

DEPARTMENT OF HEALTH AND HUMAN SERVICES**Food and Drug Administration****21 CFR Part 807****Medical Device Reports; Reports of Corrections and Removals; Establishment Registration and Device Listing; Premarket Approval Supplements; Quality System Regulation; Importation of Electronic Products; Technical Amendment; Correction**

AGENCY: Food and Drug Administration, HHS.

ACTION: Final rule; technical amendment; correction.

SUMMARY: The Food and Drug Administration (FDA) is correcting a final rule that appeared in the **Federal Register** of April 8, 2004 (69 FR 18472). That document corrected a final rule that appeared in the **Federal Register** of March 10, 2004 (69 FR 11310). The April 8, 2004, document published with inadvertent errors. This document corrects those errors.

DATES: This rule is effective May 7, 2004.

FOR FURTHER INFORMATION CONTACT: Joyce A. Strong, Office of Policy and Planning (HF-27), Food and Drug Administration, 5600 Fishers Lane, Rockville, MD 20857, 301-827-7010.

SUPPLEMENTARY INFORMATION: In FR Doc. 04-8022, appearing on page 18472 in the **Federal Register** of Thursday, April 8, 2004, the following corrections are made:

1. On page 18472, in the third column, under the **FOR FURTHER INFORMATION CONTACT** heading, the address is corrected to read "Joyce A. Strong, Office of Policy and Planning (HF-27), Food and Drug Administration, 5600 Fishers Lane, Rockville, MD 20857, 301-827-7010."

§ 807.22 [Corrected]

2. On page 18473, in the first column, in § 807.22, in paragraph (a), the first sentence is corrected to read "The first registration of a device establishment shall be on Form FDA-2891 (Initial Registration of Device Establishment)."

Dated: April 29, 2004.

Jeffrey Shuren,

Assistant Commissioner for Policy.

[FR Doc. 04-10265 Filed 5-6-04; 8:45 am]

BILLING CODE 4160-01-S

DEPARTMENT OF THE TREASURY**Internal Revenue Service****26 CFR Part 1**

[TD 9125]

RIN 1545-AW01

Deduction for Interest on Qualified Education Loans

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the deduction under section 221 of the Internal Revenue Code (Code) for interest paid on qualified education loans. The final regulations reflect the enactment and amendment of section 221 by the Taxpayer Relief Act of 1997, the Internal Revenue Service Restructuring and Reform Act of 1998, the Omnibus Consolidated and Emergency Supplemental Appropriations Act of 1999, and the Economic Growth and Tax Relief Reconciliation Act of 2001. This document also contains amendments to the final regulations under section 6050S relating to the information reporting requirements for interest payments received on qualified education loans. The final regulations affect taxpayers who pay interest on qualified education loans and payees who receive payments of interest on qualified education loans.

DATES: *Effective Date:* These final regulations are effective May 7, 2004.

Applicability Dates: Section 1.221-1 is applicable to periods governed by section 221 as amended in 2001, which relates to interest paid on qualified education loans after December 31, 2001, and on or before December 31, 2010. Section 1.221-2 is applicable to interest due and paid on qualified education loans after January 21, 1999, but before January 1, 2002, and again after December 31, 2010. Taxpayers also may apply § 1.221-2 to interest due and paid on qualified education loans after December 31, 1997, but before January 21, 1999. The amendments to § 1.6050S-3 provide a transitional rule for certain interest payments with respect to qualified education loans made before September 1, 2004, and provide guidance applicable to qualified education loans made on or after that date.

FOR FURTHER INFORMATION CONTACT: Sean M. Dwyer at (202) 622-5020 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

On January 21, 1999, the IRS published a notice of proposed rulemaking (REG-116826-97) in the **Federal Register** (64 FR 3257) under section 221 of the Code. The notice of proposed rulemaking implemented section 202 of the Taxpayer Relief Act of 1997, Public Law 105-34 (111 Stat. 778), which added section 221 to the Code. The IRS received written, including electronic, comments responding to the proposed regulations. There were no requests for a public hearing and none was held.

Subsequent to the publication of the proposed regulations, section 412 of the Economic Growth and Tax Relief Reconciliation Act of 2001, Public Law 107-16 (115 Stat. 38) (2001 Act) amended section 221 by eliminating the 60-month limitation period and the restriction on deductions of interest a taxpayer pays during a period when the lender does not require payments. The 2001 Act also increased the income limitations relating to interest deductions under section 221 from \$55,000 (\$75,000 for married individuals filing jointly) to \$65,000 (\$130,000 for married individuals filing jointly) and the income phase-out range from \$40,000-\$55,000 (\$60,000-\$75,000 for married individuals filing jointly) to \$50,000-\$65,000 (\$100,000-\$130,000 for married individuals filing jointly).

The 2001 Act amendments apply to interest paid on qualified education loans after December 31, 2001. Accordingly, the final regulations appear in two sections to reflect the law before and after the effective date of the 2001 Act. Section 1.221-1 is applicable to periods governed by section 221 as amended in 2001, which relates to interest paid on qualified education loans after December 31, 2001, and on or before December 31, 2010. Section 1.221-2 is applicable to interest due and paid on qualified education loans after January 21, 1999, but before January 1, 2002. Taxpayers also may apply § 1.221-2 to interest due and paid on qualified education loans after December 31, 1997, but before January 21, 1999. Unless the 2001 Act amendments are extended by future legislation, section 1.221-2 also will apply to interest due and paid on qualified education loans after December 31, 2010.

After consideration of all the comments, the proposed regulations under section 221 are adopted as amended by this Treasury decision.

On April 29, 2002, the IRS published final regulations (TD 8992) in the **Federal Register** (67 FR 20901) under

section 6050S relating to information reporting for interest payments received on qualified education loans. The Taxpayer Relief Act of 1997 added section 6050S to the Code, as well as section 221.

Explanation and Summary of Comments

Many of the comments concerned issues relating to the 60-month limitation period, which the 2001 Act eliminated. These comments are discussed in 7. and 8. below because the 60-month period continues to apply to interest on qualified education loans due and paid after December 31, 1997, but before January 1, 2002, and again after December 31, 2010.

1. Treatment of Capitalized Interest and Certain Fees

Several commentators discussed the treatment of capitalized interest, loan origination fees, late fees, and certain insurance fees. Courts have defined the term “interest,” for income tax purposes, as compensation paid for the use or forbearance of money. See, e.g., *Deputy v. Du Pont*, 308 U.S. 488 (1940). Consistent with this definition, the final regulations provide that capitalized interest is deductible as qualified education loan interest. Generally, fees, such as loan origination fees or late fees, are interest if the fees represent a charge for the use or forbearance of money. Therefore, if the fees represent compensation to the lender for the cost of specific services performed in connection with the borrower’s account, the fees are not interest for Federal income tax purposes. See Rev. Rul. 69–188 (1969–1 C.B. 54), amplified by Rev. Rul. 69–582 (1969–2 C.B. 29); see also, e.g., *Trivett v. Commissioner*, T.C. Memo. 1977–161, *aff’d on other grounds*, 611 F.2d 655 (6th Cir. 1979) (Tax Court found that certain fees, including insurance fees, were similar to payments for services rendered and not deductible as interest).

Some commentators expressed confusion about how to apply the rules in the proposed regulations for allocating payments to principal or interest. In response to these comments, the final regulations provide guidance on the treatment and allocation of such amounts. Under the final regulations, a payment generally first applies to interest that has accrued and remains unpaid as of the date the payment is due and then applies to the outstanding principal. An example is included.

2. Interest Paid by Someone Other Than the Taxpayer

Several commentators requested guidance on the treatment of an interest payment made by someone other than the taxpayer. To provide consistency with section 221(a), the final regulations provide, “Under section 221, an individual taxpayer may deduct from gross income certain interest paid by the taxpayer during the taxable year on a qualified education loan.” (Emphasis added.) The final regulations also clarify that certain third party payments of interest are treated as first paid to the taxpayer and then paid by the taxpayer to the lender, in a manner similar to the treatment of third party payments of tuition under § 1.25A–5(b)(1). The final regulations provide for this treatment if a third party makes a payment of interest on a qualified education loan on behalf of a taxpayer.

