

[Federal Register: December 8, 1994]

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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Parts 1 and 602

[TD 8571]
RIN 1545-AO57

Reporting Requirements for Recipients of Points Paid on
Residential Mortgages

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations setting forth the information reporting requirements for recipients of prepaid interest in the form of points (points) paid on residential mortgages. The regulations implement amendments made by the Omnibus Budget Reconciliation Act of 1989. The regulations affect any taxpayer that, in the course of a trade or business, receives \$600 or more of interest, including points, in a calendar year on a residential mortgage.

DATES: These regulations are effective December 8, 1994.

These regulations are applicable for mortgage interest received after December 31, 1987. However, the reporting requirements of Sec. 1.6050H-1 of the regulations do not apply to prepaid interest in the form of points received before January 1, 1995.

FOR FURTHER INFORMATION CONTACT: James L. Atkinson, (202) 622- 4950 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collections of information contained in these final regulations have been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3504(h)) under control number 1545-1380. The estimated annual burden per

respondent/recordkeeper varies from two hours to thirty-five hours, depending on individual circumstances, with an estimated average of ten hours.

Comments concerning the accuracy of this burden estimate and suggestions for reducing this burden should be sent to the Internal Revenue Service, Attn: IRS Reports Clearance Officer, PC:FP, Washington, DC 20224, and to the Office of Management and Budget, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503.

Background

On December 31, 1992, the IRS published in the Federal Register a notice of proposed rulemaking (57 FR 62526) proposing amendments to the Income Tax Regulations (26 CFR part 1) under section 6050H of the Internal Revenue Code of 1986 (Code). These amendments were proposed to implement section 7646 of the Omnibus Budget Reconciliation Act of 1989, Pub. L. 101-239, 103 Stat. 2106 (the 1989 Act).

Written comments responding to the notice of proposed rulemaking were received. No public hearing was requested or held. After consideration of all the comments, the proposed regulations under section 6050H are adopted as revised by this Treasury decision. The comments made on the proposed regulations and the revisions incorporated in the final regulations are discussed below.

Explanation of Revisions and Summary of Comments in General

Section 6050H provides that an information return must be made by any person who is engaged in a trade or business and who, in the course of that trade or business, receives from any individual \$600 or more of interest on any mortgage in a calendar year. Any person required to make an information return under section 6050H also must furnish a statement to the payor of record on or before January 31 of the year following the calendar year in which the interest was received.

Section 6050H(b)(2) was amended by the 1989 Act to require persons subject to the information reporting requirements of section 6050H to separately state the amount of points and the amount of interest (other than points) received from an individual on a mortgage during a calendar year. Section 6050H(d)(2) requires persons subject to the information reporting requirements to provide to the individual from whom the interest and points were received a statement separately stating the amount of points and the amount of interest (other than points) received on the mortgage during the calendar year.

On April 12, 1988, the IRS issued final regulations (TD 8191, (53 FR 12002)) regarding the application of section 6050H to amounts received as interest (other than points). The final regulations contained in this Treasury decision supplement the existing regulations by providing guidance as to the application of section 6050H to points received from an individual during a calendar year.

On December 29, 1993, the IRS issued final regulations (TD 8507, (58 FR 68751)) regarding the application of section 6050H to reimbursements of interest paid in connection with a qualified

mortgage. The final regulations contained in this Treasury decision preserve all substantive changes made to Sec. 1.6050H-2 by TD 8507, including changes made to the language of Sec. 1.6050H-2(a)(2)(iv) (renumbered as Sec. 1.6050H-2(a)(2)(v) by the final regulations). Apart from the renumbering of various provisions, the final regulations do not affect the language of the regulatory provisions adopted by TD 8507. A complete discussion of TD 8507 may be found in the preamble to that Treasury decision.

At the request of commentators, the IRS is considering the issuance of guidance providing uniform procedures for requesting extensions of time within which to file information returns with the IRS and related statements to taxpayers. This guidance, if issued, would apply to the information reporting requirements set forth in this Treasury decision.

Significant Provisions of and Changes Made by the Final Regulations

A. Definition of Points

A number of commentators submitted suggestions regarding the proper definition of prepaid interest in the form of points. These suggestions and other significant provisions are summarized below.

1. Seller-Paid Points

The final regulations require the reporting of points that are paid by the seller of a principal residence on behalf of the borrower (i.e., seller-paid points). For this purpose, seller-paid points are treated as paid by the seller to the payor of record and then paid directly by the payor of record to the interest recipient.

