EXHIBIT L

STATUTES AND REGULATIONS

EXHIBIT L: 1

California Bank and Corporation Franchise Tax Chapter 2, Article 3 and regulatory materials

herein shall not be less than 7.6 percent of its net income for the preceding income year nor less than the minimum tax determined in accordance with Section 23153.

[¶ 220-618]

(d) For purposes of this section, with respect to calendar or fiscal years ending after June 30, 1973, the tax on financial corporations after the allowance of all offsets shall not be less than 9 percent of its net income nor less than the minimum tax as provided by subdivision (c).

[¶ 220-622]

(e) Any offset which a financial corporation was entitled to apply against its franchise tax for the 1980 income year but which could not be applied during such income year because of the limitations otherwise set forth or because such amounts were not paid because they were contested or not timely assessed, shall be applied, in whole or in part, against its franchise tax for the 1981 income year, and any unused offset shall be applied in like manner against its franchise tax for the next six succeeding income years. (*As amended by Ch.* 1465, *Laws* 1988, *applicable to income years beginning on or after January* 1, 1988.)

[¶ 220-624]

(f) Notwithstanding anything to the contrary contained in this section, the tax on financial corporations after the allowance of all offsets provided for herein shall not be less than the tax on net income provided by Section 23151, or the minimum franchise tax, whichever is greater. (*As added by Ch.* 1150, *Laws* 1979; *as amended by Ch.* 1465, *Laws* 1988, *applicable to income years beginning on or after January* 1, 1988.)

(*Sec.* 23184 *is as amended by Ch.* 1139, *Laws* 1987; *Ch.* 1465, *Laws* 1988, *applicable to income years beginning on or after January* 1, 1988.)

[¶ 220-628]

Sec. 23184.5. [Offsets for financial corporations.] Litigation is pending regarding the application of Section 23182 with respect to business license taxes imposed by charter cities on financial corporations. If the final court determination is that charter cities may impose those taxes, then to the extent those taxes were imposed and paid, an offset is properly allowable pursuant to Section 23184 as if Chapter 1150 of the Statutes of 1979 had never been enacted. Pending that determination, the Franchise Tax Board shall issue proposed deficiency assessments disallowing those offsets claimed on returns for income years beginning in 1983 and thereafter. However, final action on the proposed deficiencies shall be deferred pending the final court determination. If the final court determination upholds the imposition of those taxes, then the proposed deficiencies shall be withdrawn. If the final court determination does not uphold the imposition of those taxes, the proposed deficiencies shall become final upon written notice thereof by the Franchise Tax Board and the deficiency assessments shall be due and payable within 30 days of the date of that notice by the Franchise Tax Board. If full payment is made within that 30-day period, interest shall not be imposed for the period after the date of the notice. Interest on those deficiency assessments shall accrue from the due date of the return without regard to any extensions. The period for making the proposed deficiency assessments provided by this section shall either be the period specified in Section 25663 or one year after the final court determination, whichever period is later. (*As added by Ch.* 1359, *Laws* 1984, *effective September* 25, 1984.)

[¶ 220-630]

Sec. 1, Ch. 1359, Laws 1984. [Intent of Sec. 23184.5.] It is the intent of the Legislature in enacting this act to find and declare that financial corporations are not subject to duplicative taxation under existing law notwithstanding differing interpretations of Chapter 1150 of the Statutes of 1979 by certain local jurisdictions, the Franchise Tax Board, and affected financial corporations.

The Legislature finds and declares all of the following:

(a) That banks are exempt from paying certain taxes and fees including business license taxes imposed by charter cities.

(b) Prior to the effective date of Chapter 1150 of the Statutes of 1979, financial corporations were required to pay, among other things, business license taxes imposed by charter cities, but were allowed to offset those taxes, with certain limitations, against the tax imposed upon those financial corporations by the Bank and Corporation Tax Law.

(c) That the intent of the Legislature in enacting Chapter 1150 of the Statutes of 1979, in part here relevant, was to bring parity to banks and financial corporations.

(d) That due to the limitations imposed upon that offset (and for other reasons), not all taxes paid by financial corporations to charter cities were recouped through the offset mechanism.

(e) That accordingly, the offset was ineffective to bring parity to banks and financial corporations.

The Legislature further finds and declares that it enacted Chapter 1150 of the Statutes of 1979 to, among other things, minimize the difference between banks and financial corporations by providing in Section 23182 of the Revenue and Taxation Code that the tax imposed by Part 11 (commencing with Section 23001) of Division 2 of the Revenue and Taxation Code was in lieu of, among other things, business license taxes such as those imposed by charter cities. Thus, the Legislature finds and declares that its intent in amending Section 23182 of the Revenue and Taxation Code by Chapter 1150 of the Statutes of 1979 was to prohibit, among other

things, charter cities from imposing business license taxes on financial corporations. Litigation is pending regarding the application of Section 23182 of the Revenue and Taxation Code with respect to business license taxes imposed by charter cities on financial corporations. In the event a final court decision concludes that charter cities can impose those taxes, the Legislature hereby declares that the offset provided by Section 23184 of the Revenue and Taxation Code is properly allowable for all years after the effective date of Chapter 1150 of the Statutes of 1979 as if that chapter had never been enacted.

The Legislature finds that it would be manifestly unfair and would cause severe economic hardship, inequities and injustices, if financial corporations could not offset any business license taxes imposed by and paid to charter cities with respect to any year after the effective date of Chapter 1150 of the Statutes of 1979. Failure to allow those offsets would seriously and adversely affect California financial corporations. Public policy is served by confirming that the offset is properly allowable in the event that charter cities are permitted to impose business license taxes on financial corporations after the effective date of Chapter 1150 of the Statutes of 1979.

Nothing in this act is intended to affect any pending litigation relating to the power of charter cities to impose business license taxes on financial corporations, except insofar as it reaffirms the intent of the Legislature in enacting Chapter 1150 of the Statutes of 1979 to prohibit, among other things, charter cities from imposing business license taxes on financial corporations. (*As added by Ch.* 1359, *Laws* 1984, *effective September* 25, 1984.)

[¶ 220-634]

Sec. 23185. [Offset of other taxes.] At the time of payment of the tax, each taxpayer claiming an offset against the tax, pursuant to Section 23184, shall submit to the Franchise Tax Board evidence in such form as it shall prescribe in support of said claims.

[¶ 220-638]

Sec. 23185a. [Rate of tax as applied to offset.] If a financial corporation, in paying the tax provided for in this chapter, desires to claim an offset in the computation of its tax, the rate provided in Section 23186 for financial corporations shall be applied to the offset and the amount so computed shall be added to and included in the tax of the financial corporation.

[¶ 220-642]

Sec. 23185b. [Refund of taxes after offset reportable.] If the taxes described in Section 23184 are at any time refunded to any taxpayer, and said taxpayer has been allowed an offset under Section 23184 for such taxes against any tax imposed under this chapter, said taxpayer shall pay a tax not subject to offset in an amount equivalent to any offset which has been allowed against any tax at any time imposed under this chapter on account of such refunded taxes. Said taxpayer shall report such taxes in its return for the income year in which the same are refunded. The tax herein provided for shall be due and payable in one amount on or before the due date, or the due date as extended by the Franchise Tax Board, for filing the return. The provisions of this part relating to delinquent first installment taxes shall be applicable to such tax if it is not paid on or before its due date.

[¶ 220-650]

Sec. 23186. [Rate of tax; net income—personal property tax ratio; limitation.] (a) Except as otherwise provided in this section, the rate of tax on banks and financial corporations shall be a percentage equal to the percentage of the total amount of net income, allocable to this state, of every corporation taxable under Section 23151 or subdivision (c) of Section 23151.1, or paragraph (1) of subdivision (d) of Section 23151.1, as the case may be, other than public utilities as defined in the Public Utilities Act, for the next preceding calendar year or fiscal years ended during such calendar year, required to be paid to this state as franchise taxes according to

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or measured by such net income, and required to be paid to this state or its political subdivisions by such corporations as personal property taxes during the preceding calendar year or fiscal years ended in such calendar year; provided, however, that said rate of tax shall not exceed 13 percent. The percentage of the net income of every corporation taxable under Section 23151, or subdivision (c) of Section 23151.1, or paragraph (1) of subdivision (d) of Section 23151.1, as the case may be, other than public utilities as defined in the Public Utilities Act, required to be paid to this state or its political subdivisions in personal property taxes shall be determined by ascertaining the ratio which the total amount of such personal property taxes, less 9 percent thereof, bears to the total amount of net income of such corporations allocable to California, increased by the amount of such personal property taxes; provided, however, that if any such corporation sustains a net loss allocable to California the personal property taxes required to be paid by such corporation to this state or its political subdivisions during the preceding calendar year or fiscal year ended during such calendar year shall be considered for the purpose of determining such ratio only to the extent which such personal property taxes exceed such net loss allocable to California. (*As amended by Ch.* 1150, *Laws* 1979; *Ch.* 938, *Laws* 1984; *and by Ch.* 324, *Laws* 1986, *effective July* 14, 1986.)

[¶ 220-652]

(b) The rate of tax on banks and financial corporations for income years ending in 1980, 1981, 1982, 1983, and 1984 shall be as follows:

(1) 1980 ..... 11.6 percent
(2) 1981 ..... 11.6 percent
(3) 1982 ..... 10.907 percent
(4) 1983 ..... 10.907 percent
(5) 1984 ..... 10.930 percent

(*As added by Ch.* 1150, *Laws* 1979; *as amended by Ch.* 838, *Laws* 1981; *and Ch.* 324, *Laws* 1986, *effective July* 14, 1986.)

[¶ 220-654]

(c) For income years ending in 1987 and thereafter, the rate of tax on banks and financial corporations shall be a percentage equal to the percentage of the total amount of net income, allocable to this state, of every corporation taxable under Article 2 (commencing with Section 23151) of this chapter, other than public utilities as defined in the Public Utilities Act, for the next preceding calendar year or fiscal years ended during such calendar year, required to be paid to this state as franchise taxes according to or measured by such net income, and required to be paid to this state or its political subdivisions by such corporations as personal property taxes and business license taxes during the preceding calendar year or fiscal years ended in such calendar year; provided, however, that said rate of tax shall not exceed 11.7 percent. The percentage of the net income of every corporation taxable under Article 2 (commencing with Section 23151) of this chapter, other than public utilities as defined in the Public Utilities Act, required to be paid to this state or its political subdivisions in personal property taxes and business license taxes shall be determined by ascertaining the ratio which the total amount of such personal property taxes and business license taxes, less the rate prescribed in Section 23151, bears to the total amount of net income of such corporations allocable to California, increased by the amount of such personal property taxes and business license taxes; provided, however, that if any such corporation sustains a net loss allocable to California the personal property taxes and business license taxes required to be paid by such corporation to this state or its political subdivisions during the preceding calendar year or fiscal years ended during such calendar year shall be considered for the purpose of determining such ratio only to the extent which such personal property taxes and business license taxes exceed such net loss allocable to California. Total amounts of net income shall be determined without regard to deductions attributable to carryover or carryback of net operating losses (if any). (*As added by Ch.* 1150, *Laws* 1979; *as amended by Ch.* 938, *Laws* 1984; *Ch.* 324, *Laws* 1986; *Ch.* 11, *Laws* 1988, *applicable to income years beginning on or after January* 1, 1987.)

[¶ 220-655]

(d) For income years ending in 1982 and thereafter, for the purposes of subdivision (c), the total amount of personal property taxes and business license taxes required to be paid during the income year shall be based on a statistical sample by the Franchise Tax Board consisting of all of the following:

(1) Every corporation with a net income determined without regard to deductions attributable to carryover or carryback of net operating losses (if any) of more than five million dollars ($5,000,000) for the income year.

(2) Every corporation required to pay one hundred thousand dollars ($100,000) or more of personal property tax or business license tax, or a combination thereof, during the income year.

(3) Two percent or more of all other corporations on a random basis.

For the purposes of this subdivision, "corporation" means a corporation taxable under Article 2 (commencing with Section 23151), other than public utilities as defined in the Public Utilities Act. (*As added by Ch.* 938, *Laws* 1984 *and amended by Ch.* 324, *Laws* 1986, *effective July* 14, 1986.)

[¶ 220-656]

(e) For the purpose of verifying local business license taxes reported by corporations taxable under Article 2 (commencing with Section 23151), other than public utilities as defined in the Public Utilities Act, the Franchise Tax Board is authorized to

receive source information listings directly from the cities as to the amount of business license taxes paid and the date of payment for each taxpayer subject to the business license tax, notwithstanding any city ordinance prohibiting that disclosure. (*As added by Ch.* 1150, *Laws* 1979, *and as amended by Ch.* 838, *Laws* 1981; *Ch.* 938, *Laws* 1984 *and by Ch.* 324, *Laws* 1986, *effective July* 14, 1986.)

[¶ 220-658]

(f) If, after notice and demand by the Franchise Tax Board, a taxpayer declines or refuses to furnish the Franchise Tax Board with information regarding personal property taxes, business license taxes, or net income required to determine the rate of tax on banks and financial corporations as provided by this section, then in that event, unless the failure is due to reasonable cause, the Franchise Tax Board shall disallow any deductions claimed by a taxpayer for the applicable period for personal property taxes and business license taxes and a penalty of five thousand dollars ($5,000) shall be assessed. (*As added by Ch.* 700, *Laws* 1982; *as amended by Ch.* 938, *Laws* 1984 *and by Ch.* 324, *Laws* 1986, *effective July* 14, 1986.)

[¶ 220-660]

(g) The Franchise Tax Board shall redetermine the rate of tax for banks and corporations determined in 1979 (and 1980 if applicable), taking into account additional local tax billings prior to January 1, 1982, resulting from the final court decision not to uphold the application of the tax rate provided by Article XIII A of the Constitution to the 1978-79 unsecured roll. Any additional taxes resulting from the redetermined rate will be due and payable within 30 days of mailing of a notice and demand by the Franchise Tax Board. In making the redetermination, the Franchise Tax Board shall utilize the statistical sampling method provided in subdivision (e), except that business license taxes shall not be taken into account. (*As added by Ch.* 838, *Laws* 1981, *and as amended by Ch.* 700, *Laws* 1982; *Ch.* 938, *Laws* 1984, *effective September* 6, 1984.)

(*Sec.* 23186 *is as amended by Ch.* 700, *Laws* 1982; *Ch.* 938, *Laws* 1984; *Ch.* 324, *Laws* 1986; *Ch.* 11, *Laws* 1988, *applicable to income years beginning on or after January* 1, 1987.)

[¶ 220-664]

Uncodified Sec. 2, Ch. 324, Laws 1986. [Interest allowed.] Interest on refunds of taxes resulting from the rate applicable to income years ended in 1983 as provided by this act shall be allowed pursuant to Section 26080 of the Revenue and Taxation Code. (*As added by Ch.* 324, *Laws* 1986, *effective July* 14, 1986.)

[¶ 220-666]

Uncodified Sec. 3, Ch. 324, Laws 1986. [Explanatory material.] In 1979, several amendments were made to Section 23186 of the Revenue and Taxation Code by Chapter 1150 of the Statutes of 1979. One of the amendments required the Franchise Tax Board to determine the annual bank tax rate with historical data rather than data for the current income year. The change was effective for income years ending in 1982 and thereafter. The change was not noticed by the Franchise Tax Board until 1985, and at that time, the rate for 1982 and 1983 had already been determined by the Franchise Tax Board using current, rather than historical data. The rates were determined after notice and public hearings were held in which the public and banking/financial industry were invited to inspect and question the data base.

The discovery by the Franchise Tax Board in 1985 was immediately communicated to all interested parties and the 1984 rate was thereafter determined by the Franchise Tax Board using historical rather than current data, in compliance with the 1979 amendment.

As the Franchise Tax Board had determined the 1983 rate using current (1983) data, the 1983 data was already available so it was used again to determine the 1984 rate. This rate, 10.930 percent is the rate reflected in Section 23186 of the Revenue and Taxation Code for income years ending in 1984, as provided by this act.

For income years ending in 1983, the available 1982 data (already used to determine the 1982 rate) would result in a rate for income years ending in 1983 of 10.907 percent, which is the rate reflected in Section 23186 of the Revenue and Taxation Code for income years ending in 1983, as provided by this act.

For income years ending in 1982, there is no available 1981 data because for that year the rate was statutorily set at 11.6 percent, so there was no need to collect data for that year to determine the rate. Collecting sufficient 1981 data to determine the 1982 bank tax rate will be difficult, if not impossible to do. Some taxpayer records have been destroyed. Collection of the necessary data will be very burdensome on general corporations and will result in significant administration costs for the Franchise Tax Board. At best, only incomplete data could be used to determine the 1982 rate. As time passes, the difficulty of obtaining the necessary data increases rapidly. As an alternative to recomputing the 1982 bank tax rate based on incomplete data, the 1982 rate already determined by the Franchise Tax Board based on current data is within a reasonable historical experience projection range. That rate, 10.907 percent, is therefore the rate reflected in Section 23186 of the Revenue and Taxation Code for income years ending in 1982, as provided by this act.

The Legislature therefore finds and declares that because of the difficulty, if not impossibility, of collecting the data necessary to determine the 1982 bank tax rate with reasonable accuracy, and because of the resulting burden on general corporations and the administration expense of the Franchise Tax

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Board, it is in the best interest of the state to statutorily set the bank tax rate for income years ending in 1982 as 10.907 percent. (*As added by Ch.* 324, *Laws* 1986, *effective July* 14, 1986.)

[¶ 220-670]

Sec. 23186.1. [Board to determine percentage.] The Franchise Tax Board, after public hearing and opportunity given to examine the data on which its determination is based, shall determine not later than the 31st day of January of the second calendar year following the calendar year and fiscal year to which the rate of tax is applicable the average percentage of net income specified in section 23186. Within 30 days after its determination, the Franchise Tax Board shall mail notice of its determination and the amount of tax payable or refundable, as the case may be, on the basis of such determination to all banks and financial corporations affected thereby, which are then classified on its records as banks or financial corporations. If additional tax is payable such determination shall be treated as a notice and demand for payment but shall not be considered a deficiency assessment within the meaning of Article 1 of Chapter 20. The data gathered by the Franchise Tax Board in determining the rate, referred to herein, shall be made available to the taxpayers affected by such determination at the time and in the manner prescribed by regulations adopted by the Franchise Tax Board.

[¶ 220-671]

Sec. 23186.2. [Judicial determination of rate; taxpayer relieved of liability to extent of excess.] If it be judicially determined that the rate of tax on any taxpayer is higher than is authorized by law such taxpayer shall be relieved of liability for any tax imposed by this part only to the extent of the excess beyond that legally authorized.

[¶ 220-673]

Sec. 23187. [Personal property tax receipts.] Upon the request of a taxpayer under this chapter, the tax-collecting officer of a county, city, or other political subdivision of this state, shall furnish an official receipt for real and personal property taxes paid to him setting forth a description of such property, the assessed valuation thereof, the rate of tax, the amount of taxes paid, and the beginning and ending of the year for which the taxes are paid.

[¶ 220-678]

Sec. 23188. [Reference to erroneous subsection not fatal.] In the event that taxes, interest and penalties have been or shall be assessed against, paid by or collected from a taxpayer under a subsection of Section 23181 or 23183.1, which assessment, payment or collection should have been made under a different subsection of such sections, such taxes, interest and penalties shall be considered as having been assessed, paid or collected under such different subsection as of the date or dates they were made.

Article 3.5

Credit for Prepaid Tax

[¶ 220-760]

Sec. 23201. [Determination of credit in year of dissolution or withdrawal.] (a) In the case of a taxpayer whose tax for the first taxable year was computed under Sections 23222 to 23224, inclusive (or corresponding sections of prior laws), there shall be allowed as a credit against the tax for the taxable year of dissolution or withdrawal, the excess of the tax paid over the minimum tax for the first taxable year which constituted a full 12 months of doing business in this state and whose income has been included in the measure of tax of a succeeding taxable year.

(b) Any credit previously allowed under this section or for a year in which the taxpayer ceased doing business shall not be allowed again in computing a credit under this section.

[¶ 220-765]

Sec. 23202. [Transferees in a reorganization.] (a) In the case of a taxpayer which has been a transferee in a reorganization to which Sections 23251 to 23254, inclusive (or corresponding sections of prior laws), were applicable, there shall be allowed as a credit for the taxable year of dissolution or withdrawal, the excess of the tax paid over the minimum tax paid by prior transferors or by the transferee as a transferor under Sections 23222 to 23224, inclusive (or corresponding sections of prior laws), for the first taxable year of the transferors which constituted a full 12 months of doing business and whose income has been included in the measure of tax of a succeeding taxable year.

(b) The credit allowable under this section shall be in addition to any credit which may be allowable to the taxpayer under Section 23201. However, any credit previously allowed under Section 2301 [23201], this section or for a year in which the taxpayer or transferor ceased doing business, shall not be allowed again in computing a credit under this section.

[¶ 220-770]

Sec. 23203. [Submission of evidence for credit.] The credits provided by Sections 23201 and 23202 shall be allowable only upon submission by the taxpayer of evidence establishing to the satisfaction of the Franchise Tax Board the amount of the tax paid pursuant to Sections 23222 to 23224, inclusive (or corresponding sections of prior laws), and with respect to which the credit is claimed.

[¶ 220-775]

Sec. 23204. [Statute of limitations for filing claim.] (a) No credit under this article shall be allowed or made after four years from the last day prescribed for filing the return for the taxable year of dissolution or withdrawal, or within the periods prescribed under Article 1 of Chapter 22, whichever period expires the latest, unless before the expiration of such period a claim therefor is filed by the taxpayer.

(b) Notwithstanding the provisions of Section 23204(a), no credit under this article shall be allowed or made to a taxpayer which has been suspended for a period of four continuous years beginning on or after January 1, 1975.

[The next page is 15,899.]

Article 4

Commencing Corporations

[¶ 220-850]

Sec. 23221. [Minimum tax prepayment.] A corporation which incorporates under the laws of this state or qualifies to transact intrastate business in this state shall thereupon prepay the minimum tax provided in Section 23153, except that any credit union shall thereupon prepay a tax of twenty-five dollars ($25). The prepayment shall be made to the Secretary of State with the filing of the articles of incorporation or the statement and designation by foreign corporation. The Secretary of State shall transmit the amount of the prepayment to the Franchise Tax Board. The Franchise Tax Board shall certify to the Secretary of State on an individual or class basis those domestic or foreign corporations which are exempt from prepayment or for which prepayment to the Secretary of State is waived.

[¶ 220-856]

Sec. 23222. [Computation of tax for commencing corporation.] (a) If a taxpayer commences to do business in this state during its first taxable year its tax for that year shall be adjusted upon the basis of the net income received during that taxable year, at the rate applicable to that year, a credit being allowed for the prepayment of the minimum tax. The return for the first taxable year, which shall be filed within 2 months and 15 days after the close of that year, shall also be the basis for the tax of said taxpayer for its second taxable year, if its first taxable year is a period of 12 months. In every case in which the first taxable year of a taxpayer constitutes a period of less than 12 months, or in which a taxpayer does business for a period of less than 12 months during its first taxable year, said taxpayer shall pay as a prepayment of the tax for its second taxable year a tax based on the income for the first taxable year computed under the law and at the rate applicable to the second taxable year, the same to be due and payable at the same times and in the same manner as if that amount were the entire amount of its tax for that year; and upon the filing of its tax return within 2 months and 15 days after the close of the second taxable year it shall pay a tax for said year, at the rate applicable to the year, based upon its net income received during that year, allowing a credit for the prepayment; but in no event, except as provided in Section 23332, shall the tax for the second taxable year be less than the amount of the prepayment for that year, and said return for its second taxable year shall also be the basis for the tax of said taxpayer for its third taxable year, if the second taxable year constitutes a period of 12 months.

(b) The provisions of subdivision (a) shall be applicable only if a taxpayer commenced doing business in this state before January 1, 1972.

[¶ 220-862]

Sec. 23222a. [Computation in case of short periods.] In every case in which the second or succeeding taxable years of a commencing taxpayer constitute a period of less than 12 months or in which the taxpayer does business for a period of less than 12 months during its second or succeeding taxable years, the tax for such year or years shall be measured by the income of that period or periods subject to the continuation of the prepayment procedure outlined in Section 23222. In no event shall the income of any period or periods herein described be used as the measure of the tax for the succeeding taxable year, other than the prepayment, until the last short period is succeeded by a taxable period of 12 months, in which case the income of the last short period shall, if greater than the income of the 12-month period, constitute the measure of the tax for such 12-month period.

Thereafter the procedure outlined in Section 23222, in respect of the second and third taxable years, shall apply and the taxpayer shall not be subject to the provisions of this section.

In the event that a taxpayer is dissolved or withdraws from this state while subject to the provisions of this section, its tax for the year of dissolution or withdrawal shall be measured by its net income for such year. However, in no event shall the tax be less than the minimum tax provided by Section 23153.

The provisions of this section shall be applicable only if a taxpayer commenced doing business in this state before January 1, 1972.

[¶ 220-874]

Sec. 23223. [Credit for minimum paid under Sec. 23153.] (a) When any taxpayer commences to do business in this state for the first time in any taxable year other than the year of incorporation or qualification, its tax for that taxable year and for the succeeding taxable year shall be computed in accordance with the provisions of Section 23222 relative to first and second taxable years, a credit being allowed for any tax payable under Section 23153 for the year in which it commences to do business.

(b) The provisions of subdivision (a) shall be applicable only if a taxpayer commenced doing business in this state before January 1, 1972.

[¶ 220-879]

Sec. 23224. [Computation of tax upon change from corporation income to franchise tax.] (a) Notwithstanding the provisions of Section 23222 and Section 23223, if a corporation, which has been subject to the provisions of Chapter 3 commences to do business in this state, its tax shall be computed as follows:

(1) Such corporation shall pay a tax under Chapter 3 for the whole of the year it commences to do such business;

(2) Such corporation shall, for the taxable year succeeding the year it commences to do business in this state, pay a tax under this chapter measured by its income for that taxable year;

(3) Such corporation shall, for its third taxable year, pay a tax, under this chapter, measured by its income for its second taxable year;

(4) Notwithstanding any other provisions of this part, such corporation shall file its return for such second and third taxable years on or before the 15th day of the third month following the close of its second taxable year.

(b) The provisions of subdivision (a) shall be applicable only if a taxpayer commenced doing business in this state before January 1, 1972.

[¶ 220-887]

Sec. 23224.5. [Tax on commencing corporation subject to corporate income tax.] (a) After December 31, 1971, if a corporation which has been subject to the provisions of Chapter 3 commences to do business in this state, such corporation shall pay a tax under Chapter 3 for the whole of the taxable year it commences to do such business.

(b) For the purposes of Sections 23151.1 and 23183.1, the first taxable year subsequent to the taxable year the corporation commences to do such business (as described in subdivision (a)) shall be treated as the taxable year of commencement.

[¶ 220-896]

Sec. 23225. [Due date for payment in excess of minimum.] The adjusted tax, as provided in Sections 23222 to 23224.5, inclusive, for any taxable year in excess of the prepayment for that year, shall be due and payable as provided in Chapter 19 (commencing with Section 25401). (*As amended by Ch.* 193, *Laws* 1984, *effective January* 1, 1985.)

[¶ 220-903]

Sec. 23226. [Apportionment of income of taxpayer reporting on deferred basis.] In the case of a taxpayer taxable in the manner provided in Sections 23222 to 23224.5, inclusive, reporting income from any source on a deferred basis, the Franchise Tax Board is authorized to distribute or apportion such income, or deductions applicable thereto, if it determines that such distribution or apportionment is necessary in order to prevent avoidance of taxes or clearly to reflect the income of the taxpayer.

Article 5

Reorganized Corporations

[¶ 220-970]

Sec. 23251. ["Reorganization" and "control" defined.] The term "reorganization" as used in this chapter, shall have the same meaning as that term is defined in Section 368 of the Internal Revenue Code. (*As amended by Ch.* 938, *Laws* 1984, *effective September* 6, 1984.)

[¶ 220-980]

Sec. 23253. [Transferor income taxable to transferee; return.] Section 381(b) of the Internal Revenue Code, relating to operating rules, shall apply in determining the close of the income year. If a short period year is required by use of Section 381(b) of the Internal Revenue Code, the transferor's short year tax shall be computed using the provisions of Section 23151.1 for general corporations or Section 23181 for banks and financial corporations. (*As amended by Ch.* 938, *Laws* 1984, *effective September* 6, 1984.)

Article 6

Corporations Resuming Business

[¶ 221-080]

Sec. 23281. [Payment due dates upon resuming business; exception.] (a) When a taxpayer ceases to do business within the state during any taxable year and does not dissolve or withdraw from the state during that year, and does not resume doing business during the succeeding taxable year, its tax for the taxable year in which it resumes doing business shall be the greater of the following:

(1) The tax computed upon the basis of the net income of the income year in which it ceased doing business, except where the income has already been included in the measure of a tax imposed by this chapter.

(2) The minimum tax prescribed in Section 23153.

(b) The tax shall be due and payable at the time the corporation resumes doing business, or on or before the 15th day of the third month following the close of its income year, whichever is later. All the provisions of this part relating to delinquent taxes shall be applicable to the tax if it is not paid on or before its due date.

(c) This section does not apply to a corporation which became subject to Chapter 3 (commencing with Section 23501) after it discontinued doing business in this state (see Section 23224.5). (*As amended by Ch.* 193, *Laws* 1984, *effective January* 1, 1985.)

[¶ 221-085]

Sec. 23282. [Computation of tax on revivor of corporation in year other than taxable year of suspension or forfeiture.] (a) The tax imposed upon any taxpayer which has suffered the suspension or forfeiture provided in Section 23301, and which revives in any taxable year other than the taxable year in which suspension or forfeiture occurred, shall be computed in the same manner as provided in Sections 23222 to 23224, inclusive, relative to the computation of taxes upon taxpayers commencing to do business for the first time after incorporation or qualification. In addition to the taxes, penalties, and interest specified in Section

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23305, such taxpayer shall prepay a tax in an amount equal to the minimum tax provided for in Section 23153 as a condition precedent to the issuance of a certificate of revivor.

[¶ 221-087]

(b) After December 31, 1971, the tax imposed upon any taxpayer which has suffered the suspension or forfeiture provided in Section 23301, and which revives in any taxable year other than the taxable year in which suspension or forfeiture occurred, shall be—

(1) In the case of a taxpayer which was doing business in the year next preceding the year in which revivor took place, computed upon the basis of the net income for that next preceding income year,

(2) In the case of a taxpayer which resumed doing business in the year of revivor, computed upon the basis of the net income for the year in which it ceased doing business, unless such income is or has otherwise been subject to tax,

(3) In the case of a taxpayer which first commences to do business in the year of revivor, the minimum tax provided in Section 23153,

(4) In no event less than the minimum tax provided in Section 23153.

In addition to the taxes, penalties, and interest specified in Section 23305, such taxpayer shall prepay the mimimum tax imposed by this subdivision as a condition precedent to the issuance of a certificate of revivor.

Article 7

Suspension and Revivor

[¶ 221-170]

Sec. 23301. [Suspension of corporate powers.] Except for the purposes of filing an application for exempt status or amending the articles of incorporation as necessary either to perfect that application or to set forth a new name, the corporate powers, rights and privileges of a domestic taxpayer, may be suspended, and the exercise of the corporate powers, rights and privileges of a foreign taxpayer in this state may be forfeited if any of the following conditions occur:

(a) If any tax, penalty or interest, or any portion thereof, which is due and payable either at the time the return is required to be filed, or on or before the 15th day of the ninth month following the close of the income year, is not paid on or before 6 p.m. on the last day of the 12th month after the close of the income year.

(b) If any tax, penalty or interest, or any portion thereof, due and payable upon notice and demand from the Franchise Tax Board, or due and payable under Section 25936, is not paid on or before 6 p.m. on the last day of the 11th month following the due date of the tax.

(c) If any liability, or any portion thereof, which is due and payable under Article 5 (commencing with Section 18681) of Chapter 18 of Part 10, is not paid on or before 6 p.m. on the last day of the 11th month following the date that the tax liability is due and payable. (*As amended by Ch.* 600, *Laws* 1984; *Ch.* 970, *Laws* 1988, *effective January* 1, 1989.)

[¶ 221-178]

Sec. 23301.5. [Suspension of corporate powers for failure to file.] Except for the purposes of filing an application for exempt status or amending the articles of incorporation as necessary either to perfect that application or to set forth a new name, the corporate powers, rights and privileges of a domestic corporation may be suspended, and the exercise of the corporate powers, rights and privileges of a foreign taxpayer in this state may be forfeited if a taxpayer fails to file a return. (*As amended by Ch.* 600, *Laws* 1984, *effective January* 1, 1985.)

[¶ 221-187]

Sec. 23302. [Suspension or forfeiture effective on transmittal of name to secretary of state.] The Franchise Tax Board shall transmit the names of taxpayers to the Secretary of State as to which the suspension or forfeiture provisions of Section 23301, 23301.5 or 23775 are or become applicable, and the suspension or forfeiture therein provided for shall thereupon become effective and the certificate of the Secretary of State shall be prima facie evidence of such suspension or forfeiture. (*As amended by Ch.* 235, *Laws* 1977, *effective January* 1, 1978.)

[¶ 221-193]

Sec. 23303. [Doing business while suspended; taxability.] Notwithstanding the provisions of Section 23301 or Section 23301.5, any bank or corporation which transacts business or receives income within the period of its suspension or forfeiture shall be subject to tax under the provisions of this chapter.

[¶ 221-200]

Sec. 23304. [Contracts voidable while suspended.] Every contract made in violation of this article is hereby declared to be voidable, at the instance of any party other than the taxpayer.

[¶ 221-206]

Sec. 23305. [Relief from suspension or forfeiture; application for revivor.] Any taxpayer which has suffered the suspension or forfeiture provided for in Section 23301 or Section 23301.5 may be relieved therefrom upon making application therefor in writing to the Franchise Tax Board and upon payment of the tax and the interest and penalties for nonpayment of which the suspension or forfeiture occurred, together with all other taxes, deficiencies, interest and penalties due under this part, and upon the issuance by the Franchise Tax Board of a certificate of revivor. Application for such certificate on behalf

of any domestic bank or corporation which has suffered such suspension may be made by any stockholder or creditor, by a majority of the surviving trustees or directors thereof, by an officer, or by any other person who has interest in the relief from suspension. Application for such certificate may be made by any foreign bank or corporation which has suffered such forfeiture, by any stockholder or creditor thereof, by an officer, or by any other person who has interest in the relief from forfeiture. (*As amended by Ch.* 498, *Laws* 1984, *effective January* 1, 1985.)

[¶ 221-212]

Sec. 23305a. [Certificate of revivor; indorsement by Secretary of State.] Before such certificate of revivor is issued by the Franchise Tax Board, it shall obtain from the Secretary of State an endorsement upon such application of the fact that the name of the taxpayer then meets the requirements of subdivision (b) of Section 201 of the Corporations Code in the case of a domestic bank or corporation or of subdivision (b) of Section 2106 of the Corporations Code in the case of a foreign corporation. The reference to amendment of the articles of incorporation to set forth a new name contained in Sections 23301, 23301.5 and 23775 includes in the case of a foreign corporation the filing of an amended statement and designation to set forth its new name or to set forth an assumed name under subdivision (b) of Section 2106 of the Corporations Code. Upon the issuance of such certificate by the Franchise Tax Board the taxpayer therein named shall become reinstated but such reinstatement shall be without prejudice to any action, defense or right which has accrued by reason of the original suspension or forfeiture. The certificate of revivor shall be prima-facie evidence of such reinstatement and such certificate may be recorded in the office of the county recorder of any county of this state.

[¶ 221-220]

Sec. 23305b. [Revival of corporation without tax payment.] Notwithstanding the provisions of Section 23305, the Franchise Tax Board may revive a corporation to good standing without full payment of the taxes, penalties and interest due if it determines that the revivor will improve the prospects for collection of the full amount due. Such revivor may be limited as to time or may limit the functions the revived corporation can perform, or both. The corporate powers rights, and privilege's [sic] may again be suspended or forfeited if the Franchise Tax Board determines that the prospects for collection of the full amount due have not been improved by the revivor of the corporation. (*As addded by Ch.* 426, *Laws* 1980, *effective January* 1, 1981.)

Article 8

Dissolution or Withdrawal

[¶ 221-300]

Sec. 23331. [Certificate of dissolution or withdrawal; filing; effective date.] For the purposes of this article, the effective date of dissolution of a corporation is the date on which the certified copy of the court decree, judgment or order declaring the corporation duly wound up and dissolved is filed in the office of the Secretary of State or the date on which the certificate of winding up and dissolution is filed in the office of the Secretary of State. For the purposes of this article, the effective date of withdrawal of a foreign corporation is the date on which the certificate of withdrawal is filed in the office of the Secretary of State.

[¶ 221-307]

Sec. 23332. [Ratio of tax for portion of year of dissolution or withdrawal.] (a) Except in the case of a taxpayer subject to the provisions of Section 23222a, any taxpayer which is dissolved or withdraws from the state during any taxable year shall pay a tax only for the months of the taxable year which precede the effective date of such dissolution or withdrawal, according to or measured by (1) the net income of the preceding income year or (2) a percentage of net income determined by ascertaining the ratio which the months of the taxable year, preceding the effective date of dissolution or withdrawal, bears to the months of the income year, whichever is the lesser amount. As to financial corporations, the offset from the tax for the months of such taxable year prior to the effective date of such dissolution or withdrawal shall not exceed that proportion of the offset computed under Sections 23184 to 23185b, inclusive, which the number of said months prior to the effective date of such dissolution or withdrawal bears to the number of months of the preceding income year. The taxes levied under this chapter shall not be subject to abatement or refund because of the cessation of business or corporate existence of any taxpayer pursuant to a reorganization, consolidation, or merger (as defined by Section 23251). In any event, each corporation shall pay a tax not subject to offset for such period in an amount equal to the minimum tax prescribed by Section 23153.

(b) The provisions of subdivision (a) shall be applied only with respect to taxpayers which dissolve or withdraw before January 1, 1973. On and after such date, the tax for the taxable year in which the taxpayer ceases doing business, dissolves or withdraws shall be determined under the appropriate provisions of Section 23151.1, 23181 or 23183, whichever is applicable.

However, if all of the following conditions are satisfied, a minimum franchise tax shall not be imposed with respect to the taxable year in which

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the taxpayer ceases doing business, dissolves, or withdraws:

(1) The taxpayer does not do business in this state at any time during that taxable year.

(2) The taxpayer, pursuant to Section 23334, files a request for a tax clearance certificate at least 30 days before the beginning of that taxable year.

(3) The taxpayer, pursuant to Section 23334, satisfies all requirements pertaining to the issuance of the tax clearance certificate at least 30 days before the beginning of that taxable year.

(4) The taxpayer files a certificate of dissolution or withdrawal with the Secretary of State, in accordance with Section 23331, by the expiration date of the certificate of tax clearance issued by the Franchise Tax Board. (*As amended by Ch.* 556, *Laws* 1989, *applicable to taxable years beginning on or after January* 1, 1989.)

[¶ 221-314]

Sec. 23332.5. [Financial corporation; determination of tax.] If a financial corporation ceases doing business, dissolves, or withdraws from the state during any taxable year beginning after December 31, 1972, the tax for the taxable year during which cessation of doing business, dissolution or withdrawal occurs shall be computed as prescribed by subdivision (b) or (d) of Section 23183, 23183.1, or 23183.2. In determining the amount of such tax, a financial corporation will be allowed an offset against the amounts paid during such taxable year to this state as personal property taxes, or as license fees or excise taxes as described in subdivisions (a) to (d), inclusive, of Section 23184. However, after the allowance of such offsets, the tax on a financial corporation shall not be less than the tax provided in Section 23184.

[¶ 221-325]

Sec. 23333. [Payments on dissolution before rate determined.] (a) A taxpayer subject to Section 23186 shall, if it dissolves or withdraws prior to the date the rate is determined under Section 23186, pay a tax under Section 23332 at the maximum rate prescribed by Section 23186. If the rate is subsequently determined to be less than the maximum prescribed by Section 23186, a refund shall, within 30 days of that determination, be made as prescribed by Article 1 (commencing with Section 26071) of Chapter 22.

(b) That part of the tax thus determined which is in excess of the rate specified in Section 23151 shall be collected as a demand for second installment under Article 3 (commencing with Section 25551) of Chapter 19. (*As amended by Ch.* 193, *Laws* 1984; *Ch.* 440, *Laws* 1987, *operative for taxable or income years beginning on or after January* 1, 1987.)

[¶ 221-331]

Sec. 23334. [Certificate of clearance.] No decree of dissolution shall be made and entered by any court, nor shall the county clerk of any county or the Secretary of State file any such decree, or file in the case of a credit union incorporated under the California Credit Union Law a certificate of election to dissolve or in the case of any other taxpayer any other document by which the term of existence of such taxpayer shall be reduced or terminated, nor shall the Secretary of State file any certificate of the surrender by a foreign corporation of its right to do intrastate business in this State unless the taxpayer obtains from the Franchise Tax Board and files with the said court, county clerk or Secretary of State as the case may be, a certificate to the effect the Franchise Tax Board is satisfied from the available evidence that all taxes imposed by this chapter have been paid or are secured by bond, deposit or otherwise. Within 30 days after receiving a request for a certificate, the Franchise Tax Board shall either issue the certificate or notify the person requesting the certificate of the amount of tax that must be paid or the amount of bond, deposit or other security that must be furnished as a condition of issuing the certificate. The issuance of the certificate shall not relieve the taxpayer or any individual, bank, or corporation from liability for any taxes, penalties, or interest imposed by this part, nor shall the issuance of the certificate in the case of any credit union which revokes its election to wind up and dissolve, relieve such credit union of any taxes, or interest that would have been imposed under this part had such election not been filed.

Article 9

Affiliated Railroads

[¶ 221-401]

Sec. 23361. ["Affiliated group" defined.] "Affiliated group" means one or more chains of corporations connected through stock ownership with a common parent corporation if during the period when the income was accrued or realized and on the sixteenth day of the first month after the close of the income year—

(a) At least 80 percent of the stock of each of the corporations, except the common parent corporation, is owned directly by one or more of the other corporations; and

(b) The common parent corporation owns directly at least 80 percent of the stock of at least one of the other corporations; and

(c) Each of the corporations except the common parent corporation is either (1) a corporation whose principal business is that of a common carrier by railroad or (2) a corporation the assets of which consist principally of stock in such corporations and which does not itself operate a business other than that of a common carrier by railroad. For the purpose of determining whether the principal business of a corporation is that of a common carrier by railroad, if a common carrier by railroad has leased its railroad properties and such properties are oper-

ated as such by another common carrier by railroad, the business of receiving rents for such railroad properties shall be considered as the business of a common carrier by railroad.

The provisions of this section shall not preclude the application of Chapter 17 (commencing with Section 25101) of this part.

Except in paragraph (c) "stock" does not include nonvoting stock which is limited and preferred as to dividends.

[¶ 221-407]

Sec. 23362. [Consolidated return of affiliated group.] An affiliated group, subject to the provisions of this article, shall have the privilege of making a consolidated return for the taxable year in lieu of separate returns. The making of a consolidated return shall be upon the condition that all the corporations, which have been members of the affiliated group at any time during the income year for which the return is made, consent to all regulations under Section 23363 prescribed prior to the making of such return and the making of a consolidated return shall be considered as such consent. In the case of a corporation, which is a member of the affiliated group for a fractional part of the income year, the consolidated return shall include the income of such corporation for such part of the income year as it is a member of the affiliated group. In the case of a common parent company which is not itself a common carrier by railroad the consolidated return shall include on a consolidated-return basis only the income received from affiliates which are common carriers by railroad.

¶ 221-414]

Sec. 23363. [Board's regulations on consolidated returns.] The Franchise Tax Board shall prescribe such regulations as it may deem necessary in order that the tax liability of any affiliated group of corporations making a consolidated return and of each corporation in the group, both during and after the period of affiliation, may be determined, computed, assessed, collected, and adjusted in such manner as to reflect the proper income.

[¶ 221-420]

Sec. 23364. [Group members severally liable for tax.] If a consolidated return is made subject to the provisions of this article, the tax imposed under this chapter shall be computed as a unit upon the consolidated net income of the group except as hereinafter provided. The parent corporation and each subsidiary, a member of the group during any part of a consolidated period, shall be severally liable for the tax, including any deficiency in respect thereof, computed upon the consolidated net income of the group. If a subsidiary by reason of a bona fide sale of stock for fair value has ceased to be a member of the affiliated group, its liability shall remain unchanged, except that if such cessation occurred prior to the date upon which any such deficiency is assessed, such deficiency, in the case of such former subsidiary, shall be reduced to an amount equal to such part as may be allocable to it upon the basis of the consolidated net income properly assignable to it. In no case, however, shall any demand for the payment of any deficiency be made, or any proceeding in court for the collection thereof be begun against such former subsidiary prior to the determination by the Franchise Tax Board that the amount of the deficiency cannot be collected from the parent corporation and the corporations, if any, remaining members of the affiliated group.

[¶ 221-426]

Sec. 23364a. [Computation of tax for commencing corporation who is member of affiliated group.] Where a member of an affiliated group filing a consolidated return is a corporation commencing to do business in this state for the first time after August 27, 1937, its tax for the taxable year of commencement shall be the tax for such year as provided for in subdivisions (a) and (b) of Section 23151.1.

[The next page is 15,931.]

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[¶ 10-100] RATE OF TAX

Franchise and Corporation Income Taxes ..... ¶ 10-105
Banks and Financial Corporations ..... ¶ 10-109
Offset for Financial Corporations ..... ¶ 10-113
Minimum Tax Rate ..... ¶ 10-117
Tax Rates for Years in Which Rate Changes ..... ¶ 10-123
Alternative Minimum Tax (IRC Secs. 53, 55—59) ..... ¶ 10-125
Tax on Tax Preference Items (Income Years Beginning Before January 1, 1988) ..... ¶ 10-128

[¶ 10-105] **Franchise and Corporation Income Taxes.**—The franchise and corporation income tax rate for calendar or fiscal years ending in 1987 and thereafter is 9.3 percent, a decrease from the former rate of 9.6% (.01).

For fiscal years ending in 1987, the corporate tax rate will be prorated. Therefore, if a corporation has a fiscal year that ends in 1987, its tax rate will be a composite of the 9.6% rate for 1986 and the 9.3% rate for 1987. The following chart indicates the appropriate prorated 1987 tax rate (.015):

Accounting Period Ending	Composite Rate
January	9.575%
February	9.550%
March	9.525%
April	9.500%
May	9.475%
June	9.450%
July	9.425%
August	9.400%
September	9.375%
October	9.350%
November	9.325%
December	9.300%

The tax rate for banks and financial corporations is discussed below at ¶ 10-109.

.01 Sec. 23151(g), Rev. and Tax. Code, ¶ 220-468.

.015 Tax News, Franchise Tax Board, November 1987.

.13 **Constitutional requirements to increase tax rates.**—Any increase in the bank and corporation tax must be imposed by a two-thirds majority of the House, as specified in Article XIIIA of the state constitution (Proposition 13), rather than by a simple majority of the House, as prescribed by Article XIII, Secs. 27 and 28. The ballot summary of Article XIIIA states that a two-thirds vote of the legislature is required to enact any change in state taxes; bank and corporation taxes are not excluded from this requirement. The purpose of Secs. 27 and 28 of Article XIII, which was to provide uniform tax treatment between banks and corporations and other entities, was not violated by Article XIIIA. Instead, Article XIIIA alters the standard for tax increases uniformly by requiring a two-thirds majority vote for all state tax increases. *Opinion of the Attorney General,* No. 81-1212, August 18, 1982.

[¶ 10-109] **Banks and Financial Corporations.**—Banks pay a franchise tax at a rate determined annually by the Franchise Tax Board on their net income for the next preceding income year (.01). The rate is determined by the Board before January 31st of the second calendar year following the calendar and fiscal years to which the tax rate is applicable; the Board gives notice of the rate for the year to each bank and financial corporation for which it has a record (.02). The bank tax rate for the 1988 income year for taxpayers that are not S corporations is 10.668%; the rate for the 1987 income year was 10.644%; the rate was 11.058% for the 1986 income year; the rate was 10.820% for the 1985 income year; the rate was 10.930% for the 1984 income year, and 10.907% for the 1983 income year.

For fiscal year taxpayers that are not S corporations with income years ending in 1988, the following chart indicates the appropriate prorated tax rate (.047):

Income Years Ending in 1988 Month Ending	Rate	Month Ending	Rate
January	10.646	July	10.658
February	10.648	August	10.660
March	10.650	September	10.662
April	10.652	October	10.664
May	10.654	November	10.666
June	10.656		

The tax rate for the 1988 income year for calendar year S corporation taxpayers that are financial corporations is 3.868%. For fiscal year S corporation taxpayers that are financial corporations, the following chart indicates the appropriate prorated tax rate for the 1988 income year (.047):

Month Ending	Rate	Month Ending	Rate
January	3.846	July	3.858
February	3.848	August	3.860
March	3.850	September	3.862
April	3.852	October	3.864
May	3.854	November	3.866
June	3.856		

The rate is determined on the basis of the percentage of the net income of all corporations that is paid as franchise taxes plus the amounts of taxes paid to the state or to local governments by such corporations as personal property and business license taxes. The rate so determined may not be greater than 11.7 percent (.03). The FTB is authorized to collect business license tax information from cities in order to verify local business license taxes reported by corporations (.03).

Upon notice and demand, a taxpayer is required to furnish the FTB with whatever information regarding personal property taxes, business license taxes, or net income is necessary to determine the rate of tax. The information must be furnished on FTB Form 1090, Schedules T-1 and T-2. If a taxpayer declines or refuses to provide the information demanded, a penalty of $5,000 may be imposed, along with disallowance of any deductions claimed by the taxpayer for personal property taxes and business license taxes (.03).

Financial corporations pay a franchise tax at the same rate as that paid by banks (.03, .04). See ¶ 10-036 for the definition of "financial corporation," and ¶ 10-113 concerning the personal property tax offset for financial corporations.

If a court determines that an incorrect rate has been applied to a taxpayer, the financial corporation or bank is relieved of tax liability only to the extent of the excess tax rate (.05).

- *Correction of 1983 bank and financial corporation tax rate*

A 1986 law changed the bank tax rate for income years ending in 1983 from 10.930% to 10.907% because the Franchise Tax Board had overlooked a previous legislative change that required that the tax be determined annually using historical data rather than data for the current year (.045). Interest at the statutory rate is payable on refunds that are the result of changing the rate for income years ending in 1983 (.045).

The Franchise Tax Board issued a notice of bank tax rate redetermination for each month of the income year ending in 1984. These month-by-month rates reflect the revision in 1983 rates. The FTB is reviewing all 1983 returns and all 1984 fiscal year ending returns to determine if a refund adjustment is required (.046).

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§ 25137-4. Banks and Financial Corporations—Allocation and Apportionment of Income.

(a) Definitions.

(1) "Receipts" for sales factor purposes means gross income including net taxable gain on disposition of assets derived from transactions and activities in the regular course of the taxpayer's trade or business which produce business income.

(2) "Participation loans" means joint loans by more than one bank to a common borrower.

(3) "Business situs" shall be the place at which intangible personal property is employed as capital; or the place where the property is located if possession and control of the property is localized in connection with the taxpayer's business so that substantial use or value attaches to the property.

(b) Business and Nonbusiness Income. All income of banks and financial corporations shall be "business income" unless the income arises from an investment or activity which is not a banking function.

(c) Apportionment of Business Income

The property, payroll and sales factors of the apportionment formula for banks and financial corporations shall be computed pursuant to Sections 25128 through 25137 of the Revenue and Taxation Code and the regulations adopted pursuant thereto except as provided in this regulation.

(1) Property Factor.

(A) In General.

(i) Owned intangible personal property shall be included at its tax basis for federal income tax purposes. Goodwill shall not be included in the property factor.

(ii) Coin and currency shall be taken into account for property factor purposes.

(B) The numerator of the property factor shall include, in addition to items otherwise assigned thereto, the following:

(i) Coin and currency located in this state.

(ii) Intangible personal property owned and used in the business determined as follows:

(I) Assets in the nature of loans (including federal funds sold and banker's acceptances) and installment obligations shall be attributed to this state if the office of the bank or financial corporation at which the customer applied for the loan is located in this state except in cases where the loan is recognized by appropriate banking regulatory authority as being made from and as an asset of an office located in another state, in which case it shall be attributed to the state where that office is located. For purposes of this subclause, the word "applied" means initial inquiry (including customer assistance in preparing the loan application) or submission of a completed loan application, whichever occurs first in time.

(II) A participating bank's portion of a participation loan shall be attributed to this state if the office which enters into the participation is located in this state.

(III) Loans initiated through solicitation by traveling loan officers shall be attributed to this state if the office out of which such officer operates is located in this state except in cases where the loan is recognized by appropriate banking regulatory authority as being made from and as an asset of an office located in another state, in which case it shall be attributed to the state where that office is located.

(IV) Bank credit card and travel and entertainment credit card receivables shall be attributed to the state in which the credit card holder resides in the case of an individual or, if a corporation, to the state of the corporation's commercial domicile, provided the taxpayer is taxable in such state. If the taxpayer is not taxable in the state of the individual card holder's residence or commercial domicile of the corporate card holder, such receivables shall be attributed to this state if the taxpayer's commercial domicile is in this state.

(V) Investments of a bank in securities, the income from which constitutes business income, shall be attributed to its commercial domicile except that:

a. Securities used to maintain reserves against deposits to meet fed and state reserve deposit requirements shall be attributed to each s based upon the ratio that total deposits in the state bear to total depo everywhere.

b. Securities owned by a bank but held by a state treasurer or other p lic official or pledged to secure public or trust funds deposited in a bank shall be attributed to the banking office at which such secured posit is maintained.

(VI) Investments of a financial corporation in securities, the inc from which constitutes business income, shall be attributed to its c mercial domicile unless the securities have acquired a business situs e where in which case they shall be attributed to the state of such situ

(iii) Where the taxpayer leases tangible personal property to ano the entire cost of such property shall be attributed to the state of the payer's commercial domicile unless the taxpayer establishes, or the F chise Tax Board is able to establish the location of such property in an er state or states for the entire year and the taxpayer is taxable in the or states where the property is located.

(2) Sales Factor. Numerator. The numerator of the sales factor sha clude, in addition to items otherwise assignable, the following:

(A) Receipts from the lease or rental of tangible personal property be attributed to the state of the taxpayer's commercial domicile unles taxpayer or the Franchise Tax Board is able to establish the locatic such property in another state or states for the entire year and the taxp is taxable in the state or states where the property is located.

(B) Receipts from intangible personal property shall be included i numerator as follows:

(i) Interest and other receipts from assets in the nature of loans (in ing federal funds sold and banker's acceptances) and installment ob tions shall be attributed to this state if the office at which the cust applied for the loan is located in this state except in cases where the is recognized by appropriate banking regulatory authority as being from and as an asset of an office located in another state, in which it shall be attributed to the state where that office is located. For pur of this clause, the word "applied" means initial inquiry (includin tomer assistance in preparing the loan application or submissior completed loan application) whichever occurs first in time.

(ii) Interest income from a participating bank's portion of partici loan shall be attributed to this state if the office which enters into th ticipation is located in this state.

(iii) Interest income from loans solicited by traveling loan of shall be attributed to this state if the office out of which such officer ates is located in this state except in cases where the loan is reco by appropriate banking regulatory authority as being made from an asset of an office located in another state, in which case it shall tributed to the state where that office is located.

(iv) Interest or service charges from bank, travel and entertai credit card receivables and credit card holders' fees shall be attrib the state in which the credit card holder resides in the case of an indi or, if a corporation, to the state of the corporation's commercial do provided the taxpayer is taxable in such state. If the taxpayer is not t in the state of the individual card holder's residence or commercial cile of the corporate card holder, the receipts shall be attributed to t of the taxpayer's commercial domicile.

(v) Merchant discount income derived from bank and financial ration credit card holder transactions with a merchant shall be att to the state in which the merchant is located, provided the taxpaye able in such state. If the taxpayer is not taxable in the state in wh merchant is located, the merchant discount income shall be attrib the state in which the taxpayer's commercial domicile is locate

(vi) Receipts for the performance of fiduciary services are attri to this state if the services are principally performed in this s

(vii) Receipts from investments of a bank in securities from which constitutes business income, shall be attribu mercial domicile except that:

§ 25137-4. Banks and Financial Corporations—Allocation and Apportionment of Income.

(a) Definitions.

(1) "Receipts" for sales factor purposes means gross income including net taxable gain on disposition of assets derived from transactions and activities in the regular course of the taxpayer's trade or business which produce business income.

(2) "Participation loans" means joint loans by more than one bank to a common borrower.

(3) "Business situs" shall be the place at which intangible personal property is employed as capital; or the place where the property is located if possession and control of the property is localized in connection with the taxpayer's business so that substantial use or value attaches to the property.

(b) Business and Nonbusiness Income. All income of banks and financial corporations shall be "business income" unless the income arises from an investment or activity which is not a banking function.

(c) Apportionment of Business Income.

The property, payroll and sales factors of the apportionment formula for banks and financial corporations shall be computed pursuant to Sections 25128 through 25137 of the Revenue and Taxation Code and the regulations adopted pursuant thereto except as provided in this regulation.

(1) Property Factor.

(A) In General.

(i) Owned intangible personal property shall be included at its tax basis for federal income tax purposes. Goodwill shall not be included in the property factor.

(ii) Coin and currency shall be taken into account for property factor purposes.

(B) The numerator of the property factor shall include, in addition to items otherwise assigned thereto, the following:

(i) Coin and currency located in this state.

(ii) Intangible personal property owned and used in the business determined as follows:

(I) Assets in the nature of loans (including federal funds sold and banker's acceptances) and installment obligations shall be attributed to this state if the office of the bank or financial corporation at which the customer applied for the loan is located in this state except in cases where the loan is recognized by appropriate banking regulatory authority as being made from and as an asset of an office located [illegible] another state, in which case it shall be attributed to the state where the [illegible] located. For purposes of this subclause, the word "applied" means initial inquiry (including customer assistance in preparing the loan application) or submission of a completed loan application, whichever occurs first in time.

(II) A participating bank's portion of a participation loan shall be attributed to this state if the office which enters into the participation is located in this state.

(III) Loans initiated through solicitation by traveling loan officers shall be attributed to this state if the office out of which such officer operates is located in this state except in cases where the loan is recognized by appropriate banking regulatory authority as being made from and as an asset of an office located in another state, in which case it shall be attributed to the state where that office is located.

(IV) Bank credit card and travel and entertainment credit card receivables shall be attributed to the state in which the credit card holder resides in the case of an individual or, if a corporation, to the state of the corporation's commercial domicile, provided the taxpayer is taxable in such state. If the taxpayer is not taxable in the state of the individual card holder's residence or commercial domicile of the corporate card holder, such receivables shall be attributed to this state if the taxpayer's commercial domicile is in this state.

(V) Investments of a bank in securities, the income from which constitutes business income, shall be attributed to its commercial domicile except that:

a. Securities used to maintain reserves against deposits to meet federal and state reserve deposit requirements shall be attributed to each state based upon the ratio that total deposits in the state bear to total deposits everywhere.

b. Securities owned by a bank but held by a state treasurer or other public official or pledged to secure public or trust funds deposited in such bank shall be attributed to the banking office at which such secured deposit is maintained.

(VI) Investments of a financial corporation in securities, the income from which constitutes business income, shall be attributed to its commercial domicile unless the securities have acquired a business situs elsewhere in which case they shall be attributed to the state of such situs.

(iii) Where the taxpayer leases tangible personal property to another the entire cost of such property shall be attributed to the state of the taxpayer's commercial domicile unless the taxpayer establishes, or the Franchise Tax Board is able to establish the location of such property in another state or states for the entire year and the taxpayer is taxable in the state or states where the property is located.

(2) Sales Factor. Numerator. The numerator of the sales factor shall include, in addition to items otherwise assignable, the following:

(A) Receipts from the lease or rental of tangible personal property shall be attributed to the state of the taxpayer's commercial domicile unless the taxpayer or the Franchise Tax Board is able to establish the location of such property in another state or states for the entire year and the taxpayer is taxable in the state or states where the property is located.

(B) Receipts from intangible personal property shall be included in the numerator as follows:

(i) Interest and other receipts from assets in the nature of loans (including federal funds sold and banker's acceptances) and installment obligations shall be attributed to this state if the office at which the customer applied for the loan is located in this state except in cases where the loan is recognized by appropriate banking regulatory authority as being made from and as an asset of an office located in another state, in which case it shall be attributed to the state where that office is located. For purposes of this clause, the word "applied" means initial inquiry (including customer assistance in preparing the loan application or submission of a completed loan application) whichever occurs first in time.

(ii) Interest income from a participating bank's portion of participation loan shall be attributed to this state if the office which enters into the participation is located in this state.

(iii) Interest income from loans solicited by traveling loan officers shall be attributed to this state if the office out of which such officer operates is located in this state except in cases where the loan is recognized by appropriate banking regulatory authority as being made from and as an asset of an office located in another state, in which case it shall be attributed to the state where that office is located.

(iv) Interest or service charges from bank, travel and entertainment credit card receivables and credit card holders' fees shall be attributed to the state in which the credit card holder resides in the case of an individual or, if a corporation, to the state of the corporation's commercial domicile, provided the taxpayer is taxable in such state. If the taxpayer is not taxable in the state of the individual card holder's residence or commercial domicile of the corporate card holder, the receipts shall be attributed to the state of the taxpayer's commercial domicile.

(v) Merchant discount income derived from bank and financial corporation credit card holder transactions with a merchant shall be attributed to the state in which the merchant is located, provided the taxpayer is taxable in such state. If the taxpayer is not taxable in the state in which the merchant is located, the merchant discount income shall be attributed to the state in which the taxpayer's commercial domicile is located.

(vi) Receipts for the performance of fiduciary services are attributable to this state if the services are principally performed in this state.

(vii) Receipts from investments of a bank in securities, the income from which constitutes business income, shall be attributed to its commercial domicile except that:

(I) Receipts from securities used to maintain reserves against deposits to meet federal and state reserve deposit requirements shall be attributed to each state based upon the ratio that total deposits in the state bear to total deposits everywhere.

(II) Receipts from securities owned by a bank but held by a state treasurer or other public official or pledged to secure public or trust funds deposited in such bank shall be attributed to the banking office at which such secured deposit is maintained.

(viii) Receipts (fees or charges) from the issuance of travelers checks and money orders shall be attributed to the state where the taxpayer's office is located that issued the travelers checks. If the travelers checks are issued by an independent representative or agent of the taxpayer, the following rules apply:

(I) If the taxpayer is taxable in the state in which the independent representative or agent issues the travelers checks or money orders, the receipts (fees or charges) shall be attributed to that state.

(II) If the taxpayer is not taxable in the state in which the independent representative or agent issues the travelers checks or money orders, the receipts (fees or charges) shall be attributed to the state of commercial domicile of the taxpayer.

(ix) Receipts from investments of a financial corporation, the income from which constitutes business income, shall be attributed to its commercial domicile unless the securities have acquired a business situs elsewhere in which case they shall be attributed to the state of such situs.

NOTE: Authority cited: Section 26422, Revenue and Taxation Code. Reference: Section 25137, Revenue and Taxation Code.

HISTORY

1. Editorial correction renumbering and amending former Section 25137(j) to Section 25137-4 filed 3-27-85; effective upon filing pursuant to Government Code Section 11346.2(d) (Register 85, No. 13). For prior history, see Registers 82, No. 46 and 82, No. 28. OK.

§ 25137-5. Commercial Fishing—Allocation and Apportionment of Income.

(a) Definitions.

(1) The term "business of commercial fishing" means a trade or business which utilizes a ship or ships in the taking of fish or the bringing of fish ashore for financial or pecuniary gain or profit.

(2) A "port day" is a day or part of a day spent in port or on the seas while the vessel is "in operation." A "port day" begins at the time the ship enters an area within which a state (as defined in Section 25120(f), Revenue and Taxation Code) asserts jurisdiction, including the assertion of jurisdiction for fishing, and ends when the ship leaves such area. A "port day" does not include the time a ship is "out of service."

(3) A ship shall be considered "in operation" while engaged in prevoyage and post-voyage activities as well as when it is searching for fish, fishing, or transporting fish. Prevoyage and post-voyage activities include, but are not limited to, loading, unloading, refueling, or provisioning the ship, or when the ship is being repaired (except for repairs in shipyards, including drydocking). A ship shall commence being "in operation" for a voyage when it is manned with full crew and the vessel is ready for a fishing voyage. It ceases to be "in operation" after a voyage when the vessel is unloaded and cleaned, including the preparation of the fish wells to a fish-carrying condition.

(4) A ship shall be "out of service" when it is not in operation. "Out of service" time includes, but is not limited to, time while a ship is idle between voyages, time for repairs in shipyards (including drydocking), and time after which a ship is seized by a foreign government and held under restraint pending disposition of charges alleging violation of such government's law. A ship is also considered out of service when it is involuntarily waiting to unload.

(b) Apportionment of Business Income. The property, payroll and sales factors of the apportionment formula for a commercial fishing business shall be computed pursuant to Sections 25128 through 25137 of the Revenue and Taxation Code and the regulations adopted pursuant thereto except as provided in this regulation.

(1) Property Factor. Numerator. A portion of the value of a ship and ship's equipment used in the business shall be attributed to this state based upon the ratio of the number of port days during which the ship was within this state to the total number of port days of the ship everywhere during the income year.

(2) Payroll Factor. Numerator. A portion of the compensation paid to ship's personnel and fishermen shall be attributed to this state based upon the ratio of the number of port days during which the ship was within the state to the total number of port days of the ship everywhere during the income year.

(3) Sales Factor. Numerator. Receipts from the sale of fish shall be attributed to this state based upon the ratio of the number of port days during which the ship was within this state to the total number of port days of the ship everywhere during the income year.

NOTE: Authority cited: Section 26422, Revenue and Taxation Code. Reference: Section 25137, Revenue and Taxation Code.

HISTORY

1. Editorial correction renumbering and amending former Section 25137(l) to Section 25137-5 filed 3-27-85; effective upon filing pursuant to Government Code Section 11346.2(d) (Register 85, No. 13). For prior history, see Registers 82, No. 46 and 82, No. 28.

§ 25137-6. Combined Reports Including Foreign Country Operations.

(a) In General.

(1) Unitary Business. A taxpayer is engaged in a unitary business (or a single business within the meaning of Reg. 25120(b)) when its activities within the state contribute to or are dependent upon its activities without the state. A unitary business exists when there is unity of ownership, unity of operation and unity of use.

(2) Translation Method for Determining Income. The translation method to be used for determining income shall be the "profit and loss method" as set forth in this regulation. This method excludes unrealized exchange rate gain or loss resulting from the restatement of assets or liabilities, while taking into account exchange gains or losses attributable to income transactions.

(3) General Applicability of UDITPA Regulations. The general regulations for UDITPA, Regs. 25120-25139, inclusive, shall be applicable except as otherwise provided in this regulation.

(b) Determination of income.

(1) The income of a unitary business with operations in foreign countries shall be computed in the following manner:

(A) A profit and loss statement shall be prepared for each foreign branch or corporation in the currency in which the books of account of the branch or corporation are regularly maintained.

(B) Adjustments shall be made to the profit and loss statement to conform it to the accounting principles generally accepted in the United States for the preparation of such statements except as modified by this regulation.

(C) Adjustments shall be made to the profit and loss statement to conform it to the tax accounting standards required under Division 2, Part 11 of the Revenue and Taxation Code.

(D) The profit and loss statement of each branch or corporation, whether U.S. or foreign, shall be translated into the currency in which the parent company maintains its books and records in accordance with subsection (b)(4).

(E) Business and nonbusiness income as determined under California law shall be identified and segregated. For general definition, rules and examples for determining business and nonbusiness income, see Regulation 25120.

(F) Nonbusiness income shall be allocated to a specific state pursuant to the provisions of Sections 25124 to 25127, inclusive of Division 2, Part 11 of the Revenue and Taxation Code.

(G) Business income shall be included in the combined report prepared for the unitary business and shall be apportioned on the basis of the appropriate formula for the business.

lieves another exclusion should be granted, a new application setting forth all the information listed in subsections (b) and/or (c) of this regulation shall be submitted. A corporation that has been granted an exclusion of indefinite duration which has lapsed will be eligible for a renewed exclusion with a maximum effective period of five years. During the period of exclusion, the corporation's records will be subject to audit to the same extent as are the records of any other corporation doing business or deriving income from sources within this state.

(g) Waiver of Confidentiality Provisions. Corporations applying for exclusions under Section 23101.5 shall be deemed to have waived the confidentiality provisions of Section 26451 with respect to legislative reports required by Section 23101.5.

NOTE: Authority cited: Section 26422, Revenue and Taxation Code. Reference: Section 23101.5, Revenue and Taxation Code.

HISTORY

1. New section filed 10-7-77 as an emergency; effective upon filing (Register 77, No. 41).
2. Refiling and amendment of section filed 1-16-78; effective thirtieth day thereafter (Register 78, No. 3).
3. Amendment filed 8-22-80; effective thirtieth day thereafter (Register 80, No. 34).

Article 2. Tax on General Corporations

§ 23151. Minimum Tax.

The minimum tax shall be paid even though the tax measured by the corporation's net income is less than that amount during the income year. Such payment shall be made by cooperatives, domestic holding companies, corporations sustaining a net loss, and inactive corporations. An inactive gold mining corporation shall not be considered to have done business if it engages in incidental activities, other than mining. Every domestic corporation is subject to the annual minimum tax from the date of incorporation until the certificate of dissolution is filed with the Secretary of State, even though the corporation may cease doing business prior thereto. If a foreign corporation qualifies to engage in intrastate activities, it is subject to the minimum tax until it files a certificate of withdrawal with the Secretary of State or dissolves in the state of incorporation, even though it never engages in intrastate activities. A foreign corporation which does not qualify to engage in intrastate activities, but nevertheless engages in such activities, is subject to at least the minimum tax for any year or years that it engages in such activities.

NOTE: Authority cited: Section 26422, Revenue and Taxation Code. Reference: Section 23153, Revenue and Taxation Code.

HISTORY

1. New section filed 1-7-58; effective thirtieth day thereafter (Register 58, No. 1).
2. Amendment filed 9-19-69; effective thirtieth day thereafter (Register 69, No. 38).
3. Renumbering and amendment of Section 23151-23154 to Section 23151 filed 9-3-82; effective thirtieth day thereafter (Register 82, No. 37).

Article 3. Tax on Banks and Financial Corporations

§ 23183. Financial Corporation - Defined.

(a) "Financial corporation" means a corporation, except as provided in subdivision (b) of California Revenue and Taxation Code section 23183, which predominantly deals in money or moneyed capital in substantial competition with the business of national banks.

(b) Definitions.

(1) "Predominantly" means over 50% of a corporation's total gross income is attributable to dealings in money or moneyed capital in substantial competition with the business of national banks. Generally, the determination of predominance will be made based upon the division of gross income of for the year in issue. However, the classification of a corporation as a financial corporation or as a nonfinancial corporation will not be changed based upon an occasional year in which its gross income does not or does not exceed the 50% level. For the classification of a corporation as a financial (or nonfinancial) corporation to be changed, there must be a shift in the predominant character of the gross income for two consecutive years and the average of the corporation's gross income in the current and the immediately preceding two years must fail (or satisfy) the predominance test. Where substantial amounts of gross income arise from an incidental or occasional sale of an asset of the taxpayers, such gross income shall be excluded from the for purposes of this subsection. For example, gross income from the sale of a headquarters building shall be excluded.

EXAMPLE: Corporation A earns 80%, 75%, 37%, and 78% of its total gross income from dealings in money or moneyed capital, for years #1, #2, #3, and #4, respectively. Assuming A meets all the other requirements of being classified as a financial corporation, it will be classified as such for year #3 as well as for years #1, #2 and #4, respectively. Assuming A meets all the other requirements for being classified as a financial corporation, it will be classified as such for year #3 as well as for years #1, #2, and #4, because the gross income of 37% in year #3 is within the acceptable range for an occasional variation from the 50% standard ((80 + 75 + 37) / 3 = 64%).

(2) "Deals in" means conducting transactions in the course of a trade or business on its own account as opposed to brokering the capital of others. A corporation which buys, sells, places or invests its own assets in dealing in moneyed capital.

EXAMPLE: Corporation B is a stock brokerage firm. Sixty percent of its total gross income is attributable to fees charged for buying and selling stocks and bonds on behalf of customers. B is not a financial corporation because the buying and selling of stocks and bonds on behalf of others does not constitute dealing in moneyed capital.

(3) "Money or moneyed capital" includes, but is not limited to, coin, cash, currency, mortgages, deeds of trust, conditional sales contracts, loans, commercial paper, installment notes, credit cards, and accounts receivable.

(4) "In substantial competition" means that a corporation and national banks both engage in seeking and securing in the same locality capital investment of the same class which are substantial in amount, even though the terms and conditions of the business transactions of the same class are not identical. It does not mean there must be competition as to all phases of the business of national banks, or competition as to all types of loans or all possible borrowers. The activities of a corporation need not be identical to those performed by a national bank in order to constitute substantial competition, it is sufficient if there is competition with some, but not all, bases of the business of national banks, or capital is invested in particular operations or investments like those of national banks.

EXAMPLE: Corporation C engages exclusively in purchasing, at a discount, conditional sales contracts of household furnishings and other low price articles of personal property from small local retail sellers of those articles under such contracts. C never makes loans. From 60% to 100% of the contracts were purchased by C without recourse to the seller. C requires credit references and information from the buyers named in the contracts, which must meet C's approval before it will purchase the contracts. No part of the payment to the seller for the contracts is withheld as a reserve to protect C if the credit buyer defaulted. National banks in the same area as C make personal loans for the purchase of household equipment, but rely solely on the buyer's credit and do not take the property as security. Those national banks also purchase at a discount conditional sales contracts from sellers of household equipment, but rely solely upon the credit of the seller rather than the buyer named in the contract; take all contracts with recourse; and withhold payment to the seller of 20% to 40% of the price as a reserve against default under the contract. C is a financial corporation.

EXAMPLE: Corporation D is a wholly owned subsidiary of E corporation. E engages exclusively in the sale of retail household items and clothing to the general public. E corporation extends credit to its custom-

ers by issuing credit cards. F then sells to D the credit card customer receivables arising out of E's retail business. D engages exclusively in purchasing these receivables from E and collecting on those receivables. D is a financial corporation.

EXAMPLE: Corporation F makes loans which are secured by first mortgages or first deeds of trust on real estate. The loans made by F are government insured FHA or VA loans, or conventional or uninsured loans. A substantial number of such loans are similar to real estate loans made by national banks. All loans made are intended for subsequent sale to institutional investors, usually within six months from the time they are originally made. After the loans are sold, F services them by collecting installments and providing other services, such as making certain that the underlying properties are kept insured and that taxes upon them are paid. F services only those loans made by it. F is a financial corporation.

(5) "Business of national banks" means the businesses in which national banks are permitted to operate.

NOTE: Authority cited: Section 26422, Revenue and Taxation Code. Reference: Section 23183, Revenue and Taxation Code.

HISTORY

1. New section filed 3–1–91; operative 3–31–91 (Register 91, No. 14).

Article 4. Commencing Corporations

§ 23222. Commencing Corporations.

A corporation commencing to do business in California after qualification or after having filed its articles of incorporation with the Secretary of State, a period of one–half month may be disregarded provided the corporation was not doing business in and received no income from sources in the State during such period, and a period of more than one–half a calendar month may be treated as a period of one month. For example, a corporation files its articles of incorporation on December 17th, and elects to file its return on a calendar year basis. No return will be required and no tax will be due for the period from December 17th to December 31st provided the corporation was not doing business in and received no income from sources in California during this period. However, if in the above example the corporation filed its articles on December 16th and elected to file its return on a calendar year basis, it will be required to file a return and pay a tax for the period from December 16th to December 31st, regardless of the fact that it may have been inactive and received no income during such period.

In determining whether a corporation comes within the provisions of this ruling, affidavits on behalf of the corporation that it did no business in and received no income from sources in California during such period shall be required if deemed necessary. Where it appears the corporation filed its articles only one or two days before commencement of its fiscal year period, affidavits normally will not be required.

NOTE: Authority cited: Section 26422, Revenue and Taxation Code. Reference: Section 23222, Revenue and Taxation Code.

HISTORY

1. New Regs. 23221–23226 filed 12–14–64; effective thirtieth day thereafter (Register 64, No. 25).
2. Renumbering and amendment of Section 23221–23226 to Section 23222 filed 9–3–82; effective thirtieth day thereafter (Register 82, No. 37).

Article 5. Reorganization of Corporations

§ 23251. Reorganizations—Transferee Liability.

(a) The definition of "reorganization," for the purposes of this article, is somewhat broader in scope than the comparable definition contained in Section 24562. The purpose of this article is to require the transferee in reorganization to use the income of the transferor during the year of reorganization in the measure of the transferee's tax for the following year. Consequently, the definition includes certain types of transactions which do not fall within the purview of a reorganization in which no gain or loss is recognized under Article 3 of Chapter 15 (Section 24941 and following).

For example, a nonstatutory merger is included within the type of transactions which are covered by this article. Thus, even though the merger is not strictly in compliance with the laws of the state of incorporation, the transferee becomes liable for the tax measured by the income of the transferor. The definition also includes the liquidation of a controlled subsidiary, other than a distribution to which Section 24504(b)(2) applies, where the bank or corporation stockholder, or a controlled taxpayer under a plan of reorganization, continues all or a substantial portion of the business of the liquidated corporation.

In determining whether or not a bank or corporation has transferred *all* or *a substantial portion of its business or property* to another bank or corporation for purposes of Section 23251(a) or (d), only the business or property located in this State is to be taken into account. Thus, if the business or property transferred is all of the property located in this State, but only a small percentage of the transferor's total property, the transaction is a "reorganization" for purposes of this article if the remaining provisions of Section 23251(a) or (d) are met. It is also to be noted that under Section 23251(a) or (d) a transaction may qualify as a reorganization if a "substantial portion" of the business or property is transferred to a bank or corporation. A "substantial portion" of the property or business may be less than 50%, particularly whenever an entire division or segment is transferred to a controlled subsidiary bank or corporation.

(b) A bank or corporation which commences to do business pursuant to a reorganization under this article is not subject to the commencing corporation rules prescribed in Article 4 of Chapter 2. The transaction is regarded as a continuation of business by the same interests for the purpose of assessing the tax under Chapter 2.

The income earned by the transferor, in the taxable year in which any reorganization occurs, must be reported. That income is included with income of the transferee, when it files a return for the taxable year in which the reorganization occurred, if its taxable year ends at the same time as, or before, the date on which the taxable year of the transferor ends. The income will be used to measure the tax of the transferee for the succeeding taxable year.

The income of the transferor shall be reported in a separate return, to be filed by the transferee, if the taxable year of the transferee, in which the reorganization occurred, ends after the taxable year of the transferor.

[The next page is 379.]

CHAPTER 2
THE BANK AND CORPORATION FRANCHISE TAX

Article 1

Definitions and General Provisions

[¶ 220-301]

Sec. 23101. ["Doing business" defined.] "Doing business" means actively engaging in any transaction for the purpose of financial or pecuniary gain or profit.

[¶ 220-309]

Sec. 23101.5. [Activities not constituting doing business.] (a) The Franchise Tax Board may determine that a corporation is not doing business in this state for purposes of this chapter or deriving income from sources within this state for purposes of Chapter 3 (beginning with Section 23501) if its only activities within this state are either or both of the following:

(1) The purchase of personal property or services solely for its own use or use by its affiliate outside this state if the corporation does not have more than 100 employees in this state, and their duties are limited to solicitation, negotiation, liaison, monitoring, auditing, and inspecting the property or services acquired, or providing technical advice with respect to its requirements.

(2) The presence of employees in this state only for the purpose of attending a public or private school, college or university.

[¶ 220-311]

(b) A corporation may petition the Franchise Tax Board for a determination in accord with procedures established by the Franchise Tax Board. The filing of that petition shall be deemed a waiver of the confidentiality provisions of Section 26451 with respect to the facts alleged in the petition and any additional evidence produced with respect to those facts.

[¶ 220-313]

(c) If such determination is made, it shall remain in force for five years as long as the corporation continues to meet the above criteria; provided that, with respect to corporations meeting the above criteria on or before January 1, 1978, the determination shall remain in force indefinitely so long as the corporation continues to meet the above criteria.

[¶ 220-321]

Sec. 23102. [Status of holding companies.] Any corporation holding or organized to hold stock or bonds of any other corporation or corporations, and not trading in stock or bonds or other securities held, and engaging in no activities other than the receipt and disbursement of dividends from stock or interest from bonds, is not a corporation doing business in this State for the purposes of this chapter.

[¶ 220-360]

Sec. 23113. [Tax attaches irrespective of short period.] The tax imposed under this chapter shall attach whether a taxpayer has a taxable year of twelve months or less.

Article 2

Tax on General Corporations

[¶ 220-460]

Sec. 23151. [Imposition and rate of tax.] (a) With the exception of financial corporations, every corporation doing business within the limits of this state and not expressly exempted from taxation by the provisions of the Constitution of this state or by this part, shall annually pay to the state, for the privilege of exercising its corporate franchises within this state, a tax according to or measured by its net income, to be computed at the rate of 7.6 percent upon the basis of its net income for the next preceding income year. In any event, each such corporation shall pay annually to the state, for the said privilege, a minimum tax determined in accordance with Section 23153.

(b) For calendar or fiscal years ending after June 30, 1973, the rate of tax shall be 9 percent instead of 7.6 percent as provided by subdivision (a).

(c) For calendar or fiscal years ending in 1980, the rate of tax shall be 9.6 percent. (*As amended by Ch.* 1465, *Laws* 1988, *applicable to income years beginning on or after January* 1, 1988.)

[¶ 220-463]

(d) For calendar or fiscal years ending in 1981 the rate shall be determined as follows:

If the net cash collections under the Bank and Corporation Tax Law for 1979-80, as determined by the Controller, are:

Less than $2,950,000,000, the tax rate shall be 9.6 percent.

If $2,950,000,000 or greater, but less than $3,025,000,000, the tax rate shall be 9.50 percent.

If $3,025,000,000 or greater, but less than $3,100,000,000, the tax rate shall be 9.45 percent.

If $3,100,000,000 or greater, the tax rate shall be 9.40 percent.

[¶ 220-466]

(e) For calendar or fiscal years ending in 1982 the rate shall be determined as follows:

If the net cash collections under the Bank and Corporation Tax Law for 1979-80 and 1980-81, as determined by the Controller, are:

Less than $6,000,000,000, the tax rate shall be 9.6 percent.

If $6,000,000,000 or greater, but less than $6,075,000,000, the tax rate shall be 9.50 percent.

If $6,075,000,000 or greater, but less than $6,150,000,000, the tax rate shall be 9.45 percent.

If $6,150,000,000 or greater, but less than $6,225,000,000, the tax rate shall be 9.40 percent.

If $6,225,000,000 or greater, the tax rate shall be 9.35 percent.

[¶ 220-468]

(f) For calendar or fiscal years ending in 1983 and thereafter the rate shall be determined as follows:

If the net cash collections under the Bank and Corporation Tax Law for 1979-80, 1980-81, and 1981-82, as determined by the Controller, are:

Less than $9,450,000,000, the tax rate shall be 9.6 percent.

If $9,450,000,000 or greater, but less than $9,525,000,000, the tax rate shall be 9.50 percent.

If $9,525,000,000 or greater, but less than $9,600,000,000 the tax rate shall be 9.45 percent.

If $9,600,000,000 or greater, but less than $9,675,000,000, the tax rate shall be 9.40 percent.

If $9,675,000,000 or greater, but less than $9,750,000,000, the tax rate shall be 9.35 percent.

If $9,750,000,000 or greater, the tax rate shall be 9.30 percent.

[¶ 220-470]

(g) For calendar or fiscal years ending in 1987 and thereafter, the tax rate shall be 9.3 percent. (*As added by Ch.* 1139, *Laws* 1987; *as amended by Ch.* 1465, *Laws* 1988 *applicable to income years beginning on or after January* 1, 1988.)

(*Sec.* 23151 *is as amended by Ch.* 1139, *Laws* 1987; *Ch.* 1465, *Laws* 1988, *applicable to income years beginning on or after January* 1, 1988.)

[¶ 220-482]

Sec. 23151.1. [Imposition of privilege tax on corporations doing business in state and not exempt; minimum rate.] Notwithstanding Section 23151, every corporation (except financial corporations) doing business within the limits of this state and not exempted from taxation by the provisions of the Constitution of this state or by this part, shall annually pay to the state for the privilege of exercising its corporate franchises within this state, a tax determined as follows:

(a) With respect to corporations, other than those described in subdivision (b), which commence doing business within the state after December 31, 1971, the tax for the taxable year of commencement, whether or not for 12 full months, shall be the minimum franchise tax prescribed in Section 23153.

(b) If after December 31, 1972, a corporation commences to do business and ceases doing business in the same taxable year, the tax for such taxable year shall be according to or measured by its net income for such year, to be computed at the rate prescribed in Section 23151.

(c) With respect to taxable years beginning after December 31, 1972, other than the year of commencement described in subdivision (a) or (b) or the year of cessation described in subdivision (d), the tax for such taxable year shall be according to or measured by its net income for the next preceding income year, to be computed at the rate prescribed in Section 23151.

(d) With respect to corporations which cease doing business in a taxable year beginning after December 31, 1972, other than those described in subdivision (b), the tax for the taxable year of cessation shall be:

(1) According to or measured by its net income for the next preceding income year, to be computed at the rate prescribed in Section 23151, plus

(2) According to or measured by its net income for the income year during which the corporation ceased doing business, to be computed at the rate prescribed in Section 23151.

(e) In any event, the tax for any taxable year shall not be less than the minimum tax provided for in Section 25153 for such taxable year.

[¶ 220-486]

Sec. 23151.2. [Liability for tax in year of dissolution or withdrawal.] Notwithstanding Section 23151, every corporation (except financial corporations) not exempted from taxation by the provisions of the Constitution of this state or by this part which dissolves or withdraws, shall pay a tax for its taxable year of dissolution or withdrawal according to or measured by its net income for the income year in which it ceased doing business, unless such income has previously been included in the measure of tax for any taxable year, to be computed at the rate prescribed in Section 23151 for its taxable year of dissolution or withdrawal. In any event, the tax for the taxable year of its dissolution or withdrawal shall not be less than the minimum tax provided for in Section 23153 for such taxable year.

[¶ 220-505]

Sec. 23153. [Corporations not otherwise taxed subject to annual minimum tax.] (a) Every bank and corporation subject to tax under this chapter shall be subject to the minimum tax specified in this section from the date of incorporation or the date of commencing to do business within this state, whichever applies, until the effective date of dissolution or withdrawal as provided in Section 23331. Every bank and corporation subject to tax under this chapter and not expressly exempted by the provisions of this part or the Constitution of this state shall pay annually to the state a minimum tax of not less than one hundred dollars ($100), except as provided in subdivision (b).

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(b)(1) Credit unions shall not be subject to the minimum tax specified in this section.

(2) The following corporations shall pay annually to the state a minimum tax of not less than:

(A) Twenty-five dollars ($25) for a corporation formed under the laws of this state whose principal business when formed was gold mining, which is inactive and has not done business within the limits of the state since 1950.

(B) Twenty-five dollars ($25) for a corporation formed under the laws of this state whose principal business when formed was quicksilver mining, which is inactive and has not done business within the limits of the state since 1971, or has been inactive for a period of 24 consecutive months or more.

For the purpose of subparagraphs (A) and (B) a corporation shall not be considered to have done business if it engages in other than mining. (*As amended by Ch.* 1465, *Laws* 1988; *Ch.* 1222, *Laws* 1989, *operative for income years beginning on or after January* 1, 1990.)

[¶ 220-507]

(c) For income years beginning after December 31, 1971, the one hundred dollars ($100) specified in subdivision (a) shall be two hundred dollars ($200) instead of one hundred dollars ($100). (*As amended by Ch.* 1222, *Laws* 1989, *operative for income years beginning on or after January* 1, 1990.)

[¶ 220-508]

(d) For income years beginning after December 31, 1986, the one hundred dollars ($100) specified in subdivision (a) shall be three hundred dollars ($300) instead of one hundred dollars. ($100). (*As added by Ch.* 1139, *Laws* 1987; *as amended by Ch.* 1222, *Laws* 1989, *operative for income years beginning on or after January* 1, 1990.)

[¶ 220-509]

(e) For income years beginning after December 31, 1988, the one hundred dollars ($100) specified in subdivision (a) shall be six hundred dollars ($600) instead of one hundred dollars ($100). (*As added by Ch.* 1139, *Laws* 1987; *as amended by Ch.* 1222, *Laws* 1989, *operative for income years beginning on or after January* 1, 1990.)

[¶ 200-510]

(f) For income years beginning after December 31, 1989, the one hundred dollars ($100) specified in subdivision (a) shall be eight hundred dollars ($800) instead of one hundred dollars ($100). (*As added by Ch. 1139, Laws* 1987; *as amended by Ch.* 1222, *Laws* 1989, *operative for income years beginning on or after January* 1, 1990.)

(*Sec.* 23153 *is as amended by Ch.* 1139, *Laws* 1987; *Ch.* 1465, *Laws* 1988; *Ch.* 1222, *Laws* 1989, *operative for income years beginning on or after January* 1, 1990.)

[¶ 220-513]

Sec. 23154. [Tax in lieu of other taxes upon corporate franchise.] The tax imposed under this chapter is in lieu of all ad valorem taxes and assessments of every kind and nature upon the general corporate franchises of the corporations taxable under this chapter but is not in lieu of any taxes or assessments upon special franchises owned, held or used by said corporations. All such special franchises shall be assessed annually by the board, at their actual value, in the same manner as is provided for the assessment of other property to be assessed by said board under Section 19 of Article XIII of the Constitution of this State, and shall be subject to taxation to the same extent and in the same manner as other property so assessed by said board.

[¶ 220-518]

Sec. 23155. [Assessment of tax, penalties under erroneous subdivision of Sec. 23151.1.] In the event that taxes, interest and penalties have been or shall be assessed against, paid by or collected from a taxpayer under a subdivision of Section 23151.1, which assessment, payment or collection should have been made under a different subdivision, such taxes, interest and penalties shall be considered as having been assessed, paid or collected under such different subdivision as of the date or dates they were made.

Article 3

Tax on Banks and Financial Corporations

[¶ 220-577]

Sec. 23181. [Imposition of tax.] (a) Except as otherwise provided herein, an annual tax is hereby imposed upon every bank doing business within the limits of this state according to or measured by its net income, upon the basis of its net income for the next preceding income year at the rate provided under Section 23186.

(b) If a bank commences to do business and ceases doing business in the same taxable year, the tax for such taxable year shall be according to or measured by its net income for such year, at the rate provided under Section 23186.

(c) With respect to a bank, other than a bank described in subdivision (b), which ceases doing business after December 31, 1972, the tax for the taxable year of cessation shall be:

(1) According to or measured by its net income for the next preceding income year, to be computed at the rate prescribed in Section 23186, plus

(2) According to or measured by its net income for the income year during which the bank ceased doing business, to be computed at the rate prescribed in Section 23186.

(d) In the case of a bank which ceased doing business before January 1, 1973, but dissolves or withdraws on such date or thereafter, the tax for the

taxable year of dissolution or withdrawal shall be according to or measured by its net income for the income year during which the bank ceased doing business, unless such income has previously been included in the measure of tax for any taxable year, to be computed at the rate prescribed under Section 23186 for the taxable year of dissolution or withdrawal.

(e) Commencing with income years ending in 1980, every bank shall pay to the state a minimum tax of two hundred dollars ($200) or the measured tax imposed on its income, whichever is greater.

(f) For income years beginning after December 31, 1986, every bank shall pay to the state a minimum tax of three hundred dollars ($300) or the measured tax imposed on its income, whichever is greater.

(g) For income years beginning after December 31, 1988, every bank shall pay to the state a minimum tax of six hundred dollars ($600) or the measured tax imposed on its income, whichever is greater.

(h) For income years beginning after December 31, 1989, every bank shall pay to the state a minimum tax of eight hundred dollars ($800) or the measured tax imposed on its income, whichever is greater. (*As amended by Chs.* 1139 *and* 1442, *Laws* 1987; *Ch.* 11, *Laws* 1988, *applicable for income years beginning on or after January* 1, 1987.)

[¶ 220-578]

(Uncodified Law.) Sec. 3, Ch. 1442, Laws 1987. [Regulations to be adopted.] The Franchise Tax Board shall adopt regulations dealing with apportionment and allocation of income with respect to banks and financial corporations which consider the laws and regulations of other states with an objective of preventing multiple taxation or circumstances where income is taxed in no state. (*Applicable to income years beginning on or after January* 1, 1988.)

[¶ 220-580]

Sec. 23182. [Tax on banks and financials in lieu of other taxes.] The tax imposed under this part upon banks and financial corporations is in lieu of all other taxes and licenses, state, county and municipal, upon the said banks and financial corporations except taxes upon their real property, local utility user taxes, sales and use taxes, state energy resources surcharge, state emergency telephone users surcharge, and motor vehicle and other vehicle registration license fees and any other tax or license fee imposed by the state upon vehicles, motor vehicles or the operation thereof.

The changes in this section made by the 1979-80 Legislature with respect to sales and use taxes apply to income years beginning on and after January 1, 1980, and the remaining changes apply to income years beginning on and after January 1, 1981.

[¶ 220-585]

Sec. 23183. [Financial corporation's annual tax measured by net income.] (a) An annual tax is hereby imposed upon every financial corporation doing business within the limits of this state and taxable under the provisions of Section 27 of Article XIII of the Constitution of this state, for the privilege of exercising its corporate franchises within this state, according to or measured by its net income, upon the basis of its net income for the next preceding income year at the rate provided under Section 23186.

(b) For purposes of this article, the term "financial corporation" does not include any corporation, including a wholly-owned subsidiary of a bank or bank holding company, if the principal business activity of such entity consists of leasing tangible personal property.

[¶ 220-592]

Sec. 23183.1. [Financial corporations doing business and not exempted subject to privilege tax.] Notwithstanding Section 23183, every financial corporation doing business within the limits of this state and not exempted from taxation by the Constitution of this state or by this part, shall annually pay to the state for the privilege of exercising its corporate franchises within this state, a tax determined as follows:

(a) With respect to financial corporations, other than those described in subdivision (b), which commence doing business within the state after December 31, 1971, the tax for the taxable year of commencement, whether or not for 12 full months, shall be the minimum tax prescribed in Section 23184.

(b) If after December 31, 1972, a financial corporation commences to do business and ceases doing business in the same taxable year, the tax for such taxable year shall be according to or measured by its net income for such year, at the rate provided under Section 23186.

(c) With respect to taxable years beginning after December 31, 1972, other than the year of commencement described in subdivisions (a) and (b) or the year of cessation described in subdivision (d), a tax according to or measured by its net income, to be computed at the rate prescribed in Section 23186 upon the basis of its net income for the preceding income year.

(d) With respect to financial corporations, which cease doing business in a taxable year ending after December 31, 1972, other than those described in subdivision (b), the tax for the taxable year of cessation shall be:

(1) According to or measured by its net income for the next preceding income year to be computed at the rate prescribed in Section 23186, plus

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(2) According to or measured by its net income for the income year during which the financial corporation ceased doing business, to be computed at the rate prescribed in Section 23186.

(e) In any event, the tax for any taxable year shall not be less than the minimum tax provided for in Section 23184 for such taxable year.

[¶ 220-596]

Sec. 23183.2. [Tax in year of dissolution or withdrawal.] Notwithstanding Section 23183, every financial corporation not exempted from taxation by the provisions of the Constitution of this state or by this part which dissolves or withdraws, shall pay a tax for its taxable year of dissolution or withdrawal according to or measured by its net income for the income year in which it ceased doing business, to be computed at the rate prescribed in Section 23186 for its taxable year of dissolution or withdrawal, unless such income has previously been included in the measure of tax for any taxable year. In any event, the tax for the taxable year of its dissolution or withdrawal shall not be less than the minimum tax provided for in Section 23184 for such taxable year.

[¶ 220-612]

Sec. 23184. [Tax offset for other payments by financial corporations.] (a) Financial corporations may offset against the franchise tax the amounts paid during the income year to this state or to any county, city, town, or other political subdivisions of the state as personal property taxes, or as license fees or excise taxes for the following privileges:

(1) Operating as personal property brokers or brokers as defined in the Personal Property Brokers Law provided for in Division 9 (commencing with Section 22000) of the Financial Code, or as consumer finance lenders or brokers as defined in the Consumer Finance Lenders Law provided for in Division 10 (commencing with Section 24000) of the Financial Code, or as commercial finance lenders as defined in the Commercial Finance Lenders Law provided for in Division 11 (commencing with Section 26000) of the Financial Code. Fees paid pursuant to Sections 22202, 24202, and 26202 of the Financial Code may not be offset against the franchise tax.

(2) Engaging in the business of loaning money, advancing credit, or loaning credit or arranging for the loan of money or advancing of credit or loaning of credit.

(3) Storing, using or otherwise consuming in this state of tangible personal property by savings and loan associations. This paragraph does not apply to amounts incurred and paid beginning on and after January 1, 1980. (*As amended by Ch.* 1465, *Laws* 1988 *applicable to income years beginning on or after January* 1, 1988.)

[¶ 220-614]

(b) The offset allowed to any financial corporation for any income year as provided in this section may, at the election of that financial corporation, be offset, in whole or in part, against its franchise tax for that income year or offset in whole or in part against its franchise tax in one or more of the next four succeeding years of its selection, until such time as the total amount of such offset is so utilized; provided, however, that for such purposes, offsets elected to be utilized against the franchise tax of a succeeding year shall be applied in the order of their respective years of origin and prior to the application of the offset which might otherwise be allowable for amounts paid during that income year.

[¶ 220-616]

(c) Notwithstanding anything to the contrary contained in this section, the tax on financial corporations after the allowance of all offsets provided for

[The next page is 15,881.]

TITLE 18. FRANCHISE TAX BOARD

Notice is hereby given, as required by Section 11346.4 of the Government Code, that a public hearing has been scheduled to be held at 10:00 a.m. on October 15, 1990, at the of Franchise Tax Board at 9600 Butterfield Way, Sacramento, California, to consider the adoption of Section 23183 in Title 18 of the California Code of Regulations pertaining to the definition of a financial corporation. Interested persons are requested to present statements, contentions or arguments concerning the proposed regulation. The statements may be written or oral. It is requested, but not required, that persons making oral comments at the hearing submit a written copy of their testimony at the hearing.

WRITTEN COMMENT PERIOD

Written comments will be accepted until 5:00 p.m. October 15, 1990. All relevant matters presented will be considered before adopting the regulation. Comments should be submitted to the agency officer named below.

AUTHORITY & REFERENCE:

Section 26422 of the Revenue and Taxation Code (R&TC) authorizes the Franchise Tax Board to prescribe regulations necessary for the enforcement of the Bank and Corporation Tax Law. The proposed action interprets, implements, and makes specific Section 23183 of the Revenue and Taxation Code.

INFORMATIVE DIGEST:

The proposed regulation sets forth a definition of "financial corporation" for purposes of Revenue and Taxation Code Section 23183. Under that section, financial corporations doing business within California pay a franchise tax, according to or measured by net income for the past preceding year, at a higher rate than other corporations. The reason that a higher rate is imposed upon financial corporations (and also banks) is that it is, by statute, in lieu of all other taxes and licenses, state, county and municipal, upon financial corporations (and banks), except taxes upon their real property, local utility user taxes, sales and use taxes, state energy resources surcharge, state emergency telephone users surcharge, and motor vehicle and other vehicle registration license fees and any other tax or license fee imposed by the state upon vehicles, motor vehicles or the operation thereof. (See Cal. Rev. & Tax. Code § 23182.)

The term "financial corporation" is not defined in the Revenue and Taxation Code, but has been defined in various specific contexts in California case law and in decisions of the California State Board of Equalization. The proposed regulation is intended to synthesize the case law and decisional law in the

area, and provide a comprehensive definition for compliance and self-compliance purposes.

The proposed regulation is to be retroactive, for the reason it is intended to be a comprehensive restatement of existing law in the area, with minor clarifications.

DISCLOSURES REGARDING THE PROPOSED ACTION:

Mandate on local agencies and school districts: None.

Cost or savings to any state agency: None.

Cost to any local agency or school district which must be reimbursed under Part 7, commencing with Government Code Section 17500, of Division 4: None.

Other non-discretionary cost or savings imposed upon local agencies: None.

Cost or savings in federal funding to the state: None.

Cost impact on private persons or directly affected businesses: Insignificant.

Significant adverse economic effect on small business: None.

Significant effect on housing costs: None.

CONSIDERATION OF ALTERNATIVES:

In accordance with Government Code Section 11346.5, subdivision (a)(7), the Board must determine that no alternative considered by it would be more effective in carrying out the purpose for which the action is proposed or would be as effective and less burdensome to affected private persons than the proposed action. In addition, the proposed regulation pertains to corporate taxpayers and therefore does not affect private persons.

AVAILABILITY OF STATEMENT OF REASONS AND TEXT OF PROPOSED REGULATIONS:

An initial statement of reasons has been prepared setting forth the facts upon which the proposed regulation is based. The statement includes the specific purpose of the proposed regulation and the factual basis for determining that the regulation is necessary. Copies of the express terms of the proposed regulation, as well as the initial statement of reasons and all information upon which the proposal is based, are available upon request from the agency officer named below.

