Part III. Administrative, Procedural, and Miscellaneous

Tax Consequences to Homeowners, Mortgage Servicers, and State Housing Finance Agencies of Participation in the HFA Hardest Hit Fund and The Emergency Homeowners' Loan Program

Notice 2011–14

PURPOSE

This notice provides guidance on the federal tax consequences of, and information reporting requirements for, payments made to or on behalf of financially distressed homeowners under programs designed by state housing finance agencies (State HFAs)[1] with funds allocated from the Housing Finance Agency Innovative Fund for the Hardest-Hit Housing Markets (HFA Hardest Hit Fund). This notice applies to the programs designed by State HFAs that are listed in the Appendix to this notice (State Programs).

This notice also provides guidance on the federal tax consequences of, and information reporting requirements for, payments made on behalf of financially distressed homeowners under the Department of Housing and Urban Development's Emergency Homeowners' Loan Program (EHLP) and any existing state program receiving funding from the EHLP (the substantially similar state programs or SSSPs).

Specifically, this notice addresses whether—

- Disbursements under a "Forgivable Loan" (as defined below) or a HUD Note (as defined below) are treated as payments to homeowners and not as disbursements of loan proceeds;
- Homeowners who receive or benefit from payments made under the State Programs, the EHLP, or the SSSPs exclude the payments from gross income under the general welfare exclusion and deduct otherwise deductible expenses (for example, mortgage interest and real property taxes) paid from those payments; and
- Payments to or on behalf of homeowners made under the State Programs, the EHLP, or the SSSPs are exempt from the information reporting requirements of §§ 6041 and 6050H of the Internal Revenue Code.

THE HFA HARDEST HIT FUND PROGRAM

Overview

In February 2010, the United States Department of the Treasury (Treasury Department) established the HFA Hardest Hit Fund, which is authorized by section 109 of the Emergency Economic Stabilization Act (EESA), Division A of Pub. L. 110–343, 112 Stat. 3774 (2008). The purposes of the HFA Hardest Hit Fund are to provide funds to the State Programs (1) to assist homeowners in preventing avoidable foreclosures, and (2) to stabilize housing markets. The HFA Hardest Hit Fund is designed to allow each State HFA maximum flexibility in designing locally focused programs to address the needs of financially distressed homeowners within the state or a specific region of the state. Each of the State Programs that receives funding from the HFA Hardest Hit Fund has as its primary objective preventing avoidable foreclosures of homeowners' homes and stabilizing housing markets.

The HFA Hardest Hit Fund is available in states where either housing prices have declined more than 20 percent from peak prices or the unemployment rate equals or exceeds the national average. The states eligible for this funding are Alabama, Arizona, California, the District of Columbia, Florida, Georgia, Illinois, Indiana, Kentucky, Michigan, Mississippi, Nevada, New Jersey, North Carolina, Ohio, Oregon, Rhode Island, South Carolina, and Tennessee.

To receive funding from the HFA Hardest Hit Fund, each of these states submitted proposals describing its programs and verifying that each of the programs would meet the requirements of the EESA and the purposes of the HFA Hardest Hit Fund. Funding under the HFA Hardest Hit Fund is available for, but not limited to, programs involving the following transactions: mortgage modifications, principal forbearance to facilitate additional mortgage modifications, short sales and deeds-in-lieu of foreclosure, unemployment programs, principal reductions for homeowners with severe negative equity, and second-lien reductions and modifications.

Approved State Programs and their Common Elements

The Treasury Department has approved all of the State Programs listed in the Appendix to this notice[2] and is distributing funds from the HFA Hardest Hit Fund for use by the State HFAs. Generally, under the State Programs homeowners must demonstrate that they have suffered a financial hardship due to certain events, such as unemployment, underemployment, medical condition, death of a spouse, or divorce, and as a result are in danger of losing their homes in foreclosure or need financial assistance to ensure that their loans become or remain affordable. Although most of the State Programs have the goal of helping financially distressed homeowners remain in their homes, some State Programs also help homeowners who can no longer afford their homes to transition to more affordable homes. Some states limit participation in their programs to homeowners whose income does not exceed certain limits.

