

Administrative, Procedural, and Miscellaneous

26 CFR 601.105: Examination of returns and claims for refund, credit or abatement; determination of correct tax liability.

(Also Part I, §§ 1001; 301.7701–2, 301.7701–3, 301.7701–4.)

Rev. Proc. 2020-34

SECTION 1. PURPOSE

In response to the Coronavirus Disease 2019 (COVID-19) emergency, this revenue procedure describes temporary safe harbors for the purpose of determining the Federal tax status of certain arrangements that hold real property as trusts. Under the safe harbors, certain modifications to mortgage loans, certain modifications to leases, and certain additional capital contributions are not treated under § 301.7701–4(c) of the Procedure and Administration Regulations as manifesting a power to vary.

SECTION 2. BACKGROUND—TRUSTS

.01 Section 301.7701–2(a) defines a “business entity” as any entity recognized for Federal tax purposes (including an entity with a single owner that may be disregarded as an entity separate from its owner under § 301.7701–3) that is not properly classified

as a trust under § 301.7701–4 or otherwise subject to special treatment under the Internal Revenue Code (Code).

.02 Section 301.7701–4(a) provides that, generally speaking, an arrangement is treated as a trust if the purpose of the arrangement is to vest in trustees responsibility for the protection and conservation of property for beneficiaries who cannot share in the discharge of this responsibility and, therefore, are not associates in a joint enterprise for the conduct of business for profit.

.03 Section 301.7701–4(c) provides that an “investment” trust is not classified as a trust if there is a power under the trust agreement to vary the investment of the certificate holders. An investment trust with a single class of ownership interests, representing undivided beneficial interests in the assets of the trust, is classified as a trust if there is no power under the trust agreement to vary the investments of the certificate holders.

.04 Under § 677(a) of the Code, the grantor of a trust is treated as the owner of any portion of a trust whose income, without the approval or consent of any adverse party is, or, in the discretion of the grantor or a non-adverse party, or both, may be distributed, held, or accumulated for future distribution to the grantor or the grantor’s spouse.

.05 A person that is treated as the owner of an undivided fractional interest of a trust under subpart E of part I, subchapter J of chapter 1 of the Code (§§ 671 and following), is considered to own the trust assets attributable to that undivided fractional interest of the trust for Federal income tax purposes. See Rev. Rul. 88-103, 1988-2 C.B. 304; Rev. Rul. 85-45, 1985-1 C.B. 183; and Rev. Rul. 85-13, 1985-1 C.B. 184. See also § 1.1001-2(c), Example 5 of the Income Tax Regulations.

SECTION 3. REVENUE RULING 2004-86

.01 Rev. Rul. 2004-86, 2004-2 C.B. 191, holds that a Delaware statutory trust (Trust) formed to hold real property subject to a lease under the trust agreement described in the ruling is an arrangement that is classified as a trust for Federal tax purposes under § 301.7701-4(c). Each of Trust's owners is treated, by reason of § 677, as an owner of a pro-rata portion of Trust. Because an owner of an undivided fractional interest in Trust owns for Federal tax purposes the assets of Trust attributable to that interest, each owner is considered to own for those purposes an undivided fractional interest in the rental real property held by Trust. Accordingly, under § 1031 of the Code, a taxpayer may exchange an interest in real property for an interest in Trust without recognition of gain or loss, if the other requirements of § 1031 are satisfied.

.02 Under the facts of Rev. Rul. 2004-86, an individual borrows money from a bank and signs a 10-year note bearing adequate stated interest. On the same day, the individual uses the proceeds of the loan to purchase Blackacre, rental real property. The note is secured by Blackacre and is nonrecourse to the individual. Immediately after this purchase, the individual enters into a net lease with a tenant (Tenant) for a term of 10 years.

