ELA™

EDUCATION LOAN ANALYST

Table of contents

EDUCATION LOANS

Chapter 1: Introduction

The figure is staggering - Americans owe $1.1 trillion in student loan debt, which is second only to mortgages in terms of household debt. The average balance is more than $26,000 for someone with student debt, and one in eight borrowers owe more than $50,000. In addition, some students with advanced degrees struggle to repay huge debts of $150,000 and more.

Education loans come in three major categories: student loans (e.g., Stafford and Perkins loans), parent loans (e.g., PLUS loans) and private education loans. A fourth type of education loan, the consolidation loan, allows the borrower to lump all of their loans into one loan for simplified payment. In most cases, education loans cannot be bankrupted unless extreme hardship or disability.

This manual covers: all education loans and alternatives; the various rules and regulations regarding repayment plans, forgiveness, forbearance, cancellation; and other strategies to help your client families remove the burden of education debt.

Chapter 2: Education Loans and Financial Aid

Federal Direct Loans

Federal student loans are are a form of financial aid that you must repay with interest. Whereas, scholarships and grants do not have to be repaid. A federal education loan allows students and their parents to borrow money to help pay for college through loan programs supported by the Federal Government. They have low fixed interest rates and offer flexible repayment terms, benefits, and options.

Private Education Loans

Private education loans are non-federal loans issued by a lender, such as a bank or credit union. They have variable interest rates and offer standard repayment terms and options.

Why Are Federal Direct Loans Better Than Private Loans?

Federal student loans offer borrowers many benefits not typically found in private loans. These include low fixed interest rates; income-based repayment plans; cancellation for certain employment; and deferment (postponement) options, including deferment of loan payments when a student returns to school. Here are some reasons to consider taking a federal education loan over a private education loan:

- The interest rate on federal student loans is almost always lower than that on private loans—and much lower than that on a credit card.
- You do not need a credit check or a cosigner to get most federal student loans.
- You do not have to begin repaying your federal student loans until after you leave college or drop below half-time.
- If you demonstrate financial need, you can qualify to have the government pay your interest while you are in school.
- Federal student loans offer flexible repayment plans and options to postpone your loan payments if you are having trouble making payments
- If you work in certain jobs, you may be eligible to have a portion of your federal student loans forgiven if you meet certain conditions
- Private loans usually require a credit check.

For these reasons, students and parents should always exhaust federal student loan options before considering a private loan.

Need-Based & Non-Need Based Federal Direct Education Loans

Education loans are qualified as need-based and non-need loans. In other words, education loan qualifications and limits are determined by whether or not the family has financial need. The family's financial need is determined by the difference between the cost of attendance (COA) at a school, and the family's Expected Family Contribution (EFC), as calculated from the financial data on the FAFSA financial aid application form.

Cost of Attendance (COA)
(less) Expected Family Contribution (EFC)
(equals) Financial Need

Note: While COA varies from school to school, your EFC does not change based on the school you attend.

Cost of Attendance (COA)

The Cost of Attendance, or COA, is the total amount it will cost you to go to school—usually stated as a yearly figure. COA includes:

- tuition and fees
- room and board
- allowances for books and supplies
- transportation
- education loan fees
- dependent care
- miscellaneous and personal expenses including: an allowance for the rental or purchase of a personal computer, costs related to a disability, and reasonable costs for eligible study-abroad programs.

Expected Family Contribution (EFC)

The Expected Family Contribution, or EFC, is the number that is used to determine your eligibility for federal student financial aid. In other words, the amount of money you must contribute toward your college expenses before you can be considered eligible for financial aid. This number results from the financial information you provide in your **FAFSA financial aid application form for federal student aid**. Your EFC is reported to you on your *Student Aid Report* (SAR).

Evaluating Education Loans on the Financial Aid Award

The award letter describes the aid you are offered. Although it is individually tailored, you are not obligated to accept all of the aid, or to borrow the full amount of any loans listed in the award letter. It is up to you and your family to evaluate the award, compare it to awards from other schools, and then decide what to accept and how much to borrow.

Loans can be classified in many ways, but you should be able to tell if you are getting a subsidized or unsubsidized loan. If you have any questions, or do not understand what is in your award letter, contact the school. The school, also, will tell you what actions you need to take after you review your award letter.

Always ask questions and be an informed borrower. Make sure you understand what you are receiving and the repayment terms. Before you accept any aid, you should:

- Get a breakdown of the direct expenses (tuition, room and board, and fees) and estimates of indirect expenses (travel, books, etc.) for one year of college.
- Know the actual amount (cost of attendance minus financial aid) that you will have to pay out-of-pocket to attend one year of college.

Accepting the Education Loan Offered on the Award Letter

Accepting a loan listed in the award letter involves some additional steps, which vary depending on the type of loan you are receiving. Saying yes is as simple as signing a Promissory Note, which is a contract between you and the U.S. Department of Education that specifies terms and conditions of the loan. By signing the Promissory Note, you are promising to repay your student loan. The financial aid office will guide you through the paperwork, or direct you to www.studentloans.gov to sign the online Master Promissory Note (MPN).

Master Promissory Note (MPN)

The MPN is a legal document in which the borrower promises to repay the loan, and any accrued interest and fees to the U.S. Department of Education. In most cases, a single MPN can be used for loans that you receive over several years of study. Also, before receiving your first Direct Loan, you must complete entrance counseling. Entrance counseling is a mandatory information session, which takes place before you receive your first federal student loan. Check with your school's financial aid office to find out how they want you to complete both the entrance counseling and the MPN.

Education Loan Entrance and Exit Counseling

Entrance Counseling

If you (student) are a first-time borrower of federal education loans, you must complete an entrance counseling session before given the first loan disbursement. This session provides you with useful tips and tools to help you develop a budget for managing your education expenses, and helps you to understand your loan responsibilities. Borrowers must also receive sample monthly repayment amounts based on a range of indebtedness, the average debt held by borrowers at that school, and the average debt held by borrowers in that program of study at that school.

Note: Parent PLUS Loan borrowers now participate in entrance counseling.

Exit Counseling

Exit counseling is required before the student withdraws or graduates from the school, or drops below half-time attendance (even if you plan to transfer to another school). Exit counseling helps you understand your rights and responsibilities as a student loan borrower, and provides useful tips and information to help you manage your education loans.

Borrowers must also be told the anticipated monthly repayment amounts based on the average debt held by borrowers in that program of study at that school. In addition, exit counseling must include:

- a review of the 7 available repayment options and loan consolidation
- a review of loan deferment, forbearance, and discharge options
- information about the Student Loan Ombudsman's office and responsibilities

Note: Parent PLUS Loan borrowers do not participate in exit counseling.

How Federal Student Loan Money Is Disbursed

Funds will be sent directly to the school in two disbursements (installments). No disbursement will be greater than half the amount of your loan.

- If you are a first-year undergraduate student and a first-time borrower, you must complete entrance counseling and your first disbursement cannot be made until 30 days after the first day of your enrollment period.
- Your school usually credits your loan payment to school charges on your account (tuition and fees, room and board, and other authorized charges).
- If the loan money exceeds your school charges, the school will pay you the credit balance by check or other means.

You can notify your school before your loan is disbursed that you do not need to borrow all or part of your loan, and within certain time frames after your loan has been disbursed. The time frames and the procedures for canceling a loan, also, are explained in notices that the school is required to send you.

What Federal Education Loan Money Can Be Used For

You may use the money you receive only to pay for education expenses at the school that awarded your loan. Education expenses include such school charges as tuition, room and board, fees, books, supplies, equipment, dependent child care expenses, transportation, and rental or purchase of a personal computer.

Chapter 3: Types of Federal Education Loans

There are five types of education loans:

Need-Based	Non-Need Based
Federal Subsidized Stafford Loans	Federal Unsubsidized Stafford Loans
Federal Perkins Loans	Federal Direct PLUS Loans
Private Loans	

Federal Direct Subsidized Stafford Loans

Federal Subsidized Stafford Loans are fixed-rate, need-based loans paid over a 10 year period.

Interest Rate

The Federal Subsidized Direct Stafford loan interest rate is fixed at 4.29% for loans disbursed after July 1, 2015. The interest is paid (subsidized) by the Federal Government until six months after the student leaves college.

Loan Origination Fees

The loan origination fee for all Direct Stafford loans (subsidized and unsubsidized) first disbursed on, or after, July 1, 2015 are 1.068%. These loan fees are deducted proportionately from each loan disbursement. You are responsible for repaying the entire amount you borrowed and not just the amount you received in loan disbursements.

Loan Limits

The student can receive a maximum Subsidized Stafford loan of:
$3,500 for the freshman year,
$4,500 for the sophomore year,
$5,500 for junior, senior, and higher years,
$23,000 is the total maximum amount allowed in subsidized loans.

Qualifications

The student must demonstrate a financial need by filing the FAFSA financial aid application form to receive this loan. Stafford loans carry both life and disability insurance on the student. If the student dies, or becomes totally disabled, the loan balance is forgiven. These loans are in the student's name and the student will be entitled to the student loan interest tax deduction.

Federal Direct Unsubsidized Stafford Loans

Federal Unsubsidized Stafford loans are fixed-rate, non-need based loans paid over a ten year period.

Interest Rate

The Federal Unsubsidized Direct Stafford loan interest rate is fixed at 4.29% for loans disbursed after July 1, 2015. The interest is deferred by the federal government until six months after the student leaves college, but then, the student must begin to pay back the loan including the deferred interest accrued.

Loan Origination Fees

The loan origination fee for all Direct Stafford loans (subsidized and unsubsidized) first disbursed on, or after, July 1, 2015 are 1.068%. These loan fees are deducted proportionately from each loan disbursement. You're responsible for repaying the entire amount you borrowed and not just the amount you received in loan disbursements.

Loan Limits

If the student is determined to have no financial need, the student can receive a maximum Unsubsidized Stafford loan of:

$5,500 for the freshman year,
$6,500 for the sophomore year, and
$7,500 for junior, senior, and higher years.

