

Exemption From Taxes Granted to
Real Estate Mortgage Investment Conduits (REMICs)

Chapter 817 of the Business Tax Reform and Rate Reduction Act of 1987 provides for the exemption from taxation for Real Estate Mortgage Investment Conduits (REMICs) as defined in Section 860D of the Internal Revenue Code.

Section 5 of Article One of the Tax Law exempts the REMIC from taxation. An entity that is treated for federal income tax purposes as a real estate mortgage investment conduit (REMIC) as such term is defined in IRC Section 860 D, shall be exempt from all taxation imposed or authorized under the tax law, upon its capital stock, franchises or income. A REMIC shall not be treated as a corporation, partnership or trust for purposes of the tax law. The assets of a REMIC shall not be included in the calculation of any franchise tax liability under the tax law. This provision does not exempt the holders of regular or residual interests from tax.

At the present time, a REMIC is not required to file a corporate franchise tax return, partnership return, or a fiduciary income tax return even if the REMIC is located in New York State. In addition, the REMIC is not required to file a New York State information return, Form IT-2101.1, for payments made to holders of regular or residual interests.

Definition of a REMIC

REMICs are entities authorized under provisions of the Internal Revenue Code to hold real estate mortgages and to issue interests backed by those mortgages. Holdings in a REMIC must be either in a regular or residual interest.

A REMIC can assume any form of business entity (corporation, partnership, trust, etc). A REMIC can be created by a corporation as a segregated pool of assets, in which case such assets would not be included in the capital or asset base in the franchise tax computation of that corporation.

Internal Revenue Code Section 860D(a) provides the following definition of a REMIC:

"(a) General Rule - For purposes of this title, the terms "real estate mortgage investment conduit" and "REMIC" mean any entity -

(1) to which an election to be treated as a REMIC applies for the taxable year and all prior taxable years,

- (2) all of the interests in which are regular interests or residual interests,
- (3) which has 1 (and only 1) class of residual interests (and all distributions, if any, with respect to such interests are pro rata),
- (4) as of the close of the 4th month ending after the startup day and each quarter ending thereafter, substantially all of the assets of which consist of qualified mortgages and permitted investments, and
- (5) which has a taxable year which is a calendar year."

Election to be Treated as a REMIC

Internal Revenue Code Section 860D(b) provides the following explanation for the election to be treated as a REMIC:

"(b) Election -

(1) In general - An entity (otherwise meeting the requirements of subsection (a)) may elect to be treated as a REMIC for its 1st taxable year. Such an election shall be made on its return for such 1st taxable year. Except as provided in paragraph (2), such an election shall apply to the taxable year for which made and all subsequent taxable years.

(2) Termination -

(A) In general - If any entity ceases to be a REMIC at any time during the taxable year, such entity shall not be treated as a REMIC for such taxable year or any succeeding taxable year.

(B) Inadvertent terminations - If -

- (i) an entity ceases to be a REMIC,
- (ii) the Secretary determines that such cessation was inadvertent,
- (iii) no later than a reasonable time after the discovery of the event resulting in such cessation, steps are taken so that such entity is once more a REMIC, and
- (iv) such entity, and each person holding an interest in such entity at any time during the period specified pursuant to this subsection, agrees to make such adjustments (consistent with the treatment of such entity as a REMIC or a C corporation) as may be required by the Secretary with respect to such period. then, notwithstanding such terminating event, such entity shall be treated as continuing to be a REMIC (or such cessation shall be disregarded for purposes of subparagraph (A)) whichever the Secretary determines to be appropriate."

Definitions of Regular and Residual Interests

"Internal Revenue code section 860G defines the term "regular interest" as an interest in a REMIC, the terms of which are fixed on the startup day, and which -

(A) unconditionally entitles the holder to receive a specified principal amount (or other similar amount), and

(B) provides that interest payments (or other similar amounts), if any, at or before maturity are payable based on a fixed rate (or to the extent provided in regulations, at a variable rate).

An interest shall not fail to meet the requirements of subparagraph (A) merely because the timing (but not the amount) of the principal payments (or other similar amounts) may be contingent on the extent of prepayments on qualified mortgages and the amount of income from permitted investments.

The term "residual interest" means an interest in a REMIC which is not a regular interest and is designated as a residual interest."

Tax Treatment to Holders of Regular or Residual Interests

Regular interest holdings in a REMIC are treated as debt instruments for federal income tax purposes. Accordingly, holders are taxed as if their regular interest holdings were debt obligations. The holder of a regular interest must account for income received from the REMIC using the accrual method of accounting.

Holders of residual interests are required to account for the daily income or loss of their interest in the REMIC. Losses of a residual interest holding may not exceed its adjusted basis. Any excess loss may be carried forward.

Prohibited transactions which are taxed 100% for federal income tax purposes (IRC 860F(a)) are not taxable for New York State tax purposes.

The tax treatment under various articles of New York State Tax Law follows:

Article 9-A

Holders of interests in REMICs (regular or residual) are required to report their holdings as business capital and any income earned as business income.

Article 9, Section 180

A REMIC formed as a corporation is liable for the organization tax imposed under Article 9, Section 180. That tax is imposed at the time of incorporation. A corporation does not become a REMIC until it makes the election to become a REMIC on the federal information return filed for its first taxable year (IRC 860D(b)(1)). Accordingly the corporation is not a REMIC and exempt from tax at the time this organization tax is imposed.

Article 9, Section 181.1 and 181.2

A REMIC formed as a corporation is not required to pay the license fee or annual maintenance fee required by Article 9, Sections 181.1 and 181.2.

Article 9, Section 183 & 184

The value of both the regular and residual interest holding of a REMIC must be shown at book value for Article 9, Section 183 purposes. The income of the holder of an interest in a REMIC under Article 9, Section 184 is considered a gross receipt allocated where that interest is held.

Article 9, Section 185

Holders of interests in REMICs are required to allocate the value of their holdings in REMICs where employed or located, at the average value for the year.

Article 9, Section 186

The holder of an interest in a REMIC is required to report income earned as "Gross Earnings from other Revenues." The gross earnings would be allocated where the interest in the REMIC is held.

Article 13

If the holding of an interest in a REMIC is considered an unrelated business activity, the income would be reflected in the computation of Federal unrelated taxable income. If an allocation is claimed, the receipt would be reported as an other business receipt allocated to the location where the interest is held.

Article 22

Holders of interests in REMICs who are New York State residents will include in their New York taxable income the same amount included in their federal taxable income. Nonresidents, in determining New York Source Income will only include the income received from their REMIC interests where such interests are employed in a trade, business, profession, or occupation carried on in New York State.

Article 32

If a banking corporation holds regular or residual interests in a REMIC for investment purposes, income from those interests is allocated to New York in the same manner as income from investment activities. If a banking corporation owns regular or residual interests for other business purposes, the income would be allocated to New York State in the same manner as other business receipts.

Article 33

Holders of interests in REMICs are required to report their holdings as business capital and are required to report any income earned as business income.