



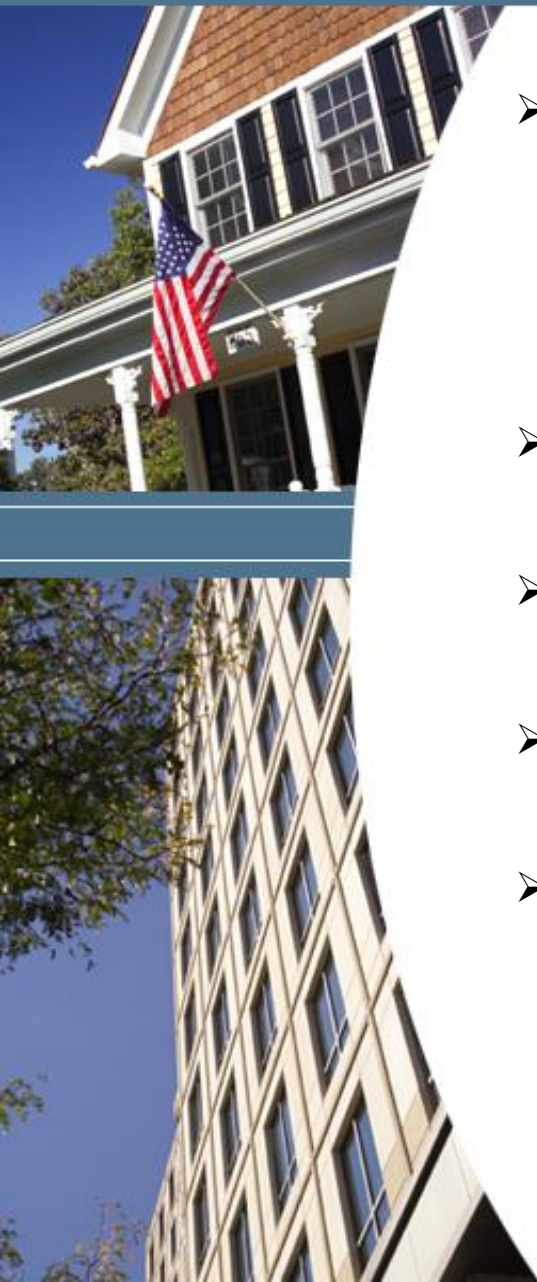
MORTGAGE BANKING TAX UPDATE

November 12, 2009

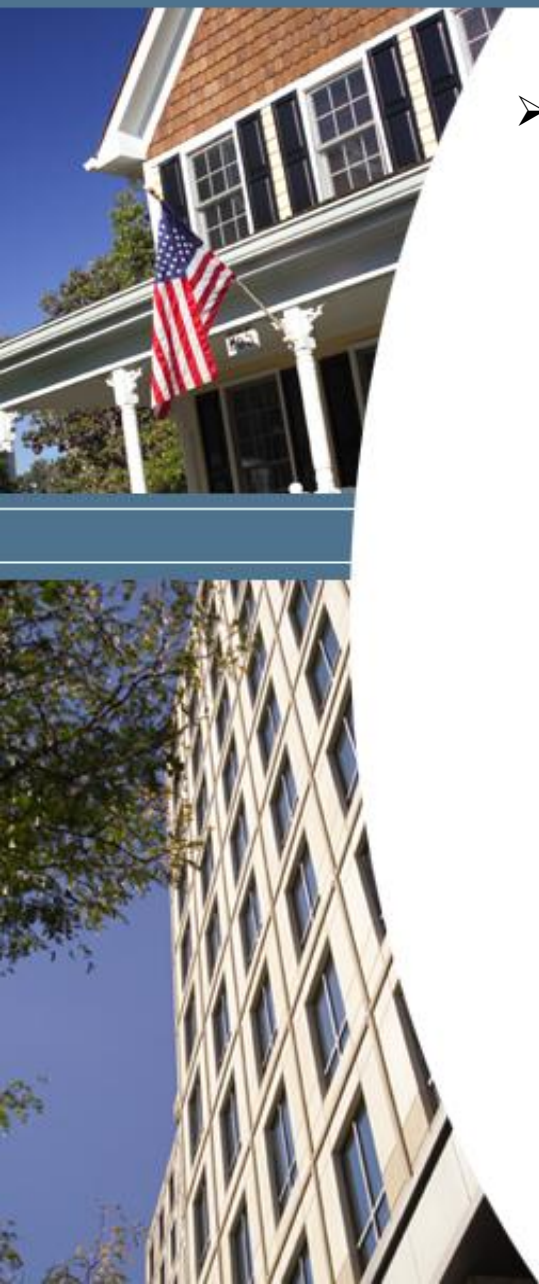
Jim Carlisle

Philip Cusack

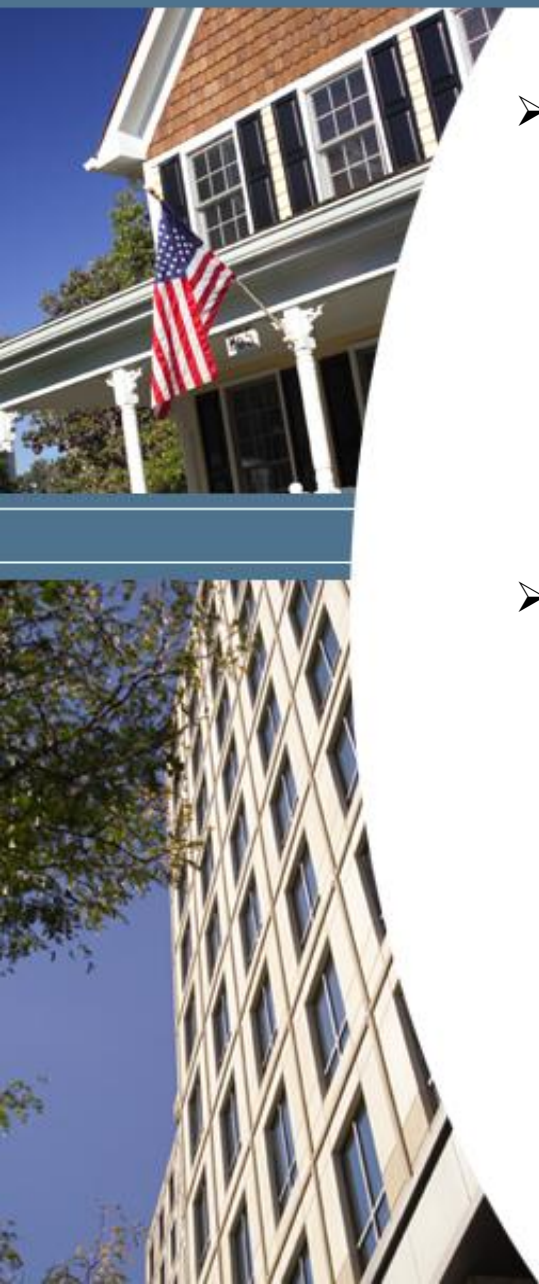
Bank of America

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- Recent Legislative Developments
 - » Extension of Homebuyer Tax Credit
 - » Net Operating Loss Carryback
 - » Health Care Revenue Raisers
 - Loan Modifications
 - Information Reporting Issues
 - IRS Focus on Charge-offs and Nonaccrual loans
 - Looking Ahead: Tax “Extenders” and Beyond

Extension of Homebuyer Tax Credit



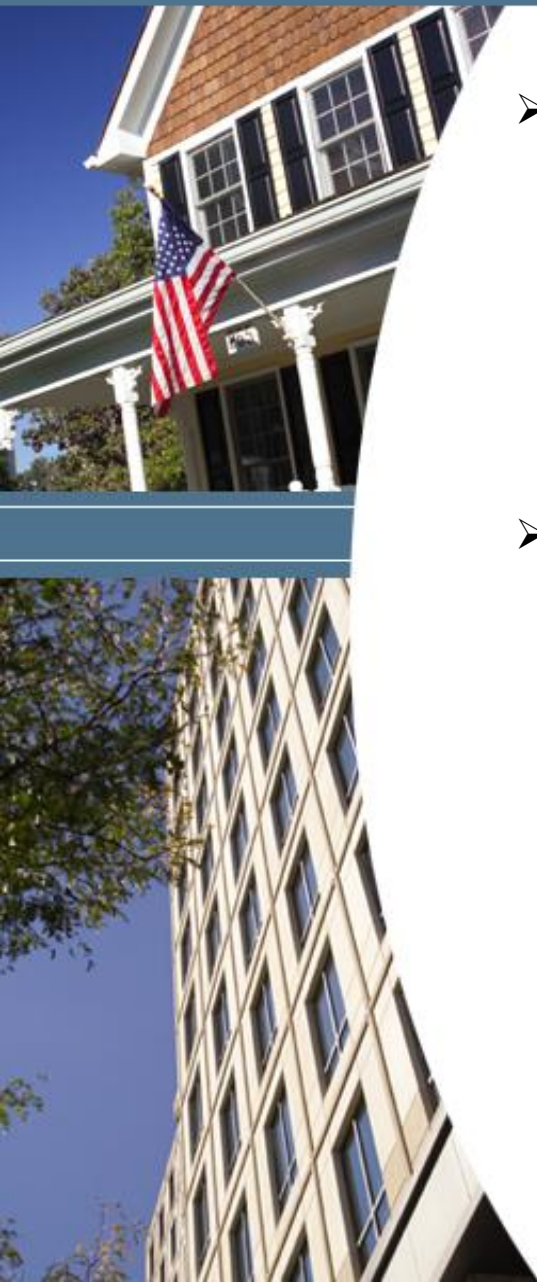
- Homebuyer tax credit extended and expanded by unemployment insurance extension legislation (HR 3548):
 - » Homebuyer tax credit extended to cover purchases through April 30, 2010; credit previously set to expire November 30.
 - » Purchases between May 1 and June 30, 2010, also qualify if binding contract is in place as of April 30.
 - » Credit extended 12 additional months for military personnel.
 - » Maximum credit remains \$8,000 for first-time homebuyers.
 - » Maximum \$6,500 credit for non-first-time homebuyers who have lived in same residence for 5 consecutive years (out of 8 prior years).
 - » Income thresholds increased: credit would begin to phase out at \$125,000 AGI/single and \$225,000 AGI/couples (prior thresholds were \$75,000 and \$150,000, respectively).
 - » Credit may continue to be claimed on prior-year tax returns.
 - » Credit not available where purchase price >\$800,000.



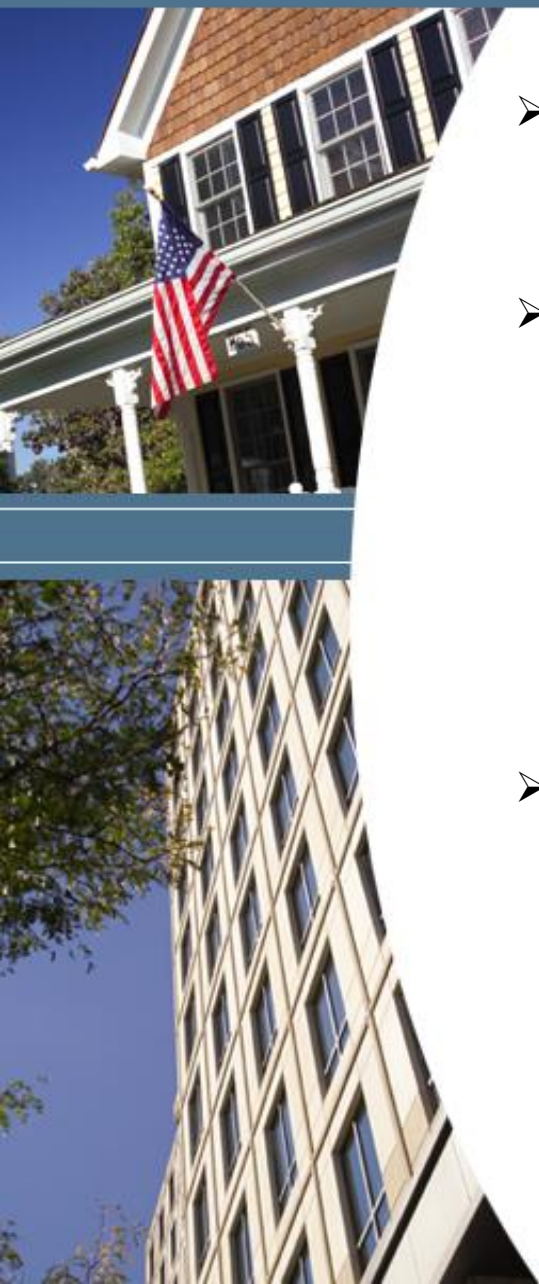
- HR 3548 also includes provisions to “enhance the administration” of the homebuyer credit:
 - » Individuals must be at least age 18 to claim the tax credit.
 - » Taxpayer must attach to the tax return a properly executed copy of the purchase settlement statement.
 - » IRS given authority to address “math errors” without issuing deficiency notice.

- House Ways and Means Committee Oversight Subcommittee October 22 hearing on homebuyer credit:
 - » As of October 9, IRS had processed more than 1.2 million returns claiming \$8.5 billion in homebuyer tax credits.
 - » IRS reported that, as of September 2009, it had identified 167 criminal schemes involving the credit and opened nearly 107,000 civil examinations.
 - » GAO reported tax credits claimed by 4-year olds.

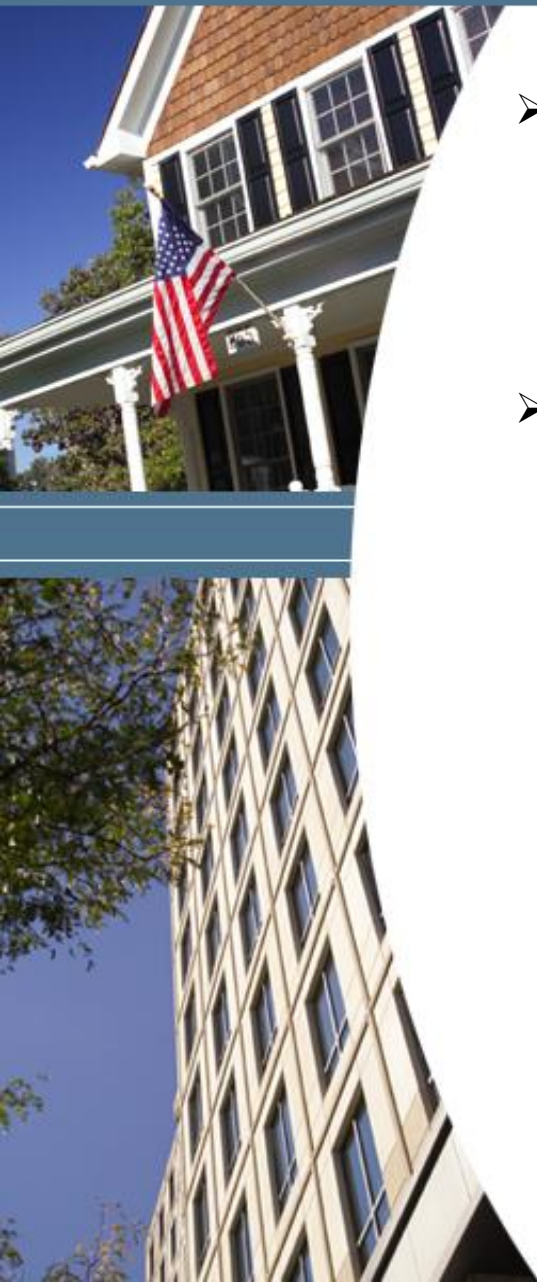
Net Operating Loss Carryback Relief

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- American Recovery and Reinvestment Act of 2009
 - » Introduced a limited opportunity for small businesses to carryback 2008 losses for 5 years (rather than the existing 2 year period).
 - » Election made available for businesses with no more than an average of \$15 million in gross receipts over a 3 year period.