Thus, for example, if a third party pays interest on behalf of the taxpayer, as a gift to the taxpayer, the taxpayer may deduct this interest for Federal income tax purposes, assuming fulfillment of all other requirements of section 221. Similarly, if an employer pays interest to a lender on behalf of the taxpayer, and the taxpayer as required by section 61 includes the payment in income for Federal income tax purposes, the taxpayer may deduct this interest, assuming fulfillment of all other requirements of section 221.

A commentator also recommended the allowance of a deduction to an individual even if the individual qualifies as a dependent of a taxpayer under section 151. This recommendation was not adopted because it is contrary to section 221(c).

3. Definition of Eligible Educational Institution

Several commentators suggested expanding the definition of *eligible educational institution* in a manner that is not consistent with the statutory definition under sections 221(d)(2) (formerly section 221(e)(2) (redesignated by the 2001 Act)) and 25A(f)(2). Accordingly, these comments were not adopted. Another commentator requested guidance on the deductibility of interest paid on a qualified education loan if the educational institution loses its status as an eligible educational institution after the end of the academic period for which the loan was incurred. The final regulations include a new example illustrating that the deductibility of interest on the loan is not affected by the institution’s subsequent change in status.

4. Definition of Qualified Education Loan

The definition of *qualified education loan* in section 221(d)(1) (formerly section 221(e)(1) (redesignated by the 2001 Act)) provides, in part, that the indebtedness must be incurred by the taxpayer solely to pay higher education expenses that are paid within a reasonable period of time before or after the indebtedness is incurred. Several comments were received in connection with this “reasonable period of time” requirement.

One commentator suggested extending the 60-day safe harbor provided in the proposed regulations for satisfying the “reasonable period of time” requirement to 90 days or changing it so that the beginning of the safe harbor period is the earlier of 60 days prior to the start of the academic period or the end of the previous academic period. Two commentators suggested extending the safe harbor to 90 days after the end of the academic period. Another commentator expressed concern that expenses paid with loans disbursed outside the 60-day window would not satisfy the “reasonable period of time” requirement. Finally, one commentator interpreted the safe harbor to impose a 60-day limit on loans that are part of a federal postsecondary loan program.

The final regulations provide that what constitutes a reasonable period of time is determined based on all the relevant facts and circumstances. The final regulations also provide that qualified higher education expenses are treated as paid or incurred within a reasonable period of time under the following circumstances: (1) The expenses are paid with the proceeds of education loans that are part of a federal postsecondary education loan program; or (2) the expenses relate to a particular academic period and the loan proceeds used to pay the expenses are disbursed within a period that begins 90 days before the start of, and ends 90 days after the end of, the academic period to which the expenses relate.

One commentator recommended expansion of the federal loan safe harbor described above to include expenses paid with the proceeds of any non-federal loan disbursed under policies mirroring the awarding and disbursement policies governing certain federal loans. Although the final regulations do not adopt this suggestion, the IRS and Treasury Department believe that loans described by the commentator probably would fall within the 90-day safe harbor, or satisfy the “reasonable period of time”

requirement based on the facts and circumstances.

Another requirement of a “qualified education loan” is that the borrower obtain the loan “solely” to pay higher education expenses. One commentator suggested that if a taxpayer refinances a qualified education loan and receives an amount in excess of the original qualified education loan, the taxpayer may take an interest deduction under section 221 for interest paid on the refinanced loan. The commentator is correct, but only if the taxpayer uses the excess amount solely to pay higher education expenses and satisfies all other requirements of a qualified education loan. Thus, if the taxpayer uses the excess amount for any other purpose, the refinanced loan is not “solely” to pay higher education expenses, and no interest paid on the loan will be deductible.

5. Miscellaneous Comments and Changes

Federal Postsecondary Education Loan Program—The final regulations clarify that a federal postsecondary education loan program includes, but is not limited to, the Federal Perkins Loan, Federal Family Education Loan, and William D. Ford Federal Direct Loan Programs under Title IV of the Higher Education Act of 1965, and the Health Education Assistance Loan and the Nursing Student Loan Programs under Titles VII and VIII of the Public Health Service Act.

Eligible Educational Institution—Although the Higher Education Amendments Act of 1998 moved section 481 from Title IV to Title I, the regulations do not reflect this change, as the statutory language refers to section 481 of the Higher Education Act as in effect on the date that section 221 was enacted.

Interest Charges on a University In-House Deferred Payment Plan—One commentator requested clarification of the deductibility of interest charges on a university’s in-house deferred payment plan, which is a revolving credit account that can include a variety of expenditures in addition to qualified higher education expenses. This situation is addressed by *Example 6* of § 1.221–1(e)(4) and *Example 6* of § 1.221–2(f)(4) concerning mixed use loans.

6. Refinanced and Consolidated Loans

The final regulations reserve a place for more detailed treatment of refinanced and consolidated loans.

7. Periods of Deferment or Forbearance

Prior to the 2001 Act, section 221(d) stated that a “deduction shall be allowed under this section only with respect to interest paid on any qualified education loan during the first 60 months (whether or not consecutive) in which interest payments are required.”

Some commentators recommended that the 60-month limitation period should not be suspended during a period of deferment or forbearance. Other commentators suggested that the 60-month limitation period should be suspended during all periods of deferment or forbearance, whether or not the taxpayer makes payments. Commentators also asked whether rules under which the 60-month period is not suspended apply to loans made under federal programs as well as non-federal loans. Finally, commentators asked whether interest payments made during periods of reduced payment forbearance are deductible.

Section 221, prior to the 2001 Act, and the legislative history provide that only interest payments required under the terms of a loan are deductible. Under that provision, interest a borrower pays voluntarily during a period when payments are not required, such as during a period of deferment or forbearance or before loan repayment begins, is not deductible.

Therefore, § 1.221–2 of the final regulations retains the rule that interest payments are not deductible if paid voluntarily during a period of deferment or forbearance. However, the final regulations provide that interest payments made during a period of deferment, forbearance, or reduced payment forbearance are deductible if required as part of the terms of the deferment, forbearance, or reduced payment agreement. The final regulations include a new example involving reduced payment forbearance.

In addition, § 1.221–2 of the final regulations provides for suspension of the 60-month period for loans not issued or guaranteed under a federal postsecondary education loan program under certain conditions. The promissory note must contain conditions for deferment or forbearance that are substantially similar to the conditions established by the U.S. Department of Education for Federal student loan programs under Title IV of the Higher Education Act of 1965 and the borrower must satisfy one of those conditions.

8. Start of the 60-Month Limitation Period

A commentator expressed concern that the month a loan first enters

repayment status may not be the same as the month the first interest payment is required. Section 1.221–2 of the final regulations clarifies that the beginning of the 60-month period commences on the first day of the month in which the first interest payment is required.

9. Information Reporting for Interest Payments Received on Qualified Education Loans

Section 6050S requires information reporting by certain lenders or other payees that receive payments of interest on qualified education loans. Section 1.6050S–3(b)(1) provides that interest includes stated interest, loan origination fees (other than fees for services), and capitalized interest. Section 1.6050S–3(e)(1) provides a special transitional rule for reporting loan origination fees and capitalized interest. Under the transitional rule, a payee is not required to report payments of loan origination fees and capitalized interest for loans made before January 1, 2004.

Several commentators representing payees requested that the transitional rule be extended because the necessary programming changes to capture and report these amounts could not be made in the absence of final regulations under section 221. Based on the comments received, these regulations amend § 1.6050S–3(e)(1) to extend the transitional rule to loans made before September 1, 2004.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and, because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, the proposed regulations that preceded these regulations were submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these final regulations is Sean M. Dwyer, Office of the Associate Chief Counsel (Income Tax & Accounting). However, other personnel from the IRS and Treasury Department participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

■ Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

■ 1. The authority citation for part 1 is amended by adding an entry in numerical order to read as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.221–2 also issued under 26 U.S.C. 221(d). * * *

Section 1.6050S–3 also issued under 26 U.S.C. 6050S(g). * * *

■ 2. Sections 1.221–1 and 1.221–2 are added to read as follows:

§ 1.221–1 Deduction for interest paid on qualified education loans after December 31, 2001.

