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subject: Deductibility of Federal Deposit Insurance Corporation (FDIC) Special Assessments

This memorandum addresses the deductibility of the FDIC Special Assessments imposed by the FDIC on November 29, 2023 by adopting a final rule, Special Assessment Pursuant to Systemic Risk Determination, 88 Fed. Reg. 83,329, (Final Rule). This memorandum should not be used or cited as precedent.

ISSUES

1. Whether a deduction for the payment of the FDIC special assessment imposed under the Final Rule is subject to the limitations for deductibility under § 162(r).

2. Whether the FDIC special assessment imposed under the Final Rule is subject to capitalization under § 263(a).

3. Whether a liability to pay the FDIC special assessment imposed under the Final Rule relating to the first collection payment due in Year 2 (2024) is fixed under the all events test of § 461 in Year 1 (2023) or Year 2 (2024).

4. Whether the liability to pay the FDIC special assessment imposed under the Final Rule qualifies for the recurring item exception of § 461(h)(3).

CONCLUSIONS

1. A deduction for the payment of the FDIC special assessment imposed under the Final Rule is not subject to the limitations set forth in § 162(r).

2. The FDIC special assessment imposed under the Final Rule is not subject to capitalization under § 263(a).

3. The liability to pay the FDIC special assessment imposed under the Final Rule is fixed under the all events test of § 461 in Year 1 (2023), and in that year the liability has been determined with reasonable accuracy. However, economic performance for the special assessment liability will generally not occur until the liability is paid.

4. The liability to pay the FDIC special assessment imposed under the Final Rule does not qualify for the recurring item exception of § 461(h)(3) because it is a liability described in § 1.461-4(g)(7) (“other” liabilities). Section 1.461-5(c) provides that the recurring item exception does not apply to any liability described in § 1.461-4(g)(7). Thus, the liability is incurred and deductible in the taxable year in which the liability is paid because the all events test of § 461 is not treated as met any earlier than when economic performance with respect to such item occurs. See § 461(h) and § 1.461-4(a)(1).

FACTS

On November 29, 2023, the FDIC adopted the Final Rule to implement a special assessment to recover the loss to the Deposit Insurance Fund (DIF) arising from the protection of uninsured depositors following the closures of two banks. Under the Final Rule, the special assessments are imposed under § 13(c)(4)(G) of the FDI Act (12 U.S.C. § 1823(c)). Section 13(c)(4)(G) of the FDI Act provides that the loss to the DIF arising from the use of a systemic risk exception must be recovered from one or more special assessments on insured depository institutions (IDIs), depository institution holding companies (with the concurrence of the Secretary of the Treasury with respect to holding companies), or both, as the FDIC determines to be appropriate.

Under the Final Rule, the assessment base for the $16.3 billion special assessment is equal to an IDI’s estimated uninsured deposits, reported for the quarter that ended December 31, 2022, adjusted to exclude the first $5 billion in estimated uninsured deposits from the IDI, or for IDIs that are part of a holding company with one or more subsidiary IDIs, at the banking organization level. The FDIC will collect the special assessment at a quarterly rate of 3.36 basis points multiplied by an IDI’s estimated uninsured deposits, reported for the quarter that ended December 31, 2022 (with certain adjustments as described above), over eight quarterly assessment periods. The FDIC estimates that the amount of the special assessment will equal the estimated losses attributable to the protection of uninsured depositors at the two failed banks.

Because the estimated loss pursuant to the systemic risk determination will be periodically adjusted, and because assessments collected may change due to corrective amendments to the amount of uninsured deposits reported for the December 31, 2022, reporting period, the FDIC retains some flexibility under the Final Rule to modify the terms of the special assessment. Specifically, the FDIC retains the ability to cease collection early, extend the special assessment period one or more quarters beyond the initial eight-quarter collection period to collect the difference between actual or estimated losses and the amounts collected, and impose a final shortfall special assessment to collect the difference between actual losses and the amounts collected on a one-time basis after the receiverships for the failed banks terminate.

Also, the Final Rule provides that if an IDI acquires through merger or consolidation another IDI following the adoption of the Final Rule or during any special assessment collection period, the acquiring IDI would be required to pay the acquired IDI's special assessment, if any, including any unpaid assessment, in addition to its own special assessment, from the quarter of the acquisition through the remainder of all special assessment collection periods. Further, when the insured status of an IDI is terminated and the deposit liabilities of the IDI are not assumed by another IDI, the IDI whose insured status is terminating must, among other things, continue to pay the special assessment quarterly payments for the assessment periods that its deposits are insured, but not thereafter. To avoid incentivizing voluntary termination as a means to escape paying the entire special assessment, the Final Rule also provides that when an IDI voluntarily terminates its deposit insurance under the FDI Act, the IDI whose insured status is terminating must pay the remaining special assessment in full at the time that it terminates its insured status.