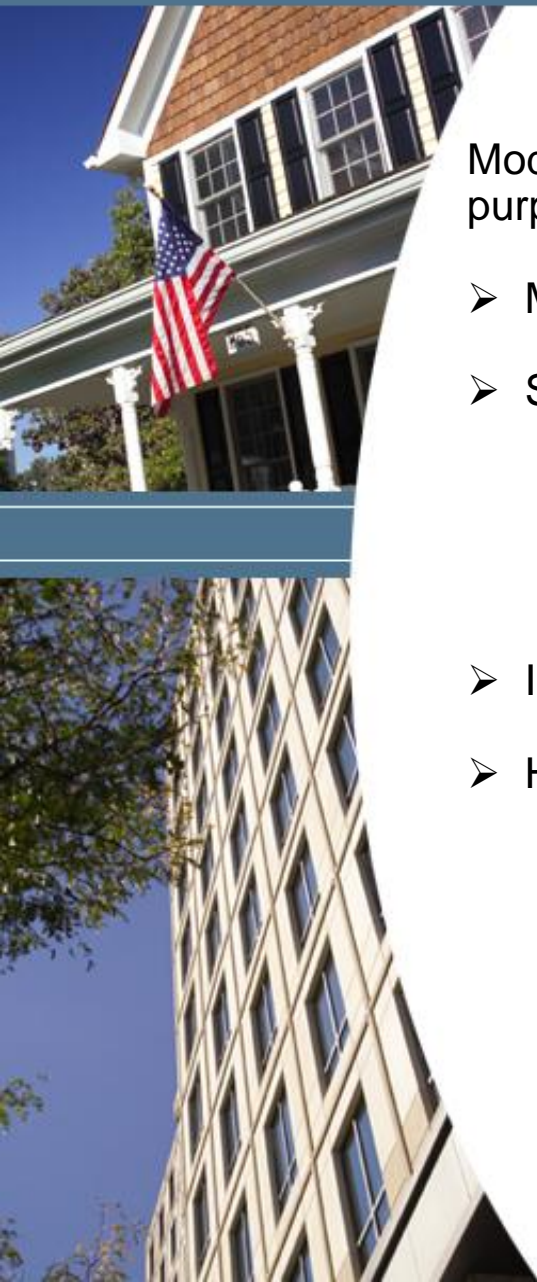
 - Unemployment insurance extension legislation (HR 3548)
 - » 5-year NOL carryback allowed for either 2008 or 2009.
 - » All taxpayers (other than TARP recipients) eligible.
 - » Certain limitations apply.



- House and Senate health reform bills include substantial revenue raisers to help offset the cost of subsidies for lower-income individuals to purchase health insurance.
- Revenue proposals common in both House and Senate bills:
 - » Repeal of general exemption from 1099 reporting for payments to corporations; gross proceeds for property or services would be reportable. (\$17B)
 - » Cost of OTC medicines (other than physician prescribed) may no longer be reimbursed by FSA or FSA. (\$5B)
 - » FSA contributions limited to \$2,500. (\$13B)
 - » Employers taxed on Medicare Part D subsidy. (\$2B)
- House-only revenue proposals:
 - » 5.4% surtax on AGI over \$1 million/joint (\$500,000 single). (\$461B)
 - » Codification of economic substance doctrine (\$6B).
 - » Limitations on tax treaty benefits. (\$7B)
 - » Tightening of biofuels tax credits. (\$24B)




- Senate-only revenue proposals:
 - » 40% excise tax imposed on employer-sponsored health coverage in excess of \$21,000/family (\$8,000/single).
 - » 7.5% AGI floor on medical expense deduction increased to 10%.
- Bills also include fees and taxes on employers whose employees take advantage of new federal subsidies, individuals who do not purchase coverage, medical device manufacturers, pharmaceutical companies.



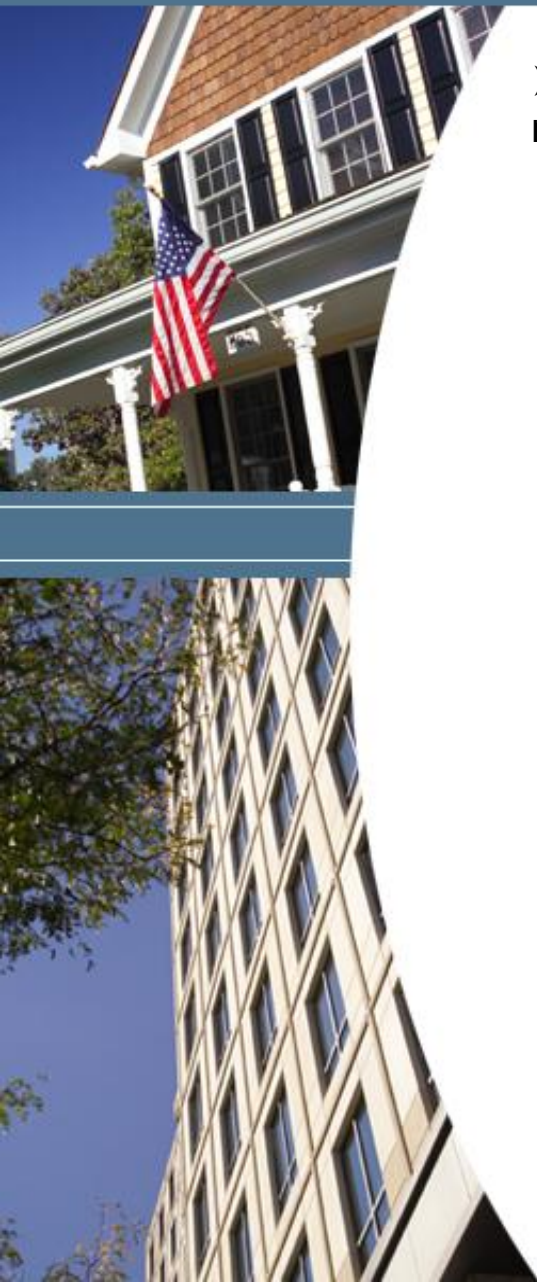
Modifications to debt instruments can result in deemed exchanges for tax purposes. Why it matters –

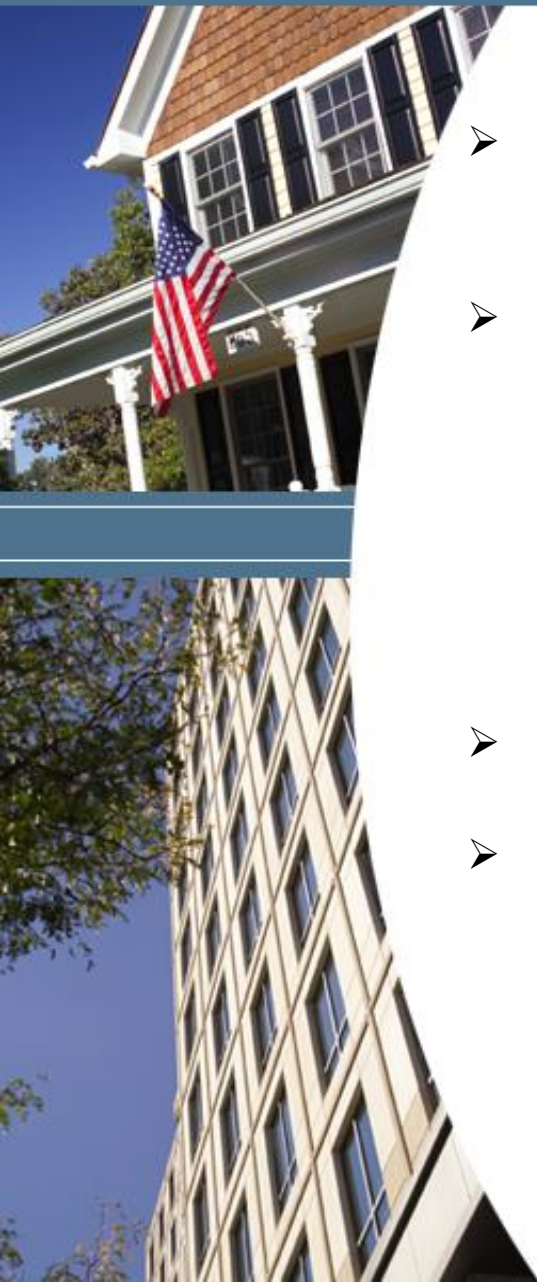
- Mortgage Loans On Balance Sheet
- Securitizations
 - » RMBS
 - » CMBS
- Information Reporting
- HAMP Incentives

