HB

370

HOUSE COMMITTEE REPORT

3/8

(7)
Date Referred: January 8, 1990 FURTHER REFERRALS: JUDICIARY FINANCE

Date of Committee Action: 3/5/90

The HEALTH, EDUCATION, & SOCIAL SERVICES Committee considered: HB 370

HOUSE BILL NO. 370 STUDENT LOANS AND GRANTS

"An Act relating to student loans and grants; and providing for an effective date."

RECOMMENDATIONS:
[X] be replaced with CSHB 370 (HESS) [ ] the same title [X] a new title
[ ] have attached amendment(s)
[ ] do pass
[ ] do not pass
[X] no recommendation
[ ] individual recommendations
[ ] additional referral to the _____ Committee

ADOPTS: House HESS letter of intent

ATTACHES NEW FISCAL NOTE(s): (Dept)
[X] fiscal impact Dept Employ Comm.
[ ] zero fiscal note 0
[ ] zero with analysis _____

APPROVES PREVIOUS: (Date/Dept)
[ ] fiscal note(s) _____
[ ] zero fiscal note(s) _____
[ ] zero fn/analysis _____

SIGNING DO PASS:

W. L. Lauenborg

Chris D. Ellis

SIGNING: (Check approp. column)

	Do Not Pass	No Rec	Amend
J. Ellis - fiscal note		X	
Mack Bayes / fiscal note		X	
Peter Gale		X	

J. Ellis
Chairman's Signature

HEALTH, EDUCATION AND SOCIAL SERVICES COMMITTEE

ALASKA STATE LEGISLATURE
HOUSE OF REPRESENTATIVES

P.O. BOX V, JUNEAU 99811
(907) 465-3759

March 7, 1990

Letter of Intent to
CSHB 370 (HESS)

The purpose of this letter is to inform the public on circumstances surrounding the issue of taxation of student loans relevant to HB 370.

The House HESS Committee passed out HB 370 in an attempt to relieve Alaska Student Loan recipients of tax liability on forgiveness portions of their loans. The bill proposes to change the loan program to a grant program. The public should be aware that this bill is not likely to relieve students of their tax liability. In a letter from the Anchorage IRS office to the State Attorney General's office, the IRS stated, "The Alaskan program is an outright loan program. Repayment is required. The original intent was to have the money revolve in the fund so that it could be loaned to another student. This money has always been considered a loan subject to repayment based upon the terms of a note signed at the time a loan is granted. The borrower knows that it is subject to repayment, and if not paid, the loan is subject to enforced collection."

Since there was no formal ruling from the IRS, the Committee passed HB 370 to the next committee of referral. The HESS Committee has requested the Postsecondary Education Commission and the Attorney General's office to solicit a formal ruling from the IRS.

The HESS Committee would also like to highlight the state Ombudsman's report dated February 27, 1990 which revealed that the student loan office knew as early as 1983 that foregiveness portions of loans were probably taxable, but decided not to notify borrowers based on advice from the Attorney General's office. The student loan office has rectified the situation and is now informing students of the tax liability associated with forgiveness.

It is the belief of members of this Committee that the Postsecondary Education Commission should seek ways of assisting students in paying their large, unanticipated tax bills.

Rep. Johnny Ellis, Chair

STATE OF ALASKA
1990 LEGISLATIVE SESSION

BILL VERSION: CSHB 370
PUBLISH DATE: _____

FISCAL NOTE

REQUEST:

Revision Date: 2/21/90
Title: Grant language reinstated forgiveness rescinded
Sponsor: Lehman, Furnace, Hanley, Sharp, Hudson
Requestor: House HESS

Agency Affected: Education
BRU: Postsecondary Education
Components: Student Loan Administration

EXPENDITURES/REVENUES: (Thousands of Dollars)

OPERATING	FY 91	FY 92	FY 93	FY 94	FY 95	FY 96
PERSONAL SERVICES	296.3					
TRAVEL						
CONTRACTUAL	30.7					
SUPPLIES						
EQUIPMENT	100.6					
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	427.6	-0-	-0-	-0-	-0-	-0-
CAPITAL						
REVENUE						

FUNDING: (Thousands of Dollars)

GENERAL FUND						
FEDERAL FUNDS						
OTHER	427.6	-0-	-0-	-0-	-0-	-0-
TOTAL	427.6	-0-	-0-	-0-	-0-	-0-

POSITIONS:

FULL-TIME	9	-0-	-0-	-0-	-0-	-0-
PART-TIME						
TEMPORARY						

ANALYSIS: (Attach a separate page if necessary)

Prepared by: Jane Byers Maynard, Executive Director
Phone: 465-2854
Division: Alaska Commission on Postsecondary Education
Date: 3/6/90

Approved by Commissioner: _____ Date: _____
Agency: _____

Distribution (by preparer):
Legislative Finance
Legislative Sponsor
Requestor
Office of Management and Budget
Impacted Agency(ies)

STATE OF ALASKA

ALASKA COMMISSION ON POSTSECONDARY EDUCATION

STEVE COWPER, GOVERNOR

P.O BOX FP
JUNEAU, ALASKA 99811-0599
PHONE: (907) 465-2854

February 2, 1990

Mr. Duncan C. Fowler
Ombudsman
P.O. Box WO
Juneau, AK 99811-3000

Dear Mr. Fowler:

RE: Ombudsman Complaints J89-0964, J89-0967, J89-0975, J89-0979, J89-0989, A89-1467, F89-0690

Thank you for the opportunity to review and comment on your January 3, 1990 report concerning the Internal Revenue Service taxation of loan forgiveness recipients and the Commission's role in that action.

I concur with your analysis of the complainants' allegations. In summary, your review finds the following complaints unsupported:

- The Commission acted illegally in providing the names and addresses of loan borrowers to the Internal Revenue Service without first obtaining the approval of individual borrowers.

- The Commission was unreasonable in failing to provide ongoing tax advice services to borrowers.

- The Commission, because of its unreasonable conduct in failing to provide borrowers with tax advice, should pay the tax bills of borrowers affected by the Internal Revenue ruling.

Your findings, however, support the fourth and final allegation:

- The Commission was unreasonable in failing to notify student loan borrowers that the forgiven portion of their loans might be considered as taxable income by the Internal Revenue Service.

While your evaluation of this allegation is reasonable, I must take issue with the statements that "it appears that everyone agreed the money was taxable . . ." and that "the Commission knew the money probably was taxable . . .." Given that the IRS did not attempt to collect on loan forgiveness prior to 1989, it was not clear that forgiveness was taxable. This is especially true in light of the Commission's specific understanding that the loan forgiveness provision was intended as a grant and the general perception that grants are not taxable. Clearly, the Legislature did not know or agree that the money was taxable either at the time of forgiveness inception or at the time of taxation.

As you know, the Commission on its own accord has already addressed your recommendation to notify borrowers of the possibility of tax liabilities. Starting last October, our forgiveness brochures, applications, and statements were amended to include the following statement:

> Reminder:
>
> The amount of your loan reduction under the forgiveness provisions of the Alaska Student Loan Program may be includable as gross income for tax purposes. We recommend you provide this information to your tax return preparer, or consult with a tax accountant prior to completing the return yourself.

Please note that the Office of the Attorney General still advises us to use the words "may be" not "is" in reference to includable taxable income. This is a precaution due to the uncertainty as to the final outcome of this matter. In addition, a separate statement with the same reminder has been sent to 1989 forgiveness recipients to insure that all of those individuals have been alerted to tax possibilities.

We intend to carry our borrower notification a step further to address the fact that the Internal Revenue Service is currently taxing students for years in which the student has received no monetary benefit from his or her forgiveness eligibility. In other words, upon receipt of the forgiveness eligibility, the student's account is adjusted to reflect a reduction in the total loan principal balance owed (which results in a shorter repayment period), but the student's monthly payments remain the same. The Internal Revenue Service, however, taxes the

student as if he or she has already seen a cost savings which, in reality, won't occur until the end of the repayment cycle when the latter years of repayment are "forgiven". (See enclosed letter to Senator Stevens which was also addressed to Congressman Young.)

Through data processing changes, we hope to revise our forgiveness statements to reflect the year in which the true impact of forgiveness eligibility will occur. We realize that if the taxation of forgiveness is upheld, this administrative action may only delay the student's reporting of the amount forgiven, but at least they are not "hit" at a time when they are still burdened with the same repayment costs they had prior to forgiveness. This administrative approach, however, is not intended as a compromise position or a solution to the problem at hand.

Finally, we are working closely with the Legislature on possible statutory language to remedy the problem. Initial attempts to restore the grant orientation of forgiveness are on hold due, in part, to the enclosed letter received from the Anchorage office of the Internal Revenue Service which disagrees with the argument that forgiveness was intended as a grant.

Since this statement essentially ignores legislative intent, the Legislature may view this as an impetus to pursue a formal ruling from the Internal Revenue Service in order to obtain a clear reading of the Legislature's ability to take effective action in this matter.

Sincerely,

Jane Byers Maynard

Jane Byers Maynard
Executive Director

Enclosure

cc: John Havelock, Chair
Alaska Commission on Postsecondary Education

HEALTH, EDUCATION AND SOCIAL SERVICES COMMITTEE

ALASKA STATE LEGISLATURE
HOUSE OF REPRESENTATIVES

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March 7, 1990

Letter of Intent to
CSHB 370 (HESS)

The purpose of this letter is to inform the public on circumstances surrounding the issue of taxation of student loans relevant to HB 370.

The House HESS Committee passed out HB 370 in an attempt to relieve Alaska Student Loan recipients of tax liability on forgiveness portions of their loans. The bill proposes to change the loan program to a grant program. The public should be aware that this bill is not likely to relieve students of their tax liability. In a letter from the Anchorage IRS office to the State Attorney General's office, the IRS stated, "The Alaskan program is an outright loan program. Repayment is required. The original intent was to have the money revolve in the fund so that it could be loaned to another student. This money has always been considered a loan subject to repayment based upon the terms of a note signed at the time a loan is granted. The borrower knows that it is subject to repayment, and if not paid, the loan is subject to enforced collection."

Since there was no formal ruling from the IRS, the Committee passed HB 370 to the next committee of referral. The HESS Committee has requested the Postsecondary Education Commission and the Attorney General's office to solicit a formal ruling from the IRS.

The HESS Committee would also like to highlight the state Ombudsman's report dated February 27, 1990 which revealed that the student loan office knew as early as 1983 that foregiveness portions of loans were probably taxable, but decided not to notify borrowers based on advice from the Attorney General's office. The student loan office has rectified the situation and is now informing students of the tax liability associated with forgiveness.

It is the belief of members of this Committee that the Postsecondary Education Commission should seek ways of assisting students in paying their large, unanticipated tax bills.

Rep. Johnny Ellis, Chair

State of Alaska
Ombudsman
Duncan C. Fowler

Reply to:

☐ P.O. Box 102636
Anchorage, AK 99510-2636
(907) 563-3673
(800) 478-2624

☑ P.O. Box WO
Juneau, AK 99811-3000
(907) 465-4970
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☐ P.O. Box 74358
Fairbanks, AK 99707
(907) 452-4001
(800) 478-3257

February 27, 1990

Garrey Peska, Chief of Staff
Office of the Governor
Post Office Box A
Juneau, Alaska 99811-0101

RE: Ombudsman Complaints J89-0964, J89-0967, J89-0975, J89-0979, J89-0989, A89-1467 and F89-0690

Dear Mr. Peska:

My office has investigated the controversy of the Internal Revenue Service's (IRS) decision to assess taxes on the forgiven portion of Alaska state student loans, and how the issue was handled by the Alaska Commission on Postsecondary Education. The commission was aware for several years that loan forgiveness probably was taxable income, yet for several reasons decided not to tell the borrowers the bad news.

