

**S B**

**350**

JAN 17 1990

Patrick M. Rodey  
Senator

# Alaska State Legislature



Senate

3111 C. St., Suite 510  
Anchorage, Alaska 99503  
(907) 561-7618

During Session:  
P.O. Box V  
Juneau, Alaska 99811  
(907) 465-3793

DATE: January 15, 1990

TO : Senator Paul Fischer, Chair  
Senate HESS Committee

FROM: Senator Patrick Rodey

A handwritten signature in cursive that reads "Pat".

RE : Senate Bill 350 - relating to student loans and grants and providing for an effective date.

I respectfully request that the above-referenced bill be scheduled for a hearing in the Senate HESS Committee as soon as possible.

I am attaching a sectional analysis on the legislation and would welcome you contacting me if you have any questions about the proposal.

As you know, The Internal Revenue Service has determined that the forgiveness provision does not fall within the existing exemption of the Internal Revenue Code; therefore, it is considered "taxable".

This issue is of great concern to the approximately 5900 students who are impacted by this determination, and I would appreciate your consideration of getting the measure scheduled.

STATE OF ALASKA  
THE LEGISLATURE

POUCH Y STATE CAPITOL  
JUNEAU, ALASKA 99811  
907 465 3800

LEGISLATIVE AFFAIRS AGENCY

M E M O R A N D U M

January 10, 1990

SUBJECT: Sectional summary of SB 350  
TO: Senator Pat Rodey  
FROM: Theresa L. Bannister *TB*  
Legislative Counsel

You have requested a sectional summary of the above described bill.

As a preliminary matter, note that a sectional summary of a bill should not be considered an authoritative interpretation of the bill and the bill itself is the best statement of its contents. If you would like an interpretation of the bill as it may apply to a particular set of circumstances, please advise.

GENERAL SUMMARY. The bill allows certain borrowers to retroactively convert their student loans into an alternate form of financial assistance. The requirements and loan/grant conditions, including the percentages and residency requirements, are designed to be the same as the old student financial assistance program. The new program is only available to replace loans made under the old financial assistance program after January 1, 1978, and only if the borrower is/was eligible for state payment of the loan under the old program after a certain date.

Section 1 makes a technical change. The amendment adds student grant programs to the description of the programs that are to be administered by the Alaska Commission on Postsecondary Education.

Section 2 clarifies that the scholarship revolving loan fund is to be used for the financial assistance program established by sec. 4 of the bill.

Section 3 makes several technical changes. The primary change is the inclusion of grant applications in the coverage of the section.

Section 4 is the heart of the bill. Subsection (a) establishes an alternative form of financial assistance for students. The subsection authorizes the student financial aid committee to provide financial assistance under this section instead of under AS 14.43.110 - 14.43.115. One-half of the assistance under this section is to be a loan, and the other one-half a grant. The subsection makes the assistance subject to the conditions under AS 14.43.110 - 14.43.115 for making loans.

Subsection (b) of sec. 4 establishes that if the borrower does not meet certain residency requirements after completing the course of study, the grant portion is converted into a loan. Lays out the residency and percentage requirements for conversion.

Subsection (c) of sec. 4 establishes when interest begins accumulating on a grant that is converted into a loan.

Subsection (d) of sec. 4 prohibits a person whose grant is converted into a loan from being eligible for state payment of the loan under former AS 14.43.120(j).

Subsection (e) of sec. 4 makes the loan portion and any grant portion that is converted into a loan subject to the same interest, payment, security, and default provisions as loans made under AS 14.43.110 - 14.43.115.

Subsection (f) of sec. 4 states that the assistance under this section is subject to the same conditions as for loans under AS 14.43.120(a) - (d).

Subsection (g) of sec. 4 states that the financial assistance is subject to the selection criteria of the former AS 14.43.130, unless the financial assistance replaces a loan made on or after July 16, 1983, the date when AS 14.43.130 was repealed.

Section 5 makes the residency requirements for the financial assistance under sec. 4 subject to AS 14.43.120(p).

Section 6 makes a technical change to bring the financial assistance under sec. 4 subject to the anti-discrimination provisions of AS 14.43.135.

Section 7 provides the guidelines for the implementation of the financial assistance program under sec. 4.