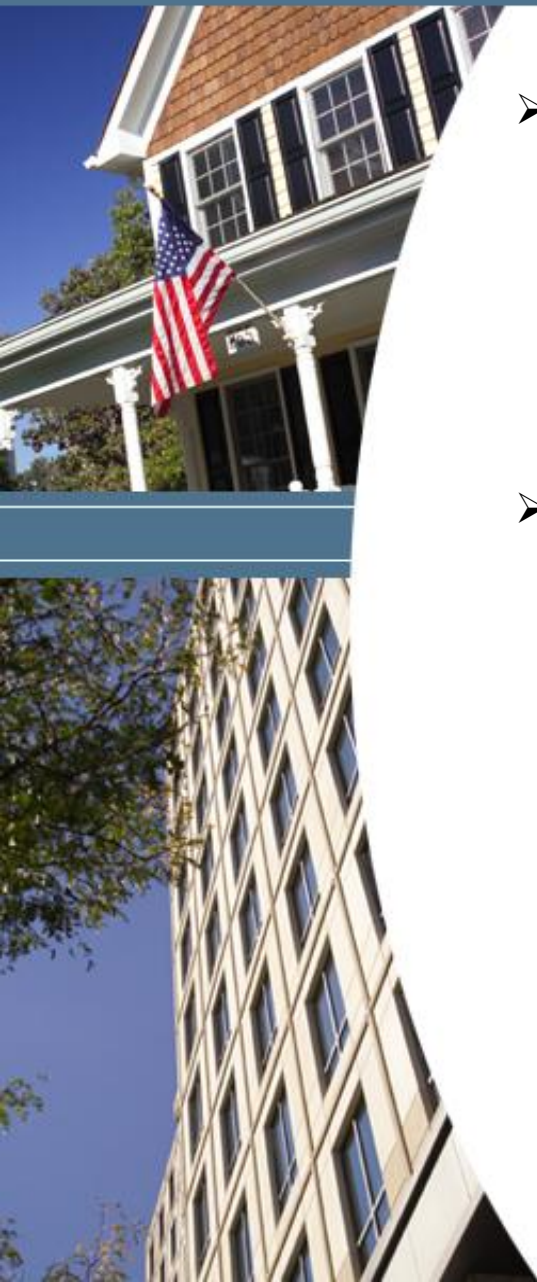
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- The consequence of changing mortgage terms can be a deemed exchange
 - » The holder has traded the old (unmodified loan) for a new (modified) loan in a taxable transaction.

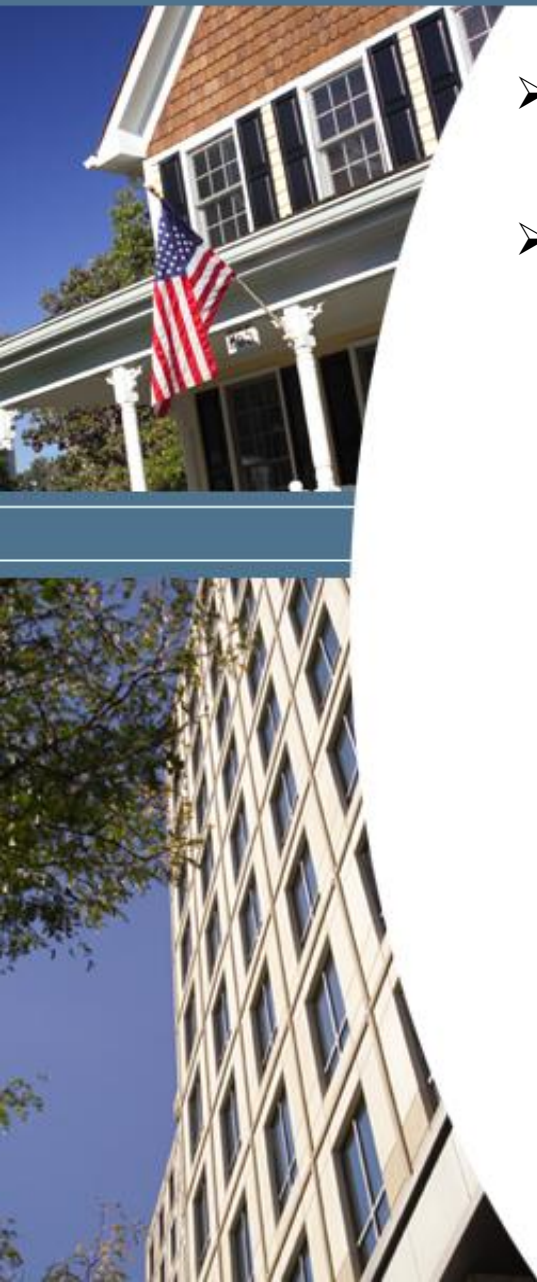
 - Under Treasury regulations, a deemed exchange results if there is (1) a “modification” and (2) the modification is “significant.”

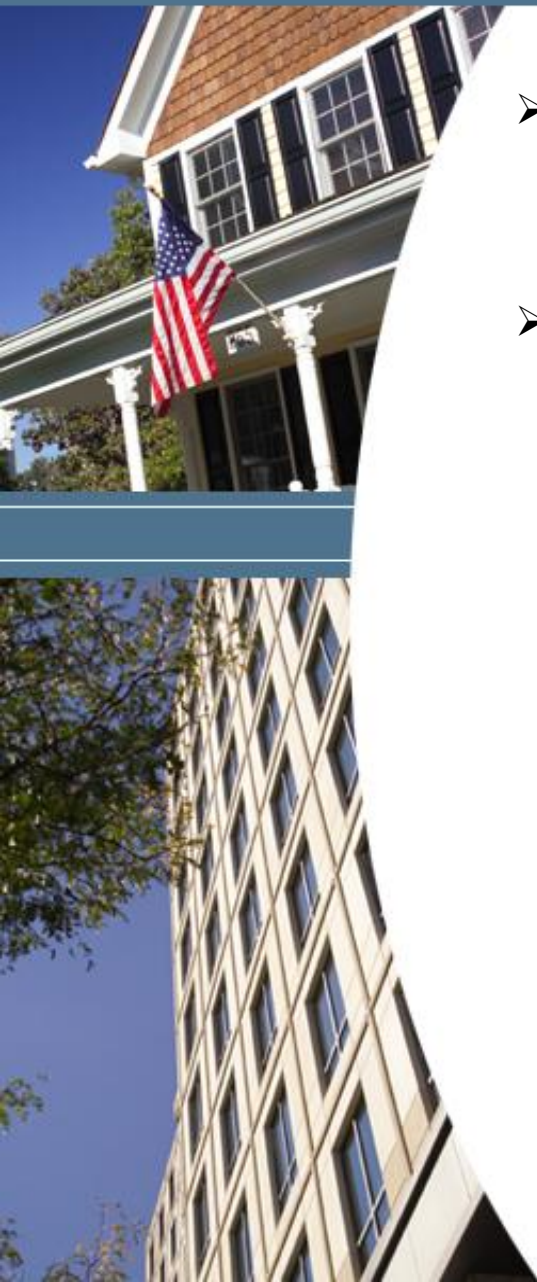
 - A change to an obligation is almost always a modification with few exceptions.
 - » A change that occurs automatically under the terms of the obligation (such as an interest rate reset) is generally not a modification.

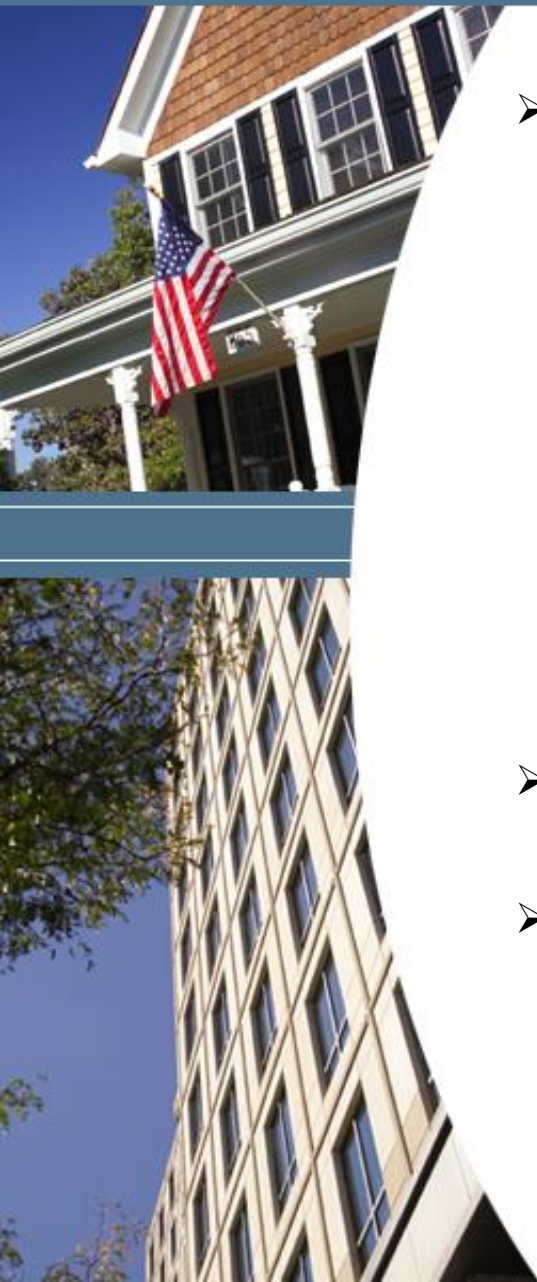
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- A modification gives rise to a deemed exchange only if the modification is significant.
 - » Change in annual yield is significant if yield of the modified mortgage varies from the yield of the unmodified mortgage by more than the greater of 25 basis points or 5%.
 - » Change in timing is significant if it results in a material deferral of scheduled payments
 - Deferrals that do not exceed the lesser of 50% of the original term or five years are not significant.
 - » Substitution of the named obligor on a nonrecourse loan is **not** a significant modification.
 - » Additions or deletions of co-obligors, security, credit enhancement are **not** significant modifications, if the change does not result in a change of the creditor's expectation of payment.