One commentator suggested that seller-paid points should not be deductible by a borrower, and as a result, should not be reported by an interest recipient. Consistent with the provisions of Sec. 1.1273-2(g)(4) (pertaining to original issue discount), however, the IRS published Rev. Proc. 94-27, 1994-1 C.B. 613, on April 11, 1994, permitting borrowers to treat seller-paid points as amounts that are deductible under section 461(g)(2) of the Code. In order to promote consistency with this treatment, the final regulations require the reporting of seller-paid points on Form 1098.

2. Loan Origination Fees

The regulations apply equally to amounts designated as points payable in connection with any residential loan, regardless of whether the loan is a conventional loan, or is insured or guaranteed by the Federal Housing Administration (FHA) or the Department of Veterans Affairs (VA). Amounts paid in connection with either a VA or an FHA loan that would not be reportable if paid in connection with a conventional loan, however, continue to be nonreportable (for example, a VA funding fee).

3. Home Improvement Loans

Commentators also suggested that the regulations be modified to reflect the statutory language of section 461(g)(2) of the Code, permitting a deduction for points paid in connection with indebtedness incurred for either the purchase or the improvement of the taxpayer's principal residence. The final regulations continue to exclude from the definition of reportable points amounts paid in respect of indebtedness

incurred for the improvement of the taxpayer's principal residence. This limitation is designed to alleviate the need for lenders to ascertain that the disbursed funds actually are used for the improvement of the taxpayer's residence.

The final regulations specifically provide that the regulations govern only the reporting of points under section 6050H of the Code, and do not affect the borrower's ability to deduct as points any amount that otherwise would be deductible under applicable authority. This provision clarifies that the deductibility of amounts such as points paid on home improvement loans are not affected by the exclusion of such amounts from the final regulations. These points are deductible under section 461(g)(2) provided that the taxpayer can establish by appropriate documentation that the points were paid for the improvement of the residence and that the requirements of section 163(h)(3) are otherwise satisfied.

4. Land Contracts

One commentator requested clarification regarding application of the regulations to the refinancing of a land contract (or land sale contract, contract for deed, or similar forms of seller financing). In a land contract between two individuals, legal title to the property is not granted to the buyer until the land contract is paid in full.

For tax purposes, the land contract generally constitutes a completed sale upon the transfer to the buyer of the benefits and burdens of ownership. Accordingly, subsequent indebtedness incurred to extinguish the outstanding balance of the amount due the seller constitutes a refinancing of the acquisition debt rather than the purchase of the residence. Accordingly, the final regulations have been revised to clarify that points paid in connection with the refinancing of land contracts and similar forms of seller-financed transactions must not be reported on Form 1098 because only points paid on the acquisition of the residence are reportable under the regulations.

B. Designation Agreement

The proposed regulations permit an interest recipient to enter into a designation agreement with a qualified person, pursuant to which the qualified person will assume responsibility for fulfilling the reporting responsibilities of the interest recipient. In general, the proposed regulations provide that a qualified person is either (i) a trade or business with respect to which the interest recipient is under common control within the meaning of Sec. 1.414(c)-2, or (ii) a person who is named as the designee by the lender of record or by another qualified person in a designation agreement, and who either was involved in the original loan transaction or is a subsequent purchaser of the loan.

1. Qualified Person

One commentator suggested that the definition of qualified person be expanded to include closing attorneys and settlement agents. The commentator suggested that closing attorneys and settlement agents are in the best position to determine the extent to which points should be reported on Form 1098.

Neither closing attorneys nor settlement agents are suited to

fulfill the continuing, annual reporting on Form 1098 of interest (other than points) paid on the mortgage. Because it is undesirable to separate the responsibility for reporting points from the responsibility for reporting interest (other than points), neither closing attorneys nor settlement agents have been added to the list of qualified persons.

It also was suggested that the definition of qualified persons be clarified to include mortgage servicers. In many cases, the mortgage lender will assign responsibility for servicing the mortgage, including applicable reporting responsibility, to a mortgage servicer that is a subsidiary of either the lender or the lender's parent corporation. The final regulations retain the existing definition of a qualified person for purposes of reporting interest (other than points). Thus, to the extent mortgage servicing corporations presently are able to comply with the provisions governing the reporting of interest (other than points), these corporations likewise should be able to comply with those requirements with respect to the reporting of points.

