

**S J R**

**57**

SENATE COMMITTEE REPORT  
FIRST COMMITTEE OF REFERRAL

DATE: 1/9/90

FURTHER:

Date of 5-Day Notice: 2/22/90  
(in accordance with Uniform Rule 23)

DATE TURNED INTO OFFICE: 3/1/90

H E S S Committee considered SJR 57

Relating to taxation of certain student loans.

and recommended:

- replace with \_\_\_\_\_ CS \_\_\_\_\_  same title
- attached amendment(s)  new title
- \_\_\_\_\_ letter of intent adopted

do pass

do not pass

no recommendation

individual recommendations

further referral to \_\_\_\_\_

ATTACHES NEW FISCAL NOTE(S):

Department(s)/Date:

Department(s)/Date:

fiscal note(s) \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

zero fiscal note(s) \_\_\_\_\_  
Postsecondary Education.  
\_\_\_\_\_  
\_\_\_\_\_

appropriation-no fiscal note

Governor's bill w/fiscal note

SIGNING DO PASS:

[Handwritten Signatures]  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

OTHER RECOMMENDATIONS:

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

Paul Fisher (De Pass)

Chair: Signature and Recommendation

# STATE OF ALASKA

## ALASKA COMMISSION ON POSTSECONDARY EDUCATION

STEVE COWPER, GOVERNOR

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 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 *JM*  
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.

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,

Members of the Senate HESS Committee  
February 28, 1990  
Page 3

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

STEVE COWPER, GOVERNOR

REPLY TO:

**DEPARTMENT OF LAW**

OFFICE OF THE ATTORNEY GENERAL

January 4, 1990

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) 465-3600  
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

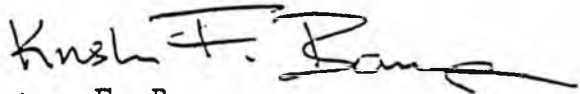
January 4, 1990  
Page 3

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 Scimson 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:

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

## INTRODUCTION AND REFERENCE OF SENATE R

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 SENAT

SB 605

SENATE BILL NO. 605 by Senators Kally 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 Co

CONSIDERATION OF THE CALENDAR  
HOUSE BILLS IN SECOND READINGHB 131

CS FOR HOUSE BILL NO. 131 (HESS) am S (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 and 1546 of the journal.

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

has had COMMITTEE SUBSTITUTE FOR SENATE BILL NO. 244 (Finance) amended (redesignating certain projects for power projects subject to the effective date) under consideration and replaced with HOUSE COMMITTEE SUBSTITUTE FOR SENATE BILL NO. 244 (Finance) that it do pass. Concurring: Phillips, Smith, O'Connell and Hayes.

was referred to the Rules Committee for calendar.

has had COMMITTEE SUBSTITUTE FOR SENATE BILL NO. 555 (Resources) (containing the Guide Licensing and Control Bill) under consideration and recommends it do pass. (Chairman), Phillips, Smith

referred to the Rules Committee for calendar.

#### REPORTS OF SPECIAL COMMITTEES

Failed

Committee which has had HCS CSSB 120 (Finance) under consideration, recommends it do pass.

REFERENCE COMMITTEE SUBSTITUTE FOR SENATE BILL NO. 120 (Education) relating to undergraduate and scholarship loans; effective date to be determined.

Statement of Intent.

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

As follows:

CS 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

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.

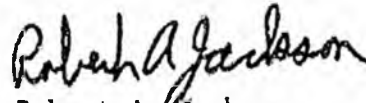
-2-

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.

(N) 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 '89, 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 "33 1/4 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 12/31/83. 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. |

ROBERT C. BYRD, WEST VIRGINIA, CHAIRMAN

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## 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.

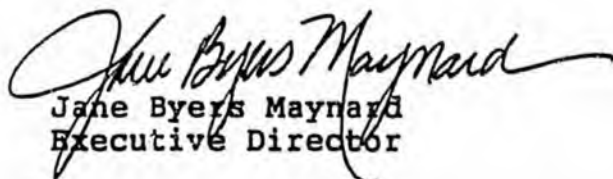
To take this a step further, when the same student has resided in the State an additional year and applies for a second 10% of loan forgiveness, the ninth year of loan repayment is forgiven, and so on up to five years of forgiveness eligibility.

