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 1, §§ 856; 1.856-3, 1.856-5, and 1.860F–4.)

Rev. Proc. 2012-14

SECTION 1. PURPOSE

This revenue procedure sets forth a safe harbor that provides the extent to which an investment by a real estate investment trust (REIT) in a regular or a residual interest in certain real estate mortgage investment conduits (REMICs) may be treated as a real estate asset for purposes of sections 856(c)(4)(A) and 856(c)(5)(B) of the Internal Revenue Code and the extent to which interest from that investment may be treated as derived from interest on an obligation secured by a mortgage on real property or on an interest in real property for purposes of section 856(c)(3)(B).

SECTION 2. BACKGROUND—HARP

.01 In April 2009, the Federal Housing Finance Agency (FHFA) and the United States Department of the Treasury introduced the Home Affordable Refinancing Program (HARP) as part of the United States Government’s Making Home Affordable Program. On October 24, 2011, FHFA, with Federal National Mortgage Association (Fannie Mae) and Federal Home Loan Mortgage Corporation (Freddie Mac), announced an expansion of HARP in an effort to serve additional eligible borrowers who can benefit from refinancing their home mortgages. Details of the expansion were announced on November 15, 2011.

HARP serves borrowers who may not otherwise qualify for refinancing, either because the value of their homes has declined or because they cannot obtain mortgage insurance. The program is available to borrowers who owe more on their mortgages than the value of their homes. HARP provides these homeowners with the ability to refinance their mortgages into more affordable and sustainable mortgages.

.02 It is expected that many mortgages refinanced under HARP will be held by REMICs.

SECTION 3. BACKGROUND—REMICS

.01 REMICs are widely used securitization vehicles for mortgages. REMICs are governed by sections 860A through 860G.

.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 In addition to being issued on the startup day with fixed terms, 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). See section 860G(a)(1).

.04 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. Section 1.860D-1(b)(3)(ii).

.05 A mortgage loan is a qualified mortgage only if it is principally secured by an interest in real property. Section 860G(a)(3)(A).

.06 In general, for purposes of section 860G(a)(3)(A), an obligation is principally secured by an interest in real property only if it satisfies the "80-percent test" set forth in § 1.860G-2(a)(1)(i).

.07 Under the 80-percent test, an obligation is principally secured by an interest in real property if the fair market value of the interest in real property securing the obligation—

(1) Was at least equal to 80 percent of the adjusted issue price of the obligation at the time the obligation was originated; or

(2) Is at least equal to 80 percent of the adjusted issue price of the obligation at the time the sponsor contributes the obligation to the REMIC.

.08 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).

.09 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.

SECTION 4. BACKGROUND—REMIC REPORTING

.01 Section 1.860F-4(e)(1)(ii)(A) provides that for calendar quarters after 1988, a REMIC must provide to each of its residual interest holders information regarding (among other items) the percentage of REMIC assets that are real estate assets defined in section 856(c)(5)(B),[1] computed by reference to the average adjusted basis (as defined in section 1011) of the REMIC assets during the calendar quarter (as described in § 1.860F-4(e)(1)(iii)). If the percentage of REMIC assets represented by real estate assets is at least 95 percent, then the REMIC need only specify that the percentage of real estate assets was at least 95 percent.

.02 Section 1.860F-4(e)(1)(ii)(B) provides that if, for any calendar quarter after 1988, less than 95 percent of the assets of the REMIC are real estate assets defined in section 856(c)(5)(B), then, for that calendar quarter, the REMIC must also provide to any REIT that holds a residual interest the following information—

(1) The percentage of REMIC assets described in section 856(c)(4)(A), computed by reference to the average adjusted basis of the REMIC assets during the calendar quarter (as described in § 1.860F-4(e)(1)(iii)),

[1] Both §§ 1.860F-4(e)(1)(ii)(A) and § 1.860F-4(e)(1)(ii)(B) refer to former section 856(c)(6)(B), and § 1.860F-4(e)(1)(ii)(B)(1) refers to former section 856(c)(5)(A). Section 1255 of the Taxpayer Relief Act of 1997 (P.L. 105-34) redesignated former sections 856(c)(6)(B) and 856(c)(5)(A) as current sections 856(c)(5)(B) and 856(c)(4)(A), respectively.

(2) The percentage of REMIC gross income (other than gross income from prohibited transactions defined in section 860F(a)(2)) described in section 856(c)(3)(A) through (E), computed as of the close of the calendar quarter, and

(3) The percentage of REMIC gross income (other than gross income from prohibited transactions defined in section 860F(a)(2)) described in section 856(c)(3)(F) (which refers to income or gain from foreclosure property), computed as of the close of the calendar quarter. For this purpose, the term "foreclosure property" has the meaning specified in section 860G(a)(8) (which governs REMICs), rather than the closely related definition of “foreclosure property” in section 856(e) (which otherwise would determine the income or gain that is described in section 856(c)(3)(F)).

.03 Notice 2012-5, this bulletin, provides that for purposes of an eligible REMIC’s reporting obligation to residual interest holders under § 1.860F-4(e)(1)(ii), if the percentage of REMIC assets represented by real estate assets is less than 95 percent but at least 80 percent, then the REMIC need only specify on Schedule Q (Form 1066), Quarterly Notice to Residual Interest Holder of REMIC Taxable Income or Net Loss Allocation, that the percentage for that category was at least 80 percent.