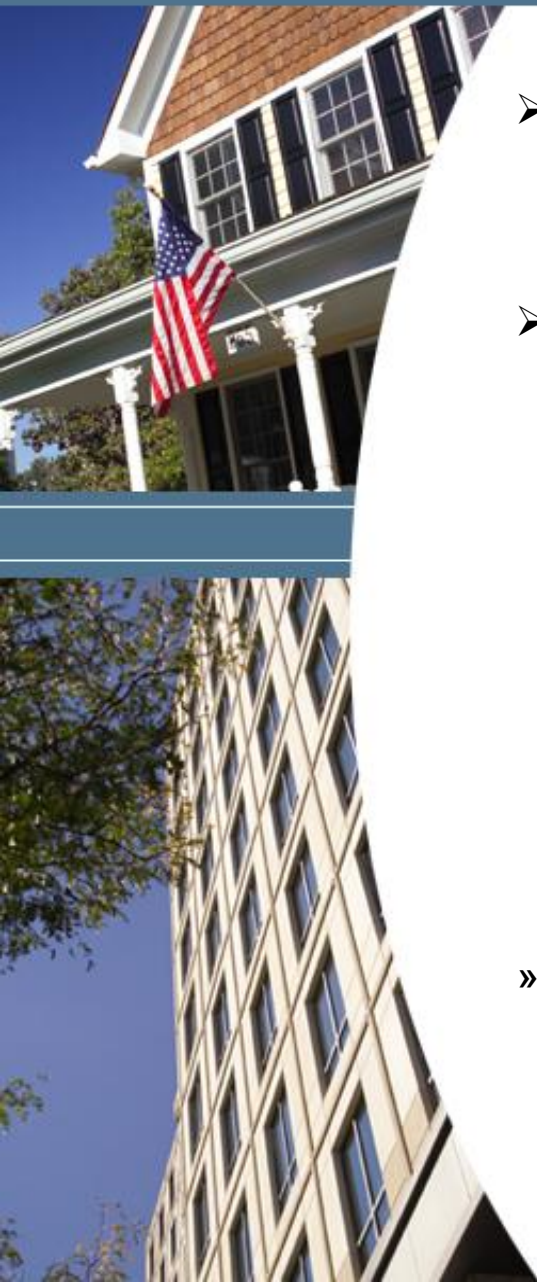
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- On deemed exchange holder's proceeds would be face amount of the modified loan, regardless of the fair value of the loan.
 - Face value of modified loan might differ from holder's tax basis in the loan.
 - » Holder has taken previous charge off
 - » Holder acquired loan through purchase at a discount or premium from another party
 - Result is taxable gain or loss to the holder.
 - Treas. Reg. 1.166-3 offers relieve where holder has claimed a deduction for the partial worthlessness of that loan in a prior year

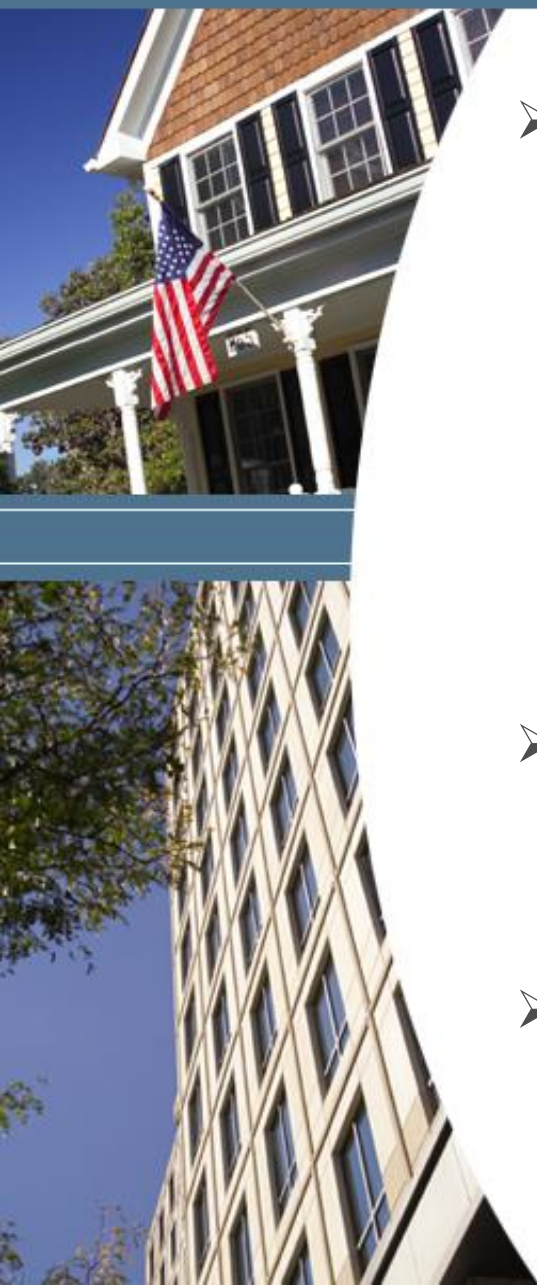
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- Treas. Regulations Sec. 1.166-3 should work well where holder originates loan but what about holder who has purchased the loan at a discount?
 - » Cannot look to charge off by prior holder
 - Dealer in loans has the opportunity to identify loans as marked to market.
 - » Change mark to market policy
 - » Identify loans in the system as mark to market
 - » Need to calculate fair value each quarter
 - » Impact of rising market

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- REMICs are pass through securitization vehicles with no tax at the REMIC level
 - REMICs are intended to be passive investment vehicles and not intended to trade loans
 - » Confiscatory (100%) tax, at the REMIC level, on gains from trading loans.
 - » Confiscatory tax on income from “new” modified loan.
 - » A constructive exchange of a loan held by a REMIC exposes the REMIC to this 100% tax.
 - » REMIC could lose REMIC status if significant loan modifications
 - » There is an exception to these rules for modifications of loans that are in default or imminent default.

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- IRS provides relief in Rev. Procs. 2007-72, 2008-47, 2008-28 and 2009-23
 - Rev Procs 2007-72 and 2008-47
 - » Modifications pursuant to American Securitization Forum's (ASF) fast track guidelines considered to be done in anticipation of reasonably foreseeable default
 - » Fast track modifications allowed for subprime mortgages and borrowers that meet strict criteria
 - » Eligible loans include specific subprime adjustable rate mortgage (ARM) loans with limited loan origination and initial interest reset dates

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- Rev. Proc. 2008-28 extends relief beyond ARM loans
 - » the servicer reasonably believes that there is a significant risk of foreclosure;
 - » the terms of the modification are less favorable to the lender; and
 - » the servicer believes the modification has substantially reduced the risk of a foreclosure.
 - Rev. Proc. 2009-23 expands relief to any modifications under HAMP
 - Notice 2009-36 – Payments made to REMICs under HAMP should not be subject to 100% confiscatory tax

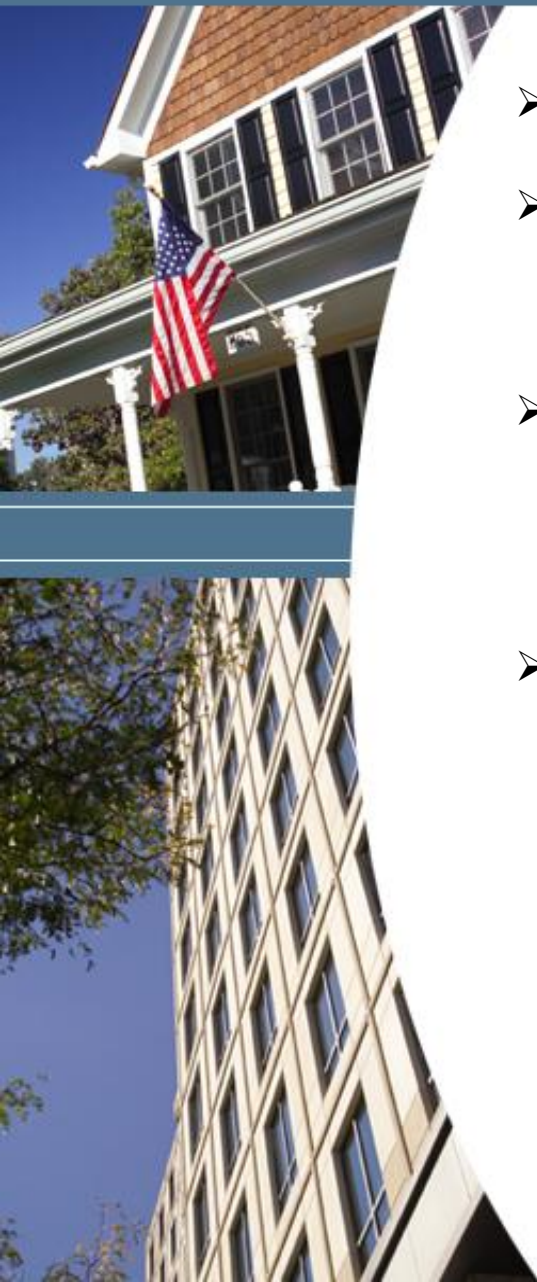
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- Rev. Proc. 2009-45 extends relief to commercial loan securitizations
 - Modifications will not cause REMICs or investment trusts to lose tax status or give rise to prohibited transactions
 - » The holder or servicer reasonably believes there is a significant risk of default of the pre-modification loan upon maturity of the loan or at an earlier date
 - » The holder or servicer reasonably believes that the modified loan presents a substantially reduced risk of default, as compared with the pre-modification loan.
 - » Effective for Loan Modifications after January 1, 2008

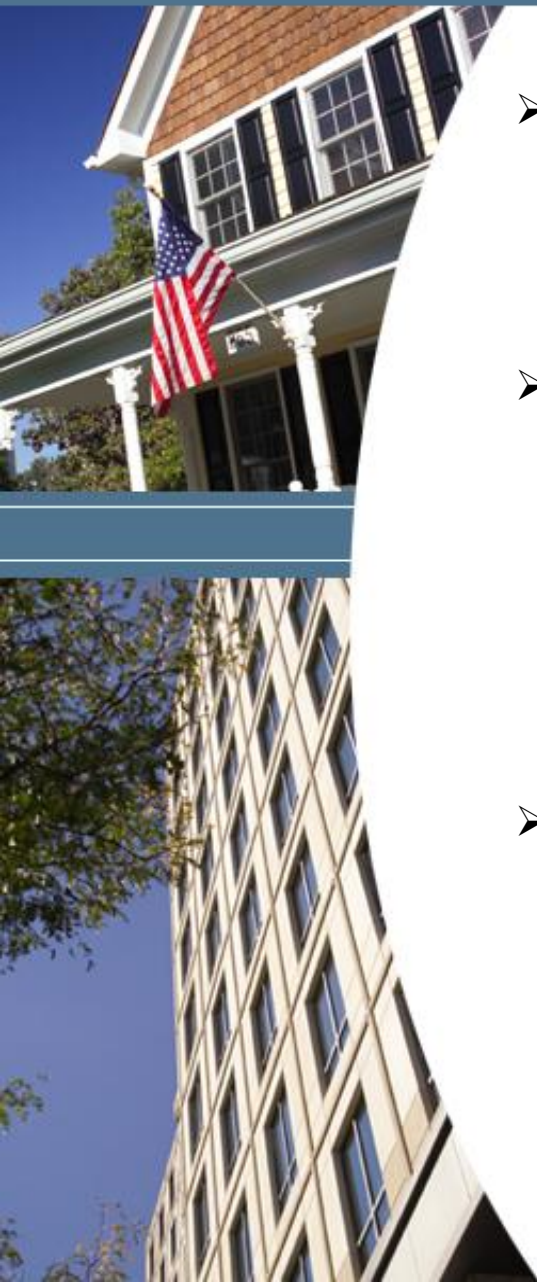


- Regulations amended to permit additional modifications to commercial loans held in REMICs (T.D. 9463)
 - » Release of collateral in exchange for guarantee or credit enhancement
 - » Change in nature between recourse/nonrecourse
 - » Clarification of Lien Release Rule

- Obligation must continue to be principally secured by real property

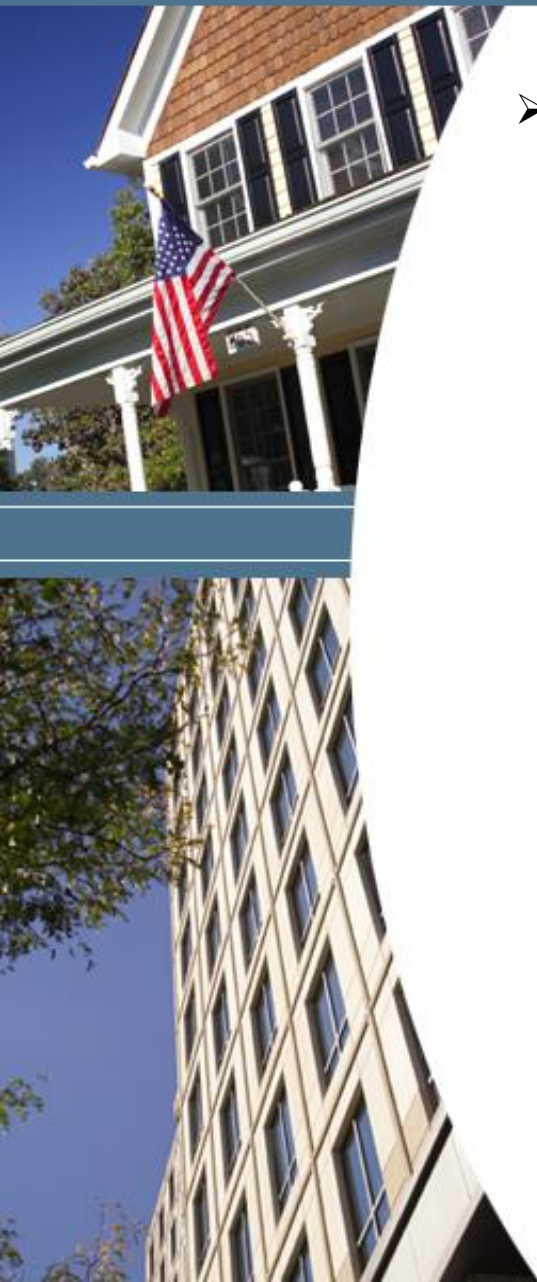
- Notice 2009-79 requesting comments on whether to extend new regulations to investment trusts