However, any combination of Subsidized Stafford loans and Unsubsidized Stafford Loans cannot go above these yearly limits. $31,000 is total maximum amount allowed in Unsubsidized loans, of which only $23,000 of this amount is allowed in subsidized loans.

Qualifications

The student does not need to demonstrate a financial need, but still must file the FAFSA financial aid application form to receive this loan. Stafford loans carry both life and disability insurance on the student. If the student dies, or becomes totally disabled, the loan balance is forgiven. These loans are in the student's name and the student will be entitled to the student loan interest tax deduction.

While the interest rate and repayment terms are the same as the Federal Subsidized Stafford loan, the interest is not subsidized by the Federal Government during the time the student is in college. Therefore, the interest will accrue on the loan until repayment begins six months after the student leaves college. Non-need loans cannot be considered financial aid when comparing financial aid award letters from various colleges.

Graduate & Professional Student Stafford Loans

Federal Graduate & Professional Student Stafford Loans are fixed-rate, non-need based loans paid over a ten year period.

Interest Rate

The Federal Graduate & Professional Student Stafford loan interest rate is fixed at 5.84%.

Loan Origination Fees

The loan origination fee for all Direct Stafford loans (subsidized and unsubsidized) first disbursed on, or after, July 1, 2015 are 1.068%. These loan fees are deducted proportionately from each loan disbursement. You are responsible for repaying the entire amount you borrowed, not just the amount you received in loan disbursements.

Loan Limits

The Graduate & Professional student can receive a maximum Unsubsidized Stafford loan of:

- $20,500 per year (no more than $8,500 of this amount may be in subsidized loans)
- $138,500 is the total maximum amount allowed in Stafford loans ($65,500 subsidized loans)

Note 1: The graduate total debt limit includes Stafford Loans received for undergraduate study.

Note 2: You can receive the remainder of your college costs not covered by other financial aid in Direct PLUS Loans. However, a credit check is required for a Graduate PLUS loan.

Other Direct Stafford Loan Observations

Planning tip: In a situation where a student does not qualify for need-based financial aid because the EFC is greater than the Cost of Attendance, it may be more beneficial for the student to borrow using an Unsubsidized Stafford loan, rather than for the parents to borrow using a PLUS loan. There may be a greater probability that the student will be able to deduct the interest as student loan interest from the Unsubsidized Stafford loan than the parents will be able to deduct the interest on a PLUS loan.

Note: The Financial Aid Administrator has the authority to determine that the parents are "precluded by exceptional circumstances from borrowing a PLUS loan." The student can then borrow a Federal Unsubsidized Stafford loan up to the independent student limit (an additional $4,000 in the freshman and sophomore years and $5,000 in the junior, senior and higher years). The regulations do not give an all-inclusive list of situations, but give several examples of what might be considered "exceptional circumstances" that might justify an FAA exercising their authority. The items listed are: "student's parent receives only public assistance or disability benefits, the parent is incarcerated, the parent has an adverse credit history, or the parent's whereabouts are unknown."

When the student leaves college and claims himself/herself on the student's tax return, the income will probably be lower than the income phase-out limits for deducting the student loan interest. The student can then deduct the interest paid on the Unsubsidized Stafford loan.
Since the interest accrues during college years, and repayment is deferred until after college years for an Unsubsidized Stafford loan, the student will be eligible for a substantial student loan interest deduction. The parents' income level may be greater than the interest deduction phaseout limit ($155,000 for married), and therefore, they will be unable to deduct any of the interest for the PLUS loan on their tax return.

Note: A college or university has the right to refuse to certify a loan application, or to certify the loan for less than a student is actually eligible to receive. As long as the college presents its reasons and explains them in writing, its decision is final.

Note: For a student who is in the process of declaring bankruptcy, the college cannot use the bankruptcy as a reason for denying a loan.

Federal Perkins Loans

Federal Perkins Loans are low-interest, need-based loans. This is a campus-based loan program, meaning the school acts as the lender, using funds provided by the Federal Government.

Interest Rate

The Federal Perkins loan interest rate is fixed at 5.0%. The interest is paid (subsidized) by the federal government until nine months after the student leaves college.

Loan Origination Fees

There are no loan origination fees for Federal Perkins Loans.

The student can receive a maximum Federal Perkins loan of $5,500 per year.

Planning tip: Think twice about consolidating Perkins loans, especially if the student plans to continue his/her education. The government subsidizes interest on a Perkins loan while the student is in school, and it may forgive the loan entirely if they pursue certain professions, such as teaching and law enforcement. Those benefits do not transfer to the new consolidated loan.

Federal Direct PLUS Loans

Federal Direct PLUS (Parents' Loans for Undergraduate Students) Loans are federal loans that graduate or professional degree students, and parents of dependent undergraduate students can use to help pay education expenses. PLUS loans are fixed-rate, non-need based loans paid over a ten year period. However, more than one PLUS loan may be consolidated into one loan, and repaid over a period of up to 20 years.

Interest Rate

The Direct PLUS loan interest rate is fixed at 6.84% for loans disbursed after July 1, 2015.

Loan Origination Fees

The loan origination fee for all Direct Direct PLUS loans first disbursed on, or after, July 1, 2015 are 4.272%. These loan fees are deducted proportionately from each loan disbursement. You are responsible for repaying the entire amount you borrowed, and not just the amount you received in loan disbursements.

Loan Limits

The maximum PLUS loan amount you can borrow is the total cost of attendance (COA determined by the school) minus any other financial assistance received.

Example:
If the COA at a college was $25,000 and the amount of financial aid offered was $12,000, the parents would be eligible for a $13,000 PLUS loan. If the financial aid offer of $12,000 contained a $2,000 college work-study award and the student declined the work-study portion of the aid offered, the parents would then be eligible for a $15,000 PLUS loan. However, if the student was offered no financial aid because the student demonstrated no financial need, the parents would be eligible for a $25,000 PLUS loan.

Qualifications

The parent or graduate/professional student does not need to demonstrate a financial need to get Direct PLUS loans, but still must file the FAFSA financial aid application form in order to qualify to receive this loan.

If a parent borrower is unable to secure a PLUS loan, the undergraduate dependent student may be eligible for additional unsubsidized loans to help pay for his or her education.

Planning tip: PLUS loans are signature loans in the parent's name. If the signatory parent (only one parent must sign for the loan) dies or becomes disabled before the loan is repaid, the remaining loan principal balance is forgiven.

Parent eligibility requirements for a Direct PLUS Loan

You must be the student's biological parent, adoptive parent, or the student's stepparent, if the biological or adoptive parent has remarried at the time of application. Your child must be a dependent student who is enrolled, at least half-time, at a school that participates in the Direct Loan Program. For financial aid purposes, a student is considered "dependent" if he or she is under 24, unmarried, and has no legal dependents at the time the Free Application for Federal Student Aid is submitted. (Exceptions are made for veterans, wards of court, and other special circumstances.) If a student is considered dependent, then the income and the assets of the parent have to be reported on the FAFSA.

Additional requirements to receive a PLUS loan

Parent PLUS Loan borrowers cannot have an adverse credit history (a credit check will be done). In addition, parents and their dependent child must be U.S. citizens or eligible noncitizens, must not be in default on any federal education loans or owe an overpayment on a federal education grant, and must meet other general eligibility requirements for the Federal Student Aid programs.

Direct PLUS Loan Credit Confirmation

A credit check will be performed during the Direct PLUS Loan application process. If you have an adverse credit history, you may still receive a Direct PLUS Loan by obtaining an endorser who does not have an adverse credit history, or by documenting to the U.S. Department of Education's satisfaction extenuating circumstances relating to your adverse credit history. If you are a parent borrower, the endorser cannot be the child on whose behalf you are borrowing.

Direct PLUS Loan Proceeds

The school will first apply Direct PLUS Loan funds to the school account to pay for tuition, fees, room and board, and other school charges of the student. If any loan funds remain, your school will give them to the graduate/professional student, or the parent of the dependent student to help pay other education expenses.

Direct PLUS Loan Repayment Deferment

Your Direct PLUS Loan enters repayment once your loan is fully disbursed (paid out).

1. If you are a graduate or professional student, your loan will be placed into deferment while you are enrolled at least half-time, and for an additional six months after you cease to be enrolled at least half-time.

2. If you are a parent borrower, you can contact your loan servicer to request a deferment,
   - while you or your child are enrolled at least half-time, and
   - for an additional six months after your child ceases to be enrolled at least half-time.

3. If your loan is deferred, interest will accrue on the loan during the deferment. You may choose to pay the accrued interest, or allow the interest to capitalize when the deferment period ends. Your loan servicer will notify you when your first payment is due.

Direct PLUS Loan Denials for Poor Credit

There is a special PLUS loan situation where the parent cannot borrow a PLUS loan, because of a poor credit rating. In this situation, the dependent student is eligible for an additional unsubsidized Stafford loan. The limits for this loan are the same as for an independent student ($4,000 for the first and second years and $5,000 for the following years). The student has to provide the college with a copy of the parent's rejection notice to document the reason why the student is receiving an additional unsubsidized Stafford loan. The documentation proving that a parent cannot borrow a PLUS loan should include:

1. A letter of denial of a PLUS loan from a lender based on a certified application, or

2. Documentation that indicates that a lender, who generally makes a PLUS loan to a parent of a student enrolled at the school, would not make a PLUS loan to the parent under circumstances that are applicable to that parent. For example, the student's parent is dependent on public assistance and the parent cannot now, or most likely in the future, be capable of repaying the loan.

This is not a "professional judgment" situation for the financial aid officer. The student cannot be denied these additional funds, unless the financial aid officer refuses to certify the student's unsubsidized Stafford loan. Furthermore, the college cannot require the other creditworthy parent to borrow a PLUS loan. If the parent who was rejected for the PLUS loan applies for a PLUS loan in a subsequent year and is again rejected, the student is again eligible for unsubsidized Stafford loans.