2. Incorporation Into Section 6045

One commentator suggested that the proposed regulations be amended to permit incorporation of the designation agreement into the designation agreement already permitted in the regulations under Code section 6045 on the sale or exchange of reportable real estate (see Sec. 1.6045-4(e)(5)). The commentator suggested that this consolidation would eliminate the need for two separate designation agreements for a single mortgage loan closing.

After careful consideration, the IRS has rejected this suggestion. The reporting provisions of the two sections serve different purposes and involve the collection of different types of information. (Compare Sec. 1.6045-4(h)(1) with Sec. 1.6050H-2(a)(2).) Moreover, the parties that are required to report under section 6045 and section 6050H, even with respect to the same transaction, generally are not identical. Thus, in most cases, each reporting person would be required to execute separate designation agreements. As a result of the fundamental incompatibility of the two reporting provisions, the final regulations retain the definition of qualified person contained in the proposed regulations.

C. Construction Loans

The regulations also provide guidance regarding the reporting of points paid on a loan incurred for the construction of a principal residence. Under the regulations, a loan incurred for the construction of a principal residence, as well as a permanent (i.e., take-out) loan incurred to refinance the construction loan, are each considered indebtedness incurred in connection with the purchase of a principal residence. Because no comments were received regarding the treatment of construction loans, the final regulations adopt the language of the proposed regulations without change.

D. \$600 Reporting Threshold

The current reporting regulations require an interest recipient

that receives at least \$600 of interest on a qualified mortgage for a calendar year to comply with the reporting requirements of the regulations. The proposed regulations clarify that for purposes of determining whether this \$600 reporting threshold has been met, interest includes prepaid interest in the form of points. Commentators suggested that the computation required by this provision would be administratively burdensome for lenders of record.

The Service believes that the additional burden that this computation will place on lenders will be minimal, while the benefits to borrowers will be tangible. Accordingly, the final regulations adopt the language of the proposed regulations without change.

E. Effective Date

The proposed regulations indicate that the reporting requirements set forth therein are to be effective for prepaid interest in the form of points received after December 31, 1993. These final regulations modify this effective date to provide that the reporting requirements with respect to points are not effective for points paid before January 1, 1995. For guidance on the application of section 6050H to points received after 1990 and before 1995, see Notice 90-70, 1990-2 C.B. 351; Rev. Proc. 92-11, 1992-1 C.B. 662; Rev. Rul. 92-2, 1992-1 C.B. 360; and Rev. Proc. 94-27, 1994-1 C.B. 613.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) and the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply to these regulations, and, therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding these regulations was submitted to the Small Business Administration for comment on its impact on small business.

Drafting Information: The principal author of these regulations is James L. Atkinson, Office of Assistant Chief Counsel (Income Tax and Accounting), IRS. However, other personnel from the IRS and Treasury Department participated in their development.

List of Subjects

26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

26 CFR Part 602

Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 602 are amended as follows:

PART 1--INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended in part by adding a new section authority to read as follows:

Authority: 26 U.S.C. 7805 * * *.

Section 1.6050H-1 also issued under 26 U.S.C. 6050H. * * *

Par. 2. Section 1.6050H-0 is revised to read as follows:

Sec. 1.6050H-0 Table of contents.

This section lists the major captions that appear in Secs. 1.6050H-1 and 1.6050H-2.

Sec. 1.6050H-1 Information reporting of mortgage interest received in a trade or business from an individual.

- (a) Information reporting requirement.
 - (1) Overview.
 - (2) Reporting requirement.
 - (3) Optional reporting.
- (b) Qualified mortgage.
 - (1) In general.
 - (2) Mortgage.
 - (i) In general.
 - (ii) Transitional rule for certain obligations existing on December 31, 1984.
 - (iii) Transitional rule for certain obligations existing on December 31, 1987.
 - (3) Payor of record.
 - (4) Lender of record.
- (c) Interest recipient.
 - (1) Trade or business requirement.
 - (2) Interest received or collected on behalf of another person.
 - (i) General rule.
 - (ii) Exception.
 - (3) Interest received in the form of points.
 - (i) In general.
 - (ii) If designation agreement is in effect.
 - (4) Governmental unit.
 - (5) Examples.
- (d) Additional rules.
 - (1) Reporting by foreign person.
 - (2) Reporting with respect to nonresident alien individual.
 - (i) In general.

