OFFICE OF
CHIEF COUNSEL

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
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INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR

FROM: DEBORAH A. BUTLER
ASSISTANT CHIEF COUNSEL (FIELD SERVICE)
CC:DOM:FS

SUBJECT: Deductibility of Revolving Credit Facility Fees

This Field Service Advice responds to your memorandum dated August 27, 1999. Field Service Advice is not binding on Examination or Appeals and is not a final case determination. This document is not to be cited as precedent.

LEGEND

Corporation	=
Year 1	=
Year 2	=
Date 1	=
Agreement 1	=
Agreement 2	=
w	=
x	=
y	=
z	=

ISSUE

Whether Corporation can currently deduct facility fees paid on a quarterly basis pursuant to a revolving credit agreement, where Corporation has borrowed the full amount available under the agreement.

CONCLUSION

No. Costs of acquiring a loan are to be capitalized and amortized ratably over the term of the loan.

FACTS

On Date 1, Corporation entered into two revolving credit agreements with a consortium of banks. Corporation entered into these agreements in connection with a corporate merger and for the purpose of paying down prior debt. Corporation borrowed the full amount available under the Agreements.

Both Agreements provide that Corporation will pay a facility fee to the banks' agent. Specifically, Section 2.3 of Agreement 1 and Agreement 2 specifies that the Company agrees to pay a facility fee with respect to the period beginning on the first day of the commitment period to the termination date. The fee is payable quarterly in arrears. Under Agreement 1, the fee is computed at the rate of w% per annum on the average daily amount of the commitment during the quarter. Under Agreement 2, the fee is computed similarly; however, the rate per annum is determined by reference to S&P and Moody's rating of Corporation's debt. Section 6.1(a) of the Agreements specifies that if Corporation fails to make an interest payment or facility fee payment, and fails to remedy the situation within five days, the banks have the option to terminate their obligations to make further loans under the Agreements and to call due all prior loans.

Agreement 1 has a term of y days, and Agreement 2 has a term of z years. The Agreements can be extended upon Corporation's request and the banks' consent. The Agreements have been extended on multiple occasions and the amounts of the lines of credit have varied. We understand that the Agreements are still in effect. The Agreements appear to provide that the loans made under the Agreements will have the same terms as the Agreements themselves. On its Annual Statement for Year 2, Corporation reported the lines of credit as long-term debt because of its averred intention to borrow these sums on a long-term basis.

During Year 1, Corporation paid $x in facility fees. Corporation deducted this full amount on its Year 1 return. Corporation contends that the facility fee is paid quarterly. If not paid, the banks could terminate the lines of credit and call for the immediate payment of all outstanding amounts. Accordingly, the facility fee is only of benefit to that quarter and should be deductible in the year of payment. However, the examining agent claims that the facility fee is in the nature of a commitment fee which is a cost of acquiring the loan and which must be deducted ratably over the life of the loan. The examining agent contends that because the parties keep extending the lines of credit there is no ascertainable useful life. Accordingly, the examining agent disallowed the deduction for the facility fee.

LAW AND ANALYSIS

The law is well settled, that costs of acquiring a loan are to be capitalized and amortized ratably over the term of the loan. Sleiman v. Commissioner, T.C. Memo. 1997-530; Enoch v. Commissioner, 57 T.C. 781, 794-95 (1972); Buddy Schoellkopf Products v. Commissioner, 65 T.C. 640 (1975). To determine how much Corporation may deduct in a given year, it is necessary to ascertain the terms of the loans created pursuant to the Agreements. Because this involves an analysis of the facts and circumstances surrounding the Agreements and the loans made pursuant to the Agreements, we conclude that you are in a better posture then are we to determine the terms of the underlying loans and thus the amortization period.

Corporation contends that the fee is paid each quarter for the right to borrow money during (and only for) that quarter. In addition, Corporation argues that the quarterly fee does not represent a cost of acquiring the right to borrow money over (or for) the entire term of the credit facilities. We are not persuaded by Corporation's arguments. First, Section 2.3(a) of the Agreements states:

> The Company agrees to pay to the Agent for the account of each Bank a facility fee in respect of the period from and including the first day of the commitment Period to the Termination Date, computed at the rate per annum [established under the Agreement], payable quarterly on the last day of [the quarter].

The underscored language suggests that there is a single facility fee required for each Agreement that relates to the entire term of Agreement 1 and Agreement 2, and that the fee is paid in quarterly installments.

Second, Section 6.1 of the Agreements lumps the facility fees with the interest fees and provides that if the Corporation defaults in any payment in respect of interest on any of the notes or any facility fees, the banks can terminate their obligations and call the notes due. If the quarterly fees represent quarterly commitments as Corporation contends, then it seems that the Corporation would be in default only with respect to the quarter to which the payment relates. However, because the facility fees are paid in arrears, this would be problematical. The language in the Agreements undermines Corporation's argument. Here, the failure to pay one quarterly installment will trigger the default provisions and give the banks the opportunity to terminate the entire Agreement and the underlying loans. This supports the argument that the Agreements are a single indivisible instrument with a single facility fee paid quarterly and not a series of quarterly commitments or options.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

[redacted]

Please call if you have any further questions.

By: ______________________________

JOEL E. HELKE
Chief, Financial Institutions &
Products Branch
(Field Service)

cc: