

§ 1.860C-2

26 CFR Ch. I (4-1-14 Edition)

REMIC must take into account the holder's daily portion of the taxable income or net loss of the REMIC for each day during the taxable year on which the holder owned the residual interest.

(b) *Adjustments to basis of residual interests*—(1) *Increase in basis.* A holder's basis in a residual interest is increased by—

(i) The daily portions of taxable income taken into account by that holder under section 860C(a) with respect to that interest; and

(ii) The amount of any contribution described in section 860G(d)(2) made by that holder.

(2) *Decrease in basis.* A holder's basis in a residual interest is reduced (but not below zero) by—

(i) First, the amount of any cash or the fair market value of any property distributed to that holder with respect to that interest; and

(ii) Second, the daily portions of net loss of the REMIC taken into account under section 860C(a) by that holder with respect to that interest.

(3) *Adjustments made before disposition.* If any person disposes of a residual interest, the adjustments to basis prescribed in paragraph (b) (1) and (2) of this section are deemed to occur immediately before the disposition.

(c) *Counting conventions.* For purposes of determining the daily portion of REMIC taxable income or net loss under section 860C(a)(2), any reasonable convention may be used. An example of a reasonable convention is "30 days per month/90 days per quarter/360 days per year."

(d) For rules on the proper accounting for income from inducement fees, see § 1.446-6.

[T.D. 8458, 57 FR 61301, Dec. 24, 1992, as amended by T.D. 9128, 69 FR 26041, May 11, 2004]

§ 1.860C-2 Determination of REMIC taxable income or net loss.

(a) *Treatment of gain or loss.* For purposes of determining the taxable income or net loss of a REMIC under section 860C(b), any gain or loss from the disposition of any asset, including a qualified mortgage (as defined in section 860G(a)(3)) or a permitted investment (as defined in section 860G(a)(5) and § 1.860G-2(g)), is treated as gain or

loss from the sale or exchange of property that is not a capital asset.

(b) *Deductions allowable to a REMIC*—

(1) *In general.* Except as otherwise provided in section 860C(b) and in paragraph (b) (2) through (5) of this section, the deductions allowable to a REMIC for purposes of determining its taxable income or net loss are those deductions that would be allowable to an individual, determined by taking into account the same limitations that apply to an individual.

(2) *Deduction allowable under section 163.* A REMIC is allowed a deduction, determined without regard to section 163(d), for any interest expense accrued during the taxable year.

(3) *Deduction allowable under section 166.* For purposes of determining a REMIC's bad debt deduction under section 166, debt owed to the REMIC is not treated as nonbusiness debt under section 166(d).

(4) *Deduction allowable under section 212.* A REMIC is not treated as carrying on a trade or business for purposes of section 162. Ordinary and necessary operating expenses paid or incurred by the REMIC during the taxable year are deductible under section 212, without regard to section 67. Any expenses that are incurred in connection with the formation of the REMIC and that relate to the organization of the REMIC and the issuance of regular and residual interests are not treated as expenses of the REMIC for which a deduction is allowable under section 212. See § 1.860F-2(b)(3)(ii) for treatment of those expenses.

(5) *Expenses and interest relating to tax-exempt income.* Pursuant to section 265(a), a REMIC is not allowed a deduction for expenses and interest allocable to tax-exempt income. The portion of a REMIC's interest expense that is allocable to tax-exempt interest is determined in the manner prescribed in section 265(b)(2), without regard to section 265(b)(3).

[T.D. 8458, 57 FR 61301, Dec. 24, 1992]

§ 1.860D-1 Definition of a REMIC.

(a) *In general.* A real estate mortgage investment conduit (or REMIC) is a qualified entity, as defined in paragraph (c)(3) of this section, that satisfies the requirements of section

860D(a). See paragraph (d)(1) of this section for the manner of electing REMIC status.

(b) *Specific requirements*—(1) *Interests in a REMIC*—(i) *In general*. A REMIC must have one class, and only one class, of residual interests. Except as provided in paragraph (b)(1)(ii) of this section, every interest in a REMIC must be either a regular interest (as defined in section 860G(a)(1) and § 1.860G-1(a)) or a residual interest (as defined in section 860G(a)(2) and § 1.860G-1(c)).

(ii) *De minimis interests*. If, to facilitate the creation of an entity that elects REMIC status, an interest in the entity is created and, as of the startup day (as defined in section 860G(a)(9) and § 1.860G-2(k)), the fair market value of that interest is less than the lesser of \$1,000 or 1/1,000 of one percent of the aggregate fair market value of all the regular and residual interests in the REMIC, then, unless that interest is specifically designated as an interest in the REMIC, the interest is not treated as an interest in the REMIC for purposes of section 860D(a) (2) and (3) and paragraph (B)(1)(i) of this section.

