AMERICAN BANKERS ASSOCIATION
CONSUMER MORTGAGE COALITION
HOUSING POLICY COUNCIL of the FINANCIAL SERVICES ROUNDTABLE
MORTGAGE BANKERS ASSOCIATION

July 7, 2014

The Honorable Ron Wyden
Chairman
Committee on Finance
United States Senate
219 Dirksen Senate Office Building
Washington, D.C. 20510

The Honorable Orrin G. Hatch
Ranking Member
Committee on Finance
United States Senate
219 Dirksen Senate Office Building
Washington, D.C. 20510

Re: Implementation Process for Amended IRS Mortgage Interest Statement

Dear Chairman Wyden and Ranking Member Hatch:

As the Senate Finance Committee considers the "*Preserving America's Transit and Highways Act of 2014,"* the undersigned trade associations wish to express concern about mortgage servicers' ability to amend the information included in IRS Form 1098, Mortgage Interest Statement. The undersigned organizations understand the IRS's need for additional information about mortgage interest. We do not object to reporting additional information to the IRS or to borrowers as proposed. Servicers do, however, need a reasonable amount of time to implement the changes that this proposal would require, and definitions, as we describe below.

Servicers currently are required to report to borrowers and to the IRS several items about interest payments on consumer mortgage loans. These include the payer's name and address, and the amount of interest and points the servicer received on the loan during the calendar year.

The proposal would require reporting additional information about mortgage loans. These new items are the unpaid principal balance; the address of the collateral property; whether the loan was a refinance during the calendar year; the real estate taxes paid from an escrow account; and the loan origination date.

Servicers Will Need Time to Implement Changed Reporting requirements

Servicers do typically collect the information proposed to be reported when they "board" new loans onto their servicing systems, depending on how some of the terms are defined. However, only some of this information is currently relevant for tax reporting purposes, so many servicers do not store all the information in a manner that would permit their automated servicing technology systems to retrieve it, and use the information to populate the appropriate boxes in a Form 1098, in a timely manner. Thus, revising the preparation of Form 1098 would require servicers to retool their technology systems. This generally requires starting with the new requirements, designing and managing the recoding necessary to implement the changes, testing, correcting and retesting, and training. Some servicers have multiple systems for servicing different types of loans, each of which must be revised separately. In addition, servicers commonly outsource some or all of the reporting functions to one or more vendors. For example, a servicer may retrieve the required data and supply them in electronic form to a print vendor, who uses the data to print the tax forms. When multiple vendors and systems are involved, the systems changes need to be coordinated and tested to ensure they can interface smoothly.

At the same time, servicers have been making extensive systems changes in recent years to adapt to the changes in both federal and state law governing servicing. These include the Dodd-Frank Act changes, new CFPB regulations, many state law amendments, as well as many changes required by Fannie Mae, Freddie Mac, and FHA, among others. Servicers, and especially smaller servicers, are not in a position to carry out another systems change on short notice.

A change in Form 1098, if begun early during a calendar year, can reasonably take several months. If the change process begins late in a calendar year, it takes longer. This is due to the fact that servicers and their vendors need to "lock down" their technology systems – that is, stop making changes – for several weeks late in the year to allow isolated testing of the many year-end changes they have been making throughout the year.

IRS Guidance Would Also Be Required

Just as servicers and their vendors would need time to make the necessary systems changes, the IRS would need time to redesign the Form 1098, revise the instructions, and to issue guidance clarifying certain aspects of the proposal.

For IRS reporting purposes, the word "refinance" is especially complex. The proposal would require servicers to indicate on Forms 1098 whether a loan was a refinance loan during the calendar year, which requires either a yes or a no answer. Typically, the term refinance means the simultaneous satisfaction and replacement of a mortgage loan on the same property with at least one borrower being the same. Loan modifications to prevent foreclosure are not typically considered refinances because there is usually no amendment to the lien, although there may be if a new property owner is added. Loan assumptions always involve a new borrower, and may or may not be in connection with

the new borrower's acquisition of the property. In connection with a modification or assumption, there may be a change in borrowers or in property owners, either by adding or removing one or more borrowers or owners. There may be a change in both borrowers and owners in the same modification or assumption. Loan modifications or loan assumptions therefore are not clearly susceptible to a binary categorization as a refinance or not a refinance.