- (ii) Nonresident alien individual status.
- (3) Reporting by cooperative housing corporations.
- (e) Amount of interest received on mortgage for calendar year.
 - (1) In general.
 - (2) Calendar year.
 - (i) In general.
 - (ii) De minimis rule.
 - (iii) Applicability to points.
 - (3) Certain interest not received on mortgage.
 - (i) Interest received from seller on payor of record's mortgage.
 - (ii) Interest received from governmental unit.
- (4) Interest calculated under Rule of 78s method of accounting.
 - (f) Points treated as interest.
 - (1) General rule.
 - (2) Limitations.
 - (3) Special rule.
 - (i) Amounts paid directly by payor of record.
 - (ii) Examples.
 - (4) Construction loans.
 - (i) In general.
 - (ii) Limitation on refinancing of construction loans.
 - (5) Amounts paid to mortgage brokers.
 - (6) Effect on deduction of points.
 - (g) Effective date.
 - (1) In general.
 - (2) Points.

Sec. 1.6050H-2 Time, form, and manner of reporting interest received on qualified mortgage.

- (a) Requirement to file return.
 - (1) Form of return.
 - (2) Information included on return.
 - (3) Reimbursements of interest on a qualified mortgage.
 - (4) Time and place for filing return.
 - (5) Use of magnetic media.
- (b) Requirement to furnish statement.
 - (1) In general.
 - (2) Information included on statement.
 - (3) Statement furnished pursuant to Federal mortgage program.
 - (4) Copy of Form 1098 to payor of record.
 - (5) Furnishing statement with other information reports.
 - (6) Time and place for furnishing statement.
- (c) Notice requirement for use of Rule of 78s method of accounting.
 - (1) In general.
 - (2) Time and manner.
 - (d) Reporting under designation agreement.
 - (1) In general.
 - (2) Qualified person.
 - (3) Designation agreement.

(4) Penalties.

(e) Penalty provisions.

(1) Returns and statements the due date for which (determined without regard for extensions) is after December 31, 1987, and before December 31, 1989.

(i) Failure to file return or to furnish statement.

(ii) Failure to furnish TIN.

(iii) Failure to include correct information.

(2) Returns and statements the due date for which (determined without regard for extensions) is after December 31, 1989.

(i) Failure to file return or to furnish statement.

(ii) Failure to furnish TIN.

(iii) Failure to include correct information.

(f) Requirement to request and to obtain TIN.

(1) In general.

(2) Manner of requesting TIN.

(g) Effective date.

(1) In general.

(2) Points.

Par. 3. Section 1.6050H-1 is amended as follows:

1. Paragraph (a) is revised.

2. Paragraph (b)(4) is added.

3. Paragraph (c) is amended as follows:

a. Paragraphs (c) (1) and (2) are revised.

b. Paragraph (c)(3) is redesignated as paragraph (c)(5) and Example (5) is added.

c. New paragraph (c)(3) is added.

4. Paragraph (e) is amended as follows:

a. Paragraphs (e)(1) and (e)(2)(i) are revised.

b. Paragraph (e)(2)(iii) is added.

5. Paragraph (f) is added.

6. Paragraph (g) is revised.

The added and revised provisions read as follows:

Sec. 1.6050H-1 Information reporting of mortgage interest received in a trade or business from an individual.

(a) Information reporting requirement--(1) Overview. The information reporting requirements of section 6050H, this section, and Sec. 1.6050H-2 apply to an interest recipient who receives at least \$600 of interest on a qualified mortgage for a calendar year or who makes a reimbursement of interest described in Sec. 1.6050H-2(a)(2)(iv). Paragraph (b) of this section defines qualified mortgage. Paragraph (c) of this section defines interest recipient. Paragraph (d) of this section contains additional rules relating to the reporting requirement for foreign persons, cooperative housing corporations, and nonresident alien individuals. Paragraph (e) of this section contains rules for determining the amount of interest received on a mortgage for a calendar year. Paragraph (f) of this section provides rules for determining when prepaid interest in the form of points is taken into

account as interest for purposes of section 6050H, this section, and Sec. 1.6050H-2.

(2) Reporting requirement. Except as otherwise provided in this section and Sec. 1.6050H-2, an interest recipient that either receives at least \$600 of interest on a qualified mortgage for a calendar year or makes reimbursements of interest described in Sec. 1.6050H-2(a)(2)(iv) must, with respect to that interest--

(i) File an information return with the Internal Revenue Service; and

(ii) Furnish a statement to the payor of record on the mortgage.

