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CLIENT ALERT

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IRS Issues Revenue Procedure Regarding Mortgage Loan Modifications

On May 16, 2008, the Internal Revenue Service ("IRS") issued Revenue Procedure 2008-28 (the "Revenue Procedure") in order to provide guidance regarding the impact of certain modifications made to loans held by real estate mortgage investment conduits ("REMICs") and fixed investment trusts ("grantor trusts"). The Revenue Procedure provides issuers and servicers greater flexibility to implement loan modifications under a foreclosure prevention program.

Under the Revenue Procedure, loan modifications meeting certain criteria will not result in taxes and potential loss of REMIC or grantor trust status that could otherwise result from proactive modifications prior to defaults. The Revenue Procedure addresses foreclosure prevention programs that have shown success in determining borrowers that are likely to benefit from proactive loan modifications and that are likely to go into foreclosure if the terms of the loan remain unmodified. The modifications that are effected pursuant to these foreclosure prevention programs may include interest rate reductions, principal forgiveness, extensions of maturity and alterations in the timing of an interest rate reset.

The Revenue Procedure applies if all of the following conditions are met:

- the real property securing the mortgage loan is a residence that contains fewer than five dwelling units and is owner-occupied;
- if a REMIC holds the mortgage loan, then either as of the start-up date or as of the end of the threee-month period beginning on the start-up date, no more than 10 percent of the stated principal balances of the total assets of the REMIC consist of mortgage loans that were 30 days or more delinquent;
- if a grantor trust holds the mortgage loan, then as of all dates when assets were contributed to the grantor trust, no more than 10 percent of the stated principal balances of all the debt instruments then held by the grantor trust consisted of debt instruments that were 30 days or more delinquent;
- the holder or servicer has a reasonable belief that there is a significant risk of foreclosure of the original loan, and such reasonable belief is based either on guidelines developed as part of a foreclosure prevention program or on any other credible systematic determination;
- the terms of the modified loan are less favorable to the holder than were the unmodified terms of the original mortgage loan; and

- the holder or servicer reasonably believes that the modified loan presents a substantially reduced risk of foreclosure as compared to the original loan.

Modifications made in accordance with the conditions in the Revenue Procedure that are made on or before December 31, 2010 will not adversely impact the tax classification of the related REMIC or grantor trust. Specifically, the Revenue Procedure provides that, in the case of one or more modifications described in the Revenue Procedure:

- the IRS will not challenge REMIC qualification on the grounds that the modifications resulted in significant modifications of the REMIC's qualified mortgages;
- the IRS will not contend that the modifications cause prohibited transactions in a REMIC;
- the IRS will not challenge grantor trust qualification on the grounds that the modifications manifest a "power to vary the investment of the certificate holders"; and
- the IRS will not challenge REMIC qualification on the grounds that the modifications resulted in a deemed reissuance of the REMIC regular interests.

The Revenue Procedure was effective on May 16, 2008. The IRS has asked for comments to the Revenue Procedure by July 15, 2008.

If you would like to receive more information about the Revenue Procedure, please contact George C. Howell, III at (804) 788-8793 or ghowell@hunton.com, or Cecelia Philipps Horner at (804) 788-7394 or chorner@hunton.com.