Other Direct PLUS Loan Observations

Note 1: If a parent is enrolled half time in college, the PLUS loan repayment may be deferred.

Note 2: Only the parent, or stepparent, may be able to take out a PLUS loan. A legal guardian cannot take out a PLUS loan, unless it is permitted by the school.

Note 3: Since the interest is not subsidized, PLUS loans cannot be considered financial aid. The terms of a PLUS loan may be favorable, but they still should not be considered financial aid when the student is comparing financial aid award offers from various colleges. Many colleges will incorrectly include PLUS loans in their financial aid award offers.

If the student will be attending a college that assesses home equity, a home equity loan may be preferable to a Federal PLUS loan. The home equity loan will reduce the value of the home. In addition, the interest on the home equity loan is not limited to $2,500, and by, the client's AGI.

Note 4: Borrowers are permitted to get deferments when they are serving in the military during war or other national emergency periods for Stafford, PLUS, and Perkins Loans.

Chapter 4: Federal Direct Loan Repayment Plans

There are various types of repayment plans for federal education loans:

1) Standard Repayment Plan

Eligible Loans

- Direct Subsidized and Unsubsidized Loans
- Subsidized and Unsubsidized Federal (FFEL) Stafford Loans
- all PLUS loans

Monthly Payment and Time Frame

- Payments are a fixed amount of at least $50 per month
- Up to 10 years

Quick Comparison

- You will pay less interest for your loan over time under this plan than you would under other plans

2) Graduated Repayment Plan

Eligible Loans

- Direct Subsidized and Unsubsidized Loans
- Subsidized and Unsubsidized Federal (FFEL) Stafford Loans
- all PLUS loans

Monthly Payment and Time Frame

- Payments are lower at first and then increase, usually every two years
- Up to 20 years

Quick Comparison

- You will pay more for your loan over time than under the 10-year standard plan

3) Extended Repayment Plan

Eligible Loans

- Direct Subsidized and Unsubsidized Loans
- Subsidized and Unsubsidized Federal (FFEL) Stafford Loans
- all PLUS loans

Monthly Payment and Time Frame

- Payments may be fixed or graduated
- Up to 25 years

Quick Comparison

- Your monthly payments would be lower than the 10-year standard plan
- You must have more than $30,000 in outstanding loans
- You will pay more for your loan interest over time than under the 10-year standard plan

4) Income Contingent Repayment Plan

Eligible Loans

- Direct Subsidized and Unsubsidized Loans
- Direct PLUS Loans made to students
- Direct Consolidation Loans

Monthly Payment and Time Frame

- Payments are calculated each year, and are based on your adjusted gross income, family size, and the total amount of your Direct Loans
- Your payments change as your income changes
- Up to 25 years

Quick Comparison

- You will pay more for your loan over time than under the 10-year standard plan
- If you do not repay your loan after making the equivalent of 25 years of qualifying monthly payments, the unpaid portion will be forgiven
- You may have to pay income tax on the amount that is forgiven

5) Income-Sensitive Repayment Plan

Eligible Loans

- Subsidized and Unsubsidized Federal FFEL Stafford Loans
- FFEL PLUS Loans
- FFEL Consolidation Loans

Monthly Payment and Time Frame

- Your monthly payment is based on annual income
- Your payments change as your income changes
- Up to 10 years

Quick Comparison

- Your monthly payment is based on annual income
- Your payments change as your income changes
- Up to 10 years

6) Income Based Repayment (IBR) Plan

Eligible Loans

- Direct Subsidized and Unsubsidized Loans
- Subsidized and Unsubsidized Federal (FFEL) Stafford Loans
- all PLUS loans made to students
- Consolidation Loans (Direct or FFEL) that do not include Direct, or FFEL PLUS loans made to parents

Monthly Payment and Time Frame

- Your maximum monthly payments will be 15 percent of discretionary income, the difference between your adjusted gross income and 150 percent of the poverty guideline for your family size and state of residence (other conditions apply)
- Your payments change as your income changes.
- Up to 25 years

Quick Comparison

- You must have a partial financial hardship
- Your monthly payments will be lower than payments under the 10-year standard plan
- You will pay more for your loan over time than you would under the 10-year standard plan
- If you have not repaid your loan in full after making the equivalent of 25 years of qualifying monthly payments, any outstanding balance on your loan will be forgiven
- You may have to pay income tax on any amount that is forgiven

7) Pay As You Earn Repayment Plan

Eligible Loans

- Direct Subsidized and Unsubsidized Loans
- Direct PLUS loans made to students
- Direct Consolidation Loans that do not include (Direct or FFEL) PLUS loans made to parents

Monthly Payment and Time Frame

- Your maximum monthly payments will be 10 percent of discretionary income, the difference between your adjusted gross income and 150 percent of the poverty guideline for your family size and state of residence (other conditions apply)
- Your payments change as your income changes
- Up to 20 years

Quick Comparison

- You must be a new borrower on, or after, Oct. 1, 2007, and must have received a disbursement of a Direct Loan on, or after, Oct. 1, 2011
- You must have a partial financial hardship
- Your monthly payments will be lower than payments under the 10-year standard plan
- You will pay more for your loan over time than you would under the 10-year standard plan
- If you have not repaid your loan in full after you made the equivalent of 20 years of qualifying monthly payments, any outstanding balance on your loan will be forgiven
- You may have to pay income tax on any amount that is forgiven

Automated Payments (Electronic Debit)

When you receive your first bill, you will learn how to sign up for the electronic debit account (EDA) option, and have your bank automatically make your monthly loan payments for you from your checking or savings account. You will not have to write checks, use stamps, or worry if your payment will get to the Federal Government by the due date. In addition, there is a 0.25% reduction in the interest rate on your loans during any period when your payments are made through EDA.

Trouble Making Payments

If you are having trouble making payments on your loans, contact your loan servicer as soon as possible. Their staff will work with you to determine the best option for you. Options include:

- Changing repayment plans
- Deferment (if you meet certain requirements). A deferment allows you to temporarily stop making payments on your loan.
- Forbearance, if you don't meet the eligibility requirements for a deferment, but are temporarily unable to make your loan payments. A forbearance allows you to temporarily stop making payments on your loan, temporarily make smaller payments, or extend the time for making payments.

If you stop making payments and do not get a deferment or forbearance, your loan could go into default, which has serious consequences.
Your loan becomes "delinquent" if your monthly payment is not received by the due date. If you fail to make a payment, you will get a reminder that your payment is late. If your account remains delinquent, you will be sent warning notices reminding you of the consequences of default, and of your obligation to repay your loans.

If you are delinquent on your loan payments, contact your loan servicer immediately to find out how to bring your account current. Late fees may be added, and your delinquency will be reported to one or more national consumer reporting agencies (credit bureaus). But, this is much better than remaining delinquent on your payments and going into default.

Consequences of Default

For student loans authorized under Section 435(i)Title IV of the Higher Education Act, default occurs on a Federal Family Education Loan (FFEL) program loan after a default has persisted for 270 days in the case of a loan repayable in monthly installments, or 330 days in the case of a loan repayable in less frequent installments. The change is effective for loans for which the first date of delinquency occurred on, or after, October 7, 1998. During the delinquency period, your loan holder must exercise "due diligence" in attempting to collect the loan; that is, your loan holder must make repeated efforts to locate and contact you about repayment. If your loan holder's efforts are unsuccessful, steps will be taken to place the loan in default and to turn the loan over to the guaranty agency in your state. Your loan holder may "accelerate" a defaulted loan, which means that the entire balance of the loan (principal and interest) becomes due in a single payment.

Once your loan is assigned to a guaranty agency or the U.S. Department of Education for collection, the following steps may be taken to recover the outstanding balance due:

If you default:

- Dept of ED will require you to immediately repay the entire unpaid amount of your loan.
- Dept of ED may sue you; take all or part of your federal and state tax refunds, and other federal or state payments; and/or garnish your wages so that your employer is required to send us 15% of your salary to pay off your loan.
- Dept of ED will require you to pay reasonable collection fees and costs, plus court costs and attorney fees.
- Dept of ED will report your default to national consumer reporting agencies (credit bureaus).
- You may be denied a professional license.
- You will lose eligibility for other federal student aid and assistance under most federal benefit programs.

Once a loan is declared in default, you are no longer entitled to any deferments or forbearances. In addition, you may not receive any additional Title IV federal student aid if you are in default on any Title IV student loan, until you have made payments of an approved amount for at least six consecutive months.

Chapter 5: Consolidating Education Loans

A Consolidation Loan is designed to help student and parent borrowers simplify loan repayment by allowing the borrower to consolidate several types of federal student loans with various repayment schedules into one loan. Even one loan can be consolidated into a Direct Consolidation Loan in order to get benefits, such as flexible repayment options. If the borrower has more than one loan, a Consolidation Loan simplifies the repayment process because there is only one payment per month. Also, the interest rate on the Consolidation Loan may be lower than what is currently being paid on one or more loans.

There is no application fee to consolidate your federal education loans into a Direct Consolidation Loan. If you are contacted by someone offering to consolidate your loans for a fee, you are not dealing with one of the U.S. Department of Education's (ED's) consolidation servicers.

Should I Consolidate My loans?

Carefully consider whether loan consolidation is the best option for you. Loan consolidation can greatly simplify loan repayment by centralizing your loans to one bill, and can lower monthly payments by giving you up to 30 years to repay your loans. You might also have access to alternative repayment plans you would not have had before. And, you will be able to switch your variable interest rate loans to a fixed interest rate.

However, if you increase the length of your repayment period, you will also make more payments and pay more in interest. Be sure to compare your current monthly payments to what monthly payments would be if you consolidated your loans.

If you want to lower your monthly payment amount but are concerned about the impact of loan consolidation, you can consider deferment or forbearance as options for short-term payment relief needs. Once your loans are combined into a Direct Consolidation Loan, they cannot be removed. The loans that were consolidated are paid off and no longer exist.