The Honorable Ted Stevens  
January 26, 1990  
Page 2

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

## FISCAL NOTE

**REQUEST:**

Revision Date: \_\_\_\_\_  
 Title: Relating to taxation of certain  
           student loans  
 Sponsor: Kerttula  
 Requestor: Senate HESS

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

**EXPENDITURES/REVENUES:** (Thousands of Dollars)

OPERATING	FY 91	FY 92	FY 93	FY 94	FY 95	FY 96
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
<b>TOTAL OPERATING</b>	-0-	-0-	-0-	-0-	-0-	-0-

CAPITAL						
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REVENUE						
---------	--	--	--	--	--	--

**FUNDING:** (Thousands of Dollars)

GENERAL FUND						
FEDERAL FUNDS						
OTHER						
<b>TOTAL</b>	-0-	-0-	-0-	-0-	-0-	-0-

**POSITIONS:**

FULL-TIME						
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: 2/28/90

Approved by Commissioner: \_\_\_\_\_ Date: \_\_\_\_\_  
 Agency: \_\_\_\_\_

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

Internal Revenue Service

Department of the Treasury

District  
Director

P.O. Box 101500, Anchorage, Alaska 99510

Person to Contact: J. Eshelman

Telephone Number:  
(907) 261-4250

Refer Reply to:  
E:2001

Date: 1-23-90

Dear

The Alaska Commission on Postsecondary Education recently provided the Internal Revenue Service with the names and Social Security numbers of those borrowers who had a portion of their Student Loan forgiven during 1987 or 1988. The amount of forgiveness benefits is taxable as income for the tax year in which it was obtained.

The information provided by the State of Alaska indicates that you received the following forgiveness benefits:

Tax Year 87/2: \$ 5999.08

Upon review of your Federal Income Tax return for the year(s) listed above, the forgiveness does not appear to have been reported on your return. The enclosed report shows the tax and interest due after the forgiveness benefits have been included as income. If you agree with our adjustment, please sign and return one copy of the report. The other copy should be kept for your records. If you are unable to pay the amount due at this time, we will bill you.

If you did report the benefits, please explain where the income appears on your return. Please provide a copy of the amended return (Form 1040X), if one has been filed. If you believe the amount of forgiveness is incorrect, please attach any supporting material you want us to consider. When you send the information or write to us, please include a telephone number where you can be reached during the day. This will allow us to contact you directly if we have any questions about your information.

Please respond within 30 days from the date of this letter. A postage-paid envelope has been included for your convenience. If you have any questions, you may contact the number shown above.

Very truly yours,

*J. D. Eshelman*

Tax Auditor

Report of Individual  
Income Tax Examination Changes

Department of the Treasury  
Internal Revenue Service

DATE OF REPORT: 01/22/90  
SOC. SEC. NUMBER:  
FORM: 1040  
YEAR: 1987  
FILING STATUS: SINGLE  
NAME AND TITLE OF PERSON WITH WHOM EXAMINING DISTRICT: 092  
MATTERS WERE DISCUSSED: NAME OF EXAMINER: J ESHELMAN  
IN REPLY REFER TO: 0E20010E

EXPLANATION CLASSIFICATION	INCOME AND DEDUCTION AMOUNTS ADJUSTED	ADJUSTMENT INCREASE (DECREASE)
1040 B115	AK STUDENT LOAN FORDIVENESS DELINQUENCY	5,999.00
A	ADJUSTMENTS TO INCOME AND/OR DEDUCTIONS INCREASE	5,999.00
B	PLUS TAXABLE INCOME AS SHOWN ON RETURN	9,509.00
C	CORRECTED TAXABLE INCOME	25,537.00
D	TAX COMPUTED WITH 1 EXEMPTIONS TAX TABLE	4,905.00
E	CORRECTED TAX	4,905.00
F	LESS TAX AS SHOWN ON RETURN	3,225.00
G	DEFICIENCY	1,680.00
H	BALANCE DUE	1,680.00
I	PENALTIES: DELINQUENCY PENALTY, SEC. 6651(A)(1) I.R.C.	119.50

ALTHOUGH THIS REPORT IS SUBJECT TO REVIEW, YOU MAY CONSIDER IT AS YOUR NOTICE THAT YOUR CASE IS CLOSED IF YOU ARE NOT NOTIFIED OF AN EXCEPTION TO THESE FINDINGS WITHIN 45 DAYS AFTER A SIGNED COPY OF THIS REPORT OR A SIGNED WAIVER, FORM 870, IS RECEIVED BY THE DISTRICT DIRECTOR. IF YOU AGREE, PLEASE SIGN ONE COPY OF THIS REPORT, AND RETURN IT IN THE ENCLOSED ENVELOPE. KEEP THE OTHER COPY WITH YOUR RECORDS.

