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MULTISTATE TAXATION OF DEPOSITORIES: AN ANALYSIS OF LEGISLATION PROPOSED BY THE AMERICAN BAR ASSOCIATION

JACOB L. TODRES*

INTRODUCTION

From 1864 until 1976, a national bank could not be subjected to income taxes by states other than its home state—the state in which its principal office was located.¹ Although state chartered banks did not enjoy this same legal immunity, in practice the immunity was voluntarily extended to them by the states in order to promote equity and competitive balance among competing banking institutions.² As of September 13, 1976, however, under the so-called permanent amendment to Section 5219 of the Revised Stat-

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¹ See National Banking Act, ch. 106, § 41, 13 Stat. 112 (codified as amended at 12 U.S.C. § 548 (1982)). This statute, which became section 5219 of the Revised Statutes, provided that "[t]he legislature of each state may determine and direct, subject to the provisions of this section, the manner and place of taxing . . . national banking associations located within its limits . . ." *Id.* (emphasis added); see *infra* note 3.

² SENATE COMM. ON BANKING, HOUSING AND URBAN AFFAIRS, 92D CONG., 2D SESS. II STATE AND LOCAL TAXATION OF BANKS 11 (Comm. Print 1972); see also Hellerstein, *Current Issues in Multistate Taxation of Banks*, 30 TAX L. REV. 155, 156 (1975) (immunity extended to state chartered banks by states because of an "unwilling[ness] to place their own . . . banks in a disadvantageous economic position").

utes, virtually all restrictions upon the taxation of national banks were eliminated.³

In May, 1979, the Council of the American Bar Association Taxation Section established a joint task force, consisting of members from the Committee on Banking and Savings Institutions and the Committee on State and Local Taxation, to review the subject of multistate taxation of depositories. The Council thought that this was an especially propitious time for such a review, since the 1976 legislation had just opened an entirely new area of taxation for the states. It was hoped that recommendations might result, the implementation of which might prevent the confusion inherent in the multistate taxation of industry from being transported into this new area.

After three years of work, the task force developed proposed federal legislation to govern state and local taxation of depositories.⁴ The proposed legislative recommendation was adopted by the American Bar Association in February, 1982 as an official position of the Association.⁵ At the time of this writing, the task force is in the process of completing an extensive and detailed report on its work. It is anticipated that as soon as the report is completed, the proposed legislation will be introduced into Congress.

The proposed legislation (the "Bill") has four separate and distinct aspects:⁶ a jurisdictional threshold defining the minimum level of activity within a state⁷ necessary to subject a depository to

³ See 12 U.S.C. § 548 (1982). Section 5219 of the Revised Statutes was amended in 1969 to provide that after January 1, 1972, "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 [for state taxation purposes]." Pub. L. No. 91-156, § 2, 83 Stat. 434, 434 (1969) (codified as amended at 12 U.S.C. § 548 (1982)). The State Taxation of Depositories Act, Pub. L. No. 93-100, § 7, 87 Stat. 347, 347 (1973) (codified as amended at 12 U.S.C. § 548 (1982)), placed a temporary moratorium on the imposition of state "doing business" taxes on "insured depositories not having [a] principal office within such state," *id.* § 7(c), but this restriction expired as of September 13, 1976, Pub. L. No. 94-222, § 1, 90 Stat. 197, 197 (1976) (codified as amended at 12 U.S.C. § 548 (1982)).

⁴ See also Committee on Banking and Savings Institutions, American Bar Ass'n, *Tax Section Recommendation No. 1981-3*, 34 TAX LAW. 861, 866 (1981) (earlier draft of proposed legislative recommendation) [hereinafter cited as *Committee Recommendation*].

⁵ 2 A.B.A. Reports, No. 105 (1982).

⁶ See Section of Taxation of the American Bar Association, *Proposal to Amend Sections 571-577 and Repeal Section 627 of Title 12 of the United States Code* (Feb. 1982) (reprinted as Appendix) [hereinafter cited as the "Bill"]. The Bill contains only three sections, but since section 1, if passed, would amend title 12 of the United States Code by adding new sections 571 through 577, it will be cited in terms of these new sections of title 12.

⁷ "State" is defined to include the District of Columbia. *Id.* § 572(m). In order to sim-

taxation within that state;⁸ a prohibition of discriminatory taxation against out-of-state depositories;⁹ a repealer of an anachronistic provision governing the taxation of Edge Act corporations;¹⁰ and a maximum limit on the portion of a depository's tax base that a state may subject to tax.¹¹ It is the purpose of this Article to explain briefly the proposed legislation, a copy of which is contained in the Appendix hereto, so that interested parties may begin to focus upon it. It is hoped that this will result in additional input to Congress, thereby enabling Congress to act on the basis of a more complete record.

I. JURISDICTION TO TAX

Section 571(a) of the Bill, which is deceptively simple on its face, contains the basic limitation upon a state's right to tax a depository. It provides:

[n]o State or political subdivision thereof shall impose any doing business tax on a depository unless such depository has a business location in the state or political subdivision during the taxable year.¹²

Before discussing the Bill's jurisdictional provisions, it is necessary to focus on the definition of "depository" and "doing business tax" as these terms are used in the Bill. "Depository," as defined in the Bill, includes any bank or thrift institution that is "engaged in the business of receiving deposits in the United States," whether or not such bank or thrift institution is incorporated or organized under the laws of any state or foreign country.¹³ It also includes any institution that is a member of the Federal Home Loan Bank or whose deposits are insured under the Federal Deposit Insurance Act or by the Federal Savings and Loan Insurance Corporation.¹⁴ Edge Act corporations¹⁵ and United States

plify the discussion, the test will refer only to "states," although the principles of the Bill apply to political subdivisions of "states" as well. *See id.* §§ 571, 577.

⁸ *Id.* § 571(a).

⁹ *Id.* § 571(b).

¹⁰ *Id.* Sec. 2.

¹¹ *Id.* § 573(a).

¹² *Id.* § 571(a).

¹³ *Id.* § 572(d).

¹⁴ *Id.*

¹⁵ *See infra* notes 43-48 and accompanying text.

branches or agencies of foreign depositories¹⁶ are also included in the definition of depository. Thus, virtually every organization that accepts deposits within the United States is a "depository" and is within the ambit of the Bill.

The jurisdictional rules of the Bill apply only with respect to "doing-business" types of taxes.¹⁷ Section 572(e) of the Bill defines this term very broadly to include any taxes other than "sales and use taxes, real property tax, documentary tax, tangible and intangible personal property tax, payroll tax, and any excise tax upon the ownership, use, or transfer of tangible or intangible personal property."¹⁸ Doing-business taxes also include taxes imposed on a shareholder or depositor on his interest as a shareholder or depositor, which tax is paid by the depository and not normally reimbursed to the depository by the shareholder or depositor.¹⁹ Although these taxes are technically imposed upon the shareholder or depositor, in practice the depository generally bears the tax.²⁰ Thus, the tax is really imposed on the depository and is so treated by the Bill.

The critical element in determining whether jurisdiction to tax exists is the presence of a business location in the state. Section 572(c), which establishes the parameters of business location, takes a three-step approach: it defines "business location"; it specifies certain activities that may be conducted within a state without thereby imbuing the state with jurisdiction to tax the depository; and it contains a *de minimis* rule whereby jurisdiction to tax does not exist unless the amounts located within the state exceed a certain minimum level, notwithstanding the nature of the activities performed in the state.

¹⁶ Bill, *supra* note 6, § 572(d). In discussing foreign depositories, § 572(d) uses the terms "agency" and "branch" as they are defined in 12 U.S.C. § 3101 (1982). A branch is an office or place of business within the United States at which deposits may be accepted. *Id.* § 3101(3). An agency is an office or other location at which certain banking functions, not including the acceptance of deposits from citizens or residents of the United States, may be performed. *Id.* § 3101(1).

¹⁷ See Bill, *supra* note 6, § 571(a).

¹⁸ *Id.* § 572(e).

¹⁹ *Id.*

²⁰ See I.R.C. § 164(e) (1984) (corporation entitled to deduction for taxes paid on behalf of shareholders); *cf.* Hillsboro Nat'l Bank v. Commissioner, ___ U.S. ___, 103 S. Ct. 1134, 1149 (1983) (corporation entitled to deduction for taxes paid on behalf of shareholders).

A. *Business Location*

The first and most basic part of the Bill's approach, the general definition of what constitutes a business location, is set forth in section 572(c)(1). Under this provision, a depository has a business location in a state if it:

- (A) maintains an office in such state;
- (B) has at least one employee who has a regular presence in such state; or
- (C) owns tangible property located in the state which it leases to others for their use, or if it owns or leases tangible property located in such state which it uses in connection with its activities in the state.²¹

An office is maintained within a state if a depository establishes a "regular, continuous and fixed place of business" within the state.²² Admittedly, this definition is imprecise and its exact parameters will have to await judicial interpretation.

