

## Internal Revenue Service

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Date:  
July 25, 2017

### Legend:

Taxpayer =

Trustee =

State =

Year =

Company A =

Company B =

Company C =

Company D =

Exchange =

Date 1 =

A =

Dear :

This letter is in reply to a letter dated February 2, 2017, in which Trustee, solely in its capacity as trustee of Taxpayer, a real estate mortgage investment conduit ("REMIC"), requests certain rulings in connection with Taxpayer's qualification as a REMIC under §§ 860A-860G of the Internal Revenue Code. Specifically, you have asked for the following rulings:

1. In the case of Taxpayer, for which a timely, valid and continuing REMIC election has been made in accordance with the Governing Agreements (as defined below), none of (i) the execution of the Settlement Agreement (as defined below), (ii) the right to receive the Settlement Payment (as defined below), or (iii) the receipt of the Settlement Payment, will cause Taxpayer to fail to meet the requirements of § 860D(a)(4).
2. In the case of Taxpayer, for which a timely, valid and continuing REMIC election has been made in accordance with the Governing Agreements, the receipt of the Settlement Payment will be treated as a payment received on qualified mortgages within the meaning of § 1.860G-2(g)(1)(ii) of the Income Tax Regulations.
3. In the case of Taxpayer, for which a timely, valid and continuing REMIC election has been made in accordance with the Governing Agreements, the distribution of the Settlement Payment in accordance with the Governing Agreements and the Settlement Agreement will not cause any regular interest in Taxpayer to fail to qualify as a "regular interest" as defined in § 860G(a)(1) or the sole class of residual interest in Taxpayer to fail to qualify as a "residual interest" as defined in § 860G(a)(2).
4. In the case of Taxpayer, for which a timely, valid and continuing REMIC election has been made in accordance with the Governing Agreements, the receipt of the Settlement Payment will not be treated as a "prohibited transaction" within the meaning of § 860F(a)(2) or as a contribution that is subject to the tax imposed under § 860G(d)(1).

## **Facts**

### *Background*

Taxpayer is one of five REMICs in a tiered REMIC structure comprising a residential mortgage-backed securitization trust (the "Trust"), which Trust is evidenced by a pooling and servicing agreement ("PSA"). In addition to the PSA, the rights of the parties relating to the Trust are governed by the mortgage loan purchase agreement (each a "Governing Agreement" and collectively, the "Governing Agreements"). Under the Governing Agreements, Trustee serves as trustee for the Trust. The laws of State

govern the rights and obligations of the parties to the Governing Agreements, including Trustee. The annual accounting period for Taxpayer is the calendar year and Taxpayer utilizes the accrual method of accounting for maintaining its accounting books and filing its U.S. federal income tax return.

Trustee is a wholly owned subsidiary of Company D, a public company whose shares of common stock are traded on the Exchange.

The Trust functions as a residential mortgage loan securitization vehicle. The Trust, including Taxpayer, was established during Year for the primary purpose of raising financing in the securitization market with respect to a pool of residential real estate mortgage loans originated or acquired by Company C, the sponsor of the mortgage securitizations.

The securitization process for the Trust occurred as follows:

1. Company A (the "Seller"), sold a portfolio of residential mortgage loans (the "Mortgage Loans") to a related party (the "Depositor").
2. The Depositor conveyed the Mortgage Loans to Company B (the predecessor to Trustee), to be held in trust pursuant to the PSA.
3. Several classes of RMBS certificates representing various entitlements to the underlying mortgage pool's cash flows then were issued and sold through an underwriter to investors ("Investors").
4. Company A acted as master servicer, charged with responsibility for, among other things, collecting debt service payments on the Mortgage Loans, taking any necessary enforcement action against borrowers, and remitting payments on a monthly basis for distribution to Investors.

In the securitization, an election was made to treat the Mortgage Loans and certain related assets held by Taxpayer as a REMIC under the Code.

The Governing Agreements for Taxpayer contain a series of representations and warranties made for the benefit of Taxpayer. In general, these include representations that the Mortgage Loans had certain characteristics, such as loan-to-value ratio, property condition and mortgagor credit metrics; that the Mortgage Loans were underwritten in all material respects in accordance with certain underwriting guidelines; that the Mortgage Loans conform in all material respects to their descriptions in the investor disclosure documents; that the origination of the Mortgage Loans complied with applicable laws; and that the Mortgage Loans were being serviced in accordance with accepted servicing practices.

*The Dispute*

On Date 1, pursuant to an agreement among Trustee and certain holders of certificates of beneficial interests in the Trust (the "Institutional Investors"), Trustee filed a complaint on behalf of the Trust in court seeking, among other things, to enforce Company C's (and its affiliates') obligation to repurchase mortgage loans that allegedly breached representations and warranties set forth in the Governing Agreements. Company C and the Trustee ultimately entered into an agreement (the "Settlement Agreement") to settle the litigation.