The Final Rule is effective April 1, 2024, with the first collection for the special assessment reflected on the invoice for the first quarterly assessment period of 2024 (i.e., January 1 through March 31, 2024), with a payment date of June 28, 2024.

LAW AND ANALYSIS

Deductibility of Special Assessment Under Section 162(r)

Section 162(a) generally allows a deduction for ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business.

Section 162(r)(1), however, provides that no deduction shall be allowed for the applicable percentage of any FDIC premium paid or incurred by the taxpayer. Section 162(r) places a limitation on tax deductions for FDIC premiums for banks with total consolidated assets between $10 and $50 billion and disallows the deduction entirely for banks with total assets of $50 billion or more. Section 162(r)(4) provides that an "FDIC premium" means any assessment imposed under § 7(b) of the FDI Act.

Under the Final Rule, a special assessment is imposed under § 13(c)(4)(G) of the FDI Act. The special assessment required by the Final Rule does not meet the definition of an FDIC premium under § 162(r)(4) because the special assessment is not imposed under § 7(b) of the FDI Act. Therefore, a deduction for the payment of the special assessment under the Final Rule is not limited by the provisions of § 162(r).

Section 263(a) Capitalization Requirement

Section 162(a) provides, in general, that "[t]here shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade of business, ..." However, § 263(a) provides, in general, that no deduction shall be allowed for any amount paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate. Section 1.263(a)-4 provides the rules for applying § 263(a) to the acquisition or creation of intangibles. Section 1.263(a)-4(b)(1) identifies the categories of intangibles that must be capitalized as including (i) an amount paid to acquire an intangible (see paragraph (c) of this section) (ii) an amount paid to create an intangible described in paragraph (d) of this section; (iii) an amount paid to create or enhance a separate and distinct intangible asset within the meaning of paragraph (b)(3) of this section; (iv) an amount paid to create or enhance a future benefit identified in published guidance and (v) an amount paid to facilitate (within the meaning of paragraph (e)(1) of this section) an acquisition or creation of an intangible described in paragraph (b)(1)(i), (ii), (iii) or (iv) of this section. In particular, § 1.263(a)-4(b)(3)(i), defines, in part, a separate and distinct intangible asset to include a fund or similar account if amounts in the fund or account may revert to the taxpayer.

Section 1.263(a)-4(d)(1) states that, except as provided in paragraph (f) relating to the 12-month rule, a taxpayer must capitalize amounts paid to create an intangible as described in paragraph (d), which includes an insurance contract that may have cash value under § 1.263(a)-4(d)(2)(i)(D).

Section 1.263(a)-(4)(d)(3) requires prepaid expenses to be capitalized. Example 1 deals with prepaid insurance and requires the capitalization of a prepayment of 3 years of insurance.

The special assessment provided in the Final Rule is intended to replenish the DIF due to the failure of two unrelated banks in a prior year. The relevant facts and circumstances here differ significantly from a prepayment on the insurance policy as provided in the example. The special assessment here required by the FDIC Final Rule is not a prepaid asset and does not create an insurance contract with a cash value. Also, § 1.263(a)-4(b)(3)(i) is not applicable because there is no indication in the Final Rule that the special assessment is subject to reversion to an IDI. As such, the special assessment amount is not required to be capitalized under § 263(a) and the regulations thereunder, as it does not fall into any of the applicable categories requiring capitalization.

Section 461 All Events Test and Recurring Item Exception

Section 461(a) provides that the amount of any deduction or credit shall be taken for the taxable year which is the proper taxable year under the method of accounting used in computing taxable income.

Section 1.461-1(a)(2)(i) provides that, under an accrual method of accounting, a liability is incurred, and taken into account for Federal income tax purposes, in the taxable year in which (1) all the events have occurred that establish the fact of the liability, (2) the amount of the liability can be determined with reasonable accuracy, and (3) economic performance has occurred with respect to the liability.

Section 461(h)(1) and § 1.461-4(a)(1) provide that, in determining whether an amount has been incurred with respect to any item during any taxable year, the all events test shall not be treated as met any earlier than when economic performance with respect to such item occurs.

Section 1.461-4(g) identifies 6 types of liabilities, in addition to liabilities arising out of workers' compensation or out of any tort, for which payment constitutes economic performance: 1) liabilities arising out of a breach of contract; 2) liabilities arising from a violation of law; 3) rebates and refunds; 4) awards, prizes and jackpots; 5) amounts paid for insurance, warranty and service contracts; and 6) taxes other than creditable foreign taxes.

Section 1.461-4(g)(7) provides that in the case of a taxpayer's liability for which specific economic performance rules are not provided elsewhere in the section or in any other regulation, revenue ruling or revenue procedure, economic performance occurs as the taxpayer makes payments in satisfaction of the liability to the person to which the liability is owed.