I have enclosed a copy of my final report on the case, and I ask that you take the time to review the issue and consider my suggestion to:

> Direct state agencies that find themselves in circumstances similar to the student loan office to promptly warn program participants of any potential for tax liability.

Granted, this suggestion may sound simplistic, but I believe it conveys a philosophy to program managers we both endorse. It is not fair to withhold information from program participants.

As an example, one of our complainants chose to apply for her 50% loan forgiveness over a two year period rather than spread it out. As a result, several things happened. First of all, the years she applied for were the years the IRS began to tax the loans. Secondly, her income was increasing and the tax liability was greater. Consequently, she tells me she would have acted differently if she had known of a potential tax liability. I suspect other loan recipients were similarly harmed.

My suggestion is for the state to always provide whatever information it may have that could help borrowers, grant recipients and program participants be aware of possible tax or other liabilities.

If you have any questions about these cases, please call. Although my suggestion to you is not a formal part of this case, I would be interested in your response to this matter.

Sincerely,

Duncan C. Fowler
Ombudsman

DWH:pjc
Enclosure
cc: Doug Baily, Attorney General

State of Alaska
Ombudsman
Duncan C. Fowler

Reply to:

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February 27, 1990

Jane Byers Maynard, Executive Director
Alaska Commission on Postsecondary Education
Post Office Box FP
Juneau, Alaska 99811-0505

RE: Ombudsman Complaints J89-0964, J89-0967, J89-0975, J89-0979, J89-0989, A89-1467 and F89-0690

Dear Ms. Maynard:

Thank you for your February 2, 1990, letter and response to my findings and recommendations regarding the referenced complaints. I am writing to conclude the investigation and close the respective case files.

While you concurred with the first three allegations of the four presented in these complaints, you took issue with some of the statements regarding the fourth allegation. However, you still found the evaluation of this allegation reasonable and accepted the related recommendation. In fact, your office has stepped beyond merely notifying borrowers of potential tax liabilities. You indicated that your office is working with the Internal Revenue Service, Alaska's Congressional Delegation and the State Legislature on improvements to the forgiveness aspects of the student loan program.

For these reasons I find the disposition of these complaints to be fully rectified and the recommendation accepted. I have notified the complainants of the status of these complaints and made the report available to them.

Again, thanks for the cooperation of you and your staff and I hope your efforts continue to improve the student loan program.

Sincerely,

Duncan C. Fowler
Ombudsman

DWH:pjc

Ombudsman

MEMORANDUM

DATE: February 27, 1990

TO: Duncan C. Fowler, Ombudsman

FROM: David W. Haas, Assistant Ombudsman DWH

SUBJ: Ombudsman Complaints J89-0964, J89-0967, J89-0975, J89-0979, J89-0989, A89-1467 and F89-0690

Our office received several calls in early October when the words "Internal Revenue Service" and "student loans" were linked together in a taxing controversy. The calls started soon after the Alaska Commission on Postsecondary Education reported that the IRS had requested the names of student loan borrowers for possible taxation of their state loan forgiveness. Callers to the ombudsman's office complained that the commission: (1) should not have turned over the information to the IRS; (2) should pay the borrowers' tax bills; (3) that the IRS was unfair; and (4) that the student loan office should have told borrowers of the tax liability.

We eventually opened seven complaints from state student loan borrowers and the cases were assigned to Assistant Ombudsman Larry Persily. Mr. Persily contacted the commission's current executive director, Jane Byers Maynard, on October 6 to notify them of the complaints and to begin review of the controversy.

Rather than treat each complaint separately, we handled all of the issues as one investigation, and reviewed the following allegations:

* The Commission on Postsecondary Education was unreasonable in failing to notify student loan borrowers that the forgiven portion of their loans might be considered as taxable income by the IRS.

* The commission acted illegally in providing the names and addresses of loan borrowers to the IRS without first obtaining the approval of individual borrowers.

* The commission was unreasonable in failing to provide ongoing tax advice services to borrowers.

* The commission, because of its unreasonable conduct in failing to provide borrowers with tax advice, should pay the tax bills of borrowers affected by the IRS ruling.

Before opinions were formed on each allegation, Mr. Persily reviewed the history of the problem, the elements of the controversy and the status of the IRS dispute.

HISTORY OF ALASKA STUDENT LOANS

The state-subsidized student loan program started in 1968-69. It offered a limited forgiveness program in its first year, according to loan officer Julie Bennett. The program grew in subsequent years to a point where thousands of borrowers have enjoyed, are enjoying and will enjoy the financial benefit of having up to half their loan debt forgiven by the state as a reward for living in Alaska for at least five years after graduation.

A requirement that graduates work in Alaska in order to qualify for loan forgiveness was added in 1971-72, Ms. Bennett said, but the work requirement was eliminated in 1981-82 and again all a graduate had to do was reside in Alaska to qualify for loan forgiveness.

In a move to make the loan program self-sufficient, the legislature abolished the forgiveness provision starting with 1987-88 school year loans. Changes in the forgiveness program through the years affected only new loans and did not reach back and change the terms of pre-existing borrower contracts.

IRS RULES ON LOAN FORGIVENESS

The federal tax code is clear on the taxation of loan forgiveness. Section 108(f)(1) says the forgiven portion of a student loan debt shall be considered as income, unless the forgiveness was based on a loan provision that required the borrower to work "for a certain period of time in certain professions for any of a broad class of employers." Even when the Alaska student loan program required that borrowers work in the state, there was no requirement that graduates work "for a certain period of time in certain professions," and certainly the "no work required" provision of the forgiveness program from 1981-82 to 1987-88 would not fall within the IRS taxable-income exemption.

WORK PROVS

Although the exemption likely would apply to borrowers under Alaska's rural teacher loan program, which requires the graduate to work as a teacher in a rural area of the state in order to qualify for loan forgiveness, the majority of borrowers who benefitted from loan forgiveness appear to be within the grasp of IRS tax collectors.

Despite some rumors making their way through the ranks of borrowers, federal tax law changes of 1986 did not change the status of student loan forgiveness, said Marilyn Steen of the IRS Anchorage office. Forgiven loan debt has been taxable all along, she said, although Steen was unable to totally explain why the IRS had been dormant in its collection efforts for so many years and only this past summer had asked for a list of borrowers from the Alaska loan office. The agency is always looking for lost income, but "the IRS can't be everywhere," she said.

GRANT

Although some people argue that the "intent" of Alaska's loan forgiveness program actually is a grant, and therefore should be tax exempt, that is a question for the IRS to rule on and is outside the jurisdiction of our office.

IRS NOTICE TO POSTSECONDARY EDUCATION COMMISSION

An IRS employee called the commission's offices in Juneau on August 7, asking for information on student loan borrowers who had benefitted from the forgiveness program, said Kevin Hanon, a finance officer for the loan program, who was interviewed in December for our report. After consulting with the commission's executive director, Ron Phipps, Mr. Hanon asked the IRS to put its request in writing.

The IRS letter, dated August 22, asked for the name, address and social security number for all individuals with state loans who had portions of their loans forgiven in 1987 and 1988. "The requested information will be used for tax administration purposes," wrote Dorothy Svatos, disclosure officer at the IRS office in Anchorage.

The letter was vague, Mr. Hanon said, so he called Ms. Svatos on August 28 for a clarification. A second IRS letter, dated September 5, asked for the same information as the August 22 letter and also asked for the amount of debt forgiven for each borrower. After consulting with the attorney general's office, the information was sent to the IRS via certified mail on September 28.

The list covered 7,743 loans to about 5,900 borrowers, totaling $10.6 million in forgiveness for 1987 and 1988, according to a memo you sent to commission members on October 12.

The student loan office the first week of October sent a letter to each borrower, notifying them that their name and account information had been given to the IRS, advising them that the IRS would use the information for tax administration purposes, warning them that "the commission understands that the amount of forgiveness benefits may be taxable income to the borrower," and recommending that the borrower should call the IRS with any questions.

IRS HANDLING OF ALASKA BORROWERS

Borrowers will be required to pay back taxes and interest, but not penalties, on their loan forgiveness for tax years 1987 and 1988, Ms. Steen said, and for 1989 and subsequent years. Loan forgiveness prior to 1987 will escape the IRS, she said, because of a statute of limitations.

Interest will be charged on 1987 income as of April 15, 1988, when 1987 tax returns were due, and interest on 1988 income will start accruing as of April 15, 1989, Ms. Steen said. The interest rate is set quarterly and has ranged between 10 and 12 percent in the past three years and currently is set at 11 percent, she said. Interest for each quarter will be computed at the rate in effect at that time.

Upon receipt of the borrowers list from the student loan office this fall, IRS agents started comparing the names and loan forgiveness amounts with individual tax returns. Letters are being sent to borrowers, informing them that they failed to report the income of their loan forgiveness and that they owe taxes and interest, as computed by the IRS. Borrowers are offered the options of immediately paying the taxes and interest as stated in the letter, agreeing to accept the debt and choosing to wait for an official bill from the IRS before making payment, or challenging the debt under IRS appeal procedures. It could take a year for the IRS to review all of the returns and send letters to each borrower, Ms. Steen said.

In the meantime, she recommended borrowers should file amended returns on their own rather than wait for the IRS review of their case. Interest continues until the day the debt is paid, so it is in a borrower's financial interest to file amended returns for 1987 and 1988 and pay the bill as soon as possible rather than waiting for the IRS to do the work, Ms. Steen said.

As for borrowers who can't afford to pay their entire tax bill with one check, Ms. Steen said the IRS is willing to consider payment plans on a case-by-case basis, but the borrower first needs to settle with the IRS on the amount owed.

In the case of a borrower under the rural teacher loan program who apparently is exempt from taxes, Ms. Steen said the person needs to tell the IRS that he or she borrowed under that program and not the non-exempt general loan program.

WHAT THE STUDENT LOAN OFFICE KNEW AND WHEN IT KNEW IT

The student loan office knew more than six years ago of the potential tax liability from loan forgiveness, but on the advice of the attorney general's office decided not to pass along any advice to borrowers.

A one-page memo of March 9, 1983, from Diane Colvin of the attorney general's office said, "As I told you on the phone, the amount forgiven probably is taxable in the year forgiven. . . ." The assistant attorney general's memo was addressed to Kevin Hanon at the postsecondary education commission.

Although her 1983 tax advice was proven correct by the IRS action of 1989, Ms. Colvin's memo included a cautious note: "You should not use this information to provide federal tax advice to loan recipients. Rather you should instruct any student who makes an inquiry on this issue to seek advice from the Internal Revenue Service."

Contacted in December at Seattle, where she works for the Alaska Department of Revenue, Ms. Colvin said she has no recollection of any events leading up to the memo or any discussions involving the tax question. Mr. Hanon said he has no recollections of any IRS requests for borrower names and loan amounts prior to August 1989.

