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Department of the Treasury
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PLR-145877-05
Date: March 6, 2006

Legend:

Taxpayer =

Dear :

This is in reply to a letter dated August 31, 2005, and subsequent correspondence, requesting rulings that (1) certain classes of pass-through certificates to be issued by a fixed investment trust qualify as “stripped coupons” or “stripped bonds” within the meaning of § 1286 of the Internal Revenue Code, and (2) the trust will be classified as a fixed investment trust under § 301.7701-4(c) of the Income Tax Regulations.

Facts:

Taxpayer is seeking to market fixed or variable rate pass-through certificates by using a vehicle that qualifies as a fixed investment trust and holds all or a portion of a single class of pass-through certificates issued by an investment trust that represent an undivided interest in real estate mortgages (“Grantor Trust Certificates”) or holds all or a portion of a single class of REMIC regular interests (“REMIC Regular Interests” and, together with the Grantor Trust Certificates, “Contributed Assets”). Taxpayer intends to sponsor a newly-formed trust (“Trust”) by contributing the Contributed Assets to the Trust in exchange for multiple classes of pass-through certificates (“Certificates”). The Contributed Assets, which Taxpayer represents are indebtedness or ownership interests in indebtedness for federal income tax purposes, may pay interest at a fixed or variable rate. The Certificates will represent rights to different portions of the principal and interest payments on the underlying Contributed Assets.

The Trust will be a passive trust. There will be no power under the Trust agreement to vary the investment of Certificate holders. The Trust will hold the

Contributed Assets, collect cash payments thereon, and pass the payments through to Certificate holders on monthly payment dates, except that a portion of the payments will be used to pay arm's-length fees for servicing and trust administration, and possibly fees for guarantees of payments on the Certificates or other credit support ("Administrative Costs"). The Trust will have the power to pursue remedies and enforce rights with respect to its assets in the event of a default.

The Certificates will represent collectively a 100 percent beneficial ownership interest in the Trust. They will be issued in multiple classes that will be separately assignable. Each class will provide for monthly distributions of interest calculated by applying a pass-through rate to the Certificate principal balance. Each Certificate within a class will be entitled to a pro rata portion of payments allocated to the class.

The Certificates will pay interest at a fixed or variable rate. The Certificate classes will be fixed rate classes, floating rate classes or inverse floating rate classes. Interest payable on all of the classes will equal in the aggregate interest on the Contributed Assets less Administrative Costs. Floating rate classes will have a pass-through rate that varies directly with an interest rate index (or a multiple of an interest rate index). Inverse floating rate classes will have a pass-through rate that varies inversely with an interest rate index (or a multiple of an interest rate index). Pass-through rates may be adjusted by adding or subtracting a fixed number of basis points and may be subject to caps or floors.

The principal amount of a class may be actual or notional. An actual principal amount represents a right to receive principal payments. A notional principal amount does not create a right to principal payments but is used in computing interest distributions.

A class of Certificates may have a pass-through rate of zero. Each class with a positive pass-through rate will be entitled to a share of the interest payable on the Contributed Assets. Such share would constitute a specified portion of such interest payments if covered by the specified portion rules of § 1.860G-1. The specified portion will not vary over the life of the class (i.e., until payments are no longer made on the class, or the class is exchanged for Contributed Assets or a different class under the exchange feature of the Trust).

The Trust will have an exchange feature allowing Certificate classes to be exchanged over time. There will be three types of permitted exchanges:

(1) A redemption by the Trust of Certificates through delivery of the underlying Contributed Assets;

(2) An exchange of Certificates for Certificates with different terms representing interests in the same Contributed Assets; and

(3) A deposit of additional Contributed Assets in the Trust identical to those already held in exchange for new Certificates representing an interest in those Contributed Assets and in the Contributed Assets already held by the Trust.

Each exchange will be for matching amounts, in that (1) the actual principal amount of Certificates or Contributed Assets given up will equal the actual principal amount of Certificates or Contributed Assets received and (2) the aggregate pass-through rate on Certificates given up will equal the aggregate pass-through rate on Certificates received or the rate of interest less Administrative Costs on Contributed Assets received. Taxpayer represents that the exchanges will not be taxable events under § 1001 and that they involve no change in economic interests in underlying assets. Taxpayer represents that the exchanges will not cause exchanging Certificate holders or non-exchanging Certificate holders to be entitled to a differing stream of aggregate payments from differing obligors.

