

CALIFORNIA FRANCHISE TAX BOARD

Legal Ruling No. 308

August 25, 1966

SAVINGS AND LOAN ASSOCIATIONS: PARTIALLY GUARANTEED LOANS: EFFECT ON BAD DEBT RESERVE

Syllabus:

Savings and loan associations make loans to war veterans which are partially guaranteed by the Veterans Administration. The loans are guaranteed to the extent of 60 percent of the principal amount outstanding or \$7,500, whichever is the lesser.

The question presented is whether the entire amount of the loans or only that portion of the loans guaranteed by the Veterans Administration should be eliminated from the savings and loan associations' accounts in computing the bad debt reserve of such associations.

Regulation 24348(a)(3), promulgated under section 24348 of the Bank and Corporation Tax Law, prescribes the rules governing the use by savings and loan associations of the reserve method of accounting for bad debts. Under the rules prescribed the ratio of losses to outstanding loans is first determined for an association on the basis of a selected 20-year period. The ratio is then applied to the outstanding loans at the close of a given income year to determine the minimum allowable reserve. The maximum allowable reserve is limited to three times the ratio applied to outstanding loans at the close of the income year.

Subparagraph (i) of Regulation 24348(a) (3) provides that Government insured loans should be eliminated from prior-year accounts in computing percentages of past losses and also from current-year loans in computing the allowable deductions for additions to the reserve. It provides further that the amount of such loans to be excluded is determined "by the extent or percentage insured or guaranteed." Thus, according to the Regulation, a loan which is 100% insured or guaranteed by the Government is excludable in its entirety and a loan which is 90% insured or guaranteed is excludable to the extent of 90%, etc.

The language appearing in subparagraph (i) was taken from paragraph 4 of Federal Minn. 6209, 1947-2 CB 26, as amplified by Rev. Rul. 57-210, 1957-1 CB 94, relating to the computation of the reserve for bad debts of banks. In applying Minn. 6209 the Internal Revenue Service initially followed the practice of excluding only Government insured or guaranteed loans which were 100% insured or guaranteed, and not excluding Government insured or guaranteed loans which were insured or guaranteed to some extent but less than 100%. In Rev. Rul. 57-210,

however, the Service ruled that the term "Government insured loans" refers to any loans which are Government insured or guaranteed, in whatever extent or percent. It is clear that in applying Rev. Rul. 57-210, the Service considered only that part of the loans insured or guaranteed by the Government as being excludable from the banks' accounts. See Rev. Rul. 58-259, 1958-1 CB 116, in which it was ruled that Title I F.H.A. loans were excludable to the extent of 90% of the loans outstanding or the balance of the banks' insurance reserve account maintained by the Federal Housing Administration, whichever is the lesser.

It is our opinion that the language of Regulation 24348(a)(3)(i) leaves no room for an interpretation that loans insured or guaranteed by the Government to the extent of less than 100% are 100% excludable. The words "by the extent" as used in the Regulation obviously refer to the specified amount insured or guaranteed as opposed to a percentage of the loans. Applying the language of the Regulation to a veteran home loan, \$7,500 of such loan is excludable if 60% of the loan is in excess of that amount. It is accordingly our conclusion that only that portion of veteran home loans made by savings and loan associations which is guaranteed by the Veterans Administration is excludable from the associations' accounts in computing their reserve for bad debts. We do not believe the fact that the associations have suffered virtually no losses on these loans is material in the application of Regulation 24348(a)(3)(i).