With regard to the regular presence of an employee within a state, sections 572(g) and (k) provide guidance. Section 572(g) defines an employee as an individual to whom "wages" are paid, with the term "wages" defined as it is defined for federal income tax withholding purposes.²³ An employee has a "regular presence" in a state, under section 572(k), if the majority of his services are performed in the state.²⁴ In those instances in which there is no state in which a majority of the employee's services is performed, the employee is deemed to have a "regular presence" in the state where the office from which his activities are directed is located.²⁵

As to the ownership or use of tangible property located in a state, section 572(j)(1) provides that tangible property generally is located wherever it is physically situated.²⁶ "Moving property," such as motor vehicles, rolling stock, or aircraft, is deemed located in the state in which it is operated, despite its operation outside the state, so long as its operation outside the state is occasional, or incidental to its operation within the state.²⁷ If moving property is operated in two or more states, it is deemed located at the princi-

²¹ Bill, *supra* note 6, § 572(c)(1).

²² *Id.* § 572(h).

²³ See 26 U.S.C. § 3401(a) (1982).

²⁴ Bill, *supra* note 6, § 572(k)(1).

²⁵ *Id.* § 572(k)(2).

²⁶ *Id.* § 572(j)(1).

²⁷ *Id.* § 572(j)(2)(A).

pal base of operations from which it is sent out.²⁸ There is no requirement that the property be physically located, even momentarily, in the state where such base of operations is located.²⁹ Finally, if such moving property is operated in more than one state and has no principal base of operations, it is deemed located at the commercial domicile of the lessee or user of the property.³⁰

B. *Non-Jurisdiction-Creating Activities*

Section 572(c)(4) contains a list of so-called negative jurisdictional standards. If a depository's activities within a state are limited to these permissible activities, business location, and, hence, jurisdiction to tax, is not created. This is true even if the depository maintains an office in the state, has employees who have a regular presence in the state, or owns or uses tangible property located in the state to carry out such activities. The permissible activities are:

- (A) maintaining or defending any action or suit;
- (B) filing, modifying, renewing, extending or transferring a mortgage, deed of trust, or security interest;
- (C) acquiring, holding, leasing, mortgaging, foreclosing, contracting with respect to, or otherwise protecting or conveying property in the State as a result of default under the terms of a mortgage, deed of trust, or other security instrument relating thereto; or
- (D) acting as an executor of an estate, trustee of a benefit plan, employees' pension, profit-sharing or other retirement plan, testamentary or inter vivos trust, corporate indenture, or in any other fiduciary capacity, including but not limited to holding title to real property in the State.³¹

In addition to these absolutely non-jurisdiction-creating activities, section 572(c)(2) contains a list of activities that will not create "regular presence" if performed by an employee within the state. These activities are:

- (A) acquisition or purchase of loans, secured or unsecured, or any interest therein;
- (B) participation in loans made by other depositories having

²⁸ *Id.* § 572(j)(2)(B).

²⁹ *See id.* § 572(j)(2).

³⁰ *Id.* § 572(j)(2)(C).

³¹ *Id.* § 572(c)(4).

offices in the State;

(C) soliciting applications for loans which are sent outside the State for approval, deposits which are received and maintained at an office outside the State, or financial or depository services which are performed outside the State; or

(D) making credit investigations and physical inspections and appraisals of real and personal property securing or proposed to secure any loan, or collecting and servicing loans in any manner whatsoever.³²

Of course, if the employee engages in any other activity within the state, no matter how minimal, the protection of section 572(c)(2) is unavailable and there exists a business location by virtue of the employee's regular presence in the state. Similarly, the protection of section 572(c)(2) is addressed only to the regular presence of an employee. If a depository maintains an office or owns or uses tangible property within a state, a business location will exist in the state regardless of the availability of sections 572(c)(2) vis-a-vis the depository's employees' activities in the state.

C. *De Minimis Exception*

Section 572(c)(3) provides that a state will not have jurisdiction to tax an out-of-state depository, notwithstanding the existence of a business location in the state, unless the depository has more than \$1 million of either payroll or receipts attributable to the state.³³ This de minimis provision was intended to eliminate jurisdiction in those instances where, despite the existence of a business location within a state, the amount of tax involved is likely to be insignificant. This is especially important to smaller depositories, where the cost of compliance with filing requirements might exceed the amount of taxes due.³⁴

³² See *id.* § 572(c)(2). The Bill contains both positive and negative jurisdictional standards to insure that states would not be able to tax banks lacking significant contacts, and that banks with significant contacts would not be able to evade state taxing jurisdiction. See *Committee Recommendation, supra* note 4, at 863-64.

³³ See Bill, *supra* note 6, § 572(c)(3). For a discussion of the receipt and payroll factors, see *infra* notes 76-87 and accompanying text.

³⁴ Many small and local depositories would escape out-of-state taxation under the de minimis exception. Cf. 1982 COMBINED FINANCIAL STATEMENTS—FSLIC INSURED SAVINGS AND LOAN ASSOCIATIONS 8 (Federal Home Loan Bank Board 1983).

II. DISCRIMINATION

The second discrete part of the Bill is the antidiscrimination provision contained in section 571(b):

No State or political subdivision thereof shall impose taxes on any depository not having its principal office within the State if such taxes are more burdensome than the taxes imposed upon depositories transacting a similar character of business having their principal office within the taxing state.³⁵

Before focusing on the provision itself, it should be noted that it is doubtful whether this provision provides any substantive protection beyond what would exist in its absence.³⁶ In its study of bank taxation, the Board of Governors of the Federal Reserve System recommended the enactment of this type of provision, even though they recognized that such a provision would be merely prophylactic.³⁷

The scope of section 571(b) is substantively much broader than the remainder of the Bill. The section prohibits the imposition of any type of discriminatory tax.³⁸ It is not limited to doing-business taxes. This is necessary because a seemingly fair doing-business tax could be circumvented by discriminatory non-business taxes working in tandem.

The provision's use of the phrase "more burdensome" to describe the prohibited taxes is based upon similar language contained in various United States income tax treaties.³⁹ While desir-

³⁵ See Bill, *supra* note 6, § 571(b).

³⁶ See, e.g., *McGoldrick v. Berwind-White Coal Mining Co.*, 309 U.S. 33, 56-57 (1940) (state taxes that place interstate commerce at a disadvantage are unconstitutional); *Osborne v. Bank of the United States*, 22 U.S. (9 Wheat.) 738, 864-65 (1924) (state statutes that tax national banks but not state banks are unconstitutional); 12 U.S.C. § 548 (1982) (states may not tax national banks in a discriminatory manner). It should be noted, however, that in his report on this issue, Professor Jerome Hellerstein concluded that the issue is not free from doubt and there is a risk "which cannot be dismissed as insubstantial" that states might have the power to discriminate against out-of-state banks. Hellerstein, *Federal Constitutional Limitations on State Taxation of Multistate Banks* (appendix II), SENATE COMM. ON BANKING, HOUSING AND URBAN AFFAIRS, 92D CONG., 2D SESS., REPORT OF STATE AND LOCAL TAXATION OF BANKS 547 (Comm. Print 1972).

³⁷ See SENATE COMM. ON BANKING, HOUSING AND URBAN AFFAIRS, 92D CONG., 2D SESS., REPORT ON STATE AND LOCAL TAXATION OF BANK 6-7 (Comm. Print 1972).

³⁸ See Bill, *supra* note 6, § 571(b).

³⁹ See, e.g., Convention on Double Taxation: Taxes on Income and Capital Gains, Apr. 31, 1976, United States-United Kingdom, art. 24(1), 31 U.S.T. 5668, 5687, T.I.A.S. No. 9682; Convention on Double Taxation: Income, March 8, 1971, United States-Japan, art. 7(1), 23 U.S.T. 967, 981-82, T.I.A.S. No. 7365. See generally O'Brien, *The Nondiscrimination Arti-*

ing to prevent discrimination against out-of-state depositories, the draftsmen were cognizant of the fact that different types of depositories frequently are taxed under different tax schemes. For instance, savings banks might be taxed differently than commercial banks.⁴⁰ Likewise, due to various practical considerations, it might be necessary to tax out-of-state depositories differently from their local counterparts.⁴¹ The draftsmen did not intend to intrude on, or prevent the use of, different tax schemes; so long as the end result of the tax scheme is not discriminatory, the provisions of the Bill are not violated.

III. TAXATION OF EDGE ACT CORPORATIONS⁴²

In 1919, section 25(a) of the Federal Reserve Act was enacted to facilitate international banking by United States banks.⁴³ This legislation authorized the Federal Reserve Board to charter corporations "for the purpose of engaging in international or foreign banking."⁴⁴ Corporations chartered under this legislation, which was sponsored by Senator Walter E. Edge,⁴⁵ became known as Edge Act corporations. In 1978, pursuant to a congressional directive,⁴⁶ the Federal Reserve Board amended its regulations to re-expand significantly the powers of Edge Act corporations to enable them to compete more effectively with foreign banks.⁴⁷ As a result,

cle in Tax Treaties, 10 LAW & POL'Y INT'L BUS. 545, 564 & n.75 (1978).

