

Internal Revenue Code Section 312

Effect on earnings and profits

(a) General rule.

Except as otherwise provided in this section , on the distribution of property by a corporation with respect to its stock, the earnings and profits of the corporation (to the extent thereof) shall be decreased by the sum of-

- (1) the amount of money,
- (2) the principal amount of the obligations of such corporation (or, in the case of obligations having original issue discount, the aggregate issue price of such obligations), and
- (3) the adjusted basis of the other property,

so distributed.

(b) Distributions of appreciated property.

On the distribution by a corporation, with respect to its stock, of any property (other than an obligation of such corporation) the fair market value of which exceeds the adjusted basis thereof-

- (1) the earnings and profits of the corporation shall be increased by the amount of such excess, and
- (2) subsection (a)(3) shall be applied by substituting "fair market value" for "adjusted basis".

For purposes of this subsection and subsection (a) , the adjusted basis of any property is its adjusted basis as determined for purposes of computing earnings and profits.

(c) Adjustments for liabilities.

In making the adjustments to the earnings and profits of a corporation under subsection (a) or (b) proper adjustment shall be made for-

- (1) the amount of any liability to which the property distributed is subject, and
- (2) the amount of any liability of the corporation assumed by a shareholder in connection with the distribution.

(d) Certain distributions of stock and securities.

- (1) In general.

The distribution to a distributee by or on behalf of a corporation of its stock or securities, of stock or securities in another corporation, or of property, in a distribution to which this title applies, shall not be considered a distribution of the earnings and profits of any corporation-

(A) if no gain to such distributee from the receipt of such stock or securities, or property, was recognized under this title, or

(B) if the distribution was not subject to tax in the hands of such distributee by reason of section 305(a) .

(2) Stock or securities.

For purposes of this subsection , the term "stock or securities" includes rights to acquire stock or securities.

(e) Repealed.

(f) Effect on earnings and profits of gain or loss and of receipt of tax-free distributions.

(1) Effect on earnings and profits of gain or loss.

The gain or loss realized from the sale or other disposition (after February 28, 1913) of property by a corporation-

(A) for the purpose of the computation of the earnings and profits of the corporation, shall (except as provided in subparagraph (B)) be determined by using as the adjusted basis the adjusted basis (under the law applicable to the year in which the sale or other disposition was made) for determining gain, except that no regard shall be had to the value of the property as of March 1, 1913; but

(B) for purposes of the computation of the earnings and profits of the corporation for any period beginning after February 28, 1913, shall be determined by using as the adjusted basis the adjusted basis (under the law applicable to the year in which the sale or other disposition was made) for determining gain.

Gain or loss so realized shall increase or decrease the earnings and profits to, but not beyond, the extent to which such a realized gain or loss was recognized in computing taxable income under the law applicable to the year in which such sale or disposition was made. Where, in determining the adjusted basis used in computing such realized gain or loss, the adjustment to the basis differs from the adjustment proper for the purpose of determining earnings and profits, then the latter adjustment shall be used in determining the increase or decrease above provided. For purposes of this subsection , a loss with respect to which a deduction is disallowed under section 1091 (relating to wash sales of stock or securities), or the corresponding provision of prior law, shall not be deemed to be recognized.

(2) Effect on earnings and profits of receipt of tax-free distributions.

Where a corporation receives (after February 28, 1913) a distribution from a second corporation which (under the law applicable to the year in which the distribution was made) was not a taxable dividend to the shareholders of the second corporation, the

amount of such distribution shall not increase the earnings and profits of the first corporation in the following cases:

(A) no such increase shall be made in respect of the part of such distribution which (under such law) is directly applied in reduction of the basis of the stock in respect of which the distribution was made; and

(B) no such increase shall be made if (under such law) the distribution causes the basis of the stock in respect of which the distribution was made to be allocated between such stock and the property received (or such basis would, but for section 307(b) , be so allocated).

(g) Earnings and profits-increase in value accrued before March 1, 1913.

(1) If any increase or decrease in the earnings and profits for any period beginning after February 28, 1913, with respect to any matter would be different had the adjusted basis of the property involved been determined without regard to its March 1, 1913, value, then, except as provided in paragraph (2) , an increase (properly reflecting such difference) shall be made in that part of the earnings and profits consisting of increase in value of property accrued before March 1, 1913.

