

December 20, 2007

Subprime Lending Response Team &amp; Tax Practice

**Modifications of Securitized Subprime Mortgage Loans**

On December 6, 2007, the Internal Revenue Service (the "Service") issued Revenue Procedure 2007-72 (the "Revenue Procedure") which favorably addresses the tax effects of certain modifications, as described in more detail below, made to subprime mortgage loans held by securitization vehicles after December 6, 2007 and on or before July 31, 2010. Specifically, in the case of a REMIC, the Revenue Procedure states that the Service (i) will not challenge the qualification of a securitization vehicle as a REMIC on the grounds that any specified modification event constitutes a significant modification of the related mortgage loan(s), or results in a deemed reissuance of the REMIC's regular interests, and (ii) will not contend that a specified modification event constitutes a 'prohibited transaction' under the REMIC rules, the net income from which is potentially subject to a 100 percent tax. In addition, the Revenue Procedure provides, in the case of a grantor trust, that the Service will not challenge the classification of the trust as a fixed investment trust on the grounds that any specified modification event manifests a prohibited power to vary the investment of the beneficial interest holders of the trust.<sup>1</sup>

The Revenue Procedure was issued in tandem with the Bush Administration's announcement, also on December 6, 2007, of an industry plan to deal with certain subprime mortgage loans on which borrowers are facing upward adjustments in interest rates. Without the Revenue Procedure, REMICs and grantor trusts, the primary securitization vehicles holding subprime mortgages, may have been reluctant to permit the desired modifications.

The Revenue Procedure affects certain subprime mortgages identified in the American Securitization Forum's "Statement of Principles, Recommendations and Guidelines for a Streamlined Foreclosure and Loss Avoidance Framework for Securitized Subprime Adjustable Rate Mortgage Loans" (the "Framework"), issued December 6, 2007. In general, such mortgage loans include first-lien subprime residential adjustable rate mortgage loans that, among other specified criteria set forth in the Framework:

- (1) have an initial fixed rate period of 36 months or less;
- (2) were originated between January 1, 2005, and July 31, 2007;
- (3) are included in securitization pools; and
- (4) have an initial interest rate rest between January 1, 2008, and July 31, 2010.

The Framework provides a "fast track" procedure for modifications ("fast track modifications") of these subprime mortgage loans pursuant to which a borrower may be given the opportunity to freeze the interest rate on the affected mortgage loan at the existing rate, generally for a five-year period beginning on the date on which the interest rate otherwise would have been reset.

The Revenue Procedure applies in the case of (i) a fast track modification of a mortgage loan pursuant to the Framework, and (ii) a second-lien holder's subordination of its lien to any new lien arising as a result of

a fast track modification (a “specified modification event”).

While the Revenue Procedure is effective December 6, 2007, it states that, in the event that material changes are made to the Framework, the Revenue Procedure will not necessarily apply to any fast track modifications or second-lien subordinations that occur pursuant to any such revised Framework.

If you have any questions, or would like additional information about this topic, please contact [Jeffrey P. Cantrell](#), [William A. Levy](#), [Helen P. Holmberg](#) or any other Mayer Brown lawyer with whom you regularly work.

[Learn more about Mayer Brown's Subprime Lending Response Team.](#)

[Learn more about Mayer Brown's Tax Practice.](#)

<sup>1</sup> A “real estate mortgage investment conduit,” or REMIC, and a grantor trust, or “fixed investment trust,” are widely used structured finance tax vehicles through which most U.S. mortgage loan securitizations are done. Each of these entities is effectively entitled to ‘pass-through’ tax treatment so long as it meets certain requirements imposed on the vehicle under federal income tax law, including specific provisions of the Internal Revenue Code. Under certain circumstances, a vehicle that initially qualifies as a REMIC or grantor trust may cease to qualify for the favorable tax treatment afforded the entity if the terms of one or more of its qualified mortgage loan assets are modified in an economically meaningful way. In the case of a REMIC, such a modification is commonly referred to as a “significant modification.” In the case of a grantor trust, the mere ability to implement such a change to the vehicle’s mortgage loan assets may reflect that the trust’s beneficial interest holders possess a prohibited “power to vary” their investment in the vehicle, pursuant to applicable tax rules.

---

If you are not currently on our mailing list and would like to be, please email [contact.edits@mayerbrown.com](mailto:contact.edits@mayerbrown.com) with your contact information. If you would like to be taken off our mailing list, please reply to this message with the word “REMOVE” in the subject line.

Mayer Brown is a combination of two limited liability partnerships, one named Mayer Brown LLP, established in Illinois, USA, and one named Mayer Brown International LLP, incorporated in England.

© 2007 Mayer Brown LLP and/or Mayer Brown International LLP. This publication provides information and comments on legal issues and developments of interest to our clients and friends. The foregoing is not a comprehensive treatment of the subject matter covered and is not intended to provide legal advice. Readers should seek legal advice before taking any action with respect to the matters discussed herein.

IRS CIRCULAR 230 NOTICE. Any advice expressed above as to tax matters was neither written nor intended by the sender or Mayer Brown LLP to be used and cannot be used by any taxpayer for the purpose of avoiding tax penalties that may be imposed under U.S. tax law. If any person uses or refers to any such tax advice in promoting, marketing or recommending a partnership or other entity, investment plan or arrangement to any taxpayer, then (i) the advice was written to support the promotion or marketing (by a person other than Mayer Brown LLP) of that transaction or matter, and (ii) such taxpayers should seek advice based on the taxpayers particular circumstances from an independent tax advisor.