

exchanges and distributions in obedience to orders of the Securities and Exchange Commission), if no gain to the distributee from the receipt of such stock, securities, or other property or money was recognized by law.

(4) A stock dividend which was not subject to tax in the hands of the distributee because either it did not constitute income to him within the meaning of the sixteenth amendment to the Constitution or because exempt to him under section 115(f) of the Revenue Act of 1934 (48 Stat. 712) or a corresponding provision of a prior Revenue Act, or section 305 of the Code.

(5) The distribution, in a taxable year of the distributee beginning after December 31, 1931, by or on behalf of an insolvent corporation, in connection with a section 112(b)(10) reorganization under the Internal Revenue Code of 1939, or in a transaction subject to section 371 of the Internal Revenue Code of 1954, of stock or securities in a corporation organized or made use of to effectuate the plan of reorganization, if under section 112(e) of the Internal Revenue Code of 1939 or section 371 of the Internal Revenue Code of 1954 no gain to the distributee from the receipt of such stock or securities was recognized by law.

(c) A distribution described in paragraph (b) of this section does not diminish the earnings or profits of any corporation. In such cases, the earnings or profits remain intact and available for distribution as dividends by the corporation making such distribution, or by another corporation to which the earnings or profits are transferred upon such reorganization or other exchange. In the case, however, of amounts distributed in liquidation (other than a taxfree liquidation or reorganization described in paragraph (b)(1), (2), (3), or (5) of this section) the earnings or profits of the corporation making the distribution are diminished by the portion of such distribution properly chargeable to earnings or profits accumulated after February 28, 1913, after first deducting from the amount of such distribution the portion thereof allocable to capital account.

(d) For the purposes of this section, the terms *reorganization* and *party to*

the reorganization shall, for any taxable year beginning before January 1, 1934, have the meanings assigned to such terms in section 112 of the Revenue Act of 1932 (47 Stat. 196); for any taxable year beginning after December 31, 1933, and before January 1, 1936, have the meanings assigned to such terms in section 112 of the Revenue Act of 1934 (48 Stat. 704); for any taxable year beginning after December 31, 1935, and before January 1, 1938, have the meanings assigned to such terms in section 112 of the Revenue Act of 1936 (49 Stat. 1678); for any taxable year beginning after December 31, 1937, and before January 1, 1939, have the meanings assigned to such terms in section 112 of the Revenue Act of 1938 (52 Stat. 485); and for any taxable year beginning after December 31, 1938, and ending before June 22, 1954, providing no election is made under section 393(b)(2) of the Internal Revenue Code of 1954, have the meanings assigned to such terms in section 112(g)(1) of the Internal Revenue Code of 1939.

§ 1.312-12 Distributions of proceeds of loans guaranteed by the United States.

(a) The provisions of section 312(j) are applicable with respect to a loan, any portion of which is guaranteed by an agency of the United States Government without regard to the percentage of such loan subject to such guarantee.

(b) The application of section 312(j) is illustrated by the following example:

Example. Corporation A borrowed \$1,000,000 for the purpose of construction of an apartment house, the cost and adjusted basis of which was \$900,000. This loan was guaranteed by an agency of the United States Government. One year after such loan was made and after the completion of construction of the building (but before such corporation had received any income) it distributed \$100,000 cash to its shareholders. The earnings and profits of the taxable year of such corporation are increased (pursuant to section 312(j)) by \$100,000 immediately prior to such distribution and are decreased by \$100,000 immediately after such distribution. Such decrease, however, does not reduce the earnings and profits below zero. Two years later, it has no accumulated earnings and has earnings of the taxable year of \$100,000. Before it has made any payments on the loan, it distributes \$200,000 to its shareholders. The earnings and profits of the taxable year of

the corporation (\$100,000) are increased by \$100,000, the excess of the amount of the guaranteed loan over the adjusted basis of the apartment house (calculated without adjustment for depreciation). The entire amount of each distribution is treated as a distribution out of earnings and profits and, accordingly, as a taxable dividend.

§ 1.312-15 Effect of depreciation on earnings and profits.

(a) *Depreciation for taxable years beginning after June 30, 1972—(1) In general.* Except as provided in subparagraph (2) of this paragraph and paragraph (c) of this section, for purposes of computing the earnings and profits of a corporation (including a real estate investment trust as defined in section 856) for any taxable year beginning after June 30, 1972, the allowance for depreciation (and amortization, if any) shall be deemed to be the amount which would be allowable for such year if the straight line method of depreciation had been used for all property for which depreciation is allowable for each taxable year beginning after June 30, 1972. Thus, for taxable years beginning after June 30, 1972, in determining the earnings and profits of a corporation, depreciation must be computed under the straight line method, notwithstanding that in determining taxable income the corporation uses an accelerated method of depreciation described in subparagraph (A), (B), or (C) of section 312(m)(2) or elects to amortize the basis of property under section 169, 184, 187, or 188, or any similar provision.

(2) *Exception.* (i) If, for any taxable year beginning after June 30, 1972, a method of depreciation is used by a corporation in computing taxable income which the Secretary or his delegate has determined results in a reasonable allowance under section 167(a) and which is not a declining balance method of depreciation (described in § 1.167(b)-2), the sum of the years-digits method (described in § 1.167(b)-3), or any other method allowed solely by reason of the application of subsection (b)(4) or (j)(1)(C) of section 167, then the adjustment to earnings and profits for depreciation for such year shall be determined under the method so used (in lieu of the straight line method).

(ii) The Commissioner has determined that the “unit of production” (see § 1.167(b)-0(b)), and the “machine hour” methods of depreciation, when properly used under appropriate circumstances, meet the requirements of subdivision (i) of this subparagraph. Thus, the adjustment to earnings and profits for depreciation (for the taxable year for which either of such methods is properly used under appropriate circumstances) shall be determined under whichever of such methods is used to compute taxable income.

(3) *Determinations under straight line method.* (i) In the case of property with respect to which an allowance for depreciation is claimed in computing taxable income, the determination of the amount which would be allowable under the straight line method shall be based on the manner in which the corporation computes depreciation in determining taxable income. Thus, if an election under § 1.167(a)-11 is in effect with respect to the property, the amount of depreciation which would be allowable under the straight line method shall be determined under § 1.167(a)-11(g)(3). On the other hand, if property is not depreciated under the provisions of § 1.167(a)-11, the amount of depreciation which would be allowable under the straight line method shall be determined under § 1.167(b)-1. Any election made under section 167(f), with respect to reducing the amount of salvage value taken into account in computing the depreciation allowance for certain property, or any convention adopted under § 1.167(a)-10(b) or § 1.167(a)-11(c)(2), with respect to additions and retirements from multiple asset accounts, which is used in computing depreciation for taxable income shall be used in computing depreciation for earnings and profits purposes.

(ii) In the case of property with respect to which an election to amortize is in effect under section 169, 184, 187, or 188, or any similar provision, the amount which would be allowable under the straight line method of depreciation shall be determined under the provisions of § 1.167(b)-1. Thus, the cost or other basis of the property, less its estimated salvage value, is to be deducted in equal annual amounts over the period of the estimated useful life