*The Settlement Agreement*

The Settlement Agreement has two principal terms. One, a settlement payment to be paid to the Trust (the "Settlement Payment"), and two, a release of claims against Company C that arise under or are based upon the Governing Agreements or that relate to the origination, sale, delivery, servicing, and/or administration of Mortgage Loans in the Trust. The Settlement Agreement also requires certain improvements in servicing the Mortgage Loans.

The released claims include all claims against Company C or its affiliates concerning or relating to any alleged breaches of representations and warranties made in connection with the origination, sale, delivery, and/or servicing of Mortgage Loans to the Trust, including breaches of any obligation to notify or to cure any such alleged breaches of representations and warranties or to repurchase any Mortgage Loan (the "Rep and Warranty Claims").

The Settlement Payment consists of a fixed cash payment in the amount of A. Taxpayer represents that the Settlement Payment does not exceed losses suffered by Taxpayer allegedly as the result of the Rep and Warranty Claims.

Taxpayer represents that the distribution provisions of the Settlement Agreement do not alter the rights or obligations of any of the REMICs comprising the Trust or REMIC interests therein. The Settlement Agreement requires that the distribution of the Settlement Payment to Investors be in accordance with the applicable provisions contained in the PSA that provide for the distribution of subsequent recoveries. The Settlement Agreement provides that the Trust's distribution of the Settlement Payment to Investors be characterized as distributions of principal. Distributions to the Investors who hold regular interest classes entitled to receive principal will be made in accordance with the PSA.

In the event the distribution waterfall provisions in the PSA and the Settlement Payment would combine to result in a distribution of any amount on or in respect of the Taxpayer's residual interest class, whether on the date of the distribution of the Settlement Payment or on any subsequent distribution date that is not the final

distribution date under the PSA, such amount shall not be paid on or distributed to such residual class. Instead, the Trustee would retain this amount in the Trust's distribution account, and on the next distribution date, the Trustee would distribute the retained amount to the regular interest Investors entitled to receive a principal distribution of subsequent recoveries.

Consistent with the Governing Agreements, the Settlement Agreement provides for the application of an amount equal to the Settlement Payment to the Trust's issued certificates, in order to restore the outstanding principal balance of such certificates attributable to the prior write down of previously incurred realized losses on Mortgage Loans. Specifically, an amount equal to the Settlement Payment will be applied to increase the class certificate balance of the class or classes of certificates with the highest payment priority to which realized losses have been previously allocated. An increase to the principal balance of any class of certificates cannot exceed the aggregate amount of realized losses previously allocated to such class under the Governing Agreements. In addition, holders of certificates whose class principal balances are restored will not be entitled to any payment in respect of interest on the restored amount for any interest accrual period relating to the distribution date on which such increase occurs or on any prior distribution date.

## **Law and Analysis**

### **Issue #1 and #2: Qualified Mortgages, Permitted Investments, and Payments Received on Qualified Mortgages**

Section 860D(a) provides that the terms "real estate mortgage investment conduit" and "REMIC" mean any entity that meets several requirements including that as of the close of the third month beginning after the startup day and at all times thereafter, substantially all of the assets of the entity consist of qualified mortgages and permitted investments.

Section 860G(a)(3)(A) defines qualified mortgage to include any obligation (including any participation or certificate of beneficial ownership therein) which is principally secured by an interest in real property and which (i) is transferred to the REMIC on the startup day in exchange for regular or residual interests in the REMIC, (ii) is purchased by the REMIC within the 3-month period beginning on the startup day if, except as provided in regulations, such purchase is pursuant to a fixed-price contract in effect on the startup day, or (iii) represents an increase in the principal amount under the original terms of an obligation described in clause (i) or (ii) if such increase (I) is attributable to an advance made to the obligor pursuant to the original terms of a reverse mortgage loan or other obligation, (II) occurs after the startup day, and (III) is purchased by the REMIC pursuant to a fixed price contract in effect on the startup day.

Section 860G(a)(5) defines "permitted investments" to mean any cash flow investment, qualified reserve asset, or foreclosure property. Section 860G(a)(6) defines "cash flow investment" to mean any investment of amounts received under qualified mortgages for a temporary period before distribution to holders of interests in the REMIC.

Section 1.860D-1(b)(3)(i) provides that, for purposes of the asset test of § 860D(a)(4), substantially all of a qualified entity's assets are qualified mortgages and permitted investments if the qualified entity owns no more than a *de minimis* amount of other assets. Section 1.860D-1(b)(3)(ii) sets forth a safe harbor rule which provides that the amount of assets other than qualified mortgages and permitted investments is *de minimis* if the aggregate of the adjusted bases of those assets is less than one percent of the aggregate of the adjusted bases of all of the REMIC's assets.