Subsection (a) of sec. 7 prohibits the financial aid committee from providing the financial assistance unless the assistance replaces a loan made before July 1, 1987, under AS 14.43.090 - 14.43.160 and the applicant is eligible on or after January 1, 1986, for state payment of the replaced loan under former AS 14.43.120(j).

Subsection (b) of sec. 7 directs the financial aid committee to provide the financial assistance if the assistance replaces certain loans, if the person was eligible on or after January 1, 1986, for state payment under AS 14.43.120(j), and if the person satisfies certain application requirements.

Subsection (c) of sec. 7 establishes that the alternate financial assistance must be for the same amount as the loan being replaced, and that the student financial aid committee must cancel the loan being replaced and make the new financial assistance retroactive to the date of the loan being replaced. Subjects the new financial assistance to the provisions of AS 14.43 that applied to the replaced loan, except as otherwise provided under the Act.

Subsection (d) of sec. 7 directs the Alaska Commission on Postsecondary Education, the Alaska Student Loan Corporation, and the student financial aid committee to take the action necessary to implement the financial assistance program established under sec. 4. Identifies certain actions to be taken, including the issuance of documents for the financial assistance.

Section 8 makes the main section of the Act and three other sections retroactive to January 1, 1978.

Section 9 makes sec. 3 retroactive to the date when the words "or grant" were deleted from the subsection.

Section 10 makes sec. 5, which refers to AS 14.43.120(p), retroactive to the date when AS 14.43.120(p) became effective.

Senator Pat Rodey  
Page 4  
January 10, 1990

Section 11 gives the bill an immediate effective date.

If I may be of further assistance, please advise.

TB:mi  
wkmi6/024

STEVE COWPER, GOVERNOR

**DEPARTMENT OF LAW**

OFFICE OF THE ATTORNEY GENERAL

January 4, 1990

REPLY TO:

1031 W 4th AVENUE SUITE 200  
ANCHORAGE, ALASKA 99501-1994  
PHONE: (907) 276-3550  
FAX: (907) 276-3697

1st NATIONAL CENTER  
100 CUSHMAN ST. SUITE 400  
FAIRBANKS, ALASKA 99701-4679  
PHONE: (907) 452-1568  
FAX: (907) 456-1317

P.O. BOX K—STATE CAPITOL  
JUNEAU, ALASKA 99811-0300  
PHONE: (907) 465-2600  
FAX: (907) 463-5295

465-3603

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,

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.

Robert Jackson  
Internal Revenue Service  
Our file: 663-89-0403

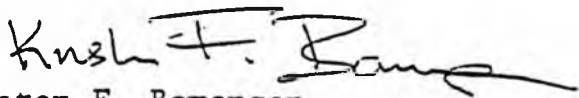
January 4, 1990  
Page 3

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

## INTRODUCTION AND REFERENCE OF SENATE J

SJR 53

SENATE JOINT RESOLUTION NO. 53 by Senator Fer

Requesting the National Park Service to improve an old mining road through the north addition to Denali National 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 C

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

was read the first time and referred to the Regional Affairs Committee and the Finance C

## CONSIDERATION OF THE CALENDAR:

## HOUSE BILLS IN SECOND READING

HB 131

CS FOR HOUSE BILL NO. 131 (HESS) am 6 (increase 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 amendment No. 2:

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

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

Committee has had COMMITTEE SUBSTITUTE FOR SENATE BILL NO. 555 (Resources) amended (redesignating certain loans and by the Alaska Power Authority for power projects for power projects subject to the power projects (effective date) under consideration and replaced with HOUSE COMMITTEE SUBSTITUTE FOR SENATE BILL NO. 244 (Rules) that it do pass. Concurring: Fuller, Phillips, Smith, O'Connell and Hayes.

was referred to the Rules Committee for calendar.

Committee has had COMMITTEE SUBSTITUTE FOR SENATE BILL NO. 555 (Resources) (continuing the Guide Licensing and Control Board; under consideration and recommends it do pass. Concurring: Fuller (Chairman), Phillips, Smith,

referred to the Rules Committee for calendar.

#### REPORTS OF SPECIAL COMMITTEES

(efd failed)

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

REFERENCE COMMITTEE SUBSTITUTE FOR SENATE BILL NO. 120 relating to undergraduate and scholarship loans; effective

letter of intent.

led by Senators Sturgulewski, Chairman, and Representatives Cuddy, Chairman.

