

If the provisions of paragraph (a) of §1.163-4 (relating to deductions for original issue discount) apply to deposits made with respect to a certificate of deposit, time deposit, bonus plan or other deposit arrangement, the provisions of this paragraph shall not apply.

(c) *Effective date.* The provisions of paragraphs (a) and (b) of this section shall apply to:

(1) Dividends or interest paid or credited after October 16, 1962, by any taxpayer which (at the time of such payment or credit) qualifies as (i) a mutual savings bank not having capital stock represented by shares, (ii) a domestic building and loan association (as defined in section 7701(a)(19)), (iii) a cooperative bank (as defined in section 7701(a)(32)), or (iv) any other savings institution chartered and supervised as a savings and loan or similar association under Federal or State law; and

(2) Dividends paid or credited before October 17, 1962, by any taxpayer which (at the time of such payment or credit) qualifies as (i) a mutual savings bank not having capital stock represented by shares, (ii) a cooperative bank without capital stock organized and operated for mutual purposes and without profit, or (iii) a domestic building and loan association (as defined in section 7701(a)(19) before amendment by section 6(c) of the Revenue Act of 1962 (76 Stat. 982)).

[T.D. 6728, 29 FR 5855, May 5, 1964, as amended by T.D. 7154, 36 FR 24997, Dec. 28, 1971]

§1.592-1 Repayment of certain loans by mutual savings banks, building and loan associations, and cooperative banks.

There is deductible, under section 592, from the gross income of a mutual savings bank not having capital stock represented by shares, a domestic building and loan association, or a cooperative bank without capital stock organized and operated for mutual purposes and without profit, amounts paid by such institutions during the taxable year in repayment of loans made before September 1, 1951, by the United States or any agency or instrumentality thereof which is wholly owned by the United States, or by any mutual fund established under the authority of the laws of any State. For example,

amounts paid by such institution in repayment of loans made by the Reconstruction Finance Corporation before September 1, 1951, are deductible under this section. Section 592 is not applicable, however, in the case of amounts paid in repayment of loans made by an agency or instrumentality not wholly owned by the United States.

§1.593-1 Additions to reserve for bad debts.

(a) *In general.* A mutual savings bank not having capital stock represented by shares, a domestic building and loan association, and a cooperative bank without capital stock organized and operated for mutual purposes and without profit may, as an alternative to a deduction from gross income under section 166(a) for specific debts which become worthless in whole or in part, deduct amounts credited to a reserve for bad debts in the manner and under the circumstances prescribed in this section and §1.593-2. In the case of such an institution, the selection of either of the alternative methods for treating bad debts may be made by the taxpayer in the return for its first taxable year beginning after December 31, 1951. The method selected shall be subject to the approval of the Commissioner upon examination of the return. If the method selected is approved, it must be followed in returns for subsequent years, unless permission is granted by the Commissioner to change to another method. Application for permission to change the method of treating bad debts shall be made at least 30 days prior to the close of the taxable year for which the change is to be effective.

(b) *Addition to reserve.* Except as otherwise provided in §1.593-2, the reasonable addition to a reserve for bad debts shall be any amount determined by the taxpayer which does not exceed the lesser of:

(1) The amount of its taxable income for the taxable year, computed without regard to section 593 and without regard to any section providing for a deduction the amount of which is dependent upon the amount of taxable income (such as section 170, relating to charitable, etc., contributions and gifts), or

(2) The amount by which 12 percent of the total deposits or withdrawable

accounts of its depositors at the close of such year exceeds the sum of its surplus, undivided profits, and reserves at the beginning of the taxable year.

(c) *Adjustments to reserve.* Bad debt losses sustained during the taxable year shall be charged against the bad debt reserve. Recoveries of debts charged against the bad debt reserve during a prior taxable year in which the institution was subject to tax under chapter 1 of the Internal Revenue Code of 1954 or under chapter 1 of the Internal Revenue Code of 1939 shall be credited to the bad debt reserve. The establishment of such reserve and all adjustments made thereto must be reflected on the regular books of account of the institution at the close of the taxable year, or as soon as practicable thereafter. Minimum amounts credited in compliance with Federal or State statutes, regulations, or supervisory orders to reserve or similar accounts, or additional amounts credited to such reserve or similar accounts and permissive under such statutes, regulations, or orders, against which charges may be made for the purpose of absorbing losses sustained by an institution, will be deemed to have been credited to the bad debt reserve.

(d) *Definitions.* When used in this section and in § 1.593-2:

(1) *Institution.* The term *institution* means either a mutual savings bank not having capital stock represented by shares, a domestic building and loan association as defined in section 7701(a)(19), or a cooperative bank without capital stock organized and operated for mutual purposes and without profit.

(2) *Surplus, undivided profits, and reserves.* (i) The phrase *surplus, undivided profits, and reserves* means the amount by which the total assets of an institution exceed the amount of the total liabilities of such an institution.

(ii) For this purpose the term *total assets* means the sum of money, plus the aggregate of the adjusted basis of the property other than money, held by an institution. Such adjusted basis for any asset is its adjusted basis for determining gain upon sale or exchange for Federal income tax purposes. (See sections 1011 through 1022, and the regulations thereunder. For special rules

with respect to adjustments to basis for prior taxable years during which the institution was exempt from tax, see section 1016(a)(3) and the regulations thereunder.) The determination of the total assets of any taxpayer shall conform to the method of accounting employed by such taxpayer in determining taxable income and to the rules applicable in determining its earnings and profits.