⁴⁰ See, e.g., MASS. GEN. LAWS ANN. ch. 63, § 2 (West Supp. 1984-1985) (net income tax on banks); *id.* § 11 (net operating income tax plus tax on deposits in savings banks).

⁴¹ In its study of state taxation of out-of-state depositories, the advisory commission on Intergovernmental Relations also recommended that Congress enact legislation preventing discrimination against out-of-state depositories. SENATE COMM. ON BANKING, HOUSING AND URBAN AFFAIRS, 94th CONG., 1st SESS., REPORT ON STATE AND LOCAL "DOING BUSINESS" TAXES ON OUT-OF-STATE DEPOSITORIES, 52 (Recommendation 4)(Comm. Print 1975). It too seems to have sanctioned the use of different tax schemes for out-of-state and in-state depositories since it sought to prevent only the imposition of heavier taxes—not different taxes—on out-of-state depositories. *Id.* at 81-84.

⁴² The discussion in this section of the article is based to a significant extent on O'Brien, *State and Local Taxation of Branches of Edge Act Corporation—Opportunities and Limitations*, 96 BANKING L.J. 893, 894-96 (1979). With Mr. O'Brien's gracious consent, parts of that article are incorporated herein without the use of quotation marks.

⁴³ Federal Reserve Act, ch. 18, § 25(a), 41 Stat. 378, 378-84 (1919) (current version codified at 12 U.S.C. §§ 611-631 (1982)).

⁴⁴ 12 U.S.C. § 611 (1982).

⁴⁵ O'Brien, *supra* note 42, at 894.

⁴⁶ International Banking Act of 1978, Pub. L. No. 95-369, 92 Stat. 608, 608 (1978) (current version at 12 U.S.C. § 611a (1982)).

⁴⁷ See 12 C.F.R. § 211 (1983). Regulation K, which governs foreign banking by banks subject to the Federal Reserve Act, was first issued by the Federal Reserve Board in 1920.

today Edge Act corporations may establish branches across state lines.⁴⁸

Since the enactment of the Edge Act legislation in 1919, state taxation of Edge Act corporations has been governed by section 627 of Title 12 of the United States Code.⁴⁹ Section 627 provides:

Any corporation organized under the provisions of Section 611-631 of this title [i.e., the Edge Act provisions] shall be subject to tax by the State within which its home office is located in the same manner and to the same extent as other corporations organized under the laws of that State which are transacting a similar character of business. The shares of stock in such corporation shall also be subject to tax as the personal property of the owners or holders thereof in the same manner and to the same extent as the shares of stock in similar State corporations.⁵⁰

Although the statute is not explicit, it would appear that only the state in which the home office of an Edge Act corporation is located is authorized to tax that corporation⁵¹ under this provision.⁵² The Supreme Court of Pennsylvania stated this position in dicta in *Commonwealth v. First Pennsylvania Overseas Finance Corp.*,⁵³ the only case discussing section 627.⁵⁴ Similarly, the his-

See J. BAKER & M. BRADFORD, *AMERICAN BANKS ABROAD: EDGE ACT COMPANIES AND MULTINATIONAL BANKING* 33 (1974). The regulation expands upon certain provisions of the Edge Act amendment to the Federal Reserve Act, see 12 U.S.C. §§ 611-631 (1982), and "defines in specific terms the conditions and limitations under which a corporation may carry on business in foreign countries and in the United States," H. PROCKNOW, *THE FEDERAL RESERVE SYSTEM* 263 (1960). For a general discussion of the history of Regulation K, see J. BAKER & M. BRADFORD, *supra*, at 31-47.

⁴⁸ 12 C.F.R. § 211.4(c)(1) (1983).

⁴⁹ See 12 U.S.C. § 627 (1982).

⁵⁰ *Id.*

⁵¹ Under the second sentence of 12 U.S.C. § 627 (1982), any state may subject the shares of stock in an Edge Act corporation to a non-discriminatory personal property tax.

⁵² See O'Brien, *supra* note 42, at 895; Note, *New Rules for Edge Act Corporations Under the International Banking Act of 1978*, 3 *FORDHAM INT'L L.F.* 193, 219 (1980). But see Note, *A Constitutional and Statutory Analysis of State Taxation of Edge Act Corporate Branches*, 51 *FORDHAM L. REV.* 991, 993 (1983) (California, Florida, Illinois, and New York tax Edge Act corporate branches regardless of home office location).

⁵³ 425 Pa. 143, 229 A.2d 896 (1967). In the only other case to cite § 627, *First Fed. Sav. & Loan Ass'n v. State Tax Comm'n*, 437 U.S. 255 (1978), the Supreme Court merely referred to this section as an example of federal legislation designed to protect federally chartered institutions from state tax discrimination. See *id.* at 258 n.2.

⁵⁴ See *First Pa. Overseas Fin. Corp.*, 425 Pa. at 146, 229 A.2d at 898. In *First Pa. Overseas Fin. Corp.*, the Commonwealth of Pennsylvania sought to impose its capital stock tax on a federally chartered bank doing business within its borders. *Id.* at 145, 229 A.2d at 897. Although the main issue addressed by the Pennsylvania Supreme Court was whether the bank constituted a "domestic" corporation under state law, it stated that § 627 "permits

tory of bank taxation in the United States indicates that this was the result that Congress intended. When the Edge Act legislation was enacted in 1919, national banks could be taxed by the states only to the extent specifically permitted by Congress.⁵⁵ Unless Congress assumed the same principle applied to Edge Act corporations, the enactment of this provision is enigmatic. If all states were already permitted to tax Edge Act corporations, why would section 627 need to contain language enabling a state in which such a corporation's home office was located to tax it? If the purpose of the provisions was merely to prevent discriminatory taxation, why was the prohibition of discriminatory taxation extended only to the state in which the home office was located, and not to other states as well?

It should be noted that when enacted in 1919, section 627 was very generous to the states as compared to their power to tax national banks. National banks could be taxed only in their home state and only by subjecting their outstanding shares to personal property tax at the shareholder level.⁵⁶ Edge Act corporations, on the other hand, could be subjected to any type of non-discriminatory tax in their home states, and all states could subject the outstanding shares of such corporations to personal property tax at the shareholder level.⁵⁷ Unfortunately, over the years, the limitations on state taxation of national banks have been reduced and are now virtually eliminated while no corresponding changes have been made to section 627. To eliminate this anachronistic situation, section 2 of the Bill repeals section 627. Furthermore, section 572(d) of the Bill brings Edge Act corporations within the ambit of the Bill by including them within the definition of depository.

IV. LIMITATIONS UPON STATE TAXATION OF DEPOSITORY INCOME

Before focusing upon the mechanics of the Bill's limitations on state taxation of depository income, it is necessary to review briefly some of the principles that guided the draftsmen in developing the

a state in which the home office of the corporation is located to tax the corporation as it would a corporation organized under its own laws." *Id.* at , 229 A.2d at 898.

⁵⁵ *E.g.*, *Chase Manhattan Bank v. Finance Admin.*, 440 U.S. 447, 448 (1979); *First Agricultural Nat'l Bank v. State Tax Comm'n*, 392 U.S. 339, 340 (1969); *Owensboro Nat'l Bank v. Owensboro*, 173 U.S. 664, 667-68 (1899).

⁵⁶ *Foreign Banking Act of 1919*, ch. 18, Rev. Stat. § 5219. Pub. L. No. 106, 41 Stat. 378, 383.

⁵⁷ *Id.*

Bill's approach. Since the draftsmen's overriding concern was to minimize the Bill's incursion upon the states' prerogatives in this area,⁵⁸ the Bill does not prescribe any particular method of taxation. It leaves undisturbed the method chosen by each state,⁵⁹ but places an upper limit upon the portion of a depository's tax base that a state may subject to tax.⁶⁰ Essentially, the Bill works as follows. Each state determines how it will tax depositories. It determines how it will allocate within and without the state whatever base it chooses to tax, which may include income, gross receipts, or capital. A formula provided by the Bill is then used to determine the permissible maximum portion of the depository's tax base that might be allocated to that state.⁶¹ If the state's formula does not allocate a greater portion to the state, all is well and the provisions of the Bill are not triggered. If the state's formula allocates a greater portion of the depository's tax base to the state than is permissible under the Bill, however, the limitation is triggered and the state may tax only the lower amount.

An admitted infirmity of the Bill's approach is that it imposes no absolute limitation on how much income may in fact be taxed by the several states having jurisdiction to tax. Although the total percentage of tax base that all states may tax in the aggregate is limited to 100 percent, this limitation may be illusory since each state may be taxing a different base. For instance, assume each of three states is limited under the Bill to taxing one-third of a depository's taxable base. If State A's tax base is net income, State B's is gross receipts, and State C's is capital, although the total is limited to 100%, the unanswered question is: 100% of what? It is

⁵⁸ See *Committee Recommendation, supra* note 4, at 865 (drafters left concept of "tax base" to be defined by state law).