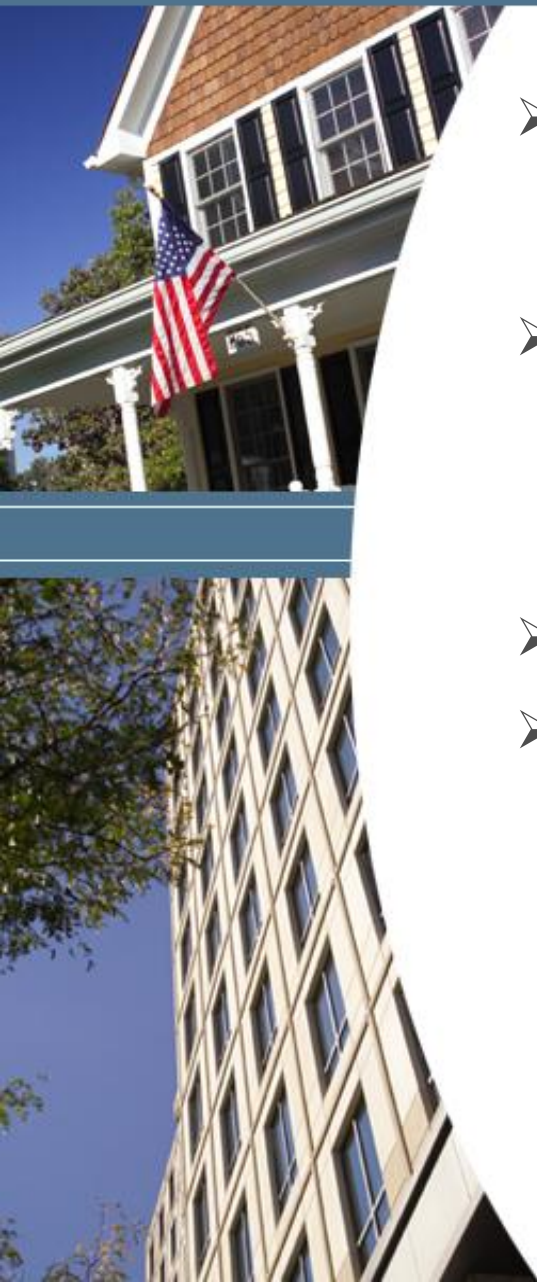
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- Mortgage Forgiveness Debt Relief Act of 2007
 - Borrower can exclude from taxable income up to \$2 million of forgiven qualified principal residence indebtedness, \$1 million if married filing separately
 - Lender/servicer must report on Form 1099-C
 - » Allows IRS to track basis
 - » Not all states conform to federal relief
 - Borrower must report on Form 982.

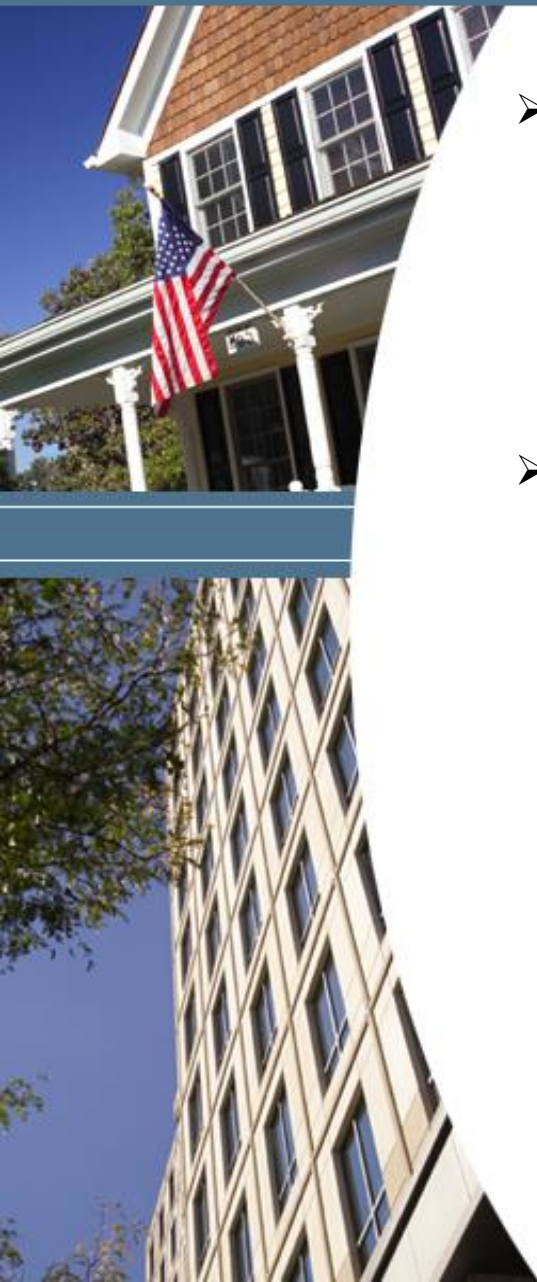
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- Lenders must report certain "points" paid on Form 1098. Reportable points must be clearly designated on the Form HUD-1.

 - New HUD-1 will be required January 1, 2010
 - » Requires all origination charges including points be reported in total on Line 801.
 - » As a result, any "loan origination point" will not be clearly designated for Form 1098 purposes.

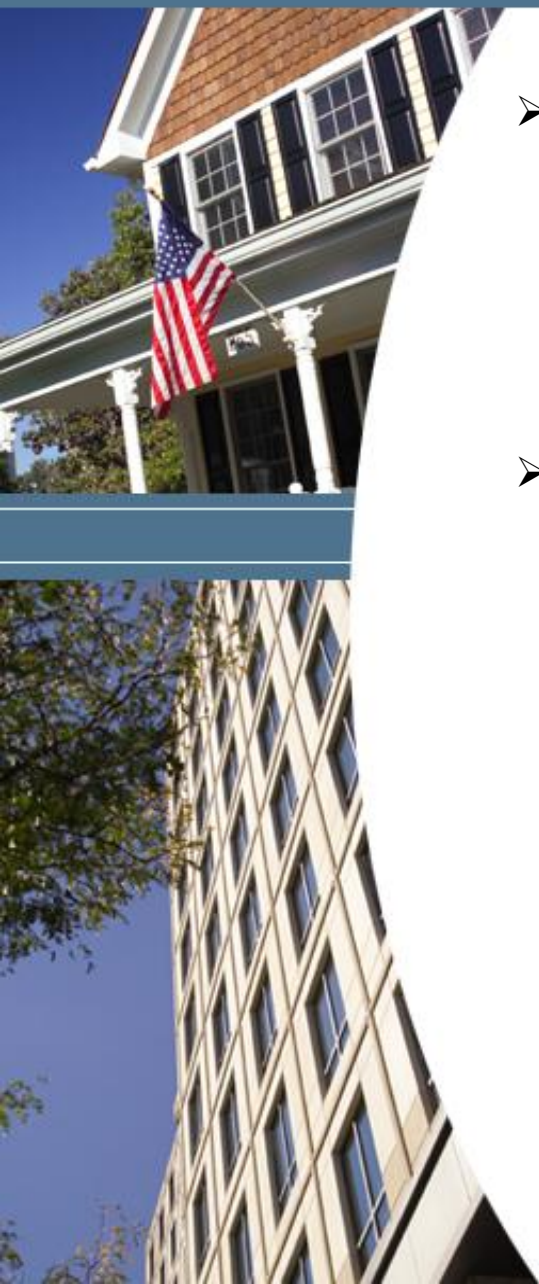
 - HUD issued guidance allowing lenders to break out and designate any "loan origination point" paid, on Line 801 of the new HUD-1.

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- Obama Administration's FY 2010 budget submissions included two additional information reporting proposals of note:
 - » Service providers would need to furnish to businesses a certified TIN on Form W-9 that matches IRS records, or be subject to 28% backup withholding on payments received.
 - » Reporting penalties would be increased from \$50 per return and an annual maximum penalty of \$250,000 to \$100 per failure with an annual maximum penalty of \$1.5 million.