(a) *In general*—(1) *Applicability*. Under section 221, an individual taxpayer may deduct from gross income certain interest paid by the taxpayer during the taxable year on a qualified education loan. See paragraph (b)(4) of this section for rules on payments of interest by third parties. The rules of this section are applicable to periods governed by section 221 as amended in 2001, which relates to deductions for interest paid on qualified education loans after December 31, 2001, in taxable years ending after December 31, 2001, and on or before December 31, 2010. For rules applicable to interest due and paid on qualified education loans after January 21, 1999, if paid before January 1, 2002, see § 1.221–2. Taxpayers also may apply § 1.221–2 to interest due and paid on qualified education loans after December 31, 1997, but before January 21, 1999. To the extent that the effective date limitation (sunset) of the 2001 amendment remains in force unchanged, section 221 before amendment in 2001, to which § 1.221–2 relates, also applies to interest due and paid on qualified education loans in taxable years beginning after December 31, 2010.

(2) *Example*. The following example illustrates the rules of this paragraph (a). In the example, assume that the institution the student attends is an eligible educational institution, the loan is a qualified education loan, the student is legally obligated to make interest payments under the terms of the loan, and any other applicable requirements, if not otherwise specified, are fulfilled. The example is as follows:

Example. Effective dates. Student A begins to make monthly interest payments on her loan beginning January 1, 1997. Student A continues to make interest payments in a timely fashion. However, under the effective date provisions of section 221, no deduction is allowed for interest Student A pays prior to January 1, 1998. Student A may deduct interest due and paid on the loan after December 31, 1997. Student A may apply the rules of § 1.221–2 to interest due and paid during the period beginning January 1, 1998, and ending January 20, 1999. Interest due and paid during the period January 21, 1999, and ending December 31, 2001, is deductible under the rules of § 1.221–2, and interest paid after December 31, 2001, is deductible under the rules of this section.

(b) *Eligibility*—(1) *Taxpayer must have a legal obligation to make interest payments*. A taxpayer is entitled to a deduction under section 221 only if the taxpayer has a legal obligation to make interest payments under the terms of the qualified education loan.

(2) *Claimed dependents not eligible*—(i) *In general*. An individual is not entitled to a deduction under section 221 for a taxable year if the individual is a dependent (as defined in section 152) for whom another taxpayer is allowed a deduction under section 151 on a Federal income tax return for the same taxable year (or, in the case of a fiscal year taxpayer, the taxable year beginning in the same calendar year as the individual's taxable year).

(ii) *Examples*. The following examples illustrate the rules of this paragraph (b)(2):

Example 1. Student not claimed as dependent. Student B pays \$750 of interest on qualified education loans during 2003. Student B's parents are not allowed a deduction for her as a dependent for 2003. Assuming fulfillment of all other relevant requirements, Student B may deduct under section 221 the \$750 of interest paid in 2003.

Example 2. Student claimed as dependent. Student C pays \$750 of interest on qualified education loans during 2003. Only Student C has the legal obligation to make the payments. Student C's parent claims him as a dependent and is allowed a deduction under section 151 with respect to Student C in computing the parent's 2003 Federal income tax. Student C is not entitled to a deduction under section 221 for the \$750 of interest paid in 2003. Because Student C's parent was not legally obligated to make the payments, Student C's parent also is not entitled to a deduction for the interest.

(3) *Married taxpayers*. If a taxpayer is married as of the close of a taxable year, he or she is entitled to a deduction under this section only if the taxpayer and the taxpayer's spouse file a joint return for that taxable year.

(4) *Payments of interest by a third party*—(i) *In general*. If a third party who is not legally obligated to make a

payment of interest on a qualified education loan makes a payment of interest on behalf of a taxpayer who is legally obligated to make the payment, then the taxpayer is treated as receiving the payment from the third party and, in turn, paying the interest.

(ii) *Examples*. The following examples illustrate the rules of this paragraph (b)(4):

Example 1. Payment by employer. Student D obtains a qualified education loan to attend college. Upon Student D's graduation from college, Student D works as an intern for a non-profit organization during which time Student D's loan is in deferment and Student D makes no interest payments. As part of the internship program, the non-profit organization makes an interest payment on behalf of Student D after the deferment period. This payment is not excluded from Student D's income under section 108(f) and is treated as additional compensation includible in Student D's gross income. Assuming fulfillment of all other requirements of section 221, Student D may deduct this payment of interest for Federal income tax purposes.

Example 2. Payment by parent. Student E obtains a qualified education loan to attend college. Upon graduation from college, Student E makes legally required monthly payments of principal and interest. Student E's mother makes a required monthly payment of interest as a gift to Student E. A deduction for Student E as a dependent is not allowed on another taxpayer's tax return for that taxable year. Assuming fulfillment of all other requirements of section 221, Student E may deduct this payment of interest for Federal income tax purposes.

(c) *Maximum deduction*. The amount allowed as a deduction under section 221 for any taxable year may not exceed \$2,500.

(d) *Limitation based on modified adjusted gross income*—(1) *In general*. The deduction allowed under section 221 is phased out ratably for taxpayers with modified adjusted gross income between \$50,000 and \$65,000 (\$100,000 and \$130,000 for married individuals who file a joint return). Section 221 does not allow a deduction for taxpayers with modified adjusted gross income of \$65,000 or above (\$130,000 or above for married individuals who file a joint return). See paragraph (d)(3) of this section for inflation adjustment of amounts in this paragraph (d)(1).

(2) *Modified adjusted gross income defined*. The term *modified adjusted gross income* means the adjusted gross income (as defined in section 62) of the taxpayer for the taxable year increased by any amount excluded from gross income under section 911, 931, or 933 (relating to income earned abroad or from certain United States possessions or Puerto Rico). Modified adjusted gross income must be determined under this

section after taking into account the inclusions, exclusions, deductions, and limitations provided by sections 86 (social security and tier 1 railroad retirement benefits), 135 (redemption of qualified United States savings bonds), 137 (adoption assistance programs), 219 (deductible qualified retirement contributions), and 469 (limitation on passive activity losses and credits), but before taking into account the deductions provided by sections 221 and 222 (qualified tuition and related expenses).

(3) *Inflation adjustment.* For taxable years beginning after 2002, the amounts in paragraph (d)(1) of this section will be increased for inflation occurring after 2001 in accordance with section 221(f)(1). If any amount adjusted under section 221(f)(1) is not a multiple of \$5,000, the amount will be rounded to the next lowest multiple of \$5,000.

(e) *Definitions*—(1) *Eligible educational institution.* In general, an *eligible educational institution* means any college, university, vocational school, or other postsecondary educational institution described in section 481 of the Higher Education Act of 1965 (20 U.S.C. 1088), as in effect on August 5, 1997, and certified by the U.S. Department of Education as eligible to participate in student aid programs administered by the Department, as described in section 25A(f)(2) and § 1.25A-2(b). For purposes of this section, an eligible educational institution also includes an institution that conducts an internship or residency program leading to a degree or certificate awarded by an institution, a hospital, or a health care facility that offers postgraduate training.

(2) *Qualified higher education expenses*—(i) *In general.* *Qualified higher education expenses* means the cost of attendance (as defined in section 472 of the Higher Education Act of 1965, 20 U.S.C. 108711, as in effect on August 4, 1997), at an eligible educational institution, reduced by the amounts described in paragraph (e)(2)(ii) of this section. Consistent with section 472 of the Higher Education Act of 1965, a student's cost of attendance is determined by the eligible educational institution and includes tuition and fees normally assessed a student carrying the same academic workload as the student, an allowance for room and board, and an allowance for books, supplies, transportation, and miscellaneous expenses of the student.

(ii) *Reductions.* Qualified higher education expenses are reduced by any amount that is paid to or on behalf of a student with respect to such expenses and that is—

(A) A qualified scholarship that is excludable from income under section 117;

(B) An educational assistance allowance for a veteran or member of the armed forces under chapter 30, 31, 32, 34 or 35 of title 38, United States Code, or under chapter 1606 of title 10, United States Code;

(C) Employer-provided educational assistance that is excludable from income under section 127;

(D) Any other amount that is described in section 25A(g)(2)(C) (relating to amounts excludable from gross income as educational assistance);

(E) Any otherwise includible amount excluded from gross income under section 135 (relating to the redemption of United States savings bonds);

(F) Any otherwise includible amount distributed from a Coverdell education savings account and excluded from gross income under section 530(d)(2); or

(G) Any otherwise includible amount distributed from a qualified tuition program and excluded from gross income under section 529(c)(3)(B).

(3) *Qualified education loan*—(i) *In general.* A *qualified education loan* means indebtedness incurred by a taxpayer solely to pay qualified higher education expenses that are—

(A) Incurred on behalf of a student who is the taxpayer, the taxpayer's spouse, or a dependent (as defined in section 152) of the taxpayer at the time the taxpayer incurs the indebtedness;

(B) Attributable to education provided during an academic period, as described in section 25A and the regulations thereunder, when the student is an eligible student as defined in section 25A(b)(3) (requiring that the student be a degree candidate carrying at least half the normal full-time workload); and

(C) Paid or incurred within a reasonable period of time before or after the taxpayer incurs the indebtedness.

(ii) *Reasonable period.* Except as otherwise provided in this paragraph (e)(3)(ii), what constitutes a reasonable period of time for purposes of paragraph (e)(3)(i)(C) of this section generally is determined based on all the relevant facts and circumstances. However, qualified higher education expenses are treated as paid or incurred within a reasonable period of time before or after the taxpayer incurs the indebtedness if—

(A) The expenses are paid with the proceeds of education loans that are part of a Federal postsecondary education loan program; or

(B) The expenses relate to a particular academic period and the loan proceeds used to pay the expenses are disbursed within a period that begins 90 days

prior to the start of that academic period and ends 90 days after the end of that academic period.

(iii) *Related party.* A qualified education loan does not include any indebtedness owed to a person who is related to the taxpayer, within the meaning of section 267(b) or 707(b)(1). For example, a parent or grandparent of the taxpayer is a related person. In addition, a qualified education loan does not include a loan made under any qualified employer plan as defined in section 72(p)(4) or under any contract referred to in section 72(p)(5).

(iv) *Federal issuance or guarantee not required.* A loan does not have to be issued or guaranteed under a Federal postsecondary education loan program to be a qualified education loan.

(v) *Refinanced and consolidated indebtedness*—(A) *In general.* A qualified education loan includes indebtedness incurred solely to refinance a qualified education loan. A qualified education loan includes a single, consolidated indebtedness incurred solely to refinance two or more qualified education loans of a borrower.

(B) *Treatment of refinanced and consolidated indebtedness.* [Reserved.]

(4) *Examples.* The following examples illustrate the rules of this paragraph (e):

Example 1. Eligible educational institution. University F is a postsecondary educational institution described in section 481 of the Higher Education Act of 1965. The U.S. Department of Education has certified that University F is eligible to participate in federal financial aid programs administered by that Department, although University F chooses not to participate. University F is an eligible educational institution.

Example 2. Qualified higher education expenses. Student G receives a \$3,000 qualified scholarship for the 2003 fall semester that is excludable from Student G's gross income under section 117. Student G receives no other forms of financial assistance with respect to the 2003 fall semester. Student G's cost of attendance for the 2003 fall semester, as determined by Student G's eligible educational institution for purposes of calculating a student's financial need in accordance with section 472 of the Higher Education Act, is \$16,000. For the 2003 fall semester, Student G has qualified higher education expenses of \$13,000 (the cost of attendance as determined by the institution (\$16,000) reduced by the qualified scholarship proceeds excludable from gross income (\$3,000)).

Example 3. Qualified education loan. Student H borrows money from a commercial bank to pay qualified higher education expenses related to his enrollment on a half-time basis in a graduate program at an eligible educational institution. Student H uses all the loan proceeds to pay qualified higher education expenses incurred within a reasonable period of time after incurring the indebtedness. The loan is not federally

guaranteed. The commercial bank is not related to Student H within the meaning of section 267(b) or 707(b)(1). Student H's loan is a qualified education loan within the meaning of section 221.

Example 4. Qualified education loan.

Student I signs a promissory note for a loan on August 15, 2003, to pay for qualified higher education expenses for the 2003 fall and 2004 spring semesters. On August 20, 2003, the lender disburses loan proceeds to Student I's college. The college credits them to Student I's account to pay qualified higher education expenses for the 2003 fall semester, which begins on August 25, 2003. On January 26, 2004, the lender disburses additional loan proceeds to Student I's college. The college credits them to Student I's account to pay qualified higher education expenses for the 2004 spring semester, which began on January 12, 2004. Student I's qualified higher education expenses for the two semesters are paid within a reasonable period of time, as the first loan disbursement occurred within the 90 days prior to the start of the fall 2003 semester and the second loan disbursement occurred during the spring 2004 semester.

Example 5. Qualified education loan. The facts are the same as in *Example 4* except that in 2005 the college is not an eligible educational institution because it loses its eligibility to participate in certain federal financial aid programs administered by the U.S. Department of Education. The qualification of Student I's loan, which was used to pay for qualified higher education expenses for the 2003 fall and 2004 spring semesters, as a qualified education loan is not affected by the college's subsequent loss of eligibility.

Example 6. Mixed-use loans. Student J signs a promissory note for a loan secured by Student J's personal residence. Student J will use part of the loan proceeds to pay for certain improvements to Student J's residence and part of the loan proceeds to pay qualified higher education expenses of Student J's spouse. Because Student J obtains the loan not solely to pay qualified higher education expenses, the loan is not a qualified education loan.

(f) **Interest—(1) In general.** Amounts paid on a qualified education loan are deductible under section 221 if the amounts are interest for Federal income tax purposes. For example, interest includes—

(i) Qualified stated interest (as defined in § 1.1273-1(c)); and

(ii) Original issue discount, which generally includes capitalized interest. For purposes of section 221, capitalized interest means any accrued and unpaid interest on a qualified education loan that, in accordance with the terms of the loan, is added by the lender to the outstanding principal balance of the loan.

(2) **Operative rules for original issue discount—(i) In general.** The rules to determine the amount of original issue discount on a loan and the accruals of

the discount are in sections 163(e), 1271 through 1275, and the regulations thereunder. In general, original issue discount is the excess of a loan's stated redemption price at maturity (all payments due under the loan other than qualified stated interest payments) over its issue price (the amount loaned). Although original issue discount generally is deductible as it accrues under section 163(e) and § 1.163-7, original issue discount on a qualified education loan is not deductible until paid. See paragraph (f)(3) of this section to determine when original issue discount is paid.

(ii) **Treatment of loan origination fees by the borrower.** If a loan origination fee is paid by the borrower other than for property or services provided by the lender, the fee reduces the issue price of the loan, which creates original issue discount (or additional original issue discount) on the loan in an amount equal to the fee. See § 1.1273-2(g). For an example of how a loan origination fee is taken into account, see *Example 2* of paragraph (f)(4) of this section.

(3) **Allocation of payments.** See §§ 1.1446-2(e) and 1.1275-2(a) for rules on allocating payments between interest and principal. In general, these rules treat a payment first as a payment of interest to the extent of the interest that has accrued and remains unpaid as of the date the payment is due, and second as a payment of principal. The characterization of a payment as either interest or principal under these rules applies regardless of how the parties label the payment (either as interest or principal). Accordingly, the taxpayer may deduct the portion of a payment labeled as principal that these rules treat as a payment of interest on the loan, including any portion attributable to capitalized interest or loan origination fees.

(4) **Examples.** The following examples illustrate the rules of this paragraph (f). In the examples, assume that the institution the student attends is an eligible educational institution, the loan is a qualified education loan, the student is legally obligated to make interest payments under the terms of the loan, and any other applicable requirements, if not otherwise specified, are fulfilled. The examples are as follows:

Example 1. Capitalized interest. Interest on Student K's loan accrues while Student K is in school, but Student K is not required to make any payments on the loan until six months after he graduates or otherwise leaves school. At that time, the lender capitalizes all accrued but unpaid interest and adds it to the outstanding principal amount of the loan. Thereafter, Student K is required to make monthly payments of interest and principal

on the loan. The interest payable on the loan, including the capitalized interest, is original issue discount. See section 1273 and the regulations thereunder. Therefore, in determining the total amount of interest paid on the loan each taxable year, Student K may deduct any payments that § 1.1275-2(a) treats as payments of interest, including any principal payments that are treated as payments of capitalized interest. See paragraph (f)(3) of this section.

