

Recapture of bad debt reserves by thrift institutions

If a thrift institution become, a commercial bank, or if the institution fails to satisfy the 60-percent qualified asset test, the institution is required to change its method of accounting for bad debts and, under proposed Treasury regulations, is required to recapture its bad debt reserve.¹ The percentage of taxable income portion of the reserve generally is included in income ratably over a 6-taxable year period. The experience method portion of the reserve is not restored to income if the former thrift institution qualified as a small bank. If the former thrift institution is treated as a large bank, the experience method portion of the reserve is restored to income either ratably over a 6-taxable year period, or under the 4-year recapture method described above.

In addition, a thrift institution may be subject to a form of reserve recapture even if the institution continues to qualify for the percentage of taxable income method. Specifically, if a thrift institution distributes to its shareholders an amount in excess of its post-1951 earnings and profits, such excess will be deemed to be distributed from the institution's bad debt reserve and must be restored to income (sec. 593(e)).

Financial accounting treatment of tax reserves of bad debts of thrift institutions

In general, for financial accounting purposes, a corporation must record a deferred tax liability with respect to items that are deductible for tax purposes in a period earlier than they are expensed for book purposes. The deferred tax liability signifies that, although a corporation may be reducing its current tax expense because of the accelerated tax deduction, the corporation will become liable for tax in a future period when the related item is expensed for book purposes (i.e., when the timing item "reverses"). Under the applicable accounting standard (Accounting Principles Board Opinion 23), deferred tax liabilities generally were not required for pre-1988 tax deductions attributable to the bad debt reserve method of thrift institutions because the potential reversal of the bad debt reserve was indefinite (i.e., generally, a reversal would only occur by operation of sec. 593(e), a condition within the control of a thrift institution). However, the establishment of 1987 as a base year by the Tax Reform Act of 1986 increased the likelihood of bad debt reserve reversals with respect to post-1987 additions to the reserve and it is understood that thrift institutions generally have recorded deferred tax liabilities for these additions.

Treatment of thrift institutions under H.R. 2491

H.R. 2491 (the "Thrift Charter Conversion Act of 1995") will require thrift institutions to forego their Federal thrift charters and become either State-chartered thrift institutions or Federally-chartered banks. If a thrift institution becomes a bank, the institution will be subject to recapture of all or a portion of its bad debt reserve under proposed Treasury regulations. It is understood that such recapture will require the institution to immediately record, for financial accounting purposes, a current or deferred tax liability for the amount of recapture taxes for which liabilities previously had not been recorded (generally, with respect to the pre-1988 reserves) regardless of when such recap-

ture taxes are actually paid to the Treasury. It is further understood that the recording of this liability generally will decrease the regulatory capital of the new bank.

DESCRIPTION OF PROPOSAL

The proposal would repeal the section 593 reserve method of accounting for bad debts by thrift institutions, effective for taxable years beginning after 1995. Under the proposal, thrift institutions that qualify as small banks would be allowed to utilize the experience method applicable to such institutions, while thrift institutions that are treated as large banks would be required to use the specific charge-off method. Thus, the percentage of taxable income method of accounting for bad debts would no longer be available for any institution.

A thrift institution required to change its method of computing reserves for bad debts would treat such change as a change in a method of accounting, initiated by the taxpayer, and having been made with the consent of the Secretary of the Treasury. Any section 481(a) adjustment required to be taken into account with respect to such change generally would be taken into account ratably over a 6-taxable year period, beginning with the first taxable year beginning after 1995. For purposes of determining the section 481(a) adjustment of a taxpayer, the balance of the reserve for bad debts with respect to the taxpayer's base year (generally, the balance of the reserve as of the close of the last taxable year beginning before January 1, 1988, adjusted for decreases in the taxpayer's loan portfolio) would not be taken into account. However, the balance of these pre-1988 reserves would continue to be subject to the provisions of present-law section 593(e) (requiring recapture in the case of certain excess distributions to shareholders).

