

## Section 25.—Interest on Certain Home Mortgages

26 CFR 1.25-3: *Qualified mortgage credit certificate.*

T.D. 8692

### DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 1

#### Reissuance of Mortgage Credit Certificates

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document contains final regulations relating to the reissuance of mortgage credit certificates. Changes to the applicable law were made by the Tax Reform Act of 1984. The regulations provide guidance to issuers and holders of mortgage credit certificates.

EFFECTIVE DATE: These regulations are effective December 17, 1996.

FOR FURTHER INFORMATION CONTACT: L. Michael Wachtel, (202) 622-3980 (not a toll-free number).

#### SUPPLEMENTARY INFORMATION:

##### Background

This document adds final regulations to the Income Tax Regulations (26 CFR part 1) to provide guidance under section 25(e)(4) of the Internal Revenue Code (Code) with respect to the reissuance of mortgage credit certificates. Section 25(e)(4) was added to the Code by section 612 of the Tax Reform Act of 1984, 98 Stat. 494, 905.

On December 22, 1993, temporary regulations (TD 8502) relating to refinancing under section 25(e)(4) were published in the **Federal Register** (58 FR 67689). A notice of proposed rulemaking (REG-209574-92, previously FI-47-92) cross-referencing the temporary regulations was published in the **Federal Register** for the same day (58 FR 67744).

Written comments responding to these notices were received. There were no requests to appear in response to publication of a notice of a hearing in the **Federal Register** (61 FR 15204). Therefore, no public hearing was held. After consideration of all the comments, the

proposed regulations under section 25(e)(4) are adopted as revised by this Treasury decision, and the corresponding temporary regulations are removed. The comments and revisions are discussed below.

Explanation of provisions and summary of comments

The temporary regulations permit the reissuance of a mortgage credit certificate on or after December 22, 1992, but no later than 1 year after the date of the refinancing. Commentators thought this unnecessarily limited eligibility for the reissuance of a certificate and limited the flexibility of State and local governments. The final regulations, reflecting the goal of giving State and local governments maximum flexibility to administer mortgage credit certificate programs, remove these limits. A State or local government may reissue a certificate to any person who refinanced a mortgage for which a mortgage credit certificate was issued and who meets the other requirements for a reissued certificate. The credit for prior years is available to the extent that the certificate holder may file a claim for refund.

The temporary regulations provide that the certified mortgage indebtedness amount on the reissued certificate cannot exceed the remaining balance of the certified mortgage indebtedness amount on the existing certificate. Commentators suggested that the final regulations permit the indebtedness amount on the reissued certificate to include costs such as closing costs of the refinancing loan. This recommendation was not implemented in the final regulations because section 25(e)(4) of the Code limits the amount of the reissued certificate to the outstanding balance of the existing certificate.

The temporary regulations provide that the reissued certificate may not result in an increase in the credit that would otherwise have been allowable to the holder under the existing certificate for any taxable year. In the case of a series of refinancings, the amount allowable on the refinanced loan would be the amount allowable on the original loan, rather than the immediately preceding refinanced loan.

A holder of a mortgage credit certificate who refinances a fixed rate loan can determine the amount of interest that would have been paid for any taxable year on the refinanced loan from

an amortization schedule that projects interest and principal payments over the life of the loan. By applying the mortgage credit rate to the amount of interest, the holder can calculate the amount of tax credit that would have been allowable for the taxable year.

The amount of tax credit that would have been allowable for a taxable year is not as easily calculated by a holder of a mortgage credit certificate who refinances a variable rate loan because the holder cannot project an amortization schedule for the refinanced loan. Instead, each year the holder must calculate the amount of interest that would have been paid on the refinanced loan under the interest rate in effect for that year and then calculate the tax credit that would have been allowable. This procedure was described as burdensome by various commentators.

The final regulations continue to reflect the statutory requirement that the reissued certificate not result in an increase in the credit that would otherwise have been allowable to the certificate holder under the existing certificate for any taxable year. The final regulations, however, permit a certificate holder who refinances a variable rate loan with either a variable rate loan or a fixed rate loan to determine the amount of credit that would have been allowable by using an alternative method instead of calculating the amount based on the actual interest that would have been paid on the refinanced loan. Under the alternative method, the credit that would have been allowable is computed using an amortization schedule of a hypothetical self-amortizing loan with level payments projected to the final maturity date of the refinanced loan. The interest rate of the hypothetical loan is the annual percentage rate (APR) of the refinancing loan determined for purposes of the Federal Truth in Lending Act. The principal of the hypothetical loan is the remaining outstanding balance of the certified mortgage indebtedness specified on the existing certificate.

