

BUREAU OF BANKING

Department of Professional and Financial Regulation

State of Maine

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BULLETIN #54 IRS DETERMINATION LETTERS AND CERTIFICATION OF CHARGE-OFFS

Earlier in 1992, the IRS promulgated new regulations regarding the deductibility of bad debt expense for financial institutions. These regulations provide for another election, the "conformity election," by which a financial institution may establish the validity of charge-offs for tax purposes. Under the new regulations, the validity of charge-offs is presumed if the financial institution has obtained a letter ("Express Determination Letter") from its primary federal regulator stating that the institution maintained and applied loan loss classification criteria consistent with regulatory standards. Transition rules permit a financial institution to make this election without an Express Determination Letter as long as the letter is obtained at the next federal examination where the internal loan loss classification process is examined. Once issued by your primary federal regulator, the Express Determination Letter will remain valid until the next examination where the internal loan loss classification process is examined. If upon a subsequent examination, an express determination letter is not obtained, for whatever reason, the conformity election is automatically revoked.

The new rules are effective October 1, 1992. Institutions choosing to make the conformity election should be aware of the following:

1. An examiner is not permitted to issue an express determination letter unless specifically requested by the institution.
2. Once issued, an express determination letter is valid until the next federal examination where internal loan loss classification are subject to examination, when the institution is, again, required to specifically request that the EIC issue a letter.
3. The institution must have clear internal guidelines for loss classifications, which are consistent with regulatory definitions and consistently applied, before the FDIC will consider issuing an express determination letter.
4. The IRS will not accept express determination letters from state examiners. While the Bureau of Banking disagrees with the position of the IRS, this position will not adversely impact state-chartered institutions as the express determination letters issued by your primary federal regulator are valid until the next federal examination, whether the examination is

concurrent or independent with state examinations, where loan loss classification criteria are examined.

5. Institutions should discuss the conformity election with their external accountants and/or tax advisors prior to implementation.

For those banks electing not or unable to obtain express determination letters, the prior IRS regulations continue to apply. Long-standing IRS rules provide that a debt charged off in a taxable year is conclusively presumed to have become worthless in that year if the charge-off was taken in response to a specific order by the institution's federal or state supervisory authority, or if the state or federal supervisory authority confirms in writing at its first examination subsequent to the charge-off that the charge-off would have been ordered had the institution been examined on the date of the charge-off.

While the Bureau has not confirmed charge-offs for institutions in nearly ten (10) years, our examiners have been instructed to provide written confirmation, assuming the charge-offs are valid, if specifically requested by the institution. Institutions, however, should be aware that this request will increase examination hours, and, thus, examination fees. The amount of increase will largely depend upon the volume of charge-offs to be confirmed and the quality of the documentation supporting the charge-offs.

/s/Donald W. Groves
Deputy Superintendent