CHANGE OR MODIFICATION OF ACTIONS:

Following the hearing, the Franchise Tax Board may adopt the

proposed regulation. The Franchise Tax Board may also adopt the regulation with modifications if the changes are nonsubstantive or the resulting regulation is sufficiently related to the text made available to the public so that the public was adequately placed on notice that the regulation as modified could result from that originally proposed. The text of the regulation as modified will be made available to the public at least 15 days prior to the date on which the Franchise Tax Board adopts the regulation. Requests for copies of any modified regulations should be sent to the attention of the agency officer named below.

ADDITIONAL COMMENTS:

If you plan on attending or making an oral presentation at the regulation hearing, please contact the agency officer named below.

The hearing room is accessible to persons with physical disabilities. Any person planning to attend the hearing who is in need of a language interpreter, including sign language, should contact the officer named below at least two weeks prior to the hearing so that the services of an interpreter may be arranged.

CONTACT:

All inquiries concerning this notice or the hearing should be directed to Beverly Moore at (916) 369-3354 or by mail to the Legal Division, Attn: Beverly Moore, P.O. Box 1468, Sacramento, California 95812-1468.

INITIAL STATEMENT OF REASONS FOR THE
ADOPTION OF REGULATION 23183

PUBLIC PROBLEM, ADMINISTRATIVE REQUIREMENT, OR OTHER CONDITION OR CIRCUMSTANCE THAT THE REGULATION IS INTENDED TO ADDRESS

Section 23183 of the Revenue and Taxation Code (R&TC) provides that financial corporations doing business within California pay a franchise tax, according to or measured by net income for the next preceding year, at a higher rate than other corporations. The reason that a higher rate is imposed upon financial corporations (and banks) is that it is, by statute, in lieu of all other taxes and licenses, state, county and municipal, upon the financial corporations (and banks), except taxes upon their real property, local utility user taxes, sales and use taxes, state energy resources surcharge, state emergency telephone users surcharge, and motor vehicle and other vehicle registration license fees and any other tax or license fee imposed by the state upon vehicles, motor vehicles or the operations thereof. (Cal. Rev. & Tax. Code § 23182.) Accordingly, the classification of a corporation as a "financial corporation" for purposes of the California Bank and Corporation Tax Law carries with it special legal significance. However, the California Revenue and Taxation Code does not define the term "financial corporation". As a consequence, a body of decisional law has evolved in the California courts and before the California State Board of Equalization which addresses the issue of when a corporation is a "financial corporation" in various specific circumstances. Leading California court cases include Crown Finance Corp. v. McColgan (1943) 23 Cal.2d 280, H.A.S. Loan Service, Inc. v. McColgan (1943) 21 Cal.2d 518, The Morris Plan Co. v. Johnson (1940) 37 Cal.App.2d 621, and Marble Mortgage Co. v. Franchise Tax Board (1966) 241 Cal.App.2d 26. However, neither these cases, nor the numerous Board of Equalization decisions in the area, address in any comprehensive fashion the issue of what constitutes a "financial corporation."

SPECIFIC PURPOSE OF THE REGULATION

The purpose of the proposed regulation is to provide a definition of "financial corporation" for purposes of California Revenue and Taxation Code section 23183. Specifically, the proposed regulation is intended to synthesize the case law and decisional law in the area, and provide a comprehensive definition for compliance and self-compliance purposes. Absent regulatory guidance, the definition of a financial in a specific circumstance must be gleaned from a review of not only the sparse California case law on the subject, most of which dates from the 1940s, but also from a review of the approximately thirty decisions of the Board of Equalization on the subject which date back to the 1930s.

The California judicial decisions in Morris Plan and Crown

Finance created a generalized two part test for determining whether a corporation is to be classified as a financial corporation: (1) it must deal in money or moneyed capital as distinguished from other commodities, and (2) it must be in substantial competition with national banks. The proposed regulation elaborates upon this skeletal test, and provides that a financial corporation is a corporation, except as provided in subdivision (b) of California Revenue and Taxation Code Section 23183, which predominantly deals in money or moneyed capital in substantial competition with the business of national banks. The proposed regulation provides definitions of the elements of "predominantly", "deals in", "money or moneyed capital", "in substantial competition", and the "business of national banks". The proposed regulation also contains examples which illustrate its operation.

TECHNICAL, THEORETICAL, AND/OR EMPIRICAL STUDY, REPORTS, OR DOCUMENTS.

Except as discussed in the Background Paper which is included in the rulemaking file for this regulation, Franchise Tax Board did not rely upon any technical, theoretical, or empirical studies, reports or documents in proposing the adoption of this regulation.

ALTERNATIVES TO THE PROPOSED REGULATORY ACTION THAT WOULD LESSEN ANY ADVERSE IMPACT ON AFFECTED PRIVATE PERSONS OR SMALL BUSINESS.

The Franchise Tax Board has determined that there were no alternatives considered which would be more effective in carrying out the purpose of the proposed regulation or would be as effective and less burdensome to affected private persons or small businesses than the proposed regulation. In addition, the proposed regulation pertains to corporate taxpayers and therefore does not affect private persons.

Section 23183 is adopted to read:

23183. Financial Corporation - Defined

(a) "Financial corporation" means a corporation, except as provided in subdivision (b) of California Revenue and Taxation Code Section 23183, which predominantly deals in money or moneyed capital in substantial competition with the business of national banks.

(b) Definitions.

(1) "Predominantly" means over 50% of a corporation's total gross income is attributable to dealings in money or moneyed capital in substantial competition with the business of national banks. Generally, the determination of predominance will be made based upon the division of gross income for the year in issue. However, the classification of a corporation as a financial corporation or as a nonfinancial corporation will not be changed based upon an occasional year in which its gross income does or does not exceed the 50% level. For the classification of a corporation as a financial (or nonfinancial) to be changed, there must be a shift in the predominant character of the gross income for two consecutive years and the average of the corporation's gross income in the current and the immediately preceding two years must fail (or satisfy) the predominance test. Where substantial amounts of gross income arise from an incidental or occasional sale of an asset of the taxpayer, such gross income shall be excluded from the gross income calculations for purposes of this subsection. For example, gross income from the sale of a headquarters building shall be excluded.

EXAMPLE: Corporation A earns 80%, 75%, 37%, and 78% of its total gross income from dealings in money or moneyed capital, for the years #1, #2, #3, and #4, respectively. Assuming A meets all the other requirements for being classified as a financial corporation, it will be classified as such for year #3 as well as for years #1, #2 and #4, because the gross income of 37% in year #3 is within the acceptable range for an occasional variation from the 50% standard ((80 + 75 + 37) / 3 = 64%).

(2) "Deals in" means conducting transactions in the course of a trade or business on its own account, as opposed to brokering the capital of others. A corporation which buys, sells, places or invests its own assets is dealing in moneyed capital.

EXAMPLE: Corporation B is a stock brokerage firm. Sixty percent of its total gross income is attributable to fees charged for buying and selling stocks and bonds on behalf of customers. B is not a financial corporation because the buying and selling of stocks and bonds on behalf of others does not constitute dealing in moneyed capital.

(3) "Money or moneyed capital" includes, but is not limited to, coin, cash, currency, mortgages, deeds of trust, conditional sales contracts, loans, commercial paper, installment notes, credit cards, and accounts receivable.

(4) "In substantial competition" means that a corporation and national banks both engage in seeking and securing in the same locality capital investments of the same class which are substantial in amount, even though the terms and conditions of the business transactions of the same class are not identical.

It does not mean there must be competition as to all phases of the business of national banks, or competition as to all types of loans or all possible borrowers. The activities of a corporation need not be identical to those performed by a national bank in order to constitute substantial competition. It is sufficient if there is competition with some, but not all, phases of the business of national banks, or capital is invested in particular operations or investments like those of national banks.

EXAMPLE: Corporation C engages exclusively in purchasing, at a discount, conditional sales contracts of household furnishings and other low price articles of personal property from small local retail sellers of those articles under such contracts. C never makes loans. From 60% to 100% of the contracts were purchased by C without recourse to the seller. C requires credit references and information from the buyers named in the contracts, which must meet C's approval before it will purchase the contracts. No part of the payment to the seller for the contacts is withheld as a reserve to protect C if the credit buyer defaulted. National banks in the same area as C make personal loans for the purchase of household equipment, but rely solely on the borrower's credit and do not take the property as security. Those national banks also purchase at a discount conditional sales contracts from sellers of household equipment, but rely solely upon the credit of the seller rather than the buyer named in the contract; take all contracts with recourse; and withhold payment from the seller of 20% to 40% of the price as a reserve against default under the contract. C is a financial corporation.

EXAMPLE: Corporation D is a wholly owned subsidiary of E corporation. E engages exclusively in the sale of retail household items and clothing to the general public. E corporation extends credit to its customers by issuing credit cards. E then sells to D the credit card customer receivables arising out of E's retail business. D engages exclusively in purchasing these receivables from E and collecting on those receivables. D is a financial corporation.

EXAMPLE: Corporation F makes loans which are secured by first mortgages or first deeds of trust on real estate. The loans made by F are government insured FHA or VA loans, or conventional or uninsured loans. A substantial number of such loans are similar to real estate loans made by national banks. All loans made are intended for subsequent sale to institutional investors, usually within six months from the time they are originally made. After the loans are sold, F services them by collecting installments and providing other services, such as making certain that the underlying properties are kept insured and that taxes upon them are paid. F services only those loans made by it. F is a financial corporation.

(5) "Business of national banks" means the businesses in which national banks are permitted to operate.

NOTE: Authority Cited: Section 26422, Revenue and Taxation Code. Reference: Section 23183, Revenue and Taxation Code.

THE DEFINITION OF A "FINANCIAL CORPORATION"
UNDER REVENUE AND TAXATION CODE SECTION 23183

Franchise Tax Board has announced its intention to consider the adoption of Section 23183 in Title 18 of the California Code of Regulations, which would define "financial corporation" for purposes of Revenue and Taxation Code Section 23183. The term "financial corporation" is not defined in the California Revenue and Taxation Code, but has been defined since the 1930's in various specific contexts in California case law and in decisions of the State Board of Equalization. The proposed regulation is intended to reflect the case law and decisional law in this area, and defines "financial corporation" to mean a corporation, except as provided in subdivision (b) of California Revenue and Taxation Code Section 23183, which predominantly deals in money or moneyed capital in substantial competition with the business of national banks.

In order to understand the rationale for the proposed regulation, it is necessary to understand the history and nature of financial corporations under the California Revenue and Taxation Code. In particular, it is necessary to understand how financial corporations have been defined in specific settings by the California courts and the Board of Equalization.

I. HISTORICAL BACKGROUND

Financial corporations (and banks) doing business in California pay a franchise tax, according to or measured by net income for the next preceding year, at a higher rate than other corporations. (Cal. Rev. & Tax. Code § 23183.) That tax rate is

fixed periodically by Franchise Tax Board. (Cal. Rev. & Tax. Code § 23186.) The reason that a higher rate is imposed upon financial corporations (and banks)[1/] is that it is, by statute, in lieu of all other taxes and licenses, state, county and municipal,[2/] upon the banks and financial corporations, except taxes upon their real property, local utility user taxes, sales and use taxes, state energy resources surcharge, state emergency telephone users surcharge, and motor vehicle and other vehicle registration license fees and any other tax or license fee imposed by the state upon vehicles, motor vehicles or the operation thereof. (Cal. Rev. & Tax. Code § 23182.)

California's method of taxing financial corporations, and the related issue of what constitutes a "financial corporation" for purposes of the California Bank and Corporation Tax Law, can be traced to the states' first attempts to impose taxes upon national banks.

In M'Culloch v. Maryland (1819) 4 Wheat 316, 4 L.Ed.

1/ For example, for income year 1989, the California franchise tax rate for banks and financial corporations was 10.668%. The rate for corporations other than banks and financial corporations was 9.3%. (See 1989 FTB Form 100, California Corporation Franchise or Income Tax Return.)

2/ Litigation is pending on the issue of whether a charter city may impose business license taxes on a financial corporation, notwithstanding Section 23182. In California Fed. Savings and Loan Assn. v. City of Los Angeles (Dec. 1989) 216 Cal.App.3d 907, the court of appeal held that under the home rule doctrine, deriving from Cal. Const., art. XI, §5, subd. (a), the power of a charter city to impose taxes for revenue purposes, including business license taxes, is strictly a municipal affair, and that the Los Angeles city business license tax was not preempted by Rev. & Tax. Code § 23182. On March 15, 1990, the California Supreme Court granted review (Case No. S013951), and the case is now pending before that Court.

579, the United States Supreme Court declared unconstitutional a state tax on the Bank of the United States. Chief Justice Marshall stated in the opinion that such a tax was "a tax on the operation of an instrument employed by the government of the Union to carry its powers into execution." (4 L.Ed. at 609.) A long line of subsequent decisions by the Court firmly established this principle first stated in M'Culloch that the States are without power, unless authorized by Congress, to tax federally created or national banks. (See Agricultural Nat. Bank v. Tax Commission (1968) 392 U.S. 339, 340, 20 L.Ed.2d 1138, 1140, and cases cited therein.) Beginning in 1864, Congress waived federal immunity by passing the National Bank Act (13 Stat. 111, 12 U.S.C. § 548) which permitted states to tax national banks by imposing certain specified types of taxes. The National Bank Act was subsequently amended on several occasions, with all tax immunity on national banks ending in 1976, as long as the method of state taxation is not discriminatory. (See generally, Hellerstein, I State Taxation (1983) § 10.5, p. 663; McCray, Constitutional Issues in State Income Taxes: Financial Institutions, 51 Albany L.Rev. 895, 900 (1987).)

The concept of the financial corporation as a special entity for tax purposes can be traced in California to the 1929 Bank and Corporation Tax Act ("the Act") (Stats. 1929, ch. 13, pp. 19-20). The classification "financial corporations" was made in the Act for the purpose of complying with 12 U.S.C. § 548 ("the federal statute") which prohibited discrimination in taxation between national banks and financial corporations, and

the term was used in the Act in the same sense as in the federal statute. (Crown Finance Corp. v. McColgan (1943) 23 Cal.2d 280, 282.) The federal statute then provided in pertinent part:

> "The legislature of each State may determine and direct, subject to the provisions of this section, the manner and place of taxing all the shares of national banking associations located within its limits. The several States may (1) tax said shares, or (2) include dividends derived therefrom in the taxable income of an owner or holder thereof, or (3) tax such associations on their net income, or (4) according to or measured by their net income, provided the following conditions are complied with: 1. (a) The imposition by any State of any one of the above four forms of taxation shall be in lieu of the others, except as hereinafter provided in subdivision (c) of this clause. (b) In the case of a tax on said shares the tax imposed shall not be at a greater rate than is assessed upon other moneyed capital in the hands of individual citizens of such State coming into competition with the business of national banks: . . . (c) In case of a tax on or according to or measured by the net income of an association, the taxing State may, except in case of a tax on net income, include the entire net income received from all sources, but the rate shall not be higher than the rate assessed upon other financial corporations nor higher than the highest of the rates assessed by the taxing State upon mercantile, manufacturing, and business corporations doing business within its limits. . . ." (See Crown Finance, supra, 23 Cal.2d at 283-284.)

The intent of the federal statute was expressed in First Nat. Bank v. Anderson (1926) 269 U.S. 341, 347-348, 70 L.Ed. 295, 302-303, as follows:

> "The purpose of the restriction is to render it impossible for any state, in taxing the shares, to create and foster an unequal and unfriendly competition with national banks, by favoring shareholders in state banks or individuals interested in private banking or engaged in operations and investments normally common to the business of banking." (See also H.A.S. Loan Service, Inc. v. McColgan (1943) 21 Cal.2d 518, 520.)

Of the four permissible methods by which a state could tax national banks under the federal statute, California chose the fourth method allowing for a tax on net income. Accordingly, financial corporations were classed under the Act with banks, both national and state, in order that the tax burden they would bear would not be less than that of banks, and thus in harmony with the federal statute. "The manifest purpose of the Legislature in establishing the classification 'financial corporations' was to avoid the tax discrimination denounced by the federal statute." (H.A.S. Loan Service, Inc. v. McColgan (1943) 21 Cal.2d 518, 520; see also Crown Finance Corp., supra, 23 Cal.2d at 283.)[3/]

II. THE TWO-PART DEFINITION OF "FINANCIAL CORPORATION"

Neither the federal statute nor the Act defined "financial corporation." The first California decision to define the term was Morris Plan Co. v. Johnson (1940) 37 Cal.App.2d 621, where the court articulated the requirement that a financial

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[3/] This goal of equal treatment is also reflected in the legislative finding made in conjunction with the 1979 amendments to Cal. Rev. & Tax. Code § 23182: "The amendment to Revenue and Taxation Code Section 23182 contained in this act reaffirms the Legislature's longstanding purpose of insuring competitive parity between banks and financial corporations by subjecting both types of institutions to an equivalent tax burden. Equal tax treatment of banks and financial corporations promotes the continued existence of both types of institutions thereby affording a full range of financial services at competitive rates. Moreover, taxation of banks and financial corporations at the rate determined under Revenue and Taxation Code Section 23186 insures that their tax burden will be comparable to the combined state and local tax burdens of nonfinancial corporations subject to Revenue and Taxation Code Section 23151." (Stats. 1979, ch. 1150, § 20, p. 4220.)

corporation is a corporation which deals in money as distinguished from other commodities:

> "Competition within the meaning of section 5219, Revised Statutes of the United States, does not mean there should be a competition as to 'all phases of the business of national banks . . . section 5219 is violated whenever capital, substantial in amount when compared with the capitalization of national banks, is employed either in a business or by private investors in the same sort of transactions as those in which national banks engaged and in the same locality in which they do business. . . . It is enough as stated if both engage in seeking and securing in the same locality capital investments of the class now under consideration which are substantial in amount, . . . even though the competition be with some, but not all, phases of the business of national banks, or it may arise from the employment of capital invested by institutions or individuals in particular operations or investment like those of national banks. . . .'
>
> "Taking up the attack on the finding that the plaintiff is not a 'financial corporation,' the briefs of counsel revolve around the fact that the Franchise Tax Act does not define the term. That contention is not helpful. . . . The word 'financial' when used with reference to corporations, refers to corporations dealing in money as distinguished from other commodities. (Webster's New International Dictionary.) Furthermore, to compete with a national bank implies the performance of some banking functions performed by a national bank. It follows that the words 'financial corporation,' as used in section 5219, Revised Statutes, and adopted into our Franchise Tax Act, designate and include moneyed corporations performing some of the functions of a national bank. . . ." (37 Cal.App.2d at 623-624, citations omitted, emphasis added.)

The California Supreme Court in 1943 in Crown Finance, supra, then added a second element to the definition of a financial corporation by holding that a financial corporation must be in "substantial competition with the business of national banks." Specifically, the Court in Crown Finance stated:

"Neither the federal statute nor the state act defines the term 'financial corporations.' However, in the federal act, in the case of a tax on national bank shares as distinguished from a tax measured by or according to the income, it is provided that the tax may not be greater than upon moneyed capital coming into competition with the business of national banks. . . . That clause is interpreted to mean that: 'The purpose of the restriction is to render it impossible for any State, in taxing the shares, to create and foster an unequal and unfriendly competition with national banks, by favoring shareholders in state banks or individuals interested in private banking or engaged in operations and investments normally common to the business of banking. (First Nat. Bank v. Anderson, 269 U.S. 341, 347 [46 S.Ct. 135, 70 L.Ed. 295].) Inasmuch as the broad purpose of the restriction in the federal statute on state taxation of national banks is to prevent discrimination between national banks and financial corporations (See Tradesman [Nat.] Bank v. Tax Comm'n, 309 U.S. 560 [60 S.Ct. 688, 84 L.Ed. 947]), and there would not likely be any discrimination where the financial corporations were not competing with national banks, we believe that a corporation may not be classed as financial under the state act unless it is in substantial competition with the business of national banks. Moreover, financial corporations being placed in a special class without definition, the other portions of the federal statute (12 U.S.C.A., sec. 548, clause 1(b)), which refer to activities similar to those customarily associated with corporations engaged in financial business, should control. The reference in section 548, clause 1(b), is to 'moneyed capital.' The word 'financial' when used with reference to corporations indicates dealing in money as distinguished from other commodities. (Morris Plan v. Johnson, supra, p. 624.) The distinguishing feature between 'mercantile, manufacturing, and business' corporations mentioned in section 548 and financial corporations would therefore appear to be the dealing in moneyed capital. It is reasonable to assume that discrimination would not be present unless the financial corporation was competing with national banks. This is indicated in the above quotation from First National Bank v. Anderson, 269 U.S. 341, 347 [46 S.Ct. 135, 70 L.Ed. 295]." (23 Cal.2d at 284-285, emphasis added.)

Accordingly, a two-part test emerged from Morris Plan and Crown Finance for defining a financial corporation.[4/] Under that test, a financial corporation is a corporation which (1) deals in money or moneyed capital; (2) in substantial competition with the business of national banks. This test, which has been incorporated into subsection (a) of the proposed regulation, has been consistently followed not only by the California courts, but also by the Board of Equalization. (See, e.g., Marble Mortgage Co. v. Franchise Tax Board (1966) 241 Cal.App.2d 26; Appeal of California State Employees Credit Union No. 1, Cal. St. Bd. of Equal., Dec. 13, 1961, CCH Cal. Tax Reports ¶ 201-874; Appeals of The Diners' Club, Inc., Cal. St. Bd. of Equal., Sept. 1, 1967, CCH Cal. Tax Reports ¶ 203-419; Appeal of First Investment Service Co., Cal. St. Bd. of Equal., July 31, 1973, CCH Cal. Tax

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4/ It should be noted that this two-part test which has developed for purposes of applying the financial tax rate does not define "financial corporations" for all purposes. Under Cal. Rev. & Tax. Code § 25110, the income and apportionment factors of certain affiliated entities are taken into account by a taxpayer which makes a "water's-edge" election. Among those entities included in a taxpayer's water's-edge combined report under subdivision (a)(5) of Section 25110 are foreign banks and foreign corporations with less than twenty percent of their factors in the United States, which are included only to the extent of their income derived from or attributable to sources within the United States. 18 Cal. Code of Regs., § 25110(d)(2)(G)(i) provides that the source of such United States income shall be determined in accordance with the sourcing rules of the Internal Revenue Code and the regulations adopted pursuant thereto. Treas. Reg. §1.864-4(c)(5) provides for special sourcing rules relating to banking, financial or similar business activity, and defines "banking, financing or similar business" for purposes of those sourcing rules. The proposed regulation defining "financial corporation" for purposes of Cal. Rev. & Tax. Code § 23183 et seq. is not intended to and shall not have any effect upon the use of the federal regulatory definitions of "banking, financing or similar business" for purposes of Cal. Rev. & Tax. Code § 25110.

Reports ¶ 204-965; Appeal of Southern Securities Corporation, Cal. St. Bd. of Equal., Aug. 16, 1977, CCH Cal. Tax Reports N.R.; Appeal of Atlas Acceptance Corporation, Cal. St. Bd. of Equal., July 29, 1981, CCH Cal. Tax Reports 400-015; Appeal of Avcar Leasing, Inc., Cal. St. Bd. of Equal., March 31, 1982, CCH Cal. Tax Reports ¶ 400-249; Appeal of Cashman Investment Corporation, Cal. St. Bd. of Equal., July 29, 1986, CCH Cal. Tax Reports ¶ 401-373.) The most recent published decision on this issue in any forum, judicial or administrative[5/], is the Board of Equalization's 1986 decision in Appeal of Cashman Investment Corporation, supra, where the Board stated:

> "The term 'financial corporation' is not defined by statute, but the courts have developed a two-part test for determining whether a corporation is to be classified as a financial corporation: (1) it must deal in money or moneyed capital as distinguished from other commodities (The Morris Plan Co. v. Johnson, 37 Cal.App.2d 621, 624 [100 P.2d 493] (1940)), and (2) it must be in substantial competition with national banks. (Crown Finance Corp. v. McColgan, 23 Cal.2d 280, 284 [144 P.2d 331 (1943).)"

Although "financial corporation" is not defined in the Revenue and Taxation Code[6/], corporations engaging in certain

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5/ To be precise, the two most recent decisions by the Board of Equalization regarding whether the taxpayer was a financial corporation are Appeal of Westamco Investment Company, Cal. St. Bd. of Equal., Aug. 17, 1989 (unpublished summary/memorandum decision, Case No. 86A-0661), and Appeal of Thomas Funding Corp. of California, Cal. St. Bd. of Equal., April 1, 1988 (unpublished summary/memorandum decision, Case No. 86A-0608). However, such summary decisions "are not citable authority and will not be relied upon or given any consideration by this board [of equalization] as precedent." (Appeal of Charles W. Fowlks, Opinion on Petition for Rehearing, Cal. St. Bd. of Equal., Oct. 31, 1989.)

6/ All further statutory references herein are to the

(CONT.)

leasing activities have been excluded by statute since 1979 from the definition of a financial corporation. Specifically, Section 23183, subdivision (b) provides in full: "For purposes of this article, the term 'financial corporation' does not include any corporation, including a wholly owned subsidiary of a bank or bank holding company, if the principal business activity of such entity consists of leasing tangible personal property." Subdivision (b) was added to Section 23183 by AB 66, Stats. 1979, ch. 1150, operative for income years beginning on or after January 1, 1979.[7/] This statutory exception to the two-part test for a financial corporation has been incorporated by reference into subsection (a) of the proposed regulation.

III. DEFINITION OF "PREDOMINANTLY"

Even after taking into account the statutory exception for corporations engaging in certain leasing activities, not every corporation which deals in money or moneyed capital in substantial competition with the business of national banks is a financial corporation for purposes of Section 23183. Another requirement of a "financial corporation" is a predominance test, meaning that over fifty percent of its total gross income is

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California Revenue and Taxation Code, except where otherwise indicated.

[7/] Appeal of Avcar Leasing, Inc., Cal. St. Bd. of Equal., Mar. 31, 1982, CCH Cal. Tax Reports ¶ 400-249, held that the taxpayer, a California corporation engaged in the business of leasing automobiles, had been properly classified by Franchise Tax Board as a financial corporation for the income year 1977. Footnote 4 of that decision states, "Pursuant to subdivision (b) of section 23183, operative for income years beginning on or after January 1, 1979, appellant would apparently no longer qualify as a 'financial corporation'."

attributable to dealings in money or moneyed capital in substantial competition with the business of national banks. The reason for including this test in the proposed regulation is a pragmatic one.

Once a corporation is classified as a financial corporation under Section 23183, all of its California taxable income is taxed at the financial corporation rate. A financial corporation may have income from non-financial, as well as financial activities. However, because the financial corporation rate tax is imposed under Section 23183 et seq. on an entity basis, even the non-financial income of a financial corporation is taxed at the financial corporation tax rate. No legal authority exists for dividing the income of a financial corporation so as to impose the financial corporation tax rate on the "financial" portion of its income and the general corporation tax rate on the non-financial portion of its income. (See Cal. Rev. & Tax. Code §§ 23183-23186; Appeals of Croddy Corporation, Cal. St. Bd. of Equal., Sept. 1, 1966, CCH Cal. Tax Reports ¶ 203-418; Appeals of Ponticopoulos, Inc., Cal. St. Bd. of Equal., Sept. 1, 1966, CCH Cal. Tax Reports ¶ 203-419. See also Marble Mortgage Co. v. Franchise Tax Board, supra, 241 Cal.App.2d 26, 30, where the Court of Appeal pointed out that the taxpayer's gross income from lending activities exceeded fifty-one percent during the years in issue. See also Traynor & Keesling, Recent Changes in The Bank And Corporation Franchise Tax Act (1934) 22 Cal. Law. Rev. 499, 512 n. 34.)

Because of the significance of being classified as a

financial corporation and the potential hardships if corporations were reclassified as general or financial on a frequent basis, the predominance requirement recognizes that reclassification should not occur based upon an occasional year in which the total gross income of the corporation in question deviates slightly from the fifty percent standard. For this reason, subsection (b)(1) of the proposed regulation provides that the classification of a corporation as a financial corporation or as a non-financial corporation will not be changed based upon an occasional year in which its gross income does or does not exceed the fifty percent level. The proposed regulation provides that for the classification of a corporation as a financial (or non-financial) to be changed, there must be a shift in the predominant character of the gross income for two consecutive years and the average of the corporation's gross income in the current and the immediately preceding two years must fail (or satisfy) the predominance test. This provision will ensure that a financial corporation is not reclassified as a general corporation if in an occasional year its gross income from dealing in money or moneyed capital in substantial competition with the business of national banks drops below 50 percent.

The predominance test set forth in the proposed regulation also recognizes that the gross income of a corporation may change drastically as the result of an incidental or occasional sale of an asset. In order to account for such changes, subsection (b)(1) of the proposed regulation provides that where substantial amounts of gross income arise from an

incidental or occasional sale of an asset of the taxpayer corporation, such gross income shall be excluded from the gross income calculation for purposes of the predominance test. This language is modeled upon language found in Section 25137(c)(1)(A) of Title 18 of the California Code of Regulations, which provides that where substantial amounts of gross receipts arise from an incidental or occasional sale of a fixed asset used in the regular course of the taxpayer's trade or business, such gross receipts shall be excluded from the sales factor. For example, gross income from the sale of a headquarters building shall be excluded from the gross income calculations in subsection (b)(1) of the proposed regulation.

A question arises regarding whether the inclusion of this predominance test in the proposed regulation is inconsistent with several early Board of Equalization decisions, specifically Appeals of Ponticopoulos, Inc., supra, and Appeals of Croddy Corporation, supra, (both decided on Sept. 1, 1966); Appeal of Continental Securities, Cal. St. Bd. of Equal., Feb. 3, 1944, CCH Cal. Tax Reports N.R.; and Appeal of Bankamerica Agricultural Credit Corporation, Cal. St. Bd. of Equal., July 7, 1942, CCH Cal. Tax Reports N.R. Although the facts are less than clear, it appears that in some of these cases fifty percent or less of the corporations' total gross income for some of the years in issue might have been derived from or attributable to dealings in money or moneyed capital on its own account and in substantial competition with the business of national banks. Yet, in each case the Board of Equalization concluded the corporation was a

financial corporation for all the years in issue, with no mention made of applying a predominance test.

In view of the fact these decisions did not even mention a predominance test, the decisions are not expressly inconsistent with the inclusion of a predominance test (including the "occasional year" provisions) in the proposed regulation. It is a well-established rule of law that a case is not authority for propositions not considered therein. (Linvill v. Perello (1987) 189 Cal.App.3d 195, 200; Consumers Lobby Against Monopolies v. Public Utilities Com. (1979) 25 Cal.3d 891, 902 - "It follows, of course, that a case is not authority for a point that was not actually decided by the court."; Leaming v. Municipal Court (1974) 12 Cal.3d 813, 816; In re Tartar (1959) 52 Cal.2d 250, 258.) If, arguendo, these decisions are read to inferentially stand for the proposition that a corporation may be in substantial competition with national banks even where less than the predominant portion of its gross income is from non-financial activities, then the decisions are inconsistent with the proposed regulation. In this situation, Franchise Tax Board staff takes the position that the predominance test in the proposed regulation supersedes, and controls over, Ponticopoulos, Croddy, Continental Securities, and Bankamerica Agricultural Credit Corporation.

IV. DEFINITION OF "DEALS IN"

The proposed regulation provides that in order for a corporation to be classified as a financial corporation, it is necessary that the corporation "deals in" money or moneyed

capital. "Deals in" is defined in subsection (b)(2) of the proposed regulation to mean transactions of the corporation in the course of a trade or business on its own account, as opposed to brokering the capital of others. For example, a corporation which sells its own assets, or buys property which it then treats as its own asset, is engaging in transactions on its own account and may be a financial corporation. This situation is in contrast to where the corporation is acting as a broker and buying and selling the assets of others. In this latter instance, the corporation cannot be classified as a financial corporation because it is not dealing in money or moneyed capital on its own account (and quite possibly is not dealing in capital on anyone's account, but is actually dealing in services).

This requirement that a financial corporation must deal in its own money or moneyed capital is supported by Marble Mortgage Co., supra, 241 Cal.App.2d 26, 35, where the court declared:

> "The focus is on competition among financial businesses for investment capital and the danger sought to be averted is that such capital might abandon the national banks for other financial enterprises if the latter were made relatively more profitable by preferential tax treatment. (Mercantile Nat. Bank v. New York, 121 U.S. 138 [7 S.Ct. 826, 30 L.Ed. 895]). Ultimate attention, however, is directed by the federal provision to the question of whether 'other moneyed capital' employed in competition with the business of national banks receives favored tax treatment, for it is primarily that capital which is attracted to or dissuaded from investment in national banks by the relative profitability of the other financial enterprises available for investment." (Emphasis added.)

Marble Mortgage, quoting from First Nat. Bank v.

Hartford, also reiterated the proposition that "[c]ompetition in the sense intended arises not from the character of the business of those who compete but from the manner of the employment of the capital at their command." (241 Cal.App.2d at 36.) Marble thus focuses upon the "attraction" of capital to national banks and the "employment" of the capital at "command." These concepts are inconsistent with the notion of a financial corporation being a corporation which merely brokers the capital of others.

V. DEFINITION OF "MONEY OR MONEYED CAPITAL"

Another requirement for a financial corporation under the proposed regulation is that it must deal in "money or moneyed capital." The question of what constitutes "money" or "moneyed capital" has been addressed by the courts and the Board of Equalization in a variety of situations. However, no comprehensive definition has ever been provided. The terms include, among other items, coin, cash and currency; loans, mortgages and deeds of trust (e.g., H.A.S. Loan Service, Inc. v. McColgan, supra, 21 Cal.2d 518; Marble Mortgage Co. v. Franchise Tax Board, supra, 241 Cal.App.2d 26; Appeal of First Investment Service Co, supra); conditional sales contracts and commercial paper (e.g., Appeal of Atlas Acceptance, supra; Appeal of Cashman Investment Corporation, supra); credit cards (e.g., Appeals of The Diners' Club, Inc., supra); and accounts receivable (e.g., Appeal of Cal-West Business Services, Inc., Cal. St. Bd. of Equal., Nov. 6, 1970, CCH Cal. Tax Reports ¶ 204-429). Subsection (b)(3) of the proposed regulation provides that "money or moneyed capital" includes, but is not limited to, these

specific items.

VI. DEFINITION OF "IN SUBSTANTIAL COMPETITION"

Another requirement for a financial corporation under the proposed regulation is that it must operate in "substantial competition" with the business of national banks. In this regard, Morris Plan held:

> "Competition . . . does not mean there should be a competition as to 'all phases of the business of national banks. . . . It is enough as stated if both are engaged in seeking and securing in the same locality capital investments of the class now under consideration which are substantial in amount, . . . even though the competition be with some, but not all, phases of the business of national banks, or it may arise from the employment of capital invested by institutions or individuals in particular operations or investments like those of national banks.'" (37 Cal.App.2d at 623-624, citation omitted.)

As pointed out in Marble Mortgage, "competition with national banks may exist even though the terms and conditions of the business transactions are not identical." (241 Cal.App.2d at 39.) The Board of Equalization concluded in Appeal of Atlas Acceptance Corporation, supra, that "[i]t is not necessary to show that national banks and competing investors solicit the same customers for the same loans or investments, but merely that competing investors make the same type of investments made by national banks, e.g., the discounting of commercial paper." Marble Mortgage reinforces this point, having concluded, "the only question here presented is whether the activities of Marble relate to moneyed capital from a source in substantial competition with the source of capital available for investment in national banks." (241 Cal.App.2d at 35, emphasis added.) Subsection (b)(4) of the proposed regulation defines "in

substantial competition" consistent with these authorities.

It should be noted that the above cited language of Morris Plan which refers to seeking and securing capital investments "in the same locality" appears antiquated in view of the changes which have taken place in the banking industry since that case was decided in 1940. Deregionalization of banking under federal law, the rise of branch banking under state and federal law, the rise of electronic and "branchless" banking, and the rise of interstate banking in California[8/] are all developments which cast doubt upon the continued legal significance of the "same locality" standard.[9/] In any event,

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8/ California will allow interstate banking through holding companies beginning in 1991 (Stats 1986, ch. 1057, §§ 2-3; Finan. Code § 3750 et seq.), and already allows limited interstate banking (Stats 1986, ch. 1250, §§ 2-3; Finan. Code § 3770 et seq.).

9/ For example, a national bank's usage of a shared automatic teller machine, which the bank does not own or rent, does not constitute establishment and operation of a "branch bank" within the meaning of the McFadden Act. (Independent Bankers Ass'n. v. Marine Midland Bank (2d Cir. 1985) 757 F.2d 453, 463, cert. den. 476 U.S. 1186.) There the court commented: "Banking, like other industries, has changed radically since the McFadden Act was passed in 1927. 'Brick and mortar' banking, with a single physical locus of bank-customer transactions, has been supplemented by many other forms of communication that could not have been contemplated in 1927. In the past two decades in particular, the industry has been transformed by the advent of computer technology. . . . Congress in 1927 could not possibly have foreseen the current revolution in banking practices. The McFadden Act pre-dated the invention of computers as well as their application to banking through electronic funds transfer systems. Banking is no longer confined to physical transactions. A rigid application of the language of 1927 to the new technology fails to confront the economic realities facing a court, and leads to anomalous results." (757 F.2d at 457, 459.) These comments are equally applicable to the "same locality" concept. For a general discussion of technological developments and changes in bank regulatory laws, see ACIR, State Taxation of Banks: Issues and Options (1989), pp. 7-12.)

this standard certainly must be read in contemporary times in the broadest possible terms, with "locality" in appropriate circumstances perhaps being construed as the entire State of California.

VII. DEFINITION OF "BUSINESS OF NATIONAL BANKS"

Finally, subsection (b)(5) of the proposed regulation defines the "business of national banks," as that phrase is used in the definition of "financial corporation." This concept is an elusive one to define with any degree of precision because of the ever-changing scope of activities which national banks are permitted to engage in by statute, federal regulatory authorities and the courts. For instance, 12 U.S.C. § 24 sets forth the powers of national banks as permitted by federal statutory law. Federal regulation 12 C.F.R. § 225.25 provides additional guidance regarding activities which are so closely related to banking or managing or controlling banks as to be a proper incident thereto and legally may be engaged in by a bank holding company or a subsidiary thereof. A listing of securities activities of banking organizations permissible under federal law is found in Isaac & Fein, Facing the Future-Life Without Glass-Steagall, 37 Catholic U. Law Rev. 281, 320-346 (1988).

Accordingly, because of the constant state of flux regarding the permissible range of activities of national banks, the proposed regulation defines the "business of national banks" by reference to mean the business in which national banks are permitted to operate, without attempting to comprehensively identify those activities.

EXHIBIT L: 2

Illinois General Assembly Resolutions
(November 30, 1990)

STATE OF ILLINOIS
EIGHTY-SIXTH GENERAL ASSEMBLY
SENATE

Senate Resolution No. 1502

Offered by Senators Woodyard, Keats and Zito

WHEREAS, The states of Indiana, Tennessee and Minnesota have enacted legislation imposing taxes on Illinois financial institutions with respect to business conducted in those states; and

WHEREAS, The adoption of said legislation by Indiana, Tennessee and Minnesota will result in the duplicative taxation of Illinois financial institutions and the incompatible and inequitable apportionment of the tax bases of Illinois financial institutions; and

WHEREAS, The adoption of said legislation by Indiana, Tennessee and Minnesota will place undue burdens on the ability of Illinois financial institutions to achieve compliance in the filing of their tax returns; and

WHEREAS, The adoption of said legislation by Indiana, Tennessee and Minnesota will cause Illinois financial institutions to withdraw credit availability from those states; and

WHEREAS, The adoption of said legislation by Indiana, Tennessee and Minnesota will cause Illinois financial institutions to increase the cost of credit made available by them to the residents and businesses of those states; and

WHEREAS, The adoption of said legislation by Indiana, Tennessee and Minnesota will cause Illinois businesses to refrain from investing in those states; and

WHEREAS, The adoption of said legislation by Indiana, Tennessee and Minnesota will foster legislation of a retaliatory nature by Illinois and other states that do not adopt said legislation; and

WHEREAS, These and other consequences of said legislation are detrimental to interstate commerce, cooperation among the states, intrastate economic development, safety and soundness within the financial services industry, and consumers and businesses; therefore, be it

RESOLVED, BY THE SENATE OF THE EIGHTY-SIXTH GENERAL ASSEMBLY OF THE STATE OF ILLINOIS, that the State of Illinois hereby rejects the multistate taxation of financial institutions based on the "source" principle of attributing income to the state where customers, transactions or secured properties are located; and be it further

RESOLVED, That the State of Illinois urges the states of Indiana, Tennessee and Minnesota to repeal said legislation to the extent such laws purport to impose taxes on Illinois financial institutions; and be it further

RESOLVED, That the State of Illinois urges the fifty states of the Union to consider and resolve the problems of multiple taxation and taxpayer compliance costs engendered by said legislation prior to further enactment of legislation intended to equitably apportion the tax bases of financial institutions doing business in multiple states; and be it further

RESOLVED, That a suitable copy of this preamble and resolution be presented to the Governors and Presidents of the Senate of Indiana, Tennessee, and Minnesota, and to the respective heads of the Departments of Revenue of the fifty states of the Union.

Adopted by the Senate, November 30, 1990.

Philip J. Rock
President of the Senate

Mimi Hauder
Secretary of the Senate

STATE OF ILLINOIS
EIGHTY-SIXTH GENERAL ASSEMBLY
HOUSE OF REPRESENTATIVES

House Resolution No. 2419

Offered by Representative Black

WHEREAS, The states of Indiana, Tennessee and Minnesota have enacted legislation imposing taxes on Illinois financial institutions with respect to business conducted in those states; and

WHEREAS, The adoption of said legislation by Indiana, Tennessee and Minnesota will result in the duplicative taxation of Illinois financial institutions and the incompatible and inequitable apportionment of the tax bases of Illinois financial institutions; and

WHEREAS, The adoption of said legislation by Indiana, Tennessee and Minnesota will place undue burdens on the ability of Illinois financial institutions to achieve compliance in the filing of their tax returns; and

WHEREAS, The adoption of said legislation by Indiana, Tennessee and Minnesota will cause Illinois financial institutions to withdraw credit availability from those states; and

WHEREAS, The adoption of said legislation by Indiana, Tennessee and Minnesota will cause Illinois financial institutions to increase the cost of credit made available by them to the residents and businesses of those states; and

WHEREAS, The adoption of said legislation by Indiana, Tennessee and Minnesota will cause Illinois businesses to refrain from investing in those states; and

WHEREAS, The adoption of said legislation by Indiana, Tennessee and Minnesota will foster legislation of a retaliatory nature by Illinois and other states that do not adopt said legislation; and

WHEREAS, These and other consequences of said legislation are detrimental to interstate commerce, cooperation among the states, intrastate economic development, safety and soundness within the financial services industry, and consumers and businesses; therefore, be it

RESOLVED, BY THE HOUSE OF REPRESENTATIVES OF THE EIGHTY-SIXTH GENERAL ASSEMBLY OF THE STATE OF ILLINOIS, that the State of Illinois hereby rejects the multistate taxation of financial institutions based on the "source" principle of attributing income to the state where customers, transactions or secured properties are located; and be it further

RESOLVED, That the State of Illinois urges the states of Indiana, Tennessee and Minnesota to repeal said legislation to the extent such laws purport to impose taxes on Illinois financial institutions; and be it further

RESOLVED, That the State of Illinois urges the fifty states of the Union to consider and resolve the problems of multiple taxation and taxpayer compliance costs engendered by said legislation prior to further enactment of legislation intended to equitably apportion the tax bases of financial institutions doing business in multiple states; and be it further

RESOLVED, That a suitable copy of this preamble and resolution be presented to the Governors and Speakers of the House of Indiana, Tennessee, and Minnesota, and to the respective heads of the Departments of Revenue of the fifty states of the Union.

Adopted by the House of Representatives on November 30, 1990.

Michael J. Madigan

Michael J. Madigan, Speaker of the House

John O'Brien

John F. O'Brien, Clerk of the House

EXHIBIT L: 3

Notice of Proposed Rule for Definition of Financial Organization (Draft), Department of Illinois

DEPARTMENT OF REVENUE

NOTICE OF PROPOSED RULE

DRAFT

Part Heading: Income Tax

Code Citation: 86 Ill. Adm. Code 100

A description of the rule: Section 1501(a)(8) of the Illinois Income Tax Act (35 ILCS 5/1501(a)(8)) ("IITA") provides the statutory definition of a "financial organization". Practitioners requested that the Department attempt to adopt a regulation which defines the types of entities contained in the "financial organization" definition.

The Department began this attempt with the publication of a discussion draft regulation in the Illinois Register on June 26, 1992. This took the form of a regulatory agenda. The Administrative Procedure Act, 5 ILCS 100/5-60, provides for the Department to submit for publication any rule it is considering proposing in the future for the purpose of elicting public comment.

We received written and verbal comments from taxpayers in the financial industry and interested practitioners in response to the regulatory agenda. Those comments were taken into account in determining whether to proceed in all or in part on proposing to promulgate a regulation.

Comments on the Department's discussion draft were received in four categories: (1) references to the Illinois statutes; and the definitions of (2) "investment company"; (3) "bank holding company"; and (4) "sales finance company". All comments were seriously considered in revising the language from the regulatory agenda. The Department has decided that enough progress has been made to commit the definition to the formal rulemaking process. To give background both to practitioners and to the general public, we think it would be beneficial to summarize the comments we received and our reaction to those comments.

References to Illinois Statutes: The first category of comments was the view that the definitions of the various entities included in the definition of "financial organization" should not reference the provisions of the Illinois Compiled Statutes that govern such entities. This was raised in the context of an entity that operates exclusively outside of Illinois, has a unitary relationship with financial organization entities that operate in Illinois, and for which the Illinois regulatory provisions would not be applicable. For example, under the regulatory agenda, a currency exchange operating exclusively in Indiana would not qualify to be included in a unitary group with currency exchanges in Illinois. The comment was that such a distinction would discriminate against out of state financial organizations.

Several suggestions were proposed on how this concern could be addressed. It was proposed that definitions based on business activities could be developed that do not make reference to Illinois law. Alternatively, it was proposed that the definitions be modified to provide that the Illinois statutory provisions only apply if the entity operates in Illinois. Another alternative proposal was that if the definitions were to reference Illinois law, a rebuttable presumption could be provided which those otherwise unitary entities operating outside of Illinois could overcome. We believe those comments have merit and have proposed changes in response to those comments.

Investment Company Definition: The second category of comments concerned the definition of "investment company". The regulatory agenda applied the definition of "investment company" under the Investment Company Act of 1940 (ICA-40). An issuer which falls within that definition under the ICA-40 is required to register and become subject to the regulatory requirements of the U.S. Securities and Exchange Commission.

An issue was raised concerning entities which are exempt from or which otherwise fall within an exception to the definition of "investment company" under the ICA-40. The argument was made that even though such an entity is not an "investment company" within the meaning of the ICA-40, it should nonetheless be entitled to be treated as an "investment company" within the meaning of the term in the IITA "financial organization" definition. The Department respectfully disagrees with that argument.

Bank Holding Company Definition: The third category of comments related to the definition of "bank holding company" and whether the General Assembly intended that that term have the same meaning as in the Bank Holding Company Act of 1956 (BHCA-56) when it was added to the "financial organization" definition in P.A. 83-217 for taxable years ending on or after December 31, 1982. The regulatory agenda applied the definition of "bank holding company" in the BHCA-56. Entities falling within that definition which the BHCA-56 treats as bank holding companies are required to register and become subject to the regulatory requirements of the Federal Reserve Board.

An issue was raised concerning whether a "savings and loan holding company" should be treated as a "bank holding company". Savings and loan holding companies which control savings associations (which include savings banks) are separately regulated under the Home Owners' Loan Act by the U.S. Department of Treasury, Office of Thrift Supervision. Those entities and the savings associations (insured institutions) which they control are specifically excepted from the registration and regulatory requirements of the BHCA-56 under which bank holding companies which control banks operate.

The argument was made that even though a "savings and loan holding company" is not a "bank holding company" under the BHCA-56, such an entity should nonetheless be entitled to be treated as a "bank holding company" within the meaning of the term in the IITA "financial organization" definition. The Department respectfully disagrees with this argument. Our analysis indicates that the intent of the General Assembly was in reference only to entities covered by the BHCA-56.

A second issue raised concerned entities which are exempted or otherwise grandfathered in some manner from being treated as a "bank holding company" under the BHCA-56. In comments to the regulatory agenda, one such entity specifically raised were commercial corporations which control so-called "nonbank banks". For a commercial corporation, a "nonbank bank" was a vehicle for acquiring a banking affiliate without complying with the nonbanking activity restrictions of the BHCA-56 and without being subject to the general supervisory authority of the Federal Reserve Board. Because they were specifically operated to <u>not</u> meet the definition of "bank" in the BHCA-56, an entity acquiring such a "nonbank bank" did not become a "bank holding company". Under amendments to the BHCA-56 in the Competitive Equality Banking Act of 1987 (CEBA), subject to grandfather restrictions, commercial corporations which control these nonbank banks continue to not be subject to the requirements of the BHCA-56.

The argument was made that even though those entities are not subject to the regulation and registration requirements under the BHCA-56 as a "bank holding company", they are nonetheless entitled to be treated as a "bank holding company" within the meaning of the term in the IITA "financial organization" definition. The Department respectfully disagrees with this interpretation of a "bank holding company". Our analysis indicates that the intent of the General Assembly was in reference only to entities treated as a "bank holding company" under the BHCA-56.

A third issue related to the question of "bank holding companies" and the CEBA concerned whether entities which are within a specific exception to the definition of "bank" under the BHCA-56 should nonetheless be entitled to be treated as a "bank" for purposes of the IITA "financial organization" definition. One such entity is a so-called "credit card bank" formed by a commercial corporation.

An entity whose operations are structured to be within the credit card institution exception is not a "bank" under the BHCA-56 and a commercial corporation which owns such an entity is also not a "bank holding company" under the BHCA-56. As a result, entities owning credit card institutions within the exception are not subject to the same registration and regulatory requirements as entities owning institutions within the definition of "bank" under the BHCA-56. A "credit card bank" within the exception is an institution which engages only in credit card operations, does

not accept demand deposits, does not accept savings or time deposits of less than $100,000, maintains only one office that accepts deposits, and does not engage in the business of making commercial loans. To minimize State law restrictions on their operations, these credit card banks are frequently organized as "national bank associations".

The argument was that even if a commercial corporation would not be a "bank holding company" and its credit card bank subsidiary would not be a "bank" under the BHCA-56 (i.e., not subject to the nonbanking activity restrictions of the Federal Reserve Board), the subsidiary should nonetheless be entitled to be treated as a "bank" if it chooses to incorporate under the National Bank Act and has received a Federal charter from the U.S. Department of Treasury, Office of the Comptroller of the Currency. The Department believes that only entities which are treated by all Federal regulatory authorities as "banks" should be treated as "banks" within the meaning of the term in the IITA "financial organization" definition. This would also be consistent with the IITA statutory language which provides that a "person" which is owned by a bank or bank holding company includes only those covered under the provisions of the BHCA-56.

Sales Finance Company Definition: The fourth category of comments concerned the definition of a "sales finance company". We received conflicting arguments about how this term in the "financial organization" definition should be properly interpreted. The regulatory agenda discussion draft limited the application of the definition to Illinois regulated entities dealing in consumer financing.

An issue raised related to concerns about referring solely to an Illinois statute. This was raised in the context of the possibility under the regulatory agenda that a taxpayer engaged in the consumer finance business with no Illinois nexus and which is otherwise part of an Illinois unitary group would not qualify to be treated as a sales finance company. This was a valid concern and this issue is discussed in the first category above.

A second issue raised was that the Illinois Sales Finance Agency Act, 205 ILCS 660/1 et seq., defines a sales finance agency, not a sales finance company. The argument was made that this definition could not be applied to the term "sales finance company" in the IITA as a matter of statutory construction. The Department's response to that argument is that in those states with such statutes, some states have chosen to refer to consumer finance entities as sale finance companies whereas other states have chosen to refer to the same entities as sales finance agencies. The General Assembly has merely chosen to take the latter approach in defining consumer finance entities.

A third issue raised concerned whether entities which, in the regular course of its business, are not licensed or otherwise

regulated as entities subject to consumer finance statutes should qualify as sales finance companies under the IITA. Specifically, this issue concerned whether commercial finance companies should also be treated as "sales finance companies" along with consumer finance companies. Taxpayers have argued that otherwise the Department would be distinguishing between identical businesses based on what kind of credit it extends, customers it has, or the type of paper it factors from unrelated persons. The controlling matter under this view is the financing activity that is being performed, not the type of credit or customer. The argument is that the distinction in the regulatory agenda discussion draft is beyond the legislative intent of the General Assembly because at time of enactment of the IITA in 1969, there were commercial (as well as consumer) sales financing entities in Illinois.

Those taking this view argue that this is also consistent with the UDITPA drafter's rationale for allowing for States like Illinois to adopt a special one factor apportionment formula for financial organizations as opposed to applying the three factor formula of payroll, property, and sales. Because different activities are looked at in determining the extent of a financial organization's activities in a State, a one factor formula is applied in Illinois to allow a better measure of business activities than the three factor formula. The Department believes these arguments have merit and in response changes to the "sales finance company" definition are proposed.

A fourth issue relates to entities that do not finance a product it sells but which operates as a financing intermediary in such a sale. Specifically, this issue relates to vendor financing, i.e., where an unrelated third party financial intermediary finances the sale of a manufactured product from another source, using financing vehicles such as operating leases, conditional sales agreements, single investor leases, or leveraged leases. Those financial intermediaries offering such products made conflicting arguments as to whether these types of entities qualify as "sales finance companies". **For purposes of the IITA "financial organization" definition, the "sales finance company" definition has been revised.** In determining whether an entity is engaging in sales financing or leasing, the IITA "sales finance company" definition will follow the federal income tax treatment as determined by the Internal Revenue Service.

The final issue raised concerned the argument that a parent which forms a subsidiary to facilitate the financial functions of their operating business should also qualify as a "sales finance company". An example would be a special purpose subsidiary such as those formed to monetize accounts receivable of other operating members of the affiliated group. The Department does not concur with that analysis and argues that to treat a separately incorporated aspect of the treasury function of an operating business as a "sales finance company" would elevate form over substance.

Based on the above, the Department has substantially revised the definition of "sales finance company" from the regulatory agenda. We welcome additional information from practitioners and interested taxpayers in the financial industry before the regulation is finalized.

Statutory Authority: 35 ILCS 5/1501(a)(8)

Schedule of dates for hearings, meetings or other opportunities for public participation: A public hearing on the draft rulemaking will be held on September 27, 1993 from 9:00 a.m. to Noon at the James R. Thompson Center, Chicago, Illinois, Room 9-040. The sole purpose of the public hearing is to gather public comment on the draft rules prior to the initiation of the rulemaking process. A Notice of Public Hearing was published in the September 10, 1993 edition of the Illinois Register. Persons who wish to present testimony should refer to that Notice for the procedures which will be followed in the conduct of the hearing.

Information concerning this proposed rule shall be directed to:

Constance W. Beard
Manager
Illinois Department of Revenue
Legal Services Bureau
101 W. Jefferson, 5-500
Springfield, IL 62794
Phone: (217) 782-7054

Will this rule affect small business: This rule will affect any small business that falls within the definition of "financial organization".

Other pertinent information concerning this rule: The actual text of the proposed regulation is as follows:

Section 100.9710 Financial Organizations (IITA Section 1501)

a) General definition

The term "financial organization" is defined in IITA Section 1501(a)(8) to mean any bank, bank holding company, trust company, savings bank, industrial bank, land bank, safe deposit company, private banker, savings and loan association, building and loan association, credit union, currency exchange, cooperative bank, small loan company, sales finance company, investment company, or any person which is owned by a bank or bank holding company. This definition constitutes an exclusive and exhaustive list of the types of entities which are "financial organizations" under the Illinois Income Tax Act.

b) Out-of-State Financial Organizations

Generally, an entity which does not fall within any of the categories defined herein does not qualify as a financial organization. However, in the case of an entity operating in other state jurisdictions pursuant to the laws of a State other than Illinois, the requirements of Section 1501(a)(8) will be considered to have been met by a showing that in the regular course of its trade or business, it is licensed or otherwise regulated as an entity of the type specifically identified in Section 1501(a)(8) as defined herein in the State of its commercial domicile.

c) Related Person

A "related person" as referred to herein means any person deemed to own stock under the attribution of ownership rules in 26 U.S.C. Section 318 of the Internal Revenue Code.

d) Active Trade or Business.

With the exception of the above categories relating to a bank holding company as defined in subsections (g) and (v) below, in order to be considered a "financial organization" under the above categories, an entity must also be engaged in the active conduct of a trade or business. A person is engaged in the "active conduct of a trade or business" where more than 50% of its assets are acquired or contributed from unrelated persons and where more than 50% of its gross income is received from unrelated persons in any tax year and in each of the immediately preceding two tax years. For purposes of the asset requirement, assets acquired in such a manner as to avoid this requirement (e.g., through the use of intermediaries, pass-thru entities, or other arrangements) if warranted by all of the facts and circumstances, shall be treated as assets acquired or contributed from a related person. For purposes of the income requirement, gross income from incidental or occasional transactions shall be disregarded. For purposes of applying the asset and income requirements where an entity is formed in a current tax year or in its immediately preceeding tax year, only the years for which the entity is in existence will be applied in determining whether there is an active trade or business.

e) Entities Engaged In Financial Organization and Other Activities

An entity must be primarily engaged in the operation of a financial organization as part of the regular course of its "active trade or business" (as defined in subsection (d) above) in order to be considered as engaged as a "financial organization" under any of the above categories. For this purpose, an entity engaged in activities within the definition of "financial organization" as well as other activities is deemed to be primarily engaged as a "financial organization" if more than 50 percent of the entity's assets represent assets of financial organization activities in any tax year and in each of the immediately preceeding two tax years. Where an entity is formed in a current tax year or in its immediately preceeding tax year, only the years for which the entity is in existence will be applied for purposes of this requirement. Assets acquired in such a manner as to manipulate this test (e.g., through the use of intermediaries, pass-thru entities, or other arrangements) if warranted by all of the facts and circumstances, shall be disregarded for purposes of determining whether an entity is primarily engaged in the operation of a financial organization.

f) **Bank**

The term "bank" means a corporation organized and operating as a national banking association (i.e., a national bank pursuant to the laws of the United States) which is a bank under the Bank Holding Company Act of 1956, 12 U.S.C. 1841 et seq. or a banking corporation organized and operating under the laws of the State of Illinois. The term includes all such banks governed by 12 U.S.C. Section 21 et seq. (National Bank Act) or 205 ILCS 5/2 et seq. (Illinois Banking Act).

g) **Bank Holding Company**

The term "bank holding company" means an entity treated as a bank holding company and required to be registered with the Board of Governors of the Federal Reserve System, i.e., a bank holding company within the Bank Holding Company Act of 1956, 12 U.S.C. Section 1841 et seq.

h) **Trust Company**

The term "trust company" means a corporation organized or eligible to act under the laws of the State of Illinois for the purpose of accepting and executing trusts, administering trusteeships and other fiduciary relationships for unrelated persons, as well as conducting a banking business.

The term includes all such entities of the type governed by 205 ILCS 620/1-1 et seq. (Corporate Fiduciary Act) and includes national banks, federally chartered savings and loan associations, and federally chartered savings banks which are authorized to accept and execute trusts and which are eligible to act in a fiduciary capacity in the State of Illinois.

i) **Savings Bank**

The term "savings bank" means an entity organized under, and subject to, the laws of the State of Illinois or the United States regarding stock or mutual savings banks and includes all such savings banks governed by 12 U.S.C. Section 1461 et seq. (Home Owners' Loan Act) or 205 ILCS 205/1001 et seq. (Savings Bank Act).

j) **Industrial Bank**

The term "industrial bank" means a corporation organized under, and subject to, State statutes regarding industrial banks or industrial loan companies.

k) **Land Bank**

The term "land bank" means a federally chartered land bank association organized to make loans on farm security at low interest rates as governed by 12 U.S.C., ch. 23 (Farm Credit System).

l) **Safe Deposit Company**

The term "safe deposit company" means a person organized and engaged in the business of renting safe deposit box facilities for the systematic safekeeping of valuable documents and property to unrelated customers. A safe deposit box is a locked box or safe that is in a vault under the control of a safe deposit company and used for the storage or safekeeping of personal property.

The term includes all such institutions of the type governed by 240 ILCS 5/0.01 et seq. (Safety Deposit License Act) and also includes banking or savings and loan institutions organized under the laws of the State of Illinois or of the United States which are authorized to operate a safety deposit business under the supervision of State or Federal statutes in connection with a bank, savings bank, savings and loan or trust company.

m) **Private Banker**

The term "private banker" means an unincorporated banking institution conducted as a partnership or as an individual propietorship which may be subject to State supervision and regulation depending on State statutes.

n) **Savings and Loan Association**

The term "savings and loan association" means a Federal savings association organized and operating pursuant to the laws of the United States or a savings and loan association organized and operating under the laws of the State of Illinois and includes all such mutual or stock savings and loans under 12 U.S.C. Section 1461 et seq. (Home Owners' Loan Act) or 205 ILCS 105/1-1 et seq. (Illinois Savings and Loan Act of 1985).

o) **Building and Loan Association**

The term "building and loan association" means a savings and loan association organized to accumulate a fund from the subscriptions and savings of its members to be used in assisting them in financing through home loans the construction or acquisition of residential real estate.

p) **Credit Union**

1) General. The term "credit union" means an entity governed by 12 U.S.C. Section 1751 et seq. (Federal Credit Union Act) or 205 ILCS 305.1 et seq. (Illinois Credit Union Act), i.e., a cooperative, non-profit association, incorporated under Illinois law, under the laws of the United States or under the laws of another State, for the purposes of encouraging thrift among its members, creating a source of credit at a reasonable rate of interest, and providing an opportunity for its members to use and control their own money in order to improve their economic and social conditions. The membership of a credit union shall consist of a group or groups each having a common bond as defined in 205 ILCS 305/1.1 of the Illinois Credit Union Act.

2) Common Bond. The term "common bond" refers to groups of people who meet one of the following qualifications:

A) Persons who belong to a specific association, group or organization, such as a church, labor union, club or society and members of their immediate families which shall include any relative by blood or marriage or foster and adopted children.

B) Persons who reside in a reasonably compact and well defined neighborhood or community, and members of their immediate families which shall include any relative by blood or marriage or foster and adopted children.

C) Persons who have a common employer or who are members of an organized labor union or an organized occupational or professional group within a defined geographical area, and members of their immediate families which shall include any relative by blood or marriage or foster and adopted children.

q) Currency Exchange

The term "currency exchange" means a person, firm, association, partnership or corporation engaged in the business of operating a currency exchange, providing services such as cashing evidences of money for a fee or engaging in the business of selling or issuing money orders and which is governed by 205 ILCS 405/.1 et seq. (Currency Exchange Act).

r) Cooperative Bank

The term "cooperative bank" means an entity organized under, and subject to, State statutes or the laws of the United States regarding cooperative banks and includes all such cooperative banks governed by 12 U.S.C., ch. 23, subchapter III (Banks for Cooperatives).

s) Small Loan Company

The term "small loan company" means a person engaged in the business of making secured consumer loans of money under a certain amount and rate of interest, and which is governed by 205 ILCS 670/1 et. seq. (Consumer Installment Loan Act).

t) Sales Finance Company

The term "sales finance company" means a person engaged in the business of providing financing to unrelated persons or third parties in the sale of tangible personal property. The term includes:

1) Persons engaged in consumer sales finance activities of the type governed by 205 ILCS 660/1. et seq. (Sales Finance Agency Act) and includes all such

activities governed by 815 ILCS 415/1 et seq. (Retail Installment Sales Act) and 815 ILCS 375/1 et seq. (Motor Vehicle Retail Installment Sales Act).

2) Persons engaged in commercial finance activities of the type governed by 810 ILCS 5/1-101 et seq. (Uniform Commercial Code).

3) Persons engaged in the finance leasing of tangible personal property. "Finance leasing" is leasing activity which is the economic equivalent of an extension of credit, and which is not treated as a lease for federal income tax purposes, i.e., the lessor is not entitled to a deduction for depreciation under 26 U.S.C. Section 167 of the Internal Revenue Code.

u) Investment Company

The term "investment company" means an entity which is registered as an investment company under the Investment Company Act of 1940, i.e., an issuer which is within the definition of investment company in 15 U.S.C. Section 80a-3(a).

v) Person Owned by a Bank or Bank Holding Company

The term "financial organization" under the Illinois Income Tax Act includes "any person which is owned by a bank or bank holding company". For the purposes of IITA Section 1501(a)(8), a "person" will include only those persons which a bank holding company may acquire and hold an interest in, directly or indirectly, under the provisions of the Bank Holding Company Act of 1956 (12 U.S.C. 1841, et seq.) and Regulation Y promulgated thereunder by the Board of Governors of the Federal Reserve System (12 C.F.R. Part 225). —For these purposes, a "person" will not include interests in any person which must be disposed of within certain required time limits under the Bank Holding Company Act of 1956.

EXHIBIT L: 4

Materials regarding Indiana HB 1625

CONSTITUTIONALITY OF TAXATION OF
NONRESIDENT LENDERS - H.B. 1625

I. The Issue and Pertinent Facts

In "Preliminary Comments" on H.B. 1625 by Larry J. Stroble questions the constitutionality of H.B. 1625 in taxing the income of nonresident financial institutions earned from making loans to Indiana residents made by mail, modern telecommunications, with computer driven loan administration and accounting as further described below, but without employees or an office in the state. The Comments acknowledge that this income is validly taxed if the nonresident lender has an office or agents in Indiana participating in that business even though the loans are prepared and generally administered outside Indiana, but believes that an Indiana office or employees may be necessary to impose the tax.

H.B. 1625 does, of course, impose a tax on banks and other financial corporations who make loans in Indiana and have an office or employees here.[1] This in itself constitutes a substantial change in Indiana taxation which heretofore did not tax banks, out-of-state or in-state, transacting a loan and banking business under the adjusted gross income tax act.[2] Further, Indiana has not taxed adequately any non-resident lender conducting business in Indiana if the final acceptance of the loan and administration is carried

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1 See Note 1 in the Appendix for the Budget Bureau list of the consumer lenders whose Indiana income has been used in projecting the tax revenue under H.B. 1625 and who are licensed to make consumer loans in Indiana under IC 24-4.5-3-503, have offices here or both.

2 IC 6-3-2-2.8.

on outside the state.[3] The bill taxes all institutions conducting a lending or banking business in Indiana, (1) because they are necessarily a part of the business protected and governed by Indiana laws which provides a forum to enforce loan contracts, (2) because they compete with Indiana's financial institutions without paying Indiana's tax, (3) because the income they earn is substantial and (4) because many types of lending can with modern technology and organization be transacted across state lines without the necessity of an office or personnel in this state.

Solicitation of loans is done by computerized mailing lists, computer assisted preparation and distribution of pamphlets and legal forms with vast advertising by national newspapers and TV and by toll free telemarketing. Negotiation is carried on by express mail, the copier, facsimile transmission, transmission by computers over phone lines and meetings held by telephone conference call and speaker phones where all parties can hear each other wherever located.[4] Administration for thousands of accounts is handled through computer driven accounting, billing, mailing, and control over the use of lost or stolen credit or bank cards.

Further, interstate lending has increased in volume and has become more concentrated in large corporate entities. Banks and other corporations in large commercial centers operate substantially in other states. Commercial loan volume in an industrial and commercial state such as Indiana has become

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3 See, 45 IAC 3.1-5-55 and Item 6 to a memorandum on this subject submitted to Frank Sullivan with letter dated February 13, 1989.

4 See, IC 23-1-34-1 by which Indiana authorizes the meeting of corporate directors by this method.

too substantial and diverse, and often individual loans are in too high dollar amounts to be handled by locally domiciled corporations. Indiana is a loan market state.

Credit card loans nationally increased by 72.4 billion dollars from 1980 to 1987. Over one-half of the increase in credit card loans is made by bank holding company affiliates in Delaware and South Dakota because these states place no cap on the credit card loan rate and because of their favorable tax rates. For example, Citicorp has created and operates its credit card through a national bank subsidiary domiciled and operating in South Dakota with assets of 12.1 billion dollars including loans of 11.6 billion dollars.[5] Charge cards of retailers are handled in the same manner. More than 78% of all credit card loans are made by the 100 top commercial banks only one of which is in Indiana.[6]

In each such loan, whether or not made by an agent in Indiana, the lender creates a loan contract extending over time, enforceable only in Indiana,[7] many with very complex provisions, and with Indiana law protecting both the lender and the borrower. In more traditional legal verbiage, Indiana is exercising its taxing power which bears "a fiscal relation to protection,

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5 "Chicago Fed Letter" The Federal Reserve Bank of Chicago, No. 10, June 1988, p. 2; "Big Players Win More of Bank Card Credit Market", American Banker, Sept. 1986, at 3.

6 "Top Number 1989", a book published by American Banker, p. 56.

7 See, Burger King Corp. v. Rudzewicz, 471 U.S. 462, 471-2, 474-5 (1985).

opportunities and benefits" given by it to the non-resident lenders and banks without agents or offices here "for which it can ask a return."[8]

The Indiana protection given in the credit card operators is especially extensive and complex. Issuance of the credit card creates many contacts in Indiana. The card is owned by the credit card company and so constitutes property within the state. In the hands of an Indiana resident the credit card becomes a form of money in Indiana. This permits the holder to purchase goods and services with bills from Indiana vendors paid by the credit card issuer in another state. This requires a contract made between Indiana vendors and the credit card company enforceable in Indiana. The credit card company is then reimbursed by remittances from the credit card holder or by the creation of a debt from the Indiana resident holder to the credit card company or a bank, all pursuant to the holder's credit card contract enforceable only in Indiana. Approximately 75% of credit card companies gross income is from the interest on credit card loans with the balance in fees from vendors or participating banks.[9]

The business of banking is carried on interstate not only by lending activity but by deposit activity, with bank cards issued across state lines permitting access to deposits there by AMT terminals.

II. The Constitutional Requirements For Taxation

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8 Wisconsin v. J. C. Penney Co., 311 U.S. 435, 444 (1941).

9 "Credit Card Business Mushrooms at Large Banks," American Banker, Aug. 1986, at 1,6.

The constitutional validity of the Indiana tax depends on satisfaction of two constitutional requirements. First is the "due process" requirement of the 14th Amendment, depending on whether Indiana's taxing power bears fiscal relation to protection, opportunities and benefits to the taxpayers in carrying out their lending business in Indiana. See, Wisconsin v. JC Penney, supra. Under the facts here presented satisfying that test will also satisfy the requirements of the Commerce Clause of the Constitution (Art. I of 8(3) that the lending activity must (1) be "sufficiently connected with the state to justify a tax" and (2) be "fairly related to the benefits provided by the state." The Commerce Clause also prohibits discrimination against interstate commerce and multiple taxation of companies operating in interstate commerce, requirements not here in question. See, Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 277-8, 287 (1977).

The crux of due process is set out in Wisconsin v. J. C. Penny Co., 311 U.S. § 435, 444-5, 446 (1940) as follows:

> That test is whether property was taken without due process of law, or, if paraphrase we must, whether the taxing power exerted by the state bears fiscal relation to protection, opportunities and benefits given by the state. The simple but controlling question is whether the state has given anything for which it can ask return. The substantial privilege of carrying on business in Wisconsin, which has here been given, clearly supports the tax.
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> Here, the incidence of the tax as well as its measure is tied to the earnings which the State of Wisconsin has made possible, in so far as government is the prerequisite for the fruits of civilization for which, as Mr. Justice Holmes was fond of saying, we pay taxes.

Curry v. McCanless, 204 U.S. 357 (1940), overruling the McReynolds - Sutherland court decision made ten years earlier that intangibles could be taxed in only one state, specifically reinstated the cases previously determining that debts created by a lender doing business in a non-domicilary state were a proper measure of its tax,[10] stating:

> The taxpayer who is domiciled in one state but carries on business in another is subject to a tax there measured by the value of the intangibles used in his business. New Orleans v. Stempel, 175 U.S. 309, 44 L.ed. 174, 20 S. Ct. 110; Bristol v. Washington County, 177 U.S. 133, 44 L. ed. 701, 20 S. Ct. 585; State Assessors v. Comptoir Nat. D'Escompte, 191 U.S. 388; Metropolitan L. Ins. Co. v. New Orleans, 205 U.S. 395; Liverpool & L. & G. Ins. Co. v. Board of Assessors, 221 U.S. 346; Wheeling Steel Corp. v. Fox, 298 U.S. 193; cf. Blodgett v. Silberman, 277 U.S.; Baldwin v. Missouri, 281 U.S. 586, supra. (204 U.S. at 368)

As stated by Justice Hughes in Liverpool & L. G. Ins. Co. v. Board of Assessors, 221 U.S. 346, 354-5 (1911):

> The debt, of course, is not property in the hands of the debtor; but is an obligation of the debtor, and is of value to the creditor, because he may be compelled to pay; and power over the debtor at his domicil is control of the ordinary means of enforcement. Blackstone v. Miller, 188 U.S. pp. 205, 206, 47 L. ed. 444, 445, 23 Sup. Ct. Rep. 277. Tested by the criteria afforded by the authorities we have cited, Louisiana must be deemed to have had jurisdiction to impose the tax. The credits would have had no existence save for the permission of Louisiana; they issued from the business transacted under her sanction within her borders; the sums were payable by persons domiciled within the state, and there the rights of the creditor were to be enforced. If locality, in the sense of subjection to sovereign power could be attributed to these credits, they could be localized there. If, as property, they could be deemed to be taxable at all, they could be taxed there.

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10 See to the same effect, see Tax Commission v. Aldrich, 316 U.S. 174, 178-9 (1942), citing and relying on Justice Holmes' opinion in Blackstone v. Miller, 188 U.S. 189, 205 (1903) dealing with taxation of a debt in the domicile of the debtor.

More recently the Court in Tyler Pipe Industry, __ U.S. ___, 97 L.ed.2nd 199, 215-6 (1988) the court in upholding a state wholesale tax has expanded the required taxpayer activities in the taxing state to those significantly associated with the establishment and making of a market, stating:

> As the Washington Supreme Court determined, "the crucial factor governing nexus is whether the activities performed in this state on behalf of the taxpayer are significantly associated with the taxpayer's ability to establish and maintain a market in this state for the sales." (98 L.E.2d at 215-6)

III. Due Process - No Agents or Offices?

Using the concepts set out in the cases discussed above, the question here in issue can be rephrased. Irrespective of whether non-resident lenders are receiving Indiana's protection and benefit in carrying on in this state the business of lending, the enforcement of its loan contracts and the making a market, does due process require in addition that it have Indiana employees or offices. The question almost answers itself. Existing cases involving loans by non-residents were decided in decades where that business could be carried out only by agents. The crucial fact, however, was not whether the taxpayer has agents or offices but whether state protection was given that business.[11] In fields comparable to lending the Court has so held.

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11 The Supreme Court in its major cases in this area has consistently based its holdings on substance rather than form, pointing out that such things as "presence", "jurisdiction to tax" and "privilege" are statements of conclusion and not criteria for adjudication. Wisconsin v. J. C. Penney

(Continued on next page)

The mail order insurance cases are in point. The insurance company in question conducted all solicitation, approval of applications and collection of premiums by mail, without agents or offices. Magee v. International Life Insurance Company, 355 U.S. 221 (1945), involved such a company. It acquired a block of insurance business in California by assignment, but never had "any office or agent" and administered its business by mail. The issue was whether the insurance company was validly sued in California on the basis of a state statute subjecting any corporation to suit on an insurance contract made with a resident of California. In defense the company also raised the right of California to regulate and tax the company on which the court stated:

> And the due process clause is not brought in issue any more by appellant's further conceptualistic contention that Washington could not levy a tax or bring suit against the corporation because it did not honor that State with its mystical "presence." For it is unthinkable that the vague due process clause was ever intended to prohibit a State from regulating or taxing a business carried on within its boundaries simply because this is done by agents of a corporation organized and having its headquarters elsewhere.

The following cases are to the same effect:

> People v. United National Life Insurance Company, 5 Cal. Rptr. 599, 427 Pac. 2d 199; 209-10 (1967), appeal dismissed for want of a substantial Federal question, 389 U.S. 300 (1967)[12]

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11 (Continued from previous page)

Co., supra, 311 U. S. at 444; International Shoe Company v. Washington, 326 U. S. 310, 316 (1945); Complete Auto Transit, Inc. v. Brady, supra, 430 U. S. at 279. As noted in Wisconsin, the crucial facts are the "protection, opportunities and benefits" afforded to non-resident lenders by Indiana.

12 A Supreme Court ruling that there is no substantial federal question, e.g., a constitutional question, is a ruling on the merits and remains controlling until doctrinal developments indicates otherwise and the Court so notes. Hicks v. Miranda, 422 U. S. 332, 343-4 (1975).

> In short, these defendants have "realistically entered the state looking for and obtaining business" . . . The main aspects of their insurance transactions are in this state; and to say that they are not doing business here is to completely ignore the facts of life and reality. We think the substantial interest of California in these transactions is obvious.
>
> * * *
>
> As we have already explained, we think it is clear that defendants' solicitation of insurance takes place in California where their advertising and other materials are received through the instrumentality of the mails. . . At the same time, the receipt of such material in this state constitutes negotiations preliminary to execution of the contracts of insurance. It seems to us an ineluctable conclusion that through such "solicitation" and such "negotiations preliminary to execution" defendants "transact * * * insurance business in this State."
>
> Ministers Life and Casualty Union v. Haase, 30 Wisc.2d 339, 141 NW2d, 287, 295 (1966), appeal dismissed for want of a substantial federal question, 385 U.S. 205 (1966).[12]

Burger King Corp. v. Rudzewicz, 471 U.S. 462 (1985) also indicates that "physical presence" is not a prerequisite when it becomes unnecessary due to modern methods of doing business. This was a suit brought in Florida by a franchisor in that state against a defaulting franchisee domiciled and doing business in Michigan. It involved a long term contract contemplating supervision of the business in Florida. Finding that the franchisee had

> ". . . manifestly has availed himself of the privilege of conducting business there, and because his activities are shielded by "the benefits and protections" of the forum's laws it is presumptively not unreasonable to require him to submit to the burdens of litigation in that forum as well.
>
> Jurisdiction in these circumstances may not be avoided merely because the defendant did not physically enter the forum State. Although territorial presence frequently will enhance a potential defendant's affiliation with a State and reinforce

> the reasonable foreseeability of suit there, it is an inescapable fact of modern commercial life that a substantial amount of business is transacted solely by mail and wire communications across state lines, thus obviating the need for physical presence within a State in which business is conducted. So long as a commercial actor's efforts are 'purposefully directed' toward residents of another State, we have consistently rejected the notion that an absence of physical contacts can defeat personal jurisdiction there. (emphasis added)

The reasoning is equally persuasive where a lender as part of the financial business makes lending contracts in Indiana without physical presence.

IV. Bellas Hess - Applicable? Conclusion.

National Bellas Hess v. Department of Revenue, 386 U.S. 753 (1967), involved the right of Illinois to impose a duty on an out of state catalog seller to collect a use tax on all sales made to Illinois buyers within the requirements of the 14th Amendment and the Commerce Clause.

The opinion notes or finds the following:

1) The requirements for satisfying the 14th Amendment and the Commerce Clause are similar.

2) State taxation can only be justified if it makes interstate commerce bear a fair share of the costs of the local government which protection it enjoys, citing Wisconsin v. J. C. Penney Co., supra.

3) The Court in past cases has sharply differentiated the state benefits received from sellers with local retail outlets and those "whose only connection with the state is communication with customers by common carrier or the United States mail."

4) If Illinois can impose such a burden so can every other state and every political sub-division, with no claim that this is justified by the necessity of paying for "a fair share of the cost of local government."

5) The purpose of the Commerce Clause is to ensure a national economy free from such unjustifiable local entanglements.

In substance Bella Hess is based on a factual situation, where the State protection is limited to protecting communication "by mail and common carrier" and where the local burden is egregious. Two recent cases citing Bella Hess have kept it within those limits.

> D. H. Holmes v. McNamara, _____ U.S. _____, 100 L.Ed.2d 21, (1988)("only connection with its Illinois customers was by mail or common carrier").
>
> Goldberg v. Sweet, _____ U.S. _____, 57 L.W. 4070, 4073 (1989)("receipt of mail provides insufficient nexus").

Whether or not Bellas Hess is valid within its limited application[13], the difference between "no more" connection by a seller than communicating than "by mail and common carrier," is as different under the facts of modern lending and banking abd the many local contractual contacts in operating a complex contractual lending business as in operating a retail store. The Court cannot reasonably be expected to determine differently.

Conclusion. No tax statute can cover in detail the infinite fact variations to which H.B. 1625 applies. Its application in turn is limited by at least the following:

1) the holding and reasoning of past and future Court cases, whether or not their limitations or requirements are written into the statute,

2) the regulations and rulings issued by the Department of Revenue interpreting its application of the statute's scope to reasonable fact situations,

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13 Bella Hess was subject to strong dessent; 18 states have now passed laws for taxation of mail order sales, and the decision has been strongly criticized. See, "Collection of the Use Tax on Mail Order Sales", Paul L. Hartman, 39 Vand. L. Rev. 993; Overturning Bella Hess: Due Process Considerations", 1985 B.Y.U. Rev. 265. Bella Hess is considered by many authorities as a Commerce Clause ruling based on the balancing of equities on the burden to interstate compliance.

3) the enforcement by the Department, again ruling out the irrational applications, and

4) the course of amending the statute with experience over time.

H.B. 1625 has been broadly drafted to protect and enhance state revenue. Its basic scope is within constitutional limitations.[14]

V. Related Questions in the Comments and Technical Questions.

These will be discussed in the Appendix.

Lewis C. Bose
Bose McKinney & Evans
April 10, 1989

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14 By statute or regulations comparable rules have been adopted in eleven states. See, "State Bank Taxation and the Rise of Interstate Banking: A Survey of States" by Kincaid and McCray, Intergovernmental Perspective (ACIR) Fall 1988, Vol. 14, No. 4, p. 18.

APPENDIX TO MEMORANDUM RELATING TO PRELIMINARY CAUSES

Part One: Footnote No. 1 to Memorandum

Estimate of Revenue Neutral Rate
for
Proposed Financial Institutions Tax
[Fin Co. data from "10K"]

	Finance Company's	1987
1	Barclay's	47.0
2	Chrysler AC	371.2
3	Credithrift Corp	115.6
4	Credithrift Inc	120.6
5	Ford Motor Accpt	1,119.2
6	GMAC	2,080.0
7	Other Fin Co.'s	500.0
8	HFC	240.1
9	ITT Fin Corp	193.1
10	Norwest Financial	130.8
11	GE Fin Serv's	567.0
12	Mack Fin Corp	22.8
13	Sears Accpt Corp	188.9
14	TransAmeric	134.7
15	Xerox Credit	116.5
16	Mellon Mort Trust	7.6
17	Dial Corp	30.3
18	UT Credit Corp	37.8
19	Beneficial	202.1
20	Comm Credit Grp	130.4
	TOTAL US Income Est	6,355.7

RATE CALCULATION SCENARIOS
PROPOSED TAX BASE

Apprtnd Inc	127.1	15.0
BANKS Base	603.9	603.9
S&L Base	168.5	168.5
CU Base	1.7	1.7
	901.3	789.2

CURRENT TAXES PAID

Fin Co's [curr pmt's]	8.0	2.0
Banks	64.0	64.0
S & L's	18.2	18.2
CU's	0.9	0.9
Bank's PP	-12.0	-12.0
Net Tax to Replace	79.1	73.1
RATE Calculation	8.77%	9.26%

Part Two: The Comments Concerning Questioned Areas:

The Comments question the scope activities of the business listed in I.C. 6-5.5-3-1 on page 10 of H.B. 1625 constituting the transaction of the business of a financial institution in Indiana. That business consists of any activity permitted under statute to a regulated deposit institution, its holding company and the subsidiary of either which is limited to the activities related to the business of banking (I.C. 6-5.5-1-17 set out on pp. 5-7 of H.B. 1625). It also includes any other corporation 80% of whose gross income is received from loans and the extension of credit, financing leases and credit card operations. These activities are the basis for a non-resident to operate a business in Indiana of lending money to its residents, an activity whose existence depends on the laws of Indiana from which it derives protection, opportunities and benefits and which justify the imposition of a net income tax.

Any of the items listed in I.C. 6-5.5-3-1 can be extended by enforcement beyond a constitutional limit. Each, however worded, is limited by past and future Supreme Court determination. The fact situations to which each is applied are infinitely varied, and H.B. 1625 as other tax statutes is drafted so that its language will not become obsolete under changing court verbilization of the legal limits of taxation. The ultimate application of each item depended on two tests: (1) is it an indicia of non-residents actually making loan contracts with debtors in Indiana, and (2) if under a hypothetical set of facts the validity of the item is questionable, it can reasonably be limited by regulation or enforcement conforming to Court decision.

This appendix part refers to the Comments by item number and page of the text.

Item (1), p. 2 & 6 (I.C. 6-5.5-8-1(2). Independent Contractor Activity. The Comments suggest the class of independent contractors making a market for a non-resident should be defined and their activity in making a loan market be limited to "substantial" involvement. The Supreme Court decisions do not differentiate on whether involvement is by agent or independent contract. See, Scripto, Inc. v. Carson, 362 U.S. 207 (____); Tyler Pipe Industries, Inc. v. Wash. Dept. of Dev., 483 U.S. 232 (1987). It is unnecessary to limit by statute by the extent of that involvement which is controlled by these Court opinions.

Item (2), p. 2 & 7 (I.C. 6-5.5-3-1(3) and (4)). Regularly Selling of Products or Services and Regular Solicitation of Indiana customers. Where the principal non-resident activity is in making loans, this is the essence of a business for which the state has given protection and is taxable within the cases set out in the memorandum. If the hypothetical facts involve sporadic loans and not a course of transaction financial business, this is an enforcement not a statutory drafting problem.

Item (3), p. 3 (I.C. 6-5.5-3-1(5)). In-State Consumption of "Out-of-State" Services. The Comments characterize the services as out-of-state but they are not. Services consumed in the state are by definition in-state services. This section is directly analogous to the normal situs rules for sales taxation. The vast majority of states use a "destination state" situs rule for that purpose - i.e., sales made from an out-of-state business location are deemed to be in-state sales if they are made to an in-state resident. Thus this provision is in line with current state practices.

Item (4), p. 3 & 11 (I.C. 6-5.5-4-1(6)). Regularly Engages in Loan Transactions. This is a statement of the basic transaction by which non-resident lender from Indiana receives the protection, opportunities and benefits of operation a financial institution business in Indiana, and which justifies the imposition of a tax. Whether it should be limited to sales which might be characterized as sporadic is an enforcement or regulatory and not a statutory drafting problem or a problem of the constitutionality of the statute.

Item (5), p. 3 (I.C. 6-5.5-4-1(8). Deposit Solicitations. An out-of-state bank whose only business in Indiana is the solicitation of deposits would not pay an Indiana tax from that activity because it would not have income from the deposit transactions. Deposits, however, are part of a banking business; and if an out-of-state bank regularly solicits deposits from Indiana residents and makes loans it is conducting a banking business in Indiana, Indiana looking to all of its activities in determining whether it is doing the business of banking.

Item (6), p. 3 & 12 (I.C. 6-5.5-3-4). Presumption of Solicitation. The non-resident is presumed to be regularly soliciting business if it has a minimum number of transactions with Indiana residents described during the year or if its deposits from Indiana residents equal a minimum amount. This is not an imposition of tax but shifts the responsibility for coming forward with facts indicating that it does not regular solicitate financial institution or business. If one were writing solicitation provisions into a statute it could reasonably follow Minnesotas 1988 provision to its financial institutions tax statute (§ 290.015(d)) or be done by regulation. That statute is as follows:

> (d) For purposes of paragraph (b), solicitation includes, but is not limited to:

(1) the distribution by mail or otherwise, without regard to the state from which such distribution originated or in which the materials were prepared, of catalogs, periodicals, advertising flyers, or other written solicitations of business to customers in this state;

(2) display of advertisements on billboards or other outdoor advertising in this state;

(3) advertisements in newspapers published inthis state;

(4) advertisements in trade journals or other periodicals, the circulation of which is primarily within this state;

(5) advertisements in a Minnesota edition of a national or regional publication or a limited regional edition of which this state is included of a broader regional or national publication which are not placed in other geographically defined editions of the same issue of the same publication;

(6) advertisements in regional or national publications in an edition which is not by its contents geographically targeted to Minnesota, but which is sold over the counter in Minnesota or by subscription to Minnesota residents;

(7) advertisements broadcast on a radio or television station located in Minnesota; or

(8) any other solicitation by telegraph, telephone, computer data base, cable, optic, microwave, or other communication system.

Minnesota also uses the presumption language used in H.B. 1625.

Item (13). Treatment of Loan Assignees. Loan assignees in the secondary market are intended to be exempted from the provisons of the bill defining what is the transaction of a finance business if their only connection with Indiana is in taking that assignment. This includes the ancillary activity of collection, evaluation and related items. See I.C. 6-5.5-3-8(5), H.B. 1625, April 3 reprinting, p. 12, ll. 14-21.

Part Three: Technical Comments:

Many of Comments very good analysis have been incorporated in the Senate Amendments to H.B. 1625 April 3 printing. Where relevant here the bill with page and line number will be referred to as "Bill p. ___, ll. ___."

Net Operating Loss Deductions. This was changed by adding net loss to the tax base, then deducting losses from the tax on a carried forward basis. Bill p. 2, ll. 1-3 and p. 8, ll. 15-36.

Unitary Taxation. The tax is not world wide. Income earned outside the United States is deducted from federal adjusted gross income subject to the Indiana Tax. Bill p. 1, ll. 15-17. Foreign banks are included because they increasingly do a lending business in the United States. Bill p. 4, ll. 35-45 and p. 6, ll. 21. The wording which authorizes a mandatory filing of a combined return is not in the opinion of the draftors significantly the language different from the adjusted gross income.

Only a strained construction of the definition of "unitary business" could include a non-financial institution in a unitary group in filing a combined return. Prevention of that result is within the province of the Department. The unitary business under the Bill is confined to a group "in transacting the business of a finance institution" (Bill p. 7, ll. 21-22). Entities in the group are limited to holding companies, regulated financial institutions and [other entities] engaged in the "business of a financial institution".

That business is limited to the permitted activities of a bank, S & L holding company, regulated financial corporation, foreign bank, or

the subsidiaries of these entities and the activities of any other corporations 80% of whose gross income is in the business of loans and the extension of credit, finance leasing and credit card operations (Bill p. 4, l. 22 and Bill p. 6, l. 24 to p. 7, l. 17). In substance the members of the group must be financial institutions. As further indication that non-financial institutions may not be included in a unitary group, non-diversified S & L holding companies are excluded (Bill p. 5, l 45 to p. 6, l. 2) because less than 50% of both their net worth and income are from S&L sources.

Amendments to the Adjusted Gross Income Tax. This has been amended as suggested in the Comments. See, Bill p. 23, ll. 8-10; p. 24, ll. 26-28, ll. 31-34 and ll. 44-45, together with Bill p. 27, l. 27 to p. 28, l. 25.

Amendments to Filing Requirements. The reporting requirement was desired by the authors of the Bill to determine the change necessary in taxation in the future with limitation of litigation in Indiana if due notice was not held or a tax paid. The bill has been amended to permit suit, where challenged, if no tax is due and a late filing of the notice is made. Bill p. 37, ll. 28-9.

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H.B. 1625 TAXATION OF FINANCE INSTITUTIONS
ITS PURPOSES AND STRUCTURE

I. The Problem and the Purpose of the Bill.

The problem. Indiana taxes banks and savings associations (S&Ls) by fixed base taxes adopted in the 1930s. Under these taxes banks and S&Ls pay the greater of:

(1) a fixed rate excise tax based on the amount of their liabilities and net worth; or

(2) a fixed rate gross tax on their total receipts.

For banks the controlling tax is the excise tax since gross tax is substantially reduced, by the deduction for interest on federal securities granted to all taxpayers coupled with the banks' need for these securities under liquidity regulations. For S&Ls the controlling tax is the higher gross income tax. In addition S&Ls pay a substantial supplemental net income tax.

Both taxes create the following problems:

(1) S&L's tax burden is highest in the country for S&Ls. The banks' among the five highest state taxes for banks.

(2) Corporations operating at a loss or with low income are taxed at the same rates as those with high incomes.

(3) Neither tax gives relief in the fluctuating interest rate market where the rates more directly affect the earnings and, therefore, the net worth of financial institutions than those of other businesses.

(4) Neither tax nor the adjusted gross income tax applies to out of state lenders, regulated or non-regulated, with whom Indiana's financial institutions increasingly compete. These lenders include among others out of state banks, other commercial lenders, auto lenders and consumer lenders (the City Corp.s, GMACs and Beneficial Finances of the world. See Items 1 and 2 attached.).

The purpose of the bill is to restructure taxation of financial institutions by adopting a uniform net income tax for banks, S&Ls, credit unions and all other corporations whose principal business is lending money or extending credit, and to tax all non-resident lenders on their income from transacting business in Indiana.

II. The Structure of the Bill.

(Reference will be to page and section or chapter of the bill.)

The bill creates a new article creating a net tax for financial institutions (pp. 1-21, CH. 1-14), together with amendments to the adjusted gross income tax (pp. 22-24, Section 6-7) and other provisions necessary to its implementation. The principal features of the bill are as follows:

1. "Taxpayers" in the new net tax include:

   (1) regulated institutions - state and federally chartered banks and S&Ls, state chartered credit unions and foreign (out-of-U.S.) banks;

   (2) bank holding companies and nondiversified S&L holding companies; and

   (3) other corporations doing financial institution business (pp. 6-7, Sec. 16).

   "Other corporations" mean any corporation 80% of whose gross income comes from:

   (1) making or servicing loans or extensions of credit in any form);

   (2) making finance leasing of real or personal property; and

   (3) operating a credit card business (p. 7, Sec. 17).

2. The tax is a franchise tax imposed on financial institutions for the purposes of conducting a financial business in Indiana and is measured by net income for federal tax purposes with add-ons and additions, comparable to Indiana gross and adjusted gross income taxes but with specific relevant

additions (pp. 2-3, Sec. 2; p. 8, Sec. 1; and all of Ch. 2, pp. 8-10.).

3. The tax base includes income from municipal and state bonds since this is a prerequisite to taxing income from U.S. securities under federal statute and under constitutional requirements. Income from the federal securities are held in major amount by banks as part of their liquidity requirements, but absent inclusion of this income the tax is ineffective as a net income tax.

4. Resident taxpayers pay a tax on all their income, with a credit for taxes paid in other states (pp. 8-9, Sec. 2 and 6).

5. Non-resident taxpayers pay a tax on their income earned in Indiana by an apportionment formula based on the percent of the corporations' gross receipts from residents or business in Indiana as a percent of their receipts in all other states (p. 9, Sec. 4 and 5).

The apportionment formula is different from the formula under Indiana's adjusted gross income tax which apportions income to non-residents by the average separate percent which property, payroll and receipts in Indiana constitute the taxpayers business in all states.

The single receipts factor in the new tax favors Indiana as a market state, where the receipts are large and the other factors of property and payroll are small or non-existent. The single factor receipts formula, the most significant factor in a financial institutions business, will generate a large and fair tax revenue.

6. The bill has extensive provisions on what receipts of non-residents are attributed to Indiana transactions. For example interest on gains on sale of the loan, are counted as Indiana income (pp. 13-15, Ch. 4); and non-resident taxpayers must report all the interest income and gain on the sales of loans made in Indiana (pp. 13-15, ch.4). Under adjusted gross income tax those income items for a non-resident lender are generally attributed to the taxpayer's principal place of business outside Indiana. The bill also makes the comparable changes in income attribution in the three factors (pp. 22-24, Sections 6-7).

7. The bill provides clear guidelines and appropriate definitions permitting or requiring combined returns or accounting adjustments for parent-subsidiary organizations where necessary to reflect income fairly (p. 15, Sec. 15) for collection and enforcement and other provisions presently necessary for an effective tax vehicle (pp. 15 & 18, ch. 5-7).

8. The bill provides for taxation of the personal property of banks and guarantees local political subdivisions a share of the new tax. That share equals the amount of revenue they received from the bank and S&L taxes in 1989 (the year before the new tax goes into effect), less the amount of new revenue from the personal property tax paid by banks.

III. Tax Rate.

The tax rate on net income in the bill as adopted by the House is 8.5%. The rate paid by business corporations generally is the greater of the gross tax or the adjsuted gross tax. The rate on the latter tax together with the supplemental net income tax paid by corporations is 7.9%.

The "neutral rate" of the new tax, as compared with the tax as now paid by banks and S&L taxes, as computed by the Budget Agency, is 8.77%. This is, however, a substantially conservative figure. It is based on the projected new tax revenues on 1987 net income base of (1) Indiana's resident banks, S&Ls and credit unions, (2) estimate of amounts which would be collected from non-resident lenders, (3) the new personal property tax revenues to be paid by banks for the first time, crediting that amount to the guaranteed amounts to be paid local political subdivisions for their loss in bank and S&L taxes, and (4) an estimate of the revenue to be received from non-resident lenders now free of Indiana taxes.

The estimate is based on the national net income of 19 large national lenders apportioned to Indiana on the basis of disposable income in Indiana as a percent of that income nationally. The selection of non-resident is good but necessarily omits many national lenders. Further, it makes no attempt to cover the Indiana income of banks in neighboring states and in out-of-state money centers making mortgages and commercial loans, since available figures of those institutions cannot be broken down by states. In addition, it does not count the income

good but necessarily omits many national lenders. Further, it makes no attempt to cover the Indiana income of banks in neighboring states and in out-of-state money centers making mortgages and commercial loans, since available figures of those institutions cannot be broken down by states. In addition, it does not count the income from credit card loans. Delaware and South Dakota accounted for over one-half the increase of credit card loans in the U.S. aggregating $37.3 billion for the period 1980 thru 1987 and are home to major credit card subsidiaries of banks from the East Coast to Texas and Minnesota. (See Items 1 and 2 attached for a significant statement of the interstate flow of money.)

IV. Observations.

H.B. 1625 is a major effort to update and restructure the taxation of financial institutions by a net income tax, not only of its resident lenders but also of its non-resident lenders, both regulated and unregulated, whose Indiana activities are comparable and competitive to Indiana banks and S&Ls. It provides fair taxation and enhanced Indiana revenue with protection of Indiana's regulated financial institutions which they do not now enjoy.

This bills is the product of several years study by the Indiana Commission on Tax and Finance Policy with drafting and staff work performed by the Legislative Service Agency under direction of the Commission and the House Ways and Means Chairmen and staff, with input from the interested financial institutions and associations.

Richard A. McKasson, President
Lewis C. Bose, Legislative Counsel
Indiana League of Savings
Institutions, Inc.

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Top 100 Finance Companies in the U.S.

