

RB 29 was rescinded 8/26/93. It was incorporated into Thrift Activities 260.

Handbook: Thrift Activities
Subject: Classification of Assets

Section: 260
RB 29

November 23, 1992

Conclusive Presumption of Worthlessness of Debts Held by Savings Associations

Summary: This Bulletin outlines the procedures to issue an Express Determination Letter in connection with the new Internal Revenue Service (IRS) regulations that relate to thrift initiated charge-offs.

For Further Information Contact: Your Regional Office or Supervision Policy (Credit Risk) or Accounting Policy, OTS, Washington, D.C.

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Background

The IRS recently issued new regulations that relate to the deductibility of loan charge-offs by financial institutions. Under these regulations, institutions may elect to conform their tax accounting for bad debts with their regulatory accounting. Institutions that make this election will automatically be allowed to deduct charge-offs¹ of loss assets for federal income tax purposes in the same year the charge-offs are taken for regulatory purposes.

The new regulations require the institution to maintain loan loss classification standards that are consistent with the standards established for loan charge-offs by its primary federal supervisory agency. If the institution meets these requirements, its loan charge-offs are conclusively presumed worthless for federal income tax purposes. These regulations are effective for taxable years ending on or after December 31, 1991.

¹ For purposes of the IRS regulation, specific valuation allowances are treated the same as charge-offs.

Election Requirements

To be eligible, an institution must file a conformity election with its federal tax return. The IRS regulations also require the institution's primary federal supervisory agency to expressly determine that the institution maintains and applies classification standards for loan charge-offs that are consistent with regulatory requirements.

Transitional Rules

The IRS transition rules allow a savings association to make the conformity election without the Express Determination Letter until the primary Federal supervisory agency's first examination that involves the loan review process after October 1, 1992.

For taxable years that end before completion of the first examination that involves the loan review process after October 1, 1992, the savings association must make a declaration that the association maintains and applies loan loss classification standards that are consistent with the regulatory standards of its supervisory authority.

Once the first examination of the loan review process after October 1, 1992, has been performed, the transition rules no longer apply and the association must have the Express Determination Letter before it makes the election. To continue to

use the new method, the institution must request a new Express Determination Letter at each subsequent examination that covers the loan review process.

Procedures

The savings association is responsible for requesting a Express Determination Letter.

When requested by a savings association that has made or intends to make the election under IRS regulation section 1.166-2(d)(3), the examiner may issue the attached Express Determination Letter, provided the savings association maintains and applies loan loss classification standards that are consistent with regulatory requirements.

The Express Determination Letter should be issued only at the completion of an examination that covers the association's loan review process, and for which the examiner has concluded that issuance of the Express Determination Letter is appropriate. Examiners should not alter the scope or frequency of examinations merely to permit a savings associations to use this new regulation.

The Express Determination Letter should be signed and dated by the examiner-in-charge and provided to the savings association for its files. The Express Determination Letter is not part of the examination report.

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The examiner should document in examination workpapers his/her conclusions regarding the association's loan loss classification standards.

OTS standards for loan charge-offs and classification standards are set forth in section 217 (Consumer Lending), section 218 (Credit Card Lending), and section 260 (Classification of Assets) of the Thrift Activities Regulatory Handbook. A listing of other OTS issuances related to OTS classification standards can be found in section 260.13 of the handbook.

The Express Determination Letter should be issued only if:

- The examination indicates that the savings association maintains and applies loan loss classification standards that are consistent with OTS standards regarding the identification of losses and charge-off of loans.

- There are no material deviations from regulatory standards. Minor criticisms of the savings association's loan review process or immaterial individual deviations from regulatory standards should not preclude issuance of the Express Determination Letter.

The Express Determination Letter should not be issued if:

- The savings association's loan review process relating to charge-offs is subject to significant criticism.
- Loan charge-offs for Thrift Financial Report purposes are consistently overstated or understated.
- There is a pattern of loan charge-offs not recognized in the appropriate year.

Revoking the Election

The savings association's election of the new method is revoked automatically if the examiner does not issue an Express Determination Letter at the end of an examination that covers the loan review process. The OTS is not required to rescind any previously issued Express Determination Letters.

An examiner's decision to withhold the Express Determination Letter generally revokes the election for the current year. However, it does not invalidate a savings association's election for any prior year(s). Withholding the Express Determination Letter places the burden of proof on the association to support its tax deductions for loan charge-offs.

Attachment



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Date

Express Determination Letter for IRS Regulation Section 1.166-2(d)(3)

In connection with the most recent examination of [NAME OF SAVINGS ASSOCIATION], by the Office of Thrift Supervision, as of [EXAMINATION DATE], we reviewed the institution's loan review process as it relates to loan charge-offs. Based on our review, we concluded that the bank, as of that date, maintained and applied loan loss classification standards that were consistent with regulatory standards regarding loan charge-offs.

This statement is made on the basis of a review that was conducted in accordance with our normal examination procedures and criteria, including sampling of loans in accordance with those procedures and criteria. It does not in any way limit or preclude any formal or informal supervisory action (including enforcement actions) by this supervisory authority relating to the institution's loan review process or the level at which it maintains its allowance for loan and lease losses.

OTS Examiner-in-charge