⁵⁹ States traditionally have been free to tax banks using a variety of different methods—bank shares taxes, franchise taxes, and various types of property taxes. See Symons, *State Taxation of Banks: Federal Limitations*, 99 *BANKING L.J.* 817, 837-38 (1982). The Bill defines a "doing business" tax as any tax upon depository income, excluding only certain types of ownership and transactional taxes. Bill, *supra* note 6, § 572(e). The Bill merely provides that a state cannot impose a "doing business" tax on a depository that does not have a "business location" in the state, *id.* at § 571(a), nor can the state discriminate against a depository that does not have its "principal office" within the state, *id.* § 571(b).

⁶⁰ Bill, *supra* note 6, § 573.

⁶¹ See *id.* § 573(a); *infra* text accompanying notes 65-93. A state's taxable share is computed by multiplying its apportionable base, a combination of various income and receipt elements, by one-half of the sum of the quotient of wages paid within and without the state, and the quotient of total receipts within and without the state. *Id.* at §§ 573(a), 574(a), 575(a).

entirely possible that the total taxes payable in all three states might exceed 100% of the depository's net income as reportable in State A or for federal purposes. Similarly, the total amount of taxes payable in all three states bears no relationship to the gross receipts reported in State B or the capital reported in State C.

The draftsmen have accepted this infirmity because the problem is not unique to depositories; it is inherent in our Constitution, which reserves the right to each state to choose any method of taxation.⁶² This reflects the other main principle adopted by the

⁶² U.S. CONST. amend. X; see *Union Pac. R.R. v. Peniston*, 85 U.S. (18 Wall.) 5, 29 (1873) (state power to tax in unlimited ways exists independently of the Constitution); *Ohio Life Ins. & Trust Co. v. Debolt*, 57 U.S. (16 How.) 416, 428 (1853) (states have discretion to impose taxes and apportion proceeds); cf. S. REP. No. 530, 91st Cong., 1st Sess. (1969), reprinted in 1969 U.S. CODE CONG. & AD. NEWS 1594, 1595 ("every State government should be allowed the greatest possible degree of autonomy with regard to the formulation of its tax structure").

Congressional enactment of uniform state tax formulas conceivably may be interpreted as an objectionable usurpation of state sovereignty. Cf. *National League of Cities v. Usery*, 426 U.S. 833, 842 (1976) ("limits upon the power of Congress to override state sovereignty, even when [it is] exercising its otherwise plenary powers . . . to regulate commerce").

To evaluate the constitutional propriety of legislative actions directed at the several states, the Court in *National League of Cities* adopted a test to determine whether the state functions affected are essential to its separate and independent existence. *Id.* at 845 (quoting *Lane County v. Oregon*, 74 U.S. (7 Wall.) 71, 76 (1868)). Functions that satisfy the test include "fire prevention, police protection, sanitation, public health, and parks and recreation." 426 U.S. at 851 & n.16. Although the list is not exhaustive, it does not appear that traditional governmental functions can be construed to encompass state taxation of depositories.

It has been suggested, however, that even legislation that impacts upon "important state functions" will not be invalidated under *National League of Cities*. See *id.*; see also Tushnet, *Constitutional and Statutory Analyses in the Law of Federal Jurisdiction*, 25 UCLA L. REV. 1301, 1324 (1978) (recommending narrow construction of *National League of Cities*). It is worth noting in this context that the *National League of Cities* decision is the only one in more than 40 years to invalidate a federal statute as a violation of state autonomy. See Varat, *State "Citizenship" and Interstate Equality*, 48 U. CHI. L. REV. 487, 565 (1981). Moreover, subsequent cases have demonstrated that despite the *National League of Cities* holding, the Supreme Court is disinclined to uphold constitutional challenges to congressional legislation. See, e.g., *Equal Employment Opportunity Comm'n v. Wyoming*, 460 U.S. 226, 229 (1983) (federal law precluding state from discharging state park and game commission employees at age 55 upheld); *Federal Energy Regulatory Comm'n v. Mississippi*, 456 U.S. 742, 745, (1982) (federal regulation of exclusively intrastate public utilities upheld); *Hodel v. Virginia Surface Mining & Reclamation Ass'n*, 452 U.S. 264, 269 (1981) (federal law displacing state regulation of amount and conditions of surface mining upheld).

The proposed Bill imposes a limitation on the percentage of a depository's tax base that may be subject to tax in a particular state. See *supra* note 11 and accompanying text. This restriction is calculated according to a formula derived from constitutional principles of due process and interstate taxation. See *supra* notes 7-9 and accompanying text. Under the Bill, states are free to choose their own methods and means of taxation, see *infra* text accompanying note 90, so only a minimal burden is placed on the discretionary judgment of the

draftsmen, to wit, that they will limit the Bill to problems unique to the depository industry.⁶³ The Bill therefore does not address problems of state taxation that apply to all industry in general.

Another general problem deemed to be beyond the scope of the Bill is state taxation of foreign income. This is currently a very serious and controversial issue.⁶⁴ To avoid becoming embroiled in this issue, the draftsmen completely eliminated foreign income from the scope of the Bill.⁶⁵ The Bill's limitations therefore apply only to non-foreign income; what a state chooses to do with foreign income is not addressed by the Bill.

Section 573(a) is the operative Bill provision that limits the states' right to tax a depository's tax base. It provides that the doing-business tax imposed by a state upon a depository's "Appor-

sovereign states, see *National League of Cities*, 426 U.S. at 848. Further, the Bill does not deprive a state of revenue unless that state allocates more of a depository's tax base to itself than is permitted by the statutory formula, see *infra* notes 91-92 and accompanying text, so the burden on state fiscal resources is also minimal. Also, any lost revenue could be recouped by raising the tax rate on all depositories subject to tax. See J. NOWAK, R. ROTUNDA & J. YOUNG, *CONSTITUTIONAL LAW* 173 (2d ed. 1983). The proposed legislation therefore appears to comport with the requirements imposed by *National League of Cities* and its progeny.

⁶³ The Bill's provisions apply only to a "depository," its "affiliated corporations" or an "affiliated group," as defined in § 572. See Bill, *supra* note 6, § 572(a), (b), (d); *supra* notes 12-18 and accompanying text.

⁶⁴ See Kaden, *State Taxation of Multinational Corporations*, 32 *CATH. U. L. REV.* 829, 829-30 (1983). The 97th Congress considered legislation in the area of state taxation of foreign income that was re-introduced in the 98th Congress. Compare S. 655, 97th Cong., 1st Sess. (1981) (bill to limit state taxation of foreign income) and H.R. 1983, 97th Cong., 1st Sess. (1981) (companion bill to S. 655) with H.R. 2918, 98th Cong., 1st Sess. (1983). The question of whether federal corporate income taxes imposed on multinational businesses affect the power of the states to tax income derived from the same source, however, has not been answered definitively by Congress or by the judiciary, see J. HELLERSTEIN & W. HELLERSTEIN, *STATE AND LOCAL TAXATION* 542-43 (4th ed. 1978), although the Supreme Court has established some limitations upon state taxation of foreign income, see, e.g., *ASARCO, Inc. v. Idaho State Tax Comm'n*, 458 U.S. 307, 315-30 (1982) (unitary business relationship must exist between subsidiary being taxed and state-domiciled parent); *F.W. Woolworth Co. v. Taxation & Revenue Dep't*, 458 U.S. 354, 363-64 (1981) (due process requires that income attributed to taxing state be rationally related to values connected with that state); cf. Dexter, *State Taxation of Multinationals: Are the Mathias and Conable Bills Constitutional?*, 18 *TAX NOTES* 715, 715-16 (1982) (courts must give due recognition to state sovereignty in ruling on federal attempts to regulate state taxation). See generally Hellerstein, *State Income Taxation of Multijurisdictional Corporations and the Supreme Court*, 35 *NAT'L TAX J.* 401, 401-10 (1982) (discussing recent Supreme Court decisions).

⁶⁵ See Bill, *supra* note 6, at § 573(b)(1)(A), (B). The Bill excludes foreign income, including net income, gross income, receipts, and capital attributable to foreign location activities or to a corporation organized outside the United States. *Id.* The kind of income that comports with this definition, however, is determined according to the individual state's rules of accounting, apportionment, and attribution. *Id.* § 573(b)(1)(A).

tionable Base" may not be greater than the apportionable base attributable to that state.⁶⁶ This provision only affects doing-business taxes⁶⁷ imposed upon a depository's apportionable base.⁶⁸ The apportionable base attributable to the state is determined by "multiplying such depository's Apportionable Base by a fraction, the numerator of which is the sum of the payroll factor and receipts factor, and the denominator of which is two."⁶⁹

Apportionable base is defined to be the tax base as determined under the taxing state's laws, reduced by that part of the tax base that is foreign.⁷¹ The state's tax base is determined before allocating the tax base within and without the state and before determining what part of the tax base is business or non-business income, if such determination is required by the taxing state's law.⁷² Foreign tax base is defined very broadly as tax base that is attributable to the conduct of business at an office located outside the United States⁷³ recorded on the books or records of any corporation organized outside the United States.⁷⁴ However, the tax base of a foreign depository's agency or branch located in the United States is deemed apportionable base and is within the purview of the Bill.⁷⁵

The payroll factor is defined in section 574(a) as a fraction, the numerator of which is the total wages paid in a state and the denominator of which is the total wages paid in the United States.⁷⁶ Wages are deemed paid in the state in which the recipient employee has a regular presence.⁷⁷ Where wages are deemed paid in a state that does not have jurisdiction to tax the depository,⁷⁸

⁶⁶ Bill, *supra* note 6, § 573(a); *see supra* notes 60-61.