Note: not after tax income

By Size of Capital Funds Dec. 31, 1987 or Nearest Fiscal Yearend (in thousands of dollars)

Rank		Total Capital Funds 12/31/87	Total Capital Funds 12/31/86	Rank 12/86	Gain in Rank	Equity & Capital 12/31/87	Receivables Net 12/31/87	Total Assets 12/31/87	Net Income 1987	Deferred Income 12/31/87	Receivables Acquired 1987	Bank Credit 12/31/87
1	General Motors Acceptance Corp., Detroit	7,381,500	7,207,800	1		6,975,200	93,885,900	98,527,000	11,453,200	9,564,200	99,906,800	17,136,000
2	Chrysler Financial Corp., Troy, Mich.	4,583,600	3,722,400	2		2,492,400	23,707,700	25,277,000	225,800	3,372,600	39,068,400	7,434,100
3	Ford Motor Credit Co., Dearborn, Mich.	3,937,600	3,282,400	3		3,647,100	48,786,200	51,241,300	678,800	6,226,300	73,570,900	11,012,000
4	General Electric Capital Corp., Stamford, Conn. (f)	3,493,563	2,672,149	5	+1	3,361,584	27,906,826	36,643,740	470,182	4,063,049	25,641,748	9,204,000
5	Sears Roebuck Acceptance Corp., Wilmington, Del.	2,382,520	2,269,002	6		2,382,520	11,657,189	11,683,129	113,372	315,770	3,147,406	6,416,000
6	Household Financial Services, Prospect Heights, Ill.	2,051,000	1,559,100	9	+3	1,105,700	8,982,200	11,771,700	174,600	264,400	603,200	2,159,600
7	Associates Corp. of No. America, Dallas(b)	1,856,359	1,583,884	8		1,326,580	9,144,100	10,571,612	236,063	1,298,387	10,366,169	2,464,125
8	Transamerica Financial Corp., Los Angeles	1,630,994	624,572	23	+15	1,114,424	5,949,567	6,897,731	83,548	432,240	2,955,491	2,626,000
9	CIT Group Holdings, Inc., Livingston, N.J. (g)	1,581,076	1,660,300	7		1,252,034	8,912,207	9,435,018	40,071	1,520,119	16,811,553	1,738,350
10	Manuf Han Corp Ser Gp, Huntingdon Valley, Pa. (g)	1,484,809	1,504,766	10		317,189	2,784,360	2,926,682	56,274	323,177	N A	N A
11	ITT Financial Corp., St. Louis, Mo.	1,105,561	1,354,003	11		757,667	6,274,566	7,539,878	101,388	777,955	91,816	2,671,736
12	Heller Financial, Inc., Chicago (ns)	1,096,121	952,891	17	+5	730,251	4,623,654	4,786,033	25,137	161,748	0	2,785,000
13	Westinghouse Credit Corp., Pittsburgh	1,093,222	986,908	14		758,539	5,269,046	6,254,160	115,203	365,006	4,076,484	2,205,800
14	American Express Credit Corp., Wilmington, Del.	1,001,000	971,000	16		903,000	7,408,000	7,907,000	88,000	76,000	61,000,000	1,800,000
15	Beneficial Corp., Wilmington, Del.	935,300	856,100	19	+4	885,300	5,824,600	6,929,200	142,200	331,900	3,423	2,215,900
16	Barclays American Corp., Charlotte, N.C. (ns)	896,515	910,200	18		557,715	3,941,396	4,330,024	27,673	484,637	10,324,000	1,740,500
17	Avco Financial Services, Inc., Irvine, Calif.	852,001	1,322,299	12		553,530	3,074,227	3,883,009	70,421	367,636	91,097	1,008,012
18	J.C. Penney Funding Corp., Dallas (b,c)	776,000	778,000	20		762,000	1,795,000	1,855,000	32,008	N A	N A	745,000
19	Commercial Credit Co., Baltimore	766,200	982,500	15		646,400	2,850,200	4,306,400	101,500	0	670,000	940,000
20	Montgomery Ward Credit Corp., Wilmington, Del.	766,000	772,000	21		701,000	2,008,000	2,883,000	41,000	669,000	N A	1,124,000
21	Security Pacific Financial Services, Inc., San Diego (g)	743,000	558,000	26	+5	743,000	5,618,000	6,044,000	75,000	0	440,000	0
22	IBM Credit Corp., Stamford (f)	690,026	669,267R	21r		690,026	5,914,219	6,449,027	85,759	756,843	2,414,755	600,000
23	John Deere Credit Co., Reno, Nev.(b)	679,379	667,217	22		604,379	2,501,791	2,876,562	45,862	484,363	1,534,476	2,774
24	Credithrift Financial Corp., Evansville, Ind.	643,014	618,485	24		451,769	1,989,681	2,771,690	67,255	0	1,610,104	2,439,500
25	Norwest Financial Services, Inc., Des Moines, Iowa (g)	572,244	509,191	27	+2	402,601	2,255,110	2,710,037	78,078	513,571	2,491,223	344,500
26	Xerox Credit Corp., Stamford, Conn. (f)	513,100	449,800	29	+3	513,100	2,567,000	3,307,900	84,900	648,900	1,913,800	150,000
27	Philip Morris Credit Corp., New York (f)	489,600	417,300	31	+4	489,600	2,207,600	2,743,500	72,300	632,400	684,700	646,000
28	Navistar Financial Corp., Schaumburg, Ill. (b)	467,659	437,759	30	+2	377,524	1,477,672	1,862,985	29,272	130,882	2,436,800	1,270,000
29	Macy Credit Corp., New York(b)	455,247	262,011	36	+7	300,943	1,214,675	1,265,577	31,998	56,124	3,640,866	850,000
30	Signal Capital Corp., Hampton, N.H.	397,274	372,020	32†	+2	397,274	1,124,284	1,679,454	25,254	0	694,520	1,010
31	Commercial Alliance Corp., New York (g)	373,618	347,826	33	+2	213,618	1,340,902	1,481,052	N A	222,614	966,400	1,750,000
32	J.I. Case Credit Corp., Racine, Wis.	360,300	369,224	32		240,200	1,309,100	1,413,900	35,400	8,800	1,681,300	600,000
33	Mellon Credit Corp., Norwalk, Conn. (g)	352,587	325,868	34	+1	352,587	2,136,609	2,181,238	26,697	283,980	1,071,412	0
34	McDonnell Douglas Finance Corp., Long Beach, Calif. (f)	345,000	284,583	35	+1	213,000	1,738,500	2,224,800	42,600	696,500	861,300	300,000
35	Pacificorp Financial Services, Inc., Portland, Ore.	323,544	157,195	46	+11	262,344	1,136,206	1,432,249	19,155	163,827	603,358	360,000
36	Toyota Motor Credit Corp., Torrance, Calif.(b)	316,265	189,138	43	+7	316,265	2,083,504	2,149,031	12,127	450,400	2,852,470	775,000
37	Nissan Motor Acceptance Corp., Torrance, Calif.(b)	314,705	202,919	41	+4	314,705	1,066,041	1,527,608	14,904	4,813	622,508	880,000
38	Fleet Financial Corp., Providence, R.I. (g)	294,261	243,253	37		184,061	1,268,927	1,363,906	34,933	172,101	976,621	25,000
39	Pitney Bowes Credit Corp., Norwalk, Conn.	292,774				251,862	1,729,737	1,750,588	56,425	614,206	1,140,831	710,000
40	Mobil Oil Credit Corp., Kansas City, Mo.	227,659	227,638	39		227,659	1,075,941	1,098,755	17,021	13,462	N A	N A
41	AmSave Credit Corp., New York	226,091				12,621	223,705	228,115	2,829	5,307	353,890	250,000
42	Greyhound Financial Corp., Phoenix, Ariz.	225,722	216,295R	41r		160,803	1,415,307	1,462,920	18,209	491,396	223,361	425,000
43	Whirlpool Acceptance Corp., Benton Harbor, Mich.	196,697	184,222	44	+1	151,697	843,995	914,774	13,475	5,466	1,997,396	360,000
44	May Department Stores Credit Co., Reno, Nev. (b,c)	188,374	171,216	45	+1	188,374	543,440	546,271	17,156	18,254	1,632,442	0
45	Equitable Life Leasing Corp., San Diego, Calif. (b,c,f)	183,737	155,924	47	+2	183,737	N A	1,493,159	25,604	N A	N A	N A
46	Mack Financial Corp., Allentown, Pa.	176,412	221,242	40		109,362	603,940	641,841	15,508	0	1,013,750	350,000
47	Advanta Corp., Horsham, Pa.	159,000	143,867	48	+1	58,000	991,000	1,285,000	3,819	N A	N A	100,000
48	Paccar Financial Corp., Bellevue, Wash.	148,700	134,787	49	+1	148,700	993,100	1,044,294	13,932	0	1,397,325	210,000
49	Foothill Group, Inc., Los Angeles	141,474	112,014	51	+2	47,427	409,630	551,643	7,772	0	236,418	245,000
50	USA Financial Services, Inc., Peoria, Ill. (b,c,g)	140,236	107,208	54	+4	87,146	371,734	429,256	12,387	94,031	113,555	167,000
51	U S West Financial Services, Inc., Englewood, Colo. (f)	127,715	95,582	58	+7	127,715	1,256,156	1,365,800	18,020	715,074	1,165,607	250,000
52	Congress Financial Corp., New York (g)	125,839	114,500	50		64,403	885,403	964,644	N A	N A	N A	N A
53	Chemical Financial Services Corp., Cleveland (g)	123,412	89,685	60	+7	123,412	1,463,308	1,527,095	33,777	472,493	758,218	0
54	Glenfed Financial Corp., Dallas (b,c,g)	117,600	104,136	55	+1	102,600	466,463	486,980	7,131	0	155,000	387,000
55	First Manufactured Housing Cred Cp, Glen Burnie, Md (g)	116,062	52,049	71	+16	21,062	204,790	207,511	3,026	486	142,531	75,213
56	New England Merchants Leasing Corp., Boston (g)	108,528	50,802	72	+16	108,528	1,488,851	1,561,381	20,141	319,544	965,073	1,132,219
57	Honeywell Finance, Inc., Minneapolis	101,635	99,756	56		101,635	182,322	182,559	1,879	0	N A	650,000
58	Cessna Finance Corp., Wichita, Kan.	99,606	81,990	62	+4	99,606	315,736	327,772	5,505	0	235,831	5,000
59	Fidelity Acceptance Corp., Minneapolis (b,g)	91,358	97,481	57		79,358	185,899	208,400	9,537	33,254	169,363	72,500
60	MNC Affiliates Group, Baltimore (g)	91,059				91,059	958,085	1,027,952	12,464	184,469	466,477	0
61	Kentucky Finance Co., Inc., Lexington	89,018	71,900	64	+3	51,808	212,115	226,296	12,724	0	7,407	65,500
62	Concord Leasing, Inc., Norwalk, Conn. (ns)	86,976	90,704	59		60,976	968,191	997,647	1,781	124,305	N A	654,000
63	Union Oil Credit Corp., Los Angeles	86,100	193,400	42		86,100	186,000	186,400	1,800	0	7,100	0
64	Signal Finance Corp., Pittsburgh (g)	81,674	80,151	63		20,562	295,489	287,161	3,063	28,141	173,761	6,000
65	ITT Credit Corp., Uniondale, N.Y.	79,842	109,776	53		79,842	467,947	469,209	9,520	1,226	33,668	345,000
66	Unisys Finance Corp., Detroit (f)	73,676	62,759	66		73,676	488,828	503,639	10,917	71,095	527,000	200,000
67	Oxford Finance Companies, Inc., Philadelphia	72,166	45,474	75	+8	37,166	293,108	314,085	5,875	317,861	370,000	184,500
68	Century Acceptance Corp., Kansas City, Mo.	62,534	68,203	65		25,259	91,977	112,119	2,905	19,891	12,694	36,000
69	Government Employees Financial Corp., Denver	57,811	60,488	68		47,284	182,984	222,570	1,376	7,295	106,797	22,000
70	Mellon Financial Services Corp., Oak Brook, Ill. (g)	56,002	59,921	70		56,002	543,388	576,920	28	34,746	228,750	0
71	Amoco Credit Corp., Chicago	54,434	60,203	69		54,434	318,013	359,491	24,231	0	1,139,851	286,000
72	Commonwealth Financial Corp., Walnut Creek, Calif.	50,320	30,833	89	+17	8,820	216,860	235,893	110	0	1,250,000	260,000
73	Rosenthal & Rosenthal, Inc., New York	46,007	42,189	78	+5	24,057	237,109	249,570	N A	N A	1,240,080	115,500
74	Allied Finance Co., Dallas (b)	45,102	44,949	76	+2	37,502	91,001	175,682	4,323	22,201	128,127	70,400
75	AgriStor Credit Corp., Elm Grove, Wis. (f)	43,540	49,865	73		43,525	161,668	237,241	39,430	37,658	7,609	136,000
76	U.S. Bancorp Leasing & Financial, Portland, Ore. (g,f)	42,079	44,467	77	+1	42,079	340,009	341,929	3,673	133,610	0	0
77	TrustSouth Financial Corp., Florence, S.C. (g)	41,817	37,769	81	+4	41,817	388,627	394,142	4,048	48,618	356,069	0
78	Crossland Credit Corp., Brooklyn, New York (b,g,f)	41,064	33,645	82	+4	41,064	83,148	86,721	7,390	17,959	44,992	0
79	First Illinois Finance Co., Northbrook (g)	41,009	32,595	87	+8	20,009	186,349	192,251	8,039	35,237	8,221	100,000
80	Dauta-Allis Credit Corp., West Allis, Wis.	40,599	89,523	61		40,599	134,566	203,201	1,694	27,261	513,456	0
81	John Hancock Leasing Corp., Boston	38,910	28,135	90	+9	36,010	222,436	246,191	7,161	51,972	93,910	0
82	Capital Finance Group, Inc., Charlotte, N.C. (g)	38,767	39,994	80		18,817	127,078	139,095	2,468	5,015	150,642	0
83	Cummins Financial Inc., Arlington, Tex.	36,989				36,989	211,534	217,531	2,155	52	N A	201,000
84	Personal Finance Co, Olympia Fields, Ill.(b)	35,850	25,209	97	+13	15,850	81,038	86,832	1,641	18,004	97,867	3,500
85	Horizon American, Inc., Reading, Pa. (f)	35,771	32,847	85		19,454	122,335	132,363	2,712	25,405	98,912	93,500
86	First Family Financial Services, Atlanta (g)	35,065	27,364	93	+7	35,043	246,273	253,194	7,445	77,080	308,664	100
87	Provident Financial Corp., Columbia, S.C. (g)	34,848	33,515	83		26,398	111,288	126,105	5,351	1,653	2,300	83,000
88	C&S Family Credit, Inc., Atlanta (g)	32,471	25,211	96	+8	32,471	195,508	196,425	7,260	0	111,280	0
89	Landmark Fin'l Services, Inc., Silver Spring, Md. (g)	32,053	27,997	91	+2	32,053	156,621	170,744	5,914	33,572	157,721	0
90	Genesco Financial Corp., Nashville, Tenn.(b)	31,438	32,567	88		31,438	28,023	40,643	421	0	N A	0
91	1st Franklin Financial Corp., Tucker, Ga.	29,182	27,375	92	+1	12,567	42,109	56,777	2,639	8,929	61,424	15,100
92	FirstMark Financial Corp, Indianapolis	28,740	32,891	86		27,428	153,669	297,467	-3,931	N A	N A	N A
93	Eaton Credit Corp., Cleveland (f)	24,877	22,910	98	+5	24,877	118,029	122,101	1,967	13,230	149,387	100,000
94	Dresser Finance Corp., Franklin Park, Ill.	24,589				24,589	134,998	153,343	12,382	8,750	362,331	140,000
95	Security Finance Corp., Spartanburg, S.C.	22,755	17,965	104	+9	21,125	49,772	52,909	4,853	12,210	190,062	18,500
96	Community Credit Co., Edina, Minn.	22,127	22,127	99	+3	18,127	68,941	85,653	2,617	21,471	103,425	37,360
97	Banc One Financial Services, Inc., Marion, Ind. (g)	20,683	17,818	106	+9	20,683	138,749	144,535	4,500	21,316	128,200	N A
98	Pioneer Credit Co., Cleveland, Tenn. (b,c)	19,224				13,761	18,127	23,611	414	4,280	N A	16,600
99	National City Credit Corp., Cleveland (g)	19,000	18,467	103	+4	19,000	147,000	180,000	500	0	0	135,000
100	First Hawaiian Creditcorp, Inc., Honolulu (g,f)	18,105	17,239	107	+7	17,963	170,460	185,245	1,785	799	85,488	0

Data Sources: American Banker questionnaire sent to commercial and consumer finance companies and leasing companies. **Total Capital Funds** consist of stockholders' equity and non-current subordinated debt. Non-current means that there is a remaining maturity of one year or more. Minority interest is excluded. **Equity capital** is the shareholders' equity portion of total capital. Stockholders' equity is the sum of capital plus surplus. **Receivables** exclude direct loans and paper purchased from manufacturers, wholesalers and retailers. **Receivables Net** excludes unearned income and loan-loss reserves. **Net Income** is income after taxes but before extraordinary items. **Deferred Income** or unearned discounts is the sum of prepaid interest on loans outstanding. **Receivables acquired** are gross receivables acquired during the year. **Bank credit** is bank credit lines available plus in use. Please note that many bank related finance companies report zero for bank credit lines because they are funded by their parent company. **(b)**— Year ending on date other than Dec. 31. **(c)**— Current year's figures are for a date different from preceding year. **(g)**— A subsidiary of a domestic commercial saving bank organization. **(l)**— A leasing company. **(ns)**— Foreign bank listed. **(R)**— Revised since publication on June 10, 1987. **(r)**— Rank would have had if revised data had been used. **(†)**— Rank firm would have had if it had been included in survey. **( )**— Indicates a loss. **N.A.**— Not available.

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Item 1, Page 1

Bank-Related Finance Companies

With Capital Greater than $10 Million (figures in thousands)

Rank 12/87		Total Capital Funds 12/31/87	Total Capital Funds 12/31/86	Rank 12/86	Gain in Rank	Parent
	Domestic Commercial and Savings Bank-Related Companies					
9	CIT Group Holdings, Inc., Livingston, N.J.	1,581,076	1,880,300	7		Manufacturers Hanover Corp. New York
10	Manuf Hanover Cons. Serv Gp, Inc. Huntingdon Valley, Pa.[1]	1,484,805	1,304,766	10		Manufacturers Hanover Corp. New York
21	Security Pacific Financial Services, Inc., San Diego	743,000	558,000	26	+ 5	Security Pacific Corp. Los Angeles
25	Norwest Financial Services, Inc., Des Moines, Iowa	572,244	509,191	27	+ 2	Norwest Corp. Minneapolis
31	Commercial Alliance Corp., New York	373,618	347,826	33	+ 2	First Interstate Bancorp. Los Angeles
33	Mentor Credit Corp., Norwalk, Conn.	352,587	325,868	34	+ 1	Mentor Financial Group. Philadelphia
38	Fleet Financial Corp., Providence, R.I.	294,261	243,253	37		Fleet/Norstar Financial Group. Providence, R.I.
39	USA Financial Services, Inc., Peoria, Ill. (b,c)	140,236	107,208	54	+ 4	United Savings of America. Chicago
42	Congress Financial Corp., New York	125,839	114,500	50		CoreStates Financial Corp. Philadelphia
53	Chemical Financial Services Corp., Cleveland	123,412	89,685	60	+ 7	Chemical Banking Corp. New York
54	Glendale Financial Corp., Dallas (b,c)	117,600	104,136	55	+ 1	Glendale Federal Savings & Loan Assn. Calif.
56	First Manufactured Housing Cred Cp., Glen Burnie, Md.	116,062	52,049	71	+16	First Maryland Bancorp. Baltimore
58	New England Merchants Leasing Corp., Boston	108,528	50,802	72	+16	Bank of New England. Boston
59	Fidelity Acceptance Corp., Minneapolis (b)	91,358	97,481	57		Society for Savings. Hartford, Conn.
63	MNC Affiliates Group, Baltimore	91,059				MNC Financial, Inc. Baltimore
64	Signal Finance Corp., Pittsburgh	81,674	80,151	63		CoreStates Financial Corp. Philadelphia
76	Mellon Financial Services Corp., Oak Brook, Ill.	56,002	59,921	70		Mellon Bank Corp. Pittsburgh
76	U.S. Bancorp Leasing & Financial, Portland, Ore.	42,079	44,467	77	+ 1	U.S. Bancorp. Portland
77	TrustSouth Financial Corp., Florence, S.C.	41,817	37,789	81	+ 4	First Nationwide Bank FSB. San Francisco
78	Crossland Credit Corp., Brooklyn, New York	41,064	33,645	82	+4	Crossland Savings FSB. Brooklyn, New York
79	First Illinois Finance Co., Northbrook	41,009	32,595	87	+8	First Illinois Corp. Evanston
82	Capital Finance Group, Inc., Charlotte, N.C.	38,767	39,994	80		First Union Corp. Charlotte, N.C.
86	First Family Financial Services, Atlanta	35,065	27,364	93	+ 7	Georgia Federal Bank FSB. Atlanta
87	Provident Financial Corp., Columbia, S.C.	34,848	33,515	83		South Carolina National Corp. Columbia
88	C&S Family Credit, Inc., Atlanta	32,471	25,211	96	+ 8	Citizens & Southern Corp. Atlanta
89	Landmark Fin'l Services, Inc., Silver Spring, Md.	32,053	27,997	91	+ 2	Signet Banking Corp. Richmond
97	Banc One Financial Services, Inc., Marion, Ind.	20,683	17,818	106	+ 9	Banc One Corp. Columbus, Ohio
98	National City Credit Corp., Cleveland	19,000	18,487	103	+ 4	National City Corp. Cleveland
100	First Hawaiian Creditcorp, Inc., Honolulu	18,105	17,239	107	+ 7	First Hawaiian, Inc. Honolulu
103	NBD Business Finance, Inc., Detroit	12,503				NBD Bancorp, Inc. Detroit
105	Coastfed Business Credit Corp., Los Angeles	11,825				Coast Savings & Loan Assn., Los Angeles
	Foreign Bank-Related Companies					
12	Heller Financial, Inc., Chicago	1,096,121	952,891	17	+ 5	Fuji Bank, Ltd. Tokyo
16	Barclays American Corp., Charlotte, N.C.	896,515	910,200	18		Barclays Bank Plc. London, U.K.
62	Concord Leasing, Inc., Norwalk, Conn.[1]	85,976	90,704	59		Hongkong & Shanghai Bank Corp. Hong Kong
102	Deutsche Credit Corp., Deerfield, Ill.	12,522				Deutsche Bank. Frankfurt, Germany
107	Marine Midland Business Credit, Wilmington, Del.	11,363				Marine Midland Banks, Inc. Buffalo, N.Y.[2]

(b)— Year ending on date other than Dec. 31. (c)— Current year's figures are for a date different from preceding year. (1)— In September 1987 Concord Leasing, a wholly owned subsidiary of Hongkong and Shanghai Banking Corp. acquired Ingersoll Rand Financial Corp. Woodcliff Lake, N.J. from Ingersoll Rand Inc. The 1986 data are for Ingersoll-Rand Financial Corp. (2)— Wholly owned subsidiary of Hongkong and Shanghai Banking Corp.

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Top Finance Companies in Net Income

50 Highest Earners During 1987 (dollar amounts in thousands)

Rank 12/87		Net Income 12/31/87	Net Income 12/31/86	% Chg.
1	General Motors Acceptance Corp., Detroit	1,453,200	1,185,100	22.62
2	Ford Motor Credit Co., Dearborn, Mich.	678,800	611,300	11.04
3	General Electric Capital Corp., Stamford, Conn. (f)	470,182	378,931	24.08
4	Associates Corp. of No. America, Dallas	236,063	213,595	10.52
5	Chrysler Financial Corp., Troy, Mich.	225,800	200,000	12.90
6	Household Financial Services, Prospect Heights, Ill.	174,600	141,100	23.74
7	Beneficial Corp., Wilmington, Del.	142,200	(171,600)	182.87
8	Westinghouse Credit Corp., Pittsburgh	115,203	106,244	8.43
9	Sears Roebuck Acceptance Corp., Wilmington, Del.	113,372	94,514	19.95
10	Commercial Credit Co., Baltimore	101,500	45,900	121.13
11	ITT Financial Corp., St. Louis, Mo.	101,388	151,923	-33.26
12	American Express Credit Corp., Wilmington, Del.	88,000	116,000	-24.14
13	IBM Credit Corp., Stamford (f)	85,759	118,118	-27.40
14	Xerox Credit Corp., Stamford, Conn. (f)	84,900	84,900	0.00
15	Transamerica Financial Corp., Los Angeles	83,548	97,085	-13.94
16	Norwest Fin'l Services, Inc., Des Moines, Iowa (g)	78,078	70,793	10.29
17	Security Pacific Fin'l Services, Inc., San Diego, Calif.	75,000	58,000	29.31
18	Philip Morris Credit Corp., New York (f)	72,300	70,900	1.97
19	Avco Financial Services, Inc., Irvine, Calif.	70,421	121,606	-42.09
20	Creditrust Financial Corp., Evansville, Ind.	67,256	64,457	4.34
21	Pitney Bowes Credit Corp., Norwalk, Conn.	56,425		
22	Manuf Han. Cons Serv Gp, Huntingdon Valley, Pa. (g)	55,274	58,231	-5.08
23	John Deere Credit Co., Reno, Nev.	45,862	50,966	-10.01
24	McDonnell Douglas Finance Corp., Long Beach, Calif. (f)	42,800	34,645	22.96
25	Montgomery Ward Credit Corp., Wilmington, Del.	41,000	43,000	-4.65
26	CIT Group Holdings, Inc., Livingston, N.J. (g)	40,071	136,740	-70.70
27	Agritiber Credit Corp., Elm Grove, Wis. (f)	39,430	3,442	1045.55
28	J.I. Case Credit Corp., Racine, Wis.	36,400	32,008	10.80
29	Fleet Financial Corp., Providence, R.I. (g)	34,923	30,214	15.62
30	Chemical Financial Services Corp., Cleveland (g)	33,777	33,427	1.05
31	J.C. Penney Funding Corp., Dallas	32,008	30,000	6.69
32	Macy Credit Corp., New York	31,998	26,070	22.74
33	Navistar Financial Corp., Schaumburg, Ill.	29,272	27,104	8.00
34	Barclays American Corp., Charlotte, N.C. (m)	27,673	22,692	21.95
35	Mentor Credit Corp., Norwalk, Conn. (g)	26,897	18,477	44.49
36	Equitable Life Leasing Corp., San Diego, Calif. (f)	25,804	18,592	37.72
37	Signal Capital Corp., Hampton, N.H.	25,254	.....	.....
38	Heller Financial, Inc., Chicago (m)	25,137	21,325R	17.86
39	Amsco Credit Corp., Chicago	24,231	28,668	-15.54
40	New England Merchants Leasing Corp., Boston (g)	20,141	14,119	42.65
41	Pacificorp Financial Services, Inc., Portland, Ore.	19,155	3,183	501.79
42	Greyhound Financial Corp., Phoenix, Ariz.	18,209	18,076	0.74
43	U S West Fin'l Services, Inc., Englewood, Colo. (f)	18,020	11,502	56.67
44	May Department Stores Credit Co., Reno, Nev.	17,158	16,396	4.65
45	Mobil Oil Credit Corp., Kansas City, Mo.	17,021	17,433	-2.36
46	Mack Financial Corp., Allentown, Pa.	15,508	18,111	-14.37
47	Nissan Motor Acceptance Corp., Torrance, Calif.	14,904	22,035	-32.36
48	Paccar Financial Corp., Bellevue, Wash.	13,932	10,816	28.81
49	Whirlpool Acceptance Corp., Benton Harbor, Mich.	13,475	14,049	-4.09
50	Kentucky Finance Co., Inc., Lexington	12,724	8,637	47.32

Net income is income after taxes but before extraordinary items. (g)— A subsidiary of a domestic commercial or saving bank organization. (f)— A leasing company. (m)— Owned by a foreign banking organization. ( )— Indicates a net loss for the year. R— Revised since publication on Oct. 19, 1988. N.A.— Not available.

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Top Finance Companies in Assets

50 Largest Firms at Yearend 1987 (dollar amounts in thousands)

Rank 12/87		Total Assets 12/31/87	Total Assets 12/31/86	% Chg.
1	General Motors Acceptance Corp., Detroit	98,527,000	90,780,900	8.53
2	Ford Motor Credit Co., Dearborn, Mich.	51,241,300	39,902,000	28.42
3	General Electric Capital Corp., Stamford, Conn. (f)	36,643,740	27,969,931	31.01
4	Chrysler Financial Corp., Troy, Mich.	25,277,000	21,028,300	20.20
5	Household Financial Services, Prospect Heights, Ill.	11,771,700	10,431,500	12.85
6	Sears Roebuck Acceptance Corp., Wilmington, Del.	11,883,129	9,228,693	26.60
7	Associates Corp. of No. America, Dallas	10,571,612	9,076,917	16.47
8	CIT Group Holdings, Inc., Livingston, N.J. (g)	9,435,018	8,393,259	12.41
9	American Express Credit Corp., Wilmington, Del.	7,907,000	8,094,000	-2.31
10	ITT Financial Corp., St. Louis, Mo.	7,539,878	6,743,429	11.81
11	Beneficial Corp., Wilmington, Del.	6,929,200	7,274,200	-4.74
12	Transamerica Financial Corp., Los Angeles	6,897,731	2,419,779	185.06
13	IBM Credit Corp., Stamford (f)	6,449,027	5,715,330	12.84
14	Westinghouse Credit Corp., Pittsburgh	6,254,160	5,748,374	8.80
15	Security Pacific Fin'l Services, Inc., San Diego, Calif.	6,044,000	4,822,000	25.34
16	Heller Financial, Inc., Chicago (m)	4,786,033	3,881,630	23.30
17	Barclays American Corp., Charlotte, N.C. (m)	4,330,024	4,147,990	4.39
18	Commercial Credit Co., Baltimore	4,306,400	4,863,800	-11.46
19	Avco Financial Services, Inc., Irvine, Calif.	3,883,009	6,120,832	-36.56
20	Xerox Credit Corp., Stamford, Conn. (f)	3,307,900	2,264,000	46.11
21	Manuf Hanover Cons. Serv Gp, Huntingdon Val., Pa. (g)	2,925,682	2,532,878	15.55
22	John Deere Credit Co., Reno, Nev.	2,876,582	3,005,425	-4.29
23	Creditrust Financial Corp., Evansville, Ind.	2,771,690	3,118,949	-11.13
24	Philip Morris Credit Corp., New York (f)	2,743,500	2,124,400	29.14
25	Norwest Financial Services, Inc., Des Moines, Iowa (g)	2,710,037	2,466,889	9.86
26	Montgomery Ward Credit Corp., Wilmington, Del.	2,683,000	2,519,000	6.51
27	McDonnell Douglas Finance Corp., Long Beach, Calif. (f)	2,224,800	1,713,411	29.85
28	Mentor Credit Corp., Norwalk, Conn. (g)	2,181,238	1,827,166	19.38
29	Toyota Motor Credit Corp., Torrance, Calif.	2,149,031	987,330	117.66
30	J.C. Penney Funding Corp., Dallas	1,856,000	1,856,000	.....
31	Pitney Bowes Credit Corp., Norwalk, Conn.	1,750,588	.....	.....
32	Signal Capital Corp., Hampton, N.H.	1,679,454	.....	.....
33	Navistar Financial Corp., Schaumburg, Ill.	1,662,985	1,563,013	6.40
34	New England Merchants Leasing Corp., Boston (g)	1,561,381	854,217	82.79
35	Nissan Motor Acceptance Corp., Torrance, Calif.	1,527,808	1,121,334	36.23
36	Chemical Financial Services Corp., Cleveland (g)	1,527,095	1,270,874	20.16
37	Equitable Life Leasing Corp., San Diego, Calif. (f)	1,493,159	1,091,558	36.79
38	Commercial Alliance Corp., New York (g)	1,481,052	1,265,386	17.04
39	Greyhound Financial Corp., Phoenix, Ariz.	1,462,920	1,552,195	-5.75
40	Pacificorp Financial Services, Inc., Portland, Ore.	1,432,249	635,979	125.20
41	J.I. Case Credit Corp., Racine, Wis.	1,413,900	1,631,293	-13.33
42	U S West Financial Services, Inc., Englewood, Colo. (f)	1,365,800	884,547	54.41
43	Fleet Financial Corp., Providence, R.I. (g)	1,363,906	1,062,979	28.31
44	Advanta Corp., Horsham, Pa.	1,285,000	959,532	33.92
45	Macy Credit Corp., New York	1,265,577	1,235,795	2.41
46	Mobil Oil Credit Corp., Kansas City, Mo.	1,098,756	875,232	25.54
47	Paccar Financial Corp., Bellevue, Wash.	1,044,294	838,731	24.51
48	MNC Affiliates Group, Baltimore (g)	1,027,952	.....	.....
49	Concord Leasing, Inc., Norwalk, Conn. (m)	997,647	611,888	63.04
50	Talcal Credit Corp., Los Angeles (m)	981,115	.....	.....

(g)— A subsidiary of a domestic commercial or saving bank organization. (f)— A leasing company. (m)— Owned by a foreign banking organization.

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FINANCE COMPANIES

Chicago Fed Letter

Excerpts from THE FEDERAL RESERVE BANK OF CHICAGO
June 1988, Number 10

First off the mark: South Dakota

South Dakota was the first state to enact commercial banking legislation specifically aimed at bringing out-of-state banking operations to the state to create jobs, expand the economy, and increase tax revenues. In February 1980, South Dakota removed all usury ceilings for credit card loans and other types of consumer lending. In March, the state amended its banking laws to permit an out-of-state bank holding company to establish a single state or national *de novo* bank in the state and move its credit card operations there. Such a bank was limited to a single banking office and was to be operated in a manner and at a location that would not attract customers from the general public. (Subsequent legislation has eliminated most of these original restrictions.)

New York's Citicorp was the first out-of-state bank holding company to establish a new national bank in South Dakota. The new bank, Citibank (South Dakota), N.A., at Sioux Falls, was to engage primarily in nationwide consumer credit card lending activities then currently conducted by Citicorp's New York banks. After seven years, it is now the largest commercial bank in South Dakota, with domestic assets of $12.0 billion, total loans to individuals of $11.6 billion, and 3,462 employees.

Other out-of-state bank holding companies from Texas and Nebraska also established subsidiaries in South Dakota, primarily to offer credit card services. At the same time, two large bank holding companies with headquarters in Minnesota expanded consumer loans and employment at existing subsidiary banks in South Dakota.

Delaware spreads a broader net

Delaware followed South Dakota with similar legislation aimed at the development of commercial banking. The Financial Center Development Act of 1981 (FCDA) allowed out-of-state bank holding companies to operate only a single office that was not likely to attract new customers from the general public. The bank was required to employ at least 100 people within one year in the state. FCDA also essentially eliminated interest rate ceilings on all types of loans including bank revolving credit (i.e., credit cards) and bank closed-end credit and permitted banks to charge fees for the borrowing privileges (i.e., annual card fees). In addition, the law included an attractive bank tax structure with declining tax rates as bank net income increased.

By the end of 1987, 17 FCDA banks had opened and one was pending. The major contributors to the expansion of assets and employment in the commercial banking industry in Delaware have been these banks. Eight are subsidiaries of bank holding companies in New York, and are variously engaged in wholesale banking, cash management services, nationwide commercial lending, as well as consumer lending and credit card operations. FCDA banks that are subsidiaries of bank holding companies in Georgia, Maryland, Virginia, North Carolina, and Pennsylvania, are primarily engaged in consumer lending and credit card operations.

In 1983 Delaware enacted two additional banking laws. The banks established under these laws have had a smaller impact on the growth of assets, total loans, and employment at commercial banks in Delaware. Part of this is attributable to the more recent enactment of the legislation.

The Delaware legislation has also encouraged the establishment of so-called nonbank banks by out-of-state companies. Such nonbank banks have usually been acquired or established by nonbank holding companies, primarily for the purpose of offering consumer loans and credit cards, or alternatively, offering commercial loans but not accepting demand deposits.[1] Eight nonbank banks are in operation in Delaware. Employment increased over 3000 at Greenwood Trust Company alone (New Castle, Delaware), after it was acquired by a subsidiary of Sears, Roebuck and Company in January 1985 and began offering the new Discover credit card.

Delaware's eleven continuing commercial banks also benefited from the legislation to encourage the expansion of banking employment in the state.

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October 27, 1988

STATEMENT IN SUPPORT OF A NET INCOME TAX FOR FINANCIAL INSTITUTIONS

1. The Tax Studies and the Burden of Indiana's Current Tax on Financial Institutions.

The Commission has over many years addressed the problems of taxing Indiana financial institutions by gross income and excise taxes and the ultimate necessity of using instead a net income tax. Extensive commission reports were made on this subject in the 1960's and in 1982. An excellent monograph was prepared for the Commission by John Sylvia of the Legislative Services Agency in 1987. Bills to effect that change have been subject of the legislative hearings since 1977 with favorable committee votes when votes were taken.

By this statement we intend only to summarize the financial harm to Indiana and to its savings institutions, banks and Indiana chartered credit unions by its present tax statutes and to urge the soundness of adopting an aggressive interstate net income tax for financial institutions, including in particular a tax on Indiana's share of the income from financial services increasingly performed in Indiana by non-residents.

The Indiana tax burden on savings institutions and banks is presently controlled by the greater of the gross income tax or by an excise tax levied on the amount of deposits and net worth. For savings institutions and for credit unions, the controlling tax is the gross income tax. For banks it is the excise tax. In either situation the tax base and the tax burden has accelerated since 1979 more rapidly with interest rate deregulation and inflation than the institutions' net income. In 1980 the Indiana tax burden was 89% of the industry aggregate pre-tax net income. For the next two years the industry had no aggregate net income and Indiana taxes contributed a substantial part of the industry's losses. It was still 18.6% of industry aggregate pre-tax net income in 1985, fell to 10.1% in 1986 and with an increase in interest rates was 21.9% in 1987. (Source: Federal Home Loan Bank of Indianapolis). For every year since 1979, savings institution taxes have increased, except for a minor decrease in 1982, irrespective of the industry's net income. (See Sylvia's study and FHLB of Indianapolis records.)

More disturbing to the industry and the State, the burden of state taxes falls disproportionately on the low or negative net income institutions, all with a critical net worth position. As shown by a study of Dr. James A. Papke, Director of the Center for Tax Policies at Purdue University (set out in the Appendix), savings institutions are taxed in Indiana at a

higher rate than in any other state. If the Indiana gross tax on the income of a representative savings institution is at $100, the tax on that same income at the rate paid in the next highest state would be $81.6; for the median state the tax would be $36.6; for the highest of the four surrounding states (Kentucky) would be $53.9, and for the lowest, (Illinois) would be $26.0. (See Table 6, Papke Report).

As a result of this burden the annual growth in the number of employees hired by Indiana savings institutions has, since 1975, been 5.4% less than the growth in the rest of the United States. (See Table 1, Papke Report). Further, the annual asset growth of Indiana savings institutions since 1975 has been 5.6% and 3.0% below the growth rate of savings institutions in the United States and in states contiguous to Indiana. (See Papke Report, Table 4 and Supplemental Table 4, at the end of the Report.).

While we do not have comparably figures for banks, past studies have shown that the amount of Indiana taxes on banks ranks in the upper ten states in the United States. The rate of increase of the Indiana tax base based either on gross income or deposits and net worth (and of the resulting tax) for both banks and savings institutions has risen more rapidly than their incomes. Without a change to a net tax the State and the financial institutions from, over time, will be consistent losers in tax revenue and net worth financial institutions in

comparison with other states and their resident financial institutions.

2 . <u>The Proposed Tax and its Focus.</u>

Indiana's adjusted gross income and supplemental net income taxes do not now <u>effectively</u> tax non-resident taxpayers doing business in this State and lose tax revenue under the following situations among others:

(1) Banks and savings associations are specifically exempted from Indiana adjusted gross income tax supplemental and net income tax. This exemption applies not only to Indiana banks but to out-of-state non-resident banks doing business here who pay no Indiana tax.

(2) Further, under these taxes Indiana collects none of the income earned on "intangibles" created from transactions with Indiana residents unless the papers are maintained in Indiana evidencing the intangibles ~~are~~ . Intangibles includes notes, installment paper and stock. The income consists of interest, dividends and the gain on intangible sales. Under present Indiana law, taxation of that income by the State becomes a matter of choice of the lender. GMAC, for example, reportedly makes many car loans in Indiana, administers

the loans, maintains the loan paper and is taxed here. Other non-resident car financing agents and other consumer lenders do not. (See Memorandum in the Appendix prepared by the Indiana League). Yet the non-residents are some of Indiana's largest financial institutions competitors.

(3). Indiana currently requires, as a pre-requisite, a business presence in Indiana narrowly defined.

(4) Under the existing adjusted gross and supplemental net income taxes a non-resident entity competing with financial institutions in Indiana and who do financial business here apportion its income under a three factor formula, based on (1) wage payments to employees, (2) the amount of real and personal tangible property and (3) receipts or sales, in Indiana as a per cent of those factors in all states where the entity is doing business. For financial institutions, this unfairly reduces the amount appportioned to Indiana by non-residents, since property and wage payments are generally greater for non-domiciled lenders and are less significant parts of the earning

capacity of a financial business than its receipts.[1]

The tax under consideration here is designed to do three things: (1) shift the taxation of Indiana resident financial institutions to a net income base, increasing the relative Indiana tax burden within the industry to institutions with higher net income, (2) tax the income of Indiana domiciled financial institutions wherever earned, with a credit for income taxed in other states at rates not in excess of Indiana's rate, (3) increase Indiana's tax revenue by effectively taxing the income earned by non-resident financial institutions to the extent they do business, loan money and financial perform services in Indiana without substantial physical presence here, Financial institutions is a broadly encompassing term. It includes credit card operations, loan offices, solicitation of loans by phones and traveling representatives, with paper work concentrated either within our without the State, and (4) apportions non-resident income by a one factor receipts formula.

The bill under consideration follows provisions in innovative statutes in Minnesota, New York and California, and

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[1] In Indiana, the supplemental tax as applied to insurance companies, in contrast, uses insurance premiums from Indiana residents as a percent of all premiums as an apportionment factor. (IC 6-3-8-2).

statutes of this type are under consideration in other states. A statute of this type has become necessary to protect State revenue in the increasingly obile financial institutions industry. We urge favorable consideration of the bill with variations deemed necessary by the Commission during its consideration.

Respectfully submitted,

INDIANA LEAGUE OF SAVINGS INSTITUTIONS

Richard H. McKasson, President
600 Union Federal Building
Indianapolis, Indiana 46204
317/632-2353

Lewis C. Bose, Counsel
2700 First Indiana Plaza
135 North Pennsylvania Street
Indianapolis, Indiana 46204
317/684-5000

2102G

EXHIBIT L: 5

Iowa Administrative Code §§701-59.25-59.29

701—59.13(422) Iowa franchise taxes. Iowa franchise taxes paid or accrued during the tax year as may be applicable under the method of filing, are permissible deductions for federal corporation income tax purposes, but not for purposes of determining Iowa net income. To the extent taxes were deducted in the determination of federal taxable income, they shall be added to federal taxable income for Iowa franchise tax purposes. Refunds of Iowa franchise tax to the extent that they are included in the determination of federal taxable income shall all be subtracted from federal taxable income.

This rule is intended to implement Iowa Code section 422.61.

701—59.14(422) Method of accounting, accounting period. The return shall be computed on the same basis and for the same accounting period as the taxpayer's return for federal corporation income tax purposes. Permission to change accounting methods or accounting periods for franchise tax purposes is not required provided the taxpayer furnishes the department with a copy of the federal consent.

This rule is intended to implement Iowa Code sections 422.35 and 422.61.

701—59.15(422) Consolidated returns. There is no provision in the Iowa franchise tax law to allow financial institutions to file consolidated Iowa franchise tax returns with another financial institution or another corporation as defined in Iowa Code section 422.32. In the absence of any statutory authority for allowing consolidated Iowa franchise tax returns, separate Iowa franchise tax returns must be filed.

This rule is intended to implement Iowa Code sections 421.14 and 422.68(1).

701—59.16(422) Federal rulings and regulations. In determining whether "taxable income," "net operating loss deduction" or any other deductions are computed for federal tax purposes under, or have the same meaning as provided by, the Internal Revenue Code, the department will use applicable rulings and regulations that have been duly promulgated by the Commissioner of Internal Revenue, unless the director has created rules and regulations or has exercised discretionary powers as prescribed by statute which call for an alternative method for determining "taxable income," "net operating loss deduction," or any other deductions, or unless the department finds that an applicable Internal Revenue ruling or regulation is unauthorized according to the Iowa Code.

This rule is intended to implement Iowa Code sections 422.35 and 422.61.

59.17 to 59.24 Reserved.

ALLOCATION AND APPORTIONMENT

701—59.25(422) Basis of franchise tax. Iowa Code section 422.60 imposes a franchise tax on financial institutions (as defined in subrule 57.1(2) for the privilege of doing business within the state. The tax is measured by net income. For financial institutions subject to the tax, the tax is levied and collected only on income which may accrue or be recognized to the financial institutions from business done or carried on in the state plus net income from certain sources without the state which by rule follows the commercial domicile of the financial institution.

If a financial institution carries on business entirely within the state of Iowa, no allocation or apportionment of its income may be made. The financial institution will be presumed to be carrying on its business entirely within the state of Iowa if its activities are carried on only within Iowa, even though it receives income from sources outside the state in the form of interest, dividends, royalties, and other sources of income from intangibles.

59.25(1) *Definition—doing business.* The term "doing business" is used in a comprehensive sense and includes all activities or any transactions for the purpose of financial or pecuniary gain or profit. Irrespective of the nature of its activities, every financial institution organized for profit and carrying out any of the purposes of its organization shall be deemed to be "doing business." In determining whether a financial institution is doing business, it is immaterial whether its activities actually result in a profit or loss.

59.25(2) *Definition—carrying on business partly within and partly without the state.* Carrying on business partly within and partly without the state means having business activities in at least one other state sufficient to meet the minimum constitutional standards for doing business in a state under the due process and commerce clauses of the United States Constitution. The determination of whether a financial institution is carrying on business partly within and partly without the state must be made on a tax-year-by-tax-year basis. The activities of past or future years have no bearing on the current year.

The following nonexclusive activities if done on a regular and continuing basis by financial institution officers or employees in at least one other state would constitute the minimum activities which would meet the constitutional standards for doing business in a state under the due process and commerce clauses of the United States Constitution:

a. Solicitation of loans by traveling loan officers.

b. Collection of overdue accounts.

c. Any other activities carried on in advancement, promotion, or fulfillment of the business of the financial institution.

This rule is intended to implement Iowa Code sections 422.60 and 422.63.

701—59.26(422) Allocation and apportionment.

59.26(1) The classification of income by the labels customarily given, such as interest, dividends, rents, and royalties, is of no aid in determining whether that income is business or nonbusiness income. Interest, dividends, rents and royalties shall be apportioned as business income to the extent the income was earned as a part of a financial institution's unitary business, a portion of which is conducted in Iowa. Mobil Oil Corp. v. Commissioner of Taxes, 455 U.S. 425 (1980); ASARCO, Inc. v. Idaho State Tax Commission, 458 U.S. 307, 73 L.Ed.2d 787 102 S.Ct. 3103 (1982); F. W. Woolworth Co. v. Taxation and Revenue Dept., 458 U.S. 354, 73 L.Ed.2d 819 102 S.Ct. 3128 (1982); Container Corporation of America v. Franchise Tax Board, 463 U.S. 159, 77 L.Ed.2d 545, 103 S.Ct. 2933 (1983). Whether income is part of a financial institution's unitary business income depends upon the facts and circumstances in the particular situation. The burden of proof is upon the taxpayer to show that the treatment of income on the return as filed is proper. There is a rebuttable presumption that an affiliated group of financial institutions in the same line of business have a unitary relationship, although that is not the only element used in determining unitariness.

59.26(2) Application of related expense to nonbusiness income. Subrule 59.26(1) deals with the separation of "net" income, therefore, determination and application of related expenses must be made, as hereinafter directed, before allocation and apportionment within and without Iowa. Related expenses shall mean those expenses directly related.

A directly related expense shall mean an expense which can be specifically attributed to an item of income. Interest expense shall be considered directly related to a specific property which generates, has generated, or could reasonably have been expected to generate gross income if the existence of all of the facts and circumstances described below is established. Such facts and circumstances are as follows:

a. The indebtedness on which the interest was paid was specifically incurred for the purpose of purchasing, maintaining, or improving the specific property;

b. The proceeds of the borrowing were actually applied to the specified purpose;

c. The creditor can look only to the specific property (or any lease or other interest therein) as security for the loan;

d. It may be reasonably assumed that the return on or from the property will be sufficient to fulfill the terms and conditions of the loan agreement with respect to the amount and timing of payment of principal and interest; and

e. There are restrictions in the loan agreement on the disposal or use of the property consistent with the assumptions described in *"c"* and *"d"* above.

A deduction for interest may not be considered definitely related solely to specific property, even though the above facts and circumstances are present in form, if any of the facts and

circumstances are not present in substance. Any expense directly attributable to allocable interest, dividends, rents and royalties shall be deducted from income to arrive at net allocable income.

EXAMPLE: For purposes of this example, it is assumed that the taxpayer has nonbusiness rental income. The taxpayer invests in a 20-story office building. Under the terms of the lease agreements, the taxpayer provides heat, electricity, janitorial services, and maintenance. The taxpayer also pays the property taxes. Construction of the building was funded through borrowings which meet the criteria of a direct expense under the provisions of this paragraph. The directly related expenses to the operation of the property are:

Interest expense	$1,200,000
Property taxes	500,000
Depreciation	500,000
Electricity	300,000
Heat	200,000
Insurance	150,000
Janitorial services	100,000
Repairs	50,000
Total expenses	$3,000,000

The directly related expense of the allocable rental income is $3,000,000.

This rule is intended to implement Iowa Code section 422.63.

701—59.27(422) Net gains and losses from the sale of assets. For purposes of administration of this rule, a capital gain or loss shall mean the sale price or value at the time of disposal of an asset less the adjusted basis, whether reportable as short-term or long-term capital gain or ordinary income for federal income tax purposes.

59.27(1) Gain or loss from the sale, exchange, or other disposition of real or tangible or intangible personal property, if the property while owned by the taxpayer was used in the taxpayer's trade or business, shall be apportioned by the business activity ratio applicable to the year the gain or loss is determined and shall be included in the computation of the business activity ratio as follows:

a. Gain from the sale, exchange, or other disposition of real property shall be included in the numerator if the property is located in this state.

b. Gain from the sale, exchange, or other disposition of tangible personal property shall be included in the numerator if:

(1) The property has a situs in this state at the time of sale; or

(2) The taxpayer's commercial domicile is in this state and the taxpayer is not taxable in the state in which the property had a situs.

c. Gains from the sale, exchange, or other disposition of intangible personal property shall be included in the numerator if the taxpayer's commercial domicile is in this state.

d. All gains shall be included in the denominator of the activity ratio.

59.27(2) Gain or loss from the sale, exchange, or other disposition of property not used in the taxpayer's trade or business shall be allocated as follows:

a. Gains or losses from the sale, exchange, or other disposition of real property located in this state are allocable to this state.

b. Gains or losses from the sale, exchange, or other disposition of tangible personal property are allocable to this state if:

(1) The property has a situs in this state at the time of sale; or

(2) The taxpayer's commercial domicile is in this state and the taxpayer is not taxable in the state in which the property had a situs.

c. Gains or losses from the sale, exchange, or other disposition of intangible personal property are allocable to this state if the taxpayer's commercial domicile is in this state.

This rule is intended to implement Iowa Code section 422.63.

701—59.28(422) Apportionment factor. In determining the total net taxable income, the apportionable income attributable to this state, as determined by use of the apportionment fraction, shall be added to the nonapportionable income allocable to this state.

59.28(1) Receipts derived from transactions and activities in the regular course of trade or business which produce business income are included in the denominator of the apportionment factor. Income which is not subject to the Iowa franchise tax shall not be included in the computation of the apportionment factor.

59.28(2) The numerator of the apportionment factor is that portion of the total receipts included in the denominator of the taxpayer attributable to this state during the income year determined as follows:

a. Receipts from the lease, rental, or other use of real property shall be included in the numerator if the real property is located in Iowa.

b. Receipts from the sale of tangible personal property shall be included in the numerator if the property is delivered or shipped to a purchaser in this state regardless of the f.o.b. point or other conditions of the sales.

c. Receipts from the use of tangible personal property shall be included in the numerator of the business activity formula to the extent that property is utilized in Iowa. The extent of utilization of tangible personal property in a state is determined by multiplying the rent by a fraction, the numerator of which is the number of days of physical location of the property in the state during the rental period in the taxable year and the denominator of which is the number of days of physical location of the property everywhere during all rental periods in the taxable year. If the physical location of the property during the rental period is unknown or not ascertainable by the taxpayer, tangible personal property is utilized in the state in which the property was located at the time the rental payer obtained possession.

d. All royalty income from intangible personal property determined to be business income shall be included in the numerator of the business activity formula if the taxpayer's commercial domicile is in Iowa. All royalty income from tangible personal property or real property determined to be business income shall be included in the numerator of the business activity formula if the situs of the tangible personal property or real property is within Iowa.

e. Interest and other receipts from assets in the nature of loans (including federal funds sold and banker's acceptances) and installment obligations shall be attributed to the state where the borrower is located.

f. Interest income from a participating bank's portion of participation loan shall be attributed to the state where the borrower is located.

g. Interest income from loans solicited by traveling loan officers shall be attributed to the state where the borrower is located.

h. Interest or service charges from bank, travel, and entertainment credit card receivables and credit card holders' fees shall be attributed to the state in which the credit card holder resides in the case of an individual or, if a corporation, to the state of the corporation's commercial domicile.

i. Merchant discount income derived from bank and financial corporation credit card holder transactions with a merchant shall be attributed to the state in which the credit card holder resides.

j. Receipts for the performance of fiduciary services are attributable to the state where the services are principally performed.

k. Receipts from investments of a bank in securities, the income from which constitutes business income, shall be attributed to its commercial domicile except that:

(1) Receipts from securities used to maintain reserves against deposits to meet federal and state reserve deposit requirements shall be attributed to each state based upon the ratio that total deposits in the state bear to total deposits everywhere.

(2) Receipts from securities owned by a bank but held by a state treasurer or other public official or pledged to secure public or trust funds deposited in the bank shall be attributed to the banking office at which the secured deposit is maintained.

l. Receipts (fees or charges) from the issuance of travelers checks and money orders shall be attributed to the state where the taxpayer's office is located that issued the travelers checks. If the travelers checks are issued by an independent representative or agent of the taxpayer, the fees or charges shall be attributed to the state where the independent representative or agent issued the travelers checks.

m. Fees, commissions, or other compensation for financial services rendered within this state.

n. Any other gross receipts resulting from the operation as a financial organization within the state to the extent the items do not represent a recapture of an expense.

This rule is intended to implement Iowa Code section 422.63.

701—59.29(422) Allocation and apportionment of income in special cases. If a taxpayer feels that the allocation and apportionment method as prescribed by rule 701—59.28(422) in its case results in an injustice, the taxpayer may petition the department for permission to determine the taxable net income, both allocable and apportionable, to the state on some other basis.

The taxpayer must first file the return as prescribed by rule 701—59.28(422) and pay the tax shown due thereon. If a change to some other method is desired, a statement of objections and schedules detailing the alternative method shall be submitted to the department. The department shall require detail and proof within the time as the department may reasonably prescribe. In addition, the alternative method of allocation and apportionment will not be allowed where the taxpayer fails to produce, upon request of the department, any information the department deems necessary to analyze the request for an alternative method of allocation and apportionment. The petition must be in writing and shall set forth in detail the facts upon which the petition is based. The burden of proof will be on the taxpayer as to the validity of the method and its results. The mere fact that an alternative method of apportionment or allocation produces a lesser amount of income attributable to Iowa is per se, insufficient proof that the statutory method of allocation and apportionment is invalid. Moorman Manufacturing Company v. Bair, 437 U.S. 267, 1978; 57 L.Ed.2d 197. In essence, a comparison of the statutory method of apportionment with another formulary apportionment method is insufficient to prove that the taxpayer would be entitled to the alternative formulary apportionment method. Moorman Maufacturing Company v. Bair, supra.

One of the possible alternative methods of allocation and apportionment is separate accounting provided the taxpayer's activities in Iowa are not unitary with the taxpayer's activities outside Iowa. Any corporation deriving income from business operations partly within and partly without Iowa must determine that net business income attributable to this state by the prescribed formula for apportioning net income, unless the taxpayer proved by clear and cogent evidence that the statutory formula apportions income to Iowa out of all reasonable proportion to the business transacted within Iowa. Moorman Manufacturing Company v. Bair, supra.

Separate accounting is not allowable for a unitary business where the separate accounting method fails to consider factors of profitability resulting from functional integration, centralization of management, and economics of scale. Shell Oil Company v. Iowa Department of Revenue, 414 N.W.2d 113 (Iowa 1987).

The burden of proof that the statutory method of apportionment attributes to Iowa income out of all reasonable proportion to the business transacted within Iowa is on the taxpayer. In order to utilize separate accounting, the taxpayer's books and records must be kept in a manner that accurately depicts the exact geographical source of profits. In any petition to utilize separate accounting, the taxpayer must submit schedules which accurately depict net income by division or product line and the amount of income earned within Iowa.

There are alternative methods of separate accounting utilizing different accounting principles. A mere showing that one separate accounting method produces a result substantially different than the statutory method of apportionment is not sufficient to justify the granting of the separate accounting method shown. The taxpayer must not only show that the separate accounting method advocated by it in comparison with the statutory method of apportionment produces a result which, if the statutory method of apportionment were used, would

be out of all reasonable proportion to the business transacted within Iowa. The taxpayer must also show that all other conceivable reasonable separate accounting methods would show, when compared with the statutory method of apportionment, that the statutory method of apportionment substantially produces a distorted result.

As used in this rule, "statutory method of apportionment" means the apportionment factor set forth in rule 701—59.28(422).

All requests to use an alternative method of allocation and apportionment submitted to the department will be considered by the audit and compliance division if the request is the result of an audit or by the policy section of the technical services division if the request is received prior to audit. If the department concludes that the statutory method of allocation and apportionment is, in fact, both inapplicable and inequitable, the department shall prescribe a special method. The special method of allocation and apportionment prescribed by the department may be that requested by the taxpayer or some other method of allocation and apportionment which the department deems to equitably attribute income to business activities carried on within Iowa.

If the taxpayer disagrees with the determination of the department, the taxpayer may file a protest within 60 days of the date of the letter setting the department's determination and the reasons therefor in accordance with rule 701—7.8(17A). The department's determination letter shall set forth the taxpayer's rights to protest the department's determination.

If no protest is filed within the 60-day period, then no hearing will be granted on the department's determination under this rule. However, this does not preclude the taxpayer from subsequently raising this question in the event that the taxpayer protests an assessment or denial of a timely refund claim, but this issue will only be dealt with for the years involved in the assessment or timely refund claim.

The use of an alternative method of allocation and apportionment would only be applicable to the years under consideration at the time the special method of allocation and apportionment is prescribed. The taxpayer's continued use of a prescribed method of allocation and apportionment will be subject to review and change within the statutory, or legally extended period(s).

If there is a material change in the business operations or accounting procedures from those in existence at the time the taxpayer was permitted to determine the net income earned within Iowa by an alternative method of allocation and apportionment, the taxpayer shall apprise the department of such changes prior to filing its return for the current year. After reviewing the information submitted, along with any other information the department deems necessary, the department will notify the taxpayer if the alternative method of allocation and apportionment is deemed applicable.

This rule is intended to implement Iowa Code section 422.63.

Rules 701—59.25(422) through 701—59.29(422) are effective for tax years beginning on or after June 1, 1989.

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EXHIBIT L: 6

New York Franchise Tax on Banking Corporations, Article 32

Article 32

Franchise Tax on Banking Corporations

[¶ 98-026]

Sec. 1450. General definitions.—As used in this article:

(a) The word "taxpayer" means a corporation or association subject to a tax imposed by this article.

[¶ 98-027]

(b) The phrase "taxable year" means the taxpayer's taxable year for federal income tax purposes, or the part thereof during which the taxpayer is subject to the tax imposed by this article.

[¶ 98-028]

(c) The term "international banking facility" shall mean an international banking facility located in New York State and shall have the same meaning as is set forth in the New York state banking law or regulations of the New York state banking department or as is set forth in the laws of the United States or regulations of the board of governors of the federal reserve system. (*As added by L.* 1978, *Ch.* 288; *amended by L.* 1985, *Ch.* 298, *effective July* 11, 1985, *and applicable to taxable years beginning on or after January* 1, 1985.)

[¶ 98-028a]

(d) The term "subsidiary" means a corporation or association of which over fifty percent of the number of shares of stock entitling the holders thereof to vote for the election of directors or trustees is owned by the taxpayer. (*As added by L.* 1985, *Ch.* 298, *effective July* 11, 1985, *and applicable* (*as amended by L.* 1989, *Ch.* 553) *to taxable years beginning on or after January* 1, 1985, *but not applicable to corporations other than savings banks and savings and loan associations for taxable years beginning on or after January* 1, 1992.)

[¶ 98-028b]

(e) The term "subsidiary capital" means investments in the stock of subsidiaries and any indebtedness from subsidiaries, exclusive of accounts receivable acquired in the ordinary course of trade or business for services rendered or for sales of property held primarily for sale to customers, whether or not evidenced by written instrument, on which interest is not claimed and deducted by the subsidiary for purposes of taxation under article nine-A, thirty-two or thirty-three of this chapter, provided, however, there shall be deducted from subsidiary capital any liabilities payable by their terms on demand or within one year from the date incurred, other than loans or advances outstanding for more than a year as of any date during the year covered by the return, which are attributable to subsidiary capital. (*As added by L.* 1985, *Ch.* 298, *effective July* 11, 1985, *and applicable* (*as amended by L.* 1989, *Ch.* 553) *to taxable years beginning on or after January* 1, 1985, *but not applicable to corporations other than savings banks and savings and loan associations for taxable years beginning on or after January* 1, 1992.)

(*Sec.* 1450 *is as last amended by L.* 1985, *Ch.* 298, *effective as noted above.*)

[¶ 98-029]

Sec. 1451. Imposition of tax.—(a) For the privilege of exercising its franchise or doing business in this state in a corporate or organized capacity, a tax, computed under section fourteen hundred fifty-five, is hereby annually imposed on every banking corporation for each of its taxable years, or any part thereof, beginning on or after January first, nineteen hundred seventy-three.

[¶ 98-030]

(b) In the case of a taxpayer whose taxable year is other than a calendar year, there is hereby imposed a tax for the privilege of exercising its franchise or doing business in this state in a corporate or organized capacity for the period beginning January first, nineteen hundred seventy-three and extending through the subsequent part of its first such taxable year ending after such date. Such tax shall be computed under section fourteen hundred fifty-five on the basis of such taxpayer's entire net income, or other applicable basis as the case may be, for such period and shall be paid with a return which shall be separately filed with the tax commission not later than the fifteenth day of the third month succeeding the close of such period. The requirements of sections fourteen hundred sixty and fourteen hundred sixty-one, relating to declarations and payments of estimated tax, except subsection (a) of section fourteen hundred sixty-one, shall not be applicable to the tax imposed by this subsection.

[¶ 98-031]

Sec. 1452. Banking corporation defined; exempt corporations.—(a) For the purpose of this article, a banking corporation means:

(1) Every corporation or association organized under the laws of this state which is authorized to do a banking business, or which is doing a banking business;

(2) every corporation or association organized under the laws of any other state or country which is doing a banking business;

(3) every national banking association organized under the authority of the United States which is doing a banking business;

(4) every Federal savings bank which is doing a banking business;

(5) every federal savings and loan association which is doing a banking business;

(6) a production credit association organized under the federal farm credit act of nineteen hundred thirty-three, which is doing a banking business and all of whose stock held by the federal production credit corporation has been retired;

(7) every other corporation or association organized under the authority of the United States which is doing a banking business;

(8) the mortgage facilities corporation created by chapter five hundred sixty-four of the laws of nineteen hundred fifty-six;

(9) any corporation sixty-five percent or more of whose voting stock is owned or controlled, directly or indirectly, by a corporation or corporations subject to article three-a of the banking law, or registered under the federal bank holding company act of nineteen hundred fifty-six, as amended, or registered as a savings and loan holding company (but excluding a diversified savings and loan holding company) under the federal national housing act, as amended, or by a corporation or corporations described in any of the foregoing paragraphs of this subsection, provided the corporation whose voting stock is so owned or controlled is principally engaged in a business, regardless of where conducted, which (i) might be lawfully conducted by a corporation subject to article three of the banking law or by a national banking association or (ii) is so closely related to banking or managing or controlling banks as to be a proper incident thereto, as set forth in paragraph eight of subsection (c) of section four of the federal bank holding company act of nineteen hundred fifty-six, as amended; and provided, further, that in no event shall a corporation principally engaged in a business described in section one hundred eighty-three, one hundred eighty-four or one hundred eighty-six of this chapter be subject to the tax imposed under this article if any of its business receipts from such principally engaged in business are from other than a corporation (A) which owns or controls, directly or indirectly, sixty-five percent or more of its voting stock, or (B) sixty-five percent or more of whose voting stock is owned or controlled, directly or indirectly, by the corporation engaged in such business, or (C) sixty-five percent or more of whose voting stock is owned or controlled, directly or indirectly, by the same interest. (*As amended by L.* 1972, *Ch.* 991, *L.* 1980, *Ch.* 883; *L.* 1983, *Ch.* 377; *L.* 1985, *Ch.* 298, *effective July* 11, 1985, *and applicable* (*as amended by L.* 1989, *Ch.* 553) *to taxable years beginning on or after January* 1, 1985, *but not applicable to corporations other than savings banks and savings and loan associations for taxable years beginning on or after January* 1, 1992.)

[¶ 98-032]

(b) Banking business defined. The words "banking business" as used in this section mean such business as a corporation or association may be created to do under article three, three-b, five, five-a, six, or ten of the banking law or any business which a corporation or association is authorized by such article to do. However, with respect to a national banking association organized under the authority of the United States, a federal savings bank, a federal savings and loan association or a production credit association, the words "banking business" as used in this section mean such business as a national banking association, federal savings bank, federal savings and loan association or production credit association, respectively, may be created to do or is authorized to do under the laws of the United States or this state. The words "banking business" as used in this section shall also mean such business as any corporation or association organized under the authority of the United States or organized under the law of any other state or country has authority to do which is substantially similar to the business which a corporation or association may be created to do under article three, three-b, five, five-a, six or ten of the banking law or any business which a corporation or association is authorized by such article to do. (*As amended by L.* 1979, *Ch.* 572; *L.* 1980, *Ch.* 883; *L.* 1983, *Ch.* 377; *L.* 1985, *Ch.* 298, *effective July* 11, 1985, *and applicable to taxable years beginning on or after January* 1, 1985.)

[¶ 98-033]

(c) Exempt corporations. A trust company all of whose capital stock is owned by twenty or more savings banks organized under New York law shall be exempt from the tax under this article.

[¶ 98-034]

(d) Corporations taxable under article nine-a. Notwithstanding the provisions of this article, all corporations of classes now or heretofore taxable under article nine-a of this chapter shall continue to be taxable under article nine-a, except: (1) corporations organized under article five-a of the banking law; (2) corporations subject to article three-A of the banking law, or registered under the federal bank holding company act of nineteen hundred fifty-six, as amended, or registered as a savings and loan holding company (but excluding a diversified savings and loan holding company) under the federal national housing act, as amended, which make a combined return under the provisions of subsection (f) of section fourteen hundred sixty-two; and (3) banking corporations described in paragraph nine of subsection (a) of section fourteen hundred fifty-two. Provided, however, that a corporation described in paragraph three of this subsection which was subject to the tax imposed by article nine-A of this chapter for its taxable year ending during nineteen hundred eighty-four may, on or before the due date for filing its return (determined with regard to extensions) for its taxable year ending during nineteen hundred eighty-five, make a one time election to continue to be taxable under such article nine-A. Such election shall continue to be in effect until revoked by the taxpayer. In no event shall such election or revocation be for a part of a taxable year. (*As amended by*

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L. 1972, Ch. 991; L. 1985, Ch. 298, effective July 11, 1985, and applicable (as amended by L. 1989, Ch. 553) to taxable years beginning on or after January 1, 1985, but not applicable to corporations other than savings banks and savings and loan associations for taxable years beginning on or after January 1, 1992.)

[¶ 98-034a]

(e) Corporations taxable under article thirty-three. Except for corporations described in subsection (1) of section fourteen hundred fifty-three, corporations liable to tax under article thirty-three shall not be subject to tax under this article. (*As added by L. 1987, Ch. 817, effective August 7, 1987, and applicable to taxable years beginning after December* 31, 1986

(*Sec. 1452 above is as last amended by L. 1987, Ch. 817, effective as noted above.*)

[¶ 98-035]

Sec. 1453. Computations of entire net income.—(a) Entire net income means total net income from all sources which shall be the same as the entire taxable income (but not alternative minimum taxable income)

(1) which the taxpayer is required to report to the United States treasury department, or

(2) which the taxpayer, in the case of a corporation which is exempt from federal income tax (other than the tax on unrelated business taxable income imposed under section 511 of the internal revenue code) but is subject to tax under this article, would have been required to report to the United States treasury department but for such exemption, or

(3) which, in the case of a corporation organized under the laws of a country other than the United States, is effectively connected with the conduct of a trade or business with in the United States as determined under section 882 of the internal revenue code subject to the modifications and adjustments hereinafter provided. (*As amended by L. 1987, Ch. 817, effective August 7, 1987, and applicable to taxable years beginning after December* 31, 1986.)

[¶ 98-036]

(b) Entire net income shall be computed without the deduction [or] exclusion of:

(1) (A) in the case of a corporation organized under the laws of a country other than the United States, (i) any part of any income from dividends or interest on any kind of stock, securities or indebtedness, but only if such income is treated as effectively connected with the conduct of a trade or business in the United States pursuant to section eight hundred sixty-four of the internal revenue code, (ii) any income exempt from federal taxable income under any treaty obligation of the United States, but only if such income would be treated as effectively connected in absence of such exemption, provided that such treaty obligation does not preclude the taxation of such income by a state, or (iii) any income which would be treated as effectively connected if such income were not excluded from gross income pursuant to subsection (a) of section one hundred three of the internal revenue code; (B) in the case of any other corporation, any part of any income from dividends or interest on any kind of stock, securities or indebtedness; (C) except that for purposes of subparagraphs (A) and (B) above there shall be excluded any amounts treated as dividends pursuant to section seventy-eight of the internal revenue code and any amounts described in paragraphs eleven and twelve of subsection (e) of this section;

(2) taxes on or measured by income or profits paid or accrued within the taxable year to the United States, or any of its possessions or to any foreign country;

(3) any net operating loss deduction for the taxable year allowable for federal income tax purposes;

(4) taxes imposed under this article, sections one hundred eighty-three, one hundred eighty-four, and one hundred eighty-six of article nine, article nine-A and article thirteen-A of this chapter;

(5) in those instances where a credit for the special additional mortgage recording tax is allowed under paragraph one of subsection (c) of section fourteen hundred fifty-six of this article, the amount allowed as an exclusion or deduction for the special additional mortgage recording tax imposed by subdivision one-a of section two hundred fifty-three of this chapter in determining the entire taxable income which the taxpayer is required to report to the United States treasury department for such taxable year; and

(6) Unless the credit allowed pursuant to subsection (c) of section fourteen hundred fifty-six of this article is reflected in the computation of the gain or loss so as to result in an increase in such gain or decrease of such loss, for federal income tax purposes, from the sale or other disposition of the property with respect to which the special additional mortgage recording tax imposed pursuant to subdivision one-a of section two hundred fifty-three of this chapter was paid, the amount of the special additional mortgage recording tax imposed by subdivision one-a of section two hundred fifty-three of this chapter which was paid and which is reflected in the computation of the basis of the property so as to result in a decrease in such gain or increase in such loss for federal income tax purposes from the sale or other disposition of the property with respect to which such tax was paid.

(7) for taxable years beginning after December thirty-first, nineteen hundred eighty-one, except with respect to property which is a qualified mass commuting vehicle described in subparagraph (D) of paragraph eight of subsection (f) of section one hundred sixty-eight of the internal revenue code (relating to qualified mass commuting vehicles), any amount which the taxpayer claimed as a deduction

in computing its federal taxable income solely as a result of an election made pursuant to the provisions of such paragraph eight as it was in effect for agreements entered into prior to January first, nineteen hundred eighty-four;

(8) for taxable years beginning after December thirty-first, nineteen hundred eighty-one, except with respect to property described in subparagraph (D) of paragraph eight of subsection (f) of section one hundred sixty-eight of the internal revenue code (relating to qualified mass commuting vehicles), any amount which the taxpayer would have been required to include in the computation of its federal taxable income had it not made the election permitted pursuant to such paragraph eight as it was in effect for agreements entered into prior to January first, nineteen hundred eighty-four;

(9) for taxable years beginning after December thirty-first, nineteen hundred eighty-one, except with respect to property subject to the provisions of section two hundred eighty-F of the internal revenue code and property subject to the provisions of section one hundred sixty-eight of the internal revenue code which is placed in service in this state in taxable years beginning after December thirty-first, nineteen hundred eighty-four, the amount allowable as a deduction determined under section one hundred sixty-eight of the internal revenue code;

(10) upon the disposition of property to which paragraph seven of subsection (e) of this section applies, the amount, if any, by which the aggregate of the amounts described in such paragraph seven attributable to such property exceeds the aggregate of the amounts described in paragraph nine of this subsection attributable to such property,

(11) in the case of a taxpayer subject to the provisions of section 585(c) of the internal revenue code, the amount allowed as a deduction pursuant to section 166 of such code, and

(12) for taxpayers subject to the provisions of subsection (i) of this section, twenty percent of the excess of (A) the amount determined pursuant to such subsection (i) over (B) the amount which would have been allowable had such institution maintained its bad debt reserve for all taxable years on the basis of actual experience. (*As amended by L.* 1977, *Ch.* 58; *L.* 1978, *Ch.* 788; *L.* 1982, *Ch.* 55; *L.* 1983, *Chs.* 15 and 400; *L.* 1985, *Chs.* 43 *and* 298; *L.* 1986, *Ch.* 638; *L.* 1987, *Ch.* 13, *effective March* 31, 1987 *and Ch.* 817, *applicable* (*as amended by L.* 1989, *Ch.* 553) *to taxable years beginning after December* 31, 1986; *effective April* 20, 1987, *and applicable to property to which the amendments made by Sec.* 201 *of the Tax Reform Act of* 1986 (*P.L.* 99-514), *concerning ACRS depreciation, apply with respect to paragraphs* (9) *and* (10); *and applicable to taxable years beginning after December* 31, 1986 *and before January* 1, 1992 *with respect to paragraphs* (11) *and* (12).)

[¶ 98-037]

(c)(1) Except as otherwise provided in paragraphs two, three and four hereof, in the case of the sale or exchange of property by a taxpayer which has been subject to article nine-B or nine-C of this chapter (as such articles were in effect on or before December thirty-first, nineteen hundred seventy-two) where the property has a higher adjusted basis for New York tax purposes than for federal tax purposes, there shall be allowed as a deduction from entire net income, the portion of any gain or loss on such sale which equals the difference in such basis.

(2) In case of property of a taxpayer, other than a savings bank or a savings and loan association, acquired prior to January first, nineteen hundred twenty-six, and disposed of thereafter, the computation of entire net income shall be modified as follows:

(i) no gain shall be deemed to have been derived if either the cost or the fair market price or value on January first, nineteen hundred twenty-six, exceeds the value realized;

(ii) no loss shall be deemed to have been sustained if either the cost or the fair market price or value on January first, nineteen hundred twenty-six, is less than the value realized;

(iii) where both the cost and the fair market price or value on January first, nineteen hundred twenty-six, are less than the value realized, the basis for computing gain shall be the cost or the fair market price or value on such date, whichever is higher;

(iv) where both the cost and the fair market price or value on January first, nineteen hundred twenty-six, are in excess of the value realized, the basis for computing loss shall be the cost or the fair market price or value on such date, whichever is lower.

(3) In case of property of a savings bank acquired prior to January first, nineteen hundred forty-four, and disposed of thereafter, in computing entire net income the basis of such property shall be the value as of December thirty-first, nineteen hundred forty-three, as set forth in such bank's report of surplus and undivided earnings filed with the tax commission as of that date.

(4) In case of property of a savings and loan association, acquired prior to January first, nineteen hundred fifty-three, and disposed of thereafter, the computation of entire net income shall be modified as follows:

(i) no gain shall be deemed to have been derived if either the cost or the fair market price or value on January first, nineteen hundred fifty-three, exceeds the value realized;

(ii) no loss shall be deemed to have been sustained if either the cost or the fair market price or value on January first, nineteen hundred fifty-three, is less than the value realized;

(iii) where both the cost and the fair market price or value on January first, nineteen hundred fifty-

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three, are less than the value realized, the basis for computing gain shall be the cost or the fair market price or value on such date, whichever is higher;

(iv) where both the cost and the fair market price or value on January first, nineteen hundred fifty-three, are in excess of the value realized, the basis for computing loss shall be the cost or the fair market price or value on such date, whichever is lower. (*As amended by L.* 1987, *Chs.* 267 *and* 333, *both effective July* 20, 1987.)

[¶ 98-038]

(d) [1] Entire net income shall not include any refund or credit of a tax for which no exclusion or deduction was allowed in determining the taxpayer's entire net income under this article for any prior year. (*As amended by L.* 1987, *Ch.* 267, *effective July* 20, 1987.)

[¶ 98-038a]

(d) [1] Entire net income shall not include any refund or credit of a tax for which no exclusion or deduction was allowed in determining the taxpayer's entire net income under this article or articles nine-a, nine-b or nine-c of this chapter for any prior year. (*As amended by L.* 1987, *Ch.* 817, *effective August* 7, 1987, *and applicable to taxable years beginning after December* 31, 1986.)

[¶ 98-039]

(e) There shall be allowed as a deduction in determining entire net income, to the extent not deductible in determining federal taxable income:

(1) interest on indebtedness incurred or continued to purchase or carry obligations or securities the income from which is subject to tax under this article but exempt from federal income tax,

(2) ordinary and necessary expenses paid or incurred during the taxable year attributable to income which is subject to tax under this article but exempt from federal income tax,

(3) the amortizable bond premium for the taxable year on any bond the interest on which is subject to tax under this article but exempt from federal income tax,

(4) that portion of wages or salaries paid or incurred for the taxable year for which a deduction is not allowed pursuant to the provisions of section two hundred eighty-C of the internal revenue code,

(5) for taxable years beginning after December thirty-first, nineteen hundred eighty-one, except with respect to property which is a qualified mass commuting vehicle described in subparagraph (D) of paragraph eight of subsection (f) of section one hundred sixty-eight of the internal revenue code (relating to qualified mass commuting vehicles), any amount which is included in the taxpayer's federal taxable income solely as a result of an election made pursuant to the provisions of such paragraph eight as it was in effect for agreements entered into prior to January first, nineteen hundred eighty-four,

(6) for taxable years beginning after December thirty-first, nineteen hundred eighty-one, except with respect to property which is a qualified mass commuting vehicle described in subparagraph (D) of paragraph eight of subsection (f) of section one hundred sixty-eight of the internal revenue code (relating to qualified mass commuting vehicles) any amount which the taxpayer could have excluded from federal taxable income had it not made the election provided for in such paragraph eight as it was in effect for agreements entered into prior to January first, nineteen hundred eighty-four,

(7) for taxable years beginning after December thirty-first, nineteen hundred eighty-one, except with respect to property subject to the provisions of section two hundred eighty-F of the internal revenue code and property subject to the provisions of section one hundred sixty-eight of the internal revenue code which is placed in service in this state in taxable years beginning after December thirty-first, nineteen hundred eighty-four, and provided a deduction has not been excluded from entire net income pursuant to paragraph seven of subsection (b) of this section, an amount with respect to property which is subject to the provisions of section one hundred sixty-eight of the internal revenue code equal to the amount allowable as the depreciation deduction under section one hundred sixty-seven of the internal revenue code as such section would have applied to property placed in service on December thirty-first, nineteen hundred eighty,

(8) upon the disposition of property to which paragraph seven of this subsection applies, the amount, if any, by which the aggregate of the amounts described in paragraph nine of subsection (b) of this section attributable to such property exceeds the aggregate of the amounts described in paragraph seven of this subsection attributable to such property,

(9) any amount of money or other property received from the federal deposit insurance corporation pursuant to subsection (c) of section thirteen of the federal deposit insurance act, as amended, regardless of whether any note or other instrument is issued in exchange therefor,

(10) any amount of money or other property received from the federal savings and loan insurance corporation pursuant to paragraph one, two, three or four of subsection (f) of section four hundred six of the federal national housing act, as amended, regardless of whether any note or other instrument is issued in exchange therefor,

(11) (i) seventeen percent of interest income from subsidiary capital, and

[1] Sec. 1453(d) was amended by L. 1987, Ch. 267, effective July 20, 1987 and L. 1987, Ch. 817, effective August 7, 1987, and applicable to taxable years beginning after December 31, 1986. CCH.

(ii) sixty percent of dividend income, gains and losses from subsidiary capital,

(12) twenty-two and one-half percent of interest income on obligations of New York state, or of any political subdivision thereof, or of the United States, other than obligations held for resale in connection with regular trading activities,

(13) in the case of a taxpayer which recaptures its balance of the reserve for losses on loans for federal income tax purposes pursuant to section 585(c) of the internal revenue code, any amount which is included in federal taxable income pursuant to section 585(c) of such code,

(14) in the case of a taxpayer subject to the provisions of section 585(c) of the internal revenue code, any amount which is included in federal taxable income as a result of a recovery of a loan. (*As amended by L.* 1978, *Ch.* 33; *L.* 1982, *Ch.* 55; *L.* 1983, *Ch.* 15; *L.* 1985, *Ch.* 43, *effective April* 17, 1985; *and Ch.* 298, *effective July* 11, 1985, *and applicable* (*as amended by L.* 1989, *Ch.* 553) *to taxable years beginning on or after January* 1, 1985, *but not applicable to corporations other than savings banks and savings and loan associations for taxable years beginning on or after January* 1, 1992; *L.* 1987, *Ch.* 817, *effective April* 20, 1987, *and applicable* (*as amended by L.* 1989, *Ch.* 553) *to property to which the amendments made by Sec.* 201 *of the Tax Reform Act of* 1986 (*P.L.* 99-514), *concerning ACRS depreciation, apply with respect to paragraphs* (7) *and* (8); *applicable to taxable years beginning after December* 31, 1986 *with respect to paragraph* (12); *and applicable to taxable years beginning after December* 31, 1986 *but not applicable after January 1, 1992 with respect to paragraphs* (13) *and* (14).)

[¶ 98-040]

(f) Provided the taxpayer has not made an election pursuant to paragraph two of subsection (b) of section fourteen hundred fifty-four of this article, there shall be allowed as a deduction in determining entire net income, to the extent not deductible in determining federal taxable income, the adjusted eligible net income of an international banking facility determined as follows:

(1) The eligible net income of an international banking facility shall be the amount remaining after subtracting from the eligible gross income the applicable expenses.

(2) Eligible gross income shall be the gross income derived by an international banking facility from:

(A) making, arranging for, placing or servicing loans to foreign persons, provided, however, that in the case of a foreign person which is an individual, or which is a foreign branch of a domestic corporation (other than a bank), or which is a foreign corporation or foreign partnership which is eighty percentum or more owned or controlled, either directly or indirectly, by one or more domestic corporations (other than banks), domestic partnerships or resident individuals, substantially all the proceeds of the loan are for use outside of the United States;

(B) making or placing deposits with foreign persons which are banks or foreign branches of banks (including foreign subsidiaries or foreign branches of the taxpayer) or with other international banking facilities; or

(C) entering into foreign exchange trading or hedging transactions related to any of the transactions described in this paragraph.

(3) Applicable expenses shall be any expenses or other deductions attributable, directly or indirectly, to the eligible gross income described in paragraph two of this subsection.

(4) Adjusted eligible net income shall be determined by subtracting from eligible net income the ineligible funding amount, and by subtracting from the amount then remaining the floor amount.

(5) The ineligible funding amount shall be the amount, if any, determined by multiplying eligible net income by a fraction, the numerator of which is the average aggregate amount for the taxable year of all liabilities, including deposits, and other sources of funds of the international banking facility which were not owed to or received from foreign persons, and the denominator of which is the average aggregate amount for the taxable year of all liabilities, including deposits and other sources of funds of the international banking facility.

(6) The floor amount shall be the amount, if any, determined by multiplying the amount remaining after subtracting the ineligible funding amount from the eligible net income by a fraction, not greater than one, which is determined as follows:

(A) The numerator shall be

(i) the percentage, as set forth in subparagraph (C) of this paragraph, of the average aggregate amount of the taxpayer's loans to foreign persons and deposits with foreign persons which are banks or foreign branches of banks (including foreign subsidiaries or foreign branches of the taxpayer), which loans and deposits were recorded in the financial accounts of the taxpayer for its branches, agencies and offices within the state for taxable years nineteen hundred seventy-five, nineteen hundred seventy-six and nineteen hundred seventy-seven, minus

(ii) the average aggregate amount of such loans and such deposits for the taxable year of the taxpayer (other than such loans and deposits of an international banking facility), provided, however, that in no case shall the amount determined in this clause exceed the amount determined in clause (i) of this subparagraph; and

(B) The denominator shall be the average aggregate amount of the loans to foreign persons and deposits with foreign persons which are banks or foreign branches of banks (including foreign subsidiaries or foreign branches of the taxpayer), which

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loans and deposits were recorded in the financial accounts of the taxpayer's international banking facility for the taxable year.

(C) The percentage shall be one hundred percent for the first taxable year in which the taxpayer establishes an international banking facility and for the next succeeding four taxable years. The percentage shall be eighty percent for the fifth, sixty percent for the sixth, forty percent for the seventh and twenty percent for the eighth taxable year next succeeding the year such taxpayer establishes such international banking facility, and zero in the ninth succeeding year and thereafter.

(7) In the event adjusted eligible net income is a loss, the amount of such loss shall be added to entire net income.

(8) For the purposes of this subsection the term "foreign person" means

(A) an individual who is not a resident of the United States,

(B) a foreign corporation, a foreign partnership or a foreign trust, as defined in section seventy-seven hundred one of the internal revenue code, other than a domestic branch thereof,

(C) a foreign branch of a domestic corporation (including the taxpayer),

(D) a foreign government or an international organization or an agency of either, or

(E) an international banking facility.

For purposes of this paragraph, the terms "foreign" and "domestic" shall have the same meaning as set forth in section seventy-seven hundred one of the internal revenue code. (*As added by L.* 1978, *Ch.* 288; *amended by L.* 1985, *Ch.* 298, *effective July* 11, 1985, *and applicable* (*as amended by L.* 1989, *Ch.* 553) *to taxable years beginning on or after January* 1, 1985, *but not applicable to corporations other than savings banks and savings and loan associations for taxable years beginning on or after January* 1, 1992; *L.* 1987, *Ch.* 817, *effective August* 7, 1987, *and applicable to taxable years beginning after December* 31, 1986.)

[¶ 98-040a]

(g) Entire net income shall be computed without regard to the reduction in the basis of property that is required by section three hundred sixty-two of the internal revenue code, because of any amount of money or other property received from the federal deposit insurance corporation pursuant to subsection (c) of section thirteen of the federal deposit insurance act, as amended, or from the federal savings and loan insurance corporation pursuant to paragraph one, two, three or four of subsection (f) of section four hundred six of the federal national housing act, as amended. (*As added by L.* 1985, *Ch.* 298, *effective July* 11, 1985, *and applicable* (*as amended by L.* 1989, *Ch.* 553) *to taxable years beginning on or after January* 1, 1985, *but not applicable to corporations other than savings banks and savings and loan associations for taxable years beginning on or after January* 1, 1992; *L.* 1987, *Ch.* 817, *effective August* 7, 1987, *and applicable to taxable years beginning after December* 31, 1986.)

[¶ 98-040b]

(h)(1) A taxpayer which computes all or a portion of its bad debt deduction pursuant to section 593(b)(1)(B) of the internal revenue code using the percentage of taxable income method set forth in section 593(b)(2) of such code, must exclude from the computation of its entire net income

(A) any amount allowed as a deduction for federal income tax purposes pursuant to such section 593(b)(1))(B) plus

(B) twenty percent of the amount by which (i) the sum of the amount determined in paragraph two of this subsection plus the amount allowed as a deduction for federal income tax purposes pursuant to section 593(b)(1)(A) of such code exceeds (ii) the amount which would have been allowable as a deduction had such institution maintained its bad debt reserves for all taxable years on the basis of actual experience.

(2) In the case of a taxpayer described in paragraph one of this subsection, there shall be allowed as a deduction in computing entire net income an amount determined pursuant to this paragraph.

(A)(i) Ascertain the amount deducted for federal income tax purposes pursuant to section 593(b)(1)(B) of the internal revenue code and add to it the amount, if any, deducted for federal income tax purposes pursuant to section 593(b(1)(A).

(ii) Multiply the amount determined in clause (i) of this subparagraph by five.

(iii) Subtract from the amount determined in clause (ii) of this subparagraph, the amount deducted for federal income tax purposes pursuant to section 593(b)(1)(A).

(B) The amount determined under subparagraph (A) of this paragraph shall not exceed the amount necessary to increase the balance at the close of the taxable year of the New York reserve for losses on qualifying real property loans to six percent of such loans outstanding at such time.

(C) The amount determined under subparagraph (A) of this paragraph shall in no case be greater than the larger of

(i) the amount determined under section 593(b)(3) of the internal revenue code for the taxable year, or

(ii) the amount which, when added to the amount determined under section 593(b)(1)(A) of such code for the taxable year, equals the amount by which twelve percent of the total deposits or withdrawable accounts of depositors of the taxpayer at the close of such year exceeds the sum of its surplus, undivided profits, and reserves at the beginning of such year (taking into account any portion thereof attributa-

ble to the period before the first taxable year beginning after December thirty-first, nineteen hundred fifty-one).

(3)(A) Each taxpayer described in paragraph one of this subsection shall establish and maintain a New York reserve for losses on qualifying real property loans. Such reserve shall be maintained for all susequent taxable years. The balance of the New York reserve for losses on qualifying real property loans at the beginning of the first day of the first taxable year the taxpayer becomes subject to this subsection shall be the same as the balance at the beginning of such day of the reserve for losses on qualifying real property loans maintained for federal income tax purposes.

(B) All debts which are charged or credited to the reserve for losses on qualifying real property loans maintained for federal income tax purposes must be charged or credited to the New York reserve for losses on qualifying real property loans. No other debts may be charged or credited to such New York reserve.

(C) The New York reserve for losses on qualifying real property loans shall be increased by the amount determined under paragraph two of this subsection or the amount determined under section 593(b)(1)(B) of the internal revenue code if such amount was determined using the experience method set forth in section 593(b)(3) of such code.

(4)(A) There shall be allowed as a deduction in computing entire net income the amount, if any, included in federal taxable income pursuant to section 593(e)(2) of the internal revenue code.

(B) Any distribution of property (as defined in section 317(a) of the internal revenue code) by a domestic building and loan association or an institution that is treated as a mutual savings bank under section 591(b) of such code to a shareholder with respect to its stock, if such distribution is not allowable as a deduction under section 591 of such code, shall be treated as made

(i) first out of its New York earnings and profits accumulated in taxable years beginning after December thirty-first, nineteen hundred fifty-one, to the extent thereof,

(ii) then out of the New York reserve for losses on qualifying real property loans, to the extent additions to such reserve exceed the additions which would have been allowed under section 593(b)(3) of such code,

(iii) then out of the supplemental reserve for losses on loans maintained for federal income tax purposes, to the extent thereof,

(iv) then out of such other accounts as may be proper.

This subparagraph shall apply in the case of any distribution in redemption of stock or in partial or complete liquidation of the association or an institution that is treated as a mutual savings bank under section 591(b) of such code, except that any such distribution shall be treated as made first out of the amount referred to in clause (ii), second out of the amount referred to in clause (iii), third out of the amount referred to in clause (i) and then out of such other accounts as may be proper. This subparagraph shall not apply to any transaction to which section 381 of such code (relating to carryovers and certain corporate acquisitions) applies, or to any distribution to the federal savings and loan insurance corporation or the federal deposit insurance corporation in redemption of an interest in an association or institution, if such interest was originally received by the federal savings and loan insurance corporation or the federal deposit insurance corporation in exchange for financial assistance pursuant to section 406(f) of the federal national housing act or pursuant to subsection (c) of section thirteen of the federal deposit insurance act.

(C) If any distribution is treated under subparagraph (B) as having been made out of the reserves described in clauses (ii) and (iii) of such subparagraph, the amount charged against such reserve shall be the amount which, when reduced by the amount of tax imposed under the internal revenue code and attributable to the inclusion of such amount in gross income, is equal to the amount of such distribution; and the amount so charged against such reserve shall be included in the entire net income of the taxpayer.

(D)(i) For purposes of clause (ii) of subparagraph (B), additions to the New York reserve for losses on qualifying real property loans for the taxable year in which the distribution occurs shall be taken into account.

(ii) For purposes of computing under this subsection the amount of a reasonable addition to the New York reserve for losses on qualifying real property loans for any taxable year, the amount charged during any year to such reserve pursuant to the provisions of subparagraph (C) of this paragraph shall not be taken into account.

(5) A taxpayer which maintains a New York reserve for losses on qualifying real property loans and which ceases to be subject to the provisions of section 593 of the internal revenue code, must include in its entire net income for the last taxable year such section applied the excess of its New York reserve for losses on qualifying real property loans over its reserve for losses on qualifying real property loans maintained for federal income tax purposes. (*As amended by L.* 1987, *Ch.* 817, *effective August* 7, 1987, *and applicable to taxable years beginning after December* 31, 1986.)

[¶ 98-040c]

(i)(1) A taxpayer subject to the provisions of section 585(c) of the internal revenue code may, in computing entire net income, deduct an amount equal to or less than the amount determined pursuant to subparagraph (A) of this paragraph or sub-

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paragraph (B) of this paragraph, whichever is greater. Provided, however, in no event shall the deduction be less than the amount determined pursuant to such subparagraph (A).

(A) The amount determined pursuant to this subparagraph shall be the amount necessary to increase the balance of its New York reserve for losses on loans (at the close of the taxable year) to the amount which bears the same ratio to loans outstanding at the close of the taxable year as (i) the total bad debts sustained during the taxable year and the five preceding taxable years (or, with the approval of the commissioner of taxation and finance, a shorter period), adjusted for recoveries of bad debts during such period, bears to (ii) the sum of the loans outstanding at the close of such six or fewer taxable years.

(B)(i) The amount determined pursuant to this subparagraph shall be the amount necessary to increase the balance of its New York reserve for losses on loans (at the close of the taxable year) to the lower of—

(I) the balance of the reserve at the close of the base year, or

(II) if the amount of loans outstanding at the close of the taxable year is less than the amount of loans outstanding at the close of the base year, the amount which bears the same ratio to loans outstanding at the close of the taxable year as the balance of the reserve at the close of the base year bears to the amount of loans outstanding at the close of the base year.

(ii) For purposes of this paragraph, the base year shall be (I) for taxable years beginning in nineteen hundred eighty-seven, the last taxable year before the most recent adoption of the experience method for federal income tax purposes or for purposes of this article, whichever is earlier, and (II) for taxable years beginning after nineteen hundred eighty-seven, the last taxable year beginning before nineteen hundred eighty-eight.

(2) Each taxpayer described in paragraph one of this subsection shall establish and maintain a New York reserve for losses on loans. Such reserve shall be maintained for all subsequent taxable years. The balance of the New York reserve for losses on loans at the beginning of the first day of the first taxable year the taxpayer becomes subject to this subsection shall be the same as the balance at the beginning of such day of the reserve for losses on loans maintained for federal income tax purposes. The New York reserve for losses on loans shall be reduced by an amount equal to the deduction allowed, but not more than the amount allowable, for worthless debts for federal income tax purposes pursuant to section 166 of the internal revenue code plus the amount, if any, charged against its reserve for losses on loans pursuant to section 585(c)(4) of such code.

(3) The determination and treatment of the New York reserve balance, including any additions thereto, subtractions therefrom, or recapture thereof, for

(A) any banking corporation which was subject to tax for federal income tax purposes but not subject to tax under this article for prior taxable years,

(B) any taxpayer which ceases to be subject to tax under this article, or

(C) any other unusual circumstances shall be determined by the commissioner of taxation and finance. Provided, however, any banking corporation which was subject to tax for federal income tax purposes but not subject to tax under this article for prior taxable years shall have as its opening New York reserve for losses on loans the amount determined by applying the provisions of subparagraph (A) of paragraph one of this subsection to loans outstanding at the close of its last taxable year for federal income tax purposes ending prior to the first taxable year for which the taxpayer is subject to tax under this article and provided, further, that the provisions of subparagraph (B) of paragraph one of this subsection shall not apply. (*As added by L.* 1987, *Ch.* 817, *effective August* 7, 1987, *and applicable* (*as amended by L.* 1989, *Ch.* 553) *to taxable years beginning after December* 31, 1986 *but not applicable to taxable years beginning after January* 1, 1992.)

[¶ 98-041]

(j)(1) In the case of property placed in service prior to January first, nineteen hundred seventy-three, for which the taxpayer properly adopted a different method of computing depreciation under section two hundred nineteen-z or section two hundred nineteen-xx of this chapter (as such sections were in effect on or before December thirty-first, nineteen hundred seventy-two) than was adopted for federal income tax purposes with respect to such property, entire net income under this article shall be computed without regard to the amount allowable as a deduction for depreciation of such property in computing federal taxable income for the taxable year but, in lieu thereof, shall be computed as if such deduction were determined by the method of depreciation adopted with respect to such property under sections two hundred nineteen-z or two hundred nineteen-xx of this chapter (as such sections were in effect on or before December thirty-first, nineteen hundred seventy-two).

(2) In computing entire net income, the amount allowable as a deduction for charitable contributions for federal income tax purposes shall be decreased by any amount allowed as a deduction for federal income tax purposes for the taxable year under section one hundred seventy of the internal revenue code as a carryover of excess contributions which are not made in such taxable year and which were deductible in computing the tax due under article nine-B or nine-C of this chapter (as such articles were in effect on or before December thirty-first, nineteen hundred seventy-two).

(3) There shall be excluded from the computation of entire net income any amount allowed as a deduction for federal income tax purposes for the taxable year under section twelve hundred twelve of the internal revenue code as a capital loss carryforward to the taxable year, which was deductible as a loss in computing the tax due under article nine-B or nine-C of this chapter (as such articles were in effect on December thirty-first, nineteen hundred seventy-two).

(4) There shall be excluded from the computation of entire net income the amount of any income or gain from the sale of real or personal property which is includible in determining federal taxable income for the taxable year pursuant to the installment method under section four hundred fifty-three of the internal revenue code, to the extent that such income or gain was includible in the computation of the tax due under article nine-B or nine-C of this chapter (as such articles were in effect on December thirty-first, nineteen hundred seventy-two).

(5) To the extent not otherwise provided in this article, there shall be excluded from entire net income the amount necessary to prevent the taxation under this article of any other amount of income or gain which was properly included in income or gain and was taxable under article nine-B or nine-C of this chapter (as such articles were in effect on or before December thirty-first, nineteen hundred seventy-two) and there shall be disallowed as a deduction in computing entire net income any amount which was allowable as a deduction in computing the tax due under such articles. (*As amended by L.* 1978, *Ch.* 288; *L.* 1985, *Ch.* 298; *L.* 1987, *Ch.* 267, *effective July* 20, 1987, *and relettered by Ch.* 817, *effective August* 7, 1987, *and applicable to taxable years beginning after December* 31, 1986.)

[¶ 98-042]

(k)(1) At the election of the taxpayer, there shall be deducted from the portion of its entire net income allocated within the state, depreciation with respect to any property such as described in paragraph two of this subsection, not exceeding twice the depreciation allowed with respect to the same property for federal income tax purposes. Such deduction shall be allowed only upon condition that entire net income be computed without any deduction for depreciation or amortization of the same property, and the total of all deductions allowed under article nine-B and nine-C of this chapter (as such articles were in effect on or before December thirty-first, nineteen hundred seventy-two) and this article in any taxable year or years with respect to the depreciation of any such property shall not exceed its cost or other basis.

(2) Such deduction shall be allowed only with respect to tangible property which is depreciable pursuant to section one hundred sixty-seven of the internal revenue code, having a situs in this state and used in the taxpayer's business, (i) constructed, reconstructed or erected after December thirty-first, nineteen hundred sixty-three, pursuant to a contract which was, on or before December thirty-first, nineteen hundred sixty-seven, and at all times thereafter, binding on the taxpayer or, property, the physical construction, reconstruction or erection of which began on or before December thirty-first, nineteen hundred sixty-seven or which began after such date pursuant to an order placed on or before December thirty-first, nineteen hundred sixty-seven, and then only with respect to that portion of the basis thereof which is properly attributable to such construction, reconstruction or erection after December thirty-first, nineteen hundred sixty-three, or (ii) acquired after December thirty-first, nineteen hundred sixty-three, pursuant to a contract which was, on or before December thirty-first, nineteen hundred sixty-seven, and at all times thereafter, binding on the taxpayer or pursuant to an order placed on or before December thirty-first, nineteen hundred sixty-seven, by purchase as defined in section one hundred seventy-nine (d) of the internal revenue code, if the original use of such property commenced with the taxpayer, commenced in this state and commenced after December thirty-first, nineteen hundred sixty-three, or (iii) acquired, constructed, reconstructed, or erected subsequent to December thirty-first, nineteen hundred sixty-seven, if such acquisition, construction, reconstruction or erection is pursuant to a plan of the taxpayer which was in existence December thirty-first, nineteen hundred sixty-seven and not thereafter substantially modified, and such acquisition, construction, reconstruction or erection would qualify under the rules in paragraphs four, five or six of subsection (h) of section forty-eight of the internal revenue code provided all references in such paragraphs four, five and six to the dates October nine, nineteen hundred sixty-six, and October ten, nineteen hundred sixty-six, shall be read as December thirty-first, nineteen hundred sixty seven. A taxpayer shall be allowed a deduction under clauses (i), (ii) or (iii) of this paragraph only if the tangible property shall be delivered or the construction, reconstruction or erection shall be completed on or before December thirty-first, nineteen hundred sixty-nine, except in the case of tangible property which is acquired, constructed, reconstructed or erected pursuant to a contract which was, on or before December thirty-first, nineteen hundred sixty-seven, and at all times thereafter, binding on the taxpayer. Provided, however, for any taxable year beginning on or after January first, nineteen hundred sixty-eight, a taxpayer shall not be allowed a deduction under paragraph (1) hereof with respect to tangible personal property leased by it to any other person or corporation. For purposes of the preceding sentence, any contract or agreement to lease or rent or for a license to use such property shall be considered a lease. With respect to property which the taxpayer uses itself for purposes other than leasing for part of a taxable year and leases for a part of a taxable year, the taxpayer shall

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be allowed a deduction under paragraph (1) in proportion to the part of the year it uses such property.

(3) If the deduction allowable for any taxable year pursuant to this subsection exceeds the portion of the taxpayer's entire net income allocated to this state for such year, the excess may be carried over to the following taxable year or years and may be deducted from the portion of the taxpayer's entire net income allocated to this state for such year or years.

(4) In any taxable year when property is sold or otherwise disposed of, with respect to which a deduction has been allowed pursuant to this subsection, subdivision twelve of section two hundred nineteen-z or subdivision ten of section two hundred nineteen-xx of this chapter (as such subdivisions were in effect on or before December thirty-first, nineteen hundred seventy-two), the gain or loss entering into the computation of federal taxable income shall be disregarded in computing entire net income, and there shall be added or subtracted from the portion of entire net income allocated within the state the gain or loss upon such sale or other disposition. In computing such gain or loss the basis of the property sold or disposed of shall be adjusted to reflect the deduction allowed with respect to such property pursuant to paragraph one of this subsection. Provided however, that no loss shall be recognized for the purposes of this paragraph with respect to a sale or other disposition of property to a person whose acquisition thereof is not a purchase as defined in section one hundred seventy-nine (d) of the internal revenue code. (*As amended by L.* 1978, *Ch.* 288; *L.* 1985, *Ch.* 298; *L.* 1987, *Ch.* 267, *effective July* 20, 1987, *and relettered by Ch.* 817, *effective August* 7, 1987, *and applicable to taxable years beginning after December* 31, 1986.)