In some cases, the State Programs assist a homeowner by making cash payments directly to or on behalf of the homeowner without mentioning any repayment obligation. On the other hand, sometimes the governing documents discuss repayment and call the arrangement a "loan" or a "forgivable loan." Even in these cases, however, the terms of the arrangement generally operate to relieve the homeowner of an obligation to make any repayments. The terms achieve this end by reducing the stated principal amount to zero over time if the homeowner meets certain program requirements. Though State Programs may

[1] For purposes of this notice, the term "state housing finance agencies" includes other non-profit agencies organized and controlled by a state. In addition, the term "state" means the 50 states, the District of Columbia, and the Commonwealth of Puerto Rico.

[2] The Treasury Department may amend the list of State Programs in the Appendix to this notice through subsequent published guidance.

vary, an arrangement like this is generally secured by a subordinate lien on the home and is documented as a zero-percent-interest, nonrecourse, non-amortizing "loan" to the homeowner with a term ranging from 3 to 10 years. (This notice calls these arrangements "Forgivable Loans.") For example, under some programs the unpaid stated principal of a Forgivable Loan declines 20 percent each year for 5 years if the homeowner remains current on the homeowner's mortgage loan payments and continues to use the property as a principal residence. In general, no payments are due on a Forgivable Loan unless (1) the homeowner sells, refinances, or transfers title to the property before the term expires, and (2) equity proceeds from the sale, refinancing, or title transfer are available to pay some or all of the remaining unpaid stated principal balance. As a result, the Treasury Department and the State Programs do not expect homeowners to make more than a minimal amount of payments on Forgivable Loans.

THE EMERGENCY HOMEOWNERS' LOAN PROGRAM AND SUBSTANTIALLY SIMILAR STATE PROGRAMS

Overview

Section 1496 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), Pub. L. 111–203, 124 Stat. 2207 (2010), reauthorized and revised the Emergency Homeowners' Loan Program (EHLP), 12 U.S.C. §§ 2701–2712, and provided $1 billion to the Department of Housing and Urban Development (HUD) to implement the EHLP and existing state programs that are substantially similar to the EHLP (the substantially similar state programs or SSSPs). The purpose of the EHLP and the SSSPs is to provide assistance to homeowners who are at risk of foreclosure and have experienced a substantial reduction in income as a result of involuntary unemployment or underemployment due to adverse economic or medical conditions. *See* 12 U.S.C. § 2702(4). The $1 billion of funding is allocated based on a state's approximate share of unemployed homeowners. The EHLP and the SSSPs complement the HFA Hardest Hit Fund by providing assistance to homeowners in Puerto Rico and the 32 states that did not receive funds from the HFA Hardest Hit Fund. *See* Emergency Homeowners' Loan Program: Notice of Allocation of Funding for Substantially Similar State Programs ("Funding Notice"), 75 Fed. Reg. 69,454 (November 12, 2010).

Eligible Pre-Existing State Programs

The Dodd-Frank Act provides that a state may administer EHLP funds if HUD determines that the state program qualifies as an SSSP. An SSSP is a state program existing on July 21, 2010, that provides substantially similar assistance to homeowners. 12 U.S.C. § 2707(d). A state with an SSSP may exercise greater flexibility in program design and is not required to modify its program to comply with Title 12 after HUD determines that the program is an SSSP. 12 U.S.C. § 2707(d). To receive funding from the EHLP, State HFAs submitted proposals describing how their programs provide assistance to homeowners that is substantially similar to that provided under the EHLP. Only SSSPs are eligible to administer an allocation from the $1 billion provided to the EHLP under the Dodd-Frank Act. Section III.B.2 of the Funding Notice. If a state does not have an SSSP, then HUD administers the state's allocation from the $1 billion of funding in accordance with the EHLP.

