

Internal Revenue Service

Department of the Treasury
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6050H.00-00

Person To Contact: _____, ID No. _____

Telephone Number: _____

Refer Reply To:
CC:PA:02
PLR-112689-11

Date:
June 28, 2011

LEGEND

Parent =

Group =

a =

b =

Dear _____ :

This letter responds to your request for ruling dated March 23, 2011, as supplemented by correspondence dated May 20, 2011, submitted on your behalf by your authorized representatives, concerning your reporting obligations with respect to certain payments made on behalf of mortgage loan borrowers. Specifically, your request concerns whether such payments will result in a significant modification of a mortgage loan pursuant to Treasury Regulation § 1.1001-3, whether such payments will constitute income and interest paid with respect to the mortgage loan borrowers, and if so, whether such payments are reportable pursuant to sections 6041 and 6050H of the Internal Revenue Code.¹

FACTS

The following facts and representations have been made on your behalf:

Parent is the common parent of an affiliated group of corporations that files a consolidated return (the "Group"). Members of the Group are engaged in the mortgage

¹ Unless otherwise stated, all section references are to the Internal Revenue Code of 1986 as of the date of this ruling (the "Code"), or the regulations issued thereunder by the U.S. Department of the Treasury ("Treas. Reg.").

lending business. As part of this business, members of the Group originate and underwrite mortgage loans, and provide servicing for residential mortgage loans that are owned by both members of the Group and third parties.

When acting as loan servicers, members of the Group manage the collection of receivables, including principal, interest and fees, from borrowers, and take action to minimize losses, including initiating foreclosure proceedings with respect to defaulted mortgages and entering into discussions with borrowers to modify or otherwise adjust the terms of mortgages. The Group performs tax reporting with respect to mortgages that it services.

Members of the Group earn fees on account of their servicing activities. As servicers, members of the Group are required to ensure that their collection and loss-minimization activities comply with federal law.

Under the Servicemembers' Civil Rights Act (the "SCRA"), members of the U.S. Armed Forces ("Servicemembers") are entitled to relief that limits the rate of interest (which, under the SCRA, is specially defined to include renewable charges and other fees) that can be charged on a mortgage loan incurred by a Servicemember before entering a period of military service to 6% per annum during the period of military service, and for one year after the end of the Servicemember's term of military service (any such mortgage, a "Covered Mortgage"). The SCRA also regulates what credit reporting may occur with respect to a Covered Mortgage, and invalidates foreclosures on Covered Mortgages during the period of military service and for nine months thereafter.

The Group has committed to go beyond the SCRA's requirements and subsidize Covered Mortgages, so that, in effect, Servicemembers will, on a going forward basis, pay an interest rate that does not exceed a% during any period during which they are eligible for benefits under the SCRA. The Group will affect this additional benefit (the "Subsidy") through a direct interest payment, made on behalf of the Servicemembers, to the owners of the Covered Mortgages equal to approximately a b% rate of interest, which is an amount equal to the difference between the statutory 6% rate and the lower a% rate. Thus, the owners of Covered Mortgages will receive the entire amount of interest that a mortgage lender is entitled to charge under the SCRA, but a% will be directly paid by the Servicemember, and the Group will pay the remaining b% of interest on behalf of the Servicemember. Servicemembers will, however, remain legally obligated for the full SCRA rate if Parent and its subsidiaries become insolvent or otherwise become unable to pay the Subsidy. In addition, owners of the mortgage loans will have no legal means by which they can require a member of the Group to pay the Subsidy. The terms of the Covered Mortgages will not be changed.

RULINGS REQUESTED

Based on the facts and representations stated above, the following rulings are requested:

1. The Group's commitment to provide the Subsidy will not result in a "significant modification" of a mortgage loan and there will be no reporting requirement when the Group makes this commitment.
2. The Subsidy will be treated, for all federal income tax purposes, as (i) a payment of gross income, made by a member of the Group to the recipient, and (ii) a payment of interest, made by the recipient, to the owner of the mortgage loan.
3. The Subsidy will, if the \$600 reporting threshold of section 6041 is met, be reportable by the Group under section 6041 as fixed or determinable miscellaneous income reported on Form 1099.
4. The Subsidy will, if the reporting thresholds of section 6050H are met, be reportable by the Group on a Form 1098, as interest received with respect to the relevant mortgage loan.