⁶⁷ *See* Bill, *supra* note 6, § 571(e); *supra* note 59.

⁶⁸ *See* Bill, *supra* note 6, § 573(a); *supra* note 61.

⁶⁹ Bill, *supra* note 6, § 573(a).

⁷¹ *Id.* § 573(b)(1)(A).

⁷² *See id.* § 573(b)(1). Since none of the other provisions of the Bill speak of a distinction between business and non-business income, all non-foreign income, whether business or non-business, is subject to the Bill's limitation. *See id.* §§ 571-572, 574-577.

⁷³ *See id.* § 573(b)(1)(A); *supra* note 65.

⁷⁴ *See* Bill, *supra* note 6, § 573(b)(1)(B); *supra* note 65.

⁷⁵ *See* Bill, *supra* note 6, § 573(b)(2).

⁷⁶ *Id.* § 574(a).

⁷⁷ *Id.* § 574(b). For a discussion of the Bill's definition of "regular presence," *see supra* notes 24-25 and accompanying text.

⁷⁸ This could occur, for instance, where an employee spends all or a major part of his time in one state engaging solely in activities that do not create a "business location" within the state. *See* Bill, *supra* note 6, § 572(c)(2), (4). The Bill contains two bases for taxing the existence of a business office in the state, or an employee with a regular presence in the state. *See id.* § 572(c)(1); *supra* notes 21-24 and accompanying text. If the employee only

they are excluded from both the numerator and the denominator of the payroll factor.⁷⁹

The receipts factor is defined as a fraction, the numerator of which is the total receipts located in a state and the denominator of which is the total receipts located in the United States.⁸⁰ To determine the location of receipts, section 575(b) provides certain guidelines. Receipts from loans secured primarily by real property are deemed located at the situs of the real property, while receipts from other loans are located at the place of origination of the loan.⁸¹ Receipts from the performance of services are deemed located in the state where the services are performed. If services are performed in more than one state, the receipts are apportioned on the basis of time spent performing such services in each state by employees having a regular presence there.⁸² Receipts from lease transactions are located where the leased property is located.⁸³ Receipts from interest or service charges other than merchant discounts from bank, travel, and entertainment card receivables and from card holders' fees are located at the residence of individual cardholders and at the commercial domicile of corporate cardholders.⁸⁴ Interest, dividends, and net gains from the sale or disposition of securities are deemed located at the office of the depository that records such securities as assets on its books.⁸⁵ Lastly, the situs of receipts from fees or charges from the issuance of traveler's checks and money orders is the place of their issuance.⁸⁶ Any receipts not specifically within these guidelines, and any receipts deemed located in a state lacking jurisdiction to tax the depository, are ex-

engages in those activities that do not create regular presence, however, his wages will be excluded from the apportionable base. See Bill, *supra* note 6, § 572(c)(2)(A)-(D).

⁷⁹ Bill, *supra* note 6, § 574(c).

⁸⁰ *Id.* § 575(a).

⁸¹ See *id.* § 575(b)(1). Principal repayments are not considered receipts from loans. *Id.* A loan originates for purposes of the Bill at the office of the depository that properly treats it as a book asset. *Id.* § 572(i). Loans made to borrowers residing or having their commercial domicile in a state, by a depository with an office in that state, however, are deemed to originate in that state unless neither negotiation, approval, nor administrative responsibility of or for the loan occurs in that state. *Id.*

⁸² *Id.* § 575(b)(2).

⁸³ *Id.* § 575(b)(3). The Bill includes within the definition of leases, rental transactions in which the lessor would have been subjected to federal income tax under the Internal Revenue Code of 1954, prior to its amendment in 1981, as if he were the owner of the leased property. See *id.* § 572(o).

⁸⁴ *Id.* § 575(b)(4).

⁸⁵ *Id.* § 575(b)(5).

⁸⁶ *Id.* § 575(b)(6).

cluded from the numerator and denominator of the receipts factor.⁸⁷

To illustrate the basic mechanics of the Bill, assume that the First State Bank is properly subject to tax in States A, B, and C. Assume further that the payroll and receipts factors, as defined in the Bill, are as follows:

	<u>States</u>			<u>Total</u>
	<u>A</u>	<u>B</u>	<u>C</u>	
1. Payroll Factor ⁸⁸	40%	40%	20%	100%
2. Receipts Factor	50%	10%	40%	100%
3. Average of Payroll & Receipts Factors ⁸⁹	45%	25%	30%	100%

Assume further that State A imposes a tax of 5% of net income, and does not tax foreign income. To determine the net income earned within State A, as opposed to that earned outside of State A, a three-factor apportionment formula is used consisting of payroll, property, and receipts factors.⁹⁰ Suppose that under State A's law, First State Bank has \$300,000 total net income, of which 40 percent is apportioned to State A as follows:

<u>State A's Factors</u>	<u>Within State A</u>	<u>Within other States</u>	<u>Total</u>
Payroll	30%	70%	100%
Property	30%	70%	100%
Receipts	<u>60%</u>	<u>40%</u>	<u>100%</u>
Average	40%	60%	100%

Since State A attributes less than 45% of First State Bank's tax base to itself, it will not be subject to the Bill's limitations.⁹¹

⁸⁷ *Id.* § 575(c).

⁸⁸ *See id.* §§ 574(a), 575(a). Although the Bill defines the factors as fractions, they will be expressed in percentages to simplify the illustrations. For the formula to derive payroll and receipt factors, see *supra* notes 76-87 and accompanying text.

⁸⁹ *See supra* note 70 and accompanying text.

⁹⁰ *See Bill, supra* note 6, § 573(b)(1). The use of payroll, property, and receipts factors is, of course, only one possible method of allocating income. These factors are used in the Uniform Division of Income for Tax Purposes Act (UDITPA), which has been adopted, in whole or in part, by 29 states. *See Hellerstein, supra* note 2, at 165; UNIFORM DIVISION OF INCOME FOR TAX PURPOSES ACT §§ 10, 13, 15 (1978) (defining property, payroll, and receipts factors). For a discussion of the difficulties that application of UDITPA factors to bank taxation may involve, see Hellerstein, *supra* note 2, at 166-67.

⁹¹ In the example given in the text, the tax that State A levies on First State Bank is limited to one-half the sum of the payroll and receipts factors, or 45%. *See supra* notes 66-

Even if State *A*'s apportionment factors were entirely arbitrary or unreasonable, or if its tax was totally confiscatory, the Bill's limitations would not be triggered. Such matters are beyond the scope of the Bill.⁹²

Now assume that State *B* imposes a tax of 1% of gross receipts and that its tax base does not include foreign receipts. To allocate receipts within and without State *B*, it uses separate accounting.⁹³ Under State *B*'s laws, First State Bank has \$2 million of receipts, 35% of which is deemed allocated to State *B* pursuant to its separate accounting method. First State Bank's tax bill would therefore be \$7,000, or 1% of \$700,000 under State *B*'s laws. Under the Bill, however, State *B* may not allocate to itself more than 25% of First State Bank's tax base.⁹⁴ The Bill's limitation thus is triggered and State *B* is limited to collecting only \$5,000 in tax, or 1% of \$500,000.

Lastly, assume State *C* imposes a tax of 1% of capital and that its tax base includes foreign capital. To allocate capital within and without State *C*, it uses separate accounting. Under State *C*'s laws, First State Bank has \$5 million of capital, 40% of which is deemed allocated to State *C* under its method of allocation. Assume further that of First State Bank's \$5 million capital, \$1 million represents capital located outside the United States.⁹⁵ Therefore, under State *C*'s laws, the tax bill of First State Bank would be \$20,000 or 1% of \$2 million.

Since State *C* allocates to itself more than 30% of First State Bank's tax base, the Bill's limitation is triggered. However, since State *C* includes in its tax base foreign capital that is not subject to the Bill's limitation, it is necessary to separate the tax base into two parts. The part that is subject to the Bill's limitation is the apportionable base. Here, the apportionable base consists of the

70 and accompanying text.

⁹² See *supra* notes 58-59 and accompanying text; *cf.* *Gorham Mfg. Co. v. Travis*, 274 F. 975, 978 (S.D.N.Y. 1921) ("when applied to corporations having business in several states, any effort at allocation must be . . . arbitrary and fictitious"), *aff'd*, 266 U.S. 265 (1924).