[¶ 98-043]

(*l*) In the case of a savings and insurance bank which conducts a life insurance business through a life insurance department under the authority of article six-a of the banking law, entire net income means the federal taxable income which such bank is required to report to the United States treasury department under paragraph one of subsection (a) of section five hundred ninety-four of the internal revenue code and the modifications required by this section in computing entire net income shall only be made with respect to such federal taxable income. (*As added by L.* 1974, *Ch.* 649; *as amended by L.* 1978, *Ch.* 288; *L.* 1985, *Ch.* 298; *as relettered by L.* 1987, *Ch.* 817, *effective August* 7, 1987, *and applicable to taxable years beginning after December* 31, 1986.)

[¶ 98-044]

(m) If the period covered by a return under this article is other than the period covered by the return to the United States treasury department, entire net income and alternative entire net income shall be determined by multiplying the taxable income reported to such department (as adjusted pursuant to the provisions of this article) by the number of calendar months or major parts thereof covered by the return under this article and dividing by the number of calendar months or major parts thereof covered by the return to such department. If it shall appear that such method of determining entire net income or alternative entire net income does not properly reflect the taxpayer's income during the period covered by the return under this article, the tax commission shall be authorized in its discretion to determine such entire net income or alternative entire net income solely on the basis of the taxpayer's income during the period covered by its return under this article. (*As amended by L.* 1974, *Ch.* 649; *L.* 1978, *Ch.* 288; *L.* 1985, *Ch.* 298; *as relettered by L.* 1987, *Ch.* 817, *effective August* 7, 1987, *and applicable to taxable years beginning after December* 31, 1986.)

[¶ 98-045]

(n) The tax commission may, whenever necessary in order properly to reflect the entire net income of any taxpayer, determine the year or period in which any item of income or deduction shall be included, without regard to the method of accounting employed by the taxpayer. (*As amended by L.* 1974, *Ch.* 649; *L.* 1978, *Ch.* 288; *L.* 1985, *Ch.* 298; *as relettered by L.* 1987, *Ch.* 817, *effective August* 7, 1987, *and applicable to taxable years beginning after December* 31, 1986.)

(*Sec.* 1453 *above is as last amended by L.* 1987, *Chs.* 13, 267 *and* 817, *effective as noted above.*)

[¶ 98-045a]

Sec. 1453-A. Computation of alternative entire net income.—(a) Alternative entire net income means entire net income as determined pursuant to section fourteen hundred fifty-three, except that the deductions described in paragraphs eleven and twelve of subsection (e) of section fourteen hundred fifty-three shall not be allowed.

(b) Any election made pursuant to paragraph two of subsection (b) of section fourteen hundred fifty-four with respect to the modification provided for in subsection (f) of section fourteen hundred fifty-three shall be deemed to have been made for purposes of computing alternative entire net income. (*As added by L.* 1985, *Ch.* 298, *effective July* 11, 1985, *and applicable to taxable years beginning on or after January* 1, 1985, *but not applicable* (*as amended by L.* 1989, *Ch.* 553) *to corporations other than savings banks and savings and loan associations for taxable years beginning on or after January* 1, 1992, *provided, however, that the provisions which relate to the alternative minimum tax measured by taxable assets shall continue to apply to all taxpayers for taxable years beginning on or after January* 1, 1992.)

[¶ 98-046]

Sec. 1454. Allocation.—(a) In general. If a taxpayer's entire net income, alternative entire net income, or taxable assets are derived from business carried on within and without the state, the taxpayer shall, for purposes of computing allocation percentages, compute payroll, receipts, and deposits percentages in accordance with the following rules:

(1) The taxpayer shall ascertain the percentage which eighty percent of the total wages, salaries and other personal service compensation during the taxable year of employees within the state, except wages, salaries and other personal service compensation of general executive officers, bears to the total wages, salaries and other personal service compensation during the taxable year of all the taxpayer's employees within and without the state, except wages, salaries and other personal service compensation of general executive officers.

(2) (A) The taxpayer shall ascertain the percentage which the receipts of the taxpayer arising during the taxable year from:

(i) loans (including a taxpayer's portion of a participation in a loan) and financing leases within the state, and all other business receipts earned within the state, bear to

(ii) the total amount of the taxpayer's receipts from loans (including a taxpayer's portion of a participation in a loan) and financing leases and all other business receipts within and without the state.

(B) All interest from loans and financing leases is located where the greater portion of income producing activity related to the loan or financing lease occurred; provided, however:

(i) In the case of a taxpayer described in paragraph one, two, three, four, five or seven of subsection (a) of section fourteen hundred fifty-two of this article, a loan or financing lease attributed by such taxpayer to a branch without the state shall be presumed to be properly so attributed provided that such presumption may be rebutted if the tax commission demonstrates that the greater portion of income producing activity related to the loan or financing lease did not occur at such branch. Where such presumption has been rebutted, the loan or financing lease shall be presumed to be within this state if the taxpayer had a branch within this state at the time the loan or financing lease was made. The taxpayer may rebut such presumption by demonstrating that the greater portion of income producing activity related to the loan or financing lease did not occur within the state. In the case of a loan or financing lease which is recorded on the books of a place without the state which is not a branch, it shall be presumed that the greater portion of income producing activity related to such loan or financing lease occurred within this state if the taxpayer had a branch within this state at the time the loan or financing lease was made. The taxpayer may rebut such presumption by demonstrating that the greater portion of income producing activity related to the loan or financing lease did not occur within this state.

(ii) In the case of a taxpayer described in paragraph six or nine of subsection (a) of section fourteen hundred fifty-two of this article, a loan or financing lease attributed by such taxpayer to a bona fide office without the state shall be presumed to be properly so attributed provided that such presumption may be rebutted if the tax commission demonstrates that the greater portion of income producing activity related to the loan or financing lease did not occur without this state.

(C) Receipts from lease transactions other than financing leases referred to in subparagraph (B) are located where the property subject to the lease is located.

(D) (i) Interest, and fees and penalties in the nature of interest, from bank, travel and entertainment card receivables are earned within the state if the card holder's domicile is in the state, and

(ii) Service charges and fees from such cards are earned within the state if the card is serviced in the state; and

(iii) Receipts from merchant discounts are earned within the state if the merchant is located within the state.

(E) The portion of total net gains and other income from trading activities (including but not limited to foreign exchange, options and financial futures), and from investment activities which is attributed within the state shall be ascertained by multiplying such total net gains and other income by a fraction the numerator of which is the average value of trading assets and investment assets attributable to this state and the denominator of which is the average value of all trading and investment assets. A trading asset or investment asset is attributable to this state if the greater portion of income producing activity related to the trading asset or investment asset occurred within the state.

(F) Fees or charges from the issuance of letters of credit, travelers checks and money orders are earned within the state if such letters of credit, travelers checks or money orders are issued within the state.

(G) All receipts from the performance of services not described above are earned within the state if the services are performed in the state. When a service is performed both within and without the state, the receipts shall be allocated within and without the state in accordance with rules and regulations of the tax commission.

(H) All other receipts not described in subparagraphs (B) through (G) of this paragraph shall be attributable within and without the state in accordance with rules and regulations issued by the tax commission.

(3) The taxpayer shall ascertain the percentage which the average value of deposits maintained at

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branches within the state during the taxable year, bears to the average value of all the taxpayer's deposits maintained at branches within and without the state during the taxable year.

(4) Each percentage computed pursuant to this subsection shall be computed on a cash or accrual basis according to the method of accounting used for the taxable year. The receipts percentage shall include only receipts which are included in alternative entire net income for the taxable year. The deposits and payroll percentages shall include only deposits and payroll the expenses of which are included in the computation of alternative entire net income for the taxable year.

(5) For purposes of this section.

(A) The term "bona fide office" means an office at which the taxpayer carries on its business in a regular and systematic manner and which is continuously maintained, occupied and used by employees of the taxpayer.

(B) The term "branch" means a bona fide office which is used by the taxpayer on a regular and systematic basis to (i) approve loans (regardless of whether the approval of certain classes of loans requires review or final approval by another office of the taxpayer), (ii) accept loan repayments, (iii) disburse funds, and (iv) conduct one or more other functions of a banking business.

(6) If it shall appear to the tax commission that the allocation percentage determined in subsection (b), (c), or (d) of this section does not properly reflect the activity, business, income or assets of a taxpayer within the state, the tax commission shall be authorized in its discretion to adjust it by (1) excluding one or more of the factors therein, (2) including one or more other factors, or (3) any other similar or different method calculated to effect a fair and proper allocation of the income or assets reasonably attributable to the state.

(7) The tax commission from time to time shall publish all rulings of general public interest with respect to any application of the provisions of paragraph six of this subsection. (*As amended by L.* 1983, *Ch.* 377; L. 1985, Ch. 298; *L.* 1987, *Ch.* 817, *effective August* 7, 1987, *and applicable (as amended by L.* 1989, *Ch.* 553) *to taxable years beginning after December* 31, 1986, *but not applicable to corporations other than savings banks and savings and loan associations for taxable years beginning on or after January* 1, 1992, *provided, however, that the provisions which relate to the alternative minimum tax measured by taxable assets shall continue to apply to all taxpayers for taxable years beginning on or after January* 1, 1992.)

[¶ 98-046a]

(b) Allocation of entire net income.

(1) If a taxpayer's entire net income is derived from business carried on both within and without the state, the portion thereof which is derived from business carried on within the state shall be determined by multiplying its entire net income by the income allocation percentage determined as follows: add the percentages ascertained under paragraphs one, two and three of subsection (a) of this section, plus an additional percentage equal to the receipts percentage ascertained under paragraph two of such subsection and an additional percentage equal to the deposits percentage ascertained under paragraph three of such subsection, and divide the result by the number of percentages so added together.

(2) (A) In lieu of the modification provided for in subsection (f) of section fourteen hundred fifty-three of this article, (relating to a modification for the adjusted eligible net income of an international banking facility), a taxpayer may, in the manner prescribed by the tax commission, elect to modify on an annual basis its income allocation percentage in the manner described in clauses (i), (ii) and (iii) below:

(i) wages, salaries and other personal service compensation properly attributable to the production of eligible gross income of the taxpayer's international banking facility shall not be included in the computation of wages, salaries and other personal service compensation of employees within the state,

(ii) receipts properly attributable to the production of eligible gross income of the taxpayer's international banking facility shall not be included in the computation of receipts within the state, and

(iii) deposits from foreign persons which are properly attributable to the production of eligible gross income of the taxpayer's international banking facility shall not be included in the computation of deposits maintained at branches within the state.

(B) For purposes of this paragraph, the term "eligible gross income" refers to such term as set out in subsection (f) of section fourteen hundred fifty-three of this article except that the term "foreign person" as defined in paragraph eight of such subsection (f) shall not include a foreign branch of the taxpayer and in no event shall transactions between the taxpayer's international banking facility and its foreign branches be considered. (*As amended by L.* 1983, *Ch.* 377; *L.* 1985, *Ch.* 298, *effective July* 11, 1985, *and applicable (as amended by L.* 1989, *Ch.* 553) *to taxable years beginning on or after January* 1, 1985, *but not applicable to corporations other than savings banks and savings and loan associations for taxable years beginning on or after January* 1, 1992, *provided, however, that the provisions which relate to the alternative minimum tax measured by taxable assets shall continue to apply to all taxpayers for taxable years beginning on or after January* 1, 1992.)

[¶ 98-046b]

(c) Allocation of alternative entire net income. If a taxpayer's alternative entire net income is derived

from business carried on both within and without the state, the portion thereof which is derived from business carried on within the state shall be determined by multiplying its alternative entire net income by the alternative entire net income allocation percentage determined as follows:

(1) Recompute the payroll percentage under paragraph one of subsection (a) of this section without giving consideration to the phrase "eighty percent of," add to the resulting percentage the percentages ascertained under paragraphs two and three of such subsection, and divide the result by the number of percentages so added together.

(2) When an election has been made pursuant to paragraph two of subsection (b) of this section (relating to international banking facilities) the taxpayer shall make the modifications described in such paragraph for purposes of its alternative entire net income allocation percentage. (*As added by L.* 1985, *Ch.* 298, *effective July* 11, 1985, *and applicable (as amended by L.* 1989, *Ch.* 553) *to taxable years beginning on or after January* 1, 1985, *but not applicable to corporations other than savings banks and savings and loan associations for taxable years beginning on or after January* 1, 1992, *provided, however, that the provisions which relate to the alternative minimum tax measured by taxable assets shall continue to apply to all taxpayers for taxable years beginning on or after January* 1, 1992.)

[¶ 98-046c]

(d) Allocation of taxable assets. If the taxpayer's taxable assets are derived from business carried on both within and without the state, the portion thereof which is derived from business carried on within the state shall be determined by multiplying its taxable assets by an asset allocation percentage determined in the same manner as the income allocation percentage under subsection (b) of this section, determined as if the election provided for in paragraph two of such subsection has been made, except that the modifications described in clauses (i), (ii) and (iii) of subparagraph (A) of such paragraph shall not be made. (*As added by L.* 1985, *Ch.* 298, *effective July* 11, 1985, *and applicable (as amended by L.* 1989, *Ch.* 553) *to taxable years beginning on or after January* 1, 1985, *but not applicable to corporations other than savings banks and savings and loan associations for taxable years beginning on or after January* 1, 1992, *provided, however, that the provisions which relate to the alternative minimum tax measured by taxable assets shall continue to apply to all taxpayers for taxable years beginning on or after January* 1, 1992.)

(*Sec.* 1454 *above is as last amended by L.* 1987, *Ch.* 817, *effective as noted above.*)

[¶ 98-047]

Sec. 1455. Computation of tax.—The tax imposed by section fourteen hundred fifty-one shall be the greater of the following computations:

(a) Basic tax. Nine percent of the taxpayer's entire net income, or the portion thereof allocated to this state, for the taxable year or part thereof. (*As amended by L.* 1975, *Ch.* 895; *L.* 1985, *Ch.* 298, *effective July* 11, 1985, *and applicable (as amended by L.* 1989, *Ch.* 553) *to taxable years beginning on or after January* 1, 1985, *but not applicable to corporations other than savings banks and savings and loan associations for taxable years beginning on or after January* 1, 1992.)

[¶ 98-048]

(b) Alternative minimum tax. If the tax under subsection (a) of this section is less than any of the following amounts, the tax shall be the larger of the following amounts:

(1)(i) Except in the case of a taxpayer described in clause (ii), (iii), or (iv) below, one-tenth of a mill upon each dollar of taxable assets, or the portion thereof allocated to this state.

(ii) In the case of a taxpayer whose net worth ratio is less than five but greater than or equal to four percent and whose total assets are comprised of thirty-three percent or more of mortgages, one-twenty-fifth of a mill upon each dollar of taxable assets, or the portion thereof allocated to this state.

(iii) In the case of a taxpayer whose net worth ratio is less than four percent and whose total assets are comprised of thirty-three percent or more of mortgages, one-fiftieth of a mill upon each dollar of taxable assets, or the portion thereof allocated to this state.

(iv) For taxable years beginning on or after January first, nineteen hundred eighty-five, a taxpayer (whether or not a qualified institution as defined in subparagraph (B) of paragraph five of subsection (f) of section four hundred six of the federal national housing act, as amended, or as defined in paragraph two of subsection (i) of section thirteen of the federal deposit insurance act, as amended) shall not be subject to the provisions of this paragraph for that portion of the taxable year in which it had outstanding net worth certificates issued in accordance with paragraph five of subsection (f) of section four hundred six of the federal national housing act, as amended, or issued in accordance with subsection (i) of section thirteen of the federal deposit insurance act, as amended.

(v) For the purpose of this article:

(A) The term "taxable assets" shall mean the average value of total assets reduced by any amount of money or other property received from or attributable to amounts received from the federal deposit insurance corporation pursuant to subsection (c) of section thirteen of the federal deposit insurance act,

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as amended, or the federal savings and loan insurance corporation pursuant to paragraph one, two, three or four of subsection (f) of section four hundred six of the federal national housing act, as amended, and, for taxpayers whose total assets are comprised of twenty percent or more of interbank placements, further reduced by an amount not to exceed five hundred million dollars. Total assets are those assets which are properly reflected on a balance sheet the income or expenses of which are properly reflected (or would have been properly reflected if not fully depreciated or expensed or depreciated or expensed to a nominal amount) in the computation of alternative entire net income for the taxable year or in the computation of the eligible net income of the taxpayer's international banking facility for the taxable year.

(B) The term "net worth ratio" shall mean the percentage of net worth to assets on the last day of the taxable year. The term "net worth" means the sum of preferred stock, common stock, surplus, capital reserves, undivided profits, mutual capital certificates, reserve for contingencies, reserve for loan losses and reserve for security losses minus assets classified loss. The term "assets" means the sum of mortgage loans, nonmortgage loans, repossessed assets, real estate held for development or investment or resale, cash, deposits, investment securities, fixed assets and other assets (such as financial futures, goodwill and other intangible assets) minus assets classified loss. In no event shall assets be reduced by reserves for losses.

(C) The term "mortgages" shall mean loans secured by real property within or without the state, participations in and securities collateralized by pools of residential mortgages, whether or not issued or guaranteed by a United States government agency, and loans secured by stock in a cooperative housing corporation. The percentage of total assets comprised of mortgages shall be an amount equal to the ratio of the average of the four quarterly balances of such mortgages ending within the taxable year, to the average of the four quarterly balances of all assets ending within the taxable year. Such quarterly balances shall be computed in the same manner as the report of condition required for federal deposit insurance corporation or federal savings and loan insurance corporation purposes, whether or not such report is required. For taxable periods of less than one year, the taxpayer shall compute such ratio using the number of such quarterly balances ending within such taxable period.

(D) The term "interbank placements" shall mean the average value of interest-bearing funds, with a maturity of less than one year, placed or deposited by a taxpayer with a banking corporation other than one described in paragraph nine of subsection (a) of section fourteen hundred fifty-two of this article (whether or not a taxpayer) provided such banking corporation is not one (I) which owns or controls, directly or indirectly, sixty-five percent or more of such taxpayer's voting stock, or (II) sixty-five percent or more of whose voting stock is owned or controlled, directly or indirectly, by such taxpayer, or (III) sixty-five percent or more of whose voting stock is owned or controlled, directly or indirectly, by the same interest.

(2) Three percent of the taxpayer's alternative entire net income, or portion thereof allocated to this state, for the taxable year, or part thereof.

(3) Two hundred fifty dollars. (*As added by L.* 1985, *Ch.* 298, *effective July* 11, 1985, *and applicable* (*as amended by L.* 1989, *Ch.* 553) *to taxable years beginning on or after January* 1, 1985, *but not applicable to corporations other than savings banks and savings and loan associations for taxable years beginning on or after January* 1, 1992, *provided, however, that the provisions which relate to the alternative minimum tax measured by taxable assets shall continue to apply to all taxpayers for taxable years beginning on or after January* 1, 1992; *L.* 1987, *Ch.* 817, *effective August* 7, 1987, *and applicable to taxable years beginning after December* 31, 1986.)

[¶ 98-049]

(c) (*Repealed by L.* 1987, *Ch.* 817, *effective July* 24, 1985.)

(*Sec.* 1455 *above is as last amended by L.* 1987, *Ch.* 817, *effective as noted above.*)

[¶ 98-050]

Sec. 1455-A. Tax surcharge.—1. In addition to the tax imposed under section fourteen hundred fifty-one of this article, there is hereby imposed, for the taxable years ending after June thirtieth, nineteen hundred eighty-nine and before July first, nineteen hundred ninety-two, a tax at the rate of two and one-half percent of the tax imposed under section fourteen hundred fifty-one of this article, before deduction of any credits against tax otherwise allowable under this article for all or any parts of such taxable years. However, the tax imposed by this section shall not be imposed upon any taxpayer for more than thirty-six months. The credits against tax otherwise allowable under section fourteen hundred fifty-six of this article shall not be allowed as a credit against the tax imposed by this section.

2. The provisions concerning returns under section fourteen hundred sixty-two of this article shall be applicable to this section, except that for purposes of an automatic extension for six months for filing a return covering the taxes imposed by this article, such automatic extension shall be allowed only if a taxpayer files with the commissioner of taxation and finance an application for extension in such form as such commissioner may prescribe and pays on or before the date of such filing in addition to any other amounts required under this article, two and one-half percent of the amount properly estimated as provided in subdivision (b) of section fourteen hundred sixty-three of this article as its tax payable

[The next page is 13,745-3.]

under section fourteen hundred fifty-one of this article, before deduction of any credits against tax otherwise allowable under section fourteen hundred fifty-six of this article. The tax imposed by this section shall be payable to such commissioner in full at the time the return is required to be filed.

Except as otherwise provided in this section, all of the provisions of this article, except for sections fourteen hundred fifty-five-B, fourteen hundred sixty and subsections (b) and (c) of section fourteen hundred sixty-one, presently applicable are applicable to the tax imposed by this section with such modifications as may be necessary to adapt such language to the tax imposed by this section. Such provisions shall apply with the same force and effect as if those provisions had been set forth in full in this section except to the extent that any provision is either inconsistent with a provision of this section or not relevant to the tax imposed by this section and to that end a reference in this article to the tax imposed by section fourteen hundred fifty-one shall be read as a reference to the tax imposed by this section unless a different meaning is clearly required.

3. Coordination with section fourteen hundred fifty-five-B of this article. The amount of tax imposed pursuant to this section shall not be included in any calculation of a tax surcharge imposed pursuant to section fourteen hundred fifty-five-B of this article. (*As added by L.* 1989, *Ch.* 61, *effective April* 19, 1989.)

[¶ 98-051]

Sec. 1455-B. Temporary metropolitan transportation business tax surcharge on banks.—1. For the privilege of exercising its franchise or doing business in the metropolitan commuter transportation district in a corporate or organized capacity, there is hereby imposed on every taxpayer subject to tax under this article for the taxable years commencing on or after January first, nineteen hundred eighty-two but ending before December thirty-first, nineteen hundred ninety, a tax surcharge, in addition to the tax imposed under section fourteen hundred fifty-one of this article, at the rate of eighteen per centum of the tax imposed under such section fourteen hundred fifty-one, for such taxable years or any part of such taxable years ending before December thirty-first, nineteen hundred eighty-three after the deduction of any credits otherwise allowable under this article, and at the rate of seventeen per centum of the tax imposed under such section for such taxable years or any part of such taxable years ending on or after December thirty-first, nineteen hundred eighty-three after the deduction of any credits otherwise allowable under this article; provided, however, that such rates of tax shall be applied only to that portion of the tax imposed under section fourteen hundred fifty-one of this article after the deduction of any credits otherwise allowable under this article which is attributable to the taxpayer's business activity carried on within the metropolitan commuter transportation district; and provided, further, that the tax surcharge imposed by this section shall not be imposed upon any taxpayer for more than ninety-six months.

2. If the tax imposed under section fourteen hundred fifty-one is derived from business activity carried on both within and without the metropolitan commuter transportation district, the portion of the tax attributable to business activity carried on in the metropolitan commuter transportation district shall be determined in accordance with rules and regulations promulgated by the tax commission.

3. The provisions concerning returns under section fourteen hundred sixty-two of this article shall be applicable to this section, except that for purposes of an automatic extension for six months for filing a return covering the tax surcharge imposed by this section, such automatic extension shall be allowed only if a taxpayer files with the tax commission an application for extension in such form as said commission may prescribe by regulation and pays on or before the date of such filing in addition to any other amounts required under this article, ninety percent of the entire tax surcharge required to be paid under this section for the applicable period. The tax surcharge imposed by this section shall be payable to the tax commission in full at the time the return is required to be filed, and such tax surcharge or the balance thereof, imposed on any taxpayer which ceases to exercise its franchise or be subject to the tax surcharge imposed by this section shall be payable to the tax commission at the time the return is required to be filed, provided such tax surcharge of a domestic corporation which continues to possess its franchise shall be subject to adjustment as the circumstances may require; all other tax surcharges of any such taxpayer, which pursuant to the foregoing provisions of this section would otherwise be payable subsequent to the time such return is required to be filed, shall nevertheless be payable at such time. All of the provisions of this article presently applicable are applicable to the tax surcharge imposed by this section except for sections fourteen hundred sixty and fourteen hundred sixty-one of this article.

4. Notwithstanding any contrary provisions of state or local law, the tax surcharge imposed under this section shall not be allowed as a deduction in the computation of any state or local tax imposed under this chapter or any chapter or local law. Furthermore, the credits otherwise allowable under this article shall not be allowed against the tax surcharge imposed by this section.

5. The term metropolitan commuter transportation district as used in this section shall be defined pursuant to section twelve hundred sixty-two of the public authorities law. (*As added by L.* 1982, *Ch.* 931; *amended by L.* 1983, *Ch.* 11; *L.* 1984, *Ch.* 999; *L.* 1985, *Chs.* 298 *and* 542; *L.* 1986, *Ch.* 929, *effective December* 31, 1986.)

[¶ 98-052—98-065]

Reserved

[¶ 98-066]

Sec. 1456. Credits.—(a) Credit for servicing mortgages. Every bank, as defined in section two thousand four hundred two of the public authorities law, which shall have entered into a contract with the state of New York mortgage agency to service mortgages acquired by such agency pursuant to the state of New York mortgage agency act, shall have credited to it annually to apply upon or in lieu of the payment of any tax to which it may be subject under this article an amount equal to two and ninety-three one hundredths percentum of the total principal and interest collected by the bank during its taxable year on each such mortgage secured by a lien on real estate improved by a one-family to four-family residential structure and an amount equal to the interest collected by the bank during its taxable year on each such mortgage secured by a lien on real property improved by a structure occupied as the residence of five or more families living independently of each other, multiplied by a fraction the denomina-

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tor of which shall be the interest rate payable on the mortgage (computed to five decimal places) and the numerator of which shall be .00125 in the case of such a mortgage acquired by such agency for less than one million dollars, and .00100 in the case of such a mortgage acquired by such agency for one million dollars or more; provided, however, that there shall in no case be credited to any such bank an amount in excess of the amount due from such bank for taxes payable to the state under this article for the taxable year for which such credit is given. In computing such tax credit for the servicing of mortgages on one-family to four-family residential structures, the bank shall be entitled to no credit for the collection of curtailments or payments in discharge of any such mortgage. For the purposes of this section, (a) a "curtailment" shall mean amounts paid by mortgagors (1) in excess of the monthly constant due during the month of collection and (2) in reduction of the unpaid principal balance of the mortgage; in the absence of clear evidence to the contrary, amounts paid in excess of the monthly constant due during the month of collection shall be deemed to be in reduction of the unpaid principal balance of the mortgage; and (b) "monthly constant" shall mean the amount of principal and interest which is due and payable according to the mortgage documents on each periodic payment date.

[¶ 98-067]

(b) Eligible business facility credit.

(1) On or after April first, nineteen hundred eighty-three, for taxable years beginning before January first, two thousand, a credit against the tax imposed by this article shall be allowed only to a taxpayer owning or operating an eligible business facility, where such taxpayer has received a certificate of eligibility for tax credits, or a renewal or extension thereof, for such facility from the New York state job incentive board prior to April first, nineteen hundred eighty-three, or has received a certificate of eligibility for tax credits, or a renewal or extension thereof, for such facility from the state tax commission subsequent to such date pursuant to paragraph eight of this subsection, and only with respect to such facility, to be computed as hereinafter provided. (*As amended by L.* 1983, *Ch.* 15; *L.* 1988, *Ch.* 165, *effective June* 29, 1988.)

[¶ 98-068]

(2) The amount of the credit allowable in any taxable year shall be the sum determined by multiplying the tax otherwise due by a percentage to be determined by:

(A) ascertaining the percentage which the total of eligible property values during the period covered by its return, as defined in paragraph four of this subsection bears to the average value of all the taxpayer's real and tangible personal property except for inventory within the state during such period. For the purposes of this subparagraph only, the taxpayer's real and tangible personal property shall include not only such property owned by the taxpayer but also property rented to it, and the value of rented property shall be deemed to be eight times the net annual rental rate, that is, the annual rental rate paid by the taxpayer less any annual rental rate received by the taxpayer from subrentals;

(B) ascertaining the percentage which the total wages, salaries and other personal service compensation during such period, of employees, except general executive officers and that portion of employee's wages, salaries and other personal service compensation attributable, directly or indirectly, to the production of adjusted eligible net income which is allowed as a deduction from entire net income as set forth in subsection (f) of section fourteen hundred fifty-three of this article, serving in jobs created or retained in an eligible area (as the term "eligible area" was defined by section one hundred fifteen of the commerce law as it existed on March thirty-first, nineteen hundred eighty-three) by such business facility, bears to the total wages, salaries and other personal service compensation, during such period, of all the taxpayer's employees within the state, except general executive officers; and

(C) adding together the percentages so determined and dividing the result by two; provided, however, that if no wages, salaries or other personal service compensation were paid or incurred by the taxpayer during such period to employees within the state other than general executive officers, subparagraph (B) of this paragraph shall be disregarded and the amount of credit allowable shall be determined by multiplying the tax otherwise due by the percentage specified in subparagraph (A) of this paragraph. (*As amended by L.* 1976, *Ch.* 924; *L.* 1978, *Ch.* 288; *L.* 1983, *Ch.* 15, *effective April* 1, 1983.)

[¶ 98-069]

(3) In no event shall the credit herein provided for be allowed in any amount which will reduce the tax payable to less than the dollar amount fixed as a minimum tax by subsection (b) of section fourteen hundred fifty-five.

[¶ 98-070]

(4)(A) Eligible property values, for the purposes of this subsection, shall include such part of the value of depreciable real and tangible personal property included in an eligible business facility as represents:

(i) expenditures paid or incurred by the taxpayer for capital improvements of the construction, reconstruction, erection or improvement of real property included in an eligible facility, which construction, reconstruction, erection or improvements were commenced on or after July first, nineteen hundred sixty-eight;

(ii) in the case of real property leased by the taxpayer from another party, eight times the portion of the net annual rental rate attributable to such

construction, reconstruction, erection or improvement commenced on or after July first, nineteen hundred sixty-eight;

(iii) expenditures paid or incurred by the taxpayer for the purchase of tangible personal property, other than vehicles, included in an eligible business facility, provided such property was purchased on or after July first, nineteen hundred sixty-eight; and

(iv) in the case of tangible personal property, other than vehicles, leased by the taxpayer from another party and included in an eligible business facility, eight times the net annual rental rate, provided the period for which such property was leased by the taxpayer began on or after July first, nineteen hundred sixty-eight.

(B) Provided, however, eligible property values for purposes of this subdivision shall not include expenditures paid or incurred more than one year prior to the filing of an application for a certificate of eligibility pursuant to section one hundred nineteen of the commerce law, as such section existed on March thirty-first, nineteen hundred eighty-three.

(C) Provided further that, for purposes of this subsection, eligible property values shall not include that portion of the value of property which is used in the production of adjusted eligible net income which is allowed as a deduction from entire net income as set forth in subsection (f) of section fourteen hundred fifty-three of this article. (*As amended by L.* 1978, *Ch.* 288; *L.* 1983, *Ch.* 15, *effective April* 1, 1983.)

[¶ 98-071]

(5) The total of all credits allowed pursuant to this subsection in any taxable year or years with reference to any eligible business facility shall not exceed the total eligible property values included.

[¶ 98-072]

(6) If a credit is allowed for any taxable year as herein provided on the basis of a certificate of eligibility, and if such certificate is revoked or modified, the taxpayer shall report such revocation or modification in its return for the taxable year during which it occurs, and the tax commission shall recompute such credit and may assess any additional tax resulting from such recomputation within the time fixed by paragraph nine of subsection (c) of section ten hundred eighty-three of this chapter. (*As amended by L.* 1983, *Ch.* 15, *effective April* 1, 1983.)

[¶ 98-073]

(7) If a business facility owned or operated by a taxpayer shall be an eligible business facility for only part of a taxable year, the credit allowed by this subdivision shall be prorated according to the period such facility was an eligible business facility and if the total of the eligible property values shall have changed during any taxable year, a prorata adjustment shall be made in computing such credit. (*As amended by L.* 1983, *Ch.* 15, *effective April* 1, 1983.)

[¶ 98-073a]

(8) The state tax commission shall be empowered, on or after April first, nineteen hundred eighty-three, to issue a certificate of eligibility for tax credits to a taxpayer for an eligible business facility with regard to which such taxpayer has, prior to July first, nineteen hundred eighty-three, received from the New York state job incentive board initial approval of an application for such certificate by such board as evidenced by the minutes of the meeting of the board at which such application was approved, or a letter of intent authorized by section 102.4 of part one hundred two of title five of the codes; rules and regulations of the state of New York regarding such certificate of eligibility and to renew, extend, revoke or modify a certificate of eligibility for tax credits, pursuant to section one hundred twenty of the commerce law as such section existed on March thirty-first, nineteen hundred eighty-three. (*As added by L.* 1983, *Ch.* 15, *effective April* 1, 1983.)

[¶ 98-074]

(c) Mortgage recording tax credit. (1) A taxpayer shall be allowed a credit, to be credited against the tax imposed by this article. The amount of the credit shall be the amount of the special additional mortgage recording tax paid by the taxpayer pursuant to the provisions of subdivision one-a of section two hundred fifty-three of this chapter on mortgages recorded on and after January first, nineteen hundred seventy-nine. Provided, however, no credit shall be allowed with respect to a mortgage of real property principally improved or to be improved by one or more structures containing in the aggregate not more than six residential dwelling units, each dwelling unit having its own separate cooking facilities, where the real property is located in one or more of the counties comprising the metropolitan commuter transportation district and where the mortgage is recorded on or after May first, nineteen hundred eighty-seven. Provided, however, no credit shall be allowed with respect to a mortgage of real property principally improved or to be improved by one or more structures containing in the aggregate not more than six residential dwelling units, each dwelling unit having its own separate cooking facilities, where the real property is located in the county of Erie and where the mortgage is recorded on or after May first, nineteen hundred eighty-seven. (*As added by L.* 1978, *Ch.* 788; *amended by L.* 1983, *Ch.* 285; *L.* 1986, *Ch.* 638; *L.* 1987, *Ch.* 13, *effective March* 31, 1987, *and Ch.* 59, *effective April* 22, 1987.)

[¶ 98-075]

(2) In no event shall the credit herein provided for, and carryovers of such credit in, the aggregate, be allowed in an amount which will reduce the tax payable to less than the dollar amount fixed as a

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minimum tax by subsection (b) of section fourteen hundred fifty-five. However, if the amount of credit or carryovers of such credit, or both, allowable under this subdivision for any taxable year reduces the tax to such amount, any amount of credit or carryovers of such credit thus not deductible in such taxable year may be carried over to the following year or years and may be deducted from the taxpayer's tax for such year or years. (*As added by L.* 1978, *Ch.* 788; *as amended by L.* 1986, *Ch.* 686, *effective July* 30, 1986, *and applicable to taxable years beginning on or after January* 1, 1986.)

[¶ 98-076]

(d) Economic development zone capital corporation credit.

(1) A taxpayer shall be allowed a credit against the tax imposed by this article. The amount of the credit shall be equal to twenty-five percent of the consideration paid for original issue stock purchased during the taxable year from one or more economic development zone capital corporations established pursuant to section nine hundred sixty-four of the general municipal law.

(2) The credit allowed under this subsection for any taxable year shall not reduce the tax due for such year to less than the minimum tax fixed by subsection (b) of section fourteen hundred fifty-five of this article. In addition, no taxpayer shall be allowed a credit, or credits with respect to more than one year, taken in the aggregate, of more than one hundred thousand dollars. In addition, such credit may not exceed fifty percent of the tax imposed under section fourteen hundred fifty-five computed without regard to any credit provided for under this article.

(3) Where stock the purchase of which is the basis for the credit provided for herein is disposed of, the taxpayer's entire net income, or the portion thereof allocated within the state, shall be computed, pursuant to regulations promulgated by the state tax commission, so as to properly reflect the reduced cost of such stock arising from the application of the credit provided for herein. (*As added by L.* 1986, *Ch.* 686, *effective July* 30, 1986, *and applicable to taxable years beginning on or after January* 1, 1986.)

[¶ 98-076a]

(e) Economic development zone credit. (1) A taxpayer shall be allowed a credit, to be computed as hereinafter provided, against the tax imposed by this article where the taxpayer has been certified pursuant to article eighteen-B of the general municipal law. The amount of such credit shall be as prescribed in paragraph four hereof.

(2) For purposes of this subsection, the following terms shall have the following meanings: (A) "Economic development zone wages" means wages paid by the taxpayer for full-time employment, other than to general executive officers, during the taxable year in an area designated as an economic development zone pursuant to article eighteen-B of the general municipal law where such employment is in a job created in the area during the period of its designation as an economic development zone.

(B) "Targeted employee" means a New York resident who receives economic development zone wages and who is (i) an eligible individual under the provisions of the targeted jobs tax credit act, (ii) eligible for benefits under the provisions of the job partnership training act (P.L. 97-300) (iii), a recipient of public assistance benefits or (iv) an individual whose income is below the most recently established poverty rate promulgated by the United States department of commerce, or a member of a family whose family income is below the most recently established poverty rate promulgated by the appropriate federal agency.

An individual who satisfies the criteria set forth in clause (i), (ii) or (iv) at the time of initial employment in the job with respect to which the credit is claimed, or who satisfies the criterion set forth in clause (iii) at such time or at any time within the previous two years, shall be a targeted employee so long as such individual continues to receive economic development zone wages.

(C) "Eligible wages" means the product of the aggregate of all economic development zone wages (but not including more than ten thousand dollars in such wages paid with respect to any single job described in subparagraph (A) during any taxable year) and a fraction the numerator of which is the difference between the net employment gain in economic development zones and the net employment loss in the state but outside any economic development zone, and the denominator of which is the net employment gain in economic development zones.

(D) "Net employment gain in economic development zones" means the difference between the average number of individuals, excluding general executive officers, employed full-time by the taxpayer in economic development zones during the taxable year and the average number of such individuals employed full-time by the taxpayer in the areas comprising such zones during the four years immediately preceding the first taxable year in which the credit is claimed with respect to any such zone.

(E) "Net employment loss in the state but outside any economic development zone" means the difference between the average number of individuals, excluding general executive officers, employed full-time by the taxpayer in the state but outside any economic development zone during the taxable year and the average number of such individuals employed full-time by the taxpayer in such area during the four years immediately preceding the first taxable year in which the credit is claimed with respect to any such zone.

(F) Where the taxpayer provided full-time employment within an economic development zone

or other area defined herein during only a portion of such four year period, for purposes of this subparagraph the term "four years" shall be deemed to refer instead to such portion, if any.

(3) The credit provided for herein shall be allowed only where

(A) at least twenty percent of the taxpayer's full-time employees, excluding general executive officers, in such zone during the taxable year who are employed in jobs created in such zone during the period of its designation as such are residents of such zone or residents of census tracts contiguous to such zone, and

(B) the average number of individuals, excluding general executive officers, employed full-time by the taxpayer in (i) the state, and (ii) the economic development zone, during the taxable year exceeds the average number of such individuals employed full-time by the taxpayer in (i) the state, and, (ii) such zone or area subsequently constituting such zone, respectively, during the four years immediately preceding the first taxable year in which the credit is claimed with respect to such zone. Where the taxpayer provided full-time employment within (i) the state or (ii) such zone or area during only a portion of such four-year period, then for purposes of this subparagraph the term "four years" shall be deemed to refer instead to such portion, if any.

The credit shall be allowed only with respect to the first taxable year during which payments of economic development zone wages are made and the conditions set forth in subparagraphs (A) and (B) of this paragraph are satisfied, and with respect to each of the four taxable years next following (but only, with respect to each of such years, if such conditions are satisfied), in accordance with paragraph four hereof.

(4) The amount of the credit shall equal the sum of (i) the portion of eligible wages attributable to wages paid to targeted employees prescribed in column two with respect to the appropriate period in column one below, and (ii) the portion of eligible wages attributable to wages paid to employees other than targeted employees prescribed in column three below with respect to the appropriate period in column one below. Provided, however, that the portion of the credit attributable to clause (ii) of the previous sentence, including any such portion of such credit carried forward to the taxable year, may not exceed forty percent of the portion of the credit attributable to clause (i) thereof. Any portion of the credit disallowed by reason of the previous sentence may be carried forward to the following year or years and may be deducted from the tax for such years:

Column 1	Column 2	Column 3
First taxable year in which credit is claimed	25%	12.5%
Second taxable year in which credit is claimed	20%	10%
Third taxable year in which credit is claimed	15%	7.5%
Fourth taxable year in which credit is claimed	10%	5%
Fifth taxable year in which credit is claimed	5%	2.5%

Provided, further, that the credit provided for herein with respect to the taxable year, and carryovers of such credit to the taxable year, may not in the aggregate exceed fifty percent of the tax imposed under section fourteen hundred fifty-five computed without regard to any credit provided for under this article.

(5) The credit and carryovers of such credit allowed under this subsection for any taxable year shall not, in the aggregate, reduce the tax due for such year to less than the minimum tax fixed by subsection (b) of section fourteen hundred fifty-five of this article. However, if the amount of credit or carryovers of such credit, or both, allowable under this subsection for any taxable year reduces the tax to such amount, or if any part of the credit or carryovers of such credit is disallowed by reason of the final sentence in paragraph four hereof, any amount of credit or carryovers of such credit thus not deductible in such taxable year may be carried over to the following year or years and may be deducted from the taxpayer's tax for such year or years. (*As added by L.* 1986, *Ch.* 686; *as amended by L.* 1987, *Ch.* 442, *effective July* 27, 1987, *applicable to taxable years beginning on or after January* 1, 1986.)

[¶ 98-076b]

(f) Credits allowable under this section which can be carried over, and carryovers of such credits, shall be deducted after credits allowable under this section which cannot be carried over. The credit allowed pursuant to subsection (a) of this section shall be deducted after the credit allowed pursuant to subsection (d) of this section, which shall be deducted after the credit allowed pursuant to subsection (b) of this section. The credit and carryovers of the credit allowed pursuant to subsection (c) of this section shall be deducted after the credit and carryovers of the credit allowed pursuant to subsection (e) of this section. (*As added by L.* 1983, *Ch.* 285; *as amended by L.* 1986, *Ch.* 686; *L.* 1987, *Ch.* 442, effective *July* 27, 1987, *applicable to taxable years beginning on or after January* 1, 1986.)

(*Sec.* 1456 *above is as last amended by L.* 1988, *Ch.* 165, *effective June* 29, 1988.)

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[¶ 98-077]

Sec. 1460. Declarations of estimated tax—(a) Requirements of declaration.—Every taxpayer subject to the tax imposed by subsection (a) of section fourteen hundred fifty-one shall make a declaration of its estimated tax for the current taxable year, containing such information as the tax commission may prescribe by regulations or instructions, if such estimated tax can reasonably be expected to exceed one thousand dollars.

[¶ 98-078]

(b) Definition of estimated tax.—The term "estimated tax" means the amount which a taxpayer estimates to be the tax imposed by subsection (a) of section fourteen hundred fifty-one for the current taxable year, less the amount which it estimates to be the sum of any credits allowable against the tax.

[¶ 98-079]

(c) Time for filing declaration.—A declaration of estimated tax shall be filed on or before June fifteenth of the current taxable year in the case of a taxpayer which reports on the basis of a calendar year, except that if the requirements of subsection (a) of this section are first met:

(1) after May thirty-first and before September first of such current taxable year, the declaration shall be filed on or before September fifteenth, or

(2) after August thirty-first and before December first of such current taxable year, the declaration shall be filed on or before December fifteenth. (*As amended by L.* 1981, *Ch.* 103, *effective May* 15, 1981, *and applicable to taxable years beginning on or after January* 1, 1981.)

[¶ 98-080]

(d) Amendments of declaration.—A taxpayer may amend a declaration under regulations of the tax commission.

[¶ 98-081]

(e) Return as declaration.—If, on or before February fifteenth of the succeeding year in the case of a taxpayer whose taxable year is a calendar year, a taxpayer files its return for the year for which the declaration is required, and pays therewith the balance, if any, of the full amount of the tax shown to be due on the return:

(1) such return shall be considered as its declaration if no declaration was required to be filed during the taxable year for which the tax was imposed, but is otherwise required to be filed on or before December fifteenth pursuant to paragraph two of subsection (c) of this section, and

(2) such return shall be considered as the amendment permitted by subsection (d) of this section to be filed on or before December fifteenth if the tax shown on the return is greater than the estimated tax shown on a declaration previously made. (*As amended by L.* 1981, *Ch.* 103, *effective May* 15, 1981, *and applicable to taxable years beginning on or after January* 1, 1981.)

[¶ 98-082]

(f) Fiscal year.—This section shall apply to taxable years of twelve months other than a calendar year by the substitutions of the months of such fiscal year for the corresponding months specified in this section.

[¶ 98-083]

(g) Short taxable period.—If the taxable period for which a tax is imposed by subsection (a) of section fourteen hundred fifty-one is less than twelve months, every taxpayer required to make a declaration of estimated tax for such taxable period shall make such a declaration in accordance with regulations of the tax commission.

[¶ 98-084]

(h) Extension of time.—The tax commission may grant a reasonable extension of time, not to exceed three months, for the filing of any declaration required pursuant to this section, on such terms and conditions as it may require.

(*Sec.* 1460 *above is as amended by L.* 1981, *Ch.* 103, *effective as noted above.*)

[¶ 98-085]

Sec. 1461. Payments of estimated tax.—(a) Every taxpayer subject to the tax imposed by section fourteen hundred fifty-one shall pay an amount equal to twenty-five percent of the preceding year's tax, if such preceding year's tax exceeded one thousand dollars. Such amount shall be paid with the return required to be filed for the preceding taxable year or with an application for the extension of the time for filing such return. (*As amended by L.* 1987, *Ch.* 267, *effective July* 20, 1987.)

[¶ 98-086]

(b) Other installments.—The estimated tax for each taxable year with respect to which a declaration of estimated tax is required to be filed under this article shall be paid, in the case of a taxpayer which reports on the basis of a calendar year, as follows:

(1) If the declaration is filed on or before June fifteenth, the estimated tax shown thereon, after applying thereto the amount if any, paid during the same taxable year pursuant to subsection (a) of this section, shall be paid in three equal installments. One of such installments shall be paid at the time of the filing of the declaration, one shall be paid on the following September fifteenth, and one on the following December fifteenth.

(2) If the declaration is filed after June fifteenth and not after September fifteenth of such taxable year, and is not required to be filed on or before June fifteenth of such year the estimated tax shown on such declaration, after applying thereto the amount,

if any, paid during the same taxable year pursuant to subsection (a) of this section, shall be paid in two equal installments. One of such installments shall be paid at the time of the filing of the declaration and one shall be paid on the following December fifteenth.

(3) If the declaration is filed after September fifteenth of such taxable year, and is not required to be filed on or before September fifteenth of such year, the estimated tax shown on such declaration, after applying thereto the amount, if any, paid in respect of such year pursuant to subsection (a) of this section shall be paid in full at the time of the filing of the declaration.

(4) If the declaration is filed after the time prescribed therefor, or after the expiration of any extension of time therefor, paragraphs two and three of this subsection shall not apply and there shall be paid at the times of such filing all installments of estimated tax payable at or before such time, and the remaining installments shall be paid at the times at which, and in the amounts in which, they would have been payable if the declaration had been filed when due. (*As amended by L.* 1981, *Ch.* 103, *effective May* 15, 1981, *and applicable to taxable years beginning on or after January* 1, 1981.)

[¶ 98-087]

(c) Amendments of declarations.—If any amendment of a declaration is filed, the remaining installments, if any, shall be ratably increased or decreased (as the case may be) to reflect any increase or decrease in the estimated tax by reason of such amendment, and if any amendment is made after September fifteenth of the taxable year, any increase in the estimated tax by reason thereof shall be paid at the time of making such amendment. (*As amended by L.* 1981, *Ch.* 103, *effective May* 15, 1981, *and applicable to taxable years beginning on or after January* 1, 1981.)

[¶ 98-088]

(d) Application of installments based on the preceding year's tax.—Any amount paid pursuant to subsection (a) shall be applied as a first installment against the estimated tax of the taxpayer for the taxable year shown on the declaration required to be filed pursuant to section fourteen hundred sixty, or if no declaration of estimated tax is required to be filed by the taxpayer pursuant to such section, any such amount shall be considered a payment on account of the tax shown on the return required to be filed by the taxpayer for such taxable year.

[¶ 98-089]

(e) Interest on certain installments based on the preceding year's tax.—Notwithstanding the provisions of section one thousand eighty-eight of this chapter or of section sixteen of the state finance law, if an amount paid pursuant to subsection (a) of this section exceeds the tax shown on the return required to be filed by the taxpayer for the taxable year during which the amount was paid, interest shall be allowed and paid on the amount by which the amount so paid pursuant to such subsection exceeds such tax, at the overpayment rate set by the commissioner of taxation and finance pursuant to section one thousand ninety-six of this chapter, or if no rate is set, at the rate of six per cent per annum from the date of payment of the amount so paid pursuant to such subsection to the fifteenth day of the third month following the close of the taxable year, provided, however, that no interest shall be allowed or paid under this subsection if the amount thereof is less than one dollar. (*As amended by L.* 1973, *Ch.* 643; *L.* 1989, *Ch.* 61, *effective September* 1, 1989, *applicable to the interest chargeable or due on taxes or on any other amounts, or any portion thereof, for which interest rates are set.*)

[¶ 98-090]

(f) The preceding year's tax defined.—As used in this section, "the preceding year's tax" means the tax imposed upon the taxpayer by subsection (a) of section fourteen hundred fifty-one for the preceding taxable year, or, for purposes of computing the first installment of estimated tax when an application has been filed for extension of the time for filing the return required to be filed for such preceding taxable year, the amount properly estimated pursuant to paragraph one of subsection (b) of section fourteen hundred sixty-three as the tax imposed upon the taxpayer for such taxable year. (*As amended by L.* 1987, *Ch.* 267, *effective July* 20, 1987.)

[¶ 98-091]

(g) Application to short taxable period.—This section shall apply to a taxable period of less than twelve months in accordance with regulations of the tax commission.

[¶ 98-092]

(h) Fiscal year.—The provisions of this section shall apply to taxable years of twelve months other than a calendar year by the substitution of the months of such fiscal year for the corresponding months specified in such provisions.

[¶ 98-093]

(i) Extension of time.—The commissioner of taxation and finance may grant a reasonable extension of time, not to exceed six months, for payment of any installment of estimated tax required pursuant to this section, on such terms and conditions as he may require, including the furnishing of a bond or other security by the taxpayer in an amount not exceeding twice the amount for which any extension of time for payment is granted, provided, however, that interest at the underpayment rate set by the commissioner pursuant to section one thousand ninety-six of this chapter, or if no rate is set, at the rate of six per centum per annum for the period of the extension shall be charged and collected on the amount for which any extension of time for payment is granted

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under this subsection. (*As amended by L.* 1973, *Ch.* 643; *L.* 1989, *Ch.* 61, *effective September* 1, 1989, *applicable to the interest chargeable or due on taxes or on any other amounts, or any portion thereof, for which interest rates are set.*)

[¶ 98-094]

(j) Payment of installments in advance.—A taxpayer may elect to pay any installment of estimated tax prior to the date prescribed in this section for payment thereof.

(*Sec.* 1461 *above is as last amended by L.* 1989, *Ch.* 61, *effective as noted above.*)

[¶ 98-095]

Sec. 1462. Returns.—(a) Every taxpayer, as well as every other banking corporation having an employee, including any officer, within the state, shall annually on or before the fifteenth day of the third month following the close of each of its taxable years transmit to the tax commission a return in a form prescribed by it setting forth such information as the tax commission may prescribe and every taxpayer which ceases to exercise its franchise or to be subject to the tax imposed by this article shall transmit to the tax commission a return on the date of such cessation or at such other time as the tax commission may require covering each year or period for which no return was theretofore filed. (*As amended by L.* 1974, *Ch.* 436, *effective May* 23, 1974, *and applicable to reports or returns due for calendar or fiscal periods beginning after December* 31, 1973.)

[¶ 98-096]

(b) Every taxpayer shall also transmit such other returns and such facts and information as the tax commission may require in the administration of this article.

[¶ 98-097]

(c) The tax commission may grant a reasonable extension of time for filing returns whenever good cause exists. An automatic extension of six months for the filing of its annual return shall be allowed any taxpayer, if within the time prescribed by subsection (a), such taxpayer files with the tax commission an application for extension in such form as said commission may prescribe by regulation and pays on or before the date of such filing the amount properly estimated as its tax.(*As amended by L.* 1985, *Ch.* 542, *effective July* 24, 1985, *and applicable to reports and returns due after December* 31, 1985.)

[¶ 98-098]

(d) Every return shall have annexed thereto a certification by the president, vice president, treasurer, assistant treasurer, chief accounting officer or any other officer of the taxpayer duly authorized so to act to the effect that the statements contained therein are true. The fact that an individual's name is signed on a certification of the return shall be prima facie evidence that such individual is authorized to sign and certify the return on behalf of the corporation. In the case of an association or publicly traded partnership referred to in paragraph one of subsection (f) of this section, such certification shall be made by any person duly authorized so to act on behalf of such association or publicly traded partnership. (*As amended by L.* 1989, *Ch.* 61, *applicable to taxable years beginning on or after January* 1, 1989 *and ending after April* 19, 1989.)

[¶ 98-099]

(e) If the amount of taxable income or alternative minimum taxable income for any year of any taxpayer as returned to the United States treasury department is changed or corrected by the commissioner of internal revenue or other officer of the United States or other competent authority, such taxpayer shall report such change or corrected taxable income or alternative minimum taxable income within ninety days after the final determination of such change or correction or as required by the tax commission, and shall concede the accuracy of such determination or state wherein it is erroneous. Any taxpayer filing an amended return with such department shall also file within ninety days thereafter an amended return with the tax commission which shall contain such information as it shall require. The allowance of a tentative carryback adjustment based upon a net capital loss carryback pursuant to section sixty-four hundred eleven of the internal revenue code, shall be treated as a final determination for purposes of this subsection. (*As amended by L.* 1981, *Ch.* 548; *L.* 1987, *Ch.* 817, *effective August* 7, 1987, *and applicable to taxable years beginning after December* 31, 1986.)

[¶ 98-100]

(f)(1) For purposes of this subsection, the term "bank holding company" means any corporation subject to article three-A of the banking law, or registered under the federal bank holding company act of nineteen hundred fifty-six, as amended, or registered as a savings and loan holding company (but excluding a diversified savings and loan holding company) under the federal national housing act, as amended. For purposes of the preceding sentence, the term "corporation" shall include an association, within the meaning of paragraph three of subsection (a) of section seventy-seven hundred one of the internal revenue code, and a publicly traded partnership treated as a corporation for purposes of the internal revenue code pursuant to section seventy-seven hundred four thereof.

(2)(i) Any banking corporation or bank holding company which is exercising its corporate franchise or doing business in this state in a corporate or organized capacity, and

(A) which owns or controls, directly or indirectly, eighty percent or more of the voting stock of one or

more banking corporations or bank holding companies, or

(B) whose voting stock is eighty percent or more owned or controlled, directly or indirectly, by a banking corporation or a bank holding company, shall make a return on a combined basis under this article covering itself and such corporations described in clause (A) or (B) and shall set forth such information as the tax commission may require unless the taxpayer or the tax commission shows that the inclusion of such a corporation in the combined return fails to properly reflect the tax liability of such corporation under this article. Provided, however, that no banking corporation or bank holding company not a taxpayer shall be subject to the requirements of this subparagraph unless the tax commission deems that the application of such requirements is necessary in order to properly reflect the tax liability under this article, because of intercompany transactions or some agreement, understanding, arrangement or transaction of the type referred to in subsection (g) of this section.

(ii) In the discretion of the tax commission, any banking corporation or bank holding company which is exercising its corporate franchise or doing business in this state in a corporate or organized capacity, and

(A) which owns or controls, directly or indirectly, sixty-five percent or more of the voting stock of one or more banking corporations or bank holding companies, or

(B) whose voting stock is sixty-five percent or more owned or controlled, directly or indirectly, by a banking corporation or a bank holding company, may be required or permitted to make a return on a combined basis under this article covering itself and such corporations described in clause (A) or (B) and shall set forth such information as the tax commission may require; provided, however, that no combined return shall be required or permitted unless the tax commission deems such report necessary in order to properly reflect the tax liability under this article of any one or more of such banking corporations or bank holding companies.

(iii) In the discretion of the tax commission, banking corporations or bank holding companies which are sixty-five percent or more owned or controlled, directly or indirectly, by the same interest may be permitted or required to make a return on a combined basis under this article and shall set forth such information as the tax commission may require, if at least one such banking corporation or bank holding company is exercising its corporate franchise or doing business in this state in a corporate or organized capacity. No combined return shall be required or permitted unless the tax commission deems such report necessary in order to properly reflect the tax liability under this article of any one or more of such banking corporations or bank holding companies.

(3) In the case of a combined return, the tax shall be measured by the combined entire net income, combined alternative entire net income or combined assets of all the corporations included in the return. The allocation percentage shall be computed based on the combined factors with respect to all the corporations included in the combined return. In computing combined entire net income and combined alternative entire net income intercorporate dividends and all other intercorporate transactions shall be eliminated and in computing combined assets intercorporate stockholdings and intercorporate bills, notes and accounts receivable and payable and other intercorporate indebtedness shall be eliminated.

(4)(i) In no event shall an item of income or expense of a corporation organized under the laws of a country other than the United States be included in a combined return unless it is includible in entire net income or alternative entire net income, as the case may be, nor shall an asset of such a corporation be included in a combined return unless it is included in taxable assets.

(ii) In no event shall a corporation organized under the laws of the United States, this state or any other state, be included in a combined return with a corporation organized under the laws of a country other than the United States.

(iii) In no event shall a corporation which has made an election pursuant to subsection (d) of section fourteen hundred fifty-two of this article to be subject to the tax imposed by article nine-a of this chapter be included in a combined return for those taxable years for which it is subject to the tax imposed by article nine-a of this chapter.

(iv) In no event shall a corporation whose net worth ratio is less than five percent and whose total assets are comprised of thirty-three percent or more of mortgages be included in a combined return for those taxable years for which its tax is determined pursuant to subparagraph (ii) or (iii) of paragraph one of subsection (b) of section fourteen hundred fifty-five of this article.

(5) Tax liability under this article may be deemed to be improperly reflected because of intercompany transactions or some agreement, understanding, arrangement or transaction referred to in subsection (g) of this section. (*As added by L.* 1985, *Ch.* 298; *as amended by L.* 1989, *Ch.* 61, *applicable to taxable years beginning on or after January* 1, 1989 *and ending after April* 19, 1989.)

[¶ 98-100a]

(g) In case it shall appear to the tax commission that any agreement, understanding or arrangement exists between the taxpayer and any other corporation or any person or firm, whereby the activity, business, income or assets of the taxpayer within the state is improperly or inaccurately reflected, the tax commission is authorized and empowered, in its dis-

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cretion and in such manner as it may determine, to adjust items of income or deductions in computing entire net income or alternative entire net income and to adjust assets, and to adjust wages, salaries and other personal service compensation, receipts or deposits in computing any allocation percentage, provided only that entire net income or alternative entire net income be adjusted accordingly and that any asset directly traceable to the elimination of any receipt be eliminated from assets so as to accurately determine the tax. If however, in the determination of the tax commission, such adjustments do not, or cannot effectively provide for the accurate determination of the tax, the commission shall be authorized to require the filing of a combined report by the taxpayer and any such other corporations. Where (1) any taxpayer conducts its activity or business under any agreement, arrangement or understanding in such manner as either directly or indirectly to benefit its members or stockholders, or any of them, or any person or persons directly or indirectly interested in such activity or business, by entering into any transaction at more or less than a fair price which, but for such agreement, arrangement or understanding, might have been paid or received therefor, or (2) any taxpayer enters into any transaction with another corporation on such terms as to create an improper loss or net income, the tax commission may include in the entire net income or alternative entire net income of the taxpayer the fair profits which, but for such agreement, arrangement or understanding, the taxpayer might have derived from such transaction. (*As added by L.* 1985, *Ch.* 298, *effective July* 11, 1985, *and applicable* (*as amended by L.* 1989, *Ch.* 553) *to taxable years beginning on or after January* 1, 1985, *but not applicable to corporations other than savings banks and savings and loan associations for taxable years beginning on or after January* 1, 1992.)

(*Sec.* 1462 *above is as last amended by L.* 1989, *Ch.* 61, *effective as noted above.*)

[¶ 98-101]

Sec. 1463. Payment of tax.—(a) To the extent the tax imposed by section fourteen hundred fifty-one of this article shall not have been previously paid pursuant to section fourteen hundred sixty-one,

(1) such tax, or the balance thereof, shall be payable to the tax commission in full at the time its return is required to be filed, and

(2) such tax, or the balance thereof, imposed on any taxpayer which ceased to exercise its franchise or to be subject to the tax imposed by this article shall be payable to the tax commission at the time the return is required to be filed, provided such tax of a domestic corporation which continues to possess its franchise shall be subject to adjustment as the circumstances may require; all other taxes of any such taxpayer, which pursuant to the foregoing provisions of this subsection would otherwise be payable subsequent to the time such return is required to be filed, shall nevertheless be payable at such time.

[¶ 98-102]

(b) If the taxpayer, within the time prescribed by subsection (c) of section fourteen hundred sixty-two, shall have applied for an automatic extension of time to file its annual return and shall have paid to the commissioner of taxation and finance on or before the date such application is filed an amount properly estimated as provided by said subsection the only amount payable in addition to the tax shall be interest at the underpayment rate set by the commissioner pursuant to section one thousand ninety-six of this chapter, or if no rate is set, at the rate of six per cent per annum upon the amount by which the tax, or portion thereof payable on or before the date the return was required to be filed, exceeds the amount so paid. For the purposes of the preceding sentence:

(1) an amount so paid shall be deemed properly estimated if it is either (i) not less than ninety per cent of the tax as finally determined, or (ii) not less than the tax shown on the taxpayer's return for the preceding taxable year, if such preceding year was a taxable year of twelve months; and

(2) the time when a return is required to be filed shall be determined without regard to any extension of time for filing such return. (*As amended by L.* 1974, *Ch.* 140; *L.* 1975, *Ch.* 895; *L.* 1985, *Ch.* 542; *L.* 1989, *Ch.* 61, *effective September* 1, 1989, *applicable to the interest chargeable or due on taxes or on any other amounts, or any portion thereof, for which interest rates are set.*)

[¶ 98-103]

(c) The tax commission may grant a reasonable extension of time for payment of any tax imposed by this article under such conditions as it deems just and proper.

(*Sec.* 1463 *is as last amended by L.* 1989, *Ch.* 61, *effective as noted above.*)

[¶ 98-104]

Sec. 1466. Deposit and disposition of revenue.—All taxes, interest and penalties collected or received by the tax commission under this article shall be deposited and disposed of pursuant to the provisions of section one hundred seventy-one-a of this chapter. (*Repealed and reenacted by L.* 1978, *Ch.* 69, *effective October* 1, 1978.)

[¶ 98-105]

Sec. 1467. Secrecy required of officials; penalty for violation.—(a) Except in accordance with the proper judicial order or as otherwise provided by law, it shall be unlawful for the tax commission, any tax commissioner, any officer or employee of the department of taxation and finance, or any person who, pursuant to this section, is permitted to inspect any return, or any person engaged or retained by

such department on an independent contract basis, or any person who in any manner may acquire knowledge of the contents of a return filed pursuant to this article, to divulge or make known in any manner the amount of income or any particulars set forth or disclosed in any return required under this article. The officers charged with the custody of such returns shall not be required to produce any of them or evidence of anything contained in them in any action or proceedings in any court, except on behalf of the state or the tax commission in an action or proceeding under the provisions of this chapter or in any other action or proceeding involving the collection of a tax due under this chapter to which the state or the tax commission is a party or a claimant or on behalf of any party in an action or proceeding under the provisions of this article when the returns or facts shown thereby are directly involved in such action or proceeding, in any of which events the court may require the production of and may admit in evidence so much of said returns or the facts shown thereby as are pertinent to the action or proceeding and no more. The tax commission may, nevertheless, publish a copy or a summary of any determination or decision rendered after the hearing provided for in section one thousand eighty-nine of this chapter. Nothing herein shall be construed to prohibit the delivery to a taxpayer or its duly authorized representative of a certified copy of any return filed in connection with its tax nor to prohibit the publication of statistics so classified as to prevent the identification of particular returns and the items thereof, or the inspection by the attorney-general or other legal representatives of the state of the return of any taxpayer which shall bring action to set aside or review the tax based thereon, or against which an action or proceeding under this chapter has been recommended by the commissioner of taxation and finance or the attorney-general or has been instituted; or the inspection of the returns of any taxpayer by the comptroller or duly designated officer or employee of the state department of audit and control for purposes of the audit of a refund of any tax paid by such taxpayer under this article. Returns shall be preserved for three years and thereafter until the tax commission orders them to be destroyed.

[¶ 98-106]

(b)(1) Any officer or employee of the state who willfully violates the provisions of subsection (a) of this section shall be dismissed from office and be incapable of holding any public office in this state for a period of five years thereafter.

(2) Cross-reference: For criminal penalties, see article thirty-seven of this chapter. (*As amended by L.* 1985, *Ch.* 65, *effective November* 1, 1985.)

[¶ 98-107]

(c) Notwithstanding any provisions of this section, the tax commission may permit the secretary of the treasury of the United States or his delegates, or the proper officer of any other state charged with tax administration, or the authorized representative of either such officer, to inspect the returns filed under this article, or may furnish to such officer or his authorized representative an abstract of any return or supply him with information concerning an item contained in any return, or disclosed by an investigation of tax liability under this article, but such permission shall be granted or such information furnished to such officer or his representative only if the laws of the United States or of such other state, as the case may be, grant substantially similar privileges to the commission or officer of this state charged with the administration of the tax imposed by this article and such information is to be used for tax purposes only; and provided further the commissioner of taxation and finance may furnish to the secretary of the treasury of the United States or his delegates such returns filed under this article and other tax information, as he may consider proper, for use in court actions or proceedings under the internal revenue code, whether civil or criminal, where a written request therefor has been made to the commissioner of taxation and finance by the secretary of the treasury or his delegates provided the laws of the United States grant substantially similar powers to the secretary of the treasury or his delegates. Where the commissioner of taxation and finance has so authorized use of returns or other information in such actions or proceedings, officers and employees of the department of taxation and finance may testify in such actions or proceedings in respect to such returns or other tax information.

[¶ 98-108]

(d) Notwithstanding the provisions of subsection (a) of this section, the tax commission may permit the officer charged with the administration of a tax on or measured by income imposed by any city of the state of New York, or the authorized representative of such officer, to inspect the returns filed under this article, or may furnish to such officer or his authorized representative an abstract of any such return or supply information concerning an item contained in any such return, or disclosed by any investigation of tax liability under this article, but such permission shall be granted or such information furnished to such officer or his representative only if the local laws of such city grant substantially similar privileges to the commission or officer of this state charged with the administration of the tax imposed by this article and such information is to be used for tax purposes only; and provided further the commissioner of taxation and finance may furnish to such city officer or his delegates and the legal representative of such city such returns filed under this article and other tax information, as he may consider proper, for use in court actions or proceedings under such local law, whether civil or criminal, where a written request therefor has been made to the commissioner of taxation and finance by such city officer or his delegates or by such legal representative of

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such city, provided the local law of such city grants substantially similar powers to the city officer charged with the administration of the city income tax or his delegates. Where the commissioner of taxation and finance has so authorized use of returns or other tax information in such actions or proceedings, officers and employees of the department of taxation and finance may testify in such actions or proceedings in respect to such returns or other tax information.

[¶ 98-109]

(e) Notwithstanding the provisions of subsection (a) of this section, the tax commission, in its discretion, may require or permit any or all persons liable for any tax imposed by this article, to make payments on account of estimated tax and payment of any tax, penalty or interest imposed by this article to banks, banking houses or trust companies designated by the tax commission and to file declarations of estimated tax, applications for automatic extensions of time to file returns, and returns with such banks, banking houses or trust companies as agents of the tax commission, in lieu of making any such payment directly to the tax commission. However, the tax commission shall designate only such banks, banking houses or trust companies as are or shall be designated by the comptroller as depositories pursuant to section fourteen hundred sixty-six.

(Sec. 1467 is as amended by L. 1985, Ch. 65, effective as noted above.)

[¶ 98-110]

Sec. 1468. Procedural provisions.—The provisions of article twenty-seven of this chapter shall apply to the provisions of this article in the same manner and with the same force and effect as if the language of such article twenty-seven had been incorporated in full into this article and had expressly referred to the tax under this article, except to the extent that any such provision is either inconsistent with a provision of this article or is not relevant to this article.

[¶ 98-111—98-131]

Reserved

[The next page is 13,761.]

EXHIBIT L: 7

Oregon Administrative Regulation 150-314.280

OREGON DEPARTMENT OF REVENUE

ADMINISTRATIVE RULE REVIEW

RULE NO.	
OAR 150– 314.280-(N)	
PAGE 1 of 16	DATE September 22, 1993 (A)
NOTICE OF INTENDED ACTION	
BULLETIN DATED	HEARING SCHEDULED

X NEW RULE — X PERMANENT RULE
___ AMENDED RULE — ___ TEMPORARY RULE
___ REPEALED RULE — ___ TEMPORARY RULE BEING GIVEN PERMANENT STATUS

PURPOSE: To adopt MTC's proposed apportionment and allocation provisions for financial organizations.

Modified Factors for Financial Organizations

150-314.280-(N)

(1) A financial organization having income from business activity which is taxable both within and without this state shall allocate and apportion its net income as provided in this rule. All items of nonbusiness income (income which is not includable in the apportionable tax base) shall be allocated pursuant to the provisions of ORS 314.610 through 314.645 and the rules thereunder. All business income (income which is includable in the apportionable income tax base) shall be apportioned to this state by multiplying such income by the apportionment percentage.

(2) The apportionment percentage is determined by adding the product of the taxpayer's receipts factor as described in section 4 of this rule multiplied by two, to the property factor as described in section 5 of this rule and the payroll factor as described in section 6 of this rule and dividing the sum by 4. If one of the factors is missing, the remaining factors are added and the sum is divided by three (divide by two if the missing factor is the receipts factor). A factor is missing if both its numerator and denominator are zero, but it is not missing merely because its numerator is zero.

(3) *Definitions.* As used in this rule, unless the context otherwise requires:

(a) *"Billing address"* means the location indicated in the books and records of the taxpayer as the address where any notice, statement and/or bill relating to a customer's account is mailed.

(b) *"Borrower or credit card holder located in this state"* shall mean (1) a borrower, other than a credit card holder, that is engaged in a trade or business which maintains its commercial domicile in this state; and (2) a borrower that is not engaged in a trade or business or a credit

card holder whose billing address is in this state.

(c) *"Commercial domicile"* means the headquarters of the trade or business, that is, the place from which the trade or business is principally managed and directed.

(d) *"Credit card"* means credit, travel or entertainment card.

(e) *"Credit card issuer's reimbursement fee"* means the receipt a taxpayer receives from a merchant's bank because one of the persons to whom the taxpayer has issued a credit card has charged merchandise or services provided by the merchant to the credit card.

(f) *"Financial organization"* is defined in ORS 314.610(4).

(g) *"Loan"* means any extension of credit resulting from direct negotiations between the taxpayer and its customer, and/or the purchase, in whole or in part, of such extension of credit from another. Loans include participations, syndications, and leases treated as loans for federal income tax purposes. Loans shall not include: loans representing property acquired in lieu of or pursuant to a foreclosure under section 595 of the Federal Internal Revenue Code; futures or forward contracts; options; notional principal contracts such as swaps; credit card receivables, including purchased credit card relationships; noninterest bearing balances due from other depository institutions; cash items in the process of collection; federal funds sold; securities purchased under agreements to resell; assets held in a trading account; securities; interests in a REMIC, or other mortgage-backed or asset-backed security; and other similar items.

(h) *"Merchant discount"* means the fee (or negotiated discount) charged to a merchant by the taxpayer for the privilege of participating in a program whereby a credit card is accepted in payment for merchandise or services sold to the card holder.

(i) *"Participation"* is an extension of credit in which an undivided ownership interest is

held on a *pro rata* basis in a single loan or pool of loans and related collateral. In a loan participation, the credit originator initially makes the loan and then subsequently resells all or a portion of it to other lenders. The participation may or may not be known to the borrower.

(j) *"Principal base of operations"* with respect to movable property means the place of more or less permanent nature from which movable property is regularly directed or controlled.

(k) *"Real property owned"* and *"tangible personal property owned"* means real and tangible personal property, respectively, (1) on which the taxpayer may claim depreciation for federal income tax purposes, or (2) property to which the taxpayer holds legal title and on which no other person may claim depreciation for federal income tax purposes (or could claim depreciation if subject to federal income tax). Real and tangible personal property include land, stocks in goods and real and tangible personal property rented to the taxpayer. Real and tangible personal property do not include coin, currency, or property acquired in lieu of or pursuant to a foreclosure.

(l) *"Regular place of business"* means an office at which the taxpayer carries on its business in a regular and systematic manner and which is continuously maintained, occupied and used by employees of the taxpayer.

(m) *"Syndication"* is an extension of credit in which two or more persons fund and each person is at risk only up to a specified percentage of the total extension of credit or up to a specified dollar amount.

(4) *Receipts Factor.*

(a) *In general.* The receipts factor is determined as provided in ORS 314.665.

(b) *Receipts from the lease of real property.* See OAR 150-314.665(3).

(c) *Receipts from the lease of tangible personal property.*

(A) Except as described in paragraph (B) of this subdivision, the numerator of the receipts factor includes receipts from the lease or rental of tangible personal property owned by the taxpayer if the property is located within this state when it is first placed in service by the lessee.

(B) Receipts from the lease or rental of movable tangible personal property owned by the taxpayer, such as aircraft, rolling stock, water vessels, or mobile equipment, are included in the numerator of the property factor to the extent that the property is used in this state. The extent an aircraft will be deemed to be used in this state is determined by multiplying the receipts from the lease or rental of the aircraft by a fraction, the numerator of which is the number of landings of the aircraft in this state and the denominator of which is the total number of landings of the aircraft. If the extent of the use of any movable tangible personal property within this state cannot be determined, then the property will be deemed to be used wholly in the state in which the property has its principal base of operations. A motor vehicle will be deemed to be used wholly in the state in which it is registered.

(d) *Interest from loans secured by real property.*

(A) The numerator of the receipts factor includes interest and fees or penalties in the nature of interest from loans secured by real property if the property is located within this state. If the property is located within this state and one or more other states, the receipts described in this subdivision are included in the numerator of the receipts factor if more than 50 percent of the fair market value of the real property is located within this state. If more than 50 percent of the fair market value of the real property is not located within any one state, then the receipts described in this subdivision shall be included in the numerator of the receipts factor if the borrower is located in this state.

(B) A loan is secured by real property if 50 percent or more of the principal amount of the loan is secured by real property at the time that the original loan agreement was made.

(C) The determination of whether the real property securing a loan is located within this state shall be made as of the time the original agreement was made and any and all subsequent substitutions of collateral shall be disregarded.

(e) *Interest from loans not secured by real property.* The numerator of the receipts factor includes interest and fees or penalties in the nature of interest from loans not secured by real property if the borrower is located in this state.

(f) *Net gains from the sale of loans.* The numerator of the receipts factor includes net gains from the sale of loans, including participations and syndications. Net gains from the sale of loans includes income recorded under the coupon stripping rules of section 1286 of the Internal Revenue Code.

(A) The amount of net gains (but not less than zero) from the sale of loans secured by real property included in the numerator is determined by multiplying such net gains by a fraction the numerator of which is the amount included in the numerator of the receipts factor pursuant to subdivision (d) of this section and the denominator of which is the total amount of interest and fees or penalties in the nature of interest from loans secured by real property.

(B) The amount of net gains (but not less than zero) from the sale of loans not secured by real property included in the numerator is determined by multiplying such net gains by a fraction the numerator of which is the amount included in the numerator of the receipts factor pursuant to subdivision (e) of this section and the denominator of which is the total amount of interest and fees or penalties in the nature of interest from loans not secured by real property.

(g) *Receipts from credit card receivables.* The numerator of the receipts factor includes interest and fees or penalties in the nature of interest from credit card receivables and receipts from fees charged to card holders, such as annual fees, if the billing address of the card holder is in this state.

(h) *Net gains from the sale of credit card receivables.* The numerator of the receipts factor includes all net gains (but not less than zero) from the sale of credit card receivables multiplied by a fraction, the numerator of which is the amount included in the numerator of the receipts factor pursuant to subdivision (g) of this section and the denominator of which is the taxpayer's total amount of interest and fees or penalties in the nature of interest from credit card receivables and fees charged to card holders.

(i) *Credit card issuer's reimbursement fees.* The numerator of the receipts factor includes all credit card issuer's reimbursement fees multiplied by a fraction, the numerator of which is the amount included in the numerator of the receipts factor pursuant to subdivision (g) of this section and the denominator of which is the taxpayer's total amount of interest and fees or penalties in the nature of interest from credit card receivables and fees charged to card-holders.

(j) *Receipts from merchant discount.* The numerator of the receipts factor includes receipts from merchant discount if the commercial domicile of the merchant is in this state. Such receipts shall be computed net of any card holder charge backs, but shall not be reduced by any interchange transaction fees or by any issuer's reimbursement fees paid to another for charges made by its card holders.

(k) *Loan servicing fees.*

(A) The numerator of the receipts factor includes loan servicing fees derived from loans

secured by real property multiplied by a fraction the numerator of which is the amount included in the numerator of the receipts factor pursuant to subdivision (d) of this section and the denominator of which is the total amount of interest and fees or penalties in the nature of interest from loans secured by real property.

(B) The numerator of the receipts factor includes loan servicing fees derived from loans not secured by real property multiplied by a fraction the numerator of which is the amount included in the numerator of the receipts factor pursuant to subdivision (e) of this section and the denominator of which is the total amount of interest and fees or penalties in the nature of interest from loans not secured by real property.

(l) *Receipts from services.* See OAR 150-314.665(3).

(m) *Receipts from investment assets and activities and trading assets and activities.*

(A) Interest, dividends, net gains and other income from investment assets and activities and from trading assets and activities shall be included in the receipts factor. Investment assets and activities and trading assets and activities include but are not limited to: investment securities; trading account assets; federal funds; securities purchased and sold under agreements to resell or repurchase; options; future contracts; forward contracts; notional principal contracts such as swaps; equities; and foreign currency transactions. With respect to the investment and trading assets and activities described in subparagraphs (i) and (ii) of this paragraph, the receipts factor shall include the amounts described in such subparagraphs.

(i) The receipts factor shall include the amount by which interest from federal funds sold and securities purchased under resale agreements exceeds interest expense on federal funds purchased and securities sold under repurchase agreements.

(ii) The receipts factor shall include the amount by which interest, net gains and other income from trading assets and activities, including but not limited to assets and activities in the matched book, in the arbitrage book, and foreign currency transactions, exceed net losses from such assets and activities.

(B) The numerator of the receipts factor includes interest, dividends, net gains and other income from investment assets and activities and from trading assets and activities described in paragraph (A) that are attributable to this state.

(i) The amount of interest, dividends, net gains and other income from investment assets and activities in the investment account to be attributed to this state and included in the numerator of the receipts factor is determined by multiplying all such income from such assets and activities by a fraction, the numerator of which is the average value of such assets which are properly booked for tax purposes at a regular place of business of the taxpayer within this state and the denominator of which is the average value of all such assets.

(ii) The amount of interest from federal funds sold and purchased and from securities purchased under resale agreements and securities sold under repurchase agreements attributable to this state and included in the numerator of the receipts factor is determined by multiplying the amount described in subparagraph (i) of paragraph (A) from such funds and such securities by a fraction, the numerator of which is the average value of federal funds sold and securities purchased under agreements to resell which are properly booked for tax purposes at a regular place of business of the taxpayer within this state and the denominator of which is the average value of all such funds and such securities.

(iii) The amount of interest, dividends, net gains and other income from trading assets and activities, including but not limited to assets and activities in the matched book, in the

arbitrage book and foreign currency transactions, but excluding federal funds sold and purchased, attributable to this state and included in the numerator of the receipts factor is determined by multiplying the amount described in subparagraph (ii) of paragraph (A) by a fraction, the numerator of which is the average value of such trading assets which are properly booked for tax purposes at a regular place of business of the taxpayer within this state and the denominator of which is the average value of all such assets.

(iv) For purposes of this paragraph, average value shall be determined using the rules for determining the average value of tangible personal property set forth in subdivisions (c) and (d) of paragraph (3).

(C) In lieu of using the method set forth in paragraph (B) of this subdivision, the taxpayer may elect, or the department may require in order to fairly represent the business activity of the taxpayer in this state, the use of the method set forth in this paragraph.

(i) The amount of interest, dividends, net gains and other income from investment assets and activities in the investment account to be attributed to this state and included in the numerator of the receipts factor is determined by multiplying all such income from such assets and activities by a fraction, the numerator of which is the gross income from such assets and activities which are properly booked for tax purposes at a regular place of business of the taxpayer within this state and the denominator of which is the gross income from all such assets and activities.

(ii) The amount of interest from federal funds sold and purchased and from securities purchased under resale agreements and securities sold under repurchase agreements attributable to this state and included in the numerator of the receipts factor is determined by multiplying the amount described in subparagraph (i) of paragraph (A) from such funds and

such securities by a fraction, the numerator of which is the gross income from such funds and such securities which are properly booked for tax purposes at a regular place of business of the taxpayer within this state and the denominator of which is the gross income from all such funds and such securities.

(iii) The amount of interest, dividends, net gains and other income from trading account assets and activities, including but not limited to assets and activities in the matched book, in the arbitrage book and foreign currency transactions, attributable to this state and included in the numerator is determined by multiplying the amount described in subparagraph (ii) of paragraph (A) by a fraction, the numerator of which is the gross income from such trading assets and activities which are properly booked for tax purposes at a regular place of business of the taxpayer within this state and the denominator of which is the gross income from all such assets and activities.

(D) If the taxpayer elects or is required by the department to use the method set forth in paragraph (C) of this subdivision, it shall use this method on all subsequent returns unless the taxpayer receives prior written permission from the department, or the department requires, the use of a different method.

(E) The taxpayer shall have the burden of proving that an investment asset or activity or trading asset or activity was properly booked for tax purposes at a regular place of business outside of this state by demonstrating that the day-to-day decisions regarding the asset or activity occurred at a regular place of business outside the state. Where the day-to-day decisions regarding an investment asset or activity or trading asset or activity occur at more than one regular place of business and one such regular place of business is in this state and one such regular place of business is outside this state, such asset or activity shall be

considered to be located at the regular place of business of the taxpayer where the investment or trading policies or guidelines with respect to the asset or activity are established. Unless the taxpayer demonstrates to the contrary, such policies and guidelines shall be presumed to be established:

(i) in the case of a taxpayer organized under the laws of the United States or of any state, at the commercial domicile of the taxpayer; or

(ii) in the case of a taxpayer organized under the laws of a foreign county, in the state which the taxpayer has declared to be its home state pursuant to the provisions of the International Banking Act of 1978. If a taxpayer described in this clause has not made such a declaration or is not required to make such a declaration, the asset or activity shall be presumed to be located at the taxpayer's place of business in the United States to which the greatest number of employees are regularly connected or out of which they are working, irrespective of where the services of such employee are performed, as of the last day of the taxable year.

(n) *All other receipts.* The numerator of the receipts factor includes all other receipts pursuant to the rules set forth under ORS 314.665.

(o) *Attribution of certain receipts to commercial domicile.* All receipts which would be assigned under this section to a state in which the taxpayer is not taxable shall be included in the numerator of the receipts factor, if the taxpayer's commercial domicile is in this state.

(5) *Property Factor.*

(a) *In general.* The property factor is a fraction, the numerator of which is the average value of the taxpayer's real property, tangible personal property, loans and credit card receivables located and used within this state during the taxable year and the denominator of

which is the average value of all such property located and used both within and without this state during the taxable year.

(b) *Value of property owned by the taxpayer.*

(A) The value of real property and tangible personal property owned by the taxpayer is the original cost or other basis of such property for federal income tax purposes without regard to depletion, depreciation or amortization.

(B) Loans are valued at their outstanding principal balance, without regard to any reserve for bad debts. If a loan is charged-off in whole or in part for federal income tax purposes, the portion of the loan charged off is not outstanding. A specifically allocated reserve established pursuant to regulatory or financial accounting guidelines which is treated as charged-off for federal income tax purposes shall be treated as charged-off for purposes of this section.

(C) Credit card receivables are valued at their outstanding principal balance, without regard to any reserve for bad debts. If a credit card receivable is charged-off in whole or in part for federal income tax purposes, the portion of the receivable charged-off is not outstanding.

(c) *Average value of property owned by the taxpayer.* See OAR 150-314.655(2)-(A) and 150-314.655(3).

(d) *Average value of real property and tangible personal property rented to the taxpayer.* See OAR 150-314.655(2)-(B).

(e) *Location of real property and tangible personal property owned by or rented to the taxpayer.*

(A) Except as described in paragraph (B) of this subdivision, real property and tangible personal property owned by or rented to the taxpayer is considered to be located within this state if it is physically located, situated or used within this state.

(B) Movable tangible property, such as aircraft, rolling stock, water vessels, or mobile equipment, are included in the numerator of the property factor to the extent that the property is used in this state. The extent an aircraft will be deemed to be used in this state and the amount of value that is to be included in the numerator of this state's property factor is determined by multiplying the average value of the aircraft by a fraction, the numerator of which is the number of landings of the aircraft in this state and the denominator of which is the total number of landings of the aircraft everywhere. If the extent of the use of any movable tangible property within this state cannot be determined, then the property will be deemed to be used wholly in the state in which the property has its principal base of operations. A motor vehicle will be deemed to be used wholly in the state in which it is registered.

(f) *Location of loans.*

(A) A loan is considered to be located within this state if:

(i) it is properly booked for tax purposes at a regular place of business of the taxpayer within this state; or

(ii) in the case of a taxpayer organized under the laws of the United States or of any state, the loan is properly booked for tax purposes at a place which is not a regular place of business of the taxpayer and such taxpayer's commercial domicile is within this state; or

(iii) in the case of a taxpayer organized under the laws of a foreign county, the loan is properly booked for tax purposes at a place which is not a regular place of business of the taxpayer and such taxpayer has declared this state to be its home state pursuant to the provisions of the International Banking Act of 1978. If a taxpayer described in this clause has not made such a declaration or is not required to make such a declaration, the loan shall be

presumed to be located at the place in the United States to which the greatest number of employees are regularly connected or out of which they are working, irrespective of where the services of such employee are performed, as of the last day of the calendar year.

(B) The state in which a loan has a preponderance of substantive contact with a regular place of business of the taxpayer shall be the state in which a loan is properly booked.

(C) In order to determine the state in which loans or credit card receivables are properly booked under the "preponderance of substantive contact" test for the purpose of locating said property under (3)(f)(B), consideration is to be given to such things as: solicitation, investigation, negotiation, approval and administration. The terms "solicitation," "investigation," "negotiation," "approval" and "administration" are defined as follows.

(i) *Solicitation*. Solicitation is either active or passive. Active solicitation occurs when an employee of the taxpayer initiates the contact with the customer. Such activity is located at the regular place of business which the taxpayer's employee is regularly connected with or working out of, regardless of where the services of such employee were actually performed. Passive solicitation occurs when the customer initiates the contact with the taxpayer. If the customer's initial contact was not at a regular place of business of the taxpayer, the regular place of business, if any, where the passive solicitation occurred is determined by the facts in each case.

(ii) *Investigation*. Investigation is the procedure whereby employees of the taxpayer determine the credit-worthiness of the customer as well as the degree of risk involved in making a particular agreement. Such activity is located at the regular place of business which the taxpayer's employees are regularly connected with or working out of, regardless of where the services of such employees were actually performed.

(iii) *Negotiation*. Negotiation is the procedure whereby employees of the taxpayer and its customer determine the terms of the agreement (e.g., the amount, duration, interest rate, frequency of repayment, currency denomination and security required). Such activity is located at the regular place of business which the taxpayer's employees are regularly connected with or working out of, regardless of where the services of such employees were actually performed.

(iv) *Approval*. Approval is the procedure whereby employees or the board of directors of the taxpayer make the final determination whether to enter into the agreement. Such activity is located at the regular place of business which the taxpayer's employees are regularly connected with or working out of, regardless of where the services of such employees were actually performed. If the board of directors makes the final determination, such activity is located at the commercial domicile of the taxpayer.

(v) *Administration*. Administration is the process of managing the account. This process includes bookkeeping, collecting the payments, corresponding with the customer, reporting to management regarding the status of the agreement and proceeding against the borrower or the security interest if the borrower is in default. Such activity is located at the regular place of business which oversees this activity.

(D) In applying the standards for determining the state to which a loan is to be located, a preponderance of substantive contact shall be presumed, subject to rebuttal, to exist at a taxpayer's regular place of business to which it has been booked, if the loan is approved and administered there.

(g) *Location of credit card receivables*. For purposes of determining the location of credit card receivables, credit card receivables shall be treated as loans and shall be subject to the

provisions of subdivision (g) of this section.

(6) *Payroll factor.*

In general. The payroll factor is determined as provided in ORS 314.660 and the rules thereunder.

Hist: Filed _____ and Eff. 12/31/93

EXHIBIT L: 8

Letter from James H. Paige III
(West Virginia Department of Tax and Revenue)
regarding Senate Bill 632

COPY

STATE OF WEST VIRGINIA
DEPARTMENT OF TAX AND REVENUE
Charleston 25305

GASTON CAPERTON
GOVERNOR

JAMES H. PAIGE III
SECRETARY

January 15, 1992

Sharon G. Bias
Acting Commissioner
Division of Banking
Building 3, Room 311
Charleston, WV 25305

Re: Questions And Answers On Taxation Of Out-Of-State Financial Organizations Pursuant To Senate Bill 632
Legal Log 91-311

Dear Sharon,

This letter is in response to your letter of November 21, 1991 requesting answers to nine questions pertaining to how out-of-state financial organizations would be taxed under the business franchise tax and corporation net income tax subsequent to enactment of Senate Bill 632 (1991).

Those questions and our responses to each question are as follows.

QUESTION 1:

> Explain when nexus would be created under this new tax law. Specifically, is nexus created if loans are outstanding each year at a certain amount or must a financial institution make NEW loans in a certain amount each year to be required to apportion their income to West Virginia?

RESPONSE TO QUESTION 1:

Senate Bill 632 (1991) requires out-of-state financial organizations with business activities within this State to apportion their capital and their business income using a single apportionment factor (gross receipts) rather than the three factor apportionment formula generally used for business franchise tax and corporation net income tax purposes. Nexus would exist when the financial organization has sufficient minimum contacts with West Virginia for the imposition of our taxing jurisdiction. Nexus is

a nebulous concept in constitutional law which is difficult to apply with any degree of certainty, and is thus ultimately determined on a case-by-case basis.

Senate Bill 632 legislatively establishes a bright line nexus rule for financial organizations and the Department of Tax and Revenue to follow, by creating a quantified nexus presumption. According to Senate Bill 632, a financial organization whose commercial domicile is out of state must apportion income and capital if it regularly engages in business in this State. The nexus presumption provides that a financial organization is considered to be regularly engaging in business in this State if, during any year, (1) it obtains or solicits business with 20 or more persons within this State, or (2) if the sum of its gross receipts attributable to sources in this State equals or exceeds $100,000.

The second part of the question is whether a financial organization must make new loans in a certain amount each year in order to be required to apportion its income to West Virginia. Our position is that new loans are not required each year, as long as business is maintained with 20 or more persons in this State or the amount of gross receipts from existing West Virginia loans is $100,000 or more during that tax year. Even if the gross receipts from existing loans drops below $100,000, if the gross receipts from new loans and old loans together is $100,000 or more, then apportionment is still required. It should be kept in mind that the nexus presumption contains an "either/or" type of test for nexus to be presumed; namely, the financial organization would be required to file if it meets either the $100,000 gross receipts test or the 20 person test.

QUESTION 2:

> Would nexus be created if a New York bank loaned an Ohio corporation money to build a plant in West Virginia?

RESPONSE TO QUESTION 2:

There would be no nexus for West Virginia to impose corporation net income tax or business franchise tax on a New York bank making a loan to an Ohio corporation, even though the money may be spent building a plant in West Virginia, because there would be insufficient minimum contacts between the New York bank and West Virginia for this State to constitutionally impose its jurisdiction to tax. Neither of the tests contained in the nexus presumption would be met in such a scenario, since the loan to an Ohio corporation would not constitute soliciting or obtaining a loan in West Virginia, and the gross receipts from the loan would be from the situs of the loan, which is in Ohio rather than West Virginia. The fact that the Ohio corporation uses the proceeds of the loan in West Virginia would not vicariously confer nexus on the New York

bank, but the Ohio corporation would be subject to this State's taxing powers when it begins building the plant in this State.

QUESTION 3:

> Is there really a "double tax" on out of state financial institutions who will now be required to pay tax in West Virginia under this new law, or will most states give their own domiciled banks "credit" for taxes which will now have to be paid in West Virginia?

RESPONSE TO QUESTION 3:

Whether or not a double tax would exist would depend on the facts of each situation, in particular the taxing scheme of the other states. To some extent, multiple taxation is constitutionally permissible as long as the apportionment formulas used are reasonable. West Virginia uses a single factor apportionment formula based on gross receipts. The United States Supreme Court has upheld the constitutionality of single factor apportionment formulas, so it seems reasonable to assume West Virginia's gross receipts apportionment formula would withstand judicial scrutiny.

The relevant inquiry if impermissible multiple taxation occurs is whether the impermissibility arises from this State's tax or elsewhere. West Virginia cannot be held accountable for, and should not be unduly concerned with, any unconstitutional multiple taxation which may occur as a result of another state's tax laws and practices. If a bank domiciled in another state does sufficient business in West Virginia to subject it to this state's tax on financial organizations, it is required to apportion the percentage of its gross receipts attributable to this State. The fairness of this approach seems almost self evident. If the state where the bank is domiciled taxes all of the bank's income, without apportioning, granting a credit or in some other way excluding from its tax that which is attributable to another state, then it is that other state's tax laws which may be constitutionally suspect. West Virginia tax laws do provide such a credit for banks with their commercial domicile in this State.

QUESTION 4:

> If West Virginia state, county and municipal bonds are purchased by out-of-state financial institutions, is that considered "lending" in West Virginia and therefore taxable under this new law?

RESPONSE TO QUESTION 4:

The term "lending" is not defined (or used) in Senate Bill 632, so the term should be given its common and ordinary meaning.

While the state, county and municipality may be said to be "borrowing" money when they issue bonds, the purchasers of such bonds are not lending the state the money. Bonds are investment securities, not loans; correspondingly, purchasing bonds is the investing, not the lending, of money. Thus, the purchase of West Virginia state, county or municipal bonds would not itself subject an out-of-state financial organization to West Virginia's business franchise tax and corporation net income tax laws. Even if the out-of-state financial organization is otherwise subject to West Virginia's business franchise tax and corporation net income tax laws, these types of bonds and the interest therefrom are generally exempt from those taxes.

QUESTION 5:

> If an out-of-state bank sells federal funds (excess bank reserves) to a West Virginia bank, is that sale of funds taxable under this new law as a loan?

RESPONSE TO QUESTION 5:

Under Senate Bill 632, any out-of-state bank will be presumed to have tax nexus during the year if it obtains or solicits business with twenty or more persons (including banks) within West Virginia, or if the sum of the value of its gross receipts attributable to sources (such as bank loans) in West Virginia is $100,000 or more. Among the ways in which an out-of-state bank could meet this nexus presumption during a twelve month period would be for it to lend its excess reserves to twenty or more West Virginia banks, or to make such loans with interest totalling $100,000 or more. While such transactions may confer nexus to tax, however, the special gross receipts factor used to apportion income to this state does not include gross receipts from loans of excess bank reserves. Thus, in effect, such receipts would be untaxed. For example, if the only gross receipts attributable to West Virginia were from interest on loans of excess bank reserves, the gross receipts factor would be zero, so the corporation net income tax owed to this State would also be zero.

QUESTION 6:

> Will it be possible for the Division of Banking to enter into a confidential information sharing agreement with the Department of Tax and Revenue to obtain the names of out-of-state lenders who register under this new tax requirement and/or the details of tax filings by these institutions?

QUESTION 7:

> If the answer to question 6 above is NO, what types of information will the Division of

Banking be able to obtain from the Department of Tax and Revenue regarding the filing of Business Activities Reports and payment of taxes by out-of-state financial institutions under this new apportionment requirement?

RESPONSE TO QUESTIONS 6 AND 7:

Senate Bill 632 contains no provisions regarding confidentiality, so the general confidentiality rules would apply. The general rule of confidentiality, W. Va. Code § 11-10-5d prohibits divulging any tax information, except as expressly authorized by statute. One such exception is contained in W. Va. Code § 11-10-5d(1)(1)(A), which authorizes the Tax Commissioner to disclose the names and addresses of persons who have a current business registration certificate, if he believes that enforcement of the tax laws will be enhanced by the disclosure. If the names and addresses were provided for the purpose of tax enforcement, such information could obviously be disclosed. But even if the primary purpose were not tax enforcement, such information could be disclosed if it would be likely to enhance tax enforcement.

At the present time, any details of tax filings by financial organizations other than names and addresses could not be accomplished by entering into a reciprocal agreement. West Virginia Code § 11-10-5s permits the Tax Commissioner to enter into exchange of information agreements with the Commissioners of labor, employment security and workers' compensation, and with other agencies pursuant to legislative rules, for the purpose of facilitating premium collection, tax collection and licensure requirements of those agencies. This provision would permit disclosure of tax return information to the Banking Division if the Tax Commissioner were to promulgate legislative rules to that effect, once those rules became effective. Even without an exchange of information agreement, available statistical information could be provided, as long as specific taxpayers cannot be identified from the information. Of course, authority for disclosure of tax return information to the Division of Banking could be obtained through legislation.

QUESTION 8:

What types of internal or external information gathering is planned by the Department of Tax and Revenue to monitor the taxes paid under this new apportionment law and what types of information will be made public?

RESPONSE TO QUESTION 8:

The Department of Tax and Revenue intends to monitor financial organizations to ensure they are complying with Senate Bill 632 and

are paying appropriate taxes. Only information which is not confidential will be released to the public.

QUESTION 9:

When were the first tax payments due to the Department of Tax and Revenue under this new apportionment rule?

ANSWER TO QUESTION 9:

Senate Bill 632 requires out-of-state financial organizations to apportion using the single gross receipts factor for tax years beginning on or after January 1, 1991. The first installment of estimated tax would normally have been due on the fifteenth day of the fourth month of the taxable year, which for most taxpayers would have been April 15, 1991. However, the new law was not signed into law until April 3, 1991. In order to provide new taxpayers a reasonable amount of time to comply with the new law, they were granted an extension of time to July 15, 1991 in which to file their declarations of estimated tax and to pay the first two installments of estimated tax. The first annual return and tax for taxable year 1991 will be due not later than the fifteenth day of the third month following the close of the taxable year, which for most taxpayers would be March 15, 1992.

I trust this information will be of assistance.

Very truly yours,

James M. Paige, III
Secretary, Tax and Revenue

LD:kl/ts

pc: Alan L. Mierke
Assistant Secretary/Acting Tax Commissioner

(v) Money or its equivalent held as a credit balance by a financial organization on behalf of its customer if such entity is engaged in soliciting and holding such balances in the regular course of its business.

(B) "Sales" means:

For purposes of apportionment, the "sales" of a financial organization shall mean the gross receipts described in the gross receipts factor in this subsection, regardless of their source.

(3) *Commercial domicile — Apportionment or credit.* — Financial organizations which do not have their commercial domicile in West Virginia shall use the apportionment rules set forth in this section. Financial organizations with their commercial domicile in West Virginia may not apportion their tax base, but shall allocate all capital to West Virginia without apportionment: Provided, That any financial organizations with their commercial domicile in West Virginia shall be allowed the credit against their business franchise tax liability as described in section twenty-seven [§ 11-23-27] of this article.

(4) *Apportionment rules.* — (A) *General method.* — If a financial organization not having its commercial domicile in this state is engaging in business both within and without this state, the portion of its capital attributable to such business, which is derived from sources within this state, shall be determined by apportionment in accordance with this subsection. The apportioned capital shall be determined by multiplying capital by the special gross receipts factor as defined in this subsection. Neither the numerator nor the denominator of the gross receipts factor shall include receipts from obligations described in paragraphs (A), (B), (C) and (D), subdivision (1), subsection (f), section six [§ 11-24-6(f)(1)(A) to (f)(1)(D)], article twenty-four of this chapter.

(B) *Special gross receipts factor.* — The gross receipts factor is a fraction, the numerator of which is the total gross receipts of the taxpayer from sources within this state during the taxable year and the denominator of which is the total gross receipts of the taxpayer wherever earned during the taxable year.

Numerator. — The numerator of the gross receipts factor shall include, in addition to items otherwise includable in the sales factor under section five of this article, the following:

(i) Gross receipts from the lease or rental of real or tangible personal property (whether as the economic equivalent of an extension of credit or otherwise) if the property is located in this state;

(ii) Interest income and other receipts from assets in the nature of loans which are secured primarily by real estate or tangible personal property if such security property is located in this state. In the event that such security property is also located in one or more other states, such receipts shall be presumed to be from sources within this state, subject to rebuttal based upon factors described in rules to be promulgated by the tax commissioner, including the factor that the proceeds of any such loans were applied and used by the borrower entirely outside of this state;

(iii) Interest income and other receipts from consumer loans which are unsecured or are secured by intangible property that are made to residents of this state, whether at a place of business, by traveling loan officer, by mail, by telephone or other electronic means or otherwise;

(iv) Interest income and other receipts from commercial loans and installment obligations which are unsecured or are secured by intangible property if and to the extent that the borrower or debtor is a resident of or is domiciled in this state: Provided, That such receipts are presumed to be from sources in this state and such presumption may be overcome by reference to factors described in rules to be promulgated by the tax commissioner, including the factor that the proceeds of any such loans were applied and used by the borrower entirely outside of this state;

No rules

(v) Interest income and other receipts from a financial organization's syndication and participation loans, under the rules set forth in items (i) through (iv) above;

(vi) Interest income and other receipts, including service charges, from financial institution credit card and travel and entertainment credit card receivables and credit card holders' fees if the borrower or debtor is a resident of this state or if the billings for any such receipts are regularly sent to an address in this state;

(vii) Merchant discount income derived from financial institution credit card holder transactions with a merchant located in this state. In the case of merchants located within and without this state, only receipts from merchant discounts attributable to sales made from locations within this state shall be attributed to this state. It shall be presumed, subject to rebuttal, that the location of a merchant is the address shown on the invoice submitted by the merchant to the taxpayer;

(viii) Gross receipts from the performance of services which are attributed to this state if:

(I) The service receipts are loan-related fees, including loan servicing fees, and the borrower resides in this state; except that, at the taxpayer's election, receipts from loan-related fees which are either: (a) "Pooled" or aggregated for collective financial accounting treatment; or (b) manually written as non-recurring extraordinary charges to be processed directly to the general ledger may either be attributed to a state based upon the borrowers' residences or upon the ratio that total interest sourced to that state bears to total interest from all sources;

(II) The service receipts are deposit-related fees and the depositor resides in this state, except that, at the taxpayer's election, receipts from deposit-related fees which are either: (a) "Pooled" or aggregated for collective financial accounting treatment; or (b) manually written as nonrecurring extraordinary charges to be processed directly to the general ledger may either be attributed to a state based upon the depositors' residences or upon the ratio that total deposits sourced to that state bears to total deposits from all sources;

(III) The service receipt is a brokerage fee and the account holder is a resident of this state;

(IV) The service receipts are fees related to estate or trust services and the estate's decedent was a resident of this state immediately before death; or the grantor who either funded or established the trust is a resident of this state; or

(V) The service receipt is associated with the performance of any other service not identified above and the service is performed for an individual

EXHIBIT M: 1

News Articles

EXHIBIT M

MISCELLANEOUS

Dan/Paul/Alan/Mary Jane

New York Times
9/9/90

Technology

The Internationalization Of the Cash Machine

By EDMUND L. ANDREWS

AMERICAN EXPRESS traveler's checks? Just leave home without them. In a development that could render traveler's checks obsolete and spell doom for street-corner money changers, automated teller machines are rapidly going global. Already, for example, a tourist from Buffalo can walk up to at least a few automated tellers in Tokyo and withdraw cash, in yen, from his or her bank back home. The Tokyo teller checks with the home bank some 10,000 miles away, obtains approval for the withdrawal and prints out a receipt indicating the customer's new balance, in dollars. Back in Buffalo, the home bank instantly logs the time, place and nature of the transaction. Customers can also make deposits from abroad, and move money between checking and savings accounts. Transaction time: about 10 seconds.

"It's a long leap from the days of money belts and letters of credit," said Roger Pierce, executive vice president of Visa International Inc., which operates a network for credit card and bank card transactions.

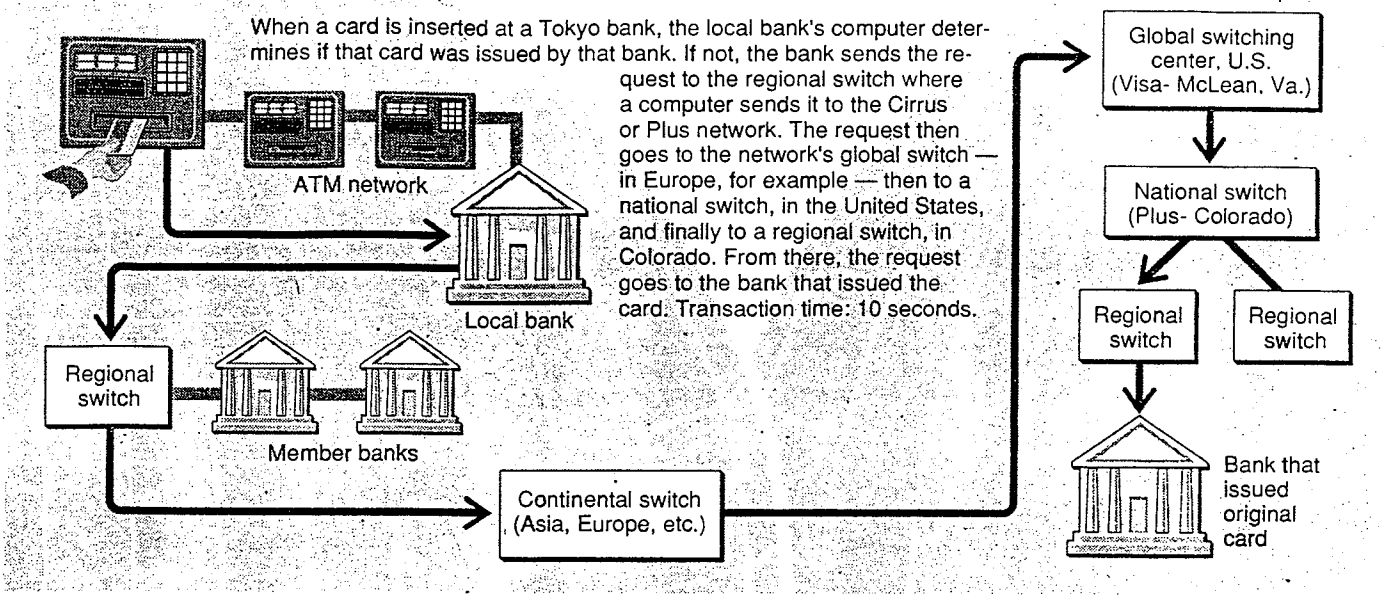
The globalization of automated teller machines, or ATM's, represents the newest expansion of the ever-widening networks that have evolved within the United States in recent years. In essence, this new activity is accomplished through scores of separate switching networks — each one owned by a different bank or cluster of banks — that operate both on their own and together as the need dictates. The upshot is that routine bank transactions can increasingly be executed from around the world about as quickly as if they were around the corner.

The networks also raise the specter of security breaches, however, because money is traveling through ever greater numbers of computerized hands. Bank officials discount these dangers, but there have already been cases of ATM fraud in which bank employees or other insiders have gained entry into classified data bases containing account information. "As with any computer system, it's relatively easy to gain entry from the position of an insider, and if it's easy for an insider it is also often possible for an outsider," said Peter Neumann, a computer scientist with SRI International Inc., a research firm in Menlo Park, Calif.

Nevertheless, ATM managers are worried enough to be investing in additional security. Increasingly, for example, telemachines are encrypting data at the outset of a transaction.

(over)

How the Emerging Global ATM Network Works



Al Granberg/The New York Times

ATM's made their debut in the early 1970's as 24-hour computerized cash dispensers at individual banks. About 10 years ago, banks began forming regional teller networks, such as New York Cash Exchange, commonly known as NYCE, and the MOST system around Washington. These networks are owned jointly by the participating financial institutions. Since the mid-80's, most of these regional networks have in turn become affiliated with one of two national networks — the Cirrus system, owned by Mastercard International Inc., and Plus Systems Inc., about a third owned by Visa.

Now, both Plus and Cirrus are racing to recruit foreign banks into ATM networks that piggyback on the global switching systems operated by Visa and Mastercard. "As the domestic market has matured, most ATM cards can now be used at tellers anywhere in the country," said Steven Van Fleet, senior vice president for operations for the Cirrus system. "The next challenge is for us to go through the same process with the rest of the world."

Cirrus currently has links to ATM's in seven countries and hopes to expand to 22 nations by year end. Plus Systems, based in Boulder, Colo., reaches tellers in 12 countries and is expanding rapidly as well.

A few large individual banks are building their own global ATM networks. Earlier this year, the Hong Kong and Shanghai Banking Corporation, which owns 15 percent of Britain's Midland Bank and all of Buffalo-based Marine Midland Bank, inaugurated a satellite network to link some 3,000 telemachines in Asia, the United Kingdom, the Middle East and the United States.

Similarly, Citicorp is now trying to connect ATM's in its 1,600 Citibank branches worldwide by both satellite and transoceanic fiber-optic telephone lines.

Citibank officials say their ultimate goal is to link the full gamut of retail bank services into an on-line network. Customers from Long Island would be able to qualify for car loans, pay credit card bills and transfer money from a branch in Hong Kong.

Banks are expanding the networks that are so popular in the U.S.

The rise of these networks should make international travel much simpler. Travelers will not have to carry nearly as much cash or cash equivalents, like travelers' checks. And, although credit cards can already be used to obtain cash in many far-flung parts of the world, credit card companies charge fees for cash withdrawals as well as interest from the moment a transaction takes place.

International ATM machines allow people to remove money without incurring interest charges. They also make it easier to avoid nonbank money-changers who charge as much as 8 percent to convert currency. Banks buy and sell currencies at wholesale rates, and thus convert money at rates far cheaper than those charged by hotels and other money-changers. The ATM's which are spreading into airports, hotels and other locations, charge customers about 1 percent conversion fee, in addition to the 50 cent-to-$2 transaction fee for using a remote teller.

A global automated teller network works like a computerized constellation of switches. Each bank serves as a single switch, which links into larger regional and international constellations as the need rises. The challenge is to route local and global transactions in the way that is most suitable for each.

Here is what happens, for example, when a traveler from Chicago withdraws $100 from a bank teller in Paris. After the customer inserts the card, punches a personal identification number and enters the withdrawal request, the bank's computer program compares the numbers on the card with its own files. The computer cannot tell where the card originated, but it does recognize it as a Plus card and routes the inquiry to European payment systems services, or EPPS, a switching center organized by banks throughout Europe.

THE European network recognizes that the card did not originate in Europe and sends the data to Visa in London, which sends it to a switching center in McLean, Va. From there the withdrawal request goes to Plus's switching center in Colorado, which determines that the card came from a regional network in Chicago. The regional banking network then routes the inquiry to the originating bank, which evaluates the request and sends a response back through the network.

In transactions in which the cardholder and the issuing bank are closer together — both in Europe, for example — the communication process is confined to the smallest possible switching network.

As global credit traffic increases, this infrastructure is becoming more elaborate. Visa, which already maintains global switching centers in McLean, San Mateo, Calif., and London, is building a new regional center in Yokohama, Japan. American banks, particularly those with branches in rural areas, are bypassing local telephone companies by erecting satellite dishes at individual branches to link ATM networks.

That could set the stage for tackling a challenge even more daunting than linking ATM's in New York and Tokyo: connecting small-town machines between places like Steubenville, Ohio and Benares, India. ■

Visa Expands Global Presence

San Mateo company strikes key deals in Eastern Europe, China

Chronicle Wire Services

Visa International, building on its base as the world's largest credit-card company, yesterday announced a new push into Eastern Europe and a link-up with the largest retail bank in China.

Visa, based in San Mateo, said that a Prague bank has issued the first internationally accepted Visa cards to Czechoslovakian citizens.

The company also said three Polish banks will issue internationally accepted Visa cards by next June.

"The benefits of carrying a Visa card are significant for Eastern European citizens. Procedures which, in the West, we take for granted, such as checking into hotels, booking airlines ... are cumbersome and time-consuming for them," said Visa Chairman Charles Russell.

Zivnostenska Banka of Prague has issued credit cards to customers with convertible foreign currency deposits. The balance will be due each month.

Next year, cardholders will be able to use the cards to make payments in koruna inside the country.

Also yesterday, Visa said the Industrial and Commercial Bank of China has introduced a domestic Visa card for its account holders.

The bank plans to issue more than 100,000 cards within the first year. There are now 3,000 places accepting Visa in China, and more are expected by the end of the year, Visa said.

With a customer base representing 46 percent of China's 1.18 billion population, the Industrial and Commercial Bank is the largest national banking network in the world. It has 30,000 branches and more than 480,000 employees.

Visa entered the Chinese market in 1987. Four other banks in China offer Visa cards, including the Bank of China.

"We think these added places will be more the kind of places where the Chinese people will shop," Visa spokesman Christoph Abt said.

Since entering the Chinese market, Visa has established the first and only computerized transaction processing network for credit-card authorization in the country.

The Industrial and Commercial Bank of China is the second bank to begin issuing Visa cards, after the Bank of China, which started to issue cards in 1988 and now has more than 20,000 cards in circulation.

Together with the Industrial and Commercial Bank of China, Visa members now include five of the six banks in China.

See the future by studying banks today

ON EXCELLENCE
By Tom Peters

ARE YOU in the steel business? Hotels? Anxious about what happens when information technology reaches its wild and woolly potential? Study the banking industry and read the just-published "Technology in Banking," by McKinsey & Co. consultants Tom Steiner and Diogo Teixeira.

Banking used to be a cozy, regulated game. Banks were all things to all people; profits were pretty much assured. Then in the early 1980s came deregulation. Next, new technologies. With computer power growing between 25 and 40 percent a year, the systems side of the banking business is reshaping the industry.

"Banking products," the authors note, "are simply information combined in new ways, so with hundredfold increases in the amount of information available, it is not surprising that there are a lot of new products." This product flood transformed bank balance sheets: Service fees, or "non-interest income" (income not generated by loans), soared in the '80s, especially at big banks that created products to maximize information-processing economies of scale. Non-interest income at Bankers Trust ($56 billion in assets), for instance, shot from 32 to 64 percent of total income between 1980 and 1988.

Deregulation and the new technologies also caused specialization and disaggregation on a grand scale. Banking's traditional "make-make-make approach," as Steiner and Teixeira call it, is now history. Consider Manufacturers Hanover Corp.'s credit card business: In 1987 it was fifth biggest in the country, with 3.4 million accounts and a $2.5 billion asset portfolio; MHC also processed $2.5 billion yearly in credit-card sales drafts for merchants. Then MHC sold its merchant-support business to Fort Lauderdale's NaBanco, a specialized data-processing company. Next it peddled credit-card processing operations to another non-bank specialist, First Data Resources. Finally MHC "securitized" (turned assets into tradable commercial instruments) and sold $475 million of its credit card receivables. "The result," the authors write, "has been to create credit card transactions that are captured by others, routed to MHC via others, processed by others, and the balances of which may ultimately belong to others. MHC retains the customer servicing, collection responsibility, and authority over all credit decisions."

Banks today aim at narrow markets where they can be truly distinct. Take First Wachovia of Winston-Salem, N.C., which has become the country's second-largest processor of student loans. "Student lending is extremely complex," Steiner and Teixeira observe, "because each state has different rules for each type of student. A medical education loan is different from a liberal arts education loan, which is different from a truck driving school loan. ... First Wachovia has developed proprietary software to track student loans and deliver the required servicing." First Wachovia generates $5 million profit on approximately $23 million in annual revenue from this speciality.

The authors offer many other examples of effectively "focused" (their favorite word) strategies. State Street Boston Corp. is no longer really a bank, but a data processing company ("a computerized record-keeping and accounting business"); the $7 billion (assets) institution dumped 90 percent of its branches and aimed instead to become a force in the "custodial" business, performing intricate record-keeping for the securities industry. State Street now handles 10 percent of the world's securities transactions.

The value of specializing/focusing is staggering: The stock market value of non-bank American Express's Green Card alone exceeds the combined stock market value of huge Chemical Bank, Chase Manhattan and Manufacturers Hanover. In fact, the rise of non-banks is as dramatic as the dismemberment of the banks themselves. The authors project a thoroughly specialized financial services environment. Smaller banks will be mainly "retailers" serving the local customer directly; big banks will become "manufacturers and wholesalers;" and non-banks will be the "production subcontractors."

Information technology systems offer "the most leverage to dominate (one of the roughly 150) lines of (banking) business," Steiner and Teixeira contend. Competition in the industry now centers on individual products (for example, student loan processing services), rather than across the board, bank vs. bank rivalry. Bank strategy amounts to deciding precisely where to strike, then designing the appropriate supporting technology systems.

Banking's saga is every industry's saga. Financial services lead by 10 years because of the central role information, by definition, plays in the industry. If you want to see in 1990 a clear snapshot of the year 2000 in your industry, digest "Technology in Banking" – and begin your search now for the unconventional new strategies and products that will separate tomorrow's winners and losers.

Tribune Media Services Inc.

TO: Alan Friedman
Paull Mines
Ed Campion

FROM: Eric Coffill

Wisconsin Bills Would Loosen Restrictions on Membership

By JAMES B. ARNDORFER

Wisconsin credit unions are backing legislation that would make it easier for all people in the state to join their institutions.

The legislation, which was developed by two state credit union trade groups, has been introduced to both houses of the state Legislature.

The two bills, which are identical, would also allow credit unions to form shared service centers and offer new services.

Catching Up

Charles W. Sullivan, president of the Wisconsin Credit Union League, said the changes would bring the state's statute in line with those of other states.

Also, much of the statute is antiquated and needs to be changed, he said.

"Some of the language dates back to the '30s," Mr. Sullivan said.

Pending legislation was developed by credit union trade groups.

The proposals would give credit union boards the power to define who in a member's family will be allowed to join. Currently, only immediate family members are eligible.

The measures also would make it easier for credit unions to serve multicounty regions.

Bankers Opposed

In addition, the proposals would allow credit unions to form shared service centers, in which different credit unions jointly use a branch, and offer services such as debit cards.

Bankers groups in Wisconsin oppose the proposals.

"I think credit unions definitely have a role, but this goes far beyond fair competition," said Harry J. Argue, executive director of Madison-based Wisconsin Bankers Association.

Mr. Argue said he did support updating the language in the statute.

Since 1988, the credit union league and the Wisconsin Federation of Cooperatives have worked on the revisions.

Bipartisan Support

"We spent a lot of time talking to credit unions, seeking input, and getting ideas of what kinds of changes needed to be made," Mr. Sullivan said.

The state Assembly held hearings earlier this month and the state Senate has scheduled a hearing for Jan. 12.

The legislation has received bipartisan support, with 10 state senators and 28 state representatives signing on as authors of the bills. □

Home Lenders Reached Ne

By EDWARD KULKOSKY

The year 1993 may have been the single most eventful period in the history of the mortgage industry. Just look at some of the things that happened.

The Refinancing Boom. With interest rates in an almost unbroken decline throughout the year, refinancings reached record levels and pushed mortgage originations to about $1.1 trillion as purchase originations also showed strength. That figure was almost double the level of any previous year but 1992, when $890 billion was lent to homeowners.

The Prepayment Drain. Mortgage prepayments are the dark underbelly of refinancings because they drain established portfolios of mortgage servicing rights, thus reducing their value. Accelerated amortization of servicing rights struck down company after company, including Fleet Mortgage Group, Margaretten Financial Corp., Lomas Financial Corp., and Express America. And Meridian Ban-

Charles Rinehart
Chief executive, H.F. Ahmanson

Saiyid T. Naqvi
President, PNC Mortgage

was shrinking, banks and thrifts took all the heat for lending policies that appeared to put minorities at a disadvantage.

While the debate continued over whether statistics gathered under the Home Mortgage Disclosure Act actually proved anything, lenders generally took the issue to heart and mounted outreach programs to increase their minority lending.

In July, meanwhile, Chase Manhattan Corp. snapped up Troy & Nichols, a $10 billion servicer in Louisiana, for an undisclosed sum.

One controversial deal was GE Capital Corp.'s purchase of Shearson Lehman Hutton Mortgage Corp., Irvine, Calif., for about $70 million. Some mortgage bankers saw Stamford, Conn.-based GE Capital as in-

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Keeping Tabs on Card Holders

1/20/91

New Computer Software Helps Credit Issuers Take a Hard Look at Customers

By Albert B. Crenshaw
Washington Post Staff Writer

When you paid your Visa or MasterCard bill last month, a computer somewhere took note.

And there is a good chance that the computer not only took note of your payment, it gave it some thought. Like whether you paid the bill on time and maybe even what merchants you dealt with.

The reason it did all this thinking is simple: The bank that issued you your credit card is a lot more interested in you than it used to be.

With the economy slumping and the credit card market saturated, card issuers are taking a hard look at their customers both to try to head off problems before they grow large and to keep good customers from going elsewhere.

In the past, "credit card portfolios have been a source of substantial revenues for banks . . . by continuing to grow," said Jim Roemmer of Credit Partners, a banking computer services firm based in Larchmont, N.Y.

Now, though, growth is getting hard to come by and solicitations have lost their force, making the need to identify and keep the best customers all the more critical.

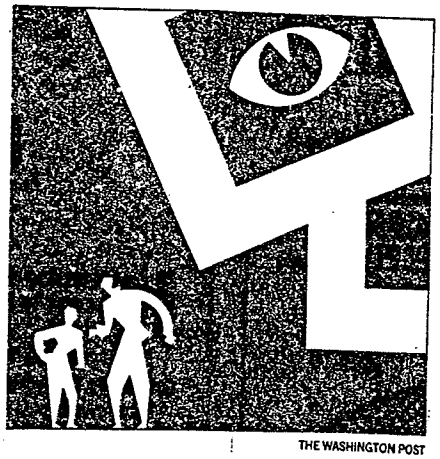
And to assist the banks in this, there are more powerful computers and more sophisticated software that allow them to collect and retain more information and sort through it in finer detail than ever before.

Though civil libertarians and others concerned with privacy issues worry about the potential for disseminating data to people who might abuse it, the banks regard these efforts as a key tool to remaining profitable in an intensely competitive environment.

In many ways, bankers add, the new computer systems simply make the same kinds of judgments that were once made by people. Most are based on "scoring" models, which assign a customer scores in certain categories, such as payment history, total debt and

See CREDIT CARDS, H4, Col. 1

New Software Developed To Rate Card Holders



THE WASHINGTON POST

CREDIT CARDS, From H1

the like, and then use those scores to decide whether to grant a customer credit and how much.

"The tool is such now that if you are of any size and sophistication, in order to be competitive you've got to use scoring systems," said Roemmer.

But he added that "there's nothing really Buck Rogers about it. It's just that computational ability of the data-processing software is such that more sophisticated determinations can be made. The basic premise on how to design a scoring system—that's not changing as rapidly."

Buck Rogers or not, the new systems allow bankers to make increasingly sophisticated predictions about whether their card holders will pay their bills.

Bankers and others say that an individual's own credit history is by far the most reliable predictor, while generic data such as demographics are far less dependable and can raise discrimination questions.

And the parameters are being adjusted to reflect current conditions.

For example, a person with multiple credit cards, as long as he or she kept them all current, counted favorably on older scoring systems. But now some issuers are changing that.

One Southern banker noted that small-business owners he knows often take every card solicitation they get, regarding the extra cards as a backup source of cash in case of disaster. "That's not what we want," he said.

Another vendor said there are three major areas where the software is used today:

- Predicting whether a newly delinquent account will return to "current" status or become seriously delinquent and possibly default. Such a forecast helps the bank decide whether to mount a prompt collection effort, let the account ride or step in and cut the consumer off entirely.
- Deciding whether to grant an increase in a customer's credit limit. If the account is current, the software can predict whether it will remain so even if more credit is extended.
- Evaluating over-the-limit authorizations. If a card holder seeks to charge more than he or she is currently allowed, the system, based on its scoring model, can authorize the additional credit automatically or kick the request out, along with the score, to a human evaluator. This usually involves an item large enough for the merchant to check before accepting the card.

In addition, banks also may call upon their systems for help in deciding whether to reissue a card to someone with a less-than-perfect payment history.

In practice, said Darryl Hansen, president of Norwest Card Services in Des Moines, this means that "the software goes in and looks at the attributes of a customer's account and how that account is being handled [by the customer]. And through a statistical methodology it can predict whether that account might have high probability of becoming delinquent or a low probability of becoming delinquent.

> *The software "can't predict a specific account—it can't look at Darryl Hansen and say that definitely someday he will be delinquent. It can look at a lot of accounts and predict that out of that pool of, say, 10,000 accounts that one of them will go delinquent."*
>
> — Darryl Hansen, president, Norwest Card Services

"It looks at payment patterns, usage patterns . . . " Hansen added. "We look at every account automatically and assign a behavior score. That score is, if you will, an odds quote, 100 to 1 or 1,000 to 1.

"It can't predict a specific account—it can't look at Darryl Hansen and say that definitely someday he will be delinquent. It can look at a lot of accounts and predict that out of that pool of, say, 10,000 accounts that one of them will go delinquent. So we can look at that pool and get a sense of risk from the profile."

Norwest, with 2 million accounts, uses the software not only as a means of protecting itself from defaults but to try to improve service, sometimes in ways the consumer is not even aware of, Hansen said.

For example, if an over-the-limit transaction is approved automatically, the customer may know only that he or she didn't have to spend very long at the cash register.

On the other hand, "if a customer's score is very low, suggesting high-risk profile, then a transaction above the limit might not be authorized" at all, Hansen said.

The software "helps us to discriminate, to be more selective in servicing those customers that are handling their accounts properly," he said.

In addition, instead of treating all 2 million customers as one account, they can be sorted out to solicitations for additional bank services. This not only cuts the costs of such solicitations but also spares those least likely to want the service from receiving such mail.

Hansen said his bank is still learning how best to use automation. "There's a lot of technology out there, but not all of it is right," he said, adding that there is "a learning curve" that he and other card issuers continue to climb.

The technology could be abused, Hansen said. Security could be breached or data misused, he conceded, "but that is obviously not in our best interests" and "we work very hard at preventing that from happening."

Ford Revamps Firm to Realize Big Tax Savings

Holding Firm Set in Move To Include Private Sale Of 25% Stake to Investors

By MATTHEW WINKLER
Staff Reporter of THE WALL STREET JOURNAL

NEW YORK—Ford Motor Co. has quietly formed a new holding company for some of its major financial units and is selling privately a 25% stake in it for $800 million to institutional investors in a move that should garner it major tax savings.

While Ford officials won't discuss the tax savings from the transaction, tax experts say the auto giant should save many millions of dollars. "We never talk about our tax returns," says George V. Brown III, executive director of strategic planning for the company's Ford Financial Services operation.

The new holding company, Ford Holdings Inc., includes Associates Corp., a consumer and commercial finance company that is Ford's most recent and largest acquisition, as well as Ford's insurance and leasing subsidiaries.

The transaction will allow Ford to preserve major tax benefits and avoid an increase in taxes resulting from its $3.35 billion acquisition of Associates from Paramount Communications Inc., a purchase that is scheduled to be completed at the end of this month.

Since 1986, when Congress passed landmark legislation overhauling the U.S. tax code, U.S. multinationals have been required to allocate interest expenses on a consolidated basis. The effect for many companies has been to increase the effective cost of debt financing, because interest expenses allocated against foreign income "crowd out" tax credits that otherwise might be available.

Thus, interest expenses in the U.S. must now be allocated prorata to foreign-based assets. This reduces the calculation of foreign tax credits used in the U.S., effectively increasing U.S. tax payments by decreasing foreign tax credits, tax lawyers say.

Ford, which makes and sells cars overseas, typically has large foreign tax credits each year. However, by setting up Ford Holdings, and selling the 25% stake making it a stand-alone unit under the tax law, Ford isn't required to consolidate these interest expenses and can preserve its foreign tax credits.

Ford's push to trim its tax bill follows three straight years of record earnings, which have made it one of the nation's most profitable corporations. In 1988, the No. 2 auto maker earned $5.3 billion, the highest net income ever achieved by an auto maker world-wide. Earnings, however, are expected to decline this year because of slower U.S. car sales, higher incentive costs and temporary plant shutdowns.

At the same time, Ford executives have said they expect financial services to take an increasing role in the company's profit, eventually constituting one-third of earnings, according to Ford Vice Chairman Harold A. Poling.

The Ford Motor Credit subsidiary, which was incorporated in Delaware in 1959, received a special exemption under the 1986 tax act. The 1986 law generally lowered tax rates while closing many loopholes. But the more recent planned acquisition of Associates, a huge, highly leveraged company, would have eaten up much of Ford's foreign tax credits if it wasn't established through a separate company.

In an interview, Ford's Mr. Brown said the auto company is in the midst of selling $800 million of voting preferred stock to institutions in the so-called private placement market. This nearly $200-billion market is made up of insurance companies, pension funds and other big investors; individual investors can't buy securities issued there.

Mr. Brown confirms that the creation of Ford Holdings as a separate entity preserves tax benefits Ford currently receives because Ford will own less than 80% of the concern.

However, Mr. Brown says Ford formed the new holding unit primarily to help finance Ford's acquisition of Associates and to begin selling preferred stock, "a market Ford hasn't accessed." As for avoiding potential taxes, he only says, "There may be some tax benefits and there may be some tax detriments."

The innovative Ford transaction could be imitated by other multinational corporations, investment bankers and tax lawyers say.

"This is one of the strategies that many U.S. multinationals have explored to alleviate the adverse consequences of the 1986 tax act," says James A. Duncan, a partner at the New York law firm of Cleary, Gottlieb, Steen & Hamilton. "Many U.S. multinationals have explored variations on this strategy. But its costs and benefits depend very much on complex considerations specific to each company," he added.

Unlike common stock, whose price fluctuates with the perceived value of a company, its assets and earnings, preferred stock has a fixed, stated value that doesn't move with the actual value of the company. Preferred stock normally pays dividends to holders comparable to interest rates on some money-market investments.

Ford Holdings' offering of preferred, which is being arranged by Goldman, Sachs & Co. and Shearson Lehman Hutton Inc., is unusual because it is one of the rare instances when so-called money market preferred has been sold with voting rights, which are required to achieve beneficial tax treatment in this case.

10/12/89

Japanese Warm To U.S. Market In Mortgages

11/1/89

By MARCUS W. BRAUCHLI
Staff Reporter of THE WALL STREET JOURNAL

TOKYO—Japan has found another safe outlet for its money: U.S. home mortgages.

An increasing number of big Japanese investors are buying up U.S. home mortgages that have been pooled and packaged for sale as interest-bearing instruments known as mortgage-backed securities. As much as 10% of new U.S. mortgage securities issued by the Federal National Mortgage Association, or Fannie Mae, and Federal Home Loan Mortgage Corp., or Freddie Mac, now flow into Japanese hands.

That may not come as a surprise to Americans who have watched the Japanese snap up properties in the U.S. from golf courses to a stake in Rockefeller Center. But it marks a big change for the Japanese, who shunned mortgage securities after getting burned by a big downturn in interest rates a few years back.

"You can't say it's a *tsunami* (tidal wave), but we're making some headway," says Fannie Mae's chairman, David O. Maxwell, who visits Tokyo at least once a year to explain and drum up investor interest in mortgage securities. "Interest is a great deal higher than it was a year ago." The steady growth of the mortgage securities market in the U.S. has even triggered talk of building up a similar market here.

Evidence of the growing Japanese demand for mortgage securities abounds. Earlier this year, Blackstone Group, a New York investment bank, had no trouble selling out a special $570 million mortgage-securities trust it created for Japanese investors. Industrial Bank of Japan, which claims to be the biggest Japanese buyer of U.S. mortgage securities, says it will more than double its purchases this year, to an amount one official puts at several billion dollars. And a Fannie Mae seminar this week promises to draw hundreds of prospective investors, who can be expected to channel tens of billions of dollars into the market in the next few years.

"Last year, there were only several big investors who were interested," says Kinji Kato, a vice president at the international arm of Nomura Securities Co. "This year, some investors are changing their policies and investing a lot." Ultimately, he says, strong demand could help to drive down interest rates on mortgage securities.

At the moment, Nomura is the only Japanese institution authorized to act as a primary seller of Fannie Mae instruments. But other Japanese institutions say privately that they are considering asking to join the 59-dealer selling group.

These securities are attractive to Japanese investors for three reasons. First, they are safe. While they aren't backed by the full faith and credit of the U.S. government, as Treasury bonds are, it is widely assumed that the government would support them if necessary. (U.S. Treasury bonds are still the dollar-denominated investment of choice for long-term Japanese investors). Second, they are liquid. The secondary market in federally backed mortgage securities now exceeds $900 billion, or nearly half of the $2.2 trillion in U.S. residential mortgages issued. Third, they offer high yields. At the moment, some offer as much as 1.6 to 1.8 percentage points over Treasury securities of similar maturities.

But there is a risk, which the Japanese discovered when they first dipped their toes into the market nearly five years ago. Since most mortgages can be prepaid or refinanced at any time, issuers of mortgage securities retain the right to buy back their bonds before maturity. That's a headache for long-term investors, since it forces them to reinvest their money—usually at lower rates than the original mortgage securities carried.

"Two or three years ago, the problem

Please Turn to Page C17, Column 4

Japanese Investors Develop an Appetite For Mortgage Market

Continued From Page C1

was that people didn't understand the prepayment risk," says Nomura's Mr. Kato. "So they were surprised and very disappointed by prepayment."

Compounding the trouble to Japanese investors, mortgage securities pay interest monthly, since most mortgages require homeowners to make monthly payments. But Japanese institutional investors are used to quarterly or semiannual payments on their investments, so the monthly cash flow posed administrative problems. As a result, Japanese investors steered clear of the mortgage securities.

But they didn't lose touch with the U.S. issuers. Since 1985, Japanese investors have bought nearly 80% of $10 billion in Fannie Mae corporate debt issued to foreigners, money that Fannie Mae uses to buy mortgages from U.S. banks. And Japanese investors took up nearly all of two $200 million Real Estate Mortgage Investment Conduits, a kind of collateralized mortgage obligation, that were offered to foreigners this year.

In addition, further packaging of mortgage-backed securities, such as Blackstone's fund, have reduced the effects of prepayment risk and automatically reinvest monthly payments so institutions don't have to. Freddie Mac for years has offered a so-called participation certificate that guarantees it won't be prepaid for a set number of years and offers semi-annual payments.

Commercial banks, computers and other forms of competition are moving powerfully into the investment banking business. Could be bad news for Wall Street.

Tough new kid on the block

By Marcia Berss

MORGAN STANLEY sure looks like a cheap stock, at only 8.7 times earnings. Merrill Lynch and Bear, Stearns are trading at even lower multiples.

Maybe the stocks are bargains, maybe not. In evaluating a stock, investors look more at expected future earnings than current ones. In the case of the brokerage stocks, the market has some strong reasons for being skeptical about the future. New competition and technology are conspiring to take a big bite out of investment banking, the big moneymaker for Wall Street firms. Changes coming to this industry are good news for corporations that need to raise capital, good news for investors who buy their securities and bad news for the investment firms in the middle. Predicts John Tamagni, managing director at investment bank Lazard Frères: "You'll have fewer and poorer investment bankers around."

Investment banking—underwriting public stock and bond issues, privately placing securities and arranging mergers and acquisitions—is the principal source of profits for most securities firms today, according to Perrin Long at Lipper Analytical Services. He estimates that investment banking, with pretax margins of 35% and up, is supporting other activities like trading, where profits are razor-thin, and brokerage, which is languishing.

Now consider recent events:

- In June Wall Street lost a decade-long battle when the Federal Reserve gave commercial banks limited powers to underwrite corporate bonds, hitherto a protected preserve for investment bankers. One Fed member called the ruling a "milestone in the deregulation of the American financial system." The Fed, having found a loophole in the Glass-Steagall Act (the 1933 law that separates commercial banking from investment banking), is expected to extend commercial banks' underwriting privileges to stock underwritings in 1990.
- In April CapitaLink, a small firm loosely affiliated with J.P. Morgan & Co., announced a system for corporations to issue bonds directly to investors, bypassing the underwriter. CapitaLink's no-frills service will offer new-issue, public, high-grade bonds via a computer dutch auction; it will cost 0.2% of the money raised, less than a third of the commission an underwriter charges. Savings on a midsize $300 million debt deal: $1.3 million. CapitaLink's target market is

Doomsday for dealmakers?

Investment banking is a small portion of revenue of Wall Street firms but a large source of net income. Competition is coming to this lucrative business at a time when other lines, like retail trading, are languishing.

Company	Investment banking revenue contribution[1]	Latest 12 months EPS	Price	P/E
Bear, Stearns	19.9%	$2.02	16¼	8.0
Merrill Lynch	17.1	4.14	34¼	8.3
Morgan Stanley	45.8	9.05	78⅞	8.7
PaineWebber	18.8	0.75	22⅞	30.5
Salomon Brothers	21.7	1.54	26⅞	17.5
Shearson Lehman Hutton	27.8	(0.03)	21⅞	NM

[1]Investment banking revenue as fraction of total revenue, net of interest expense, for fiscal 1988.
NM: Not meaningful.
Source: Company reports.

the $100 billion in high-grade new issues sold in 1988, 43% of all public corporate debt. The Morgan bank will begin marketing the system this fall.

Issuers are enthusiastic. Richard Culver, treasurer of Westinghouse Credit, says, "We think CapitaLink has a good deal of potential." So do investors: In April Metropolitan Life tried to cut out the middleman by buying an entire public debt deal direct from issuer Carolina Power & Light. Metropolitan ultimately abandoned the bid on a technical issue, but not before sending tremors through Wall Street.

• The Securities & Exchange Commission is expected shortly to approve a rule expanding private placements. In this market, companies sell securities (usually bonds) directly to an insurance company or pension manager. Corporations raising capital have, of late, discovered private placements in a big way. They now total $181 billion, or 40% of all corporate capital raised, against 22% of capital raised in 1980, according to IDD Information Services. Investment bankers are none too happy, since their fees for brokering such deals are well below those collected on public bond issues.

And their fees are about to get lower. This fall the SEC will probably relax disclosure requirements in the private market, making it even more attractive to issuers and buyers. This will eliminate red tape in simple private offerings and cut out the middleman banker. "The SEC knows we don't need them to tell us what financial information we need to make an investment decision," says Richard Yorks of Prudential Insurance, the nation's biggest holder of private placements, with $30 billion. As a result, "you may not need an investment banker to do these deals," says David Marks, senior vice president at Cigna Investment Group, another big private placement investor.

The fattest middlemen's margins are in the public underwriting of complex or riskier securities, including junk bonds and common stock. There the middleman's spread is 3% of the offering amount, up to 7% for initial public offerings. Commercial banks covet this business. The June Federal Reserve action permits commercial banks to underwrite corporate debt, provided they set up separate investment banking subsidiaries and limit underwriting to 5% of the unit's revenue. Four banks—Bankers Trust, Chase Manhattan, Citicorp and J.P. Morgan—are establishing such operations. The ruling is expected to be extended to more lucrative stock underwriting next year. As these banks, with the connivance of their regulators, push the outer limits of Glass-Steagall, they increase the pressure on Congress to repeal the law altogether.

In junk bond underwriting, commercial banks have a head start. They typically lend 60% of the financing in a leveraged buyout, and it's a short leap from analyzing the credit for a senior loan to analyzing the credit for the more junior debt. And it is the latter that is harder and thus more profitable to sell. Jerry Thompson, executive vice president at NCNB National Bank of North Carolina, was a senior lender in the recent RJR Nabisco buyout. Says he: "We feel like jerks when we put up most of the money in a deal and Mike Milken is making $500 million. We can find people to take on risky paper. They can't be hiding under rocks."

As Wall Street has already learned to do, commercial banks are starting to be equity players in takeover deals. In June commercial bank Bankers Trust raised eyebrows when it invested $80 million of equity in Alfred Checchi's $3.7 billion purchase of Northwest Airlines. The bank is also an equity player in James Goldsmith's $20 billion bid for B.A.T Industries. Commercial banks have long had the right to own up to 5% of voting stock in an industrial corporation (and up to 25% of shareholder equity). Only recently have they exercised this right. Often, they pick up equity kickers while arranging debt financing for a leveraged buyout.

In this invasion of underwriting and equity participation, commercial banks are attacking the bread and butter of investment bankers, mergers and acquisitions. At the top firms, 50% to 75% of investment banking earnings comes from merger work. Barry Friedberg, head of Merrill Lynch's investment banking group, says: "We perceive commercial banks to be a competitive force to be reckoned with."

Friedberg is being realistic: In the past Wall Street tended to sneer at banks as competitors in the merger business. There never was anything in Glass-Steagall to stop commercial banks from getting a piece of the action. All that stopped them was a perception that they were too clumsy. The buy-and-hold mindset of commercial bankers was supposedly no match for the risk-taking ethos of investment bankers; besides, argued Wall Street, commercial banks won't pay for talent.

They will now. In November Bankers Trust signed Gerald Rosenfeld, formerly of investment bank Salomon Brothers, to a reported $2 million-a-year, three-year contract. Another top investment banker says a commercial bank offered to top his seven-figure salary by 50%.

"Oct. 19 played to the advantage of commercial banks," notes Windle Priem of executive recruiter Korn Ferry International. Since the crash, mid-level investment banking salaries have been flat, while commercial bank pay is up. Among middle managers the investment bank salaries are still better, but the gap is narrowing. At entry level, the shift is even more dramatic. At Harvard's and Stanford's business schools, median starting salaries for graduates headed to a commercial bank now exceed those at investment banks, reversing a historic trend. Last year, Harvard grads started at $54,700 at commercial banks, $50,200 at investment banks.

It never happens overnight, but it happens inevitably: An abnormally profitable business attracts competition, and the profits shrink to more normal levels. No, the death knell of Wall Street is not sounding. But the glory days are fast coming to an end. ■

Citicorp to Buy Bank of New England's Credit-Card Business for $828 Million

1/30/90

By CHRISTOPHER J. CHIPELLO
Staff Reporter of THE WALL STREET JOURNAL

BOSTON—Bank of New England Corp. said it reached a definitive agreement to sell its credit-card business to Citicorp for $828 million, helping Bank of New England raise cash and bolster its weakened capital base.

H. Ridgely Bullock, newly appointed interim chairman and chief executive officer, said in an interview that Bank of New England's plan to sell assets and boost its capital ratios is "going very well," and said the company remains "a very viable enterprise."

Many analysts and investors have raised doubts about Bank of New England's ability to remain independent, in the wake of an estimated $1.2 billion fourth-quarter loss and a massive increase in problem loans. Depositors—especially those with large, uninsured deposits—have been withdrawing funds from the bank, forcing it to borrow from the Fed.

Mr. Bullock declined to specify Bank of New England's current level of Fed borrowings. He said the company's cash needs "appeared to be stabilizing" at the end of last week, but added that the amount is likely to fluctuate from day to day depending on whether maturing deposits are rolled over. Government statistics indicate that, as of last Wednesday, Bank of New England had borrowed as much as $475 million from the Fed.

Besides generating cash, the sale of $670 million in credit-card assets to Citicorp will result in a gain of $176 million for Bank of New England, whose equity capital has sunk to about $500 million—roughly 1.7% of its $29 billion in assets. The sale is subject to clearance by the federal government under the Hart-Scott-Rodino antitrust act; both companies have requested expedited approval, Bank of New England said.

With more than 27 million MasterCard and Visa credit cards outstanding, Citicorp is the largest credit-card issuer in the nation. Bankers have been particularly eager to increase their credit-card portfolios, because credit cards are usually twice as profitable as the typical commercial loan.

With the pool of desirable consumers needing credit cards shrinking, Citicorp and other large issuers in recent years have turned to buying credit-card portfolios from smaller issuers. Most recently, Citicorp bought a portfolio from First City Corp. of Houston.

With their huge processing systems and economies of scale, the large issuers can usually wring greater profits out of these portfolios.

By the end of this week, Bank of New England expects to receive bids for $1.3 billion in home-equity loans, Mr. Bullock said. The company could also receive this week some advance funding related to the sale of $500 million in residential mortgages, he said.

In composite trading on the New York Stock Exchange, Bank of New England's share price closed at $4.125, up 62.5 cents, on volume of 1,993,000 shares.

Mr. Bullock, a member of Bank of New England's board, has been chairing the directors' committee supervising the company's effort to sell $6 billion in loans and other assets and to explore the possible sale or merger of some of the company's affiliate banks—including its Connecticut Bank & Trust Co. unit in Hartford, Conn., and smaller units in Maine and Rhode Island.

Whether the company agrees to sell any of the affiliate banks could depend on the "success and speed" of the other asset sales—as well as on the prices offered for the affiliates, Mr. Bullock said. "I would expect that the value of those [banking] subsidiaries will increase over time," as the level of nonperforming loans declines, he said. "We're not holding a fire sale."

Although Citicorp and other bank holding companies are said to be interested in the Connecticut unit, Mr. Bullock said Bank of New England hasn't received "firm offers" for any of the affiliate banks.

Mr. Bullock was named interim chairman and chief executive after the dismissal last Friday of Walter Connolly Jr. as chairman and chief executive officer. Mr. Bullock is president and chief executive of Montchanin Management Corp., a New York-based firm that does management consulting and mergers-and-acquisition work. Previously, he was chairman

Vienna-Based Digital Radio Taps the Credit Card Option

Wash. Post April 16, 1990

Transmitters Speed Transaction Approvals

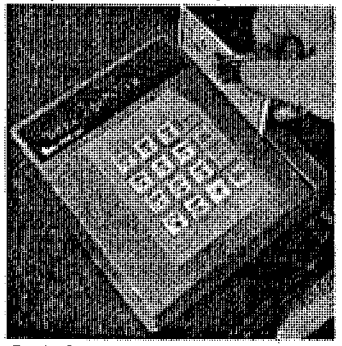
By Thomas K. Hetlage
Special to The Washington Post

Travelers returning to Dulles International Airport without cash to pay for parking have another option—one that may mark the takeoff point for the Vienna-based company that provides it.

Digital Radio Networks Inc. (DRN) of Vienna has installed transmitters at 14 parking lot exit gates at Dulles, enabling attendants to get credit card transactions approved within seconds via radio. The system is faster than using telephone lines, and it could make credit cards a substitute for cash in other kinds of transactions.

Those factors haven't escaped the attention of MasterCard International and Visa U.S.A., both of which tried Digital Radio's sole product and plan to offer it to merchants and financial institutions.

MasterCard recently tested the system at Herman's Sporting Goods stores in Virginia and California, and although it is moving ahead cautiously, the credit card provider may offer the option to all of its member banks by midyear, said MasterCard spokesman Sharon Cline.



Digital Radio has transmitters at 14 parking lot exit gat[illegible] Dulles.

Visa U.S.A. completed a broader pilot program with 100 merchants in four states and will offer the system to financial institutions under a recently signed agreement. And American Express Co. has just launched a pilot program. Digital officials declined to reveal the value of the agreements or the potential number of sales through them.

Brian Bates, Digital's eastern regional sales manager, estimates that by the end of this year there will be 6,000 to 8,000 units in circulation. By the end of 1991, the company predicts, 30,000 units will have been installed. Each unit costs $125, installed by Digital Radio Networks, or $50 if the merchant installs it. Digital charges a $60 a month flat fee for using the service.

"We love the service," said Visa official Jeff Connelly. "However," he added, "it's not for all merchants." For businesses handling fewer than 500 credit card purchases a month, or who don't need the added speed, he said, it's not a necessity.

Cline said the Digital Radio Networks system will help mid-size merchants compete with major retail chains. "Large merchants have electronic cash register systems for efficiency, but they are very expensive. Now smaller stores can have quick checkouts as well," she said.

PHOTOS BY CYRENA CHANG FOR THE WASHINGTON POST

Shahjajan Dodhy of Reston completes a credit card transaction at toll booth at Dulles airport's main parking lot.

Quick was a key requirement for the company that operates the Dulles parking lots, too. The agreement that Hills Capitol Security signed with the Washington Airports Authority was contingent on introducing credit card service at the exits. "We explored a lot of programs, but our focus was on time. We didn't want to take a lot of time processing credit cards and create backups," said Joe Scott of the Airports Authority.

Scott said the Digital Radio Networks system approves card transactions in five to seven seconds, while the closest competitor, a traditional phone line hookup, averaged 27 to 35 secor[illegible] He said the overall cost of the system was "what we considered to be under the current market price" for telephone-based systems.

One potential obstacle to growth is the limited amount of space on the broadcast spectrum that the Federal Communications Commission can offer. Digital must set up a kind of radio station—licensed by the FCC—in each city in which it operates; credit card transactions are beamed from there to a California processing center run by a company called BT Tymnet.

"Anything like this has to get in line. A decision is made about who gets space on the spectrum by our officials," said Tom Stanley, chief engineer at the FCC's Office of Engineering and Technology. "There is a limited quantity . . . available and to give space to someone, you might have to take away from somebody else."

Citicorp created Digital Radio Networks to develop the transmitters, spun off the company in 1987 and remains a majority investor through its venture capital program. Company officials decline to disclose recent revenue or earnings figures. DRN started test-marketing its transmitters in 1987, but only began a full-scale marketing program last June.

Bates likens the Vienna company's progress to the development of a child. "It's taken awhile to get from the crawling stage to walking, but walking to running should be very quick," he said. ■

Sears Roebuck and Citibank Step Up Offerings In Booming Market for Asset-Backed Securities

1/10/90

By CONSTANCE MITCHELL
And ANDREW BARY
Staff Reporters of THE WALL STREET JOURNAL

NEW YORK—The market for asset-backed securities is heating up again after record-breaking fourth quarter.

Sears, Roebuck & Co., the nation's largest retailer, is expected to offer about $500 million of credit card securities sometime this week while Citibank, a unit of Citicorp, sold $750 million of credit card securities yesterday in Europe. The Citibank issue indicates broadening foreign demand for asset-backed securities.

The Sears offering, which will be backed by receivables from the retailer's consumer credit cards, will use a senior-subordinated structure. A subordinated class, totaling 8.5% of the underlying pool of receivables, will support the senior securities which will be sold publicly.

News of the Sears and Citibank offerings come as Chemical Securities Inc., a subsidiary of Chemical Banking Corp., reported that issuance of asset-backed securities reached $24 billion in 1989, the largest amount in the market's five-year history. That compares with issuance of $16.3 billion in 1988, $10.3 billion in 1987, $10 billion in 1986 and $1.2 billion in 1985.

Stephen King, a vice president in the fixed-income research department at Chemical Securities, said issuance is expected to grow even faster this year. He said banks find that securitizing consumer debt is an attractive, and lucrative, way to reduce assets from their balance sheets. And more are doing so to meet the stricter capital requirements of banking regulators.

"Less than 10% of all consumer credit debt has been securitized so there is a lot of potential for further securitization," said Mr. King.

Chemical Securities noted that the final quarter of 1989 accounted for 50% of last year's volume of new asset-backed securities. Credit-card securities accounted for half of that volume, followed by auto-loan securities which accounted for 33%. The rest of the volume was comprised of other kinds of asset-backed issues, particularly home-equity loans and boat loans.

Citicorp's 'Plastic' Bonds for the Charge-It Crowd

By ROBERT GUENTHER
And ALEXANDRA PEERS
Staff Reporters of THE WALL STREET JOURNAL

NEW YORK—Tired of stocks and run-of-the-mill investments? **Citicorp** has something new for small investors: "plastic bonds."

The New York-based banking giant is packaging credit-card loans from its Visa and MasterCard holders into four-year certificates in bite-sized pieces of only $1,000 each.

Two big Wall Street firms, Merrill Lynch & Co. and Shearson Lehman Hutton Inc., will be selling this credit-card backed paper to small investors. Citicorp filed with the Securities and Exchange Commission for a $500 million offering next month of what some wags have dubbed plastic bonds.

But some investment specialists note that Citicorp, the nation's biggest credit-card issuer, is charging its credit-card holders 19.8% to borrow on their cards. Meanwhile, small investors, most of whom probably have credit cards themselves, will probably earn between 9.5% and 10% interest when Citicorp borrows from them by selling the certificates.

Even a Citicorp official concedes: "There are plenty of investments out there that provide much better yields."

Credit-card-backed certificates are a relatively recent innovation in the trend on Wall Street to repackage any form of debt, like car, boat and recreational vehicle loans, and issue bonds backed by these receivables. Since 1987 when credit-card-backed securities were introduced, $13 billion in credit-card receivables have been sold off in securities form, but only to institutional investors. Citicorp alone has sold $3.5 billion just since last November.

A Citicorp spokesman said targeting the issue at the individual investor "represents an effort to broaden the investor base." In the past, Citicorp has tailored issues to appeal to institutional as well as overseas investors.

Money Fund Assets Fall

Total assets in money-market mutual funds fell for the first time since early January as investors focused on the rising stock market. Story on page C17.

Investment advisers and financial planners point out that at the expected yield, the Citicorp certificates wouldn't yield much more than the bank's own five-year certificates of deposits, which currently pay 9.53% and, unlike the certificates, are federally insured.

"Why would I want to do this when I could get a CD that is insured?" asked Hank Madden, a financial planner of IDS Financial Services Inc.

However, the deal's underwriters expect strong demand for the issue from individual investors based on the certificates' anticipated yield. Robert I. Shapiro, executive vice president for taxable fixed-income securities at Shearson, said, "Our sales force is very enthusiastic about the offering. Right now, there is a real need for fixed-income retail product."

The packaging of credit-card loans for individual investors is yet another example of Wall Street's push to come up with new financial products to hawk to equity-shy investors.

While an average 3% to 4% of credit card loans go bad, Citicorp said that it anticipates the certificates will be rated triple-A by Standard & Poor's Corp. and Moody's Investors Services based on a back-up letter of credit provided by Credit Suisse, the big Swiss bank.

Broadening the investor base for asset-backed securities could be important to Citicorp. With $210 billion in assets, Citicorp has the potential to be one of the biggest beneficiaries of the trend toward transforming financial assets into securities.

Not only does such a transformation

Please Turn to Page C10, Column 6

Citicorp Is Packaging Its Credit-Card Loans For Small Investors

Continued From Page C1

free Citicorp capital for other purposes, but it enables the bank to continue to earn income from servicing the credit-card accounts.

The certificates represent undivided interests in a trust, which will hold a pool of credit card receivables and make payments to investors. The trust will purchase receivables originated through about 634,000 nationwide Visa and MasterCard accounts of Citibank (South Dakota) and Citibank (Nevada).

Citicorp declined to speculate on what rate the four-year certificates, which will be in denominations of $1,000, will carry. However, market analysts said that the certificates would probably yield investors between 9.5% and 10% based on current interest rates. Interest will be paid monthly.

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10/12/89

Credit Siege

U.S. Banks Are Losing Business to Japanese At Home and Abroad

Legal and Tax Structures Spur Trend, Which Could Hurt American Firms in Crunch

Cheap Loans for Compatriots

By ROBERT GUENTHER
And MICHAEL R. SESIT
Staff Reporters of THE WALL STREET JOURNAL

If California is truly a window on America's tomorrow, the nation's bankers have reason to worry.

Japanese-owned banks now control about 25% of the banking market in the most populous U.S. state, thanks largely to pricing so razor-thin that American banks have virtually ceded certain types of lending.

Roger V. Smith, the president of Silicon Valley Bank in Santa Clara, knows all about that. He tells why his bank has given up calling on local technology companies backed by Japanese investors. He says that after a sales call on a small company that was sagging financially but had Japanese backing, his bank would have offered a loan at three percentage points over the prime rate, the benchmark for commercial loans. But a Japanese bank made the loan at the incredibly low rate of 0.25 percentage point over the federal funds rate, the far-lower rate that banks charge each other for loans.

Stunned by such incidents, Mr. Smith says "it's a waste of time" to seek similar companies' business. "If a Japanese company is in on a deal, there is a different price."

Cheap Letters of Credit

Moreover, Japanese banks are making inroads all across the U.S. In Providence, R.I., Terry Murray, the chairman of Fleet Norstar Financial Group Inc., says he was shocked when his company went shopping for letters of credit—basically, bank guarantees of payment—for some of its nonbanking subsidiaries. Japanese banks offered letters of credit for a fee only about a quarter as much as what U.S. banks were charging.

Some bankers wouldn't be surprised to see Japanese banks capture 25% of the U.S. commercial-loan market by the mid-1990s. In six years, Japanese banks have come from nowhere to become the leading providers of letters of credit for U.S. municipal bonds. Last year, foreign banks, mainly Japanese, provided letters of credit for $12 billion in municipal-bond offerings—69% of the market.

"The Japanese are absolutely running circles around us," Mr. Murray says.

American banks also are suffering from more than pricing problems. Compared with most of their major competitors, U.S. banks are hobbled by structural impediments that include barriers to forming national networks, rigorous reporting requirements and disadvantageous tax and accounting standards. And they are hurt by some self-inflicted wounds.

Slipping Away

But the message is unmistakable: U.S. banks, once riding high in global finance, are losing their grip on the nation's and the world's credit reins.

More than 260 foreign banks are operating in the U.S., and their slice of the domestic banking pie has grown to more than 21% from 14% in 1982. At the same time, U.S. banks are retreating from the international arena. Among major industrialized nations' banks, only U.S. banks now have fewer cross-border assets, chiefly loans and securities, than they did in 1983; such assets now total $102 billion. In contrast, Japanese banks have increased their international assets fourfold to $129 billion.

"Clearly, the U.S. has lost and continues to lose position globally," says Willard C. Butcher, the chairman of Chase Manhattan Corp., the parent of the second-largest U.S. bank. Guido Schmidt-Chiari, the chairman of Austria's Creditanstalt, agrees. "American banks are definitely losing importance," he says. "Just look at how Bank of America, Chemical and others have retreated from Europe."

Dangers for Business

More is at stake in U.S. banks' slippage than mere national pride. In a financial crisis, control of credit often determines the outcome. On Oct. 19, 1987, when the stock market crashed, the Federal Reserve Bank of New York leaned on New York banks to meet the cash needs of Wall Street firms. The banks generally responded, and a national economic calamity was narrowly averted.

But would the banks have acted as quickly if the final decisions had rested in Tokyo or London? It's hard to say.

"In a credit crunch," Citicorp Chairman John S. Reed warns, "financial institutions would be faced with a choice: Which customers do you take care of? In such a situation, banks would have a natural bias toward their hometown players."

And a credit crunch is always possible. "If Eastern Europe and the Soviets were to open up to Western investment," Mr. Reed adds, "it would absorb immense amounts of capital. It's in this country's national interest to have four or five American international banks. At best, we now have one or two players."

H. Robert Heller, a former Federal Reserve governor, echoes that view: "American business isn't being served by U.S. financial institutions on a global basis. American business is directly affected by this. They don't have the support of their hometown bank in promoting their exports."

American banks certainly aren't out of the game already. They still lead in devising new financial products, such as commodity swaps to insulate buyers and sellers against future price swings, and in turning various loans, ranging from credit-card receivables to boat loans, into securities and selling them to investors. They operate out of a huge domestic market; the dollar is the world's major reserve currency, and English is the world's language of business. And though only Citibank ranks among the world's top 20 banks in assets, it is the world's most profitable; J.P. Morgan & Co. also ranks high in profitability.

But the slippage of U.S. banks is real. To a great extent, it is an inevitable consequence of America's huge trade deficit and low savings rate. "I view Japan to capital as I view Saudi Arabia to oil," Mr. Reed says.

Self-Inflicted Wounds

U.S. banks also have themselves to blame. Until recently, they have been running on slimmer and slimmer capital bases ever since the Civil War. Now, faced with higher capital requirements imposed by the Bank for International Settlements, many of them can't afford to be patient investors in new businesses; so, they are selling assets. Manufacturers Hanover Corp. agreed to sell 60% of its CIT Group Inc. to Dai-Ichi Kangyo Bank Ltd. for $1.28 billion. BankAmerica Corp. sold its Italian subsidiary to Germany's Deutsche Bank AG for $600 million. And Chase Manhattan sold Nederlandse Credietbank, the sixth-largest Dutch bank, to France's Credit Lyonnais.

In addition, U.S. banks' $60 billion of troubled Third World loans are dragging down their earnings and raising their cost of capital. Yoshihisa Tabuchi, the chief executive of Japan's Nomura Securities Co., says: "The reason American banks are having such trouble is because they didn't observe the basic principles. The Latin American debt problem came from their side; they forgot the principles of sound management; the S&L difficulty is the same." Adds Hans-Ulrich Doerig, Zurich-based member of the managing board of Credit Suisse, "Americans always act on fashion, a fad; they want to be with it."

U.S. banks also have been burned by scores of poorly planned acquisitions. In London, U.S. banks, including Citicorp and Chase Manhattan, paid top dollar for British securities firms, only to see cutthroat competition, in the wake of deregulation of British financial markets, wipe out profits. Just weeks ago, Chase became the latest U.S. institution to flee the British government bond market.

Legal Barriers

And legal barriers preventing U.S. banks from establishing interstate networks and offering securities and insurance products have hampered competitiveness, especially vis-a-vis European banks. The U.S. has long distrusted concentrations of power—a populism that may have served a frontier nation well but is a handicap in a global economy. "Our banking system is an antique," says Christopher L. Snyder Jr., the president of Loan Pricing Corp., which sells data on commercial loans.

Another hurdle for American banks is that they must publicly report financial results every 90 days and thus tend to pay a great deal of attention to day-to-day events. In addition, banks in several European countries, particularly Switzerland and West Germany, are granted tax relief for bad-debt provisions. Japan's banks enjoy lower reserve requirements, and its deposit-insurance premiums are a mere 1.2 cents per $100, compared with 15 cents per $100 for U.S. institutions.

A less-understood but important factor hampering U.S. banks is their high cost of capital. The difference in the stock values of Japanese and of U.S. banks is stark: Stocks of Japanese banks sell, on average, at 58 times annual earnings per share, while big U.S. banks generally sell for six to 10 times earnings.

As a result, Japan's 13 largest banks have a market capitalization of $500 billion, compared with $95 billion for the 50 largest U.S. banks. Some critics suggest that the Japanese banks' low-cost capital is a by-product of Japan's stock market, in which informal networks of corporate cross-shareholdings inflate stock prices.

Many Advantages

In addition to an advantage in pricing loans and services, the high market capitalization of Japanese banks makes it relatively painless for them to meet the new capital requirements. It also enables them to "acquire foreign banks easily without diluting their earnings because other banks are making more money," says Mr. Doerig of Credit Suisse.

Several years ago, First Manhattan Consulting Group estimated that a U.S. bank needed to price its loans 2.05 percentage points above its cost of funds to earn an adequate return. By contrast, a Japanese bank needed only an additional 1.1 points to get the same return.

The new capital requirements and some deregulation of Japanese financial markets have reduced that advantage, but James McCormick of First Manhattan estimates that Japanese banks still have about a 0.5-point edge. That might not sound like much, but in big corporate loans, it is.

Such figures may suggest that Japanese banks are "buying market share" by accepting lower returns. But David D. Hale, the chief economist at Kemper Financial Services Inc., suspects that foreign banks' lower cost of capital may allow them to earn adequate returns on the slim margins. Meanwhile, higher capital costs may be forcing U.S. banks to pursue fatter-margin, and riskier, loans.

Looking Ahead

Though Japanese banks haven't so far acted as the lead manager of a major commercial-loan syndication for a U.S. corporate borrower, they are angling for such a prestigious role. In real-estate financing, some U.S. companies, such as Marriott Corp., regularly rely on Japanese banks.

According to Greenwich Associates, a Greenwich, Conn., consulting firm, 45% of large U.S. companies currently use one or more Japanese banks. And almost 60% of those surveyed believe that Japanese banks have the skills to be fully competitive with U.S. banks in complex financings. However, the survey found that 80% of the surveyed companies termed it "unlikely" that a Japanese bank would become one of their principal banks within five years.

While foreign banks seize bigger shares here, U.S. banks are losing their toehold in Japan. In recent years, bankers estimate, U.S. banks' share of the Japanese market has dropped to 1% from 3%.

Some critics favor "managed trade," a form of protectionism, in financial services. Already, the U.S. has used U.S. government bond dealerships for Japanese financial institutions as a lever to gain wider access for U.S. players to the Japanese government debt market.

U.S. Changes Urged

Some observers also advocate revisions in laws separating the banking, securities and insurance industries. And they want the Fed to make a slew of changes. The Fed, for instance, currently requires banks to post 12% of their checking-account balances in reserves with it, even though federal law requires only 8%.

Behind such changes would be a recognition that the U.S. needs a globally competitive financial system. Even a change in American attitudes would help, says Chase's Mr. Butcher, who adds: "The U.S. government has certainly not been a friend or supporter of its banking system." But Rep. Charles Schumer, a New York Democrat who has pushed legislation to open foreign financial markets to U.S. institutions, says, "It's been a lonely fight. No one in the administration has this as their No. 1 priority."

More problematic but fundamental to reversing the U.S. banking system's decline is the promotion of greater savings and investment by individuals, corporations and the federal government. But here again, Rep. Schumer doesn't hold out much hope. "We still don't see the importance of being a nation of savers," he says. "Our banks and securities firms have the financial technology and the entrepreneurial drive; other nations' financial institutions have the capital.

"My fear is that in 10 years they will have the technology and the capital. Then, we will have real trouble."

Japanese Banks Lead in Assets, Lag in Equity

World's largest banking companies, ranked by total assets on Dec. 31, 1988; data for foreign banks are translated at fiscal-year-end exchange rates

BANKING COMPANY	COUNTRY	ASSETS (In billions)	EQUITY CAPITAL (In billions)	EQUITY CAPITAL-TO-ASSETS (In percent)
Dai-Ichi Kangyo Bank	Japan	$386.94	$10.95	2.83%
Sumitomo Bank	Japan	376.09	10.46	2.78
Fuji Bank	Japan	364.04	10.73	2.95
Sanwa Bank	Japan	348.36	9.31	2.67
Mitsubishi Bank	Japan	343.59	9.68	2.82
Industrial Bank of Japan	Japan	257.58	8.57	3.33
Norinchukin Bank	Japan	241.95	1.38	0.57
Tokai Bank	Japan	225.12	6.16	2.74
Mitsui Bank	Japan	219.67	5.77	2.63
Mitsubishi Trust	Japan	210.47	5.13	2.44
Credit Agricole	France	207.99	9.03	4.34
Citicorp	United States	203.83	9.86	4.84
Sumitomo Trust	Japan	196.59	4.69	2.39
Banque Nationale de Paris	France	194.52	5.50	2.83
Barclays PLC	Britain	189.20	10.32	5.46

NOTE: Japanese bank data as of March 31, 1989

Source: American Banker

Ford Revamps Firm to Realize Big Tax Savings

Holding Firm Set in Move To Include Private Sale Of 25% Stake to Investors

By MATTHEW WINKLER
Staff Reporter of THE WALL STREET JOURNAL

NEW YORK—Ford Motor Co. has quietly formed a new holding company for some of its major financial units and is selling privately a 25% stake in it for $800 million to institutional investors in a move that should garner it major tax savings.

While Ford officials won't discuss the tax savings from the transaction, tax experts say the auto giant should save many millions of dollars. "We never talk about our tax returns," says George V. Brown III, executive director of strategic planning for the company's Ford Financial Services operation.

The new holding company, Ford Holdings Inc., includes Associates Corp., a consumer and commercial finance company that is Ford's most recent and largest acquisition, as well as Ford's insurance and leasing subsidiaries.

The transaction will allow Ford to preserve major tax benefits and avoid an increase in taxes resulting from its $3.35 billion acquisition of Associates from Paramount Communications Inc., a purchase that is scheduled to be completed at the end of this month.

Since 1986, when Congress passed landmark legislation overhauling the U.S. tax code, U.S. multinationals have been required to allocate interest expenses on a consolidated basis. The effect for many companies has been to increase the effective cost of debt financing, because interest expenses allocated against foreign income "crowd out" tax credits that otherwise might be available.

Thus, interest expenses in the U.S. must now be allocated prorata to foreign-based assets. This reduces the calculation of foreign tax credits used in the U.S., effectively increasing U.S. tax payments by decreasing foreign tax credits, tax lawyers say.

Ford, which makes and sells cars overseas, typically has large foreign tax credits each year. However, by setting up Ford Holdings, and selling the 25% stake making it a stand-alone unit under the tax law, Ford isn't required to consolidate these interest expenses and can preserve its foreign tax credits.

Ford's push to trim its tax bill follows three straight years of record earnings, which have made it one of the nation's most profitable corporations. In 1988, the No. 2 auto maker earned $5.3 billion, the highest net income ever achieved by an auto maker world-wide. Earnings, however, are expected to decline this year because of slower U.S. car sales, higher incentive costs and temporary plant shutdowns.

At the same time, Ford executives have said they expect financial services to take an increasing role in the company's profit, eventually constituting one-third of earnings, according to Ford Vice Chairman Harold A. Poling.

The Ford Motor Credit subsidiary, which was incorporated in Delaware in 1959, received a special exemption under the 1986 tax act. The 1986 law generally lowered tax rates while closing many loopholes. But the more recent planned acquisition of Associates, a huge, highly leveraged company, would have eaten up much of Ford's foreign tax credits if it wasn't established through a separate company.

In an interview, Ford's Mr. Brown said the auto company is in the midst of selling $800 million of voting preferred stock to institutions in the so-called private placement market. This nearly $200-billion market is made up of insurance companies, pension funds and other big investors; individual investors can't buy securities issued there.

Mr. Brown confirms that the creation of Ford Holdings as a separate entity preserves tax benefits Ford currently receives because Ford will own less than 80% of the concern.

However, Mr. Brown says Ford formed the new holding unit primarily to help finance Ford's acquisition of Associates and to begin selling preferred stock, "a market Ford hasn't accessed." As for avoiding potential taxes, he only says, "There may be some tax benefits and there may be some tax detriments."

The innovative Ford transaction could be imitated by other multinational corporations, investment bankers and tax lawyers say.

"This is one of the strategies that many U.S. multinationals have explored to alleviate the adverse consequences of the 1986 tax act," says James A. Duncan, a partner at the New York law firm of Cleary, Gottlieb, Steen & Hamilton. "Many U.S. multinationals have explored variations on this strategy. But its costs and benefits depend very much on complex considerations specific to each company," he added.

Unlike common stock, whose price fluctuates with the perceived value of a company, its assets and earnings, preferred stock has a fixed, stated value that doesn't move with the actual value of the company. Preferred stock normally pays dividends to holders comparable to interest rates on some money-market investments.

Ford Holdings' offering of preferred, which is being arranged by Goldman, Sachs & Co. and Shearson Lehman Hutton Inc., is unusual because it is one of the rare instances when so-called money market preferred has been sold with voting rights, which are required to achieve beneficial tax treatment in this case.

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By CONSTANCE MITCHELL
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If California is truly a window on America's tomorrow, the nation's bankers have reason to worry.

Japanese-owned banks now control about 25% of the banking market in the most populous U.S. state, thanks largely to pricing so razor-thin that American banks have virtually ceded certain types of lending.

Roger V. Smith, the president of Silicon Valley Bank in Santa Clara, knows all about that. He tells why his bank has given up calling on local technology companies backed by Japanese investors. He says that after a sales call on a small company that was sagging financially but had Japanese backing, his bank would have offered a loan at three percentage points over the prime rate, the benchmark for commercial loans. But a Japanese bank made the loan at the incredibly low rate of 0.25 percentage point over the federal funds rate, the far-lower rate that banks charge each other for loans.

Stunned by such incidents, Mr. Smith says "it's a waste of time" to seek similar companies' business. "If a Japanese company is in on a deal, there is a different price."

Cheap Letters of Credit

Moreover, Japanese banks are making inroads all across the U.S. In Providence, R.I., Terry Murray, the chairman of Fleet Norstar Financial Group Inc., says he was shocked when his company went shopping for letters of credit—basically, bank guarantees of payment—for some of its nonbanking subsidiaries. Japanese banks offered letters of credit for a fee only about a quarter as much as what U.S. banks were charging.

Some bankers wouldn't be surprised to see Japanese banks capture 25% of the U.S. commercial-loan market by the mid-1990s. In six years, Japanese banks have come from nowhere to become the leading providers of letters of credit for U.S. municipal bonds. Last year, foreign banks, mainly Japanese, provided letters of credit for $12 billion in municipal-bond offerings—69% of the market.

"The Japanese are absolutely running circles around us," Mr. Murray says.

American banks also are suffering from more than pricing problems. Compared with most of their major competitors, U.S. banks are hobbled by structural impediments that include barriers to forming national networks, rigorous reporting requirements and disadvantageous tax and accounting standards. And they are hurt by some self-inflicted wounds.

Slipping Away

But the message is unmistakable: U.S. banks, once riding high in global finance, are losing their grip on the nation's and the world's credit reins.

More than 260 foreign banks are operating in the U.S., and their slice of the domestic banking pie has grown to more than 21% from 14% in 1982. At the same time, U.S. banks are retreating from the international arena. Among major industrialized nations' banks, only U.S. banks now have fewer cross-border assets, chiefly loans and securities, than they did in 1983; such assets now total $102 billion. In contrast, Japanese banks have increased their international assets fourfold to $129 billion.

"Clearly, the U.S. has lost and continues to lose position globally," says Willard C. Butcher, the chairman of Chase Manhattan Corp., the parent of the second-largest U.S. bank. Guido Schmidt-Chiari, the chairman of Austria's Creditanstalt, agrees. "American banks are definitely losing importance," he says. "Just look at how Bank of America, Chemical and others have retreated from Europe."

Dangers for Business

More is at stake in U.S. banks' slippage than mere national pride. In a financial crisis, control of credit often determines the outcome. On Oct. 19, 1987, when the stock market crashed, the Federal Reserve Bank of New York leaned on New York banks to meet the cash needs of Wall Street firms. The banks generally responded, and a national economic calamity was narrowly averted.

But would the banks have acted as quickly if the final decisions had rested in Tokyo or London? It's hard to say.

"In a credit crunch," Citicorp Chairman John S. Reed warns, "financial institutions would be faced with a choice: Which customers do you take care of? In such a situation, banks would have a natural bias toward their hometown players."

And a credit crunch is always possible. "If Eastern Europe and the Soviets were to open up to Western investment," Mr. Reed adds, "it would absorb immense amounts of capital. It's in this country's national interest to have four or five American international banks. At best, we now have one or two players."

H. Robert Heller, a former Federal Reserve governor, echoes that view: "American business isn't being served by U.S. financial institutions on a global basis. American business is directly affected by this. They don't have the support of their hometown bank in promoting their exports."

American banks certainly aren't out of the game already. They still lead in devising new financial products, such as commodity swaps to insulate buyers and sellers against future price swings, and in turning various loans, ranging from credit-card receivables to boat loans, into securities and selling them to investors. They operate out of a huge domestic market; the dollar is the world's major reserve currency, and English is the world's language of business. And though only Citibank ranks among the world's top 20 banks in assets, it is the world's most profitable; J.P. Morgan & Co. also ranks high in profitability.

But the slippage of U.S. banks is real. To a great extent, it is an inevitable consequence of America's huge trade deficit and low savings rate. "I view Japan to capital as I view Saudi Arabia to oil," Mr. Reed says.

Self-Inflicted Wounds

U.S. banks also have themselves to blame. Until recently, they have been running on slimmer and slimmer capital bases ever since the Civil War. Now, faced with higher capital requirements imposed by the Bank for International Settlements, many of them can't afford to be patient investors in new businesses; so, they are selling assets. Manufacturers Hanover Corp. agreed to sell 60% of its CIT Group Inc. to Dai-Ichi Kangyo Bank Ltd. for $1.28 billion. BankAmerica Corp. sold its Italian subsidiary to Germany's Deutsche Bank AG for $600 million. And Chase Manhattan sold Nederlandse Credietbank, the sixth-largest Dutch bank, to France's Credit Lyonnais.

In addition, U.S. banks' $60 billion of troubled Third World loans are dragging down their earnings and raising their cost of capital. Yoshihisa Tabuchi, the chief executive of Japan's Nomura Securities Co., says: "The reason American banks are having such trouble is because they didn't observe the basic principles. The Latin American debt problem came from their side; they forgot the principles of sound management; the S&L difficulty is the same." Adds Hans-Ulrich Doerig, Zurich-based member of the managing board of Credit Suisse, "Americans always act on fashion, a fad; they want to be with it."

U.S. banks also have been burned by scores of poorly planned acquisitions. In London, U.S. banks, including Citicorp and Chase Manhattan, paid top dollar for British securities firms, only to see cutthroat competition, in the wake of deregulation of British financial markets, wipe out profits. Just weeks ago, Chase became the latest U.S. institution to flee the British government bond market.

Legal Barriers

And legal barriers preventing U.S. banks from establishing interstate networks and offering securities and insurance products have hampered competitiveness, especially vis-a-vis European banks. The U.S. has long distrusted concentrations of power—a populism that may have served a frontier nation well but is a handicap in a global economy. "Our banking system is an antique," says Christopher L. Snyder Jr., the president of Loan Pricing Corp., which sells data on commercial loans.

Another hurdle for American banks is that they must publicly report financial results every 90 days and thus tend to pay a great deal of attention to day-to-day events. In addition, banks in several European countries, particularly Switzerland and West Germany, are granted tax relief for bad-debt provisions. Japan's banks enjoy lower reserve requirements, and its deposit-insurance premiums are a mere 1.2 cents per $100, compared with 15 cents per $100 for U.S. institutions.

A less-understood but important factor hampering U.S. banks is their high cost of capital. The difference in the stock values of Japanese and of U.S. banks is stark: Stocks of Japanese banks sell, on average, at 58 times annual earnings per share, while big U.S. banks generally sell for six to 10 times earnings.

As a result, Japan's 13 largest banks have a market capitalization of $500 billion, compared with $95 billion for the 50 largest U.S. banks. Some critics suggest that the Japanese banks' low-cost capital is a by-product of Japan's stock market, in which informal networks of corporate cross-shareholdings inflate stock prices.

Many Advantages

In addition to an advantage in pricing loans and services, the high market capitalization of Japanese banks makes it relatively painless for them to meet the new capital requirements. It also enables them to "acquire foreign banks easily without diluting their earnings because other banks are making more money," says Mr. Doerig of Credit Suisse.

Several years ago, First Manhattan Consulting Group estimated that a U.S. bank needed to price its loans 2.05 percentage points above its cost of funds to earn an adequate return. By contrast, a Japanese bank needed only an additional 1.1 points to get the same return.

The new capital requirements and some deregulation of Japanese financial markets have reduced that advantage, but James McCormick of First Manhattan estimates that Japanese banks still have about a 0.5-point edge. That might not sound like much, but in big corporate loans, it is.

Such figures may suggest that Japanese banks are "buying market share" by accepting lower returns. But David D. Hale, the chief economist at Kemper Financial Services Inc., suspects that foreign banks' lower cost of capital may allow them to earn adequate returns on the slim margins. Meanwhile, higher capital costs may be forcing U.S. banks to pursue fatter-margin, and riskier, loans.

Looking Ahead

Though Japanese banks haven't so far acted as the lead manager of a major commercial-loan syndication for a U.S. corporate borrower, they are angling for such a prestigious role. In real-estate financing, some U.S. companies, such as Marriott Corp., regularly rely on Japanese banks.

According to Greenwich Associates, a Greenwich, Conn., consulting firm, 45% of large U.S. companies currently use one or more Japanese banks. And almost 60% of those surveyed believe that Japanese banks have the skills to be fully competitive with U.S. banks in complex financings. However, the survey found that 80% of the surveyed companies termed it "unlikely" that a Japanese bank would become one of their principal banks within five years.

While foreign banks seize bigger shares here, U.S. banks are losing their toehold in Japan. In recent years, bankers estimate, U.S. banks' share of the Japanese market has dropped to 1% from 3%.

Some critics favor "managed trade," a form of protectionism, in financial services. Already, the U.S. has used U.S. government bond dealerships for Japanese financial institutions as a lever to gain wider access for U.S. players to the Japanese government debt market.

U.S. Changes Urged

Some observers also advocate revisions in laws separating the banking, securities and insurance industries. And they want the Fed to make a slew of changes. The Fed, for instance, currently requires banks to post 12% of their checking-account balances in reserves with it, even though federal law requires only 8%.

Behind such changes would be a recognition that the U.S. needs a globally competitive financial system. Even a change in American attitudes would help, says Chase's Mr. Butcher, who adds: "The U.S. government has certainly not been a friend or supporter of its banking system." But Rep. Charles Schumer, a New York Democrat who has pushed legislation to open foreign financial markets to U.S. institutions, says, "It's been a lonely fight. No one in the administration has this as their No. 1 priority."

More problematic but fundamental to reversing the U.S. banking system's decline is the promotion of greater savings and investment by individuals, corporations and the federal government. But here again, Rep. Schumer doesn't hold out much hope. "We still don't see the importance of being a nation of savers," he says. "Our banks and securities firms have the financial technology and the entrepreneurial drive; other nations' financial institutions have the capital.

"My fear is that in 10 years they will have the technology and the capital. Then, we will have real trouble."

Japanese Banks Lead in Assets, Lag in Equity

World's largest banking companies, ranked by total assets on Dec. 31, 1988; data for foreign banks are translated at fiscal-year-end exchange rates

BANKING COMPANY	COUNTRY	ASSETS (In billions)	EQUITY CAPITAL (In billions)	EQUITY CAPITAL-TO-ASSETS (In percent)
Dai-Ichi Kangyo Bank	Japan	$386.94	$10.95	2.83%
Sumitomo Bank	Japan	376.09	10.46	2.78
Fuji Bank	Japan	364.04	10.73	2.95
Sanwa Bank	Japan	348.36	9.31	2.67
Mitsubishi Bank	Japan	343.59	9.68	2.82
Industrial Bank of Japan	Japan	257.58	8.57	3.33
Norinchukin Bank	Japan	241.95	1.38	0.57
Tokai Bank	Japan	225.12	6.16	2.74
Mitsui Bank	Japan	219.67	5.77	2.63
Mitsubishi Trust	Japan	210.47	5.13	2.44
Credit Agricole	France	207.99	9.03	4.34
Citicorp	United States	203.83	9.86	4.84
Sumitomo Trust	Japan	196.59	4.69	2.39
Banque Nationale de Paris	France	194.52	5.50	2.83
Barclays PLC	Britain	189.20	10.32	5.46

NOTE: Japanese bank data as of March 31, 1989

Source: American Banker

Ford Revamps Firm to Realize Big Tax Savings

Holding Firm Set in Move To Include Private Sale Of 25% Stake to Investors

By MATTHEW WINKLER
Staff Reporter of THE WALL STREET JOURNAL

NEW YORK—Ford Motor Co. has quietly formed a new holding company for some of its major financial units and is selling privately a 25% stake in it for $800 million to institutional investors in a move that should garner it major tax savings.

While Ford officials won't discuss the tax savings from the transaction, tax experts say the auto giant should save many millions of dollars. "We never talk about our tax returns," says George V. Brown III, executive director of strategic planning for the company's Ford Financial Services operation.

The new holding company, Ford Holdings Inc., includes Associates Corp., a consumer and commercial finance company that is Ford's most recent and largest acquisition, as well as Ford's insurance and leasing subsidiaries.

The transaction will allow Ford to preserve major tax benefits and avoid an increase in taxes resulting from its $3.35 billion acquisition of Associates from Paramount Communications Inc., a purchase that is scheduled to be completed at the end of this month.

Since 1986, when Congress passed landmark legislation overhauling the U.S. tax code, U.S. multinationals have been required to allocate interest expenses on a consolidated basis. The effect for many companies has been to increase the effective cost of debt financing, because interest expenses allocated against foreign income "crowd out" tax credits that otherwise might be available.

Thus, interest expenses in the U.S. must now be allocated prorata to foreign-based assets. This reduces the calculation of foreign tax credits used in the U.S., effectively increasing U.S. tax payments by decreasing foreign tax credits, tax lawyers say.

Ford, which makes and sells cars overseas, typically has large foreign tax credits each year. However, by setting up Ford Holdings, and selling the 25% stake making it a stand-alone unit under the tax law, Ford isn't required to consolidate these interest expenses and can preserve its foreign tax credits.

Ford's push to trim its tax bill follows three straight years of record earnings, which have made it one of the nation's most profitable corporations. In 1988, the No. 2 auto maker earned $5.3 billion, the highest net income ever achieved by an auto maker world-wide. Earnings, however, are expected to decline this year because of slower U.S. car sales, higher incentive costs and temporary plant shutdowns.

At the same time, Ford executives have said they expect financial services to take an increasing role in the company's profit, eventually constituting one-third of earnings, according to Ford Vice Chairman Harold A. Poling.

The Ford Motor Credit subsidiary, which was incorporated in Delaware in 1959, received a special exemption under the 1986 tax act. The 1986 law generally lowered tax rates while closing many loopholes. But the more recent planned acquisition of Associates, a huge, highly leveraged company, would have eaten up much of Ford's foreign tax credits if it wasn't established through a separate company.

In an interview, Ford's Mr. Brown said the auto company is in the midst of selling $800 million of voting preferred stock to institutions in the so-called private placement market. This nearly $200-billion market is made up of insurance companies, pension funds and other big investors; individual investors can't buy securities issued there.

Mr. Brown confirms that the creation of Ford Holdings as a separate entity preserves tax benefits Ford currently receives because Ford will own less than 80% of the concern.

However, Mr. Brown says Ford formed the new holding unit primarily to help finance Ford's acquisition of Associates and to begin selling preferred stock, "a market Ford hasn't accessed." As for avoiding potential taxes, he only says, "There may be some tax benefits and there may be some tax detriments."

The innovative Ford transaction could be imitated by other multinational corporations, investment bankers and tax lawyers say.

"This is one of the strategies that many U.S. multinationals have explored to alleviate the adverse consequences of the 1986 tax act," says James A. Duncan, a partner at the New York law firm of Cleary, Gottlieb, Steen & Hamilton. "Many U.S. multinationals have explored variations on this strategy. But its costs and benefits depend very much on complex considerations specific to each company," he added.

Unlike common stock, whose price fluctuates with the perceived value of a company, its assets and earnings, preferred stock has a fixed, stated value that doesn't move with the actual value of the company. Preferred stock normally pays dividends to holders comparable to interest rates on some money-market investments.

Ford Holdings' offering of preferred, which is being arranged by Goldman, Sachs & Co. and Shearson Lehman Hutton Inc., is unusual because it is one of the rare instances when so-called money market preferred has been sold with voting rights, which are required to achieve beneficial tax treatment in this case.

10/12/89

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RECEIVED

See the future by studying banks today

ON EXCELLENCE
By Tom Peters

ARE YOU in the steel business? Hotels? Anxious about what happens when information technology reaches its wild and woolly potential? Study the banking industry and read the just-published "Technology in Banking," by McKinsey & Co. consultants Tom Steiner and Diogo Teixeira.

Banking used to be a cozy, regulated game. Banks were all things to all people; profits were pretty much assured. Then in the early 1980s came deregulation. Next, new technologies. With computer power growing between 25 and 40 percent a year, the systems side of the banking business is reshaping the industry.

"Banking products," the authors note, "are simply information combined in new ways, so with hundredfold increases in the amount of information available, it is not surprising that there are a lot of new products." This product flood transformed bank balance sheets: Service fees, or "non-interest income" (income not generated by loans), soared in the '80s, especially at big banks that created products to maximize information-processing economies of scale. Non-interest income at Bankers Trust ($56 billion in assets), for instance, shot from 32 to 64 percent of total income between 1980 and 1988.

Deregulation and the new technologies also caused specialization and disaggregation on a grand scale. Banking's traditional "make-make-make approach," as Steiner and Teixeira call it, is now history. Consider Manufacturers Hanover Corp.'s credit card business: In 1987 it was fifth biggest in the country, with 3.4 million accounts and a $2.5 billion asset portfolio; MHC also processed $2.5 billion yearly in credit-card sales drafts for merchants. Then MHC sold its merchant-support business to Fort Lauderdale's NaBanco, a specialized data-processing company. Next it peddled credit-card processing operations to another non-bank specialist, First Data Resources. Finally MHC "securitized" (turned assets into tradable commercial instruments) and sold $475 million of its credit card receivables. "The result," the authors write, "has been to create credit card transactions that are captured by others, routed to MHC via others, processed by others, and the balances of which may ultimately belong to others. MHC retains the customer servicing, collection responsibility, and authority over all credit decisions."

Banks today aim at narrow markets where they can be truly distinct. Take First Wachovia of Winston-Salem, N.C., which has become the country's second-largest processor of student loans. "Student lending is extremely complex," Steiner and Teixeira observe, "because each state has different rules for each type of student. A medical education loan is different from a liberal arts education loan, which is different from a truck driving school loan. ... First Wachovia has developed proprietary software to track student loans and deliver the required servicing." First Wachovia generates $5 million profit on approximately $23 million in annual revenue from this speciality.

The authors offer many other examples of effectively "focused" (their favorite word) strategies. State Street Boston Corp. is no longer really a bank, but a data processing company ("a computerized record-keeping and accounting business"); the $7 billion (assets) institution dumped 90 percent of its branches and aimed instead to become a force in the "custodial" business, performing intricate record-keeping for the securities industry. State Street now handles 10 percent of the world's securities transactions.

The value of specializing/focusing is staggering: The stock market value of non-bank American Express's Green Card alone exceeds the combined stock market value of huge Chemical Bank, Chase Manhattan and Manufacturers Hanover. In fact, the rise of non-banks is as dramatic as the dismemberment of the banks themselves. The authors project a thoroughly specialized financial services environment. Smaller banks will be mainly "retailers" serving the local customer directly; big banks will become "manufacturers and wholesalers;" and non-banks will be the "production subcontractors."

Information technology systems offer "the most leverage to dominate (one of the roughly 150) lines of (banking) business," Steiner and Teixeira contend. Competition in the industry now centers on individual products (for example, student loan processing services), rather than across the board, bank vs. bank rivalry. Bank strategy amounts to deciding precisely where to strike, then designing the appropriate supporting technology systems.

Banking's saga is every industry's saga. Financial services lead by 10 years because of the central role information, by definition, plays in the industry. If you want to see in 1990 a clear snapshot of the year 2000 in your industry, digest "Technology in Banking" – and begin your search now for the unconventional new strategies and products that will separate tomorrow's winners and losers.

Tribune Media Services Inc.

TO: Alan Friedman
Paull Mines
Ed Campion

FROM: Eric Coffill

Sears Roebuck and Citibank Step Up Offerings In Booming Market for Asset-Backed Securities

1/10/90

By CONSTANCE MITCHELL
And ANDREW BARY
Staff Reporters of THE WALL STREET JOURNAL

NEW YORK—The market for asset-backed securities is heating up again after record-breaking fourth quarter.

Sears, Roebuck & Co., the nation's largest retailer, is expected to offer about $500 million of credit card securities sometime this week while Citibank, a unit of Citicorp, sold $750 million of credit card securities yesterday in Europe. The Citibank issue indicates broadening foreign demand for asset-backed securities.

The Sears offering, which will be backed by receivables from the retailer's consumer credit cards, will use a senior-subordinated structure. A subordinated class, totaling 8.5% of the underlying pool of receivables, will support the senior securities which will be sold publicly.

News of the Sears and Citibank offerings come as Chemical Securities Inc., a subsidiary of Chemical Banking Corp., reported that issuance of asset-backed securities reached $24 billion in 1989, the largest amount in the market's five-year history. That compares with issuance of $16.3 billion in 1988, $10.3 billion in 1987, $10 billion in 1986 and $1.2 billion in 1985.

Stephen King, a vice president in the fixed-income research department at Chemical Securities, said issuance is expected to grow even faster this year. He said banks find that securitizing consumer debt is an attractive, and lucrative, way to reduce assets from their balance sheets. And more are doing so to meet the stricter capital requirements of banking regulators.

"Less than 10% of all consumer credit debt has been securitized so there is a lot of potential for further securitization," said Mr. King.

Chemical Securities noted that the final quarter of 1989 accounted for 50% of last year's volume of new asset-backed securities. Credit-card securities accounted for half of that volume, followed by auto-loan securities which accounted for 33%. The rest of the volume was comprised of other kinds of asset-backed issues, particularly home-equity loans and boat loans.

JANE BRYANT QUINN

10/15/89

Credit Card Banks and High Interest Rates

The door is now open for the interest rate on retail charge cards to go up.

Under a law passed by Congress in 1987, retailers can escape state usury laws, which set ceilings on how high interest rates can rise. Sixteen states have no ceilings, but those that do tend to cluster at 18 percent to 21 percent.

The '87 law allows companies to form "credit card" banks, devoted entirely to issuing and managing credit cards. Here's the significance of these banks to retailers and their customers:

An individual store can't charge an interest rate any higher than the state's usury ceiling. Right now, for example, Texas's ceiling on retail cards is 18 percent.

But an out-of-state bank can send cards into any state it wants, and charge the rate allowed in its home state. The usury ceiling in Ohio is 25 percent. So if a Texas store had its credit cards issued by an Ohio bank, it could charge up to 25 percent—regardless of Texas's ceiling.

The Limited, a retailing chain based in Columbus, Ohio, is leading the way. In May, it received permission from the federal government to set up a banking subsidiary called the World Financial Network National Bank, devoted entirely to issuing charge cards for its Lane Bryant and Lerner divisions and three of its mail-order catalogues.

The Limited's interest rate, in states with high usury ceilings, has been 22.8 percent. Since its new bank went into operation, that rate has been exported to 16 states where ceilings are lower.

The May Department Stores Co. just received permission to start three credit-card banks, based in Ohio, Arizona and Maryland. A spokesman says that May is planning no increase in interest rates at the present time, although that could change.

General Electric Capital has established the Monogram Bank in Cincinnati. Right now, it issues only Visa and MasterCard. But it is looking at the possibility of managing credit-card programs for retailers, says William Nutting, marketing manager of its Retailer Financial Services.

Ralph Spurgin, president of The Limited's credit-card bank, says the increase in interest rates on his cards is not a big deal. If you charge $100 and pay it off at $10 a month, he says, your debt costs only 11 cents more a month at 21 percent interest than it did at 18 percent. Perhaps because of these small price differences, studies The Limited did in 1987 show that higher interest rates don't make a significant impact on sales, he says.

Retailers' charge cards are often unprofitable because of the low balance customers carry on their cards. The average is only $250 ($170 for The Limited), compared with $1,100 on bank cards, says John Love, publisher of the Chicago-based newsletter Credit Card News. Spurgin says that charging higher interest rates should put The Limited's credit-card operation into the black—something retailers would very much like to do.

Consumers who do notice interest rates have been using their retail cards less and their bank cards more. Your Visa might charge 16 percent to 18 percent on unpaid balances, while your store charges 18 percent to 23 percent. Faced with customer defections, retailers have been thinking up ways to make their cards more attractive to use.

There's talk of "frequent shopper" programs, although there isn't a lot of enthusiasm for them, Nutting says. Stores increasingly announce special sales to their charge-card customers or mail discount coupons with their bills. A few stores give VIP cards to heavy shoppers. They entitle you to special services, like free gift wrapping or speedy repairs on your appliances.

Instead of fighting the bank cards, some stores will join them. Take the retailing chain Hit or Miss. In June, it started offering customers a Monogram Bank Visa card with the store's logo on it, Nutting says. The card can be used anywhere that accepts Visa. But every time the customer pulls it out she'll see the store name—a reminder to go there and shop.

Citicorp to Buy Bank of New England's Credit-Card Business for $828 Million

1/30/90

By CHRISTOPHER J. CHIPELLO
Staff Reporter of THE WALL STREET JOURNAL

BOSTON—Bank of New England Corp. said it reached a definitive agreement to sell its credit-card business to Citicorp for $828 million, helping Bank of New England raise cash and bolster its weakened capital base.

H. Ridgely Bullock, newly appointed interim chairman and chief executive officer, said in an interview that Bank of New England's plan to sell assets and boost its capital ratios is "going very well," and said the company remains "a very viable enterprise."

Many analysts and investors have raised doubts about Bank of New England's ability to remain independent, in the wake of an estimated $1.2 billion fourth-quarter loss and a massive increase in problem loans. Depositors—especially those with large, uninsured deposits—have been withdrawing funds from the bank, forcing it to borrow from the Fed.

Mr. Bullock declined to specify Bank of New England's current level of Fed borrowings. He said the company's cash needs "appeared to be stabilizing" at the end of last week, but added that the amount is likely to fluctuate from day to day depending on whether maturing deposits are rolled over. Government statistics indicate that, as of last Wednesday, Bank of New England had borrowed as much as $475 million from the Fed.

Besides generating cash, the sale of $670 million in credit-card assets to Citicorp will result in a gain of $176 million for Bank of New England, whose equity capital has sunk to about $500 million—roughly 1.7% of its $29 billion in assets. The sale is subject to clearance by the federal government under the Hart-Scott-Rodino antitrust act; both companies have requested expedited approval, Bank of New England said.

With more than 27 million MasterCard and Visa credit cards outstanding, Citicorp is the largest credit-card issuer in the nation. Bankers have been particularly eager to increase their credit-card portfolios, because credit cards are usually twice as profitable as the typical commercial loan.

With the pool of desirable consumers needing credit cards shrinking, Citicorp and other large issuers in recent years have turned to buying credit-card portfolios from smaller issuers. Most recently, Citicorp bought a portfolio from First City Corp. of Houston.

With their huge processing systems and economies of scale, the large issuers can usually wring greater profits out of these portfolios.

By the end of this week, Bank of New England expects to receive bids for $1.3 billion in home equity loans, Mr. Bullock said. The company could also receive this week some advance funding related to the sale of $500 million in residential mortgages, he said.

In composite trading on the New York Stock Exchange, Bank of New England's share price closed at $4.125, up 62.5 cents, on volume of 1,993,000 shares.

Mr. Bullock, a member of Bank of New England's board, has been chairing the directors' committee supervising the company's effort to sell $6 billion in loans and other assets and to explore the possible sale or merger of some of the company's affiliate banks—including its Connecticut Bank & Trust Co. unit in Hartford, Conn., and smaller units in Maine and Rhode Island.

Whether the company agrees to sell any of the affiliate banks could depend on the "success and speed" of the other asset sales—as well as on the prices offered for the affiliates, Mr. Bullock said. "I would expect that the value of those [banking] subsidiaries will increase over time," as the level of nonperforming loans declines, he said. "We're not holding a fire sale."

Although Citicorp and other bank holding companies are said to be interested in the Connecticut unit, Mr. Bullock said Bank of New England hasn't received "firm offers" for any of the affiliate banks.

Mr. Bullock was named interim chairman and chief executive after the dismissal last Friday of Walter Connolly Jr. as chairman and chief executive officer. Mr. Bullock is president and chief executive of Montchanin Management Corp., a New York-based firm that does management consulting and mergers-and-acquisition work. Previously, he was chairman

Ford Revamps Firm to Realize Big Tax Savings

Holding Firm Set in Move To Include Private Sale Of 25% Stake to Investors

By MATTHEW WINKLER
Staff Reporter of THE WALL STREET JOURNAL

NEW YORK—Ford Motor Co. has quietly formed a new holding company for some of its major financial units and is selling privately a 25% stake in it for $800 million to institutional investors in a move that should garner it major tax savings.

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Since 1986, when Congress passed landmark legislation overhauling the U.S. tax code, U.S. multinationals have been required to allocate interest expenses on a consolidated basis. The effect for many companies has been to increase the effective cost of debt financing, because interest expenses allocated against foreign income "crowd out" tax credits that otherwise might be available.

Thus, interest expenses in the U.S. must now be allocated prorata to foreign-based assets. This reduces the calculation of foreign tax credits used in the U.S., effectively increasing U.S. tax payments by decreasing foreign tax credits, tax lawyers say.

Ford, which makes and sells cars overseas, typically has large foreign tax credits each year. However, by setting up Ford Holdings, and selling the 25% stake making it a stand-alone unit under the tax law, Ford isn't required to consolidate these interest expenses and can preserve its foreign tax credits.

Ford's push to trim its tax bill follows three straight years of record earnings, which have made it one of the nation's most profitable corporations. In 1988, the No. 2 auto maker earned $5.3 billion, the highest net income ever achieved by an auto maker world-wide. Earnings, however, are expected to decline this year because of slower U.S. car sales, higher incentive costs and temporary plant shutdowns.

At the same time, Ford executives have said they expect financial services to take an increasing role in the company's profit, eventually constituting one-third of earnings, according to Ford Vice Chairman Harold A. Poling.

The Ford Motor Credit subsidiary, which was incorporated in Delaware in 1959, received a special exemption under the 1986 tax act. The 1986 law generally lowered tax rates while closing many loopholes. But the more recent planned acquisition of Associates, a huge, highly leveraged company, would have eaten up much of Ford's foreign tax credits if it wasn't established through a separate company.

In an interview, Ford's Mr. Brown said the auto company is in the midst of selling $800 million of voting preferred stock to institutions in the so-called private placement market. This nearly $200-billion market is made up of insurance companies, pension funds and other big investors; individual investors can't buy securities issued there.

Mr. Brown confirms that the creation of Ford Holdings as a separate entity preserves tax benefits Ford currently receives because Ford will own less than 80% of the concern.

However, Mr. Brown says Ford formed the new holding unit primarily to help finance Ford's acquisition of Associates and to begin selling preferred stock, "a market Ford hasn't accessed." As for avoiding potential taxes, he only says, "There may be some tax benefits and there may be some tax detriments."

The innovative Ford transaction could be imitated by other multinational corporations, investment bankers and tax lawyers say.

"This is one of the strategies that many U.S. multinationals have explored to alleviate the adverse consequences of the 1986 tax act," says James A. Duncan, a partner at the New York law firm of Cleary, Gottlieb, Steen & Hamilton. "Many U.S. multinationals have explored variations on this strategy. But its costs and benefits depend very much on complex considerations specific to each company," he added.

Unlike common stock, whose price fluctuates with the perceived value of a company, its assets and earnings, preferred stock has a fixed, stated value that doesn't move with the actual value of the company. Preferred stock normally pays dividends to holders comparable to interest rates on some money-market investments.

Ford Holdings' offering of preferred, which is being arranged by Goldman, Sachs & Co. and Shearson Lehman Hutton Inc., is unusual because it is one of the rare instances when so-called money market preferred has been sold with voting rights, which are required to achieve beneficial tax treatment in this case.

