The Asset Management Industry
SERVING INDIVIDUAL INVESTORS

INVESTMENT COMPANY INSTITUTE

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INTERNAL REVENUE SERVICE ISSUES FINAL REGULATIONS ON REMICS

January 7, 1993 TO: TAX COMMITTEE NO. 1-93 ACCOUNTING/TREASURERS COMMITTEE NO. 1-93 RE: INTERNAL REVENUE SERVICE ISSUES FINAL REGULATIONS ON REMICS ____ The Internal Revenue Service has released the attached final regulations related to real estate mortgage investment conduits ("REMICS"). Of possible interest to regulated investment companies ("RICs") are several provisions dealing with the treatment of holders of REMIC regular and residual interests, and in particular two provisions dealing with the tax on the transfer of REMIC residual interests to "disqualified organizations". The Internal Revenue Code imposes a tax on transfers of REMIC residual interests to "disqualified organizations". A disqualified organization is any U.S. or foreign government and any entity exempt from the federal income tax, other than a tax exempt entity paying tax on unrelated business taxable income. The tax is imposed at the highest corporate rate on the present value of the total excess inclusions anticipated to accrue on the residual interest after the transfer. Excess inclusions on a REMIC residual interest are defined as the excess of the income actually allocated by the REMIC to the REMIC residual interest over the amount of income which would accrue if the purchase price of the REMIC residual interest earned income at 120 percent of the federal long-term rate. The regulations provide that a transferor will not be liable for the tax if (1) the transferee of the REMIC residual interest provided, under penalties of perjury, the transferee's social security number and a statement that it is not a disqualified organization and (2) the transferor did not know that this information was false. See Treas. Reg. section 1.860E-2(a)(7). In addition, the Code provides that if a "pass-thru entity", which includes a RIC, holds a REMIC residual interest and has a disqualified organization as a shareholder, the pass- thru entity is subject to tax annually. The tax is imposed at the highest corporate rate on the total excess inclusions for the year with respect to the REMIC residual interest. No tax will be imposed with respect to a shareholder in a pass-thru entity if the entity obtains an affidavit from the shareholder similar to that described above, and has no actual knowledge that the affidavit is false. Where the tax is imposed, it is deductible against the pass-thru entity's taxable income. The regulations clarify that a RIC will not be considered to be paying preferential dividends within the meaning of Code section 562(c) if the tax incurred by the RIC with respect to a shareholder which is a disqualified organization is allocated to that shareholder, thus reducing the shareholder's distribution from the RIC. See Treas. Reg. section 1.860E-2(b). We will keep you informed of further developments. David J. Mangefrida Jr. Assistant Counsel - Tax