What Types of Loans Can Be Consolidated?

The following education loans, are eligible for consolidation:

- Direct Subsidized Loans
- Direct Unsubsidized Loans
- Direct PLUS Loans
- Federal Perkins Loans
- Subsidized Federal Stafford Loans from the FFEL Program
- Unsubsidized Federal Stafford Loans from the FFEL Program
- PLUS loans from the FFEL Program
- Supplemental Loans for Students (SLS)
- Federal Nursing Loans
- Health Education Assistance Loans
- some existing consolidation loans

Note 1: Private education loans are not eligible for consolidation.

Note 2: A PLUS loan made to the parent of a dependent student cannot be transferred to the student through consolidation. Therefore, a student who is applying for loan consolidation cannot include the PLUS loan the parent took out for the dependent student's education.

What Are the requirements to Consolidate a Loan?

You must have at least one Direct Loan, or FFEL Program loan, that is in a grace period, or in repayment. If you want to consolidate a defaulted loan, you must either make satisfactory repayment arrangements on the loan with your current loan servicer before you consolidate, or you must agree to repay your new Direct Consolidation Loan under one of the following three plans:

1. Income-Based Repayment Plan,
2. Pay As You Earn Repayment Plan, or
3. Income-Contingent Repayment Plan

Generally, you cannot consolidate an existing consolidation loan again, unless you include an additional Direct Loan, or FFEL Program loan, in the consolidation. However, under certain circumstances, you may re-consolidate an existing FFEL Consolidation Loan without including any additional loans.

There are no application fees for a Direct Consolidation Loan, and you may prepay your loan at any time without penalty.

What Is the Interest Rate on a Consolidation Loan?

A Direct Consolidation Loan has a fixed interest rate for the life of the loan. The fixed rate is based on the weighted average of the interest rates on the loans being consolidated, rounded up to the nearest one-eighth of 1%. There is no cap on the interest rate of a Direct Consolidation Loan.

When Do I Begin Repayment?

Repayment of a Direct Consolidation Loan can begin 60 days after the loan is disbursed, or sooner. Your loan servicer will let you know when the first payment is due. The repayment term ranges from 10 to 30 years, depending on: the amount of your consolidation loan, your other education loan debt, and the repayment plan you select.
Note: If any loan you want to consolidate is still in the grace period, you can delay entering repayment on your new Direct Consolidation Loan until closer to your grace period end date. You will indicate this when you apply, and the consolidation servicer will wait to process your application until the appropriate time.

How Do I apply For A Direct Consolidation Loan?

You apply for a Direct Consolidation Loan through StudentLoans.gov. This process offers both electronic and paper options. You can complete the electronic application as explained below, or you can download and print a paper application from StudentLoans.gov for submission by U.S. mail.

Once you sign in to StudentLoans.gov using your personal identifiers and Federal Student Aid PIN, you will be able to electronically complete the Federal Direct Consolidation Loan Application and Promissory Note. The electronic application on StudentLoans.gov consists of the following five steps:

1. Choose Loans & Servicer
2. Repayment Plan Selection
3. Terms & Conditions
4. Borrower & Reference Information
5. Review & Sign

You may request technical assistance, while signed in to StudentLoans.gov and completing the application, by clicking on the Contact Us tab in the top menu bar of StudentLoans.gov.

After you submit your application electronically via StudentLoans.gov or by mailing a paper application, the consolidation servicer selected will complete the actions required to consolidate your eligible loans. The consolidation servicer will be your point of contact for any questions you may have related to your consolidation application.

It is critical that you continue making payments, if required, to the holders or servicers of the loans you want to consolidate until your consolidation servicer informs you that the underlying loans have been paid off.

Planning Tip 1: Federal rules stipulate the student can only consolidate student loans one time There is one way around the rule, but it means taking on even more debt. The government will allow students to refinance consolidated student loans, but only if the student has a new student loan – or one that was never consolidated in the first place – to include in the consolidation. If, for example, a student consolidated his or her loans five years ago, and then took out a new loan this year to pay for career-related courses, the student may be eligible to consolidate both loans.

Planning tip 2: If the student plans to borrow for graduate school, they can consolidate their undergraduate loans during their grace period, and defer payment on the combined loan once they return to graduate school That will leave the student the option of consolidating any grad school loans down the road.

Planning tip 3: If the student is extremely strapped for cash, they could extend their repayment period as well as reduce the interest rate. This lets them cut the monthly tab by as much as half.

A lender may not refuse to consolidate a loan because of:

- the number or types of loans to be consolidated
- the type of school attended
- the interest rate that would be charged on a consolidation loan
- the types of repayment schedule available

Chapter 6: Postponing Education Loans

Loan Deferment & Forbearance

Loan Deferment

What Is Loan Deferment?

A deferment is a period during which repayment of the principal and interest of your loan is temporarily delayed.

Who Qualifies for a Loan Deferment?

The student qualifies for deferment of the student loans when the student meets one of the following six criteria:

1. The student must be enrolled, at least half time, at an institution that meets the eligibility requirements for a particular loan.
2. The student must be enrolled in a graduate fellowship program, or a rehabilitation training program for the disabled.
3. The student must be unemployed (for up to three years), but actively seeking employment.
4. The student is facing economic hardship (for up to three years). Economic hardship includes a broad range of reasons that enable the student to defer the loans.
5. During a period of active duty military service during a war, military operation, or national emergency.
6. During the 13 months following the conclusion of qualifying active duty military service, or until you return to enrollment on at least a half-time basis, whichever is earlier.

What Happens to My Loan During Deferment?

During a deferment, you do not need to make payments. What is more, depending on the type of loan you have, the Federal Government may pay the interest on your loan during a period of deferment.

The government may pay the interest on your:

- Federal Perkins Loan,
- Direct Subsidized Loan, and/or
- Subsidized Federal Stafford Loan.

The government does not pay the interest on your:

- unsubsidized loans
- PLUS loans

You are responsible for paying the interest that accrues (accumulates) during the deferment period, but your payment is not due during the deferment period. If you do not pay the interest on your loan during deferment, it may be capitalized (added to your principal balance), and the amount you pay in the future will be higher.

Federal Perkins Loan Deferment

The Perkins loan program provides for deferment of loan repayment. Perkins borrowers (except hardship) also get a six-month grace period following deferment. Loan forgiveness for the Perkins loan may be obtained, if the student is employed in one of the following services:

- Full-time teachers teaching a "shortage subject", or serving children with disabilities, low-income students, or pre-schoolers.
- Full-time law enforcement officers or correctional officers.
- Nurses or medical technicians.
- Full-time social services employees serving low-income children and families.
- Military personnel serving in "areas of hostility."
- Peace Corps or ACTION volunteers.
- Health Education Assistance Loan (HEAL) and Health Professional Student Loan (HPSL) borrowers engaged in similar service or "shortage" activities.

How Do I Request a Deferment?

The procedure for obtaining a loan deferment is simple, but many deferments are not automatic. You will likely need to submit a request, to your loan servicer, the organization that handles your loan account. If you are enrolled in school, at least half-time, and you would like to request an in-school deferment, you will need to contact your school's financial aid office, as well as your loan servicer.

Your deferment request should be submitted to the organization to which you make your loan payments.

- Direct Loans and FFEL Program loans: contact your loan servicer
- Perkins Loans: contact the school you were attending when you received the loan

Loan Forbearance

What is Loan Forbearance?

If you cannot make your scheduled loan payments, but do not qualify for a deferment, your loan servicer may be able to grant you a forbearance. With forbearance, you may be able to stop making payments or reduce your monthly payment for up to 12 months. Interest will continue to accrue on your subsidized and unsubsidized loans (including all PLUS loans).

There are two types of forbearances:

- Discretionary
- Mandatory

Discretionary Forbearance

For discretionary forbearances, your lender decides whether to grant forbearance or not.
You can request a discretionary forbearance for the following reasons:

- Financial hardship
- Illness

Mandatory Forbearance

For mandatory forbearances, if you meet the eligibility criteria for the forbearance, your lender is required to grant the forbearance. You can request a mandatory forbearance for the following reasons:

- You are serving in a medical, or dental, internship or residency program, and you meet specific requirements.
- The total amount you owe each month for all the student loans you received is 20 percent or more of your total monthly gross income (additional conditions apply).
- You are serving in a national service position, for which you received a national service award.
- You are performing teaching service that would qualify for teacher loan forgiveness.
- You qualify for partial repayment of your loans under the U.S. Department of Defense Student Loan Repayment Program.
- You are a member of the National Guard and have been activated by a governor, but you are not eligible for a military deferment.

How Do I Request a Forbearance?

Receiving loan forbearance is not automatic. You must apply by making a request to your loan servicer. In some cases, you must provide documentation to support your request.

What Happens to the Interest on My Loan During Forbearance?

Interest will continue to be charged on all loan types, including subsidized loans. You can pay the interest during forbearance or allow the interest to accrue (accumulate). If you do not pay the interest on your loan during forbearance, it may be capitalized (added to your principal balance), and the amount you pay in the future will be higher.

Final Notes on Loan Deferment & Forbearance

You MUST continue making payments on your student loan until you have been notified that your request for deferment or forbearance has been granted. If you stop paying and your deferment or forbearance is not approved, you will become delinquent and you may default on your loan.

Always contact your loan servicer, immediately, if you are having trouble making your student loan payment. If you do not qualify for deferment or forbearance, you may be able to change your repayment plan. There may be a repayment plan that offers lower payments than you are currently making.

Chapter 7: Discharging Education Loans

Loan Forgiveness, Cancellation, Discharge & Bankruptcy

Loan Forgiveness for Public Service

What is the Public Service Loan Forgiveness (PSLF) Program?

The PSLF Program is intended to encourage individuals to enter, and continue to work, full-time in public service jobs. Under this program, you may qualify for forgiveness of the remaining balance due on your William D. Ford Federal Direct Loan Program (Direct Loan Program) loans after you have made 120 qualifying payments on those loans while employed full-time by certain public service employers.