10/12/89

Sears Roebuck and Citibank Step Up Offerings In Booming Market for Asset-Backed Securities

1/10/90

By CONSTANCE MITCHELL
And ANDREW BARY
Staff Reporters of THE WALL STREET JOURNAL

NEW YORK—The market for asset-backed securities is heating up again after record-breaking fourth quarter.

Sears, Roebuck & Co., the nation's largest retailer, is expected to offer about $500 million of credit card securities sometime this week while Citibank, a unit of Citicorp, sold $750 million of credit card securities yesterday in Europe. The Citibank issue indicates broadening foreign demand for asset-backed securities.

The Sears offering, which will be backed by receivables from the retailer's consumer credit cards, will use a senior-subordinated structure. A subordinated class, totaling 8.5% of the underlying pool of receivables, will support the senior securities which will be sold publicly.

News of the Sears and Citibank offerings come as Chemical Securities Inc., a subsidiary of Chemical Banking Corp., reported that issuance of asset-backed securities reached $24 billion in 1989, the largest amount in the market's five-year history. That compares with issuance of $16.3 billion in 1988, $10.3 billion in 1987, $10 billion in 1986 and $1.2 billion in 1985.

Stephen King, a vice president in the fixed-income research department at Chemical Securities, said issuance is expected to grow even faster this year. He said banks find that securitizing consumer debt is an attractive, and lucrative, way to reduce assets from their balance sheets. And more are doing so to meet the stricter capital requirements of banking regulators.

"Less than 10% of all consumer credit debt has been securitized so there is a lot of potential for further securitization," said Mr. King.

Chemical Securities noted that the final quarter of 1989 accounted for 50% of last year's volume of new asset-backed securities. Credit-card securities accounted for half of that volume, followed by auto-loan securities which accounted for 33%. The rest of the volume was comprised of other kinds of asset-backed issues, particularly home-equity loans and boat loans.

MTC/DC
JUN 05 1990
RECEIVED

See the future by studying banks today

ON EXCELLENCE
By Tom Peters

ARE YOU in the steel business? Hotels? Anxious about what happens when information technology reaches its wild and woolly potential? Study the banking industry and read the just-published "Technology in Banking," by McKinsey & Co. consultants Tom Steiner and Diogo Teixeira.

Banking used to be a cozy, regulated game. Banks were all things to all people; profits were pretty much assured. Then in the early 1980s came deregulation. Next, new technologies. With computer power growing between 25 and 40 percent a year, the systems side of the banking business is reshaping the industry.

"Banking products," the authors note, "are simply information combined in new ways, so with hundredfold increases in the amount of information available, it is not surprising that there are a lot of new products." This product flood transformed bank balance sheets: Service fees, or "non-interest income" (income not generated by loans), soared in the '80s, especially at big banks that created products to maximize information-processing economies of scale. Non-interest income at Bankers Trust ($56 billion in assets), for instance, shot from 32 to 64 percent of total income between 1980 and 1988.

Deregulation and the new technologies also caused specialization and disaggregation on a grand scale. Banking's traditional "make-make-make approach," as Steiner and Teixeira call it, is now history. Consider Manufacturers Hanover Corp.'s credit card business: In 1987 it was fifth biggest in the country, with 3.4 million accounts and a $2.5 billion asset portfolio; MHC also processed $2.5 billion yearly in credit-card sales drafts for merchants. Then MHC sold its merchant-support business to Fort Lauderdale's NaBanco, a specialized data-processing company. Next it peddled credit-card processing operations to another non-bank specialist, First Data Resources. Finally MHC "securitized" (turned assets into tradable commercial instruments) and sold $475 million of its credit card receivables. "The result," the authors write, "has been to create credit card transactions that are captured by others, routed to MHC via others, processed by others, and the balances of which may ultimately belong to others. MHC retains the customer servicing, collection responsibility, and authority over all credit decisions."

Banks today aim at narrow markets where they can be truly distinct. Take First Wachovia of Winston-Salem, N.C., which has become the country's second-largest processor of student loans. "Student lending is extremely complex," Steiner and Teixeira observe, "because each state has different rules for each type of student. A medical education loan is different from a liberal arts education loan, which is different from a truck driving school loan. ... First Wachovia has developed proprietary software to track student loans and deliver the required servicing." First Wachovia generates $5 million profit on approximately $23 million in annual revenue from this speciality.

The authors offer many other examples of effectively "focused" (their favorite word) strategies. State Street Boston Corp. is no longer really a bank, but a data processing company ("a computerized record-keeping and accounting business"); the $7 billion (assets) institution dumped 90 percent of its branches and aimed instead to become a force in the "custodial" business, performing intricate record-keeping for the securities industry. State Street now handles 10 percent of the world's securities transactions.

The value of specializing/focusing is staggering: The stock market value of non-bank American Express's Green Card alone exceeds the combined stock market value of huge Chemical Bank, Chase Manhattan and Manufacturers Hanover. In fact, the rise of non-banks is as dramatic as the dismemberment of the banks themselves. The authors project a thoroughly specialized financial services environment. Smaller banks will be mainly "retailers" serving the local customer directly; big banks will become "manufacturers and wholesalers;" and non-banks will be the "production subcontractors."

Information technology systems offer "the most leverage to dominate (one of the roughly 150) lines of (banking) business," Steiner and Teixeira contend. Competition in the industry now centers on individual products (for example, student loan processing services), rather than across the board, bank vs. bank rivalry. Bank strategy amounts to deciding precisely where to strike, then designing the appropriate supporting technology systems.

Banking's saga is every industry's saga. Financial services lead by 10 years because of the central role information, by definition, plays in the industry. If you want to see in 1990 a clear snapshot of the year 2000 in your industry, digest "Technology in Banking" – and begin your search now for the unconventional new strategies and products that will separate tomorrow's winners and losers.

Tribune Media Services Inc.

TO: Alan Friedman
Paull Mines
Ed Campion

FROM: Eric Coffill

Commercial banks, computers and other forms of competition are moving powerfully into the investment banking business. Could be bad news for Wall Street.

Tough new kid on the block

By Marcia Berss

MORGAN STANLEY sure looks like a cheap stock, at only 8.7 times earnings. Merrill Lynch and Bear, Stearns are trading at even lower multiples.

Maybe the stocks are bargains, maybe not. In evaluating a stock, investors look more at expected future earnings than current ones. In the case of the brokerage stocks, the market has some strong reasons for being skeptical about the future. New competition and technology are conspiring to take a big bite out of investment banking, the big moneymaker for Wall Street firms. Changes coming to this industry are good news for corporations that need to raise capital, good news for investors who buy their securities and bad news for the investment firms in the middle. Predicts John Tamagni, managing director at investment bank Lazard Frères: "You'll have fewer and poorer investment bankers around."

Investment banking—underwriting public stock and bond issues, privately placing securities and arranging mergers and acquisitions—is the principal source of profits for most securities firms today, according to Perrin Long at Lipper Analytical Services. He estimates that investment banking, with pretax margins of 35% and up, is supporting other activities like trading, where profits are razor-thin, and brokerage, which is languishing.

Now consider recent events:

- In June Wall Street lost a decade-long battle when the Federal Reserve gave commercial banks limited powers to underwrite corporate bonds, hitherto a protected preserve for investment bankers. One Fed member called the ruling a "milestone in the deregulation of the American financial system." The Fed, having found a loophole in the Glass-Steagall Act (the 1933 law that separates commercial banking from investment banking), is expected to extend commercial banks' underwriting privileges to stock underwritings in 1990.
- In April CapitaLink, a small firm loosely affiliated with J.P. Morgan & Co., announced a system for corporations to issue bonds directly to investors, bypassing the underwriter. CapitaLink's no-frills service will offer new-issue, public, high-grade bonds via a computer dutch auction; it will cost 0.2% of the money raised, less than a third of the commission an underwriter charges. Savings on a midsize $300 million debt deal: $1.3 million. CapitaLink's target market is

Doomsday for dealmakers?

Investment banking is a small portion of revenue of Wall Street firms but a large source of net income. Competition is coming to this lucrative business at a time when other lines, like retail trading, are languishing.

Company	Investment banking revenue contribution[1]	Latest 12 months EPS	Price	P/E
Bear, Stearns	19.9%	$2.02	16¼	8.0
Merrill Lynch	17.1	4.14	34¼	8.3
Morgan Stanley	45.8	9.05	78⅞	8.7
PaineWebber	18.8	0.75	22⅞	30.5
Salomon Brothers	21.7	1.54	26⅞	17.5
Shearson Lehman Hutton	27.8	(0.03)	21⅞	NM

[1]Investment banking revenue as fraction of total revenue, net of interest expense, for fiscal 1988.
NM: Not meaningful.
Source: Company reports.

the $100 billion in high-grade new issues sold in 1988, 43% of all public corporate debt. The Morgan bank will begin marketing the system this fall.

Issuers are enthusiastic. Richard Culver, treasurer of Westinghouse Credit, says, "We think CapitaLink has a good deal of potential." So do investors: In April Metropolitan Life tried to cut out the middleman by buying an entire public debt deal direct from issuer Carolina Power & Light. Metropolitan ultimately abandoned the bid on a technical issue, but not before sending tremors through Wall Street.

• The Securities & Exchange Commission is expected shortly to approve a rule expanding private placements. In this market, companies sell securities (usually bonds) directly to an insurance company or pension manager. Corporations raising capital have, of late, discovered private placements in a big way. They now total $181 billion, or 40% of all corporate capital raised, against 22% of capital raised in 1980, according to IDD Information Services. Investment bankers are none too happy, since their fees for brokering such deals are well below those collected on public bond issues.

And their fees are about to get lower. This fall the SEC will probably relax disclosure requirements in the private market, making it even more attractive to issuers and buyers. This will eliminate red tape in simple private offerings and cut out the middleman banker. "The SEC knows we don't need them to tell us what financial information we need to make an investment decision," says Richard Yorks of Prudential Insurance, the nation's biggest holder of private placements, with $30 billion. As a result, "you may not need an investment banker to do these deals," says David Marks, senior vice president at Cigna Investment Group, another big private placement investor.

The fattest middlemen's margins are in the public underwriting of complex or riskier securities, including junk bonds and common stock. There the middleman's spread is 3% of the offering amount, up to 7% for initial public offerings. Commercial banks covet this business. The June Federal Reserve action permits commercial banks to underwrite corporate debt, provided they set up separate investment banking subsidiaries and limit underwriting to 5% of the unit's revenue. Four banks—Bankers Trust, Chase Manhattan, Citicorp and J.P. Morgan—are establishing such operations. The ruling is expected to be extended to more lucrative stock underwriting next year. As these banks, with the connivance of their regulators, push the outer limits of Glass-Steagall, they increase the pressure on Congress to repeal the law altogether.

In junk bond underwriting, commercial banks have a head start. They typically lend 60% of the financing in a leveraged buyout, and it's a short leap from analyzing the credit for a senior loan to analyzing the credit for the more junior debt. And it is the latter that is harder and thus more profitable to sell. Jerry Thompson, executive vice president at NCNB National Bank of North Carolina, was a senior lender in the recent RJR Nabisco buyout. Says he: "We feel like jerks when we put up most of the money in a deal and Mike Milken is making $500 million. We can find people to take on risky paper. They can't be hiding under rocks."

As Wall Street has already learned to do, commercial banks are starting to be equity players in takeover deals. In June commercial bank Bankers Trust raised eyebrows when it invested $80 million of equity in Alfred Checchi's $3.7 billion purchase of Northwest Airlines. The bank is also an equity player in James Goldsmith's $20 billion bid for B.A.T Industries. Commercial banks have long had the right to own up to 5% of voting stock in an industrial corporation (and up to 25% of shareholder equity). Only recently have they exercised this right. Often, they pick up equity kickers while arranging debt financing for a leveraged buyout.

In this invasion of underwriting and equity participation, commercial banks are attacking the bread and butter of investment bankers, mergers and acquisitions. At the top firms, 50% to 75% of investment banking earnings comes from merger work. Barry Friedberg, head of Merrill Lynch's investment banking group, says: "We perceive commercial banks to be a competitive force to be reckoned with."

Friedberg is being realistic: In the past Wall Street tended to sneer at banks as competitors in the merger business. There never was anything in Glass-Steagall to stop commercial banks from getting a piece of the action. All that stopped them was a perception that they were too clumsy. The buy-and-hold mindset of commercial bankers was supposedly no match for the risk-taking ethos of investment bankers; besides, argued Wall Street, commercial banks won't pay for talent.

They will now. In November Bankers Trust signed Gerald Rosenfeld, formerly of investment bank Salomon Brothers, to a reported $2 million-a-year, three-year contract. Another top investment banker says a commercial bank offered to top his seven-figure salary by 50%.

"Oct. 19 played to the advantage of commercial banks," notes Windle Priem of executive recruiter Korn Ferry International. Since the crash, mid-level investment banking salaries have been flat, while commercial bank pay is up. Among middle managers the investment bank salaries are still better, but the gap is narrowing. At entry level, the shift is even more dramatic. At Harvard's and Stanford's business schools, median starting salaries for graduates headed to a commercial bank now exceed those at investment banks, reversing a historic trend. Last year, Harvard grads started at $54,700 at commercial banks, $50,200 at investment banks.

It never happens overnight, but it happens inevitably: An abnormally profitable business attracts competition, and the profits shrink to more normal levels. No, the death knell of Wall Street is not sounding. But the glory days are fast coming to an end. ■

JANE BRYANT QUINN

10/15/89

Credit Card Banks and High Interest Rates

The door is now open for the interest rate on retail charge cards to go up.

Under a law passed by Congress in 1987, retailers can escape state usury laws, which set ceilings on how high interest rates can rise. Sixteen states have no ceilings, but those that do tend to cluster at 18 percent to 21 percent.

The '87 law allows companies to form "credit card" banks, devoted entirely to issuing and managing credit cards. Here's the significance of these banks to retailers and their customers:

An individual store can't charge an interest rate any higher than the state's usury ceiling. Right now, for example, Texas's ceiling on retail cards is 18 percent.

But an out-of-state bank can send cards into any state it wants, and charge the rate allowed in its home state. The usury ceiling in Ohio is 25 percent. So if a Texas store had its credit cards issued by an Ohio bank, it could charge up to 25 percent—regardless of Texas's ceiling.

The Limited, a retailing chain based in Columbus, Ohio, is leading the way. In May, it received permission from the federal government to set up a banking subsidiary called the World Financial Network National Bank, devoted entirely to issuing charge cards for its Lane Bryant and Lerner divisions and three of its mail-order catalogues.

The Limited's interest rate, in states with high usury ceilings, has been 22.8 percent. Since its new bank went into operation, that rate has been exported to 16 states where ceilings are lower.

The May Department Stores Co. just received permission to start three credit-card banks, based in Ohio, Arizona and Maryland. A spokesman says that May is planning no increase in interest rates at the present time, although that could change.

General Electric Capital has established the Monogram Bank in Cincinnati. Right now, it issues only Visa and MasterCard. But it is looking at the possibility of managing credit-card programs for retailers, says William Nutting, marketing manager of its Retailer Financial Services.

Ralph Spurgin, president of The Limited's credit-card bank, says the increase in interest rates on his cards is not a big deal. If you charge $100 and pay it off at $10 a month, he says, your debt costs only 11 cents more a month at 21 percent interest than it did at 18 percent. Perhaps because of these small price differences, studies The Limited did in 1987 show that higher interest rates don't make a significant impact on sales, he says.

Retailers' charge cards are often unprofitable because of the low balance customers carry on their cards. The average is only $250 ($170 for The Limited), compared with $1,100 on bank cards, says John Love, publisher of the Chicago-based newsletter Credit Card News. Spurgin says that charging higher interest rates should put The Limited's credit-card operation into the black—something retailers would very much like to do.

Consumers who do notice interest rates have been using their retail cards less and their bank cards more. Your Visa might charge 16 percent to 18 percent on unpaid balances, while your store charges 18 percent to 23 percent. Faced with customer defections, retailers have been thinking up ways to make their cards more attractive to use.

There's talk of "frequent shopper" programs, although there isn't a lot of enthusiasm for them, Nutting says. Stores increasingly announce special sales to their charge-card customers or mail discount coupons with their bills. A few stores give VIP cards to heavy shoppers. They entitle you to special services, like free gift wrapping or speedy repairs on your appliances.

Instead of fighting the bank cards, some stores will join them. Take the retailing chain Hit or Miss. In June, it started offering customers a Monogram Bank Visa card with the store's logo on it, Nutting says. The card can be used anywhere that accepts Visa. But every time the customer pulls it out she'll see the store name—a reminder to go there and shop.

EXHIBIT M: 2

Tape Recordings—Public Hearing Sessions
(on file at MTC headquarters)

EXHIBIT M: 3

Tape Recordings—MTC/FTA Financial Institutions Workshop
(on file at MTC headquarters)

EXHIBIT M: 4

Memorandum from Alan H. Friedman (MTC)
(June 4, 1991) (without attachments)

Multistate Tax Commission

TO: HEIDI HEITKAMP, N.D. TAX COMMISSIONER

FROM: ALAN H. FRIEDMAN, GENERAL COUNSEL

RE: FINANCIAL INSTITUTIONS MEETINGS

DATE: JUNE 4, 1991

The following is a background paper regarding the current status of the MTC effort to develop an allocation and apportionment regulation for the financial institutions industry. In order to acquaint you with the subject and process, I am attaching the following documents for your information:

1. Results of a Survey on State Taxation of Banks.

2. A draft of the regulation proposal reflecting changes to the original draft made after the four informal regional meetings were held.

3. Minutes of informal in Chicago with industry representatives on April 19, 1989.

4. Minutes of informal in Atlanta with industry representatives on June 22, 1989.

5. August 21, 1990 testimony of Fred Ferguson on behalf of FIST.

6. August 21, 1990 testimony of Paul Claytor, Chairman of the American Bankers Association Tax Committee.

7. Letter dated January 21, 1991 from Fred Ferguson on behalf of FIST.

8. Letter dated April 8, 1991 from Philip Plant of Bank of America.

9. The Interim Report of the Hearing Officer and Executive Committee Resolution dated November 9, 1990.

10. List of persons who attended the four public hearings held on the proposal.

Headquarters Office:
444 North Capitol Street, N.W.
Suite 409
Washington, D.C. 20001
(202) 624-8699

New York Audit Office:
25 W. 43rd Street, Suite 212
New York, NY 10036
Telephone (212) 575-1820

Chicago Audit Office
30 W. Washington, Suite 1000
Chicago, Illinois 60602
Telephone (312) 263-3232

Houston Audit Office
One Park 10 Place, Suite 128
Houston, Texas 77084
Telephone (713) 492-2260

Item #1 will provide you with a snapshot of the state of bank taxation in the mid-1980s and is our jumping off point. Item #2 shows in one place the original proposal developed by Sandy, as well as an amended version (the one that is now pending) that reflects suggestions by Phil Plant of the Bank of America that were designed to reduce some of the compliance burdens that were present in the original proposal. You should be aware that there are many technical drafting changes that remain to be made. I have included as item #5 above a fairly detailed delineation of the technical drafting issues. These will be addressed in the final version of the Hearing Officer's recommended regulation and you need not linger too long with them.

HOW WE GOT HERE

A thumbnail sketch regarding the process followed thus far might be useful. Sandy McCray spent the better part of a year learning this area back in 1986-87. She drafted the regulation and Gene and, to a lesser extent, I reviewed them. Mike Brownell of the California FTB became very familiar, even expert, with the draft. He and Sandy would have extended discussions and arguments about the draft both at and away from the Uniformity Committee meetings.

Sandy left the Commission shortly after she completed the draft and Gene took over the responsibility of dealing with it. Not much happened to push the draft further. When Gene became a short-termer, I got involved as the only Indian left standing. We held four informal regional meetings - in Seattle, Chicago, New York and Atlanta - at which we invited industry representatives to have at the draft. Each meeting was fairly well attended and all but the New York meeting was productive. The folks in New York were quite hostile, would not discuss the substance of the draft. It was in New York that the states were likened to "a bunch of hyenas chasing deer through the forest." Jim Wetzler was also quite vocal in his opposition to the MTC's effort to apportion the income of one of New York's most important industries on a market state basis.

Several substantive issues that were raised at the regional meetings were then incorporated into a survey and presented to the MTC states. See Item #2. Based upon the results, a final draft of the regulation was completed and referred out of the Uniformity and Executive Committees in mid-1990 for public hearing. I held four public hearings - in Washington, D.C. (August 21, 1990), San Francisco, California (August 23, 1990), Chicago, Illinois (December 3, 1990) and Atlanta, Georgia (December 4, 1990)(see Item #10).. Much written comment has been received raising many issues, the more substantive of which I will note below.

The hearings brought out most of the financial institutions industry, including the New York bank interests that had earlier declined to talk to us about the substance of the proposal. Fred

Ferguson of Price Waterhouse organized a group of the larger money-centered banks and that group is called the Financial Institutions State Tax coalition (FIST). Its members and objections to the proposals are reflected in Item ##5 and 7, Comments of Fred E. Ferguson on behalf of FIST; and Haskell Edelstein of Citibank is its main spokesperson. Haskell, whom during one debate I likened to "Grumpy" of the Snow White tale, is expending a lot of energy on this issue and I respect his effort. He will present several policy issues that he thinks the states need to address before grappling with a formula.

After the Executive Committee resolution of November 9, 1990, the process was slowed to an imperceptible crawl to await some breakthrough or direction. Given the S & L debacle, declining bank revenues, opposition from South Dakota and New York, it did not seem the right time for rapid advancement of the regulation.

Why then are we moving forward? An apparent breakthrough occurred in Chicago in April. A conference was organized by the American Bankers Association and Price Waterhouse at which Dan and I were asked to participate in a 1 1/2 day public meeting that was preceded by a private meeting of about 35 banking and state (Tennessee, Indiana, Minnesota, MTC) representatives. Fred Ferguson led a fairly balanced discussion of issues and all got to express themselves. At some time during this meeting, I suggested two things that I think created a stirring of the pot.

First, I read to the group certain language in Mobil (that I was reminded of by Paull Mines the day before) that was, in my opinion, foreboding of the outcome of the battle between market and commercial domicile states. That language suggested that the Supreme Court might well rule that if a market state had acquired sufficient taxing jurisdiction over a taxpayer so that it could apportion in some of the taxpayer's income, the state of commercial domicile would not be permitted to tax 100% of the taxpayer's income. In other words, if there were a situation where the combined taxation by both state of domicile and market state exceeded that which was constitutionally tolerable, the commercial domicile is the state that would have to accede to the taxing power of the market state.

The second suggestion that I made was that, as Hearing Officer, I did not think that the Commission would want me to sit on the regulation forever. I stated that I anticipated issuing a Hearing Officer's Report sometime by late Spring of 1992 so that the Executive Committee and the Commission could act if they wished to at the 1992 Annual Meeting. I suggested that if the industry wished to place a constructive suggestion on the table, one that included a recognition of the market states' contributions, that the time was before the end of 1991.

Wally Hellerstein (who was not at the private meeting) was asked to address the public session the next day. I talked to him

before his presentation and raised with him the Mobil thought. He got excited because he was just arguing the same issue with New Mexico in the context of a business/non-business issue. He agreed with the suggestion that the Supreme Court would rule in favor of the market state having jurisdiction to apportion and asked me if this audience would be interested in hearing his thoughts on the subject. I told him I thought they would be most interested in his views. His presentation could not have helped the market states more. And, during his presentation, Henry Reumpler, the lobbyist for the American Bankers Association came over to me and whispered that he had not credited my discussion of Mobil the day before as much as he should have. Undaunted by this unintended slight, I almost leapt from my chair to hug Wally. Instead, I initiated the only round of applause (thank goodness others followed my lead) that was given for a speaker at the conference. Later and publicly, the ABA agreed to meet and work with the MTC to try to develop a mutually acceptable apportionment approach. It sees the MTC as offering a lesser of several evils approach and an opportunity to be heard.

A BRIEF LOOK AT THE MTC PROPOSAL

The two over-all policy issues raised by the MTC proposal are -

"Should financial institutions that do business in interstate commerce continue to be treated differently from all other commercial enterprises that derive income from selling services in interstate commerce?."

"If financial institutions that do business in interstate commerce should be treated similarly to other businesses that engage in interstate commerce, what, if any, factors are prevalent in the manner by which financial institutions earn their income that warrant differential tax treatment by the states?"

These questions, as well as the many subsidiary ones, have been the subject of the MTC public hearings on the Commission's proposed Regulation IV.18.(i). That proposal has already been tempered with a substantial amount of industry input to this point. Its principal provisions can be generally described as follows -

- **Application:**

  1. Holding companies.

  2. Regulated financial corporations.

  3. Any corporation carrying on the "business of a financial corporation". This category includes corporations that conduct activities that are

substantially similar to the ones authorized under the state's laws governing financial institutions; and any corporations that derive more than 50% of their gross income from lending activities.

4. State chartered credit unions.

- **Jurisdiction or nexus:**

The proposed regulation sets forth the activities that render the financial institution subject to apportionment of income:

1. In-state ownership of property.

2. Direct loans secured by in-state property.

3. In-state presence of employees or contractors.

4. Regular solicitation of in-state loans or deposits by mail, telephone or electronic means. "Regular solicitation" is presumed to exist if the bank (i) has debtor/creditor relationships with 100 or more residents; (ii) has $10,000,000 of assets or deposits in the states; or (iii) has in excess of $500,000 in receipts from in-state sources.

- Participation and syndication loans and other secondary market activities do not, alone, create nexus; but if nexus is otherwise established, income from these activities will be subject to apportionment.

- **Apportionment:**

Net income from the bank's activities is determined by the application of the standard, equally-weighted three-factor formula, modified to reflect more accurately the manner in which the income of a financial organization is earned.

- Receipts Factor. The sourcing of receipts from interest or fees to the place where the services are consumed by the bank's customer.

Receipts from rentals and from secured loans sourced to the location of the property or security.

Receipts from unsecured consumer and commercial loans and fees sourced to state of residence of debtor.

Receipts from credit card interest and fees source to residence of cardholder.

Deposit or loan related fees that are pooled may, at the bank's election, be attributed (i) to the state of residence of the borrowers or depositors or (ii) to the state based upon the ratio that total deposits (or total interest) sourced to that state bears to total deposits (or total interest) from all sources.

Receipts from a bank's purchase of securities or money market instruments sourced based upon the ratio that in-state deposits bear to deposits from all sources.

Receipts attributed to a state in which the bank is not taxable is attributed pursuant to the laws of the state of commercial domicile.

- Deposits Factor. Includes real, tangible and intangible property. Sourced to states in a comparable fashion as receipts are sourced.

- Payroll Factor. Standard provisions used - compensation paid to employees in the state.

- Relief Provision. If the application of the regulation can be shown to represent the bank's income-producing activities unfairly in the state, then the bank may petition or the tax administrator may require the use of another apportionment methodology.

TENNESSEE'S APPROACH

Tennessee imposes an excise tax on net earnings and a franchise tax upon financial institutions doing business in Tennessee. The law, effective as to corporate fiscal years commencing on or after July 15, 1990, follows the single factor apportionment approach.

- **Application:**

  1. Holding companies.

  2. Regulated financial corporations.

  3. Any corporation carrying on the business of a financial corporation, excluding (i) corporations that derive less than 50% of their gross income from lending activities, (ii) federal and state credit unions, (iii) regulated investment funds or companies holding not less than 75% of its assets in government bonds, and (iv) corporations organized for lodge purposes.

- **Jurisdiction or nexus:**

  Under Tennessee's new law, a financial institution is

presumed to be doing business in Tennessee if it has -

1. assets and deposits attributable to Tennessee sources totalling more than $5,000,000 (excludes federal and non-Tennessee government obligations); or

2. an employee, representative or independent contractor conducting business in the state; or

3. regularly sells products or services to customers in the state that receive such products or services in the state; or

4. regularly solicits business from potential customers in the state; or

5. regularly performs services outside the state that are consumed in the state; or

6. regularly engages in transactions with customers in the state that involve tangible property, including loans, and which result in receipts flowing to the taxpayer from within the state; or

7. owns or leases property located in the state; or

8. regularly solicits and receives deposits from customers in the state.

As with the M.T.C. proposed regulation, as well as the Minnesota and Indiana statutes, the secondary loan market is carved out of the conduct that, by itself, creates nexus. See T.C.A. Sections 67-4-806(e) and 67-4-903(g).

- **Apportionment:**

Business earnings of both foreign and domestic banks are apportioned to Tennessee based upon a single factor - gross receipts derived from in-state loan activities.

THE NEXUS ISSUE.

The states have been constantly asked to justify their requiring certain non-domiciliary banks to register and pay franchise or income taxes when the banks maintain no physical presence in the state. As noted above, the proposed M.T.C. regulation is founded primarily on traditional nexus concepts - the presence of property interests and/or representatives. See the definition of "Exercising a Corporate Franchise of Transacting Business in a State" set forth in Reg. IV.18.(i)(B)(5)(a)-(c). The reliance on traditional, as well as newer nexus concepts, is also evident with respect to the

Indiana, Minnesota and Tennessee approaches.

It is primarily subsection (d) of Reg. IV.18.(i)(B)(5) that reflects something other than the traditional notions of nexus-creating activity. That subsection provides that nexus exists if the out-of-state bank regularly solicited business in the state (presumed, subject to rebuttal, to exist from either 100 or more direct debtor/creditor relationships, $10,000,000 in assets and deposits, or $500,000 in receipts). This basis for nexus - regular solicitation - is derived from United State Supreme Court case law that support personal jurisdiction and tax jurisdiction in modern commercial contexts.

The newer nexus principles relied upon by the states suggest that Due Process and Commerce Clauses to the United States Constitution may be satisfied by either traditional nexus-creating activities or by regular or systematic solicitation of banking business in the state. The physical presence of the non-resident bank is no longer required before a state may impose a reasonable tax burden. This position finds its footing in the principles that North Dakota is trying to establish in the Quill case:

- National Bellas Hess was limited to use of U.S. Postal Service and common carrier for delivery of the goods. It did not involve the use of in-state facilities such as telephones or 1-800 numbers, banking or credit cards, or any type of advertising other than that sent through the mails.

- National Bellas Hess was decided before the change in U. S. Supreme Court jurisprudence relating to the ability of the states to tax interstate commerce; and before a major shift in the Court's decisions in the area of personal jurisdiction.

- More recent U.S. Supreme Court personal jurisdiction and tax cases can be reasonably read to support a finding of nexus for use tax collection purposes for the "regular", "continuous", "systematic", or "purposeful" conduct of the out-of-state marketers' solicitation and conducting of business with the in-state market base.

- "Governmental jurisdiction in matters of taxation, as in the exercise of the judicial function, depends upon the power to enforce the mandate of the State by action taken within its borders, either in personam or in rem ... ." Shaffer v. Carter, 252 U.S. 37, 49 (1920).

- "..... [Holmes'] argument ignores, however, [its] significant economic presence in Louisiana, its many connections with the State, and the direct benefits it receives from Louisiana in conducting its business. D.H. Holmes Co., Ltd. v. McNamara, 486 U.S. 24 (1988) (emphasis supplied).

In my opinion, the nexus objections to the rule were more red herring than real, and they can be solved merely by deleting the nexus portion of the proposal with the states relying upon both traditional and emerging nexus principles. However, I still believe that having certain nexus presumptions or de minimis standards are to the benefit of both the industry (so that clear notice of when the regulation is applicable can be had) and to the states (to better ward off Due Process and Commerce Clause challenges). In any event, the currently pending branching laws look like they will become a reality. If so, the nexus issue with respect to the larger institutions should disappear, limiting the nexus issue to credit card and other interstate lenders.

I hope this background paper is sufficient for your purposes. What I have left out is a description of the Indiana, West Virginia, New York and California approaches, which I have as yet had the time to gather up; but, I will do so before the July meeting. If you need anything further, my instincts tell me that you will not hesitate to ask for it. You should be receiving information shortly regarding the first of the two meetings with interested state and industry representatives that is set for July 15-16, 1991 in San Francisco.

EXHIBIT M: 5

Opinion and selective pleadings: *Siegelman v. Chase Manhattan Bank, et al.,* 575 So.2d 1041 (Ala. 1991)

Don Siegelman, as Attorney General for the State of Alabama v. Chase Manhattan Bank (USA), National Association; Chase Manhattan Bank (USA), National Association v. Don Siegelman, as Attorney General for the State of Alabama

Siegelman v. Chase Manhattan Bank

Nos. 89-1020, 89-1104

Supreme Court of Alabama

575 So. 2d 1041; 1991 Ala. LEXIS 34

January 11, 1991

SUBSEQUENT HISTORY: [**1] Released for Publication March 3, 1991.

PRIOR HISTORY:
Appeal from Circuit Court, Montgomery County; No. CV-88-288-G; William R. Gordon, Judge.

DISPOSITION: AFFIRMED.

COUNSEL: David Cromwell Johnson, Spec. Asst. Atty. Gen. and Thomas Whitwell Bowron II of Polson, Jones, Bowron & Robbins, Birmingham, for Cross-Appellee.

William D. Coleman and Richard F. Allen of Capell, Howard, Knabe & Cobbs and Andrew J. Noble III of Montgomery, Bradley, Arant, Rose & White, Birmingham, for Cross-Appellant.

JUDGES: Hornsby, Chief Justice. Almon, Shores, Houston, and Kennedy, JJ., concur. Maddox and Steagall, JJ., concur, with opinion by Steagall, J.

OPINION BY: HORNSBY

OPINION: [*1041] This case presents the question of whether the financialinstitution excise tax, levied pursuant to Ala. Code 1975, | 40-16-1 et seq., applies to the credit card business conducted by national banks located outside Alabama with Alabama residents. The trial court, relying on this Court's decision in Ex parte Dixie Tool & Die Co., 537 So. 2d 923 (Ala. 1988), held that because Alabama's financial institution excise tax was enacted at a time when the State was prohibited by federal law from taxing out-of-state [**2] national banks and the legislature was aware of this federal law when

enacting the tax, the tax could not be levied on these banks. We affirm.

FACTS

The attorney general of the State of Alabama sued Chase Manhattan Bank (USA), [*1042] National Association; Citibank (South Dakota), N.A.; Maryland Bank, N.A.; Bank of America National Trust and Savings Association; Colonial National Bank USA; and First Interstate Bancard Company, N.A., seeking a judgment declaring that the financial institution excise tax levied pursuant to Ala. Code 1975, | 40-16-1 et seq. ("the excise tax"), applies to out-of-state national banks that solicit applications from residents of Alabama for Visa and MasterCard credit cards issued by these banks. By agreement, the banks are acting through Chase Manhattan Bank (USA), National Association ("Chase").

The facts of the case are stipulated as follows:

"1. The Chase Manhattan Bank (USA), National Association ('Chase') is a National Banking Association.

"2. Chase is located in Wilmington, Delaware and has no offices, branches or other places of business in Alabama. . . .

"3. To facilitate the making of loans as authorized by the National Bank Act, Chase maintains credit [**3] card accounts.

"4. Chase issues credit cards -- both Visa and MasterCard.

"5. Chase has been issuing Visa credit cards since February, 1982 and MasterCard credit cards since March, 1985.

"6. Chase has issued Visa and Mastercard credit card accounts to persons residing in Alabama as well as to persons residing in other states.

"7. Since 1982 Chase has opened approximately 50,000 Visa and MasterCard credit card accounts with persons having billing addresses in Alabama out of a total of more than 4,000,000 credit card accounts opened by Chase during such period.

"8. From outside Alabama by direct mail Chase solicits credit card applications from persons residing throughout the United States, including from time to time persons residing in Alabama.

"9. Since 1982, Chase has from outside Alabama by direct mail solicited applications for credit card accounts from persons residing throughout the United States including, from time to time, persons residing in Alabama, and

continues to solicit applications by direct mail from time to time from persons with Alabama addresses along with persons having addresses elsewhere.

"10. The Visa and MasterCard credit cards that are issued to persons residing [**4] in Alabama are valid for a term certain, up to 2 years, and the credit card may be used by the cardholder as long as he or she complies with the terms of the credit card agreement. The credit cards remain the property of Chase, and
may be recalled by Chase or returned by the cardholder for any reason, or for no reason and have no value as a tangible item in and of themselves.

"11. An annual fee of $ 20.00 is charged on most Visa and MasterCard credit card accounts maintained with Chase by persons residing in Alabama; interest and fees are charged by Chase pursuant to the credit agreement . . . in connection
with said accounts.

"12. Chase has on occasion used the courts of Alabama to collect accounts of persons residing in Alabama which are delinquent.

"13. Persons residing in Alabama may use Visa and Mastercards throughout the United States and the world to purchase merchandise and services or to obtain cash advances.

"14. When Chase opens a credit card account in Delaware with a person residing in Alabama, that person is given a line of credit.

"15. Chase has never filed an excise tax return with the State of Alabama Department of Revenue.

"16. Chase has never paid any excise taxes [**5] to the State of Alabama Department of Revenue.

"17. Chase pays state franchise tax based on net income to the State of Delaware based upon 100% of its net income, and Chase does not pay income tax, Financial Institution Excise Tax, or any other income-based tax to any state except the State of Delaware.

[*1043] "18. Chase's principal business consists of making loans in connection with its credit card accounts.

"19. A person residing in Alabama may obtain a Visa or MasterCard credit card account with Chase and obtain an extension of credit with respect to such account as follows:

"(1) He or she -- Alabama resident -- receives a solicitation through the mail . . . which was sent from outside Alabama to Martha H. Cluck residing in Montgomery, Alabama. That solicitation states that a 'new Chase Premier Visa card with a $ 5,000 credit line has been reserved in your name'. . . .

"(2) If the person residing in Alabama who is solicited wants the credit card account offered, he or she fills out the application, and signs it. He or she then mails the application from Alabama or elsewhere to Chase in Wilmington, Delaware in an envelope furnished by Chase. Postage is paid by Chase in Delaware.

"(3) [**6] Chase reviews the application in Delaware. Approval of the application is made, if at all, in Delaware; an account is opened in Delaware; and Chase mails the credit card (and also credit card account checks if requested) from outside Alabama to the person residing in Alabama along with an agreement.

"(4) The cardholder may use his or her Visa or MasterCard to purchase goods or services from a retailer in Alabama or elsewhere.

"(5) In making a purchase with a credit card the cardholder generally signs a credit card sales slip and receives a copy of it. In other circumstances purchases may be made by phone without the credit card by the card holder identifying himself or herself by supplying his or her account number to the merchant.

"(6) The merchant takes the sales slip to a merchant bank ('merchant bank') (which may be located inside or outside Alabama) with which it has a contract and receives his money less a discount.

"(7) The merchant bank or a transaction processor acting on its behalf records the information from the sales slip and transmits the information to a Visa (USA) Inc. or MasterCard International, Inc. interchange center located outside of Alabama for the purpose of [**7] obtaining payment of the face amount of the slip, less an interchange fee, from the bank which issues the credit card.

"(8) The Visa (USA) Inc. or MasterCard International, Inc. interchange center settles transactions. On a regular basis Visa and MasterCard inform Chase of the amount owed by it with respect to sales slips which have been tendered for Chase's account from all acquiring merchant banks in aggregate and from Delaware
Chase wire transfers funds to accounts maintained by Visa (USA) Inc. and MasterCard International, Inc. in New York to pay such amounts.

"(9) The Visa (USA) Inc. or MasterCard International, Inc. interchange center

also transmits the data relating to particular transactions to the computer center utilized by Chase which is located outside of Alabama at which individual transactions are posted to cardholders' accounts and from which statements are
generated and mailed to cardholders.

"(10) The cardholder pays part or all of the statement balance by sending the payment by mail to Delaware from Alabama or elsewhere. Payment is effective only when received by Chase in Delaware.

"20. Chase Visa and MasterCard accounts may also be accessed through the use of credit [**8] card checks which when used are negotiated like any other check and clear through the Federal Reserve System in the same manner as checks drawn on checking accounts and are honored or dishonored by Chase in Delaware. A
credit card may be used to obtain a cash advance from certain banks. Drafts for cash advances are settled through Visa (USA) Inc. or MasterCard International, Inc. interchange centers located outside Alabama along with sales slips amounts as described in paragraph 19(8).

"21. The relationship between the cardholder and Chase is governed by the Agreement . . . .

[*1044] "22. Chase does not act as a merchant bank for any merchant located in the State of Alabama.

"23. Chase has no directors, officers, agents or employees in Alabama, and it does not regularly send its directors, officers, agents or employees into Alabama in connection with performance of their duties for the bank.

"24. Chase does not receive payments in Alabama.

"25. Chase has no material contacts with Alabama other than those relating to credit card accounts described above.

"26. No national bank located outside the State of Alabama currently or in the past has paid the Financial Institution Excise Tax to the [**9] State of Alabama.

"27. No state or national bank, which does not have an office or branch in Alabama, pays or has paid the Financial Institution Excise Tax nor has such tax ever been assessed against any such entity by the State of Alabama. A number of such state and national banks without offices or branches in Alabama issue credit cards or provide other financial services to Alabama residents.

"28. Financial institutions with offices in Alabama pay the Financial Institution Excise Tax based on 100% of their income attributable to such offices regardless of the residence of their customers."

DISCUSSION

We must consider whether Alabama's excise tax can be imposed on the credit card business conducted by national banks located outside Alabama with Alabama residents. The State argues that the trial court would have held that the State could tax income derived by Chase from Alabama credit card holders "but for" the existence of 12 U.S.C. | 548, see infra, when the statute levying the excise tax (the "Excise Tax Statute") was enacted in 1935. In reaching its decision, the trial court relied on this Court's holding in Ex parte Louisville & Nashville R.R., 398 So. 2d 291 (Ala. [**10] 1981), Ex parte Dixie Tool & Die Co., supra, and N. Singer, 2A Sutherland Statutory Construction | 45.12 (Sands 4th ed. 1984), in finding that the legislature is presumed to be aware of existing
federal laws and judicial enlargements when statutes are enacted or amended. Consequently, the trial court reasoned, the failure of the legislature to amend or reenact the Excise Tax Statute once Congress changed federal law to allow states to impose taxes on out-of-state national banks indicates the legislature's intent not to impose the excise tax on out-of-state national banks.

The State contends that the only impediment to the trial court's imposition of the excise tax on Chase is that the Excise Tax Statute was enacted when federal law prohibited such taxation. The State asserts that once that impediment was removed, the excise tax became fully applicable to out-of-state national banks. The State further argues that from the inception of the excise tax in 1935 to the most recent amendment in 1978 the Excise Tax Statute included
any person, firm, or corporation doing business in Alabama as a national banking association. n1 In support of that argument, the State relies on the [**11] preamble to the Alabama Department of Revenue Regulations, which states that the excise tax is levied to give effect to federal law limiting the rights of states to tax national banking associations. n2 The State contends, based on Alabama statutes and the revenue regulations, that any national banking association or national bank doing business in Alabama is subject to the excise tax and that neither the statutes nor the regulations preclude taxation of out-of-state national banks.

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n1 In oral arguments before this Court, the State argued that the intent of the legislature in enacting the act levying the excise tax was to tax a

transaction rather than a "person."

n2 "The Excise Tax on Financial Institutions is levied to give effect to the provisions of Federal law limiting the right of the states to tax national banking associations. It is not a tax on income but is an excise tax measured by income. The proceeds of the tax, after the expense of administration, are distributed one-half to the municipalities, one-fourth to the counties and one-fourth to the general fund of the State."

Dept. of Rev. Reg., Preamble (emphasis added).

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[**12]

Chase [*1045] argues that the Excise Tax Statute has the same applicability today that it had when it was first enacted. Chase contends that both Ex parte Dixie Tool & Die Co., supra, and Ex parte Louisville & Nashville R.R., supra, control the resolution of this case, because the legislature is presumed to be aware of existing limitations on the state's power to act or of judicial enlargement of the state's permissible area and method of taxation.

To determine whether the excise tax applies to out-of-state national banks such as Chase, we must look to the language of the statute to determine the legislature's intent. See Tin Man Roofing Co. v. Birmingham Board of Educ., 536 So. 2d 1383 (Ala. 1988), and Ex parte Holladay, 466 So. 2d 956 (Ala. 1985) (duty of court in construing statute is to ascertain legislative intent, which may be gleaned from the language used, reason and necessity for the act or statute, and the purpose sought to be obtained). When determining legislative intent from the language used in a statute, a court may explain the language but it may not detract from or add to the [**13] statute. State ex rel. Graddick v. Jebsen S. (U. K.) Ltd., 377 So. 2d 940 (Ala. 1979); Town of Loxley v. Rosinton Water,
Sewer & Fire Protection Auth., Inc. 376 So. 2d 705 (Ala. 1979); Employees' Retirement Sys. of Alabama v. Head, 369 So. 2d 1227 (Ala. 1979); Alabama Indus. Bank v. State ex rel. Avinger, 286 Ala. 59, 237 So. 2d 108 (1970); May v. Head, 210 Ala. 112, 96 So. 869 (1923). Courts may not improve a statute, but may only expound it. Lewis v. Hitt, 370 So. 2d 1369 (Ala. 1979); Alabama Indus. Bank,
supra. In the case of taxing statutes, such statutes are to be construed strictly in favor of the taxpayer and against the taxing authority. Eagerton v. Terra Resources, Inc., 426 So. 2d 807 (Ala. 1982).

Accordingly, we must first look at the language of the Excise Tax Statute to determine the legislative intent. The excise tax applies to every "financial institution." That term is defined in Ala. Code 1975, | 40-16-1(1), in part, as

follows:

"Any person, firm, corporation and any legal entity whatsoever doing business in this state as a national banking association, bank, banking association, trust company, industrial or other loan company or [**14] building and loan association, and such term shall likewise include any other institution or person employing moneyed capital coming into competition with the business of
national banks, and shall apply to such person or institution regardless of what business form and whether or not incorporated, whether of issue or not, and by whatsoever authority existing." n3

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n3 The Department of Revenue, pursuant to the authority granted to it by Ala. Code 1975, | 40-16-3(e), further defines a "financial institution" as a "national banking association of any persons or entity which by employing monied capital as its principal business activity comes into competition with the business of national banks." Dept. of Rev. Reg. 810-9-1-.01(1) (1982). "Financial institutions" include common parent corporations but do not include insurance companies, individual citizens or fiduciaries who act in a representative capacity for individual citizens "merely because they make loans or investments of funds in bonds, notes or other evidences of indebtedness if such transactions are not made in competition with the business of national banks." Id. 810-9-1-.01(1)(b).

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[**15]
The Excise Tax Statute further provides:

"Every . . . financial institution shall pay to the state annually for each taxable year an excise tax for the privilege of engaging in this state in the business of banking and of conducting a financial institution, as in this chapter defined, and of conducting a business employing moneyed capital coming into competition with the business of national banks measured by its net income for such taxable year at the rate of six percent of such net income."

Ala. Code 1975, | 40-16-4.

Although the Excise Tax Statute defines "financial institution" as "any person, firm, corporation and any legal entity whatsoever doing business in this state as a national banking association," it does not explicitly include out-of-state national banks operating in the State in the same manner as Chase. In looking at the statute as a [*1046] whole, n4 we find further

evidence that the Excise Tax Statute does not include out-of-state national banks in | 40-16-6. Section 40-16-6 provides for the distribution of income derived from the excise tax to the municipalities and counties "in which such financial institutions are located." Section 40-16-6 provides that one-quarter [**16] of the proceeds derived from the excise tax is distributed to the county, one-half of the proceeds derived from the excise tax is distributed to the municipality, and one-quarter of the proceeds derived from the excise tax is distributed to the State's general fund. The factor controlling the distribution of the excise tax proceeds is the location of the financial institution. There is no provision in the Excise Tax Statute for the distribution of excise tax proceeds when a financial institution is not located in a county or a municipality in the State. n5

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n4 "The cardinal rule for construction of a statute is to ascertain the legislative intent, which must be determined by examining the statute as a whole in light of its general purpose." Gulf Coast Media, Inc. v. Mobile Press Register, Inc., 470 So. 2d 1211, 1213 (Ala. 1985). See also State ex rel. Moore v. Strickland, 289 Ala. 488, 268 So. 2d 766 (1972); Vick v. Bishop, 252 Ala. 250, 40 So. 2d 845 (1949).

n5 See also Ala. Code 1975, | 40-16-4(d): "The state shall have a lien upon the property of such taxpayer as provided for in this title for the collection of the taxes herein assessed." For such a lien to be enforced, Chase would have to have some property located in this state.

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[**17]

Because the Excise Tax Statute does not expressly encompass national banks located outside Alabama and because no provision is made for the distribution of any proceeds derived from financial institutions not located in a county or a municipality in the State, we must look beyond the language of the statute. Although rules of statutory construction aid in ascertaining legislative intent, other factors may also be considered in resolving questions of legislative intent. Ex parte Burns, 266 Ala. 241, 96 So. 2d 308 (1957). In addition to looking at the language of the statute, courts may also look to the history of a statute. Bowlin Horn v. Citizens Hosp., 425 So. 2d 1065 (Ala. 1982). Courts, however, may not indulge in conjecture or search for imaginary purposes. Alabama Indus. Bank v. State ex rel. Avinger, supra; State v. Zewen, 270 Ala. 52, 116 So. 2d 373 (1959). Additionally, courts may not "amend statutes so as to make them express what [the courts] conceive the legislature would have done or should have done." Town of Loxley v. Rosinton Water, Sewer & Fire Protection Auth., Inc., supra, [**18] at 708 (relying on May v. Head, supra).

Neither is it the role of the courts to "usurp the role of the legislature and correct defective legislation or amend statutes under the guise of [judicial] construction." Town of Loxley v. Rosinton Water, Sewer & Fire Protection Auth., Inc., supra, at 708 (relying on Employees' Retirement Sys. of Ala., supra); see also Ex parte Holladay, 466 So. 2d 956 (Ala. 1985).

A statute levying an excise tax was first enacted on October 22, 1932 (Ala. Acts 1932, Extra Session, Act No. 111, p. 107), but that statute was later repealed and was reenacted with amendments on April 4, 1933 (Ala. Acts 1933, Extra Session, Act No. 111, p. 104). The legislature repealed that statute and enacted the present Excise Tax Statute as part of the general revenue bill of 1935. Ala. Acts 1935, Act No. 194, Art. XII, Ch. I, || 346.1-346.6, pp. 428-34. Subsequent amendments have been adopted, but the legislature has never made provisions to include out-of-state national banks.

The purpose in levying the excise tax is to raise revenue for the State, not to enforce national or state banking laws. First Nat'l Bank v. State, 262 Ala. 155, 164, 77 So. 2d 653, [**19] 660 (1954) (Department of Revenue assessed an excise tax against a national bank on net income earned on a exchange/sales transaction). This Court has recognized that the Excise Tax Statute did not apply to out-of-state national banks because of the federal prohibition against such taxation. In State v. First Nat'l Bank of Mobile, 239 Ala. 492, 196 So. 114 (1940), the Court addressed the issue of whether bond premium amortization deductions made by a national bank in computing [*1047] its net income for purposes of the state excise tax should be allowed or disallowed. In reaching its decision that part of the deductions claimed by the bank should be allowed while other deductions should be disallowed, the Court examined the relation between federal law and state law. The Court stated that:

"Since the decision in McCulloch v. Maryland, . . . it has been the settled law that National Banks are Federal Agencies directly related to the fiscal affairs of the Federal Government; that such banking institutions are not subject to state tax burdens, except as Congress shall grant the privilege. The State has no inherent power to impose the taxes here in question. It is a question of power [**20] conferred by Congress.

"The privilege granted by Congress finds expression in Section 5219, Revised Statutes of the United States and sundry amendments, now codified in 12 U.S.C.A. p. 604, | 548."

Id. at 494. The Court further stated:

"The statute must be read as a whole in the light of constitutional principles, and also in view of the fact that all the State's power to tax National Banks is permissive, and its statutes must be considered in the light of Federal Statutes

granting this permission." Id. at 496.

In 1969, Congress added a temporary amendment and a permanent amendment n6 to | 5219 of the Revised Statutes, 12 U.S.C. | 548. Public L. No. 91-156, S. Rep. No. 92-448, 92d Cong., 1st Sess., reprinted in, 1971 U.S. Code Cong. & Admin. News 2317, 2321. The temporary amendment provided:

"(b) Except as otherwise herein provided, the legislature of each State may impose . . . the following taxes on a national bank not having its principal office located within the jurisdiction of such State, if such taxes are imposed generally throughout such jurisdiction on a nondiscriminatory basis."

Act of December 24, 1969, Pub. L. No. 91-156, 1969 U.S. Code Cong. & Admin. News [**21] (83 Stat.) 457-58. n7

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n6 The permanent amendment to | 5219 appears in the current version of 12 U.S.C. | 548 (1988).

n7 The temporary amendment was effective from December 24, 1969, through January 1, 1972.

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In 1973, Congress imposed a moratorium until September 12, 1976, during which time States could impose only one tax in addition to those enumerated in the temporary amendment to Public L. No. 91-156. n8 This moratorium expired without any action by Congress, leaving states free to tax out-of-state national banks subject to the permanent amendment to | 548. 12 U.S.C. | 548 provides:

"For the purposes of any tax law enacted under authority of the United States or any State, a national bank shall be treated as a bank organized and existing under the laws of the State or other jurisdiction within which its principal office is located."

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n8 The State Taxation of Depositories Act of August 16, 1973, Public L. No. 93-100, 1973 U.S. Code Cong. & Admin. News (87 Stat.) 397, provides:

"(b) The Congress finds that the national goals of fostering an efficient banking system and the free flow of commerce among the States will be furthered by clarifying the principles governing State taxation of interstate

transactions of banks and other depositories. Application of taxes measured by income or receipts, or other 'doing business' taxes, in States other than the States in which depositories have their principal offices should be deferred until such time as uniform and equitable methods are developed for determining jurisdiction to tax and for dividing the tax base among States.

"(c) With respect to any taxable year or other taxable period beginning on or after the date of enactment of this section and before January 1, 1976, no State or political subdivision thereof may impose any tax measured by income or receipts or any other 'doing business' tax on any insured depository not having its principal office within such State."

- - - - - - - - - - - - - - - - -End Footnotes- - - - - - - - - - - - - - - - -

[**22]

In addition to the changes made by Congress, the United States Supreme Court has changed its analysis of the application of the Commerce Clause to state taxing statutes. Prior to its decision in Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 97 S. Ct. 1076, 51 L. Ed. 2d 326 (1977), the [*1048] Supreme Court had held that any state tax imposed on the "privilege of doing business" in interstate commerce was per se unconstitutional. Spector Motor Serv., Inc. v. O'Connor, 340 U.S. 602, 71 S. Ct. 508, 95 L. Ed. 573 (1951). However, in Complete Auto Transit, Inc., the Supreme Court rejected this per se rule, reasoning that no economic consequence existed under the Spector rule and that the rule obscured the question of whether a state tax was unconstitutional. In rejecting the Spector rule, the Supreme Court enunciated a four-pronged test permitting states to tax interstate commerce as long as the tax is applied to an activity with a substantial nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State." 430 U.S. at 279. See also Amerada Hess Corp. v. Director, Div. of Taxation, New Jersey Dept. of the Treasury, 490 U.S. 66, [**23] 109 S. Ct. 1617, 104 L. Ed. 2d 58 (1989); Goldberg v. Sweet, 488 U.S. 252, 109 S. Ct. 582, 102 L. Ed. 2d 607 (1989); American Trucking Ass'ns, Inc. v. Scheiner, 483 U.S. 266, 107 S. Ct. 2829, 97 L. Ed. 2d 226 (1987); Wardair Canada, Inc. v. Florida Dep't of Revenue, 477 U.S. 1, 106 S. Ct. 2369, 91 L. Ed. 2d 1 (1985); Armco, Inc. v. Hardesty, 467 U.S. 638, 104 S. Ct. 2620, 81 L. Ed. 2d 540 (1984); Commonwealth Edison Co. v. Montana, 453 U.S. 609, 101 S. Ct. 2946, 69 L. Ed. 2d 884 (1981); Washington Stevedoring Cos. v. Department of Revenue, 435 U.S. 734, 98 S. Ct. 1388, 55 L. Ed. 2d 682 (1978). For a discussion of the history of state taxation under the Commerce Clause, see Hellerstein, State Taxation of Interstate Business: Perspectives on Two Centuries of Constitutional Adjudication, 41 Tax Law. 37 (1987).

In the case presently before us, the trial court in its opinion stated that Ex

parte Dixie Tool & Die Co., supra, controlled the resolution of the case:

"In Dixie Tool & Die, as in the instant case, the issue was whether in originally enacting the statute, the legislature intended to tax transactions not previously taxed under that statute.

"The Court holds that at the time | 40-16-1 was enacted, the State was prohibited by federal statute from taxing out-of-state national banks. The National Bank Act expressly limited the state's authority to [**24] tax only those 'national banking associations located within its limits.' Because the federal statute was in force at the time | 40-16-1 was enacted, full knowledge and information as to the prior and existing law on the subject of this section is imputed to the legislature. A legislature is presumed to know the limit of its taxing power. Further, the statute will be interpreted on the assumption that the legislature was aware of existing statutes at the time new statutes are enacted.

"Based on the foregoing, the Court finds that at the time | 40-16-1 was enacted the legislature could not have intended to impose a tax on out-of-state national banks."

In Dixie Tool & Die Co., the Alabama Department of Revenue assessed a sales tax against an Alabama corporation for sales made to out-of-state buyers and to federal government contractors. The Court in Dixie Tool & Die Co. considered whether sales made by the corporation to out-of-state purchasers were subject to Alabama's sales tax. The sales tax provision in question was Ala. Code 1975,40-23-4(a)(17). This code section provides:

"(a) There are exempted from the provisions of this division and from the computation of the amount [**25] of the tax levied, assessed or payable under this division the following:

". . . .

"(17) The gross proceeds of sales of tangible personal property or the gross receipts of any business which the state is prohibited from taxing under the Constitution or laws of the United States or under the Constitution of this state."

In its opinion, the Court in Dixie Tool & Die Co. recognized that the United States Supreme Court allowed taxation of interstate [*1049] commerce if the tax met certain criteria. However, the Court stated:

"'[These] recent pronouncements of the United States Supreme Court which enlarge the permissible area of state taxation cannot change the intent or

enlarge the scope of enactments passed by our Legislature. State v. Southern Electric Generating Co., 274 Ala. 668, 151 So. 2d 216 (1963). Therefore, the question is not whether the State may, under prevailing caselaw, impose a tax upon the gross receipts earned from those transactions. Rather, the controlling issue is whether, in originally enacting this statute, the Legislature intended to tax these transactions.'

"The provision that has become | 40-23-4(a)(17) was originally enacted in 1959. In 1959, and, [**26] indeed, until Complete Auto Transit [v. Brady] in 1977, the applicable case law held that a tax on the sale of goods in interstate commerce was invalid. The Legislature must be deemed to have been aware of the then-existing limits on a state's power to tax when it enacted the 1959 statute from which | 40-23-4(a)(17) derives. Thus, we must presume that the legislature knew, at the time the statute was passed, that the applicable case law would prevent the application of a sales tax to transactions in interstate commerce. The Legislature must also be presumed to be aware of the judicial enlargement of the State's permissible area and method of taxation, so it could have taken full advantage of those changes if it either intended or desired to do so. No changes have been made to | 40-23-4(a)(17). We conclude, therefore, that it applies today in the same manner that it did when enacted in 1959 and that it exempts sales of goods in interstate commerce from sales tax." 537 So. 2d at 925 (quoting Ex parte Louisville & Nashville R.R., 398 So. 2d 291, 293 (Ala. 1981) (emphasis in original)).

The trial court also relied on Ex parte Louisville & Nashville R.R., supra. In Ex parte [**27] Louisville & Nashville R.R., the Court considered "whether Alabama's gross receipts tax upon a railroad's earnings from 'intrastate business' applies to receipts generated by the L & N Railroad's movement of goods between two points in Alabama." Id. at 292. The railroad gross receipts tax statute in question, Ala. Code 1975, | 40-21-57, provided:

"In addition to all other taxes imposed by this title, there is hereby levied a license or privilege tax upon each person engaged in the business of operating a railroad in the state of Alabama for the privilege of engaging in such business; said license tax or privilege tax shall be . . . in a sum equal to two and one-half percent of the gross receipts in excess of $ 150,000.00 of such railroad from all intrastate business of such railroad within the state of Alabama during the preceding year, the gross intrastate earning to be determined by the amount received from intrastate business."

The Court stated that the controlling issue in the case was whether in originally enacting the statute the legislature intended to tax these transactions:

"The question before us is one of legislative intent. We presume that, in

enacting the statute [**28] in 1935, the Legislature was aware of the existing interpretations and permissible limits of a state's power to tax. Thus, we presume our Legislature knew that at the time the statute was passed, the rule in [Minnesota v.] Blasius would have prevented the application of the tax to transactions similar to those at issue because they constitute a portion of interstate commerce. We also presume that the Legislature was aware of the fact that this tax could not be sustained as one 'in lieu of' other taxes because the tax was expressly levied 'in addition to all other taxes.' Similarly, we presume that the Legislature was apprised of the fact that it could not justify this tax as one upon 'local activity,' because to do so would require the indulgence in the proscribed conceptual segmentation of the integral parts of an interstate transaction. Finally, we presume that the Legislature is aware of the [*1050] judicial enlargement of the State's permissible area and method of taxation, so that the Legislature could have taken full advantage of those changes if it either intended or desired to. No such changes have been made during the forty-five years since the statute was passed and the State [**29] has not, by legislation, attempted to enlarge the scope of its taxation. Thus, viewed in its broadest scope, the statute in question could reach and impose a tax upon only those activities which were local and purely intrastate in character. We therefore conclude that the statute, as enacted in 1935 and as it exists today, was not intended to apply to receipts generated by transactions such as these which, although conducted wholly within the confines of Alabama, constitute an integral portion or segment of interstate commerce." 398 So. 2d at 296-97. See also State v. Southern Elec. Generating Co., 274 Ala. 668, 151 So. 2d 216 (1963).

Like the question in Dixie Tool & Die Co. and Ex parte Louisville & Nashville R.R., the question before us is whether in originally enacting the Alabama Excise Tax Statute, the legislature intended to tax the net income derived by out-of-state national banks from solicitation of credit card applications from Alabama residents.

In determining the intent of the legislature, we presume that in enacting the Excise Tax Statute the legislature was aware of existing prohibitions against the State's power to tax national banks. When the Excise Tax [**30] Statute was enacted in 1935, federal law and judicial interpretation prohibited states from taxing out-of-state national banks. It was not until the Congressional moratorium expired in 1976 that states were allowed to tax out-of-state national banks. Even after the expiration of the moratorium in 1976, the Alabama legislature failed to amend or to reenact the Excise Tax Statute in light of the federal change. See Freeman v. Jefferson County, 334 So. 2d 902, 904 (Ala. 1976) ("the rejection of an amendment by the Congress which would have made the statute applicable to a given situation furnishes a strong inference that the statute was not intended to be applicable to that given situation"). Also, the Alabama legislature failed to amend or to reenact the

Excise Tax Statute after the United States Supreme Court's 1977 announcement that there would no longer be a per se ban on taxation of interstate commerce. In fact, the last amendment to the Excise Tax Statute occurred in 1978, after the change in both federal statutory and judicial law that would have allowed taxation of out-of-state national banks, and no provision was then made for such taxation. Ala. Acts 1978, Special and Regular [**31] Sessions, Act No. 840, p. 1247. We do note, however, that a bill was introduced in the 1990 Regular Session of the Alabama legislature for the stated purpose of extending the Excise Tax Statute to out-of-state national banks, but it was not enacted. House Bill No. 944, Legislative Digest, Final Status p. 14 (May 3, 1990). n9

- - - - - - - - - - - - - - - - - -Footnotes- - - - - - - - - - - - - - - - - -

n9 Other states have actively passed legislation in the face of the changes in federal law so as to tax the kind of transactions at issue in the present case. These states include Indiana, Iowa, and Tennessee.

- - - - - - - - - - - - - - - - - -End Footnotes- - - - - - - - - - - - - - - - -

In the present case, we recognize that under existing federal law and judicial enlargement states are able to tax out-of-state national banks if their taxing measures are nondiscriminatory. See 12 U.S.C. | 548 (1988). However, when the Excise Tax Statute was enacted in 1935, federal law prevented taxation of out-of-state national banks. In addition to the changes implemented by Congress in 1976, the United States Supreme Court changed its position so as to allow taxation of interstate commerce. [**32] See Complete Auto Transit, Inc. v. Brady, supra.

Under prevailing Alabama statutory construction law, we presume that the legislature was aware of the federal law in 1935 and of the subsequent changes in that law in 1976, as well as the changes in the United States Supreme Court's analysis of the taxation of interstate commerce. Ex parte Louisville & Nashville R.R., supra, [*1051] and Ex parte Dixie Tool & Die Co., supra. Although the Alabama legislature presumably was aware of Congress's enlargement of state taxing power over national banks, and of the United States Supreme Court's enlargement in regard to taxation of interstate commerce, it made no changes to the Excise Tax Statute.

This Court's role is not to displace the legislature by amending statutes to make them express what we think the legislature should have done. Nor is it this Court's role to assume the legislative prerogative to correct defective legislation or amend statutes. Consequently, we conclude that the Excise Tax Statute applies today in the same manner that it did when it was first enacted. Because states were prohibited from taxing out-of-state national banks at the

time the statute levying the excise [**33] tax was first enacted and judicial interpretation disallowed taxation of interstate commerce, the State may not tax Chase, an out-of-state national bank, in the absence of additional action by the Alabama legislature.

Because we hold that the Excise Tax Statute does not apply to Chase, we need not address any further issues raised. Consequently, the trial court's summary judgment in Chase's favor is due to be affirmed.

AFFIRMED.

CONCUR BY: STEAGALL

CONCUR: STEAGALL, JUSTICE (concurring specially).

I write specially to say that, in my opinion, out-of-state banks should be taxed in the same manner that in-state banks are taxed on revenues generated through credit cards held by Alabama citizens. This course of action is now available because existing federal laws permit taxation of out-of-state national banks. If I were in the legislature, I would support legislation to accomplish this result. However, I agree with the majority that the role of the judiciary is limited and that this matter should remain in the hands of the legislature.

Maddox and Steagall, JJ., concur.

IN THE CIRCUIT COURT OF MONTGOMERY COUNTY, ALABAMA
15TH JUDICIAL CIRCUIT

FILED
CIRCUIT COURT OF
MONTGOMERY COUNTY, AL.

'88 FEB 18 A11:35

STATE OF ALABAMA, ex rel Donald Siegelman, Attorney General of Alabama,	)	
Plaintiffs,	)	
vs.	)	CASE NO. CV-88-288-G
CREDIT CARD COMPANIES: (1) Citibank Visa/Mastercard, Citibank (South Dakota), National Association; (2) Chase Manhattan Visa/Mastercard, Chase Manhattan Bank, (USA), National Association; (3) Maryland Bank Visa/Mastercard, Maryland Bank, National Association; (4) Bank of America Visa/Mastercard, Bank America, National Association; (5) Colonial National Bank (USA); National Association; (6) First Interstate Bancard Company, N.A., and XYZ Visa/Mastercard Companies who are issuing Visa/Mastercard Credit Cards in Alabama, fictitiously named, and whose correct legal identities will be added by Amendment when they are ascertained.	)	
Defendants.	)	

BILL FOR DECLARATORY JUDGMENT
AND FOR OTHER RELIEF

STATEMENT OF FACTS

1. The defendants are national banking associations who are transacting business in Alabama by issuing Visa and Mastercard credit cards to Alabama residents. The credit cards are issued under a contract entered into Alabama, and performed in Alabama. The credit cards remain the property of the banks, and may be recalled by them for any reason or for no reason.

2. The cardholder pays the banks an annual fee for the credit card and interest on loans made by the cardholder either for purchases or for cash loans. Charges are paid for late payments, court costs and attorneys' fees are paid by the cardholder in event of default and in the event of default, Alabama Courts are used for collection of amounts due the banks, and to enforce the bank's contracts in Alabama.

3. The banks have never filed a return and have fees or taxes due the State of Alabama from the use of their credit cards even though the Alabama financial institution statute requires them to file returns annually and pay the taxes.

4. The defendant, Citibank (South Dakota) received its charter as a national association on February 19, 1981. The said defendant has 151,700 credit card accounts in Alabama and has been transacting credit card business in Alabama since 1981. It charges an annual fee of $20.00 for use of its credit cards. Its rate of interest is 19.8% per annum.

5. The defendant, Chase Manhattan Bank USA, received its charter on February 11, 1982, and has been transacting business in Alabama since 1983. It has 48,000 accounts in Alabama. It charges an annual fee of $20.00. It charges an interest rate of 17.5% per annum.

6. The defendant, Bank of America National Trust and Savings Association, has been transacting business in Alabama, since 1981. It has 22,585 accounts in Alabama. It charges an annual fee of $20.00 for its card, and an interest rate of 19.8%.

7. The defendant, Colonial National Bank, USA was chartered December 6, 1982, and has been issuing credit cards to Alabama residents since July, 1983. Colonial has 250 accounts in Alabama. It charges an interest rate of 19.8% per annum.

8. The defendant, First Interstate Bancard Company, N.A. received its charter on December 13, 1982, and has been issuing credit cards to Alabama residents since 1982, and has 2626 accounts in Alabama. It charges an annual card fee of $20.00, and its rate of interest is 21% per annum.

9. The defendant, Maryland Bank, N.A received its charter on March 15, 1982. It has been issuing credit cards to Alabama residents in Alabama. Its annual fee for the card is $20.00 and its interest rate is 18% per annum.

COUNT ONE

The plaintiff avers that the defendant banking associations have purposely availed themselves of an Alabama market of transacting business in Alabama by engaging in regular and continuous solicitation of business in the State of Alabama; that such continuous solicitation results in the creation of intangible, to-wit, loans in the State, and therefore establishes a nexus between the defendant banks and the State of Alabama sufficient for the State to tax the defendant banks on its income from interest and fees derived in Alabama. Plaintiff further aver that the defendant banks have deliberately engaged in significant activities within the State of Alabama by soliciting Alabama residents, and by issuing credit cards to Alabama, and further aver that the said banks have created a continuing

contractual obligation with Alabama residents with revolving accounts. Plaintiff further aver that the defendant banks own property in the State of Alabama, and that property is used by Alabama residents, and that by the use of defendants' property, the banks are transacting business in Alabama, and plaintiff aver that the defendant banks owe the taxes as calculated in Count Two.

COUNT TWO

The plaintiff aver that, based upon the best available evidence that it has, that:

1. Citibank (South Dakota) owes the State in fees, taxes, and penalties the sum of $20,799,360.00.

2. Chase Manhattan Bank, USA owes the State of Alabama the sum of $5,458,940.00 in fees, taxes and penalties.

3. Maryland Bank, N.A. owes the State of Alabama in fees, taxes, and penalties $3,179,420.00.

4. First Interstate Bancard Company, N.A. owes the State of Alabama $347,000.00 in fees, taxes and penalties.

5. The Bank of America National Trust and Savings Association owes the State of Alabama $3,047,020.00 in fees, taxes and penalties.

6. The Colonial National Bank, USA owes the State of Alabama the sum of $25,875.00 in fees, taxes and penalties.

7. The above named banks therefore owe a total of $32,510,715.00 to the State which based upon the best available information which the plaintiff have, and which the plaintiff claims are due.

8. The defendant banks have denied that they are transacting business in the State of Alabama through the use of their Visa and Mastercard credit cards by Alabama residents; they deny that they owe taxes to the State of Alabama, under the financial distribution tax statute, and have never filed any tax returns with the State Department of Revenue.

9. Because the State of Alabama claims that the defendant banks are transacting business in the State and owe taxes, and the defendant banks deny that they are transacting business in the State, and do not owe taxes, a justiciable controversy exists between the State and the banks.

10. The actions of the banks have likewise violated Code of Alabama §10-2A-247 which authorizes the Attorney General to recover all fees, fines and penalties as result of the violation.

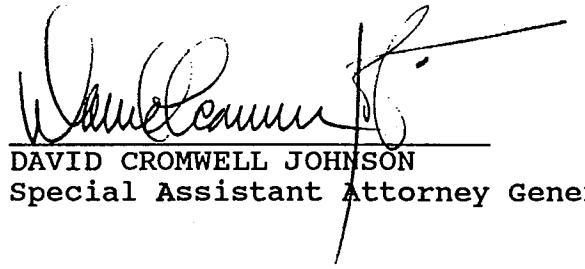
WHEREFORE, PREMISES CONSIDERED, plaintiff request the following relief:

1. A Declaratory Judgment that defendants are transacting credit card business in the State of Alabama and have a sufficient nexus with the State of Alabama for State tax purposes, and therefore owe the taxes for all years that they have done business in the State of Alabama.

2. Award the plaintiffs costs and expenses of this action.

3. Award a reasonable attorney's fee.

4. Any further and different relief which the Court may deem fit and proper under the facts and circumstances of this case, and these defendants.



DAVID CROMWELL JOHNSON
Special Assistant Attorney General

JAMES H. FAULKNER
Special Assistant Attorney General
300 North 21st Street
Birmingham, Alabama 35203
Telephone (205) 328-1414

Jury Demand

Plaintiffs demand a trial by struck jury on all issues of this case which are triable by a jury.

DAVID CROMWELL JOHNSON

JAMES H. FAULKNER

Plaintiffs' Address

David Cromwell Johnson
Special Assistant Attorney General
300 North 21st Street
Birmingham, Alabama 35203

IN THE CIRCUIT COURT OF MONTGOMERY COUNTY, ALABAMA
15th JUDICIAL CIRCUIT

STATE OF ALABAMA, ex rel. Donald Siegelman, Attorney General of Alabama, Plaintiff, vs. CREDIT CARD COMPANIES: (1) Citibank Visa/Mastercard, Citibank (South Dakota), National Association; (2) Chase Manhattan Visa/Mastercard, Chase Manhattan Bank, (USA), National Association; (3) Maryland Bank Visa/Mastercard, Maryland Bank, National Association; (4) Bank of America Visa/Mastercard, Bank of America, National Association; (5) Colonial National Bank (USA); National Association; (6) First Interstate Bancard Company, N.A., and XYZ Visa/Mastercard companies who are issuing Visa/ Mastercard Credit Cards in Alabama, fictitiously named, and whose correct legal identities will be added by Amendment when they are ascertained. Defendants.	)	CASE NO. CV-88-288-G

ANSWER

Defendants (other than the fictitious defendants) answer the Complaint as follows:

FIRST DEFENSE

The Attorney General lacks standing to seek a construction of the Financial Institution Excise Tax in an action for declaratory judgment, because the Commissioner of Revenue is the officer of the State of Alabama charged with assessing tax under said statute. The Attorney General has no authority to assess tax under said statute, nor to bring an action to collect tax under the statute until it has been assessed, therefore there is no justiciable controversy between plaintiff and defendants.

SECOND DEFENSE

Even if the Attorney General has standing to state a justiciable controversy, which defendants aver is not the case, this Court in the first instance would merely have concurrent jurisdiction with the Department of Revenue with regard to matters concerning the Financial Institution Excise Tax; therefore under the doctrine of Primary Jurisdiction the Court should defer to the Department of Revenue and dismiss the instant action, or alternatively, stay this action pending action by the Department of Revenue.

THIRD DEFENSE

There has been a failure to exhaust administrative remedies.

FOURTH DEFENSE

The Financial Institution Excise Tax, §40-16-1 et seq. Ala. Code (1975), only applies to entities "doing business" in Alabama. None of the defendants is doing business in Alabama and therefore the Financial Institution Excise Tax does not apply to any of them.

FIFTH DEFENSE

The credit card accounts maintained with each of the defendants by individuals with Alabama addresses are interstate in nature and the defendants have no physical presence in the State of Alabama. Consequently were the legislature to have attempted to levy a tax on the defendants' activities any such legislation would be unconstitutional under the Constitution of the United States and under the Constitution of the State of Alabama.

SIXTH DEFENSE

The construction of the Financial Institution Excise Tax Statute advanced by plaintiff is contrary to the construction of the statute under which the State and the defendants have operated for a number of years and upon which the defendants in this case have relied. To adopt the plaintiff's new construction of this statute and apply it retroactively would be unfair and unconstitutional under the Constitution of the United States and under the Constitution of the State of Alabama.

SEVENTH DEFENSE

As national banks the defendants are creatures of the federal government and are not subject to §10-2A-247 Ala. Code (1975).

EIGHTH DEFENSE

None of the defendants is transacting business in Alabama, nor have any of them done so in the past.

NINTH DEFENSE

The application of §10-2A-247 to the defendants, each of which is a national bank, would be unconstitutional under the Constitution of the United States and under the Constitution of the State of Alabama.

TENTH DEFENSE

The Complaint and each purported claim therein separately and severally fails to state a claim upon which relief can be granted.

ELEVENTH DEFENSE

The Court lacks personal jurisdiction of each defendant and venue is improper.

TWELFTH DEFENSE

1. The correct names of the defendants are as follows:

   (1) Citibank (South Dakota), N.A.

   (2) The Chase Manhattan Bank (USA), National Association

   (3) Maryland Bank, N.A.

   (4) Bank of America National Trust and Savings Association

   (5) Colonial National Bank USA

   (6) First Interstate Bancard Company, N.A.

2. The defendants deny each of the material allegations of the Complaint, except that each defendant admits that it is a national bank chartered by the United States government, that it offers Visa and Mastercard accounts to the public, and that it maintains some credit card accounts with individuals who give Alabama addresses. In addition, each defendant admits the allegations of paragraph 8 of Count II with the provision that the financial institution excise tax is erroneously referred to therein as the "financial distribution tax statute."

3. Further, each defendant avers that each credit card account is subject to a contract between the defendant and the particular holder of such account, the terms of which may vary from account to account, and that such contract is the best evidence of its terms. Generally, pursuant to these contracts while holders of accounts have possession of the credit cards issued in connection with such accounts, defendants retain legal title thereto. In many cases annual fees are paid by the holder of the account,

interest is charged on unpaid account balances after some period of time, and the holder of the account is liable for various charges and attorneys' fees in the event of default. The defendants assume the courts of Alabama are open to each defendant.

4. Any allegation of the complaint which is not expressly admitted is denied and defendants contest the relief sought by plaintiff.

5. Plaintiff is not entitled to a trial by jury and the jury demand is due to be stricken.

William D. Coleman

William D. Coleman
57 Adams Avenue
Montgomery, Alabama 36197
(205) 241-8000

A. J. Noble, III

A. J. Noble, III
1400 Park Place Tower
Birmingham, Alabama 35203
(205) 252-4500

Attorneys for Defendants

OF COUNSEL:

CAPELL, HOWARD, KNABE & COBBS, P.A.
57 Adams Avenue
Montgomery, Alabama 36197
(205) 241-8000

BRADLEY, ARANT, ROSE & WHITE
1400 Park Place Tower
Birmingham, Alabama 35203
(205) 252-4500

CERTIFICATE OF SERVICE

I hereby certify that I have served a copy of the foregoing Answer upon the Honorable James H. Faulkner, 300 North 21st Street, Suite 900, Birmingham, Alabama 35203 by depositing a copy of same in the United States Mail, postage prepaid and properly addressed this the 6th day of May, 1988.

C. J. Noble, III

EXHIBIT A

IN THE CIRCUIT COURT OF MONTGOMERY COUNTY, ALABAMA
15th JUDICIAL CIRCUIT

STATE OF ALABAMA, ex rel. Donald Siegelman, Attorney General of Alabama, Plaintiff, vs. CREDIT CARD COMPANIES: etc. Defendants.	)))))))))))	CASE NO. CV-88-288-G

STIPULATION OF FACTS

1. The Chase Manhattan Bank (USA), National Association ("Chase") is a National Banking Association.

2. Chase is located in Wilmington, Delaware and has no offices, branches or other places of business in Alabama. A copy of Chase's certificate of authority is attached hereto as Exhibit 1.

3. To facilitate the making of loans as authorized by the National Bank Act Chase maintains credit card accounts.

4. Chase issues credit cards - both Visa and MasterCard.

5. Chase has been issuing Visa credit cards since February, 1982, and MasterCard credit cards since March, 1985.

6. Chase has issued Visa and MasterCard credit card accounts to persons residing in Alabama as well as to persons residing in other states.

7. Since 1982 Chase has opened approximately 50,000 Visa and MasterCard credit card accounts with persons having billing

addresses in Alabama out of a total of more than 4,000,000 credit card accounts opened by Chase during such period.

8. From outside Alabama by direct mail Chase solicits credit card account applications from persons residing throughout the United States, including from time to time persons residing in Alabama.

9. Since 1982, Chase has from outside Alabama by direct mail solicited applications for credit card accounts from persons residing throughout the United States including, from time to time, persons residing in Alabama, and continues to solicit applications by direct mail from time to time from persons with Alabama addresses along with persons having addresses elsewhere.

10. The Visa and MasterCard credit cards that are issued to persons residing in Alabama are valid for a term certain, up to 2 years, and the credit card may be used by the cardholder as long as he or she complies with the terms of the credit card agreement. The credit cards remain the property of Chase, and may be recalled by Chase or returned by the cardholder for any reason, or for no reason and have no value as a tangible item in and of themselves.

11. An annual fee of $20.00 is charged on most Visa and MasterCard credit card accounts maintained with Chase by persons residing in Alabama; interest and fees are charged by Chase pursuant to the credit agreement (Exhibit "E") in connection with said accounts.

12. Chase has on occasion used the courts of Alabama to collect accounts of persons residing in Alabama which are delinquent.

13. Persons residing in Alabama may use Visa and MasterCards throughout the United States and the world to purchase merchandise and services or to obtain cash advances.

14. When Chase opens a credit card account in Delaware with a person residing in Alabama, that person is given a line of credit.

15. Chase has never filed an excise tax return with the State of Alabama Department of Revenue.

16. Chase has never paid any excise taxes to the State of Alabama Department of Revenue.

17. Chase pays state franchise tax based on net income to the State of Delaware based upon 100% of its net income, and Chase does not pay income tax, Financial Institution Excise Tax, or any other income-based tax to any state except the State of Delaware.

18. Chase's principal business consists of making loans in connection with its credit card accounts.

19. A person residing in Alabama may obtain a Visa or MasterCard credit card account with Chase and obtain an extension of credit with respect to such account as follows:

(1) He or she - Alabama resident - receives a solicitation through the mail as shown by Exhibit "A" which was sent from outside Alabama to Martha H. Cluck residing in Montgomery, Alabama. That solicitation states that a "new Chase Premier Visa card with a $5,000 credit line has been reserved in your name". Exhibit "B" is the application. Exhibit "C" is another form of solicitation used by Chase.

(2) If the person residing in Alabama who is solicited wants the credit card account offered, he or she fills out the application, and signs it. He or she then mails the application from Alabama or elsewhere to Chase in Wilmington, Delaware in an envelope furnished by Chase. Postage is paid by Chase in Delaware. (Exhibit "D").

(3) Chase reviews the application in Delaware. Approval of the application is made, if at all, in Delaware; an account is opened in Delaware; and Chase mails the credit card (and also credit card account checks if requested) from outside Alabama to the person residing in Alabama along with an agreement. (Exhibit "E").

(4) The cardholder may use his or her Visa or MasterCard to purchase goods or services from a retailer in Alabama or elsewhere.

(5) In making a purchase with a credit card the cardholder generally signs a credit card sales slip and receives a copy of it. In other circumstances purchases may be made by phone without the credit card by the card holder identifying himself or herself by supplying his or her account number to the merchant.

(6) The merchant takes the sales slip to a merchant bank ("merchant bank") (which may be located inside or outside Alabama) with which it has a contract and receives his money less a discount.

(7) The merchant bank or a transaction processor acting on its behalf records the information from the sales slip and transmits the information to a Visa (USA) Inc. or MasterCard International, Inc. interchange center located outside of Alabama for the purpose of obtaining payment of the face amount of the slip, less an interchange fee, from the bank which issues the credit card.

(8) The Visa (USA) Inc. or MasterCard International, Inc. interchange center settles transactions. On a regular basis Visa and MasterCard inform Chase of the amount owed by it with respect to sales slips which have been tendered for Chase's account from all acquiring

merchant banks in aggregate and from Delaware Chase wire transfers funds to accounts maintained by Visa (USA) Inc. and MasterCard International, Inc. in New York to pay such amounts.

(9) The Visa (USA) Inc. or MasterCard International, Inc. interchange center also transmits the data relating to particular transactions to the computer center utilized by Chase which is located outside of Alabama at which individual transactions are posted to cardholders' accounts and from which statements are generated and mailed to cardholders.

(10) The cardholder pays part or all of the statement balance by sending the payment by mail to Delaware from Alabama or elsewhere. Payment is effective only when received by Chase in Delaware.

20. Chase Visa and MasterCard accounts may also be accessed through the use of credit card checks which when used are negotiated like any other check and clear through the Federal Reserve System in the same manner as checks drawn on checking accounts and are honored or dishonored by Chase in Delaware. A credit card may be used to obtain a cash advance from certain banks. Drafts for cash advances are settled through Visa (USA) Inc. or MasterCard International, Inc. interchange centers located outside Alabama along with sales slips amounts as described in paragraph 19(8).

21. The relationship between the cardholder and Chase is governed by the Agreement attached hereto as Exhibit "E".

22. Chase does not act as a merchant bank for any merchant located in the State of Alabama.

23. Chase has no directors,officers, agents or employees in Alabama, and it does not regularly send its directors, officers, agents

or employees into Alabama in connection with performance of their duties for the bank.

24. Chase does not receive payments in Alabama.

25. Chase has no material contacts with Alabama other than those relating to credit card accounts described above.

26. No national bank located outside the State of Alabama currently or in the past has paid the Financial Institution Excise Tax to the State of Alabama.

27. No state or national bank, which does not have an office or branch in Alabama, pays or has paid the Financial Institution Excise Tax nor has such tax ever been assessed against any such entity by the State of Alabama. A number of such state and national banks without offices or branches in Alabama issue credit cards or provide other financial services to Alabama residents.

28. Financial institutions with offices in Alabama pay the Financial Institution Excise Tax based on 100% of their income attributable to such offices regardless of the residence of their customers.

29. The current regulations of the Department of Revenue promulgated under the Financial Institution Excise Tax are found at Alabama Administrative Code Reg. 810-9-1-.01 et seq.

30. A copy of prior regulations of the Department of Revenue under the Financial Institution Excise Tax are attached hereto as Exhibit 2.

31. This stipulation may be supplemented inter alia by materials and evidence (whether expert or otherwise) relating to the burden, or lack thereof, on interstate commerce of the Financial Institution Excise Tax given the contacts between Chase and the State of Alabama described herein.

James H. Faulkner
300 21st Street North
Birmingham, Alabama 35203
(205) 328-1414

Attorney for Plaintiff

A.J. Noble, III
1400 Park Place Tower
Birmingham, Alabama 35203
(205) 252-4500

Attorney for Defendant
The Chase Manhattan Bank (USA),
National Association

EXHIBIT B

IN THE CIRCUIT COURT OF MONTGOMERY COUNTY, ALABAMA
15th JUDICIAL CIRCUIT

STATE OF ALABAMA, ex rel. Donald Siegelman, Attorney General of Alabama, Plaintiff, vs. CREDIT CARD COMPANIES: etc. Defendants.	)))))))))))	CASE NO. CV-88-288-G

STIPULATION

The parties stipulate and agree as follows:

1. (a) That a declaration is sought by plaintiff only as to the following questions with respect to such tax years as plaintiff may prove: (1) whether on the facts of this case, the Financial Institution Excise Tax §40-16-1 et seq. of the Alabama Code of 1975 purports to apply to each defendant and, if so, (2) whether on the facts of this case there was a sufficient constitutional nexus (under the federal and state constitutions) between each defendant and the State of Alabama to allow the State of Alabama to exercise taxing jurisdiction to impose said tax.

(b) That each defendant shall be free to interpose any defenses which it may have to this action.

(c) In line with the limited purposes of this proceeding, the fact that there has been no assessment, and the specific relief sought by the State, the parties agree that any claims or defenses not actually

litigated and adjudicated herein by specific declaration of the Court are reserved to the parties without prejudice.

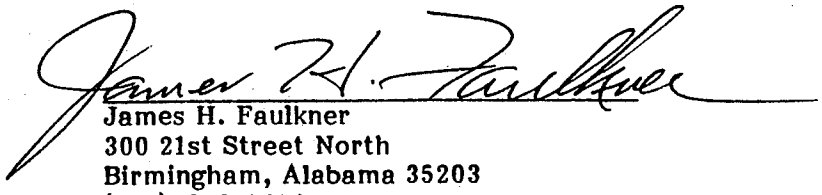
2. By separate paper plaintiff and defendant The Chase Manhattan Bank (USA) National Association ("Chase") have stipulated to certain facts. Plaintiff and defendants Maryland Bank, National Association and Citibank (South Dakota), N.A. agree that the case shall be tried on the basis of the Chase stipulation and that judgment shall be entered against or in favor of these defendants on the basis of such stipulation provided that each of them may pursue or continue any appeal independently.

3. (a) That should the issues in paragraph 1 finally be resolved after all appeals by all parties (including without limitation any proceedings in the United States Supreme Court) against any defendant, then in that event, the State shall proceed, if at all, as provided under the Financial Institution Excise Tax statute to assess such taxes as may be owed by such defendant for the year or years adjudicated.

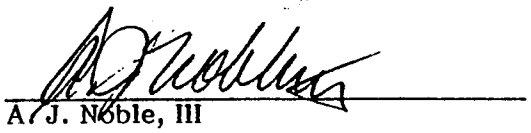
(b) In such event, such defendant shall be bound by the resolution of the issues actually litigated and adjudicated by specific declaration of the Court herein for the particular year or years adjudicated; but such defendant shall have the right to contest and appeal any such assessment without prejudice as in the case of any assessment under the Financial Institution Excise Tax, and shall be free to raise any defenses to the imposition or assessment of the tax which were not actually litigated and adjudicated by specific declaration of the Court in this case, including

without limitation any defenses relating to whether the tax has been correctly determined or whether the statute as applied is unconstitutional.

Respectfully submitted,



James H. Faulkner
300 21st Street North
Birmingham, Alabama 35203
(205) 328-1414
Attorney for Plaintiff



A. J. Noble, III
1400 Park Place Tower
Birmingham, Alabama 35203
(205) 252-4500

Attorney for Defendants

cc: James H. Faulkner
William D. Coleman
A. J. Noble Smith

IN THE CIRCUIT COURT FOR MONTGOMERY COUNTY,
ALABAMA

STATE OF ALABAMA, ex rel DONALD SIEGELMAN, Attorney General of Alabama, Plaintiff, v. CREDIT CARD COMPANIES, etc., et al, Defendants.	))))))))))))	Case No: CV 88-288-G

MEMORANDUM BRIEF IN SUPPORT OF
MOTION FOR SUMMARY JUDGMENT

Introduction

1. The Plaintiff filed this action in the Circuit Court of Montgomery County, Alabama, against certain credit card companies issuing Visa and Mastercard credit cards to residents of Alabama, to-wit: Citibank (South Dakota), Chase Manhattan Bank USA, Maryland Bank USA and First Interstate Bancard Company, Bank of America and Colonial National Bank USA.

Basis of Suit

1. Plaintiffs contend that Defendant credit card companies are transacting intrastate and interstate business in the State of Alabama through the use of credit cards issued by them to residents of Alabama, and are evading the tax due on the income derived in the State from the use of the cards.

2. Plaintiffs also contend that defendant credit card companies have purposely availed themselves of a market in Alabama; they have engaged in regular and continuous solicitation of credit card accounts in Alabama; that the solicitation results

in an intangible, to-wit, loans in the State of Alabama, and therefore there are sufficient contacts by the Defendants with residents of Alabama to establish a nexus between the Defendants and the State of Alabama as to authorize the State to tax defendants' income from interest and fees and other income derived in the State. Moreover, by using the courts of Alabama, Defendants have derived benefits and protection by the State of Alabama.

Standing of Attorney General To Bring Suit

The Attorney General is authorized to institute and prosecute, in the name of the State all civil actions and other proceedings necessary to protect the rights and interest of the State. §36-15-12 Code of Alabama, 1975. This section is not to be read in conflict, but rather in pari materia with all other statutes empowering officers of the executive branch of government to pursue legal action. Montgomery v. Sparks, 225 Ala. 343, 142 So. 769 (1932), Ex Rel Morgan County, 248 Ala. 128, 26 So. 2d 577 (1946).

The Attorney General is afforded express and implied powers, including that to do "all things necessary and proper" to direct the final conclusion of actions on behalf of the State. McDowell v. State, 243 Ala. 87, 8 So. 2d 569 (1942). Moreover, the Attorney General is empowered to employ private counsel in furtherance of their responsibilities. § 36-15-21 Code of Alabama, 1975.

The Facts

The facts of the case are shown by the stipulation of facts

attached hereto.

The Issues Presented

1. Is Chase Manhattan Bank USA doing business in Alabama by virtue of the use of its property i.e. the credit card in the State of Alabama, thereby subjecting itself to taxes payable to the State of Alabama on its income derived in Alabama? This is the primary issue in this case.

2. Are there sufficient minimum contacts between Chase Manhattan Bank USA and the State of Alabama to establish a nexus between the State and the Bank so as to permit the State to assess a tax on the bank's income earned in the State?

3. Are due process requirements satisfied?

4. Is the State of Alabama prohibited by the Commerce Clause from taxing the bank's income derived from is activities in the State?

5. Intangibles.

Taxation of Chase

As to taxation of a National Bank Association by States other than that one in which its principal office is located, the temporary amendment in 1969 of §5219 of the revised statutes (12 USC 548 5(a) to (d) limited the types of taxes a State could impose, such as sales and use taxes, real and personal property taxes, documentary stamp taxes, excise taxes, and license taxes. The amendment was limited to two years. On and after January 1, 1972, the state became free to impose intangible property taxes on national banks. Likewise, the States are now free to impose taxes

on income or other doing business tax on income derived within its borders by the operations of a bank having its principal office in a different state, regardless of whether the foreign bank is State or national. P.L. 94-222 90 State 197 198, effective January 1, 1976, commonly known as the State Taxation of Depositories Act.

The Senate Committee on Banking and Currency reported in S-Rep. No. 91-530 91st Congress 1st Session:

> "There may have at one time been justification for giving national banks privileges and immunities which were denied State banks, under the theory that national banks are peculiarly an instrumentality of the Federal Government, and, as such, hold a unique and distinct position from that of other institutions. Without specifically addressing the question of whether national banks remain, in substance, such a Federal instrumentality, the committee is agreed that there is no longer any justification for Congress continuing to grant national banks immunities from State taxation which are not afforded State banks."

<u>Doing Business in Alabama by Chase Manhattan Bank USA</u>

By some quirk of the defendants imagination, Chase says that it is not doing business in Alabama, and therefore does not derive any income within the borders of Alabama. That is a very unusual position to take on the part of the Bank.

The bank has nearly 50,000 accounts in Alabama. On the credit card fee alone, the bank receives approximately $1,000,000.00 a year as income. There is no way without an audit to determine the amount of income derived from interest. But to speculate, assume that the average card holder will pay about $250.00 per year in interest. That comes to roughly twelve million, Five hundred thousand dollars ($12,500,000.00) per annum. To say that that money is not income derived within the borders of Alabama leaves one in a state of bewilderment.

Of course, Chase Manhattan Bank USA is doing business in Alabama, and the question is whether it is interstate, intrastate or both. To analyze the bank's intrastate activities one finds this:

> First, the bank sends the prospective card holder a solicitation from Delaware that says, "We have reserved a card in your name with a credit line of X number of dollars". "Send applications." "Offer expires on a certain date." Second, the not so wise person accepts the offer in Alabama and mails the same to Chase Manhattan Bank USA in Wilmington, Delaware. Third, Chase mails the customer in Alabama a Visa or Mastercard credit card with an agreement which among other things provides that the credit card is owned by the bank and is the property of the bank, and can be recalled at any time by the bank. A fee of $20.00 is charged. Fourth, the card holder uses the bank's property in Alabama to buy goods. Fifth, Chase Manhattan Bank USA in due time sends the Alabama card holder a bill. Sixth, the Alabama card holder sends his check from Alabama to Delaware to pay the Chase bill. Payment is received in Delaware. The check clears in Alabama.

It is the contention of the plaintiff that credit card contract is made in Alabama when the Alabama resident accepts the bank's offer and when the card is used for the first time. The contract is also performed in Alabama by the card holder when he uses the credit card to buy goods or makes a cash loan in Alabama and pays the bill by mailing Chase his check. The check clears in an Alabama clearing house.

With the above background, is Chase Manhattan Bank USA doing business in Alabama and subject to taxes under §40-16-4 Code of Alabama, 1975. The answer is an overwhelming yes. There are a number of cases, both State and Federal, holding what constitutes doing business in Alabama. Genesco Employment Credit Association v. Cobb, 411 So 2d 151 (Ala. Civ. App.), Lee v. Great Northern Nebraska Corporation, 465 F 2d 1132 (5th Cir. 1972), Linton and

Company, Inc. v. Robert Reid Engineers, Inc., 504 F. Supp 1169 (1981) Hobbs, J. These cases interpret the law on what constitutes doing business in Alabama, and state the rule to be: (1) If a contract is made in Alabama, then of course that is doing business in Alabama. (2) If the contract is made outside Alabama but is performed in Alabama, it is the performance that would amount to doing business in Alabama. Lee v. Great Northern Nebraska Corporation supra First National Life Insurance Company v. Fidelity & Deposit Company, 525 F 2d 966 (5th Cir. 1976).

Plaintiff contends in this case that the contract is made in Alabama. First, when the offer is accepted in Alabama, and second, when the credit card is used in Alabama for the first time, A binding contract comes into existence. Next, the contract is performed in Alabama, by making payments on the account by mailing his check in Alabama, and then the check clears in Alabama. CF Genenco Emp. Credit Association v. Cobb, supra and SAR Manufacturing Company, Inc. v. Dumas Brothers Manufacturing Company, 526 F 2d 1283 (5th Cir. 1976). In SAR Manufacturing, the Fifth Circuit held that a company soliciting business in Alabama coupled with ownership of property in Alabama is doing business in Alabama. Finally, the Alabama Supreme Court has held that the mere solicitation or sale of goods to Alabama customers is a sufficient nexus to constitute doing business in Alabama. See Thompson-Hayward Chemical Company v. Childress, 277 Ala. 285, 169 So 2d 305 (1969).

Under Alabama statutes as codified by §40-16-1-§ 40-16-4, Code of Alabama, 1975, provides that all national banks, and

national banking association doing business in Alabama are subject to an excise tax. Chase Manhattan Bank, USA, is certainly subject to an excise tax on its Alabama income. All that is required in that the State may not discriminate against Chase as a national Banking Association. The Alabama Legislature saw fit to prevent discrimination in taxation of State banks and national banks doing business in the State of Alabama by enacting acts 1967. Ex Session No. 242, §40-1-9, Code of Alabama, 1975.

Minimum Contracts-Interstate Business

The Plaintiffs state that Chase Manhattan Bank, USA, has purposely availed itself of a market in Alabama; that it has engaged in regular and continuous solicitations of credit card (Visa and Mastercard) accounts in Alabama; that the solicitation results in an intangible, i.e. loans of money in Alabama, and by availing itself of a market, continuous solicitation, plus retaining ownership of is credit cards held by Alabama residents, there is established a sufficient nexus between Chase and the State so that Chase is doing business in the State and is subject to taxes on the same basis as banks situated in the State.

Chase has been soliciting Visa and Mastercard accounts in Alabama since 1983 and has issued credit cards in 1983-1986 and 1987. There is a continuous contractual relationship between Chase Manhattan Bank, USA and the Alabama card holder. Chase has availed itself of the Alabama market. Chase makes loans to residents of Alabama. These factors coupled together show without a doubt that Chase is transacting business in Alabama.

Due Process Requirements of Taxing

The bank's principal source of income comes from credit

cards. It is also admitted that Chase has been soliciting credit cards in Alabama since 1983, and that the use of the card creates loans by the he card holder to Chase. It is also admitted that Chase Manhattan Bank USA has no branches in Alabama. Therefore, how can the State of Alabama assert taxing jurisdiction over Chase, plus having judicial jurisdiction over Chase to enforce its tax laws? Admittedly, the State must show due process requirements to have judicial jurisdiction.

A State may exercise personal jurisdiction over a nonresident who purposely directs its activities toward the forum residents. Burger King Corporation v. Rudzewicz, 471 US 462, 85 LE 2d 528, 105 S. Ct. 2174. Moreover, whereas here, Chase derives benefits i.e. income from the use of its credit cards, it is unfair to allow it to escape having to account to the State of Alabama for taxes. Burger King Corporation supra p. 541. And, with respect to interstate contractual obligations, parties who go beyond one State and create continuing relationships and obligations with citizens of another State are subject to regulations and sanctions in the other State - Travelers Health Associations v. Virginia, 339 US 643 94 L Ed 1154, 70 S. Ct. 927 (1950). To carry the "continuing relationships and obligations" idea further, the United States Supreme Court in McGee v. International Life Insurance Company, 355 US 220, 2 L. Ed 223, 78 S. Ct. 199 stated, "In a continuing process of evolution this Court accepted and then abandoned consent, doing business, and presence as the standard for measuring the extent of State judicial power over such

corporation..." More recently in International Shoe Company v. Washington, 326 US 310, 90 L. Ed 95, 66 S. Ct. 154, the Court decided that "due process requires only that in order to subject a defendant to a judgment in personam, if he be not present within the territory of the forum, he have certain minimum contacts with it such that the maintenance of the suit does not offend traditional notions of fair play and substantial justice." "It is sufficient for purposes of due process that the suit was based on a contract which had substantial connections with that State."