⁹³ See *supra* notes 66-70 and accompanying text. The separate accounting method treats all business activity performed within a state as though it were unconnected with business activity performed by the same company outside the state.

⁹⁴ See Bill, *supra* note 6, § 573(a). The Bill would prohibit State *B* from levying taxes on First State Bank's tax base in an amount greater than one-half the sum of the payroll and receipts factors, or 25%. See *id.*; *supra* notes 66-70, 88-89 and accompanying text.

⁹⁵ See *Committee Recommendation*, *supra* note 4, at 865. The proposed Bill does not "in any way sanction or prohibit state taxation" of depository capital outside the United States. *Id.*

total tax base before allocation within and without State C, or \$5 million reduced by the foreign capital,⁹⁶ \$1 million. Of this \$4 million, State C may allocate only 30% to itself. The tax that State C may collect, therefore, is \$12,000, or 1% of \$1.2 million. The remaining part of State C's tax base, the \$1 million representing foreign capital, is not subject to the Bill's limitation and State C may collect \$4,000—the full amount of tax imposed by its law (1% of \$400,000, i.e., 40% of \$1 million).

A. *Affiliated Corporations*

The problems inherent in our system of state taxation, whereby each state is free to choose any method of taxation, are multiplied manifold when considered from the vantage of a group of related corporations.⁹⁷ The tax burden of the group will depend not only on the various methods of taxation, but also on whether each state applies its method to each group member individually, or on some sort of combined or consolidated basis to the entire group, or to some, but not all, members of the group. For instance, assume Depository A, domiciled in State A, has a wholly-owned subsidiary, Corporation B, that is domiciled in State B. Assume further that neither Depository A nor Corporation B is itself subject to tax in the non-domiciliary state. Suppose Depository A has a net income of \$1,000, and Corporation B has a loss of \$100. Note the differing tax consequences if each state requires separate returns,⁹⁸ if each state requires a combined or consolidated return,⁹⁹ if State B requires a combined or consolidated return and State A requires a separate return,¹⁰⁰ or if State A requires a combined or consolidated return and State B requires a separate return.¹⁰¹

Although these problems are very significant, the Bill does not

⁹⁶ See *supra* notes 71-75 and accompanying text.

⁹⁷ See *id.*

⁹⁸ If both states require separate returns for each domestic affiliate, State A could levy a tax on \$1,000 of Depository A's net income. Since Corporation B suffered a loss, it would not be subject to a tax in State B.

⁹⁹ If both State A and State B require returns, each will tax some allocable portion of the \$900 consolidated net income. Therefore, tax will be levied on a total of \$1,800.

¹⁰⁰ If State A requires a separate return and State B requires a consolidated return, State A will tax some allocable portion of the \$1,000 net income of Depository A and State B will tax some allocable portion of the \$900 consolidated income. Thus, tax will be levied on a total of \$1,900. See *supra* notes 98-99.

¹⁰¹ If State A requires a consolidated return and State B requires a separate return, tax will be levied only on \$900. State A will tax some allocable portion of the \$900 consolidated income, but State B will levy no tax since Corporation B suffered a loss. See *supra id.*

attempt to cure them because they are not unique to the depository industry¹⁰² and because to do so would require significant encroachment upon each state's method of taxation.¹⁰³ Due to the repeated expressions of concern by many members of the depository industry, however, the Bill does address these problems in a limited manner.

Initially, the Bill does contain one substantive rule that has the potential to encroach upon the states' methods of combined or consolidated reporting. Section 576(e) prohibits any state from requiring or permitting the determination of a doing-business tax on a depository by reference to the combined or consolidated base of both a depository and any corporation that is not "affiliated" with the depository.¹⁰⁴ Corporations are affiliated if they are members of the same "controlled group" as the term is used in section 1563(a) of the Internal Revenue Code.¹⁰⁵ For purposes of the bill, however, control of more than 50% is all that is required,¹⁰⁶ and insurance companies are deemed not to be affiliated with any other corporation.¹⁰⁷

The second prong of the Bill's approach to the problems of affiliated corporations is its provision that, in certain limited circumstances, the determination of the Bill's limitation on the tax base attributable to a state is to be made by reference to the apportionable base and the factors of the entire affiliated group, not of the depository or its affiliates individually.¹⁰⁸ To assure that this method of computing the Bill's limitation is restricted appropriately, the Bill provides that it is applicable only to an "affiliated

¹⁰² See *supra* note 63 and accompanying text.

¹⁰³ See *supra* note 58 and accompanying text.

¹⁰⁴ See Bill, *supra* note 6, § 576(e).

¹⁰⁵ See Bill, *supra* note 6, § 572(a); I.R.C. § 1563(a) (1982). The Internal Revenue Code defines a controlled group of corporations to include parent-subsidiary groups, brother-sister groups, and various combinations of these. See I.R.C. § 1563(a)(1)-(3) (1982).

¹⁰⁶ See Bill, *supra* note 6, § 572(a); *Committee Recommendation, supra* note 4, at 866. Under the Internal Revenue Code, the parent corporation in a parent-subsidiary control group must control 80% of the subsidiary's stock to obtain a surtax exemption. See I.R.C. § 1563(a)(1)(B) (1982).

¹⁰⁷ See Bill, *supra* note 6, § 572(a); *Committee Recommendation, supra* note 4, at 866; I.R.C. § 1563(b)(2)(D) (1982). Only insurance companies as defined under subchapter L of the Internal Revenue Code are excluded from the definition of "affiliated group." See Bill, *supra* note 6, § 572(a); I.R.C. §§ 801, 821, 831 (1982).

¹⁰⁸ See Bill, *supra* note 6, § 576. If the provisions of § 573 apply to a business' tax base, the apportionable base under the Bill shall be the sum of the apportionable bases of all affiliate group members. See *id.* § 576(c)(2).

group" of corporations in certain prescribed circumstances.¹⁰⁹

An affiliated group is defined in the Bill as the group of all affiliated corporations of which a depository is a member, provided that the sum of either the payroll or receipts factors of the depository members of the group exceeds 50% of the respective total combined payroll or receipts factors of the entire group, or the common parent of the group is a depository or a bank holding company.¹¹⁰ Thus, only those groups in which the depository members loom large are eligible for such treatment.

There are two situations in which determining the Bill's limitation requires reference to the combined apportionable bases and factors of the entire group. First, if a taxing state determines the doing-business tax of any member, even a non-depository member, of an affiliated group to which a depository belongs by reference to the combined or consolidated tax base of any two or more group members. The combined group method is available only for such taxing state.¹¹¹ Second, if a depository's domiciliary state determines its doing-business tax by reference to the combined or consolidated tax base of two or more members of the affiliated group. The combined group method is now extended to every state in which the depository and all other members of the affiliate group are taxable.¹¹² However, if an affiliated group contains more than one depository member and one of its depository members is domiciled in a state that does not determine the tax on its depositories on a combined or consolidated basis, the Bill's limitation for such domiciliary state only is determined solely by reference to the individual apportionable base and factors of the depository or other group member.¹¹³

The mechanics of determining the Bill's limitation on a group basis requires that the aggregate limitation for the apportionable base of the group be determined first. The apportionable base of the group is the total of the apportionable bases of all members of the group,¹¹⁴ excluding intergroup dividends and investments in, or

¹⁰⁹ See *id.* § 576. If a state includes a corporation within its combined or consolidated return which is not within the "affiliated group," the Bill's limitations do not apply to the income of such. *Id.* § 576(d).

¹¹⁰ See *id.* § 572(b).

¹¹¹ See *id.* § 576(a).

¹¹² *Id.* § 576(b).

¹¹³ See *id.* § 576(b).

¹¹⁴ See *id.* § 576(c)(2).

advancements to, other members of the affiliated group.¹¹⁵ The group's apportionable base is then multiplied by the average of the group's payroll and receipts factors.¹¹⁶ The numerator of the group's factors consists of the wages paid or the receipts located in a state by all members of the group that are taxable in such state. The denominator of the factors consists of the total wages paid and receipts located in the United States by all members of the group.¹¹⁷ Wages paid in a state not having jurisdiction to tax the paying corporation are excluded from the numerator and denominator of the payroll fraction.¹¹⁸ Similarly, receipts located in a state not having jurisdiction to tax the recipient as well as those receipts not described in the Bill are excluded from both the numerator and the denominator of the receipts fraction.¹¹⁹

The Bill then provides that, if necessary, this aggregate limitation is apportioned among each of the individual group members taxable in the state.¹²⁰ The determination of what part of the group's apportionable base that has been attributed to the state is derived from each corporation taxable in the state is to be made on the basis of each such corporation's proportionate share of payroll and receipts attributable to the taxing state.¹²¹ The appropriate individual or multi-individual limit is then compared with what the state attributes to itself under its laws. For instance, assume State A may tax three of the five members of an affiliated group. Under the Bill, the aggregate of the entire group's apportionable base attributable to State A with respect to the three group members taxable in State A is determined first. Then, if necessary, this aggregate limit is apportioned to each of the three group members. Such apportionment might be necessary when, for instance, State A determines the tax of each of the three group members on an individual basis.¹²² If State A taxes some, or all, of the three group members under different methods of taxation,¹²³ all of the above steps

¹¹⁵ *Id.*

¹¹⁶ *Id.* § 576(c)(4).

