Part III – Administrative, Procedural, and Miscellaneous

SAFE HARBOR REPORTING METHOD FOR ELIGIBLE REMICS REQUIRED TO REPORT ON SCHEDULE Q INFORMATION WITH RESPECT TO REMIC ASSETS

Notice 2012-5

PURPOSE

This notice provides a safe harbor reporting method that an eligible real estate mortgage investment conduit (REMIC) may use to satisfy its reporting obligations under § 1.860F-4(e)(1)(ii) of the Income Tax Regulations with respect to information regarding REMIC assets that the REMIC must report to residual interest holders on a Schedule Q (Form 1066), Quarterly Notice to Residual Interest Holder of REMIC Taxable Income or Net Loss Allocation (Schedule Q).

THE HOME AFFORDABLE REFINANCE PROGRAM (HARP)

In April 2009, the Federal Housing Finance Agency (FHFA) and the United States Department of the Treasury introduced the Home Affordable Refinance 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.

LAW

REMICs are widely used securitization vehicles for mortgages. REMICs are governed by sections 860A through 860G of the Internal Revenue Code. 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).

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. In general, the term "qualified mortgage" means an obligation that is principally secured by an interest in real property. See section 860G(a)(3)(A). That is, an obligation secured by an "interest in real property" is not a qualified mortgage unless the obligation is "principally secured" by such an interest.

An obligation is "principally secured" if the fair market value of the interest in real property securing the obligation equals at least 80 percent of the adjusted issue price of the obligation (the 80-percent test). See § 1.860G-2(a)(1). The regulations require the 80-percent test to be satisfied either at the time the obligation was originated or at the time the sponsor contributes the obligation to the REMIC. After the startup day, the regulations generally do not require retesting of the value of the interest in real property that secures the obligation.

The REMIC regulations cross-reference the real estate investment trust (REIT) regulations to define the term "interest in real property." Specifically, § 1.860G-2(a)(4) provides that the definition of "interests in real property" in § 1.856–3(c) and the definition of "real property" in § 1.856–3(d) apply for purposes of section 860G(a)(3) and § 1.860G-2(a). In addition, a mortgage pass-thru certificate that is guaranteed by Fannie Mae or Freddie Mac is included as an obligation secured by an interest in real property for purposes of section 860G(a)(3)(A). See § 1.860G-2(a)(5).

Section 1.860F-4(e) provides that, at the close of each calendar quarter, a REMIC must provide to each person who held a residual interest in the REMIC during that quarter notice on Schedule Q of certain information, including information with respect to REMIC assets. Under § 1.860F-4(e)(1)(ii)(A), a REMIC must provide to each of its residual interest holders the following information: (1) the percentage of REMIC assets that are described in section 7701(a)(19) (Category 1); and (2) the percentage of REMIC assets that are real estate assets defined in section 856(c)(5)(B) (Category 2),[1] computed by reference to the average adjusted basis (as defined in section 1011) of the REMIC assets during the calendar quarter.[2] If the percentage of REMIC assets

[1] The regulation refers to former section 856(c)(6)(B). Section 1255 of the Taxpayer Relief Act of 1997 (P.L. 105-34) redesignated former section 856(c)(6)(B) as current section 856(c)(5)(B).

[2] Section 1.860F-4(e)(1)(ii)(A) also requires a REMIC to provide information with respect to the percentage of REMIC assets that are qualifying real property loans under section 593. Section 1616(a) of

represented by either Category 1 or Category 2 is at least 95 percent, then the REMIC need only specify on Schedule Q that the percentage for that category was at least 95 percent (the 95-percent asset-reporting test).

Under § 1.860F-4(e)(1)(ii)(B), if, for any calendar quarter after 1988, the 95-percent asset-reporting test is not met with respect to assets in Category 2 (that is, real estate assets as defined in section 856(c)(5)(B)), then for that calendar quarter, the REMIC must provide the following additional information to any REIT that holds a residual interest:

(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)),

(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)) that is 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

---

the Small Business Job Protection Act of 1996 (P. L. 104-188), however, repealed the section 593 reserve method of accounting for bad debts of thrift institutions for tax years beginning after December 31, 1995. Accordingly, whether assets are “qualifying real property loans under section 593” is no longer relevant, and the reporting of this information to residual interest holders is unnecessary.

section 856(e) (which otherwise would determine the income or gain that is described in section 856(c)(3)(F)).

Section 1.860G–2(a)(1) generally treats a mortgage loan as an obligation "principally secured by an interest in real property" for purposes of section 860G(a)(3) if the loan is secured by an interest in real property that is worth at least 80 percent of the outstanding stated principal of the loan (in other words, the loan-to-value ratio of the loan—commonly referred to as "LTV"—is not greater than 125 percent).[3] If, however, a REMIC holds one or more qualified mortgages that are less than 95–percent secured by an interest in real property, the REMIC may fail the 95-percent asset-reporting test and may be required to report additional information to residual interest holders with respect to the REMIC assets.

SAFE HARBOR REPORTING METHOD

As a safe harbor for purposes of a REMIC's reporting obligation to residual interest holders under § 1.860F-4(e)(1)(ii), if a REMIC is an "eligible REMIC" as defined below and if the percentage of its assets represented by either Category 1 or Category 2 is less than 95 percent but at least 80 percent, then the REMIC need only specify on Schedule Q that the percentage for that category was at least 80 percent.

To qualify as an "eligible REMIC" under this notice—

(1) The REMIC must have a guarantee from Fannie Mae or Freddie Mac that will supplement amounts received by the REMIC as required to

[3] In general, the adjusted issue price of a home mortgage loan is equal to or slightly less than the outstanding stated principal of the loan. Thus, although LTV is based on stated principal rather than on adjusted issue price, if LTV is not greater than 125 percent, then the criterion for "principally secured" will generally be satisfied (that is, the value of the real property collateral will be at least 80 percent of the adjusted issue price).

permit the payment of principal and interest, as applicable, on both the regular interests and residual interests issued by the REMIC; and

(2) 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.

See also Rev. Proc. 2012-14, this bulletin, for guidance to REITs that hold a regular or residual interest in an eligible REMIC.

EFFECTIVE DATE

The safe harbor reporting method described in this notice applies to reporting for calendar quarters ending on or after December 31, 2011.

DRAFTING INFORMATION

The principal author of this notice is Diana Imholtz of the Office of Associate Chief Counsel (Financial Institutions and Products). For further information regarding this notice, contact Ms. Imholtz at 202-622-3920 (not a toll-free call).