

## § 1.593-4

26 CFR Ch. I (4-1-04 Edition)

### § 1.593-4 Organizations to which section 593 applies.

The provisions of section 593 and §§ 1.593-5 through 1.593-11 (except subsection (f) of section 593 and § 1.593-10) apply to any mutual savings bank not having capital stock represented by shares, any domestic building and loan association, and any cooperative bank without capital stock organized and operated for mutual purposes and without profit. The term *thrift institution*, as used in this section and §§ 1.593-5 through 1.593-11, refers to any such financial institution. For definition of the terms *domestic building and loan association* and *cooperative bank*, see paragraphs (19) and (32), respectively, of section 7701(a).

[T.D. 549, 43 FR 21454, May 18, 1978]

### § 1.593-5 Addition to reserves for bad debts.

(a) *Amount of addition.* As an alternative to a deduction from gross income under section 166(a) for specific debts which become worthless in whole or in part, a thrift institution is allowed a deduction under section 166(c) for a reasonable addition to a reserve for bad debts. In the case of a thrift institution, the amount of the reasonable addition to such reserve for a taxable year may not exceed:

(1) For taxable years beginning after July 11, 1969, the sum of (i) the amount determined to be the reasonable addition to the reserve for losses on nonqualifying loans, determined in the same manner as is provided with respect to additions to the reserve for losses on qualifying real property loans under paragraph (d) of § 1.593-6A (relating to the experience method), and (ii) the amount determined under § 1.593-6A to be the reasonable addition to the reserve for losses on qualifying real property loans, or

(2) For taxable years beginning before July 12, 1969, the sum of (i) the amount determined under § 1.166-4 to be the reasonable addition to the reserve for losses on nonqualifying loans, and (ii) the amount determined under § 1.593-6 to be the reasonable addition to the reserve for losses on qualifying real property loans.

(b) *Crediting to reserves required*—(1) *In general.* The amounts referred to in paragraph (a) (1) and (2) of this section must be credited, respectively, to the reserve for losses on nonqualifying loans and to the reserve for losses on qualifying real property loans by the close of the taxable year, or as soon as practicable thereafter. For rules with respect to accounting for such reserves see paragraph (a) (2) of § 1.593-7.

(2) *Subsequent adjustments.* If an adjustment with respect to the income tax return for a taxable year is made, and if such adjustment (whether initiated by the taxpayer or the Commissioner) has the effect of permitting an increase, or requiring a reduction, in the amount claimed on such return as an addition to the reserve for losses on nonqualifying loans or to the reserve for losses on qualifying real property loans, then the amount initially credited to such reserve for such year pursuant to subparagraph (1) of this paragraph may have to be increased or decreased, as the case may be, to the extent necessary to reflect such adjustment.

(c) *Transition year.* For rules governing the computation of taxable income in the case of a taxable year beginning in 1962 and ending in 1963, see § 1.593-9.

[T.D. 6728, 29 FR 5857, May 5, 1964, as amended by T.D. 549, 43 FR 21455, May 18, 1978]

### § 1.593-6 Pre-1970 addition to reserve for losses on qualifying real property loans.

(a) *In general.* For purposes of paragraph (a)(2)(ii) of § 1.593-5, the amount of the addition to the reserve for losses on qualifying real property loans for any taxable year beginning before July 12, 1969, is the amount which the taxpayer determines to constitute a reasonable addition to such reserve for such year. However, the amount so determined for such year:

(1) Cannot exceed the largest of the amounts computed under one of the three methods described in paragraph (b), (c), or (d) of this section (relating, respectively, to the percentage of taxable income method, the percentage of real property loans method, and the experience method),

(2) Cannot exceed the maximum permissible addition described in paragraph (e) of this section (if applicable), and

(3) Shall be determined without regard to any amount charged for any taxable year against the reserve for losses on qualifying real property loans pursuant to §1.593-10 (relating to certain distributions to shareholders by a domestic building and loan association).

For each taxable year the taxpayer must include in its income tax return for such year a computation of the addition under this section. The use of a particular method in the return for a taxable year is not a binding election by the taxpayer to apply such method either for such taxable year or for subsequent taxable years. Thus, in the case of a subsequent adjustment described in paragraph (b)(2) of §1.593-5 which has the effect of permitting an increase, or requiring a reduction, in the amount claimed in the return for a taxable year as an addition to the reserve for losses on qualifying real property loans, the amount of such addition may be recomputed under whichever method the taxpayer selects for the purposes of such recomputation, irrespective of the method initially applied for such taxable year. However, a taxpayer may not subsequently reduce the amount claimed in the return for a taxable year for the purpose of obtaining a larger deduction in a later year.

