



February 10, 2015

The Honorable Mark Mazur
Assistant Secretary for Tax Policy
United States Department of Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Dear Assistant Secretary Mazur:

The Education Finance Council (EFC) and the National Council of Higher Education Resources (NCHER) and our member organizations that are state agencies providing student loans under Section 144(b) of the Internal Revenue Code (“Code”) request clarification regarding an interpretation of the Code as it relates to refinancing student loans and making loans to parents using Qualified Student Loan Bonds. These clarifications would significantly ease the student loan burden of students and their parents.

Last year, representatives of one of our common members had discussions with the Internal Revenue Service (“Service”) regarding the member’s education loan program described in Section 144(b)(1)(B) of the Code. Those discussions ultimately led to the issuance of a private letter ruling¹ (“Ruling”) that addressed only one aspect of the issues raised by our member. Given all the public attention to education debt, including the need for lower cost loans and more refinancing alternatives for students and parents, we request that Treasury address the issues that remain outstanding following the Ruling as well as clearing up a question that arises from the Ruling itself.

Education loan debt is a national issue and not just for those trying to manage the debt, but for middle class families and our economy as a whole. Students are leaving college with debt levels that are having a growing impact on their credit, spending habits, and ability to save for retirement. High loan balances, which often have high interest rates and high monthly payments, are delaying borrowers from making major purchases that will help spur our economy.

The clarifications we seek would ease the burden of student loans for both parents and students and have an overall positive impact on the U.S. economy. This letter provides an analysis of the code, the policy issues, and our specific requests for clarification as it relates to (1) making loans to parents without the student being obligated on the note, and (2) allowing the refinancing of private and federal loans for parents and students. In addition, in the case of refinancings, we

¹Ruling Number 201447023, released on November 21, 2014.

request that it be made clear that loans to current state residents count in meeting the state nexus test and that the refinancings can be funded through a new issue using new cap allocation, not just refunding bonds.

Analysis of the Code

Section 144(b) of the Code provides for the financing on a tax-exempt basis of certain education loans using Qualified Student Loan Bonds. Qualified Student Loan Bonds are bonds issued to make or finance student loans under (i) a program of general application to which the Higher Education Act of 1965 (“HEA”) applies, subject to certain limitations including that the program must impose limitations on the maximum amount of loans outstanding (Section 144(b)(1)(A)), or (ii) a program of general application approved by the state to which part B of title IV of the HEA does not apply, also subject to the certain limitations (Section 144(b)(1)(B)).

Under Section 144(b)(1)(A), eligible issuers are authorized to issue Qualified Student Loan Bonds to finance on a tax-exempt basis education loans made under the Federal Family Education Loan Program authorized under title IV, part B of the HEA.² These loans include Subsidized and Unsubsidized Stafford Loans made to students, Parent PLUS Loans made to parents of undergraduate students, Consolidation Loans that allow a borrower of certain eligible federal loans to consolidate or refinance those loans once the borrower leaves school and, most recently, GRAD PLUS Loans made to graduate and professional students. With the enactment of the Tax Reform Act of 1986, this authority was expanded by the addition of Section 144(b)(1)(B).

The questions that remain following the Service’s ruling revolve around whether private educational loans made to parents to pay for their children’s postsecondary education are financeable under Section 144(b)(1)(B) in cases where the child (i.e. the student) is not also an obligor on the note, and whether federal and private education loans made to students or parents may be refinanced using the proceeds of bonds issued under Section 144(b)(1)(B). The Ruling addresses just one aspect of the latter issue. For the purposes of this letter, we are assuming that the issuer’s financing or refinancing program is a program of general application approved by the issuer’s state and that the loans themselves will be used to pay for the cost of postsecondary education or to refinance a loan that was used for this purpose.

