Part III -- Administrative, Procedural, and Miscellaneous

Allocation of Prepaid Qualified Mortgage Insurance Premiums for 2007

Notice 2008-15

PURPOSE

This notice provides guidance to individual taxpayers on how to allocate prepaid qualified mortgage insurance premiums to determine the amount of the prepaid premium a taxpayer may deduct in 2007 under § 163(h)(4)(F) of the Internal Revenue Code (the “Code”).

This notice also provides guidance to reporting entities receiving prepaid qualified mortgage insurance premiums in 2007.

BACKGROUND

Section 163(a) of the Code generally allows a deduction for all interest paid or accrued within the taxable year on indebtedness. However, § 163(h)(1) provides that in the case of a taxpayer other than a corporation, no deduction shall be allowed for personal interest paid or accrued during the taxable year. Section 163(h)(2)(D) excludes qualified residence interest from the definition of personal interest.

Section 163(h)(3)(A) defines qualified residence interest, in part, as interest paid or accrued during the taxable year on acquisition indebtedness with respect to any qualified residence of the taxpayer. The determination of whether any property is a qualified residence of the taxpayer is made as of the time the interest is accrued.

Section 163(h)(4)(A) defines a qualified residence as the taxpayer's principal residence and one other property that the taxpayer designates as a residence for purposes of § 163(h)(4) for the taxable year and that the taxpayer uses as a residence (within the meaning of § 280A(d)(1)). This general rule is subject to several special rules contained in § 163(h)(4).

Section 163(h)(3)(B) defines acquisition indebtedness as any indebtedness that is incurred in acquiring, constructing, or substantially improving any qualified residence of the taxpayer and is secured by such residence. Acquisition indebtedness includes indebtedness secured by the residence resulting from the refinancing of indebtedness meeting the requirements of the preceding sentence (or this sentence); but only to the extent the amount of the indebtedness resulting from the refinancing does not exceed the amount of the refinanced indebtedness. The aggregate amount treated as acquisition indebtedness for any period may not exceed $1,000,000 ($500,000 in the case of a married individual filing a separate return).

Section 419 of the Tax Relief and Health Care Act of 2006, Pub. L. No. 109-432, 120 Stat. 2967 (the "Act"), added provisions to §§ 163(h)(3) and 163(h)(4) to treat qualified mortgage insurance premiums paid or accrued in 2007 for qualified mortgage insurance contracts issued in 2007 as deductible qualified residence interest. In the case of prepaid qualified mortgage insurance premiums, the deduction is limited to the amount allocable to 2007. The allocable amount may be reduced or eliminated under § 163(h)(3)(E)(ii), which provides that the amount allowed as a deduction is phased out ratably by 10 percent for each $1,000 ($500 in the case of a married individual filing a separate return) the taxpayer's adjusted gross income exceeds $100,000 ($50,000 in the case of a married individual filing a separate return). Prior to enactment of section 419 of the Act, taxpayers could not deduct premiums paid for mortgage insurance as qualified residence interest.

Section 163(h)(3)(E) provides that premiums paid or accrued for qualified mortgage insurance in connection with acquisition indebtedness for a qualified residence are treated as qualified residence interest for purposes of § 163.

Section 163(h)(4)(E) defines qualified mortgage insurance as --

> (i) mortgage insurance provided by the Veterans Administration, the Federal Housing Administration, or the Rural Housing Administration,[1] and (ii) private mortgage insurance (as defined by section 2 of the Homeowners Protection Act of 1998 (12 U.S.C. § 4901), as in effect on December 20, 2006, the date § 163(h)(4)(E) was enacted).

Section 163(h)(4)(F) states that any amount paid by the taxpayer for qualified mortgage insurance that is properly allocable to any mortgage the payment of which extends to periods that are after the close of the taxable year in which such amount is paid shall be chargeable to capital account and shall be treated as paid in such periods to which so allocated. No deduction shall be

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[1] References in § 163(h)(4)(e)(i) to the Veterans Administration ("VA") and Rural Housing Administration ("Rural Housing"), are interpreted to mean their respective successors, the Department of Veterans Affairs and Rural Housing Service.

allowed for the unamortized balance of such account if such mortgage is satisfied before the end of the term. The preceding sentences shall not apply to amounts paid for qualified mortgage insurance provided by the VA or Rural Housing.