CONSENT TO ASSESSMENT AND COLLECTION - I DO NOT WISH TO EXERCISE MY APPEAL RIGHTS WITH THE INTERNAL REVENUE SERVICE OR TO CONTEST IN THE UNITED STATES TAX COURT THE FINDINGS IN THIS REPORT. THEREFORE, I CONSENT TO: THE IMMEDIATE ASSESSMENT AND COLLECTION OF THE TOTAL DUE ON THE ATTACHED EXPLANATION OF ADJUSTMENTS.

TAXPAYER SIGNATURE

DATE

SPICER'S SIGNATURE

DATE

(IF JOINT RETURN FILED)

EXPLANATION OF ADJUSTMENTS

1987

01/22/90

TOTAL AMOUNT DUE AS A RESULT  
OF THE EXAMINATION ON 01/22/90 \$ 2,137.32

ADDITIONAL TAXES:

BALANCE DUE 1,680.00  
TOTAL ADDITIONAL TAXES: 1,680.00

INTEREST:

INTEREST DUE BASED ON STATUTORY  
INTEREST RATES 362.07  
TOTAL ADDITIONAL TAXES PLUS INTEREST 2,042.07

PENALTIES:

DELINQUENCY PENALTY  
DELINQUENCY PENALTY I.R.C. 6651 119.50  
25% OF 478.00  
TOTAL DELINQUENCY PENALTY 119.50  
INTEREST ON DELINQUENCY PENALTY 25.75  
TOTAL PENALTIES 145.25

\*\*\*\*\*  
\*\*\*\*\*  
TOTAL ADDITIONAL TAXES, INTEREST AND  
PENALTIES AS OF 01/22/90 \$ 2,187.32  
\*\*\*\*\*  
\*\*\*\*\*

ADDITIONAL INTEREST WILL BE CHARGED AT THE CURRENT RATE OF 11 PERCENT COMPOUNDED DAILY. INTEREST IS CHARGED FROM THE ORIGINAL DUE DATE OF THE RETURN TO THE EARLIER OF THE DATE OF PAYMENT, A DATE 30 DAYS AFTER AN AGREEMENT TO THE ADDITIONAL TAX IS SIGNED, OR THE ASSESSMENT DATE. NEGLIGENCE AND FRAUD PENALTIES, IF APPLICABLE, WILL ALSO CONTINUE TO BE CHARGED. GENERALLY, IF NOTICE AND DEMAND IS MADE FOR PAYMENT OF ANY AMOUNT, AND THAT AMOUNT IS PAID WITHIN 10 DAYS AFTER THE DATE OF THE NOTICE AND DEMAND, INTEREST ON THE AMOUNT PAID WILL NOT BE CHARGED AFTER THE DATE OF THE NOTICE AND DEMAND. SINCE ADDITIONAL TAX IS DUE, YOU MAY WANT TO PAY IT NOW AND LIMIT THE INTEREST AND PENALTY CHARGES. PLEASE MAKE YOUR CHECK PAYABLE TO INTERNAL REVENUE SERVICE.

IN ARRIVING AT YOUR TAX DEFICIENCY, AMOUNTS HAVE BEEN ROUNDED TO THE NEAREST DOLLAR.

EXPLANATION OF ADJUSTMENTS

1987

01/22/90

CONTINUED FROM PRECEDING PAGE

THE IRS HAS EXCHANGE AGREEMENTS WITH STATE TAX AGENCIES UNDER WHICH INFORMATION ABOUT INCREASES OR DECREASES IN FEDERAL TAX LIABILITY IS EXCHANGED WITH STATES. YOU SHOULD CHECK YOUR STATE TAX RETURN AND FILE AN AMENDED RETURN IF THIS CHANGE AFFECTS YOUR STATE INCOME TAX LIABILITY.

YOU MAY BE SUBJECT TO BACKUP WITHHOLDING IF YOU UNDERREPORT YOUR INTEREST, DIVIDEND, OR PATRONAGE DIVIDEND INCOME AND DO NOT PAY THE TAX. BACKUP WITHHOLDING, AT THE RATE OF 20 PERCENT, MAY BE ORDERED BY THE IRS AFTER YOU HAVE RECEIVED FOUR NOTICES ABOUT BACKUP WITHHOLDING, ISSUED OVER 120 DAYS, AND THE TAX HAS BEEN ASSESSED AND REMAINS UNPAID.

