April 3, 2020

Delivered via email:

Internal Revenue Service

U.S. Department of the Treasury

Ladies and Gentlemen:

As you are aware, the U.S. economy is facing sudden and momentous headwinds unprecedented in modern times due to the national health emergency posed by the COVID-19 pandemic. The global COVID-19 crisis and resultant mandatory quarantines and business closures have disrupted daily economic life across the country for millions of Americans. With unemployment expected to rise dramatically and many sectors of the economy on virtual lockdown, a meaningful percentage of households and businesses in the United States will face hardships making payments on mortgages, car loans and leases, student loans and other debt obligations. In response, lenders and servicers are providing assistance to borrowers through wide-ranging forbearance programs, fee waivers and other flexible repayment programs as quickly and efficiently as they can. As an indication of the anticipated scope of these actions, we note that Section 4022 of the Coronavirus Aid, Relief, and Economic Security Act ("CARES Act") mandates that forbearance relief be provided to a broad category of borrowers under federally backed mortgage loans (as defined in and to the extent required under the CARES Act).

To aid in the implementation of these efforts, Structured Finance Association ("SFA")[1] respectfully requests that the Internal Revenue Service (the "IRS") and the U.S. Department of the Treasury ("Treasury") issue guidance that will relieve issuers and holders of outstanding debt instruments from severe tax consequences that could arise as a result of the widespread forbearance and loan payment accommodations occasioned by this health crisis. In the case of structured debt, these adverse tax consequences can include not only the recognition of income, but more importantly, the loss of the issuer's special tax status and the collapse of the transaction. We appreciate Treasury's and the IRS's prompt guidance during the prior financial crisis,[2] and we stress the vital role that prompt and clear guidance would play during current market uncertainties.

[1] SFA is a member-based, trade industry advocacy group focused on improving and strengthening the broader structured finance and securitization market. SFA provides an inclusive network for securitization professionals to collaborate and, as industry leaders, drive necessary changes, be advocates for the securitization community, share best practices and innovative ideas, and educate industry members through conferences and other programs. Members of SFA represent all sectors of the securitization market including issuers, investors, financial intermediaries, law firms, accounting firms, technology firms, rating agencies, servicers, and trustees. Further information can be found at www.structuredfinance.org.

[2] For example, please see Rev. Proc. 2007-72, Rev. Proc. 2008-28, Rev. Proc. 2008-47; Notice 2008-27, Notice 2008-41, Notice 2008-88; Rev. Proc. 2008-26, Notice 2008-91, and Treasury Decision 9463.

Specifically, SFA seeks guidance from the IRS and Treasury related to the treatment and classification of such forbearance actions and loan term modifications, and the potential tax implications of such classifications. We make this request without concluding how a forbearance or deferral of a customer's payments are necessarily characterized at law or under the applicable transaction documents; we appreciate that this characterization may differ based on the context and circumstances.

Our request is focused on the status of the financing structures that hold these impacted financial obligations, including but not limited to real estate mortgage investment conduits ("REMICs") and fixed investment or grantor trusts. Further, with respect to REMICs, these concerns apply to both residential mortgages and commercial mortgages, and we are seeking guidance that would address not only mortgage loans already held within REMICs but also the future REMIC eligibility of modified mortgage loans.

(1) Section 1001

For mortgages and consumer loans, the chief "program" being rolled out right now provides forbearance (rather than specific reductions in interest rates, for example),[3] which may be coupled with a deferral of the missed payments to the end of the loan (which will cause an extension of the term of the loan to account for such missed payments). The existing "forbearance" exception of Treas. Reg. Section 1.1001-3(c)(4) has limitations that result in uncertainties when applied to a COVID-19 forbearance. For example, the repayment of the deferred forbearance amounts may be too far into the future for the exception to qualify. SFA requests that the IRS provide guidance that:

a) A legislatively or administratively mandated forbearance or payment holiday, which may include extended repayment terms or other similar loan modifications, will not constitute a "modification" of a loan under Treas. Reg. Section 1.1001-3(c), and

b) A "COVID-19 forbearance" (a non-legislatively or -administratively mandated forbearance or payment holiday), which may include extended repayment terms or other similar loan modifications, will not constitute a "modification" of a loan under Treas. Reg. Section 1.1001-3(c), regardless of whether the forbearance is mandated or encouraged by a governmental entity as long as it is offered in response to financial hardship experienced by the consumer, directly or indirectly, due to COVID-19.

[3] See Section 4022 of the CARES Act. Note, however, that our request for guidance here applies to all asset classes (mortgage loans, consumer loans, credit card loans, auto loans etc.), as many lenders in every segment are working to cooperate and alleviate the economic pressure of the COVID-19 pandemic.