.03 Under the terms of the lease, Tenant must pay all taxes, assessments, fees, or other charges imposed on Blackacre by Federal, state, or local authorities. In addition, Tenant must pay all insurance, maintenance, ordinary repairs, and utilities relating to Blackacre. Tenant may sublease Blackacre. Tenant's rent is fixed. The revenue ruling indicates that Tenant's rent qualifies as fixed even if the lease agreement includes automatic periodic adjustments to the rent that are based on a fixed rate or on an

objective index, such as an escalator clause based on the consumer price index. No adjustments are within the control of any of the parties of the lease. The amount of rent is not contingent on the tenant's ability to lease the property, on the tenant's gross sales, or on net profits derived from the property.

.04 On the same day that the lease was executed, the individual forms Trust and contributes Blackacre to Trust. Upon the transfer of Blackacre, Trust assumes the rights and obligations of the individual as to the note with the bank and the lease with Tenant.

.05 The terms of Trust provide for the following—

- (1) A single class of trust interests, each representing an undivided interest in the assets of Trust (in this case, Blackacre, which is subject to both the lease and the note);
- (2) Authorization for the trustee to establish a reasonable reserve for expenses that are associated with Trust's holding Blackacre and that are payable out of trust funds;
- (3) Required quarterly distributions of all available cash, less reserves, to each beneficial owner of Trust in proportion to that owner's relative interest in Trust;
- (4) The right of each beneficial owner to an in-kind distribution of that owner's proportionate share of trust property;
- (5) A requirement that Trust invest all cash that it holds in either—
 - (a) Short term obligations of (or guaranteed by) the United States, or any agency or instrumentality thereof; or
 - (b) Certificates of deposit of a bank or trust company having a minimum stated surplus and capital;
- (6) Requirements that the trustee both invest only in obligations maturing prior to the next distribution date and hold those obligations until maturity;

(7) A limitation on the activities of the trustee to collection and distribution of income;

(8) A prohibition against the trustee—

(a) Exchanging Blackacre for other property;

(b) Purchasing assets other than the short-term investments described above;

(c) Accepting additional contributions of assets (including money) to Trust;

(d) Renegotiating the terms of the debt used to acquire Blackacre; and

(e) Renegotiating the lease with Tenant except in the case of Tenant's

bankruptcy or insolvency;

(9) The termination of Trust at the earlier of 10 years or the disposition of Blackacre.

.06 The ruling states that Trust would have been treated as a business entity and not a trust if Trust's trustee had a power under the trust agreement to, among other things, renegotiate the lease with its tenant, to enter into leases with other tenants, or to renegotiate or refinance the mortgage loan whose proceeds were used to purchase Blackacre.

SECTION 4. COVID-19 EMERGENCY AND REVENUE PROCEDURE 2020-26

.01 On March 13, 2020, the President of the United States issued an emergency declaration under the Robert T. Stafford Disaster Relief and Emergency Assistance Act in response to the ongoing Coronavirus Disease 2019 (COVID-19) pandemic (Emergency Declaration). The Emergency Declaration instructed the Secretary of the Treasury "to provide relief from tax deadlines to Americans who have been adversely

affected by the COVID-19 emergency, as appropriate, pursuant to 26 U.S.C. 7508A(a).”¹

.02 To provide additional relief, on March 27, 2020, Congress and the President enacted the Coronavirus, Aid, Relief, and Economic Security Act, Pub. L. No. 116-136, 134 Stat. 281 (CARES Act).

.03 On April 13, 2020, the Department of the Treasury (Treasury Department) and the Internal Revenue Service (IRS) issued safe harbors in Rev. Proc. 2020-26, 2020-18 I.R.B. 753. These safe harbors apply for determining the Federal income tax status of certain securitization vehicles that hold mortgage loans. Under the safe harbors, certain modifications of mortgage loans in connection with forbearance programs described in that guidance are not treated as replacing the unmodified obligation with a newly issued obligation, as giving rise to prohibited transactions, or as manifesting a power to vary.