Kerry Romesburg, who served as commission director from 1975-87, remembers some details of the 1983 attorney general's office memo. Congress was debating the question of taxing stipends paid to graduate students and other financial aid programs, and the commission asked the attorney general for an opinion on Alaska's loan forgiveness program. Contacted in December at his job as president of Utah Valley Community College, Mr. Romesburg said he remembers discussing the 1983 opinion at a commission meeting and being told by the attorney general's representative: "You guys aren't in the tax advice business, so don't get into it."

Although he believed students should have been notified of the possible tax liability, Mr. Romesburg said the loan office followed the attorney general's advice and did nothing to warn borrowers. The loan office sends annual notices to its borrowers of loan forgiveness and interest paid, and a line could have been added to the statement to advise borrowers of the tax issue, but that never was done.

The issue came up again in 1986, when Congress was debating major changes in federal tax laws. Ms. Bennett sent a letter to Robert Maynard, assistant attorney general, asking whether changes in federal tax laws would affect the 1983 attorney general's memo that said loan forgiveness is taxable income. Hand-written notes on a copy of the May 1986 letter on file at the loan office say: "Still advised that ACPE should not give tax advice per attorney general's office." The comments are dated June 2 and are attributed to Mr. Maynard.

The next written record of the issue came in November 1988, when Price Waterhouse, a nationwide accounting firm, sent a letter to the commission on the subject of loan forgiveness. The main point of the letter was to tell the commission that it was under no legal obligation to report loan forgiveness to the IRS on a Form 1099 (used to report non-wage income). The accounting firm said, "There is no information return reporting requirement, even though the forgiveness is income to the borrower." The accountants said their advice was based on an informal opinion from the IRS, although the commission could face penalties of up to $500,000 a year if the opinion was wrong and the commission was in violation of reporting requirements to the IRS. The company suggested the commission seek a formal ruling from the IRS.

In stating that loan forgiveness is considered taxable income by the IRS, Price Waterhouse offered some advice:

> During our meeting, we discussed your responsibilities to the borrowers who receive debt forgiveness, since there is no information return reporting requirement. While there are no additional responsibilities required by the IRS or the code, you may wish to inform the individuals of the tax ramifications of the forgiveness. We would recommend that you provide a statement of the tax implications either in the application for the forgiveness, or in your letter to the individual when you notify them of the approval. Your statement could be worded as follows:
>
> "The amount of your loan reduction under the forgiveness provisions of the Alaska Guaranteed Student Loan Program is includible in your gross income for tax purposes. We recommend you provide this information to your tax return preparer, or consult with a tax accountant prior to completing the return yourself."

Nothing was done in response to the Price Waterhouse suggestion.

"We wanted to be very careful not to alarm people," Mr. Phipps said of the commission's reaction to the Price Waterhouse letter. He served as director of the Alaska student loan program from April 1988 to September 1989, and was interviewed by phone in December at his new job as assistant secretary for finance and policy analysis at the Maryland Higher Education Commission.

The commission wanted to take a cautious approach to the problem of potential tax liability, he said. Although Price Waterhouse had suggested that the commission consider asking for a private ruling from the IRS on the loan

forgiveness issue and reporting requirements, Mr. Phipps said he recommended against such action. In addition to the cost of a private ruling, estimated at $15,000, there was the possibility that the ruling could go against the commission for not reporting the loan forgiveness and could result in tax bills to borrowers. The decision was, "Let's just take our chances," Mr. Phipps said.

Ms. Maynard's response was similar in an October 10 phone interview with Mr. Persily. Paying for a formal IRS ruling was not worth the price, she said, especially "if one wasn't wanted in the first place."

It appears one reason the commission chose not to notify students of the potential tax liability or ask the IRS for a formal ruling was for fear of alerting the IRS to tax revenue it had been neglecting for years. The attorney general's warning to avoid giving out tax advice may have been the legal reasoning behind the policy of silence, but it also appears that through the years the commission wanted, as one person said, "to let sleeping dogs lie."

"In hindsight, perhaps we should have" notified borrowers of the tax liability, said Gary Amendola, assistant attorney general to the Alaska Student Loan Corporation, in an interview in December with Mr. Persily. Mr. Amendola had previously served as legal counsel to the commission, prior to establishment of the loan corporation as a separate entity.

Mr. Amendola's advice through the years was consistent: Do not give tax advice. He said the state was under no legal obligation to report loan forgiveness to the IRS or to advise borrowers, and the attorney general's office did not deviate from its advice to the commission. However, he said there would have been no "legal downside" had the state warned students of the tax issue. "We could have done that before," he said. "It seemed pretty clear that it was taxable."

As a point of information, the Price Waterhouse report was requested and paid for by the Department of Administration, which was conducting a review of several state programs to determine if the state was in compliance with IRS reporting requirements. Division of Finance Director Keith Busch said he started working with the attorney general's office in 1988 to ensure that the state was correctly reporting to the IRS all payments made under various state programs.

Every so often through the years, a borrower would call the student loan office and ask if loan forgiveness was taxable, Ms. Bennett said, and the answer she gave was to advise the caller to consult a tax accountant. That was the commission's policy until this past fall when the IRS action caused a reaction and the commission added a notice of tax liability to its annual statement to borrowers. In fact, the notice now included on forgiveness applications and annual statements is the same notice that Price Waterhouse recommended one year ago.

ANALYSIS OF THE ALLEGATIONS

The easiest part of the case to resolve is the alleged illegal action by the commission in turning over to the IRS the name, address and loan amount of borrowers. Alaska Statute 09.25.110 says that state records are open to the public, unless there is a specific state or federal law protecting the confidentiality of the records. State regulations 6 AAC 95.010-900 say that public record requests shall be filled in a timely and responsive manner, unless a state or federal law or principle recognized by the courts prevents public disclosure. None of the exceptions appear

to apply to the name, address and loan amount of student loan borrowers. The borrowers are using public money, not private funds from a bank, and the expenditure of public money is public record under the law.

In this case, the records are public; the commission did not violate any state or federal law that I could find in the release of the records; there is no requirement in law or regulation that the commission ask borrowers' permission before releasing public records; and it would have been unreasonable for the commission to challenge the constitutionality of the public records law solely for the tax avoidance benefit of borrowers.

Consequently, you found this aspect of the complaint unsupported.

As for tax advice services, it is not the job of the student loan office to act as a tax consultant to borrowers. The commission's duties under state law include providing financial aid to college and vocational students and ensuring that schools follow the rules for participation in the loan program. The commission is not a branch office of H & R Block. It should provide what borrowers need to know to complete accurate tax returns, such as interest paid during the year, amount of loan forgiven and, everyone now knows, the tax consequences of loan forgiveness. But the tax buck stops there. Borrowers who are angry at the commission for not fighting the IRS over the issue of forgiveness, who are upset that the commission did not act as an advocate on the issue or who are frustrated at the lack of tax services from the commission are expecting too much from the state. The commission's job is to administer the student loan program, not help borrowers fight the IRS.

You found this allegation over the lack of tax advice unsupported.

As for whether the commission should pay the interest charged on borrowers' tax bills, the legal versus moral obligations of the state must be considered. Although it is true that several thousand borrowers face the unpleasant task of paying interest on back taxes because they were unaware that loan forgiveness was taxable income, they did benefit from having the use of that money for an extra year or two before having to pay taxes to the IRS. However, if the commission had notified borrowers of the tax status of the program, they could have made individual decisions whether to pay their taxes on time and avoid interest charges. I believe that because of its decision not to tell borrowers of the tax issue, the commission morally shares in the blame for the interest that has accrued.

For example, the average borrower in this group of 5,900 had about $1,800 in loans forgiven during 1987 and 1988. For a person in a 28 percent tax bracket, that could result in about $500 in back taxes for the two years and about $80 in interest as of this spring.

Had the IRS assessed heavy penalties against the borrowers for non-payment of taxes, it would have been easier to say the commission should assist in paying the bill. But the IRS is not assessing any penalties, and the borrowers' use of the money for an extra year or two in part compensates them for the interest charges they must now pay.

On the legal side, it appears the state was under no legal obligation to warn borrowers of the forgiveness issue and Mr. Persily could not find any law that would require the commission to pay the interest. However, our office was aware of

several borrowers who are considering legal action against the state over their tax bills and interest.

The commission followed the attorney general's advice in good faith, although in hindsight that advice was too conservative. The advice was legally correct, but morally flawed and a disservice to borrowers. Balancing the moral and legal issues is difficult, and although our office agreed with the borrowers' frustration that the commission shares in the moral blame for the problem, the legal answer appears to be that the commission is not required to pay the bills.

Therefore, you found this aspect of the complaint unsupported.

However, you found supported the allegation that the commission erred in failing to advise borrowers of what it knew about loan forgiveness as soon as it knew it.

The reasoning that there was no legal requirement to tell borrowers that their loan forgiveness could be taxable is a weak excuse, even if it does get the state off the financial hook for the interest charges. There should not have to be a law for everything. Just because the lack of notice was legal does not mean it was fair to the borrowers who are now stuck with interest on their tax bills. The commission knew something that apparently most borrowers did not know, yet needed to know, and the commission should have told them at the earliest possible time and let the borrowers make their own tax decisions.

The reasoning that the commission should avoid giving tax advice was a cop-out. We're not talking about tax advice here; the issue was the commission knew the loan forgiveness money probably was taxable and yet did not give that information to the people who could be directly affected. That's not inappropriate advice or overstepping the jurisdiction of state government; that's sharing information with the people who need to know.

The reasoning that keeping the issue low key may have helped keep the issue from the IRS is well-meaning, but the benefits that accrued to borrowers who escaped taxes does nothing to alleviate the problems created for borrowers today.

The reasoning that the commission lacked a formal IRS ruling on the subject, and had only informal opinions from the attorney general's office and an accounting firm, also is flawed. It appears that everyone agreed the money was taxable -- that never was questioned in any of the documents reviewed or people interviewed for this report. If the lack of a formal IRS ruling was so important, why didn't the commission ask for it and spare everyone the risk and uncertainty, or just tell the borrowers that the money may be taxable and let each individual deal with the question. No news may be good news in some cases, but in this case no notice to borrowers was bad news.

Overall, you found these complaints partially justified.

RECOMMENDATION

Your only recommendation was that the commission notify borrowers or grant recipients of any potential tax liabilities that may exist now or in future programs administered by the agency.

You then notified the complainants that the review was completed, that you had sent it to the commission for comment and that the commission had an opportunity to dispute the findings before our office concluded the investigation and released it to them. You also told the commission that you planned to send a copy of the report to Governor Cowper's chief of staff, Garrey Peska. You said that this might prevent similar problems in other state programs with similar circumstances.

AGENCY RESPONSE

Ms. Maynard responded on behalf of the commission to our office in a February 2, 1990, letter addressing our investigatory findings and recommendation. She accepted our first three findings which were unsupported and noted that the commission had already notified students of the potential tax liability as we had recommended they do. In addition, she found our evaluation of the fourth allegation (concerning notification to borrowers of potential tax liability to be "reasonable." She did challenge several statements in the report which indicated the commission "knew" the loans were taxable. However, her portrayal of that finding as "reasonable" and the commission's notification to borrowers lead you to conclude officially that the complaints were fully rectified and the recommendation was accepted.

Ms. Maynard also informed us that the commission is working with United States Senator Ted Stevens and Congressman Don Young on further complications to this issue. The Internal Revenue Service (IRS) ". . . is currently taxing students for years in which the student has received no monetary benefit . . ." from forgiveness eligibility. They currently tax borrowers from the time of forgiveness eligibility as if the student has already seen a cost savings. Since this is not the case, the commission hopes that the Congressional delegation will impress the facts upon the IRS.