(2) *Certain rights not treated as interests*. Certain rights are not treated as interests in a REMIC. Although not an exclusive list, the following rights are not interests in a REMIC.

(i) *Payments for services*. The right to receive from the REMIC payments that represent reasonable compensation for services provided to the REMIC in the ordinary course of its operation is not an interest in the REMIC. Payments made by the REMIC in exchange for services may be expressed as a specified percentage of interest payments due on qualified mortgages or as a specified percentage of earnings from permitted investments. For example, a mortgage servicer's right to receive reasonable compensation for servicing the mortgages owned by the REMIC is not an interest in the REMIC.

(ii) *Stripped interests*. Stripped bonds or stripped coupons not held by the REMIC are not interests in the REMIC even if, in a transaction preceding or contemporaneous with the formation of the REMIC, they and the REMIC's qualified mortgages were created from the same mortgage obligation. For ex-

ample, the right of a mortgage servicer to receive a servicing fee in excess of reasonable compensation from payments it receives on mortgages held by a REMIC is not an interest in the REMIC. Further, if an obligation with a fixed principal amount provides for interest at a fixed or variable rate and for certain contingent payment rights (e.g., a shared appreciation provision or a percentage of mortgagor profits provision), and the owner of the obligation contributes the fixed payment rights to a REMIC and retains the contingent payment rights, the retained contingent payment rights are not an interest in the REMIC.

(iii) *Reimbursement rights under credit enhancement contracts*. A credit enhancer's right to be reimbursed for amounts advanced to a REMIC pursuant to the terms of a credit enhancement contract (as defined in § 1.860G-2(c)(2)) is not an interest in the REMIC even if the credit enhancer is entitled to receive interest on the amounts advanced.

(iv) *Rights to acquire mortgages*. The right to acquire or the obligation to purchase mortgages and other assets from a REMIC pursuant to a clean-up call (as defined in § 1.860G-2(j)) or a qualified liquidation (as defined in section 860F(a)(4)), or on conversion of a convertible mortgage (as defined in § 1.860G-2(d)(5)), is not an interest in the REMIC.

(3) *Asset test*—(i) *In general*. For purposes of the asset test of section 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.

(ii) *Safe harbor*. 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. Nonetheless, a qualified entity that does not meet this safe harbor may demonstrate that it owns no more than a de minimis amount of other assets.

(4) *Arrangements test*. Generally, a qualified entity must adopt reasonable arrangements designed to ensure that—

(i) Disqualified organizations (as defined in section 860E(e)(5)) do not hold residual interests in the qualified entity; and

(ii) If a residual interest is acquired by a disqualified organization, the qualified entity will provide to the Internal Revenue Service, and to the persons specified in section 860E(e)(3), information needed to compute the tax imposed under section 860E(e) on transfers of residual interests to disqualified organizations.

(5) *Reasonable arrangements*—(i) *Arrangements to prevent disqualified organizations from holding residual interests.* A qualified entity is considered to have adopted reasonable arrangements to ensure that a disqualified organization (as defined in section 860E(e)(5)) will not hold a residual interest if—

(A) The residual interest is in registered form (as defined in § 5f.103-1(c) of this chapter); and

(B) The qualified entity's organizational documents clearly and expressly prohibit a disqualified organization from acquiring beneficial ownership of a residual interest, and notice of the prohibition is provided through a legend on the document that evidences ownership of the residual interest or through a conspicuous statement in a prospectus or private offering document used to offer the residual interest for sale.

(ii) *Arrangements to ensure that information will be provided.* A qualified entity is considered to have made reasonable arrangements to ensure that the Internal Revenue Service and persons specified in section 860E(e)(3) as liable for the tax imposed under section 860E(e) receive the information needed to compute the tax if the qualified entity's organizational documents require that it provide to the Internal Revenue Service and those persons a computation showing the present value of the total anticipated excess inclusions with respect to the residual interest for periods after the transfer. See § 1.860E-2(a)(5) for the obligation to furnish information on request.

(6) *Calendar year requirement.* A REMIC's taxable year is the calendar year. The first taxable year of a REMIC begins on the startup day and ends on December 31 of the same year. If the

startup day is other than January 1, the REMIC has a short first taxable year.

(c) *Segregated pool of assets*—(1) *Formation of REMIC.* A REMIC may be formed as a segregated pool of assets rather than as a separate entity. To constitute a REMIC, the assets identified as part of the segregated pool must be treated for all Federal income tax purposes as assets of the REMIC and interests in the REMIC must be based solely on assets of the REMIC.

(2) *Identification of assets.* Formation of the REMIC does not occur until—

(i) The sponsor identifies the assets of the REMIC, such as through execution of an indenture with respect to the assets; and

(ii) The REMIC issues the regular and residual interests in the REMIC.

