

Office of Chief Counsel
Internal Revenue Service
Memorandum

Number: **AM2013-001**

Release Date: 3/1/2013

CC:ITA:B06:JZOIdak
POSTS-101012-13

Third Party Communication: None
Date of Communication: Not Applicable

UILC: 263A.01-02, 263A.02-13

date: February 22, 2013

to: Linda M. Kroening
Division Counsel
(Large Business & International)

from: Andrew J. Keyso
Associate Chief Counsel
(Income Tax & Accounting)

subject: Treatment of Other Real Estate Owned under § 263A

This memorandum responds to your January 4, 2013, request for Generic Legal Advice. This advice may not be used or cited as precedent.

ISSUE

Whether Other Real Estate Owned (OREO) acquired through foreclosure proceedings or by deed-in-lieu of foreclosure by the bank that originated the underlying loan is property acquired for resale within the meaning of § 263A(b)(2) of the Internal Revenue Code.

CONCLUSION

OREO acquired by the loan-originating bank through foreclosure proceedings or by deed-in-lieu of foreclosure is not property acquired for resale within the meaning of § 263A(b)(2).

GENERIC FACT PATTERN

In the ordinary course of its lending business, Bank lends money to enable borrowers to purchase real property from third parties. Each loan is secured by the property purchased by the borrower. Although Bank generally sells the resulting loan, it does hold a substantial portfolio of these mortgage loans.

When a borrower defaults on a mortgage loan, Bank commences a foreclosure proceeding to take title to, and possession of, the real property as a means of mitigating any loss on the defaulted loan. In some cases, a borrower in default on the mortgage loan voluntarily transfers title to the real property to Bank in exchange for cancellation of the remaining debt obligation in a transaction known as a deed-in-lieu of foreclosure. Property acquired by Bank through foreclosure proceedings or by deed-in-lieu of foreclosure is referred to by Bank as “other real estate owned” or OREO.

Bank immediately seeks to sell real property that was acquired through foreclosure proceedings or by deed-in-lieu of foreclosure. Bank generally seeks to sell the property in “as-is” condition upon acquisition, and does not make improvements to the property prior to the sale. Bank’s activities, including acquiring, holding, and disposing of OREO, are regulated by governmental authorities. These authorities generally require Bank to sell the property within certain time frames. Bank also may be required to return to a borrower any proceeds of a subsequent sale of the foreclosed property that exceed the outstanding balance due to Bank on the mortgage obligation. Bank is generally restricted from acquiring property to resell for profit.

Bank treats OREO as property held primarily for sale to customers in the ordinary course of its trade or business for purposes of § 1221(a)(1) of the Code.¹

LAW AND ANALYSIS

Section 263A and the regulations thereunder generally require a reseller to capitalize the acquisition costs and certain indirect costs that are properly allocable to property acquired for resale.

As provided by § 263A(b)(2)(A), “property acquired for resale” means real or personal property described in § 1221(a)(1) that is acquired by the taxpayer for resale. See also § 1.263A-3(a)(1).

A reseller is defined in § 1.263A-1(a)(3)(iii) as a retailer, wholesaler, or other taxpayer, that acquires real or personal property described in § 1221(a)(1) for resale.

Property described in § 1221(a)(1) includes property held by a taxpayer primarily for sale to customers in the ordinary course of the taxpayer’s trade or business.

To constitute “property acquired for resale” within the meaning of § 263A(b)(2)(A), the statute requires that the property be both “held” by the taxpayer primarily for sale to customers in the ordinary course of trade or business and “acquired” for resale.

¹ Whether property is held by a taxpayer primarily for sale to customers in the ordinary course of business within the meaning of § 1221(a)(1) depends on the type and scope of the taxpayer’s activities. See Rev. Rul. 74-159, 1974-1 C.B. 232. This memorandum assumes, as a factual matter, that Bank properly accounts for OREO as property described in § 1221(a)(1).

Assuming that Bank holds OREO for sale to customers in the ordinary course of business within the meaning of § 1221(a)(1), the sole question is whether Bank acquired that OREO for resale.

In determining whether property is acquired for resale, the regulations under § 263A provide a special rule for banks and others that originate (and generally sell) loans. As provided in § 1.263A-1(b)(13), the origination of loans is not considered the acquisition of property for resale, notwithstanding the frequency with which the taxpayer sells the loans it originates or the percentage of its originated loans that it sells.

As a result of the special rule in § 1.263A-1(b)(13), Bank's activity of originating loans is not considered the acquisition of property for resale within the meaning of § 263A(b)(2)(A). Thus, Bank's acquisition and sale of the property securing the loan do not convert Bank into a reseller if the foreclosure or deed-in-lieu of foreclosure and subsequent sale of the OREO are properly viewed as an extension of Bank's loan origination activity.

Under the facts presented, Bank is acting in its capacity as a lender and not as a traditional reseller of property. Bank is economically compelled to acquire the property and takes title and possession only as a last resort to recover funds originally loaned to the borrower. Bank is not acquiring property for the purpose of reselling it at a profit. In fact, Bank is not necessarily entitled to keep all of the proceeds from the sale of the property; Bank typically returns to the borrower any proceeds from the sale of the property that exceed the amount due to Bank on the mortgage obligation. In this context, solely taking title to and possession of mortgaged property from borrowers in default in an effort to mitigate loss is an extension of the primary activity of originating loans within the meaning of § 1.263A-1(b)(13). Accordingly, where the loan-originating Bank acquires real property through foreclosure or deed-in-lieu of foreclosure and promptly attempts to sell the OREO without improvement, we conclude that the property is not "property acquired for resale" within the meaning of § 263A(b)(2)(A).

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

This writing may contain privileged information. Any unauthorized disclosure of this writing may undermine our ability to protect the privileged information. If disclosure is determined to be necessary, please contact this office for our views.

Please call (202) 622-4970 if you have any further questions.