Along these lines, the commission also hopes to make data processing changes which reflect "the year in which the true impact of forgiveness eligibility will occur." Lastly, they are working with the State Legislature on possible statutory changes to remedy the problem.

DWH:pjc

STATE OF ALASKA
THE LEGISLATURE

LEGISLATIVE AFFAIRS AGENCY

POUCH Y STATE CAPITOL
JUNEAU ALASKA 99811
907 465 3800

MEMORANDUM February 16, 1990

SUBJECT: Student loans and grants under HB 370 (Work Order No. 6-1862A)

TO: Representative Johnny Ellis, Chair
Health, Education, and Social Services Committee

FROM: Theresa L. Bannister TB
Legislative Counsel

You have asked whether the passage of HB 370, relating to student loans and grants, is likely to prevent recipients of Alaska student educational assistance from paying income tax on certain "forgiven" portions of the assistance.

1. BASIC PROBLEM ADDRESSED BY THE BILL. The Internal Revenue Service appears to be taking the position that if the state pays/has paid part of a student's loan under AS 14.-43.120(j), the amount so paid is income to the student, and the student must pay federal income tax on it.

2. SOLUTION PROPOSED BY HB 370. HB 370 attempts to avoid this result by retroactively providing a new optional form of financial assistance. Under the new program one-half of the assistance is a grant. Instead of "forgiving" part of a loan for residency, a percentage (up to 100%) of the grant is converted into a loan if the borrower does not satisfy certain residency requirements.

3. LIMITATIONS OF PROPOSED SOLUTION. Several significant issues have been raised regarding the proposed solution, any one of which could prove fatal to the success of the bill. Several of the most significant issues are identified in the following paragraphs.

(A) It is very possible that the IRS may not accept that the new financial program changes what happened in the past. Because the borrower actually was operating under the old

program when the events took place that determine taxability, the IRS may refuse to accept that the new program can retroactively change these events and facts.

(B) The new program may be counterproductive. It is very possible that the IRS would take the position that the cancellation of the old financial obligation (when the borrower switches to the new program) is itself a taxable event to the borrower. 26 U.S.C. 61(a)(12). If determined to be a taxable event, the cancellation would produce taxable income.

(C) The IRS may take the position that the new program actually imposes a future residency requirement as a condition of the grant portion of the assistance. If the IRS successfully characterizes return to the state as a service for which the state "forgives" the borrower's payments, the grant would be taxable income, since the scholarship would not qualify for the scholarship exclusion under 26 U.S.C. 117.

(D) Implementation of this legislation may impair contracts with bondholders. If so, the legislation would violate the federal and state constitutional prohibitions against impairment of contracts. The outstanding loans that would be cancelled by this legislation have been pledged as security for the outstanding bonds of the Alaska Student Loan Corporation.

(4) LIKELIHOOD OF SUCCESS OF THE PROPOSED PROGRAM. In light of the seriousness of the issues raised by HB 370, I would have to say that the likelihood is not very good that, even if the constitutional issue were resolved favorably, the proposed program would be accepted by the IRS and prevent the taxation of the student borrowers for whom the state has made payments under former AS 14.43.120(j).

If I may be of further assistance, please advise.

TLB:gc
G13/095

HJR65

Testimony before the House HESS Committee
Representative Johnnie Ellis, Chair
February 22, 1990
By Bill Potter, NEA Alaska

My name is Bill Potter, and I am testifying for NEA-Alaska.

We support H. B. 370 *HJR 65 and/or any other legislative vehicle which would result in any student loan forgiveness being classed as nontaxable income, or bringing about the same net effect.

NEA-Alaska has long supported loans, grants, and other incentives for Alaskans to pursue a postsecondary education. The I.R.S. decision to consider loan forgiveness under the Alaska Student Loan program as taxable income has created a disincentive to an incentive. In addition, the decision of the I.R.S. to tax this loan forgiveness in a retroactive fashion flies in the face of the spirit of, if not the letter of, the constitutional prohibition against "ex-post facto laws."

NEA-Alaska sees the subject of this proposed legislation as an issue of fairness; an issue of justice. We commend your efforts to remove the taxable income onus from the Alaska Student Loan program.

STATE OF ALASKA

STEVE COWPER, GOVERNOR

ALASKA COMMISSION ON POSTSECONDARY EDUCATION

P.O BOX FP
JUNEAU, ALASKA 99811-0595
PHONE: (907) 465-2854

M E M O R A N D U M

TO: MEMBERS OF THE HOUSE HESS COMMITTEE

THE HONORABLE JOHNNY ELLIS, CHAIR
THE HONORABLE MARK BOYER, VICE CHAIR
THE HONORABLE PETER GOLL
THE HONORABLE MAX GRUENBERG
THE HONORABLE CHERI DAVIS
THE HONORABLE WALT FURNACE

FROM: JANE MAYNARD, EXECUTIVE DIRECTOR
ALASKA COMMISSION ON POSTSECONDARY EDUCATION

RE: IMPACTS OF RESCINDING FORGIVENESS BENEFITS FOR CALENDAR YEARS 1987, 1988 AND 1989

DATE: February 20, 1990

IF CSHB 370 MANDATED THE RESCINDING OF FORGIVENESS BENEFITS FOR THE 1987, 1988, AND 1989 YEARS, THE ALASKA COMMISSION ON POSTSECONDARY EDUCATION (ACPE) WOULD CONTACT THE BORROWER TO DETERMINE WHETHER OR NOT THEY WANT TO RESCIND THEIR FORGIVENESS BENEFIT. THIS WOULD INVOLVE UP TO TWO CONTACTS WITH THE BORROWER, TRACKING THE PAPERWORK, AND REQUIRED SKIP TRACING BORROWERS WHO HAVE NOT KEPT US INFORMED OF THEIR CURRENT ADDRESS. THE NEXT STEP WOULD BE RESCINDING THE FORGIVENESS BENEFITS, RECALCULATING PRINCIPAL AND INTEREST DUE FROM THE TIME OF THE FIRST FORGIVENESS, MAKING THE NECCESSARY CHANGES ON THE COMPUTER SYSTEM TO ADJUST PRINCIPAL AND INTEREST, NOTIFYING THE BORROWER OF THE NEW PRINCIPAL BALANCE DUE AND NOTIFYING THE IRS OF THE AMOUNT OF FORGIVENESS RESCINDED. WE WOULD THEN TRACK RESCINDED FORGIVNESS BENEFITS UNTIL TERM DATE IN THE BILL OR UNTIL BORROWER RE-APPLIED FOR THE BENEFIT (WHICHEVER IS APPLICABLE) AND, RE- APPLY THE FORGIVENESS.

COST OF NOTIFICATIONS

NOTIFICATION WOULD BE REQUIRED:

1. TO DETERMINE IF THE BORROWER WANTS TO RESCIND FORGIVENESS (UP TO TWO NOTICES)
2. TO RELAY THE NEW LOAN BALANCE AND CHANGES TO PRINCIPAL AND INTEREST
3. TO ADVISE IRS OF THE ADJUSTED FORGIVENESS BENEFITS

COST OF FORMS AND MAILING: $ 10,750

RECALCULATION OF PRINCIPAL AND INTEREST

RESCINDING OF FORGIVENESS BENEFITS WOULD REQUIRE RE-COMPUTATION OF PRINCIPAL AND INTEREST FOR EACH INDIVIDUAL LOAN.

SINCE INTEREST IS CHARGED ON A DECLINING BALANCE AND THE INTEREST CHARGES DECLINE AS THE PRINCIPAL DECLINES, THE INTEREST AMOUNT THAT WE CHARGE WILL BE GREATER IF WE REMOVE THE FORGIVENESS BENEFIT. EACH PAYMENT ON EACH LOAN FROM THE TIME OF THE FIRST FORGIVENESS WOULD HAVE TO HAVE A REMOVAL OF INTEREST AND PRINCIPAL AND A RE-APPLICATION OF BOTH. IN SOME CASES IT MAY BE POSSIBLE TO DO THIS AUTOMATICALLY, BUT MOST CASES WOULD BE MANUAL.

STAFFING REQUIREMENTS/DATA PROCESSING COSTS

IT WOULD BE POSSIBLE FOR SOME OF THE LOANS TO BE REWORKED (PRINCIPAL AND INTEREST RECALCULATION) BY CREATING A NEW COMPUTER PROGRAM. ANY LOANS, HOWEVER, THAT HAVE HAD REVISED SCHEDULES OR GONE INTO DEFERMENT SINCE THE TIME FORGIVENESS WAS DONE WOULD NOT FALL INTO THIS CATEGORY AND WOULD HAVE TO BE WORKED BY STAFF.

THE AMOUNT OF TIME REQUIRED TO IMPLEMENT THESE CHANGES, RESPOND TO CORRESPONDENCE AND TELEPHONE INQUIRIES ABOUT THESE CHANGES, TRACK THE NOTIFICATIONS, RESCIND FORGIVENESS AND REPROCESS PAYMENTS (WHETHER MANUALLY OR AUTOMATICALLY) TRACK FORGIVENESS ELIGIBLITY AND REAPPLY FORGIVENESS, PROCESS THE DATA IN THE ACCOUNTING SYSTEM AND FILM THE RECORDS ONTO MICROFICHE WOULD BE OUT OF THE SCOPE OF THE ABILITIES OF PRESENT STAFF. WITHOUT ADVERSELY IMPACTING PRESENT LOAN SERVICING COMMUNICATIONS AND COLLECTIONS FUNCTIONS.

ESTIMATED STAFFING REQUIREMENTS:

DATA ENTRY/DOCUMENT TRACKING	1 STAFF	32,480.00
SKIP TRACING STAFF	1 STAFF	32,480.00
ACCOUNTING TECHNICIAN	1 STAFF	32,480.00
FORGIVENESS PROCESSOR	5 STAFF	170,955.00
MICROFICHE/RECORDS PROCESSOR	1 STAFF	27,940.00
TOTAL STAFF COSTS	9 STAFF	296,335.00
SPACE AND EQUIPMENT COSTS	9 STAFF	100,600.00
TOTAL COST.....		396,935.00

DATA PROCESSING COSTS HAVE YET TO BE DETERMINED.

Official Business

Representative Loren Leman

Alaska State Legislature

3111 C Street
Suite 425
Anchorage, Alaska 99503
561-7614

During Session:

P.O. Box V
Juneau, Alaska 99811
465-2095

M E M O R A N D U M

TO: Rep. Johnny Ellis, Chairman

FROM: Rep. Loren Leman

DATE: February 21, 1990

SUBJ: Student Loans (HB370)

I urge the members of the House Health, Education and Social Services Committee to support taking prompt action in defense of Alaskan residents who have earned "forgiveness" for a portion of their student loan.

5,900 Alaskans and 7,743 loans were included in a recent decision made by the I.R.S. to levy taxes with interest on "forgiveness" earned during 1987, 1988 and 1989. The I.R.S. also plans to tax future "forgiveness" earned by Alaskans.

I propose a simple, direct statement by this Legislature that confirms our intention that the Alaskan Student Loan forgiveness provisions are grants earned by graduates who live and work in the State.