The introductory language to Section 144(b)(1) provides that a certain percentage (either 90 percent or 95 percent) of the net proceeds of Qualified Student Loan Bonds must be used directly or indirectly to make or finance student loans. This requirement applies to Qualified Student Loan Bonds described in both Section 144(b)(1)(A) and Section 144(b)(1)(B). Because Parent PLUS Loans and Consolidation Loans are eligible for financing under Section 144(b)(1)(A), the reference to “student loans” in the introductory language has been read broadly. Under Section 428B of the HEA, Parent PLUS Loans (originally called Parent Loans for Undergraduate Students – or PLUS Loans) are made to parents, without any student co-signer. Consolidation Loans are governed by Section 428C of the HEA and refinance certain eligible Federal student loans that were made to finance postsecondary education. Pursuant to Section 428C(a)(3)(A)(ii), borrowers are not eligible for a Consolidation Loan until they are in grace or repayment status (i.e. they must already have

² 20 U.S.C. 1071 et seq.

left school). The availability of tax-exempt financing to fund Parent PLUS and Consolidation Loans is well established. The reference to “student loans” in the introductory paragraph therefore has been read to contemplate the financing of both loans to parents and Consolidation (or refinancing) Loans, not just loans to students. Since the introductory language also applies to Qualified Student Loan Bonds that finance private education loans, it is logical to assume loans to parents (without a student co-borrower or co-signer) and loans that refinance student and parent loans are financeable under Section 144(b)(1)(B).³

Nonetheless, it is implied in the Ruling that references to “student borrower” in Section 144(b)(1)(B) and in the heading to Section 144(b)(3) foreclose the availability of tax-exempt financing for private education loans where the student is not an obligor on the note and for the refinancing of loans in cases where the underlying loans are not already owned by the issuer. We believe that, upon examination of the language of the Code and based on long standing practice, these interpretations are erroneous.

Section 144(b)(3), which is entitled “Student Borrowers Must Be Residents of the Issuing State, etc.” requires that a financed loan have a nexus with the state of the issuer. The section applies to bonds issued under both Section 144(b)(1)(A) and Section 144(b)(1)(B). Since borrowers of loans financeable under Section 144(b)(1)(A) include parents and persons who have left school, the term “student borrower” must be read to include persons who are not students (or current students).

Further, as is the case of Section 144(b)(3), the reference to “student loan” in the introductory language to Section 144(b)(1) cannot be read to limit the scope to loans to current students only; the reference in Section 144(b)(1)(B) to “student borrower” must also be read broadly so that it refers to students and parents, and to borrowers who desire to refinance student and parent loans.

Among other things, Section 144(b)(1)(B) provides that no loan under the state approved program can exceed “the difference between the total cost of attendance and other forms of student assistance, not including loans pursuant to section 428B(a)(1) of the HEA (relating to parent loans)...for which the student borrower may be eligible” (emphasis added). There is no reason to specifically exclude parent loans made under Section 428B(a)(1) from the amount of student assistance for which the borrower may be eligible if the term student borrower were limited only to students. The purpose of this section clearly is to set limits on the size of a financeable loan, not to establish who may be an eligible obligor on a loan. The loan amount restriction parallels the HEA’s maximum loan limits which are incorporated into Section 144(b)(1)(A). The test can easily be applied not only to private education loans to parents, but also to refinancing loans (so long as the underlying loans being refinanced are education loans that incorporate similar limits).

³In addition to the long standing interpretations that have allowed Parent PLUS Loans to be financed under Section 144(b)(1) of the Code, there’s existing statutory precedent for defining student borrower to include parent borrowers. When the Parent PLUS program was created in 1980, section 428B(a) of the HEA stated that “Whenever necessary to carry out the provisions of this section the terms ‘student’ and ‘student borrower’ used in this part shall include a parent borrower under this section.”