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

Internal Revenue Service

2 P. 2 91:51 06/22/10 01/25/90 15:18 FROM HGO/ANNEX/JUNO  
Department of the Treasury

District  
Director

P.O. Box 101500, Anchorage, Alaska 99510

Person to Contact: Robert Jackson

Telephone Number: (907) 261-4303

Refer Reply to: E:TC

Date: January 23, 1990

25  
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.

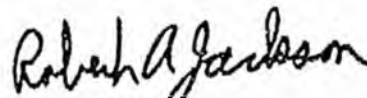
-2-

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  
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 term "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 term "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 "and" 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 (c)" 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)(3), substituted "33 1/2 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)(2)(B), effective for tax. yrs. begin. after 12/31/85. Prior to amendment, subpara. (b)(2)(B) read as follows:

ATTACHMENT 2

Existing statute can be amended with following addition:

A portion of a loan made before July 1, 1987 shall be considered a grant if, upon completion of the course of study for which the loan was granted, the borrower is a resident of the state for at least two years. The portion of the loan which shall be regarded as a grant shall be the following percentages of the total loan received plus interest up to a total of 50 percent of the total loan:

- |   |                           |
|---|---------------------------|
| (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. |

DANIEL K. INOUE, HAWAII  
ERNEST F. HOLLINGS, SOUTH CAROLINA  
J. BENNETT JOHNSTON, LOUISIANA  
QUENTIN N. BURDICK, NORTH DAKOTA  
PATRICK J. LEAHY, VERMONT  
JIM SASSER, TENNESSEE  
FRANK R. LANTIERI, ARIZONA  
JEFF BUMPERS, ARKANSAS  
FRANK R. LAUTENBERG, NEW JERSEY  
M. MARKS, IOWA  
BARBARA A. MIKULSKI, MARYLAND  
HARRY REID, NEVADA  
BROCK ADAMS, WASHINGTON  
WYCHE FOWLER, JR., GEORGIA  
J. ROBERT KERREY, NEBRASKA

MARK O. HATFIELD, OREGON  
TED STEVENS, ALASKA  
JAMES A. MCCLURE, IDAHO  
JAKE GARM, UTAH  
THAD COCHRAN, MISSISSIPPI  
ROBERT W. KASTEN, JR., WISCONSIN  
ALFONSE M. D'AMATO, NEW YORK  
WARREN RUDDMAN, NEW HAMPSHIRE  
ARLEN SPECTER, PENNSYLVANIA  
PETE V. DOMENICI, NEW MEXICO  
CHARLES E. GRASSLEY, IOWA  
DON NICKLES, OKLAHOMA  
PHIL GRAMM, TEXAS

JAMES H. ENGLISH, STAFF DIRECTOR  
J. KEITH KENNEDY, MINORITY STAFF DIRECTOR

# United States Senate

COMMITTEE ON APPROPRIATIONS  
WASHINGTON, DC 20510-8025

RECEIVED  
FEB 16 1990

Alaska Commission on  
Postsecondary Education

February 7, 1990

Jane Byers Maynard  
Executive Director  
Alaska Commission on Postsecondary Education  
P.O. Box FP  
Juneau, Alaska 99811-0599

Dear Jane:

Thank you for your letter of January 26, 1990, regarding the IRS decision to tax student loan forgiveness benefits. Your description of the timing of forgiveness benefits raises some important questions about the legitimacy of the IRS ruling. I have asked Robert Brock, District Director of the Anchorage IRS Office, for his prompt review of the issues you raise.

Thank you again for keeping in touch with us on this important matter.

With best wishes,

Cordially,

  
TED STEVENS

# 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.

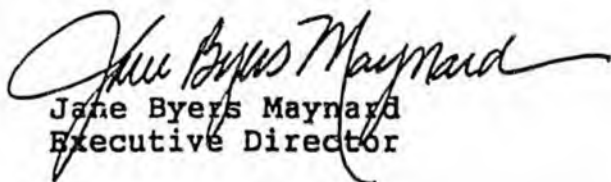
To take this a step further, when the same student has resided in the State an additional year and applies for a second 10% of loan forgiveness, the ninth year of loan repayment is forgiven, and so on up to five years of forgiveness eligibility.

The Honorable Ted Stevens  
January 26, 1990  
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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  
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

# STATE OF ALASKA

## ALASKA COMMISSION ON POSTSECONDARY EDUCATION

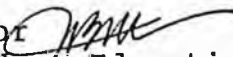
STEVE COWPER, GOVERNOR

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

### MEMORANDUM

TO: Members of the Senate HESS Committee

The Honorable Paul Fischer, Chairman  
The Honorable Jim Duncan, Vice Chair  
The Honorable Al Adams  
The Honorable Lloyd Jones  
The Honorable Tim Kelly

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

RE: Status of IRS Taxation of Alaska Student Loan  
Forgiveness Benefits

DATE: February 28, 1990

On behalf of the Commission, I would like to express our appreciation and support for legislative efforts to date to address the problem of IRS taxation of Student Loan forgiveness benefits. Legislative efforts thus far include joint resolutions in support of Congressional proposals S.1803 and H.R.3518 which would exempt Alaska Student Loan forgiveness from taxation. Staff at the Congressional offices believe that a resolution from the Alaska Legislature will strengthen the State's position and enhance chances for passage of the Congressional bills.

State approaches to date by both the Legislature and the Office of the Attorney General have focused on restoring the original grant intent of the forgiveness provision as stated in initial statutory references to forgiveness, but which was dropped from statute in 1981. The grant approach is offered in the enclosed letter of January 4, 1990 from the Attorney General to the IRS regional representative Robert Jackson. This letter encourages the IRS to treat forgiveness as an educational grant under 26 U.S.C. 117, in light of the original statutory language.

As you can see from the IRS response dated January 23, 1990, however, the Anchorage IRS office is not amenable to the grant argument. Since this is the first written communication the State has received from the IRS on this matter and since IRS action ignores legislative intent, the Legislature may wish to pursue a formal ruling to determine a workable solution.

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It is possible that during formal ruling deliberations the grant approach could be reconsidered and the Anchorage office decision overturned. For this reason, restoration of original grant language as worded in Attachment 2 could still proceed without harmful effect either during the formal ruling process or after a final determination has been made. In any event, it seems prudent to obtain a clear reading from the IRS concerning the ability of the Legislature to take effective action in this matter.

In terms of administrative action taken to address this problem, the Commission has now notified 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 itself.

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,

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in reality, won't occur until the end of the repayment cycle when the latter years of repayment are "forgiven". This "delayed benefit" argument is of considerable interest to the Congressional offices. It has been relayed by Senator Stevens to the IRS and we are waiting for a response. (See Attachment 3.)

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.

The Commission will continue to work closely with Congress and the Legislature to remedy this unfortunate situation.

Attachments

cc: The Honorable Jay Kerttula  
Alaska State Senate

1040, George enters his net benefits of \$5,980. On line 21b, he enters his taxable part of \$2,990.

**Example 2.** Joe and Betty Johnson are married and are filing a joint return for 1989. Joe is retired and receives a fully taxable pension of \$28,000. Joe and Betty both received social security benefits in 1989. Joe's Form SSA-1099 shows \$6,600 in Box 3, \$1,100 in Box 4, and \$5,500 in Box 5. Betty's Form SSA-1099 shows \$3,500 in Box 3 and the same amount in Box 5. The only other income Joe and Betty had in 1989 was \$2,400 in interest income. They figure their taxable social security benefits by completing the worksheet shown below. They enter \$9,000 on line 21a, Form 1040, and \$1,450 on line 21b, Form 1040.

**Social Security and Equivalent Railroad Retirement Benefits Worksheet**  
(Keep for your records)

Check only one box.

- A. Single—enter \$25,000 on line 7 below.
- B. Married filing a joint return—enter \$32,000 on line 7 below.
- C. Married not filing a joint return and lived with your spouse at any time during the year—enter 0— on line 7 below.
- D. Married not filing a joint return and DID NOT live with your spouse at any time during the year—enter \$25,000 on line 7 below.

1. Enter the total amount from Box 5 of ALL your Forms SSA-1099 and Forms RRB-1099 (if applicable) ..... 9,000

*Note.* If line 1 is zero or less, stop here; none of your benefits are taxable. Otherwise, go on to line 2.