Although the Anchorage I.R.S. office, in a January 23 letter to the ACPE, said that it would still consider the "forgiveness" taxable even if it were called a grant, this opinion could be appealed. Passage of HB370 would put the State in a much better position.

I also propose allowing Alaskans who earned forgiveness during those three years to rescind and postpone the receipt of that grant.

We need to make a strong effort to enable these Alaskans to avoid paying retroactive taxes plus interest for forgiveness received in 1987, 1988 and 1989. According to the 1988-89 State of Alaska Student Financial Aid Programs Annual Report (page 10), the amount of forgiveness is close to $15 million (interest not included).

I would like to be able to tell the 5,900 Alaskans who earned forgiveness that the Legislature took a stand in their favor.

PUBLIC OPINION MESSAGE

DEAR: REPRESENTATIVE LEMAN

NAME: TIMOTHY W. DOEBLER
TITLE: ASSISTANT PROFESSOR-UAA
ADDRESS: P.O.BOX 104698
CITY: ANCHORAGE ZIP: 99510
PHONE: 786-1403
BILL NO: HB370
SUBJECT: TAXATION OF ALASKA STUDENT LOAN.FORGIVENESS
MESSAGE: I FUNDED MY EDUCATION WITH THE ALASKA STUDENT LOAN. UNDER AGREEMENT WITH THE STATE I AGREED TO RECEIVE HALF OF THIS LOAN AS A GRANT IF I REMINDED IN ALASKA. I REMAINED HERE, I MAKE MY LOAN PAYMENTS AND AM NOW UNFAIRLY TAXED FOR IT. WHAT HAPPENED? THIS ISN'T FAIR! /BN

POMID: 03093449
DATE: 02/07/90
TIME: 09:34:49
LIONAME: ANCHORAGE LIO

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HB 370

An educational grant

Dear Editor:

The Alaska Commission on Postsecondary Education recently sent out notices to Alaska Student Loan recipients regarding the possible taxation of loan forgiveness. The forgiveness portion of the Alaska Student Loan should more appropriately be considered an "Educational Grant" instead of taxable income. On the reverse side of the Alaska Student Loan Application form, under special loan provisions, Item No. 2 reads "Up to 50 percent of the total loan may be considered a grant if upon completion of course of study, the loan recipient meets Alaska residency criteria of the loan program."

When individual Alaskans signed the promissory notes for loans received under the Alaska Student Loan program, each person entered into a contractual agreement with the state of Alaska with the irrevocable stipulation that 50 percent of the proceeds of each loan would be forgiven if certain conditions of the loan were met, the same process as described in an educational grant. The state of Alaska, in allowing forgiveness of loan indebtedness, actually benefited from the forgiveness by attracting newly educated students back to the state, but failed to inform loan recipients of possible future tax consequences. Instead, students were actually informed that the forgiveness would be a grant.

Regardless of whether each individual is insolvent or not, as argued by the Alaska Society of Certified Public Accountants, taxation of the Alaska Student Loan forgiveness for any loans obtained prior to tax reform is simply unjust and inappropriate by the IRS. If taxation is going to be levied, then each and every person should be given the opportunity to evaluate the circumstances relative to how future taxation will affect them prior to committing to an elective program, rather than afterwards. Many people may have elected not to request an Alaska student loan knowing the tax consequences as implied. Many students could have and would have sought residency as in-state students in another state and paid less for college tuition, resulting in the need for lesser amounts of funding for college.

This is but one instance that shows how current tax structure in the United States of America actually provides a deterrent for those wanting to pursue higher education, especially in light of the fact that the U.S. is faced with significant shortages of trained professionals for the 1990s and beyond.

Thomas G. Hipsher
Anchorage

AT 8 Nov 89 B5

Rep. Loren Leman

Petty politics in Juneau

YOU WOULD think the legislators would learn.

They complain and harp and cry that they work hard and long — but that most Alaskans don't appreciate them.

They whine about not understanding the reason for continuing complaints from average Alaskans that the lawmaking sessions last too long and the pay is too high.

And then they keep on playing the same silly games that turn off the people back home, that lower the legislature's prestige and that generally make people think that politicians are just that — politicians who are more interested in posturing and backbiting than they are in doing a job in public service.

A case in point occurred in Juneau a couple of days ago.

The ladies and gentlemen of the state House had before them a relatively simple, non-controversial measure to expand the student loan program to include people attending college on a part-time basis.

A good idea. Not every Alaskan can be a full-time student. Many have to work. Many have family obligations. Many pursue their academic degees over a long period of years.

A BILL TO make loans available to them — in an amount of up to 50 percent of what a full-time student might obtain — could provide a helpful boost. It has Democratic sponsorship and surely will draw bipartisan support.

But when it came up for action, it was bumped back to committee because a Republican, Rep. Loren Leman of Anchorage, proposed an amendment that likewise deserves bipartisan support.

Mr. Leman's amendment would retroactively change the state's foregiveness of portions of the student loans to a grant — in hopes that the Internal Revenue Service might then reverse its ruling that the foregiveness portion of the loan amounts to income, subject to taxation.

Yesterday, the IRS rejected the idea, calling the write-off earned income.

BUT THAT is immaterial to this discussion.

The point is that Mr. Leman had a good idea.

There's no reason on earth why his amendment should not be an appropriate amendment to this worthwhile bill.

Except one.

The Democrats — or some of them, anyway — don't want a Republican to be able to take credit for a good piece of legislation, or a part of a good piece of legislation, to be more precise.

How foolish and how petty.

But it's the kind of claptrap that happens over and over and over again in the legislature — as the lawmakers fritter away hours and days with little regard to the huge cost involved in keeping them in Juneau.

And with little real regard, too, to what reaction such monkey business causes among the voters.

It's no wonder that legislators, in the minds of many, are held in low esteem. And they're so befogged in Juneau they never seem to see why.

HB370

FRANK H. MURKOWSKI
ALASKA

COMMITTEES:
VETERANS' AFFAIRS (RANKING MEMBER)
ENERGY AND NATURAL RESOURCES
FOREIGN RELATIONS
INDIAN AFFAIRS
INTELLIGENCE

United States Senate

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JUNEAU
U.S. FEDERAL BUILDING
BOX 1647, 99802
(907) 586-7400

January 12, 1990

JAN 23 1990

The Honorable Loren Leman
3111 C St, Suite 425
Anchorage, Alaska 99503

Dear Loren:

Thank you for contacting me about about the decision made by the IRS to tax the debt forgiveness many Alaskans have received through the Alaska student loan program.

I commend you on your efforts to address this issue in the State Legislature by modifying the state's student loan program. As you know, I am working with Senator Stevens and Congressman Young to enact legislation which would provide for an exclusion from gross income for the amount forgiven under the program. The bill was originally introduced in the House by Congressman Young.

The congressional delegation will continue to press for a solution to this issue on the federal level. Please feel free to keep me advised of your progress on the issue in the Legislature.

With warm regards,

Sincerely,

Frank H. Murkowski

Frank H. Murkowski
United States Senator

TAX ON STUDENT LOAN FORGIVENESS STILL IN LIMBO

At the October meeting, CARTAns passed a resolution objecting to the recent IRS ruling to tax Alaskans on the forgiven portion of their student loans. Letters were subsequently written in part as follows to Senators Murkowski and Stevens and Congressman Young:

The Central Alaska Retired Teachers Association has gone on record as objecting to the Internal Revenue Service ruling that forgiveness of student loans is to be treated as income. Teachers know that education can be expensive and the loan forgiveness gives beneficiaries an opportunity to reestablish themselves in Alaska. To make this retroactive ruling after years of different treatment is totally unfair to the individuals targeted. This forgiveness for returning to Alaska was regarded by everyone as a kind of scholarship that was awarded after rather than before the college work was completed.

The following reply dated December 7, 1989, has come from Senator Murkowski:

Thank you for contacting me about the decision made by the IRS to tax the debt forgiveness received through the Alaska student loan program. I share your concerns about the unfairness of this change. Recently I cosponsored a bill introduced by Senator Stevens which would provde for an exclusion from gross income for the amount forgiven under the program. The bill was originally introduced in the House by Congressman Young.

Be assured I intend to work with Senator Stevens and Congressman Young to ensure that this legislation is enacted as quickly as possible.

Sincerely,
s/Frank H. Murkowski
United States Senator

The appropriate initial steps have been taken, but continued watchfulness is in order. Letters to our Congressional delegation from concerned individuals would undoubtedly be helpful.

CARTA
c/o Leah A. Peterson

Bulk Rate

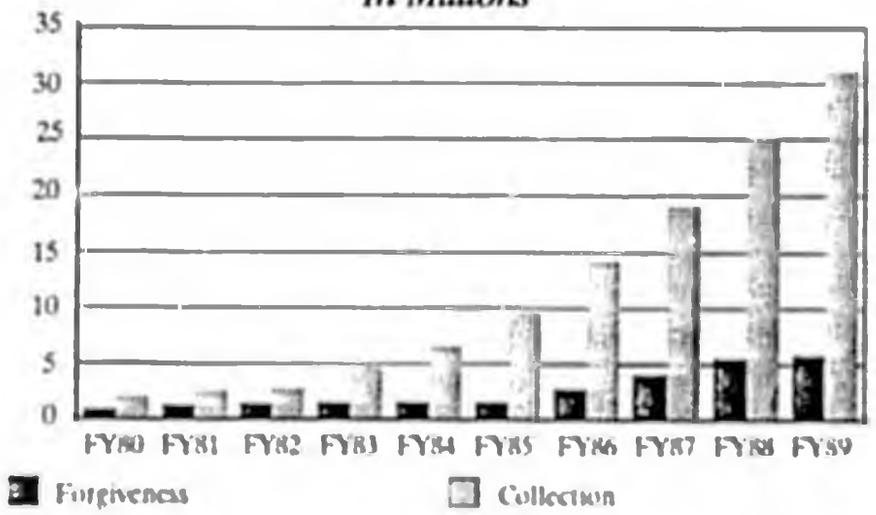
Loan Repayments

The student loan program is based upon a revolving fund with the students' loan repayments being re-utilized for future student loans. Since 1971-72 (actually 1974-75, since there were no repayments received the first few years), Alaskans have repaid close to $120 million on their educational loans. As can be seen in Figure 8, these repayments are rapidly increasing each year. Also presented in Figure 8 is a representation of the forgiveness history of the student loan program. Students who received loans before 1987-88 and reside in Alaska after completion of their course of study are eligible to have up to 50 percent of their loans forgiven. Beginning with the first such forgiveness in 1974-75, the total amount of loan funds (including interest) which the State of Alaska has forgiven has generally shown large annual increases, with the exception of 1979-80 when forgiveness benefits temporarily leveled. Since the inception of the program, almost 10,000 Alaskans have received partial forgiveness of their student loans. Increases are projected to continue over the next few years as larger numbers of students complete their educational programs. However, loan forgiveness provisions were repealed beginning with 1987-88 loans, so these totals will begin to decline over time and will eventually be non-existent.

