

**Revenue Ruling  
No. 02- 002  
August 30, 2002**

**Corporation Franchise Tax**

**Mortgage Recourse Reserves Included in Franchise Tax Base**

Purpose: The purpose of this Revenue Ruling is to determine whether recourse reserves should be included in the computation of surplus and undivided profits for franchise tax purposes.

Analysis/Discussion: Consumer mortgage loan companies make mortgage loans to consumers. These companies then bundle groups of these loans and sell the bundled receivables created by these loans to agencies such as Fannie Mae. Some sales agreements with Fannie Mae are “with recourse.” That is, if the original borrower defaults on a loan, the consumer mortgage loan company must buy the loan back from Fannie Mae.

When the receivables are sold with recourse, they are removed from the books of the consumer mortgage loan company because it no longer owns the receivables. At the same time, based upon historical data, the consumer mortgage loan company creates a reserve in anticipation of any loans it might have to repurchase due to consumer defaults.

It is the recourse reserve created at the time of sale to Fannie Mae that is the subject of this revenue ruling. The question is if the recourse reserve can be excluded from the franchise tax base.

La. Rev. Stat. Ann. § 47:605(A)(West 2001), provides that “... in computing surplus and undivided profits there shall be included all reserves other than those for definitely fixed liabilities, reasonable depreciation, bad debts and established valuation reserves....”

A definitely fixed liability implies an existing, unconditional, and legally enforceable obligation to pay in all events. Since the mortgage recourse reserve is contingent upon the default of the borrower, it cannot be thought of as a definitely fixed liability.

“Depreciation” is defined in Black’s Law Dictionary 452 (7<sup>th</sup> ed. 1999) as “a decline in an asset’s value because of use, wear, or obsolescence.” Since the mortgage recourse reserve doesn’t impact the use, wear and tear, or obsolescence of a tangible asset, it cannot be thought of as being capable of reasonable depreciation.

“Bad Debt” is defined in Black’s Law Dictionary 410 (7<sup>th</sup> ed. 1999) as “a debt that is uncollectible ....” Since when receivables are sold with recourse, they are removed from the books of the consumer mortgage loan company and the company receives the cash associated with the receivables, the mortgage recourse reserve cannot be thought of as a bad debt because there are no accounts receivable to value.

“Established valuation reserve” is a reserve created to reflect a decrease in the value of an asset. Since the receivable is no longer on the taxpayer’s books, the mortgage recourse reserve cannot be thought of as an established valuation reserve because there is no asset to value.

A Revenue Ruling is issued under the authority of LAC 61III.101 (C ). A Revenue Ruling is written to provide guidance to the public and to Department of Revenue employees. It is a written statement issued to apply principles of law to a specific set of facts. A Revenue Ruling does not have the force and effect of law and is not binding on the public. It is a statement of the department's position and is binding on the department until superseded or modified by a subsequent change in statute, regulation, declaratory ruling, or court decision.

Conclusion: Since mortgage recourse reserves cannot be considered definitely fixed liabilities, reasonable depreciation, bad debts, or established valuation reserves, such reserves should be included in the computation of surplus and undivided profits for franchise tax purposes.

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