DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF
CHIEF COUNSEL

June 3, 2000

Number: **200044002**
Release Date: 11/3/2000
CC:DOM:FS:FI&P

UILC: 593.00-00

INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR BENJAMIN A. DE LUNA
DISTRICT COUNSEL CC:SER:NFL:JAX
Attn: James F. Kearney

FROM: Deborah A. Butler
Assistant Chief Counsel (Field Service) CC:DOM:FS

SUBJECT: I.R.C. 593 - Reserves For Losses on Loans

This Field Service Advice responds to your memorandum dated April 4, 2000. Field Service Advice is not binding on Examination or Appeals and is not a final case determination. This document is not to be cited as precedent.

LEGEND

Corporation A =
Corporation B =
Parent =
Year 1 =
Year 2 =
State A =

ISSUE:

Whether Corporations A and B qualify as "domestic building and loan associations" within the meaning of I.R.C. § 7701(a)(19) and are thereby entitled to maintain reserves for bad debts pursuant to I.R.C. § 593.

CONCLUSION:

We conclude that Corporations A and B do not qualify as domestic building and loan associations. Rather, they are commercial banks and therefore are not entitled to maintain reserves for bad debts pursuant to I.R.C. § 593.

FACTS:

Parent is a bank holding company with 33 banking affiliates that provide a full range of traditional commercial banking and related financial services to the manufacturing, retail, wholesale, real estate, and financial sectors. All of Parent's banking affiliates are chartered commercial banks. Parent is subject to regulation under the Bank Holding Company Act of 1956, as amended. That Act requires prior approval of the Board of Governors of the Federal Reserve System for bank acquisitions, limits the acquisition of shares of out of state banking organizations unless permitted by state law, and prescribes limitations on the non-banking activities of companies subject to its regulation. Parent's affiliated group has total assets that exceed $500 million.

In Year 1, Parent acquired Corporation A in a transaction involving: (1) the conversion of a federally chartered savings and loan association into a State A chartered savings and loan association; (2) the conversion of the State A chartered savings and loan association into a State A banking corporation; and (3) the merger of the State A banking corporation with a wholly owned banking subsidiary of Parent. Similarly, in Year 2, Parent acquired Corporation B in a transaction involving the conversion of a federal savings bank into a State A savings and loan association, which then converted into a State A banking corporation which was then merged with a wholly owned banking subsidiary of Parent.

Prior to the acquisitions described above, both Corporations A and B were engaged in the business of attracting deposits from the general public and making loans secured by first mortgage liens to purchase or construct single-family homes, and commercial and multi-family real estate. Both corporations were supervised by the Federal Home Loan Bank Board and their deposits were insured by the Federal Savings and Loan Insurance Corporation. Subsequent to the acquisitions, Corporations A and B continued to be engaged in essentially the same business activities as they had before the acquisitions. However, as State A chartered banking corporations, they were supervised by the State A Department of Banking and Finance, and the deposits of both corporations were insured by the Federal Deposit Insurance Corporation.

Prior to their acquisition by Parent, Corporations A and B consistently maintained reserves for bad debts pursuant to I.R.C. § 593. In the consolidated returns for Years 1 and 2 filed with Parent, neither Corporation A nor B recaptured these reserves or changed to the specific charge-off method of accounting for bad debts. Rather, Parent, on behalf of Corporations A and B, maintained that those corporations were entitled to continue maintaining bad debt reserves pursuant to I.R.C. § 593 because they were domestic building and loan associations within the meaning of I.R.C. § 7701(a)(19).

LAW AND ANALYSIS

Before 1987, I.R.C. § 585(a)(1) allowed a deduction for a reserve for bad debts for any bank (as defined in I.R.C. § 581) other than an organization to which I.R.C. §

593 applied. Section 585 allowed commercial banks to use the percentage of eligible loans method or the experience method to calculate deductible reserve additions. The Tax Reform Act of 1986, which enacted § 585(c), required any large bank (defined as a bank with assets or in a parent-subsidiary controlled group with assets exceeding $500 million) to recapture its bad debt reserve and subsequently to use the specific charge-off method for deducting bad debts.

During the same years, I.R.C. § 593 provided a more generous deduction for bad debt reserves for (1) domestic building and loan associations, (2) mutual savings banks, and (3) cooperative banks without capital stock that were organized and operated for mutual purposes and without profit. Section 7701(a)(19) provides that the term "domestic building and loan association" means a domestic building and loan association, a domestic savings and loan association, or a Federal savings and loan association, but only if the association meets the following three requirements: (1) it is either an insured institution within the meaning of section 401(a) of the National Housing Act or subject by law to supervision and examination by State or Federal authority having supervision over such associations; (2) its business consists principally of acquiring the savings of the public and investing in loans; and (3) at least 60 percent of its total assets consists of cash, certain State or Federal obligations, and certain types of loans.

Treasury Regulation § 301.7701-13A(a) provides that the term "domestic building and loan association" means a domestic building and loan association, a domestic savings and loan association, a Federal savings and loan association, and any other savings institution chartered and supervised as a savings and loan or similar association under Federal or State law which meets the supervisory test (described in paragraph (b)), the business operations test (described in paragraph (c)), and the assets test (described in paragraph (d)) of the regulation.

Rev. Rul. 90-54, 1990-2 C.B. 270, holds that an institution that is chartered as a bank cannot qualify as a domestic building and loan association under I.R.C. § 7701(a)(19), because such an institution is not described in the introductory language of that provision.

In the instant case it is clear that Corporations A and B were chartered as commercial banks in State A.   As chartered commercial banks, these corporations were legally empowered to offer a full panoply of financial services to the public that exceeded the traditional, and legally limited, role of domestic savings and loan associations. That legal status, together with the opportunities presented thereby, was not altered for tax purposes merely because these corporations voluntarily continued to conduct their businesses in a manner similar to that of domestic building and loan associations.

Rev. Rul. 90-54, supra, at 271, correctly provides that "(t)raditionally, the introductory language of section 7701(a)(19) has been applied by reference to an institution's charter and its operation in accordance with that charter." Corporations

A and B may not simply ignore this part of the statutory provision and claim that their charters do not matter because their business operations comport with those of other institutions that qualify by virtue of their charters and operations.

Moreover, the term “similar association” in Treas. Reg. § 301.7701-13A(a) simply does not include commercial banks. Since Corporations A and B are chartered commercial banks, they are not described in I.R.C. § 7701(a)(19), and thus they do not qualify as domestic building and loan associations.

<u>CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS</u>

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

Please call if you have any further questions.

Deborah A. Butler
Assistant Chief Counsel (Field Service)
By: JOEL E. HELKE
Branch Chief
CC:DOM:FS:FI&P