(b) *Percentage of taxable income method*—(1) *In general.* The amount determined under the percentage of taxable income method for any taxable year is an amount equal to 60 percent of the taxable income for such year, minus the amount determined under §1.166-4 as a reasonable addition for such year to the reserve for losses on nonqualifying loans. However, the amount determined under such method shall not exceed the amount necessary to increase the balance (as of the close of the taxable year) of the reserve for losses on qualifying real property loans to an amount equal to 6 percent of such loans outstanding at such time.

(2) *Taxable income defined.* For purposes of this paragraph, taxable income shall be computed:

(i) By excluding from gross income any amount included therein by reason of the application of §1.593-10 (relating to certain distributions to shareholders by a domestic building and loan association);

(ii) Without regard to any deduction allowable under section 166(c) for an addition to a reserve for bad debts;

(iii) 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), other than sections 243, 244, and 245 (relating to deductions for dividends received); and

(iv) Without regard to any net operating loss carryback to such year under section 172.

In computing the deductions under sections 243, 244, and 245, section 246(b) (relating to limitation on aggregate amount of deduction) shall not apply. For purposes of subdivision (iii) of this subparagraph, a net operating loss deduction under section 172 is not a deduction the amount of which is dependent upon the amount of taxable income.

(c) *Percentage of real property loans method*—(1) *General rule.* The amount determined under the percentage of real property loans method for any taxable year is the amount necessary to increase the balance (as of the close of such year) of the reserve for losses on qualifying real property loans to:

(i) An amount equal to 3 percent of such loans outstanding at such time, plus

(ii) In the case of a taxpayer described in subparagraph (2) of this paragraph, an amount equal to:

(a) The lesser of 2 percent of such loans outstanding at such time, or \$80,000, reduced (but not below zero) by

(b) The balance as of the close of such year, if any, of such taxpayer's supplemental reserve for losses on loans.

(2) *Certain new companies.* (i) Subparagraph (1)(ii) of this paragraph applies only in the case of a taxpayer which is a new company, and which does not have capital stock with respect to which distributions of property (as defined in section 317(a)) are not allowable as a deduction under section 591.

(ii) For purposes of this subparagraph, a taxpayer is a new company for any taxable year only if such year begins not more than 10 calendar years after the first day on which such taxpayer, or any predecessor of such taxpayer, was authorized by Federal or State law to do business as (a) a mutual savings bank not having capital stock represented by shares, (b) a domestic building and loan association, (c) a cooperative bank without capital stock organized and operated for mutual purposes and without profit, or (d) any other savings institution chartered and supervised as a savings and loan or similar association under Federal or State law.

(iii) As used in subdivision (ii) of this subparagraph, the term *calendar year* has the meaning assigned to such term in section 441 (relating to the period for computation of taxable income); and the term *predecessor* means any organization which transferred more than 50 percent of the total amount of its assets to the taxpayer, and which, prior to the time of such transfer, was (a) authorized by Federal or State law to do business as 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, or (b) any other savings institution chartered and supervised as a savings and loan or similar association under Federal or State law. The term *predecessor* also means any predecessor of such predecessor.

(d) *Experience method.* The amount determined under the experience method for any taxable year is the amount determined under § 1.166-4 to be a reasonable addition for such year to the reserve for losses on qualifying real property loans.

(e) *Maximum permissible addition where percentage of taxable income method or percentage of real property loans method is applied—(1) 12 percent of deposits limitation.* If, for the taxable year, the taxpayer uses either the percentage of taxable income method described in paragraph (b) of this section or the percentage of real property loans method described in paragraph (c) of this section, then (unless subparagraph (2) of this

paragraph applies) the maximum permissible addition for such year is equal to the lesser of:

(i) The amount determined under such paragraph (b) or (c), or

(ii) An amount which, when added to the amount determined under § 1.166-4 as an addition for such year to the reserve for losses on nonqualifying loans, equals the amount by which 12 percent of the total deposits or withdrawable accounts of depositors of the taxpayer at the close of such year exceeds the sum of the taxpayer's surplus, undivided profits, and reserves at the beginning of such year (taking into account any portion thereof which is attributable to the period before the first taxable year beginning after December 31, 1951).

For definition of the terms *surplus, undivided profits, and reserves and total deposits or withdrawable accounts*, see paragraph (f) of this section.

