State Taxation of Banks

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Before we get started…

- Today’s presentation slides can be downloaded at www.wolfandco.com/webinars/2016
- The session will last about an hour, and we’ll then have time for Q & A.
- Our audience will be muted during the session.
- Please send your questions in using the “Questions Box” located on the webinar’s control panel.
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- Offer Audit, Tax, and Risk Management services to over 250 financial institutions
- Offices located in:
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  - Springfield, Massachusetts
  - Albany, New York
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- Over 200 professionals

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Today's Presenter

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Today’s Agenda

• Definitions
• Trends in State Taxation
• Overview of State Tax Rules
  – Massachusetts
  – Connecticut
  – Maine
  – New Hampshire
  – New Jersey
  – New York
  – Rhode Island
  – Vermont
• Conclusion
Definitions

• **Nexus**
  – A situation where a business has sufficient presence in a state to be subject to that state’s income tax and tax return filing requirement.

• **Economic Nexus**
  – A situation where a business has sufficient economic presence in a state to have nexus, even if the business does not have physical presence in that state.
Definitions

• Apportionment
  – Method whereby a business’ taxable income is allocated among the states in which it has nexus.
  – Gross Receipts
    • Generally, income is sourced to the state from which it is derived
  – Property
    • For loans, generally sourced to the state in which the preponderance of contacts have occurred
    • SINAA (Solicitation, Investigation, Negotiation, Approval, Administration)
  – Payroll
Definitions

• Unitary Business
  – A group of related business organizations doing business that share a unity of ownership, operation, and use, and whose functions are interdependent.

• Combined Reporting
  – The filing of a tax return in a state in which the return includes entities in a unitary business.

• Foreign Corporation
  – An entity that is not domiciled in the home state; it does not mean an entity from outside of the U.S.
Trends

• **Nexus**
  - Traditionally, banks have filed tax returns in states where they have physical locations, or in states where employees do their work.
  - Increasing use of economic nexus standards.
  - For 2016, of the 50 states plus DC:
    - 41 states have an economic nexus requirement.
    - 6 states do not have economic nexus.
    - 4 states do not have a corporate income tax.
Trends

• Nexus
  – Several states have economic nexus thresholds.
  – Some states – nexus created if a business registers or otherwise obtains authority to do business in the state.
  – Each state has different nexus rules.
Apportionment

- Traditionally, most states have used all three factors, with variances in the relative weighting.

- Single-factor gross receipts apportionment becoming more prevalent.

- States vary in how each factor is computed.
• Combined Reporting
  – Combined reporting more common.
  
  – 2003: 16 states required combined reporting (only NH and Maine in the Northeast).
  
  – 2016: 26 states require combined reporting, including NY and all New England states, except VT.
  
  – So, in several states, a greater portion of the combined group’s income may be subject to tax.
Massachusetts

- Different rules for banks and other corporations

- The financial institution excise tax applies to any bank that is engaged in business in MA

- Also applies to a bank that, in MA, regularly:
  - Performs services
  - Engages in transactions with customers
  - Receives loan interest income, or
  - Solicits and receives deposits from MA customers.
• For purposes of the last bullet point Business is considered “regular” if any of the following apply:
  – Activities are conducted with at least 100 MA residents,
  – Bank has $10 million or more of MA assets,
  – Bank has $500,000 of MA receipts.

• Combined reporting applies – ownership threshold is 50%
Massachusetts

• Security corporation
  – Meets certain requirements
  – Not liable for the financial institutions tax
  – Not included in the Combined Report

• Taxable Income - Bank
  – Starting point is federal taxable income
  – Add back state tax and federal tax-exempt interest income
  – Subtract federal interest expense disallowed
  – Adjustment for federal bonus depreciation
Massachusetts

• Apportionment – 3-factor, with each having equal weight

• Tax Rates
  – Bank: 9%
  – Security Corp. Subsidiaries: 1.32% of gross income
  – Security Corp. Holding Co.: .33% of gross income
  – Minimum tax: $456 per corporation
Connecticut

• Nexus applies if a company engages in active solicitation of CT residents and has $500,000 or more in CT receipts.

• Same tax rules for banks and other corporations.

• Combined reporting applies starting in 2016 (exception for Passive Investment Companies).
Connecticut

- **Taxable Income**
  - Starting point is federal taxable income
  - Add back state tax and federal tax-exempt interest income
  - NOL carryovers are allowed, but only to offset 50% of CT taxable income starting in 2016
  - Adjustment for federal bonus depreciation

- **Apportionment – Gross Receipts factor**
Connecticut

• Tax Rates
  – Corporate Rate: 7.5%
  – Surcharge of 20% of the tax through 2017, and 10% in 2018.
  – Minimum tax: $250 per company
  – Allowable credit utilization:
    • 50.01% of tax liability in 2015
    • 55% in 2016
    • 60% in 2017
    • 65% in 2018
    • 70% in 2019 and thereafter
Connecticut

• Passive Investment Company (“PIC”)
  – Exempt from corporation business tax.
  – Requirements:
    • 5 CT full-time equivalent employees
    • Maintain CT office
    • Activities limited to purchase, receipt, maintenance, and sale of intangible investments, and collection and distribution of income from those investments
  – Dividend from PIC to Bank is not taxable to the Bank for CT purposes.
Maine

- For financial institutions franchise tax, bank must accept deposits and be subject to FDIC insurance. Otherwise, taxed as regular corporation if nexus requirements are met.