In the Ruling, the Service concluded that the issuer's tax-exempt refunding bonds may refinance loans originally made by the issuer. However, it says that the bonds used to refinance the education loans "will be refunding bonds of the Prior Bonds." This assumption has raised some concern for which clarification would be helpful. We believe issuers should be able to conduct refinancing using refunding bonds or, if new private activity cap is utilized, a new issue. The Ruling states that the refinanced loans already met the Code's nexus test since the original loans qualified under the nexus test when they were originally financed. However, we request clarification that in the case where loans being refinanced are private loans held by another lender or prior to the refinancing were federal education loans, the nexus test is applied either at the time the loans are refinanced (i.e., the borrower of the new private loan should be a resident of the issuer's state), or at the time the student attended school within the state.

Policy Implications

The state agency organizations we represent originated more than \$557 million in private education loans this year and have a combined outstanding portfolio of private education loans of \$10.8 billion. The loans made today by state agencies offer interest rates that average 4.84%, much lower than the current Federal Direct PLUS Loan interest rate of 7.21%. Additionally, many of the state agencies charge no or very low origination fees as compared to the Federal Direct PLUS Loan origination fee of 4.292%. These lower rates and terms equate to real savings for families as well as lower, more manageable, monthly payments.

There are limited options available to students and parents for refinancing their private loan debt today. Many students and parents may have borrowed under the Federal title IV loan program as well as private loans. Each loan may carry a different interest rate, repayment terms, payment dates, amounts, and lenders. With interest rates at historic lows, refinancing these loans not only makes sense for lowering the overall cost and monthly payment, but also for combining and simplifying loan repayment terms. Credit card holders have the option to consolidate debt on multiple cards to a manageable single payment and millions of homeowners have been able to take advantage of lower interest rates, decreasing their monthly mortgage payment, and allowing them to more easily manage other life expenses. This same opportunity should be available to student and parent loan borrowers.

In the Ruling, the Service concluded that the issuer's tax-exempt refunding bonds may refinance loans originally made by the issuer. This Ruling only benefits a narrow class of borrowers. Expanding the access to private refinancing loans to include borrowers of private student loans made by other lenders (including lenders that are no longer making new loans) and to borrowers of Federal student loans would be appropriate and would be in line with the Consumer Financial Protection Bureau's position⁴ that student loan borrowers need more refinancing options.

When a student takes out a loan with a parent co-signer, the amount borrowed is based both on the unmet need (the cost of education less other financial aid) and the creditworthiness of the borrower. While the student is the primary borrower, the vast majority of student borrowers do

⁴ CFPB Report entitled "Student Loan Affordability" dated May 8, 2013.

not have the required credit history to be approved on their own. Most of these loans require a co-signer, usually a parent, with a credit score that meets the requirements for the loan. Both the student and the co-signer are parties to the loan and the loan appears on the credit reports for both the borrower and co-signer.

When a student graduates and attempts to obtain credit, make purchases, rent an apartment, etc., this loan debt along with any other loan debt, including federal student loans, appears on his/her credit report. This combined debt has a negative impact on a recent graduate's purchasing power. A majority of the parents who are co-signing these loans intend to make the payments and question why this debt, made based on their credit score, should be negatively impacting their child's ability to get started in life. Allowing a parent to be the primary borrower, without the student on the loan, would place the credit reporting where it should be and minimize the negative impact on the student's credit.

The clarifications we are requesting are to: 1) allow education loans to parents without the student being obligated on the note, and (2) allow the refinancing of private and federal loans to parents and students. In addition, in the case of refinancings, we request that it be made clear that loans to current state residents count in meeting the nexus test and that the refinancings can be funded through a new issue using new cap allocation, not just refunding bonds. These clarifications will have a considerable positive impact on helping issuers meet the real challenges borrowers and families face in financing college expenses and managing education loan repayment. Since the majority of our member state agencies are restricted to tax-exempt financing, without the clarification and interpretations we are seeking, they are limited in the assistance they can provide to the residents of their states. We look forward to further discussions with you and your staff to obtain an interpretation of the Code that would ease the education loan burden of students and their parents.

Sincerely,

Debra J. Chromy, Ed.D.



President
Education Finance Council

James P. Bergeron



President
National Council of Higher Education Resources

cc: Mr. John J. Cross, III; Associate Tax Legislative Counsel