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LEGAL ALERT

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IRS Issues Welcome Guidance Regarding Treatment of Releases of Property Securing REMIC Loans

On August 17, the IRS issued Revenue Procedure 2010-30, much anticipated guidance relating to the release of property securing a loan that is held by a real estate mortgage investment conduit (REMIC). The guidance specifically addresses releases contemplated by the terms of the loan or that result from a casualty loss or condemnation of part or all of the property securing a loan. Final REMIC regulations issued in September 2009 (the Regulations), which generally require a valuation of the properties securing a loan at the time of any release of property, were criticized as overly burdensome, and sometimes inappropriate, with respect to certain common transactions.

Revenue Procedure 2010-30 responds to industry concerns with respect to the application of the Regulations by exempting certain releases of property from the valuation requirements of the Regulations. Specifically, under the Revenue Procedure, the IRS will not challenge a loan's status as a "qualified mortgage" due to the release of an interest in real property securing the loan if the release is a "grandfathered transaction" or a "qualified pay-down transaction."

A "grandfathered transaction" generally refers to the release of a lien on real property that occurs pursuant to the terms of a debt instrument that is executed no later than December 6, 2010. The release must not otherwise result in a "significant modification" of the loan for tax purposes. A release of property resulting from the exercise of a unilateral option generally is not a significant modification.

Thus, for example, if a loan agreement executed in 2007 and held by a REMIC provides the Borrower with a unilateral option to obtain the release of a designated parcel on satisfaction of specified conditions, so long as those conditions are satisfied the release of the designated parcel generally is permitted under the REMIC regulations without the need to obtain a valuation of the remaining properties securing the loan. And, as compared to the "qualified pay-down transactions" discussed below, it is not necessary that a specified portion of the loan be paid down in connection with the release.

A release that is not a "grandfathered transaction" (e.g., because it is made pursuant to a loan agreement executed after December 6, 2010) nonetheless may be eligible for the benefits of the Revenue Procedure if it is a "qualified pay-down transaction". A "qualified pay-down transaction" generally refers to a release of a lien on real property, provided that in connection with the release the borrower makes a payment on the loan that reduces the adjusted issue price of the loan by a "qualified amount." For this purpose, a "qualified amount" generally is either (i) an amount greater than or equal to the net proceeds from the disposition, (ii) a proportionate amount of the obligation based on the property value at the time of the origination of the loan or the time of the release, or (iii) the "fair market value" of the released property, determined based on the servicer's reasonable belief. Just as under the Regulations, the servicer's reasonable belief must be based on one of the specified valuation methods in the Regulations, including a commercially reasonable valuation method.

The Revenue Procedure thus eliminates the need for a valuation in the case of condemnations and other similar involuntary releases (provided any proceeds received are used to pay down the loan), where the requirement in the Regulations to obtain a valuation seemed particularly inappropriate.

It is important to note that in the case of loan documents executed after December 6, 2010, parties must ensure that contemplated releases of property satisfy the requirements of a "qualified pay-down transaction." In the case of a loan that is secured by multiple properties, for example, the release schedule generally could be structured to require a payment that is proportionate to the value of the release parcel relative to all properties securing the loan at the time of origination.

The additional guidance in the Revenue Procedure generally alleviates concerns about the impact of the Regulations on certain common transactions. In those cases, it provides much needed flexibility to release property securing a loan held by a REMIC, without the need to obtain a contemporaneous valuation. However, the Regulations still require valuations with respect to releases that do not qualify under the Revenue Procedure, even if they would not otherwise result in a "significant modification" for tax purposes. For example, certain releases made in connection with the workout of a loan held by a REMIC generally are not considered to be significant modifications under the REMIC rules, but nevertheless may not qualify for the exceptions under the Revenue Procedure.

The Revenue Procedure is effective retroactive to the date of the Regulations and thus applies to transactions effected on or after September 16, 2009.

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If you have any questions about this development, please feel free to contact any of the attorneys listed below or the Sutherland attorney with whom you regularly work.

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