Trust 2 is the obligor, have a stated principal amount of \$5,000,000, bear a relationship to the FNMA Certificates (within the meaning of § 301.7701(i)-1(f)), and have a different maturity than the Class A bonds (within the meaning of § 301.7701(i)-1(e)). Certificate 2 represents the residual beneficial ownership of Certificate 1.

(iii) For purposes of determining whether Trust 1 is classified as a taxable mortgage pool, the Commissioner can disregard the separate existence of Trust 2 and treat Trust 1 and Trust 2 as a single trust.

Example 2. (i) Corporation Q files a consolidated return with its two wholly-owned subsidiaries, Corporation R and Corporation S. Corporation R is in the business of building and selling single family homes. Corporation S is in the business of financing sales of those homes.

(ii) On August 10, 1998, Corporation S transfers a pool of its real estate mortgages to Trust 3, taking back Certificate 3 which represents beneficial ownership of the pool. On September 25, 1998, with a view to avoiding the application of section 7701(i), Corporation R issues bonds that have different maturities (within the meaning of § 301.7701(i)–1(e)) and that bear a relationship (within the meaning of § 301.7701(i)-1(f)) to the real estate mortgages in Trust 3. The holders of the bonds have an interest in a credit enhancement contract that is written by Corporation S and collateralized with Certificate 3.

(iii) For purposes of determining whether Trust 3 is classified as a taxable mortgage pool, the Commissioner can treat Trust 3 as the obligor of the bonds issued by Corporation R.

Example 3. (i) Corporation X, in addition to its other assets, owns \$110,000,000 in Treasury securities. From time to time, Corporation X acquires pools of real estate mortgages, which it immediately uses to issue multiple-class debt obligations.

(ii) On October 1, 1996, Corporation X transfers \$20,000,000 in Treasury securities to Trust 4 in exchange for Class C bonds, Class D bonds, Class E bonds, and Certificate 4. Trust 4 is the obligor of the bonds. The different classes of bonds have the same stated maturity date, but if cash flows from the Trust 4 assets exceed the amounts needed to make interest payments, the trustee uses the excess to retire the classes of bonds in alphabetical order. Certificate 4 represents the residual beneficial ownership of the Treasury securities.

(iii) With a view to avoiding the application of section 7701(i), Corporation X reserves the right to replace any Trust 4 asset with real estate mortgages or guaranteed mortgage pass-through certificates. In the event the right is exercised, cash flows on the real estate mortgages and guaranteed pass-through certificates will be used in the same manner as cash flows on the Treasury securities. Corporation X exercises this right of replacement on February 1, 1997.

(iv) For purposes of determining whether Trust 4 is classified as a taxable mortgage pool, the Commissioner can treat February 1, 1997, as a testing day (within the meaning of § 301.7701(i)-3(c)(2)). The result is the same if Corporation X has an obligation, rather

than a right, to replace the Trust 4 assets with real estate mortgages and guaranteed passthrough certificates.

Example 4. (i) Corporation Y, in addition to its other assets, owns \$1,900,000 in obligations secured by personal property. On November 1, 1995, Corporation Y begins negotiating a \$2,000,000 loan to individual A. As security for the loan, A offers a first deed of trust on land worth \$1,700,000.

(ii) With a view to avoiding the application of section 7701(i), Corporation Y induces A to place the land in a partnership in which A will have a 95 percent interest and agrees to accept the partnership interest as security for the \$2,000,000 loan. Thereafter, the loan to A, together with the \$1,900,000 in obligations secured by personal property, are transferred to Trust 5 and used to issue bonds that have different maturities (within the meaning of § 301.7701(i)-1(e)) and that bear a relationship (within the meaning of § 301.7701(i)-1(f)) to the \$1,900,000 in obligations secured by personal property and the loan to A.

(iii) For purposes of determining whether Trust 5 is a taxable mortgage pool, the Commissioner can treat the loan to A as an obligation secured by an interest in real property rather than as an obligation secured by an interest in a partnership.

