**Internal Revenue Service**

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Department of the Treasury
Washington, DC 20224

Person To Contact:
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Refer Reply To:
CC:FIP:B02
PLR-102723-06

Date:
September 29, 2006

**Legend:**

Taxpayer =

Date 1 =

Corporation A =

Corporation B =

a =

b =

c =

d =

Dear :

This is in reply to a letter dated January 6, 2006, in which Taxpayer requests a ruling concerning the proper treatment of a master repurchase agreement (the Repo Agreement) under section 856 of the Internal Revenue Code. You have requested a ruling that the Repo Agreement, which is secured by the collateral assignment of mortgage loans and mortgage backed securities, will generate income that is treated as interest on obligations secured by mortgages on real property or interests in real property within the meaning of section 856(c)(3)(B); and that the Repo Agreement will be treated as a real estate asset under section 856(c)(5)(B) and not as a security under section 856(c)(4)(B)(ii).

**FACTS:**

Taxpayer is a publicly traded domestic corporation that elected to be taxed as a real estate investment trust (REIT) beginning with its tax year ended Date 1. Taxpayer's principal activity is to acquire and hold mortgage loans secured by mortgages or deeds of trust and mortgage backed securities for the production of interest income.

Corporation A is a domestic corporation that is wholly-owned by Taxpayer. Taxpayer and Corporation A have jointly elected under section 856(l) to treat Corporation A as a taxable REIT subsidiary (TRS) of Taxpayer. Corporation A's principal activity is to hold the stock of one of more subsidiaries. Corporation A currently owns all of Corporation B's single class of stock. Corporation B is engaged in the business of originating, purchasing, pooling, selling, securitizing, and servicing mortgage loans and selling securities in pools of mortgages. Taxpayer provides financing to Corporation B under a warehouse line of credit to allow Corporation B to originate mortgage loans and assemble pools of mortgages. Corporation B services mortgage loans held by Taxpayer, as well as loans that it previously securitized in REMIC transactions. Substantially all of the mortgage loans that Taxpayer acquires are obtained from Corporation B, including pools of mortgage loans securitized by Corporation B.

Taxpayer and Corporation B propose to enter into a Repurchase Agreement ("Repo Agreement"). Taxpayer represents that the Repo Agreement is patterned after the form of Master Repurchase Agreement generally employed in the mortgage backed securities industry. Under the terms of the Repo Agreement, Corporation B will transfer mortgage loans to Taxpayer against a transfer of funds by Taxpayer, with a simultaneous agreement by Taxpayer to transfer to Corporation B the purchased assets at a date certain, against a transfer of funds by Corporation B. The aggregate amount of the outstanding balances of the assigned mortgage loans will equal or exceed the amount advanced to Corporation B under the Repo Agreement.

The mortgage loans that are the collateral security and the subject of the Repo Agreement include both fixed rate and adjustable rate loans. The interest rate on the Repo Agreement will be LIBOR plus a spread that reflects the rate that Corporation B would be charged as a stand alone borrower by an independent third party bank. The interest rate on the Repo Agreement is not correlated to the interest rates on the underlying mortgage loans. The Repo Agreement will be structured as an assignment of the mortgage loans from Corporation B to Taxpayer on a non-recourse basis and Corporation B's books would reflect Taxpayer's ownership of the mortgages. Taxpayer will be treated for all purposes, included state contract law and bankruptcy law, as being in possession of the mortgage loans that are sold pursuant to the Repo Agreement. Corporation B will remain as the servicer of the mortgages under the Repo Agreement and, in the event of default on any mortgage, will enforce the mortgage terms in Taxpayer's name. As the mortgage loan servicer, Corporation B will remit to Taxpayer amounts due on the Repo Agreement and retain any excess received on the mortgage payments.

