***Fed. Home Loan Mortg. Corp. v. Commissioner, 121 T. C. 254 (2003)***

In Federal Home Loan Mortgage Corp. v. Commissioner, the U. S. Tax Court ruled that the economic benefit from below-market financing arrangements can be considered an intangible asset subject to amortization, provided the taxpayer can establish its fair market value and limited useful life. This decision impacts how financial institutions treat such benefits for tax purposes, potentially allowing deductions based on the value of favorable financing terms.

**Parties**

Federal Home Loan Mortgage Corporation (Petitioner) v. Commissioner of Internal Revenue (Respondent). The case was filed in the U. S. Tax Court.

**Facts**

Federal Home Loan Mortgage Corporation (FHLMC) was originally exempt from federal income taxation but became subject to taxation on January 1, 1985, due to the Deficit Reduction Act of 1984 (DEFRA). Prior to this date, FHLMC had entered into various financing arrangements with below-market interest rates due to subsequent interest rate increases. FHLMC claimed these arrangements constituted an intangible asset termed “favorable financing,” which it valued at $456,021,853 as of January 1, 1985, and sought to amortize this value over the years 1985 through 1990. The Commissioner challenged the validity of these claimed amortization deductions.

**Procedural History**

FHLMC filed a petition in the U. S. Tax Court contesting deficiencies determined by the Commissioner for the tax years 1985-1990. Both parties filed cross-motions for partial summary judgment specifically addressing whether the economic benefit of FHLMC’s below-market financing could be considered an intangible asset subject to amortization under the Internal Revenue Code. The court granted partial summary judgment to FHLMC on the legal question but reserved judgment on factual issues related to valuation and useful life.

**Issue(s)**

Whether, as a matter of law, the economic benefit attributable to below-market borrowing costs from FHLMC’s financing arrangements on January 1, 1985, can constitute an intangible asset that could be amortized for tax purposes?

**Rule(s) of Law**

Section 167(a) of the Internal Revenue Code allows a depreciation deduction for the exhaustion, wear and tear (including obsolescence) of property used in a trade or business or held for the production of income. Section 1. 167(a)-3 of the Income Tax

 

Regulations further clarifies that an intangible asset may be subject to depreciation if it has a limited useful life ascertainable with reasonable accuracy. DEFRA section 177(d)(2)(A)(ii) provides a specific adjusted basis for FHLMC's assets as of January 1, 1985, to be the higher of the adjusted basis or the fair market value.

**Holding**

The court held that the economic benefit of FHLMC's below-market financing as of January 1, 1985, can, as a matter of law, constitute an intangible asset subject to amortization, contingent upon FHLMC establishing a fair market value and a limited useful life for the asset.

**Reasoning**

The court reasoned that the right to use borrowed money at below-market rates represents a valuable economic benefit, analogous to the value of using property under a favorable lease. The court cited cases such as *Dickman v. Commissioner* and *Citizens & Southern Corp. v. Commissioner* to establish that the right to use money at below-market rates is a property interest with a measurable economic value. The court rejected the Commissioner's argument that the benefit was merely fortuitous and not an asset, drawing parallels with cases involving bank deposit bases and favorable leaseholds. The court emphasized that the legislative history of section 197 of the Internal Revenue Code, which does not apply to the years in question, suggests that the treatment of below-market financing should be determined under existing law, specifically section 167(a) and related regulations. The court also noted that FHLMC's failure to report the favorable financing as an asset on its financial statements was not determinative of its tax treatment.

**Disposition**

The U. S. Tax Court granted partial summary judgment to FHLMC on the legal issue of whether the benefit of below-market financing could constitute an intangible asset subject to amortization, but reserved judgment on factual issues related to the asset's valuation and useful life.

**Significance/Impact**

This case sets a precedent for the treatment of below-market financing as an amortizable intangible asset, potentially affecting how financial institutions account for and claim deductions on such arrangements. The decision underscores the principle that economic benefits arising from financing terms can be considered assets for tax purposes, provided they meet the criteria of having a fair market value and a limited useful life. Subsequent judicial and administrative interpretations of this ruling will further clarify its application and impact on tax policy and financial reporting.

 