(2) *Special rule where a domestic building and loan association or cooperative bank exceeds certain assets limitations.* If, for the taxable year, the taxpayer uses either the percentage of taxable income method described in paragraph (b) of this section or the percentage of real property loans method described in paragraph (c) of this section, and if for such year such taxpayer qualifies as a domestic building and loan association under the first sentence of paragraph (19) of section 7701(a) (or as a cooperative bank under paragraph (32) thereof) solely by reason of the application of the second sentence of such paragraph (19) (that is, solely by reason of the fact that for such year more than 36 percent, but not more than 41 percent, of the amount of the total assets of such association or bank consists of assets other than assets described in section 7701(a)(19)(D)(ii)), then the maximum permissible addition for such year is equal to the amount determined under subparagraph (1) of this paragraph, reduced in accordance with the following table:

If the percentage of the taxpayer's assets which are not assets described in section 7701(a)(1)(D)(ii) exceeds—Percent	But does not exceed—Percent	The reduction shall be the following proportion of the amount determined under such subparagraph (1)—
36	37	1/12

If the percentage of the taxpayer's assets which are not assets described in section 7701(a)(1)(D)(ii) exceeds—Percent	But does not exceed—Percent	The reduction shall be the following proportion of the amount determined under such subparagraph (1)—
37	38	1/6
38	39	1/4
39	40	1/3
40	41	5/12

(f) *Definitions.* For purposes of this section:

(1) *Surplus, undivided profits, and reserves.* The term *surplus, undivided profits, and reserves* means the amount by which the total assets of the taxpayer exceed its total liabilities. The determination of such total assets and total liabilities shall conform to the method of accounting employed by the taxpayer in determining taxable income and to the rules applicable in determining its earnings and profits. Total deposits or withdrawable accounts (as defined in subparagraph (3) of this paragraph but determined as of the beginning of the taxable year) shall be considered a liability. In the case of a domestic 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. However, reserves for contingencies and other reserves which are mere appropriations of surplus are not liabilities for purposes of this section.

(2) *Total assets.* The term *total assets* means the sum of money (including time or demand deposits with, or withdrawable accounts in, any financial institution), plus the aggregate of the adjusted basis (determined under §1.1011-1) of the property other than money held by the taxpayer. For special rules with respect to adjustments to basis in the case of property acquired by the taxpayer in a transaction described in section 595(a), see section 595.

(3) *Total deposits or withdrawable accounts.* The term *total deposits or withdrawable amounts* means the total of the amounts placed with the taxpayer for deposit or investment. Such term also includes earnings outstanding on the books of account of the taxpayer at the close of the taxable year which have been credited as divi-

dends or interest upon such deposits or withdrawable accounts prior to the close of such taxable year, and which are withdrawable on demand subject only to customary notice of intention to withdraw. In the case of a domestic building and loan association, however, such phrase does not include permanent nonwithdrawable capital stock represented by shares, or earnings credited thereon.

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

*Example 1.* (i) *Facts.* X is a domestic building and loan association which was organized in 1947 and which makes its returns on the basis of the calendar year and the reserve method of accounting for bad debts. X's accounts contain the following entries:

Account	Balance as of—	
	Jan. 1, 1965	Dec. 31, 1965
Total deposits or withdrawable accounts .....	\$1,000,000	\$1,200,000
Nonqualifying loans .....	50,000	60,000
Qualifying real property loans ...	900,000	940,000
Reserve for losses on nonqualifying loans .....	200	*160
Reserve for losses on qualifying real property loans .....	24,000	*21,000
Supplemental reserve for losses on loans .....	60,800	60,800
Surplus, undivided profits, and other reserves .....	15,000	18,040

\*Computed before any addition for 1965 under section 166(c).

X's taxable income for 1965 (before any deductible addition to a reserve for bad debts and without regard to charitable contributions of \$200) is \$20,000, computed as follows:

Interest and other income .....	\$19,940
Dividends received from Y Corporation, a domestic corporation subject to taxation under chapter 1 of the Code .....	400
	20,340
Deduction for 85 percent of dividends received computed without regard to the limitation of section 246(b) .....	340
Taxable income .....	20,000

It is assumed that under §1.166-4 X's addition for 1965 to its reserve for losses on nonqualifying loans is \$80.

(ii) *Computation of addition to reserve for losses on qualifying real property loans—(a) In general.* X determines that the reasonable addition for 1965 to its reserve for losses on qualifying real property loans is \$11,920. Such amount, compared under the percentage of taxable income method, is the largest of the amounts determined under (b), (c), and (d) of this subdivision, and does not exceed

§ 1.593-6A

26 CFR Ch. I (4-1-04 Edition)

the 12 percent of deposits limitation computed under (e) of this subdivision.