Thus, under the proposal, subject to the special rule described below, a thrift institution that would be treated as a large bank generally would be required to recapture its post-1987 additions to its bad debt reserve, whether such additions are made pursuant to the percentage of taxable income method or the experience method. In addition, subject to the special rule described below, a thrift institution that would qualify as a small bank generally only would be required to recapture its post-1987 additions to its bad debt reserve that were attributable to the use of the percentage of taxable income method during such period. If such small bank would later become a large bank, any amount required to be recaptured under present law would be reduced by the amount of the pre-1988 reserve.

Under a special rule, if the taxpayer meets a "residential loan requirement" for any taxable year, the amount of the section 481(a) adjustment otherwise required to be restored to income would be suspended. A taxpayer would meet the residential loan requirement if for any taxable year, the principal amount of residential loans made by the taxpayer during the year is not less than the average of the principal amount of such loans during the six most recent testing years. A "testing year" means (1) each taxable year ending on or after December 31, 1990, and before January 1, 1996, and (2) each taxable year ending after December 31, 1995, for which the taxpayer met the residential loan would be a loan described in section 7701(a)(19)(C)(v) (generally, loans secured by residential real and church property and mobile homes). The determination of whether a member of controlled group of corporations meet the residential loan requirement would be made on a controlled group basis. A special rule would provide that a taxpayer that calculates its estimated tax installments on an annualized basis would determine wheth-

er it meets the residential loan requirement with respect to each such installment. Treasury regulations are expected to provide rules for the application of the residential loan requirement rules in the case of mergers, acquisitions, and other reorganizations of thrift and other institutions.

EFFECTIVE DATE

The proposal would be effective for taxable years beginning after December 31, 1995.

2. Treatment of payments made to the SAIF fund pursuant to H.R. 2491.

PRESENT LAW AND BACKGROUND

In general, a taxpayer is allowed to deduct ordinary and necessary expenses paid or incurred in carrying on a trade business during the taxable year (sec. 162). However, amounts that give rise to a permanent improvement or betterment must be capitalized rather than deducted currently (sec. 263). Whether an expenditure is deductible under section 162 or must be capitalized under section 263 is often a matter of dispute between the IRS and taxpayers and has been the subject of significant litigation. Most recently, in *INDOPCO v. Commissioner*, 503 U.S. 79 (1992), the U.S. Supreme Court held that expenditures that give rise to a future benefit must be capitalized. The *INDOPCO* decision overruled a prior U.S. Supreme Court decision that has been interpreted to hold that an expenditure must give rise to an identifiable asset before it is capitalized (*Lincoln Savings v. Comm.*, 403 U.S. 345 (1971), relating to additional premiums paid by a thrift institution to the Federal Savings and Loan Insurance Corporation). The scope of the *INDOPCO* decision is uncertain.

H.R. 2491 would require thrift institutions to pay a special assessment to the Saving Association Insurance Fund ("SAIF"). The due date of the payment would be the first business day of January 1996. The SAIF generally is the insurance fund for deposits in thrift institutions. Effective January 1, 1998, the SAIF would be merged with the Bank Insurance Fund ("BIF") (the insurance fund for deposits in banks). Thrift institutions and banks also are required to pay annual premiums to the SAIF and BIF, respectively, based on the amount of their insured deposits. Currently, the premium rate for the SAIF deposits is substantially higher than the premium rate for BIF deposits. After the merger of the SAIF and BIF in 1998, under H.R. 2491, thrift institutions and banks would be subject to the same lower deposit insurance rates generally applicable to banks.

DESCRIPTION OF PROPOSAL

The proposal would provide that the special assessment paid to the SAIF as required by H.R. 2491 would be deductible when paid.

EFFECTIVE DATE

The proposal would be effective upon enactment.

FORSAKING A VALUED BULWARK TO EXTREMISM

HON. JIM BUNN

OF OREGON

IN THE HOUSE OF REPRESENTATIVES

Wednesday, October 18, 1995

Mr. BUNN. Mr. Speaker, the Government of Turkey has, for several decades, been one of America's closest allies. They have stood by us throughout the cold war, during Operation Desert Storm, and the crisis in the Balkans. Unfortunately, some in Congress have failed to recognize Turkey's friendship and strategic importance in recent weeks.

¹The requirement of the proposed regulations that a thrift institution recapture its bad debt reserves upon a change in the method of its accounting for bad debts is based on *Nash v. U.S.*, 398 U.S. 1 (1970), where the U.S. Supreme Court held that a taxpayer essentially was required to recapture its bad debt reserve when the related accounts receivable were transferred by the taxpayer.

