APPEALS
INDUSTRY SPECIALIZATION PROGRAM
COORDINATED ISSUE PAPER

INDUSTRY: SAVINGS & LOAN

ISSUE: INTEREST INCOME ON SALE OF
   FORECLOSED PROPERTY

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APPROVED:

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EFFECTIVE DATE: 4/1/93

SETTLEMENT POSITION

Interest Income on the Sale of Foreclosed Property

<u>Statement of Issue</u>

Whether a savings and loan association must include in gross income gain from the sale of foreclosed property to the extent there was interest which was unpaid at the time of the foreclosure which had not been previously accrued.

Examination Division's Position

Examination Division's position is that such gain be included in income.

<u>Discussion</u>

The tax treatment of the foreclosure and subsequent sale or disposition of property by a savings and loan institution is governed by IRC 595. The basis rules set forth in that section are that (1) foreclosure is a non-taxable event and (2) any amount realized upon sale or disposition is accounted for as a bad debt. For reserve method taxpayer's, such gain or loss is accounted for through adjustments to the bad debt reserve.

The Service took the position in Revenue Ruling 75-251, 1975-1 CB 175, that the portion of the gain realized upon the foreclosure sale representing the interest (as opposed to capital) characteristic of the property represents interest income in the year received.

The Service's position has been upheld in <u>First Charter Financial Corp.</u>, 669 F. 29 1342, 82-1 USTC 9222, CA-9 and <u>Gibraltar Financial Corp.</u>, 825 F. 2nd 1568, 87-2 USTC 9445 CA-FC, reversing 10 Cls. Ct. 31, 86-1 9405.

Although this issue normally arises with respect to cash basis taxpayers, it could arise with an accrual basis taxpayer which had not accrued the unpaid interest. Footnote 2 in <u>Gibraltar Financial Corp.</u>, supra, indicates that the same result would be obtained.

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