# **F**inancial **I**nstitutions **S**tate **T**ax Coalition

October 21, 2008

**COMMENTS RELATING TO QUESTIONS RASIED ON THE SEPTMBER 2008 CONFERENCE CALL (List of Questions included in Appendix A)**

**I. Re: Data comparing "non-passive" interest income as a percent of total income for the financial sector to the same percentage for other economic sectors.**

**A. Is this type of information helpful to resolving a question currently before the work group?**

As discussed on the September conference call, if the states are considering addressing the sourcing of receipts based on streams of income for all taxpayers, that approach appears to be mutually exclusive to that of maintaining industry apportionment provisions. Accordingly, if the states are considering the new approach, we believe that we should discontinue any future work on revisions to the financial organization apportionment provisions until that decision has been made.

We further believe (as noted in our September 16, 2008 comments) that an in-depth analysis of market versus greater cost of performance sourcing for service income should be appropriately vetted in the NCCUSL study committee forum in conjunction with other discussions related to UDITPA section 17. It is not appropriate to address in isolation for certain income components of financial organizations.

**B. If this type of information would be helpful to resolving a question currently before the work group, are there suggestions for Elliott and Ann on how to make the data more relevant to our specific question?**

Not applicable based on response to A above.

**II. Re: Sourcing receipts from trust activities and investment management activities performed on behalf of trusts and persons other than the financial institution.**

**A. How difficult is it to determine legal domicile of trusts that are managed by the financial institution?**

For the many reasons noted in our September 16, 2008 comments, we strongly believe that service fee income earned by a financial organization should be sourced in the same manner as like income under the states' general business corporation apportionment provisions. We find no compelling reason why such income earned by a financial organization should be sourced differently than if the income is earned by a corporation not classified as a financial organization.

Moreover as noted on the September conference call, assuming all of the states can agree on the same single factor for determining the "situs" of a trust, the time, efforts and out-of pocket costs that financial organizations would need to incur in order to comply with such sourcing is significant especially when compared with the low percentage of gross income that such income is comprised of for most financials.

While we assume that the information regarding the situsing of a trust could be found somewhere within the trust departments of most financial organizations, we are not aware of that information being available in a form that will list the situs of all trusts. Instead, it is our understanding that for most situations, the actual trust document would need to be reviewed to determine the trust's situs. In addition, the general ledger system would need to be revised to permit a new state sourcing coding field for every fee included in the category of "trust fees" in order for the revenue for each fee to be appropriately sourced to the proper state and additional programming would be needed to develop the reports that would need to be provided to tax departments. Moreover, once the information for situs of each trust is determined and the general ledger software has been revised to permit the capturing of a state sourcing code, then someone would have to input the state situs code for each trust, or depending on the system, each time revenue is booked to the trust fee income account the party would need to also key in the state situs code.

As also noted on the September call, for most financial organizations the percentage of gross trust fees is small and this requirement would impose a significant burden in order to change the sourcing of a type of fees that comprise a small percentage of income, which seems far from the original goal of being administrable.

Moreover, as is easily recognizable from reading the front pages of all major newspapers or tuning in to any news channel, the financial services industry is not in the financial condition to expect them to incur significant costs in order to compute a change in policy of how a small percentage of income is sourced among the states. The resources within the industry need to be focused on stabilizing financial conditions and the market – not on complying with a new way to divide up a small percentage of income among the states.

**B. How difficult/expensive is a cost of performance study and how often is such a study generally produced?**

While we believe that the cost of such a study is not relevant, it can be a fairly significant expense, particularly the first time it is done. In a large number of situations, an official study is not required because based on the facts, it is clear that the greater cost of performance is located in a specific state, where the majority of the day-to-day work related to a specific stream of income is located. Where such a study has been conducted, the range of costs of the study would vary significantly based on what is being studied, magnitude of costs, ease of compiling the information, etc.

**C. Does industry have a suggestion for how receipts from such activities could be sourced to the market state?**

We have no suggestion that would correlate to the income that is earned.

## III. Re: Financial Crisis – Does it affect how we should proceed on this project?

We are working through extremely stressful and uncertain times. Based on the events over the past 4-6 weeks, it is unclear what the structures and services of financial institutions will look like in a year. Accordingly, we suggest that this project be put on hold until May or June of 2009 when we will better understand what "normal/routine" is again.

APPENDIX A
FOLLOW-UP QUESTIONS
FROM MEETING OF SEPTEMBER 23, 2008

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**I. Re: Data comparing "non-passive" interest income as a percent of total income for the financial sector to the same percentage for other economic sectors.**

**A. Is this type of information helpful to resolving a question currently before the work group?**

Background from meeting notes:

- At our April, 2008 meeting, the work group considered whether the model rule should apply to types of activity rather than types of institutions. We noted that the current rule applies to "financial institutions." §1(a). A separate appendix to the model rule provides a model definition of "financial institution." That definition lists ten types of organizations that meet the definition of "financial institution" and then adds:

  > (11) Any other person or business entity, other than [an insurance company taxable under ___________], [a real estate broker taxable under ___________ ], [a securities dealer taxable under ___________] or [a __________ company taxable under ___________],which derives more than fifty percent (50%) of its gross income from activities that a person described in subsections (2) through (8) and (10) above is authorized to transact.

- At our July, 2008 meeting, the work group considered the issue and the following comments were made:

  "Elliott Dubin walked the group through a compilation of data he prepared showing source of bank non-interest income as a percentage of all bank income over several years. Fiduciary income is typically 80% of non-interest income. There is a jump in percentage from 1994 to 2006. Karen Boucher explains this could be due to gains on trading activities. It could also include operating lease income. She asked if it is possible to pull out investment income. The information is from call reports so it includes all subs of insured banks as well as the insured banks.

  If definitions are based on common financial activities, rather than on whether the taxpayer is a financial institution, should any changes to the apportionment rules be made to the gen'l apportionment rules rather than the special rule for financial institutions? If so, Steve suggests that NCCUSL should make any gen'l changes. Bank reps are "agnostic" on the issue.

  If we go the activities route, would other affected industries want to participate in the work groups? Brenda agrees other affected stakeholders may want to participate in the work groups if the definitions are based on activities.

Shirley:  Should the states have a conversation amongst themselves about pulling other industries into the rule, since banks are agnostic?  Brenda:  perhaps in Santa Fe. Karen?

Shirley:  Do states want to learn more about Gramm-Leach-Bliley effect on the interaction with Insurance and brokerage?  Carl: yes.

Shirley/Brenda asks states to again list issues they have now with the definition portion of the model rules – as they did for our first meeting in April – now that we've discussed what some of those issues might be.  Send the list to Shirley, Brenda will work with Shirley on this.  The list will be due 2 weeks prior to the next work group meeting."

**B. If this type of information would be helpful to resolving a question currently before the work group, are there suggestions for Elliott and Ann on how to make the data more relevant to our specific question?**

**II. Re:  Sourcing receipts from trust activities and investment management activities performed on behalf of trusts and persons other than the financial institution.**

**A. How difficult is it to determine legal domicile of trusts that are managed by the financial institution?**

**B. How difficult/expensive is a cost of performance study and how often is such a study generally produced?**

**C. Does industry have a suggestion for how receipts from such activities could be sourced to the market state?**

**III. Re:  Financial Crisis – Does it affect how we should proceed on this project?**