Taxpayer may engage in a number of transactions with Corporation B pursuant to the Repo Agreement at the same time. Each transaction will involve different pools of mortgage loans. Each transaction under the Repo Agreement effectively will be collateralized by a separate, discrete pool of mortgage loans in the form sold to fund that transaction. In the event of a default under one transaction made pursuant to the Repo Agreement, each of the other mortgage pools, to the extent that it represents excess collateral for its loan, would act as additional security for the other transactions between Taxpayer and Corporation B under the Repo Agreement.

The mortgage loans will have initial stated terms of a to b years. The average term of the advances on the Repo Agreement is about c days. Each principal advance of funds that Taxpayer makes to Corporation B on the Repo Agreement will have a stated term of no longer than d days.

**Law and Analysis:**

To qualify as a REIT, an entity must derive at least 75 percent of its gross income from sources listed in section 856(c)(3). Among the sources of income that qualify under section 856(c)(3) is interest on obligations secured by mortgages on real property or on interests in real property.

Section 856(c)(4)(A) provides that at the close of each quarter of the taxable year at least 75 percent of a REIT's total assets must be represented by real estate assets, cash and cash items (including receivables), and Government securities. Section 856(c)(4)(B) provides, in relevant part, that at the end of each quarter of a taxable year, not more than 25 percent of the value of a REIT's total assets may be represented by securities; not more than five percent of the REIT's total assets may be represented by securities of any one issuer; and a REIT may not hold securities possessing more than 10 percent of the total voting power or value of the outstanding securities of a single issuer.

Section 856(c)(5)(B) defines the term "real estate assets," in part, to mean 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. Section 1.856-3(d) of the Income Tax regulations 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. Section 1.856-3(e) provides that the term "securities" does not include "real estate assets" as defined in section 856.

Rev. Rul. 80-280, 1980-2 C.B. 207, concerns a REIT that made loans to commercial real estate developers (the "developer loans"). The developer loans were nonrecourse except for the security of commercial mortgages made to third party owners of real property that were assigned to the REIT by the developers as collateral. The balances of the developer loans would never exceed the unpaid balance of the assigned mortgages. To perfect its security interest in the assigned mortgages, the REIT took custody of them. As holder of the assigned mortgages, the REIT was able to enforce payment in its own name if an original mortgagor defaulted. The REIT collected all amounts due from the original mortgagors. From these amounts, the REIT retained the interest due on the developer loans and remitted the balance to the developers. Rev. Rul. 80-280 holds that the developer loans (commonly referred to as hypothecation loans) qualify as real estate assets under section 856, and the interest on the developer loans qualifies as "interest on obligations secured by mortgages on real property".

The terms of the Repo Agreement between Taxpayer and Corporation B are comparable to the terms of the loans made by the REIT to developers in Rev. Rul. 80-280. The Repo Agreement provides that the assignment and sale of the underlying mortgage loans will be made on a nonrecourse basis and the outstanding balance of principal and accrued interest of the advances made under the Repo Agreement will not exceed the fair market value of the real estate securing the mortgage loans. Additionally, any default on a mortgage loan held as collateral will be enforced by Corporation B in Taxpayer's name.

Accordingly, based on the information submitted and representations made, we conclude that if the fair market value of the collateral securing the Repo Agreement continues to exceed the principal and accrued interest of the obligations issued by Corporation B pursuant to the Repo Agreement, interest paid by Corporation B to Taxpayer under the Repo Agreement will qualify as interest on obligations secured by mortgages on real property or on interests in real property within the meaning of section 856(c)(3)(B). Consequently, the Repo Agreement constitutes a real estate asset within the meaning of section 856(c)(5)(A) and is not a security for purposes of the REIT assets tests under section 856(c)(4).

Except as specifically ruled upon above, no opinion is expressed concerning any federal income tax consequences relating to the facts herein under any other provision of the Code. Specifically, we do not rule whether Taxpayer will otherwise qualify as a REIT under part II of subchapter M of Chapter 1 of the Code.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent. In accordance with the Power of

Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely yours,

William E. Coppersmith
William E. Coppersmith
Chief, Branch 2
Office of Associate Chief Counsel
(Financial Institutions & Products)