(3) Optional reporting. An interest recipient may, but is not required to, report its receipt of less than \$600 of interest on a qualified mortgage for a calendar year. Similarly, an interest recipient also may report reimbursements of interest on a qualified mortgage even if the reimbursements are not required to be reported by Sec. 1.6050H-2(a)(2)(iv). An interest recipient that chooses, but is not required, to file a return as provided in this section and Sec. 1.6050H-2(a) or to furnish a statement as provided in this section and Sec. 1.6050H-2(b) is subject to the requirements of this section and Sec. 1.6050H-2.

(b) * * *

(4) Lender of record. The lender of record is the person who, at the time the loan is made, is named as the lender on the loan documents and whose right to receive payment from the payor of record is secured by the payor of record's principal residence. An intention by the lender of record to sell or otherwise transfer the loan to a third party subsequent to the close of the transaction will not affect the determination of who is the lender of record.

(c) Interest recipient--(1) Trade or business requirement. Except as provided in paragraph (c)(4) of this section, an interest recipient is a person that is engaged in a trade or business (whether or not the trade or business of lending money) and that, in the course of the trade or business, either receives interest on a mortgage or makes a reimbursement of interest on a qualified mortgage described in Sec. 1.6050H-2(a)(3). For purposes of this paragraph (c)(1), if a person holds a mortgage which was originated or acquired in the course of a trade or business, the interest on the mortgage is considered to be received in the course of that trade or business. For example, if real estate developer A lends money to individual B to enable B to purchase a house in a subdivision owned and developed by A, and B gives a mortgage to A for the loan, A is an interest recipient for interest received on the mortgage. Alternatively, if C, a person engaged in the trade or business of being a physician, lends money to individual D to enable D to purchase C's home, and D gives a mortgage to C for the loan, C is not an interest recipient for interest received on the mortgage, because C will not receive the interest in the course of the trade or business of being a physician.

(2) Interest received or collected on behalf of another person--(i) General rule. Except as otherwise provided in paragraph (c)(2)(ii) or (3) of this section, a person that, in the course of its trade or business, receives or collects interest on a mortgage on behalf of another person (e.g., the lender of record) is the interest recipient

(the initial recipient) for the mortgage. In this case, the reporting requirement of paragraph (a) of this section does not apply to the transfer of interest from the initial recipient to the person for which the initial recipient receives or collects the interest. For example, if financial institution A collects interest on behalf of financial institution B, A is the initial recipient for the mortgage and is subject to the reporting requirements of section 6050H, and B is not required to report the interest received on the mortgage from A.

(ii) Exception--(A) Scope of exception. Paragraph (c)(2)(i) of this section does not apply for any period for which--

(1) An initial recipient does not possess the information needed to comply with the reporting requirement of paragraph (a) of this section; and

(2) The person for which the interest is received or collected would receive the interest in the course of its trade or business if the interest were paid directly to that person. For purposes of this paragraph (c)(2)(ii)(A)(2), if interest is received or collected on behalf of a person other than an individual, that person is presumed to receive interest in a trade or business.

(B) Application of exception. If the exception provided by this paragraph (c)(2)(ii) applies, the person for which the interest is received or collected is the interest recipient with respect to interest received or collected on the mortgage during the period described in this paragraph (c)(2)(ii).

(3) Interest received in the form of points. For purposes of this section and Sec. 1.6050H-2, in the case of prepaid interest received in the form of points (as defined in paragraph (f) of this section):

(i) In general. Except as provided in paragraph (c)(3)(ii) of this section, only the lender of record or a qualified person (as defined in Sec. 1.6050H-2(d)(2)) is treated as receiving the points. The lender of record or qualified person is treated as receiving all points paid directly by the payor of record in connection with the purchase of the principal residence.

(ii) If designation agreement is in effect. If a designation agreement is executed pursuant to Sec. 1.6050H-2(d) with respect to points, only the designated party under the agreement is treated as receiving points with respect to any mortgage to which the agreement applies. The designated party is treated as receiving all points with respect to any mortgage to which the agreement applies.

* * * * *

(5) * * *

Example (5). On December 1, Borrower obtains from Lender funds with which to purchase an existing structure to be used as Borrower's principal residence. In connection with the mortgage, Lender charges Borrower \$300 as points. Borrower pays this amount to Lender at closing using unborrowed funds. In addition, Lender receives from Borrower with respect to the mortgage \$300 as interest (as determined under paragraph (e) of this section) other than points. Because Lender has received at least \$600 in interest, including points, with respect to Borrower's mortgage during the calendar year, Lender must report the payments in accordance with

paragraph (a) of this section and Sec. 1.6050H-2. Under those sections, Lender must separately state on the information return and the statement to Borrower the \$300 received as interest (other than points) and the \$300 received as points.

