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Department of the Treasury
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August 24, 2023

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Dear :

This is in reply to a letter dated December 6, 2022, and subsequent correspondence, requesting the following rulings:

(1) The Exchange Certificates (defined below) to be issued by the Exchange Trust (defined below) will qualify as interests in ‘stripped coupons’ or ‘stripped bonds’ within the meaning of § 1286 of the Internal Revenue Code, as amended (the “Code”) (assuming that all Exchange Certificates issued by an Exchange Trust are not held by one person); and

(2) The Exchange Trust’s Exchange Mechanism (discussed below), including the ability to exchange fixed rate Certificates (defined below) for floating and inverse floating rate Exchange Certificates, will not cause the Exchange Trust to fail to be classified as a fixed investment trust under § 301.7701-4(c) of the income tax regulations.

FACTS

Taxpayer structures a variety of mortgage-backed securities offerings pursuant to multi-class mortgage-backed securities programs maintained by Agencies. In each case, qualified mortgages[1] are conveyed to a trust (referred to herein as a "REMIC Trust" or a "Grantor Trust," each defined below) pursuant to the terms of a trust agreement in exchange for several classes of mortgage-backed pass-through certificates (each such certificate (other than the residual class) is referred to herein as a "Certificate").

For REMIC Trusts, each trust agreement requires that one or more Real Estate Mortgage Investment Conduit ("REMIC") elections be made with respect to the assets of the trust. With respect to each REMIC, one class of certificates is designated as the sole class of residual interest in the REMIC that is not entitled to distributions from the sole REMIC (or top-level REMIC in the case of a structure with tiers of REMICs). All other classes of certificates in each REMIC, referred to herein as "REMIC Certificates," are designated as classes of regular interests of the sole REMIC.[2]

For Grantor Trust transactions, qualified mortgages are conveyed to a trust that is or includes a grantor trust. These grantor trusts issue "Grantor Trust Certificates" representing discrete entitlements to income and principal.[3]

Taxpayer offers Certificates for sale to its customers pursuant to the terms of an offering document. In many Agency transactions, the owner of a Certificate has the right to deposit the Certificate in a supplemental trust (an "Exchange Trust") in exchange for a proportionate interest in newly issued classes of pass-through certificates issued by the Exchange Trust (the "Exchange Certificates") in accordance with the Exchange Mechanism discussed below. Taxpayer intends to contribute all or a portion of a single class of Certificates to an Exchange Trust in exchange for Exchange Certificates.

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[1] For purposes of this letter, the term "qualified mortgages" includes certain pass-through certificates issued by single-class pass-through trusts that are classified as trusts for federal income tax purposes as well as REMIC regular interests or grantor trust certificates indirectly representing REMIC regular interests. See §§ 860G(a)(3); 1.860G-2(a)(5).

[2] Each REMIC Certificate (other than a principal-only class) will bear interest at a fixed rate or floating rate permitted by § 1.860G-1(a)(3) or consist of a specified portion of the interest payments on qualified mortgages as described in § 1.860G-1(a)(2).

[3] Each Grantor Trust Certificate (other than a principal-only class) will bear interest at a fixed rate or floating rate or will consist of a specified portion (within the meaning of § 1.860G-1(a)(2)) of the interest payments on grantor trust certificates backed by qualified mortgages.

The Exchange Trust

The sole assets of an Exchange Trust will be all the Certificates contributed by Taxpayer. Subsequent contributions of Certificates to the Exchange Trust must be of the same class that the Exchange Trust already holds.

All distributions made with respect to Certificates held by the Exchange Trust are immediately distributed in respect of the Exchange Certificates. The aggregate principal and interest entitlements on the Exchange Certificates received will equal the aggregate principal and interest entitlements on the Certificates deposited in the Exchange Trust.

The sole activities of an Exchange Trust will consist of accepting deposits of Certificates, issuing Exchange Certificates, and distributing principal and interest received in respect of the Certificates held by the Exchange Trust to the holders of the Exchange Certificates issued by the Exchange Trust. An Exchange Trust will not have the power to reinvest amounts collected on the Certificates held by the Exchange Trust. Taxpayer represents that an Exchange Trust will not be a taxable mortgage pool and will not be an obligor of debt instruments with two or more maturities within the meaning of §§ 7701(i)(2)(A)(ii) and 301.7701(i)-1(e).

The Exchange Certificates

The Exchange Certificates each represent the right to receive a portion of the interest and principal distributions on the underlying Certificates; each class of Exchange Certificate typically has rights to distributions of principal and/or interest on the underlying Certificates that differ from those of any other class of Exchange Certificates issued in respect of the Certificates. In each case, however, the aggregate distributions of principal and interest on the various classes of Exchange Certificates outstanding on any distribution date will always equal the distributions of principal and interest on the underlying Certificates for the distribution date. Further, the aggregate principal amount of any issued Exchange Certificates will always equal the principal amount of the underlying Certificates.