Example 2. Allocation of payments. The facts are the same as in *Example 1*, except that, in addition, the lender charges Student K a loan origination fee, which is not for any property or services provided by the lender. Under § 1.1273-2(g), the loan origination fee reduces the issue price of the loan, which reduction increases the amount of original issue discount on the loan by the amount of the fee. The amount of original issue discount (which includes the capitalized interest and loan origination fee) that accrues each year is determined under section 1272 and § 1.1272-1. In effect, the loan origination fee accrues over the entire term of the loan. Because the loan has original issue discount, the payment ordering rules in § 1.1275-2(a) must be used to determine how much of each payment is interest for federal tax purposes. See paragraph (f)(3) of this section. Under § 1.1275-2(a), each payment (regardless of its designation by the parties as either interest or principal) generally is treated first as a payment of original issue discount, to the extent of the original issue discount that has accrued as of the date the payment is due and has not been allocated to prior payments, and second as a payment of principal. Therefore, in determining the total amount of interest paid on the qualified education loan for a taxable year, Student K may deduct any payments that the parties label as principal but that are treated as payments of original issue discount under § 1.1275-2(a).

(g) **Additional Rules—(1) Payment of interest made during period when interest payment not required.** Payments of interest on a qualified education loan to which this section is applicable are deductible even if the payments are made during a period when interest payments are not required because, for example, the loan has not yet entered repayment status or is in a period of deferment or forbearance.

(2) **Denial of double benefit.** No deduction is allowed under this section for any amount for which a deduction is allowable under another provision of Chapter 1 of the Internal Revenue Code. No deduction is allowed under this section for any amount for which an exclusion is allowable under section 108(f) (relating to cancellation of indebtedness).

(3) **Examples.** The following examples illustrate the rules of this paragraph (g). In the examples, assume that the institution the student attends is an eligible educational institution, the loan is a qualified education loan, and the student is legally obligated to make

interest payments under the terms of the loan:

Example 1. Voluntary payment of interest before loan has entered repayment status. Student L obtains a loan to attend college. The terms of the loan provide that interest accrues on the loan while Student L earns his undergraduate degree but that Student L is not required to begin making payments of interest until six full calendar months after he graduates or otherwise leaves school. Nevertheless, Student L voluntarily pays interest on the loan during 2003, while enrolled in college. Assuming all other relevant requirements are met, Student L is allowed a deduction for interest paid while attending college even though the payments were made before interest payments were required.

Example 2. Voluntary payment during period of deferment or forbearance. The facts are the same as in *Example 1*, except that Student L makes no payments on the loan while enrolled in college. Student L graduates in June 2003 and begins making monthly payments of principal and interest on the loan in January 2004, as required by the terms of the loan. In August 2004, Student L enrolls in graduate school on a full-time basis. Under the terms of the loan, Student L may apply for deferment of the loan payments while Student L is enrolled in graduate school. Student L applies for and receives a deferment on the outstanding loan. However, Student L continues to make some monthly payments of interest during graduate school. Student L may deduct interest paid on the loan during the period beginning in January 2004, including interest paid while Student L is enrolled in graduate school.

(h) *Effective date.* This section is applicable to periods governed by section 221 as amended in 2001, which relates to interest paid on a qualified education loan after December 31, 2001, in taxable years ending after December 31, 2001, and on or before December 31, 2010.

§ 1.221-2 Deduction for interest due and paid on qualified education loans before January 1, 2002.

(a) *In general.* Under section 221, an individual taxpayer may deduct from gross income certain interest due and paid by the taxpayer during the taxable year on a qualified education loan. The deduction is allowed only with respect to interest due and paid on a qualified education loan during the first 60 months that interest payments are required under the terms of the loan. See paragraph (e) of this section for rules relating to the 60-month rule. See paragraph (b)(4) of this section for rules on payments of interest by third parties. The rules of this section are applicable to interest due and paid on qualified education loans after January 21, 1999, if paid before January 1, 2002. Taxpayers also may apply the rules of

this section to interest due and paid on qualified education loans after December 31, 1997, but before January 21, 1999. To the extent that the effective date limitation ("sunset") of the 2001 amendment remains in force unchanged, section 221 before amendment in 2001, to which this section relates, also applies to interest due and paid on qualified education loans in taxable years beginning after December 31, 2010. For rules applicable to periods governed by section 221 as amended in 2001, which relates to deductions for interest paid on qualified education loans after December 31, 2001, in taxable years ending after December 31, 2001, and before January 1, 2011, see § 1.221-1.

(b) *Eligibility—(1) Taxpayer must have a legal obligation to make interest payments.* A taxpayer is entitled to a deduction under section 221 only if the taxpayer has a legal obligation to make interest payments under the terms of the qualified education loan.

(2) *Claimed dependents not eligible—(i) In general.* An individual is not entitled to a deduction under section 221 for a taxable year if the individual is a dependent (as defined in section 152) for whom another taxpayer is allowed a deduction under section 151 on a Federal income tax return for the same taxable year (or, in the case of a fiscal year taxpayer, the taxable year beginning in the same calendar year as the individual's taxable year).

(ii) *Examples.* The following examples illustrate the rules of this paragraph (b)(2):

Example 1. Student not claimed as dependent. Student A pays \$750 of interest on qualified education loans during 1998. Student A's parents are not allowed a deduction for her as a dependent for 1998. Assuming fulfillment of all other relevant requirements, Student A may deduct the \$750 of interest paid in 1998 under section 221.

Example 2. Student claimed as dependent. Student B pays \$750 of interest on qualified education loans during 1998. Only Student B has the legal obligation to make the payments. Student B's parent claims him as a dependent and is allowed a deduction under section 151 with respect to Student B in computing the parent's 1998 Federal income tax. Student B may not deduct the \$750 of interest paid in 1998 under section 221. Because Student B's parent was not legally obligated to make the payments, Student B's parent also may not deduct the interest.

(3) *Married taxpayers.* If a taxpayer is married as of the close of a taxable year, he or she is entitled to a deduction under this section only if the taxpayer and the taxpayer's spouse file a joint return for that taxable year.

(4) *Payments of interest by a third party—(i) In general.* If a third party who is not legally obligated to make a payment of interest on a qualified education loan makes a payment of interest on behalf of a taxpayer who is legally obligated to make the payment, then the taxpayer is treated as receiving the payment from the third party and, in turn, paying the interest.

(ii) *Examples.* The following examples illustrate the rules of this paragraph (b)(4):

Example 1. Payment by employer. Student C obtains a qualified education loan to attend college. Upon Student C's graduation from college, Student C works as an intern for a non-profit organization during which time Student C's loan is in deferment and Student C makes no interest payments. As part of the internship program, the non-profit organization makes an interest payment on behalf of Student C after the deferment period. This payment is not excluded from Student C's income under section 108(f) and is treated as additional compensation includible in Student C's gross income. Assuming fulfillment of all other requirements of section 221, Student C may deduct this payment of interest for Federal income tax purposes.

Example 2. Payment by parent. Student D obtains a qualified education loan to attend college. Upon graduation from college, Student D makes legally required monthly payments of principal and interest. Student D's mother makes a required monthly payment of interest as a gift to Student D. A deduction for Student D as a dependent is not allowed on another taxpayer's tax return for that taxable year. Assuming fulfillment of all other requirements of section 221, Student D may deduct this payment of interest for Federal income tax purposes.

(c) *Maximum deduction.* In any taxable year beginning before January 1, 2002, the amount allowed as a deduction under section 221 may not exceed the amount determined in accordance with the following table:

Taxable year beginning in	Maximum deduction
1998	\$1,000
1999	1,500
2000	2,000
2001	2,500

(d) *Limitation based on modified adjusted gross income—(1) In general.* The deduction allowed under section 221 is phased out ratably for taxpayers with modified adjusted gross income between \$40,000 and \$55,000 (\$60,000 and \$75,000 for married individuals who file a joint return). Section 221 does not allow a deduction for taxpayers with modified adjusted gross income of \$55,000 or above (\$75,000 or above for married individuals who file a joint return).

(2) *Modified adjusted gross income defined.* The term *modified adjusted gross income* means the adjusted gross income (as defined in section 62) of the taxpayer for the taxable year increased by any amount excluded from gross income under section 911, 931, or 933 (relating to income earned abroad or from certain United States possessions or Puerto Rico). Modified adjusted gross income must be determined under this section after taking into account the inclusions, exclusions, deductions, and limitations provided by sections 86 (social security and tier 1 railroad retirement benefits), 135 (redemption of qualified United States savings bonds), 137 (adoption assistance programs), 219 (deductible qualified retirement contributions), and 469 (limitation on passive activity losses and credits), but before taking into account the deduction provided by section 221.