2. Divide the amount on line 1 by 2 ..... 4,500

3. Add the amounts on Form 1040, lines 7, 8a, 8b through 20, plus line 22. Do not include here any amounts from lines 16a or 17a of Form 1040, or from Box 5 of Forms SSA-1099 or RRB-1099 ..... 30,400

4. Add lines 2 and 3 ..... 34,900

5. Enter the amount from Form 1040, line 30 ..... 0—

6. Subtract line 5 from line 4 ..... 34,900

7. Enter:

- \$25,000 if you checked Box A or D, or
- \$32,000 if you checked Box B, or
- 0— if you checked Box C ..... 32,000

8. Subtract line 7 from line 6. Enter the result, but not less than zero ..... 2,900

*Note.* If line 8 is zero, stop here. None of your benefits are taxable. Do not enter any amounts on Form 1040, lines 21a or 21b, unless you checked Box D above. If you checked Box D, enter 0— on line 21b and write "D" on the dotted line to the left of line 21a. If line 8 is more than zero, go on to line 9.

9. Divide the amount on line 8 by 2 ..... 1,450

**10. Taxable benefits.**

- First, enter on Form 1040, line 21a, the amount from line 1 above.
- Then, compare amounts on lines 2 and 9 above, and enter the smaller of the two amounts on this line and also on Form 1040, line 21b ..... 1,450

**Repayments More Than Gross Benefits**

In some situations, your Form SSA-1099 or Form RRB-1099 will show that the total benefits you repaid (Box 4) is more than the gross benefits (Box 3) you received. If this occurred, the amount in Box 5 will be a negative figure and none of your benefits will be taxable. If you receive more than one form, a negative figure in Box 5 of one form is used to offset a positive figure in Box 5 of another form. If you have any questions about this negative figure, contact your local Social Security Administration office or your local Railroad Retirement Board field office.

**Joint return.** If you and your spouse file a joint return, and your Forms SSA-1099 or Forms RRB-1099 show that your repayments are more than your gross benefits, but your spouse's are not, subtract the amount in Box 5 of your form from the amount in Box 5 of your spouse's form to get your net benefits when figuring if your combined benefits are taxable.

**Example.** John and Mary are married and file a joint return for 1989. John received Form SSA-1099 showing \$3,000 in Box 5. Mary also received Form SSA-1099 and the amount in Box 5 was (\$500). John and Mary will use \$2,500 (\$3,000 minus \$500) as the amount of their net benefits when figuring if any of their combined benefits are taxable.

**Repayment of benefits received in an earlier year.** If the sum of the amount shown in Box 5 of all of your Forms SSA-1099 and Forms RRB-1099 is a negative figure and part or all of this negative figure is for benefits you included in gross income in 1984, 1985, 1986, 1987, or 1988, you can take an itemized deduction for the amount of the negative figure that represents those benefits. This deduction, if \$3,000 or less, is subject to the 2%-of-adjusted-gross-income limit that applies to certain miscellaneous itemized deductions.

If this deduction is more than \$3,000, you should figure your tax two ways:

- 1) Figure your tax for 1989 with the itemized deduction. This deduction is *not* subject to the 2%-of-adjusted-gross-income limit that applies to certain miscellaneous itemized deductions.
- 2) Figure your tax for 1989 without the deduction. If a portion of the negative figure represents a repayment of 1984 benefits, you must first recompute your 1984 tax, reducing your 1984 social security benefits by that portion. Recompute your 1985, 1986, 1987, and 1988 tax in the same manner, using any portion of the negative figure that represents a repayment of benefits for those years. Reduce your 1989 tax, figured without the deduction, by the total decrease in your 1984, 1985, 1986, 1987, or 1988 tax as recomputed.

Compare the tax figured in methods (1) and (2). Your tax for 1989 is the lesser of the two amounts. If method (1) results in less tax, take the itemized deduction on Schedule A (Form

1040). If method (2) results in less tax, claim a credit for the applicable amount on line 62 of Form 1040 and write "I.R.C. 1341" in the margin to the left of line 62. If both methods produce the same tax, deduct the repayment in full on Schedule A.

**13. Other Income**

**Important Change**

**Jury duty pay.** If you are required to give your jury duty pay to your employer because your employer continues to pay your salary while you serve on the jury, you can, beginning in 1987, deduct the amount repaid as an adjustment to gross income, rather than as an itemized deduction. See *Jury duty pay*, later.