(2) If the application of subsection (f) to a sale or other disposition after February 28, 1913, results in a loss which is to be applied in decrease of earnings and profits for any period beginning after February 28, 1913, then, notwithstanding subsection (f) and in lieu of the rule provided in paragraph (1) of this subsection , the amount of such loss so to be applied shall be reduced by the amount, if any, by which the adjusted basis of the property used in determining the loss exceeds the adjusted basis computed without regard to the value of the property on March 1, 1913, and if such amount so applied in reduction of the decrease exceeds such loss, the excess over such loss shall increase that part of the earnings and profits consisting of increase in value of property accrued before March 1, 1913.

(h) Allocation in certain corporate separations and reorganizations.

(1) Section 355 .

In the case of a distribution or exchange to which section 355 (or so much of section 356 as relates to section 355) applies, proper allocation with respect to the earnings and profits of the distributing corporation and the controlled corporation (or corporations) shall be made under regulations prescribed by the Secretary.

(2) Section 368(a)(1)(C) or (D) .

In the case of a reorganization described in subparagraph (C) or (D) of section 368(a)(1) , proper allocation with respect to the earnings and profits of the acquired corporation shall, under regulations prescribed by the Secretary, be made between the acquiring corporation and the acquired corporation (or any corporation which had control of the acquired corporation before the reorganization).

(i) Distribution of proceeds of loan insured by the United States.

If a corporation distributes property with respect to its stock and if, at the time of distribution-

(1) there is outstanding a loan to such corporation which was made, guaranteed, or insured by the United States (or by any agency or instrumentality thereof), and

(2) the amount of such loan so outstanding exceeds the adjusted basis of the property constituting security for such loan,

then the earnings and profits of the corporation shall be increased by the amount of such excess, and (immediately after the distribution) shall be decreased by the amount of such excess. For purposes of paragraph (2) , the adjusted basis of the property at the time of distribution shall be determined without regard to any adjustment under section 1016(a)(2) (relating to adjustment for depreciation, etc.). For purposes of this subsection , a commitment to make, guarantee, or insure a loan shall be treated as the making, guaranteeing, or insuring of a loan.

(j) Repealed.

(k) Effect of depreciation on earnings and profits.

(1) General rule.

For purposes of computing the earnings and profits of a corporation 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 each taxable year beginning after June 30, 1972.

(2) Exception.

If for any taxable year a method of depreciation was used by the taxpayer which the Secretary has determined results in a reasonable allowance under section 167(a) and which is the unit-of-production method or other method not expressed in a term of years, 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).

(3) Exception for tangible property.

(A) In general. Except as provided in subparagraph (B) , in the case of tangible property to which section 168 applies, the adjustment to earnings and profits for depreciation for any taxable year shall be determined under the alternative depreciation system (within the meaning of section 168(g)(2)).

(B) Treatment of amounts deductible under section 179 , 179B , 179C , 179D , or 179E . For purposes of computing the earnings and profits of a corporation, any amount deductible under section 179 , 179B , 179C , 179D , or 179E shall be allowed as a deduction ratably over the period of 5 taxable years (beginning with the taxable year for which such amount is deductible under section 179 , 179B , 179C , 179D , or 179E , as the case may be).

(4) Certain foreign corporations.

The provisions of paragraph (1) shall not apply in computing the earnings and profits of a foreign corporation for any taxable year for which less than 20 percent of the gross

income from all sources of such corporation is derived from sources within the United States.

(5) Basis adjustment not taken into account.

In computing the earnings and profits of a corporation for any taxable year, the allowance for depreciation (and amortization, if any) shall be computed without regard to any basis adjustment under section 50(c) .

(l) Discharge of indebtedness income.

(1) Does not increase earnings and profits if applied to reduce basis.

The earnings and profits of a corporation shall not include income from the discharge of indebtedness to the extent of the amount applied to reduce basis under section 1017 .

(2) Reduction of deficit in earnings and profits in certain cases.

If-

(A) the interest of any shareholder of a corporation is terminated or extinguished in a title 11 or similar case (within the meaning of section 368(a)(3)(A)), and

(B) there is a deficit in the earnings and profits of the corporation,

then such deficit shall be reduced by an amount equal to the paid-in capital which is allocable to the interest of the shareholder which is so terminated or extinguished.

(m) No adjustment for interest paid on certain registration-required obligations not in registered form.

