INTERNAL REVENUE SERVICE

IRS News Release

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IRS Announces Guidance on the Principal Reduction Alternative Offered in the Home Affordable Modification Program (HAMP)

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WASHINGTON — The Internal Revenue Service today announced guidance to borrowers, mortgage loan holders and loan servicers who are participating in the Principal Reduction Alternative℠ offered through the Department of the Treasury's and Department of Housing and Urban Development's Home Affordable Modification Program® (HAMP-PRA®).

To help financially distressed homeowners lower their monthly mortgage payments, Treasury and HUD established HAMP, which is described at www.makinghomeaffordable.gov. Under HAMP-PRA, the principal of the borrower's mortgage may be reduced by a predetermined amount called the PRA Forbearance Amount if the borrower satisfies certain conditions during a trial period. The principal reduction occurs over three years.

More specifically, if the loan is in good standing on the first, second and third annual anniversaries of the effective date of the trial period, the loan servicer reduces the unpaid principal balance of the loan by one-third of the initial PRA Forbearance Amount on each anniversary date. This means that if the borrower continues to make timely payments on the loan for three years, the entire PRA Forbearance Amount is forgiven. To encourage mortgage loan holders to participate in HAMP–PRA, the HAMP program administrator will make an incentive payment to the loan holder (called a PRA investor incentive payment) for each of the three years in which the loan principal balance is reduced.

Guidance on Tax Consequences to Borrowers

The guidance issued today provides that PRA investor incentive payments made by the HAMP program administrator to mortgage loan holders are treated as payments on the mortgage loans by the United States government on behalf of the borrowers. These payments are generally not taxable to the borrowers under the general welfare doctrine.

If the principal amount of a mortgage loan is reduced by an amount that exceeds the total amount of the PRA investor incentive payments made to the mortgage loan holder, the borrower may be required to include the excess amount in gross income as income from the discharge of indebtedness. However, many borrowers will qualify for an exclusion from gross income.

For example, a borrower may be eligible to exclude the discharge of indebtedness income from gross income if (1) the discharge of indebtedness occurs (in other words, the loan is modified) before Jan. 1, 2014, and the mortgage loan is qualified principal residence indebtedness, or (2) the discharge of indebtedness occurs when the borrower is insolvent. For additional exclusions that may apply, see Publication 4681, *Canceled Debts, Foreclosures, Repossessions, and Abandonments (for Individuals).*

Borrowers receiving aid under the HAMP–PRA program may report any discharge of indebtedness income — whether included in, or excluded from, gross income — either in the year of the permanent modification of the mortgage loan or ratably over the three years in which the mortgage loan principal is reduced on the servicer's books. Borrowers who exclude the discharge of indebtedness income must report both the amount of the income and any resulting reduction in basis or tax attributes on Form 982 *Reduction of Tax Attributes Due to Discharge of Indebtedness (and Section 1082 Basis Adjustment)*.

Guidance on Tax Consequences to Mortgage Loan Holders

The guidance issued today explains that mortgage loan holders are required to file a Form 1099-C with respect to a borrower who realizes discharge of indebtedness income of $600 or more for the year in which the permanent modification of the mortgage loan occurs. This rule applies regardless of when the borrower chooses to report the income (that is, in the year of the permanent modification or one-third each year as the mortgage loan principal is reduced) and regardless of whether the borrower excludes some or all of the amount from gross income.

Penalty relief is provided for mortgage loan holders that fail to timely file and furnish required Forms 1099-C, as long as certain requirements described in the guidance are satisfied.

Details are in Revenue Procedure 2013-16 available on IRS.gov.

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