* * * * *

(e) Amount of interest received on mortgage for calendar year--(1) In general. For purposes of this section and Sec. 1.6050H-2, interest includes mortgage prepayment penalties and late charges other than late charges for a specific mortgage service. Interest also includes prepaid interest in the form of points (as defined in paragraph (f) of this section). Whether an interest recipient receives \$600 or more of interest on a mortgage for a calendar year is determined on a mortgage-by-mortgage basis. An interest recipient need not aggregate interest received on all of the mortgages of a payor of record held by the interest recipient to determine whether the \$600 threshold is met. Therefore, an interest recipient need not report interest of less than \$600 received on a mortgage, even though it receives a total of \$600 or more of interest on all of the mortgages of the payor of record for a calendar year.

(2) Calendar year--(i) In general. Except as otherwise provided in paragraph (e)(2)(ii) or (iii) of this section, the calendar year for which interest is received is the later of the calendar year in which the interest is received or the calendar year in which the interest properly accrues.

(ii) * * *

(iii) Applicability to points. Paragraphs (e)(2)(i) and (ii) of this section do not apply to prepaid interest in the form of points (as defined in paragraph (f) of this section). Points (as defined in paragraph (f) of this section) must be reported in the calendar year in which they are received.

* * * * *

(f) Points treated as interest--(1) General rule. Subject to the limitations of paragraph (f)(2) of this section, an amount is deemed to be points paid in respect of indebtedness incurred in connection with the purchase of the payor of record's principal residence (points) for purposes of this section and Sec. 1.6050H-2 to the extent that the amount--

(i) Is clearly designated on the Uniform Settlement Statement prescribed under the Real Estate Settlement Procedures Act of 1974, 12 U.S.C. 2601 et seq., (e.g., the Form HUD-1) as points incurred in connection with the indebtedness, for example as loan origination fees (including amounts so designated on Veterans Affairs (VA) and Federal Housing Administration (FHA) loans), loan discount, discount points, or points;

(ii) Is computed as a percentage of the stated principal amount of the indebtedness incurred by the payor of record;

(iii) Conforms to an established practice of charging points in the area in which the loan is issued and does not exceed the amount generally charged in the area;

(iv) Is paid in connection with the acquisition by the payor of record of a residence that is the principal residence of the payor of record and that secures the loan. For this purpose, the lender of

record may rely on a signed written statement of the payor of record that states whether the proceeds of the loan are for the purchase of the mortgagor's principal residence; and

(v) Is paid directly by the payor of record.

(2) Limitations. An amount is not points for purposes of this section to the extent that the amount is--

(i) Paid in connection with indebtedness incurred for the improvement of a principal residence;

(ii) Paid in connection with indebtedness incurred to purchase or improve a residence that is not the payor of record's principal residence, such as a second home, vacation property, investment property, or trade or business property;

(iii) Paid in connection with a home equity loan or a line of credit, even though the loan is secured by the payor of record's principal residence;

(iv) Paid in connection with a refinancing loan (except as provided by paragraph (f)(4) of this section), including a loan incurred to refinance indebtedness owed by the borrower under the terms of a land contract, a contract for deed, or similar forms of seller financing;

(v) Paid in lieu of amounts that ordinarily are stated separately on the Form HUD-1, such as appraisal fees, inspection fees, title fees, attorney fees, and property taxes; or

(vi) Paid in connection with the acquisition of a principal residence, to the extent that the amount is allocable to indebtedness in excess of the aggregate amount that may be treated as acquisition indebtedness under section 163(h)(3)(B)(ii).

(3) Special rule--(i) Amounts paid directly by payor of record. For purposes of this section, an amount is considered paid directly by the payor of record if it is--

(A) Provided by the payor of record from funds that have not been borrowed from the lender of record for this purpose as part of the overall transaction. The amount provided may include amounts designated as down payments, escrow deposits, earnest money applied at the closing, and other funds actually paid over by the payor of record at or before the time of closing; or

(B) Paid as points (within the meaning of this paragraph (f)) on behalf of the payor of record by the seller. For this purpose, an amount paid as points to an interest recipient by the seller on behalf of the payor of record is treated as paid to the payor of record and then paid directly by the payor of record to the interest recipient.

