

RESCINDED

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EXAMINING ISSUANCE

Comptroller of the Currency
Administrator of National Banks

Replaced by Comptroller's Handbook - Loan Portfolio
Management

Type: Examining Circular

Subject: IRS Determination Letters

To: Deputy Comptrollers, District Administrators, Department and Division Heads and all
Examining Personnel

PURPOSE

This circular outlines the procedures for issuing an express determination letter in connection with the new Internal Revenue Service (IRS) regulations relating to bank-initiated charge-offs. This issuance supplements Examining Circular 216, "Certification Procedures for Consumer Loans Charged-off Between Examinations" (EC 216). The procedures contained in EC 216 remain in effect for banks choosing not to elect the new regulations.

BACKGROUND

The IRS recently issued new regulations relating 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 making this election will automatically be allowed to deduct charge-offs of loss assets, for federal income tax purposes, in the same year the charge-offs are taken for regulatory purposes.

The new regulations require an 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.

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.



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TRANSITION RULES

The transition rules allow a bank to make the conformity election without the express determination letter until the primary federal supervisory agency's first examination involving the loan review process after October 1, 1992.

For taxable years ending before completion of the first examination involving the loan review process after October 1, 1992, the bank must make a declaration that the bank 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 bank must obtain the determination letter before making the election. To continue using the new method, the bank must request a new letter at each subsequent examination that covers the loan review process.

PROCEDURES

The bank is responsible for requesting a determination letter.

When requested by a bank 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 bank maintains and applies loan loss classification standards that are consistent with regulatory requirements.

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

The letter should be signed and dated by the examiner-in-charge and provided to the bank for its files. The letter is not part of the examination report. The examiner should document, in examination workpapers, his/her conclusions regarding the bank's loan loss classification standards.



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OCC standards for loan charge-offs and classification standards are set forth in section 209 (Installment Loans), section 212 (Credit Card Loans), and section 215 (Classification of Credits) of the Comptroller's Handbook for National Bank Examiners. A listing of other OCC banking and examining issuances related to OCC classification standards can be found in section 215.2 of the handbook.

The determination letter should be issued only if:

- The examination indicates that the bank maintains and applies loan loss classification standards that are consistent with OCC standards regarding the identification of losses and charge-off of loans.
- There are no material deviations from regulatory standards. Minor criticisms of the bank's loan review process or immaterial individual deviations from regulatory standards should not preclude issuance of the letter.

The letter should not be issued if:

- The bank's loan review process relating to charge-offs is subject to significant criticism.
- Loan charge-offs for call 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 bank'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 covering the loan review process. The OCC is not required to rescind any previously issued express determination letters.



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

ORIGINATING OFFICE

Questions about this circular may be directed to the Office of the Chief Accountant or to Traditional Activities, Office of the Chief National Bank Examiner (202) 874-5350.

Jerilyn Gilland
Acting Chief National Bank Examiner

Related Links

- [Express Determination Letter](#)



Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

Date

Chief Executive Officer
National Bank

EXPRESS DETERMINATION LETTER FOR IRS REGULATION 1.166-2(d)(3)

In connection with the most recent examination of [NAME OF BANK] by the Office of the Comptroller of the Currency, 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.

Sincerely yours,

National Bank Examiner
Examiner-in-charge