Since you must make 120 qualifying payments on your eligible federal student loans after October 1, 2007 before you qualify for the loan forgiveness, the first forgiveness of loan balances will not be granted until October 2017.

Teacher Loan Forgiveness

If you are a teacher and also a new borrower (i.e., you did not have an outstanding balance on a Direct Loan or FFEL Program loan on Oct. 1, 1998, or on the date you obtained a Direct Loan or FFEL Program loan after Oct. 1, 1998), and have been teaching full-time in a low-income elementary or secondary school, or educational service agency for five consecutive years, you may be able to have as much as $17,500 of your subsidized or unsubsidized loans forgiven. Your PLUS loans cannot be included.

Public Service Loan Forgiveness

If you are employed in certain public service jobs and have made 120 payments on your Direct Loans (after Oct. 1, 2007), the remaining balance that you owe may be forgiven. Only payments made under certain repayment plans may be counted toward the required 120 payments. You must not be in default on the loans that are forgiven.

What Federal Student Loans Are Eligible for forgiveness Under the PSLF Program?

Any non-defaulted loan made under the Direct Loan Program is eligible for loan forgiveness. The Direct Loan Program includes the following loans:

- Federal Direct Stafford/Ford Loans
- Federal Direct Unsubsidized Stafford/Ford Loans
- Federal Direct PLUS Loans - for parents and graduate or professional students
- Federal Direct Consolidation Loans

NOTE 1: Parents who received a Direct PLUS Loan may qualify for forgiveness of the PLUS loan, if the parent borrower—not the student on whose behalf the loan was obtained—is employed by a public service organization.

NOTE 2: PLUS loans received by parents may not be repaid under the IBR, Pay As You Earn, or ICR Plan - the three repayment plans most likely to leave a borrower with a remaining balance to be forgiven under PSLF.

How Can Other Federal Student Loans Become Eligible for Loan Forgiveness Under the PSLF Program?

Although loan forgiveness under this program is available only for loans made and repaid under the Direct Loan Program, loans made under other federal student loan programs may become eligible for forgiveness if they are consolidated into a Direct Consolidation Loan. However, only payments made on the Direct Consolidation Loan will count toward the required 120 qualifying payments.

The following loans may be consolidated into the Direct Loan Program:

- Federal Family Education Loan (FFEL) Program loans, which include:
    1. Subsidized Federal Stafford Loans
    2. Unsubsidized Federal Stafford Loans
    3. Federal PLUS Loans—for parents and graduate or professional students
    4. FFEL Consolidation Loans (excluding joint spousal consolidation loans)
- Federal Perkins Loans
- Certain Health Professions and Nursing Loans

NOTE: To consolidate a Federal Perkins Loan, a Health Professions, or a Nursing Loan into a Direct Consolidation Loan, you also must consolidate at least one FFEL Program loan or Direct Loan.

What Are the Borrower Eligibility Requirements for Loan Forgiveness Under the PSLF Program?

- You must not be in default on the loans for which forgiveness is requested.
- You must be employed full time by a public service organization:
- when making each of the required 120 qualifying loan payments (certain repayment conditions apply—see below);
- at the time you apply for loan forgiveness; and
- at the time the remaining balance on your eligible loans is forgiven.

What Are the Specific Loan Repayment Requirements for Loan Forgiveness Under the PSLF Program?

- You must have made 120 separate monthly payments, after October 1, 2007, on the Direct Loan Program loans for which forgiveness is requested. Payments made before this time do not count toward meeting this requirement. Each of the 120 qualifying payments must be made for the full scheduled installment amount, and no later than 15 days after the scheduled payment due date. The 120 required payments do not need to be made consecutively.
- The 120 required payments must be made under one or more of the following Direct Loan Program repayment plans:
- Income-Based Repayment (IBR) Plan (not available for Direct PLUS Loans made to parents, or for Direct Consolidation Loans that repaid Direct or FFEL PLUS Loans made to parents)
- Pay As You Earn Plan (not available for Direct PLUS Loans made to parents, or for Direct Consolidation Loans that repaid Direct or FFEL PLUS Loans made to parents)
- Income Contingent Repayment (ICR) Plan (not available for Direct PLUS Loans made to parents; however, Direct Consolidation Loans that repaid Direct or FFEL PLUS loans made to parents may be repaid under ICR)
- 10-Year Standard Repayment Plan
- Any other Direct Loan Program repayment plan; but, only payments that are at least equal to the monthly payment amount that would have been required under the 10-Year Standard Repayment Plan, may be counted toward the required 120 payments.

NOTE: The PSLF Program provides for forgiveness of the remaining balance of a borrower's eligible loans, after the borrower has made 120 qualifying payments on those loans. In general, only borrowers who are making reduced monthly payments through the IBR, Pay As You Earn, or ICR repayment plans will have a remaining balance after making 120 payments on a loan.

What Are On-Time, Full, Scheduled, Monthly Payments?

On-time payments are those that are received by your federal loan servicer, no later than 15 days after the scheduled payment due date.

Full payments are payments on your Direct Loan in an amount that equals, or exceeds, the amount you are required to pay each month under your repayment schedule. If you make a payment for a month that is less than what you are required to pay for that month, that month's payment will not count as one of the required 120 qualifying payments. If you make multiple partial payments in a month, and the total of those partial payments equals, or exceeds, the required full monthly payment amount, those payments will count as only one qualifying payment.

Scheduled payments are those that are made under a qualifying repayment plan, after your federal loan servicer has billed you for the month's payment. They do not include payments made while your loans are in an in-school or grace status, or in a deferment or forbearance period.

You must make separate monthly payments. Lump sum payments, or payments you make as advance payments for future months, are not qualifying payments. There are special rules on lump sum payments for borrowers whose public service employment is with AmeriCorps or the Peace Corps.

What Types of Public Service Jobs Will Qualify a Borrower for Loan Forgiveness Under the PSLF Program?

You must be employed full time (in any position) by a public service organization, or must be serving in a full-time AmeriCorps or Peace Corps position. Organizations that meet the definition of "public service organization" for purposes of the PSLF Program are listed below.

- A government organization (including: a federal, state, local, or tribal organization, agency, or entity; a public child or family service agency; or a tribal college or university).
- A not-for-profit, tax-exempt organization under section 501(c)(3) of the Internal Revenue Code.
- A private, not-for-profit organization (that is not a labor union or a partisan political organization) that provides one or more of the following public services:
    - Emergency management
    - Military service
    - Public safety
    - Law enforcement
    - Public interest law services
    - Early childhood education (including licensed or regulated health care, Head Start, and state-funded pre-kindergarten)
    - Public service for individuals with disabilities and the elderly
    - Public health (including nurses, nurse practitioners, nurses in a clinical setting, and full-time professionals engaged in health care practitioner occupations and healthcare support occupations)
    - Public education
    - Public library services
    - School library or other school-based services

What Is Full-Time Employment?

You must meet your employer's definition of full-time. However, for PSLF purposes, that definition must be at least an annual average of 30 hours per week. For purposes of the full-time requirement, your qualifying employment at a not-for-profit organization does not include time spent participating in religious instruction, worship services, or any form of proselytizing.

If you are a teacher, or other employee of a public service organization, under contract for at least eight out of 12 months, you meet the full-time standard, if you work an average of at least 30 hours per week during the contractual period, and receive credit by your employer for a full year's worth of employment.

If you are employed in more than one qualifying part-time job simultaneously, you may meet the full-time employment requirement, if you work a combined average of at least 30 hours per week with your employers.

What does it mean that my 120 qualifying payments must be made while I am working full-time at certain public service organizations?

For a payment to count as one of the required 120 qualifying payments, you must be a full-time employee at a qualifying public service organization on the date that your federal loan servicer receives your monthly Direct Loan payment.

In addition, you must be a full-time employee at a qualifying public service organization at the time you apply for PSLF Program loan forgiveness, and at the time forgiveness is granted.

How Can I Keep Track of My Eligibility for the PSLF Program?

The Department of Education has created the Employment Certification for Public Service Loan Forgiveness form (Employment Certification form), and a process to help you monitor your progress toward making the 120 qualifying payments necessary to apply for PSLF. You should complete the form, including your employer's certification of employment, and submit it to FedLoan Servicing (PHEAA), the PSLF servicer, at the address listed in Section 6 of the Employment Certification form.

The form allows you to get your employer's certification of employment while you are still employed at that organization, or shortly after leaving. The process allows you to receive confirmation of qualifying employment and Direct Loan payment eligibility. You may also submit the form less frequently than annually to cover more than one year's employment, or for more than one employer.

While use of the form and process is not required, it will help you keep track of your progress toward meeting the PSLF eligibility requirements. If you do not periodically submit the form, you will still be required to submit a form for each qualifying employer at the time you apply for forgiveness, and when forgiveness is granted.

- Instructions for Completing Employment Certification for Public Service Loan Forgiveness
- Employment Certification for Public Service Loan Forgiveness Form

What Should I Do After I Become Eligible for PSLF?

After you make your 120th qualifying payment, you will need to submit the PSLF application to receive loan forgiveness. The application is under development, and will be available prior to the date when the first borrowers will be eligible for PSLF Program forgiveness, in October 2017. You must be working for a qualified public service organization at the time you submit the application for forgiveness, and at the time the remaining balance on your loan is forgiven.

Loan Cancellation & Discharge

Discharge Due to School Closing

You may be eligible for a 100% discharge of your Direct Loans, Federal Family Education Loan (FFEL) Program loans, or Federal Perkins Loans under either of these circumstances:

- Your school closes while you're enrolled, and you do not complete your program because of the closure. If you were on an approved leave of absence, you are considered to have been enrolled at the school.
- Your school closes within 90 days after you withdraw.

You are not eligible for discharge of your loans if your school closes, and any of the following is true:

- You withdraw more than 90 days before the school closes.You are completing a comparable educational program at another school. If you complete such a program at another school after your loan is discharged, you might have to pay back the amount of the discharge.
- You have completed all the coursework for the program, even if you have not received a diploma or certificate.

