Internal Revenue Service

Number: **201827002**
Release Date: 7/6/2018

Index Number: 7701.03-00

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:FIP:B02
PLR-116460-16

Date:
March 16, 2018

Legend

Taxpayer =
State A =
Sponsor =
Date 1 =
Date 2 =
Securitizer =
a =
b =
x =

Dear :

This is in reply to a letter dated May 17, 2016, and supplemental submissions requesting a ruling on behalf of Taxpayer. Taxpayer requests a ruling that it does not have a power to vary its investments under § 301.7701-4(c) of the Procedure and Administration Regulations.

FACTS

Taxpayer is a statutory trust formed under the laws of State A. Sponsor sponsored the formation of Taxpayer.

On various dates (each date, a “Sale Date”) during a 90-day period between Date 1 and Date 2 (the “Aggregation Period”) in connection with Taxpayer’s formation, Taxpayer purchased residential mortgage loans (the “Mortgage Obligations”) from Sponsor. Sponsor remains the servicer on the Mortgage Obligations sold to Taxpayer. The Mortgage Obligations are mortgages evidenced by promissory notes or other similar evidence of indebtedness, each of which is a first mortgage, deed of trust or

similar security instrument on residential property consisting of one-to-four family dwelling units, individual condominium units or individual units in planned unit developments. The aggregate Mortgage Obligations sold by Sponsor to Taxpayer during the Aggregation Period comprise the “Mortgage Pool.”

On each Sale Date, Taxpayer simultaneously sold the acquired Mortgage Obligations to Securitizer. In exchange, Taxpayer received Securitizer-issued mortgage-backed securities. Taxpayer then transferred most of the mortgage-backed securities to Sponsor in a transaction disregarded for federal income tax purposes and retained one mortgage-backed security representing a x basis point interest-only strip (the “Retained I/O Strip”). Taxpayer represents that the Retained I/O Strip is not related to any amounts received by Sponsor for normal mortgage servicing rights and that the Retained I/O Strip qualifies to be treated as a stripped coupon under § 1286 of the Internal Revenue Code.

In addition, as part of the transactions with Securitizer, Taxpayer agreed to provide collateral equal to a % of the outstanding principal balance on the Mortgage Pool, for a period of b years. Taxpayer has deposited cash into the Cash Collateral Account to satisfy this requirement. Taxpayer also holds two other cash accounts: the Interest Account and the Distribution Account

Under the terms of the trust agreement, Taxpayer is permitted to acquire and hold the Retained I/O Strip, the Cash Collateral Account, the Interest Account, and the Distribution Account. The Cash Collateral Account and the Interest Account may be invested in cash, U.S. dollar denominated demand deposits held at US. financial institutions that are member banks of the Federal Reserve System, and money market funds described in Rev. Rul. 2012-17, 2012-25 I.R.B. 1018. The Distribution Account will be funded by transfers from the Cash Collateral Account and the Interest Account.

Taxpayer is not permitted to acquire any other assets. Taxpayer only has the right to invest as described above and does not have the power to dispose, sell, reinvest, purchase or vary the investments of Taxpayer in any manner not described above.

LAW AND ANALYSIS

Section 7701(a)(3) provides that the term “corporation” includes associations.

Section 301.7701-4(c)(1) provides that an “investment trust” will not be classified as a trust if there is a power under the trust agreement to vary the investment of the certificate holders.

In Commissioner v. North American Bond Trust, 122 F.2d 545 (2d Cir. 1941), cert. denied, 314 U.S. 701 (1942), the court stated that a power to vary the investment

of the certificate holders exists if there is managerial power under the trust instrument that enables a trust to take advantage of market variations to improve the investment of the investors. The court held that a power to acquire new bonds upon the admission of new investors, where existing investors would acquire a pro rata interest in the new bonds, was a power to vary the investment of the existing investors, as the power allowed the trustee to take advantage of market variations in a manner that could improve the investment of the original investors.

Although a trustee may not actually exercise all the powers and discretion granted under the trust agreement, the parties are not at liberty to say that their purpose was other or narrower than that which they formally set forth in the instrument under which their activities were conducted. Helvering v. Coleman-Gilbert Associates, 296 U.S. 369, 374, (1935), XV-1 C.B. 261 (1936).

In Rev. Rul. 75-192, 1975-1 C.B. 384, a trustee receives principal and interest payments on a pool of mortgages. Under the trust agreement, the trustee will make quarterly distributions of all principal and interest payments received to each investor in proportion to its interest. During the period between quarterly distribution dates, the trustee is required to invest cash on hand in short-term obligations of (or guaranteed by) the United States (or any agency or instrumentality thereof) and in certificates of deposit of any bank or trust company having a minimum stated surplus and capital. The trustee is permitted to invest only in obligations maturing prior to the next distribution date and is required to hold such obligations until maturity. All the proceeds received from the mortgage payments along with the interest earned on these short-term investments and deposits will be distributed to the investors quarterly. The trustee has no authority under the trust agreement to purchase new securities or mortgages, or to make any other new investments. The revenue ruling concludes that the requirements limit the trustee to a fixed return similar to that earned on a bank account and eliminate any opportunity to profit from market fluctuations.

In Rev. Rul. 86-92, 1986-2 C.B. 214, a trust holds tax- exempt bonds and contracts to purchase tax-exempt bonds. The contracts provide that the bonds must be transferred to the trust within 90 days of the trust's creation. If a bond is not transferred for reasons beyond the control of the trustee or the trust's sponsor, the sponsor has 20 days within which to transfer different bonds of substantially the same character and quality. The revenue ruling concludes that neither the trustee nor the sponsor has a power to take advantage of market variations to improve the investment of certificate holders. The powers are incidental to the organization of the trust.

In this case, Taxpayer has limited ability to alter the assets it holds. Taxpayer may only hold the Retained I/O Strip, the Cash Collateral Account, the Interest Account, and the Distribution Account. The Cash Collateral Account and the Interest Account may only be invested in cash, U.S. dollar denominated demand deposits held at US. financial institutions that are member banks of the Federal Reserve System, and money

market funds described in Rev. Rul. 2012-17. Because Taxpayer does not have the discretion to make an investment decision to reinvest the Retained I/O Strip in other assets and may only invest the Cash Collateral Account and the Interest Account in assets similar to those described in Rev. Rul. 75-192, even if Taxpayer does change the assets held by the Cash Collateral Account and the Interest Account, it is limited to a return similar to that earned on a bank account and has eliminated any opportunity to profit from market fluctuations. Therefore, Taxpayer does not have a managerial power under the trust instrument that enables Taxpayer to take advantage of market variations to improve the investment of the holders, and Taxpayer does not have a power to vary the investment of the certificate holders under § 301.7701-4(c).

CONCLUSION:

Based on the information submitted and representations made, we conclude that the Trust, if operated in accordance with the above representations, will not have a power to vary under § 301.7701-4(c).

Sincerely,

Pamela Lew
Senior Counsel, Branch 2
Office of Associate Chief Counsel
(Financial Institutions & Products)

cc: