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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,

the amount of the addition to the reserve for losses on qualifying real property loans for any taxable year beginning after July 11, 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:

(i) Cannot exceed the largest of the amount determined under section 593(b)(2), (3), or (4) (relating, respectively, to the percentage of taxable income method, the percentage method, and the experience method), and

(ii) 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 amount of the addition determined 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 purpose of such recomputation, irrespective of the method initially applied for such taxable year.

(2) *Method of determination.* For purposes of this section and §1.596-1 (relating to limitation on dividends received deduction), a thrift institution is deemed to have determined the addition to its reserve for losses on qualifying real property loans for the taxable year under the percentage of taxable income method provided by section 593(b)(2) and paragraph (b) of this section if the amount finally determined to be a reasonable addition for such year to such reserve exceeds the amount determined for such year under

section 593(b)(3) (relating to the percentage method) and exceeds the amount determined for such year under section 593(b)(4) (relating to the experience method).

(b) *Percentage of taxable income method—(1) In general.* Subject to the limitations described in subparagraph (4) of this paragraph and in paragraph (e) of this section, the amount determined under section 593(b)(2) and this paragraph for the taxable year, if such section and paragraph are applicable, is an amount equal to the applicable percentage of the taxable income for such year, reduced by the amount determined under subparagraph (3) of this paragraph. For this purpose, taxable income is computed as provided in subparagraph (5) of this paragraph, and the applicable percentage (except as reduced under subparagraph (2) of this paragraph) is determined under the following table:

For a taxable year beginning in—	The applicable percentage under this subparagraph is—
1969	60 percent.
1970	57 percent.
1971	54 percent.
1972	51 percent.
1973	49 percent.
1974	47 percent.
1975	45 percent.
1976	43 percent.
1977	42 percent.
1978	41 percent.
1979 or thereafter	40 percent.

(2) *Reduction of applicable percentage in certain cases—(i) General rules.* If for the taxable year the percentage of the assets of a thrift institution, which are assets described in section 7701(a)(19)(C) (relating to assets of a domestic building and loan association) is less than:

(a) 82 percent of the total assets in the case of a thrift institution other than a mutual savings bank, the applicable percentage for such year provided by subparagraph (1) of this paragraph is reduced by three-fourths of 1 percentage point for each 1 percentage point of such difference; or

(b) 72 percent of the total assets in the case of a thrift institution which is a mutual savings bank, the applicable percentage for such year provided by subparagraph (1) of this paragraph is reduced by 1½ percentage points for

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each 1 percentage point of such difference.

If such percentage is less than 60 percent of the total assets in the case of any thrift institution (less than 50 percent of the total assets for a taxable year beginning before 1973 in the case of a thrift institution which is a mutual savings bank), section 593(b)(2) and this paragraph are not applicable. The percentage of total assets specified in this subparagraph is computed as of the close of the taxable year or, at the option of the taxpayer, may be computed on the basis of the average assets outstanding during the taxable year. Such average is determined by computing such percentage either as of the close of each month, as of the close of each quarter, or as of the close of each semiannual period during the taxable year and by using the yearly average of the monthly, quarterly, or semiannual percentages. A thrift institution which is a mutual savings bank and which determines the amount of the reasonable addition for the taxable year to the reserve for losses on qualifying real property loans under this paragraph shall file for such taxable year a statement which shall show the amount of assets defined in paragraph (e) of § 402.1-2 (Temporary Regulations on Procedure and Administration under Tax Reform Act of 1969) as of the close of the taxable year and a brief description and the amount of all other assets, together with a description of the method used in determining such amounts. If the percentage specified in this subparagraph is computed by such thrift institution on the basis of the average assets outstanding during the taxable year, the statement shall also show such information as of the end of each month, each quarter, or each semiannual period and the manner of calculating the average.

(ii) *Example.* The provisions of this subparagraph may be illustrated by the following example:

Example. M is a cooperative bank to which section 593 applies. For its taxable year beginning in 1970, 80.4 percent of M's assets (computed as of the close of such year) constitute assets described in section 7701(a)(19)(C). M's assets which are assets described in section 7701(a)(19)(C), when computed on semiannual, quarterly, and month-

ly bases, constitute 79.8, 79.6, and 79.5 percent, respectively, of its total assets computed on the corresponding bases. M's applicable percentage for 1970 is 56.25 percent, determined as follows:

	<i>Per- cent</i>
Percentage of total assets specified in (a) of subdivision (i) of this subparagraph	82.0
Percentage of total assets constituting assets described in section 7701(a)(19)(C)	80.4
Difference	1.6
Applicable percentage determined under table in subparagraph (1) of this paragraph	57.0
Reduction of applicable percentage required by (a) of subdivision (i) of this subparagraph (¾ of 1 percentage point for each full percentage point of difference)75
Applicable percentage	56.25

(3) *Reduction for addition to reserve for nonqualifying loans—(i) General rule.* Subparagraph (1) of this paragraph provides that, subject to certain limitations, the amount determined under the percentage of taxable income method provided by section 593(b)(2) and this paragraph for the taxable year is an amount equal to the applicable percentage of the taxable income for such year, reduced by the amount determined under this subparagraph. In the case of a thrift institution other than a mutual savings bank, the amount determined under this subparagraph is an amount equal to the amount determined under paragraph (a)(1)(i) of § 1.593-5 to be a reasonable addition for the taxable year to the reserve for losses on nonqualifying loans multiplied by a fraction:

(a) The numerator of which is 18 percent, and

(b) The denominator of which is the percentage (in no case less than 18 percent) of the assets of the taxpayer for such year which are not assets defined in paragraph (e) of § 402.1-2 of this chapter.

In the case of a thrift institution which is a mutual savings bank, the amount determined under this subparagraph is an amount determined in the manner described in the preceding sentence, except that the numerator of the fraction described therein is 28 percent, and the denominator of such fraction shall not be less than 28 percent. For purposes of this subparagraph, the percentage of assets for a taxable year which are not assets defined in paragraph (e) of § 402.1-2 of this chapter is determined

upon the same annual or average basis as is used in determining the percentage specified in subparagraph (2) of this paragraph.

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

Example 1. K is a domestic building and loan association to which section 593 applies. The amount determined under subparagraph (1) of this paragraph (before reduction by the amount determined under this subparagraph) to be the reasonable addition for the taxable year to K's reserve for losses on qualifying real property loans is \$100,000. The amount determined under paragraph (a)(1)(i) of §1.593-5 as the reasonable addition for the taxable year to the association's reserve for losses on nonqualifying loans is \$10,000. The percentage of K's assets which are not assets defined in paragraph (e) of §402.1-2 is 24 percent. The amount determined under subparagraph (1) of this paragraph (\$100,000) must be reduced by \$7,500.

$\$100,000 \times 18 \text{ percent} / 24 \text{ percent}.$

Therefore, subject to the limitations described in subparagraph (4) of this paragraph and in paragraph (e) of this section, the amount determined under this paragraph to be the reasonable addition for the taxable year to K's reserve for losses on qualifying real property loans is \$92,500 (\$100,000 less \$7,500).

Example 2. The facts are the same as in example 1, except that the percentage of K's assets which are not assets defined in paragraph (e) of §402.1-2 is 12 percent. The amount determined under subparagraph (1) of this paragraph (before reduction by the amount determined under this subparagraph) to be the reasonable addition for the taxable year to K's reserve for losses on qualifying real property loans must be reduced by \$10,000.

$\$10,000 \times 18 \text{ percent} / 12 \text{ percent}.$

Because the denominator of the fraction may not be less than 18 percent, the fraction used in determining the amount of such reduction is equal to 1.

(4) *Overall limitation.* The amount determined under this paragraph 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 6 percent of such loans outstanding at such time.

(5) *Computation of taxable income.* For purposes of this paragraph, taxable income is computed:

(i) By excluding from gross income any amount included therein by reason of the application of section 593(e) and §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) (whether or not determined under section 593) and the regulations thereunder for an addition to a reserve for bad debts.

(iii) (a) By excluding from gross income an amount equal to the excess (if any) or (f) the total gains of the taxable year arising from sales and exchanges at a gain of (j) obligations the interest on which is excludable from gross income under section 103, and (ii) corporate stock, over (z) the total losses of such year arising from sales and exchanges at a loss of such obligations and stock.