Homeowners Eligible for Assistance and Operation of the EHLP and SSSPs

To receive assistance from the EHLP or an SSSP, a homeowner must meet certain eligibility requirements. The homeowner must reside in the mortgaged property as his or her principal residence at the time of application and for the duration of the assistance. The homeowner must also be involuntarily unemployed or underemployed because of adverse economic or medical conditions. The homeowner must have household income equal to or less than 120% of the area median income for the area in which the homeowner resides, and have experienced a substantial reduction in income as a result of involuntary unemployment or underemployment due to adverse economic or medical conditions. *See* 12 U.S.C. § 2702(4). The homeowner also must be at least three months delinquent on the homeowner's first mortgage and provide evidence that foreclosure on that mortgage is likely or imminent. In addition, the homeowner must have a reasonable likelihood of being able to (1) resume repayments of the first mortgage obligation within two years, and (2) meet other housing expenses and debt obligations when the assistance ends. *See* 12 U.S.C. § 2702.

Under the EHLP (but not an SSSP), eligible homeowners must contribute the greater of 31 percent of their monthly gross income or $25 towards the monthly payments on the first mortgage. Under the EHLP, homeowner contributions will be combined with the governmental funds and forwarded to the servicer/lender as the monthly payment on the first mortgage. HUD expects the SSSPs to use their existing procedures for handling borrower contributions.

The EHLP will provide a reasonably necessary amount to assist an eligible homeowner with (i) a maximum of 24 months of monthly payments of mortgage principal, interest, mortgage insurance premiums, taxes, and hazard insurance, and (ii) payments of arrearages (mortgage principal, interest, mortgage insurance premiums, taxes, hazard insurance, late fees, and certain foreclosure related legal expenses). HUD prefers, but does not require, the SSSPs to limit assistance to a 24-month period. The EHLP and the SSSPs must include assistance in making monthly payments to the servicer of the first mortgage and may not restrict payments only to arrearages. If the household's gross income increases to 85% or more of the income prior to the unemployment, underemployment, or medical condition, then the assistance will be phased out over a two-month period.

The assistance that the EHLP and the SSSPs provide to a homeowner must be pursuant to a note with terms and repayment conditions that are similar to the Forgivable Loan described above, except that the homeowner is responsible for repayment of the applicable balance of the note if the homeowner defaults on the homeowner's monthly mortgage payment obligation during the five-year period after the assistance ends. (This notice calls these arrangements "HUD Notes.") As a result, HUD and the SSSPs do not expect homeowners to make more than a minimal amount of payments on the HUD Notes.

APPLICABLE PROVISIONS OF LAW

Characterization of Forgivable Loans and the HUD Notes

If assistance to a homeowner under a State Program is structured as a Forgivable Loan, the Internal Revenue Service will treat the disbursements to or on behalf of the homeowner as payments to the homeowner rather than as disbursements of loan proceeds, and those payments are treated as occurring at the time the disbursements are made. Similarly, if assistance to a homeowner under the EHLP or an SSSP is pursuant to a HUD Note, the IRS will treat the disbursements to or on behalf of the homeowner as payments to the homeowner rather than as disbursements of loan proceeds, and those payments are treated as occurring at the time the disbursements are made.

Income Tax Consequences to Homeowners

Section 61(a) of the Code provides that, except as otherwise provided by law, gross income means all income from whatever source derived. The Service has consistently held, however, that payments made under governmental programs for the promotion of the general welfare are not includible in an individual recipient's gross income (general welfare exclusion). *See* Rev. Rul. 2009–19, 2009–28 I.R.B. 111, holding that Pay-for-Performance Success Payments made under the Home Affordable Modification Program to help homeowners who are at risk of losing their homes pay their mortgage loans on their principal residences are excluded from income under the general welfare exclusion. *See also* Rev. Rul. 76–373, 1976–2 C.B. 16.

