PUBLIC FINANCE

Kutak Rock Client Alert

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Services

[Student Loan Finance]

[Public Finance Tax]

Guidance Released Regarding Bonds Issued for Student Loan Refinance Programs (I.R.S. Notice 2024-32)

On March 25, 2024, the Internal Revenue Service released I.R.S. Notice 2024-32 (the "Notice"). A copy of the Notice is available online here. The Notice responds to industry comments provided since issuance of I.R.S. Notice 2015-78 (the "2015 Notice"). The 2015 Notice attempted to clarify that tax exempt bonds could be issued to refinance existing student loans as long the refinancing loans and the loans being refinanced were made to eligible borrowers and did not exceed applicable loan size limits. Notwithstanding the 2015 Notice, several gaps in existing statutory and regulatory guidance remained and have hindered tax-exempt issuance of bonds for student loan refinance programs. The Notice attempts to fill these gaps. Kutak Rock's national Student Loan Finance Practice Group and Public Finance Tax Group have prepared this client summary to outline key provisions of the Notice.

1. Eligible Borrowers

Section 4.01 of the Notice provides that an eligible borrower of a refinancing loan may be the parent of the student borrower of the original loan (or a refinancing loan) or a child of a parent who borrowed an original loan (or a refinancing loan) on the child's behalf. This provision is intended to clarify that parent loans that were made on behalf of student borrowers, and vice versa, are eligible to be refinanced under the refinancing provisions originally introduced by the 2015 Notice.

2. Loan Size Compliance

Under existing statutory provisions, the amount of a qualified student loan may not exceed the difference between the total cost of attendance and other forms of student assistance for which the student may be eligible. Section 4.02(a) of the Notice sets forth the following two circumstances under which an original loan will be treated as having met the loan size limitation:

> A. The original loan was made under a student loan program that applied the same loan size limitation as the statutory size limit in Section 144(b)(1)(B) of the Internal Revenue Code of 1986 (the "Code") or a stricter limit during the period when the original loan was made. The Notice appears to bless the loan sizing limits for FFELP loans and other loan programs under Title IV of the Higher Education Act of 1965 and other state supplemental loan programs under Section 144(b)(1)(B) of the Code, whether or not financed with tax-exempt bonds.

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B. The previous lender, other holder, or loan servicer of the original loan certifies that the original loan amount did not exceed the difference between the total cost of attendance and other forms of student assistance as reported on the original loan application.

To establish compliance with the statutory loan size limitation with respect to an original loan, Section 4.02(b) allows the issuer to rely on: (1) the amount of the original loan stated on the promissory note for the loan or otherwise provided by the previous lender, other holder or loan servicer of the original loan; and (2) the amount of the student's total cost of attendance and other forms of student assistance for the academic period for which the original loan was made, as reported on the original loan application (provided by either the previous lender, other holder or loan servicer of the original loan or the educational institution the student attended for the academic period which includes the amount of the original loan) or as stated in the student's financial aid award letter that is from the educational institution attended by the student. Issuers will need to evaluate whether this documentation is readily available and sufficiently reliable to make the necessary loan size determinations, and ensure procedures are in place to retain such documentation for post-issuance compliance obligations.

3. Loan Refinancing and Cross-Calling

The Notice clarifies that bonds issued to refinance existing loans and cross-calling bonds with loan repayments will not result in refunding treatment. The Notice addresses these points by reference to Section 1.150-1(d) of the Treasury Regulations which provides that a bond is a refunding bond only if the "proceeds" of the bond are used to pay debt service on another bond. Section 4.03 of Notice states that, for purposes of this regulation, the term "proceeds" does not include investment proceeds (or transferred proceeds allocable to investment proceeds) received from investing in a qualified student loan. This section of the Notice further contemplates that the issuer of the refinancing bonds must reasonably expect to use all actual net proceeds of the bond issue to refinance qualified student loans within two years of the issue date of the issue. The following three hypotheticals illustrate the application of this section of the Notice as it relates to student loan bonds.

A. An issuer of tax-exempt bonds uses the bond proceeds to make a refinancing loan to a student loan borrower. The borrower uses the proceeds to pay off an existing student loan. The existing loan was made by the issuer with proceeds of prior tax-exempt bonds. Once the issuer receives the loan payoff amount, the issuer uses the amount to redeem the prior tax-exempt bonds. Are the new tax-exempt bonds "refunding bonds" and, if they are, must the prior tax exempt bonds be redeemed within 90 days of the date the new bonds are issued to avoid an advance refunding prohibition under existing statutory provisions? Based on Section 4.03 of the Notice, the new tax-exempt bonds are not refunding bonds because the redemption of the prior tax-exempt bonds does not occur with "proceeds" of the new tax-exempt bonds. Note that new volume cap under Section 146 of the Code is required for the new tax-exempt bonds.

B. An issuer of tax-exempt refunding bonds uses the proceeds of the bonds to redeem prior tax-exempt bonds within 90 days of the date of issuance of the refunding bonds. The prior bonds funded student loans, some of which have repaid, resulting in cash repayment amounts held with respect to the prior bonds. When the prior bonds are redeemed, these cash amounts (to the extent remaining allocated after application of the universal cap) become transferred proceeds of the refunding bonds. Such transferred proceeds are then used to make refinancing loans. Based on Section 4.03 of the Notice, transferred proceeds allocable to investment

Contacts

Anne Gish
(303) 292-7782
anne.gish@kutakrock.com

Kristin Caid
(303) 292-7858
kristin.caid@kutakrock.com

Matthias Edrich
(303) 292-7887
matthias.edrich@kutakrock.com

proceeds are not "proceeds," which means that, while the tax-exempt refunding bonds are current refunding bonds of the prior tax-exempt bonds, such refunding bonds will not also be considered potential advance refunding bonds of the bonds that originally funded the refinanced loans. As long as the tax-exempt refunding bonds satisfy the usual refunding exception to volume cap set forth in Section 146(i)(2) of the Code, no new volume cap is required for the tax-exempt refunding bonds.

C. An issuer uses investment proceeds from the repayment of student loans allocated to one issue of tax-exempt bonds to redeem tax-exempt bonds of another issue in, for example, the same trust indenture. This practice is sometimes referred to as "cross-calling." The issuer engaged in cross-calling first uses proceeds of the issue to make student loans and then, as the loans repay, uses such repayments to redeem bonds, generally selecting bonds with the highest interest rates and not necessarily the bonds that originally funded the loans. Based on Section 4.03 of the Notice, cross-calling does not cause proceeds of one issue of bonds to be used to refund another issue of bonds.

Please contact any member of the firm's national Student Loan Finance Practice Group if you have questions about the Notice. Key contacts for this summary are provided on the left. You may also visit us at www.KutakRock.com.

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