¹¹⁷ *Id.* § 576(c)(5)-(6).

¹¹⁸ *Id.* § 576(c)(5).

¹¹⁹ *Id.* § 576(c)(6).

¹²⁰ *See id.* § 576(c)(7).

¹²¹ *See id.*

¹²² *See id.* § 576(b).

¹²³ *See, e.g.,* N.Y. TAX LAW §§ 1450-1468 (McKinney 1975 & Supp. 1983-1984) (franchise tax on banking corporations); N.Y. TAX LAW §§ 208-219a (McKinney 1975 & Supp. 1983-1984) (franchise tax on business corporations).

must be repeated for each tax method as if the entire group was subject to that particular method.¹²⁴

CONCLUSION

Although the Bill is the culmination of a long and sometimes arduous process of attempting to create an end product that is both sensible as well as sensitive to the conflicting needs of the depository industry and the state taxing authorities, it is recognized that other resolutions of the issues addressed are possible. While the Bill is believed by its draftsmen to be a fair and even-handed resolution of the problems perceived, it is not presented as ultimate wisdom. Instead, it is presented with the hope that it will serve both as a catalyst for Congress to legislate in this area and as the springboard from which a perfect, or, at least, a more perfect, resolution of the existing problems is achieved.

¹²⁴ See Bill, *supra* note 6, § 576(c)(3).

APPENDIX

PROPOSED STATUTORY LANGUAGE

RESOLVED that the Section of Taxation implement the foregoing by urging the following amendments, or their equivalent in purpose and effect, on the proper committees of the Congress:

Sec. 1. Title 12 of the United States Code is amended by the addition of new section 571 through 577 providing as follows:

Sec. 571. JURISDICTION TO TAX

(a) No State or political subdivision thereof shall impose any doing business tax on a depository unless such depository has a business location in the state or political subdivision during the taxable year.

(b) No State or political subdivision thereof shall impose taxes on any depository not having its principal office within the State if such taxes are more burdensome than the taxes imposed upon depositories transacting a similar character of business having their principal office within the taxing State.

Sec. 572. DEFINITIONS

For purposes of sections 571 through 577 of this title, the following definitions shall apply:

(a) **Affiliated Corporations**—Corporations shall be considered “affiliated corporations” if they qualify as members of a “controlled group” within the meaning of section 1563(a) of the Internal Revenue Code of 1954, except that the phrase “more than 50%” shall be substituted for the phrase “at least 80 percent” each place it appears therein, and section 1563(b)(2) of the Internal Revenue Code of 1954 shall not apply. No corporation which qualifies as an insurance company under Subchapter L of the Internal Revenue Code of 1954 shall be considered affiliated with any other corporation.

(b) **Affiliated Group**—An “affiliated group” consists of the group of all affiliated corporations of which a depository is a member if: (1) the sum of either the payroll or receipts of all depository members, as defined in sections 574 and 575 of this title, respectively, exceeds 50% of either the combined payroll or the combined receipts of the entire group; or (2) a depository or a bank holding company as defined in section 1841 of this title is the common parent of the group within the meaning of section 1563(a)(1) of the Internal Revenue Code of 1954.

(c) **Business Location**—

(1) **General Rule**—A depository has a “business loca-

tion" in a State in a taxable year only if:

(A) such depository maintains an office in such State; or

(B) one or more employees of the depository has or have a regular presence in such State; or

(C) such depository owns tangible property located in such State which it leases to others for their use, or such depository owns or leases tangible property located in such State which it uses in connection with its activities within the State.

(2) **Exceptions From General Rule Regarding Presence of Employees**—No employee shall be deemed to have a regular presence in a State if the only activities engaged in by such employee within the State are, or are in connection with, one or more of the following:

(A) acquisition or purchase of loans, secured or unsecured, or any interest therein;

(B) participation in loans made by other depositories having offices in the State;

(C) soliciting applications for loans which are sent outside the State for approval, deposits which are received and maintained at an office outside the State, or financial or depository services which are performed outside the State;

(D) making credit investigations and physical inspections and appraisals of real and personal property securing or proposed to secure any loan, or collecting and servicing loans in any manner whatsoever.

(3) **De Minimis Exception From Business Location**—A depository shall be deemed to have a business location in a nondomiciliary State only if it has (during the taxable year) more than \$1,000,000 of either payroll or receipts attributable to such State under sections 574 or 575 of this title.

(4) **General Exceptions From Business Location**—Notwithstanding any other provision of this title, a depository shall not be deemed to have a business location in a State if the only activities of the depository in the State are, or are in connection with:

(A) maintaining or defending any action or suit;

(B) filing, modifying, renewing, extending or transferring a mortgage, deed or trust, of security interest;

(C) acquiring, holding, leasing, mortgaging,

foreclosing, contracting with respect to, or otherwise protecting or conveying property in the State as a result of default under the terms of a mortgage, deed of trust, or other security instrument relating thereto;

(D) acting as an executor of an estate, trustee of a benefit plan, employees' pension, profit-sharing or other retirement plan, testamentary or inter vivos trust; corporate indenture, or in any other fiduciary capacity, including but not limited to holding title to real property in the State.

(d) **Depository**—A “depository” is an institution the deposits or accounts of which are insured under the Federal Deposit Insurance Act or by the Federal Savings and Loan Insurance Corporation, any institution which is a member of a Federal Home Loan Bank, any other bank or thrift institution incorporated or organized under the laws of a State or any foreign country which is engaged in the business of receiving deposits in the United States, any corporation organized under the provisions of sections 611 to 631 of this title (Edge Act Corporations), and any agency or branch of a foreign depository as defined in section 3101 of this title.

(e) **Doing Business Tax**—A “doing business tax” is any tax imposed by a State or political subdivision thereof except sales and use tax, real property tax, documentary tax, tangible and intangible personal property tax, payroll tax, and excise tax upon the ownership, use or transfer of tangible or intangible personal property. The term “doing business tax” shall include any tax imposed on a shareholder or depositor of a depository on his interest as a shareholder or depositor which is paid by the depository and not normally reimbursed to the depository by such shareholder or depositor.

(f) **Domiciliary State**—The State in which a depository's principal office is located is its “domiciliary State.” In the case of a corporation which is not a depository, the term “domiciliary State” means the State in which such corporation has its commercial domicile. In the case of an Edge Act Corporation, the term “domiciliary State” means the State designated as the place where the home office is to be located in its organization certificate made pursuant to section 613 of this title. In the case of a branch or agency of a foreign depository, the term “domiciliary State” means the State in which is located the office which is designated as the principal office pursuant to section 3101 of this title, and the applicable regulations thereunder.

(g) **Employee**—Any individual to whom wages are paid within the meaning of section 3401 of Title 26 is an “employee.”

(h) **Maintains an Office**—A depository “maintains an office” wherever it has established a regular, continuous and fixed place of business.

(i) **Origination of Loans**—A loan is deemed to have originated in the State in which the office is located which properly treats the loan as an asset on its books. However, if a depository maintains an office within a State, loans made to borrowers residing or having their commercial domicile within the State are deemed to have originated at such office within the State, unless neither negotiation, approval, nor administrative responsibility of or for the loan by the depository occurs in the State.

(j) **Property Located in a State**—

(1) **General Rule**—Except as otherwise provided in this section, tangible property, including leased property, shall be deemed to be located in the State in which such property is physically situated.

(2) **Moving Property**—Tangible personal property which is characteristically moving property, such as motor vehicles, rolling stock, aircraft, vessels, mobile equipment, and the like, shall be deemed to be located in a State if:

(A) the operation of the property is entirely within the State, or the operation without the State is occasional or incidental to its operation within the State; or

(B) the operation of the property is in two or more States, but the principal base of operations from which the property is sent out is in the State; or

(C) the State is the commercial domicile of the lessee or other user of the property, where there is no principal base of operations and the operation of the property is in two or more States.

(k) **Regular Presence of Employees**—An employee shall be deemed to have a regular presence in a State if:

(1) a majority of the employee’s service is performed within the State, or

(2) the office from which his activities are directed or controlled is located in the State, where a majority of the employee’s service is not performed in any one State.

(l) **Securities**—United States Treasury securities, obligations of United States Government agencies and corporations, federal funds sold, clearinghouse funds sold, securities purchased under

agreements to resell, commercial paper, purchased certificates of deposit, obligations of States and political subdivisions, corporate stock and other securities, participations in securities backed by mortgages held by United States or State government agencies, and similar obligations.

(m) State—Any of the several States of the United States and the District of Columbia.

(n) Taxable Year—

(1) Unless the laws of a State require a corporation to prepay a tax imposed on, according to, or measured by income, the calendar year, fiscal year or other period upon which its taxable income is computed for purposes of federal income tax.