Similar to the payments in Rev. Rul. 2009–19, the payments made under the State Programs with funds from the HFA Hardest Hit Fund and the payments made under the EHLP and the SSSPs with funds authorized by the Dodd-Frank Act promote the general welfare by helping homeowners who are at risk of losing their homes either pay their mortgage loans or transition to more affordable housing and do not involve the performance of services. Therefore, payments made under the State Programs, the EHLP, and the SSSPs to or on behalf of a homeowner are excluded from gross income under the general welfare exclusion.

For taxable years 2010, 2011, and 2012, this notice provides a safe harbor method pursuant to which a homeowner may deduct on his or her federal income tax return an amount equal to the sum of all payments the homeowner actually makes during that year to the mortgage servicer, HUD, or the State HFA on the home mortgage, but not in excess of the sum of the amounts shown on Form 1098, *Mortgage Interest Statement*, in box 1 (mortgage interest received), box 4 (mortgage insurance premiums) for years 2010 and 2011 only, and box 5 (real property taxes). This safe harbor method of computing the homeowner's deduction applies for a taxable year if (1) the homeowner meets the requirements of §§ 163 and 164 to deduct all of the mortgage interest on the loan and all of the real property taxes on the principal residence; and (2) the homeowner participates in the EHLP, an SSSP, or a State Program described in the Appendix to this notice in which the program payments could be used to pay interest on the home mortgage.

Information Reporting Obligations

Section 6041 of the Code requires every person engaged in a trade or business (including state governments and their agencies) to (1) file an information return for each calendar year in which the person makes in the course of its trade or business payments to another person of fixed and determinable income aggregating $600 or more, and (2) furnish a copy of the information return to that person. *See* § 6041(a) and (d) and § 1.6041–1(a)(1) and (b) of the Income Tax Regulations.

Because the payments made under the State Programs, the EHLP, and the SSSPs are excluded from the gross income of the homeowners, they are not fixed or determinable income under § 6041. Thus, under § 6041 payors do not file information returns or furnish copies to homeowners for payments made under the State Programs, the EHLP, or the SSSPs.

Section 6050H of the Code requires every person engaged in a trade or business (including state governments and their agencies) to (1) file an information return for each calendar year in which the person receives in the course of its trade or business payments from an individual of interest on a mortgage aggregating $600 or more, and (2) furnish a copy of the information return to that individual. See § 6050H(a) and (d) and § 1.6050H–1(a) of the regulations.

For purposes of § 6050H, interest received from a governmental unit or its agency or instrumentality is not interest received on a mortgage, and thus should not be reported as interest received on a mortgage. See § 1.6050H–1(e)(3)(ii) of the regulations.

Accordingly, if a person receives payments under a State Program, the EHLP, or an SSSP from a governmental unit or its agency or instrumentality of interest on the homeowner's mortgage, that person should not include those payments in the amount reported as interest received on a mortgage on Form 1098.

Section 6721 of the Code imposes penalties on a person for failing to include all required information or including incorrect information on an information return. Section 6722 imposes penalties on a person for failing to include all required information or including incorrect information on a payee statement. However, the Service will not assert penalties under §§ 6721 and 6722 against a mortgage servicer that reports on Forms 1098 payments received under a State Program, the EHLP, or an SSSP during calendar year 2010. Additionally, the Service will not assert penalties under §§ 6721 and 6722 against a mortgage servicer that reports on Forms 1098 payments received under a State Program, the EHLP, or an SSSP during calendar years 2011 or 2012 if the servicer notifies homeowners that the amounts reported on the Form 1098 are overstated because they include government subsidy payments. The Service will not assert penalties under §§ 6721 and 6722 against any State HFA for failing to file and furnish Forms 1098 for calendar year 2010. Furthermore, the Service will not assert penalties under §§ 6721 and 6722 against any State HFA for failing to file and furnish Forms 1098 for calendar years 2011 and 2012 if the State HFA provides each homeowner and the IRS a statement setting forth (1) the homeowner's name and TIN, and (2) the amount of payments the State HFA made to the mortgage servicer under the State Program or the SSSP during that year (separately stating the amount

the State HFA paid and the amount the homeowner paid). The statement the State HFA provides to the IRS must be a single statement that separately lists the names, TINs, and relevant payment amounts for each homeowner. In addition, for calendar years 2011 and 2012, HUD should provide each homeowner and the IRS a statement setting forth (1) the homeowner's name and TIN, and (2) the amount of payments HUD made to the mortgage servicer under the EHLP during that year (separately stating the amount HUD paid and the amount the homeowner paid). The statement HUD provides to the IRS should be a single statement that separately lists the names, TINs, and relevant payment amounts for each homeowner. The IRS intends to issue future published guidance specifying the IRS office where the State HFAs and HUD should send the single statements.