Figure 8

Forgiveness Benefits and Collection Receipts

In Millions



STEVE COWPER, GOVERNOR

ALASKA COMMISSION ON POSTSECONDARY EDUCATION

P.O. BOX FP
JUNEAU, ALASKA 99811-0599
PHONE (907) 465-2854

M E M O R A N D U M

TO: Members of the Alaska Commission on Postsecondary Education

Mr. John Havelock, Chair	Mr. Donald Eller
Ms. Patricia Abney	Senator Paul Fischer
Ms. Alice Bosshard	Ms. Karen Fultz
Ms. Ruth Burnett	Mr. Paul Harris
Mr. John Chenoweth	Mr. Mark Helmericks
Dr. Patricia Clark	Representative Niilo Koponen
Dr. April Crosby	Ms. Bettye Smith

FROM: Jane Byers Maynard, Executive Director
Alaska Commission on Postsecondary Education

SUBJECT: Internal Revenue Service Request Regarding Alaska Student Loan Forgiveness Recipients

DATE: October 12, 1989

As you may be aware, the IRS has requested information from the Alaska Commission on Postsecondary Education concerning 1987 and 1988 Alaska Student Loan forgiveness recipients "for tax administration purposes." The information requested was public information subject to release at the request of the IRS.

Following the release of this information on September 26, 1989, we sent a courtesy letter dated October 3, 1989 to the forgiveness recipients to advise them that information had been given to the IRS and to provide an IRS contact number in the event of questions.

Understandably, this matter is of concern to a number of loan borrowers. In order to explain the sequence of events which led to the IRS request, the following information is provided for your use in responding to questions on this matter.

The Commission and the Alaska Student Loan Corporation have never received a ruling or correspondence from the IRS regarding the tax status of the forgiven portion of loans. To date, the Commission has only received an August 1989 request and a September 1989 clarification from the IRS for information concerning 1987 and 1988 forgiveness recipients. From press reports, it appears that the IRS took the action as part of an overall review of the tax status of Alaska benefit programs.

The data requested included the borrower's name, current address, social security number, and amount of forgiveness benefit received. The information provided to the IRS covered 7,743 loans and approximately 5,900 borrowers (since some had multiple loans) and $10.6 million in forgiveness over the two-year period. It has since come to our attention that the IRS operates under a three-year statute of limitations that precluded requests regarding forgiveness benefits received prior to 1987.

Prior to this event, our agency was directed on two occasions, in 1983 and 1986, by the Office of the Attorney General to avoid providing federal tax advice to loan recipients. Staff was advised instead to direct individual inquiries to the IRS.

In November 1988, Commission staff asked Price Waterhouse officials whether information return (Form 1099) reporting requirements applied to the forgiven portion of student loans. An informal opinion from IRS representatives told Price Waterhouse that forgiveness of loans does not constitute a "payment" although it may be income to the student, and therefore, there is no information reporting requirement on the part of the State. This was reported to the Alaska Student Loan Corporation.

No further action was taken on this matter until the 1989 request for information was received from the IRS. As a result of that request, we are now advising borrowers on both the forgiveness application and the forgiveness statement of the following:

> REMINDER: The amount of your loan reduction under the forgiveness provisions of the Alaska Student Loan Program may be includable as gross income for tax purposes. We recommend you provide this information to your tax return preparer, or consult with a tax accountant prior to completing the return yourself.

We continue to be advised by the Office of the Attorney General to not give direct tax advice to individuals or take further action prior to a more formal determination of IRS action in this matter. Callers are being given the following toll-free number to contact the IRS for further information: 1-800-424-1040. In addition, we are working with Alaska's Congressional delegation in their review of this matter.

You will be advised of any further developments as they occur.

STATE OF ALASKA

ALASKA COMMISSION ON POSTSECONDARY EDUCATION

STEVE COWPER, GOVERNOR

P.O BOX FP
JUNEAU, ALASKA 99811-0599
PHONE: (907) 465-2854

January 26, 1990

The Honorable Ted Stevens
United States Senate
522 Hart Building
Washington, DC 20510

Dear Senator Stevens:

On behalf of the members of the Alaska Commission on Postsecondary Education, I would like to take this opportunity to thank you for your efforts to address the recent action by the IRS to tax Alaska Student Loan forgiveness recipients. While it is understood that congressional action may take a year or more to resolve this problem, your genuine concern and action to date are appreciated by both loan borrowers and state officials.

As you work with IRS representatives, it is important to alert you to a procedural aspect of forgiveness that may affect the IRS position on taxation. The IRS is currently taxing students for years in which the student has received no monetary benefit from his or her forgiveness eligibility.

For example, a student becomes eligible for the first 10% of his or her loan forgiveness upon residing in the State for two years after graduation. The student applies to our office, we determine the forgiveness eligibility, and notify the student that they are qualified for the first forgiveness. The student's account is adjusted to reflect a reduction in the total loan principal balance owed, but the student's monthly payments remain the same. The student receives no monetary benefit (i.e., reduction in payments) until the scheduled tenth (final) year of the repayment cycle when no payments will be owed. The tenth year of repayment is, therefore, forgiven.

To take this a step further, when the same student has resided in the State an additional year and applies for a second 10% of loan forgiveness, the ninth year of loan repayment is forgiven, and so on up to five years of forgiveness eligibility.

05:ES3LH

1/26/90
Attachments to Sen Stevens

Again, the issue here is that the student continues to pay the same amount out-of-pocket whether or not forgiveness has been received. It is only the length of the repayment period that gets progressively shorter with each forgiveness eligibility. The IRS, however, is currently taxing a student at the time of forgiveness eligibility as if the student has already seen a cost savings. This is simply not the case, and it is imperative that the IRS be made aware of this fact.

Thank you again for your assistance in this matter. If I can provide additional information, please contact me.

Sincerely,

Jane Byers Maynard

Jane Byers Maynard
Executive Director

cc: The Honorable Pat Rodey
Alaska State Senate

The Honorable Loren Leman
Alaska House of Representatives

Frank Baxter, Commissioner
Department of Administration

John Havelock, Chair
Alaska Commission on Postsecondary Education

Kristen Bomengen, Assistant Attorney General
Alaska Department of Law

January 19, 1990

Jane Byers Maynard
Executive Officer
Alaska Student Loan Corporation
P.O. Box FP
Juneau, Alaska 99811-0599

Re: Senate Bill No. 350

Dear Jane:

At your request, I have reviewed SB 350 as introduced on January 8, 1990. The bill is a legislative response to the well publicized determination by the Internal Revenue Service to tax, as imputed income to the student loan borrower, the "forgiven" amount of that borrower's loan. Under AS 14.43, as its provisions read before 1987, a borrower who remained in Alaska following graduation was entitled to reimbursement from the State for a portion of the amounts repaid on the borrower's student loan. Although the statute referred to reimbursement from the State, in practice the borrower was simply not required to make the payments that were to be reimbursed by the State. It is the amount of the payments that the borrower was not required to repay that the Internal Revenue Service has now determined to be taxable income.

The approach taken by SB 350 is to recast these pre-1987 loans as part loan and part grant. The theory is that an amount received as a grant is not taxable income. To the extent that the borrower does not or did not qualify for forgiveness under the previous program, SB 350 would require that the grant portion of the financial assistance be converted over to a loan with interest accruing thereon from the date the grant was made.

I have a number of questions and comments about this bill which are set forth in the following paragraphs. Some of those questions and comments directly relate to the bill's impact on the Corporation's bonds and bonding ability. Others are general questions and comments which may only indirectly relate to bonds and bonding.

1/19/90
Ken Vassar attests Post-Standard

1. Will it work? My initial reaction to SB 350 is that it seems unlikely that the Service would accept a recharacterization of the affected loans such as proposed by the bill. Having made loans to borrowers under specific terms that were agreed to in writing by the borrowers, I would expect the Service to conclude that the loans are loans regardless of what you call them. A cat is still a cat no matter how many times you call it a cow. The real point of this comment is that, before going to the effort of passing legislation and committing the Corporation and the other entities affected by this legislation to an expensive and laborious effort to revise these loans, there should be a high level of comfort that the bill will produce the desired effect with the Service. Has a tax lawyer been consulted? Has there been any formal or informal approach to the Service for guidance?

2. Is it counterproductive? Under the bill, an outstanding loan would be terminated and replaced, at the request of the borrower, with new financial assistance in the form of a loan and a grant. The new loan and grant would "for the same amount as the loan being replaced" (see Section 7(c) of the bill. I have difficulty understanding this language, but more on that subject in paragraph 5 below). I wonder whether the Service would consider that the termination of the outstanding loan is itself a taxable event to the borrower at least to the extent that it is being replaced by a grant. This is perhaps only a variation on the question presented in paragraph one, but it could result in the borrower being placed in a worse position as to income taxation that the borrower would have been in under the existing provisions. Under the existing provisions, the borrower would be taxed only as and to the extent that a portion of the borrower's loan in a given year was forgiven. If the Service takes the view that the termination of the outstanding loan (at least to the extent of its replacement by a grant) consititutes a forgiveness of that loan that is a taxable event, then the borrower could be liable for taxes on the entire amount of the loan so forgiven.

Again, the point here is the same as in paragraph one; i.e., there needs to be a careful tax analysis of the impact of this bill -- preferably including an approach to the Service -- before the State commits itself to this proposal.

3. Section 7(d)(3). Under Section 7(d)(3) of the bill, the Corporation and other entities are directed to advise borrowers as to "how their federal tax obligation may be affected" by the proposed form of financial assistance. Before the Corporation or any other entity undertakes this task, I would reiterate and stress that there needs to be a careful tax analysis of the proposal which preferably includes seeking guidance from the Service.

4. Section 7(a) and (b). My first comment with respect to these two subsections is simply to state my understanding that they limit the applicability of SB 350 to loans that were made before July 1, 1987. In other words, there is no prospective effect of this bill, and the current lending program is not being replaced by either the old forgiveness program or the bill's grant program. I think it would be helpful to have that explicitly stated in Section 7.

My second comment as to these subsections is that I do not understand the reason for having two subsections which say virtually the same thing. Subsection (a) says do not provide financial assistance unless certain circumstances exist. Subsection (b) says do provide financial assistance if those same circumstances exist (except that (b) does add one new circumstance which must also exist). I just do not see the point of having both of these subsections, and I wonder whether I am missing something.

5. Section 7(c). Section 7(c) of the bill states that the amount of financial assistance to be given a borrower "must be for the same amount as the loan being replaced". Does this refer to the outstanding principal balance of the loan being replaced at the time it is replaced? Or, does it refer to the original principal amount of the loan? If it is the former, then will the grant provisions of sec. 14.43.118(a) and (b) result in a grant amount equal to what would have been forgiven? It does not appear so. On the other hand, if the amount of the financial assistance is to equal the original principal amount of the loan, then the borrower may be undertaking a larger loan than the borrower then has outstanding. If there has previously been amounts of the borrower's outstanding loan forgiven under the existing program, will this result in the borrower benefitting from greater forgiveness than would have been originally the case? And if, as intimated in paragraphs one and two above, this forgiveness amount (whether cast in terms of a forgiven loan or in terms of a grant) constitutes taxable income, might the borrower's tax burden thereby be increased? Regardless of whether the borrower has received any forgiveness, if the borrower has paid off a portion of the borrower's loan and now receives a loan and grant equal to the original amount borrowed, is the borrower to receive any credit for the amount paid off under the previous loan? Finally, with regard to this subsection, what is the meaning of the direction to the financial aid committee to "make the financial assistance retroactive to the date of the loan being replaced"?

6. Would implementation of this legislation impair contracts with bondholders? The loans that would be affected by this legislation have been pledged as security for the

outstanding bonds of the Corporation. The terms of those loans have been described in detail in the Official Statements prepared in connection with the sale of those bonds. It must be assumed that holders of the Corporation's bonds relied on those descriptions in making their determinations to buy the bonds.