In New York, consumers commonly use consolidation, extension, and modification agreements instead of a refinance, to reduce recording taxes that would payable in a traditional refinance. The loan is modified and extended but neither satisfied nor replaced. In this case, a modification is in the nature of a refinance.

The opposite also is possible. In any state, modifications can be used to acquire a property. A buyer may acquire a property by assuming an existing mortgage loan at the same time as the lender modifies the loan as part of the acquisition. In this case, a modification is in the nature of acquisition debt.

Further, clarity would be needed about whether a refinance includes a borrower who owns a property on which there was no loan, then takes out a loan on the property. This loan neither satisfies nor replaces a loan so it is not what is typically considered a refinance, yet it is not acquisition debt either. If the transaction involves adding a new owner on the property and that new owner is obligated on the mortgage loan, it would be acquisition debt as to that borrower.

Servicers will report as required, but reporting whether a loan is a refinance may not provide the IRS with information it needs. A refinanced loan may be acquisition debt, home equity debt, or a combination of the two, and the tax treatment of each differs. We would be pleased to discuss the types of information lenders and servicers have or could obtain that would be useful to the IRS, but we strongly prefer making all of the necessary systems changes at one time rather than piecemeal.

The definition of unpaid principal balance would also need to be clarified. Some default resolutions involve loan modifications that defer and capitalize arrearages, and may extend the maturity date. Some default resolutions involve splitting a loan into two loans, with arrearages as a subordinate loan on which there are no periodic payments, so that the principal balance of the senior loan is reduced, but the amount owed is not significantly changed. Some loans are "shared appreciation" loans, on which the amount the borrower must repay is contingent on the sales price in a future sale.

Servicers would also need to know specifically what is included in real estate taxes paid from an escrow account. Servicers sometimes escrow ground rents. Servicers may pay a taxing jurisdiction from an escrow, but the payment may be for a service rather than for deductible taxes. It is also possible that a borrower pays real estate taxes outside of an escrow in addition to taxes that are paid through an escrow. The IRS may be better served by receiving reports from taxing authorities about real estate taxes paid because

those authorities have the information necessary to determine whether the taxes are properly deductible.

In addition, the IRS would need to provide guidance about how to categorize a loan when the servicer does not have sufficient information, such as when a servicer acquired servicing rights from a transferor who does not provide the necessary information in a timely manner.[1] Depending on how the definitions or the new reportable items are written, lenders may need to collect new information at loan origination. In this event, the information would likely not be available on loans originated before the definitions are final and are implemented.

The IRS will need time to provide the necessary clarity, and to redesign the form, and servicers and their vendors will need time to make the necessary systems changes to adapt to the new requirements. For these reasons, we respectfully request that the amendments to the Form 1098 Mortgage Interest Statement become effective for statements due after December 31, 2015, and that the IRS guidance be required to be final by April 1, 2015.

Sincerely,

American Bankers Association
Consumer Mortgage Coalition
Housing Policy Council of the Financial Services Roundtable
Mortgage Bankers Association

cc: The Honorable Dave Camp
Chairman
Committee on Ways and Means
United States House of Representatives
1102 Longworth House Office Building
Washington D.C. 20515

The Honorable Sander Levin
Ranking Member
Committee on Ways and Means
United States House of Representatives
1102 Longworth House Office Building
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[1] The Consumer Financial Protection Bureau requires that during transfers of mortgage servicing, the transferor and transferee have policies and procedures in place to ensure timely transfer all relevant information in the transferor's possession. 12 C.F.R. § 1024.38(b)(4). However, this regulation does not apply to open-end credit. 12 C.F.R. § 1024.30(a), referencing § 1024.31. In any event, it is possible that a transferor may not transfer all information a transferee requires, such as when a transferor is a receiver for a failed servicer whose accounts were in disarray or incomplete. In this event, the transferee may be able to manually research the necessary information, but there may not be enough time to complete the research before the Form 1098 filing deadline, especially if the number of loans involved is more than a few.