(2) REMICs

In an effort to streamline the process of assisting borrowers struggling with making mortgage payments, recent legislation and guidance from Federal and state agencies do not require a borrower to prove or verify the nature of its financial hardship when seeking a modification or forbearance of its loan; indeed, the federal legislation expressly prohibits mortgage servicers from seeking documentation or verification of hardship beyond a borrower's attestation of financial hardship, directly or indirectly, due to COVID-19. Certain large private banks, financial services companies and other holders of loans, and servicers also are implementing similar programs either on a blanket or loan by loan basis. Therefore, guidance is needed regarding whether a modification of a loan held by a REMIC without specific borrower hardship information would cause the loan to no longer be a "qualified mortgage" within the meaning of Section 860G. SFA requests that the IRS provide guidance as described below:

a) Confirmation that a COVID-19 forbearance in the circumstances described above will be considered for this purpose to have occurred as a result of default or reasonably foreseeable default as described in Treas. Reg. Section 1.860G-2(b)(3)(i). If not, SFA members are concerned that the inclusion of the deemed "new" loans within the REMIC may result in a prohibited transaction tax and/or cause the REMIC to fail to qualify as a REMIC, and

b) Confirmation that if a loan is in forbearance triggered by COVID-19 at the time it is contributed to a REMIC, the "improper knowledge" standard of Treas. Reg. 1.856-6(b)(3) will not be violated such that in a case of foreclosure on such loan, any resulting foreclosure property would constitute "good" foreclosure property within the meaning of Section 860G(a)(5)(C).

In addition, for a REMIC regular interest to qualify as such, payments of the principal amount of a REMIC regular interest cannot be contingent unless an exception applies. One such exception provides that a REMIC regular interest will not fail to qualify as such if the amount or timing of payments of principal or interest is affected by defaults on qualified mortgages and permitted investments, unanticipated expenses incurred by the REMIC or lower than expected returns, as well as contingencies that are only remotely likely to occur. The open issue presented to the IRS for which we seek guidance on is:

a) Confirmation that delays or shortfalls in payments associated with or caused by COVID-19, including but not limited to (i) excess fees paid for specially serviced loans, (ii) a servicer no longer advancing funds, and/or (iii) payments that are subject to forbearance not accruing further interest, will not cause a REMIC regular interest issued in current market circumstances to fail to qualify as such.

(3) Grantor Trusts

Guidance is needed regarding whether a modification of a loan within a grantor trust without specific borrower hardship information would affect the trust's status as a grantor trust for tax purposes. We suggest guidance providing that any modification of a loan in this context is not a "significant modification" for purposes of Treas. Reg. Section 1.1001-3, which would also address the question above in respect of REMICs. Alternatively, guidance could provide that the modification would not cause there to be an impermissible "power to vary." The guidance is necessary because if such modifications cause a trust to have an impermissible "power to vary" then it may fail to qualify as a grantor trust for tax purposes. The industry would appreciate the ability to fast track modifications in order to assist obligors during this unprecedented time of economic instability and stem any systematic deterioration of loan portfolios without the need for excessive diligence on individual loans and obligors.

(4) Taxable Mortgage Pool

Uncertainty regarding the delinquency status of the loans may impair tax counsel's ability to issue an opinion that an issuing entity is "not a taxable mortgage pool". We have heard that lenders may not be reporting the forbearance period as part of the delinquency period (because the payments originally required to be made are no longer due), which may make it more difficult to determine qualification under the "seriously impaired" safe harbor. Again, the practices of lenders and servicers may be the immediate result of recently-issued policies and/or new legislation that seeks to streamline the process of aiding borrowers seeking assistance; it also may result from the lingering question of whether to characterize a loan subject to forbearance as current or delinquent for different purposes, where, as noted above, the answer may differ based on the context. The question presented to the IRS for which we seek guidance on a Taxable Mortgage Pool is:

a) If a loan is in forbearance triggered by COVID-19, will the delinquency status of such loan include the forbearance period notwithstanding that payments that otherwise would have been due are, on account of a forbearance, no longer required to be made based on the original schedule, for purposes of determining whether a real estate mortgage is "seriously impaired" under the safe harbor of Treas. Reg. Section 301.7701(i)-1(b)(5)(ii)(A)? The issue arises in two contexts. First, if a loan is already in default (say 45 days delinquent) when the forbearance is offered, does a forbearance toll the delinquency period? Second, if a loan is not in default when a forbearance is implemented does the forbearance period count towards the safe harbor?

SFA members are concerned that if the above questions are not addressed, the resulting uncertainty will have a significant impact on lenders' and servicers' ability to act immediately in support of borrowers requesting payment relief due to COVID-19 related hardships. In addition,

negative tax consequences may result from loan modifications at the issuer level and may have significant adverse effects for REMICs and the investors in such REMICs and securitizations of assets that utilize a grantor trust structure. Again, by these questions, we are not asking the IRS to take a stance on the various consequences that may arise under the relevant transactional documents based on the classification of a loan subject to forbearance as either current or delinquent. Rather, assuming for purposes of this letter that a loan subject to forbearance could be considered delinquent, in default, or a reasonably foreseeable default, we want to ensure that such a characterization does not result in adverse tax consequences merely because holders and servicers are providing consumer relief in a time of an unprecedented crisis.

SFA appreciates your consideration of these requests and welcomes the opportunity to discuss these issues further. If you have any questions about this matter, please contact Kristi Leo, SFA President, at (917) 415-8999 or via email at kristi.leo@structuredfinance.org.

Very truly yours,

Kristi Leo, President
Structured Finance Association