OFFICE OF
CHIEF COUNSEL

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

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INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR

FROM: CAROL P. NACHMAN
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SUBJECT: Internal Revenue Service National Office Field Service Advice

This Field Service Advice responds to your memorandum dated September 3, 1998. 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:

Bank =
Year 1 =
Year 7 =

ISSUE(S):

Whether amounts paid by Bank to create home equity lines of credit (“HELOCs”) and fixed-term home equity loans should be capitalized and amortized over the average life of such loans.

CONCLUSION:

In general, costs incurred in creating loans that are separate and distinct assets, must be capitalized and amortized pursuant to section 263(a). See, PNC Bancorp, Inc. v. Commissioner, 110 T.C. 349 (1998). Substantial factual

development will be necessary to determine to what extent the costs at issue in this case should be capitalized and amortized.

FACTS:

From Year 1 through Year 7, Bank incurred closing costs to create HELOCs and fixed-term home equity loans. These costs included appraisal fees, costs to obtain credit reports, and recording fees. Generally, these costs are paid by the borrowers. Bank claimed deductions for these costs in the years in which the costs were incurred. Bank capitalized and amortized the interest income received in connection with the HELOCs and fixed-term home equity loans. Specifically, Bank amortized the interest income on the HELOCs over the length of time the credit was outstanding. With respect to the fixed-term home equity loans, Bank amortized the interest income over the term of the loan.

The examining agent disallowed the current deductions that the Bank claimed in connection with the loan origination costs.

LAW AND ANALYSIS:

In general, loan origination costs must be capitalized and amortized over the terms of the loans. See PNC Bancorp, Inc. v. Commissioner, 110 T.C. 349 (1998). In PNC, the court reasoned that the loans were separate and distinct assets of the bank. Id. at 364. Accordingly, the court concluded that the costs incurred in creating these asset should be capitalized pursuant to section 263(a). Id. (relying on INDOPCO, Inc. v. Commissioner, 503 U.S. 79, 86 (1992), and Commissioner v. Lincoln Savings & Loan Association, 403 U.S. 345, 354 (1971).

Given that the facts in this case have not been developed, we are unable to opine as to whether the costs in issue should be capitalized and amortized. However, the following discussion should assist you in developing the relevant facts for purposes of addressing this issue.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS:

We suggest that you focus your discovery efforts as follows. Can Bank more fully identify the types of costs involved? For example, do the costs at issue include salaries and fringe benefits paid to employees for evaluating the borrower's financial condition, evaluating guaranties, collateral and other security arrangements, negotiating loan terms, preparing and processing loan documents, and closing the loan transactions? Do the costs include advertising expenditures which are currently deductible pursuant to section 162? What are the terms of the loans in issue?

In addition, you will also want to discover what percentage of these costs were incurred in connection with Bank's unsuccessful loan efforts (i.e. where a loan was not originated)? Also, were any of these costs incurred subsequent to a loan's origination by Bank?

You should also ascertain whether Bank deferred these costs for financial accounting purposes pursuant to SFAS 91?

If you have any further questions, please call.