(e) *60-month rule*—(1) *In general.* A deduction for interest paid on a qualified education loan is allowed only for payments made during the first 60 months that interest payments are required on the loan. The 60-month period begins on the first day of the month that includes the date on which interest payments are first required and ends 60 months later, unless the 60-month period is suspended for periods of deferment or forbearance within the meaning of paragraph (e)(3) of this section. The 60-month period continues to run regardless of whether the required interest payments are actually made. The date on which the first interest payment is required is determined under the terms of the loan agreement or, in the case of a loan issued or guaranteed under a federal postsecondary education loan program (such as loan programs under Title IV of the Higher Education Act of 1965 (20 U.S.C. 1070) and Titles VII and VIII of the Public Health Service Act (42 U.S.C. 292., and 42 U.S.C. 296)) under applicable Federal regulations. For a discussion of interest, see paragraph (h) of this section. For special rules relating to loan refinancings, consolidated loans, and collapsed loans, see paragraph (i) of this section.

(2) *Loans that entered repayment status prior to January 1, 1998.* In the case of any qualified education loan that entered repayment status prior to January 1, 1998, section 221 allows no deduction for interest paid during the portion of the 60-month period described in paragraph (e)(1) of this section that occurred prior to January 1, 1998. Section 221 allows a deduction only for interest due and paid during that portion, if any, of the 60-month

period remaining after December 31, 1997.

(3) *Periods of deferment or forbearance.* The 60-month period described in paragraph (e)(1) of this section generally is suspended for any period when interest payments are not required on a qualified education loan because the lender has granted the taxpayer a period of deferment or forbearance (including postponement in anticipation of cancellation). However, in the case of a qualified education loan that is not issued or guaranteed under a Federal postsecondary education loan program, the 60-month period will be suspended under this paragraph (e)(3) only if the promissory note contains conditions substantially similar to the conditions for deferment or forbearance established by the U.S. Department of Education for Federal student loan programs under Title IV of the Higher Education Act of 1965, such as half-time study at a postsecondary educational institution, study in an approved graduate fellowship program or in an approved rehabilitation program for the disabled, inability to find full-time employment, economic hardship, or the performance of services in certain occupations or federal programs, and the borrower satisfies one of those conditions. For any qualified education loan, the 60-month period is not suspended if under the terms of the loan interest continues to accrue while the loan is in deferment or forbearance and either—

(i) In the case of deferment, the taxpayer agrees to pay interest currently during the deferment period; or

(ii) In the case of forbearance, the taxpayer agrees to make reduced payments, or payments of interest only, during the forbearance period.

(4) *Late payments.* A deduction is allowed for a payment of interest required in one month but actually made in a subsequent month prior to the expiration of the 60-month period. A deduction is not allowed for a payment of interest required in one month but actually made in a subsequent month after the expiration of the 60-month period. A late payment made during a period of deferment or forbearance is treated, solely for purposes of determining whether it is made during the 60-month period, as made on the date it is due.

(5) *Examples.* The following examples illustrate the rules of this paragraph (e). In the examples, assume that the institution the student attends is an eligible educational institution, the loan is a qualified education loan and is issued or guaranteed under a federal postsecondary education loan program,

the student is legally obligated to make interest payments under the terms of the loan, the interest payments occur after December 31, 1997, but before January 1, 2002, and with respect to any period after December 31, 1997, but before January 21, 1999, the taxpayer elects to apply the rules of this section. The examples are as follows:

Example 1. Payment prior to 60-month period. Student E obtains a loan to attend college. The terms of the loan provide that interest accrues on the loan while Student E earns his undergraduate degree but that Student E is not required to begin making payments of interest until six full calendar months after he graduates. Nevertheless, Student E voluntarily pays interest on the loan while attending college. Student E is not allowed a deduction for interest paid during that period, because those payments were made prior to the start of the 60-month period. Similarly, Student E would not be allowed a deduction for any interest paid during the six month grace period after graduation when interest payments are not required.

Example 2. Deferment option not exercised. The facts are the same as in *Example 1* except that Student E makes no payments on the loan while enrolled in college. Student E graduates in June 1999, and is required to begin making monthly payments of principal and interest on the loan in January 2000. The 60-month period described in paragraph (e)(1) of this section begins in January 2000. In August 2000, Student E enrolls in graduate school on a full-time basis. Under the terms of the loan, Student E may apply for deferment of the loan payments while enrolled in graduate school. However, Student E elects not to apply for deferment and continues to make required monthly payments on the loan during graduate school. Assuming fulfillment of all other relevant requirements, Student E may deduct interest paid on the loan during the 60-month period beginning in January 2000, including interest paid while enrolled in graduate school.

Example 3. Late payment, within 60-month period. The facts are the same as in *Example 2* except that, after the loan enters repayment status in January 2000, Student E makes no interest payments until March 2000. In March 2000, Student E pays interest required for the months of January, February, and March 2000. Assuming fulfillment of all other relevant requirements, Student E may deduct the interest paid in March for the months of January, February, and March because the interest payments are required under the terms of the loan and are paid within the 60-month period, even though the January and February interest payments may be late.

Example 4. Late payment during deferment but within 60-month period. The terms of Student F's loan require her to begin making monthly payments of interest on the loan in January 2000. The 60-month period described in paragraph (e)(1) of this section begins in January 2000. Student F fails to make the required interest payments for the months of November and December 2000. In

January 2001, Student F enrolls in graduate school on a half-time basis. Under the terms of the loan, Student F obtains a deferment of the loan payments due while enrolled in graduate school. The deferment becomes effective January 1, 2001. In March 2001, while the loan is in deferment, Student F pays the interest due for the months of November and December 2000. Assuming fulfillment of all other relevant requirements, Student F may deduct interest paid in March 2001, for the months of November and December 2000, because the late interest payments are treated, solely for purposes of determining whether they were made during the 60-month period, as made in November and December 2000.

Example 5. 60-month period. The terms of Student G's loan require him to begin making monthly payments of interest on the loan in November 1999. The 60-month period described in paragraph (e)(1) of this section begins in November 1999. In January 2000, Student G enrolls in graduate school on a half-time basis. As permitted under the terms of the loan, Student G applies for deferment of the loan payments due while enrolled in graduate school. While awaiting formal approval from the lender of his request for deferment, Student G pays interest due for the month of January 2000. In February 2000, the lender approves Student G's request for deferment, effective as of January 1, 2000. Assuming fulfillment of all other relevant requirements, Student G may deduct interest paid in January 2000, prior to his receipt of the lender's approval, even though the deferment was retroactive to January 1, 2000. As of February 2000, there are 57 months remaining in the 60-month period for that loan. Because Student G is not required to make interest payments during the period of deferment, the 60-month period is suspended. After January 2000, Student G may not deduct any voluntary payments of interest made during the period of deferment.

Example 6. 60-month period. The terms of Student H's loan require her to begin making monthly payments of interest on the loan in November 1999. The 60-month period described in paragraph (e)(1) of this section begins in November 1999. In January 2000, Student H enrolls in graduate school on a half-time basis. As permitted under the terms of the loan, Student H applies to make reduced payments of principal and interest while enrolled in graduate school. After the lender approves her application, Student H pays principal and interest due for the month of January 2000 at the reduced rate. Assuming fulfillment of all other relevant requirements, Student H may deduct interest paid in January 2000. As of February 2000, there are 57 months remaining in the 60-month period for that loan.

Example 7. Reduction of 60-month period for months prior to January 1, 1998. The first payment of interest on a loan is due in January 1997. Thereafter, interest payments are required on a monthly basis. The 60-month period described in paragraph (e)(1) of this section for this loan begins on January 1, 1997, the first day of the month that includes the date on which the first interest payment is required. However, the borrower may not deduct interest paid prior to January

1, 1998, under the effective date provisions of section 221. Assuming fulfillment of all other relevant requirements, the borrower may deduct interest due and paid on the loan during the 48 months beginning on January 1, 1998 (unless such period is extended for periods of deferment or forbearance under paragraph (e)(3) of this section).