SECTION 5. BACKGROUND—REITS

.01 Many REITs invest in real estate loans that are secured by real property. REITs may also invest in REMIC regular or residual interests (see section 856(c)(5)(E)).

.02 Section 856(a) provides that an entity shall not be considered a REIT for any taxable year unless certain requirements are satisfied. Under section 856(c)(4)(A), at the close of each quarter of its taxable year, at least 75 percent of the value of a REIT's total assets must be represented by real estate assets, cash and cash items (including receivables), and Government securities.

.03 Section 856(c)(5)(B) provides that the term "real estate assets" means real property (including interests in real property and interests in mortgages on real property) and shares (or transferable certificates of beneficial interest) in other REITs that meet the requirements of sections 856 through 859. Section 1.856-3(d) provides that the term "real property" means land or improvements thereon, such as buildings and that the term "real property" includes interests in real property. Section 1.856-3(d) further provides that local law definitions are not controlling for purposes of determining the meaning of the term "real property" as used in section 856 and the regulations thereunder.

.04 Section 856(c)(3)(B) provides that at least 75 percent of a REIT's gross income must be derived from certain items, including interest on obligations secured by mortgages on real property or on interests in real property.

.05 Section 1.856-5(c)(1) provides that if a mortgage covers both real property and other property, an apportionment of the interest income must be made for purposes of the 75-percent requirement of section 856(c)(3). Section 1.856-5(c)(1)(i) provides that if the loan value of the real property is equal to or exceeds the amount of the loan, the entire amount of interest income shall be apportioned to the real property. Section 1.856-5(c)(2) provides that the loan value of the real property is the fair market value of the property, determined on the date the commitment by the trust to purchase the loan or to make the loan becomes binding on the trust.

.06 Section 856(c)(5)(E) provides that for purposes of Part II of subchapter M, a regular or residual interest in a REMIC shall be treated as a real estate asset, and any amount includible in gross income with respect to such an interest shall be treated as interest on an obligation secured by a mortgage on real property, except that a REIT shall be treated as holding and receiving directly its proportionate share of the assets and income of a REMIC if less than 95 percent of the assets of such REMIC are real estate assets (determined as if the REIT held such assets). For purposes of determining whether any interest in a REMIC qualifies under the preceding sentence, any interest held by such REMIC in another REMIC shall be treated as a real estate asset under principles similar to the principles of the preceding sentence, except that, if such REMICs are part of a tiered structure, they shall be treated as one REMIC for purposes of section 856(c)(5)(E).

.07 The REMIC provisions do not require REMICs to provide holders of regular interests with information regarding the percentage of REMIC assets that are real estate assets for purposes of Part II of subchapter M. Furthermore, if the percentage of an eligible REMIC's assets that are real estate assets is less than 95 percent but at least 80 percent, then the REMIC need only inform a REIT holding a residual interest in that REMIC that the percentage of assets described in section 856(c)(5)(B) was at least 80 percent. See Notice 2012-5, this bulletin.

.08 To qualify as an "eligible REMIC" under Notice 2012-5, the REMIC must have a guarantee from Fannie Mae or Freddie Mac that will supplement amounts received by the REMIC as required to permit the payment of principal and interest, as applicable, on both the regular interests and residual interests issued by the REMIC; and all of the qualified mortgages (including mortgage pass-thru certificates) that are held by the REMIC must be secured by interests in single-family (one-to-four unit) dwellings.

.09 Although eligible REMICs are not required to provide more than limited information to REITs holding residual interests in those REMICs regarding the percentage of the REMICs' assets described in section 856(c)(5)(B), it is important for those REITs to know—

(1) The extent to which both regular and residual interests may be treated as real estate assets for purposes of sections 856(c)(4)(A) and 856(c)(5)(B); and

(2) The extent to which gross income with respect to those investments may be treated for purposes of section 856(c)(3)(B) as derived from interest on obligations secured by a mortgage on real property or on an interest in real property.

SECTION 6. SCOPE

.01 Section 7 of this revenue procedure applies to a regular interest that is held by a REIT in an eligible REMIC as defined in Notice 2012-5.

.02 Section 7 of this revenue procedure applies to a residual interest that is held by a REIT in an eligible REMIC as defined in Notice 2012-5, if, in accordance with Notice 2012-5, the REMIC informs the REIT holding the residual interest in that REMIC that the percentage of the REMIC's assets described in section 856(c)(5)(B) was at least 80 percent.

SECTION 7. APPLICATION

If a REIT holds a regular or a residual interest in an eligible REMIC that meets the requirements of either section 6.01 or section 6.02 of this revenue procedure, then –

.01 The REIT may treat 80 percent of the value of the regular or residual interest as a real estate asset. If the REIT has information establishing that, as a result of holding the interest, its proportionate share of the eligible REMIC's assets under section 856(c)(5)(E) produces a higher percentage for purposes of section 856(c)(4)(A), then the REIT may use that higher percentage.

.02 Any amount includible by the REIT in gross income with respect to the regular or residual interest may be treated as 80 percent derived from interest on an obligation secured by a mortgage on real property within the meaning of section 856(c)(3)(B). If the REIT has information establishing that, as a result of holding the interest, its proportionate share of the eligible REMIC's income under section 856(c)(5)(E) produces a higher percentage for purposes of section 856(c)(3), then the REIT may use that higher percentage.

SECTION 8. EFFECTIVE DATE

This revenue procedure is effective for regular or residual interests in an eligible REMIC that has a startup date after November 30, 2011.

DRAFTING INFORMATION

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