(3) *Qualified entity defined.* For purposes of this section, the term “qualified entity” includes an entity or a segregated pool of assets within an entity.

(d) *Election to be treated as a real estate mortgage investment conduit*—(1) *In general.* A qualified entity, as defined in paragraph (c)(3) of this section, elects to be treated as a REMIC by timely filing, for the first taxable year of its existence, a Form 1066, U.S. Real Estate Mortgage Investment Conduit Income Tax Return, signed by a person authorized to sign that return under § 1.860F-4(c). See § 1.9100-1 for rules regarding extensions of time for making elections. Once made, this election is irrevocable for that taxable year and all succeeding taxable years.

(2) *Information required to be reported in the REMIC's first taxable year.* For the first taxable year of the REMIC's existence, the qualified entity, as defined in paragraph (c)(3) of this section, must provide either on its return or in a separate statement attached to its return—

(i) The REMIC's employer identification number, which must not be the same as the identification number of any other entity,

(ii) Information concerning the terms and conditions of the regular interests and the residual interest of the REMIC, or a copy of the offering circular or prospectus containing such information,

(iii) A description of the prepayment and reinvestment assumptions that are made pursuant to section 1272(a)(6) and the regulations thereunder, including a statement supporting the selection of the prepayment assumption,

(iv) The form of the electing qualified entity under State law or, if an election is being made with respect to a segregated pool of assets within an entity, the form of the entity that holds the segregated pool of assets, and

(v) Any other information required by the form.

(3) *Requirement to keep sufficient records.* A qualified entity, as defined in paragraph (c)(3) of this section, that elects to be a REMIC must keep sufficient records concerning its investments to show that it has complied with the provisions of sections 860A through 860G and the regulations thereunder during each taxable year.

[T.D. 8366, 56 FR 49516, Sept. 30, 1991; T.D. 8458, 57 FR 61301, Dec. 24, 1992]

§ 1.860E-1 Treatment of taxable income of a residual interest holder in excess of daily accruals.

(a) *Excess inclusion cannot be offset by otherwise allowable deductions—(1) In general.* Except as provided in paragraph (a)(3) of this section, the taxable income of any holder of a residual interest for any taxable year is in no event less than the sum of the excess inclusions attributable to that holder's residual interests for that taxable year. In computing the amount of a net operating loss (as defined in section 172(c)) or the amount of any net operating loss carryover (as defined in section 172(b)(2)), the amount of any excess inclusion is not included in gross income or taxable income. Thus, for example, if a residual interest holder has \$100 of gross income, \$25 of which is an excess inclusion, and \$90 of business deductions, the holder has taxable income of \$25, the amount of the excess inclusion, and a net operating loss of \$15 (\$75 of other income - \$90 of business deductions).

(2) *Affiliated groups.* If a holder of a REMIC residual interest is a member of an affiliated group filing a consolidated income tax return, the taxable income of the affiliated group cannot be less than the sum of the excess inclusions

attributable to all residual interests held by members of the affiliated group.

(3) *Special rule for certain financial institutions—(i) In general.* If an organization to which section 593 applies holds a residual interest that has significant value (as defined in paragraph (a)(3)(iii) of this section), section 860E(a)(1) and paragraph (a)(1) of this section do not apply to that organization with respect to that interest. Consequently, an organization to which section 593 applies may use its allowable deductions to offset an excess inclusion attributable to a residual interest that has significant value, but, except as provided in section 860E(a)(4)(A), may not use its allowable deductions to offset an excess inclusion attributable to a residual interest held by any other member of an affiliated group, if any, of which the organization is a member. Further, a net operating loss of any other member of an affiliated group of which the organization is a member may not be used to offset an excess inclusion attributable to a residual interest held by that organization.

(ii) *Ordering rule—(A) In general.* In computing taxable income for any year, an organization to which section 593 applies is treated as having applied its allowable deductions for the year first to offset that portion of its gross income that is not an excess inclusion and then to offset that portion of its income that is an excess inclusion.

(B) *Example.* The following example illustrates the provisions of paragraph (a)(3)(ii) of this section:

Example. Corp. X, a corporation to which section 593 applies, is a member of an affiliated group that files a consolidated return. For a particular taxable year, Corp. X has gross income of \$1,000, and of this amount, \$150 is an excess inclusion attributable to a residual interest that has significant value. Corp. X has \$975 of allowable deductions for the taxable year. Corp. X must apply its allowable deductions first to offset the \$850 of gross income that is not an excess inclusion, and then to offset the portion of its gross income that is an excess inclusion. Thus, Corp. X has \$25 of taxable income (\$1,000 - \$975), and that \$25 is an excess inclusion that may not be offset by losses sustained by other members of the affiliated group.

(iii) *Significant value.* A residual interest has significant value if—