Section 1.860G-2(g)(1)(ii) states that, in determining what is a cash flow investment, the term "payments received on qualified mortgages" includes, among other payments, payments by a sponsor or prior owner in lieu of the sponsor's or prior owner's repurchase of a defective obligation, as defined in § 1.860G-2(f), that was transferred to the REMIC in breach of a customary warranty.

Section 1.860G-2(f)(1) defines a defective obligation as a mortgage subject to certain defects including that the mortgage does not conform to a customary representation or warranty given by the sponsor or prior owner of the mortgage regarding the characteristics of the mortgage, or the characteristics of the pool of mortgages of which the mortgage is a part.

Taxpayer's right to receive the Settlement Payment under the Settlement Agreement arises from the Mortgage Loans. The right to receive the Settlement Payment for Taxpayer is a contract claim that stems directly from the rights held by the Trustee on behalf of Taxpayer and its status as a REMIC. Therefore, Taxpayer's right to receive the Settlement Payment does not constitute an asset that is newly acquired by a REMIC after its startup date. The execution of the Settlement Agreement and the receipt of the Settlement Payment by Taxpayer, arise from Taxpayer's interest in the Mortgage Loans and its status as a REMIC, and, therefore, will not cause Taxpayer to fail to meet the requirements under § 860D(a)(4).

The Settlement Payment under the Settlement Agreement is the result of a dispute between the Institutional Investors and Company C regarding whether the Mortgage Loans conveyed to Taxpayer violated customary representations and warranties under the Governing Agreements. For purposes of the REMIC rules, a defective obligation includes a mortgage that does not conform to a customary representation or warranty given by the sponsor or prior owner of the mortgage regarding the characteristics of the mortgage, or the characteristics of the pool of mortgages of which the mortgage is a part. Taxpayer's right to the Settlement Payment under the Settlement Agreement is akin to a payment received by Taxpayer from a sponsor or prior owner in lieu of the

sponsor or prior owner's repurchase of such a defective obligation. Therefore, pursuant to § 1.860G-2(g)(1)(ii), the Settlement Payment will be considered a payment received on a qualified mortgage pursuant to § 1.860G-2(g)(1)(ii).

### Issue #3: Regular and Residual Interests

Section 860G(a)(1) defines a "regular interest" in a REMIC to mean any interest in a REMIC which is issued on the startup day with fixed terms and which is designated as a regular interest if (A) such interest unconditionally entitles the holder to receive a specified principal amount (or other similar amount), and (B) interest payments (or other similar amount), if any, with respect to such interest at or before maturity (i) are payable based on a fixed rate (or to the extent provided in regulations, at a variable rate), or (ii) consist of a specified portion of the interest payments on qualified mortgages and such portion does not vary during the period such interest is outstanding.

Section 860G(a)(2) defines a "residual interest" in a REMIC to mean an interest in a REMIC which is issued on the startup day, which is not a regular interest, and which is designated as a residual interest.

Section 860G(a)(9) defines the term "startup day" to mean the day on which the REMIC issues all of its regular and residual interests.

Section 1.860G-1(a)(1) provides that, for purposes of § 860G(a)(1), a REMIC designates an interest as a regular interest by providing to the Internal Revenue Service the information specified in § 1.860D-1(d)(2)(ii) in the time and manner specified in § 1.860D-1(d)(2). Section 1.860G-1(c) provides that a residual interest is an interest in a REMIC that is issued on the startup day and that is designated as a residual interest by providing the information specified in § 1.860D-1(d)(2)(ii) at the time and in the manner provided in § 1.860D-1(d)(2). A residual interest need not entitle the holder to any distributions from the REMIC.

Section 1.860G-1(a)(4) provides that, for purposes of § 860G(a)(1), a regular interest in a REMIC has fixed terms on the startup day if, on the startup day, the REMIC's organizational documents irrevocably specify (i) the principal amount (or other similar amount) of the regular interest, (ii) the interest rate or rates used to compute any interest payments (or other similar amounts) on the regular interest, and (iii) the latest possible maturity date of the interest.

A REMIC regular interest must be issued on the startup date with fixed terms. A REMIC residual interest is an interest in the REMIC issued on the startup date that is not a regular interest. Taxpayer represents that the distribution provisions of the Settlement Agreement do not alter the rights or obligations of either Taxpayer or the Investors' interests therein and that the distribution of the Settlement Payment to Investors is consistent with the distribution provisions contained in the Governing Agreements that

provide for the distribution of subsequent recoveries or unscheduled principal amounts received. Distributions that are made pursuant to these provisions are treated as and constitute distributions of underlying Mortgage Loan principal collections. The Settlement Agreement also provides that should a principal payment become payable to a class of REMIC residual interests on a distribution date that is not the final distribution date under the applicable Governing Agreement, such payment will be maintained in the distribution account and Trustee shall distribute the retained amount on the next distribution date to the applicable regular interest Investors entitled to receive a principal distribution of subsequent recoveries or unscheduled payments of principal. Accordingly, the distribution of the Settlement Payment to Investors will not cause any regular interest in Taxpayer to fail to qualify as a regular interest or the sole class of residual interest in Taxpayer to fail to qualify as a residual interest.