(f) **Definitions**—(1) **Eligible educational institution.** In general, an *eligible educational institution* means any college, university, vocational school, or other post-secondary educational institution described in section 481 of the Higher Education Act of 1965, 20 U.S.C. 1088, as in effect on August 5, 1997, and certified by the U.S. Department of Education as eligible to participate in student aid programs administered by the Department, as described in section 25A(f)(2) and § 1.25A-2(b). For purposes of this section, an eligible educational institution also includes an institution that conducts an internship or residency program leading to a degree or certificate awarded by an institution, a hospital, or a health care facility that offers postgraduate training.

(2) **Qualified higher education expenses**—(i) **In general.** *Qualified higher education expenses* means the cost of attendance (as defined in section 472 of the Higher Education Act of 1965, 20 U.S.C. 1087l, as in effect on August 4, 1997), at an eligible educational institution, reduced by the amounts described in paragraph (f)(2)(ii) of this section. Consistent with section 472 of the Higher Education Act of 1965, a student's cost of attendance is determined by the eligible educational institution and includes tuition and fees normally assessed a student carrying the same academic workload as the student, an allowance for room and board, and an allowance for books, supplies, transportation, and miscellaneous expenses of the student.

(ii) **Reductions.** Qualified higher education expenses are reduced by any amount that is paid to or on behalf of a student with respect to such expenses and that is—

(A) A qualified scholarship that is excludable from income under section 117;

(B) An educational assistance allowance for a veteran or member of the armed forces under chapter 30, 31, 32, 34 or 35 of title 38, United States Code, or under chapter 1606 of title 10, United States Code;

(C) Employer-provided educational assistance that is excludable from income under section 127;

(D) Any other amount that is described in section 25A(g)(2)(C)

(relating to amounts excludable from gross income as educational assistance);

(E) Any otherwise includible amount excluded from gross income under section 135 (relating to the redemption of United States savings bonds); or

(F) Any otherwise includible amount distributed from a Coverdell education savings account and excluded from gross income under section 530(d)(2).

(3) **Qualified education loan**—(i) **In general.** A *qualified education loan* means indebtedness incurred by a taxpayer solely to pay qualified higher education expenses that are—

(A) Incurred on behalf of a student who is the taxpayer, the taxpayer's spouse, or a dependent (as defined in section 152) of the taxpayer at the time the taxpayer incurs the indebtedness;

(B) Attributable to education provided during an academic period, as described in section 25A and the regulations thereunder, when the student is an eligible student as defined in section 25A(b)(3) (requiring that the student be a degree candidate carrying at least half the normal full-time workload); and

(C) Paid or incurred within a reasonable period of time before or after the taxpayer incurs the indebtedness.

(ii) **Reasonable period.** Except as otherwise provided in this paragraph (f)(3)(ii), what constitutes a reasonable period of time for purposes of paragraph (f)(3)(i)(C) of this section generally is determined based on all the relevant facts and circumstances. However, qualified higher education expenses are treated as paid or incurred within a reasonable period of time before or after the taxpayer incurs the indebtedness if—

(A) The expenses are paid with the proceeds of education loans that are part of a federal postsecondary education loan program; or

(B) The expenses relate to a particular academic period and the loan proceeds used to pay the expenses are disbursed within a period that begins 90 days prior to the start of that academic period and ends 90 days after the end of that academic period.

(iii) **Related party.** A qualified education loan does not include any indebtedness owed to a person who is related to the taxpayer, within the meaning of section 267(b) or 707(b)(1). For example, a parent or grandparent of the taxpayer is a related person. In addition, a qualified education loan does not include a loan made under any qualified employer plan as defined in section 72(p)(4) or under any contract referred to in section 72(p)(5).

(iv) **Federal issuance or guarantee not required.** A loan does not have to be issued or guaranteed under a federal

postsecondary education loan program to be a qualified education loan.

(v) *Refinanced and consolidated indebtedness*—(A) *In general.* A qualified education loan includes indebtedness incurred solely to refinance a qualified education loan. A qualified education loan includes a single, consolidated indebtedness incurred solely to refinance two or more qualified education loans of a borrower.

(B) *Treatment of refinanced and consolidated indebtedness.* [Reserved.]

(4) *Examples.* The following examples illustrate the rules of this paragraph (f):

Example 1. Eligible educational institution. University J is a postsecondary educational institution described in section 481 of the Higher Education Act of 1965. The U.S. Department of Education has certified that University J is eligible to participate in federal financial aid programs administered by that Department, although University J chooses not to participate. University J is an eligible educational institution.

Example 2. Qualified higher education expenses. Student K receives a \$3,000 qualified scholarship for the 1999 fall semester that is excludable from Student K's gross income under section 117. Student K receives no other forms of financial assistance with respect to the 1999 fall semester. Student K's cost of attendance for the 1999 fall semester, as determined by Student K's eligible educational institution for purposes of calculating a student's financial need in accordance with section 472 of the Higher Education Act, is \$16,000. For the 1999 fall semester, Student K has qualified higher education expenses of \$13,000 (the cost of attendance as determined by the institution (\$16,000) reduced by the qualified scholarship proceeds excludable from gross income (\$3,000)).

Example 3. Qualified education loan. Student L borrows money from a commercial bank to pay qualified higher education expenses related to his enrollment on a half-time basis in a graduate program at an eligible educational institution. Student L uses all the loan proceeds to pay qualified higher education expenses incurred within a reasonable period of time after incurring the indebtedness. The loan is not federally guaranteed. The commercial bank is not related to Student L within the meaning of section 267(b) or 707(b)(1). Student L's loan is a qualified education loan within the meaning of section 221.

Example 4. Qualified education loan. Student M signs a promissory note for a loan on August 15, 1999, to pay for qualified higher education expenses for the 1999 fall and 2000 spring semesters. On August 20, 1999, the lender disburses loan proceeds to Student M's college. The college credits them to Student M's account to pay qualified higher education expenses for the 1999 fall semester, which begins on August 23, 1999. On January 25, 2000, the lender disburses additional loan proceeds to Student M's college. The college credits them to Student M's account to pay qualified higher education expenses for the 2000 spring

semester, which began on January 10, 2000. Student M's qualified higher education expenses for the two semesters are paid within a reasonable period of time, as the first loan disbursement occurred within the 90 days prior to the start of the fall 1999 semester, and the second loan disbursement occurred during the spring 2000 semester.

Example 5. Qualified education loan. The facts are the same as in *Example 4*, except that in 2001 the college is not an eligible educational institution because it loses its eligibility to participate in certain federal financial aid programs administered by the U.S. Department of Education. The qualification of Student M's loan, which was used to pay for qualified higher education expenses for the 1999 fall and 2000 spring semesters, as a qualified education loan is not affected by the college's subsequent loss of eligibility.

Example 6. Mixed-use loans. Student N signs a promissory note for a loan that is secured by Student N's personal residence. Student N will use part of the loan proceeds to pay for certain improvements to Student N's residence and part of the loan proceeds to pay qualified higher education expenses of Student N's spouse. Because Student N obtains the loan not solely to pay qualified higher education expenses, the loan is not a qualified education loan.

(g) *Denial of double benefit.* No deduction is allowed under this section for any amount for which a deduction is allowable under another provision of Chapter 1 of the Internal Revenue Code. No deduction is allowed under this section for any amount for which an exclusion is allowable under section 108(f) (relating to cancellation of indebtedness).

(h) *Interest*—(1) *In general.* Amounts paid on a qualified education loan are deductible under section 221 if the amounts are interest for Federal income tax purposes. For example, interest includes—

(i) Qualified stated interest (as defined in § 1.1273-1(c)); and

(ii) Original issue discount, which generally includes capitalized interest. For purposes of section 221, capitalized interest means any accrued and unpaid interest on a qualified education loan that, in accordance with the terms of the loan, is added by the lender to the outstanding principal balance of the loan.

(2) *Operative rules for original issue discount*—(i) *In general.* The rules to determine the amount of original issue discount on a loan and the accruals of the discount are in sections 163(e), 1271 through 1275, and the regulations thereunder. In general, original issue discount is the excess of a loan's stated redemption price at maturity (all payments due under the loan other than qualified stated interest payments) over its issue price (the amount loaned).

