Part III

Administrative, Procedural, and Miscellaneous

26 CFR 601.105: Examination of returns and claims for refund, credit or abatement; determination of correct tax liability.
(Also Part I, §§ 860D, 860F, 860G, 1001; 1.860G–2, 1.1001–3, 301.7701–2, 301.7701-3, 301.7701-4.)

Rev. Proc. 2009-23

SECTION 1. PURPOSE

This revenue procedure describes the conditions under which modifications to certain mortgage loans will not cause the Internal Revenue Service (Service) to challenge the tax status of certain securitization vehicles that hold the loans or to assert that those modifications give rise to prohibited transactions.

This revenue procedure provides certainty in the current economic environment with respect to certain potential tax issues that may be implicated by loan modifications made pursuant to the Home Affordable Modification Program (“HAMP”), described below. No inference should be drawn about whether similar consequences would obtain if a transaction falls outside the limited scope of this revenue procedure. Furthermore, there should be no inference that, in the absence of this revenue procedure, transactions within its scope would have impaired the tax status of securitization vehicles or would have given rise to prohibited transactions.

SECTION 2. BACKGROUND—THE HAMP

.01 The deep contraction in the economy and in the housing market has created distress for homeowners and communities throughout the country. Large numbers of homeowners are unable to afford their current monthly mortgage payments and are at risk of losing their homes. In response, on February 18, 2009, the United States Government announced the Homeowner Affordability and Stability Plan (the "Plan"). The Plan is intended to help at-risk homeowners to modify their mortgages to avoid foreclosure. On March 4, 2009, as a key component of the Plan, the United States Government released further details about the HAMP. See documents entitled "Home Affordable Modification Program Guidelines" and "Making Home Affordable, Summary of Guidelines."

.02 The HAMP includes detailed protocols for identifying borrowers at risk of default. As is more fully set forth in the program documents, the HAMP is intended to reach borrowers with high mortgage debt service compared to income and other indications of being at risk of default. Delinquency is not a requirement for eligibility. Rather, because loan modifications are more likely to succeed if they are made before a borrower misses a payment, the HAMP is also intended to reach borrowers for whom default is imminent despite the fact that those borrowers are current on their mortgage payments. In determining whether default is imminent for a particular borrower, the HAMP takes into account a broad range of information, including whether the borrower has had a change in circumstances that causes financial hardship, or is facing a recent or imminent increase in the monthly mortgage payment that would likely create a financial hardship.

.03 The HAMP applies both to loans that investors hold directly and to those that are held through securitization vehicles such as investment trusts and real estate mortgage investment conduits (REMICs).

SECTION 3. BACKGROUND—REMICS

.01 REMICs are widely used securitization vehicles for mortgages. REMICs are governed by sections 860A through 860G of the Internal Revenue Code.

.02 For an entity to qualify as a REMIC, all of the interests in the entity must consist of one or more classes of regular interests and a single class of residual interests, see section 860D(a), and those interests must be issued on the startup day, within the meaning of § 1.860G–2(k) of the Income Tax Regulations.

.03 A regular interest is one that is designated as a regular interest and whose terms are fixed on the startup day. Section 860G(a)(1). In addition, a regular interest must (1) unconditionally entitle the holder to receive a specified principal amount (or other similar amount), and (2) provide that interest payments, if any, at or before maturity are based on a fixed rate (or to the extent provided in regulations, at a variable rate).

.04 An interest issued after the startup day does not qualify as a REMIC regular interest.

.05 Under section 860D(a)(4), an entity qualifies as a REMIC only if, among other things, as of the close of the third month beginning after the startup day and at all times thereafter, substantially all of its assets consist of qualified mortgages and permitted investments. This asset test is satisfied if the entity owns no more than a *de minimis* amount of other assets. See § 1.860D–1(b)(3)(i). As a safe harbor, the amount of assets other than qualified mortgages and permitted investments is *de minimis* if the aggregate of the adjusted bases of those assets is less than one percent of the aggregate of the adjusted bases of all of the entity's assets. § 1.860D–1(b)(3)(ii).

.06 With limited exceptions, a mortgage loan is not a qualified mortgage unless it is transferred to the REMIC on the startup day in exchange for regular or residual interests in the REMIC. See section 860G(a)(3)(A)(i).

.07 The legislative history of the REMIC provisions indicates that Congress intended the provisions to apply only to an entity that holds a substantially fixed pool of real estate mortgages and related assets and that "has no powers to vary the composition of its mortgage assets." S. Rep. No. 99–313, 99th Cong., 2d Sess. 791–92, 1986–3 (Vol. 3) C.B. 791–92.

.08 Section 1.1001–3(c)(1)(i) defines a "modification" of a debt instrument as any alteration, including any deletion or addition, in whole or in part, of a legal right or obligation of the issuer or holder of a debt instrument, whether the alteration is evidenced by an express agreement (oral or written), conduct of the parties, or otherwise. Section 1.1001–3(e) governs which modifications of debt instruments are "significant." Under § 1.1001–3(b), for most federal income tax purposes, a significant modification produces a deemed exchange of the original debt instrument for a new debt instrument.

.09 Under § 1.860G–2(b), related rules apply to determine REMIC qualification. Except as specifically provided in § 1.860G–2(b)(3), if there is a significant modification of an obligation that is held by a REMIC, then the modified obligation is treated as one that was newly issued in exchange for the unmodified obligation that it replaced. See § 1.860G-2(b)(1). For this purpose, the rules in § 1.1001–3(e) determine whether a modification is "significant." See § 1.860G-2(b)(2). Thus, even if an entity initially qualifies as a REMIC, one or more significant modifications of loans held by the entity may terminate the qualification if the modifications cause less than substantially all of the entity's assets to be qualified mortgages.

.10 Certain loan modifications, however, are not significant for purposes of § 1.860G–2(b)(1), even if the modifications are significant under the rules in § 1.1001-3. In particular, under § 1.860G-2(b)(3)(i), if a change in the terms of an obligation is "occasioned by default or a reasonably foreseeable default," the change is not a significant modification for purposes of § 1.860G-2(b)(1), regardless of the modification's status under § 1.1001–3.

.11 Section 860F(a)(1) imposes a tax on REMICs equal to 100 percent of the net income derived from "prohibited transactions." The disposition of a qualified mortgage is a prohibited transaction unless the "disposition [is] pursuant to—(i) the substitution of a qualified replacement mortgage for a qualified mortgage . . . , (ii) a disposition incident to the foreclosure, default, or imminent default of the mortgage, (iii) the bankruptcy or insolvency of the REMIC, or (iv) a qualified liquidation." Section 860F(a)(2)(A).

.12 Under section 860C(b)(1), "The taxable income of a REMIC shall be determined under an accrual method of accounting . . . except that— . . . (C) there shall not be taken into account any item of income, gain, loss, or deduction allocable to a prohibited transaction, . . ."

SECTION 4. BACKGROUND—TRUSTS

.01 Section 301.7701-2(a) of the Procedure and Administration Regulations defines a “business entity” as any entity recognized for federal tax purposes (including an entity with a single owner that may be disregarded as an entity separate from its owner under § 301.7701-3) that is not properly classified as a trust under § 301.7701-4 or otherwise subject to special treatment under the Code.

.02 Section 301.7701-4(a) provides that an arrangement is treated as a trust if the purpose of the arrangement is to vest in trustees responsibility for the protection and conservation of property for beneficiaries who cannot share in the discharge of this responsibility and, therefore, are not associates in a joint enterprise for the conduct of business for profit.

.03 Section 301.7701-4(c) provides that an “investment” trust is not classified as a trust if there is a power under the trust agreement to vary the investment of the certificate holders.

SECTION 5. SCOPE

This revenue procedure applies to a modification made pursuant to the HAMP of a mortgage loan that is held by a REMIC or by an investment trust.

SECTION 6. APPLICATION

If one or more modifications of mortgage loans are described in Section 5 of this revenue procedure—

.01 The Service will not challenge a securitization vehicle’s qualification as a REMIC on the grounds that the modifications are not among the exceptions listed in § 1.860G-2(b)(3);

.02 The Service will not contend that the modifications are prohibited transactions under section 860F(a)(2) on the grounds that the modifications result in one or more dispositions of qualified mortgages and that the dispositions are not among the exceptions listed in section 860F(a)(2)(A)(i)–(iv);

.03 The Service will not challenge a securitization vehicle's classification as a trust under § 301.7701–4(c) on the grounds that the modifications manifest a power to vary the investment of the certificate holders; and

.04 The Service will not challenge a securitization vehicle's qualification as a REMIC on the grounds that the modifications result in a deemed reissuance of the REMIC regular interests.

SECTION 7. OTHER GUIDANCE

For the treatment of mortgage loans modified pursuant to certain foreclosure prevention programs, see Rev. Proc. 2008-47, 2008-31 I.R.B. 272, and Rev. Proc. 2008-28, 2008-23 I.R.B. 1054.

SECTION 8. EFFECTIVE DATE

This revenue procedure is effective for loan modifications on or after March 4, 2009.

SECTION 9. DRAFTING INFORMATION

The principal author of this revenue procedure is Diana Imholtz of the Office of Associate Chief Counsel (Financial Institutions and Products). For further information, contact Ms. Imholtz on (202) 622–3930 (not a toll-free call).