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- Payment Reduction Cost Share
 - » Reimburse by Treasury to lender/investor of $\frac{1}{2}$ of cost of reducing payment from 38% to 31% DTI
 - Servicer Incentives
 - » Incentive Fee
 - » Pay for Success
 - » Current Borrower Incentive Fee
 - Incentive for Borrowers – Pay for Success
 - Incentives for Lenders
 - » Current Borrower Incentive
 - » Other

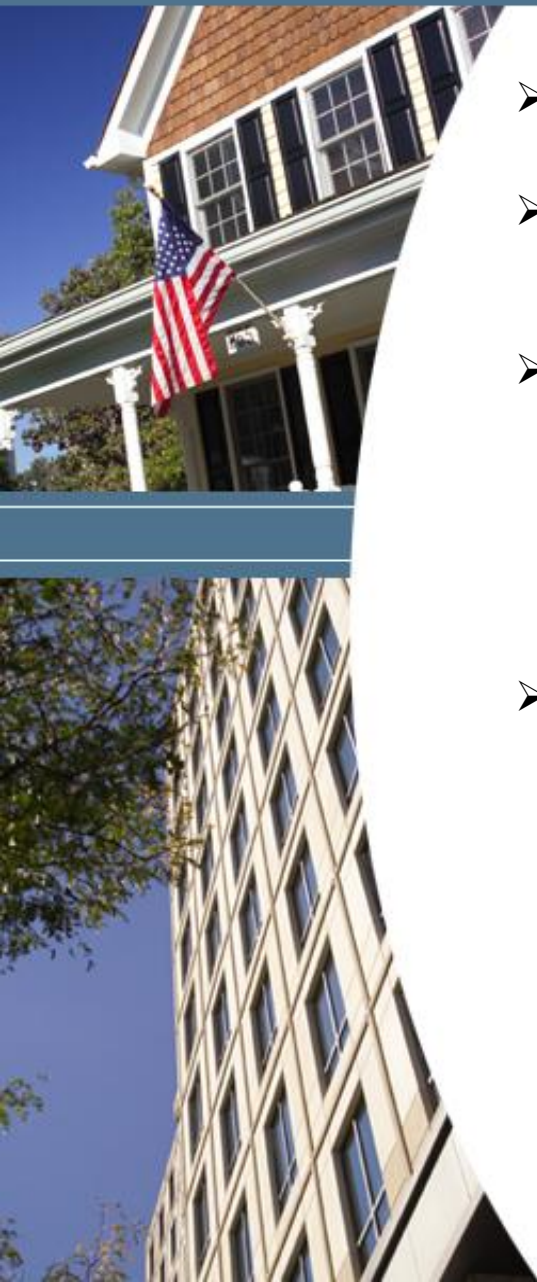
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- Nonaccrual loan
 - » GAAP and regulatory accounting prohibit banks from accruing interest if there is serious question as to the likelihood of payment.

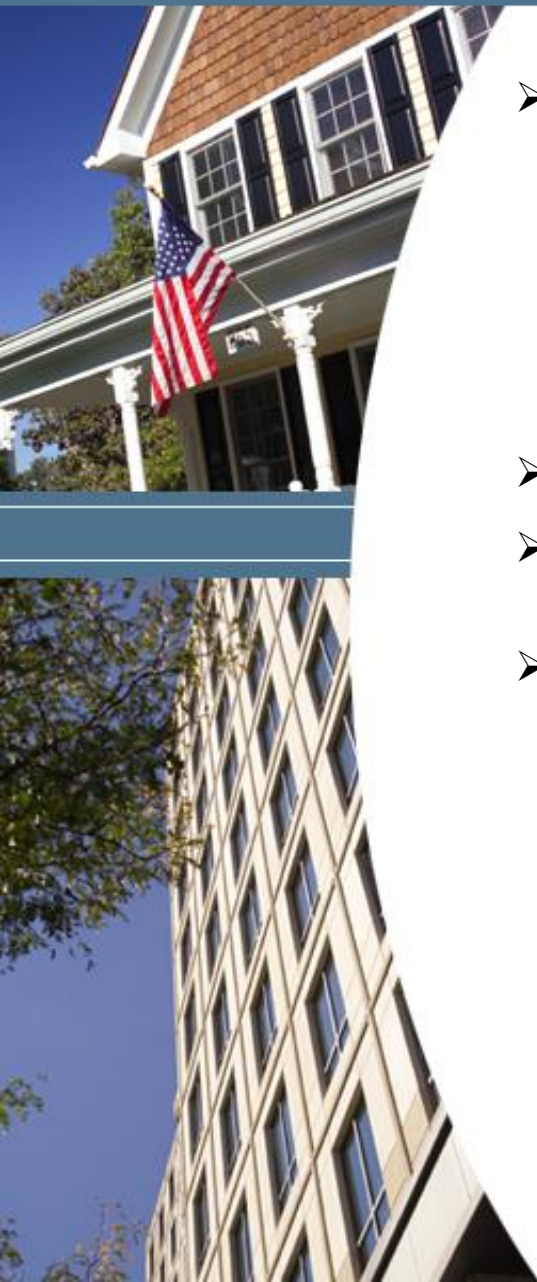
 - Typical accounting policy
 - » Loans are placed on nonaccrual status if 90 days delinquent, or sooner if necessary.
 - » Accrued interest is reversed against income when loans are classified nonaccrual.
 - » Interest collected is applied first to principal.

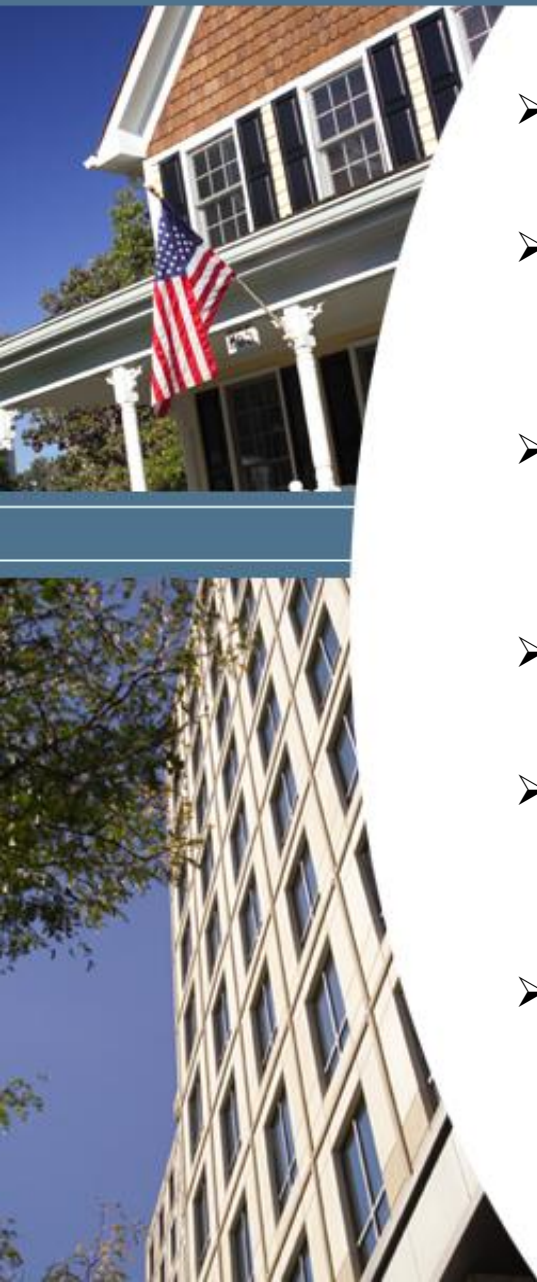


- IRS view of nonaccrual loans
 - » An accrual method bank must continue to accrue taxable income from nonaccrual loans, unless the loans are charged off (RR 2007-32)

- IRS has offered a safe harbor accounting method based on the bank's collection experience (Rev. Proc. 2007-33).

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- Rev. Proc. 2007-33 provides an automatic accounting change
 - Bank does not accrue interest for which it has no “reasonable expectancy of repayment”
 - Bank calculates its “recovery percentage”
 - » This is the ratio of total payments (P & I) received on loans over the past five years, divided by
 - » Total amounts due on the loans
 - Bank multiplies this by the total amount of uncollected interest for which the bank has a “reasonable expectancy of payment”

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- Banks are allowed a deduction for wholly or partially worthless debts
 - » A debt is presumed worthless in the year it is charged off, provided the charge-off is pursuant to a regulatory directive (1.166-2(d)(1))
 - Net realizable value in lieu of fair market value
 - Estimated maintenance and selling expenses
 - A bank can make a conformity election, to make this a conclusive presumption. This requires
 - » express regulatory directive to write loan off,
 - » punctilious adherence to regulatory loan classification standards (1.166-2(d)(3))



- More than 70 tax provisions (e.g., R&D tax credit) expire at the end of 2009; Congress may consider one-year extensions.
- Tax-writing committee chairmen in October unveiled \$8.5 billion package of offshore account tax compliance proposals; proposals could be used as revenue offsets for extenders.
- Congress by year-end also expected to address 2010 repeal of estate tax; one option would be to extend or make permanent the 2009 structure (45% top rate; \$3.5 million exemption).
- President’s Economic Recovery Advisory Board expected to unveil tax reform options in December.
- Administration next year may seek to revisit corporate revenue-raising proposals included in FY 2010 budget (e.g., proposals targeting U.S. multinationals).
- Need to address 12/31/10 sunset of 2001 and 2003 tax cuts.

TAX UPDATE