Although original issue discount generally is deductible as it accrues under section 163(e) and § 1.163-7, original issue discount on a qualified education loan is not deductible until paid. See paragraph (h)(3) of this section to determine when original issue discount is paid.

(ii) *Treatment of loan origination fees by the borrower.* If a loan origination fee is paid by the borrower other than for property or services provided by the lender, the fee reduces the issue price of the loan, which creates original issue discount (or additional original issue discount) on the loan in an amount equal to the fee. See § 1.1273-2(g). For an example of how a loan origination fee is taken into account, see *Example 2* of paragraph (h)(4) of this section.

(3) *Allocation of payments.* See §§ 1.446-2(e) and 1.1275-2(a) for rules on allocating payments between interest and principal. In general, these rules treat a payment first as a payment of interest to the extent of the interest that has accrued and remains unpaid as of the date the payment is due, and second as a payment of principal. The characterization of a payment as either interest or principal under these rules applies regardless of how the parties label the payment (either as interest or principal). Accordingly, the taxpayer may deduct the portion of a payment labeled as principal that these rules treat as a payment of interest on the loan, including any portion attributable to capitalized interest or loan origination fees.

(4) *Examples.* The following examples illustrate the rules of this paragraph (h). In the examples, assume that the institution the student attends is an eligible educational institution, the loan is a qualified education loan, the student is legally obligated to make interest payments under the terms of the loan, and any other applicable requirements, if not otherwise specified, are fulfilled. The examples are as follows:

Example 1. Capitalized interest. Interest on Student O's qualified education loan accrues while Student O is in school, but Student O is not required to make any payments on the loan until six months after he graduates or otherwise leaves school. At that time, the lender capitalizes all accrued but unpaid interest and adds it to the outstanding principal amount of the loan. Thereafter, Student O is required to make monthly payments of interest and principal on the loan. The interest payable on the loan, including the capitalized interest, is original issue discount. Therefore, in determining the total amount of interest paid on the qualified education loan during the 60-month period described in paragraph (e)(1) of this section, Student O may deduct any payments that

§ 1.1275-2(a) treats as payments of interest, including any principal payments that are treated as payments of capitalized interest. See paragraph (h)(3) of this section.

Example 2. Allocation of payments. The facts are the same as in *Example 1* of this paragraph (h)(4), except that, in addition, the lender charges Student O a loan origination fee, which is not for any property or services provided by the lender. Under § 1.1273-2(g), the loan origination fee reduces the issue price of the loan, which reduction increases the amount of original issue discount on the loan by the amount of the fee. The amount of original issue discount (which includes the capitalized interest and loan origination fee) that accrues each year is determined under section § 1272 and § 1.1272-1. In effect, the loan origination fee accrues over the entire term of the loan. Because the loan has original issue discount, the payment ordering rules in § 1.1275-2(a) must be used to determine how much of each payment is interest for federal tax purposes. See paragraph (h)(3) of this section. Under § 1.1275-2(a), each payment (regardless of its designation by the parties as either interest or principal) generally is treated first as a payment of original issue discount, to the extent of the original issue discount that has accrued as of the date the payment is due and has not been allocated to prior payments, and second as a payment of principal. Therefore, in determining the total amount of interest paid on the qualified education loan during the 60-month period described in paragraph (e)(1) of this section, Student O may deduct any payments that the parties label as principal but that are treated as payments of original issue discount under § 1.1275-2(a). The 60-month period does not begin in the month in which the lender charges Student O the loan origination fee.

(i) **Special rules regarding 60-month limitation—(1) Refinancing.** A qualified education loan and all indebtedness incurred solely to refinance that loan constitute a single loan for purposes of calculating the 60-month period described in paragraph (e)(1) of this section.

(2) **Consolidated loans.** A consolidated loan is a single loan that refinances more than one qualified education loan of a borrower. For consolidated loans, the 60-month period described in paragraph (e)(1) of this section begins on the latest date on which any of the underlying loans entered repayment status and includes any subsequent month in which the consolidated loan is in repayment status.

(3) **Collapsed loans.** A collapsed loan is two or more qualified education loans of a single taxpayer that constitute a single qualified education loan for loan servicing purposes and for which the lender or servicer does not separately account. For a collapsed loan, the 60-month period described in paragraph (e)(1) of this section begins on the latest date on which any of the underlying

loans entered repayment status and includes any subsequent month in which any of the underlying loans is in repayment status.

(4) **Examples.** The following examples illustrate the rules of this paragraph (i):

Example 1. Refinancing. Student P obtains a qualified education loan to pay for an undergraduate degree at an eligible educational institution. After graduation, Student P is required to make monthly interest payments on the loan beginning in January 2000. Student P makes the required interest payments for 15 months. In April 2001, Student P borrows money from another lender exclusively to repay the first qualified education loan. The new loan requires interest payments to start immediately. At the time Student P must begin interest payments on the new loan, which is a qualified education loan, there are 45 months remaining of the original 60-month period referred to in paragraph (e)(1) of this section.

Example 2. Collapsed loans. To finance his education, Student Q obtains four separate qualified education loans from Lender R. The loans enter repayment status, and their respective 60-month periods described in paragraph (e)(1) of this section begin, in July, August, September, and December of 1999. After all of Student Q's loans have entered repayment status, Lender R informs Student Q that Lender R will transfer all four loans to Lender S. Following the transfer, Lender S treats the loans as a single loan for loan servicing purposes. Lender S sends Student Q a single statement that shows the total principal and interest, and does not keep separate records with respect to each loan. With respect to the single collapsed loan, the 60-month period described in paragraph (e)(1) of this section begins in December 1999.

(j) **Effective date.** This section is applicable to interest due and paid on qualified education loans after January 21, 1999, if paid before January 1, 2002. Taxpayers also may apply this section to interest due and paid on qualified education loans after December 31, 1997, but before January 21, 1999. This section also applies to interest due and paid on qualified education loans in a taxable year beginning after December 31, 2010.

■ 3. Section 1.6050S-3 is amended by revising paragraphs (d)(1)(iii)(B) and (e)(1) to read as follows:

§ 1.6050S-3 Information reporting for payments of interest on qualified education loans.

* * * * *

(d) * * * (1) * * *

(iii) * * *

(B) In the case of qualified education loans made before September 1, 2004, for which the payee does not report payments of interest other than stated interest, state that the payor may be able to deduct additional amounts (such as certain loan origination fees and

capitalized interest) not reported on the statement;

* * * * *

(e) **Special rules—(1) Transitional rule for reporting of loan origination fees and capitalized interest—(i) Loans made before September 1, 2004.** For qualified education loans made before September 1, 2004, a payee is not required to report payments of loan origination fees or capitalized interest or to take such payments into account in determining the \$600 amount for purposes of paragraph (a)(1) of this section.

(ii) **Loans made on or after September 1, 2004.** For qualified education loans made on or after September 1, 2004, a payee is required to report payments of interest as described in § 1.221-1(f). Under § 1.221-1(f), interest includes loan origination fees that represent charges for the use or forbearance of money and capitalized interest. Under this paragraph (e)(1)(ii), a payee shall take such payments of interest into account in determining the \$600 amount for purposes of paragraph (a)(1) of this section. For purposes of this section and section 6050S, interest (including capitalized interest and loan origination fees) is treated as received, and is reportable, in the year the interest is treated as paid under the allocation rules in § 1.221-1(f)(3).

See § 1.221-1(f) for rules relating to capitalized interest, and § 1.221-1(f)(2)(ii) for rules relating to loan origination fees, on qualified education loans.

* * * * *

Mark E. Matthews,

Deputy Commissioner for Services and Enforcement.

Approved: April 27, 2004.

Gregory F. Jenner,

Acting Assistant Secretary of the Treasury.

[FR Doc. 04-10359 Filed 5-6-04; 8:45 am]

BILLING CODE 4830-01-P

DEPARTMENT OF THE INTERIOR

Minerals Management Service

30 CFR Part 203

RIN 1010-AD01

Oil and Gas and Sulphur Operations in the Outer Continental Shelf—Relief or Reduction in Royalty Rates—Deep Gas Provisions; Correction

AGENCY: Minerals Management Service (MMS), Interior.

ACTION: Correction.

SUMMARY: The technical amendments to the document titled "Oil and Gas and