1404 AK STUDENT LOAN FORGIVENESS

THE AMOUNT OF YOUR DEBT IS INCLUDIBLE IN INCOME IN THE YEAR IN WHICH IT WAS FORGIVEN.

SHOWN ON RETURN OR AS PREV. ADJUSTED	\$	0.00
CORRECTED AMOUNT	\$	5,999.00
ADJUSTMENT	\$	5,999.00

8115 DELINQUENCY

SINCE YOU DID NOT FILE YOUR RETURN WITHIN THE TIME PRESCRIBED BY LAW, AND YOU DID NOT SHOW THAT SUCH FAILURE WAS DUE TO REASONABLE CAUSE, A PENALTY OF 5 PERCENT IS ADDED TO THE TAX FOR EACH MONTH OR A PART OF A MONTH (BUT NOT TO EXCEED A TOTAL OF 25 PERCENT) FOR WHICH YOUR RETURN WAS LATE. IF YOUR RETURN WAS MORE THAN 60 DAYS LATE, THE MINIMUM PENALTY IS THE LESSER OF \$100 OR THE TAX DUE. THE PENALTY SHOWN HAS TAKEN INTO CONSIDERATION ANY PREVIOUSLY ASSESSED PENALTY. SEE SECTION 6651(A) OF THE INTERNAL REVENUE CODE.

101ST CONGRESS  
1ST SESSION

S. 1803

To amend section 108(f) of the Internal Revenue Code of 1986 to clarify the tax treatment of discharges of indebtedness under certain student loans.

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IN THE SENATE OF THE UNITED STATES

OCTOBER 26 (legislative day, SEPTEMBER 18), 1989

Mr. STEVENS (for himself and Mr. MURKOWSKI) introduced the following bill;  
which was read twice and referred to the Committee on Finance

---

A BILL

To amend section 108(f) of the Internal Revenue Code of 1986 to clarify the tax treatment of discharges of indebtedness under certain student loans.

1 *Be it enacted by the Senate and House of Representa-*  
2 *tives of the United States of America in Congress assembled,*

3 SEC. . TREATMENT OF DISCHARGES OF INDEBTEDNESS

4 UNDER CERTAIN STUDENT LOANS.

5 (1) IN GENERAL.—Paragraph (1) of section 108(f) of  
6 the Internal Revenue Code of 1986 (relating to student  
7 loans) is amended—

8 (1) by inserting “(A)” after “discharged”, and

9 ~~\_\_\_\_\_~~ at the end the

10 United States Senate Bill S.1803 \_\_\_\_\_ an made by a

1 State (or from funds provided by a State) which had no  
2 accredited professional schools for the study of law or  
3 medicine on the date the loan was made, if the individ-  
4 ual resided for a certain period of time in the State  
5 after completion of the individual's attendance at the  
6 educational organization with respect to which the loan  
7 was made".

8 (b) EFFECTIVE DATE; WAIVER OF STATUTE OF LIMITI-  
9 TIONS.—

10 (1) EFFECTIVE DATE.—The amendment made by  
11 subsection (a) shall apply to discharges of indebtedness  
12 made on or after January 1, 1986.

13 (2) WAIVER OF STATUTE OF LIMITATIONS.—In  
14 the case of any taxable year ending before the date of  
15 the enactment of this Act—

16 (A) the period for claiming a credit or refund  
17 of any overpayment of tax resulting from the ap-  
18 plication of the amendment made by subsection (a)  
19 shall not expire before the date which is 1 year  
20 after the date of the enactment of this Act; and

21 (B) if, after the application of subparagraph  
22 (A), credit or refund of any overpayment of tax  
23 resulting from the application of the amendment  
24 made by subsection (a) is prevented at any time  
25 before the close of such 1-year period by the oper-

1           ation of any law or rule of law (including res judi-  
2           cata), credit or refund of such overpayment (to the  
3           extent attributable to the application of the  
4           amendment made by subsection (a)) may, never-  
5           theless, be made or allowed if claim therefore is  
6           filed before the close of such 1-year period.

○

# Ted Stevens

## United States Senator For Alaska

October 26, 1989  
FOR IMMEDIATE RELEASE



Contact: Press Office  
(202) 224-3200

### STEVENS INTRODUCES MEASURE TO EXEMPT INCOME TAX ON STUDENT LOAN FORGIVENESS

Alaska student loan forgiveness income would not be taxed under legislation introduced today by Senator Ted Stevens. The bill is a companion measure to one introduced this week by Congressman Don Young in the House of Representatives.

