

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; 1.856-6, 1.860G-2, 1.1001-3, 301.7701-2, 301.7701-3, 301.7701-4.)

Rev. Proc. 2020-26

SECTION 1. PURPOSE

This revenue procedure describes safe harbors under which modifications to certain mortgage loans in connection with a forbearance program, described in section 2 of this revenue procedure, are not treated as replacing the unmodified obligation with a newly issued obligation, as giving rise to prohibited transactions, or as manifesting a power to vary for purposes of determining the Federal income tax status of certain securitization vehicles that hold the loans. This revenue procedure also describes a safe harbor under which certain securitization vehicles are not treated as having improper knowledge of an anticipated default on the grounds that they acquired a mortgage loan with respect to which the borrower had participated in a forbearance program.

SECTION 2. BACKGROUND—FORBEARANCE PROGRAMS

.01 On March 27, 2020, the President signed into law the Coronavirus Aid, Relief, and Economic Security Act, Pub. L. No. 116-136, 134 Stat. 281 (2020) (CARES Act). Under Division A of Title IV of the CARES Act, the term “COVID-19 emergency” means the national emergency concerning the novel coronavirus disease (COVID–19) outbreak declared by the President on March 13, 2020, under the National Emergencies Act (50 U.S.C. 1601 et seq.). See sections 4022(a)(1) and 4023(f)(4) of the CARES Act. The CARES Act provides, among other things, that during the covered period, borrowers with Federally backed mortgage loans and multifamily borrowers with Federally backed multifamily mortgage loans experiencing a financial hardship due, directly or indirectly, to the COVID-19 emergency may request and obtain forbearance on their loans. See sections 4022 and 4023 of the CARES Act.

.02 For Federally backed multifamily mortgage loans, the CARES Act defines the term “covered period” to be the period beginning on the date of its enactment (March 27, 2020) and ending on the earlier of the termination date of the COVID-19 emergency or December 31, 2020. See section 4023(f)(5) of the CARES Act. For Federally backed mortgage loans, however, there is no corresponding statutory definition of “covered period” in section 4022 of the CARES Act.

.03 Section 4022(a)(2) of the CARES Act defines the term “Federally backed mortgage loan” to include any loan that is secured by a first or subordinate lien on residential real property (including individual units of condominiums and cooperatives) designed principally for the occupancy of from 1- to 4- families and that is (A) insured by the Federal Housing Administration under title II of the National Housing Act (12 U.S.C.

1707 et seq.); (B) insured under section 255 of the National Housing Act (12 U.S.C. 1715z–20); (C) guaranteed under section 184 or 184A of the Housing and Community Development Act of 1992 (12 U.S.C. 1715z–13a, 1715z–13b); (D) guaranteed or insured by the Department of Veterans Affairs; (E) guaranteed or insured by the Department of Agriculture; (F) made by the Department of Agriculture; or (G) purchased or securitized by the Federal Home Loan Mortgage Corporation or the Federal National Mortgage Association.

.04 Upon a request by a borrower with a Federally backed mortgage loan experiencing a financial hardship due to the COVID-19 emergency for a forbearance on such loan, the borrower’s servicer shall provide the forbearance for up to 180 days, which may be extended for an additional period of up to 180 days at the request of the borrower, provided that, the borrower’s request for an extension is made during the covered period, and, at the borrower’s request, either the initial or extended period of forbearance may be shortened. See section 4022(b)(2) and (c)(1) of the CARES Act. During the period of forbearance, no fees, penalties, or interest beyond the amounts scheduled or calculated as if the borrower made all contractual payments on time and in full under the terms of the mortgage contract shall accrue on the borrower’s account. See section 4022(b)(3) and (c)(1) of the CARES Act.

.05 The term “multifamily borrower” means a borrower with a residential mortgage loan that is secured by a lien against a property comprising 5 or more dwelling units. See section 4023(f)(3) of the CARES Act. The term “Federally backed multifamily mortgage loan” includes any loan (other than temporary financing such as a construction loan) that (A) is secured by a first or subordinate lien on residential

multifamily real property designed principally for the occupancy of 5 or more families, including any such secured loan the proceeds of which are used to prepay or pay off an existing loan secured by the same property; and (B) is made in whole or in part, or insured, guaranteed, supplemented, or assisted in any way, by any officer or agency of the Federal Government or under or in connection with a housing or urban development program administered by the Secretary of Housing and Urban Development or a housing or related program administered by any other such officer or agency, or is purchased or securitized by the Federal Home Loan Mortgage Corporation or the Federal National Mortgage Association. See section 4023(f)(2) of the CARES Act.