The exchange feature permits exchanging Certificate holders to take advantage of market opportunities that arise from differences in pricing of the whole Certificate or separate pieces thereof.

The exchanges will have no effect on the rights to principal or interest of any Certificate holder not participating in the exchange. The Trust may charge an administrative fee for an exchange.

Law and Analysis:

Section 1286 provides rules governing the tax treatment of stripped bonds and stripped coupons. Section 1286(a) treats a stripped bond or stripped coupon in the hands of a purchaser as if it were a newly issued debt instrument issued at a price equal to the purchase price. Section 1286(b) provides rules governing the person stripping a bond, including rules for allocating basis between stripped bonds or coupons that are sold and disposed of.

Section 1286(e)(3) defines a “stripped coupon” as any coupon relating to a stripped bond. A “stripped bond” is defined in § 1286(e)(2) as a bond issued at any time with interest coupons where there is a separation in ownership between the bond and any coupon which has not yet become payable. A “bond” is defined in § 1286(e)(1) to include any evidence of indebtedness. Section 1286(e)(5) defines a “coupon” as any right to receive interest on a bond (whether or not evidenced by a coupon).

Section 860B(a) provides that in determining the tax under this chapter of any holder of a regular interest in a REMIC, such interest (if not otherwise a debt instrument) shall be treated as a debt instrument.

Revenue Rulings 84-10, 1984-1 C.B. 155; 77-349, 1977-2 C.B. 20; and 74-169, 1974-1 C.B. 147, provide that the holders of a single class of certificates in a mortgage pass-through trust are treated as holding undivided interests in the pool of mortgages held by the Trust.

Revenue Ruling 91-46, 1991-2 C.B. 358, provides that a mortgage is a bond for purposes of section 1286.

Section 301.7701-4(c) provides that an investment trust with multiple classes of ownership interests ordinarily will be classified as a business entity under § 301.7701-2. However, an investment trust with multiple classes of ownership interests, in which there is no power to vary the investment of the certificate holders, will be classified as a trust if the trust is formed to facilitate direct investment in the assets of the trust and the existence of multiple classes of ownership interests is incidental to that purpose. Section 301.7701-4(c)(2), Example 4, applies this rule to a trust that holds bonds and issues certificates evidencing interests in the bonds. It provides:

> Corporation N purchases a portfolio of bonds and transfers the bonds to a bank under a trust agreement. At the same time, the trustee delivers to N certificates evidencing interests in the bonds. These certificates are sold to public investors. Each certificate represents the right to receive a particular payment with respect to a specific bond. Under section 1286, stripped coupons and stripped bonds are treated as separate bonds for federal income tax purposes. Although the interest of each certificate holder is different from that of each other certificate holder, and the trust thus has multiple classes of ownership, the multiple classes simply provide each certificate holder with a direct interest in what is treated under section 1286 as a separate bond. Given the similarity of the interests acquired by the certificate holders to the interests that could be acquired by direct investment, the multiple classes of trust interests merely facilitate direct investment in the assets held by the trust. Accordingly, the trust is classified as a trust.

A power to contribute assets to a trust that are identical to existing assets in exchange for new certificates identical to those already outstanding is not a power to vary because it does not change the economic position of existing certificate holders. *Comm'r v. Chase Nat'l Bank*, 122 F.2d 540 (2nd Cir. 1941) (an investment trust holding stocks was not an association where the depositor could make up additional units of the same number and type of stock as originally deposited).

Revenue Ruling 90-7, 1990-1 C.B. 153, provides that the redemption of pass-through certificates issued by a fixed investment trust for a pro rata share of trust assets is not a realization event for the certificate holder who goes from being a co-owner of all of the trust's assets to a sole owner of a proportionate share of the trust's assets because the redemption effects no material change in his position.

Conclusion:

Based on the information submitted and representations made, we conclude that (1) with the qualification stated in the following sentence, the classes of Certificates to be issued by the Trust (holding all or a portion of a single class of pass-through certificates issued by an investment trust or a single class of REMIC regular interests) qualify as "stripped coupons" or "stripped bonds" within the meaning of § 1286, and (2) the Trust, if operated in accordance with the above representations, will be classified as a fixed investment trust under § 301.7701-4(c). No conclusion is expressed with respect to Certificates that represent rights to the same portions of the principal and interest payments on the underlying Contributed Assets

This ruling letter 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 Taxpayer's authorized representative.

Sincerely,

Patrick E. White
Patrick E. White
Senior Counsel, Branch 1
Office of Associate Chief Counsel
(Financial Institutions and Products)