(b) *Percentage of taxable income method.* The amount determined under the percentage of taxable income method is \$11,920, that is, 60 percent of the taxable income for 1965, or \$12,000 (60 percent of \$20,000), minus \$80, the addition for such year to the reserve for losses on nonqualifying loans. This amount is not subject to reduction under the 6 percent of qualifying real property loans limitation described in paragraph (b) (1) of this section since the addition of \$11,920 to the \$21,000 balance of the reserve for losses on qualifying real property loans at the close of 1965 will not increase such balance to an amount in excess of \$56,400, that is, 6 percent of such loans of \$940,000 outstanding at such time.

(c) *Percentage of real property loans method.* Since X is not a new company within the meaning of paragraph (c) (2) of this section, the amount determined under the percentage of real property loans method is \$7,200, that is, the amount necessary to increase the balance of the reserve for losses on qualifying real property loans at the close of 1965 from \$21,000 to an amount equal to 3 percent of such loans outstanding at such time, or \$28,200 (3 percent of \$940,000).

(d) *Experience method.* The amount determined under the experience method is zero since it is assumed that the \$21,000 balance of the reserve for losses on qualifying real property loans at the close of 1965 before any addition for such year exceeds the maximum amount to which such reserve could be increased under such method.

(e) *12 percent of deposits limitation.* The amount determined under the 12 percent of deposits limitation is \$43,920, that is, \$44,000 (the excess of 12 percent of \$1,200,000 of deposits at the close of 1965, or \$144,000, over the \$100,000 of surplus, undivided profits, and reserves at the beginning of such year), minus \$80, the addition for such year to the reserve for losses on nonqualifying loans. Since such \$43,920 is greater than \$11,920 (the amount determined under (b) of this subdivision), the 12 percent of deposits limitation does not apply for 1965.

(iii) *Computation of taxable income for 1965.* X's taxable income for 1965, after deducting the additions for such year to its reserves for losses on nonqualifying loans and on qualifying real property loans, after deducting the charitable contributions which were not taken into account in computing taxable income for purposes of the addition to the reserve for losses on qualifying real property loans, after including in taxable income dividends received from Y Corporation, and after taking into account the deduction for dividends received under section 243 (subject to the limitation in section 246(b)), is \$7,800, computed as follows:

Interest and other income ..... \$19,940

Dividends received from Y Corporation .....	400	
		\$20,340
Less:		
Deduction for charitable contributions .....	200	
85 percent of dividends received from Y Corporation .....	340	
Additions to reserves for bad debts .....	12,000	
		12,540
Taxable income .....		7,800

*Example 2.* Assume the same facts as in example 1, except that X Corporation was organized in 1957, and qualifies for the taxable year 1965 as a new company within the meaning of paragraph (c) (2) of this section. The maximum permissible addition for 1965 to X's reserve for losses on qualifying real property loans is \$18,000, the amount computed under the percentage of real property loans method, since such amount is greater than (i) \$11,920, the amount computed under the percentage of taxable income method, or (ii) zero, the amount computed under the experience method. The \$18,000 amount (as computed under the percentage of real property loans method) is the amount necessary to increase the reserve for losses on qualifying real property loans from the \$21,000 closing balance to \$39,000, computed as follows:

3 percent of \$940,000 of qualifying real property loans at close of 1965 .....	\$28,200
Plus:	
Lesser of \$80,000 or \$18,800 (2 percent of such loans of \$940,000) .....	\$18,800
Reduced by the balance of supplemental reserve for losses on loans .....	8,000
	\$10,800
	39,000

*Example 3.* Assume the same facts as in example 1, except that for 1965, 38.4 percent of X's total assets consist of assets other than the assets described in section 7701(a)(19)(D)(ii). In such case, the maximum permissible addition of \$11,920 for such year to the reserve for losses on qualifying real property loans (as determined under subdivision (ii) of example 1) would be reduced by \$2,980 (1/4 of \$11,920) to \$8,940.

[T.D. 6728, 29 FR 5857, May 5, 1964, as amended by T.D. 549, 43 FR 21455, May 18, 1978]

**§ 1.593-6A Post-1969 addition to reserve for losses on qualifying real property loans.**

(a) *In general*—(1) *Amount of addition determined for the taxable year.* For purposes of paragraph (a) (1) (ii) of § 1.593-5,