(b) The provisions of this subdivision (iii) may be illustrated by the following example:

Example. For its taxable year beginning in 1971, the gains and losses of a domestic building and loan association from sales of stock and securities (all of which were made on December 31, 1971) were as follows:

	Gain	Loss
Municipal bonds acquired July 1, 1969, the interest on which is excludable from income under sec. 103	\$25,000
Stock of Corporation A, acquired July 14, 1971	\$6,000
Stock of Corporation B, acquired Dec. 22, 1970	\$3,000

For purposes of this paragraph, the association's taxable income for 1971 is computed by excluding \$22,000 (\$25,000+\$3,000-\$6,000) from its gross income.

(iv) By excluding from gross income an amount equal to the lesser of (a) three-eighths of the net long-term capital gain for the taxable year or (b) three-eighths of the net long-term capital gain for the taxable year from the sale or exchange of property other than property described in subdivision (iii) of this subparagraph.

(v)(a) By excluding from gross income so much of the amount of dividends with respect to which a deduction is allowable under part VIII, subchapter B, chapter 1, subtitle A of the Code (section 241 and following) as

is in excess of the applicable percentage (determined under subparagraphs (1) and (2) of this paragraph) of the dividends received deduction (determined under part VIII, subchapter B, chapter 1, subtitle A of the Code, without regard to section 596) for the taxable year.

(b) The provisions of this subdivision (v) may be illustrated by the following example:

Example. For its taxable year beginning in 1977, a domestic building and loan association receives dividends of \$100 with respect to which a dividends received deduction of \$85 is allowable under section 243(a)(1). The association receives no other dividends for the taxable year. The association's applicable percentage for the taxable year, as determined under subparagraphs (1) and (2) of this paragraph, is 42 percent. For purposes of this paragraph, the association's taxable income is computed by excluding from gross income the excess of the amount of dividends received (\$100) over the applicable percentage of the allowable dividends received deduction (42 percent of \$85, or \$35.70), computed without regard to section 596. Thus, for purposes of this paragraph, \$64.30 (\$100 less \$35.70) is excluded from gross income. See section 596 and § 1.596-1 with respect to the computation of the dividends received deduction for purposes of determining taxable income under section 63(a).

(vi) For taxable years beginning before January 1, 1978, without regard to any deduction the amount of which is computed upon, or may be subject to a limitation computed upon, the amount of taxable income, and without regard to any net operating loss carryback to such year from a taxable year beginning before January 1, 1979. (For purposes of this subparagraph, a net operating loss deduction under section 172 is not a deduction the amount of which may be subject to a limitation computed upon the amount of taxable income.)

(vii) For taxable years beginning after December 31, 1977, by taking into account any deduction the amount of which is computed upon or may be subject to a limitation computed upon the amount of taxable income, and any other deduction or loss allowed under subtitle A of the Code, such as any deduction allowable under section 172 or any loss allowable under section 1212 (a), unless otherwise provided in this subparagraph.

(c) *Percentage method.* [Reserved]

(d) *Experience method.* [Reserved]

(e) *Percentage of deposits limitation where percentage of taxable income method or percentage method is applied.* If the amount determined by the taxpayer to constitute a reasonable addition for the taxable year to the reserve for losses on qualifying real property loans is greater than the amount determined under paragraph (d) of this section (relating to the experience method), the amount so determined cannot exceed an amount which, when added to the amount determined under paragraph (a)(1)(i) of § 1.593-5 to be a reasonable 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. The terms *surplus*, *undivided profit*, and *reserves* and *total deposits* or *withdrawable accounts* have the same meanings as are assigned to them in paragraph (f) of § 1.593.6.

[T.D. 549, 43 FR 21455, May 18, 1978, as amended by T.D. 7626, 44 FR 31177, May 31, 1979]

§ 1.593-7 Establishment and treatment of reserves for bad debts.

(a) *Establishment of reserves—(1) In general.* A taxpayer described in § 1.593-4 shall establish and maintain a reserve for losses on nonqualifying loans, a reserve for losses on qualifying real property loans, and, if required under paragraph (b)(4) or (c)(3)(i)(c) of this section, a supplemental reserve for losses on loans. For rules governing the crediting of additions to the reserve for losses on nonqualifying loans and the reserve for losses on qualifying real property loans, see paragraph (b) of § 1.593-5.

(2) *Accounting for reserves.* (i) The taxpayer shall establish and maintain as a permanent part of its regular books of