

## Examination Bulletin: FCA 2008-2

### Subject: IRS Determination Letter

Date Published: 3/2008

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#### PURPOSE

This Bulletin defines the use of express determination letters to address the Internal Revenue Service (IRS) regulations regarding loan charge-offs.

#### BACKGROUND

The IRS allows a deduction for loans that become worthless in accordance with direction established in IRS Regulations 26 CFR Section 1.166-2(d). Under the rule, taxable financial institutions write off that loans have become worthless based on the individual facts and circumstances of the loans charged-off. Alternatively, the statute provides for regulated financial institutions may conclusively presume the worthlessness of loans if the institution maintains and applies loan loss classifications that are consistent with regulatory standards. To apply this option, the regulator must provide written confirmation of compliance with regulatory standards.

As a result of the IRS direction, the Farm Credit Administration (FCA) will provide documentation of compliance with regulatory standards in an express determination letter when an examination concludes that loan losses are identified in accordance with the Uniform Classification System. The attached express determination letter will be used.

#### PROCEDURE

At the conclusion of an examination of the loan review process at a taxable Farm Credit System institution, the Office of Examination will determine if the express determination letter is appropriate. The Examiner-in-Charge will document the examination conclusions regarding the institution's loan loss classification practices, and the Director or designee will determine whether to issue the express determination letter.

The express determination letter will be issued if:

- The examination concludes that the institution maintains and applies loan classifications consistent with the Uniform Classification Standards. Minor criticisms of the review process or immaterial individual deviations from standards should not preclude issuance of the letter.

The letter will not be issued if:

- The examination did not include a review of charge-offs or a review of the institution's loan review process.
- The institution's loan review process relating to charge-offs is subject to significant criticism.
- Loan charge-offs recorded are consistently over or understated.
- There is a pattern of loan charge-offs not recognized in the appropriate year.

Attachment

March 26, 2008

Date

/S/

Thomas G. McKenzie  
Director and Chief Examiner

**Express Determination Letter for IRS Regulation § 1.166-2(d)**

Dear [Name of Institution's President and/or CEO]:

In connection with the examination of [Name of Institution] by the Farm Credit Administration (FCA), as of [Examination Date], we reviewed a portion of the institution's charge-offs and/or the institution's loan review/classification process. Based on our review, we concluded the [Institution], maintained a loan review process that applied loss classifications consistent with FCA's standards.

This statement is made on the basis of an examination conducted in accordance with our examination procedures and criteria. It does not in any way inhibit, estop, or bar FCA from initiating any formal or informal action (including actions pursuant to 12 U.S.C. 2261-2274 or otherwise) including, but not limited to, actions relating to the institution's loan review process or the level at which it maintains its allowance for loan and lease losses.

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Examiner-in-Charge

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Date