



UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF POSTSECONDARY EDUCATION

THE ASSISTANT SECRETARY

Subject: Statutory Changes to Special Allowance Payment Calculations

Summary: This letter provides a brief description of the recent changes made by the "Taxpayer-Teacher Protection Act of 2004" to the calculation of special allowance payments for loans made (directly or indirectly) with the proceeds of tax-exempt obligations.

Dear Colleague:

On October 30, 2004, President Bush signed the "Taxpayer-Teacher Protection Act of 2004" (P. L. 108-409) that, among other things, changes Section 438(b)(2)(B) of the Higher Education Act of 1965, as amended (HEA). In particular, P. L. 108-409 changes the rules for calculating the special allowance rates for certain Federal Family Education Loan Program (FFEL) loans made or purchased with tax-exempt funds. The new law also authorizes up to \$17,500 in loan forgiveness for new Federal Stafford Loan borrowers under the FFEL Program and Federal Direct Loan Program who meet certain criteria. The teacher loan forgiveness changes were discussed in Dear Colleague Letter GEN-04-14.

Under the HEA as it existed prior to the passage of P. L. 108-409, loans that were financed with funds obtained by the holder from the issuance of tax-exempt obligations originally issued prior to October 1, 1993 received a special allowance at a rate that was generally one-half of the rate established for other loans. However, that rate would not be less than 9.5 percent minus the applicable interest rate on such loans. With the enactment of P. L. 108-409, the special allowance paid on some loans that would have been subject to this treatment will revert to the usual rates paid on other loans as specified in subparagraphs (A), (E), (F), (G), (H), or (I) of section 438(b)(2).

Specifically, the loans for which the special allowance reverts to those usual rates are those that are:

- Financed by a tax-exempt obligation that, after September 30, 2004, and before January 1, 2006, has matured or been retired or defeased;
- Refinanced after September 30, 2004, and before January 1, 2006, with funds obtained from a source other than funds described in section 438(b)(2)(B)(v)(I) of the HEA; or
- Sold or transferred to any other holder after September 30, 2004, and before January 1, 2006.

Loans that are made or purchased with funds obtained by the holder from collections or default reimbursements on, or interest or other income pertaining to, eligible loans made or purchased with funds from the original pre-October 1993 tax-exempt obligations or from income on the investment of such funds would still receive a special allowance of not less than 9.5 percent minus the applicable interest rate on such loans.

The term "holder", as used in the preceding paragraphs, has the meaning specified in section 435(i) of the HEA, which defines a holder as an eligible lender who owns a loan.

We have attached a copy of section 438(b)(2)(B) of the HEA showing the changes made by P. L. 108-409.

We do not believe that any changes are necessary to the Lender Reporting System-LaRS (formerly ED Form 799) in order to account for the changes made by P. L. 108-409. We expect that loan holders will make whatever adjustments are necessary when making LaRS submissions to assure that special allowance payments are made at the correct rate. Lenders impacted by this statutory change should ensure that future independent audits include a review of all special allowance calculations and billings to assure that the lender has properly identified the various categories of loans included in its LaRS submission.

If you have questions concerning the recent statutory changes, please contact Pam Moran at 202-502-7732 or George Harris at (202) 502-7521. If you have questions concerning LaRS reporting please contact Matteo Fontana at 202-377-3005.

Sincerely,

A handwritten signature in black ink, appearing to read "Sally L. Stroup". The signature is fluid and cursive, with a large loop at the end.

Sally L. Stroup  
Assistant Secretary for  
Postsecondary Education

P. L. 108-409 made the following changes (shown in **bold type**) to section 438(b)(2)(B) of the HEA:

(B)(i) The quarterly rate of the special allowance for holders of loans which were made or purchased with funds obtained by the holder from the issuance of obligations, the income from which is exempt from taxation under the Internal Revenue Code of 1954 shall be one-half the quarterly rate of the special allowance established under subparagraph (A), except that, in determining the rate for the purpose of this ~~division clause~~, subparagraph (A)(iii) shall be applied by substituting “3.5 percent” for “3.10 percent” . Such rate shall also apply to holders of loans which were made or purchased with funds obtained by the holder from collections or default reimbursements on, or interests or other income pertaining to, eligible loans made or purchased with funds described in the preceding sentence of this subparagraph or from income on the investment of such funds. This subparagraph shall not apply to loans which were made or insured prior to October 1, 1980.

(ii) The quarterly rate of the special allowance set under ~~clause division~~ (i) of this subparagraph shall not be less than 9.5 percent minus the applicable interest rate on such loans, divided by 4.

(iii) No special allowance may be paid under this subparagraph unless the issuer of such obligations complies with subsection (d) of this section.

(iv) Notwithstanding clauses (i) and (ii), the quarterly rate of the special allowance for holders of loans which are financed with funds obtained by the holder from the issuance of obligations originally issued on or after October 1, 1993, **or refunded after September 30, 2004, and before January 1, 2006**, the income from which is excluded from gross income under the Internal Revenue Code of 1986, shall be the quarterly rate of the special allowance established under subparagraph (A), (E), (F), (G), (H), or (I) as the case may be. Such rate shall also apply to holders of loans which were made or purchased with funds obtained by the holder from collections or default reimbursements on, or interest or other income pertaining to, eligible loans made or purchased with funds described in the preceding sentence of this subparagraph or from income on the investment of such funds.

(v) **Notwithstanding clauses (i) and (ii), the quarterly rate of the special allowance shall be the rate determined under subparagraph (A), (E), (F), (G), (H), or (I) of this paragraph, or paragraph (4), as the case may be, for a holder of loans that--**

**(I) were made or purchased with funds--**

**(aa) obtained from the issuance of obligations the income from which is excluded from gross income under the Internal Revenue Code of 1986 and which obligations were originally issued before October 1, 1993; or**

**(bb) obtained from collections or default reimbursements on, or interest or other income pertaining to, eligible loans made or purchased with funds described in division (aa), or from income on the investment of such funds; and**

**(II) are--**

**(aa) financed by such an obligation that, after September 30, 2004, and before January 1, 2006, has matured or been retired or defeased;**

**(bb) refinanced after September 30, 2004, and before January 1, 2006, with funds obtained from a source other than funds described in subclause (I) of this clause; or**

**(cc) sold or transferred to any other holder after September 30, 2004, and before January 1, 2006.**