#### Issue #4: Tax on Contributions after Startup Date and Prohibited Transaction

Except as provided in § 860G(d)(2), § 860G(d)(1) imposes on any amount that is contributed to a REMIC after the startup day a tax equal to 100 percent of the amount contributed. Section 860G(d)(2) provides that the tax on contributions after the startup date shall not apply to any contribution which is made in cash and is (A) a contribution to facilitate a cleanup call (as defined in regulations) or a qualified liquidation, (B) a payment in the nature of a guarantee, (C) a contribution during the 3-month period beginning on the startup day, (D) a contribution to a qualified reserve fund by any holder of a residual interest in the REMIC, or (E) any other contribution permitted in regulations.

Section 860F(a)(1) imposes a tax equal to 100 percent of the net income derived from prohibited transactions. Section 860F(a)(2) defines prohibited transaction to mean one of the following: (A) disposition of any qualified mortgage transferred to the REMIC other than a disposition pursuant to (i) the substitution of a qualified replacement mortgage for a qualified mortgage (or the repurchase in lieu of substitution of a defective obligation), (ii) a disposition incident to the foreclosure, default, or imminent default of the mortgage, (iii) the bankruptcy or insolvency of the REMIC, or (iv) a qualified liquidation, (B) the receipt of any income attributable to any asset which is neither a qualified mortgage nor a permitted investment, (C) the receipt by the REMIC of any amount representing a fee or other compensation for services, or (D) gain from the disposition of any cash flow investment other than pursuant to any qualified liquidation.

As discussed above, the receipt of the Settlement Payment by Taxpayer arises from the Mortgage Loans and Taxpayer's status as a REMIC. The Settlement Payment arises in connection with Taxpayer's interest in the Mortgage Loans and is neither a contribution of cash to the REMIC nor is it listed as a prohibited transaction in § 860F(a)(2). As a result, the receipt of the Settlement Payment by Taxpayer will not be treated as a



prohibited transaction within the meaning of § 860F(a)(2) or as a contribution subject to tax under § 860G(d)(1).

## **Conclusion**

We hereby rule as follows:

1. In the case of Taxpayer, for which a timely, valid and continuing REMIC election has been made in accordance with the applicable Governing Agreement, none of (i) the execution of the Settlement Agreement, (ii) the right to receive the Settlement Payment, or (iii) the receipt of the Settlement Payment will cause Taxpayer to fail to meet the requirements of § 860D(a)(4).
2. In the case of Taxpayer, for which a timely, valid and continuing REMIC election has been made in accordance with the applicable Governing Agreement, the receipt of the Settlement Payment will be treated as a payment received on qualified mortgages within the meaning of § 1.860G-2(g)(1)(ii).
3. In the case of Taxpayer, for which a timely, valid and continuing REMIC election has been made in accordance with the applicable Governing Agreement, the distribution of the Settlement Payment in accordance with the applicable Governing Agreement and the Settlement Agreement will not cause any regular interest in Taxpayer to fail to qualify as a "regular interest" as defined in § 860G(a)(1) or the sole class of residual interest in the Taxpayer to fail to qualify as a "residual interest" as defined in § 860G(a)(2).
4. In the case of Taxpayer, for which a timely, valid and continuing REMIC election has been made in accordance with the applicable Governing Agreement, the receipt of the Settlement Payment will not be treated as a "prohibited transaction" within the meaning of § 860F(a)(2) or as a contribution that is subject to the tax imposed under § 860G(d)(1).

This ruling's application is limited to the facts, representations, Code sections, and regulations cited herein. Except as specifically ruled upon above, no opinion is expressed concerning any federal income tax consequences related to the facts herein under any other provisions of the Code. Specifically, we do not rule whether Taxpayer qualifies as a REMIC under §§ 860A-860G or whether any Mortgage Loan qualifies as a qualified mortgage as defined in § 860G(a)(3).

This ruling is directed only to the taxpayer that requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent. In accordance with the

provisions of a Power of Attorney on file, we are sending a copy of this ruling letter 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.

Sincerely,

John W. Rogers III  
John W. Rogers III  
Senior Technician Reviewer, Branch 6  
Office of Associate Chief Counsel  
(Financial Institutions & Products)