American Bankers Association
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VIA EMAIL

Internal Revenue Service
Office of Pre-filing and Technical Services
Large Business and International Division SE:LM:PFT
Mint Building 3rd Floor M3-420
1111 Constitution Avenue, NW
Washington, DC 20224

RE: Revenue Procedure 2003-36 - Application for Industry Issue Resolution Program – Information Reporting for Accrued but Unpaid Interest With Respect to Loan Modifications

Dear Sir or Madam:

The American Bankers Association (ABA)[1] hereby submits the following issue for Internal Revenue Service (IRS) guidance under the Industry Issue Resolution (IIR) program. The issue is important for both borrowers and lenders, and we look forward to working with the IRS proactively towards a successful resolution. The following information is submitted in accordance with Revenue Procedure 2003-36.

Issue Statement:

Pursuant to Section 6050H of the Internal Revenue Code (IRC), a lender or party servicing a loan who receives $600 or more of interest on a mortgage from a borrower is required to annually report the amount received to both the borrower and the IRS on *Form 1098, Mortgage Interest Statement*. The reporting issue for consideration arises where interest that is due to the lender, but not paid, becomes part of the principal of a modified mortgage.

Statement as to Whether the Issue is Appropriate for the IIR Program:

This issue is appropriate for consideration due to at least the following characteristics:

1. ***The proper tax treatment of a common factual situation is uncertain.*** There is ambiguity regarding whether, when, or how interest that accrues but goes unpaid prior to a modification and then becomes part of the principal of a modified loan should be

[1] The American Bankers Association is the voice of the nation's $16 trillion banking industry, which is composed of small, regional and large banks that together employ more than 2 million people, safeguard $12 trillion in deposits and extend more than $8 trillion in loans.

reported. There is no guidance addressing that scenario under section 6050H of the IRC or the Regulations thereunder.

2. ***The issue is significant and affects a large number of taxpayers either within an industry or across industry lines.*** The economic downturn affected a significant number of mortgage borrowers (see estimates below). As a result, a significant number of modifications of mortgage loans occurred and continue to occur, most of which include the resolution of accrued but unpaid interest. The reporting issue has potential implications for both the borrowers and the lenders in the banking industry as well as third-party servicers.

3. ***The issue requires extensive factual development, and an understanding of industry practices and views concerning the issues would assist the IRS in determining the proper tax treatment.*** The information reporting regulations require separate reporting with respect to individual mortgage loans. By working with the industry in the IIR program, there is significant knowledge regarding current and recommended practices that can be leveraged.

Explanation of the Need for Guidance:

As noted above, Section 6050H of the IRC requires reporting of interest received by a lender or a party servicing a mortgage loan. The reporting is done annually on Form 1098. In normal circumstances, this reporting is routine and systems have been developed to capture and report this information.

Reporting become less routine when there is a modification or refinancing of a loan. There is a variety of circumstances where accrued but unpaid interest on the existing loan becomes part of the principal of the new loan. These transactions result in a variety of questions relating to reporting under Section 6050H.

For example, assume a borrower is having difficulty making payments on a $200,000 mortgage and there is $4,000 of accrued but unpaid interest on the loan. The lender and borrower agree to modify the loan with a lower interest rate and extended payment terms, including treating the $4,000 of accrued but unpaid interest as part of the principal of the new loan. In the absence of guidance directly on point under Section 6050H, there are differing views on if, when or how the $4,000 should be reported to borrowers and the IRS.

In reviewing the technical guidance in this area, there does not appear to be guidance under section 6050H addressing whether, when or how to report accrued but unpaid interest that becomes part of the principal of a loan upon modification.[2] In the absence of guidance directly on point, lenders have adopted varying positions on the questions of whether, when or how to report such amounts. Some are reporting the amounts as payments are made on the new loan, others do not report previously unpaid interest that has been included in principal of the new loan and others may be reporting all the interest as paid at the time the loan is modified.

[2] Treasury regulations under sections 221 and 6050S addressing substantive and reporting treatment of student loans specifically reserve on the treatment of interest following a modification of the loan.

It is important to note that borrowers are ultimately responsible for determining the amount of interest that is deductible on their individual returns, and generally would have that information available in the loan documentation that is received as part of the lending transaction. The information reported on Form 1098 is not determinative of the deduction of the borrower. The fact that differences may arise between the borrower's determination of a deductible amount and the lender's reporting was anticipated by the IRS. In *Publication 936, Home Mortgage Interest Deduction*, there are instructions for borrowers to follow in circumstances when differences arise. That said, IRS reporting guidance should be clear so that reporting by lenders to borrowers is consistent across the industry.

As additional evidence of the uncertainty in this area, there have been a number of recent court cases in which plaintiffs (borrowers) have alleged that lenders have provided inaccurate or incomplete information reporting documents, resulting in alleged damage. Generally, the cases have either been dismissed or delayed on the grounds that existing rules do not address the issue and the IRS has primary jurisdiction over how to resolve the question.[3]

Estimated Number of Taxpayers Affected by the Issue:

It is difficult to estimate the number of taxpayers affected by the issue, but we believe the number is substantial. The issue has an impact on both lenders and borrowers. Figures reported by the Office of the Comptroller of the Currency suggest that more than 6 million mortgages were modified between January 2008 and June 2015, and over 100,000 more continue to be modified each quarter.[4]

Issue Resolution:

For the reasons set forth above, the ABA believes this issue is appropriate for acceptance into the IIR program. We look forward to working with you to evaluate the issues and develop effective and practical solutions. We suggest that reporting guidance in this area should be based on at least the following tenets:

1. Any reporting guidance should be applied on a prospective basis and applied only to loans that are modified after the effective date.
2. Since there are significant technology and systems challenges associated with any required changes in reporting, guidance should allow for an appropriate amount of time for changes to be made.
3. Consideration should be given to borrowers who may need to make changes in the interest deductions taken on previously filed returns with a view to avoid significant levels of amended tax returns.

[3] See a variety of cases including *Smith v. Bank of America, N.A.*,No. CV 14-6668 DSF (PLA) (C.D. Cal. February 3, 2015), *Pemberton v. Nationstar Mortgage LLC*, 14-cv-1024-BAS (WVG) (S.D. Cal. February 4, 2015), *Strugala v. Flagstar Bank, FSB*, 5:13-cv-05927-Ejd (N.D. Cal. September 4, 2015).

[4] There figures are approximations based on quarterly *OCC Mortgage Metrics Reports* issued by the Office of the Controller of the Currency since 2009, calculated by grossing up the amount of mortgage loan modifications reported by OCC (and OTS) chartered national banks and savings banks by the portion of the first-lien residential mortgage market in these institutions' portfolios over time.

Contact Information:

If you have questions or need additional information, please contact me at 202-663-5317 or jkinsella@aba.com.

Sincerely,

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