Total and Permanent Disability Discharge

A TPD discharge relieves you from having to repay a William D. Ford Federal Direct Loan (Direct Loan) Program loan, Federal Family Education Loan (FFEL) Program loan, and/or Federal Perkins Loan (Perkins Loan) Program loan, or complete a TEACH Grant service obligation on the basis of your total and permanent disability. Before your federal student loans, or TEACH Grant service obligation, can be discharged, you must provide information to the U.S. Department of Education (ED) to show that you are totally and permanently disabled. ED will evaluate the information and determine if you qualify for a TPD discharge.

You can show that you are totally, and permanently, disabled in one of the following three ways:

1. If you are a veteran, you can submit documentation from the U.S. Department of Veterans Affairs (VA), showing that the VA has determined that you are unemployable due to a service-connected disability.
2. If you are receiving Social Security Disability Insurance (SSDI), or Supplemental Security Income (SSI) benefits, you can submit a Social Security Administration (SSA) notice of award for SSDI or SSI benefits stating that your next scheduled disability review will be within five to seven years from the date of your most recent SSA disability determination.
3. You can submit certification from a physician that you are totally, and permanently, disabled. Your physician must certify that you are unable to engage in any substantial gainful activity by reason of a medically determinable physical or mental impairment that:
    - Can be expected to result in death,
    - Has lasted for a continuous period of not less than 60 months, or
    - Can be expected to last for a continuous period of not less than 60 months.

Discharge Due to Death

If you, the borrower, die, then your federal student loans will be discharged. If you are a parent PLUS loan borrower, then the loan may be discharged if you die, or if the student on whose behalf you obtained the loan dies.

The loan will be discharged if a family member or other representative provides a certified copy of the death certificate to the school (for a Federal Perkins Loan), or to the loan servicer (for a Direct Loan or FFEL Program loan).

False Certification of Student Eligibility or Unauthorized Payment Discharge

You may be eligible for a discharge of your Direct Loan, or FFEL Program loan, in these circumstances:

- Your school falsely certified your eligibility to receive the loan based on your ability to benefit from its training, and you did not meet the ability to benefit student eligibility requirements.
- The school signed your name on the application, or promissory note, without your authorization, or the school endorsed your loan check, or signed your authorization for electronic funds transfer without your knowledge, unless the proceeds of the loan were delivered to you or applied to charges owed by you to the school.
- Your loan was falsely certified because you were a victim of identity theft.
- The school certified your eligibility, but, because of a physical or mental condition, age, criminal record, or other reason, you are disqualified from employment in the occupation in which you were being trained.

Unpaid Refund Discharge

You may be eligible for a discharge of your Direct Loan, or FFEL Program loan, if you withdrew from school, but the school didn't pay a refund that it owed to the U.S. Department of Education or to the lender, as appropriate. Check with the school to see how refund policies apply to federal aid at the school.

Only the amount of the unpaid refund will be discharged. You may qualify for this partial discharge whether the school is closed or open. Contact your loan servicer for more information.

Perkins Loan Cancellation and Discharge

The following Federal Perkins Loan Program cancellations apply to individuals who perform certain types of public service, or are employed in certain occupations.

For each complete year of service, a percentage of the loan may be canceled. The total percentage of the loan that can be canceled depends on the type of service performed. Depending on the type of loan you have, and when that loan was taken out, you may be eligible to cancel part of, or your entire loan, if you have served as one of the following:

- Volunteer in the Peace Corps or ACTION program (including VISTA)
- Teacher
- Member of the U.S. armed forces (serving in area of hostilities)
- Nurse or medical technician
- Law enforcement or corrections officer
- Head Start worker
- Child or family services worker
- Professional provider of early intervention services

There is no standard application form for Perkins Loan cancellations. Contact the school that you were attending when you received the loan.

Loan Bankruptcy

A borrower may be able to bankrupt out of a federal education loan only if the court allows it, because of excessive hardship of repayment. This is very tough to show and most courts will not let the borrower bankrupt out of an education loan. You must prove to the bankruptcy court that repaying your student loan would cause undue hardship.

If you file Chapter 7, or Chapter 13, bankruptcy, you may have your loan discharged in bankruptcy only if the bankruptcy court finds that repayment would impose undue hardship on you and your dependents. This must be decided in an adversary proceeding in bankruptcy court. Your creditors may be present to challenge the request. The court uses this three-part test to determine hardship:

- If you are forced to repay the loan, you would not be able to maintain a minimal standard of living.
- There is evidence that this hardship will continue for a significant portion of the loan repayment period.
- You made good-faith efforts to repay the loan before filing bankruptcy (usually this means you have been in repayment for a minimum of five years).

Your loan will not be discharged if you are unable to satisfy any one of the three requirements. If your loan is discharged, you will not have to repay any portion of your loan, and all collection activity will stop. You also will regain eligibility for federal student aid if you had previously lost it.

Chapter 8: Federal Education Loan Servicers

For information pertaining to the following:

- Loan Status
- Loan Cancellation
- Loan Disbursement Amounts and Timing

Contact your school's financial aid office directly. Only your school's financial aid office can provide this information.

For questions regarding Loan Repayment, Deferment or Forbearance, contact your loan servicer:

Nelnet	www.nelnet.com	1-888-486-4722
Great Lakes Educational Loan Services, Inc.	www.mygreatlakes.org	1-800-236-4300
Sallie Mae	www.salliemae.com	1-800-722-1300
FedLoan Servicing (PHEAA)	www.myfedloan.org	1-800-699-2908
MOHELA	www.mohela.com	1-888-866-4352
ESA/Edfinancial	www.edfinancial.com/DL	1-855-337-6884
CornerStone	www.MyCornerStoneLoan.org	1-800-663-1662
Aspire Resources Inc	www.AspireResourcesInc.com	1-855-475-3335
Granite State - GSMR	www.gsmr.org	1-888-556-0022
OSLA Servicing	www.osla.org	1-866-264-9762
VSAC Federal Loans	www.vsacfederalloans.org	1-888-932-5626
Debt Management and Collections System	www.myeddebt.com	1-800-621-3115

Chapter 9: Private Education Loans

If you apply for financial aid, your school will likely include federal student loans as part of your financial aid package. However, many times the student still ends up with a funding shortfall between the tuition bill owed and the limited amount the federal loans available and private loans become necessary.

Private education loans are non-federal loans, made by a private lender such as a bank, credit union, state agency, or a college, and there are no federal forms to complete. These loans tend to cost more than loans offered by the federal government, but are less expensive than credit card debt.

Federal education loans offer low fixed interest rates, while private loans typically carry variable interest rates of 3% to 12%, and include higher origination fees and other charges. Federal education loans also offer better repayment and forgiveness options, and as such, students should exhaust their eligibility for federal education loans before resorting to private student loans.

Below is a summary of the differences between federal and private education loans. Private education loans:

- require payments while you are still in school
- are not subsidized (no one pays the interest while the student attends college
- can have variable interest rates, some even greater than 18%, and the loan interest may not be tax deductible
- require an established credit record, which in turn may require a cosigner to get the best possible deal
- cannot be consolidated into the federal loan consolidation program
- may include prepayment penalty fees

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Eligibility, interest rates, and the fees that you pay on a private student loan are largely based on your credit score, or the credit score of your cosigner. Generally, if your FICO credit score is less than 650 you will not be approved for a private student loan. And an increase of 20 to 50 points above a 650 score is often enough to get you much better terms on your loan.

It is better to apply for a private student loan with a cosigner, even if you could qualify for the loan on your own. Applying with a cosigner usually results in a lower rate because they are not as risky for the lender. Moreover, the interest rates and fees are usually based on the higher of the two credit scores. So if your cosigner has a much better credit score than you, it could result in both lower interest rates and fees.

The Benefits of Using a Cosigner on a Private Education Loan

- Better chance of qualifying for a loan
- Lower interest rates, which means less total borrowing
- Your child begins establishing their own credit history
- Release option available after 24-48 months

However, the chief advantage of using a co-signer on a private education loan is the student can leverage the co-signer's higher income and more extensive credit history to begin establishing their own credit history, since the loan is in the student's name. By establishing good student credit most private loans have a release option available for the cosigner after 24-48 months

What Parents Need to Know About Agreeing to Be A Private Education Loan Cosigner

Many times private education loans are needed to allow students to complete their education. However, it does not change the fact that the student remains the primary borrower. Agreeing to cosign a loan guarantees that the cosigner (parent, legal guardian or family member) on the loan application will step in and take responsibility for paying the money back, in the event the student cannot. The student borrower's account must remain current until the request for the cosigner release is processed, and the student must be a U.S. citizen or permanent resident at the time the cosigner release is processed.

To search for private student loan servicers and compare the best deals on go to: www.SimpleTuition.com.

Chapter 10: Other Loans for Education

Personal Residence and Home Equity Loans

Parents who consider using private education loans often also consider using a personal residence or home equity loan to finance the student's education. Home equity is the difference between the fair market value of your home and what you owe on it. In other words, it is the portion of the total value in your house that you already own.

Although many parents do not want to mortgage their home to pay for college costs, it may be a better source of funds than borrowing on their business assets or from their retirement accounts.

The interest rates on most home equity loans, and lines of credit, are higher than the interest rates on the Federal Stafford and Federal PLUS loans, but lower than most private education loans. This means a Federal loan will cost less than a home equity loan, and a home equity loan will cost less than a private education loan.

Another consideration is the fees you may pay for a loan. Federal education loans and private education loans have fees, in addition to the interest rate. Home equity loans may also have fees. The fees on private education loans are usually higher than the fees on home equity loans, which in turn are higher than the fees on Federal education loans. Fees are simply another loan cost in addition to interest, and as such, all education loans being considered should be compared by calculating the equivalent interest rate and fees of each loan.