In my letter to Dr. Ron Phipps dated April 18, 1989, I discussed the constitutional inhibition against State action which impairs the obligations of contracts. That letter was written with respect to proposed legislation which would have retroactively modified the terms of certain student loans that had been pledged as security for the Corporation's bonds. The legislation discussed in that letter would have applied forgiveness provisions to loans that were made without any such provisions. My conclusion was that such a modification would have violated the constitutional inhibition.

It is difficult to analyze SB 350 under this constitutional issue without first obtaining clarification with respect to the questions asked in paragraph 5 above. However, based upon my general understanding of the bill, I believe it would not pass constitutional scrutiny.

The program suggested by the bill would take loans that might be forgiven in part to loans and grants that might become loans in part. The intent is that the amount of the existing loans that would be forgiven would equal the amount of the grants that would remain grants. Even if it actually worked out in accordance with that intent (which, again, cannot be determined without knowing the answers to the questions presented in this letter), there would nevertheless be a distinct change in the security for the bonds. At one moment, the bondholders would be secured by loans which might be forgiven at a time in the future. The next moment, the bondholders would be secured by a lesser amount of loans with a possibility that there might be more loans created in the future by virtue of conversion of the grants. The two are not the same.

What happens if the borrower goes into default? Is the Trustee, acting on behalf of the bondholders, in the same position with respect to enforcing payment of amounts that might become due if the grant ever becomes a loan as the Trustee would be in in attempting to enforce payment of a loan that might at some time be forgiven? What happens if the borrower goes into bankruptcy? Is the Trustee, as one of the bankrupt's creditors, in the same position with respect to a loan and a grant that might become a loan at some time in the future as the Trustee would be in with respect to a larger loan that might at some time in the future be forgiven? What

position is the Trustee or the Corporation in with respect to determining whether any portion of the grant is to be converted to a loan? Must either of them take affirmative steps to trace every borrower to determine where the borrower is living and how long the borrower has lived there? Upon whom is the burden of producing evidence to show that the grant should or should not become a loan?

Sec. 14.43.118(c) of the bill states that interest on a grant that has been converted to a loan begins on the date the grant was made. Therefore, interest will accrue for a period of time until it is determined how much of the grant will be converted to a loan. How will this accrued interest be paid? In a lump sum or over time? Will the accrued interest compound until it is actually paid? And does the payment of this accrued interest at some time in the future put the Trustee and the Corporation in the same position as if interest on the whole loan had been paid on a regularly scheduled basis and in due course? What happens if the borrower leaves the State and returns periodically within the first six years after the borrower completes his or her course of study? Must the Corporation and Trustee wait the full six years before being able to determine how much of the grant will become a loan?

These are genuine questions. I just do not know what the answers are or what the intent is. It seems to me that the answers may lead to the conclusion that the loans and grants which would be offered under the terms of SB 350 as substitute collateral to replace the existing loans are significantly different.

7. <u>Will this have an impact on the Corporation's ability to issue bonds in the future?</u> There could be an impact for one of two reasons. If there is any diminution of revenues to the Corporation, it will directly affect the Corporation's ability to meet the coverage tests set forth in its indenture for the outstanding bonds and, therefore, will limit the Corporation's ability to issue bonds. It appears that the effect of the bill on the Corporation's revenues would be negligible, although it is not possible to determine this with certainty until the questions asked in the preceding paragraphs are answered. If the effect on the Corporation's revenues were more than negligible, then the bill would probably be unconstitutional under the impairment of contracts clause referred to in paragraph 6.

The second reason that the bill might affect the Corporation's ability to issue bonds would be marketplace concerns. Even if the bill does not violate the impairment of contracts clause of the constitution, a perception that the State has unilaterally "changed the deal" with respect to

outstanding bonds could have an adverse impact on potential buyers of bonds to be issued in the future. This is not my area of expertise, and I would suggest contacting the Corporation's financial advisor for a reaction to this concern.

These are my initial reactions to the bill. I hope that they are helpful to you. I am certainly happy to discuss this with you at any time.

Very truly yours,

Kenneth E. Vassar

Internal Revenue Service
Department of the Treasury

District Director

P.O. Box 101500, Anchorage, Alaska 99510

23

Person to Contact: Robert Jackson

Telephone Number: (907) 261-4303

Refer Reply to: E:TC

Date: January 23, 1990

Kristen B. Bomengen
Assistant Attorney General
State of Alaska, Department of Law
P. O. Box K
Juneau, Alaska 99811

Re: Your letter of January 4, 1990

Dear Mrs. Bomengen:

When the State of Alaska forgives a portion of a student loan, the amount forgiven is a taxable event to the borrower. The debt forgiven is subject to tax in accordance with section 108 of the Internal Revenue Code.

A review of your letter and the copy of the Alaskan Statutes that you sent to me did not change that result. I discussed your letter with our attorneys and they agree with that conclusion.

The Alaskan legislature set up a revolving loan fund, in order to loan money to Alaskans so that they could attend college. The loans are subject to repayment upon termination of studies, over a period of six years. Upon the Alaskan meeting certain conditions, a portion of the loan may be forgiven, if application is made to the State of Alaska by the student. If no application is made, the full loan is subject to repayment.

The statute says that a portion of the loan shall be considered a "grant" based upon residency. This is the amount that is forgiven, but the statute uses the word grant rather than calling it a loan forgiveness.

The question revolves around the difference between a scholarship (or grant) and a loan.

A scholarship or grant is an amount given to a student without any strings attached to it concerning repayment. It is an outright gift to a student. This type of scholarship is covered by I.R.C. section 117. No repayment is involved as no debt was ever created.

1/23/90
IRS mails to AG's office

Kristen B. Bomengen

The Alaskan program is an outright loan program. Repayment is required. The original intent was to have the money revolve in the fund so that it could be loaned to another student. This money has always been considered a loan subject to repayment based upon the terms of a note signed at the time a loan is granted. The borrower knows that it is subject to repayment, and if not paid, the loan is subject to enforced collection.

As a loan, its' forgiveness is subject to I.R.C. section 108.

Sincerely yours,

Robert A Jackson

Robert A. Jackson
Technical coordinator

account in determining whether entity meets reit qualifications. Any amount included in gross income by reason of the discharge of indebtedness shall not be taken into account for purposes of paragraphs (2) and (3) of section 856(c).

(10) Indebtedness satisfied by corporation's stock.

(A) In general. For purposes of determining income of a debtor from discharge of indebtedness, if a debtor corporation transfers stock to a creditor in satisfaction of its indebtedness, such corporation shall be treated as having satisfied the indebtedness with an amount of money equal to the fair market value of the stock.

(B) Exception for title 11 cases and insolvent debtors. Subparagraph (A) shall not apply in the case of a debtor in a title 11 case or to the extent the debtor is insolvent.

(f) Student loans.

(1) In general. In the case of an individual, gross income does not include any amount which (but for this subsection) would be includible in gross income by reason of the discharge (in whole or in part) of any student loan if such discharge was pursuant to a provision of such 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.

(2) Student loan. For purposes of this subsection, the term "student loan" means any loan to an individual to assist the individual in attending an educational organization described in section 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 section 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 so described pursuant to an agreement with any entity described in subparagraph (A), (B), or (C) under which the funds from which the loan was made were provided to such educational organization.

(g) Special rules for discharge of qualified farm indebtedness.

(1) Discharge must be by qualified person.

(A) In general. Subparagraph (C) of subsection (a)(1) shall apply only if the discharge is by a qualified person.

(B) Qualified person. For purposes of subparagraph (A), the term "qualified person" has the meaning given to such term by section 46(c)(8)(D)(iv); except that such term shall include any Federal, State, or local government or agency or instrumentality thereof.

(2) Qualified farm indebtedness. For purposes of this section, indebtedness of a taxpayer shall be treated as qualified farm indebtedness if

(A) such indebtedness was incurred directly in connection with the operation by the taxpayer of the trade or business of farming, and

(B) 50 percent or more of the aggregate gross receipts of the taxpayer for the 3 taxable years preceding the taxable year in which the discharge of such indebtedness occurs is attributable to the trade or business of farming.

(3) Amount excluded cannot exceed sum of tax attributes and business and investment assets.

(A) In general. The amount excluded under subparagraph (C) of subsection (a)(1) shall not exceed the sum of—

(i) the adjusted tax attributes of the taxpayer, and

(ii) the aggregate adjusted bases of qualified property held by the taxpayer as of the beginning of the taxable year following the taxable year in which the discharge occurs.

(B) Adjusted tax attributes. For purposes of subparagraph (A), the ter. "adjusted tax attributes" means the sum of the tax attributes described in subparagraphs (A), (B), (C), and (E) of subsection (b)(2), determined by taking into account $3 for each $1 of the attributes described in subparagraphs (B) and (E) of subsection (b)(2).

(C) Qualified property. For purposes of this paragraph, the tenn "qualified property" means any property which is used or is held for use in a trade or business or for the production of income.

(D) Coordination with insolvency exclusion. For purposes of this paragraph, the adjusted basis of any qualified property and the amount of the adjusted tax attributes shall be determined after any reduction under subsection (b) by reason of amounts excluded from gross income under subsection (a)(1)(B).

In '88, P.L. 100-647, Sec. 1004(a)(1), deleted "or" at the end of subpara. (a)(1)(A), substituted ", or" for the period at the end of subpara. (a)(1)(B) and added subpara. (a)(1)(C) . . . Sec. 1004(a)(2), amended para. (a)(2) . . . Sec. 1004(a)(3)(A), substituted "subparagraph (A), (B), or (C)" for "subparagraph (A) or (B)" in para. (b)(1) . . . Sec. 1004(a)(3)(B) deleted "in title 11 case or insolvency" after "attributes" in the heading of subsec. (b) . . . Sec. 1004(a)(4), amended subsec. (g) . . . Sec. 1004(a)(6)(A), substituted "subsections (a), (b) and (g)" for "subsections (a) and (b)" in paras. (d)(6) and (7) . . . Sec. 1004(a)(6)(B), substituted "subsections (a), (b), and (g)" for "subsections (a), (b), and (c)" in the heading of subsec. (d) . . . Sec. 1004(a)(6)(C), substituted "subsections (a), (b), and (g)" for "subsections (a) and (b)", in the headings of para. (d)(6) and subpara. (d)(7)(A), effective for tax. yrs. begin. after 12/31/86.

Prior to amendment, para. (a)(2) read as follows:

"(2) Coordination of exclusions. Subparagraph (B) of paragraph (1) shall not apply to a discharge which occurs in a title 11 case."

Prior to amendment, subsec. (g) read as follows:

"*(g) Special rules for discharge of qualified farm indebtedness of solvent farmers.*

"(1) In general. For purposes of this section and section 1017, the discharge by a qualified person of qualified farm indebtedness of a taxpayer who is not insolvent at the time of the discharge shall be treated in the same manner as if the discharge had occurred when the taxpayer was insolvent.

"(2) Qualified farm indebtedness. For purposes of this subsection, indebtedness of a taxpayer shall be treated as qualified farm indebtedness if—

"(A) such indebtedness was incurred directly in connection with the operation by the taxpayer of the trade or business of farming, and

"(B) 50 percent or more of the average annual gross receipts of the taxpayer for the 3 taxable years preceding the taxable year in which the discharge of such indebtedness occurs is attributable to the trade or business of farming.