To sum up, for the State of Alabama to impose a tax on Chase Manhattan Bank, USA and the other defendants the due process requirements are met if the defendants have purposely established a relationship with the State. Hanson v. Penckla, 357 US 235, and purposely directed their activities at residents of the State Worldwide Volkswagon Corporation v. Woodson, 444 US 286 and have created a continuing contractual obligations with citizen of the State, McGee v. International Life Insurance Company, 355 US 220 and has deliberately engaged in significant activities within the State. Burger King Corporation v. Rudzewicz, 471 US 462, 85 L Ed 2d 528, 105 S. Ct. 2174.

The evidence of the plaintiff clearly shows that the due process requirements are met, and therefore, this Court has jurisdiction.

Commerce Clause

While the plaintiff contends that defendant banks are engaged in intrastate credit card business and are thereby subject to State of Alabama taxation, they also contend that the State is not

precluded from taxing defendants on the income derived in Alabama, even though the banks are also engaged in interstate commerce. The tax to be assessed by the State of Alabama is not a tax on the privilege of engaging in the credit card business in Alabama. In Northwestern States Portland Cement Company v. Minnesota, 358 US 450 the U.S. Supreme Court first articulated that characterization as interstate commerce does not conclusively preclude the assertion of power by State to tax income derived in the State and does not offend the commerce clause. The Court held that net income from interstate operations of a foreign corporation may be subject to State taxation provided the levy is not discriminatory. It is noteworthy that the Court stated that levying taxes on that portion of income derived from activities in the State was a valid exercise of State power. In a later case, Complete Auto Transit, Inv. v. Brady, 430 N.S. 274, 51 L Ed 2d 326, 97 S. Ct 1076, the Court went further and stated that a State tax on the privilege of doing business in the State was not per se unconstitutional under the commerce clause to relieve those engaged in interstate commerce from their just share of State tax burden even though its increased the cost of doing business. See Brady at 288 quoting from Western Livestock v. Bureau of Revenue, 303 U.S. 250.

A four prong test as to whether a State tax violates the commerce clause was announced by the U.S. Supreme Court in Wardair Canada v. Florida Department of Revenue, 91 L Ed 2d 1. (1) Is the tax applied to an activity with a substantial nexus with the taxing State? (2) Is the tax fairly apportioned? (3)

Does the tax discriminate against interstate commerce? (4) Is the tax fairly related to the services provided by the State?

Although the Court uses a four prong test to measure the validity of a State tax under the commerce clause, the first and fourth prong test are similar to due process requirements. Mobile Oil Corporation v. Commission, 445 U.S. 425 (1980) Exxon Corporation v. Department of Revenue, 447 U.S. 207 (1980. The second and third prongs require that the tax be apportioned and does not discriminate against interstate commerce.

Section 40-1-9 Code of Alabama, 1975 equalize the taxation of State and National Banks doing business in Alabama and by statute, Alabama is authorized only to tax that income derived from instate activity by a foreign corporation.

Tax on Intangibles

What is being dealt with in this case is the proposed taxation of intangible to-wit the loans of money by the Delaware Credit Card Company to the card holder in Alabama. What is the situs of the intangible - Delaware, the creditor state or Alabama the debtor state, for tax purposes. This question was answered by Justice Stone writing for the Court in Curry v. McCanless, 307 U.S. 357 (1939). (1) Since rights in intangibles are not related to physical things, the governmental protection given intangibles does not depend on the physical location or situs of the intangibles. (2) The source of rights in intangibles is a relationship between person and entities, which is enforceable in Court. (3) And, if the owner of the intangible, the creditor, has availed itself of the benefits and protections of a State by

creating rights and relationships enforceable in Court there, that State has jurisdiction to tax interests in those rights.

It will be noted that Chase Manhattan Bank, USA maintains that the bank makes loans in Delaware to "persons having Alabama addresses". Under Curry v. McCanless, 307 U.S. 357 (1939). (1) Since rights in intangibles are not related to physical things, the governmental protection given intangibles does not depend on the physical location or situs of the intangibles. (2) The source of rights in intangibles is a relationship between persons and identities, which is enforceable in court. (3) And, if the owner of the intangible, the creditor, has availed itself of the benefits and protections of a State by creating rights and relationship enforceable in Court there, that State has jurisdiction to tax interest in those rights.

Conclusion

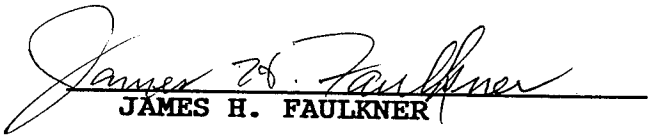
This case is about whether the State of Alabama has authority to assess an excise tax on the income of Chase Manhattan Bank, and the other credit card companies, earned in the State of Alabama. Once the Court declares that there is a nexus between the State and the Credit Card Companies, the next step is to determine how much taxes are owed to the State. We are not at the second step yet.

The State's formula for taxing the bank's income is provided for in §40-16-1 Code of Alabama, 1975, and the corresponding regulations. The statute and regulations provide for an apportionment formula for inclusion of a foreign corporation's income earned in the State of Alabama. As late as November 8, 1988, the

United States Supreme Court stated in Shell Oil Company v. Iowa Department of Revenue, U.S. Law Week, Vol 57 No. 18 November 8, 1988, 101 L. Ed 2d 880 (1988): "As our commerce clause analysis of apportionment formulas has made clear, the inclusion of income in the preapportioned tax base of a state apportionment formula does not amount to extraterritorial taxation. This Court has repeatedly emphasized that the function of an apportionment formula is to determine the portion of a unitary business income that can be attributed to instate activities." Citing Exxon Corp. v. Wisconsin Department of Revenue, 440 U.S. 207 (1980); Mobile Oil Corp. v. Commission of Taxes of Vermont, 445 U.S. 425 (1980).

The sole question before this Court is: Does the State of Alabama have jurisdiction to tax the income derived from its activities in the State via the credit card business. The answer is yes it does.

A judgment in the State's favor is due to be rendered.



JAMES H. FAULKNER

THOMAS W. BOWRON

Attorneys for the State of Alabama
300 North 21st Street
Suite 900
Birmingham, Alabama 35203
Phone: 328-1414

CERTIFICATE OF SERVICE

I hereby certify that I have served a copy of the above and foregoing upon the following by U.S. First Class Mail, postage

prepaid and properly addressed, this the 17th day of November, 1988.

JAMES H. FAULKNER

Andrew J. Noble, III, Esquire
1400 Park Place Tower
Birmingham, Alabama 35203

William D. Coleman, Esquire
57 Adams Avenue
P. O. Box 2069
Montgomery, Alabama 36197

IN THE CIRCUIT COURT OF MONTGOMERY COUNTY, ALABAMA
15th JUDICIAL CIRCUIT

STATE OF ALABAMA, ex rel. Donald Siegelman, Attorney General of Alabama, Plaintiff, vs. Citibank (South Dakota), N.A., et al., Defendants.	))))))))))))	CASE NO. CV-88-288-G

BRIEF IN SUPPORT
OF MOTION FOR SUMMARY JUDGMENT

Defendants submit this brief in support of their motion for summary judgment.

Introduction And Summary Of Argument

In this case the State seeks a declaration that the Financial Institution Excise Tax, §40-16-1 et seq. Ala. Code (1975), applies to The Chase Manhattan Bank (USA), National Association which is a national bank located in Wilmington, Delaware.[1/]

1/ The stipulation incorporated into the Pre-trial Order defines the issue as follows: That a declaration is sought by plaintiff only as to the following questions with respect to such tax years as plaintiff may prove: (1) whether on the facts of this case, the Financial Institution Excise Tax §40-16-1 et seq. of the Alabama Code of 1975 purports to apply to each defendant and, if so, (2) whether on the facts of this case there was a sufficient constitutional nexus (under the federal and state constitutions) between each defendant and the State of Alabama to allow the State of Alabama to exercise taxing jurisdiction to impose said tax.

The Financial Institution Excise Tax is a privilege tax. It was adopted in the 1930's to tax national banks located in Alabama and institutions competing with them, in one of the specific ways in which states were permitted by federal statute to tax national banks. It was not intended to apply to out of state national banks or to any financial institution engaged solely in interstate commerce. Further, under the prevailing federal law at the time, it could not have applied to such institutions.

While developments of federal law since the statute was first adopted have expanded the permissible scope of state taxing jurisdiction, the Legislature has not amended the Financial Institution Excise Tax to expand its scope or to test the outer limits of the State's jurisdiction to tax. Further, there are sound policy reasons why the Legislature would not enact such legislation.

Our Supreme Court has made it absolutely clear that taxing statutes, such as the Financial Institution Excise Tax, must be strictly construed in accordance with their scope and intent at the time of enactment:

> [R]ecent pronouncements of the United States Supreme Court which enlarge the permissible area of state taxation cannot change the intent or enlarge the scope of enactments of our legislature. Therefore, the question is not whether the state may, under prevailing case law impose a tax. . . . Rather the controlling issue is whether, in originally enacting this statute, the Legislature intended to tax these transactions. To determine that intent, we must look to the nature of the activity involved as well as the "history of the times" when the statute was enacted.

Ex parte L & N Railroad Co., 398 So.2d 291, 293 (Ala. 1981) (emphasis by the Court).

The declaration sought by the State would extend the statute far beyond its intended scope.

Further, Chase believes that an attempt by the Legislature to tax an out of state bank in Chase's position would be unconstitutional. However, the Court does not reach this hypothetical question because the current statute plainly does not purport to impose a tax on Chase. See State ex rel. Baxley v. Johnson, 293 Ala. 69, 300 So.2d 106 (1974).

Facts

Chase is a national bank located in Wilmington, Delaware. Stipulation of Facts ¶ 1-2. It has no branch or place of business in Alabama. Stipulation of Facts ¶ 2. It has no officers, agents or employees in Alabama. Stipulation of Facts ¶ 23. To facilitate the making of loans as authorized by the National Bank Act, Chase maintains credit card accounts. Stipulation of Facts ¶ 3. It solicits applications for credit card accounts from Alabama residents by mail from outside Alabama. Stipulation of Facts ¶ 8. Applications for such accounts are returned by Alabama residents by mail to Chase in Delaware. Stipulation of Facts ¶ 19(2). Chase accepts or rejects all applications in Delaware. Stipulation of Facts ¶ 19(3). No matter where or how an Alabama resident may use his or her credit card account, all funds are advanced by Chase in Delaware and all payments are received by Chase in Delaware. Stipulation of Facts ¶ 19(8), 19(10), and 20.

No state or national bank, which does not have an office or branch in Alabama, pays or has paid the Financial Institution Excise Tax, nor has such tax ever been assessed against any such entity by the State of Alabama. Stipulation of Facts ¶ 27. A number of such state and national banks without offices or branches in Alabama issue credit cards or provide other financial services to Alabama residents. Stipulation of Facts ¶ 27.

The Tax Does Not Apply To Out Of State National Banks

At the time the Financial Institution Excise Tax was adopted it was not intended to apply to out of state national banks. Further under the prevailing federal law of the time, the State could not impose such a tax on national banks located outside Alabama.

The Financial Institution Excise Tax was first adopted in 1932 and, as relevant here, the statute has not changed significantly since then.[2/] The statute defines a financial institution as follows:

> Any person, firm, corporation and any legal entity whatsoever doing business in this state as a national banking association, bank, banking association, trust company, industrial or other loan company or building and loan association, and such term shall likewise include any other institution or person employing

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2/ The statute was first enacted at Acts of Ala., Extra Session 1932, #11 page 107; then repealed and readopted with amendments at Gen. Acts of Ala. 1933, Extra Session, Page 104; then repealed and re-enacted with amendments as part of the General Revenue Bill of 1935 at Article XII, Chapter I, Sections 346.1 to 346.6, Gen. Acts of Ala., Regular Session, 1935 Pages 428-434; and brought forward as reflected in the notes to the current code following §40-16-1 et seq.

> moneyed capital coming into competition with the business of national banks, and shall apply to such person or institution regardless of what business form and whether or not incorporated, whether of issue or not, and by whatsoever authority existing. . . .

§40-16-1(1) Ala. Code (1975); and further provides:

> Every such financial institution shall pay to the state annually for each taxable year an excise tax for the privilege of engaging in this state in the business of banking and of conducting a financial institution, as in this chapter defined, and of conducting a business employing moneyed capital coming into competition with the business of national banks measured by its net income for such taxable year at the rate of six percent of such net income. The amount of such excise tax shall not be in excess of any limit fixed thereon by any present or future federal statute relating to the taxation of national banks by this state.

§40-16-4 Ala. Code (1975).

National banks are creatures of the federal government and are subject to taxation by the states only as permitted by Congress. McCulloch v. Maryland, 4 Wheat. 316, 4 L.Ed. 579 (1819); First National Bank of Birmingham v. State, 262 Ala. 155, 77 So.2d 653 (1954). In 1926 Congress amended the National Bank Act to permit states, for the first time, to levy upon national banks located in their state an excise tax measured by net income, such as the Financial Institution Excise Tax.

Prior to the adoption of the Financial Institution Excise Tax in 1932, the State had taxed national banks located in the State through use of an excise tax on bank shares. However, the validity of the State's statute was questioned in Ward v. First National Bank of Hartford, 225 Ala. 10, 142

So. 93 (1932), where the Supreme Court found that the shares tax as applied discriminated against the bank in violation of the National Bank Act. James T. Stovall, in his article on the history and development of bank taxation in Alabama, describes the background of the current statute's enactment:

> On account of this element of uncertainty in regard to the collection of the excise tax [on bank stock caused by the Ward case], it was realized by both bankers and the State Tax Commission that the law should be changed. During the fall of 1932 the Legislature was in session, and a committee appointed by the Alabama Bankers Association met with a legislative committee with the view of formulating a new plan of taxation for national and state banks. It was noted that whereas Revised Statute 5219 of U.S. (12 USCA 548) had formerly permitted a state to tax national banks within its borders by only three methods a fourth method had been added on March 25, 1926. . . . Both the bankers and the legislators felt that what was needed was a tax which could be applied equally to national banks, state banks, trust companies and other institutions and individuals employing moneyed capital coming into competition with the business of national banks. . . . The said fourth method added to the said Revised Statute 5219 of U.S. (12 USCA 548) seemed to solve the problem.

Stovall, History and Development of Bank Taxation in Alabama, 6 Ala. Lawyer 55, 56-57 (1945).

In State v. First National Bank of Mobile, 239 Ala. 492, 196 So. 114 (1940), the Supreme Court discussed the interrelation between federal law and the Financial Institution Excise Tax, and the Legislature's intent in adopting the statute:

> The state has no inherent power to impose the taxes here in question. It is a question of power conferred by Congress. Sumter County v. National Bank of Gainsville, 62 Ala. 464, 34 Am. Rep. 30.

> The privilege granted by Congress finds expression in Section 5219, Revised Statutes of the United States and sundry amendments now codified in 12 U.S.C.A. p. 604, §548.
>
> The pertinent provision of this statute reads: "The legislature of each State may determine and direct, subject to the provisions of this section, the manner and place of taxing all the shares of national banking associations located within its limits. The several States may (1) tax said shares, or (2) include dividends derived therefrom in the taxable income of an owner or holder thereof, or (3) tax such associations on their net income, or (4) according to or measured by their net income, provided the following conditions are complied with."
>
> The "manner" or "form" of taxing such banking institutions thus prescribed is in the alternative, the selection of one being in lieu of the others. . . .
>
> With these restrictions in view, the Legislature of Alabama by the Act of 1933, General Acts Extra Session 1933, p. 104, elected alternative No. 4, of §548, supra, namely, the imposition of an excise tax measured by the net income of Banks and other financial institutions coming into competition with national banks.

239 Ala. at 494-495, 196 So. at 115-116 (emphasis added). With regard to the construction and application of the statute the Court explained:

> The statute must be read as a whole in the light of constitutional principles, and also in view of the fact that all the State's power to tax National Banks is permissive, and its statutes must be considered in the light of Federal Statutes granting this permission.

239 Ala. at 496, 196 So. at 117.

Thus, the statute was adopted to tax national banks and those competing with them, in one of the ways permitted by the National Bank Act, and the statute must be considered in light of the federal statute granting the State permission to tax.

The permission granted to the State by the National Bank Act was expressly limited to taxation of "national banking associations located within its limits." 12 U.S.C. §548 as amended in 1926. As the legislative history of the 1926 amendment to the federal statute makes clear, "the net income of a national banking association would be taxed only in the state where the bank is located, because that is the location of the capital and business of the bank." House Report No. 526, Sixty-ninth Congress, First Session, Congressional Record pp. 5761-62 (1926) (emphasis added). See also Tradesman's National Bank v. Oklahoma Tax Commission, 309 U.S. 560, 563, 84 L.Ed. 947, 60 S.Ct. 688 (1940).

Under Section 548, as amended in 1926, a national bank has been held to be located for tax purposes only in the state where it is established under its charter. National City Bank v. Domenech, 71 F.2d 13, 16 (1st Cir. 1934), aff'd, Domenech v. National City Bank, 294 U.S. 199, 79 L.Ed. 857, 55 S.Ct. 366 (1934).[3/]

Chase's Certificate of Authority from the Comptroller of the Currency, Charter Number 17199, clearly states that it is located in

---

3/ While national banks have been permitted to have branches in U.S. territories and possessions, with the exception of certain grandfathered branches not relevant here, they have not been permitted to have branches in a state other than the one in which they maintain their principal place of business. 12 U.S.C. §36. Some banks have paid certain taxes of the types authorized by 12 U.S.C. §548 to U.S. territories or possessions with respect to branches located there and this practice has apparently not been questioned. See, e.g., Domenech v. National City Bank, supra, and Posadas v. National City Bank, 296 U.S. 497, 80 L.Ed. 351, 56 S.Ct. 349 (1936).

Wilmington, Delaware. Exhibit 1 to Stipulation of Facts. Further, under the National Bank Act, Chase may not have a branch in Alabama. 12 U.S.C. §36.

The location of a national bank has been relevant for several purposes under the National Bank Act. In a case involving interest chargeable by a national bank on credit card accounts under 12 U.S.C. §85, the U.S. Supreme Court rejected the contention that a national bank was "located" in a state in which it did not have a branch merely because it maintained credit card accounts for residents of the state. The Court provided the following analysis:

> There is no question but that Omaha Bank itself, apart from its BankAmericard program, is located in Nebraska. Petitioners concede as much. The National Bank Act requires a national bank to state in its organization certificate "[t]he place where its operations of discount and deposit are to be carried on, designating the State, Territory, or district, and the particular county and city, town, or village." The charter address of Omaha Bank is in Omaha, Douglas County, Neb. The bank operates no branch banks in Minnesota, nor apparently could it under federal law.
>
> The State of Minnesota, however, contends that this conclusion must be altered if Omaha Bank's BankAmericard program is considered: "In the context of a national bank which systematically solicits Minnesota residents for credit cards to be used in transactions with Minnesota merchants the bank must be deemed to be 'located' in Minnesota for purposes of this credit card program."
>
> We disagree. Section 85 was originally enacted as §30 of the National Bank Act of 1864, 13 Stat 108. The congressional debates surrounding the enactment of §30 were conducted on the assumption that a national bank was "located" for purposes of the section in the State named in its organization certificate. Omaha Bank cannot be deprived of this location merely because it is extending credit to residents of a foreign State. Minnesota residents were always free to visit Nebraska and receive loans in that State.

Marquette National Bank v. First of Omaha Service Corp., 439 U.S. at 309-310, 58 L.Ed.2d. 534, 99 S.Ct. 540 (1978) (citations and footnotes omitted).

Chase is a national banking association located in Delaware and has no office or branch in Alabama. Stipulation of Facts ¶2. Clearly, at the time the Financial Institution Excise Tax was enacted Alabama could not under federal law have taxed an out of state national bank such as Chase.

Consistent with the federal limitations on the State's power to tax national banks, the language of the statute clearly contemplates that each financial institution subject to the tax will have a physical location in Alabama. For example, Section 40-16-6 provides that 75 percent of the net proceeds of the tax will be allocated particularly to the counties and municipalities in Alabama where an institution is "located."

The regulation implementing this provision states that the location of a taxpayer's office within Alabama is "absolutely essential" to the administration of the Financial Institution Excise Tax and that for these purposes "the financial institution conducts business only in locations where offices are maintained." Ala. Adm. Code, Reg. 810-9-1-.02(6).[4/] Other

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4/ "Sec. 40-16-6 requires that the taxpayer report in detail the percentage of the financial institution's total business transacted in each municipality and county in Alabama. The method of determination of these percentages shall be developed based upon the nature of the taxpayer's overall operations and consistently applied on a year to year basis. For purposes of this regulation, the financial institution conducts business only

(continued on next page)

provisions of the regulations also presume that any out of state institution subject to the tax will have Alabama offices. See, e.g., Ala. Adm. Code, Reg. 810-9-1-.01(4)(c).

In summary, the Financial Institution Excise Tax was adopted in the 1930's to tax national banks to the limited extent permitted by federal statute and is to be construed in light of the permission there given. The federal statute only permitted states to tax national banks located within their borders. Under the National Bank Act, a bank that does not have a branch in a state is not deemed located there merely because residents of the state maintain credit card accounts with the bank. Thus, the Financial Institution Excise Tax was not intended to apply to Chase, which is a national bank located in Delaware -- not Alabama.

The Tax Does Not Apply To Financial Institutions Engaged In Exclusively Interstate Business

Further, the Financial Institution Excise Tax was plainly not intended to apply to institutions engaged in purely interstate business. It is a privilege tax and, at the time it was adopted, the State could not have constitutionally exacted a tax for the privilege of doing exclusively interstate business.

(continued from previous page)

in locations where offices are maintained. This information is absolutely essential to the administration of the Financial Institution Excise Tax Law. Omission of this information from the return will cause the return to be deemed incomplete and subject it to treatment as a delinquent return." Ala. Adm. Code, Reg. 810-9-1-.02(6) (emphasis added).

While we have found no case where an effort was made to impose the Financial Institution Excise Tax on an out of state institution engaged in interstate commerce, there has been litigation involving the Alabama Foreign Corporation Franchise Tax, which is a privilege tax of the same vintage. The franchise tax is levied on "Every corporation organized under the laws of any other state, nation, or territory and doing business in this state." §40-14-41 Ala. Code (1975).

In State v. Plantation Pipe Line Company, 265 Ala. 69, 89 So.2d 549 (1956), cert. denied, 352 U.S. 943, 1 L.Ed.2d 237, 77 S.Ct. 263 (1956), the Court was called upon to determine whether an interstate pipeline company that was engaged exclusively in interstate commerce was doing business in the State within the meaning of the statute. The Court noted that the doing business concept was embodied both in the franchise tax statute and Section 232 of the Constitution, relating to qualification and taxation of foreign corporations. After reviewing the history of the franchise tax and Section 232, the Court concluded that the standard was the same for both purposes. 265 Ala. at 84, 89 So.2d at 561. The Court then held that: "We are satisfied that the franchise tax is only applicable to foreign corporations doing intrastate business in Alabama." 265 Ala. at 85-86, 89 So.2d at 563. Thus, as the Court found that the pipeline company's activities in the State were exclusively interstate in nature, the company was not subject to the tax.

Further, in Plantation Pipe Line the Court, writing in 1956, pointed out that any attempt by the State to exact a tax for the privilege of

doing an exclusively interstate business would contravene the Commerce Clause of the U.S. Constitution. 265 Ala. at 90, 89 So.2d at 567-568. See also Alpha Portland Cement Co. v. Massachusetts, 268 U.S. 203, 69 L. Ed. 916, 45 S. Ct. 477 (1925); Spector Motor Service, Inc. v. O'Connor, 340 U.S. 602, 95 L.Ed. 573, 71 S.Ct. 508 (1951), along with other authorities cited by the Court in Plantation Pipe Line.

Recent cases applying Alabama's foreign corporation qualification requirements have further clarified the relevant interstate/intrastate distinction. In Johnson v. MPL Leasing Corp., 441 So.2d 904 (Ala. 1983), the Supreme Court confronted the question of whether a foreign corporation which provided credit by leasing personal property for use in the State was required to qualify to do business in Alabama. In concluding that the corporation was not required to qualify, the Court made it clear that the qualification requirements only come into play when the business conducted in the State by the non-qualified corporation is intrastate in nature. 441 So.2d at 905. The Court emphasized that this standard should not be confused with the minimum contacts standard applicable to service of process: "It is far easier to find that a foreign corporation is 'doing business' for service of process . . ." 441 So.2d at 906. Further, the Court made it clear that a corporation may carry on substantial activities within the State without being deemed to be doing business, so long as such activities are incident to interstate commerce. 441 So.2d at 905-906.[5/]

5/ See also Wallace Construction Co. v. Industrial Boiler Co., 470 So.2d 1151 (Ala. 1985) (delivery and installation of boiler not intrastate activity, but incidental to interstate sale of boiler); Kentucky Galvanizing Co. Inc. v. Continental Casualty Co., 335 So.2d 649 (Ala. 1976) (delivery of guard rails not intrastate activity).

A review of the facts in the MPL Leasing case underscores that Chase's dealings with Alabama are interstate in nature. The Supreme Court set forth the relevant facts as follows:

> MPL Leasing Corporation ("MPL") is a California corporation organized for the purpose of offering alternative financing plans to dealers of Saxon Business Products. Saxon specializes in the sale of paper copiers which are distributed through independent dealers located throughout the United States, including Alabama. Jay Johnson was a Saxon dealer in Alabama.
>
> Through mailings and telephone calls into the state, MPL solicited Johnson's attendance at a sales seminar in Atlanta. Johnson attended the seminar and entered into an agreement with MPL. The agreement provided for Johnson to lease Saxon copiers with the option to buy. MPL shipped the machines into Alabama and filed a financing statement with the Secretary of State.
>
> Johnson became several months delinquent with his payment to MPL. MPL filed suit in Montgomery Circuit Court. Johnson moved to dismiss, alleging, among other defenses, that MPL was not qualified to do business in Alabama. We find that the trial judge correctly denied the motion.

441 So.2d at 905.

Even though MPL had solicited business through mailings and telephone calls into the state of Alabama, had delivered personal property into the state of Alabama, had retained ownership of that property subject to the lease to Johnson, had filed a financing statement covering such property with the Secretary of State of Alabama, and had filed suit in the state courts of Alabama to enforce Johnson's obligations, the Supreme Court determined that MPL was engaged solely in interstate commerce and was not required to qualify to do business in Alabama.

The factual similarity of this case to the one before the Court is apparent. Chase has no place of business nor employees in Alabama; it solicits accounts by mail in interstate commerce; it accepts all applications in Delaware; it makes all loans by approving applications and advancing funds in Delaware; and all payments are effective when received by Chase in Delaware. Once the account is opened, the use of a credit card or credit card account check by an Alabama resident in Alabama initiates an interstate transaction by which the Alabama resident draws on his or her line of credit at the bank in Delaware. To the extent an account holder uses his card or checks in Alabama that activity is clearly an incident of his interstate business relationship with Chase.

Consequently, even if Chase were not a national bank, but were merely a corporation located outside Alabama, the statute would not apply because its dealings with Alabama residents are interstate in nature. Chase is thus not "doing business" in Alabama within the meaning of the statute.

The Controlling Issue Is What The Legislature Intended To Do When It Enacted The Statute, Not What It Might Be Able To Do Today

Although the State may not concede as much, we believe that the real thrust of this case is an effort by the State to put an old statute to a new and unintended use, due to recent changes in federal law. This effort cannot be successful in view of the Supreme Court's decision in Ex Parte L & N Railroad Co., 398 So.2d 291 (Ala. 1981).

Federal restrictions on state taxation of national banks have been relaxed in recent years. Since 1976 Congress has permitted states to tax national banks in the same manner in which they tax state banks existing under the laws of the state where the national bank is located.[6/] Further, in 1977 the U.S. Supreme Court overruled Spector, supra, and for the first time permitted states to impose privilege taxes under certain conditions on enterprises engaged exclusively in interstate commerce. Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 51 L.Ed.2d 326, 97 S.Ct. 1076 (1977).

Given the change of federal law there has been a good deal of academic discussion in the last few years concerning state taxation of out of state financial institutions and a number of proposals for new approaches for taxation have been advanced. See, e.g., Judson & Duffy, State and Local Taxation of Financial Institutions: An Opportunity for Reform, 39 Vand. L. Rev. 1057 (1986). However, even the most active proponents of expanding the scope of state taxation concede that legislatures have been slow to act. McCray, State Taxation of Interstate Banking, 21 Ga.L.Rev. 283 (1986)

6/ After remaining substantially unchanged since 1926, in 1969 Congress adopted temporary amendments to §548 which, among other things, authorized states for the first time to impose certain limited taxes on non-domiciliary national banks, with a permanent amendment due to take effect in 1972, later extended to 1973, removing all restrictions other than non-discrimination. In 1973 Congress imposed a moratorium on the imposition of income or doing business taxes on any federally insured depository including national banks by any states other than the one in which the institution's principal place of business was located. The moratorium expired in 1976, leaving states free to tax out of state national banks subject to the permanent amendment to §548 and constitutional restrictions applying to taxation of corporations generally. The History of Amendments from 1969 forward is found under §548 at pages 2 and 3 of the 1988 pocket part to 12 U.S.C.A. §§531-1460 and the prior history at pp. 6-7 of the bound volume under §548.

("According to a recent survey of state bank taxation conducted by the Multistate Tax Commission, only Minnesota has revised its law to assert taxing jurisdiction over absent out of state banks." 21 Ga.L.Rev. at 304, n. 92.).

As in the case of most other states, our Legislature has not acted to test the limits of its taxing jurisdiction over out of state banks. The fact that the states have been slow to enact such legislation can be easily understood when the policy factors militating against such a change in the law are considered. Commentators have pointed out, for example, that non-financial center states such as Alabama are generally interested in obtaining capital for use inside the state from out of state sources and, therefore, wish to maintain a tax structure which encourages rather than discourages the flow of capital into the state from financial center states. Judson & Duffy, supra, at 1072-79.

Further, although there has been a relaxation of federal limitations in the area, there are a number of unresolved constitutional questions relating to tax revision proposals. One such question, raised in the State's complaint in this case, concerns the nexus required to permit imposition of a tax. Had the Legislature attempted to impose a tax on out of state banks such as Chase on the facts of this case, the statute would run squarely up against National Bellas Hess, Inc. v. Dept. of Revenue, 386 U.S. 753, 18 L.Ed.2d 505, 87 S.Ct. 1389 (1967), which held that there was an

insufficient nexus between a state and an out of state mail-order house that engaged solely in interstate commerce.[7/]

However, as stated at the beginning of this brief, the controlling issue is not what the Legislature could do by adoption of a hypothetical statute, but rather what it has in fact done. The Supreme Court made this point clear in Ex Parte L & N Railroad Co., 398 So.2d 291 (Ala. 1981).

The question before the Court in the L&N case was whether the State's railroad privilege tax, Section 40-21-57, was intended to apply to activities of L&N which constituted an integral segment of interstate commerce. As this case is controlling, and the State's contentions were so similar to the ones presented in the case at bar, we quote at some length:

> It is clear from recent decisions of the United States Supreme Court that, under proper circumstances and regardless of whether the transaction is characterized as interstate or intrastate, the State may tax the gross receipts generated by L&N's services without offending either the Commerce Clause, Art. I, §8 cl. 3, or Import-Export Clause, Art. I, §10, cl. 2 of the Federal Constitution. That fact alone, however, does not necessarily justify the imposition of the tax to the transactions in this case. As we have stated, recent pronouncements of the United States Supreme Court which enlarge the permissible area of state taxation cannot change the intent or enlarge the scope of enactments passed by our legislature. Therefore, the question is not whether the State may, under prevailing caselaw, impose a tax upon the gross

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7/ In addition, were the current statute to be applied to a national bank not located in Alabama like Chase it would be unconstitutionally discriminatory; for example, by virtue of the credit provisions of Section §40-16-8 which allow a credit for certain taxes paid to the State of Alabama while denying such credit for taxes paid to other states. See Boston Stock Exchange v. State Tax Commission, 429 U.S. 318, 50 L.Ed.2d 514, 97 S.Ct. 599 (1977).

> receipts earned from these transactions. Rather, the controlling issue is whether, in originally enacting this statute, the Legislature intended to tax these transactions. To determine that intent, we must look to the nature of the activity involved as well as the "history of the times" when the statute was enacted. . . .

398 So.2d at 293 (emphasis the Court's) (citations and footnote omitted). The Court then reviewed the evolution of the U.S. Supreme Court's decisions in the commerce clause area and concluded:

> The question before us is one of legislative intent. We presume that, in enacting the statute in 1935, the Legislature was aware of the existing interpretations and permissible limits of a state's power to tax. . . . Finally, we presume that the Legislature is aware of the judicial enlargement of the State's permissible area and method of taxation, so that the Legislature could have taken full advantage of those changes if it either intended or desired to. No such changes have been made during the forty-five years since the statute was passed and the State has not, by legislation, attempted to enlarge the scope of its taxation. Thus, viewed in its broadest scope, the statute in question could reach and impose a tax upon only those activities which were local and purely intrastate in character. We therefore conclude that the statute as enacted in 1935 and as it exists today, was not intended to apply to receipts generated by transactions such as these which, although conducted wholly within the confines of Alabama, constitute an integral portion or segment of interstate commerce.

398 So.2d at 296-297 (citations omitted). As in L&N, the State seeks to have this Court do something that the Legislature has not done, and at the time the statute was enacted could not have done.

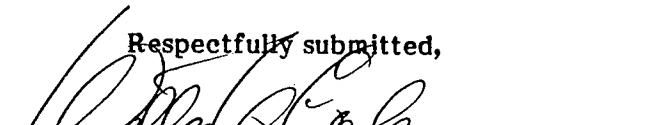
The Financial Institution Excise Tax means the same thing today that it meant fifty years ago. When the Financial Institution Excise Tax was adopted, the State could not tax out of state national banks, nor

could it impose a tax on the privilege of doing interstate business. The statute's history and language clearly reflect that it was intended to tax only those national banks located in Alabama as permitted under the 1926 amendment to 12 U.S.C. §548, and further that it was intended to apply to only those corporations doing an intrastate business. Chase is a national bank located in Delaware; it has no branch or office here; and its lending transactions with Alabama residents are interstate in nature. Therefore, the statute does not apply to Chase.

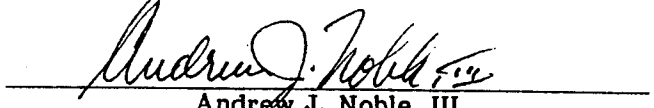
Conclusion

The relief sought by the State is available if at all from the Legislature. Summary judgment is due to be entered in Chase's favor.

Respectfully submitted,



William D. Coleman
CAPELL, HOWARD, KANABE & COBBS, P.A.
57 Adams Avenue
Montgomery, Alabama 36197
(205) 241-8000



Andrew J. Noble, III
BRADLEY, ARANT, ROSE & WHITE
1400 Park Place Tower
Birmingham, Alabama 35203
(205) 252-4500

Attorney for Defendants, The
Chase Manhattan Bank (USA), National
Association, Maryland Bank, N.A.,
Citibank (South Dakota), N.A.

CERTIFICATE OF SERVICE

I hereby certify that I have served a copy of the foregoing brief upon the Honorable James H. Faulkner, Johnson & Cory, P.C., 300 North 21st Street, Suite 900, Birmingham, Alabama 35203 by depositing a copy of same in the United States Mail, postage prepaid and properly addressed this the 18th day of November, 1988.

Andrew J. Noble, III

J. Robert Flenn...

J. Robert Flenn...

FINANCIAL INSTITUTION EXCISE TAX

Law and Regulations

STATE OF ALABAMA

Department of Revenue

The Excise Tax on Financial Institutions

The Excise Tax on Financial Institutions is levied to give effect to the provisions of Federal law limiting the right of the states to tax national banking associations. It is not a tax on income but is an excise tax measured by income. The proceeds of the tax, after the expense of administration, are distributed one-half to the municipalities, one-fourth to the counties and one-fourth to the general fund of the State.

The following regulations are promulgated in accordance with Sec. 40-16-3(e), Code of Alabama 1975 as amended, for the information and guidance of all concerned.

Given under my hand and seal this 28th day of September, 1982 at Montgomery, Alabama.

Ralph P. Eagerton, Jr.
Commissioner of Revenue

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FINANCIAL INSTITUTION EXCISE TAX

§40-16-1. Definitions.

For the purpose of this chapter, the following terms shall have the respective meanings ascribed to them by this section:

(1) FINANCIAL INSTITUTION. Any person, firm, corporation and any legal entity whatsoever doing business in this state as a national banking association, bank, banking association, trust company, industrial or other loan company or building and loan association, and such term shall likewise include any other institution or person employing moneyed capital coming into competition with the business of national banks, and shall apply to such person or institution regardless of what business form and whether or not incorporated, whether of issue or not, and by whatsoever authority existing. The common parent corporation of a controlled group of corporations eligible to elect to file a consolidated excise tax return, in accordance with section 40-16-3, shall be considered a "financial institution" if such parent corporation is a registered bank

holding company as defined by the Bank Holding Company Act of 1956, as amended. As a financial institution, the common parent corporation will be governed by sections 40-16-1 through 40-16-8 and exempt from all income taxes under sections 40-18-1 through 40-18-85, with the exception that the credit for licenses or taxes as provided by section 40-16-8 and the regulations issued or promulgated pursuant thereto by the department of revenue will not apply to amounts of excise tax on financial institutions imposed hereby and paid by such parent corporation. "Financial institution" shall not mean or include individual citizens and fiduciaries acting in a representative capacity for individual citizens, not engaged in a banking, loan, investment or similar business, but merely making personal investments of personal or fiduciary funds in bonds, notes or other evidences of indebtedness and not made in competition with the business of national banks, nor shall such term apply to insurance companies or insurance associations merely making investments of reserves in bonds, notes or other evidences of indebtedness and not made in competition

with the business of national banks.,

(2) NET INCOME. The net income for the taxable year, as in this title defined, arising from the business the privilege to engage in which is hereby taxed, computed by deducting from the gross income arising from such business, without any exclusions from or credit to such gross income, the total amount of the following deductions:

a. All the ordinary and necessary expenses paid or incurred during the year the income is received which is made the basis of the tax in carrying on the business, the privilege to engage in which is hereby taxed, including a reasonable allowance for salaries or other compensation for personal service actually rendered; also all contributions paid by a financial institution as employer to or under a stock bonus, pension, profit-sharing or annuity plan, or if compensation is paid or accrued on account of any employee of any financial institution under the plan deferring the receipt of such compensation, such contributions or compensation shall be deductible, but only to the following extent:

1. In the taxable year when paid, if the contributions are paid into a pension trust and if such taxable year ends within or with a taxable year of the trust for which the trust is exempt under section 40-18-25 in an amount determined as follows: (i) An amount not in excess of five percent of the compensation otherwise paid or accrued during the taxable year to all the employees under the trust, but such amount may be reduced for future years if found by the commissioner of revenue upon periodical examinations at not less than five year intervals to be more than the amount reasonably necessary to provide the remaining unfunded cost of past and current service credits of all employees under the plan, plus (ii) any excess over the amount allowable under clause (i) necessary to provide with respect to all of the employees under the trust the remaining unfunded cost of their past and current service credits distributed as a level amount, or a level percentage of compensation, over the remaining future service of each such employee, as determined under regulations prescribed by the commissioner of revenue, but if such remaining unfunded cost with respect to any

three individuals is more than 50 percent of such remaining unfunded cost, the amount of such unfunded cost attributable to such individuals shall be distributed over a period of at least five taxable years, or (iii) in lieu of the amounts allowable under (i) and (ii) above, an amount equal to the normal cost of the plan, as determined under regulations prescribed by the commissioner of revenue plus, if past service or other supplementary pension or annuity credits are provided by the plan, an amount not in excess of 10 percent of the cost which would be required to completely fund or purchase such pension or annuity credits as of the date when they are included in the plan, as determined under regulations prescribed by the commissioner of revenue; except, that in no case shall a deduction be allowed for any amount (other than the normal cost) paid in after such pension or annuity credits are completely funded or purchased, (iv) any amount paid in a taxable year in excess of the amount deductible in such year under the foregoing limitations shall be deductible in the succeeding taxable years in order of time to the extent of the difference between the amount paid and deductible in each such succeeding year and the maximum amount deductible for such year in accordance with the foregoing limitations.

2. In the taxable year when paid, in an amount determined in accordance with subparagraph 1 of this paragraph, if the contributions are paid toward the purchase of retirement annuities and such purchase is a part of a plan which meets the requirements of subsection (e) of section 40-18-25, and if refunds of premiums, if any, are applied within the current taxable year or next succeeding taxable year towards the purchase of such retirement annuities.

3. In the taxable year when paid, if the contributions are paid into a stock bonus or profit-sharing trust, and if such taxable year ends within or with a taxable year of the trust with respect to which the trust is exempt under subsection (e) of section 40-18-25, in an amount not in excess of 15 percent of the compensation otherwise paid or accrued during the taxable year to all employees under the stock bonus or profit-sharing plan. If

in any taxable year beginning after the approval of this chapter by the governor there is paid into the trust, or a similar trust then in effect, amounts less than the amounts deductible under the preceding sentence, the excess or, if no amount is paid, the amounts deductible shall be carried forward and be deductible when paid in the succeeding taxable years in order of time, but the amount so deductible under this sentence in any such succeeding taxable year shall not exceed 15 percent of the compensation otherwise paid or accrued during such succeeding taxable year to the beneficiaries under the plan. In addition, any amount paid into the trust in a taxable year beginning after the approval of this chapter by the governor in excess of the amount allowable with respect to such year under the preceding provisions of this subparagraph shall be deductible in the succeeding taxable years in order of time, but the amount so deductible under this sentence in any one such succeeding taxable year together with the amount allowable under the first sentence of this subparagraph shall not exceed 15 percent of the compensation otherwise paid or accrued during

such taxable year to the beneficiaries under the plan. The term "stock bonus or profit-sharing trust," as used in this subparagraph, shall not include any trust designed to provide benefits upon retirement and covering a period of years, if under the plan the amounts to be contributed by the employer can be determined actuarially as provided in subparagraph 1. If the contributions are made to two or more stock bonus or profit-sharing trusts, such trusts shall be considered a single trust for the purposes of applying the limitations of this subparagraph.

4. In the taxable year when paid, if the plan is not one included in subparagraphs 1, 2 or 3, if the employees' rights to or derived from such employer's contribution or such compensation are nonforfeitable at the time the contribution or compensation is paid.

5. For the purposes of subparagraphs 1, 2 and 3, a taxpayer on the accrual basis shall be deemed to have made a payment on the last day of the year of accrual if the payment is on account of such taxable year and is made within 60 days after the

close of the taxable year of accrual.

6. If amounts are deductible under subparagraphs 1 and 3, or 2 and 3, or 1, 2 and 3, in connection with the two or more trusts, or one or more trusts and an annuity plan, the total amount deductible in a taxable year under such trusts and plans shall not exceed 25 percent of the compensation otherwise paid or accrued during the taxable year to the persons who are the beneficiaries of the trust or plans. In addition, any amount paid into such trust or under such annuity plans in any taxable year in excess of the amount allowable with respect to such year under the preceding provisions of this subparagraph shall be deductible in the succeeding taxable years in order of time, but the amount so deductible under this sentence in any one such succeeding taxable year, together with the amount allowable under the first sentence of this subparagraph, shall not exceed 30 percent of the compensation otherwise paid or accrued during such taxable years to the beneficiaries under the trusts or plans. This subparagraph shall not have the effect of reducing the amount otherwise deductible

under subparagraphs 1, 2 and 3, if no employee is a beneficiary under more than one trust, or a trust and an annuity plan. If there is no plan but a method of employer contributions or compensation has the effect of a stock bonus, pension, profit-sharing, or annuity plan, or similar plan deferring the receipt of compensation, this paragraph shall apply as if there were such a plan. Also, all contributions or gifts made by financial institutions to a community chest or to recognized religious, charitable, scientific or educational institutions or agencies, or to institutions or agencies for the prevention of cruelty to children or animals, which are not operated for profit and no part of the net earnings of which inures to the benefit of any private stockholder or individual or contributions or gifts for vocational rehabilitation authorized by the United States Vocational Rehabilitation Act. The amount of such deduction shall not be, however, in excess of five percent of the financial institution's net income as computed without the benefit of this subsection. Such contributions or gifts shall be allowable as deductions only where made to a community chest or institution or agency recog-

nized as such for the above purposes under rules and regulations prescribed by the department of revenue. Traveling expenses, including a reasonable amount expended for meals and lodgings while away from home in the necessary business of such institutions; rentals or other payments required to be made as the condition to the continued use or possession for the purposes of such business, or property to which the taxpayer has not taken or is not taking title or in which the taxpayer has no equity, provided the amount and the reasonableness of all such expenditures shall be approved by the state department of revenue.

b. All interest paid or accrued within the taxable year on the indebtedness of said business. Also, all dividends paid or accrued within the taxable year on the shares of preferred stock held or owned by a reconstruction finance corporation or any other governmental agency;

c. Taxes actually paid within the year in which the income on which the tax is based was received, except the excise tax imposed by this chapter and taxes assessed against local benefits of

a kind tending to increase the value of the property assessed;

d. Losses sustained and determined during the taxable year by the business and not compensated for by insurance or otherwise:

1. The basis for determining the amount of any loss or gain shall be the cost to the financial institution of the asset disposed of less the actual depreciation sustained on physical asset and any reduction charged as an expense upon stocks, bonds or other securities in previous years.

2. No loss shall be allowable unless the property is actually disposed of and the loss thereby determined or an appraisal of the loss is made and allowed under the supervision of the department of revenue, except as hereinafter provided.

e. Debts ascertained to be worthless and charged off within the taxable year; provided, that a schedule of such debts shall be filed and the reasons supporting such claim for deduction be filed with the return; provided, further, that bad debts shall not

include losses on stocks and bonds or a reduction in the market value of such stocks and bonds except where loss is determined by the sale of such securities; provided, that in the case of any financial institution required by law to be examined by state, federal or federal reserve bank examiners, such debts can be charged off and to such an amount or extent as required to be charged off by state, federal or federal reserve bank examiners. Any reduction in the book value of any stocks or bonds carried on the books of any such financial institution required by any state, federal or federal reserve bank examiners shall be allowed as proper deductions by the state department of revenue. On the sale of any securities, the book value of which has been reduced on the requirement of such examiners, and the reduction so made claimed as a deduction, accomplishing a reduction of the tax paid, any excess of the sale price over said book value of such securities shall be reflected as income and subject to the excise tax levied by this chapter. When in the opinion of state, federal or federal reserve bank examiners a debt is recoverable only in part

and when a part of such debt is charged off by requirement of state, federal or federal reserve bank examiners, the department of revenue shall allow a deduction in an amount equal to the amount of such charge-off;

f. A reasonable allowance for the exhaustion, wear and tear of property used in the business, including a reasonable allowance for obsolescence. The basis for determining the amount of such depreciation deduction shall be the cost of such property, or, if acquired prior to October 15, 1935, the basis shall be the depreciated cost as of October 1, 1935;

g. The amount received as dividends from a corporation organized and existing under the laws of the state of Alabama and the amount received as dividends in liquidation paid from capital;

h. In the discretion of the department of revenue, in lieu of such deductions for losses or bad debts, a reasonable addition to reserves therefor and for extraordinary expenses;

i. In the case of savings and loan associations the amount paid

out as dividends on the withdrawable shares thereof;

j. In computing the net income of credit unions for the purpose of the excise tax levied by this chapter, there shall, in addition to all other deductions allowed by law, be deducted the amount paid out as dividends on the withdrawable shares of such credit union; and

k. All financial institutions shall be allowed to carry back their net operating losses to apply as a deduction against prior income, and to deduct from succeeding years' income the excess loss, if any, that is not absorbed thereby. For purposes of this subdivision, the term "net operating loss" means the excess of allowable deductions over gross income. No net operating loss deduction (arising out of a net loss in an earlier or later year) shall be allowed in computing a net operating loss. Casualty losses and losses arising from theft, fraud and embezzlement, however, shall be deductible in computing the net operating loss. A net operating loss for a taxable year ending after the year 1952 may be carried back two years, then forward to the eight succeeding taxable years in chronological order; provided, that no part of the net operating loss which has been previously applied against income for one taxable year may be applied as a carryback or carryover to another taxable year. The net operating loss deduction allowed herein shall be the sum of the carrybacks and carryovers applicable to the taxable years. A successor financial institution shall be allowed to carry over and deduct from succeeding years' income, in the manner prescribed herein, the net operating loss of its predecessor. Refunds under the provisions of this subdivision shall be paid from the current year's receipts.

(3) TAXABLE YEAR. A full period of 12 consecutive months constituting the fiscal year or calendar year of each financial institution ended last prior to April 1, 1935, and thereafter ended last prior to April 1 of each year in which such tax is to be assessed. In the case of any business hereby taxed conducted only during a fractional period of any year, a return shall be made as herein provided and the tax computed as herein provided, and such tax as assessed shall be an

excise for the privilege of doing business in this state for such fractional year.

(4) STATE TAX YEAR. The calendar year. (Acts 1935, No. 194, p. 256; Acts 1939, No. 48, p. 56; Acts 1939, No. 369, p. 496; Code 1940, T. 51, §425; Acts 1945, No. 130, p. 129; Acts 1945, No. 319, p. 520; Acts 1955, No. 568, p. 1232; Acts 1957, No. 639, p. 964; Acts 1978, No. 840, p. 1247, §1.)

810-9-1-.01. Definitions.

(1) A "financial institution" is a national banking association or any person or entity which by employing monied capital as its principal business activity comes into competition with the business of national banks.

(a) "Financial institution" also means those common parent corporations which are registered bank holding companies as defined by the Bank Holding Company Act of 1956, as amended, and which are eligible to elect to file a consolidated Financial Institution Excise Tax Return as specified in Section 40-16-3.

(b) The term "financial institution" does not include insurance companies, individual citizens or fiduciaries acting in a representative capacity for individual citizens merely because they make loans or investments of funds in bonds, notes or other evidences of indebtedness if such transactions are not made in competition with the business of national banks.

(2) "Net income" is defined as "gross income" less the deductions provided in this chapter.

(3) "Gross income" means all wealth flowing to the taxpayer other than return of its capital without credit or exclusion and includes all dividends and interest from whatever source.

(4) "Deductions" include the ordinary and necessary business expenses incurred in the production of the gross income required to be reported by this chapter. If both personal and business expenses are incurred in a single transaction, only the business expenses may be deducted.

(a) Salaries or other compensation for personal service actually rendered are deductible if such payments constitute a reasonable allowance.

1. In the case of proprietorships, no deduction shall be allowed for the value of services rendered by the proprietor.

2. In the case of partnerships, the salary paid to a partner for active management of the business shall be allowed as a

deduction so long as the amount can be shown to be reasonable within the judgment of the Department of Revenue. No deduction shall be allowed when the partner's interest is purely financial and active day by day participation in the operation of the business does not exist.

(b) Management fees, to the extent they are reasonable, ordinary and necessary, will be allowed.

(c) Interest expense paid or accrued as an ordinary and necessary business expense is deductible.

1. A domestic corporation or resident individual is entitled to deduct interest paid or accrued to the extent that it is a necessary and ordinary business expense.

2. A branch office of a foreign corporation is entitled to a deduction for interest which shall be that portion of the total interest paid or accrued by the foreign corporation that the gross income in Alabama is to the total gross income of the corporation.

(d) Taxes are deductible only in the year they are paid and only when levied on the taxpayer claiming the deduction.

1. The Federal income tax paid shall be deductible only to the extent that it is applicable to financial institution net income earned in the State of Alabama. Any

allocation which is necessary shall be made on the basis of the ratio of the adjusted gross income in Alabama from the financial business to the total adjusted gross income, as computed under this chapter for the year for which the tax was paid. In the case of corporations allocation and apportionment shall be on the same basis as provided by the Alabama Income Tax Law and Regulations.

2. In the case of corporate taxpayers which are members of affiliated groups which file consolidated Federal income tax returns, the deductible tax will be allocated and apportioned based upon the regulations provided under the Alabama income tax law.

3. No deduction will be allowed for the excise tax imposed by this chapter or for taxes assessed against local benefits of a kind tending to increase the value of the property against which it is assessed.

4. Any licenses legally levied which qualify and are taken as a credit under Section 40-16-8, shall not be allowed as a deduction in computing net income.

(e) Losses on the disposition of property, not compensated for by insurance or otherwise, are deductible for the taxable year in which the disposition occurs. See the Alabama income tax regulations for determination of basis for gains or losses.

(f) Bad debts may be deducted under either the reserve method or the direct charge off method. The requirements of appropriate regulatory authorities and regulations and rulings of the Internal Revenue Service will be considered. Any adjustment to the deductions or provisions for the reserve for bad debts by the Federal Internal Revenue Service must be made to similar deductions in Financial Institutions Excise Tax returns, the adjustment will be made in the current year by increasing or decreasing the applicable deduction, so that in all cases the reserve balances will be identical for Federal income tax and Alabama excise tax purposes.

(g) Depreciation will be allowed as a deduction and computed as directed in Alabama Income Tax Regulation 810-3-15-.05.

(h) Dividends received must be included in gross receipts without exception.

1. A deduction is provided for dividends received from corporations organized and existing under the laws of Alabama.

2. Dividends paid from the capital of the payor corporation in liquidation are deductible by the recipient financial institution. For purposes of this paragraph "capital" means the amounts contributed by shareholders of the payor corporation and does not include its accumulated earnings and profits.

3. Dividends received from its financial institution subsidiaries by the common parent corporation of a group qualified to file a consolidated return under this chapter will be deductible.

(i) Dividends paid by savings and loan associations and credit unions on their withdrawable shares may be deducted by the payor institution.

(j) Net operating losses of financial institutions may be carried back for two years from the year of the loss, and then carried forward for eight years. A loss may thus be used to offset the income of ten years in addition to the year in which the loss arose, and must be used to offset the income of these ten years in chronological order. The law regarding computing and applying loss carrybacks and carryovers is similar to Federal income tax law dealing with this subject. Federal rules and decisions will be considered by the Department in these matters.

(5) "State tax year" is defined as the calendar year.

(6) "Taxable year" is defined as a twelve month period which is the fiscal or calendar year of the institution last ended prior to April 1st of the year in which the tax is to be assessed. Thus, for the "State tax year" 1983, "taxable years" could end on the last day of any month from April 1, 1982 through March 31, 1983. See

Section 40-16-1(3) for treatment of fractional years or periods.

Statutory authority §40-16-3(e)

§40-16-2. Production credit associations taxable under chapter.

Production credit associations, incorporated pursuant to the provisions of the act of congress known as the Farm Credit Act of 1933, are not foreign corporations, and any such association which may become taxable by the state shall be subject to the same taxation imposed upon national banks under the provisions of this chapter, and such associations shall be exempt from all other forms of income, privilege and license taxes imposed by the state. (Acts 1965, No. 276, p. 390.)

§40-16-3. Returns.

(a) Every financial institution, as in this chapter defined, shall within the first 15 days of April in each year, make and file with the department of revenue a return, signed under the penalties of a perjury by its cashier, treasurer or other authorized

officer or employee, if a corporation, or by a person or authorized employee in charge of the conduct of the business to be taxed if an individual, firm, association or other legal entity, in such form as may be prescribed by the department of revenue, giving such detailed information as the department of revenue may in its opinion require to determine the net income of such financial institution for the taxable year, by the net income of which said excise tax is to be measured.

(b) Qualified corporate groups, as in this chapter defined, shall have the option to file one excise tax return on a consolidated basis or to file separate returns. Qualified corporate groups electing to file one excise tax return on a consolidated basis shall be assessed a fee of $6,000.00 for the privilege of filing on a consolidated basis. Newly acquired corporations which have a potential separate return year as well as a consolidated year would have the option of filing a separate return including all of their income for that year or filing as part of the consolidated group for the entire taxable year. Newly created, con-

trolled corporations would either file a separate return or as part of the consolidated return determined by the election of the corporate group for that year.

(c) In order for financial institution members of a controlled group to be eligible to elect to file on a consolidated basis, the members would have to meet the following two tests:

(1) OWNERSHIP TEST. Includable financial institutions will be connected through stock ownership with a common parent corporation, which financial institutions are includable corporations if:

a. Stock possessing at least 80 percent of the voting power of all classes of stock and at least 80 percent of each class of the nonvoting stock of each of the includable corporations (except the common parent corporation) is owned directly by one or more of the other includable corporations; and

b. The common parent owns directly stock possessing at least 80 percent of the voting power of all classes of stock and at least 80 percent of each class of the

nonvoting stock of at least one of the other includable corporations.

(2) FILING TEST. In order to be eligible for this election, each member must be a financial institution as defined in section 40-16-1 and be required to file an excise tax return.

(d) To the extent operating rules are required for the filing of a consolidated excise tax return, the consolidated return regulations of the Internal Revenue Code and the principles contained therein would be used as a guideline in the absence of clarifying regulations issued by the department of revenue.

(e) The department of revenue may make such reasonable rules and regulations as it may deem necessary to determine the businesses conducted and in the state which are subject to said excise tax and to determine the net income of such businesses by which said tax is to be measured; provided, that any financial institution conducting a business both within and without the state of Alabama and coming within the provisions of this chapter shall be required to make a report to the department of

revenue showing the amount of its income received from the business conducted by it within the state of Alabama and the expenses incurred by it in the conduct of its business within the state of Alabama. Failure to file any such return on or before the due date thereof in the absence of extension of time in writing for the filing thereof granted by the department of revenue shall subject the financial institution so failing to a penalty of 15 percent of the amount of tax assessed, which amount shall be assessed and collected as a part of the tax, and a like penalty of $5.00 per day for each day's failure to file such return, which penalty shall be collected by civil action. (Acts 1935, No. 194, p. 256; Code 1940, T. 51, §426; Acts 1971, No. 1941, p. 3136; Acts 1978, No. 840, p. 1247, §2.)

810-9-1-.02. Returns.

(1) Every financial institution, as defined in this chapter and in Reg. 810-9-1-.01, must make and file a return with the Department of Revenue by April 15 of each year. The return must be made on the form prescribed by the Department, complete as to information and in accordance with the instructions provided. Corporation

returns must be signed under penalty of perjury by the cashier, treasurer or other authorized officer or employee. The returns of other financial institutions must be signed under penalty of perjury by the owner, managing partner or other authorized employee.

(2) Consolidated returns may be filed by registered bank holding companies as described in Sec. 40-16-1(1) and their subsidiaries which meet the tests described in Sec. 40-16-3(c)(1) and (2).

(a) There shall be the following requirements as to the proper filing of consolidated returns:

1. Form ETC must be properly completed and filed by April 15 along with remittance of $6,000.00 which is clearly designated as the "consolidated filing fee". This fee is paid for the privilege of filing in consolidation which is elective with the taxpayer. No provision is made for refund of this fee and the election to file a consolidated return is irrevocable.

2. Form ET-1 must be completed for each member participating in the consolidation.

3. The form ET-1 completed for the consolidation should be clearly marked on its face "Consolidated Return".

4. Management fees allocated to affiliates may not exceed the cost of the parent company's operations in rendering services to its subsidiaries which are part of the consolidation. Interest expense incurred by the parent on funds borrowed and invested in subsidiaries or otherwise will not be allowed to be included in computation of such management fees.

5. Net operating losses shall be carried back or carried forward only on the account of the member which incurs the loss.

6. Net operating losses of parent companies shall be allocated among the members of the consolidation based on the percentage which the gross assets of each member of the consolidation bears to the total gross assets of all members of the consolidation.

7. The credits provided by Sec. 40-16-8 against the tax imposed by this chapter are not allowable as credits to the parent. Neither may any excess credits of any member be transferred.

(3) The tax imposed by this chapter is due by April 15 of the state tax year.

(4) Extension of time for filing may be granted by the Department of Revenue. Application for such extension must be made on form ET-8 and be received by the Department by April 15 of the state tax year and must be properly completed. In accordance with Sec. 40-16-5, at least one

half the net tax shown to be due on the return must be remitted with the application for extension. Failure to remit at least fifty percent of the net tax due will cause the revocation of the extension and subject the return to the penalties for delinquency provided in Sec. 40-16-3. Note that the tax is due by April 15 of the state tax year and interest accrues at the rate determined under Sec. 40-1-44 on any tax due and unpaid on April 15 of the state tax year.

(5) Penalties for failure to file a timely return and for failure to pay the tax assessed are provided for in Sec. 40-16-3(e) and 40-16-5(a) respectively.

(a) The penalties for failure to file a timely return are fifteen percent of the tax due, plus five dollars per day for each day's delinquency.

(b) The penalty for failure to pay the tax timely shall be incurred after 30 days from the date of the notice of assessment and shall be computed at the rate of one percent per month or fraction thereof that the tax remains unpaid.

(6) Sec. 40-16-6 requires that the taxpayer report in detail the percentage of the financial institution's total business transacted in each municipality and county in Alabama. The method of determination of these percentages shall be developed based upon the nature of the taxpayer's overall operations and consistently applied on a

year to year basis. For purposes of this regulation, the financial institution conducts business only in locations where offices are maintained. This information is absolutely essential to the administration of the Financial Institution Excise Tax Law. Omission of this information from the return will cause the return to be deemed incomplete and subject it to treatment as a delinquent return.

Statutory authority §40-16-3(e)

§40-16-4. Levy and review.

(a) Every such financial institution shall pay to the state annually for each taxable year an excise tax for the privilege of engaging in this state in the business of banking and of conducting a financial institution, as in this chapter defined, and of conducting a business employing moneyed capital coming into competition with the business of national banks measured by its net income for such taxable year at the rate of six percent of such net income. The amount of such excise tax shall not be in excess of any limit fixed thereon by any present or future federal statute relating to the taxation of national banks by this state. Under no circumstances will any dividends

paid from a financial institution, as in this chapter defined, to the common parent corporation of a controlled group of corporations, as defined in section 40-16-3, be subject to excise tax. The excise tax provided for in this chapter shall be assessed and fixed as hereinafter provided by the department of revenue and upon blanks in the form to be prescribed by the department of revenue. The amount shown to be due by the taxpayer's return shall constitute and create a prima facie liability for such amount on which taxes shall be paid as herein provided. "Assessment" or "assessed" herein used shall refer to and mean the final determination of the amount found to be due by the department of revenue. The mailing of the excise tax blank to persons liable for the tax herein provided shall be the only notice required to be given, except where the amount as finally fixed by the department of revenue shall be different from the amount shown to be due by the returns as made by the taxpayer. The failure to receive such blank shall not relieve any person required to make a return from making such return or the penalties for failure to do so or liability for tax. Where the

department of revenue determines that the amount due is different from that shown by the taxpayer's return, notice of such different amount shall be given to the taxpayer by certified or registered mail, return receipt requested, notifying such taxpayer that the department of revenue will sit at a day named not less than 10 days from the date of mailing said notices to hear any objections thereto. If, on or before the day set for hearing, no objections have been filed, or if upon hearing the department of revenue is of the opinion that the assessment as made should not be changed, the department of revenue shall make said assessment final. The department of revenue shall immediately notify the attorney general of such final assessment. Such final assessment shall have the full force and effect of a judgment, upon which execution may be issued by the department of revenue directed to any sheriff of the state of Alabama to be executed in like manner as executions upon judgments of circuit courts, and return shall be made within 30 days of the receipt thereof.

(b) Either the state or the taxpayer may appeal from the final assessment made by the department of revenue in the manner provided for appeals from assessments made by the department of revenue.

(c) In any trial in the circuit court there may be presented in evidence by the department of revenue or by the state facts secured by the department of revenue from the United States treasury department or any department or bureau thereof, which facts so secured shall be legal evidence upon such trial.

(d) The state shall have a lien upon the property of such taxpayer as provided for in this title for the collection of the taxes herein assessed. (Acts 1935, No. 194, p. 256; Code 1940, T. 51, §427; Acts 1978, No. 840, p. 1247, §3.)

§40-16-5. When tax due; penalty for delinquency; extension of time for payment; limitation on time for assessment and collection.

(a) The excise tax hereby levied and to be assessed shall be payable on or before April 15 of

the current state tax year and on the same date of each state tax year thereafter for the privilege of engaging in such business within this state during the current state tax year of the corporation. Said tax shall become delinquent if unpaid on April 15 and shall thereafter bear interest at the rate of six percent per annum until paid. If the financial institution has received a written extension of time to file the excise tax return from the department of revenue, then one half of the estimated tax due shall be payable on April 15 and the remaining one half shall be payable when the return is filed with the six percent per annum interest applicable to the portion of tax unpaid after April 15. But if the delinquency continues more than 30 days after the notice of assessment, there shall be collected a penalty of one percent per month for each month or part thereof that the tax shall remain unpaid after the beginning of the delinquency period. The department of revenue may, in its discretion, extend the time for the payment of the tax either by general extension to all taxpayers liable therefor or by special extension to a particular taxpayer, in which event the one

percent penalty herein prescribed shall not accrue. The department, for good and sufficient reason shown, may waive or remit any penalty or portion thereof imposed or authorized to be imposed under the provisions of this chapter.

(b) The amount of excise taxes imposed by this chapter shall be assessed within three years after the return was filed, and no proceedings in court, without assessment, for the collection of such taxes shall be begun after the expiration of such period; provided, that the state department of revenue may, at any time within five years from the date of the filing of an excise tax return with the state of Alabama, assess and institute proceedings for the collection of the excise taxes so imposed, if the taxpayer omits from the gross income reported on said tax return an amount which is in excess of 25 percent of the amount of gross income so reported in said return. (Acts 1935, No. 194, p. 256; Code 1940, T. 51, §428; Acts 1943, No. 524, p. 490; Acts 1978, No. 840, p. 1247, §4.)

§40-16-6. Payment and distribution of tax.

The remittance of the excise tax herein required shall be made to the department of revenue at Montgomery, Alabama, with checks payable to the state treasurer of Alabama. The proceeds of the excise tax herein imposed by this chapter shall be, without delay, covered into the state treasury to the credit of the financial institution excise tax fund. Such amount of money as shall be appropriated for each fiscal year by the legislature to the department of revenue with which to pay the salaries, the cost of operation and the management of the said department shall be deducted, as a first charge thereon, from the taxes collected under and pursuant to section 40-16-4; provided, that the expenditure of said sum so appropriated shall be budgeted and allotted pursuant to article 4 of chapter 4 of Title 41 of this Code and limited only to the amount appropriated with which to defray the expenses of operating said department for each fiscal year. The balance of the tax collected under and pursuant to said section 40-16-4 shall, on September 1 in each year, be

distributed as follows: On certificate of the department of revenue the comptroller shall draw his warrant on the state treasurer payable to the county treasurer of each of the several counties in which such financial institutions are located for an amount equal to one fourth of the tax received from the institutions located in such county, after deducting the proportionate part of the expenses incurred in the administration of this chapter. On similar certificate the comptroller shall draw his warrant on the state treasurer in favor of the treasurer of each of the several municipalities in which such financial institutions are located for an amount equal to one half of the tax received from the institutions located in such municipalities, after deducting the proportionate part of the expenses incurred in the administration of this chapter. The amount remaining in such financial institution excise tax fund, after the payment of the expenses as heretofore in this chapter provided, and after the distribution to the counties and municipalities of their proportionate part of the said tax, shall be covered into the general fund of the state of Alabama. Any financial institu-

tion which conducts its business in more than one municipality or in more than one county in this state shall, in making the return required by this chapter, report in detail the percentage of its total business in the state conducted in each such municipality and in each such county, and the portions of tax paid by each such financial institution due to be distributed to the municipality and county shall be distributed pro rata according to the percentage so reported to the several municipalities and counties where such business is conducted instead of solely to the one where the principal place of business of such financial institution is located in this state. No municipality or county within the state shall have the right to levy or assess any such excise tax for the privilege of engaging in such business in addition to that hereby levied and to be distributed to it as herein provided, except license taxes not in excess of those heretofore legally levied and in effect. (Acts 1935, No. 194, p. 256; Acts 1939, No. 396, p. 517; Code 1940, T. 51, §429; Acts 1943, No. 547, p. 536; Acts 1951, No. 839, p. 1470.)

§40-16-7. Refunds.

In case any taxpayer has through mistake or error paid an excise tax which is not legally due or has paid an amount in excess of which he was in fact due, such taxpayer may make an application for said refund within the time and manner as provided for refunds of income tax so paid and shall be entitled to the same rights and remedies. Such refund shall be made in the same manner as refunds are made in income tax cases. (Code 1940, T. 51, §430.)

810-9-1-.03. Refund Claims.

Claims for overpayments of tax paid by mistake or error must be filed on forms provided by the Department (Form FIET-AR). As provided by law, these claims shall be administered in the same manner as those made under the income tax law and regulations and are subject to the same statutes for timely filing. Please note that since refunds must be made from current collections it is possible that there may be substantial delays due to lack of available funds from which to make payment in a particular jurisdiction.

Statutory authority §40-16-3(e)

§40-16-8. Exemptions and credits for other taxes.

All moneyed capital employed in the business the privilege of engaging in which is hereby taxed and the shares of all financial institutions, as in this chapter defined, shall be exempted from assessment and payment of ad valorem taxes, except the moneyed capital and shares of any business hereby taxed which fails to make and file the returns required by this chapter and to pay the tax levied by this chapter as and when in this chapter provided. The real estate owned by every such financial institution shall not be exempted. If any other tax, whether on property (other than ad valorem taxes on real estate), income, business or any element thereof, except license taxes not in excess of those heretofore legally levied and in effect, is hereafter levied by this state or by any political subdivision of this state on any financial institution as in this chapter defined, the amount of such other tax due by such institution shall be credited on account of the tax payable pursuant to the provisions of this chapter; provided, that no other tax levied by this

title shall be credited against the excise tax herein levied. (Acts 1935, No. 194, p. 256; Code 1940, T. 51, §431.)

810-9-1-.04. Credits Against the Tax.

(1) There may be taken as a direct credit against the tax the amounts of taxes (other than the Financial Institution Excise Tax and certain license taxes) levied on the institution by the State of Alabama or its political subdivisions.

(2) Any amounts claimed as direct credits against the Financial Institutions Excise Tax may not be taken as deductions.

(3) The taxes which may currently be claimed as credits rather than as deductions are:

(a) State, county and city sales and use taxes paid on tangible personal property purchased and paid for by the institution for its consumption;

(b) State utility taxes paid on telephone, electrical power, gas or water;

(c) Rental or leasing taxes paid directly to the State for the privilege of leasing tangible personal property to others within the State of Alabama;

(d) Increases in the city or county license taxes imposed upon financial institutions between July 10, 1943 and October 1, 1951.

(4) Credits will not be allowed on any taxes not levied on the financial institution. Examples of such taxes are:

(a) State, county or city sales or use taxes on items purchased for resale such as checks, promotional items or equipment;

(b) Gross receipts taxes levied on the seller;

(c) Rental or leasing taxes paid to others;

(d) Federal taxes of any nature;

(e) Taxes paid to contractors or others on equipment attached to real property or in the construction of buildings, etc.;

(f) The tax imposed by this chapter.

Statutory authority §40-16-3(e)

CIRCUIT COURT
FIFTEENTH JUDICIAL CIRCUIT
CASE NO. CV 88-288-G

STATE OF ALABAMA, ex rel DONALD SIEGELMAN, Attorney General of Alabama, Plaintiff, v. CREDIT CARD COMPANIES, etc., et al., Defendants.	* * * * * * * * * * * *	MEMORANDUM OPINION AND JUDGMENT

Donald Siegelman, as Attorney General of the State of Alabama, filed this action against Chase Manhattan Bank (Chase) and others seeking a declaratory judgment that the Financial Institution Excise Tax, Ala. Code § 40-16-1 et seq. (1975), applies to out-of-state national banks transacting business in the state of Alabama through solicitation of their credit cards to Alabama residents.

Chase is a national banking association domiciled in Delaware. Commencing in 1982 Chase starting soliciting Alabama residents to become credit card holders of its Visa credit cards. In 1985, Chase added solicitation of its Mastercards.

At present, Chase has 50,000 Visa and Mastercard accounts within this state. The State of Alabama contends that all of the defendant credit card companies are transacting business in Alabama, they leave a nexus with the State; that they are earning money in the State through the issuance of credit cards to Alabama residents and making direct loans to Alabama residents; that they are subject to the Financial Institutions Tax on

banking institutions; and that they have not paid any taxes to the State since they began transacting business in the State. Plaintiffs contentions, Pretrial Order. The defendants' argue that each defendant national bank is located outside the State of Alabama and is not doing business in the state. Further, the Financial Institutions Excise Tax was not intended to tax national banks located outside Alabama; nor was it intended to tax any financial institutions without a bank or office in Alabama; nor was it intended to tax any financial institutions engaged in solely interstate business. In addition, had the Legislature intended to levy this tax upon these defendants, the statute would be unconstitutional under both the State and United States Constitutions. Defendants' Contention, Pretrial Order. Both parties have filed motions for summary judgment.

The Court finds that Ex parte Dixie Tool & Die Company, Inc., 537 So.2d 923 (1988) controls the resolution of this case. In Dixie Tool & Die, as in the instant case, the issue was whether in originally enacting the statute, the legislature intended to tax transactions not previously taxed under that statute. Dixie Tool & Die at 925.

The Court holds that at the times § 40-16-1 was enacted, the State was prohibited by federal statute from taxing out-of-state national banks. The National Bank Act expressly limited the state's authority to tax only those "national banking associations located within its limits." 12 U.S.C. § 548 as

amended. (Emphasis added).[1] Because the federal statute was in force at the time § 40-16-1 was enacted, full knowledge and information as to the prior and existing law on the subject of this section is imputed to the legislature. Miller v. State, 349 So.2d 129 (Ala. Civ. App. 1977). A legislature is presumed to know the limit of its taxing power. Dixie Tool & Die at 925. Further, the statute will be interpreted on the assumption that the legislature was aware of existing statutes at the time new statutes are enacted. 2A Sutherland Statutory Construction § 45.12 (1984 rev.).

Based on the foregoing, the Court finds that at the time § 40-16-1 was enacted the legislature could not have intended to impose a tax on out-of-state national banks.

However, but for the existence of 12 U.S.C. § 548 at the time § 40-16-1 was enacted, the Court would find that the excise tax meets the criteria of Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977) and Alabama could tax Chase under the facts of this case. Goldberg v. Sweet, _____ U.S. _____, 109 S.Ct 582 (1989).

For the foregoing reasons it is ORDERED that judgment is for Chase Manhattan Bank and against Donald Siegelman as Attorney

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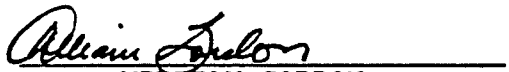
1. Section 548 governing state taxation of national banks marks the outer limits within which states can tax national banks. See Agricultural National Bank v. Tax Commission, 392 U.S. 339, 345 (1968)(holding that Massachusetts could not collect sales and use taxes on a Massachusetts national bank's purchases of tangible property for its own use). See First National Bank of Birmingham v. State, 262 Ala. 155, 164, 77 So.2d 63 (Ala. 1954). See generally 8 Michie on Banks and Banking Chp. 19 § 1 p. 348 (permanent ed. 1971).

General of the State of Alabama.

The Court further holds that there is no just reason for delay and that in accordance with Rule 54(b) A.R. Civ. P. the judgment in favor of Chase Manhattan Bank is made final.

DONE and ORDERED in chambers this 7th day of March, 1990.



WILLIAM GORDON
CIRCUIT JUDGE

cc: James H. Faulkner
William Coleman
Andrew J. Noble
Thomas W. Bowron

EXHIBIT M: 6

Opinion: *Prulease Inc., v. Michigan Department of Treasury,*
Dkt. No. 91414
(Michigan Tax Tribunal 7/8/92)

1ST CASE of Level 1 printed in FULL format.

Prulease, Inc., Petitioner v Department of Treasury, Respondent

MTT Docket No. 91414

STATE OF MICHIGAN -- MICHIGAN TAX TRIBUNAL

1992 Mich. Tax LEXIS 24

July 8, 1992

¡*1¿

Tribunal Judge Present: Mark A. Hilpert

HILPERT

OPINION AND JUDGMENT

This matter having come on before Hearing Officer Claris Kaye Cwirko, and a Proposed Opinion and Judgment having been issued on May 21, 1992, and 20 days having since elapsed during which time no exceptions or written arguments were filed by either party, and

The Tribunal, pursuant to Section 26 of the Tax Tribunal Act, as amended by 1980 PA 437, having considered the Proposed Judgment, and being fully familiar in the premises, does hereby adopt and incorporate by reference the Findings of Fact and Conclusions of Law in the said Proposed Opinion and Judgment as the final decision of the Tribunal.

PROPOSED OPINION AND JUDGMENT

Hearing Officer Presiding

Claris Kaye Cwirko

This matter, a single business tax appeal, was heard at Detroit, Michigan on January 29 and 30, 1990 by Tribunal Judge Randall H. Darnell who resigned his position without having reached a decision. The case was subsequently reassigned by Norman D. Shinkle, Chairman, to Hearing Officer Claris Kaye Cwirko for decision.

Findings of Fact

Petitioner Prulease, Inc. (Prulease) appeals a single business tax (SBT) assessment for the ¡*2¿ 1978, 1979, 1980 and 1981 tax years. The assessment number is C074922. The notice of final assessment was issued on November 30, 1984. The taxes assessed were in addition to the taxes already paid by petitioner for the years at issue. The amounts assessed are summarized below:

Tax Year	Amount Assessed
1978	$ 12,552
1979	21,083
1980	48,345
1981	71,030
Total	$ 153,010

The assessment was issued as a result of an audit performed by respondent during the 1982 and 1983 calendar years at petitioner's offices in Cambridge, Massachusetts. No penalties were assessed. The audit transmittal letter indicates that the audit was completed on May 20, 1983.

Prulease is a Delaware corporation acquired by Prudential Insurance Company in 1974. During the tax years at issue petitioner was primarily engage in leasing equipment (70% of its income) and lending money (30% of its income). Prulease had no offices in the State of Michigan where loans were made. All lending activity within the state was sourced out to other states where offices were located.

During the tax years at issue Prulease's income from secured and unsecured loans increased from $ 16,700,000 (in 1978) to $ ¡*3¿ 79,000,000 (in 1981). Prulease offered three business arrangements to its customers. Their first choice was a straight lease agreement where Prulease owned the leased property, claimed depreciation on it and received rental income from its customers.

The second choice was a lease with a security agreement (referred to as a LASA by Prulease) . The customer took possession of the personal property but Prulease retained title as security. Prulease, however, did not depreciate the property and did not include it in the property factor of the apportionment formula by which it determined its SBT liability. Prulease retained bare legal title and received interest on the loans to its customers. The customers took equitable title to the property and made payments with interest to Prulease.

The last arrangement was an unsecured loan. Prulease retained no security interest in the property in possession of its customer but did receive interest as a result of the money loaned.

Prulease deducted its interest income from its total tax base before apportionment and added its interest income to the sales factor of the apportionment formula in computing its SBT liability for the tax years at ¡*4¿ issue. Petitioner asserts this is the correct method pursuant to the Single Business Tax Act (the Act). The interest petitioner deducted was included in its federal taxable income as evidenced by the federal tax returns introduced as petitioner's exhibits 5-7.

Respondent argues that petitioner's interest income should not be deducted from its tax base and should not be included in the sales factor because its lending activities are not considered "business activities" for a nonfinancial corporation.

The auditor made certain adjustments with respect to the compensation reported by Prulease in its payroll factor. The auditor opined that some of the employees actually working for Prulease were being paid by its parent company. The wages of these employees were charged back to Prulease through management service fees. After discussions with a Prulease employee, the auditor presumed petitioner agreed that 25% of the management service fees less the marketing service fees Prulease charged its wholly owned subsidiaries (PruSupply, Inc., PruFunding, Inc. and Prulease Management, Inc.) would be reported as compensation paid by Prulease.

Petitioner also alleged that respondent was guilty ¡*5¿ of administrative discrimination because the department asserted a position with respect to Prulease which was contrary to its published position during the tax years at issue. Prulease asserted that respondent was bound by its published "Questions and Answers" regarding the treatment of interest income.

Petitioner elicited testimony from two witnesses at hearing. They were Robert Szuhany (Szuhany), its former tax manager and the comptroller of Prulease at the time of the hearing, and Frederick Lynch (Lynch) who was respondent's administrator of business taxes at the time of hearing.

Szuhany testified about the compensation issue. He described the relationship between Prulease and its subsidiaries. He stated that, of the group, only Prulease, Inc. and Prulease Management had employees. Most of the employees worked for Prulease Management and would be assigned tasks relative to any of the four companies. The employees were interchangeable and shared common office space. Prulease Management derived all of its income from billing its parent corporation and the other subsidiaries for its services.

The evidence presented was unclear as to petitioner's right to control the employees ¡*6¿ of Prulease Management. Szuhany testified that petitioner had no budget allotment for administrative expenses and that the procedural manuals for the leasing and lending activities engaged in by Prulease were prepared by Prulease Management.

Petitioner also elicited testimony from Lynch, respondent's administrator of business taxes. Lynch participated in the review of the audit conducted by Bruce Horn, an auditor employed by respondent. Lynch recommended that the interest income of Prulease be excluded from the sales factor as evidenced by a memo to the then acting revenue commissioner. The memo was introduced into evidence as petitioner's exhibit 10.

Petitioner also introduced into evidence a selection of questions and answers fro the Official Michigan Tax Guide. (Petitioner's Exhibit 15.) This guide was published with respondent's approval and contains the following questions and answers relevant to the tax years at issue:

Question E-1	Is interest income included in gross receipts?
Answer:	Yes, if it is derived from a business activity.
Question E-2	What interest should be included in gross receipts?
Answer:	Interest and finance charges are gross receipts to the extent that they are generated from the sale of inventory items or the performance of service.
Question M-11	Is royalty, interest or dividend income included in the sales factor for apportioning the tax base?
Answer:	Yes to the extent that such income must be reported as gross receipts. This amends retroactively the previous position that if this income is not included in the base subject to apportionment, such income is not reflected

in the apportionment formula . . .

¡*7¿

Lynch also testified that the interest income from a statutorily defined financial organization should be included in its gross receipts but that the interest from a nonfinancial organization such as petitioner should not be so included. He conceded that "sales" and "gross receipts" as defined in MCLA 208.7(1) and (3) have only one definition applicable to all businesses.

Respondent also called Lynch to testify as part of its case in chief. Lynch stated that interest for financial organizations is expressly included in the total tax base pursuant to MCLA 208.21(1). He observed that "sales" as defined in section 7(1) makes no express mention of interest income.

Lynch further stated the department's position with respect to nonfinancial organizations such as petitioner. That position is that interest income is not included in gross receipts. He observed that section 7(3) makes no mention of interest income in its definition of gross receipts.

Lynch also testified that respondent has held its current position since 1981. According to him, the basis for this position was a combination of experience, litigation, threats of litigation and advice from legal counsel. Lynch opined ¡*8¿ that respondent's treatment of interest income for nonfinancial organizations was uniform.

Respondent next elicited testimony from David Kirvan, the administrator of the SBT. Kirvan discussed the department's litigation with Dayton-Hudson. In that case, Treasury auditors attempted to include interest earned on Michigan sales in the numerator of the sales factor. Kirvan states that, based on legal advice from the Michigan Attorney General's office and respondent's own review of the statute, interest income should not be included in the sales factor. The parties so stipulated in an out-of-court settlement of the litigation. Kirvan testified that, to his knowledge, respondent has not allowed any nonfinancial organizations to include interest generated from other than sales of inventory.

Respondent's final witness was Bruce Horn (Horn), the person who performed the audit. Horn testified that he talked to a Mr. Henderson at Prulease regarding the interest income included in the apportionment formula and the relatively low amount of compensation reported. Mr. Henderson allegedly agreed that 25% of the management service fee less the marketing service fee could be reported by the ¡*9¿ auditor as additional wages chargeable to Prulease. Horn said that such agreements were common during audits and he made no further investigation into this issue.

Petitioner introduced into evidence a letter to respondent in which it reserved the right to comment on all points raised in the audit.

Horn claimed to have consulted his supervisors on all relevant decisions during the course of the audit.

Conclusions of Law

This case revolves around various sections of the Single Business Tax Act, MCLA 208.1, et seq. Section 31 of the Act states in pertinent part:

(1) There is hereby levied and imposed a specific tax of 2.35% upon the adjusted tax base of every person with business activity in this state which is allocated or apportioned to this state.

(2) As used in this section, "adjusted tax base" means the tax base allocated or apportioned to this state pursuant to chapter 3 and the adjustments permitted by section 23 and the exemptions permitted by sections 35 and 37 . . .

(4) The tax so levied and imposed is upon the privilege of doing business and not upon income . . . MCLA 208.31. (Emphasis supplied.)

The facts in this case, other than Prulease's alleged agreement ¡*10¿ to the change in the amount of wages charged to Prulease, are generally not in dispute. The issues revolve around the application of certain relevant sections of the Act. Several issues have been raised and each will be discussed.

The two issues regarding the treatment of interest (whether it should be deducted from the tax base but added to sales for the determination of the sales factor of the apportionment formula) are closely intertwined and will be discussed together. Petitioner argues that all of its activities fall within the definitions of "business activities" pursuant to section 3(2) and "sales" pursuant to section 7(1) of the Act. Since it reported its interest income as part of its federal taxable income, it steadfastly maintains it should deduct that interest from the tax base but add it for computation of the sales factor.

Section 3 defines business activities as:

. . . a transfer of legal or equitable title to or rental of property, whether real, personal, or mixed, tangible or intangible, or the performance of services, or a combination thereof, made or engaged in, or cause to be made or engage in, within this state, whether in intrastate, interstate, or foreign ¡*11¿ commerce, with the object of gain, benefit or advantage, whether direct or indirect, to the taxpayer or to others, but shall not include the services of an employee. . . Although an activity of a taxpayer may be incidental to another or other of his business activities, each activity shall be considered to be business engaged in within the meaning of this act. MCLA 208.3(2). (Emphasis supplied.)

Section 7(1) of the Act defines sales as:

. . . the gross receipts arising from a transaction or transactions in which gross receipts constitute consideration: (a) for the transfer of title to, or possession of, property that is stock in trade or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the tax period or property held by the taxpayer primarily for sale to customers in the ordinary course of its trade or business, or (b) for the performance of services, which constitute business activities other than those included in (a), or from a combination of (a) or (b). MCLA 208.7(2). (Emphasis supplied.)

Section 7(3) defines gross receipts as ". . . the sum of sales, as defined in subsection (1), and rental or lease ¡*12¿ receipts . . ." MCLA 208.7(3).

It is clear that sales and gross receipts must be read together since each makes reference to the other.

Section 9 states in pertinent part:

(1) "Tax base" means business income, before apportionment, or allocation as provided in chapter 3, even if zero or negative, subject to the adjustments in subsection (2) to (9) . . .

(4) Add, to the extent deducted in arriving at federal taxable income:

. . . (f) All interest . . .

(7) Deduct, to the extent included in arriving at federal taxable income:

. . . (b) All interest . . . MCLA 208.9.

Section 45 of the Act provides that:

All of the tax base, other than the tax base derived principally from transportation, financial, or insurance carrier services or specifically allocated, shall be apportioned to this state by multiplying the tax base by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor, and the denominator of which is 3. MCLA 208.45.

Section 46 provides that the property factor is:

. . . a fraction, the numerator of which is the average value of the taxpayer's real and tangible personal property owned or rented in this state during the tax ¡*13¿ year and the denominator of which is the average value of all the taxpayer's real and tangible personal property owned or rented during the tax year. MCLA 208.46.

Section 49 provides that the payroll factor is:

. . . a fraction, the numerator of which is the total wages paid in this state during the tax year by the taxpayer and the denominator of which is the total wages paid everywhere during the tax year by the taxpayer. For the purposes of this chapter only, "wages" means wages as defined in section 3401 of the internal revenue code. MCLA 208.49.

Section 51 provides that the sales factor is:

. . . a fraction, the numerator of which is the total sales of the taxpayer in this state during the tax year, and the denominator of which is the total sales of the taxpayer everywhere during the tax year. MCLA 208.51.

Reading the various sections together, it is clear that the Act intends to impose a tax on the privilege of doing business in Michigan. The tax is imposed on the adjusted tax base allocated or apportioned to Michigan. The tax base begins with business income and is subject to certain adjustments such as the addition of any interest deducted to arrive at federal taxable ¡*14¿ income and the deduction of any interest added to arrive at federal taxable income. MCLA 208.9, supra.

The tax base is then allocated to Michigan pursuant to the statutory formula which, based on the pertinent sections of the statute, is as follows:

(Michigan) (Michigan) (Michigan)

$$\text{(tax base)} \times \frac{\text{(property)}}{\text{(all) (property)}} + \frac{\text{(payroll)}}{\text{(all) (payroll)}} + \frac{\text{(sales)}}{\text{(all) (sales)}}$$

3

It is petitioner's position that the interest income it received as a result of its lending activities, and which was included in arriving at its federal taxable income, should be deducted from its business income to determine its tax base. Further, petitioner argues that, since its lending activities are business activities in which it engages as a service to its customers, and/or in which equitable if not legal title is transferred to the customers, with the object of gain, benefit or advantage to itself, then the interest income it has realized is a portion of its sales used in computing the sales factor.

Respondent argues that the SBT on nonfinancial organizations does not tax the "financial activity" of a business. Respondent opines that lending money is a ¡*15¿ financial activity rather than the performance of a service and, thus, interest income is treated differently in the tax bases of financial and nonfinancial organizations. Respondent also asserts that the interest petitioner receives equates to investment interest which is not subject to the SBT.

We note that the SBT has a specific section dealing with the tax base of a financial organization. Section 21 of the Act states in pertinent part:

The tax base of a financial organization shall be the sum of business income and the adjustments provided in section 9, with the exception of section 9(4)(f) and (7)(b), plus the following adjustments:

(a) Deduct, to the extent included in federal taxable income, interest derived from obligations of the United States which this state is by federal law prohibited from subjecting to taxation, other than nondiscriminatory franchise or nonproperty taxes. . . MCLA 208.21.

Section 9(4)(f), as previously indicated, states that the tax base means business income before allocation or apportionment to which is added certain interest. Financial organizations do not add back interest to the extent that it was deducted in arriving at federal taxable ¡*16¿ income. Nonfinancial organizations are to add back that interest.

Section 9(7)(b), also previously noted, indicates that the tax base means business income before apportionment or allocation but from which is deducted any interest to the extent that such interest was included in arriving at federal taxable income. Financial organizations are not to deduct any interest that was included for the purposes of determining federal taxable income. Nonfinancial organizations do deduct interest that was included in arriving at federal taxable income.

Petitioner is admittedly not a financial organization and deducted the interest it included for federal income tax purposes. The question remains whether the deduction was proper under the statute.

As the Michigan Court of Appeals noted in J C Penney Company, Inc v Department of Treasury, 171 Mich App 30, 38-39 (1988):

To claim the subsection (7)(b) adjustment, a single business taxpayer must show that the income was "interest," and that it was included in determining the taxpayer's federal income tax liability.

The Single Business Tax Act does not define "interest." However, our Supreme Court has interpreted the term to mean ¡*17¿

compensation allowed by law or fixed by the respective parties for the use or forbearance of money, "a charge for the loan or forbearances of money," or a sum paid for the use of money, or for the delay in payment of money. ¡Citations omitted.¿ ¡Town & Country Dodge, Inc v Dep't of Treasury, 420 Mich 226, 242; 3623 NW2d 618 (1984).¿

The facts in the Penney case noted above were different from that here in that J C Penney engaged in sales at retail and had issued its own credit card to some of its customers. Penney had a wholly owned subsidiary to which it sold customer accounts together with any interest accrued at the time of sale of the account but not including the right to future interest that might accrue. The Court held that Penney could deduct any interest that accrued after the sale of the account to its subsidiary since the subsidiary only purchased what was currently owed by the customer, not what might be owed.

Respondent, no doubt, would argue that this case is distinguishable because the interest in Penney accrued as the result of a retail sale of tangible personal property. Petitioner here receives interest not from the sale of personal property ¡*18¿ but rather from the secured and unsecured loans made to its customers in the ordinary course of its leasing business. Respondent would have us define "sale" with a narrow brush while petitioner would paint it more broadly to include the service it provides its customers by lending.

The decision of the Michigan Supreme Court in Trinova Corporation v Department of Treasury, 433 Mich 141 (1989); aff'd 111 S Ct 818; 112 L Ed 2d 884 (1991), is instructive. As the court noted:

. . . The single business tax is a form of value added tax. . . The act employs a value added measure of business activity, but its intended effect is to impose a tax upon the privilege of conducting business activity within Michigan. MCL 208.31(4); MSA 7.558(312)(4).

Value added, or business activity, is subject to calculation by two equivalent methods. The first method begins with the taxpayer's gross receipts from which all outside purchases are subtracted. The residual figure represents the value added by the internal operations of the taxpayer. The second method is additive. All internal payments representing factors of production such as wages, rent, interest, together with the taxpayer's ¡*19¿ profit are totaled and constitute the value added by the taxpayer's efforts. The act employs a modified additive method of value added computation. (Citation omitted.)

The computation of the tax involves several steps beginning with the calculation of the taxpayer's tax base. Under the act, "tax base" is defined as business income (or loss) before apportionment subject to certain adjustments. MCL 208.9; MSA 7.558(9). "Business income" is essentially federal taxable

income. MCL 208.3(3); MSA 7.558(3)(3). Common adjustments to business income include additions to reflect the business consumption of labor and capital. Those include adding back compensation, depreciation, dividends, and interest paid by the taxpayer to the extent deducted from federal taxable income. Common deductions from business income include dividends, interest, and royalties received by the taxpayer to the extent included in federal taxable income. This income is deducted for the purpose of value added computation because it does not result from capital expenditure by the taxpayer. (Citation omitted.) (Emphasis in original and supplied.) Trinova, supra, at 149-151.

Although the Trinova ¡*20¿ decision involved an issue not relevant to this appeal, we conclude that the Supreme Court's observations about the nature of the single business tax in general, and the deduction from business income of interest received by the taxpayer, are equally applicable here. The interest petitioner received from its lending operation did not result from capital expenditures on its part. We conclude that interest is to be deducted from petitioner's business income to the extent that it was included in federal taxable income to determine its tax base for Michigan single business tax purposes. Petitioner, a nonfinancial organization, should follow the statutory instructions contained in section 9 of the Act. Those instructions are clear and unambiguous.

Petitioner would also add the amount it received in interest from its lending activities to its sales factor in apportioning its tax base to Michigan. Here the issue revolves around the meaning of the word "sale" as used in the statute. As we previously noted, sales are defined in section 7(1) and mean more than the consideration received from the transfer of title to property which could properly be held in inventory but also mean the ¡*21¿ consideration or gross receipts received from a transaction involving the performance of services which constitute business activities. MCLA 208.7(1).

At this point it is appropriate to again distinguish between petitioner's options offered to its customers. The first option is a straight lease in which Prulease retains title to the leased property and collects rental payments from its customer. There is no controversy regarding the income generated by this activity.

The second option, called a lease and security agreement or LASA by Prulease, needs closer examination. Szuhany testified that Prulease retains title to the property for security purposes only, does not include the property in its property-owned apportionment schedule but does receive interest income as a result of this arrangement with its customer.

Although Prulease may characterize this transaction as a lease with a security agreement, the evidence presented suggests that it contains all the elements of a conditional sale. As the Michigan Supreme Court observed in In re Petition for Dissolution of Parkstone Apartment Co, 243 Mich 401, 404-405 (1928);

A conditional sale is an agreement for the sale of a ¡*22¿ chattel in which the vendee undertakes to pay the price, and possession of the chattel is immediately given to the vendee, but title to the same is retained by the vendor until the purchase price is paid, when it passes to the vendee. (Citation omitted.) It gives possession of the chattel with the right to ownership upon payment of the agreed price, retaining title in the seller with right of

reclamation in case of default or the alternative of passing the title by suit for the purchase price. (Citation omitted.)

A conditional sale and a chattel mortgage are inconsistent with one another. A conditional sale exists where the title remains in the vendor. A chattel mortgage may exist only when the title to the property has passed and the vendee has given the chattel mortgage or lien upon his title as security for the payment of the debt. Title cannot be retained and passed at the same time. (Citation omitted.)

Since the definition of "sale" in section 7(1) includes the transfer of title to or possession of property which is the stock in trade of the taxpayer, then petitioner's LASAs, which we conclude are really conditional sales contracts, fall within the definition. As Szuhany ¡*23¿ tetified, Prudential Insurance Company acquired CNA Nuclear Leasing, changed its name to Prulease and expanded into areas other than nuclear leasing. An examination of petitoner's exhibit 8 indicated that, as of November 30, 1979, the LASAs included such equipment as nuclear, over the road, off road, EDP, furniture, aircraft and various categories of non vehicle. An examination of the straight leases evidenced by this exhibit indicates that Prulease would lease substantially the same types of equipment in a straight lease that it would also sell to its customers through its LASAs. We conclude that the equipment was part of petitioner's stock in trade, would have been properly included in petitioner's inventory had it been on hand at the close of the tax period and was the type of property petitioner held primarily for sale through its LASAs.

We hold that petitioner's activities with respect to its self-named LASAs fall within the definition of "sales" in section 7(1) of the Act. Neither party has cited an appellate decision that deals with the interest generated by a conditional sale and whether that interest should be considered as a part of the sales factor. Indeed, neither ¡*24¿ of the parties considered the LASAs to be other than lease transactions because of the label affixed to them by Prulease.

As was previously noted in Trinova, supra, the SBT employs a modified additive method of value added determination. In the additive method, all internal factors which represent factors of production such as wages, rent, interest, and profits are totaled and represent the value added by the taxpayer's efforts. It appears, then, that the interest received by Prulease as a result of its LASAs is a proper component of the sales factor since, under Trinova, it is a factor of production that represents value added by petitioner's efforts.

We next must consider petitioner's third type of transaction which it characterizes as a loan with no security retained. The evidence presented at hearing clearly demonstrates that this is not a casual course of conduct but rather one in which Prulease has chosen to engage in order to gain an advantage for itself (generate a profit). Section 3(2) clearly covers this type of operation under its definition of business activity. Business activity includes more than the transfer of legal or equitable title to or the rental ¡*25¿ of property. It also includes the performance of services that may or may not be in combination with transfer of title or rental of property. The controlling factor is whether the object is gain, benefit or advantage to the taxpayer or to others. MCLA 208.3(2).

It has long been the rule in Michigan that:

Words and clauses in different parts of a statute must be read so as to harmonize with the subject-matter and general purpose of the statute. If the general meaning and object of the statute be found inconsistent with the literal import of any particular clause, such clause or section must, if possible, be construed according to that purpose. The mere literal construction ought not to prevail if it is opposed to the intention of the legislature apparent from the statute, and if words are sufficiently flexible to admit of some other construction by which that intention can be better effected, the law requires that construction to be adopted. Heckathorn v Heckathorn, 284 Mich 677, 681 (1938).

In addition:

To the end that every word, sentence, and section of a statute be given effect, the entire act must be read and the interpretation to be given to a particular word ¡*26¿ in one section arrived at after due consideration of every other section so as to produce, if possible, a harmonious and consistent enactment as a whole. (Citation omitted.) In re Chamberlain's Estate. Chabre v Page, 298 Mich 278, 283 (1941).

As we previously noted, section 31 of the Act imposes a specific tax upon the adjusted tax base of every person with business activity in Michigan which is allocated or apportioned to Michigan. The section clearly states it is a tax on the privilege of doing business and not on income. MCLA 208.31.

The question then becomes whether Prulease's receipt of interest from Michigan customers when Prulease has not retained title to the property but has loaned money to its customers constitutes doing business in Michigan. If it does, then clearly it is the purpose of the Single Business Tax Act to tax that activity.

A previous decision of the Tribunal, Genesee Merchants Bank and Trust Co v Michigan Department of Treasury, MTT Docket Nos. 35057 & 35058 (1979) is instructive. Although petitioner there was a financial organization and petitioner here is not, both receive interest from their customers. The Tribunal noted:

It ¡*27¿ is then abundantly clear that the Petitioner's acknowledged activities of loaning and investing of money is within the definition of "business activities" contained in section 3(2) of the Act. Therefore, Petitioner's business activities, which are constituted of services, falls (sic) within the definition of "sales" as provided in section 7(1)(b) of the Act. It then logically follows that the interest and dividend income that Petitioner receives in the ordinary course of its business is also a part of its "gross receipts" as that term is defined in section 7(3) of the Act. Genesee, supra, at 7.

Much was made of the difference between financial and nonfinancial organizations in the posthearing written closing arguments and briefs filed by the parties. However, the only difference the Act makes with reference to these two types of business entities is, as previously noted, found in section 21 where the tax base of financial organizations is delineated. The Act itself makes no distinction in sections 3 or 7, both of which contain definitions

that apply to the entire Act unless otherwise noted, between these two entities. We must conclude, in reading the statute as a whole, ¡*28¿ that the definition of "sales" applicable to a financial organization is equally applicable to a nonfinancial organization, respondent's arguments notwithstanding.

We find no rational basis in distinguishing between these two types of business organizations with reference to sections 3 or 7 of the statute. To do so would effectuate an unreasonable classification not imposed by the plain, unambiguous language of the statute.

With reference to respondent's characterization of the interest received by Prulease as being the equivalent of investment interest, we note that the facts of this case are readily distinguishable from those in USX Corporation v Department of Treasury, 187 Mich App 256 (1990). There petitioner had sold and redeemed certain investment securities and argued that the proceeds from the sale of the investment securities were sales within the meaning of the Act. The court held that, since petitioner was not in the business of selling securities to third parties and was not licensed or registered as a dealer in marketable securities but was rather purchasing and selling securities for its own account, petitioner was not entitled to include the proceeds in ¡*29¿ the sales factor.

