

Office of Chief Counsel
Internal Revenue Service
Memorandum

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to: Director, Tax Exempt Bonds
(Tax Exempt & Governmental Entities)

from: Associate Chief Counsel
(Financial Institutions & Products)

subject: Exception to the Three-Year Requirement for Residences for Veterans Under Section 143(d)(2)(D)

This memorandum addresses the scope of § 143(d)(2)(D) of the Internal Revenue Code, which contains an exception to the three-year requirement of § 143(d)(1) for qualified mortgage bonds. This memorandum should not be used or cited as precedent.

ISSUE

If the financed property is a residence for a veteran that satisfies the exception under § 143(d)(2)(D), but neither the veteran nor a co-mortgagor, who is not a veteran, satisfies the three-year requirement of § 143(d)(1), are the veteran and the co-mortgagor treated as satisfying the three-year requirement?

CONCLUSION

If the financed property is a residence for a veteran that satisfies the exception under § 143(d)(2)(D), both the veteran and a co-mortgagor, who is not a veteran, are treated as satisfying the three-year requirement of § 143(d)(1).

FACTS

Bonds were issued in 2007 as qualified mortgage bonds under § 143(a) of the Code. The issuer loaned proceeds of the bonds to V, a veteran within the meaning of 38 U.S.C.A. § 101 (West 2007), and to C, an individual who is not a veteran. V and C used the proceeds to finance a home that they use as their principal residence. V and C had a present ownership interest in another principal residence within the three-year period that ended on the date the mortgage on the new principal residence was executed. None of V's previous financing for a principal residence satisfied § 143(d)(2)(D).

LAW AND ANALYSIS

Under § 103(a), gross income does not include interest on any State or local bond. Section 103(b) denies this exclusion to any private activity bond that is not a qualified bond within the meaning of § 141.

Among the qualified bonds listed in § 141(e) are bonds that are part of a qualified mortgage issue. A qualified mortgage issue is defined in § 143 as an issue of bonds, the proceeds of which are used to finance mortgages for residences. To be a qualified mortgage issue, certain requirements must be met. Under § 143(d)(1), the mortgagors must not have had a present ownership interest in a principal residence in the three years preceding the execution of the mortgage. Section 6a.103A-2(e)(3) further explains that if there is more than one mortgagor of a particular residence, then each of the mortgagors must meet this three-year requirement.

Section 143(d)(2) provides exceptions to the three-year requirement in § 143(d)(1). If the proceeds of bonds are used as described in any of the exceptions, then those proceeds are treated as used to finance residences of mortgagors who meet the three-year requirement. Before December 2006, § 143(d)(2) set forth exceptions for proceeds that provide (A) financing for targeted area residences, (B) qualified home improvement loans and qualified rehabilitation loans, and (C) financing for land described in § 143(i)(1)(C) and the construction of any residence on that land.

On December 20, 2006, § 416 of the Tax Relief and Health Care Act of 2006, Pub. L. No. 109-432, 120 Stat. 2922 (2006), added § 143(d)(2)(D) as a new exception. This new exception is for proceeds that provide:

... in the case of bonds issued after the date of the enactment of this subparagraph and before January 1, 2008, financing of any residence for a veteran (as defined in section 101 of title 38, United States Code), if such veteran has not previously qualified for and received such financing by reason of this subparagraph.

No committee reports describe this new provision, and the joint tax staff's explanation only describes it without explaining its purpose. Joint Committee on Taxation, *Technical Explanation of H.R. 6408, the "Tax Relief and Health Care Act of 2006," as Introduced in the House on December 7, 2006* (JCX-50-06), December 7, 2006. Consequently, it is unclear from the legislative history whether Congress envisioned that the new exception would apply only to the qualifying veteran or instead would apply to every mortgagor of a particular residence, as long as one mortgagor were a qualifying veteran.

Section 6a.103A-2(e)(1) contains the general rule that each mortgagor to whom mortgage financing is provided must meet the three-year requirement. Section 6a.103A-2(e)(3) makes it clear that this rule applies to each mortgagor when there are multiple mortgagors of the same residence. Thus, § 6a.103A-2(e)(3) explains the general rule in § 6a.103A-2(e)(1). Section 6a.103A-2(e)(2) sets forth exceptions to § 6a.103A-2(e)(1). In fact, § 6a.103A-2(e)(2) states that if an exception is met, then § 6a.103A-2(e)(1) does not apply. If a particular situation is removed from the general rule of § 6a.103A-2(e)(1) by an exception, then the rule for multiple mortgagors in § 6a.103A-2(e)(3) does not apply. Thus, the regulations conclude that none of the mortgagors of a particular residence need to satisfy the three-year requirement if any exception is met. Because § 143(d)(2)(D) is now a listed exception, neither V nor C must meet the three-year requirement of § 143(d)(1).

The previous exceptions in § 143(d)(2)(A) through (C) focus on the use of proceeds for certain types of projects. In contrast, the new exception under § 143(d)(2)(D) focuses on the nature of the mortgagor. This difference could suggest a different application of the rule for multiple mortgagors. Thus, the new exception could be interpreted to apply only to the veteran, who is the focus of the new provision. Under this interpretation, the three-year requirement in § 143(d)(1) would be met if V failed to satisfy § 143(d)(1), but would not be met if C failed to satisfy § 143(d)(1). This interpretation would impose a stricter rule for the new exception than for the three previous exceptions. There is no indication in the legislative history or in the structure of the new exception to suggest that this stricter rule was intended. Accordingly, if V satisfies the new exception, then neither V nor C is required to satisfy the three-year requirement of § 143(d)(1).

Please call (202) 622-3980 if you have any further questions.

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