You must include on your tax return all income you receive in the form of money, property, and services that is not exempt from tax. This chapter discusses many items of taxable income, as well as some major items that are not taxable.

**Miscellaneous Taxable Income**

This section begins with brief discussions of numerous income items, arranged in alphabetical order. These discussions are followed by other taxable income items which are discussed in greater detail as follows:

- Bartering
- Recoveries (including state income tax refunds)
- Repayments
- Royalties

**Note.** When you report miscellaneous taxable income on line 22 of Form 1040, write a brief description of the income on the dotted line next to line 22.

**Activity not for profit.** You must include on your return income from an activity not for profit. An example of this type of activity would be a hobby or a farm you operate mostly for recreation and pleasure. Deductions for expenses related to the activity are limited, cannot total more than the income you report, and can be taken only if you itemize deductions on Schedule A (Form 1040).

The activity will be presumed to have been for profit if it results in a profit in at least 3 out of 5 consecutive tax years. However, for the breeding, training, showing, or racing of horses, the activity must result in a profit in at least 2 out of 7 consecutive tax years. If the activity meets this test, it is presumed to be carried on for profit and the limits will not apply.

If you have engaged in an activity for less than 3 years, you can postpone the determination that the activity is not for profit by filing Form 5213, *Election To Postpone Determination*. Get Publication 535, *Business Expenses*, for more information.

**Alaska oil royalties.** If you were a resident of Alaska and qualified to receive a payment from Alaska's mineral income fund, you must report this amount on line 22, Form 1040. The state of Alaska will send you a Form 1099-MISC which shows this amount. IRS will receive a copy of the Form 1099.

**Alimony.** Include in income on line 11, Form 1040, any alimony payments you receive. Amounts you receive for child support are not income to you. Alimony and child support payments are discussed in Chapter 20.

**Allowances and reimbursements.** If you receive travel, transportation, or other allowances or reimbursements from your employer, see Chapter 28.

**Cancelled debt.** A cancelled debt, or a debt paid for you by another person, is generally income to you and must be reported on line 22, Form 1040. A discount offered by a financial institution for the prepayment of a mortgage loan is income from the cancellation of a debt. However, you have no income from the cancellation of a debt if the cancellation, or the payment by another person, is intended by the other person as a gift to you.

If your debt is cancelled in a bankruptcy case (title 11) or when you are insolvent, the discharge of debt is not income. Get Publication 908, *Bankruptcy and Other Debt Cancellation*.

**Cancellation of student loan.** You do not have income if your student loan is cancelled because you agreed to certain conditions to obtain the loan and then performed the services required. Under the terms of the loan you must be required to work for a specified period of time in certain professions for one of a broad class of employers. To qualify, the loan must have been made by:

- 1) The government—federal, state, or local, or an instrumentality, agency, or subdivision thereof.
- 2) A tax-exempt public benefit corporation which has assumed control of a state, county, or municipal hospital, and whose employees are considered public employees under state law.
- 3) An educational organization under an agreement with an entity described in (1) or (2) that provided the funds to the institution to make the loan.

Cancellations of student loans under section 465 of the Higher Education Act of 1965 also are not income.

**Court awards and damages.** To determine if settlement amounts you receive by compromise or judgment must be included in income, you must consider the item which the settlement replaces. Include the following as ordinary income:

- 1) Interest on any award.
- 2) Compensation for lost wages or lost profits.
- 3) Punitive damages.
- 4) Amounts received in settlement of pension rights (if you did not contribute to the plan).
- 5) Damages for:
  - a) Patent or copyright infringement.
  - b) Breach of contract.
  - c) Interference with business operations.

Do not include as income compensatory damages for the following:

- 1) Personal injury or sickness (whether received in a lump sum or installments).
- 2) Damage to your character.
- 3) Alienation of affection.
- 4) Surrender of custody of a minor child.

Get Publication 525, *Taxable and Nontaxable Income*, for additional information.

**Estate and trust income.** An estate or trust, unlike a partnership, may have to pay federal income tax. If you are a beneficiary of an estate or trust, you are taxed on your share of its income. However, there is never a double tax. Estates and trusts file their returns on Form 1041, *U.S. Fiduciary Income Tax Return*, and report your share of the income on Schedule K-1 of Form 1041.

**Current income required to be distributed.** If you are the beneficiary of a trust that must distribute currently all of its income, you must report your share of the distributable net income whether or not you have actually received it.