Stevens' measure is intended to bring Alaska's student loan program under a section of the Internal Revenue Code which provides an exemption from taxation for certain student loan forgiveness programs.

Currently, the section of the Internal Revenue Code which provides for tax exemption for forgiveness is based on the recipient's working for a certain period of time in certain professions for any of a broad class of employers, Stevens noted.

"However, Alaska's loan forgiveness provisions, unlike those of other states, are conditioned on residing in the state for a specified period of time following graduation," Stevens explained.

"Alaska's student loan forgiveness program was designed to encourage students to return to our state after receiving an education elsewhere," Stevens said in a statement on the Senate floor.

"Because Alaska's program is not tied into service in specified professions, Alaska's loan forgiveness program does not technically fall within the current exemption in the Internal Revenue Code," the Senator said. "This legislation would bring fairness to the tax treatment of Alaskans who come under the state's forgiveness program."

The amendment would be effective retroactively through calendar year 1986, the Senator said. The bill also

more

clarifies that those individuals who may already have paid tax on loan forgiveness would receive refunds, he said.

"Alaska should have the opportunity, along with other states, to treat as grants those portions of student loans which have been forgiven for individuals who bring their educational training back home," Stevens said.

He noted that many Alaskans, who intend to return to the state after graduation, must travel outside for their college educations. "We have no schools in our state to train lawyers and doctors, and we're also limited to a small number of undergraduate institutions," he said in his floor statement.

"Alaskans should not be prevented from utilizing the existing student loan forgiveness exemption simply because Alaska chose to condition its forgiveness program on residency rather than practicing in specified professions," Stevens said.

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# Anchorage Daily News

ANCHORAGE, ALASKA, SATURDAY, OCTOBER 7, 1989

## IRS makes claim on forgiven loans

By LARRY CAMPBELL  
Daily News reporter

People who had parts of student loans forgiven during the past two years are learning that the Internal Revenue Service wants its share — plus interest.

The state Commission on Postsecondary Education this week sent the federal agency, at its request, the names of everyone who received permission during

1987 and 1988 to repay less than they borrowed, and how much was chopped off each debt. At the same time, the commission sent letters to the borrowers telling them their names were in IRS hands.

The commission sent information on 7,743 loans, on which about \$10.6 million had been forgiven. Because a

Please see Back Page, IRS

## IRS: Uncle Sam says student loan forgiveness is income and he wants his cut

Continued from Page A-1

person can have more than one loan, the commission didn't know how many individual borrowers are affected.

IRS spokeswoman Marilyn Steen said those borrowers will be expected to file amended tax returns showing the amount they had forgiven as income, and pay tax and interest if owed. Those who don't file, but still owe tax, will be billed, Steen said.

"The law's always been there," Steen said. "It's not like it's something new, but, judging from the calls we've

been getting, it's a surprise to a lot of people."

The IRS asked only for the past two years' information because, under normal circumstances, it would only review tax filings that far back.

The rule will affect all future loans that qualify for forgiveness, too. Commission officials expect that the number of people who will ask for forgiveness will continue to rise through 1992, then start to decline.

The commission's student loan program offers 8 percent college or vocational school loans to Alaska residents — as much as \$5,500 a

year for undergraduates, \$6,500 for graduate students. Under the forgiveness clause, borrowers could erase as much as half the amount they owed if they returned to the state after graduation and stayed as long as five years. A borrower can request forgiveness at any time, even after the loan has been repaid.

The forgiveness clause was rescinded as of July 1, 1987, meaning loans made after that date will not be forgiven. The action was one of a number of changes made by the commission that helped shore up the

sagging loan repayment rate.

State officials have suspected for years that the IRS might consider the forgiveness as income, but never pushed the federal government for a ruling, said Jane Maynard, the commission's new executive director. She took the post this summer.

"It never became an issue (before), and we weren't asked for information (by the IRS)," Maynard said. "I think the thinking had been, 'If they haven't asked, why make it an issue.' It seemed no one ever knew for sure before, and it could have been that to act on this

sooner would have affected loans all the way back to 1983 or so."

The IRS decided to make loans an issue last August when it asked the commission for names and loan amounts.

"This is one of those little things that people overlook," said Steen. "And one that we haven't been checking on in the past. I doubt that (the commission) knew about it, but I don't think it was anything intentional to avoid the tax."

Figuring an average tax rate of 28 percent, the IRS could generate revenue of about \$3 million.