A certificate holder who refinances a variable rate loan may use the alternative method or may compute the actual amount of credit that would have been allowable. However, the method chosen must be consistently applied by the holder beginning with the first taxable year for which the tax credit based upon the reissued certificate is claimed.

The temporary regulations do not address whether a refinancing loan is a financing that is subject to the recapture provisions of section 143(m) if the refinanced loan was not subject to recapture. The final regulations provide that the refinancing loan underlying a reissued mortgage credit certificate that replaces a mortgage credit certificate issued on or before December 31, 1990, is not a federally subsidized indebtedness that is subject to the recapture provisions of section 143(m) of the Code.

Commentators asked for clarification of whether additional volume cap was required in order to reissue a mortgage credit certificate and whether additional reporting was required by the issuer of a reissued mortgage certificate. Reissuance of a mortgage credit certificate relates to refinancing by a mortgage credit certificate holder of a mortgage loan on the holder's principal residence. Volume cap was required to be obtained in connection with the program under which the original certificate had been issued. Because the reissued certificate is replacing the existing certificate, it is treated as issued in connection with the original program, and additional volume cap is unnecessary for the reissuance. For similar reasons, no additional reporting is required by an issuer of a reissued mortgage credit certificate.

#### Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in EO 12866. It also has been determined that section 553(b) of the Administrative Procedures Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the notice of proposed rulemaking preceding the regulations was issued prior to March 29, 1996, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rule making preceding these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

#### Drafting Information

The principal author of these regulations is L. Michael Wachtel, Office of the Assistant Chief Counsel (Financial Institutions and Products), IRS. However, other personnel from the IRS and Treasury Department participated in their development.

#### Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

#### PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by removing the entry "1.25-1T-1.25-8T" and adding entries in numerical order to read as follows:

Authority: 26 U.S.C. 7805 \* \* \*  
Section 1.25-1T also issued under 26 U.S.C. 25.  
Section 1.25-2T also issued under 26 U.S.C. 25.  
Section 1.25-3 also issued under 26 U.S.C. 25.  
Section 1.25-3T also issued under 26 U.S.C. 25.  
Section 1.25-4T also issued under 26 U.S.C. 25.  
Section 1.25-5T also issued under 26 U.S.C. 25.  
Section 1.25-6T also issued under 26 U.S.C. 25.  
Section 1.25-7T also issued under 26 U.S.C. 25.  
Section 1.25-8T also issued under 26 U.S.C. 25. \* \* \*

Par. 2. Section 1.25-3 is added to read as follows:

#### § 1.25-3 Qualified mortgage credit certificate.

(a) through (g)(1)(ii) [Reserved] For further guidance, see § 1.25-3T(a) through (g)(1)(ii).

(g)(1)(iii) *Reissued certificate exception.* See paragraph (p) of this section for rules regarding the exception in the case of refinancing existing mortgages.

(g)(2) through (o) [Reserved] For further guidance, see § 1.25-3T(g)(2) through (o).

(p) *Reissued certificates for certain refinancings—(1) In general.* If the issuer of a qualified mortgage credit certificate reissues a certificate in place of an existing mortgage credit certificate to the holder of that existing certificate, the reissued certificate is treated as satisfying the requirements of this section. The period for which the reissued certificate is in effect begins with the date of the refinancing (that is, the date on which interest begins accruing on the refinancing loan).

(2) *Meaning of existing certificate.* For purposes of this paragraph (p), a mortgage credit certificate is an existing certificate only if it satisfies the requirements of this section. An existing certifi-

cate may be the original certificate, a certificate issued to a transferee under § 1.25-3T(h)(2)(ii), or a certificate previously reissued under this paragraph (p).

(3) *Limitations on reissued certificate.* An issuer may reissue a mortgage credit certificate only if all of the following requirements are satisfied:

(i) The reissued certificate is issued to the holder of an existing certificate with respect to the same property to which the existing certificate relates.

(ii) The reissued certificate entirely replaces the existing certificate (that is, the holder cannot retain the existing certificate with respect to any portion of the outstanding balance of the certified mortgage indebtedness specified on the existing certificate).

(iii) The certified mortgage indebtedness specified on the reissued certificate does not exceed the remaining outstanding balance of the certified mortgage indebtedness specified on the existing certificate.

(iv) The reissued certificate does not increase the certificate credit rate specified in the existing certificate.

(v) The reissued certificate does not result in an increase in the tax credit that would otherwise have been allowable to the holder under the existing certificate for any taxable year. The holder of a reissued certificate determines the amount of tax credit that would otherwise have been allowable by multiplying the interest that was scheduled to have been paid on the refinanced loan by the certificate rate of the existing certificate. In the case of a series of refinancings, the tax credit that would otherwise have been allowable is determined from the amount of interest that was scheduled to have been paid on the original loan and the certificate rate of the original certificate.