Here, petitioner is in the business of leasing personal property to its customers. As an incident of this business activity, it makes loans to some of its customers. These loans are not investments for its own account but rather are business arrangements that foster its primary business. We must conclude that petitioner's lending activities, and the interest generated thereby, are incidental to its other business activities and are a business activity engaged in for gain or profit.

The Court of Claims decisions attached to respondent's posthearing brief are also distinguishable. In H J Heinz Company, Inc v Revenue Division, Department of Treasury, Court of Claims File No. 89-12196-CM (opinion issued 2/2/90), the interest the taxpayer sought to include in its sales factor was interest Heinz earned as the result of short term investments it made so that its money would not sit idle. The purchases in Heinz, like in USX, supra, were made on its own account. Heinz frequently sold the paper back to the entity from which it had been purchased, perhaps even the next day. The interest received was clearly investment interest and did not result from ¡*30¿ its primary business activity. The interest received by Prulease, by contrast, did not result from the investment of its idle cash but rather as a results of the options it offered the customers with which it did business.

Although the facts in Coltec Industries, Inc, f/k/a Colt Industries, Inc v Revenue Division, Department of Treasury, Court of Claims File No. 89-12518-CM, are not as clearly stated as they were in Heinz, supra, it appears that the taxpayer here again invested in short term securities and turned its money over every few days. This case is as clearly distinguishable from the facts of Prulease as were USX, supra, and Heinz, supra, for the reasons stated above. The interest Prulease seeks to include in its sales factor is not investment interest earned on its own account.

The final issue to be resolved in that of the compensation component of the three factor formula for apportioning petitioner's tax base to Michigan. We

must conclude that insufficient evidence was presented at hearing from which we could determine that petitioner should be chargeable with more wages than were reported on its various SBT returns. Respondent's auditor admittedly ¡*31¿ made no investigation to support his arbitrary allocation of 25% of the management service fee less the marketing service fee. His alleged agreement with a Mr. Henderson was not a meeting of the minds on this issue. Rather, it appears that the auditor informed Mr. Henderson that he proposed to increase the compensation reported and the only thing to which Prulease, through its agent, agreed was that the auditor did intend to increase the compensation to a level he opined was reasonable.

We note that there is a rather detailed test for the determination of an employer-employee relationship. The various factors which should be examined include:

1. Control of the worker's duties;

2. The payment of wages;

3. The right to hire and fire and the right to discipline; and

4. The performance of the worker's duties as an integral part of the business toward the accomplishment of a common goal. Osner v Boughner, 180 Mich App 248, 263 (1989).

In this case, the testimony established that Prulease Management controlled the workers' duties, paid the workers' wages, and hired, fired and disciplined the workers. The only factor that might be satisfied is that the various employees ¡*32¿ were assigned to projects relevant to Prulease's business goals. We conclude that this is insufficient to establish an employer-employee relationship especially where, as here, the withholding from wages was accomplished by Prulease Management, not petitioner. Withholding is a specific test established the SBT for the determination of an employer. MCLA 208.5(2).

We must conclude that the additional wages attributed to Prulease are inappropriate.

With reference to petitioner's claim of administrative discrimination, we need only note that the "Questions and Answers" to which petitioner refers are not the statute but rather an interpretation of the statute that do not purport to establish either rules or regulations. They contain a clear disclaimer and do not purport to state policy, rules or regulations.

In any event, respondent is authorized to conduct audits. Section 21 of the revenue division statute states in pertinent part:

(1) . . . The department by its duly authorized agents, may examine the books, records, and papers and audit the accounts of a person or any other records pertaining to the tax. As soon as possible after procuring information, the department shall ¡*33¿ assess the tax determined to be due and shall notify the taxpayer of the assessed amount and the specific reasons for the assessment . . . MC

EXHIBIT M: 7

Opinion: *H.J. Heinz Company, Inc. v. Michigan Department of Treasury,* 494 N.W.2d 850 (Ct. App. 1992)

1ST CASE of Level 1 printed in FULL format.

H.J. HEINZ COMPANY, INC., Plaintiff-Appellant, v. REVENUE DIVISION, DEPARTMENT OF TREASURY, STATE OF MICHIGAN, Defendant-Appellee.

No. 126707

COURT OF APPEALS OF MICHIGAN

1992 Mich. App. LEXIS 434

December 7, 1992, Decided

NOTICE: ¡*1¿ THIS OPINION IS UNCORRECTED AND SUBJECT TO REVISION BEFORE PUBLICATION IN THE MICHIGAN COURT OF APPEALS REPORTS.

DISPOSITION: Affirmed.

JUDGES: Before: Reilly, P.J., and Holbrook, Jr., and Marilyn Kelly, JJ.

OPINIONBY: MARILYN KELLY

OPINION: MARILYN KELLY, J.

This case involves an interpretation of Michigan's Single Business Tax Act (SBTA) for the purpose of determining whether certain arrangements known as "repo" transactions are "sales" as defined under the act. MCL 208.1 et seq.; MSA 7.558(1) et seq. Plaintiff appeals as of right from an order of the Court of Claims which ruled that the transactions in question were sales, thus denying plaintiff requested tax refunds. On appeal, plaintiff again argues that its repo transactions constituted sales under the act. We disagree and affirm.

I

Plaintiff is a Pennsylvania corporation doing business in over thirty-five states, including Michigan. It operates a pickle processing plant in Holland, Michigan. In 1988, after recharacterizing its repo transactions as sales, plaintiff filed amended single business tax returns seeking refunds for the tax years 1984 through 1987. The alleged sales arose from the "purchase" of securities, certificates of deposit and commercial paper through ¡*2¿ repurchase (repo) agreements.

At the beginning of each business day, plaintiff's Cash Administrator, who worked in its Money and Banking Department, determined the cash needs of the company for that day. In the event of excess cash, the Cash Administrator contacted various financial institutions to determine which offered the highest yield. Then, the company's excess funds were wired to the institution offering the highest yield. The next day, the institution wired the funds back to plaintiff's account along with the previous day's earnings on them. The wireback was done automatically, without further contact from plaintiff. The securities, themselves, never changed hands.

II

The single business tax is a form of value-added tax which imposes a tax on the value added to a product at each step of its production and distribution. Trinova Corp v Michigan Treasury Dep't, 433 Mich 141, 149; 445 NW2d 428 (1989), aff'd 498 U.S. ; 111 S Ct 818; 112 L Ed 2d 884 (1991). When calculating tax liability under the SBTA, a taxpayer must apportion its tax base according to the amount ¡*3¿ of activity it conducts inside as contrasted with outside the state. MCL 208.41; MSA 7.558(41). The tax base is the taxpayer's business income before apportionment. MCL 208.9(1); MSA 7.558(9)(1). The tax base is apportioned to Michigan by multiplying the tax base by:

Michigan Property Michigan Payroll Michigan Sales

+ +

Total Property Total Payroll Total Sales

3

MCL 208.45(1); MSA 7.558(45)(1). If the taxpayer's total sales increase, and the other factors remain constant, the taxpayer will owe less in single business taxes. See MCL 208.46; MSA 7.558(46); MCL 208.49; MSA 7.558(49); MCL 208.51; MSA 7.558(51).

A "sale" under the SBTA is defined as

. . . the gross receipts arising from a transaction or transactions in which gross receipts constitute consideration: (a) for the transfer of title to, or possession of, property that is stock in trade or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the tax period or property held by the taxpayer primarily for sale to customers in the ordinary course of its trade or business, or (b) for the performance of services, which constitute business ¡*4¿ activities other than those included in (a), or from any combination of (a) or (b). ¡MCL 208.7(1); MSA 7.558(7)(1).¿

III

In this case, when plaintiff amended its single business tax returns, it increased its total sales by denominating its repo transactions as sales rather than as interest bearing investments. Plaintiff's amended returns increased the total sales factor by the entire amount of the repo transaction, which includes the return of capital and interest. These calculations resulted in a lower apportionment percentage attributable to Michigan.

The trial court ruled that the repo transactions did not involve stock in trade held by plaintiff primarily for sale to customers in the ordinary course of its business. In fact, the gain received from the transactions arose from plaintiff's attempts to avoid holding idle cash. The court recognized that plaintiff had created a profitable Department of Money and Banking. However, the department was formed for astute business operation, not for the sale of securities.

On appeal, plaintiff argues that the transactions in question involved the use of stock in trade. It asserts that the repo transactions were not merely collateralized ¡*5¿ loans but sales. It points out that express contractual language in the repurchase agreements or confirmation letters clearly established that plaintiff owned the securities. They contained such indicia of ownership as being alienable and vesting title and the risk of loss in plaintiff.

IV

We recently ruled in a case factually similar that receipts from the redemption and sale of certificates of deposit and other securities do not constitute sales under the SBTA. USX Corp v Treasury Dep't, 187 Mich App 256; 466 NW2d 294 (1991). In USX, the plaintiff "purchased" investment securities including certificates of deposit, commercial paper, stocks and bonds. The securities were acquired from those who issued them, then redeemed or resold to banks or investors. Id. 258.

In USX, we indicated there was insufficient evidence to categorize these transactions as sales. The trial court found that the plaintiff was neither in the business of selling securities to third parties nor licensed or registered as a dealer in marketable securities. The plaintiff's major lines of business were other than the sale of securities. The ¡*6¿ only evidence presented showed that plaintiff was purchasing and selling securities for its own account. Id.

Plaintiff in this case admits that the facts underlying USX and this case are similar. In both, the alleged sales occurred soon after the alleged purchases. Plaintiffs' major lines of business were other than the sale of securities. Each created a department dealing only with the investment of excess cash. One distinction in this case is that the alleged sales frequently were evidenced by a repurchase agreement requiring the sellers to repurchase identical securities at a later specified date. In USX, the plaintiff had no such commitment.

Some of the repurchase agreements or confirmation letters stipulated as exhibits in this case identified the transactions in issue as purchases and sales. One confirmation letter stated that plaintiff had the same rights as the seller in the securities. However, we must consider the real nature of the transactions without regard to the terms applied to them by the parties. Central Discount Co v Dep't of Revenue, 355 Mich 463, 467; 94 NW2d 805 (1959).

Unlike the plaintiff ¡*7¿ in USX, plaintiff in this case could not sell the securities to third parties. It could retrieve them and sell them on the market only if the financial institutions where it invested failed to reacquire the securities at maturity pursuant to the repurchase agreements. The financial institutions never failed to reacquire the securities.

We agree with those courts which classify repo transactions as collateralized loans rather than purchases and sales. See Hammond Lead Products, Inc v State of Ind Tax Comm, 575 NE2d 998 (Ind, 1991); Massman Construction Co v Director of Revenue, State of Missouri, 765 SW2d 592 (Mo, 1989). We disagree with plaintiff that Matz should control our decision. Matz v Dep't of Treasury, 155 Mich App 778; 401 NW2d 62 (1986). Matz is clearly distinguishable from this case; it did not involve the short term investment of excess daily cash. Matz stands for the proposition merely that income from government securities flows through mutual

funds to the original investors. Id.

Our classification of plaintiff's repo transactions ¡*8¿ as collateralized loans not sales is consistent with our ruling in USX. We find no reason to treat the transactions in this case differently from those in USX. Therefore, we conclude that the trial court did not err in ruling that plaintiff's repo transactions did not fall within the definition of sales under the SBTA.

Affirmed.

Marilyn Kelly

Maureen Pulte Reilly

Donald E. Holbrook, Jr.

EXHIBIT M: 8

Opinion: ***Crocker Equipment Leasing Inc. v. Oregon Department of Revenue,***
838 P.2d 552 (Or. 1992)

Separate copy to
Mr. ~~Nexus Man~~
Mr. Financials, AHF

PM ✓
SDS —
AJD —
MRM —
DRB —
PM — (for safekeeping)

FILED: August 20, 1992

IN THE SUPREME COURT OF THE STATE OF OREGON

CROCKER EQUIPMENT LEASING, INC.,

Respondent,

v.

DEPARTMENT OF REVENUE,
State of Oregon,

Appellant.

Note Court's reliance on McCray's testimony — The lady who sales factor only apportionment of financial institutions.

(OTC 2973; SC S38059)

PM 09/01/92

In Banc

On appeal from the Oregon Tax Court.*

Argued and submitted March 3, 1992.

Marilyn J. Harbur, Assistant Attorney General, Salem, argued the cause for appellant. With her on the briefs was Dave Frohnmayer, Attorney General, Salem.

Roy E. Crawford, of Brobeck, Phleger & Harrison, San Francisco, California, argued the cause for respondent. With him on the brief was Craig R. Berne, San Francisco, California.

GRABER, J.

The judgment of the Tax Court is affirmed.

*12 OTR 16 (1991).

DESIGNATION OF PREVAILING PARTY AND AWARD OF COSTS

Prevailing party: Respondent on review

[ ] No costs allowed.

[X] Costs allowed, payable by: Petitioner on review

In a case in which a party could be represented by appointed counsel entitled to compensation under ORS 138.500, but the prevailing party is represented by retained counsel or appeared pro se, the prevailing party is allowed costs.

MONEY JUDGMENT

	Judgment #1	Judgment #2*
Creditor:	_____	State of Oregon, Judicial Department
Debtor:	_____	_____
Amount: Costs:	_____	Unpaid filing fee:
Attorney Fees	_____	
TOTAL:	_____	$_____

Interest: Simple, 9% per annum, from the date of this appellate judgment.

*Judgment for unpaid filing fees. ORS 21.605(1)(c).

This section to be completed when the appellate judgment issues. See ORAP 14.05.

NOTICE OF EXPENSES AND COMPENSATION UNDER ORS 138.500(4)

The appellate court has affirmed the conviction in this criminal case and has certified expenses and compensation of appointed counsel. This is notice to the trial court so that it may exercise its discretion under ORS 161.665(2) to include the expenses and compensation of appointed counsel in the final judgment, in addition to transcript preparation expenses allowed by the trial court. The court has certified expenses and compensation in the amount of $_____.

This section to be completed when the appellate judgment issues. See ORAP 14.05.

Appellate Judgment Effective Date:

SUPREME COURT
(seal)

GRABER, J.

The Department of Revenue (Department) appeals from a judgment of the Oregon Tax Court concerning Oregon corporate excise taxes owed by taxpayer Crocker Equipment Leasing, Inc. (CELI), a California corporation, for the years 1978 through 1980. CELI challenged the Department's assessment, contending that the formula that the Department used to apportion CELI's Oregon business income did not fairly represent the extent of its business activity in this state. The Tax Court agreed with CELI and ordered a refund. Crocker Equipment Leasing, Inc. v. Dept. of Rev., 12 OTR 16 (1991). We review de novo, ORS 305.445, 19.125(3), and affirm the judgment of the Tax Court.

CELI and the Department stipulated to the following facts:[1]

> "1. During the three tax years (calendar years 1978, 1979, and 1980) Crocker Equipment Leasing, Inc. ("CELI") was a California Corporation engaged in the business of owning, leasing and financing tangible personal property. CELI was a 100% owned subsidiary of Crocker National Bank, a U.S. chartered national bank engaged in virtually all aspects of normal banking activities. Crocker National Bank was headquartered in California. Crocker National Bank was a subsidiary of Crocker National Corporation, a holding company incorporated in the laws of Delaware and registered under the Bank Holding Company Act of 1956, as amended, 12 U.S.C. §§1841 et. seq. Both Crocker National Corporation and Crocker National Bank owned other subsidiaries * * *.

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[1] Because of the parties' stipulation, our fact-finding role in this case is limited. In any event, this court's factual decisions as a finder of fact on de novo review of the record made in the Tax Court have no precedential value. United Telephone Co. v. Dept. of Rev., 307 Or 428, 431, 770 P2d 43 (1989); Bend Millwork v. Dept. of Revenue, 285 Or 577, 581-82, 592 P2d 986 (1979).

"2. Crocker National Bank and its subsidiaries were engaged in the business of banking as authorized by 12 U.S.C. §24 (Seventh).[2] * * *

"3. The only corporation engaged in business in Oregon and required to file an Oregon corporate excise tax return for 1978, 1979 and 1980 was CELI.

"4. The original tax returns filed in Oregon by CELI for 1978, 1979, and 1980 were prepared on a separate return basis. On audit the Department of Revenue determined that CELI was part of a unitary group headed by Crocker National Corporation. CELI agrees with this determination, and that the Oregon taxable income of CELI should be a fairly apportioned part of the combined income of this unitary group. The disagreement between CELI and the Department of Revenue is whether the apportionment method applied by the Department of Revenue fairly represents the activity conducted by CELI in Oregon or in the alternative, is constitutional.

"5. CELI filed its California corporate franchise (income) tax returns for the taxable years 1978, 1979, and 1980 on a combined unitary basis including the corporations treated as unitary by the Oregon Department of Revenue (DOR). These returns were used by the DOR as a source for information to determine income subject to apportionment, and the denominators of the property, payroll and sales factors. These numbers were modified for Oregon tax purposes because of differences in reporting income to the two states and to reflect federal audit adjustments. * * * Defendant disputes the relevance of California's treatment of intangibles in the property factor.

"* * * * *

"7. During 1978 through 1980 CELI leased a broad spectrum of tangible personal property to business lessees, including transportation equipment (such as trucks, tractors, airplanes, vessels, barges, and passenger car fleets), manufacturing, retail, mining, agricultural, and office equipment. A small number of vehicles were leased on an individual basis as an accommodation to clients.

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[2] During the years 1978 through 1980, 12 CFR § 7.7376 authorized an operating subsidiary of a national bank to "lease property."

"Normally the leased property was sold at the end of the lease either to the lessee or to another person. In a few instances the property would again be released to another lessee. Leases of vehicles were 'closed-end' leases whereby the lessee agreed to lease for an agreed upon number of months and guaranteed a lump sum payment at the end of the lease.

"Many of the leases generated a federal investment tax credit. In some cases CELI claimed the credit; in other leases CELI agreed to elect to pass on the credit to its lessees. Appropriate rental rate adjustments would be made to account for whether the lessor or the lessee took the investment tax credit.

"CELI obtained new leases both (1) by purchase from other corporations such as leasing companies or banks that originated a lease transaction, and (2) by originating a new lease itself. CELI maintained its principal offices in California, and did not have an office, telephone listing, or mail drop in Oregon. CELI did not have any employees based in Oregon, but on occasion a CELI employee from California or the Seattle office of CELI may have visited a client in Oregon.

"In all cases lease documents were executed by CELI in California. All credit decisions were made in California, including evaluation of the credit worthiness of the prospective lessee. Appraisals of the equipment proposed to be leased were made in California, including estimates of value at the outset, during the term, and at the termination of the lease. All funds were advanced by CELI in California. All administration of existing leases was done in California. Payments were received by CELI in California.

"The original cost of leased property owned by CELI and located in Oregon was $7,643,298 in 1978, $7,212,021 in 1979, and $5,977,672 in 1980. Rental receipts were $1,431,829 in 1978, $1,410,299 in 1979, and $1,42,757 in 1980. In addition, CELI received interest on transactions classified for federal and state income tax purposes as installment sales contracts from Oregon customers in the amount of $96,802 in 1978, $195,812 in 1979, and $195,913 in 1980.

"8. The Department of Revenue determined that CELI's apportioned income in Oregon was $319,715 in 1978, $361,435 in 1979, and $295,701 in 1980, resulting

in tax of $23,979 in 1978, $27,108 in 1979, and $22,178 in 1980.

"9. If intangible personal property were included in the property factor, CELI's apportioned income in Oregon would be $54,652 in 1978, $60,669 in 1979, and $48,759 in 1980, resulting in tax of $4,099 in 1978, $4,550 in 1979, and $3,657 in 1980.

"10. The Department of Revenue applied the following apportionment factors to CELI:

	1978	1979	1980
Receipts	.123%	.093%	.061%
Payroll	0%	0%	0%
Property	.931%	.748%	.502%
Average	.351%	.280%	.188%

"11. If intangible property were included in the denominator of the property factor, the apportionment factors would be as follows:

	1978	1979	1980
Receipts	.123%	.093%	.061%
Payroll	0%	0%	0%
Property	.056%	.046%	.033%
Average	.060%	.046%	.031%"

The parties also incorporated into their stipulation a number of documents, including CELI's California corporate franchise tax returns for tax years 1978, 1979, and 1980 and Forms 10-K (Annual Reports under Sections 13 or 15(d) of the Securities Exchange Act of 1934) of Crocker National Corporation (Crocker) for 1978, 1979, and 1980.

Generally, the Uniform Division of Income for Tax Purposes Act (UDITPA), ORS 314.605 to 314.670, prescribes the method for determining how much of a taxpayer's national or worldwide income is allocable to its Oregon business activities. Pacific Coca-Cola Bottling Co. v. Dept. of Rev., 307 Or 667, 669

& n 2, 773 P2d 1290 (1989). In the relevant tax years, ORS 314.650 provided:

> "All business income shall be apportioned to this state by multiplying the income by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor, and the denominator of which is three."

In Twentieth Century-Fox Film v. Dept. of Rev., 299 Or 220, 224, 700 P2d 1035 (1985), this court explained how the three-factor formula operates:

> "Dollar values are assessed to each of three aspects of taxpayer's business: property, sales and payroll. Each of these factors is a fraction. The numerator of each fraction is the Oregon portion of the value and the denominator is the total value everywhere. Each fraction is rendered [as] a percentage. The three percentages are added together and divided by three. The resultant percentage represents the extent of taxpayer's business in Oregon. It is multiplied by taxpayer's income during the tax year to determine the Oregon taxable income. The resultant dollar figure * * * is multiplied by the applicable excise tax rate to determine the amount taxpayer must pay."

The statutory structure applicable in this case is slightly more complicated, because the parties agree, as do we, that the unitary business of which CELI is a part is a financial organization. Financial organizations are excluded, by ORS 314.615, from the coverage of UDITPA. ORS 314.615 provides in part:

> "Any taxpayer having income from business activity which is taxable both within and without this state, <u>other than activity as a financial organization</u> * * *, shall allocate and apportion the net income of the taxpayer as provided in ORS 314.605 to 314.675. <u>Taxpayers engaged in activities as a financial organization * * * shall report their income as provided in ORS 314.280</u> * * *." (Emphasis added.)

ORS 314.280 provides for a method of apportioning income for taxpayers that are financial organizations and authorizes the Department to adopt regulations. Notwithstanding the legislature's express exclusion of financial organizations from UDITPA, the Department, by regulation, applies the UDITPA three-factor apportionment formula to financial organizations, except that a "gross revenues" factor is used in place of the "sales" factor. OAR 150-314.280(E). In this court, taxpayer does not challenge the Department's authority to promulgate OAR 150-314.280.[3]

To compute each apportionment factor, OAR 150-314.280(F) incorporates by reference the UDITPA methodology used to determine the property (ORS 314.655), payroll (ORS 314.660), and sales (ORS 314.655) factors of nonfinancial businesses. In this case, the parties agree on all factors except the property factor. The property factor is computed as follows:

> "(1) The property factor is a fraction, the numerator of which is the average value of the taxpayer's real and tangible personal property owned or rented and used in this state during the tax period and the denominator of which is the average value of all the taxpayer's real and tangible personal property owned or rented and used during the tax period.
>
> "(2) Property owned by the taxpayer is valued at its original cost. Property rented by the taxpayer is valued at eight times the net annual rental rate. Net annual rental rate is the annual rental rate paid by the taxpayer less any annual rental rate received by

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[3] Taxpayer did challenge the validity of those regulations in its complaint to the Tax Court. In responding to the Department's appeal, however, taxpayer does not argue for affirmance on this alternative ground, and we therefore assume the validity of the regulations.

the taxpayer from subrentals.

"(3) The average value of property shall be determined by averaging the values at the beginning and ending of the tax period but the department may require the averaging of monthly values during the tax period if reasonably required to reflect properly the average value of the taxpayer's property." ORS 314.655.

CELI maintains that intangible property must be included in the property factor to avoid distortion. Its position rests primarily on the nature of the unitary business. CELI asserts: Crocker's business is banking; its basic function is to loan money on which it earns interest; about 98 percent of Crocker's earning assets[4] are intangibles; and even CELI's leases of equipment represent an alternative form of financing although they involve tangible property.

The Department did not include intangibles in the property factor. The Department asserts that using only tangible property does not produce a disproportionate result, because the gross revenues factor reflects the interest income earned by intangibles.

ORS 314.280, which applies to financial organizations, provides an avenue of relief for taxpayers who allege that the statutory formula does not fairly represent their Oregon business activity. ORS 314.280 provides:

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[4] CELI uses the term "earning assets" to refer to property that produces income, such as loans and equipment that CELI leases to others. Other property, such as cash on hand and bank premises, is not included in CELI's use of the term "earning assets." If all property is considered, tangible property represented about 3 percent of Crocker's property in the relevant tax years.

"(1) If a taxpayer has income from business activity as a financial organization * * * which is taxable both within and without this state * * *, the determination of net income shall be based upon the business activity within the state, and the department shall have power to permit or require either the segregated method of reporting or the apportionment method of reporting, under rules and regulations adopted by the department, so as fairly and accurately to reflect the net income of the business done within the state.

"(2) The provisions of subsection (1) of this section dealing with the apportionment of income earned from sources both within and without the State of Oregon are designed to allocate to the State of Oregon on a fair and equitable basis a proportion of such income earned from sources both within and without the state. Any taxpayer may submit an alternative basis of apportionment with respect to the income of the taxpayer and explain that basis in full in the return of the taxpayer. If approved by the department that method will be accepted as the basis of allocation."

In the relevant tax years, OAR 150.214.280(I) incorporated, for financial organizations, the regulation for nonfinancial businesses, OAR 150-314.670(A), which was promulgated under ORS 314.670 (1977). OAR 150-314.670(A) provided in part:

"ORS 314.670 provides that if the allocation and apportionment provisions of ORS 314.610 to 314.665 do not fairly represent the extent of the taxpayer's business activity in this state, the taxpayer may petition for or the Department may require, in respect to all or any part of the taxpayer's business activity, if reasonable:

"(1) Separate accounting;

"(2) The exclusion of any one or more of the factors;

"(3) The inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in this state; or

"(4) The employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income.

"ORS 314.670 permits a departure from the allocation and apportionment provisions of ORS 314.610 to 314.665 only in limited and specific cases. ORS 314.670 may be invoked only in specific cases where unusual fact situations (which ordinarily will be unique and nonrecurring) Produce [sic] incongruous results under the apportionment and allocation provisions contained in ORS 314.610 to 314.665."[5]

In the present case, the Tax Court found that "use of only tangible property in the property factor in this case results in a disproportionate apportionment of income to Oregon." Crocker Equipment Leasing v. Dept. of Rev., supra, 12 OTR at 21. The Tax Court also found that CELI's suggested alternative of including intangibles in the property factor was reasonable, because it "results in an apportionment which fairly and accurately reflects plaintiff's business activity within the state." Id. at 23.

Taxpayer has the burden of proving, by a preponderance of the evidence, that the statutory apportionment formula does not fairly represent the extent of taxpayer's business activity in Oregon. ORS 305.427; ORS 314.280; Twentieth Century-Fox Film v. Dept. of Rev., supra, 299 Or at 225, 237. In Twentieth Century-Fox, this court discussed what a taxpayer seeking to deviate from the statutory three-factor apportionment formula

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[5] ORS 314.670 and OAR 150-314.670 have been amended to permit these alternative methods of allocation and apportionment "only where unusual fact situations (which ordinarily will be unique and nonrecurring) produce results which violate a taxpayer's rights under the constitution of Oregon or of the United States." OAR 150-314.670. That amendment is not retroactive, and we express no view concerning it.

must prove:[6] First, the taxpayer must demonstrate that "the statutory formula as a whole does not 'fairly represent the extent of the taxpayer's business activity in this state.'" 299 Or at 233. Second, the taxpayer must establish that its alternative method of allocating income is reasonable. Ibid.

The first question, then, is whether taxpayer demonstrated, by a preponderance of the evidence, that the statutory formula as a whole does not fairly represent the extent of its business activity in Oregon. Taxpayer presented the testimony of Sandra B. McCray, whom it qualified as an expert on state taxation of the banking industry.[7] She testified that, based on her knowledge of banks in general, using a property factor that omits intangibles does not reasonably reflect how the income is generated for a bank, because a bank's income is generated mainly through intangibles. McCray further testified that about 98 percent of Crocker's earning assets[8] are intangibles and that excluding intangibles from the denominator

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[6] Twentieth Century-Fox Film v. Dept. of Rev., supra, interpreted the UDITPA formula for nonfinancial businesses. As noted above, the Department's regulations for financial organizations incorporate the UDITPA formula, and we assume the validity of those regulations in this case.

[7] McCray had worked for the Multistate Tax Commission to develop a new method for state taxation of banks. She also has been a member of the Colorado State Banking Board, a Director of the New York Legislative Tax Study Commission, an author of the report by the Federal Advisory Commission on Intergovernmental Relations on state taxation of banks, and a consultant to the states of Massachusetts, Nevada, and New York concerning state banking laws.

[8] McCray used the term "earning assets" in the same sense as CELI does. See note 3, supra.

of the property factor in this case did not fairly reflect taxpayer's business activity in Oregon. She testified that excluding intangibles in this case yielded a "grossly distorted" result.

We find in accordance with McCray's testimony. There was no evidence to the contrary.

The Department counters that using only tangible property in the property factor does not produce a disproportionate result, because the gross revenues factor adequately reflects the interest income earned by intangibles.[9] We disagree. Each factor in the formula is weighted equally; the three-factor formula "'has the built-in assumption that one-third of the net income is derived from the use of property, one-third from services and one-third from selling.'" 12 OTR at 21 n 4 (quoting W. Beaman, Paying Taxes To Other States 3.15 (1963)). Including interest income from intangibles in the gross revenues factor does not correct the extremely disproportionate representation of business activity caused by excluding intangibles from the property factor. As the stipulated facts show, exclusion of intangibles from the property factor increases that factor about 16 times and increases the average of the three apportionment factors about 6 times.

We agree with the Tax Court that "[t]he unitary income which is being apportioned is the income of a large bank, 98

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[9] The gross revenues factor includes "all income, including interest, fees, service charges, discounts, gains from sale of assets and miscellaneous income." OAR 150-314.280(E).

percent of which is attributable to loans or intangible property." 12 OTR at 21. To exclude that 98 percent from the property factor does not fairly represent CELI's, as part of the unitary Crocker organization's, business activity in Oregon. The Department's formula as a whole does not fairly represent the extent of CELI's business activity in this state.

The second question is whether CELI's proposed alternative of including intangibles in the property factor is a reasonable method of apportioning income. Reasonableness in this context has three components:

> "(1) the division of income fairly represents business activity and if applied uniformly would result in taxation of no more <u>or</u> no less than 100 percent of taxpayer's income; (2) the division of income does not create or foster lack of uniformity among UDITPA jurisdictions; and (3) the division of income reflects the economic reality of the business activity engaged in by the taxpayer in Oregon." <u>Twentieth Century-Fox Film v. Dept. of Rev.</u>, <u>supra</u>, 299 Or at 233-34 (emphasis in original).

The first component of our inquiry is whether taxpayer's proposal fairly represents business activity and, if applied uniformly, would result in taxation of neither more nor less than 100 percent of the business's activity. McCray testified that including intangibles in the property factor yields a property factor that bears a realistic relationship to how the income is earned. CELI also introduced the testimony of James Brown, a Department employee, to the Multistate Tax Commission, in which he agreed that, for financial organizations, intangibles should be included in the property factor in order to reflect properly the business activity of banks. We find that

1 including intangibles in the property factor properly reflects
2 business activity. The Department does not dispute that
3 taxpayer's proposed formula, if applied uniformly, would result
4 in taxation of neither more nor less than 100 percent of the
5 business's activity.

6 The second component of the inquiry into the
7 reasonableness of taxpayer's proposal is whether the division of
8 income creates or fosters lack of uniformity among jurisdictions.
9 McCray testified that, in the relevant tax years, state taxation
10 of banks was "chaos," with states using 32 different methods of
11 apportioning state banks' income. McCray further testified that
12 many states did not apportion income of banks at all and that
13 many had no formal guidelines. She stated that the Multistate
14 Tax Commission had proposed a regulation, which would include
15 intangibles in the property factor, as a move toward uniformity.
16 CELI also introduced evidence that California, Crocker's
17 domicile, included intangibles in the property factor. We find
18 that using taxpayer's proposed formula would not create or foster
19 any greater lack of uniformity among jurisdictions than already
20 exists, and might even reduce it somewhat.

21 The third component of the inquiry is whether including
22 intangibles reflects the economic reality of the business
23 activity engaged in by the taxpayer in Oregon. Including
24 intangibles would reflect economic reality for the same reasons
25 that excluding intangibles fails to reflect economic reality.

26 CELI has met its burden of proving both that the

1 Department's formula is inadequate and that CELI's alternative
2 formula is reasonable. We so find.
3 The judgment of the Tax Court is affirmed.

EXHIBIT M: 9

Plant, Philip M., Testimony before Oregon Department of Revenue (November 17, 1993)

MEMO NOVEMBER 19, 1993

TO: ALAN FRIEDMAN, GENERAL COUNSEL
MULTISTATE TAX COMMISSION

FROM: LEONARD HAMILTON, CORPORATION AND ESTATE SECTION
OREGON DEPARTMENT OF REVENUE

SUBJECT: FINANCIAL ORGANIZATIONS
ADMINISTRATIVE RULE HEARING

Attached are copies of the written testimony received at our administrative rule hearing on November 17. I hope these are helpful.

Don't hesitate to call me if you have any comments or concerns.

(503) 945-8427

TESTIMONY OF PHILIP M. PLANT

OREGON DEPARTMENT OF REVENUE

NOVEMBER 17, 1993

Thank you for giving me this opportunity to speak. I am Philip Plant, Assistant General Tax Counsel of Bank of America NT&SA in San Francisco. I am testifying today on behalf of the Financial Institutions State Tax (FIST) Coalition which I co-chair. FIST is a coalition of banks and financials* formed to address state tax issues. A primary objective of the FIST Coalition is the promotion of fair and administrable state taxation of multistate banking activities.

It is the position of the FIST Coalition that administrative rules adopted by the Oregon Department of Revenue to deal with the apportionment of financial organization income should exactly parallel the Multistate Tax Commission (MTC) Proposed Regulation IV.18.(i) which addresses the same subject. This uniformity will promote equitable and administrable multistate taxation of financial institutions. To achieve this uniformity, however, the Oregon rules should adopt the equally weighted three factor apportionment approach of the MTC proposal rather than the double weighted receipts factor approach currently under consideration.

History of the MTC Proposal

The MTC proposal for apportionment of the income of financial institutions, as

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* Bank of America, NT&SA
Bank of New York Co., Inc.
Bankers Trust Company
Boatmen's Bancshares, Inc.
Capital Holding Corp.
Chase Manhattan Bank
Citicorp/Citibank, N.A.
First Chicago Corp.
First Interstate Bancorp
First Union Corporation
Great Western Financial
KeyCorp
Morgan Guaranty Trust Co. NY
NationsBank
Shawmut National Corp.
Society National Bank
SunTrust Banks, Inc.
Wachovia Corporation

amended May 10, 1993, represents the product of a three year effort between government and industry to fashion a prototype for a fair and administrable tax system.

The full extent of this endeavor and the competing interests of the participants that had to be balanced to produce this proposal are perhaps best described in the introduction to the May 10, 1993 interim report of hearing officer regarding proposed regulation IV.18(i) authored by Alan Friedman, General Counsel of the MTC. Mr. Friedman stated as follows:

> The draft formula presented here was developed through the collective efforts of extremely able and experienced persons representing both government and industry interests. It represents the result of a cooperative effort that continues between government and industry, as well as between and within various factions of government.... On the one hand, representatives of jurisdictions such as New York State, South Dakota and New York City represented a more commercial domicile or "money-center" approach. On the other, representatives of states such as Minnesota, Tennessee, New Hampshire, North Dakota and several others represented a more "market-center" approach. California represented those states that are a true hybrid between the money-center and market-center approaches. Industry and government representatives spent countless hours on telephone conference calls and at meetings discussing, arguing, negotiating,

cajoling, and then drafting and critiquing alternative apportionment approaches.

The industry component of this effort has been noteworthy in its support and cooperation. Early resistance to the Commission's efforts to develop a uniform statute or rule to apportionment has dissipated considerably, at least with respect to those industry representatives who have played active, constructive parts in this process [footnote omitted]. The process pursued over the past year entailed assignments of teams (comprised of a mixture of both industry and government representatives) to address and resolve at least twenty-one components of the formula....

.....

The current effort raises exciting potential, as well as downside risk, for the development of joint state tax policy in an extremely complicated area of taxation of multistate business activity. Should the states fail to achieve substantial uniformity, future industry efforts to have their way with the states in Congress may be enhanced by that failure. While Congressional pre-emptive efforts still may occur, should a sufficient number of states not support a common apportionment methodology, the current effort has produced at least one theoretically acceptable approach

that is based upon a good deal of consultation and common sense compromise.

.....

The basic purpose of this effort - the achievement of a fair, administrable and uniform apportionment methodology - will be greatly undermined should states modify, in any substantial manner, the attribution or factor weighting rules that are suggested by a uniform apportionment method. (Emphasis added.) Unilateral modifications raise the serious risk (theoretically at least) of affected institutions being subject to apportionment and taxation of either more or less than 100% of their net income. While the United States Supreme Court has tolerated a certain amount of over-apportionment of income, neither over-apportionment, nor under-apportionment to any substantial degree should be an acceptable goal for a rational, fair state tax system affecting interstate business enterprises.

Should a sufficient number of states, as well as a few of the more directly affected states, not adopt either the attached suggested approach or some other uniformly supported method, it is likely and understandable for the industry representatives to withdraw their current support of this

effort. Should the states fall short of obtaining a fair, uniform and administrable apportionment approach in this most important area, voluntary industry compliance will be seriously impeded; and "business as usual" - division between taxpayer and government, contentiousness and conflict - will likely fill the void left from the emptying of this cooperative effort. All involved in this effort - industry representatives, tax officials and legislatures - are requested to keep in focus the cooperative manner by which the following draft statute was created, its weighing of competing interests between government and industry, as well as among the government entities themselves.

Receipts Factor Weighting

As touched upon earlier, the equally weighted three factor approach embodied in the MTC regulations represents an essential element of the compromise between the conflicting interests of the market states and the money center states. The sourcing rules (which destination source receipts but origin source property) are designed to strike a proper balance between these competing state interests if equally weighted. Double weighting the receipts factor shifts this balance and virtually eliminates the chance of uniformity because money center states will refuse to accept this change.

The adoption of the double weighted sales factor approach by Oregon in

conjunction with general corporate apportionment under UDITPA should not control factor weighting under the financial industry rules. First of all, UDITPA itself is expressly inapplicable to financial organizations. Moreover, the other modifications of the standard three factor formula contained in the MTC proposal and adopted under the Oregon administrative rule draft here under consideration have multiple variations from UDITPA factor components and sourcing rules of such major import as to destroy any basis for comparison between the two apportionment approaches. Accordingly, the factor weighting element of the UDITPA formula is completely distinguishable and should not be unthinkingly carried over.

Thank you for the opportunity to share my views. I will be happy to answer any questions you might have now or at a later time.

pmp3:183:cnc

OREGON DEPARTMENT OF REVENUE

PROPOSED RULEMAKING HEARING

ADOPTION OF RULES PROPOSED BY

MULTISTATE TAX COMMISSION FOR

FINANCIAL ORGANIZATIONS

SALEM, OREGON

NOVEMBER 17, 1993

TESTIMONY OF RICHARD A. HAYES

ON BEHALF OF OREGON BANKERS ASSOCIATION

Good morning, I am Richard Hayes, Senior Vice President and Director of Taxes for First Interstate Bancorp, located in Los Angeles, which is the parent of First Interstate Bank of Oregon, N.A. I am testifying today on behalf of the Oregon Bankers Association ("OBA").

There will be subsequent testimony today from the Financial Institutions State Tax Coalition ("FIST"). First Interstate is a member of the FIST Coalition which has worked with the Multistate Tax Commission ("MTC"), the Federation of Tax Administrators ("FTA") and member states of the two organizations on the MTC draft regulations which form the basis for the proposed rulemaking here in Oregon. However, I would like to note that my comments today are directed to the concerns of the OBA with respect to the proposed regulation.

The OBA appreciates the opportunity to appear today and to testify in support of the proposed rules for apportionment of income of financial organizations. Subject to the comments set forth herein, the OBA urges the adoption of rule number OAR 150-314.280-(N), proposed October 12, 1993.

Before discussing several, specific points, we would like to express our recognition of the time and effort devoted by the Oregon Department of Revenue to the state working group comprised of representatives of the MTC and FTA. This project has spanned several years with many "potholes" encountered along the way. The participation and support provided by the Oregon Department of Revenue and other states to this project has been of critical

importance. We also would like to express appreciation for the spirit of cooperation demonstrated by Oregon and the other states as they worked with industry representatives to produce the work product that is under discussion today.

The OBA supports Oregon's adoption of the MTC proposal for several reasons. Adoption of the proposal would, for the first time, provide our industry with a detailed, comprehensive set of rules for apportionment under the Oregon's Corporation Excise Tax. Both the State and the taxpayers will benefit from such rules which deal directly and specifically with the specialized nature of our industry.

Secondly, we recognize the interest shown by many states in recent years in promulgating apportionment rules for financial organizations. The MTC's goal in this project has been to develop an apportionment methodology that is "fair, administrable and uniform." (See discussion in the May 10, 1993, Interim Report of Hearing Officer, issued by Alan H. Friedman, General Counsel of the MTC.) The OBA believes that the MTC proposal represents the best, all-around package of rules and the optimum avenue for achieving the goals of fairness, administrability and uniformity. The MTC proposal embodies a balanced approach when evaluated from the following perspectives:

- The specific rules strike a balance between sourcing based on destination (i.e., customer location or market state approach) versus sourcing based on commercial domicile (i.e.,

booking location or money-center state approach). Thus, there will be a more equitable balance between the Oregon banks serving their Oregon customers from within the State and those institutions dealing with Oregon customers from locations outside the State.

- The proposal represents an effort to fashion rules that will achieve an appropriate result for banks of all sizes within the State.

- Some people may view Oregon as more of a market state when compared to money center states, such as New York. However, for certain OBA members, Oregon is also the headquarters or regional center for multistate banking activity. For OBA members in this situation, the MTC proposal should result in a tax liability reflective of and commensurate with the scope of such activities.

In addition, Oregon's adoption of the proposal will hopefully influence other states as they consider the proposed rules in the near future. The uniform adoption of the MTC rules will minimize the possibility for multiple tax burdens for OBA members having operations in those states.

- While information gathering changes will be required by the banks, the proposed rules represent the most workable approach from a taxpayer compliance perspective.

- For the Department of Revenue, the proposed rules likewise represent an administratively workable approach. Earlier MTC

proposals, with nebulous destination sourcing rules, effectively would have required the Department of Revenue to audit the bank's customers to determine the proper tax liability of the bank.

In addition to these general comments, we would like to address the following specific, technical aspects of the proposed regulation.

Our first comment relates to the distinction between "business" and "nonbusiness" income. The MTC proposal prescribes a methodology for the apportionment of business income. While the MTC proposal retains references to nonbusiness income, and the allocation thereof, we direct your attention to Footnote 2 of the MTC proposal, which states as follows:

> While it is understood that all income derived from currently known activities of a financial institution, whether from deposit, lending and other credit activities or from investment activities dealing with tangible and intangible property, is business income, this sentence allows for the future possibility that some activity may be unrelated to the business activities commonly associated with financial institutions, but still authorized by law. Since this discrete business activity is theoretically possible, the proposed statute will more readily conform on its face to the dictates of the Allied Signal, Inc. v. Director, Div. of Taxation, 112 S.Ct. 2251 (1992).

Over the years, we understand that the Department of Revenue has, by administrative practice, generally followed the MTC's view set forth in the footnote -- namely, that all income derived from currently known activities of a financial institution is business

income. In light of this understanding, we suggest the following:

- A definition of business income be inserted which incorporates the administrative practice into the regulation and declares all income of a financial organization to be business income. However, to avoid any Constitutional issues, it should be limited to activities currently permitted by financial organizations. New activities might be subject to a rebuttable presumption that they produce business income.

We mention the desirability of the above definition to minimize the chances of an artificial and inconsistent splitting off of a financial organization's income into the nonbusiness category, thereby undercutting the intended impact of the proposed rules.

The second aspect of the proposed regulation which we would like to address is the question of the weighting of the factors. We understand that the Department of Revenue intends to continue the double weighting of the receipts factor, which presently exists under the Excise Tax. The OBA recommends that the State return to a single weighting of the receipts factor in the application of the proposed regulation.

When Oregon and other states moved to double weighting as the general rule in recent years, typically there have been several reasons advanced. Probably, the most important technical reason for double weighting has been to achieve a more appropriate balance

of the market considerations (i.e., state where the customer is located) versus the production side (i.e., state where the taxpayer engages in activities). However, for financial organizations, such balancing was not achieved through either single or double weighting. For Oregon and other states, the reason was the traditional booking rule. Under such rule, virtually all receipts from loans and other activities have been sourced to the taxpayer's location where such income is booked. The booking rule also has been followed for the property factor, which for Oregon now includes intangibles as a result of the Crocker decision.

In the proposed MTC regulation, we note the conscious attempt to strike a more equal balance. The receipts factor leans heavily toward destination sourcing (i.e., customer location) while the property factor reflects essentially the traditional booking approach.

The MTC has long favored an equally weighted three factor formula, and in fact the proposed MTC regulation explicitly provides for equal weighting. The proposal for equal weighting in conjunction with the sourcing of the factors represents an effort to achieve an appropriate balance.

For Oregon, double weighting may yield somewhat greater revenues from out-of-state banks. However, that positive impact is outweighed by the following negatives:

- The MTC's attempt at balancing, described above, would be undercut.

- The odds of uniformity will be diminished significantly. Money center states will not adopt double weighting. Once the tax principle of equal weighting is dismissed, there is little impediment to other states moving haphazardly beyond double weighting to other forms of super weighting (e.g., Minnesota with a 70% receipts factor).
- The lack of uniformity will lead to distortive, multiple tax burdens for OBA members doing business in Oregon and other states.

As an aside, I would like to touch on California's 1993 adoption by statute of double weighting as the general rule. I do so since First Interstate's parent company is based in the state, and I realize that Oregon and California often look to each other for tax policy ideas. The adoption of double weighting was pushed by companies in certain non-financial industries. The Franchise Tax Board ("FTB") apportionment regulation for banks and financial corporations, adopted in prior years, does not address the weighting of factors since it was not an issue at the time. Accordingly, banks and financial corporations are now subject to double weighting because no exclusion is provided under the regulation.

The California banking industry did not take a position on the double weighting legislation since it is expected that the FTB will consider the MTC proposal in the near future, hopefully in 1994.

I cannot speak for the California Bankers Association or other members. However, First Interstate and, I expect, other banks which participated in the development of the MTC proposal intend to argue for a return to single weighting of the receipts factor for the industry in California.

Next, we would like to comment on the nexus standard. The MTC proposal does not include a definition. This is an issue on which the state and industry representatives agreed to disagree, leaving the matter to the individual states to consider. The MTC proposal assumes that a Constitutional basis for nexus exists. The U.S. Supreme Court's decision in Quill leaves unsettled the question of Constitutional nexus standards. (See Quill v. North Dakota, 112 S.Ct. 1904 (1992).) Until the issue is resolved definitively, the OBA urges the Department of Revenue to retain a standard based on a financial organization's physical presence versus the mere presence of the organization's customer. The latter approach may yield somewhat greater revenue from out-of-state financial organizations. If the State proceeds on that basis, there is still the distinct possibility, in our view, that the taxes (plus interest) will ultimately have to be refunded.

Nexus based on customer presence would cause financial organizations the compliance burden of filing a combined return, which in many instances would generate a de minimis tax liability.

If Oregon abandons the physical presence standard, it will encourage other states to do likewise. Thus, OBA members would be

subjected to the same compliance burdens in those states that Oregon would inflict on out-of-state institutions. We note, in particular, the potential burdens on our member banks, often community banks, located near Oregon's borders with neighboring states.

The May 10, 1993, Interim Report includes appendices that are not part of the present MTC proposed regulation. The appendices contain suggested language on several points, such as definitions of "financial institution" (somewhat broader than Oregon's statutory definition of "financial organization") and "preponderance of substantive contacts" applicable to certain loans and credit card receivables. Points regarding these appendices, as well as other matters, have been discussed in the three MTC hearings. Rather than commenting specifically on these points, we would like to refer to them collectively as part of our next comments on the timing of adoption.

We understand that the Department of Revenue would like to finalize its regulation by the end of this year, effective for taxpayers' 1993 income years. When the Department of Revenue previously considered an earlier draft of the MTC proposal, the OBA strongly urged a delay pending revision and final adoption by the MTC. At this point, the MTC process is substantially, but not totally, completed. We understand that the final report of the Hearing Officer probably will be issued in January, 1994. Final action by the MTC will occur thereafter; however, we have not been

apprised, as yet, of the probable timing.

We do not expect that the Hearing Officer's final report will contain major revisions. However, it almost certainly will reflect changes, including technical refinements and possible incorporation of (and/or changes to) the appendices.

In order to achieve maximum uniformity among the states, it is still preferable for Oregon and others to defer their final action until completion of the MTC process - or, at least, until issuance of the Hearing Officer's final report.

On the other hand, we acknowledge that the joint state/industry development of the current MTC proposal has taken longer than expected and that states, such as Oregon, are eager to put the regulation in place. If the Department of Revenue elects to finalize its regulation at this time, we recommend that such action be done with the express proviso that any modifications in the final MTC regulation will be promptly considered and incorporated.

A related issue is the effective date of the regulation. Even though the MTC proposal significantly reduces compliance problems, most banks will have to make changes to their systems. For the receipts factor in particular, some systems do not presently compile the information in the manner necessary for destination sourcing.

If the regulation is effective for the 1993 income year, it will be impossible for many banks to achieve full compliance. If

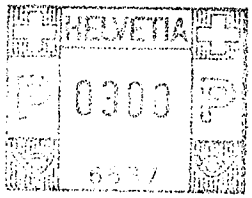
the Department of Revenue moves forward to adopt the regulation, we urge that the effective date be deferred until the 1994 income year.

Once again, the OBA would like to express its appreciation for the opportunity to appear today. I would be pleased to respond to any questions that you may have.

EXHIBIT M: 10

Solicitation from Swiss Bank Corporation

Private Banking Division
101 California Street
San Francisco, CA 94111



Alan Harvey Friedman
386 University Ave.
Los Altos, CA 94022
U.S.A.

Swiss Bank Corporation
New York Branch
Private Banking Division

Swiss Bank Corporation
608 Fifth Avenue
New York, NY 10020
(212) 492-5732

Swiss Bank Corporation
101 California Street
San Francisco, CA 94111
(415) 774-3324

Swiss Bank Corporation
300 South Grand Avenue
Los Angeles, CA 90071
(213) 625-1926

Swiss Bank Corporation
Three First National Plaza
Suite 2100
Chicago, IL 60602
(312) 368-0513

Swiss Bank Corporation
Schweizerischer Bankverein
Société de Banque Suisse

Global Investment Management

Swiss Bank Corporation
Schweizerischer Bankverein
Société de Banque Suisse

Who we are.

Swiss Bank Corporation was founded in 1872. Its headquarters are in Basel, Switzerland. And it has a worldwide network of more than 200 locations with 18,000 employees on 6 continents.

In the United States, we have more than 1,200 employees to serve you in offices in New York, Chicago, Atlanta, Miami, Houston, Dallas, San Francisco and Los Angeles.

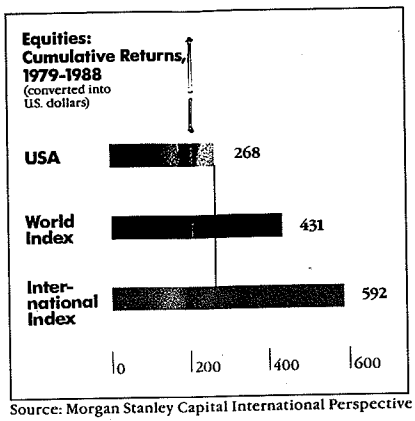
Swiss Bank Corporation is one of the strongest and most stable financial institutions in the world. It is the second largest bank in Switzerland and the 29th largest in the world. What's more, its broad earnings base, high capital ratio, and substantial cushion of reserves are *virtually unmatched* in the banking industry. This strength—plus a conservative lending policy—are reflected in Swiss Bank Corporation's superior "Triple A" credit rating.

Our Private Banking Division serves a select number of individuals with $1 million or more to invest. Our Private Bankers are knowledgeable and experienced professionals who draw on a full range of products and services to design personalized financial solutions for their clients. And each Private Banker manages a strictly limited number of client relationships to assure the highest quality of personal service.

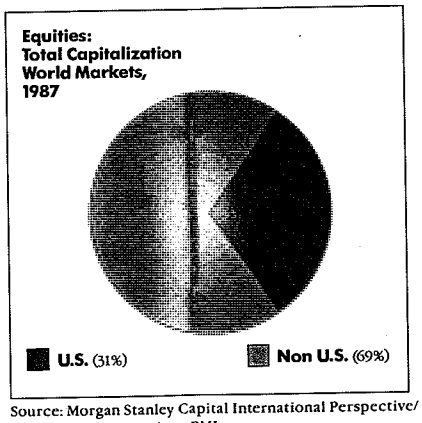
Swiss Bank Corporation represents over 100 years experience in successfully managing assets. Today, we manage one of the largest investment pools in the world. This brochure is a brief introduction to our global investment philosophy and how we can help you get started.

The manifold advantages of a global investment strategy.

The bar chart at right testifies to the way global and international markets have outperformed the U.S. stock market over the last ten years. Yet increased return is just one of many reasons why more and more sophisticated investors are extending their horizons to international markets.



Source: Morgan Stanley Capital International Perspective



Source: Morgan Stanley Capital International Perspective/ Swiss Bank Corporation—PMI

Risk Reduction.

The United States investor often considers foreign investments risky. Yet the opposite is most often true. Risk reduction can be the *key advantage* to international diversification. For these reasons:

- Spreading investments across many markets limits exposure to political or economic risk.
- Foreign markets are usually quite independent of the U.S. market, thereby insulating you from unfavorable domestic conditions.
- Historical comparisons between global and U.S. portfolios have shown that global diversification can decrease risk by more than 50%.[1]

Better performance potential.

The reduced risk of an international portfolio does not in any way rule out potential for increased performance. Over the last three decades foreign stock and bond markets have outperformed U.S. securities markets. Here's why:

- Higher growth rates exist in foreign economies. This growth is likely to persist, perhaps even accelerate.
- Psychological and cultural barriers to investing in foreign markets create greater opportunities for the "informed" investor with a global strategy.
- The relative independence of foreign markets creates stability. A decline in one market is often offset by an advance in another.

Profit from currency fluctuations.

International investment offers investors the opportunity to protect or hedge against a decline in the dollar by maintaining part of their wealth in foreign assets. Additionally...

- Foreign currency fluctuations, although often difficult to forecast, can provide attractive opportunities for return.
- U.S. stock and bond markets react strongly to domestic monetary policy. Foreign investments allow the investor to counteract such volatility and to diversify this risk.

Expanded opportunities.

Rapid growth in foreign markets has created a dramatic expansion of international investment opportunities. As of year end 1987:

- The U.S. share of total world stock market capitalization was only 31%, down from 66% in 1970.
- Bonds denominated in U.S. dollars represented only 51.5% of all outstanding world bonds.

These figures make it clear that restricting security selection to the U.S. alone effectively eliminates 50-70% of worldwide investment opportunities.

1 B. Solnik, *International Investments,* Addison-Wesley Publishing Company Inc., 1988

How we can help.

Any broker can buy foreign securities, currency or precious metals. But only Swiss Bank Corporation combines the expertise and timely execution of a vast worldwide network with local, customized portfolio supervision.

Swiss Bank Corporation is a major force in international investments. More than 6,000 Swiss Bank employees are active in the investment sector. We have teams of expert analysts in all major financial centers. We enjoy direct computer access to all major trading centers in the world. This plus our ultra-modern communication system allow us to react *immediately* to any change in world markets.

Our Private Bankers serve a limited number of clients to provide the highest quality personal service. They go well beyond traditional investment advice to:

- Plan a specifically tailored asset strategy.
- Analyze current and potential holdings.
- Evaluate the tax ramifications of your investments.
- Create portfolios that provide total financial solutions.

All this is handled discreetly, with a level of personal service that is rarely, if ever, encountered today.

To find out how we at Swiss Bank Corporation can help you take advantage of global markets, call us at one of the numbers on the back cover of this brochure. We would welcome the opportunity to demonstrate how our capabilities can meet your needs.

Other Private Banking services.

Swiss Bank Corporation offers a wide array of banking services for individuals who would like to invest $100,000 or more. Our Private Bankers can offer you expert assistance in all these areas:

- Banking Deposits—both fixed-term and money market accounts at attractive rates.
- Offshore Deposit Capability—through our Cayman Island branch.
- Foreign Currency Deposits—including accounts in most major currencies.
- Portfolio Loans—an immediate line of credit is available when you need it.
- Precious Metals Capability—as a special investment opportunity and a hedge against inflation.
- Custody Account— for Clients who wish to direct their own investments while enjoying the security of a Triple A rated bank.

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Swiss Bank Corporation
P.O. Box 54955
Santa Clara, CA 95054-4955

Information Request.

TO: Alan Harvey Friedman
386 University Ave.
Los Altos, CA 94022

FROM: Diane M. Spirandelli, CFA
Vice President

SS2-E

Please indicate your wishes below and return this form in the envelope provided.

☐ I want to know more about your approach to global investment management. Please contact me at

( )
Area Code Phone No.

to set up a consultation at my convenience.

☐ Please send me a complimentary subscription to "Economic and Financial Prospects," your bi-monthly world economic review.

☐ Please put me on your mailing list for information on Swiss Bank Corporation Global Investment Seminars.

Swiss Bank Corporation
Schweizerischer Bankverein
Société de Banque Suisse

BP748

Swiss Bank Corporation
Schweizerischer Bankverein
Société de Banque Suisse

Fifty USA 1959-2009

Private Banking Division
101 California Street
San Francisco, CA 94111
(415) 774-3324

Alan Harvey Friedman
386 University Ave.
Los Altos, CA 94022
BP748

Dear Alan Friedman:

During the last ten years, the U.S. stock markets have been substantially outperformed by most major world markets.

While U.S. markets have averaged an annual return of 13.9%, the French market averaged 15.6%, Britain 18%, Hong Kong 19.7%, and Japan 26.5%.

It's no wonder this subject has been so much in the financial news of late...or why you or your clients may have asked how to take advantage of this phenomenal growth.

At the same time, inflation and the volatility of the U.S. dollar may have also made you curious how international currency diversification might protect hard-earned portfolio assets.

Until recently, the problem has been to find an organization with the knowledge, reach and discretion to help you diversify - safely and profitably - into the international arena.

That's why I'm pleased to introduce you to Swiss Bank Corporation and our unique global approach to investment management. We are Switzerland's second largest bank. We have been in the United States for 50 years. And we are the only financial institution that combines the expertise and timely execution of a vast worldwide network with local, totally-customized portfolio supervision.

We would be pleased to work with you to add value to portfolios - yours or your clients' - of $1 million or more. But our immediate aim is <u>not</u> to sell you anything, but rather to establish a relationship based upon providing you with the information you need about global investments and Swiss Bank Corporation.

(Over, please)

To that end, I want to offer you:

1. A consultation at your convenience to explain how our capabilities might meet your clients' needs. We would also, if you wish, develop a personal proposal based upon your clients' specific objectives and preferences.

2. A complimentary subscription to "Economic and Financial Prospects", our bi-monthly world economic review. Each issue provides trenchant analysis of world financial markets, trends and investment opportunities.

3. Advance information on our Global Investment Seminar Series. These seminars will cover topics such as International Economies & Markets, The Merger of Europe 1992: Investment Opportunities, and Currency Prospects: Where is the Dollar Headed.

I have enclosed an information request form for you to indicate your wishes as to any or all of the above opportunities. Please take a moment to mail it today. Or, if you prefer, call my office at (415) 774-3324. One of our Private Bankers will be happy to talk to you.

We look forward to hearing from you and telling you more about the potential for increased return and lower risk through our global investment management.

Sincerely,

Diane M. Spirandelli

Diane M. Spirandelli, CFA
Vice President

SFP

EXHIBIT N:

MATERIALS RECEIVED SUBSEQUENT TO SUBMISSION OF FINAL REPORT OF HEARING OFFICER BUT BEFORE BYLAW VII SURVEY

EXHIBIT N: 1

Letter from James W. Wetzler (Commissioner, New York Department of Taxation and Finance) (May 25, 1994)

STATE OF NEW YORK
DEPARTMENT OF TAXATION AND FINANCE
W. A. HARRIMAN CAMPUS
ALBANY, NY 12227

JAMES W. WETZLER
COMMISSIONER OF TAXATION AND FINANCE

May 25, 1994

The Honorable Timothy J. Leathers
Commissioner of Revenue
Arkansas Department of Revenue
P.O. Box 1272
Little Rock, Arkansas 72203

Re: Final Report of Hearing Officer Regarding Apportionment of Net Income of Financial Institutions

Dear Commissioner Leathers:

We have read the April 28, 1994 Final Report to the Executive Committee of the Multistate Tax Commission concerning the Formula for the Uniform Apportionment of Net Income from Financial Institutions. The report is the result of many meetings and conference calls among and between representatives of headquarters states, market states and the banking industry. Alan Friedman's efforts is this process are deeply appreciated.

The April 28 report specifically invited comments concerning the treatment of non-US financial institutions and the treatment of trading and investment income. We have attached our comments concerning these important topics. In addition, we have raised policy questions concerning the throwback rule and the burden of proof. The remainder of our comments are of a technical nature. In making our comments, we consulted with the City of New York and representatives of some large New York banks.

Thank you for providing us this opportunity to comment. We look forward to continuing our dialogue with the Multistate Tax Commission on this project.

Sincerely,

James W. Wetzler
Commissioner

Attachments
cc: Alan Friedman

ATTACHMENT

Language that we are suggesting to delete is placed in brackets and language we are suggesting to add is underlined.

Section 1 (a) - p.1 - The first sentence would give a non-US bank (i.e., an alien bank) the right to allocate and apportion income if it is taxable in its home state and, for example, in New York. We do not think this is correct because, pursuant to section 882 of the Internal Revenue Code (IRC), the taxable income of an alien corporation is its net income that is effectively connected to the conduct of a trade or business in the United States.[1] To the best of our knowledge, states that use Federal taxable income as the starting point in determining the net income that is subject to tax, use effectively connected income. We recommend that the first sentence be revised to read, "Except as provided in the next sentence, a financial institution whose business activity is taxable both within and without this state shall allocate and apportion its net income as provided in this Act. A financial institution organized under the laws of a foreign country, the Commonwealth of Puerto Rico, a territory or a possession of the United States whose effectively connected income (as defined in the Federal Internal Revenue Code) is taxable both within this state and any state other than the state in which it is organized shall allocate and apportion its net income as provided in this Act."

Section 2(b) - p.2 - In the fourth line of the definition of "Borrower or credit card holder located in this state," change the word "and" to "or". The phrase "borrower or credit card holder located in this state" means the borrower listed in item 1 or the borrower listed in item 2 or both. Since the word "or" can mean one or the other or both, we think this is the correct word to use in this situation.

Section 2(c) - p. 3 - In the definition of "Commercial domicile," the definition would be clearer if the third line of page 3 read: "Banking Act of 1978; or[.] , if [the] such a taxpayer [described in this subdivision] has". It should be noted that if the apportionable base of an alien bank is its worldwide income, then the location of its commercial domicile should not be limited to a US location.

Section 2(i)(4)(ii) - p. 4 - In the definition of "Gross rents," add the word "for" before "janitorial" to make the sentence grammatically correct. We believe these are the only services excluded from gross rents.

Section 2(q) - p.6 - We note that the definition of "state" includes territories and possessions of the US as well as foreign countries. This definition is not the one used by New York State or City in its taxing statues or regulations or the one contained in the IRC. We have

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[1] Alien corporations also pay a tax to the Federal government pursuant to the provisions of section 881 of the IRC on their US source not effectively connected income. This tax is imposed at the rate of 30% (unless a lower rate is set by treaty - which is usually the case) and is on gross income, not net income.

serious reservations about departing from the well-established meaning of the word. The issue we pointed out with respect to Section 1 is an example of the problems that can arise when dealing with an unusual definition of a common word. However, we understand this definition addresses concerns raised by some US multi-national financial institutions regarding the ability to apportion if they have foreign branches.

Section 2(s) - p.6 - Since New York State and City do not have any taxing statutes that employ "throwback" we have no substantive comments on the definition of "taxable". However, we do not know if the definition, when read in conjunction with Section 3(o) on page 14, produces the correct result in every case. For example, does the definition work where the New York office of a French bank earns interest income on an unsecured loan to a corporation whose commercial domicile is Germany. Assume that Germany taxes non German banks on income that is effectively connected with the conduct of a trade or business in Germany. If the French bank has a branch in Germany, there is no throwback. If the bank does not have a German branch, there is throwback. But, in neither case has the US effectively connected income been taxed by Germany. This may require further discussion.

On a more technical level, the last two lines of page 6 should read, "bank shares tax), a single business tax, [and] <u>or an</u> earned surplus tax, or any [other] tax which is imposed upon or measured by net income." We recommend that the word "and" be changed to "or" because we do not believe that the intent is that a taxpayer must be subject to all of the listed taxes for this definition to apply. We recommend that the word "other" be deleted because all of the listed taxes are not "upon or measure by net income". For example, a corporate stock tax is not on or measured by net income. Some have pointed out that when a non-income based tax is apportioned, such apportionment may be based on income (or receipts). Therefore, as a policy matter, perhaps there should be further discussion as to the inclusion of taxes that are not measured, in whole or in part, by net income as well as whether throwback is appropriate where a state chooses to impose no tax.

Section 3(a) - p. 7 - In the "General" description of the receipts factor, we recommend that the two paragraphs in subdivision (a) either be combined into one paragraph or that they be numbered (1) and (2), respectively. The latter approach is the style used in subdivision (c) and it makes the provisions easier to cite in letters, etc.

Section 3(d)(2) - p. 8 - In the provision setting forth the treatment of interest income from loans secured by real property, we recommend that a sentence be added stating how the collateral is to be valued (fair market value, book value, cost, etc.) The sentence we recommend is "<u>For purposes of this paragraph, collateral shall be valued at fair market value at the time of the loan.</u>" In addition, we recommend that the whole paragraph be moved to section 2, Definitions, because it is a definition and the phrase "loan secured by real property" is used several times in the document (e.g., p. 9 - (f)(1) and p. 10 - (k)(1)). If this suggestion is not accepted, then we suggest that the definition be repeated in the places where the phrase is used or that a cross reference to this provision be added each time.

Section 3(k) - p. 10 - In the subdivision that discusses loan servicing fees, we think that the numbering should be changed to conform to the style used in section 4(g). This will prevent the inclusion of unnumbered paragraphs and will make the paragraphs easier to cite in letters, etc. It will also make it clear that the last paragraph is not a continuation of (2). More specifically, the first paragraph should be numbered (1)(A), the second paragraph (B) and the third paragraph (2).

Section 3(m) - pp. 11 - 14 - Subdivision (m) sets forth the rules for the treatment of receipts from investment assets and activities and trading assets and activities. In paragraph (1), we recommend that the phrase "(but not less than zero)" be added after the phrase "net gains". This will conform the language to that found in section 3(h) on page 9. The same change should also be made in the second line of (m)(2), the first line of (2)(A), and the first line of (3)(A).

Subparagraph (m)(1)(B) should be revised as follows: "The receipts factor shall include the amount by which interest, dividends, [net] gains and other income from trading assets and activities, including but not limited to assets and activities in the matched book, in the arbitrage book, and foreign currency transactions, exceed [interest expense from securities sold not yet purchased and net] <u>amounts paid in lieu of interest, amounts paid in lieu of dividends, and</u> losses from such assets and activities." This provision was discussed with the New York bankers and we all believe that it achieves the correct netting of receipts for purposes of computing the receipts factor. In addition, the word "net" should be deleted from the first lines of (2)(C) and (3)(C). This will conform the language in these subparagraphs to that in (1)(B).

Section 3(o) - p. 14 - Subdivision (o) is the "throwback" rule. See our comments for Section 2(s).

Section 4(e)(1) - p. 16 - In the first paragraph of the subdivision concerning the value of property rented to the taxpayer, the word "leased" in the second line should be changed to "rented" to conform to the title of the subdivision.

Section 4(f)(2) - p. 17 - The phrase "movable tangible property" in the third sentence should be changed to "transportation property" because this is the phrase used throughout the document.

Section 4(g)(1)(A)(ii) and (iii) - pp. 17 and 18 - If the term "Commercial domicile" is as currently defined in section 2(c), subclause (iii) could be deleted and subclause (ii) could be written as follows:

> "(ii) [in the case of a taxpayer organized under the laws of the United States or of any state of the United States, the District of Columbia, the Commonwealth of Puerto Rico or any territory or possession of the United States,] the loan is assigned to a place which is not a regular place of business of the taxpayer and such taxpayer's commercial domicile is within this state[; or]."

If the above suggestion is not accepted, subclauses (ii) and (iii) should be revised to make them correct. Subclause (ii) should read:

> "(ii) in the case of a taxpayer organized under the laws of the United States [or], of any state of the United States or of the District of Columbia, [the Commonwealth of Puerto Rico or any territory or possession of the United States,] the loan is assigned to a place which is not a regular place of business of the taxpayer and such taxpayer's commercial domicile is within this state; or".

With respect to (iii), the phrase "Commonwealth of Puerto Rico or a possession or territory of the United States" should be added after the phrase "foreign country" in the second line.

Section 4(i) - pp. 18 and 19 - We recommend that the first unnumbered paragraph be numbered (1), and that paragraphs (1) through (5) be lettered (A) through (E), respectively. This will make it easier to cite the unnumbered paragraph in letters, etc.

We also recommend that the last unnumbered paragraph, relating to the burden of proof, be deleted because each state has its own rules on the level of the taxpayer's burden of proof in tax matters. In addition, we believe this is not a matter where uniformity is needed. However, we wish to point out that while the property factor rules for situsing loans are based on the New York State and City law and regulations, the rules are not the same as the New York rules with respect to presumptions. The New York statute creates a presumption that a loan booked at a branch (or, to use the term of this document, a regular place of business) is "properly assigned" unless the taxing authority can prove that the preponderance of substantive contact occurred somewhere else. The relevant statutory provision is section 1454(a)(2)(B)(i) of the Tax Law, copy enclosed.

Finally, there is a typographical error on the third line of (i) on page 18. The quotation marks should be removed. As a matter of style, we recommend that the first sentence of (i) be rewritten as follows: "For purposes of subdivisions (g) and (h) of this section, in determining the state in which a preponderance of substantive contact with respect to a loan or credit card receivable occurred, consideration will be given to such activities as the solicitation, investigation, negotiation, approval and administration of the loan or credit card receivable."

For your information, section 19-6.2(c) of the New York regulations on this matter contains the following sentences.

> "Each loan or financing lease has its own characteristics. In some cases, one or more of the activities to be considered may not be present. The significance to be accorded to each activity depends upon the facts in each case."

It may be desirable to add this language, or something similar, to this document.

Section 5(a) - p.21 - The word "which" should be added to the first line of page 21 after the word "compensation".

Section 5(c)(3)(C) - p. 22 - There is a typographical error here. The provision should read:

> "(C) if the principal base of operation and the place from which [some part of] the services are directed or controlled are not in any state in which some <u>part</u> of <u>the</u> service is performed but the employee's residence is in this state."

:10, and section 21 of L.1983, c
out as a note under section 300

82, c. 55. See section 95 of
c. 55, set out as a note under
10.

72, c. 167. See §§ 8, 9 of
c. 167 set out as a note under

eposits, see Taxation ⇐386(1).

ion § 424.

entire net income

ns entire net income as
undred fifty-three, except
ohs eleven and twelve of
d fifty-three shall not be

aph two of subsection
n respect to the modifi-
ection fourteen hundred
n made for purposes of

o apply in certain cases after
90, as provided by section 51 of
298, set out as a note under
31.

posits, see Taxation ⇐386(1).

on § 424.

not illegal indirect tax, even
come derived from such bond
rom taxation by state. Anchor
k, F.S.B. v. Chu, 1986, 117
9, 498 N.Y.S.2d 898.

§ 1454. Allocation

(a) In general. If a taxpayer's entire net income, alternative entire net income, or taxable assets are derived from business carried on within and without the state, the taxpayer shall, for purposes of computing allocation percentages, compute payroll, receipts, and deposits percentages in accordance with the following rules:

(1) The taxpayer shall ascertain the percentage which eighty percent of the total wages, salaries and other personal service compensation during the taxable year of employees within the state, except wages, salaries and other personal service compensation of general executive officers, bears to the total wages, salaries and other personal service compensation during the taxable year of all the taxpayer's employees within and without the state, except wages, salaries and other personal service compensation of general executive officers.

(2) (A) The taxpayer shall ascertain the percentage which the receipts of the taxpayer arising during the taxable year from:

(i) loans (including a taxpayer's portion of a participation in a loan) and financing leases within the state, and all other business receipts earned within the state, bear to

(ii) the total amount of the taxpayer's receipts from loans (including a taxpayer's portion of a participation in a loan) and financing leases and all other business receipts within and without the state.

(B) All interest from loans and financing leases is located where the greater portion of income producing activity related to the loan or financing lease occurred; provided, however:

(i) In the case of a taxpayer described in paragraph one, two, three, four, five or seven of subsection (a) of section fourteen hundred fifty-two of this article, a loan or financing lease attributed by such taxpayer to a branch without the state shall be presumed to be properly so attributed provided that such presumption may be rebutted if the tax commission demonstrates that the greater portion of income producing activity related to the loan or financing lease did not occur at such branch. Where such presumption has been rebutted, the loan or financing lease shall be presumed to be within this state if the taxpayer had a branch within this state at the time the loan or financing lease was made. The taxpayer may rebut such presumption by demonstrating that the greater portion of income producing activity related to the loan or financing lease did not occur within the state. In the case of a loan or financing lease which is recorded on the books of a place without the state which is not a branch, it shall be presumed that the greater portion

of income producing activity related to such loan or financing lease occurred within this state if the taxpayer had a branch within this state at the time the loan or financing lease was made. The taxpayer may rebut such presumption by demonstrating that the greater portion of income producing activity related to the loan or financing lease did not occur within this state.

(ii) In the case of a taxpayer described in paragraph six or nine of subsection (a) of section fourteen hundred fifty-two of this article, a loan or financing lease attributed by such taxpayer to a bona fide office without the state shall be presumed to be properly so attributed provided that such presumption may be rebutted if the tax commission demonstrates that the greater portion of income producing activity related to the loan or financing lease did not occur without this state.

(C) Receipts from lease transactions other than financing leases referred to in subparagraph (B) are located where the property subject to the lease is located.

(D) (i) Interest, and fees and penalties in the nature of interest, from bank, travel and entertainment card receivables are earned within the state if the card holder's domicile is in the state, and

(ii) Service charges and fees from such cards are earned within the state if the card is serviced in the state; and

(iii) Receipts from merchant discounts are earned within the state if the merchant is located within the state.

(E) The portion of total net gains and other income from trading activities (including but not limited to foreign exchange, options and financial futures), and from investment activities which is attributed within the state shall be ascertained by multiplying such total net gains and other income by a fraction the numerator of which is the average value of trading assets and investment assets attributable to this state and the denominator of which is the average value of all trading and investment assets. A trading asset or investment asset is attributable to this state if the greater portion of income producing activity related to the trading asset or investment asset occurred within the state.

(F) Fees or charges from the issuance of letters of credit, travelers checks and money orders are earned within the state if such letters of credit, travelers checks or money orders are issued within the state.

(G) All receipts from the performance of services not described above are earned within the state if the services are performed in the state. When a service is performed both within and without the

state, the receipts shall be allocat
accordance with rules and regul
(H) All other receipts not descr
(G) of this paragraph shall be at
state in accordance with rules a
commission.

(3) The taxpayer shall ascertair
value of deposits maintained at b
taxable year, bears to the average
maintained at branches within
taxable year.

(4) Each percentage computed
be computed on a cash or accrua
accounting used for the taxable y
include only receipts which are
income for the taxable year. Th
shall include only deposits and
included in the computation of a
taxable year.

(5) For purposes of this sectio

(A) The term "bona fide offi
taxpayer carries on its business i
and which is continuously mair
ployees of the taxpayer.

(B) The term "branch" means
the taxpayer on a regular and sy
(regardless of whether the app
requires review or final approva
(ii) accept loan repayments, (iii
one or more other functions of

(6) If it shall appear to the t
percentage determined in subse
does not properly reflect the acti
taxpayer within the state, the tax
its discretion to adjust it by (1) e
therein, (2) including one or m
similar or different method cal
allocation of the income or as
state.

(7) The tax commission fro
rulings of general public interes
the provisions of paragraph six

EXHIBIT N: 2

Letter from Haskell Edelstein (June 9, 1994)

Haskell Edelstein
340 East 69th Street
New York, N.Y. 10021-5706
(212) 879-6126

June 9, 1994

Alan H. Friedman, Esq.
General Counsel
Multistate Tax Commission
444 North Capitol Street, N.W. - Suite 425
Washington, D.C. 200001-1538

Dear Alan:

I had the opportunity about a week ago to meet with the Tax Committee of the Institute of International Bankers (chaired by Reuben Tatz of National Westminster Bank), to present to them, and discuss, your Hearing Officer's Report. I urged that they review the proposal and prepare comments for submission to you. They agreed to consider that, and I expect that I will play some role in that activity.

While most of the questions raised were essentially informational, one major item which will probably need to be addressed is the dichotomy resulting from differences in the apportionable income base - U.S. effectively connected (e.g., treaty-determined) income or worldwide income, as determined by individual states. In the former case, problems of determining the base may well overlap into problems in determining the factors. In the latter case, some of the existing proposals simply won't work in the case of foreign-headquartered banks operating in the U.S. through branches. A prime example is the definition of commercial domicile, which doesn't reach a correct result in the case of a foreign bank taxed by a state on the basis of apportioned worldwide income - both the receipts throwback rule and the location of loan assets may achieve erroneous results under the existing proposal. While I may have suggestions on dealing with these problems, I will obviously leave it to the foreign banks themselves to present their concerns and recommended solutions.

I have advised them that comments should be submitted by the end of June, which I trust will not inconvenience you.

Sincerely,

Haskell

EXHIBIT N: 3

Letter from Phil Plant (Bank of America) (June 29, 1994)

Post-it™ brand fax transmittal memo 7671 | # of pages ▸ 4

To ALAN FRIEDMAN	From PHIL PLANT
Co.	Co.
Dept.	Phone #
Fax #	Fax #

Bank of America

Philip M. Plant
Vice President and
Assistant General Tax Counsel

General Tax Counsel #3245

June 29, 1994

Alan Friedman
Hearing Officer
Multistate Tax Commission
386 University Avenue
Los Altos, CA 94022

Re: MTC Proposal Apportioning Net Income of Financial Institutions - Modified Throwback Provision

Dear Mr. Friedman:

Thank you for allowing us to share our concerns regarding the above captioned throwback modification during our recent telephone conversation. You asked that we comment on how the modified throwback provision imposes a greater tax burden on financial institutions than corporations subject to UDITPA. We have done so below. We have also identified other respects in which the modified throwback provision would be unfair and difficult to administer.

The Modified Throwback Provision Would Impose a Greater Tax Burden on Financial Institutions Than Corporations Subject to UDITPA

In your Report of Hearing Officer, you have suggested that the modified throwback provision would accord financial institutions comparable tax treatment to corporations subject to the UDITPA. You note that Article IV.16(b), which deems a taxpayer "taxable in another state" for throwback purposes if the state of attribution has jurisdiction to impose a net income tax even though it has not done so, only applies to the sourcing of receipts from sales of tangible personal property. You state that other receipts, while not subject to a throwback provision, are effectively thrown back to the taxpayer's commercial domicile under Article IV.17(b). This section assigns such receipts to the state where the greater proportion of the income-producing activity is performed, based on costs of performance. You reason that because the majority of costs incurred by a multistate service provider is likely incurred in its commercial domicile, "then 100% of the receipts will likely be assigned there". (Final Report of Hearing Officer, p.46.) This reasoning will only hold up under a strained and over broad interpretation of the costs of performance test.

In order to conclude that Article IV.17(b) frequently causes a 100% throwback of destination state sourced receipts to the commercial domicile, you would have to apply the costs of performance test on the basis of an aggregation of receipts-related costs without regard to the types of receipts involved or the office locations where the costs are incurred. Thus, the total receipts of a service company that generates receipts from investment activities performed in its commercial domicile and trust services operations performed outside the state would be thrown back under this "macro" approach if the majority of the combined costs associated with both types of services are attributed to the commercial domicile. Similarly, to sustain your reasoning, you would have to combine services despite their having been rendered out of separate office locations. For example, if our service company conducted investment activities within and without the state, but operated its out-of-state business through a separately staffed office outside the domiciliary state, you would attribute all receipts to the commercial domicile if the costs of performance there represented the majority of the total costs of the instate and out-of-state operations combined.

Such a construction would be illogical and would almost surely be held unconstitutional. Indeed, MTC Reg. IV.17 properly avoids such a construction, stating that "[t]he term 'income-producing activity' applies to each separate item of income...." Under the regulation, the trust services receipts or the separate office nondomiciliary state investment receipts in the preceding two examples should be recognized as discrete under the costs of performance test. As so applied, the costs of performance test should result in only modest reattribution of receipts of UDITPA service providers to the commercial domicile. In contrast, the modified throwback provision would result in 100% reattribution in market states electing not to impose a tax. This disparity of tax treatment is particularly significant as applied to financial institutions because they provide a wide variety of discrete types of services and often use multistate office locations.*

The modified throwback provision is not only unfair, it is anti-competitive. A throwback to a financial institution's commercial domicile of factor values that are

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* The types of discrete services provided by banks generate broad categories of receipts associated with leasing activities, loan servicing, credit card administration, investment advice, brokerage activities and estate and trust services, to name but a few. The large multistate financial institutions which are the primary focus of the MTC regulations have a great number of office locations many of which are outside the commercial domicile. While those that are national banks are federally barred from interstate branch banking, they can operate through multistate locations for the conduct of non-banking related activities (including virtually all types of service operations) and partial banking activities (such as loan production). Moreover, other financial institutions, including Edge Act corporations and savings and loan associations, presently can operate in an interstate branch configuration.

not taxed under Article IV.16(b) gives UDITPA corporations an unfair competitive advantage. The prospect that an MTC state could treat a competitor of a bank or savings and loan association as a general corporation subject to UDITPA is very real because the MTC proposal itself does not attempt to define "financial institutions".

The Modified Throwback Provision
Would Be Unfair and Difficult to Administer

Additional reasons can be cited as to why the modified throwback provision should be rejected in the interests of fairness and avoidance of unreasonable compliance burdens on taxpayer and tax administrators alike. These reasons are set forth below.

The modification of the throwback provision represents a fundamental change in the overall scheme of taxation of multistate financial institutions which is inappropriate at this late date. By allowing the domiciliary state to tax values attributable to a state where the taxpayer is taxable but not taxed, the throwback provision effectively converts the scheme of taxation to a residence-based tax system with a credit equivalent for foreign state taxes paid. This approach deviates from the guiding principles of fairness and administrability underlying the SIMS effort. The standard UDITPA Article IV.16(b) throwback is the preferred approach that most participating industry representatives assumed would be accepted in furtherance of the uniform treatment of taxpayers generally.

A throwback of values plainly attributed outside the taxing jurisdiction to a state with nexus to tax represents extraterritorial taxation of questionable constitutionality. The United States Supreme Court has recognized that apportionment is the ordinarily accepted method of determining the measure of an income tax and that the constitutionality of unapportioned taxation by the domiciliary state should not be presumed even in the absence of an actual tax overlap. Mobil Oil Corp. v. Comm. of Taxes (1980) 445 US 425. To the extent the modified throwback approach differs from the Article IV.16(b), it results in such unapportioned domiciliary taxation. It is neither fair nor sound tax policy to recommend adoption of a constitutionally suspect sourcing rule.

The modified throwback provision promotes audit uncertainties and cripples the ability of financials to compete internationally from a worldwide combined reporting commercial domicile. By expanding the throwback application to all instances where certain taxes are not paid, it becomes necessary to specifically identify the type of taxes payment of which will preclude throwback. While the taxes identified in the modification may arguably be broad enough to encompass all existing state doing business taxes, its application to foreign country tax systems is less clear and will invite needless audit controversy. Moreover, the effective domiciliary state taxation of offshore bookings will cripple the ability of U.S. banks domiciled in states such as California to compete in certain Eurodollar transactions.

We hope the foregoing discussion persuades you that the modified throwback provision is neither as fair nor as administrable as the Article IV.16(b) approach. If you need further examples or elaboration on any of the points raised please do not hesitate to contact us.

Sincerely,

Philip M. Plant
Co-Chair
FIST Coalition

cc: Fred E. Ferguson

pmp4:248:cnc

EXHIBIT N: 4

Letter from Phil Plant (Bank of America) (July 1, 1994)

Post-it™ brand fax transmittal memo 7671 | # of pages ▸ 6

To ALAN FRIEDMAN	From PHIL PLANT
Co.	Co.
Dept.	Phone #
Fax #	Fax #

Bank of America

Philip M. Plant
Vice President and
Assistant General Tax Counsel

General Tax Counsel #3245

July 1, 1994

Alan Friedman
Hearing Officer
Multistate Tax Commission
386 University Avenue
Los Altos, CA 94022

Re: MTC Proposal Apportioning Net Income of Financial Institutions - Property Factor Loan Sourcing Under SINAA

Dear Mr. Friedman:

Your June 29, 1994 draft modification of the property factor loan sourcing rules is acceptable to us subject to the further changes described below. While you have not formulated a precise set of rules that would ensure the uniform application of the SINAA standard, you have described the analytical approach to be taken in making the SINAA sourcing assessment. Hopefully, states and taxpayers alike will respect the origin sourcing emphasis reflected by this approach and recognize its compatibility with the money center state bias of the property factor generally. Any observations to this effect in your Final Report of Hearing Officer would be very helpful.

A primary change necessary to promote a coherent reading of the SINAA section is the elimination of the final paragraph of subdivision (i) of Section 4. This paragraph reads as follows:

> Notwithstanding any provision contained herein to the contrary, the taxpayer shall have the burden to prove, by clear and convincing evidence, that an item of receipt, property or payroll has been properly assigned on its books and records.

This paragraph conflicts with the newly added presumption that a loan or credit card receivable has been properly assigned as reflected on the taxpayer's books of account in the normal course of business. Its retention therefore nullifies the intended effect of the presumption.

Furthermore, because the reference to proof by clear and convincing evidence has intended application to all three apportionment factors, it should not appear within subdivision (i) of the property factor section in any event. It most logically belongs in "Section 1. Apportionment and Allocation" if it is retained at all.* Most importantly, if it is retained and relocated, its opening clause must read "Except as otherwise provided" rather than "Notwithstanding any provision contained herein to the contrary". Otherwise, it undercuts the presumption in subdivision (i) despite its relocation to Section 1.

As a separate but related issue, subdivision (j) of the property factor section, which provides that a properly assigned loan remains assigned to the same state for the original term of the loan, is too inflexible in its terms. The subdivision should commence with the clause "Absent a change of material fact,". This less structured approach is consistent with the parallel approach the MTC has taken in declining to spell out precise SINAA applications generally.

Should subdivision (j) of Section 4 be retained without this suggested addition, it should at a minimum be modified to account for two unreasonable or unintended applications. First, it should be made clear that loans transferred at arm's length prices between unitary affiliates are not subject to subdivision (j) and should be reassigned by combined reporting jurisdictions if the preponderance of substantive contact has shifted. Failure to so provide would produce disparate taxpayer sourcing alternatives depending upon whether the state was a separate return or a combined reporting jurisdiction. Secondly, subdivision (j) of Section 4 should be made expressly inapplicable to credit card receivables. Credit card receivables don't have fixed loan terms and are inadministrable under this provision.

Further suggested technical corrections are reflected in the attached mark up by Jeff Serether. Please let me know if you wish further submissions or clarifications with respect to the foregoing. We greatly appreciate the opportunity to express our concerns and hope you agree that the above suggestions improve the administrability of the regulations.

Sincerely,

Philip M. Plant
Co-Chair
FIST Coalition

cc: Fred E. Ferguson

pmp4:249:cnc

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* This evidentiary rule of general application should not appear in a special industry regulation. The state evidentiary standards applicable to all taxpayers should control.

(g) Location of loans.

(1)(A) A loan is considered to be located within this state if -

(i) it is properly assigned to a regular place of business of the taxpayer within this state; or

(ii) ~~in the case of a taxpayer organized under the laws of the United States or of any state of the United States, the District of Columbia, the Commonwealth of Puerto Rico or any territory or possession of the United States,~~ the loan is assigned to a place which is not a regular place of business of the taxpayer and such taxpayer's commercial domicile is within this state; ~~or~~

Because of the new definition of "commercial domicile" I believe the changes to (ii) and (iii) are appropriate. If my changes are not made then I think (ii) should apply to taxpayers organized under US law or the laws of any state of the US and (iii) should apply to taxpayers organized under the laws of Puerto Rico, any territory or possession of the US or a foreign country.

~~(iii) in the case of a taxpayer organized under the laws of a foreign country, the loan is assigned to a place which is not a regular place of business of the taxpayer and such taxpayer has declared this state to be its home state pursuant to the provisions of the International Banking Act of 1978. If a taxpayer described in this clause has not made such a declaration or is not required to make such a declaration, the loan shall be presumed to be located at the place in the United States to which the greatest number of employees are regularly connected or out of which they are working, irrespective of where the services of such employee are performed, as of the last day of the calendar year.~~

(B) A loan is properly assigned to the state in which it a loan has a preponderance of substantive contact ~~with a regular place of business of the taxpayer shall be the state in which a loan is properly assigned.~~

I have suggested this change since a determination as to whether a loan is "properly assigned" only applies when a regular place of business of the taxpayer is involved.

(h) **Location of credit card receivables.**

For purposes of determining the location of credit card receivables, credit card receivables shall be treated as loans and shall be subject to the provisions of subdivision (g) of this section.

(i) **Presumption of Proper Assignment: Elements to Consider in Determining Proper Assignment of Certain Intangible Assets.**

In order to determine the state to which loans or credit card receivables are properly assigned under the "preponderance of substantive contact" test for the purpose of locating said property under Section 4(g)~~(1)(B)~~and 4(h), it shall be presumed, subject to rebuttal, that the loan or credit card receivable has been properly assigned ~~as~~ when it is reflected on the taxpayer's books of account ~~when such assignment is to a regular place of business of the taxpayer and has been so assigned~~ maintained in the normal course of business for the meeting of requirements including but not limited to, regulatory or asset requirements with respect to the making of such loans or the extension of credit by such location. → see note on previous page

Such presumption may be rebutted and the loan or credit card receivable assigned to another state than is reflected on the books of account of the taxpayer upon a showing that the preponderance of substantive contact with respect to such receivable has occurred within another state. In determining if such presumption has been rebutted, consideration shall ~~is to~~ be given to, but not limited to, such things as: solicitation, investigation, negotiation, approval and administration. The terms "solicitation", "investigation", "negotiation", "approval" and "administration" are defined as follows:

(1) *Solicitation.* Solicitation is either active or passive. Active solicitation occurs when an employee of the taxpayer initiates the contact with the customer. Such activity is

located at the regular place of business which the taxpayer's employee is regularly connected with or working out of, regardless of where the services of such employee were actually performed. Passive solicitation occurs when the customer initiates the contact with the taxpayer. If the customer's initial contact was not at a regular place of business of the taxpayer, the regular place of business, if any, where the passive solicitation occurred is determined by the facts in each case.

(2) *Investigation.* Investigation is the procedure whereby employees of the taxpayer determine the credit-worthiness of the customer as well as the degree of risk involved in making a particular agreement. Such activity is located at the regular place of business which the taxpayer's employees are regularly connected with or working out of, regardless of where the services of such employees were actually performed.

(3) *Negotiation.* Negotiation is the procedure whereby employees of the taxpayer and its customer determine the terms of the agreement (e.g., the amount, duration, interest rate, frequency of repayment, currency denomination and security required). Such activity is located at the regular place of business which the taxpayer's employees are regularly connected with or working out of, regardless of where the services of such employees were actually performed.

(4) *Approval.* Approval is the procedure whereby employees or the board of directors of the taxpayer make the final determination whether to enter into the agreement. Such activity is located at the regular place of business which the taxpayer's employees are regularly connected with or working out of, regardless of where the services of such employees were actually performed. If the board of directors

makes the final determination, such activity is located at the commercial domicile of the taxpayer.

(6) *Administration.* Administration is the process of managing the account. This process includes bookkeeping, collecting the payments, corresponding with the customer, reporting to management regarding the status of the agreement and proceeding against the borrower or the security interest if the borrower is in default. Such activity is located at the regular place of business which oversees this activity.

~~Notwithstanding any provision contained herein to the contrary, the taxpayer shall have the burden to prove, by clear and convincing evidence, that an item of receipt, property or payroll has been properly assigned on its books and records.~~

(j) **Period for which Properly Assigned Loan Remains Assigned.**

Absent a change of a material fact, a

A loan that has been properly assigned to a state shall remain assigned to said state for the length of the original term of the loan. Thereafter, said loan may be properly assigned to another state if said loan has a preponderance of substantive contact there. This subsection (j) shall not apply to credit card receivables.

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To ALAN FRIEDMAN	From PHIL PLANT
Co. 348-8582	Co.
Dept. PLEASE REPLACE	Phone # LAST PAGE
Fax # OF JULY 1	Fax # LETTER

EXHIBIT N: 5

Letter from Lawrence R. Uhlick (Institute of International Bankers) (August 11, 1994)

INSTITUTE OF INTERNATIONAL BANKERS

299 PARK AVENUE, 17TH FLOOR, NEW YORK, N.Y. 10171

TELEPHONE: (212) 421-1611

FACSIMILE: (212) 421-1119

LAWRENCE R. UHLICK
EXECUTIVE DIRECTOR -
HEAD OF LEGAL AND EXTERNAL AFFAIRS

August 11, 1994

Mr. Timothy J. Leathers
Commissioner of Revenue
Arkansas Department of Finance
& Administration
800 West 7th Street, Room 215
Little Rock, AR 72201

Dear Mr. Leathers:

We have enclosed for your consideration, as the current Chairman of the Multistate Tax Commission, comments on the "Statutory Proposal for Apportionment and Allocation of Net Income of Financial Institutions." These comments are submitted on behalf of the Institute of International Bankers, an association of over 200 international banking organizations that operate in the United States. Please contact the undersigned if you should have any questions concerning our submission.

Very Yours truly,

Lawrence R. Uhlick
Executive Director - Head of
Legal and External Affairs

Enclosure

cc: Mr. Alan Friedman, Hearing Officer
Multistate Tax Commission

The Institute, founded in 1966, is an association of over 200 banking organizations that operate in the United States and have their headquarters in 50 other countries.

Institute of International Bankers Comments
Concerning the Multistate Tax Commission's
"Statutory Proposal for Apportionment and Allocation of
Net Income of Financial Institutions"

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1. Use of Home State as Commercial Domicile - Section 2(c)

Section 2(c) of the Act provides in part that:

" 'Commercial domicile' means the headquarters of the trade or business, that is, the place from which the trade or business is principally managed and directed." This section provides further that: "If a taxpayer is organized under the laws of a foreign country ... such taxpayer's commercial domicile shall be deemed to be the state which the taxpayer has declared to be its home state [emphasis added] pursuant to the provisions of the International Banking Act of 1978; or if the taxpayer ... has not made such a declaration or is not required to make such a declaration, its commercial domicile for purposes of this [ACT] shall be deemed to be the state of the United States or the District of Columbia to which the greatest number of employees are regularly connected or out of which they are working, irrespective of where the services of such employee are performed, as of the last day of the taxable year."

08-12-1994 04:17PM FROM Institute Intl Bankers TO 914153488582 P.03

Comment:

Section 5(a) of the International Banking Act ("IBA") requires a foreign bank that has or acquires an unrestricted branch or bank subsidiary in the United States to select the state where such full service operation is located as its "IBA home state." Once it is selected, a bank's designated home state may be changed only once. Except for any grandfathered operations, the IBA, by its terms, prohibits a foreign bank from having an unrestricted branch outside its IBA home state.

The treatment of a foreign bank's IBA home state as its "commercial domicile" may be appropriate at the present time for foreign banks that entered the United States after enactment of the IBA in 1978, because these banks typically do not operate in states other than their IBA home state. This will no longer be the case, however, as new laws are enacted to permit interstate branching for banking corporations. With interstate branching, a foreign bank's IBA home state may not always be "the place from where the trade or business is principally managed or directed."

This situation already exists with respect to foreign banks that were operating in branch form in more than one state at the time the IBA was enacted. These banks

08-12-1994 04:18PM FROM Institute Int'l Bankers TO 914153488582 P.04

were required to choose one the states in which they were operating as their IBA home state, and may have selected a particular state for a variety of reasons, including: (i) to have the opportunity for future expansion in that state, and (ii) to be located in a particular Federal Reserve District. An IBA home state selected by a foreign bank for one of these reasons may not be "the place from where the trade or business is principally managed or directed." Thus, it may be inappropriate for that IBA home state to be deemed to be the "commercial domicile" of the bank.

The Institute recommends, therefore, that the "commercial domicile" of a foreign bank be, in all cases, the state where the bank's U.S. management is located, or if no single office serves this function, the state to which the greatest number of employees are regularly connected or out of which they are working, irrespective of where the services of such employee are performed, as of the last day of the taxable year, i.e., consistent with the latter rule proposed in Section 2(c). A conforming change should be made to Section 4(g)(1)(A)(iii) regarding the location of loans, i.e., in the case of a foreign bank, a loan should be considered located within a state if the loan is assigned to a place which is not a regular place of business of the taxpayer and the state is the location

to which the greatest number of employees are regularly connected or out of which they are working, irrespective of where the services of such employee are performed, as of the last day of the taxable year.

2. "Net" Receipts from Investment Assets and Activities and Trading Assets and Activities - Section 3(m)

Subsections 1(A) and 1(B) of Section 3(m) provide for, among other things, the netting of interest income and expense from certain types of transactions.

Foreign banks compute their interest expense for U.S. Federal income tax purposes under U.S. Treasury Regulation Section 1.882-5. This regulation provides for, among other things, the imputation of capital to the U.S. operations of the foreign bank. Accordingly, the Institute believes that it would be inappropriate to use the amount of interest expense computed under U.S. Treasury Regulation Section 1.882-5 for purposes of Section 3(m) of the Act. Instead, the Institute recommends use of the amount of interest expense shown on the books and records of the U.S. operations of the foreign bank. This would assure parity with the computation made by domestic banks. Therefore, it is recommended that a new subsection be added to Section 3(m) as follows:

08-12-1994 04:18PM FROM Institute Int'l Bankers TO 914153488582 P.06

New Subsection 6

For purposes of this Section 3(m), the term "interest expense" for a bank organized under the laws of a foreign country shall mean the aggregate amount of interest expense shown on the books and records of the U.S. branches or other offices of the bank.

3. Attribution of Receipts to Commercial Domicile - Section 3(o) and Definition of "Taxable" - Section 2(s)

Section 3(o) provides for the throwback of receipts to the taxpayer's state of commercial domicile, if such receipts would otherwise be assigned to a state in which the taxpayer is not taxable. The definition of the term "taxable" in Section 2(s) is different than that used for general business corporations. The Institute recommends that the definition be changed, as follows, to conform to the language of Section 3 of the Uniform Division of Income for Tax Purposes Act:

New Section 2(s)

Definition of the Term "Taxable"

08-12-1994 04:19PM FROM Institute Int1 Bankers TO 914153488582 P.07

"For purposes of the allocation and apportionment of income under this [ ], a taxpayer is taxable in another state if: (1) in that state the taxpayer is subject to a net income tax, a franchise tax measured by net income, a franchise tax for the privilege of doing business, or a corporate stock tax; or (2) that state has jurisdiction to subject the taxpayer to a net income tax regardless of whether, in fact, the state does or does not do so."

The foregoing definition will ensure parity in the treatment of banking corporations and general business corporations.

4. Elements to Consider in Determining Proper Assignment of Certain Intangible Assets - Section 4(i)

Section 4(i) provides various criteria for determining whether certain intangible assets are properly assigned to a state under the "preponderance of substantive contact" test of Section 4(g)(1)(B). In order to avoid having two or more states take the position that loans are properly assigned to their state, a presumption is needed that loans are properly assigned to the state in which they are booked. Both New York statute (Article

08-12-1994 04:19PM FROM Institute Int'l Bankers TO 914153488582 P.08

32, Section 1454(a)(2)(B)(i)) and regulations section 19-6.2(a)(1) relating to the sourcing of receipts from intangibles provide that "...a loan or financing lease that is attributed by such taxpayer to a branch without New York State is presumed to be properly attributed [emphasis added], provided that such presumption may be rebutted if the Tax Commission demonstrates that the greater portion of income-producing activity relating to the loan or financing lease did not occur at such branch."

The Institute recommends that language comparable to the foregoing New York language be incorporated in the Act in order to avoid audit controversies. Specifically, the Institute recommends that a new section 4(k) be added as follows:

New Section 4(k)

A loan is presumed to be properly attributed to the place of business to which it is booked, provided that such presumption may be rebutted if the State demonstrates that the preponderance of substantive contact did not occur at such place of business.

08-12-1994 04:20PM FROM Institute Int'l Bankers TO 914153488582 P.09

EXHIBIT O:

BYLAW VII SURVEY OF RECOMMENDATION

Exhibit O is missing