If the family uses a home equity line of credit to fund college, they can borrow what is needed as it is needed. Therefore, they will pay interest on only the amount they borrow. The family is usually allowed to make minimum monthly payments, and can then make larger payments after the student is done with college.

Another strategic advantage of paying for college with a home equity loan is the fact that proceeds from a home equity line of credit that are used for education are not considered as 'income' in the financial aid formula.

However, if the family refinances, or uses a second mortgage to fund college, they will borrow a fixed, lump sum amount which probably will not be used all at once, and they will be paying interest on money not currently needed. Therefore, the family should consider investing the excess funds in a short-term investment until the funds are needed for college.

For parents whose income is too high (modified adjusted gross income (MAGI) is less than $75,000 ($155,000 if filing a joint return) to take advantage of the student loan interest deduction, a personal residence loan can give them an itemized income tax deduction (subject to the phase-out rules for high income). This deduction is not limited to $2,500, as is the case for student loan interest.

The repayment term on residence loans is usually longer than retirement account loans and other types of loans, which makes the monthly payments smaller.

Planning tip: For conservative long-term investors, aggressively prepaying their home mortgage to avoid high interest costs can pay big dividends as a college and retirement strategy. The longer the client stays in a home, the larger the cash flow savings.

Example 1:
Joe has 15 years to go before his son attends college. Joe has a 30-year, $200,000 mortgage at an 8% rate. If Joe pays an extra $500 per month towards his loan, he'll pay off the mortgage in 14 years and save $193,000 in interest (cash flow). Plus, Joe will have created a minimum $200,000 in equity (line of credit) to borrow against when his son goes to college. If he pays an extra $200 per month, he will pay off his mortgage in 20 years and save $125,000 in interest costs. Regardless of the amount of prepayment, once the mortgage is paid off, the monthly payments can be used to pay college costs or invest for retirement.

Caution: Prepaying a home mortgage reduces a source of low cost financing and the ability to use tax-favored mortgage financing for college. Mortgage interest is tax-deductible only on borrowing used to acquire a home, not on subsequent financing. Each homeowner is allowed to deduct up to $100,000 on home equity borrowing but interest on additional borrowing is not tax-deductible. Prepaying will reduce the value for deductible borrowing.

Example 2:
Your home is worth $300,000 and the mortgage is paid down to $200,000 through normal payments. A home-equity loan of $100,000 can be used to borrow against the home's full value. If prepayments of $50,000 have also been made, reducing the mortgage balance to $150,000, you can only borrow against $250,000 of your home's value with deductible interest--$50,000 of its value will not qualify for deductible borrowing.

Planning tip: For clients with a business, IRC Regulation 1.163-10T(o)(5) allows personal residence interest to be treated as a business expense, if the loan was used for business purposes. In addition to a tax deduction that is not subject to the itemized deduction phase-out at high-income levels, this deduction reduces the social security and Medicare tax liability for a self-employed client, if the interest expense qualifies as business interest expense.

The election does not have to be made in the year the debt is incurred; instead, it can be made in that year or any subsequent year the debt is outstanding. Once made, the election is binding on all future years (as to the debt) unless the IRS consents to revoke the election. The election is made by attaching a statement to the return for the year of the election.
Electing out of home equity debt treatment by a taxpayer who otherwise would be able to deduct the interest above-the-line (via Schedule C, E. or F) enables the taxpayer to "save" the $100,000 home equity debt benefit for another use.
Example: James takes out a home equity loan for $50,000. He deposits the loan proceeds into an account used by his sole proprietorship, a business in which he actively participates. The money is immediately spent on new equipment for the business. James should elect to treat the $50,000 loan as not secured by a qualified residence, thereby allowing him to deduct the interest on his Schedule C. The election also preserves the availability of the full $100,000 home equity debt tax break for the future.

Caution: The regulations do not state whether the election can be made for a portion of a debt without tainting the remaining debt. Thus, it appears an election to treat debt as not secured by a qualified residence prevents a taxpayer from claiming a qualified residence interest deduction for any interest related to that debt. For example, an election made for a home equity debt used 70% for a Schedule C business related-

related activity, and 30% for purchasing a personal-use automobile would apparently cause the interest allocable to the automobile purchase (30%) to be nondeductible personal interest expense because of the interest tracing rules. To avoid this unfavorable treatment, it is a good idea to take out two separate home equity loans, and then make the election only for the one used for business purposes.

The client may want to borrow from the home and put the loan (indirectly) into a 403(B) plan. The benefits of this are:

- The client can deduct the home loan interest.
- They will reduce taxable wages by the 403(B) contribution.
- The 403(B) will grow tax-deferred, and the client may borrow from it tax-free to help fund college.
- The 403(B) is a non-assessable asset.

Planning tip 1: When trying to determine whether to use money to prepay a mortgage or as investment there a couple of things to consider when making the decision. What is the time horizon? What is the rate on the mortgage? What is the income tax rate? To calculate the after-tax mortgage cost use the formula: [mortgage rate x (1 – tax rate)]. Then, compare this to the after-tax returns expected from the market over a period of time. The mortgage cost is fixed, but the market returns do carry risk. However, this can help make an informed decision.

Planning tip 2: Borrowing against a home provides handsome tax benefits. The taxpayer can deduct the interest on no more than $100,000 worth of home-equity debt. Even though less interest is deductible, the taxpayer can take the deduction no matter how the money is spent.

Example:
Using a line of credit secured by the taxpayer's home, they borrow $150,000 to pay personal bills. The total interest comes to $9,000 the first year. Interest on the first $100,000 of home-equity debt ($6,000) is deductible, but interest on the excess $50,000 ($3,000) is not deductible.
The taxpayer can elect to treat home-equity debt as debt not secured by their home. In some cases, this results in a larger deduction.

Example 1:
If Sam borrows $150,000 on a home-equity line of credit, and $50,000 of that is used for business-related expenses, then Sam can elect to treat that $50,000 as trade or business debt, which may be deductible.

Example 2:
In another situation, Sam borrows $150,000 to buy a second home. He can elect to have the excess $50,000 treated as investment-related debt, stating that he is holding the second home for an investment. In this case, the interest on the excess $50,000 may be investment interest, deductible up to the amount of his net investment income.

Note: The taxpayer's net investment income will come from dividends and interest. They can count net capital gains, too, if that would work to their advantage, knowing that they may lose the benefit of the lower 15% long-term capital gains rate.

Retirement Account Loans

Borrowing from retirement accounts may be considered as a source for college funding. The advantages of borrowing from these sources are a generally favorable interest rate and repayment terms, and ease of obtaining the loan. However, if these loans are not repaid within a certain period of time, usually five years, the outstanding principal balance becomes taxable income and subject to a 10% penalty if the borrower is under age 59 1/2.

Also, if the employee loses a job, the outstanding loan balance may have to be immediately repaid or taxable income occurs. In addition, the borrower gives up the ability to defer tax on the withdrawn assets and may be jeopardizing retirement savings.

Furthermore, even though the retirement fund is earning interest on the college loan, it is foregoing the interest it would have earned had it been invested in a mutual fund at a possibly higher rate of return.

Some retirement plans prohibit or restrict distributions before retirement. However, hardship distributions from 401(k) plans (subject to the 10% penalty) are allowed to meet certain college expenses. Taking a hardship distribution precludes the plan participant from contributing to the plan for 12 months.

Life Insurance Loans

Some clients use life insurance loans as a source of college funding. The client should beware of taking out a life insurance loan. What typically happens when a client takes out a life insurance loan for a long period of time is that the loan balance increases, because the client doesn't pay the interest. Therefore, as the loan value increases, the client's family gets very little, if any, death benefits. Also, the loan balance can eat up all the cash value and there is no cash left in the policy to sustain it. The policy then terminates unless the client pays back the loan. If it terminates, the client doesn't have to repay the loan plus accrued interest, but then has to recognize this as taxable income.

If the client is borrowing from the policy for college expense and doesn't plan on repayment, the client should only borrow an amount that will not terminate the policy until age 100, taking into account whether interest and premiums will be paid out of pocket or not. The loan is usually paid off on death out of the proceeds. Life insurance loans can give the client an option of paying for college, but the client should beware of the pitfalls of borrowing too much and causing the policy to terminate.

Intra-family Loans

Generally, a disparity exists between the rate of earnings on an investment and the interest rate a borrower must pay on a loan. Loaning money to a child for college costs can offer savings opportunities for both the parents and the child. The parents may be able to both increase their rate of return on investments and assist their child in paying for college. The child may increase cash flow for college, due to the lower interest rate on the loan than could be obtained from other financing.

Note: The interest paid on loans from relatives is not deductible as student loan interest expense.

Example:

The parents have $150,000 in their savings account that earns 5% annually. Their child needs $125,000 for college; however, the 9% rate the child needs to pay to a lending institution is higher than the child would like. The parents want to loan the student the money, but they need the income generated from their savings account to live on. The parties agree on a 7% interest rate on the loan. The parent's marginal tax rate is 25% and the child's tax rate is 10/15%. In this case, the parents will have an increase in earnings of $2,500 [(7% - 5%) x $125,000], less the increased tax liability of $625, or a net after-tax increase to cash flow of $1,875. The student will have a decrease in interest expense of $2,500 [(9% - 7%) x ($125,000]. The combined increase in family cash flow is $4,375 ($1,875 + $2,500).

Chapter 11: Tax Ramifications of Education Loans

Student Loan Interest Deduction

This tax benefit is a deduction to adjusted gross income, allowed for interest paid on qualified student loans. The loans do not have to be federal interest subsidized loans.

Calculation of the Interest Deduction

The interest deduction is calculated by taking 100% of any interest due and paid on a qualified student loan.

Maximum Interest Deduction Allowed

The maximum interest deduction allowed is $2,500. Payments made before the required repayment dates are now deductible. Voluntary payments of interest during periods in which the education loan is in deferral or forbearance are also deductible.

Note: Parents are able to deduct education interest expense on PLUS loans during college years. Repayment begins immediately, after the loan proceeds are disbursed to the parents. Students who claim themselves on their tax returns are able to deduct education interest expense on Federal Stafford and Perkins loans . Repayment of these loans does not begin until after the student leaves college.

