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 (¼ of $11,920) to $8,940.


§ 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)(i) 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 experience method, and the percentage 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:

<table>
<thead>
<tr>
<th>For a taxable year beginning in—</th>
<th>The applicable percentage under this subparagraph is—</th>
</tr>
</thead>
<tbody>
<tr>
<td>1969</td>
<td>60 percent.</td>
</tr>
<tr>
<td>1970</td>
<td>57 percent.</td>
</tr>
<tr>
<td>1971</td>
<td>54 percent.</td>
</tr>
<tr>
<td>1972</td>
<td>51 percent.</td>
</tr>
<tr>
<td>1973</td>
<td>48 percent.</td>
</tr>
<tr>
<td>1974</td>
<td>45 percent.</td>
</tr>
<tr>
<td>1975</td>
<td>43 percent.</td>
</tr>
<tr>
<td>1976</td>
<td></td>
</tr>
</tbody>
</table>

373
§ 1.593–6A

(2) Reduction of applicable percentage in certain cases—(1) 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 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 monthly 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:

<table>
<thead>
<tr>
<th>Percentage of total assets specified in (a) of subdivision (i) of this subparagraph</th>
<th>82.0</th>
</tr>
</thead>
<tbody>
<tr>
<td>Percentage of total assets constituting assets described in section 7701(a)(19)(C)</td>
<td>80.4</td>
</tr>
<tr>
<td>Difference</td>
<td>1.6</td>
</tr>
<tr>
<td>Applicable percentage determined under table in subparagraph (1) of this paragraph</td>
<td>57.0</td>
</tr>
<tr>
<td>Reduction of applicable percentage required by (a) of subdivision (i) of this subparagraph (% of 1 percentage point for each full percentage point of difference)</td>
<td>0.75</td>
</tr>
<tr>
<td>Applicable percentage</td>
<td>56.25</td>
</tr>
</tbody>
</table>

(3) Reduction for addition to reserve for nonqualifying loans—(1) 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 qualifying real property loans must be reduced by $7,500.

$10,000×18 percent/24 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 $30,000.

$10,000×18 percent/18 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 (i) the total gains of the taxable year arising from sales and exchanges at a gain of (i) obligations the interest on which is excludable from gross income under section 103, and (ii) corporate stock, over (2) 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:

<table>
<thead>
<tr>
<th>Type of Investment</th>
<th>Gains</th>
<th>Losses</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real property</td>
<td>$50,000</td>
<td>$15,000</td>
</tr>
<tr>
<td>Corporate stock</td>
<td>$20,000</td>
<td>$20,000</td>
</tr>
</tbody>
</table>

Therefore, the taxable income for the year is $50,000 – $15,000 + $20,000 – $20,000 = $35,000.
§ 1.593–6A 26 CFR Ch. I (4–1–09 Edition)

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.

(v) 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.

(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 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

---

<table>
<thead>
<tr>
<th>Gain</th>
<th>Loss</th>
</tr>
</thead>
<tbody>
<tr>
<td>$25,000</td>
<td>$6,000</td>
</tr>
</tbody>
</table>

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 $25 is allowable under section 243(a)(1). The association receives no other dividends for the taxable year. The association's taxable income is computed by excluding from gross income the excess of the amount of dividends received over the applicable percentage of the amount of dividends received deduction (2 percent of $25), 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).
withdrawable accounts have the same meanings as are assigned to them in paragraph (f) of §1.593–6.


§ 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 subparagraph (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 account an account for each of the reserves established pursuant to subparagraph (1) of this paragraph. For purposes of the preceding sentence, a taxpayer may establish and maintain a permanent subsidiary ledger containing an account for each of such reserves. If a taxpayer maintains such a permanent subsidiary ledger, the total of the reserve accounts in such ledger and the total of the reserve accounts in any other ledger must be reconciled.

(ii) Any credit or charge to a reserve established pursuant to subparagraph (1) of this paragraph must be made to such reserve irrespective of whether the amount thereof is also credited or charged to any surplus, reserve, or other account which the taxpayer may be required or permitted to maintain pursuant to any Federal or State statute, regulation, or supervisory order. Minimum amounts credited in compliance with such Federal or State statutes, regulations, or supervisory orders to reserve or similar accounts, or additional amounts credited to such reserve or similar accounts and permissible under such statutes, regulations, or orders, against which charges may be made for the purpose of absorbing losses sustained by the taxpayer, may also be credited to the reserve for losses on nonqualifying loans or the reserve for losses on qualifying real property loans, provided that the total of the amounts so credited to the reserve for losses on nonqualifying loans, or to the reserve for losses on qualifying real property loans, for any taxable years does not exceed the amount described in subparagraph (1) or (2) of §1.593–5(a) (whichever applies) as the addition to such reserve for such year.

(b) Allocation of pre-1963 reserves—(1) In general. In the case of a taxpayer described in §1.593–4, the pre-1963 reserves, if any, of such taxpayer shall be allocated to (and constitute the opening balance of) the reserve for losses on nonqualifying loans, the reserve for losses on qualifying real property loans, and, if required under subparagraph (4) of this paragraph, the supplemental reserve for losses on loans. The term pre-1963 reserves means the net amount (determined as of the close of December 31, 1962) accumulated for taxable years beginning after December 31, 1961, in the taxpayer’s reserve for bad debts pursuant to section 166(c) of the Internal Revenue Code of 1954 and section 23(k) (1) of the Internal Revenue Code of 1939 (including the amount of any bad debt reserves acquired from another taxpayer). For purposes of the preceding sentence in the case of a taxable year beginning before January 1, 1963, and ending after December 31, 1962, the part of such year occurring before January 1, 1963, shall be treated as a taxable year. Thus, the pre-1963 reserves of the taxpayer shall be an amount equal to:

(i) The sum of the amounts allowed as deductions for additions to a reserve for bad debts for taxable years beginning after December 31, 1961, and ending before January 1, 1963, plus

(ii) In the case of a taxable year beginning before January 1, 1963, and ending after December 31, 1962, the amount (determined under §1.593–1 or 1.593–2) which would be allowable under section 166(c) as a deduction for an addition to a reserve for bad debts for the part of such year occurring before January 1, 1963, if such part year constituted a taxable year, minus

(iii) The total amount of bad debts charged against a reserve for bad debts during the period which begins with the opening of the first taxable year.