SUMMARY OF FEDERAL TAX CONSEQUENCES OF PAYMENTS UNDER THE STATE PROGRAMS, THE EHLP, OR THE SSSPS TO ASSIST FINANCIALLY DISTRESSED HOMEOWNERS

Disbursements under a Forgivable Loan or a HUD Note are treated as payments to a homeowner and not as disbursements of loan proceeds.

A homeowner who receives or benefits from payments made under the State Programs, the EHLP, or an SSSP excludes the payments from gross income under the general welfare exclusion.

Payments to or on behalf of a homeowner made under the State Programs, the EHLP, and the SSSP are not subject to the information reporting requirements of § 6041.

The Service will not assert penalties under §§ 6721 and 6722 against a mortgage servicer that reports on Forms 1098 payments received under a State Program, the EHLP or an SSSP during calendar year 2010. Additionally, the Service will not assert penalties under §§ 6721 and 6722 against a mortgage servicer that reports on Forms 1098 payments received under a State Program, the EHLP, or an SSSP during calendar years 2011 or 2012 if the servicer notifies homeowners that the amounts reported on the Form 1098 are overstated because they include government subsidy payments.

The Service will not assert penalties under §§ 6721 and 6722 against any State HFA for failing to file and furnish Forms 1098 for calendar year 2010. In addition, the Service will not assert penalties under §§ 6721 and 6722 for calendar years 2011 and 2012 against any State HFA if the State HFA provides each homeowner and the IRS a statement setting forth (1) the homeowner's name and TIN, and (2) the amount of payments the State HFA made to a mortgage servicer under the State Program or the SSSP during that year (separately stating the amount the State HFA paid and the amount the homeowner paid). The statement the State HFA provides to the IRS must be a single statement that separately lists the names, TINs, and relevant payment amounts for each homeowner. For calendar years 2011 and 2012, HUD should provide each homeowner and the IRS a statement setting forth (1) the homeowner's name and TIN, and (2) the amount of payments HUD made to the mortgage servicer under the EHLP during that year (separately stating the amount HUD paid and the amount the homeowner paid). The statement HUD provides to the IRS should be a single statement that separately lists the names, TINs, and relevant payment amounts for each homeowner. The IRS intends to issue future published guidance specifying the IRS office where the State HFAs and HUD should send the single statements.

For taxable years 2010, 2011, and 2012, this notice provides a safe harbor method pursuant to which a homeowner may deduct on his or her federal income tax return an amount equal to the sum of all payments the homeowner actually makes during that year to the mortgage servicer, HUD, or the State HFA on the home mortgage, but not in excess of the sum of the amounts shown on Form 1098, *Mortgage Interest Statement*, in box 1 (mortgage interest received), box 4 (mortgage insurance premiums) for years 2010 and 2011 only, and box 5 (real property taxes). This safe harbor method of computing the homeowner's deduction applies for a taxable year if (1) the homeowner meets the requirements of §§ 163 and 164 to deduct all of the mortgage interest on the loan and all of the real property taxes on the principal residence, and (2) the homeowner participates in the EHLP, an SSSP, or a State Program described in the Appendix to this notice in which the program payments could be used to pay interest on the home mortgage.

PERSON TO CONTACT

The principal author of this notice is Shareen S. Pflanz of the Office of Associate Chief Counsel (Income Tax & Accounting). For further information regarding this notice, contact Shareen S. Pflanz at (202) 622–4920 (not a toll-free call).