(iii) The term *total liabilities* means all liabilities of the taxpayer, which are fixed and determined, absolute and not contingent, and includes those items which constitute liabilities in the sense of debts or obligations. The total deposits or withdrawable accounts, as defined in subparagraph (3) of this paragraph, shall be considered a liability. In the case of a building and loan association having permanent nonwithdrawable capital stock represented by shares, the paid-in amount of such stock shall also be considered a liability. Reserves for contingencies and other reserves, however, which are mere appropriations of surplus, are not liabilities.

(3) *Total deposits or withdrawable accounts.* The phrase *total deposits or withdrawable accounts* means the aggregate of (i) amounts placed with an institution for deposit or investment and (ii) earnings outstanding on the books of account of the institution at the close of the taxable year which have been credited as dividends upon such accounts prior to the close of the taxable year, except that such term, in the case of a building and loan association, does not include permanent nonwithdrawable capital stock represented by shares, or earnings credited thereon.

(e) *Examples.* The provisions of this section may be illustrated by the following examples:

Example 1. (i) Institution X, which keeps its books on the basis of the calendar year, has surplus, reserves, and undivided profits of \$800,000 as of January 1, 1955, and total deposits or withdrawable accounts of \$10,000,000 as of December 31, 1955. During 1955 the institution credits \$30,000, as required by a Federal agency, to a Federal insurance reserve for the sole purpose of absorbing losses. Likewise, it credits \$25,000, as permitted by State statute, to another reserve fund for

the purpose of absorbing losses. In 1955 Institution X charges \$5,000 against its bad debt reserve for losses sustained during the taxable year.

(ii) The taxable income of Institution X for the taxable year 1955, computed without regard to section 593 and without regard to any section providing for a deduction the amount of which is dependent upon the amount of taxable income, is \$200,000.

(iii) Upon the basis of the facts as stated in subdivision (i) of this example, the amount by which 12 percent of the total deposits or withdrawable accounts of Institution X at the close of taxable year 1955 exceeds the sum of such institution's surplus, undivided profits, and reserves at the beginning of the taxable year is \$400,000 (12 percent of \$10,000,000, minus \$800,000).

(iv) Institution X, therefore, may deduct, for the taxable year 1955, as an addition to a reserve for bad debts, any amount it may determine that does not exceed the lesser of the amounts determined in subdivision (ii) or (iii) of this example. That amount is \$200,000 (as determined in subdivision (ii) of this example). Since under paragraph (c) of this section, the \$30,000 credited to the reserve as required by the Federal agency and the \$25,000 credited to the reserve as permitted by the State statute are regarded as amounts credited to a reserve for bad debts account Institution X can credit an additional \$145,000 (\$200,000 minus \$55,000) to a general reserve for bad debts account at any time during the taxable year.

(v) The loss of \$5,000 charged to the bad debt reserve during the taxable year does not affect the amount of the addition to the bad debt reserve provided for in paragraph (b) of this section. It is of significance only in determining the surplus, undivided profits, and reserves of Institution X as of January 1, 1956.

Example 2. The taxable income of Institution Y for the taxable year 1955, computed without regard to the deduction under section 593 and without regard to any section providing for a deduction the amount of which is dependent upon the amount of taxable income, is determined to be \$250,000. The amount by which 12 percent of the total deposits or withdrawable accounts of Institution Y at the close of the taxable year exceeds the sum of such institution's surplus, undivided profits, and reserves at the beginning of the taxable year is \$500,000. Institution Y credits \$250,000 to its bad debt reserve in 1955. In 1957, it is determined that the correct taxable income of Institution Y for 1955, computed without regard to any deduction under section 593 and without regard to any section providing for a deduction the amount of which is dependent upon the amount of taxable income, is \$275,000 and not \$250,000. Assuming that Institution Y credits the additional \$25,000 to its bad debt reserve,

\$275,000 is allowable as a deduction from gross income for such institution for the taxable year 1955.

§ 1.593-2 Additions to reserve for bad debts where surplus, reserves, and undivided profits equal or exceed 12 percent of deposits or withdrawable accounts.

Where 12 percent of the total deposits or withdrawable accounts of an institution at the close of the taxable year is equal to or less than the sum of such institution's surplus, undivided profits, and reserves at the beginning of the taxable year, a reasonable addition to the reserve for bad debts as determined under the general provisions of section 166(c) may be allowable as a deduction from gross income. In making such determination, there shall be taken into account (a) surplus or bad debt reserves existing at the close of December 31, 1951 (i.e., the amount of surplus, undivided profits, and reserves accumulated prior to January 1, 1952, and in existence at the close of December 31, 1951), and (b) changes in the surplus, undivided profits, and reserves of the institution from December 31, 1951, until the beginning of the taxable year. A deduction for an addition to the reserve for bad debts pursuant to this section will be authorized only in those cases where the institution proves to the satisfaction of the Commissioner that the bad debt experience of the institution warrants an addition to the reserve for bad debts in excess of that provided in paragraph (b) of § 1.593-1. For definitions, see paragraph (d) of § 1.593-1.

§ 1.593-3 Taxable years affected.

Sections 1.593-1 and 1.593-2 apply only to taxable years beginning after December 31, 1953, and ending after August 16, 1954, but before January 1, 1963, and all references to sections of the Code are to the Internal Revenue Code of 1954 before amendment by the Revenue Act of 1962. Sections 1.593-4 through 1.593-11 apply only to taxable years ending after December 31, 1962, and all references to sections of the Code are to the Internal Revenue Code of 1954 after amendment by the Revenue Act of 1962.

[T.D. 6728, 29 FR 5857, May 5, 1964]