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.

About Wolf & Company, P.C.

- Established in 1911
- Offer Audit, Tax, and Risk Management services to over 250 financial institutions
- Offices located in:
  - Boston, Massachusetts
  - Springfield, Massachusetts
  - Albany, New York
  - Livingston, NJ
- Over 200 professionals

As a leading regional firm founded in 1911, we provide our clients with specialized industry expertise and responsive service.

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- Over 45 Risk Management Professionals:
  - IT Assurance Services Group
  - Internal Audit Services Group
  - Regulatory Compliance Services Group
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- Provide services to over 300 financial institutions:
  - Approximately 85 FIs with assets > $1B
  - Approximately 40 publicly traded FIs
  - Constant regulatory review of our deliverables
- Provide Risk Management Services in 27 states and 2 U.S. territories

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.

Trends

- 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.

Trends

- 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.

Massachusetts

- 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.

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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

New York

- 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.

New York

- 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

New York

- 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.

Rhode Island

- 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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