.04 In the case of mortgage loans held by real estate mortgage investment conduits (REMICs) and investment trusts, Rev. Proc. 2020-26 applies to—

(1) Forbearance (and all related modifications) of a Federally backed mortgage loan or a Federally backed multifamily mortgage loan, if the forbearance is provided under section 4022 or 4023, respectively, of the CARES Act (CARES Act Forbearances); and

(2) Forbearances (and all related modifications) that are not CARES Act Forbearances, that are agreed to by the borrower of any Federally backed or non-Federally backed mortgage loan, and that are provided by a holder or servicer of the loan under a forbearance program for borrowers experiencing a financial hardship due,

¹ <https://www.whitehouse.gov/wp-content/uploads/2020/03/LetterFromThePresident.pdf>

directly or indirectly, to the COVID-19 emergency. The forbearance programs covered are those—

(a) Which are identical or similar to those described in section 2.07 of Rev. Proc. 2020-26; and

(b) Pursuant to which, between March 27, 2020, and December 31, 2020, inclusive, the borrower requests or agrees to the forbearance (and all related modifications).

.05 Section 6.01 of Rev. Proc. 2020-26 provides that for mortgage loans held by REMICs, forbearances (and all related modifications) described in section 5.01 of Rev. Proc. 2020-26 are not treated as resulting in a newly issued mortgage loan for purposes of § 1.860G-2(b)(1), are not prohibited transactions under § 860F(a)(2) of the Code, and do not result in a deemed reissuance of the REMIC regular interests.

.06 Under section 6.02 of Rev. Proc. 2020-26, in the case of mortgage loans held by investment trusts, certain transactions do not manifest a power to vary the investment of the certificate holders. These transactions are—

(1) CARES Act forbearances (and all related modifications); and

(2) Forbearances (and all related modifications) that are described in section 2.07 of Rev. Proc. 2020-26, that are requested, or agreed to, between March 27, 2020, and December 31, 2020, and that are granted as a result of a borrower experiencing a financial hardship due to the COVID-19 emergency.

SECTION 5. COMMENTS RECEIVED

.01 The Treasury Department and the IRS received comments addressing arrangements organized as trusts under § 301.7701-4(c) and Rev. Rul. 2004-86 that

hold rental real property. The commenters reported that many of these arrangements and their tenants are experiencing financial hardship due, directly or indirectly, to the COVID-19 emergency.

.02 These comments indicate that, in order to respond appropriately to these challenges, trustees may find it necessary to—

(1) Respond to the COVID-19 financial hardship of their tenants by modifying the trust's real property leases with the tenants to defer or waive rent payments;

(2) Request relief under various forbearance programs with respect to debt service on the mortgage loan secured by the trust's real property; and

(3) Accept additional cash contributions in order to avoid default on the trust's loan obligations, to satisfy lender demands on which receiving a loan modification may be contingent, to pay trust expenses, or to bolster trust reserves for the payment of expenses and loan payments. Depending on the circumstances for a particular trust, these contributions may come pro-rata from current trust interest holders, non-pro rata from these current interest holders, or from outside investors.

SECTION 6. SCOPE

.01 This revenue procedure applies to arrangements that are trusts under § 301.7701-4(c) and Rev. Rul. 2004-86² and that hold real property and engage in one or more of the actions described in sections 6.02, 6.03, or 6.04 of this revenue procedure.

² Although Rev. Rul. 2004–86 describes a trust that had been formed under a specific Delaware statute, the SCOPE of this revenue procedure includes trusts formed under the equivalent law (if any) of other States or the District of Columbia.

.02 Modification of one or more mortgage loans that secure the trust's real property in—

(1) A CARES Act Forbearance (and all related modifications); or

(2) A forbearance (and all related modifications)—

(a) That are described in section 2.07 of Rev. Proc. 2020-26;

(b) That the trust requested, or agreed to, between March 27, 2020, and December 31, 2020; and

(c) That were granted as a result of the trust experiencing a financial hardship due to the COVID-19 emergency.