"(3) Qualified person. For purposes of this subsection, the term "qualified person" means a person described in section 46(c)(8)(D)(iv)."

In '86, P.L. 99-514, Sec. 104(b)(2), substituted "33⅓ cents" for "50 cents" in subpara. (b)(3)(C), effective for tax. yrs. begin. after 12/31/86.

—P.L. 99-514, Sec. 231(d)(3)(D), amended subpara. (b)(3)(B), effective for tax. yrs. begin. after 12/31/85. Prior to amendment, subpara. (b)(3)(B) read as follows:

STEVE COWPER, GOVERNOR

REPLY TO:

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ANCHORAGE, ALASKA 99501-1994
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☐ 1st NATIONAL CENTER
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☒ P.O. BOX K—STATE CAPITOL
JUNEAU, ALASKA 99811-0300
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FAX: (907) 463-5295

465-3603

DEPARTMENT OF LAW

OFFICE OF THE ATTORNEY GENERAL

January 4, 1990

Robert Jackson
Internal Revenue Service
P.O. Box 101500
Anchorage, Alaska 99510

Re: Taxation of state-paid portion of student loans

Dear Mr. Jackson:

I have enclosed copies of some of the legislative background that surfaced when I researched the development of Alaska's Scholarship Loan Program. As we discussed briefly about a week ago, it appears that the program was developed as an educational grant program, with grant benefits extended only to those who qualified by returning to the state after receiving a degree.

By way of brief summary, the state, at that time, was interested in encouraging people to remain in or return to the state to avert a "brain drain" that could be an indirect consequence of making an education more accessible to Alaskans through the scholarship loan program. The 1981 statutory change did not affect and was not intended to address the "grant" aspect of the program. It also appears unlikely the change would have been acceptable to the legislature had it been thought that returning students would face increased expenses by incurring tax liability during the early years after graduation.

As you can see from the enclosed documents, the original statutory language specifically stated that the forgiveness "portion of a loan shall be considered a grant" to the recipient or grantee who returns to the state. Because loans were only available to pay for specific school-related expenses,

03-C5LM

1/4/90
A.G letter to I.R.S

and were not available for other purposes, these funds appear to fall within the requirements for educational or scholarship grants as set out in 26 U.S.C. 117(b).

In 1981, the statute underwent a number of other changes that included the addition of another 10 percent "forgiveness" benefit so that up to 50 percent of the original loan amount would be eligible for payment by the state if the recipient returned to the state after receiving an education. The letter of intent that was accepted by both legislative bodies, and published in the legislative journals, demonstrates that the concern of the legislature at the time was with reducing immediate costs for returning students so that they would not be burdened with high debts during the early years after graduation. (It should be noted that the practice of reimbursement that was endorsed in this letter was in effect for less than a year when it became apparent that it would not be a workable system. An administrative determination was made at that time, with the concurrence of legislative committee members, to stop sending checks to loan recipients while they still owed a considerable debt to the state.)

The statutory language that clearly designated that this state benefit program was intended to be a grant has been buried from view for many years. The most recent statutory provision addressing this benefit was repealed in 1987 and no longer appears in current Alaska statutes. Because it was repealed, students who obtained loans after the 1986-87 school year do not qualify for this state benefit.

The State of Alaska has a unique loan program and is beset by some unique problems. Among these problems are limited educational opportunities within the state, and a relatively high cost of living for students who may wish to return to the state after graduation. The loan program was intended to have the effect of reducing the costs to these students and providing an incentive for returning to the state shortly after graduation by designating a portion of the loan to be a grant upon return to the state.

There is good reason to consider, in light of the original statutory language, whether this state benefit may be more appropriately treated as an educational grant, as addressed in 26 U.S.C. 117, rather than a discharge of indebtedness under 26 U.S.C. 108.

Please let me know if you have any questions or comments in light of this information about the original intent of the Scholarship Loan Program. I will be interested in hearing your thoughts about this matter.

Sincerely yours,

DOUGLAS B. BAILY
ATTORNEY GENERAL

By: Kristen F. Bomengen
Kristen F. Bomengen
Assistant Attorney General

KFB:jh

Enclosure

cc: Jerry Leonard, District Counsel
Internal Revenue Service

Jane Byers Maynard, Executive Director
Alaska Commission on Postsecondary Education

SPECIAL COMMITTEE REPORTS

FREE CONFERENCE COMMITTEE REPORT

SB 120

June 19, 1981

Mr. President:
Mr. Speaker:

The Free Conference Committee considering CS FOR SENATE BILL NO. 120 (HESS) (amending the undergraduate and graduate scholarship loan program; eff. date) and HOUSE CS FOR CS FOR SENATE BILL NO. 120(FIN) (efd fld) (relating to undergraduate and graduate scholarship loans) recommends that FREE CONFERENCE CS FOR SENATE BILL NO. 120 (relating to undergraduate and graduate scholarship loans; eff. date) be adopted with a Letter of Intent.

Senate members signing the report: Senator Sturgulewski, Chairman and Senators Stimson and Parr. House members signing the report: Representative Cuddy, Chairman and Representatives Hurlbert and Buchholdt.

Letter of Intent on Free Conference CS for Senate Bill No. 120 follows:

FCCS SB 120 amends the Student Loan Program by increasing the maximum amount which can be borrowed and the number of years in which the loans may be paid. It increases the incentive for students to remain in the State after graduation (so that the State may profit by its investment) by increasing the loan forgiveness from 40 percent to 50 percent.

It is the intent of the Committee that the loan forgiveness not wait until the end of the repayment cycle, as is currently the practice, since students cannot perceive these benefits during the first several years. For the loan forgiveness to be truly effective, benefits should be realized as they are earned.

It is the intent of the Committee that forgiveness benefits be provided to the borrower in the form of annual refunds as eligibility is established. Under this policy the borrower remaining in the State will get 10 percent loan forgiveness at the end of each incremental period.

The above loan forgiveness policy can be handled by administrative action and no legislation is required.

President Kertzula stated the above Free Conference Committee Report would be held on the Secretary's desk one legislative day.

INTRODUCTION AND REFERENCE OF SENATE BI

SJR 53

SENATE JOINT RESOLUTION NO. 53 by Senator Ferg

Requesting the National Park Service to improve an old mining road throug the north addition to Denali Nationa Park and Preserve and to extend the road to the McKinley Park Road at Wonder Lake-Kantishna.

was read the first time and referred to the Committee.

INTRODUCTION AND REFERENCE OF SENATE

SB 605

SENATE BILL NO. 605 by Senators Kelly and G:

"An Act limiting municipal taxes on personal property; and providing fo: an effective date."

was read the first time and referred to th. Regional Affairs Committee and the Finance Co:

CONSIDERATION OF THE CALENDAR

HOUSE BILLS IN SECOND READING

HB 131

CS FOR HOUSE BILL NO. 131 (HESS) am S (increa: for health facilities and hospitals) which from June 19 with amendment No. 2 moved before the Senate at this time.

Senator Sackett offered the following amendm No. 2:

Amendment No. 2 is on pages 1545 a 1546 of the journal.

First paragraph, delete underlined beginning with "except that money ending with health facility"

ittee has had COMMITTEE SUBSTITUTE FOR SENATE
inance) amended (redesignating certain loans
w and by the Alaska Power Authority for power
cts for power projects subject to the power
effective date) under consideration and
replaced with HOUSE COMMITTEE SUBSTITUTE
BSTITUTE FOR SENATE BILL NO. 244 (Rules)
that it do pass. Concurring: Fuller
ins. Smith, O'Connell and Hayes.

was referred to the Rules Committee for
calendar.

ee has had COMMITTEE SUBSTITUTE FOR SPONSOR
NATE BILL NO. 555 (Resources)(continuing
the Guide Licensing and Control Board)
nder consideration and recommends it do
Fuller (Chairman), Phillips, Smith,
ss.

s referred to the Rules Committee for place-
ar.

PORTS OF SPECIAL COMMITTEES

·fd failed)

Committee which has had HCS CSSB 120(Fin)
SB 120(HESS) under consideration, recom-

TRENCE COMMITTEE SUBSTITUTE FOR
E NO. 120
elating to undergraduate and
scholarship loans; effective

tter of intent.

ed by Senators Sturgulewski, Chairman,
and Representatives Cuddy, Chairman,
t.

follows:

HCS CSSB 120(Fin)(efd failed) continued

SENATE LETTER OF INTENT

ON

CS FOR SENATE BILL NO. 120

CSSB 120 amends the Student Loan Program by increasing the maximum amount which can be borrowed and the number of years in which loans may be paid. It increases the incentive for the student to remain in the State after graduation (so that the State may profit by its investment) by increasing the loan forgiveness from 40 percent to 50 per cent.

It is the intent of the Committee that the loan forgiveness not wait until the end of the repayment cycle, as is currently the practice, since students cannot perceive these benefits during the first several years. For the loan forgiveness to be a truly effective incentive, benefits should be realized as they are earned.

It is the intent of the Committee that forgiveness benefits be provided to the borrower in the form of annual refunds as eligibility is established. Under this policy the borrower remaining in the State will get 10 percent loan forgiveness at the end of each year.

The above loan forgiveness policy can be handled by administrative action, and no legislation is required.

A copy was placed on each member's desk and will be taken up later under Unfinished Business.

CONSIDERATION OF THE DAILY CALENDAR

The Speaker stated that consideration of the daily calendar would be held until after Unfinished Business. Without objection, the House advanced to

6-1682E
Ford
2/21/90

Original sponsor(s): REP. LEMAN, Furnace, Hanley, Sharp, Hudson

IN THE HOUSE

CS FOR HOUSE BILL NO. 370 ( )

IN THE LEGISLATURE OF THE STATE OF ALASKA

SIXTEENTH LEGISLATURE - SECOND SESSION

A BILL

For an Act entitled: "An Act relating to conditions of scholarship loans; and providing for an effective date."

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

* Section 1. AS 14.43.120 is amended by adding new subsections to read:

(s) A portion of a loan shall be considered a grant if the loan was made after July 1, 1971, and before July 1, 1987, and if, after completion of the course of study for which the loan was received, the borrower is a resident of the state for at least two years. The portion of the loan that shall be considered a grant is based on the following percentages of the principal amount of the loan plus interest up to a total of 50 percent of the total indebtedness:

(1) two - three years residence in the state, 10 percent;

(2) three - four years residence in the state, an additional 10 percent;

(3) four - five years residence in the state, an additional 10 percent;

(4) five - six years residence in the state, an additional 10 percent;

(5) over six years residence in the state, an additional 10 percent.

(t) A person who became eligible or who received forgiveness for a loan, on or after January 1, 1987, and before January 1, 1990, may elect to defer the forgiveness or may rescind an application for forgiveness that has been approved. A person may defer forgiveness or

a loan for up to five years.

* Sec. 2. .This Act takes effect immediately under AS 01.10.070(c).

STATE OF ALASKA
THE LEGISLATURE

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LEGISLATIVE AFFAIRS AGENCY

LEGISLATIVE REFERENCE LIBRARY

Copies of minutes listed below were originally included in this file. The minutes are available on the STAIRS database CMPR. In order to save space copies of minutes have not been left in the files.

Mary Van Nimwegen

H. HESS 2-22-90

H. HESS 3-5-90