(ii) Examples. The provisions of this paragraph (f) are illustrated by the following examples:

Example 1. Financed payment of points. Buyer purchases a principal residence for \$100,000. There is a total of \$7,000 in closing costs (exclusive of down payment) charged in connection with the sale. Of this amount, \$3,000 is charged as points (within the meaning of paragraph (f) of this section). At closing, Buyer makes a down payment of \$20,000 and provides unborrowed funds in the amount of \$4,000 for the payment of various closing costs other than points. Buyer finances payment of the points by increasing the principal amount of the loan by \$3,000. Seller makes no payments on

Buyer's behalf. Because Buyer has provided at closing funds that have not been borrowed from the lender of record for this purpose in an amount at least equal to the amount charged as points in the transaction, the lender of record (or a qualified person) must report \$3,000 as points in accordance with this section and Sec. 1.6050H-2.

Example 2. Seller-paid points. Buyer purchases a principal residence for \$100,000. There is a total of \$7,000 in closing costs (exclusive of down payment) charged in connection with the sale. Of this amount, \$3,000 is charged as points (within the meaning of this paragraph (f)). Seller agrees to pay all closing costs on behalf of Buyer, including the amount charged as points. Accordingly, the amount paid by Seller as points is treated as paid directly by Buyer, and the lender of record (or a qualified person) must report the \$3,000 as points in accordance with this section and Sec. 1.6050H-2.

(4) Construction loans--(i) In general. An amount paid in connection with indebtedness incurred to construct a residence, or to refinance indebtedness incurred to construct a residence, is deemed to be points for purposes of this section to the extent the amount--

(A) Is clearly designated on the loan documents as points incurred in connection with the indebtedness, for example, as loan origination fees, loan discount, discount points, or points;

(B) Is computed as a percentage of the stated principal amount of the indebtedness incurred by the payor of record;

(C) Conforms to an established practice of charging points in the area in which the loan is issued and does not exceed the amount generally charged in the area;

(D) Is paid in connection with indebtedness incurred by the payor of record to construct (or to refinance construction of) a residence that is to be used, when completed, as the principal residence of the payor of record;

(E) Is paid directly by the payor of record; and

(F) Is not allocable to indebtedness in excess of the aggregate amount that may be treated as acquisition indebtedness under section 163(h)(3)(B)(ii).

(ii) Limitation on refinancing of construction loans. Amounts paid in connection with refinancing indebtedness incurred to construct a residence are not treated as points to the extent they are allocable to indebtedness that exceeds the indebtedness incurred to construct the residence.

(5) Amounts paid to mortgage brokers. Amounts received directly or indirectly by a mortgage broker are treated as points under this paragraph (f) to the same extent the amounts would be so treated if they were paid to and retained by the lender of record, and must be reported by the lender of record in accordance with this section and Sec. 1.6050H-2.

(6) Effect on deduction of points. This section and Sec. 1.6050H-2 address only the information reporting requirements of section 6050H and do not affect a payor of record's deduction for any amount in accordance with applicable provisions of the Internal Revenue Code.

(g) Effective date--(1) In general. Except as provided in paragraph (g)(2) of this section, this section is effective for mortgage interest received after December 31, 1987. Section 1.6050H-1T contains rules for reporting mortgage interest received after December 31, 1984, and before January 1, 1988.

(2) Points. The reporting requirements of this section do not apply to prepaid interest received in the form of points before January 1, 1995. In addition, the inclusion of points in the determination of interest under paragraph (e)(1) of this section applies only to transactions occurring after December 31, 1994.

Par. 4. Section 1.6050H-2 is amended as follows:

1. Paragraph (a) is amended as follows:

a. Paragraph (a)(2)(iii) is revised.

b. In paragraph (a)(2)(iv)(B) the word "and" at the end of the paragraph is removed.

c. Paragraph (a)(2)(v) is redesignated as paragraph (a)(2)(vi).

d. New paragraph (a)(2)(v) is added.

2. Paragraph (d) is revised.

3. Paragraph (e) is amended as follows:

a. Paragraph (e)(1) is revised.

b. Paragraph (e)(1)(i) is added.

4. Paragraphs (e)(2) and (3) are redesignated as paragraphs (e)(1)(ii) and (iii), respectively.

5. New paragraph (e)(2) is added.

6. Paragraph (g) is revised.

The additions and revisions read as follows:

Sec. 1.6050H-2 Time, form, and manner of reporting interest received on qualified mortgage.