.06 Upon receipt of an oral or written request for forbearance from a multifamily borrower with a Federally backed multifamily mortgage loan that was current on its payments as of February 1, 2020, and that is experiencing a financial hardship during the COVID-19 emergency, a servicer shall (A) document the financial hardship; (B) provide the forbearance for up to 30 days; and (C) subject to satisfying certain conditions, extend the forbearance for up to 2 additional 30 day periods. See section 4023(b) and (c)(1) of the CARES Act. A multifamily borrower shall have the option to discontinue the forbearance at any time. See section 4023(c)(2) of the CARES Act.

.07 Comments received by the Department of the Treasury (Treasury Department) and the Internal Revenue Service (IRS) have indicated that many holders and servicers of mortgage loans that are not Federally backed mortgage loans or Federally backed multifamily mortgage loans (non-Federally-backed mortgage loans) intend, either voluntarily or through a State-mandated loan forbearance program (in either case, a “program”), to provide forbearances for the next three to six months on non-Federally-

backed mortgage loans to borrowers that are experiencing a financial hardship due, directly or indirectly, to the COVID-19 emergency. These programs often contemplate related modifications in addition to the forbearance itself. For example, loan payments deferred as result of the forbearance may be added to the principal amount of the loan to be paid by the borrower after what would otherwise be the final payment on the loan. Other programs contemplate that, at the end of the forbearance period, an amortizing loan will be reamortized to preserve the original maturity date.

.08 Many Federally backed mortgage loans, Federally backed multifamily mortgage loans, and non-Federally-backed mortgage loans are held in securitization vehicles such as investment trusts and real estate mortgage investment conduits (REMICs). See generally, sections 860A through 860G of the Internal Revenue Code (Code).

.09 Comments received by the Treasury Department and the IRS have requested guidance on: (1) whether the forbearance of Federally backed mortgage loans, Federally backed multifamily mortgage loans, and non-Federally-backed mortgage loans held by investment trusts and REMICs will jeopardize the Federal tax qualifications of the securitization vehicles; and (2) whether Federally backed mortgage loans, Federally backed multifamily mortgage loans, and non-Federally-backed mortgage loans for which servicers have provided forbearances to borrowers that are experiencing financial hardship due to the COVID-19 emergency may be acquired by a REMIC without the acquiring REMIC being treated as having improper knowledge of an anticipated default for purposes of the rules governing REMIC foreclosure property.

SECTION 3. BACKGROUND—REMICs

.01 REMICs are widely used securitization vehicles for mortgages. REMICs are governed by sections 860A through 860G of the 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. See 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 The principal amount of a regular interest generally may not be contingent. See § 1.860G-1(a)(5). Notwithstanding this general rule, § 1.860G–1(b)(3) lists certain contingencies affecting the payment of principal and interest, including defaults on qualified mortgages and permitted investments, unanticipated expenses incurred by the REMIC, or lower than expected returns on permitted investments, that do not prevent an interest in a REMIC from being a regular interest.

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

.06 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. See § 1.860D–1(b)(3)(ii).

.07 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.

.08 In addition, status as a qualified mortgage depends in part on the collateral securing the obligation on its origination date. See § 1.860G-2(a)(1).

.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.

.10 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.

.11 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 REMIC qualification if the modified loans are retained by the entity and their presence causes less than substantially all of the entity’s assets to be qualified mortgages.

.12 Certain loan modifications, however, are not treated as resulting in a newly issued obligation 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.

.13 Under section 860G(a)(5), a REMIC’s permitted investments include any (a) cash flow investment, (b) qualified reserve asset, or (c) foreclosure property. “Foreclosure property” means property---(A) which would be foreclosure property under section 856(e) (without regard to paragraph (5) thereof) if acquired by a real estate

investment trust, and (B) which is acquired in connection with the default or imminent default of a qualified mortgage held by the REMIC. See Section 860G(a)(8).

.14 A REMIC cannot treat property as foreclosure property if the loan with respect to which the default occurs (or is imminent) was acquired by the REMIC with an intent to evict or foreclose, or when the REMIC knew or had reason to know that default would occur (improper knowledge). See § 1.856-6(b)(3).