(2) If the laws of a State require prepayment of a tax, the calendar year, fiscal year or other periods upon which the tax base is computed under the laws of such State.

(o) Lease—A lease is any leasing transaction in which the lessor would be treated as owner of the leased property under the provisions of the Internal Revenue Code of 1954 prior to the enactment of the Economic Recovery Tax Act of 1981. All other transactions purporting to be leases shall be treated as loans for purposes of sections 572, 575, and 576 of this title.

Section 573. MAXIMUM AMOUNT OF INCOME, RECEIPTS OR CAPITAL ATTRIBUTABLE TO TAXING JURISDICTION

(a) No State may impose any doing business tax upon the Apportionable Base of a depository in excess of the Apportionable Base attributable to the State determined by multiplying such depository's Apportionable Base by a fraction, the numerator of which is the sum of the payroll factor and the receipts factor, and the denominator of which is two.

(b) Apportionable Base—

(1) The Apportionable Base of a depository shall be its net income, gross income, gross receipts, capital or other tax base for the taxable year as determined under the laws of the taxing State before apportionment or allocation within and without the taxing State, and before determining what items are business or nonbusiness; provided, however, there shall be excluded from Apportionable Base:

(A) net income, gross income, gross receipts, capital or other tax base which would be determined to be attributable to the conduct of business at an office outside any State by application of the taxing

State's apportionment, attribution or separate accounting rules for determining the portion of the total tax base attributable to the taxing State; and

(B) except as provided in paragraph (2) below, net income, gross income, gross receipts, capital or other tax base recorded on the books or records of any corporation organized under the laws of any jurisdiction other than the United States or any State.

(2) The Apportionable Base of an agency or branch within the meaning of section 3101 of this title shall be its net income, gross income, gross receipts, capital or other tax base which under laws of the taxing State is determined to be derived from, or attributable to the conduct of business at an office within any State.

Section 574. PAYROLL FACTOR

(a) In General—The payroll factor is a fraction, the numerator of which is the total wages paid in the State and the denominator of which is the total wages paid in all States.

(b) Location of Compensation—Wages are paid in a State if paid to an employee having a regular presence therein.

(c) Wages Paid to Employees Located in States Without Taxing Jurisdiction—Neither the numerator nor the denominator of the payroll factor shall include wages paid to an employee having a regular presence in a State without jurisdiction to tax.

Section 575. RECEIPTS FACTOR

(a) In General—The receipts factor is a fraction, the numerator of which is total receipts located in the State and the denominator of which is the total receipts located in all States.

(b) Location of Receipts—

(1) All receipts from loans secured primarily by real property are located in the State in which the predominant part of the security real property is or will be located. All receipts from other loans are located at the place of origination except as otherwise provided. Receipts from loans do not include principal repayments.

(2) All receipts from performance of services are located in a State to the extent the services are performed in the State. If services are performed partly within two or more States, the receipts located in each State shall be measured by the ratio which the time spent in performing such services in the State bears to the total time spent in performing such services in all States. Time spent in performing services in a State is the time spent by employees

having a regular presence in the State in performing such services.

(3) Receipts from lease transactions are located in the State in which the leased property is deemed located.

(4) Interest or service charges (excluding merchant discounts) from bank, travel and entertainment card receivables and credit card holders' fees are located in the State in which the credit card holder resides in the case of an individual or, if a corporation, in the State of the card holder's commercial domicile.

(5) Interest, dividends and net gains from sale or disposition of securities are located in the State in which the depository maintains an office which treats such securities as assets on its books or records.

(6) Fees or charges from the issuance of travelers checks and money orders are located in the State in which such travelers checks or money orders are issued.

(c) **Other Receipts And Receipts Located in States Without Taxing Jurisdiction**—All receipts not described in subparagraphs (1) through (6) of subsection (b) and all receipts located in a State without jurisdiction to tax shall be excluded from both the numerator and denominator of the receipts factor.

Section 576. COMBINED AND CONSOLIDATED REPORTING

In determining the maximum Apportionable Base attributable to a taxing State for purposes of the limitations imposed by section 573 of this title, the following rules shall apply:

(a) If any taxing State determines the doing business tax of a depository or any member of an affiliated group of which a depository is a member by reference to the combined or consolidated base of the affiliated group or any two or more of its members, the provisions of section 573 of this title shall apply to determine the maximum Apportionable Base of the affiliated group attributable to the taxing State.

(b) If the domiciliary State of a depository which is a member of an affiliated group determines the doing business tax of the depository by reference to the combined or consolidated base of the affiliated group or any two or more of its members, section 573 of this title shall apply to determine the maximum Apportionable Base of all members of the affiliated group attributable to each State in which such depository or other member of the affiliated group is taxable. However, if two or more depositories are members of the affiliated group, and they are domiciled in

different States, one of which does not determine doing business taxes by reference to the base of the depository combined or consolidated with any other member of the affiliated group, then the Apportionable Base of the affiliated group or any of its members attributable to the domiciliary State shall be computed by reference to the combined or consolidated base of the affiliated group only if such State would determine the doing business taxes of the domiciliary depository by reference to a combined or consolidated base.

(c) When, pursuant to subsection (a) and (b) hereof the provisions of section 573 of this title are made applicable, the following rules shall apply to determine the maximum Apportionable Base of the affiliated group attributable to any taxing State, and the maximum Apportionable Base of each member of the affiliated group upon which a taxing State may levy any doing business tax:

(1) In applying the provisions of section 573(a) of this title, the term "an affiliated group" shall be substituted for the term "a depository."

(2) The Apportionable Bases of the affiliated group shall be the total of the Apportionable Bases of all members of the affiliated group, determined as if the term "a member of an affiliated group" were substituted for the term "depository" in section 573(b) of this title, excluding dividends from members of the affiliated group and investments in or advancements to members of the affiliated group.

(3) If the taxing State levies more than one type of doing business tax upon members of the affiliated group, or determines the doing business tax of members of the affiliated group by references to differing tax bases, the Apportionable Base of the affiliated group shall be determined for each different tax base as defined under the laws of the taxing State, and the Apportionable Base of all members of the affiliated group shall be determined as if they were subject to the particular tax for which the Apportionable Base of the affiliated group is calculated.

(4) The maximum Apportionable Base of the affiliated group attributable to the taxing State shall be determined by multiplying the Apportionable Base of the affiliated group by a fraction, the numerator of which is the sum of the payroll factor and receipts factor of the affiliated group, and the denominator of which is two.

(5) In determining the payroll factor of the affiliated group pursuant to section 574 of this title, the numerator

shall be the total wages paid in the State by all members of the affiliated group taxable in such State, and the denominator shall be all wages paid by all members of the affiliated group in all States. All wages paid by a member of the affiliated group in a State not having jurisdiction to tax such member shall be excluded from both the numerator and denominator.

(6) In determining the receipts factor of the affiliated group pursuant to section 575 of this title, the numerator shall be the total of the receipts described in subparagraphs (1) through (6) of section 575 of this title located in the taxing State of all members of the affiliated group which are taxable in such State and the denominator shall be the total of such receipts of all members of the affiliated group located in all States. Receipts of a member of the affiliated group not described in subparagraphs (1) through (6) of section 575 of this title and all receipts located in a State having no jurisdiction to tax such member shall be excluded from both the numerator and denominator.

(7) The maximum Apportionable Base of any member of an affiliated group upon which a taxing State may impose its doing business tax shall be computed by multiplying the total Apportionable Base of the affiliated group attributable to the taxing State under this section by a fraction, the numerator of which is the payroll and receipts of the member attributable to the taxing State of all members of the affiliated group over which the taxing State has jurisdiction. The provisions of Section 574 of this title shall apply to determine payroll attributable to the taxing State, and the provisions of section 575 of this title shall apply to determine receipts attributable to the taxing State.

(d) If any taxing State determines the doing business tax of a depository by reference to the combined or consolidated base of the depository and any other entity which is not a member of an affiliated group of which the depository is a member, the provisions of section 573 of this title shall apply only to the depository and other members of an affiliated group of which the depository is a member, and the maximum Apportionable Base of the depository attributable to the taxing State shall be computed without reference to the base or factors of such other entity.

(e) No State may require or permit the determination of the doing business taxes of a depository by reference to the combined

or consolidated base of corporations unless they are affiliated corporations with the depository.

Section 577 POLITICAL SUBDIVISIONS

(a) For purposes of determining whether a depository is taxable in a political subdivision, or whether payroll or receipts are located in a political subdivision, appropriate provisions of this Act shall be applied by treating any reference therein to a State as a reference to a political subdivision.

(b) The maximum income, receipts, capital, or other base attributable to a political subdivision for the tax purposes shall be determined under this title in the same manner as though such political subdivision were a State.

Sec. 2. Section 627 of this title is hereby repealed.

Sec. 3. The amendments made by Secs. 1 and 2 shall apply to taxable years beginning after December 31, 1987.