The earnings and profits of any corporation shall not be decreased by any interest with respect to which a deduction is not or would not be allowable by reason of section 163(f) , unless at the time of issuance the issuer is a foreign corporation that is not a controlled foreign corporation (within the meaning of section 957) and the issuance did not have as a purpose the avoidance of section 163(f) or this subsection.

(n) Adjustments to earnings and profits to more accurately reflect economic gain and loss.

For purposes of computing the earnings and profits of a corporation, the following adjustments shall be made:

(1) Construction period carrying charges.

(A) In general. In the case of any amount paid or incurred for construction period carrying charges-

(i) no deduction shall be allowed with respect to such amount, and

(ii) the basis of the property with respect to which such charges are allocable shall be increased by such amount.

(B) Construction period carrying charges defined. For purposes of this paragraph, the term "construction period carrying charges" means all-

- (i) interest paid or accrued on indebtedness incurred or continued to acquire, construct, or carry property,
- (ii) property taxes, and
- (iii) similar carrying charges,

to the extent such interest, taxes, or charges are attributable to the construction period for such property and would be allowable as a deduction in determining taxable income under this chapter for the taxable year in which paid or incurred.

(C) Construction period. The term "construction period" has the meaning given the term production period under section 263A(f)(4)(B).

(2) Intangible drilling costs and mineral exploration and development costs.

(A) Intangible drilling costs. Any amount allowable as a deduction under section 263(c) in determining taxable income (other than costs incurred in connection with a nonproductive well)-

- (i) shall be capitalized, and
- (ii) shall be allowed as a deduction ratably over the 60-month period beginning with the month in which such amount was paid or incurred.

(B) Mineral exploration and development costs. Any amount allowable as a deduction under section 616(a) or 617 in determining taxable income-

- (i) shall be capitalized, and
- (ii) shall be allowed as a deduction ratably over the 120-month period beginning with the later of-

(I) the month in which production from the deposit begins, or

(II) the month in which such amount was paid or incurred.

(3) Certain amortization provisions not to apply.
Sections 173 and 248 shall not apply.

(4) LIFO inventory adjustments.

(A) In general. Earnings and profits shall be increased or decreased by the amount of any increase or decrease in the LIFO recapture amount as of the close of each taxable year; except that any decrease below the LIFO recapture amount as of the close of the taxable year preceding the 1st taxable year to which this

paragraph applies to the taxpayer shall be taken into account only to the extent provided in regulations prescribed by the Secretary.

(B) LIFO recapture amount. For purposes of this paragraph , the term "LIFO recapture amount" means the amount (if any) by which-

(i) the inventory amount of the inventory assets under the first-in, first-out method authorized by section 471 , exceeds

(ii) the inventory amount of such assets under the LIFO method.

(C) Definitions. For purposes of this paragraph -

(i) LIFO method. The term "LIFO method" means the method authorized by section 472 (relating to last-in, first-out inventories).

(ii) Inventory assets. The term "inventory assets" means stock in trade of the corporation, or other property of a kind which would properly be included in the inventory of the corporation if on hand at the close of the taxable year.

(iii) Inventory amount. The inventory amount of assets under the first-in, first-out method authorized by section 471 shall be determined-

(I) if the corporation uses the retail method of valuing inventories under section 472 , by using such method, or

(II) if subclause (I) does not apply, by using cost or market, whichever is lower.

(5) Installment sales.

In the case of any installment sale, earnings and profits shall be computed as if the corporation did not use the installment method.

(6) Completed contract method of accounting.

In the case of a taxpayer who uses the completed contract method of accounting, earnings and profits shall be computed as if such taxpayer used the percentage of completion method of accounting.

(7) Redemptions.

If a corporation distributes amounts in a redemption to which section 302(a) or 303 applies, the part of such distribution which is properly chargeable to earnings and profits shall be an amount which is not in excess of the ratable share of the earnings and profits of such corporation accumulated after February 28, 1913, attributable to the stock so redeemed.

(8) Special rule for certain foreign corporations.

In the case of a foreign corporation described in subsection (k)(4) -

(A) paragraphs (4) and (6) shall apply only in the case of taxable years beginning after December 31, 1985, and

(B) paragraph (5) shall apply only in the case of taxable years beginning after December 31, 1987.

(o) Definition of original issue discount and issue price for purposes of subsection (a)(2) .
For purposes of subsection (a)(2) , the terms "original issue discount" and "issue price" have the same respective meanings as when used in subpart A of part V of subchapter P of this chapter.