.15 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). The receipt of any income attributable to any asset which is not a permitted investment is a prohibited transaction. Section 860F(a)(2)(B).

.16 Under section 860C(b)(1), “[t]he 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 the following transactions:

.01 For mortgage loans held by REMICs or investment trusts—

(1) Forbearances of any Federally backed mortgage loans or Federally backed multifamily mortgage loans provided under sections 4022 or 4023 of the CARES Act, respectively, and all related modifications, and

(2) Forbearances (and all related modifications) that are not described in section 5.01(1) of this revenue procedure, that are provided by a holder or servicer, that are agreed to by the borrower of any Federally backed or non-Federally-backed mortgage loan, and that are made under forbearance programs for borrowers experiencing a financial hardship due, directly or indirectly, to the COVID-19 emergency. For this purpose, forbearance programs are programs that are identical or similar to those described in section 2.07 of this revenue procedure pursuant to which, between

March 27, 2020, and December 31, 2020, inclusive, the borrower requests or agrees to the forbearance (and all related modifications).

.02 The direct or indirect acquisition by a REMIC on or after March 27, 2020, of—

(1) Any Federally backed mortgage loans, and any Federally backed multifamily mortgage loans, with respect to which the borrower received a forbearance under section 4022 or 4023 of the CARES Act, respectively; and

(2) Any mortgage loans not described in section 5.02(1) of this revenue procedure for which—

(a) Between March 27, 2020, and December 31, 2020, inclusive, the borrower requested or agreed to a forbearance; and

(b) The forbearance was granted under a forbearance program that is for borrowers experiencing a financial hardship due to the COVID-19 emergency and that is identical or similar to those described in section 2.07 of this revenue procedure.

Loans described in this section 5.02 are hereinafter referred to as “forbearance loans.”

SECTION 6. APPLICATION

.01 For mortgage loans held by REMICs, forbearances (and all related modifications) described in section 5.01 of this revenue procedure—

(1) Are not treated as resulting in a newly issued mortgage loan for purposes of § 1.860G-2(b)(1);

(2) Are not prohibited transactions under section 860F(a)(2); and

(3) Do not result in a deemed reissuance of the REMIC regular interests.

.02 For mortgage loans held by investment trusts, forbearances (and all related modifications) do not manifest a power to vary the investment of the certificate holders if the forbearances (and all related modifications)—

(1) Are described in section 5.01(1) of this revenue procedure; or

(2) Are described in section 2.07 of this revenue procedure and that relief was requested or agreed to between March 27, 2020, and December 31, 2020, and granted as a result of a borrower experiencing a financial hardship due to the COVID-19 emergency.

.03 If a forbearance loan described in section 5.02 of this revenue procedure is acquired by a REMIC—

(1) That prior forbearance (and all related modifications) are not treated as evidence that the REMIC had improper knowledge of an anticipated default under § 1.856-6(b)(3); and

(2) That prior forbearance (and all related modifications) are not taken into account in the determination of the origination date of the mortgage loan for purposes of § 1.860G-2(a)(1).

.04 For mortgage loans held by REMICs, delays and shortfalls in payments associated with or caused by forbearances (and any related modifications) described in section 5.01 of this revenue procedure are contingencies under § 1.860G-1(b)(3)(ii) that can be disregarded. As a result, an interest in a REMIC does not fail to be a regular interest because of such contingencies. For this purpose, contingencies that can be disregarded include excess fees paid for specially serviced loans, an inability of a

servicer to advance funds, or payments that are subject to forbearance not accruing compound interest.

SECTION 7. NO INFERENCES ON LAW

.01 No inference should be drawn about whether similar consequences would obtain if a transaction falls outside the limited scope of this revenue procedure.

.02 Furthermore, there should be no inference that, in the absence of this revenue procedure, transactions within its scope would have impaired the Federal tax status of securitization vehicles, would have given rise to prohibited transactions, or would have involved improper knowledge.

SECTION 8. DRAFTING INFORMATION

The principal authors of this revenue procedure are Diana Imholtz and Michael Chin of the Office of Associate Chief Counsel (Financial Institutions and Products). For further information, contact Mr. Chin at (202) 317-6842 (not a toll-free call).