Tax Alert: IRS Auditors Target Community Bank Loan Write-offs

The Challenge:

Community banks are now coming under fire from IRS auditors focused on disallowing charge-offs for nonperforming loans and imputing additional interest income. The IRS is leveraging small samples of loans determined not to be worthless and then inferring the sample to the bank's entire loan portfolio. This results in some shocking proposed assessments of tax, interest and penalties.

What you can do:

You can be proactive in taking important steps to mitigate the IRS auditor's reach:

- Fully document the reason for each loan charge-off at the time of the charge-off. Such documents should be maintained in the loan file for at least six years.
- With assistance of Tax Counsel, perform a compliance audit of your documentation in advance of any IRS audit to identify areas for supplemental/curative action, where possible.
- Consider making an optional "conformity election" that will result in a presumption that certain charge-offs are properly deductible. While not a panacea, it may work in certain situations.
- If the IRS notifies you that your bank will be audited, Tax Counsel can help provide strategies and counsel for resolving the issues and managing the scope and procedures for the audit.

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