(a) * * *

(2) * * *

(iii) The amount of interest (other than points) required to be reported with respect to the qualified mortgage for the calendar year;
* * * * *

(v) The amount of points paid directly by the payor of record (within the meaning of Sec. 1.6050H-1(f)(3)) required to be reported with respect to the qualified mortgage for the calendar year; and
* * * * *

(d) Reporting under designation agreement--(1) In general. An interest recipient that receives or collects interest (including points) on a mortgage may designate a qualified person to satisfy the reporting requirements of paragraphs (a), (b), and (c) of this section. If a designated qualified person reports as permitted under this paragraph (d), it will satisfy the requirement of paragraph (a)(2)(ii) of this section by including on Form 1098 (and Form 1096) the name, address, and TIN of the designated qualified person.

(2) Qualified person. A qualified person is either--

(i) A trade or business with respect to which the interest recipient is under common control within the meaning of Sec. 1.414(c)-2; or

(ii) A person who is named as the designee by the lender of record or by a qualified person (under paragraph (d)(2) of this section) in a designation agreement entered into in accordance with paragraph (d)(3) of this section, and who either was involved in the original loan transaction or is a subsequent purchaser of the loan.

(3) Designation agreement. An interest recipient that designates a qualified person to satisfy the reporting requirements described in paragraphs (a), (b), and (c) of this section must make that designation in a written designation agreement. The designation agreement must identify the mortgage(s) and calendar years for which the designated qualified person must report, and must be signed by both the designator and designee. A designee may report an amount as having been paid directly by the payor of record (for purposes of paragraph (a)(2)(v) of this section) only if the designation agreement contains the designator's representation that it did not lend such amount to the payor of record as part of the overall transaction. The designator must retain a copy of the designation agreement for four years following the close of the calendar year in which the loan is made. The designation agreement need not be filed with the Internal Revenue Service.

(4) Penalties. A designated qualified person is subject to any applicable penalties provided in part II of subchapter B of chapter 68 of the Internal Revenue Code as if it were an interest recipient. A designator is relieved from liability for applicable penalties by designating a qualified person under the provisions of paragraph (d)(3) of this section. Paragraph (e) of this section describes applicable penalties.

(e) Penalty provisions--(1) Returns and statements the due date for which (determined without regard for extensions) is after December 31, 1987, and before December 31, 1989. For purposes of this paragraph (e)(1) only, all references to sections of the Internal Revenue Code refer to sections of the Internal Revenue Code of 1986, as amended on or before December 31, 1987.

(i) Failure to file return or to furnish statement. The section 6721 penalty applies to an interest recipient that fails to file a return required by paragraph (a) of this section with respect to a payor of record. The section 6722 penalty applies to an interest recipient that fails to furnish a statement required by paragraph (b) of this section to a payor of record.

* * * * *

(2) Returns and statements the due date for which (determined without regard for extensions) is after December 31, 1989--(i) Failure to file return or to furnish statement. The section 6721 penalty applies to an interest recipient that fails to file a return required by paragraph (a) of this section with respect to a payor of record. The section 6722 penalty applies to an interest recipient that fails to furnish a statement required by paragraph (b) of this section to a payor of record.

(ii) Failure to furnish TIN. The section 6721 penalty may apply to an interest recipient that fails to furnish the TIN of a payor of record on a return required by paragraph (a) of this section. The section 6721 penalty may apply to an interest recipient that fails to request and to obtain the TIN of a payor of record under paragraph (f)

of this section.

(iii) Failure to include correct information. The section 6721 penalty may apply to an interest recipient that fails to include correct information on a return required by paragraph (a) of this section. The section 6722 penalty may apply to an interest recipient that fails to include correct information on a statement required by paragraph (b) of this section to be furnished to a payor record.

* * * * *

(g) Effective date--(1) In general. Except as provided in paragraph (g)(2) of this section, this section is effective for mortgage interest received after December 31, 1987. Section 1.6050H-1T contains rules for reporting mortgage interest received after December 31, 1984, and before January 1, 1988.

(2) Points. The reporting requirement of this section does not apply to prepaid interest in the form of points received before January 1, 1995.

PART 602--OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 5. The authority for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 6. Section 602.101, the table in paragraph (c) is amended by revising the entries for Secs. 1.6050H-1 and 1.6050H-2 to read as follows:

Sec. 602.101 OMB Control numbers.

* * * * *

(c) * * *

CFR part or section where identified and described	Current OMB control No.
1.6050H-1.....	1545-0901 1545-1380
1.6050H-2.....	1545-0901 1545-1339 1545-1380

Margaret Milner Richardson,
Commissioner of Internal Revenue.

Approved: November 1, 1994.
Leslie Samuels,

Assistant Secretary of the Treasury.
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