.03 Modifications of one or more real property leases (including modifications to the specific allocations of fixed rent in the lease agreements as described in § 467 of the Code and the regulations under § 467; see section 9.01 of this revenue procedure). The lease must have been entered into by the trust on or before March 13, 2020, and the modifications must have been requested and agreed to on or after March 27, 2020, and on or before December 31, 2020. The reason for the modifications must be—

(1) To coordinate the lease cash flows with the cash flows that result from one or more transactions described in section 6.02 of this revenue procedure; or

(2) To defer or waive one or more tenants' rental payments for any period between March 27, 2020, and December 31, 2020 (and all related modifications), because the tenants are experiencing a financial hardship due to the COVID-19 emergency.

.04 Acceptance of cash contributions that are made between March 27, 2020, and December 31, 2020, as a result of the trust experiencing financial hardship due to the COVID-19 emergency, provided the contribution must be needed to increase permitted

trust reserves, to maintain trust property, to fulfill obligations under mortgage loans, or to fulfill obligations under real property leases. See section 10 of this revenue procedure regarding the tax treatment of non-pro rata contributions or contributions from new investors for an interest in the trust.

SECTION 7. SAFE HARBOR

For the purpose of determining whether the arrangement is treated as a trust under § 301.7701-4(c) and Revenue Ruling 2004-86, the actions described in section 6 of this revenue procedure are not manifestations of a power to vary.

SECTION 8. NO INFERENCE

.01 No inferences should be drawn about whether similar consequences would obtain if an arrangement takes actions that fall outside the limited scope of this revenue procedure.

.02 Thus, an arrangement's qualification as a trust under § 301.7701-4(c) may be affected by a waiver or deferral of rent (and related modifications) that is inconsistent with section 3.03 of this revenue procedure and the lease arrangement described in Rev. Rul. 2004-86.

.03 Similarly, contributions that are not described in section 6.04 of this revenue procedure are outside the scope of the safe harbor in section 7 of this revenue procedure. For example, the scope of the safe harbor does not include additional contributions to the trust that are used to make more than minor, non-structural modifications to the trust's real property. Additionally, contributions of property other than cash generally manifest a power to vary.

SECTION 9. GUIDANCE ON MODIFICATIONS OF REAL PROPERTY LEASES

.01 The regulations under § 467 include rules for determining the income and deductions required to be taken into account in connection with § 467 rental agreements (generally, rental agreements with increasing or decreasing rents, or deferred or prepaid rents, as described in § 1.467-1). The fixed rent under a § 467 rental agreement is included in the income of the lessor and deducted by the lessee in accordance with the allocations of fixed rent provided in the rental agreement. See § 1.467-1(d)(2)(iii). For agreements with no specific allocation of fixed rent as described in § 1.467-1(c)(2)(ii), rent is included in the lessor's income and deducted by the lessee in accordance with the agreement's rent payment schedule. For agreements with a specific allocation of rent, the specific allocation of rent is used to determine the income and deductions under the agreement.

.02 For § 467 rental agreements that have a specific allocation of fixed rent, if the payment terms under the rental agreement are modified under this revenue procedure because the tenant is experiencing a financial hardship due to the COVID-19 emergency, amendments are also permitted to the agreement's specific allocation of fixed rent. In addition, any amendments to the rental agreement must be given appropriate tax effect under the applicable provisions of the Code and regulations, including the provisions in § 1.467-1(f) relating to substantial modifications of § 467 rental agreements.

SECTION 10. GUIDANCE ON TAX TREATMENT OF NON-PRO RATA
CONTRIBUTIONS FROM CURRENT TRUST INTEREST HOLDERS AND
CONTRIBUTIONS FROM NEW INVESTORS.

A cash contribution from one or more new trust interest holders to acquire a trust interest or a non-pro rata cash contribution from one or more current trust interest holders must be treated as a purchase and sale under § 1001 of the Code of a portion of each non-contributing (or lesser contributing) trust interest holder's proportionate interest in the trust's assets.

SECTION 11. DRAFTING INFORMATION

The principal author of this revenue procedure is Christiaan Cleary of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information, contact Christiaan Cleary at (202) 317-6850 (not a toll-free call).