As the Foreign Operation Subcommittee prepares to enter into a conference with the other body, I hope that my fellow conferees will take a moment to read the following editorial, which appeared in today's Washington Times.

This editorial illustrates the danger of basing our foreign policy on ethnic head counts in our districts, instead of the national security concerns of the United States. I sincerely hope that we can pursue a policy of friendship and cooperation with the Government of Turkey, and thereby ensure a long-lasting and mutually beneficial relationship between our two nations.

FORSAKING A VALUED BULWARK TO
EXTREMISM

(By Amos Perlmutter)

It's generally acknowledged that Turkey is one of the key, critical strategic states in the Middle East, yet that acknowledgement seems to have escaped the United States in recent times.

Challenged by both internal and external forces, Turkish Prime Minister Tansu Ciller resigned after losing a vote of confidence on Sunday. The future of her Government—Turkey's friendliest to the U.S. in a long time—poses serious challenges to American foreign policy in the Middle East.

As far back as 1954, the United States and Great Britain helped engineer the Northern Tier, a North Asian political bulwark and fortress against the Soviet Union in the depths of the Cold War. The leading elements of the tier then were Turkey, Iran, Pakistan and Iraq, seen as partners to the West in the Cold War against the Soviet Union.

Turkey, which stands between Europe and Asia and controls the Black Sea passage to the Mediterranean did more than its part. It made a real and still vivid contribution to the Korean War by delivering its legendary tough soldiers, who displayed conspicuous heroism. Turkey today remains a critical member of NATO and stands in key contrast to Iran, Iraq, Syria and the Muslim states of the former Soviet Union.

Given its critical importance and its basically steadfast history, it seems more than passing strange that the United States has never fully acknowledged or rewarded the contributions and importance of Turkey, including its key participation in the Gulf war, by allowing the use of its air space.

Why this casual treatment of Turkey? Some of the explanations for the American failure to recognize the importance of Turkey's strategic role in the Middle East have their roots in the workings of Congress, where the domestic lobbies of Armenia and Greece hold sway in a ferocious battle against Turkish influence. In fact, the specter of Sen. Robert Dole's candidacy bodes no good for Turkey. Mr. Dole, who was horribly wounded in World War II, was saved by the heroic medical efforts of an Armenian physician, a personal fact that appears to have influenced Mr. Dole's policy toward Turkey. Even without Mr. Dole, the Armenian lobby has been very effective in preventing Turkey from gaining the full economic fruits and benefits of the European Economic Community.

The even more powerful Greek lobby has managed to help relegate Turkey's image in the public eye to that of a non-European Muslim and Ottoman state that bears little resemblance to the reality of modern Turkey. In fact, Turkey's civic culture since the Kemalist revolution after World War I is that of a secular state, even if it is, like so many other countries in the region, burdened by the threat of an emerging radical, Islamic and Kurdish opposition.

The problem for Turkey is that it has so far displayed no gift for the kind of lobbying and public proselytizing that is characteristic of the Greek and Armenian efforts. Turkish-Americans are spread throughout the United States and form no cohesive voting or social bloc. The absence of a natural and organized lobby and the challenge presented by the organized Greek and Armenian lobbies have combined to result in a hesitant U.S. support for Turkey, despite its history and its strategic importance, which is greater than Greece.

The persistent complaint is that Turkey is not a real democracy, an argument that can be applied more correctly to the corrupt regime of Prime Minister Andreas Papandreu of Greece, a former sympathizer of the Soviet Union and of anti-American Third World radicals and terrorists. It's true that neither Greece nor Turkey are complete democracies on the order of the United States or Britain, but a good case can be made for Turkey on its substantive political and social culture, which is characterized by a history of civility, an absence of racism and anti-Semitism and a certain steadfastness to allies ever since the collapse of the Ottoman Empire.

It's true that the Ottoman Empire, once called "the Sick Man of Europe" was an abusive and corrupt empire. Yet even then, its system of vilayat rule allowed considerable autonomy and achieved more tolerance for religious groups than other empires of its time.