**Current income not required to be distributed.** If you are the beneficiary of an estate or trust and the fiduciary has the choice of whether to distribute all or a part of the current income, you must report all income that is required to be distributed to you, whether or not it is actually distributed, plus all other amounts actually paid or credited to you, to the extent of your share of distributable net income.

**How to report estate and trust income.** Each item of income is treated the same for you as for the estate or trust. If it is dividend income for the trust, it is the same for you.

The fiduciary of the estate or trust must tell you the type of items making up your share of the estate or trust income and any credits you are allowed on your individual income tax return.

**Losses of estates and trusts** generally are not deductible by the beneficiaries.

**Grantor trust.** Income earned by a grantor trust is taxable to the grantor, not the beneficiary. This rule applies if the property put into the trust will revert (be returned) to the grantor or the grantor's spouse. Generally, for transfers after March 1, 1986, a trust is a grantor trust if the grantor has a reversionary interest valued (at the date of transfer) at more than 5% of the value of the transferred property. For transfers in trust made before March 2, 1986, a trust was a grantor trust if it was expected that the property would revert to the grantor within 10 years.

**Fees.** Include all fees for your services in gross income. Examples of these fees are amounts you receive for services as:

- 1) A corporation director.
- 2) An executor or administrator of an estate.
- 3) A notary public.
- 4) An election precinct official.

**Free tour.** A free tour you receive from a travel agency for organizing a group of tourists must be included in income on line 22, Form 1040, or on Schedule C (Form 1040) at the fair market value of the tour. You cannot deduct your expenses in serving as the voluntary leader of the group at the group's request.

**Gambling winnings.** You must include your gambling winnings in income on line 22, Form 1040. If you itemize your deductions on Schedule A (Form 1040), you can deduct gambling

losses you had during the year, but only up to the amount of your winnings.

**Winnings from lotteries and raffles** are gambling winnings. You must include in income bonds, cars, houses, and other noncash prizes at their fair market value.

**Note.** If you win a state lottery prize payable in installments, you must include in gross income the annual payments and any amount you receive designated as "interest" on the unpaid installments.

**Hobby losses.** Losses from a hobby are not deductible from other income. A hobby is an activity from which you do not expect to make a profit. See *Activity not for profit*, earlier.

**Note.** If you collect stamps, coins, or other items as a hobby for recreation and pleasure, and you sell any of the items, your gain is taxable as a capital gain. (See Chapter 16.) However, if you sell items from your collection at a loss, you cannot deduct a net loss.

**Illegal income,** such as stolen or embezzled funds, must be included in gross income on line 22, Form 1040, or on Schedule C (Form 1040).

**Indian fishing rights.** If you are a member of a qualified Indian tribe that has fishing rights secured by treaty, executive order, or an Act of Congress as of March 17, 1988, do not include in income amounts you receive from activities related to those fishing rights. The income is not subject to income tax, self-employment tax, or employment taxes.

**Investment clubs.** An investment club is a group of friends, neighbors, business associates, or others who pool limited or stated amounts of funds to invest in stock or other securities. The club may or may not have a written agreement, charter, or by-laws. Usually the group operates informally with members pledging a regular amount to be paid into the club monthly. Some clubs have a committee that gathers information on securities, selects the most promising, and recommends that the club invest in them. Other clubs rotate the investigatory responsibilities among all their members. Most require all members to vote for or against all investments, sales, exchanges, or other transactions.

How the income from an investment club is reported on your tax return depends on how the club operates. Most clubs operate as partnerships and are treated as such for federal tax purposes. Others operate as corporations, trusts, or associations taxed as corporations.

For more information about investment clubs, get Publication 550, *Investment Income and Expenses*.

**Jury duty pay** you receive must be included in income. If you are required to give the pay to your employer because your employer continues to pay your salary while you serve on the jury, you can deduct the amount turned over to your employer as an adjustment to income. Include the amount you repay your employer on line 30, Form 1040, and write "Jury pay" and the amount on the dotted line next to line 30.

**Kickbacks.** You must include in income on line 22, Form 1040, or on Schedule C (Form 1040), kickbacks, side commissions, push money, or similar payments you receive.

**Example.** You are a car salesperson and help arrange car insurance for buyers. Insurance brokers kick back part of their commissions to you for referring customers to