(A) In the case of a refinanced loan that is a fixed interest rate loan, the interest that was scheduled to be paid on the refinanced loan is determined using the scheduled interest method described in paragraph (p)(3)(v)(C) of this section.

(B) In the case of a refinanced loan that is not a fixed interest rate loan, the interest that was scheduled to be paid on the refinanced loan is determined using either the scheduled interest method described in paragraph (p)(3)(v)(C) of this section or the hypothetical interest method described in paragraph (p)(3)(v)(D) of this section.

(C) The scheduled interest method determines the amount of interest for

each taxable year that was scheduled to have been paid in the taxable year based on the terms of the refinanced loan including any changes in the interest rate that would have been required by the terms of the refinanced loan and any payments of principal that would have been required by the terms of the refinanced loan (other than repayments required as a result of any refinancing of the loan).

(D) The hypothetical interest method (which is available only for refinanced loans that are not fixed interest rate loans) determines the amount of interest treated as having been scheduled to be paid for a taxable year by constructing an amortization schedule for a hypothetical self-amortizing loan with level payments. The hypothetical loan must have a principal amount equal to the remaining outstanding balance of the certified mortgage indebtedness specified on the existing certificate, a maturity equal to that of the refinanced loan, and interest equal to the annual percentage rate (APR) of the refinancing loan that is required to be calculated for the Federal Truth in Lending Act.

(E) A holder must consistently apply the scheduled interest method or the hypothetical interest method for all taxable years beginning with the first taxable year the tax credit is claimed by the holder based upon the reissued certificate.

(4) *Examples.* The following examples illustrate the application of paragraph (p)(3)(v) of this section:

*Example 1.* A holder of an existing certificate that meets the requirements of this section seeks to refinance the mortgage on the property to which the existing certificate relates. The final payment on the holder's existing mortgage is due on December 31, 2000; the final payment on the new mortgage would not be due until January 31, 2004. The holder requests that the issuer provide to the holder a reissued mortgage credit certificate in place of the existing certificate. The requested certificate would have the same certificate credit rate as the existing certificate. For each calendar year through the year 2000, the credit that would be allowable to the holder with respect to the new mortgage under the requested certificate would not exceed the credit allowable for that year under the existing certificate. The requested certificate, however, would allow the holder credits for the years 2001 through 2004, years for which, due to the earlier scheduled retirement of the existing mortgage, no credit would be allowable under the existing certificate. Under paragraph (p)(3)(v) of this section, the issuer may not reissue the certificate as requested because, under the existing certificate, no credit would be allowable for the years 2001 through 2004. The issuer may, however, provide a reissued certificate that limits the amount of the credit allowable in each year to the

amount allowable under the existing certificate. Because the existing certificate would allow no credit after December 31, 2000, the reissued certificate could expire on December 31, 2000.

*Example 2.* (a) The facts are the same as *Example 1* except that the existing mortgage loan has a variable rate of interest and the refinancing loan will have a fixed rate of interest. To determine whether the limit under paragraph (p)(3)(v) of this section is met for any taxable year, the holder must calculate the amount of credit that otherwise would have been allowable absent the refinancing. This requires a determination of the amount of interest that would have been payable on the refinanced loan for the taxable year. The holder may determine this amount by—

(1) Applying the terms of the refinanced loan, including the variable interest rate or rates, for the taxable year as though the refinanced loan continued to exist; or

(2) Obtaining the amount of interest, and calculating the amount of credit that would have been available, from the schedule of equal payments that fully amortize a hypothetical loan with the principal amount equal to the remaining outstanding balance of the certified mortgage indebtedness specified on the existing certificate, the interest equal to the annual percentage rate (APR) of the refinancing loan, and the maturity equal to that of the refinanced loan.

(b) The holder must apply the same method for each taxable year the tax credit is claimed based upon the reissued mortgage credit certificate.

(5) *Coordination with section 143(m)(3).* A refinancing loan underlying a reissued mortgage credit certificate that replaces a mortgage credit certificate issued on or before December 31, 1990, is not a federally subsidized indebtedness for the purposes of section 143(m)(3) of the Internal Revenue Code.

### § 1.25-3T [Amended]

Par. 3. Section 1.25-3T is amended by removing paragraphs (g)(1)(iii) and (p).

Margaret Milner Richardson,  
*Commissioner of Internal Revenue.*

Approved November 27, 1996.

Donald C. Lubick,  
*Acting Assistant Secretary  
of the Treasury.*

(Filed by the Office of the Federal Register on December 16, 1996, 8:45 a.m., and published in the issue of the Federal Register for December 17, 1996, 61 F.R. 66212)