1).

In the case of a FFEL, the analysis is more complicated because DOED is not the holder of the loan at the time the debt is forgiven. The nominal private financial

institution may not be a lender described in § 108(f)(2)(A) of the Code. However, by statute, DOED ultimately is the source of funds for debt forgiveness through its obligation to guarantee substantially all of the forgiven amount. As guarantor, DOED pays the borrower's debt to the private financial lender and then, in turn, discharges the borrower's debt. As a matter of subrogation, DOED reasonably can be viewed as the lender for purposes of § 108(f)(2)(A). Additionally, as with the Direct Loan program, CLAARP loan forgiveness under the FFEL program is conditioned on the borrower working for a certain period of time in qualifying public service positions. Therefore, loan forgiveness under the FFEL program satisfies the requirements of § 108(f)(1), and a FFEL borrower may exclude loan forgiveness amounts under CLAARP from gross income under § 108(f)(1).

In the case of a Perkins Loan, DOED is the source of 75 percent of the loan fund and is the source of 100 percent of the funds for loan repayment under CLAARP. Thus, the educational organization reasonably can be viewed as a lender described in § 108(f)(2)(D)(i).<sup>3</sup> Additionally, as with the Direct Loan program and the FFEL program, CLAARP loan forgiveness under the Perkins Loan program is conditioned on the borrower working for a certain period of time in qualifying public service positions. Therefore, loan forgiveness under the Perkins Loan program satisfies the requirements of § 108(f)(1), and a Perkins Loan borrower may exclude loan forgiveness amounts under CLAARP from gross income under § 108(f)(1).

This letter calls your attention to certain general principles of the law. It is intended for informational purposes only and does not constitute a ruling. See Rev. Proc. 2011-1, 2011-1 I.R.B. 7, § 2.04. If you have any additional questions, please contact  
of the Office of Associate Chief Counsel (Income Tax & Accounting) on

Sincerely,

Donna J. Welsh  
Senior Technician Reviewer, Branch 4  
(Income Tax & Accounting)

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<sup>3</sup> Only "educational organizations" as defined in § 170(b)(1)(A)(ii) of the Code qualify to make a "student loan" under § 108(f)(2). However, loan forgiveness of student loans made by non-qualifying educational organizations may qualify for an exclusion from gross income under the Perkins Loan program for a full-time attorney employed in a defender organization established in accordance with 18 U.S.C. § 3006A(g)(2). 20 U.S.C. § 1087ee(a)(2)(F).