Appendix
Alabama
Hardest Hit for Alabama's Unemployed Homeowners
Arizona
Save My Home AZ Program:
Permanent Modifications Component
Second Mortgage Assistance Component
Temporary Modification Component

California
Unemployment Mortgage Assistance Program Mortgage Reinstatement Assistance Program Principal Reduction Program The Transition Assistance Program
District of Columbia
Homesaver Program
Florida
Unemployment Mortgage Assistance Program Mortgage Loan Reinstatement Program
Georgia
Mortgage Payment Assistance (MPA)
Illinois
Hardest Hit Fund Homeowner Emergency Loan Program (HHF HELP)
Indiana
Hardest Hit Fund Unemployment Bridge Program
Kentucky
Kentucky Unemployment Bridge Program
Michigan
Principal Curtailment Program Loan Rescue Program Unemployment Mortgage Subsidy Program
Mississippi
Home Saver Program
Nevada
Principal Reduction Program Second Mortgage Reduction Plan Short-Sale Acceleration Program Mortgage Assistance Program (MAP)
New Jersey
New Jersey Homekeeper Program (NJHK)
North Carolina
Mortgage Payment Program (MPP–1) Mortgage Payment Program (MPP–2) Second Mortgage Refinance Program (SMRP) Permanent Loan Modification Program (PLMP)

Ohio
Rescue Payment Assistance Program
Partial Mortgage Payment Assistance Program
Mortgage Modification with Principal Reduction Program
Transition Assistance Program
Short Refinance Program
Oregon
Loan Modification Assistance Program
Mortgage Payment Assistance Program
Loan Preservation Assistance Program
Transition Assistance Program
Rhode Island
Loan Modification Assistance for HAMP Customers (LMA-HAMP)
Loan Modification Assistance for Non-HAMP Customers (LMA-Non-HAMP)
Temporary and Immediate Homeowner Assistance (TIHA)
Moving Forward Assistance
Mortgage Payment Assistance — Unemployment Program
South Carolina
Monthly Payment Assistance Program
Direct Loan Assistance Program
HAMP Assistance Program
Second Mortgage Assistance Program
Property Disposition Assistance Program
Tennessee
Hardest Hit Fund Program (HHFP)

Postponing Filing Date for Section 6045B Issuer Return

Notice 2011–18

PURPOSE

This notice provides transitional relief from information reporting requirements in section 6045B of the Internal Revenue Code ("Code") that apply to issuers of stock with respect to organizational actions that affect the basis of the stock. This notice provides that, for organizational actions occurring in 2011, the Internal Revenue Service will not impose penalties against issuers for missing the deadline to file a return reporting the action or make the return publicly available provided that the issuer files the return with the Service or makes it publicly available by January 17, 2012. This notice does not apply to an issuer's requirement to furnish the same information to the issuer's stockholders and nominees of its stockholders.

BACKGROUND

Section 403 of the Energy Improvement and Extension Act of 2008, Div. B of Pub. L. No. 110–343, 122 Stat. 3765, enacted on October 3, 2008, added section 6045B to the Code. Section 6045B provides that, for organizational actions beginning in 2011, an issuer of stock must file a return with the Service to describe any organizational action (such as a stock split, merger, or acquisition) that affects the basis of a specified security. Under section 6045B(d) and section 6045(g)(3)(B), in 2011 a specified security is limited to stock in a corporation. The issuer generally must file the return within 45 days after the organizational action. The issuer must also furnish a corresponding statement to each nominee of the stockholder (or to each stockholder if there is no nominee) by January 15th of the year following the calendar year of the organizational action.

Alternately, the issuer is not required to file an issuer return with the Service if it posts the return on its primary public Web site in a readily accessible format by the filing date. Treas. Reg. § 1.6045B–1(a)(3).

The requirements under section 6045B do not apply to issuers of stock in a regulated investment company until 2012.

Under the 45-day deadline, the earliest date that an issuer must file a return is February 15, 2011, for an organizational action that took place on January 1, 2011.