LAW & ANALYSIS

Under Treas. Reg. § 1.1001-3, for most federal income tax purposes, a significant modification of a debt instrument (including a mortgage loan) produces a deemed exchange of the original debt instrument for a new debt instrument. For this purpose, Treas. Reg. § 1.1001-3(c)(1)(i) defines a "modification" as any alteration, including any deletion or addition, in whole or in part, of a legal right or obligation of the issuer or holder of a debt instrument, whether the alteration is evidenced by an express agreement (oral or written), conduct of the parties, or otherwise. A modification is generally "significant" if the legal rights or obligations that are altered are economically significant. See Treas. Reg. § 1.1001-3(e).

The Subsidy does not represent a "significant modification" of any of the mortgages with respect to which it is paid. The Group's agreement to subsidize these mortgage payments does not affect the mortgage owner's legal relationship with the borrower – it is solely an arrangement between the Group and the Servicemembers. As noted above, Servicemembers will remain legally obligated to the mortgage owners for the full SCRA rate if Parent and its subsidiaries become insolvent or otherwise become unable to pay the Subsidy. In addition, owners of the mortgage loans will have no legal means by which they can require a member of the Group to pay the Subsidy. As a result, the Subsidy does not affect the legal rights or obligations of either the Servicemember or the mortgage owner. Therefore, a mortgage loan is not "modified" within the meaning of Treas. Reg. § 1.1001-3 by the Subsidy. As a result, Group's commitment to provide an interest Subsidy on behalf of a Servicemember will not result in a significant modification of the mortgage loan under Treas. Reg. § 1.1001-3.

Section 61 provides that, except as otherwise provided by the Code, gross income includes all income from whatever source derived.

Section 163 generally permits taxpayers to deduct all interest paid or accrued within the taxable year on indebtedness.

Revenue Ruling 76-75, 1976-1 C.B. 14, concludes that interest reduction payments made by the United States Department of Housing and Urban Development to a mortgagee on behalf of a limited-profit corporation are includible in the gross income of the taxpayer. Further, Rev. Rul. 76-75 concludes that the payments are treated as interest within the meaning of section 163, and are deductible by the limited-profit corporation.

Similar to the interest reduction payments described in Rev. Rul. 76-75, the Subsidy is an amount paid by a third party to the lender on behalf of the borrower. Accordingly, for federal tax purposes, the Subsidy is included in the gross income of the Servicemember under section 61 and is treated as a payment of interest within the meaning of section 163 made by the Servicemember to the owner of the Covered Mortgage.²

Section 6041 states that all persons engaged in a trade or business and making payment in the course of such trade or business to another person of "fixed or determinable gains, profits and income . . . of \$600 or more in any taxable year" shall render a true and accurate return to the Service setting forth the amount of such gains, profits, and income, and the name and address of the recipient of such payment.

Treas. Reg. § 1.6041-1(a)(2) states that the return required under section 6041 shall be made on Forms 1096 (transmittal form) and 1099 with a separate Form 1099 to be furnished to the recipient of the fixed and determinable income payment.

Treas. Reg. § 1.6041-1(c) provides that income is fixed when it is paid in amounts definitely predetermined. It further provides that income is determinable whenever there is a basis of calculation by which the amount to be paid may be ascertained.

Section 6050H of the Code states that any person who is engaged in a trade or business, and who, in the course of such trade or business, receives from any individual interest aggregating \$600 or more for any calendar year on any mortgage, shall make a return setting forth the amount of interest, the name and address of the payor, and other relevant information.

² This ruling does not address a Servicemember's ability to deduct the Subsidy payment under section 163, or the proper taxable year in which the Servicemember may deduct the Subsidy payment, if deductible under section 163.

Treas. Reg. § 1.6050H-2(a)(1) provides that an interest recipient must file a return required under section 6050H on Form 1098 (with Form 1096 as the transmittal form). Subsection (b) provides that an interest recipient must also furnish to the interest payor a statement containing the information reported on the Form 1098.

As stated above, for federal tax purposes, the Subsidy is included in the gross income of the Servicemember under section 61. Accordingly, provided the reporting thresholds of section 6041 are met, the Subsidy will be reportable on Form 1099 as a payment of fixed and determinable income. The Subsidy is also treated as a payment of interest within the meaning of section 163 made by the Servicemember to the owner of the Covered Mortgage. As a result, provided the reporting thresholds of section 6050H are met, the Subsidy will be reportable on Form 1098 as interest received by the owner of the Covered Mortgage.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

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.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Sincerely,

Pamela Wilson Fuller
Senior Technician Reviewer
(Procedure & Administration)

Enclosures:

Copy of letter

Copy of letter for section 6110 purposes