Client Alert

pillsbury

Tax | Financial Services Regulation

October 7, 2008

IRS Liberalizes Use of Bad Loan Losses for Acquired Banks

by James T. Chudy and Lisa B. Procopio

On September 30, 2008, the Internal Revenue Service issued Notice 2008-83 on the proper treatment of built-in loss deductions after a bank ownership change under Section 382 of the Internal Revenue Code. The new rules will reduce the after-tax cost of acquiring banks that hold bad loans.

A bank may have a built-in loss for federal income tax purposes when bad loans and other bad debts are worth less than their tax bases (after taking into account bad debt reserves and previous write-offs). Currently, Section 382 of the Internal Revenue Code would limit a bank's ability to use tax losses and deductions attributable to built-in losses on bad loans and other bad debts following an "ownership change," which is generally a 50% change in ownership of the bank's stock (directly or indirectly through a holding company) over a three-year period. An ownership change would include a whole-company sale as well as a major capital infusion or large trade.

Notice 2008-83 allows the free use of built-in losses on bad loans and bad debts, including additions to bad debt reserves, triggered after an ownership change. This Notice only applies to a change in direct or indirect ownership of a bank, not to the outright taxable purchase of bad loans or bad debts.

While the IRS and the Treasury Department are still studying the proper application of Code Section 382, banks may rely on this guidance until further notice. The Code Section 382 limitation on the use of net operating loss carryovers for losses recognized prior to the ownership change remains unchanged.

For further information, please contact:

James T. Chudy (bio)
New York
+1.212.858.1116
james.chudy@pillsburylaw.com

Ernest T. Patrikis (bio)
New York
+1.212.858.1317
ernest.patrikis@pillsburylaw.com

Randi Lane Maidman
New York
+1.212.858.1994
randi.maidman@pillsburylaw.com

Lisa B. Procopio
New York
+1.212.858.1207
lisa.procopio@pillsburylaw.com

Rodney R. Peck (bio)
San Francisco
+1.415.983.1516
rodney.peck@pillsburylaw.com