Today, Turkey is marked for its civility, and is important as a strategic partner. Most of the vestiges of the Ottoman Empire have long since vanished in the wake of the work of the model military reformist Kamal Ataturk, who is the father of modern, secular Turkey. Turkey, in fact, is the only secular Muslim state in the world today, a not unremarkable feat and status.

Turkey ought to be rewarded instead of ignored for its secularization efforts. True, Turkey must find a better way to deal with its Kurdish problem, although its current approach is relatively moderate, compared to the way Iraq treats its Kurdish minority. The Turkish government should probably do its utmost to recognize the Kurds, although not the PKP revolutionary Marxist group, as equal citizens.

Still, the reasons for American disinterest have more to do with domestic American lobbying activities than any real or perceived Turkish failings. It's high time the United States woke up to the strategic and critical importance of Turkey. The easiest way to do that is to imagine Turkey in the hands of fundamentalist Islamic forces. The opposite is true today—Turkey stands as a real and honest bulwark to the forces of radical and fundamentalist Islam.

EXCLUSIVE ECONOMIC ZONE

HON. PETER A. DeFAZIO

OF OREGON

IN THE HOUSE OF REPRESENTATIVES

Wednesday, October 18, 1995

Mr. DeFAZIO. Mr. Speaker, I join my colleague from the First District of California, Representative RIGGS, in supporting an extension of State jurisdiction into the exclusive economic zone [EEZ] for the States of Alaska, Washington, Oregon, and California. Certain fisheries, such as Dungeness crab, scallops, and thresher shark are not covered by a Federal fishery management plan [FMP]. States lack the authority to manage these fisheries while the Pacific Fishery Management Council

and NMFS lack the resources to manage them. In the absence of management and conservation authority, these fisheries can easily be exploited by fishermen fishing exclusively in the EEZ and then landing the product in State or foreign nation without landing laws addressing that species of fish. The bill as it is currently written grants authority to manage in the EEZ to Alaska. I am hopeful that similar authority will be granted to Washington, Oregon, and California. I applaud the commitment by Representative YOUNG to work toward resolution of this issue.

WHO WILL NOTICE?

HON. PHILIP M. CRANE

OF ILLINOIS

IN THE HOUSE OF REPRESENTATIVES

Wednesday, October 18, 1995

Mr. CRANE. Mr. Speaker, lately there has been a great deal of rhetoric about train wrecks and other analogies to cataclysmic events to describe the impending doom to the Nation's financial markets should the Government shut down if Congress and President Clinton disagree on a Federal budget. I believe that most of the gloom and doom forecasts come from bureaucrats and Democrats who generally overstate the importance of Washington to the rest of the Nation.

As far as I am concerned, the shutdown of non-essential Federal agencies would constitute the fulfillment of my mission as a Member of Congress. However, in the past, the Government has, in fact, shut down temporarily as Congress and the President fought over the details of the funding for the Federal agencies. I suspect that, outside the Capital Beltway, no one noticed when it was shut down.

In a recent Wall Street Journal article, Jim Miller, the former director of the Office of Management and Budget, also argues that no one, even those on Wall Street, will notice if the Federal Government temporarily shuts down during budget negotiations.

As we in Congress continue to convince President Clinton of the necessity to balance the Federal budget, I commend Mr. Miller's article, "Government Shutdown? 'See If Anybody Notices'" to my colleagues for reassurance.

[From the Wall Street Journal]

GOVERNMENT SHUTDOWN? 'SEE IF ANYBODY NOTICES'

(By James C. Miller III)

Washington is reaching the end game on the budget. The White House wants Congress to compromise on—read, back off—a budget that simultaneously cuts taxes by \$245 billion, pays dollar for dollar for those tax cuts with spending cuts, and balances the books by the year 2002. In a fit of rhetorical overkill, the Clinton administration has warned of a "train wreck" that will shut the government down and shake the financial markets if no agreement is reached by Nov. 15.

In fact, the so-called train wreck would be more of a fender bender. The law is quite clear: There would be no shutdown—only "non-essential services" would be curtailed. The armed forces would stand ready as ever; social security checks would be mailed on time (and the post office would deliver them along with all other mail); air traffic controllers and meat inspectors would stay on the job. The fact is, the government has