Section 461(h)(3) and § 1.461-5(a) provide a recurring item exception to the general economic performance rule requirement for accrual method taxpayers.

Section 1.461-5(b)(1) provides that economic performance is treated as having been satisfied for the taxable year that all events test is satisfied for the liability, provided that: payment is made by the taxpayer before the earlier of the date the taxpayer files a timely (including extensions) return for that taxable year or 8 ½ months as of the close of such taxable year; the liability is recurring in nature; and either the amount of the liability is not material or the accrual of the liability for that taxable year results in a better matching of the liability with the income to which it relates than would result from accruing the liability for the taxable year in which economic performance occurs.

Section 1.461-5(c) provides, in part, that the recurring item exception does not apply to any liability of a taxpayer described in paragraph (g)(7) (other liabilities) of § 1.461-4.

It is fundamental to the all events test that, although expenses may be deductible before they have become due and payable, liability must first be firmly established. United States v. General Dynamics Corp., 481 U.S. 239 (1987). Taxpayers may not deduct a liability that is contingent, or an estimate of anticipated expenses if the estimate is based on events that have not occurred by the close of the taxable year. Id.

The assessment base for the FDIC special assessment is equal to an IDIs estimated uninsured deposits, reported for the quarter that ended December 31, 2022 (with certain adjustments). Also, the Final Rule indicates that an IDI's special assessment liability is not extinguishable (even in the event that an IDI is terminated) if the IDI is liable as of the date the assessment base is established, December 31, 2022. 88 Fed. Reg. 83,329.

Although the amount of the special assessment is subject to adjustments by the FDIC changing the collection of the special assessments resulting from changes to the amount of uninsured deposits as of December 31, 2022, or the experience of the receiverships of the failed banks, the amount that each IDI will be assessed has been estimated by the FDIC with reasonable accuracy. Continental Tie & Lumber v. US, 286 U.S. 290 (1932).

We note that the present case is distinguishable from the facts of Rev. Rul. 80-230, 1980-2 C.B. 169. Rev. Rul. 80-230, addresses the proper year in which a bank can accrue its liability for a semiannual assessment by the Comptroller of the Currency to pay the expenses of bank examinations. The assessment was based on the total assets of the bank as shown on the bank's December 31, 1978, report of condition, and was due on or before January 31, 1979. The ruling indicates that the event fixing the liability for the assessment was the required performance of bank examinations covering the first semiannual period of 1979, and not the filing of the December 31, 1978, report of condition or the payment date of January 31, 1979. Thus, the analysis of Rev. Rul. 80-230 concludes that the taxpayer's liability for assessments covering the first semiannual period of Year 2 is not fixed until January 1, 1979 (Year 2).

Unlike in Rev. Rul. 80-230, in the present case the IDIs accrue a liability based upon the IDIs estimated uninsured deposits on hand as of December 31, 2022, a prior year. Also, as of this date, the liability is not extinguishable, and the identity of the taxpayers required to pay the special assessment (i.e., IDIs) is known and certain, and the amount of the liability can be determined with reasonable accuracy though it is subject to adjustment. Moreover, unlike in Rev. Rul. 80-230 in which the taxpayer incurred a liability for a payment relating to a future taxable year, in the present case the payments relate to a prior year.

Furthermore, the Final Rule was issued on November 29, 2023. Although the Final Rule states that it is effective on April 1, 2024, with the first collection for the special assessment reflected on the invoice for the first quarterly assessment period of 2024, with a payment date of June 28, 2024, the necessary events establishing the fact of the

liability occurred before the effective date of the Final Rule. There is no event that might occur between the issuance of the Final Rule and the effective date that would change a taxpayer's status as an IDI liable for the special assessment. Moreover, the publication of the Final Rule was the last event establishing the fact of the FDIC special assessment liability because that is when the FDIC special assessment became official. Hence, under these facts, all the events that determine the fact of the liability for the FDIC special assessment occur in Year 1 (2023), the year when the Final Rule was officially released.

Additionally, the FDIC special assessment payment is a liability under § 1.461-4(g), and economic performance occurs as payments are made. Moreover, since the liability to pay the FDIC special assessment is not specifically enumerated in the list of liabilities under § 1.461-4(g), by default it is a liability under § 1.461-4(g)(7) ("other" liabilities). As such, the liability does not qualify for the recurring item exception. See § 1.461-5(c).

Accordingly, since the recurring item exception does not apply for the FDIC special assessment liability under the Final Rule, the liability is incurred and deductible in the taxable year in which the liability is fixed (Year 1 (2023)) and payment is made. If payment of the liability is made in Year 2 (2024), then the liability is incurred and deductible in that taxable year because the all events test of § 461 is not treated as met any earlier than when economic performance with respect to such item occurs. See § 461(h)(1) and § 1.461-4(a)(1).

Please call me at (202) 317-3900 if you have any further questions.