Section 419 of the Act also added § 6050H(h) to the Code, which generally provides that any person who, in the course of a trade or business, receives from any individual premiums for mortgage insurance aggregating $600 or more for any calendar year, shall make an information return in the form prescribed by the Secretary. For 2007, qualified mortgage insurance premiums should be reported in box 4 on Form 1098, *Mortgage Interest Statement*. The Instructions for Form 1098 state that, except for amounts paid to the VA or Rural Housing, payments allocable to periods after 2007 are treated as paid in the periods to which they are allocable.

Generally, under § 6724(a) a failure to file a correct information return shall not be subject to a penalty if it is shown that such failure is due to reasonable cause and not to willful neglect. Under § 301.6724-1(a)(2)(i) of the Procedure and Administration Regulations, a penalty is waived for reasonable cause if the filer establishes that there are significant mitigating factors with respect to the failure. Section 301.6724-1(b)(1) provides that a significant mitigating factor includes the fact that, prior to the failure to file, the filer was never required to file the particular type of return or to furnish the particular type of statement with respect to which the failure occurred.

ALLOCATION OF PREPAID QUALIFIED MORTGAGE INSURANCE PREMIUMS UNDER § 163(h)(4)(F) PAID IN 2007

The Department of the Treasury (the “Treasury”) and the Internal Revenue Service (the “IRS”) have received comments on the implementation of section 419 of the Act. Notwithstanding the general rules for the treatment of qualified residence interest (for example, the period over which certain points paid to refinance a mortgage are allocable), the Treasury and IRS have determined, as a matter of administrative convenience, to provide the following guidance on the treatment of prepaid qualified mortgage insurance premiums.

In the case of an individual taxpayer who, in 2007, obtained a mortgage qualifying as acquisition indebtedness on a qualified residence and, in connection with that mortgage, paid (by cash or financing, without regard to source) a qualified mortgage insurance premium for private mortgage insurance or mortgage insurance provided by the Federal Housing Administration issued in 2007 but extending beyond 2007, the taxpayer may allocate the prepaid premium ratably over the shorter of --

(1) the stated term of the mortgage, or

(2) 84 months, beginning with the month in which the insurance was obtained,

to determine the amount treated as deductible qualified residence interest for 2007 (the “allocation method”). The individual taxpayer may have to contact the issuer of the Form 1098 to ascertain the manner in which the premium amount was reflected in box 4.

The Treasury and IRS have determined 84 months to be an appropriate allocation period after reviewing comments received from representatives of the mortgage insurance industry.

REPORTING REQUIREMENTS FOR 2007 FOR ENTITIES RESPONSIBLE FOR REPORTING PREPAID QUALIFIED MORTGAGE INSURANCE PREMIUMS

A reporting entity that receives, from an individual, qualified mortgage insurance premiums of $600 or more in 2007 is required to file the 2007 Form 1098. For prepaid qualified mortgage insurance premiums, except for amounts paid to the VA or Rural Housing, the entity should report in box 4 of the Form 1098 the portion of the amount received that is allocable to 2007, as provided in the instructions to the form. However, an entity reporting either the amount actually received or the amount determined under the 84-month allocation method described above will be deemed to meet the requirements of § 6724(a).

REQUEST FOR COMMENTS

This notice provides transitional relief for individual taxpayers and reporting entities for 2007. Section 3 of the Mortgage Forgiveness Debt Relief Act of 2007, Pub. L. No. 110-142, 121 Stat. 1803, which was enacted on December 20, 2007, contains a provision extending the deductibility of qualified mortgage insurance premiums under § 163(h)(3)(E) through 2010. The Treasury and IRS request comments regarding the appropriate allocation method and reporting requirements that should apply to future years.

Written comments in response to this notice should be submitted no later than March 28, 2008, to the Internal Revenue Service, CC:PA:LPD:RU (Notice 2008-15), room 5203, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand carried between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:RU (Notice 2008-15), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW, Washington, DC 20224. Alternatively, comments may be submitted via the Internet at Notice.Comments@irscounsel.treas.gov in which case "Notice 2008-15" should be in the subject line. All submissions will be available for public inspection and copying in their entirety. Therefore, submissions received by the IRS should not include taxpayer-specific information of a confidential nature. Submissions should include the name and telephone number of a person to contact.

DRAFTING INFORMATION

The principal author of this notice is Charles H. Kim of the Office of Associate Chief Counsel (Income Tax and Accounting). For further information regarding this notice, contact Charles H. Kim at (202) 622-5020 (not a toll free call).