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TRANSACTIONAL TAX PLANNING ADVISORY

# New IRS Guidance on Forbearances and Modifications of Mortgage Loans as a Result of COVID-19

April 14, 2020

## KEY POINTS

The Internal Revenue Service (IRS) yesterday released Revenue Procedure 2020-26, which is designed to alleviate tax uncertainty related to forbearances and modifications of mortgage loans in response to the COVID-19 pandemic. As discussed further below, the Revenue Procedure provides specific guidance on the tax treatment of:

- Forbearances and related modifications of mortgage loans (residential and commercial); and
- Real estate mortgage investment conduits or REMICs and grantor trusts that hold such mortgage loans.

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To address economic disruptions across the United States from the pandemic, lenders and servicers of consumer and commercial debt are assisting borrowers by implementing forbearance and repayment programs, waiving fees and loan requirements, and other similar actions. In addition, the Coronavirus Aid, Relief, and Economic Security Act or CARES Act, enacted into law on March 27, mandated much of the same relief for borrowers under federally backed mortgage loans.

In the absence of IRS guidance, these actions taken by lenders and servicers to assist borrowers can create uncertainty under current tax law, including the possible recognition of income and loss, questions as to the ongoing classification of securitization vehicles holding such debt, and other potentially negative tax consequences to issuers and investors. In response, the IRS issued Revenue Procedure 2020-26 to address, in part, the requests for guidance from the securitization industry, including the Structured Finance Association (SFA) (available here).

Revenue Procedure 2020-26 applies to forbearances and all related modifications requested by borrowers between March 27 and December 31, 2020 and provided by lenders or servicers with respect to mortgage loans under forbearance programs for borrowers experiencing financial hardships due directly or indirectly to the COVID-19 emergency.

For mortgage loans held by a REMIC, such forbearances and all related modifications will not:

- Result in newly issued mortgage loans for purposes of Treasury regulation section 1.860G-2(b)(1);
- Be treated as prohibited transactions under IRC section 860F(a)(2); or
- Cause deemed reissuances of the regular interests of the REMIC.

Furthermore, delays and shortfalls in payments associated or caused by such forbearances (and any related modifications) of mortgage loans held by a REMIC will be treated as contingencies under Treasury regulation section 1.860G-1(b)(3)(ii) that can be disregarded.

For mortgage loans held by a grantor trust that is an investment trust for US federal tax purposes, such forbearances and all related modifications will not cause the trust to be treated as having a power to vary the investment of the certificate holders of the trust.

If a REMIC acquires, directly or indirectly, a mortgage loan after March 27, and that loan was subject to a forbearance (and any related modifications) as described above, then such forbearance (and any related modifications) will not:

- Cause the REMIC to be treated as having improper knowledge of an anticipated default under Treasury regulation section 1.856-6(b)(3); and
- Be taken into account in determining the origination date of the mortgage loan for purposes of Treasury regulation section 1.860G-2(a)(1).

It is important to note that the Revenue Procedure does not apply to loans other than mortgage loans. As a result, grantor trusts that hold other assets (including, for example, auto loans or leases, credit card receivables, etc.) did not receive the specific relief related to “significant modifications” under Treasury regulation section 1.1001-3 that was granted by the IRS to mortgage loans.

In addition, contrary to the SFA’s request, the IRS did not provide clarification as to whether the forbearance period of a mortgage loan is required to be included as part of that loan’s delinquency period, which guidance is needed to determine whether such a loan would be treated as “seriously impaired” under the taxable mortgage pool rules.

Although the guidance is limited to mortgage loans, and REMICs and investment trusts that hold mortgage loans, the Revenue Procedure provides that no inference should be made that similar results would not apply to forbearances (and any related modifications) that arise in transactions that fall outside the limited scope of the guidance.

The clarifications and relief in Revenue Ruling 2020-26 are in line with similar guidance and relief provide by the IRS during the financial crisis a dozen years ago. See Revenue Procedure 2008-28 and Revenue Procedure 2009-45 for similar guidance for loan modifications made between May 16, 2008 and December 31, 2010.

***This advisory is a summary of certain changes to the federal tax laws and is not intended to and does not constitute legal or tax advice.***

## CONTACTS

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*04/14/20*