Example 5. (i) Corporation Z, in addition to its other assets, owns \$3,000,000 in notes secured by interests in retail shopping centers. Partnership L, in addition to its other assets, owns \$20,000,000 in notes that are principally secured by interests in single family homes and \$3,500,000 in notes that are principally secured by interests in personal property.

(ii) On December 1, 1995, Partnership L asks Corporation Z for two separate loans, one in the amount of \$9,375,000 and another in the amount of \$625,000. Partnership L offers to collateralize the \$9,375,000 loan with \$10,312,500 of notes secured by interests in single family homes and the \$625,000 loan with \$750,000 of notes secured by interests in personal property. Corporation Z has made similar loans to Partnership L in the past.

(iii) With a view to avoiding the application of section 7701(i), Corporation Z induces Partnership L to accept a single \$10,000,000 loan and to post as collateral \$7,500,000 of the notes secured by interests in single family homes and all \$3,500,000 of the notes secured by interests in personal property. Ordinarily, Corporation Z would not make a loan on these terms. Thereafter, the loan to Partnership L, together with the \$3,000,000 in notes secured by interests in retail shopping centers, are transferred to Trust 6 and used to issue bonds that have different maturities (within the meaning of § 301.7701(i)-1(e)) and that bear a relationship (within the meaning of $\S 301.7701(i)-1(f)$) to the loans secured by interests in retail shopping centers and the loan to Partnership L.

(iv) For purposes of determining whether Trust 6 is a taxable mortgage pool, the Commissioner can treat the \$10,000,000 loan to Partnership L as consisting of a \$9,375,000 obligation secured by interests in real property and a \$625,000 obligation secured

by interests in personal property. Under $\S 301.7701(i)-1(d)(3)(ii)(A)$, the notes secured by single family homes are treated as \$7,500,000 of interests in real property. Under $\S 301.7701(i)-1(d)(3)(i)(A)$, \$7,500,000 of interests in real property are sufficient to treat the \$9,375,000 obligation as principally secured by an interest in real property \$7,500,000 equals \$0 percent of \$9,375,000).

§ 301.7701(i)–2 Special rules for portions of entities.

- (a) Portion defined. Except as provided in paragraph (b) of this section and § 301.7701(i)-1, a portion of an entity includes all assets that support one or more of the same issues of debt obligations. For this purpose, an asset supports a debt obligation if, under the terms of the debt obligation (or underlying arrangement), the timing and amount of payments on the debt obligation are in large part determined, either directly or indirectly, by the timing and amount of payments or projected payments on the asset or a group of assets that includes the asset. Indirect payment arrangements include, for example, a swap or other hedge, or arrangements where the timing and amount of payments on the debt obligations are determined by reference to a group of assets (or an index or other type of model) that has an expected payment experience similar to that of the assets. For purposes of this paragraph, the term payments includes all proceeds and receipts from an asset.
- (b) Certain assets and rights to assets disregarded—(1) Credit enhancement assets. An asset that qualifies as a credit enhancement contract (as defined in $\S 301.7701(i)-1(c)(4)(ii)$) is not included in a portion as a separate asset, but is treated as part of the assets in the portion to which it relates under $\S 301.7701(i)-1(c)(4)(i)$. An asset that does not qualify as a credit enhancement contract (as defined in $\S 301.7701(i)-1(c)(4)(ii)$), but that nevertheless serves the same function as a credit enhancement contract, is not included in a portion as a separate asset or otherwise.
- (2) Assets unlikely to service obligations. A portion does not include assets that are unlikely to produce any significant cash flows for the holders of the debt obligations. This paragraph applies even if the holders of the debt obligations are legally entitled to cash flows from the assets. Thus, for example, even if the sale of a building would cause a series of debt obligations to be redeemed, the building is not included in a portion if it is not likely to be sold.
- (3) *Recourse.* An asset is not included in a portion solely because the holders