- Economic nexus applies, with no bright-line test.
Maine

- Financial institutions – 2 methods to compute tax
  - 1% of Maine financial statement income, plus 8 cents for every $1,000 of Maine assets at the end of the year
  - 39 cents for every $1,000 of Maine assets at the end of the year
- No minimum tax
- Apportionment: 3 factor, with double-weighting of the Gross Receipts factor
- Combined reporting for unitary businesses
New Hampshire

- Economic nexus applies, with no bright line test
- Combined reporting applies
- Same rules for banks and other corporations
- Two taxes: Business Profits Tax (“BPT”), and Business Enterprise Tax (“BET”)
- BET is allowed as a credit against BPT
New Hampshire

• Business Profits Tax
  – Starting point is federal taxable income
  – State tax deduction is added back
  – US Government interest is subtracted
  – NOLs are allowed subject to a special rule
  – Adjustment for federal bonus depreciation and Section 179
New Hampshire

• Apportionment: 3-factor with Gross Receipts doubled

• Tax Rate:
  – 8.5% for periods ending before 12/31/16
  – 8.2% for periods ending on or after 12/31/16
  – 7.9% for periods ending on or after 12/31/18 if certain NH revenue levels are met
  – No minimum tax
New Hampshire

- **Business Enterprise Tax**
  - Three Components
    - Dividends to shareholders
    - Compensation
    - Interest
  - Components are added together
  - **Tax Rate**
    - .0075 for periods ending before 12/31/16
    - .0072 for periods ending on or after 12/31/16
    - .00675 for periods ending on or after 12/31/18, if certain NH revenue levels are met
New Jersey

- Foreign corporations with NJ taxable status are subject to corporation business tax.

- Taxable status is acquired by obtaining or soliciting business or by having NJ gross receipts.

- There is no bright line test.

- Corporations file standalone returns.
New Jersey

• Taxable Income
  – Starting point is federal taxable income
  – State tax is added back
  – NOLs are allowed
  – Adjustment for bonus depreciation

• Apportionment: Gross Receipts Factor
New Jersey

• Tax Rate
  – 9% if taxable income before apportionment is greater than $100,000
  – Minimum tax between $500 and $2,000 based on NJ gross receipts
  – If federal consolidated return is filed, and overall payroll is greater than $5 million, minimum tax is $2,000
Starting in 2015, banks are subject to the same franchise tax as other corporations.

Economic nexus applies starting in 2015, with a threshold of $1 million in NY receipts.

A bank also has nexus if it meets certain NY credit cards issued and/or customer contracts.
Corporations file combined with other corporations that comprise a unitary business

Business Income

- Starting point is federal taxable income
- Reduced by investment income (income from investment capital) – limited to 8% of federal taxable income
- Municipal income is added back, and municipal interest disallowance is subtracted
• Business Income (cont.)
  – Deductions allowed for:
    • REIT dividends paid deduction
    • Portion of net interest income from residential or small business loans, OR
    • Percentage of taxable income in excess of the federal bad debt deduction
  – These particular deductions not allowed for banks with assets greater than $8 billion
New York

- Apportionment – single Gross Receipts factor
  - Numerator includes all income related to NY property
  - Numerator also includes 8% of asset-backed securities, repos, and federal funds, regardless of where sourced
New York

• Tax Rate
  – 6.5% for years beginning in 2016 and thereafter.
  – MTA surcharge of 28% of franchise tax for corporations doing business in certain counties.
  – Minimum tax – sliding scale based on NY receipts, ranging from $25 for receipts less than $100,000 to $200,000 for receipts greater than $1 billion.
Rhode Island

- A bank has nexus if it is incorporated in RI or has a physical location in RI.

- If there is no physical presence, there is no nexus.

- Corporations must file a combined return, but banks are exempted.
• Taxable Income
  – Starting point is federal taxable income
  – RI state tax, and federal tax-exempt interest, is added back
  – US Government interest is subtracted
  – Non-security gains are not taxable, and losses are not deductible. Loans are considered securities
  – Adjustment for federal bonus depreciation

• Apportionment: 3 factor, equally weighted
Rhode Island

- Passive Investment Companies
  - Rules are similar to CT but less stringent
  - Exempt from combined reporting
  - Dividends from a PIC are not taxable in RI
Vermont

• Franchise tax on banks with VT locations.

• Economic nexus rules for banks without VT location – pay tax as regular corporation.

• Franchise tax computed monthly on average monthly deposits.

• Corporations – combined reporting for unitary businesses.
Vermont

• Taxable Income
  – Starting point is federal taxable income
  – State tax and non-VT municipal interest is added back
  – US Government interest is subtracted
  – Adjustment for federal bonus depreciation
  – Post-apportionment NOL is deducted

• Apportionment: 3-factor, with Gross Receipts double-weighted
Vermont

- Tax Rate – Sliding Scale ranging from 6% for income $10,000 or less to 8.5% for income in excess of $25,000

- Minimum tax based on VT gross receipts
  - $300 for receipts less than $2 million
  - $500 for receipts between $2 million and $5 million
  - $750 for receipts greater than $5 million
Conclusion

• State tax is increasingly complex, and that trend will continue
• Understand rules for states from which your bank derives income
• Understand nexus rules – nexus study?
• Voluntary Disclosure Agreements
• Electronic filing and payment requirements
• RULES ARE SUBJECT TO CHANGE!!!
Questions?

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