Interest Deduction Phase-Out

The deduction for student loan interest is phased-out when the taxpayer reaches certain levels of Modified AGI. The AGI phase-out range is doubled for married taxpayers filing jointly, and the income limits are increased as follows:

Filing Status	AGI Phase-out Range
Joint	$130,000 - $160,000
Single	$65,000 - $80,000

Planning tip: As a tax planning strategy, families who have Modified AGI, in excess of the phase-out levels, and do not qualify for financial aid may have the student take out “Unsubsidized Federal Stafford Loans” during college years. The student can take out these loans, even though the student does not qualify for financial aid. The interest on these loans can be accrued and paid after the student leaves college. At that time, the student will be able to file a tax return and claim an exemption for the student, and will probably be under the income phase-out levels. The student can then deduct the interest on the student’s tax return; the maximum deduction at that time could be $2,500 per year.

Example:
A married taxpayer, with $145,000 in Modified AGI, would have a maximum interest deduction of $1,250 in the year 2014.

Qualified Expenses

The student loan interest deduction is only available for qualified expenses for undergraduate or graduate courses. The loan must have been used to pay the cost of attendance at an eligible educational institution for a student enrolled at least half-time in a program leading to a degree, certificate, or other recognized educational credential. These qualified educational expenses are defined in Section 472 of the Higher Education Act of 1965, which include tuition, fees, room and board, supplies, equipment, transportation and related personal expenses.

Qualified expenses do not include expenses paid by a loan from a person related to the student. Also, qualified expenses do not include expenses paid with a loan from a qualified employer retirement plan.

The qualified expenses are reduced by: (1) IRC Sec. 135 exclusions (U.S. EE Savings Bonds used to pay education expenses), (2) distributions from CESAs which are excluded from gross income, (3) IRC Sec. 117 exclusions, scholarship or fellowship grants, and (4) other tax-free educational assistance, such as IRC Sec. 127, employer provided education assistance.

Eligible Students

To be eligible for the interest deduction, the student must be enrolled on at least a half-time basis in a program leading to a degree, certificate, or other recognized educational credential. The student must be the taxpayer, the taxpayer's spouse, or a dependent of the taxpayer at the time the loans were received. No deduction is allowed for an individual who is claimed as a dependent on another taxpayer's tax return.

Eligible Educational Institutions

To qualify for the interest deduction, the student must attend an eligible educational institution. The institution must be a postsecondary institution, as defined in Section 481 of the Higher Education Act of 1965 and, therefore, eligible to participate in the federal student aid programs administered by the Department of Education. This category includes virtually all accredited public, nonprofit, and proprietary post-secondary institutions. For purposes of the student loan interest deduction, eligible educational institutions also include institutions that conduct an internship or residency program leading to a degree or certificate awarded by an institution of higher education, a hospital, or a healthcare facility that offers postgraduate training.
In early 1999, the IRS issued proposed regulations regarding student loan interest, and indicated that the regulations may be relied upon now in preparing tax returns (Prop. Reg. 1.221-1, REG-116826-97, 1/21/99).

Qualified Education Loan

The loan must have been incurred solely to pay qualified higher education expenses at an eligible institution (any college, university, vocational school or other post-secondary institution described in the Higher Ed Act of 1965 and certified by the U.S. Dept. of Higher Education as eligible to participate in student aid programs). In addition, an eligible institution includes one conducting an internship or residency program leading to a degree or certificate awarded by an institution, hospital, or healthcare facility that offers post-graduate training [Prop. Reg. 1.221-1(f)].

The higher education expenses must be paid or incurred within a reasonable period of time before or after the debt originates. The regulations provide two safe harbors in meeting the reasonable period test:

1. Any education loan that is issued as part of a federal post-secondary education loan program is deemed to meet the requirement.

2. Loan proceeds disbursed within a period that begins 60 days prior to the start of an academic period, and ends 60 days after the end of that academic period, are deemed to be within the reasonable period of time of the indebtedness [Prop. Reg. 1.221=1(f)(3)].

The proposed regulations do not require actual tracing of loan proceeds to the payment of qualified higher education expenses.

Planning Tip: Robert is single with $61,000 of income. He completed graduate school three years ago and is in his 3rd year of 10 years of payments on his student loans from college and graduate school. He pays $3,500 of interest. Robert can deduct education loan interest of $1,500 [$2,500 x ($70,000 - $61,000)/$15,000)]. If Robert's income continues to rise, his interest deduction will continue to be limited by the cap and phase-outs. If he refinances his student loans using a home equity loan, he could deduct a portion of his interest payments as a student loan and the remaining portion as a home mortgage interest itemized deduction.

Example:

In August, Ron borrows $9,000 from a local bank for the purpose of paying his tuition and board for the fall semester at Minnesota University. Ron, an avid traveler, deposits the loan proceeds in his personal vchecking account, and immediately expends the funds on a world vacation. In September, Ron starts school, and arranges a monthly payment plan for his tuition and board with the university. Ron coversvv these monthly payments to the school through part-time work. Because the loan proceeds were disbursed with the time frame described in the regulations, and because the regulations do not require actual tracing of the loan proceeds to the payment of the higher education expenses, Ron will be able to deduct the interest expense on the student loan, assuming the other requirements are met.

Loan Fees and Capitalized Interest

Loan origination fees (other than any fees for service) and capitalized interest are deductible. These are deemed to be paid by the taxpayer when the principal is repaid on the qualified education loan.

The regulations provide a priority to the allocation of payments:

1. payments (regardless of its label) are treated first as a payment of interest, to the extent interest has accrued and remains unpaid.

2. payments are allocated to any loan origination fees or capitalized interest, until such amounts are reduced to zero.

3. payments are allocated to principal.

Planning tip: Students who have Unsubsidized Stafford Loans or other educational loans with accruing interest on the principal balance when the student completes school should consider the following:

The accrued interest that is added to the original loan amount will be nondeductible as student loan interest to the taxpayer, and will become part of the principal balance of the loan if the student does not pay that interest before they finish school. If the student does pay the accrued interest on the educational loan before they finish school, the interest is then deductible to the taxpayer as student loan interest.

Interaction With Other Education Tax Benefits

The qualified education expenses for the interest deduction are reduced by distributions from CESAs which are excluded from taxable income.

Financial Aid Consequences

Since the interest deduction is "above-the-line," this will increase the financial aid eligibility of any student who is currently enrolled in college. Since the interest deduction lowers the financial aid income of the parents or student, it could increase the financial aid eligibility by the amount of the interest deduction times the parents' (47%) or student's (50%) financial aid income assessment rate.

Planning tip: Some taxpayers may want to take out a home equity loan on their personal residence and use the proceeds to pay for qualified education expenses. However, the interest expense on this home equity loan must be deducted on Schedule A instead of on page one of the Form 1040. If the student will be attending a college that does not assess the personal residence, it probably is more beneficial for the taxpayer to take out a PLUS loan, rather than a personal residence equity loan, in order to pay for the college costs. The interest would be deductible in arriving at AGI (subject to the maximum deduction limits) rather than as an itemized deduction, which may be of no benefit if the taxpayer uses the standard deduction.

Conversely, should the student be attending a college that will assess the personal residence equity, it may be advantageous for the parents to take an equity loan on the personal residence, rather than a PLUS loan.

The equity loan will reduce the value of the personal residence and therefore increase the student's financial aid eligibility by the amount of the decrease in residence equity times the parental asset assessment rate of 5.6%.

Example:

A home equity loan of $12,000 will lower the value of the personal residence by that amount. Since the assessment rate for parents' assets is 5.6%, the student would be eligible for an increase in financial aid of $672 per year, $12,000 x 5.6%, annually.

Planning tip: As a financial planning strategy, the parents may "certify," using IRS Form W-9S, to treat any debt that is secured by a qualified residence as not so secured. This "certification" allows the taxpayer to deduct the interest on the personal residence as student loan interest and in addition, reduce the value of an assessable asset (the personal residence).

Note: The residence interest deduction is not limited to only $2,500. Therefore, it may be advantageous to claim an itemized deduction for the residence interest rather than the student loan interest deduction. Also, note that residence interest deducted as an itemized deduction is not subject to the student loan interest phase-out rules. However, the client may be subject to the itemized deduction phase-out rules.

Planning tip: An election, under Treas. Reg. 1.163-10T(o)(5), could be made for personal residence interest to be treated as a business expense if the loan was used for business purposes. In addition to the tax advantages (reduction of self-employment tax and receiving a 100% deduction in all situations), the business interest deduction will reduce the parents' AGI. In turn, the reduction of AGI will increase the financial aid eligibility of the student by 47% (the parents' assessment rate on income); the decrease in AGI being a result of the interest deduction taken on Schedule C or F.

Example:
A client wishes to borrow money for his child's college costs. To achieve the maximum financial aid and tax benefits, the client takes a mortgage on his personal residence. The loan proceeds are used in the client's sole-proprietor business. The client pays for college expenses from the cash flow generated from the business. The result is that the interest is business interest expense that lowers the client's AGI. The lower AGI decreases the client's EFC. In addition, the net worth of the personal residence is lowered. If the client's child attends a college that assesses the personal residence, the lower value will also decrease the EFC.

Cancellation of Student Loans

The law allows tax-free treatment for student loans cancelled by educational organizations after August 5, 1998 [IRC Sec. 108(f)]. The loan must be made under a program that encourages students to provide public service by working in occupations or areas with unmet needs and the services must be under the direction of a governmental unit or tax-exempt charity. Services to the lender organization do not qualify.

A cancelled student loan is taxable income with this exception: If a loan by a government agency, by a government-funded loan program of an education organization, or by a qualified hospital organization is cancelled because the student worked for a period of time in specified geographical areas for qualified employers, such as practicing medicine in rural areas or teaching in inner-city schools, then the cancelled amount is not taxable.