The Exchange Certificates will represent collectively a 100 percent beneficial ownership interest in the Exchange Trust and will be entitled to 100 percent of all amounts distributed in respect of the Certificates held by the Exchange Trust. They will be issued in multiple classes that will be separately assignable.

Exchange Certificates may provide for principal and interest, principal-only, or interest-only entitlements. Moreover, the Exchange Certificates' interest distributions may be based on fixed rates, floating rates, or inverse floating rates. For interest-only Exchange Certificates, there will be no right to receive principal, but interest payments will be based upon a notional principal amount. Each Exchange Certificate within a class will be entitled to a pro rata portion of payments allocated to the class. All Exchange Certificates (other than principal-only classes) will provide for interest distributions based on a fixed rate, a floating rate described in § 1.860G-1(a)(3), or a specified portion[4] of the interest payments on the Certificates under § 1.860G-1(a)(2) as if the Exchange Trust were a REMIC. There exists in place a mechanism for accounting for the Exchange Certificates as separate bonds.

Exchange Certificates issued by an Exchange Trust will have the same maturity as the underlying Certificates exchanged for them. Each class of Exchange Certificates having a principal amount will receive on each distribution date a pro-rata portion of the principal distributions on the underlying Certificates based on the related principal amounts of each such class of Exchange Certificates immediately before the distribution (i.e., no Exchange Certificates will be issued in a fast-pay/slow-pay structure or with any time-tranching).

The Exchange Mechanism

The Exchange Mechanism will operate in the following manner. Certificates may be deposited in exchange for Exchange Certificates on the issue date of the Certificates or any time thereafter and may occur repeatedly. Exchange Certificates may also be deposited into an Exchange Trust at any time in exchange for a proportionate interest in the underlying Certificates or for different classes of Exchange Certificates, provided the owner holds the necessary Exchange Certificates in the correct proportion to permit the exchange.

Each exchange, including the initial deposit of the Certificates (or portion thereof) in exchange for the Exchange Certificates, will be for matching amounts, in that: (1) the aggregate principal and interest entitlements on the Exchange Certificates received will equal the aggregate principal and interest entitlements on the Certificates or Exchange Certificates deposited in the Exchange Trust and (2) the Exchange Certificates or Certificates received from the Exchange Trust will retain the same tax attributes as the Certificates or Exchange Certificates deposited in the Exchange Trust. A certificate owner will be charged a fee for each exchange, generally based on a percentage of the principal amount of the certificates exchanged.

Although an Exchange Trust can accept additional deposits of Certificates over time, the subsequent deposits of Certificates must be the same class of Certificates as is already held by the Exchange Trust. 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 further represents that the exchanges will not cause

[4] The referenced interest rate index and formula applicable to a floating or inverse floating Exchange Certificate will not vary while the Exchange Certificate is outstanding, other than any needed changes to the index to account for the cessation of LIBOR as an interest rate index or the substitution of compounded average SOFR, term SOFR, or some other SOFR variant, or other index variation per each transaction's governing documents. See generally T.D. 9961 (Jan. 4, 2022) (discussing background of LIBOR's pending cessation and generally allowing for modifications of LIBOR-referencing instruments to successor index such as SOFR to be treated as non-realization events for federal income tax purposes).

exchanging Certificate holders or non-exchanging Certificate holders to be entitled to a differing stream of aggregate payments from differing obligors. Additionally, Taxpayer represents that the exchanges will have no effect on the rights to principal or interest of any Certificate or Exchange Certificate holder not participating in the 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.

Rev. Ruls. 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.

Rev. Rul. 91-46, 1991-2 C.B. 358, provides that a mortgage is a bond for purposes of § 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. Example 4 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 (2d 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).

Rev. Rul. 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.

CONCLUSIONS

Based on the information submitted and representations made, we conclude the following:

(1) The Exchange Certificates to be issued by the Exchange Trust will qualify as interests in stripped coupons or stripped bonds within the meaning of § 1286 (assuming that all Exchange Certificates issued by an Exchange Trust are not held by one person); and

(2) The Exchange Trust's Exchange Mechanism, including the ability to exchange fixed rate REMIC Certificates or Grantor Trust Certificates for floating rate and inverse floating rate Exchange Certificates, will not cause the Exchange Trust to fail to be classified as a fixed investment trust under § 301.7701-4(c).

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination. Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

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 your authorized representative.

Sincerely,

Bernard J. Audet, Jr.
Chief, Branch 2
(Financial Institutions & Products)

cc: